Annual Report

2005

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2005

Content

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.

	2005	2004
Financials		
Revenues [1]	61,031	61,515
OIBDA – Operating income before finance costs, tax, depreciation and amortization [2]	27,279	29,302
Operating income	9,461	8,520
Income before taxes	8,748	8,157
Net income	6,248	5,729
Total assets	124,211	134,661
Property, plant and equipment	88,003	99,345
Total equity	94,975	88,705
Borrowings	9,425	25,470
Capital expenditure	6,072	5,807

	2005	2004
Operations		
Number of telephone lines installed (x 1,000)	3,126	3,368
– of which ISDN connections (x 1,000)	449	492
– of which ADSL connections (x 1,000)	274	101
Internet – number of IOL and Quick customers (x 1,000) [3]	1,244	1,040
Fixed line penetration per population (in %)	31	33
Number of ČESKÝ TELECOM employees	7,524	8,794
Number of lines per ČESKÝ TELECOM employee	415	383
Number of Eurotel customers (x 1,000)	4,676	4,394
Number of CDMA customers (x 1,000)	70	30
Mobile penetration per population (in %)	112	105
Number of Eurotel employees	2,490	2,483

	2005	2004
Ratios (in %)		
OIBDA/Business Revenues (OIBDA margin) [2]	45	48
Net income/Revenues	10	9
Capital expenditure/Revenues	10	9
ROA (Net income/Total assets)	5	4
ROE (Net income/Equity)	7	6
Gross gearing (Borrowings/Total equity)	10	29

Macroeconomic indicators [4]		
Population (in millions)	10.2	10.2
GDP (in %) [5]	6.0	4.7
Inflation (in %)	1.9	2.8
Unemployment (in %)	9.0	9.2
Exchange rate CZK/USD – average over the period	23.9	25.7
Exchange rate CZK/USD – end of period	24.6	22.4
Exchange rate CZK/EUR – average over the period	29.8	31.9
Exchange rate CZK/EUR – end of period	29.0	30.5

[1] Business and recurring revenues.
[2] Including impairment charge; in 2005 ČESKÝ TELECOM posted an impairment charge of CZK 1,261 million compared to CZK 56 million in 2004.
[3] Paid (IOL) and free (Quick) Internet access.
[4] Source: Czech Statistical Office, Czech National Bank, Ministry of Finance, Ministry of Labour and Social Affairs.
[5] In 1995 constant prices; the 2005 figure is an estimate.

Letter from the Chairman of the Board of Directors and Chief Executive Officer of ČESKÝ TELECOM

I firmly believe that Telefónica, which is one of the largest global telecommunications operators as measured by market capitalisation, has gained an efficient and promising asset by integrating ČESKÝ TELECOM into its structure.

To Our Shareholders,

Let me review the results of ČESKÝ TELECOM for 2005 for the first time in my capacity as Chairman of the Board of Directors. The past year was a turning point for the company. In the middle of the year, Telefónica, S.A. (Telefónica) purchased a 51.1% stake in ČESKÝ TELECOM. Three corporations submitted binding bids in the final round of the open tender for the stake. Telefónica won with a bid of CZK 82.6 billion, which translates to CZK 502 per share. The transaction was concluded on 16 June 2005 when Telefónica paid up the remaining 90% of the purchase price and the National Property Fund of the Czech Republic transferred the 51.1% stake in ČESKÝ TELECOM to Telefónica. In the mandatory share buy-out offer which followed, Telefónica acquired an additional 18.3% of the shares from minority shareholders, thus increasing its holding to 69.4%.

I firmly believe that Telefónica, which is one of the largest global telecommunications operators as measured by market capitalisation, has gained an efficient and promising asset by integrating ČESKÝ TELECOM into its structure. Telefónica's international experience will, on the other hand, support further development of ČESKÝ TELECOM and Eurotel and help offer quality products and services to our customers conforming to the highest European and global standards.

At the beginning of 2006, Telefónica closed the acquisition of British mobile operator O2, which has a significant presence in the UK, Germany and Ireland. Based on the new organization structure of Telefónica Group, ČESKÝ TELECOM Group belongs into O2 group of operating companies, which will further increase synergies and enable us to benefit from O2 product, marketing, and management experience.

The effects of the new shareholder structure began to show back at the General Meeting of shareholders held on 23 June 2005 and immediately thereafter, when changes were made in the governing bodies of ČESKÝ TELECOM and Eurotel. ČESKÝ TELECOM also underwent an overhaul of its management structure – three new divisions were formed (Commercial, Operations and Finance and Resources), reporting directly to the Chief Executive Officer.

In the second half of the year, we identified areas of potential synergy between ČESKÝ TELECOM and Eurotel on the one hand and Telefónica on the other. The areas where the ČESKÝ TELECOM Group may benefit from the experience of, and its partnership with, the new majority shareholder include commercial and fundamental technical development and the marketing and promotion of new services. There will also be opportunities to increase operating efficiency by making process and organisation changes based on Telefónica's experience, to take advantage of procurement synergies generating substantial savings of resources, and to deliver other operating and capital expenditure savings.

The year 2005 saw the implementation of some of these synergies, most notably the IPTV project, procurement of technology, telephone sets and accessories for high-speed Internet and UMTS services, and a number of value added services based on high-speed Internet access.

2005 saw several major events in the field of regulation of the telecommunications market. The new Electronic Communications Act came into force on 1 May 2005, transposing new EU legislation (the so-called regulatory framework) laying down rules for electronic communication to the Czech legal system. Another important milestone was the Czech Telecommunications Office's decision on tariff rebalancing, the first in three years. This allowed ČESKÝ TELECOM to bring its structure of tariffs closer into line with its real costs. Other pricing decisions – relating to wholesale ADSL prices, rates for Local Loop Unbundling, prices for interconnection of dial-up Internet traffic and to fixed and mobile call termination charges – will, in the view of ČESKÝ TELECOM Group, have a positive effect on the development of the Czech telecommunications market.

As far as the trends on the Czech telecommunications market in 2005 are concerned, there was a continuing surge in demand for broadband Internet, data and other value added services in both the fixed line and mobile segments. In the light of these developments, ČESKÝ TELECOM adjusted its portfolio.

In the challenging conditions on the Czech telecommunications market, where there is high mobile penetration and fierce competitive pressure in both the fixed line and mobile segments, the Group successfully defended its leadership as the only integrated operator. At approximately 32% at the end of 2005, fixed line penetration has been flat for several years. Mobile SIM card penetration, on the other hand, is still intensifying. It reached 112% at the end of 2005 and we expect it to rise further as the number of customers with more than one SIM card grows. As at 31 December 2005, ČESKÝ TELECOM was operating 3,126,015 fixed lines. As at the same date, Eurotel registered 4,676,036 customers, ranking it as the number one again on the Czech mobile market.

The activities of the ČESKÝ TELECOM Group in 2005 stemmed from its strategy to be the operator-of-choice, offering a wide range of services. In the fixed line segment, we concentrated on maintaining voice revenues and on developing and introducing new services in growth segments such as high-speed Internet access and data and other value added services. Eurotel's activities focused on winning back and defending its market leadership as measured by customer numbers. Eurotel successfully increased its share of contract customers in total customers, a fact that should stimulate total revenues as well as ARPU. Eurotel also concentrated on developing and marketing its 2.5G Internet and data services. On 1 December 2005 it became the first Czech mobile operator to launch a fully-fledged voice and data UMTS service. Both companies in the Group introduced a new voice tariff structure and a new range of high-speed Internet services. The total number of users of ČESKÝ TELECOM and Eurotel high-speed Internet services reached 344,000 as at the end of 2005. Our mission in the field of new services is to offer the broadest spectrum of services so as to meet the changing requirements, individual needs and budget of every customer.

We also concentrated on improving our operating and financial efficiency by means of operating and capital expenditure savings. Our efforts in this respect helped increase our financial and operating performance. The value of ČESKÝ TELECOM as measured by market capitalisation grew by 42% in 2005, securing an above-average return on investment for our shareholders.

Financial results for 2005 were affected by several changes in accounting policy, which we made in the fourth quarter of 2005. The one-off items represented mainly by impairment charge impacted also the results for 2005. Results excluding the impact of such effects show improvement in revenues trend in the second half of 2005, returning to growth in the fourth quarter. Similarly the consolidated OIBDA before one off items increased by 5% and 3% yoy in the third and fourth quarters respectively. Consolidated revenues and consolidated costs reached in 2005 CZK 61 billion and CZK 32.7 billion, respectively. The impairment charge reached CZK 1.3 billion in 2005, while in 2004 the amount was negligible. The consolidated OIBDA amounted to CZK 27.3 billion. The reported OIBDA margin reached 44.9%, while OIBDA margin excluding impairment charge would reach 47% in 2005. This operating performance indicator still ranks ČESKÝ TELECOM Group in the better average of the industry. Likewise, the volume of free cash flow remains on a rather high level. In 2005, ČESKÝ TELECOM Group generated a free cash flow of CZK 18.7 billion. It helped us reduce our net gearing to 6% at the end of 2005, compared to 28% as at the end of the year before. A substantial portion of the debt reduction is attributable to the repayment of the syndicated loan for the acquisition of the remaining 49% share in Eurotel and for general use by the Group.

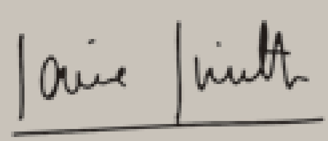
As far as the results in the fixed line segment are concerned, the year 2005 saw a growth in the revenues from Internet, broadband, data and value added services. The share of this revenue category in total revenues has reached 26% the same as in 2004. This underlines ČESKÝ TELECOM's efforts to diversify the structure of its revenues and to offset the shortfall of revenues from the traditional voice services. The total revenues in the fixed line segment fell in 2005 by 4.5% year on year to CZK 32.3 billion, and operating costs declined by 4.6% to CZK 17.4 billion. OIBDA in the fixed line segment, with the inclusion of one off charges, reached CZK 14.2 billion, which represents an OIBDA margin of 44.5%.

Eurotel in 2005 successfully upheld its strong financial and operating performance in the conditions of the highly saturated Czech mobile market. Eurotel's total revenues grew 2% year on year to CZK 30 billion. Similarly to the fixed line business, the customers in the mobile market also continue to demand data, Internet and value added services including content. Operating costs of Eurotel grew 4.8% year on year to CZK 16.8 billion – the amount was influenced by the posting of several exceptional items. Eurotel's OIBDA reached CZK 12.9 billion in 2005, with an OIBDA margin of 42.8%. The OIBDA margin before the one-off items reached 45% in 2005.

Our goal for 2006 remains the same – to meet the needs of our customers as best as possible, primarily by offering new products and services for broadband Internet access, data services and value added services. We will also continue to focus on stimulating revenues from voice and traditional data services.

With the backing and market knowledge of Telefónica, our new majority shareholder, and our peer companies in the group, lead by O2, we will accelerate execution of our strategy to increase our leadership on the telecommunications market in the Czech Republic. In terms of financial management, the main aspects include an accent on attaining an above-average OIBDA margin, effective investment and robust free cash flow.

Jaime Smith Basterra
Předseda představenstva



Letter from the Chairman of the ČESKÝ TELECOM's Supervisory Board

The year 2005 was rich in important events.
We successfully increased by 42%
the market value of the ČESKÝ TELECOM Group.

To Our Shareholders,

The past year, 2005, has brought to ČESKÝ TELECOM a major change in the arrival of the new majority shareholder, Telefónica, one of the largest global telecommunications operators. Coming to ČESKÝ TELECOM, Telefónica voiced its commitment to the social and economic development in the Czech Republic which it plans to realise by means of offering modern and customer-oriented telecommunications services. The principal focus of ČESKÝ TELECOM will, in the view of the shareholders, be the same as in other companies of the Telefónica Group – to achieve positive financial results and, with the help of the Group's financial strength, extensive managerial experience, its broad product portfolio and customer orientation to offer to the shareholders the best short, medium and long term combination of growth and return on their invested capital. As at the beginning of 2006, Telefónica catered to customers with more than 180 million connections worldwide.

The year 2005 was rich in important events, so let me mention only those which were of paramount importance for the future of ČESKÝ TELECOM. We successfully increased by a significant 42% the market value of the ČESKÝ TELECOM Group in 2005. In mid-2005, a stake representing 51.1% of the company shares found a new owner, and personnel changes were made in the composition of the Supervisory Board and the Board of Directors of ČESKÝ TELECOM, in the persons of Eurotel's Statutory Representatives and in the positions of Chief Executive Officers in both companies. To satisfy Czech law, Telefónica subsequently made a mandatory share buy-out offer to all holders of ČESKÝ TELECOM shares. This process was concluded at the end of the third quarter of 2005, with Telefónica increasing its share to 69.4 %. At the end of 2005, Telefónica decided to acquire O2 of the UK which is a major player on the UK, German and Irish markets, and so gave a further impetus to the growth of Telefónica in the European arena.

In the first half of the year, the Supervisory Board concentrated primarily on the supervision of the change of the majority owner – its efficiency, transparency and the respect for the rights of the minority shareholders. In the second half of the year, the Supervisory Board focused on the monitoring of the preparation of conditions for exploitation of the synergies within Telefónica and on the preparation of the ČESKÝ TELECOM Group for further growth, with the view to increasing the value for our shareholders. As the operational results and customers' satisfaction in the second half of the last year show, this cooperation is already proving beneficial.

The financial results of ČESKÝ TELECOM clearly attest to the company's aptitude for great financial performance, above-average EBITDA and free cash flow generation both in the fixed line and the mobile segments.

Finally, I want to thank all of the employees of the ČESKÝ TELECOM Group, for having proven that they can, even in such a dynamic year, concentrate on their work and produce excellent results for the benefit of the company and its customers, and, last but not least, of you, the shareholders.

Moreover, I also want to express my thanks to you, the owners of ČESKÝ TELECOM, for the trust you have vested in our company as its shareholders.

Julio Esteban Linares López
Chairman of the Supervisory Board

Calendar of key events in 2005

January

More than 130 thousand customers are now using one of the high-speed Internet access tariffs from ČESKÝ TELECOM and Eurotel. ČESKÝ TELECOM now registers over 100 thousand ADSL connections.

Eurotel launches the unique combination of affordable ADSL-based unlimited Internet access via a fixed line and a mobile voice tariff.

February

An Extraordinary General Meeting of shareholders of ČESKÝ TELECOM is held.

ČESKÝ TELECOM puts into operation new technology for processing calls to the 112 emergency hotline.

ČESKÝ TELECOM publishes selected preliminary unaudited consolidated financial results for the fiscal year 2004 under International Financial Reporting Standards.

Eurotel, ČESKÝ TELECOM and Microsoft form a strategic alliance for the development, marketing and delivery of innovative products and services.

Eurotel introduces a brand new portfolio of voice tariffs – Eurotel Bronze, Eurotel Silver, Eurotel Gold, Eurotel Platinum, Eurotel Diamant, Eurotel Start and Eurotel Pohoda.

March

The Czech government announces that Telefónica of Spain has won the tender for the sale of a majority interest in ČESKÝ TELECOM.

ČESKÝ TELECOM starts operating a new PPPoE technology platform for high-speed Internet services.

Since the beginning of the year, ČESKÝ TELECOM has brought high-speed Internet to 154 new locations. Internet Express service is now available in 988 locations. Potential high-speed Internet coverage has thus increased to almost 3 million lines, and almost 90% of ČESKÝ TELECOM's customers can subscribe for the service.

ČESKÝ TELECOM publishes its audited consolidated financial results for the fiscal year 2004 under International Financial Reporting Standards. The results consolidate in full the results of Eurotel. With revenues of CZK 62.1 billion, ČESKÝ TELECOM reported a consolidated net profit of CZK 5.6 billion in 2004.

Eurotel implements EDGE technology in areas with the heaviest GPRS traffic, affording its customers many times higher data transmission speeds.

Eurotel begins to offer Eurotel Přepínám based on Push To Talk technology, which simulates a short-wave radio in a mobile phone.

April

Telefónica's top executives sign the purchase agreement for a 51.1% share in ČESKÝ TELECOM with representatives of the National Property Fund.

ČESKÝ TELECOM's Internet Express service is now available in more than 1,000 locations.

ČESKÝ TELECOM decides to distribute a CZK 3 billion portion of the retained profit of Eurotel, its wholly owned subsidiary.

ČESKÝ TELECOM announces its unaudited financial results for the first quarter of 2005 under International Financial Reporting Standards.
The results consolidate in full the results of Eurotel.

Eurotel begins to market a comprehensive Internet For Everyone range of unlimited Internet access services – Internet Mobil, Internet Doma, Internet Business and Internet Kombi, which combines mobile and fixed Internet access.

May

ČESKÝ TELECOM becomes the only integrated operator in the Czech Republic to join the Fixed-Mobile Convergence Alliance (FMCA).

June

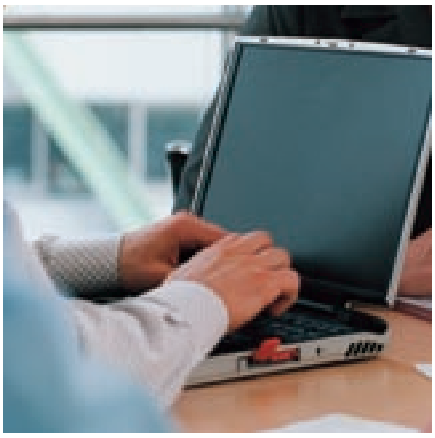
The European Commission approves the sale of ČESKÝ TELECOM to Telefónica.

Telefónica pays the remaining 90% of the total purchase price for ČESKÝ TELECOM in the amount of CZK 82.6 billion, and the shares held by the National Property Fund of the Czech Republic are transferred to Telefónica. Telefónica thus becomes the majority shareholder of the ČESKÝ TELECOM Group.

Jaime Smith Basterra is appointed Chief Executive Officer of ČESKÝ TELECOM. Salvador Anglada Gonzalez became Chief Executive Officer of Eurotel.

An Ordinary General Meeting of shareholders of ČESKÝ TELECOM is held. Owing to the changes in the ownership structure of the company, shareholders do not propose the payment of dividends. Telefónica's representatives are appointed to the Supervisory Board and Board of Directors of ČESKÝ TELECOM.

The number of users of high-speed Internet from ČESKÝ TELECOM and Eurotel exceeds the 200 thousand mark.
Telefónica presents to the Securities Commission for approval a mandatory buy-back offer for the outstanding 48.9% of ČESKÝ TELECOM shares.
Eurotel presents Eurotel Mobile Exchange Plus, a new service unique



in the Czech Republic, the first of three mobile solutions for corporate clients on the Microsoft Windows Mobile platform. The solutions were developed in a strategic partnership between Eurotel, ČESKÝ TELECOM and Microsoft.

July

ČESKÝ TELECOM introduces Expres Klik, a unique service allowing faster Internet access.

ČESKÝ TELECOM publishes its unaudited financial results for the first half of 2005 under International Financial Reporting Standards. The results consolidate in full the results of Eurotel.

The number of Eurotel customers using the Data Expres high-speed mobile Internet service based on CDMA technology exceeds the 50 thousand mark.

Eurotel and ČESKÝ TELECOM open another conceptual Digi Home / Digi Biz store in Eden shopping centre.

August

ČESKÝ TELECOM extends its ISO 9001:2000 certification of quality management systems to the whole company.

Eurotel launches Eurotel Spolu, a new service which lets customers call up to three numbers in Eurotel's network 25% cheaper, and Eurotel Car Control, targeted at business customers, who can now monitor the movement of their car fleet or fuel consumption.

September

The high-speed Internet service from ČESKÝ TELECOM now has 200 thousand subscribers in the Czech Republic.

ČESKÝ TELECOM decides to distribute a CZK 4 billion portion of the retained profit of Eurotel, its wholly owned subsidiary.

Eurotel substantially and permanently cuts its activation fees across all customer segments and changes the level of so-called minimal monthly payments required to obtain subsidised mobile handsets.

Eurotel declares its readiness to launch voice and data traffic in the UMTS network, the third-generation and most advanced mobile telecommunication technology.

October

ČESKÝ TELECOM begins digital broadcasting of the Óčko music TV channel via its DVB-T digital TV multiplex.

ČESKÝ TELECOM and Microsoft unveil Centrum Digitální Zábavy, a digital entertainment project, at the Invex 2005 exhibition.

ČESKÝ TELECOM's Internet Expres walks away with the Service of the Year 2005 Award.

ČESKÝ TELECOM publishes its unaudited financial results for the first three quarters of 2005 under International Financial Reporting Standards.

At Invex 2005, Eurotel presents the first part of its UMTS service offering, incorporating data, voice and video transmission in combination with quality real-time multimedia, and announces the commercial launch of its UMTS network for 1 December 2005.

Eurotel Car Control, a service developed jointly by Eurotel, Secar Bohemia and

Deltax Systems, wins the Crystal Disc Award for Professional Software.

November

ČESKÝ TELECOM wins the prestigious IR Magazine Award for Best Investor Relations in the Czech Republic.
Eurotel opens a new brand store in Chodov shopping centre, a new addition to what is already the largest sales network run by a Czech mobile operator.

Eurotel introduces its Christmas offer, which is very well received by customers, again becoming the most successful Christmas campaign on the Czech mobile market. It also offers both existing and new customers free calls after minute three and reduces its MMS price to CZK 2.50.

As part of its Christmas campaign, Eurotel reduces its MMS price to CZK 2.50 – by far the best price on the market.

December

In the course of 2005, 173 thousand new customers have subscribed to ČESKÝ TELECOM’s high-speed Internet service. The total number of high-speed Internet customers over a fixed line in the Czech Republic thus reaches 274 thousand, an increase of 170% compared to the end of 2004.

ČESKÝ TELECOM wins the tender for the publication of the telephone directory and the related information service.

Eurotel launches commercial operation of the UMTS network, becoming the first mobile operator in the Czech Republic to offer an integrated portfolio of third-generation mobile voice and data services.

The number of Eurotel customers using Data Expres, the high-speed mobile Internet access service via CDMA, reaches the 70 thousand mark as at the year-end.

Eurotel registers 4,676 thousand active customers in its network as at the end of the year, up 6.4% year on year, thus confirming its leadership on the Czech mobile market. The fourth quarter of 2005 was particularly successful, with Eurotel claiming a victory with 187,000 new customers, more than both its mobile competitors put together.

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About Telefónica

Leadership in Figures

Telefónica is one of the world's leaders in the telecommunications sector

Accesses
At the end of 2005, the number of accesses managed totalled 154 million. Including the O2 customers, Telefónica manages up to 180.9 million accesses.
The number of our mobile customer base increased to 99.1 million and the Group’s Fixed accesses reached 40.9 million.
Fourth mobile operator worldwide by customers following the acquisition of O2 assets in Europe.

Investments
In the last two years, Telefónica has enhanced its portfolio of companies with the acquisition of BellSouth assets in Latin America (2004), ČESKÝ TELECOM (2005), 5% of China Netcom (2005) and O2 (2006). Telefónica operates in 19 countries. We are the first private Investor in Latin America with accumulated investments of over EUR 75 billion between 1990 and 2005. During 2005, Telefónica invested approximately EUR 2.9 billion in technological innovation.

Results
Telefónica Group revenues increased 25.1% compared with 2004, reaching an absolute figure of EUR 37,882.1 million. Consolidated OIBDA in January-December 2005 stood at EUR 15,276.4 million, a 25% growth in relation to the same period in 2004, despite the high levels of commercial activity. Net income reached a record amount of EUR 4,445.8 million, 40% higher than in 2004, thanks to the good evolution of operations and the positive contribution of the executed acquisitions.

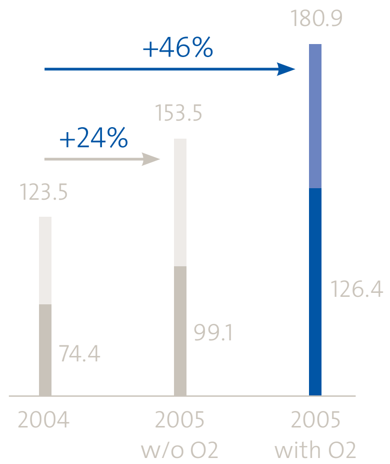
Workforce
The Group’s consolidated workforce totalled 207 thousand employees as of 2005, of which 37% are located in Europe and 63% in Latin America.

Shareholders
It is a 100% public company with approximately 1.7 million direct shareholders; its shares are listed on the main national and international stock markets.

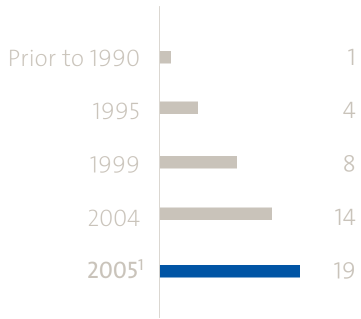
Telefónica

- Telefónica de España
- Telefónica Móviles
- Telefónica Latinoamérica
- O2
- Others

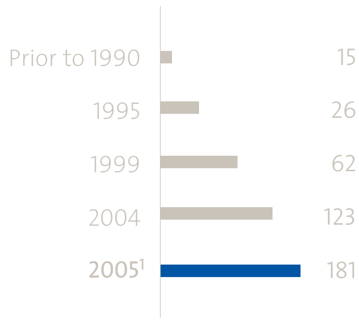
Telefónica Total Accesses
(in million)



Countries



Accesses



[1] Includes O2. Only countries with significant operations have been taken into consideration.

Telefónica Group. Global Scale

In terms of Accesses

Telefónica had a sharp increase in total accesses (+24% over the prior year) driven by the growth in mobile customers and in broadband, which stood at 153.5 million at the end of the year. Including the O2 customers, whose acquisition was completed in 2006, the Telefónica Group's customer base would increase to 180.9 million:
The Group's Mobile customer base increased to 99.1 million, gaining 24.68 million new customers.
The Group's retail Internet broadband accesses reached 5 million, up from 3.2 million in December of 2004.

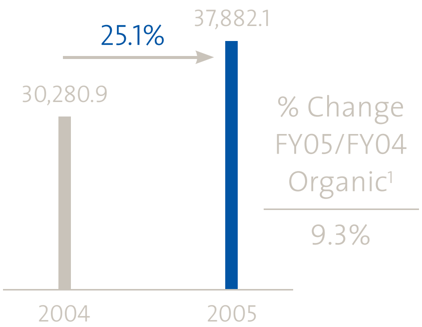
In terms of transformation

Telefónica has run a transformation process that has probably been one of the most striking ones in the industry in this last 20 years:
The Company has gone from operating in a single country to doing business in nineteen, with a potential market of 670 million. The Company has jumped from basic telephone service to comprehensive information and communication solutions, designed for each segment. Assets have increased sevenfold from, while revenues have been multiplied by twenty-one and stock market value by thirty-nine.
Telefónica now has three times as many employees and twenty times as many customers.

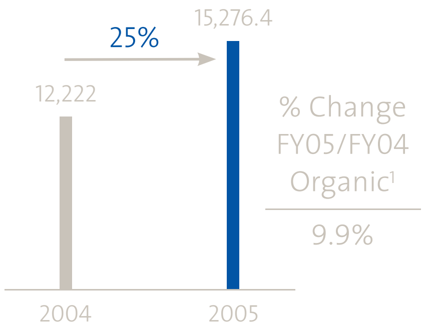
Telefónica in the world

Prior to 1990	1990 – 1995	1998	1999	2000	2004	2005	2006
Spain	Chile	Brasil	Morocco	México	Columbia	Czech Rep.	Great Britain
	Argentina	El Salvador	Guatemala		Uruguay	China	Ireland
	Venezuela				Ecuador		Germany
	Portorico				Panama		
	Peru				Nicaragua		

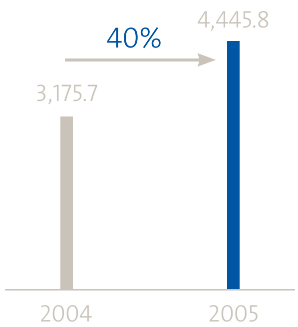
Revenues
(in EUR millions)



OIBDA
(in EUR millions)



Net Income
(in EUR millions)



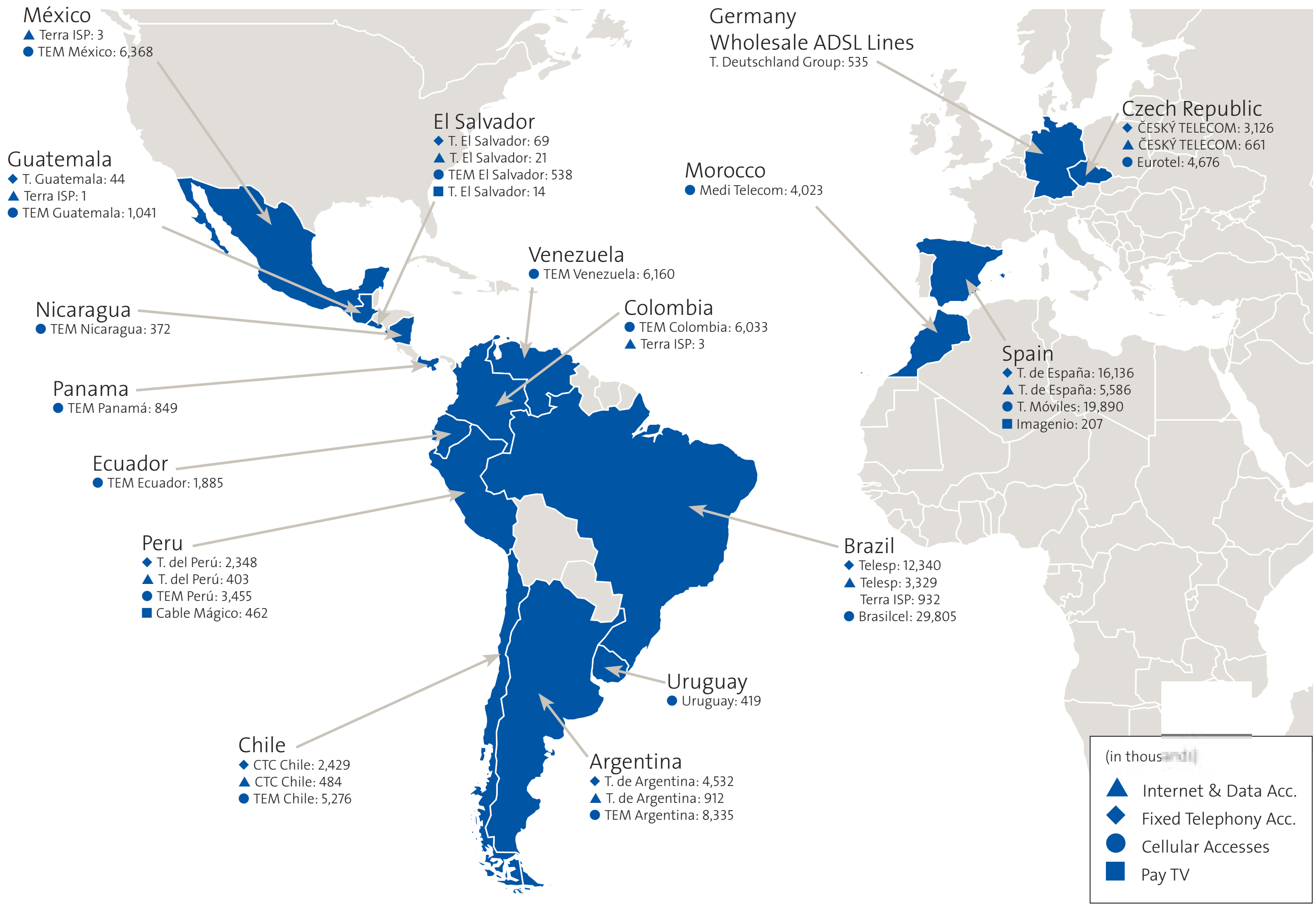
[1] Assuming constant exchange rates as of 2004. Incorporating the assets acquired to BellSouth in Argentina, Colombia, Chile, Ecuador, Guatemala, Nicaragua, Panama, Peru, Uruguay and Venezuela into the mobile business and Atrium into Telefónica Latinoamérica's Group, from January 1st 2004. Including ČESKÝ TELECOM from 1 July 2005.

Telefónica is reaching global size while keeping its focus local

Telefónica works in countries that are very different, with different challenges and opportunities. The value of its plan lies not so much in the dynamic of entering new markets as in the day-to-day management of our operations, thinking globally but acting locally.

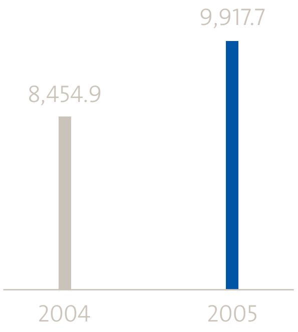
Telefónica can only become more global if we manage to be more local. To do this, its common focus is the customer. What differentiates Telefónica from other operators is that it attaches greater importance to the customer, and must continue to stay ahead of the rest in this area.

Telefónica Group Market Size (as at 31 December 2005)



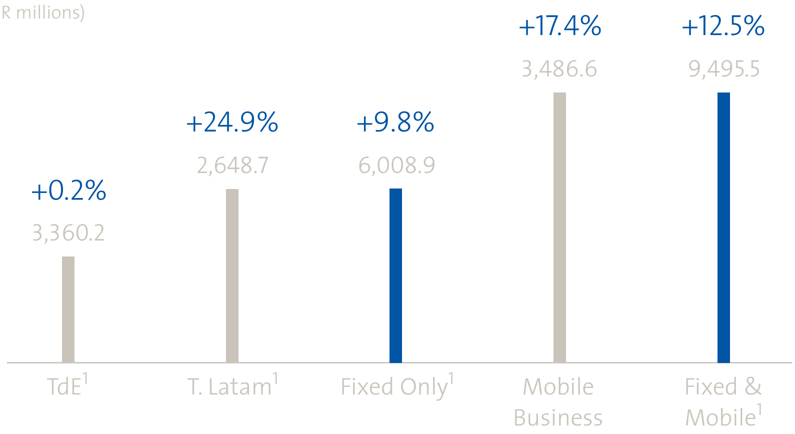
OIBDA-CapEx

(in EUR millions)



OIBDA-CapEx Breakdown

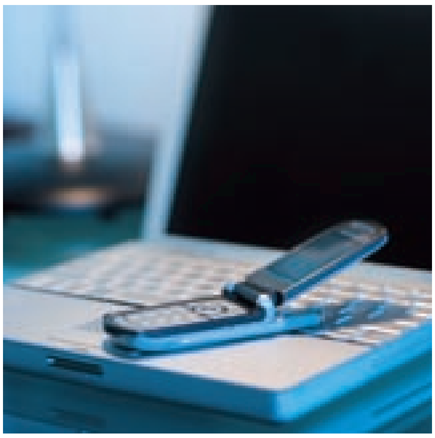
(in EUR millions)



[1] Includes Terra España and Latinoamérica, respectively, since Jul'05. For Latam, 2004 and 2005 OIBDA excludes capital gains from the sale of Telinver (Directories in Argentina, EUR 48.4 million) and of the CTC mobile company (EUR 425.5 million), respectively. 2005 OIBDA includes capital gains from the sale of Infonet (EUR 80.0 million).

2005 results

The most relevant factors of Telefónica Group results for fiscal year 2005 are the following



Telefónica Group revenues increased 25.1% compared with 2004, reaching an absolute figure of 37,882.1 million euros. This strong yearly growth was due to the increased revenues achieved by all business lines, and changes in the consolidation perimeter, mainly the BellSouth and ČESKÝ TELECOM assets.

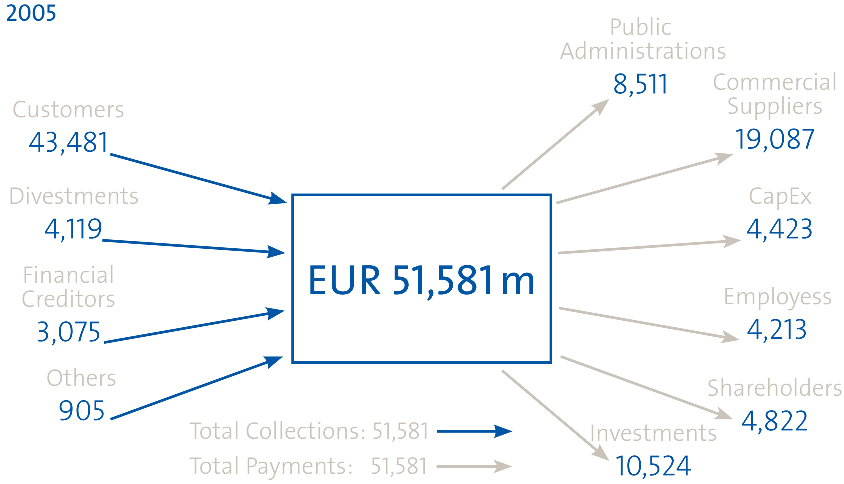
Consolidated OIBDA in January – December 2005 stood at 15,276.4 million euros, a 25% growth in relation to the same period in 2004. In terms of profitability, despite the high levels of commercial activity, particularly in the cellular business, (OIBDA margin) was maintained practically stable compared with the previous year (40.33% vs. 40.36%).

Net income reached a record amount of 4,445.8 million euros, 40% higher than in 2004, thanks to the good evolution of operations and the positive contribution of the executed acquisitions

Operating free cash flow (OIBDA-CapEx) rose to 9,917.7 million euros, equivalent to 17.3% increase over the 2004 figure with the positive contribution of all business lines, despite a higher investment in growth.

World Income Distribution 2005

(in EUR millions)



This information has been obtained from internal sources of Telefónica Group.
The data mentioned above has been reported according to cash criteria and includes indirect taxes.

Telefónica empowering economic, social and technological development in each of the countries where it is present

In 2005, Telefónica performance made a significant contribution to all its stakeholders (customers, employees, society, suppliers, Environment..). The results underpin the company's position an important driver of economic, technological and social development in the countries where it operates.

Economic development driver

It redistributed over 51,581 million euros among its interest groups, of which 4,213 went to employees, 4,822 to shareholders, 19,087 to suppliers and 8,511 to public administrations. Telefónica's economic activities contribute in average 1.7% of GDP of the main countries in which it operates. Telefónica is the first private Investor in Latin America with accumulated investments of over 75 billion euros between 1990 and 2005. The Group's consolidated workforce totalled 207 thousand employees, of which 37% are located in Europe and 63% in Latin America. Over 18 thousand suppliers around the world collaborate with Telefónica, 85% of which are local suppliers in each country.

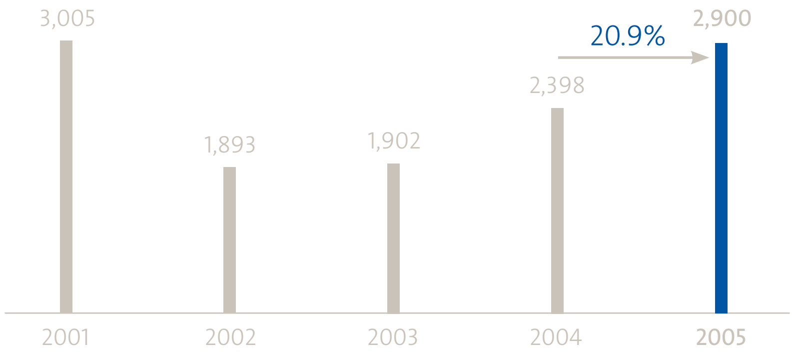
Finally, it is important to emphasize the indirect impact of Telefónica Group's services have on the economies of the main countries where it is present. For instance, activities targeted at reducing the digital divide; a reduction in the price of services; greater availability of broadband services and permanent connectivity; are having a significant impact on the increase of the productivity levels of the local economies.

Technological development driver

During 2005 it invested approximately 2.9 billion euros in technological innovation, according to OECD measurement criteria. During 2005, is has increased even more its R&D activities that accounted for over 530 million euros, which represents a 1.4% as of Total Telefónica revenues. Telefónica Móviles is the largest investor in innovation within the Telefónica Group as a result of its new generation networks deployment. By country distribution, Spain is the recipient of 45% of the total innovation and Brazil of 23% respectively. It has 1,509 patents, 1,546 intellectual property rights registered and 296 new products developed by Telefónica I+D in 2005.

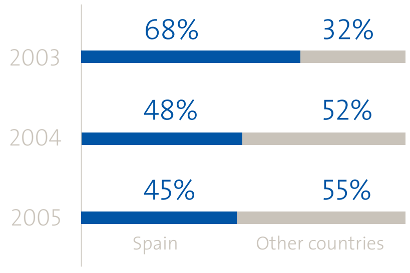
Total Technology Innovation Investment of Telefónica[1]

(in EUR millions)



[1] Technological innovation definition, according to OECD measurement criteria

Geographical Distribution



Social development driver

In 2005, Telefónica has developed several projects oriented to improve its behaviour as a responsible company to all its stakeholders:

Telefónica pursues customer satisfaction, through great customer orientation and operational excellence. As a consequence of this effort, customer satisfaction levels reached 83% in Spain.

In 2005, Fundación Telefónica performed a strategic review of all its projects, focusing on educational ones (educared) and children integration in society (proniño). Complementing Fundación Telefónica's commitment, it is important to highlight the employees' commitment to volunteering; already 60 thousand employees engage with ATAM (Telefónica Association to Aid Disabled People).

Digital inclusion of people with the lowest income levels (over 5 million prepaid or control fixed lines in Latin America) or disabled people (Telefónica Accesible programme kick off) are examples of programmes where Telefónica shows its commitment to social inclusion. The corporate norm on environmental management, approved in 2004, has progressed to implementation within Telefónica subsidiaries; outstanding progress has been made in energy management, visual impact and waste management.

In 2005, Telefónica has – for the first time ever – completed a supplier satisfaction assessment in their relationship with Telefónica. Satisfaction levels achieved an average of 6.75 (on a scale from 0 to 10).

Moreover, it is important to mention three circumstances that confirm Telefónica's commitment to corporate responsibility:

- Code of Ethics approved by the Telefónica Group
- Publication of corporate responsibility annual reports in Argentina, Brazil, Chile and Peru; complementing the existing ones for Telefónica S.A, Telefónica Móviles and TPI
- Confirmation of Telefónica presence in major Sustainability Indexes (FTSE4Good and Dow Jones Sustainability Indexes, among others)


02

Board of Director's report on business activity

ČESKÝ TELECOM Group

Description of the business of the Group

ČESKÝ TELECOM, a.s. (ČESKÝ TELECOM, Company) and its subsidiary companies together form a strong telecommunications group (Group) which operates primarily in the area of provision of telecommunication and related services. In addition to ČESKÝ TELECOM, the second most important entity in the Group is Eurotel Praha, spol. s r.o. (Eurotel), the largest mobile operator in the Czech Republic. This strong telecommunications group, the only one in the Czech Republic, offers a complete portfolio of voice and data services in the areas of fixed line and mobile technologies, including the service of access to network infrastructure for operators and providers of both public and private networks and services. A complete overview of the Group is given in Section 03/02 of the Annual Report. As at 31 December 2005, ČESKÝ TELECOM operated a total of 3,126,015 fixed lines and Eurotel registered 4,676,036 customers. This fact confirms the Group's leading position of the former in the fixed line market and the second position of the latter among mobile operators.

Most of the services of the Group are provided on the territory of the Czech Republic. Services are retailed to four main customer segments: residential, SME, corporate clients and government. Additionally, ČESKÝ TELECOM provides wholesale services, catering to other public telecommunications network operators and providers of public telecommunications services in the Czech Republic and abroad.

On 1 March 2006, the Board of Directors and the Supervisory Board of ČESKÝ TELECOM have approved an intention to integrate Eurotel and ČESKÝ TELECOM into a new telecommunications operator, Telefónica O2 Czech Republic, a.s. The integration means that ČESKÝ TELECOM will acquire all assets and liabilities of Eurotel, including all rights and obligations arising out of employment relations and the company Eurotel Praha, spol. s r.o. will be dissolved without liquidation and will be wound up. The Board of Directors of ČESKÝ TELECOM will ask the General Meeting, which will take place on 27 April 2006, to approve the integration and to adopt the Company's new name Telefónica O2 Czech Republic, a.s. The decisive date for the transfer of Eurotel's assets and liabilities to ČESKÝ TELECOM is proposed for 1 January 2006. The integrated organization is expected to become effective in mid-2006 after all required legal steps have been completed.

If the proposed transfer of assets and liabilities of Eurotel to ČESKÝ TELECOM is approved it would change the tax position

Number of employees of the Group as at 31 December 2005

	2005	2004
ČESKÝ TELECOM	7,524	8,794
Eurotel	2,490	2,483
Other companies	45	36
Total employees	**10,059**	**11,313**

of Eurotel as at 31 December 2005 and the tax position presented in the consolidated financial statements of ČESKÝ TELECOM Group as at 31 December 2005.
The adjustments reflecting the impact of the merger would result in an increase of the current income tax liability by CZK 465 million, decrease of deferred tax liability by CZK 298 million and decrease in equity by CZK 167 million.

Human resources

Also in 2005, the Group continued to implement its human resources strategy of which goal is to strike a balance between the continuous improvement of employee performance and a high level of staff motivation, personal and professional development and satisfaction.

The total number of employees of the Group fell in 2005 by 1,254, representing a decline of 11%. While Eurotel's workforce remained more or less on the same level, ČESKÝ TELECOM's fell by almost 14.5%. This is one of the results of the ongoing Transformation Programme, which, inter alia, set out to reduce the workforce in the area of fixed line business while increasing labour productivity to a level close to the best performers in the telecommunications industry.

Out of the total of 1,942 employees who left ČESKÝ TELECOM in 2005, 69% left as a result of the reorganisation. Under the Collective Agreement, employees were entitled to severance pay depending on the duration of their employment in the Company.
In 2005, this was CZK 205,592, representing 7.87 times the average monthly wage on average. For employees who cannot find another position in the Company, ČESKÝ TELECOM has developed an efficient social and re-training programme. The programme has helped the employees who were leaving cope better with the negative aspects of the situation. As a result, the relationship between the management and representatives of the workforce remained at a very good level.

In 2005, the synergetic effects between ČESKÝ TELECOM and Eurotel in the area of human resources were intensifying. Joint teams comprising people from both companies started working on a number of common projects.

The Collective Agreement for the period 2006 – 2007 was successfully signed.

A quality management system under ISO 9001:2000 was implemented in 2005. The readiness of the quality management system was successfully verified in a certification audit by the multinational company Lloyd's Register Quality Assurance Limited.

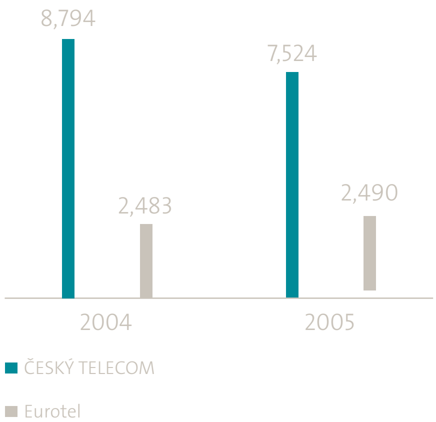
A company-wide equal opportunities program was launched in the area of human resources in 2005. The program helps employees balance out their work and non-work activities, build awareness of equal opportunities issues and also develop the management potential of women employees.

Development and training program in ČESKÝ TELECOM continued in implementing the Leadership Academy. Training for all managers in the Group was organised at the beginning of the year, with the aim of strengthening and stimulating business thinking and behaviour. The training concentrated on developing the managers' business skills by means of games simulating strategic and operative management of a fictitious company.

E-learning was used as the standard platform for employee development. The Company

Number of employees of ČESKÝ TELECOM and Eurotel

(In Thousands)



launched Spanish and English courses means of the so-called combined teaching – both in the Virtual University and live sessions with a tutor. Emphasis was laid also on the development of courses for the sales force in order to improve their relationship with the customers and build their sales potential. The portfolio of employee benefits was expanded. The aim was to help the employees address their housing concerns and help young families. The drawing of benefits in the form of our products was also supported in 2005.

Eurotel, too, always creates a motivating environment and working conditions for its employees. As mentioned above, the workforce is stabilised in the medium term. One proof is the relatively high proportion of satisfied and loyal employees who have been with the company for ten years or longer. Every year, more than hundred people are rewarded for their ten years with the company. Moreover, Eurotel is imprinted in the public view as a prestigious employer, as attested by many years of presence at the highest places of charts of most preferred employers. As in the year before, also in 2005 Eurotel came second in the prestigious Employer of the Year poll.

In 2005, Eurotel employed dozens of people with disabilities (in call centres, stores, etc.). In employing people with disability Eurotel actively co-operated with its foundation, Nadace Eurotel, and with other organisations. All Eurotel's premises (Prague, Kolín and Příbram) are barrier free. The majority of vacancies are suitable also for people with disability; such employees were however subject to the same demands as other employees.

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, as a pro-active, dynamic and self-improving system, which is focussed primarily on the elimination or mitigation of negative effects of risks which are external and internal to the company, and on the application of positive effects of the risks on the company. Risk management is an inherent part of the strategic management of the Group.

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

The risks are identified based on an assessment of the relevant management levels, and suggestions made by the Risk Management, Internal Audit and other units of the Group, and evaluated in terms of their potential financial impact and likelihood of materialisation. Where the value of the 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.

Risk Management is responsible for the methodology and risk management system on the Group level. The Board of Directors and the Supervisory Board, or its Finance and Audit Committee, respectively, are informed of major risks to which the Group is exposed on a monthly basis.

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

Financial markets risk

ČESKÝ TELECOM is exposed to the risk of foreign exchange rate and interest rate fluctuations. In line with the Treasury Policy, financial instruments are used to hedge the Company against foreign exchange rate and interest rate fluctuations which could present a risk for the Company's future cash flow.

Regulation

Activities in the fixed line segment are subject to supervision and regulatory intervention by regulatory authorities. The impacts of such risks may be assessed only in a limited scope. These risks are continually managed and mitigated to the maximum extent by the Regulation and Interconnect Unit.

Competition

The fixed line and mobile segments are fiercely competitive. This risk presents a direct danger for the Group's market share and revenues. The Group aims to provide its customers with such technologies, products and services that will prevent the negative effects.

Major damage to or interruption of the network/system operation

Major damage to or interruption of the network/system operation would mean that companies in the Group would not be able to provide customers with the usual scope and quality of service. Most system and network elements are designed to activate the back-up systems in the event of damage or a shutdown. The Group has emergency documents for cases when the risks materialise; the documents limit the potential lapse in service to a time which is critically necessary for restoration of the damaged systems.

Corporate social responsibility

Employee health and safety

Also in 2005, ČESKÝ TELECOM recognised the need for sustainable development in the area of employee welfare and health protection as part of its social responsibility. The principles for implementing these requirements are laid down in an internal Occupational Health and Safety Directive.

ČESKÝ TELECOM was in 2005 the only Czech company to implement the EH & S module by SAP for the management and control in the area of employee health and safety. For the first time in the Company's history, all sites and activities performed there were handled in a way which does not present a hazard for the health of our employees.

In addition to conforming to the statutory duties, ČESKÝ TELECOM implemented also preventive health promotion programs. An internal regulation laid down the requirements for occupational health and safety in working with display units (the most frequent activity in ČESKÝ TELECOM). ČESKÝ TELECOM is a non-smoking company.

Eurotel, too, espoused the importance of employee health and safety and gave long-term support to improvements in the working climate and protection of its employees' health. In the field of health and safety in a workplace, the level of safety of employees in performing the most hazardous work was increased and the number and seriousness of work-related injuries were successfully kept to the minimum.

In the course of 2005, exit routes in 62 base stations were modified to assure conformity with the legislation and standards governing working at height. This helped increase the total number of previously built base stations to 187. In 2005, Eurotel became the first telecommunications operator in the Czech Republic to receive the Health Promoting Company Award for its excellence in caring for the health of their employees.

Environment

ČESKÝ TELECOM's policy in the area of environmental protection remained focused in particular on continuous improvement of environmental care, prevention of emissions and compliance with the statutory and other requirements in the area of environmental protection by which the Company is bound. The basic principles of ČESKÝ TELECOM's relations to the environment have not changed even after the arrival of Telefónica. ČESKÝ TELECOM continued to meet its duties and commitments in this area.

A selected regional pilot unit underwent an EMS (Environmental Management System) audit under ISO 14001:2004 which was performed by Lloyd's Register Quality Assurance. As part of EMS improvement, environment-related demands with respect to suppliers were made more stringent. Likewise, ČESKÝ TELECOM, too, was subject to increasing environment-related requirements from customers and stakeholders.

In 2005, the trend of mitigation of negative effects on the environment successfully continued. Compared to 2004, ČESKÝ TELECOM reduced the total volume of waste produced by 30%. From this amount, 22% were recyclable types of waste, and a substantial part of the other forms of waste could be put to some other use.

Compared to 2004, the total volume of pollutants released into air from heat producing facilities and transport vehicles was reduced. For its operations, ČESKÝ TELECOM used 0.5% less heat in 2005 compared to 2004, while the consumption of electricity fell 1.8% on the year before. The volume of waste water produced has also gradually decreased.

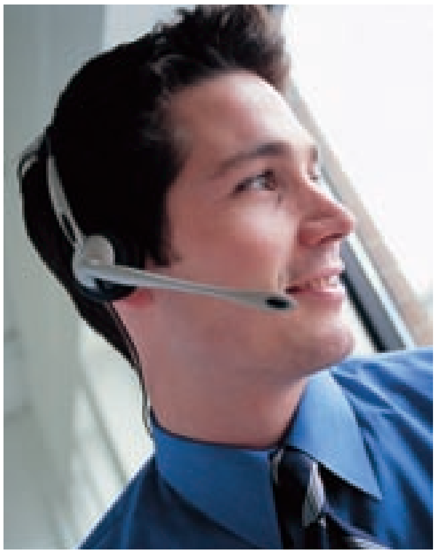
Eurotel, too, implemented all measures for protection of the environment. It is the only telecommunications operator in the Czech Republic certified to ISO 14001:2004 in the area of environmental protection. In 2005, the certification of a part of the integrated system under ISO 14001:1996 was upgraded to the ISO 14001:2004 standard.

Security

The Group paid greater attention to the issues of security of its products and services. As a result, the Company launched a number of security products (e.g. Dohled 24) and enhanced security aspects of other services.

ČESKÝ TELECOM is the holder of National Security Office security clearance for organisations up to the level of SECRET. The Company has also an adequate number of employees with security clearance for meeting of statutory duties, provision of telecommunications services to the government sector and for bidding in tenders for government elecommunications services contracts involving access to classified information.

ČESKÝ TELECOM uses the PKI (Public Key Infrastructure) tool, including the certified electronic signature function, for communication with its business partners and for protecting the personal data of its customers, telecommunications and commercial secrets and other sensitive information in compliance with the statutory requirements. The company successfully operates a number of security systems to protect against unauthorised use of telecommunications services and unlawful



enrichment at the expense of ČESKÝ TELECOM and its customers (e.g. Fraud Protect, Info Limit). The company has a functional crisis management system put in place, to assure the continuity of its business in times of potential crises and emergencies.

Also Eurotel regarded security as an important an inherent part of all its key processes and services. In 2004, the Company implemented an integrated management system. All its parts were successfully certified by RWTUV, an independent accreditation and certification authority. Eurotel was the only Czech telecommunications operator to earn the BS 7799-2 certificate in the area of security management and the OHSAS 18001 certificate in the employee health and safety area.

Eurotel is the holder of National Security Office organisational security clearance to the level of CLASSIFIED, as per the Act No. 148/1998 Coll., on protection of secret information. In the course of 2005, the National Security Office modified and approved a security project for the protection of confidential information to the level of SECRET. Eurotel has thus complied with all the statutory qualification requirements for security clearance to the level of SECRET which is expected to be issued to Eurotel soon.

Sponsoring

Sponsorship activities of ČESKÝ TELECOM have a long tradition and concentrate on three main areas – culture and society, sports and charity. In the field of culture, ČESKÝ TELECOM has been partner of Czech theatre and film. Support went to selected ensembles, many theatre and music festivals (e.g. Mezi ploty Festival, Shakespeare Festival). For tenth year running, ČESKÝ TELECOM has been partner of the Karlovy Vary International Film Festival, and supported again also the Summer School of Film in Uherské Hradiště.

In the field of sport, ČESKÝ TELECOM supported the national ice hockey league and the Czech Skiing Federation. It also gave support to selected motor sport events and the Zlatá tretra track and field event.

ČESKÝ TELECOM also reacted to the situation after the tsunami disaster in Southeast Asia and organised a fundraising campaign among employees. The Group donated CZK 1.6 million to the Man in Need Foundation. A Small Donation Fund of ČESKÝ TELECOM was established, following on the long tradition of supporting small projects of both NGOs and underprivileged individuals. The Company also organised a campaign in aid of sheltered workshops and selected NGOs.

Eurotel, too, was involved in a host of sponsorship projects. Some of the more prominent cultural undertakings were Eurotel's support to the Karlovy Vary International Film Festival, general partnership with the Tanec Praha dance festival and Struny podzimu music festival, as well as a series of Christmas concerts held in several locations across the country. Eurotel is the general and titular partner of Go Žluté Lázně. For many years, Eurotel has been general partner of the Czech national ice hockey team and the AC Sparta Praha football team. A new partnership was forged with the Czech Athletic Federation.

Moreover, Eurotel continued its support to NGOs and philanthropic projects via its foundation, Nadace Eurotel, whose mission for 2005 was again to help fund projects in aid of children and youth in the whole of the Czech Republic. Nadace Eurotel continued its third successful year of the Zaměstanci pomáhají project which, in various forms, supports children in selected institutional homes. Last year, the home in Pyšely u Benešova was added to the three homes which have enjoyed the patronage so far.

The telecommunications market in the Czech Republic

The development on the Czech telecommunications market in 2005 took a similar course as in the previous years. The overall market growth measured by revenues continued to lag behind the GDP growth, primarily as a result of the stagnation on the fixed line market which was not offset adequately by growth in the mobile segment. ČESKÝ TELECOM estimates that the Czech telecommunications market grew in 2005 by approximately 3% on the year before. While the revenues in the fixed line segment remained in 2005 on the level of 2004, the mobile market recorded a year on year growth of 5%. The development was attributed to the relatively late upgrade of and investment in the fixed line network and to the rather fast uptake of mobile technology, as well as to some unfavourable regulatory decisions. The result was a fixed line penetration rate of 32% and which has been steadily falling over the years. On the other hand, the mobile SIM card penetration exceeded 110% at the end of 2005, and it is expected to grow further, as the number of customers who own more than one SIM card increases.

The EU-related accession change of the regulatory environment in the Czech Republic several pricing decisions of the Czech Telecommunications Office (CTO) also significantly shaped the development of the Czech telecommunications market.

Changes occurred also in the field of competition, in both the fixed line and the mobile segment. A strong international mobile operator, Vodafone Group, entered the mobile market by taking over the youngest Czech mobile operator Oskar Mobil and its Oskar retail brand in 2005. In the fixed line segment, several small operators consolidated as a result of several acquisitions by GTS Central Europe (GTS CE) and GTS CZECH. An important event, not only for ČESKÝ TELECOM, but also for the whole telecommunications market, was the privatisation of the 51.1% stake in our company to the Telefónica Group of Spain. Telefónica, having made the mandatory share buy-out offer to minority shareholders, subsequently increased its shareholding in ČESKÝ TELECOM to 69.4%.

Fixed line market

The year 2005 saw stagnation on the fixed line market compared to the previous year. Total revenues are estimated at CZK 48 billion. The majority of alternative operators concentrate primarily on providing services to the business segment. Other areas of their interest included voice services to households via Carrier Selection and Pre-selection, and recently also retail marketing of Internet services. According to available information, the revenue market

share of alternative operators in 2005 was approximately 33%.

GTS Novera – a product of the merger of two biggest alternative operators, GTS CZECH and Aliatel, became the largest alternative operator on the Czech fixed line market in 2005. On 11 February 2005, shares of Aliatel were transferred to GTS CZECH, which formally concluded the process of acquisition of Aliatel by GTS CZECH. GTS Novera, or its 100% owner, GTS CE, also stands behind the other acquisitions on the Czech fixed line market which were made in late 2005. On 29 November 2005, GTS CE signed a purchase agreement for 100% of shares of Contactel. On 6 December 2005, GTS CE concluded a contract with Telenor of Norway, for the transfer of 100% interests in Telenor Networks and Nextra. After the approval of both transactions by the Office for Protection of Economic Competition (OPEC) on 18 January 2006, acquisitions of Telenor Networks and Nextra were officially closed on 31 January 2006, and the acquisition of Contactel was officially closed on 2 February 2006. After the merger of these three entities into GTS Novera, the position of GTS Novera on the fixed line market will be strengthened.
In addition to the consolidation of companies around GTS CE, changes occurred in the shareholder structure of several smaller alternative operators. Skynet became a part of Tinezo Investments of the Netherlands. Dial Telecom merged with Inway which owns the metropolitan optical fibre network in Prague.

Mobile market

Eurotel in 2005

At the end of 2005, Eurotel confirmed its market leadership in the mobile market, both in terms of the number of customers and in terms of profitability and revenues. During 2005, Eurotel also continued to significantly increase its lead in the contract customer segment.

At the end of 2005, Eurotel registered 4.68 million customers, representing a year on year increase by 282 thousand customers, i.e. by 6.4%. The number of contract customers[1] alone grew by a record 487 thousand in 2005, which represents a 46% year-on-year growth. The development was substantially aided by the successful migration of pre-paid service customers to the new post-paid tariffs launched by Eurotel in 2005 which were very well received by the customers. The proportion of contract customers in the total of Eurotel's customers has thus increased to more than 33% as at the end of 2005, compared to 24% as at the end of 2004.

Eurotel's competitive position

With its 4.68 million customers at the end of 2005, Eurotel confirmed its stable 41% share in the total mobile customers in the Czech Republic. From the remaining 59%, T-Mobile accounts for more than 40% and Oskar for less than 19%; Oskar improved its share by more than 1 percentage point compared to the situation as at the end of 2004.

Owing to the successful acquisition of customers for the new tariffs and the successful migration of pre-paid customers to one of the new tariffs, Eurotel's share of the contract customer market as at the end of 2005 increased to 39%, compared to 35% as at the end of 2004. T-Mobile's share of the total contract customer market fell year on year from 36% to 33%, and the share of Oskar fell slightly from 29% in 2004 to 28% as at the end of 2005.

Eurotel also confirmed its traditional leadership on the data market. Eurotel's

[1] All figures on Eurotel's contract customers in the Annual Report include GSM and NMT customers.

customers benefited from the most comprehensive offer of data services on the Czech market; in December 2005 the service portfolio was expanded to include third generation UMTS data services. With the exception of T-Mobile which launched a third generation data network, Eurotel does not have an equal competitor in the high-speed mobile Internet market. The flagship of Eurotel's data products – Data Expres was gaining in popularity with customers. As at the end of the year, the service registered already 70 thousand users, i.e. 133% more than as at the end of 2004.

Eurotel has held its traditionally strong position in the segment of business customers with more than 5 staff. T-Audit, an independent survey performed in October 2005 , concluded that Eurotel's service was used by 78% of companies with more than 200 employees, 51% of companies with 20 – 199 employees and 42% companies with 6 – 19 employees.

In the area of competition, the biggest change in 2005 was the takeover of the youngest Czech operator, Oskar Mobil, by the multinational Vodafone Group in June. ČESKÝ TELECOM's privatisation to Telefónica in June 2005, should give Eurotel additional competitive advantages, especially in the area of third generation mobile services and data, Internet and value added services.

After the acquisition of ČESKÝ TELECOM by Telefónica, Eurotel in mid-2005 changed its methodology for reporting the number of pre-paid customers; the new method accounts only for those pre-paid customers who charged their credit in the last 13 months, as opposed to 18 months under the previous methodology. All customer figures in this Annual Report are presented under the new methodology, including figures for the past periods which were to make them fully comparable.

Trends on the mobile market in 2005

Mobile SIM card penetration in the Czech population grew to 112% as at the end of 2005, compared to 104% in 2004. However we still believe that the mobile market has not reached the saturation point and that further growth is possible. Penetration of the real number of customers who use mobile services is estimated at 80% of the population. Another source for a growth in the revenues and in profitability was the ongoing migration of customers from the pre-paid to the post-paid service which boasts a wider range of additional services, especially data services. Other growth areas which have been in the focus of attention of Eurotel in the past year included the high-speed mobile Internet services, content services, value added services and, newly, the third generation UMTS services such as video telephony, real time video transmission and video and music downloads (for more details please refer to Section Mobile segment – Products).

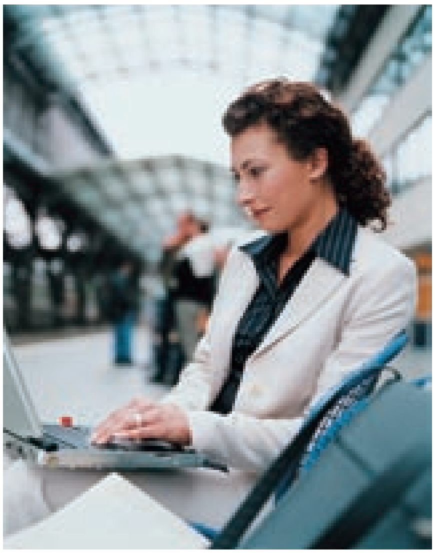
Despite the high mobile market penetration, the rate of growth in 2005 did not experience a major slowdown compared to 2004. Net adds of customers in 2005 reached 867 thousand compared to 1,099 thousand in 2004. The number of customers increased 8% in 2005 year on year, compared to 12% in 2004.

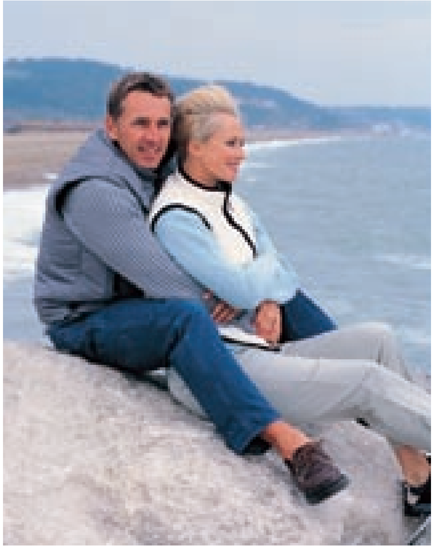
The year 2005 was successful for Eurotel also in terms of its share in the net adds of mobile customers in the Czech Republic. From the total net adds of 867 thousand, Eurotel claimed 282 thousand, i.e. 33%. From the total net adds of 893 thousand in the contract customer segment, Eurotel's share was 487 thousand, i.e. 55%.

Regulation

Main developments in 2005

The regulatory environment on the electronic communications market in the Czech





Republic experienced a number of changes in the course of 2005; the most significant development was the replacement of the Act No. 151/2000 Coll., on telecommunications, as amended (Telecommunications Act), with effect from 1 May 2005, by a new law, the Act No. 127/2005 Coll., on electronic communications, as amended (Act on Electronic Communications), and the subsequent adoption of related bylaws (government regulations, decrees, general provisions). The most significant changes contained in this law were enumerated on page 19 of the 2004 Annual Report.

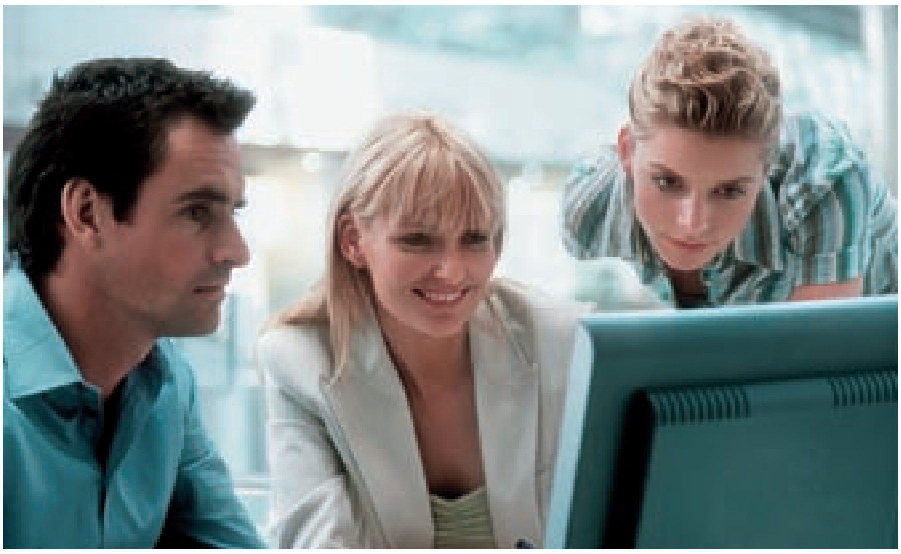
State administration in the field of telecommunications still falls by law to the Ministry of Informatics of the Czech Republic (MoI) and the Czech Telecommunications Office (CTO). The authorities of the MoI lie mostly in the area of policy and international relations, whereas the exercise of regulation is mainly in the power of the CTO and the market competition aspects fall to the Office for the Protection of Economic Competition (OPEC).

In carrying out its business of electronic communications, ČESKÝ TELECOM is obliged to respect the duties set forth in the law, regulations, government directives, general provisions and the decisions of the CTO and OPEC.

Until 12 August 2005, ČESKÝ TELECOM carried on its business based on a telecommunications licence for the construction and operation of a public telecommunications network and a telecommunications licence for the provision of a public telephone service on a public fixed telecommunications network which also lays down the terms and conditions of provision of the Universal Service. The force of all telecommunications licences and certificates under general licences ended, as per the new Act on Electronic Communications, on 1 September 2005.

From 12 August 2005, ČESKÝ TELECOM has carried out its telecommunications business under the Act on Electronic Communications based on a notification and certification from the CTO. In compliance with the provisions of Section 13 of the Act on Electronic Communications, ČESKÝ TELECOM notified the CTO on 12 August 2005 of its electronic communications services which constitute doing business in electronic communications as per Section 8 of the Act. On 29 September 2005, ČESKÝ TELECOM supplemented the notification with other documents required by the Act on Electronic Communications. Subsequently, on 11 October 2005, ČESKÝ TELECOM received a certification from the CTO confirming that it had duly provided notification of its electronic communications services. Electronic communications services include the following:

a) Public fixed electronic communications network
   Territorial coverage: Czech Republic
b) Public radio and television broadcasting network
   Territorial coverage: Czech Republic
c) Public fixed telephone network
   Territorial coverage: Czech Republic
d) Publicly available telephone service
   The service is publicly available. Territorial coverage of the service: Czech Republic
e) Other voice services
   The service is publicly available. Territorial coverage of the service: Czech Republic
f) Leased lines
   The service is publicly available. Territorial coverage of the service: Czech Republic
g) Radio and television signal broadcasting
   The service is publicly available. Territorial coverage of the service: Czech Republic



h) Data transmission services
The service is publicly available. Territorial coverage of the service: Czech Republic
i) Internet access services
The service is publicly available. Territorial coverage of the service: Czech Republic
j) Other voice services
The service is not publicly available. Territorial coverage of the service: Czech Republic

Universal service

Under the Telecommunications Act, ČESKÝ TELECOM was awarded a telecommunications licence for the provision of a fixed telecommunications licence (Telecommunications Licence) by CTO Decision Ref. No.: 38155/2001/I-603 dated 4 March 2005.

The CTO obliged ČESKÝ TELECOM, the licence holder, to operate the Universal Service in the public interest on a public fixed telecommunications network as per Section 29 of the Telecommunications Act.

To comply with the deadline stipulated in the Act on Electronic Communications, the CTO should determine the scope and new detailed conditions for the provision of individual elements of the Universal Service by the end of January 2006, including the selection of one or more providers. Based on the results of a tender, the CTO decided on 21 December 2005 that ČESKÝ TELECOM would be the provider of the following components of the Universal Service:
• regular publication of telephone directories in the area of the public telephone service and provision of access of users to these directories under Section 38(2c) of the Act on Electronic Communications,
• directory information service in the area of the public telephone service and provision of access of users to the information service under Section 38(2d) of the Act on Electronic Communications.

Pending the launch of the other Universal Service components as per the Act on Electronic Communications, ČESKÝ TELECOM remains the only Universal Service Provider under the conditions of the Regulatory Framework set forth in the Act on Electronic Communications, the related bylaws and telecommunications licences.

Also in 2005, ČESKÝ TELECOM dutifully honoured its commitment arising from the Universal Service obligation. During the whole period, ČESKÝ TELECOM delivered on the Universal Service quality indicators as per the Decree No. 196/2000 of the Ministry of Transport and Communications of the Czech Republic from 30 June 2000. ČESKÝ TELECOM has developed, as it intends to do in the future, the basic mandatory form of the services comprising the Universal Service, and offered a number of premium value added and utility services. It can be concluded from comparable indicators that ČESKÝ TELECOM is one of the top Universal Service providers in EU member states.

The Electronic Communications, entitles ČESKÝ TELECOM to compensation for legitimate losses incurred as a result of providing the individual listed components of the Universal Service package.
The legitimate loss for the year 2004 (the legitimate loss for the year 2005 will be presented at the end of the first half of 2006) is the difference between the economically justified costs incurred as a result of complying with the duty to provide the Universal Service which ČESKÝ TELECOM would not have incurred had it not been bound by this duty, and the revenues of ČESKÝ TELECOM from the Universal Service.

The loss incurred in connection with the Universal Service provision in 2004 and which should be compensated to ČESKÝ TELECOM by Other Licensed Operators, as per the Telecommunications Act, which was claimed by the company with the CTO was quantified at CZK 4,894,734,641. The CTO, however, recognised a much lower loss from the provision of the Universal Service – the calculation accounted for only a limited scope of the Universal Service defined in the Decree No. 235/2001 Coll., of the Ministry of Transport and Communications, and the CTO also unlawfully included the effects of the impairment charge in the calculation. According to the CTO, the loss from the provision of the Universal Service in 2004 amounted only to CZK 302,622,498.

A regulation of the MoI will be adopted in 2006, which will stipulate the method for calculation and determination of net costs of the Universal Service provision (formerly known as the Universal Service loss); the decree should already account for the whole scope of the Universal Service as laid down in the law. The net costs of the Universal Service provisions according to the regulation will be first calculated for the year 2006.

Analysis of the relevant markets

The newly adopted Act on Electronic Communications stipulates that regulatory remedies may be imposed only on providers with significant market strength and on providers of the individual Universal Service components. These providers will be identified, and subsequently charged with the implementation of remedies based on the results of analyses of 18 relevant markets performed by the CTO in keeping with the Act on Electronic Communications. These remedies are the principal drivers of regulation on the electronic communications market. The above-mentioned remedies may include, for instance, pricing regulation, the duty to keep a separate account of costs and revenues and the duty to allow access to specified network elements.

The Act on Electronic Communications stipulates that the analyses ought to be concluded in January 2006, and that the related remedies must be imposed by the end of April of 2006. The progress of the analysis process to date indicates that the deadlines set in the law will not be met for all the relevant markets and that the analyses will be concluded in the course of 2006.

Government policy and support in the area of broadband Internet access

The government meeting of 26 January 2005 approved the National Broadband Access Policy. This document attempts to identify the main causes for the rather slow uptake of broadband Internet in the Czech Republic, emphasizing the need to support its development. In line with the policy, the Ministry of Informatics earmarked 1% from the proceeds from the sale of the state's stake in ČESKÝ TELECOM to set up a grant fund for the development of broadband Internet access (the so-called Broadband Forum).

The fund will support selected projects, analogously to the EU Structural Funds, and will have a positive effect on the growth in the demand for broadband Internet access services in the Czech Republic. However there is a risk of supporting projects which would distort the market competition and jeopardise private investment in the broadband Internet access area. Together with other companies which do business in the field of electronic communications, ČESKÝ TELECOM highlighted the need of the relevant public

authorities to pay attention to this risk in the process of approving grants.

CTO pricing decisions

Before the Act on Electronic Communications was adopted, the CTO issued five important new pricing decisions and one amendment to a pricing decision:

1. CTO Pricing Decision No. 01/2005, dated 22 April 2005, effective from 25 April 2005, giving a list of telecommunications services with regulated prices. Appendix 1 of the Pricing Decision gives the maximum regulated prices and the terms and conditions for domestic telecommunications services provided by ČESKÝ TELECOM as part of the Universal Service. The Pricing Decision reduced the price of the monthly subscription for residential lines in the basic price plan to CZK 276 exclusive of VAT and in the Mini price plan to CZK 167 exclusive of VAT, and also reduced the flat monthly fee for business lines in the basic price plan to CZK 495 exclusive of VAT. The conditions for provision of the basic price plans and the Mini price plan ban usage credits. The limitation on provision of CS/CPS, SUALL and ADSL services was preserved for the Mini price plan. The prices of voice services were cut across-the-board. The decision stipulates the duty to keep the top-up packages separate from the flat monthly fee. In Appendix 2 to the Pricing Decision, the maximum prices and the terms and conditions for international telecommunications services provided by ČESKÝ TELECOM as part of the Universal Service were reduced by an even bigger margin than the domestic service. At least in part, the Pricing Decision accommodated ČESKÝ TELECOM's request for the ebalancing of tariffs which has been repeatedly made since 2001. From 2003 to 2005, the CTO kept the maximum prices on the same levels. While the tariffs were rebalanced in full for the business lines, the residential lines were subject to only a partial rebalancing.

Amendment No. 1 to the Pricing Decision No. 03/PROP/2004 dated 22 April 2005, effective from 25 April 2005 allowed adding a separate item of CZK 158/month on top of the maximum price for shared access to the local loop. This item in part covers the cost of using the so-called non-voice frequency band in the access network in the broadband access to Internet and other services via ADSL.

2. CTO Pricing Decision No. 01/PROP/2005, dated 24 February 2005, effective from 15 March 2005, stipulating the method of calculation of prices for interconnection to public telecommunications networks for access to the virtual calling card services from public mobile telecommunications networks. The Pricing Decision permits the interconnection also with mobile operators for giving access to the virtual calling card services, and laid down the method of calculation of prices for such interconnection.

3. CTO Pricing Decision No. 03/PROP/2005, dated 22 April 2005, effective from 25 April 2005, laying down the method for calculation of prices for Local Loop Unbundling (the whole local loop or a part thereof) and of the maximum price for Local Loop Unbundling (the whole local loop or a part thereof). The decision reduced the maximum prices for Local Loop Unbundling (the whole local loop or a part thereof) – by 18% for the full access and by 43% for the shared access. This measure opens doors to the reduction of the retail prices of ADSL services.

4. CTO Pricing Decision No. 04/PROP/2005, dated 22 April 2005, effective from 25 April 2005, stipulating the maximum prices for the interconnection of public telecommunications networks for the service of call termination in public fixed telecommunications networks. The pricing decision reduced the maximum prices for interconnection by 5%.

5. CTO Pricing Decision No. 05/PROP/2005, dated 22 April 2005, effective from 25 April 2005, stipulating the prices for interconnection to public telecommunications network for access to the dial-up Internet via a point of interconnection. The maximum prices for call origination were cut by 5% to the level of prices for call termination in public fixed telecommunications networks (Pricing Decision No. 04/PROP/2005); the minimum prices for call termination were reduced by 50%, a level which respect the actual costing of the service. If the decision is translated into agreements with other Internet access providers, it may bring about a reduction of the Internet access service for all dial-up users.

In the second half of 2005, the CTO definitively decided to implement FRIACO, a service which allows the provision of dial-up Internet services for a flat fee. The service is expected to find its use particularly in those areas where the broadband Internet access service (namely ADSL) are not available.

Eurotel

Eurotel holds a licence to carry out its business in the scope of the Act on Electronic Communications and under its implementing regulations, as well as under other CTO provisions. Licences and authorisations issued to Eurotel under the Telecommunications Act were superseded by the certificates and permits for the use of frequencies and numbers. The company conformed to all the statutory requirements.

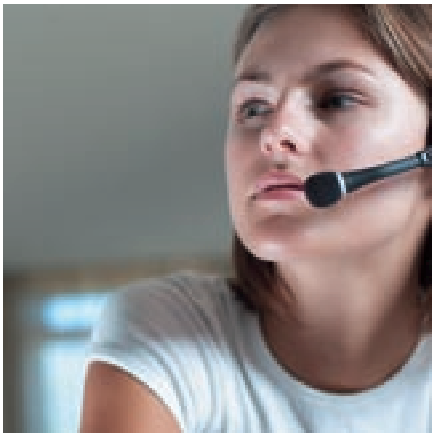
Eurotel holds a certification which gives it the mandate to render all electronic communications services; the certification supersedes all the previous licences.
The certification gives Eurotel the mandate to operate the public fixed and mobile communications networks and to provide all telecommunications services on the territory of the Czech Republic:

a) to operate a public mobile telephone network
b) to operate a public fixed telephone network
c) to provide a public telephone service
d) to provide other voice services
e) to provide the service of leased lines
f) to provide the data transmission service
g) to provide the Internet access service

Unlike the fixed line market, where the CTO regulates primarily the revenues from telecommunications services, the Universal Service prices and the interconnection prices, the main area of regulation in the mobile market is the determination of the prices for interconnection to public mobile networks. In its Pricing Decision No. 02/PROP/2005, effective from 1 April 2005, the CTO reduced the maximum price for interconnection to public telecommunications networks for the service of call termination in public mobile telecommunications networks by 2.5%, from CZK 3.19 per minute to CZK 3.11 per minute.

Moreover, the duty to implement number portability between mobile networks imposed on mobile operators by the Act on Electronic Communications was jointly complied with on 15 January 2006.

Fixed line segment



Networks and technology

ČESKÝ TELECOM operates a fully digital network offering voice PSTN, ISDN and IN services, a network for ADSL services with access points in 1,322 locations, nationally available data networks providing a broad range of data and IP services over the IP/MPLS, FR and ATM networks, including the leased lines (LL) networks, and the SDH and DWDM backbone networks, together guaranteeing a premium quality and reliability of all services.

The access network was further upgraded; the main part of the network consists of metallic cables covering the whole territory of the country. The network also comprised optical cables and radio systems. The technologies used in ČESKÝ TELECOM are subject to stringent testing and quality assurance. A pre-condition for deployment and operation is the existence of central supervision which give ČESKÝ TELECOM a top quality and reliable network which conforms to the highest international standard. The total length of the optical fibres as at 31 December 2005 was 29 thousand km, and the total length of fibres was 869,777 km. The company's network comprises the total of 137 HOST offices and 2,387 remote subscriber units (RSU). The total number of subscriber ports reached 4,117,626, of which 2,971,239 were occupied.

In 2005, ČESKÝ TELECOM's investment was directed primarily to broadband infrastructure for the ADSL technology. The goal was to increase the coverage of this technology and fuel the availability of the Internet Expres services. During 2005, the installed base grew from 132,596 ports in 834 locations to 319,768 ports in 1,322 locations. This helped increase the availability of high-speed Internet access from 78% to 89% of all customers.

To provide for further roll-out of broadband services and for the implementation of IPTV and VoD (Internet Television and Video on Demand), the construction of an L2 Ethernet aggregation network was commenced and yet another stage of the ATM aggregation network development was completed. The IP MPLS backbone network was successfully expanded in 2005.

From the Q3 2005, new ADSL connections were installed using the ADSL2+, technology which brings additional transmission speed enhancements for users in the proximity of ADSL access points. The changes ensured fulfilment of the technical pre-requisites for the provision of television over ADSL. ČESKÝ TELECOM secured a licence for the provision of the service and in the last quarter of 2005 it was able to start a pilot IPTV operation.

With respect to the trend in customer demand, the capacity of our optical network was expanded in 2005, to accommodate our services which are in the pipeline (IPTV, DVB-T). The start of the pilot construction of FTTH optical access networks enabled us to test possible network solutions which are based on the latest high technology, such as the microtube system and optical fibre units. FTTx networks are the future of broadband IP services (VoIP, IPTV, etc.).

A key investment project in the area of information technology in 2005 was the implementation of a new order management system using Siebel and BEA technologies. This system will help ČESKÝ TELECOM offer new services to its customers much more flexibly, and respond fast to the ever-changing needs of the telecommunications market. Full implementation is scheduled to finish in 2006.

Products

Voice services

As at 31 December 2005, the number of telephone lines (main telephone lines including ISDN channels) operated by ČESKÝ TELECOM was 3,126,016, of which 2,127,957 were residential lines and 998,059 were business lines. The business lines include company lines, public payphones, service lines and lines in the special-purpose telephone network. The total number of telephone lines fell by 242,309 compared to the beginning of the year, which represents a 7% decline.

A major event in the area of voice services of ČESKÝ TELECOM was the CTO Pricing Decision No. 01/2005 (see Section Regulation of the Annual Report), which stipulates new maximum prices for the provision of telephone services as part of the Universal Service. Acting on the pricing decision, ČESKÝ TELECOM published new tariffs for all segments on 28 April 2005.

Voice services – residential segment

Voice services in 2005 again ranked among the Company's basic products and are subscribed to by around 2,200,000 residential customers. The most popular service is the traditional telephone line with price plans.

As mentioned above, on 28 April 2005 ČESKÝ TELECOM published new tariffs based on the CTO Pricing Decision. In the residential segment, these comprised Telefon Mini and Telefon Standard and the off-peak tariffs Telefon Start, Telefon Volno and Telefon Volno Plus. The tariffs have been marketed to residential customers since 1 May 2005 (Telefon Volno and Telefon Volno Plus have been on the market since 1 April 2005).

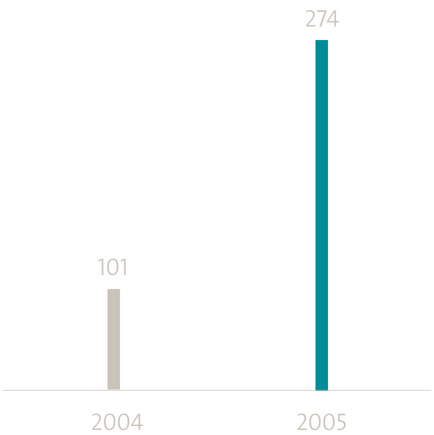
In line the Pricing Decision, usage credit was eliminated from the basic tariff. ČESKÝ TELECOM offered lower usage rates by way of compensation.

Telefon Start is a tariff with 60 minutes of free local and domestic calls to fixed line networks in the Czech Republic, peak and off-peak. Telefon Volno offers free off-peak, weekend and holiday calls to fixed networks in the Czech Republic and lower usage rates than Telefon Start. Like Telefon Volno, Telefon Volno Plus offers free off-peak, weekend and holiday calls, plus it comes with 60 minutes of free peak-time calls to fixed line networks in the Czech Republic.

Migration of all customers to the new tariffs commenced on 1 June 2005 and continued based on each customer's billing cycle. Depending on the type of the line subscribed

ADSL connections

(In Thousands)



to, top-up packages were prepared for calls to fixed line networks, to mobile networks, for international calls and dial-up Internet. From 1 May 2005, ČESKÝ TELECOM has been offering a free e-účet service which gives the user online access to his bill for telecommunications services.

Voice services – business segment

Business customers of ČESKÝ TELECOM can, from 1 January 2005, benefit from the new Business Profit voice service solutions with more economical price plans. The new voice solutions are suitable for businesses of all sizes as they are based on a system of volume rebates according to the traffic generated by the customer.

ČESKÝ TELECOM simplified its portfolio for business customers and introduced two new price plans – Trend and Universal. The Trend price plan, to which 90% of all business customers were migrated, applies a single rate to both local and domestic calls.

Voice services – corporate segment

The key area which was in the centre of ČESKÝ TELECOM's attention in 2005 in respect of the corporate segment was the development of a comprehensive portfolio of telecommunications services, incorporating, in addition to voice services, also services of comprehensive support of the customer's internal processes. These were products which provide corporations with teleworking facilities for their internal and external workers, helping them to be more efficient.

Voice over Internet Protocol

In 2005, ČESKÝ TELECOM embarked on an extensive project of preparation of voice services powered by state-of-the-art Internet technology (Voice over IP). The project aims not only to provide the actual voice service, but also a number of value added products reaching also to convergent solutions which combine fixed and mobile data and voice services.

Data services

The data services market is seeing declining prices and migration of customer from Frame Relay leased lines to IP MPLS services and Ethernet. Customers are increasingly demanding the so-called low end products. ČESKÝ TELECOM successfully faced up to this situation by offering flexible services of the highest quality. ČESKÝ TELECOM expanded its portfolio of services based on the IP MPLS technology. Here we need to mention IP Connect Mini, a service which uses ADSL as access technology to the MPLS gateway. Yet another service is IP Connect Remote which gives customers remote access to their internal corporate network from any point with Internet access.

The Group began to market Corporate Mobile Access, a service which allows remote access to the corporate network via GPRS or CDMA mobile technologies. ČESKÝ TELECOM has been offering the service since November 2005.

ČESKÝ TELECOM also continued to develop its hosting centres in Prague (Nagano) and in Brno. New services such as Internet Hosting (Internet access via a dedicated bandwidth with unlimited traffic) or Internet Kredit (Internet access with a specified monthly data traffic limit) were introduced as new ways of Internet access.

In 2005, ČESKÝ TELECOM continued its experimental operation of DVB-T (terrestrial digital television broadcasting). ČESKÝ TELECOM was the first multiplex operator to launch, in co-operation with the TV Óčko music channel, the first program-specific voting application, and, in partnership with the Czech Ministry of Interior, developed

the first public administration application. At present, ČESKÝ TELECOM is the only operator with an experimental gaming application – the games can be played also via a mobile telephone and by up to several dozen players and displayed on a TV screen. Furthermore, ČESKÝ TELECOM is also preparing for the commercial launch of DVB-T broadcasting.
In September 2005, ČESKÝ TELECOM became the sole registration authority for the .eu domain. The new EU domain is intended for EU citizens and corporations. In addition to the portfolio of other domains (.cz, .com, .org, etc.), the EU domain became yet another domain offered by ČESKÝ TELECOM via DOMAIN OnLine, its service which has been offering domains to corporations and businesses for many years.

Internet services and other value added services

As regards the development of Internet services, the year 2005 saw an increase in the demand for higher broadband Internet access speeds. The number of ADSL connections of ČESKÝ TELECOM grew in the course of 2005 by 173 thousand to the total of 273,741, i.e. by more than 170%. The record increase of the absolute number of customers was powered primarily by the development and promotion of new services, the declining prices, expanding ADSL coverage and the progress in data technology.
According to the last survey conducted by research organisation Point Topic, in 12 EU member states, the penetration of high-speed Internet (per 100 households) has been growing at the fastest rate in the Czech Republic (118% year on year). The survey also identified the growing trend also in other countries of central and Eastern Europe – Slovakia and Romania took the second and the third place with 112% and 92%, respectively.

In the past 12 months, ČESKÝ TELECOM brought high-speed Internet access to additional 488 locations. Internet Expres was available in 1,322 locations and it covered almost 90% of all our customers. Moreover, ČESKÝ TELECOM made a great effort to accommodate the requirements of customers who live far away from the exchange. In 2005, the maximum distance for connecting a customer to high-speed Internet has increased to 8.2 km from the exchange. Quality improvements in the network and the installation of a measuring system made this possible.

In 2005, ČESKÝ TELECOM contributed to the development of high-speed Internet in the Czech Republic by several innovative services. In January 2005, ČESKÝ TELECOM came out with the new Internet Expres Optimal tariff offering a very high maximum speed of 1,024/ 256 kb/s. At the same time it cut the monthly subscription fee for the service from CZK 1,420 to CZK 799.
On 1 March 2005, ČESKÝ TELECOM introduced a new basic Internet Expres product – Internet Expres Hit with the speed 256/64 kb/s. It was designed for customers who are considering getting a high-speed Internet connection and the monthly subscription was set at CZK 599. From the beginning of June 2005, ČESKÝ TELECOM marketed a new range of high-speed Internet access services under the brand Internet Expres Doma. Prices started at CZK 399. The offer also contained economical weekly data limits – Impuls (256 MB), Ideal (1 GB), Sprint (2 GB) and Maxi (3 GB). ČESKÝ TELECOM launched a new service packaged with Internet Expres Doma – Expres Klik, which offers a short-term increase of the speed. Several promotions run before the end of the year.
In the area of fixed Internet access, ČESKÝ TELECOM has registered an increased demand of customers for migration to higher speeds.

The number of Internet connections with speeds upwards from 2 Mb/s has grown by 40% in the course of 2005. In November 2005, ČESKÝ TELECOM started offering the new PC Strážce service. The service was provided in package with all Internet service subscriptions from ČESKÝ TELECOM (Internet Expres, Internet Broadband and IOL Dial-up). It provides comprehensive protection of PCs, data and communication from malicious code, unauthorised interventions and hidden attacks from the Internet.

Wholesale

The year 2005 was a year of consolidation in the sector of fixed line service providers. The last year was also marked with the incoming trend of new services marketed by operators using leased metallic networks and the much fiercer competition in the voice and data market. The events on the telecommunications market were also affected by the CTO decisions, especially those which reduced the minimum prices for Internet traffic termination. As a result, a number of alternative operators and Internet access providers concentrated on the provision of high-speed Internet access, at the expense of dial-up Internet.

The area of the wholesale lease of lines to Other Licensed Operators showed a clear trend of migration of customers to higher transmission speeds, i.e. from 64-128 kb/s to higher rates, in particular 2Mb/s. This was driven by expanding customer needs, particularly by the demand of applications for more bandwidth. At the same time, there was a trend clearly visible in migration in the use of the services towards the end of the year. The trend was driven by the consolidation in the telecommunications market and the related optimisation of alternative operators' networks, as well as by the migration of traffic from the leased lines to the Carrier Broadband service; other alternative technologies may have played a part, too. The biggest customers in the area of leased lines in 2005 were the Other Licensed Operators and fixed line network operators (GTS Novera, Nextra Czech Republic, Contactel, Tiscali ČR and others) and mobile network operators (Eurotel, Oskar Mobil/Vodafone and T-Mobile).
In 2005, the dynamic development of the Carrier Broadband services continued. The total number of lines leased to the other operators doubled in 2005, as did the revenues from these services. The biggest Carrier Broadband customers were Contactel, Nextra Czech Republic, GTS Novera, Tiscali ČR and Czech On Line.

International services

Voice services

ČESKÝ TELECOM increased the number of direct lines to international telecommunications operators to 95. We interconnected our networks with an additional 14 major mobile and fixed line operators and took a leading place among their suppliers of international services. The services rendered to these customers were the service of termination of voice traffic in the Czech Republic and that of transiting of other operators' traffic via ČESKÝ TELECOM's network (hubbing). ČESKÝ TELECOM also provided transit of traffic from Czech operators to other countries. ČESKÝ TELECOM's principal customers in this area were operators that forward traffic to mobile networks. In 2005, ČESKÝ TELECOM was a fast growing provider of hubbing services in Central and Eastern Europe.

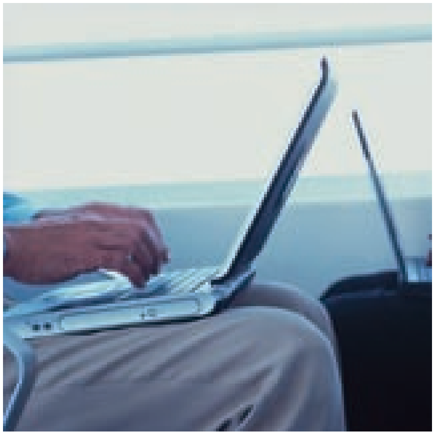
Data services

In the field of international data services in 2005, two factors took a full effect – the first was demand for high capacities (E1, STM 1, STM 4, STM 16, etc.), which was

accompanied by a downward pressure on the price of individual types of the capacities. Even in the conditions of significant price erosion of unit capacity, we managed to post a 11% year on year increase in revenues. Also in the area of international data services rendered to big corporations, the customers were pressing the prices down. We are meanwhile seeing the trend of migration of these customers from the leased lines and Frame Relay technology to IP MPLS services. The neighbouring countries are, and will continue to be, the key destinations for these customers, followed by Western Europe, Russia and the Baltic countries also show good potential.

ČESKÝ TELECOM recognises two main markets in international data services to which these services are provided – big corporations seeking a safe and reliable communication with other countries, and operators which request the service for their own use or on behalf of their end customers in foreign markets. ČESKÝ TELECOM found a regime of co-operation with its key partners in the regions of interests, which was one of the drivers of a 25% increase in the installed base of lines.

Mobile segment



Networks and technology

In 2005 Eurotel concentrated on the development of mobile services, especially in the area of mobile data, and on the transmission of video, following the trends on the global telecommunications market. The new technologies gave customers a wider portfolio of services, primarily content services, and higher data transmission speeds.

Launch of 3rd generation mobile services

On 1 December 2005, i.e. more than a year ahead the date it committed to in the licence conditions, Eurotel started commercial operation of the UMTS (Universal Mobile Telecommunications System) network was started. Eurotel has thus become the first Czech operators to launch a comprehensive mobile 3rd generation service, comprising not only data, but also voice, video and multimedia transmission in real time. The services can be used automatically by all customers – both contract and pre-paid service customers of Eurotel. The customer needs only a SIM card from Eurotel.

In 2005, 366 UMTS base stations (NodeB) were put into operation in a record time of four months; their signal covers the cities of Prague and Brno. In October 2005, Eurotel demonstrated HSDPA (High Speed Downlink Packet Access), the latest data transmission technology in the UMTS network; the technology allows for transmission at speeds of up to 1.8 Mbit/s initially. Eurotel presented a comprehensive HSDPA portfolio, at the Invex 2005 exhibition in October. The combination of modern mobile telephones and the speed of the new UMTS network enabled Eurotel to market a number of brand new services and to improve those services which work already in the GSM/GPRS network – albeit with limitations stemming from the 2nd generation network.

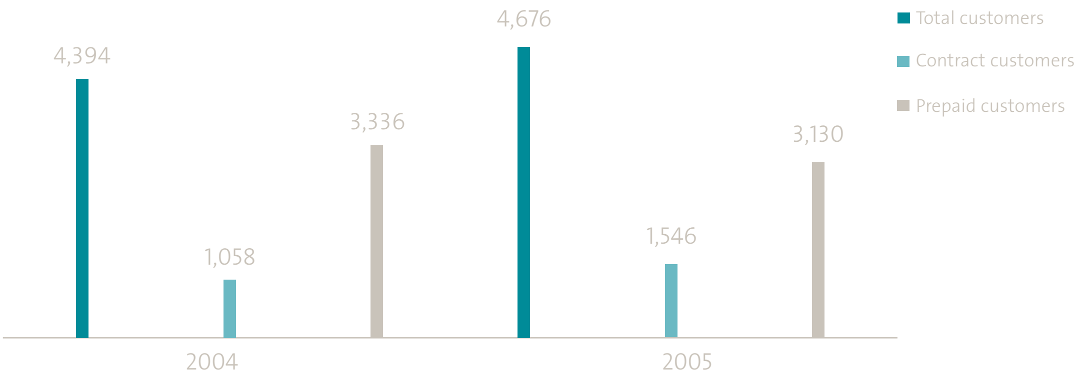
Development of mobile data services

The traditionally widest coverage, mobility and roaming possibilities were the reasons why more than 60 thousand customers used Eurotel Data Nonstop, the mobile Internet service of Eurotel, in 2005.

These customers could also automatically use the UMTS network which offers more than six times the speed of the GPRS or twice the speed of the EDGE technology. During 2005, Eurotel continued to develop its high-speed mobile Internet access service - Eurotel Data Expres, now running on the CDMA 1xEV-DO platform in the 450 MHz frequency. The Internet access is unlimited in terms of time spent online, the customer is charged only the monthly subscription. In 2005 the service attracted many new customers – the network capacity had to be continually and substantially increased and the radio

Number of Eurotel's customers

(In Thousands)



signal coverage had to be expanded as a result. At the end of 2005 when Eurotel Data Expres had already 70 thousand users, the total of 304 CDMA base stations were already in service and Eurotel Data Expres was available to 80% of the Czech population.

Premium quality

The first-rate network was expanded to more than 3,800 base stations which also used the latest VoIP (Voice over Internet Protocol) technology. The capacity building was fuelled primarily by the expansion of hypermarkets and shopping centres, industrial parks and new roads in the Czech Republic.
The parameters of the existing mobile network were also modified to accommodate the dynamically changing customer needs.

Products

Eurotel operates several mobile networks in the Czech Republic which cover more than 99% of the Czech population.
The combination of these networks and different technologies and, along with its partnership with its 100% owner, ČESKÝ TELECOM, enables Eurotel to offer to its contract and pre-paid customers the most comprehensive portfolio of voice and data services supported by the locally unique integration of fixed line and mobile telephony.

Voice services

Voice services again formed the traditional core of Eurotel's service portfolio. In 2005, Eurotel introduced a number of new and innovated services in all customer segments, striving to accommodate customer needs to the maximum extent possible.
On 1 February 2005, Eurotel introduced a new structure of tariffs. Six brand new tariffs and two new special tariffs for the contract customers were introduced – Eurotel SMS, Eurotel Bronz, Eurotel Silver, Eurotel Gold, Eurotel Platinum and Eurotel Diamant. The tariffs came with optional attractive Max top-up packages giving customers cheaper rates on calls and free airtime in exchange for a commitment of 12 or 24 months.
Pre-paid Go customers who wished to switch to post-paid service could do so easily with Eurotel Start, and students can benefited from the new Eurotel Pohoda tariff.
From August 2005 Eurotel was offering Eurotel Spolu, a service which let the customer the option to call up to three numbers in the network of Eurotel 25% cheaper. Both the pre-paid Go customers and contract customers could take advantage of the summer promotion of international calls. From the summer months of 2005, pre-paid Go customers could also activate free calls at weekends for a fixed fee of CZK 25.
The overwhelming response of customers caused the promotion of free weekend calls to be extended until November 2005.
As part of its Christmas campaign, Eurotel prepared a surprise for its customers – a "call for free after minute three" offer to all existing and new customers, free airtime for two years to all networks for contract customers, a 100% bonus on the first charge-up of Go credit for Go customers, a CD and DVD as a gift with selected Go sets with a mobile telephone, and a range of attractive mobile telephones with prices starting from CZK 1.

Data and Internet services

Also in 2005, Eurotel strived to honour its commitment – to provide quality Internet access to all customers and to meet their individual needs.

In co-operation with ČESKÝ TELECOM, Eurotel offered a unique combination of unlimited fixed Internet access via ADSL and a mobile voice tariff. At the beginning of 2005, Eurotel expanded its mobile data service via GPRS technology by launching EDGE, an enhanced

GPRS technology which, among other things, provides higher speeds and quality to mobile data transmission and, together with the ADSL, CDMA, GPRS, HSCSD, WiFi and UMTS technologies, makes up the most comprehensive offering on the market.

In April 2005, Eurotel introduced a brand new comprehensive family of products branded as Internet for Everyone. Four new data tariffs – Internet Mobil, Internet Doma, Internet Business and Internet Kombi – presented a unique choice of different options for Internet access. The offer suitably combines a complete range of technologies for mobile and fixed Internet access. Customers can choose his tariff by the required degree of mobility, speed, budget of the connection.

On 15 March 2005, Eurotel became the first among Czech mobile operators to launch Eurotel Přepínám, a service based on the Push to Talk communication technology. The service lets the customer transform his mobile telephone into a short-wave radio and communicate instantly with a whole group of colleagues or friends. The service was especially welcomed by business customers who manage teams of people in the field.

Yet another service which Eurotel brought to market in 2005 is Eurotel Car Control. The service was designed with the business customer in mind – it controls the movement of vehicles and their fuel consumption, and to long journeys. At the Invex 2005 exhibition in October, Eurotel Car Control took the Crystal Disc Award in the Professional Software category.

Since 1 December 2005, Eurotel has been providing a 3rd generation UMTS mobile service; Eurotel was the first mobile operator in the Czech Republic to introduce video telephony, an extensive multimedia content, premium high-speed mobile Internet access, fast video and music downloads and TV reception and the services of real-time traffic cameras.

As a result of the new CDMA base stations put in service and successful Christmas marketing campaign, the number users of Data Expres (high-speed mobile Internet access via the CDMA2000 1xEV-DO technology) reached the 70 thousand mark at the end of 2005.

Value added services

Eurotel also offered a number of value added services; several important new services were added to this category in 2005:

In 2005, Eurotel added a number of interesting new features to the multimedia content of its Internet and wap portal Eurotel Live!:

- personal welcome melodies and company melodies
- a comprehensive offer of mobile content services themed around Hollywood blockbusters
- a range of mobile phone utilities themed around the Czech Pop Idol
- a booking system on the Eurotel Live! portal and via SMS, introduced as part of the 40th Karlovy Vary International Film Festival
- exclusive mobile services in connection with the World Ice Hockey Championship
- MMS for an unbeatable price of CZK 2.50 as part of the Christmas promotion

Comments on the financial results

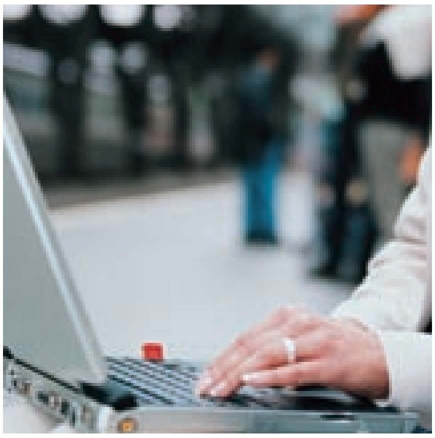
This section presents the financial results of ČESKÝ TELECOM Group for 2005 prepared under International Financial Reporting Standards (IFRS).

The 2005 results excluding the impact of one-off charges and accounting policy changes made in 2005 show an improvement in the revenues trend in the second half of 2005 and a return to growth in Q4. Similarly, consolidated EBITDA increased by 3% and 4% yoy in Q3 and Q4 respectively. The statutory results are influenced by several accounting policy changes made in 2005, which are commented on in detail below.

Change in accounting policy

During 2005, ČESKÝ TELECOM made several changes to its accounting policy which impacted on its results in the fixed line technology segment and consequently on its consolidated results. These changes had a negligible effect on the mobile business results. The changes concern the revenue recognition of connection fees related to fixed line activation for all periods from 1996 onwards, associated connection costs and treatment of revenues from premium rate numbers (colour lines). In previous periods, the Company had recognised the activation fees in full in the income statement upon connection of customers to the network in the relevant accounting period. Under the accounting policy introduced in Q4 2005, connection fees are deferred and recognised in the income statement over the estimated average remaining customer relationship period. Together with the change in accounting policy for connection fees, ČESKÝ TELECOM identified associated connection costs that met the definition of subsequent costs increasing the carrying value of property, plant and equipment but were originally expensed. In 2005, ČESKÝ TELECOM decided to retrospectively capitalise these costs as property, plant and equipment. Revenues from premium rate numbers are now recognised only for the amount of the net margin, compared to the previously applied accounting where we recognised gross revenues and costs related to payment to premium content providers.

As a result of the accounting policy changes made in Q4 2005, revenues from connection fees increased by CZK 606 million in 2005, while netting of colour lines decreased revenues and costs by CZK 253 million in 2005, with no impact on EBITDA, and depressed retained earnings by CZK 1.4 billion as at the end of 2005.



To provide more relevant disclosure of individual income statement items we adopted a reporting structure close to that of Telefónica and we adjusted the structure of the income statement and both ČESKÝ TELECOM's and Eurotel's standalone revenues and opex accordingly in 2005. The newly presented parameter of OIBDA is comparable with the previously reported EBITDA, with the exception of the impairment charge, which is now included within OIBDA whereas previously it was reported below the depreciation and amortisation line. The impairment charge in 2005 represents a one-off depreciation charge relating to changed estimates of the economic life of certain equipment in the fixed line technology business and intangible assets (brand names and trade marks) acquired through the purchase of the remaining share in Eurotel in 2003. It did not impact on the cash flow of the Group.

To allow for relevant year-on-year comparison of the 2005 and 2004 results, in addition to the IFRS statements we restated the 2004 results on a pro-forma basis to include the accounting policy changes as if they had been applied in 2004.

The following section contains the actual 2005 figures, including the effects of accounting policy changes, compliant with the statutory IFRS statements, and the 2004 restated pro forma numbers. Both the 2005 and 2004 restated results are shown under the new reporting structure.

Consolidated Financial Statements

Revenues, operating costs and OIBDA

Consolidated revenues (business and recurring revenues) reached CZK 61 billion in 2005, down by 0.8% yoy, but up by 1% yoy in Q4. Total consolidated operating costs reached CZK 32.7 billion, up by 0.2% yoy, with 5.2% and 0.3% yoy decreases in Q3 and Q4 respectively. The impairment charge was CZK 1.3 billion in 2005, while in 2004 the amount was negligible. Consolidated OIBDA amounted to CZK 27.3 billion, down by 6.9% yoy. OIBDA excluding the impairment charge would have been down by 2.8% yoy. The reported OIBDA margin (OIBDA over business revenues) reached 44.9%, compared to 48.2% in 2004. OIBDA margin excluding the impairment charge would have been 47% in 2005.

Depreciation and amortisation

Consolidated depreciation and amortisation in 2005 amounted to CZK 17.8 billion, down by 14.6% yoy. The significant decrease is a result of low CAPEX in recent years and changes in goodwill and amortisation of certain intangible assets.

Operating income, income before taxes and net income

Consolidated operating income and consolidated income before taxes went up by 10.2% yoy and 7.2% yoy, reaching CZK 9.4 billion and CZK 8.7 billion respectively in 2005, on the back of the decrease in consolidated depreciation and amortisation. Consolidated net income amounted to CZK 6.2 billion, up by 9.1% yoy.

Capex

ČESKÝ TELECOM continued its conservative investment policy in 2005. Major investments were made in growth areas (Internet, data services, UMTS). Total consolidated CAPEX amounted to CZK 6.1 billion, up by 4.6% yoy. While CAPEX in the fixed line technology business decreased by 12.1% yoy to CZK 2.2 billion, Eurotel's CAPEX increased by 19%, mainly due to the investments made in the UMTS network.

Free cash flows

The free cash flows[1] generated by ČESKÝ TELECOM Group totalled CZK 18.7 billion, down by 4.1% yoy, mainly as a result of the decrease in OIBDA.

Debt levels

ČESKÝ TELECOM Group's consolidated debt amounted to CZK 9.4 billion as at 31 December 2005, down by 63% compared to the same period a year before. This number represents a gross leverage of 10% and a net leverage of 6%. The significant cash flows generated by both ČESKÝ TELECOM and Eurotel and the distribution of Eurotel's retained earnings to ČESKÝ TELECOM enabled a reduction in consolidated debt of CZK 16 billion in the course of 2005. This reduction was related mainly to the repayment of the acquisition financing of the purchase of the remaining 49% of Eurotel in November 2003. In Q3, ČESKÝ TELECOM also repaid CZK 4 billion in domestic bonds issued in July 2002.

Overview of the Fixed Line Technology Business[2]

Activities in the fixed line technology business in 2005 focused mainly on developing and marketing new Internet and data services. This allowed us to respond to the increasing demand among our customers for broadband Internet, data and other value added services. Thus, revenues from Internet, broadband, data and other Telco services accounted for 26% of business revenues in 2005, the same as in the previous year.

Revenues

Total revenues (business and recurring revenues) in the fixed line technology business went down by 4.5% yoy to CZK 32.3 billion in 2005, and decreased by 2.6% yoy in Q4. Business revenues decreased by 3.1% to CZK 31.9 billion, driven mainly by a decline in traditional voice services which was not fully offset by the increase in recently introduced broadband Internet based services and data and value added services.

The total number of ČESKÝ TELECOM's fixed lines was 3,126 thousand at the end of 2005, down by 7.2% compared to 2004. PSTN lines recorded a 7% decrease to 2.7 million, while number of ISDN channels went down by 8.7% to 449 thousand. As a result, revenues from monthly subscriptions and connection charges decreased by 3.7% to CZK 11.8 billion.

Revenues from traditional voice services (communication traffic and interconnection) declined in total by 5.2% yoy to CZK 10.9 billion in 2005. Revenues from communication traffic declined by 19.5% yoy to CZK 6.2 billion. This was a result of lower voice traffic generated by ČESKÝ TELECOM's customers in 2005, which decreased by 14.8% compared to 2004. Fixed to mobile substitution, a lower number of fixed lines and increased competition were the main drivers of the decreasing voice traffic.

Interconnection revenues increased by 23.2% to CZK 4.7 billion in 2005, mainly due to growth in revenues from international operators as a result of the extension of international carrier transit services provided in the Central and Eastern Europe market space.

[1] Net cash flow from operations and net cash flow from investment activities, exclusive of purchase of securities and proceeds from the sale of securities.

[2] ČESKÝ TELECOM standalone, i.e. excluding minor subsidiary companies, before consolidation adjustments

Revenues from broadband services amounted to CZK 1.8 billion in 2005, up by 84.9% yoy. From this, CZK 1.5 billion constituted revenues from retail broadband and CZK 283 million revenues from wholesale services. ČESKÝ TELECOM recorded 173 thousand net adds to ADSL connections in 2005. Net adds to ADSL connections in 2H 2005 reached 111 thousand, compared to 62 thousand in 1H 2005, as a result of successful Christmas campaign. The total number of ADSL connections reached 274 thousand as at 31 December 2005, compared to 101 thousand at the end of 2004. Out of the total connections, ČESKÝ TELECOM's retail customers represented about 80%. Internet Express services are now available in 1,322 locations in the Czech Republic, representing a potential coverage of more than 90% of the fixed lines operated by ČESKÝ TELECOM.

Revenues from dial-up (narrowband) Internet decreased by 44.9% yoy to CZK 1.2 billion. Dial-up Internet traffic went down by 41.7% yoy to 2,818 million minutes in 2005, as a result of dial-up traffic migration to ADSL broadband Internet access and other fast Internet service alternatives.

Revenues from data services decreased by 0.9% yoy to CZK 4.4 billion, mainly due to a decline in revenues from leased lines, which went down by 4.5% yoy. Data network services increased by 5.2% yoy to CZK 1.7 billion in 2005 due to growth in IP Connect and IP VPN connections and the introduction of new ADSL based data services.

Equipment revenues amounted to CZK 771 million, up by 5.2% yoy, reflecting increased commercial activities in this area. Revenues from IT services and business solutions reached CZK 231 million in 2005, compared to CZK 79 million in 2004.

OPEX

Fixed line operating costs (excluding non-recurring items) went down by 4.6% in 2005 compared to 2004 and amounted to CZK 17.4 billion. They decreased by 6% yoy in Q4. Controllable operating costs (operating costs excluding supplies expenses) decreased by a full 8.4% yoy in 2005, confirming the management's effort to increase cost savings.

Supplies expenses grew by 2.4% in 2005 to CZK 6.6 billion. Interconnection costs increased by 6.7% to CZK 4.9 billion. Costs of goods sold went up by 11.1% to CZK 401 million while other supplies decreased by 13.5% to CZK 1.3 billion.

Personnel costs, including headcount reduction costs, amounted to CZK 5.7 billion, down by 0.9% yoy. The number of ČESKÝ TELECOM employees was reduced by 14% yoy in 2005 and stood at 7,524 at the end of 2005. Operational efficiency, as measured by number of fixed lines per employee, improved by 8.5% yoy to 415 lines as at the end of 2005.

The cost of subcontracts (external services) decreased in total by 7% yoy to CZK 4.9 billion in 2005. In this cost category, reductions were reported in all items except utilities (material and energy) supplies, which amounted to CZK 468 million, the same as in 2004. Marketing and sales costs went down by 8.9% yoy to CZK 774 million, network & IT repairs and maintenance by 10.3% yoy to CZK 1.5 billion and rentals, buildings and vehicles costs by 5.4% yoy to CZK 828 million.

Other subcontracting costs, including consultancy fees, went down by 5.2% yoy to CZK 1.3 billion.

Taxes other than income tax and provisions decreased by 70.3% yoy to CZK 246 million in 2005.

ČESKÝ TELECOM's OIBDA, including business revenues, other revenues, non-recurring revenues and costs and the impairment charge, amounted to CZK 14.2 billion in 2005, down by 8.9% yoy, representing an OIBDA margin (OIBDA over business revenues) of 44.5%. OIBDA excluding the impact of impairment would have been CZK 14.7 billion, down by 6.2% yoy, and the OIBDA margin would have been 46% in 2005.

Overview of the Mobile Technology Business[1]

In the competitive environment of the Czech mobile market, Eurotel confirmed its strong financial and operational performance in 2005. At the end of 2005, Eurotel won back its leadership position in terms of total number of subscribers, mainly due to strong figures in Q4. Similarly to the fixed line technology business, customers in the mobile market also continue to demand data, Internet and value added services, including content.

Revenues

This trend is clearly reflected in Eurotel's changing revenue structure. In 2005, Eurotel's total business revenues increased by 2% yoy and amounted to CZK 30 billion. In Q4 alone they grew by 4.2% yoy.

Eurotel's revenues from voice services (monthly fees, traffic and interconnection) increased in total by 0.2% yoy to CZK 22.8 billion.

The total number of Eurotel customers at the end of 2005 amounted to 4,676 thousand, which represents a 6.4% increase compared to the end of 2004. Eurotel thus regained its number one position overall at 2005 YE, primarily thanks to record-breaking growth in the number of contract customers. Eurotel's attractive Christmas campaign helped to increase its customer base by 187 thousand in Q4, which is more than the number added by the two competing operators put together.

At the end of 2005, Eurotel recorded 1,546 thousand contract customers (GSM, CDMA and NMT), up by 488 thousand yoy, which represents 46% growth. Despite the fact that SIM card penetration has been continuously growing and reached 112% of the population at the end of 2005, net additions of contract customers reached 158 thousand in Q4, compared to 118 thousand in Q3 and 66 thousand in Q4 2004. Contract customers accounted for 33% of the total customer base, compared to 24% at the end of 2004. Successful migration of pre-paid customers to contract services played an important role in the growth in contract customer numbers. In addition, by the end of 2005, 641 thousand contract customers had subscribed to the new tariffs which Eurotel introduced on 1 February 2005. Out of this total number, 202 thousand were new Eurotel customers, 269 thousand existing contract customers migrating from other tariffs and 170 thousand customers migrating from prepaid services.

Prepaid customers totalled 3,130 thousand at the end of 2005, a decrease

[1] Eurotel standalone, before consolidation adjustments

of 205 thousand (6.2%) compared to the end of 2004. This decrease was substantially influenced by significant migrations of customers from the prepaid to the contract segment as a result of Eurotel's marketing activities in this area. Under the methodology, which defines a prepaid customer as a customer generating revenue in the last 3 months, the number of Eurotel's prepaid customers at the end of 2005 amounted to 2,770 thousand down by 6.8% yoy.

Revenues from monthly fees increased by 10.6% yoy to CZK 5.9 billion as a result of significant growth in the contract customer base.

Traffic revenues decreased by 3% yoy to CZK 11.3 billion, while the total usage traffic increased by almost 10% yoy in 2005. The reason is a higher share of contract customers with monthly packages, which include free minutes, and market pressure on revenue per minute. The increased voice traffic can be attributed to the increasing number of customers and successful usage stimulation activities.

Interconnection revenues amounted to CZK 5.5 billion in 2005, down by 3% yoy due to decreased interconnection rates charged to other operators.

A continuous increase in multiple SIM card users, together with lower ARPU generated by new customers, had a negative impact on blended ARPU. In 2005, ARPU reached CZK 510, compared to CZK 526 last year and CZK 503 in the first half of 2005. Average MOU per subscriber was 92 minutes in 2005, up from 90 minutes in 2004.

The total revenue from value added services (including SMS, MMS and content) increased by 4.1% yoy to CZK 4.1 billion. Eurotel customers sent and received in total 2,519 million SMS messages in 2005, up by 9.9% yoy. Internet and data revenues recorded a 97.5% increase in 2005 and reached CZK 1.4 billion. At the end of 2005, the total number of customers of Eurotel Data Express (an unlimited high-speed Internet access service based on CDMA technology) amounted to 70 thousand (up by 40 thousand yoy) and the total number of customers of Eurotel Data Nonstop (an unlimited mobile Internet access service based on GPRS technology) was 67 thousand (up by 14% yoy).

Lower handset sales led to a 9.5% yoy decrease in equipment sales (including connection fees) to CZK 1.6 billion. The lower sales of handsets were influenced by an increasing proportion of customers taking advantage of a cheaper tariff in return for a commitment to stay with Eurotel for a specific time period.

Other business revenues (IT services and other revenues) decreased by 37.4% to CZK 176 million.

OPEX

Eurotel's operating costs increased by 4.8% yoy to CZK 16.8 billion, with a 6.9% yoy increase in Q4, which was caused by higher subsidies for new contract customers.

Supplies expenses, which comprise interconnection and roaming, costs of goods sold and other supplies, reached CZK 9.6 billion in 2005, up by 0.7% yoy. The major item in this category is interconnection and roaming costs, which amounted to CZK 5.8 billion, up by 4.7% yoy.

Similarly to equipment sales, the cost of goods sold decreased in 2005 to CZK 3.3 billion, down by 6.3% yoy. Other purchases and cost of sales increased by 7.1% to CZK 495 million. The number of Eurotel employees as of 31 December 2005 was 2,490, almost same as at the end of 2004. Staff costs increased by 27.2% yoy to CZK 2.2 billion as a result of one-off items posted in Q2.

The cost of subcontracts at Eurotel increased by 3.3% yoy to CZK 4.3 billion in 2005. Marketing and sales expenses increased by 12.1% to CZK 1.9 billion, mainly due to growth in commissions. Network & IT repairs and maintenance went down by 6% yoy in 2005 to CZK 878 million. Rentals, buildings and vehicles costs amounted to CZK 809 million in 2005, up by 0.9% yoy. Utilities supplies went up by 10.6% in 2005 and reached CZK 208 million. Other subcontracts (consultancy fees etc.) amounted to CZK 545 million, down by 6.5% yoy.

Taxes other than income tax, fees paid to the regulator and provisions amounted to CZK 668 million in 2005, which represents a 16.2% yoy increase.

Eurotel's OIBDA was CZK 12.9 billion in 2005, which represents a 5.5% yoy decrease, with an OIBDA margin of 42.8%. The OIBDA margin before one-off items was 45% in 2005.

Outlook for 2006

In 2006, ČESKÝ TELECOM Group will continue to actively address the changes and trends in the Czech telecommunication market, specifically in the areas of broadband, Internet, data and value added services. The primary goal of our activities is to best meet our customers' needs and to enable them to effectively use our services at a competitive price. At the same time, ČESKÝ TELECOM Group will continue to concentrate on revenue retention in voice and traditional data services areas.

As a result of its new ownership structure, ČESKÝ TELECOM Group can achieve a number of tangible material benefits emanating from its close interaction with Telefónica. The key areas of experience-sharing and cooperation with the new majority shareholder are: commercial and underlying technical development, leading to the introduction and marketing of new services and products (e.g. UMTS, IPTV, IP-based value added services, content, integrated business solutions); further operational efficiencies, facilitated by process and organisational redesign based on sharing of best practices; synergies in purchasing, leading to decreased costs of resources; and opex and capex savings. Several areas are already in the execution phase, specifically IPTV (based on Telefonica's Imagenio product), purchasing of broadband and UMTS technology, and the range of broadband based value added services. ČESKÝ TELECOM Group is the only integrated telecommunication provider in the Czech Republic covering both the fixed and mobile segments, which represents additional benefit for its customers.

The key strategic effort of the management is to maintain its leading position in the Czech telecommunication market. The financial management of ČESKÝ TELECOM Group will remain focused on generating above-average OIBDA margins, efficient CAPEX levels and strong free cash flows. We expect to stop the decline in both revenues and OIBDA in 2006 and attain the same levels as in 2005.


03

Corporate Governance

Corporate Governance of the ČESKÝ TELECOM Group

Several important developments occurred in the ČESKÝ TELECOM's corporate governance in 2005, which related primarily to the conclusion of the for-consideration transfer of the majority stake held by the National Property Fund of the Czech Republic (NPF) to Telefónica, S.A. (Telefónica). The process was concluded on 16 June 2005 when the NPF transferred 51.1% of the company's shares. In the mandatory share buy-out offer which followed, Telefónica acquired another 18.3%, raising its ownership position in ČESKÝ TELECOM to the total of 69.4% shares. Personnel changes were made in the governing bodies of ČESKÝ TELECOM and Eurotel, the executive macrostructure of ČESKÝ TELECOM and Eurotel were modified and changes were effected in the subsidiary companies.

As at the end of 2005, the ČESKÝ TELECOM Group comprised ČESKÝ TELECOM, a.s. (ČESKÝ TELECOM or the parent company), Eurotel Praha, spol. s r.o. (Eurotel), and other subsidiary companies, as shown in the table. No changes occurred in the structure of these companies compared to the situation as at 15 April 2005, as published in the 2004 Annual Report.

The Board of Directors of ČESKÝ TELECOM, as the sole member, exercises the ownership rights of ČESKÝ TELECOM in the subsidiary companies, save for subsidiaries incorporated abroad. The ownership rights of the parent company in respect of foreign subsidiaries are exercised by persons with a remit given by the parent company's Board of Directors and within the scope of the powers approved by the parent company's Board of Directors. Personnel changes in the statutory and supervisory bodies of the subsidiaries (in positions reserved for ČESKÝ TELECOM's officers) are approved by the Board of Directors of the parent company, and in accordance with ČESKÝ TELECOM's Articles of Association the personnel changes are subject to a prior consent of the Supervisory Board of ČESKÝ TELECOM. In the second half of 2005, the system of corporate governance in the subsidiary companies was strengthened by means of implementation of standardised principles, procedures and instruments of corporate governance, and the administration processes in respect of corporate governance in companies across the ČESKÝ TELECOM Group were strengthened and unified.

Subsidiary companies
(as at 31 March 2006)

In the second quarter of 2005, the ČESKÝ TELECOM's ownership interest in CenTrade, a.s. was increased from 86.5% to 100% by means of a buy-back of ownership interests from SAP ČR, spol. s r.o. and Citicorp Overseas Investment Corporation.

In December 2005, basic capital of the company was decreased by means of a reduction of the nominal value of all shares of CenTrade for the reason of accounting settlement of accumulated losses incurred in the previous accounting periods (2002 – 2004).

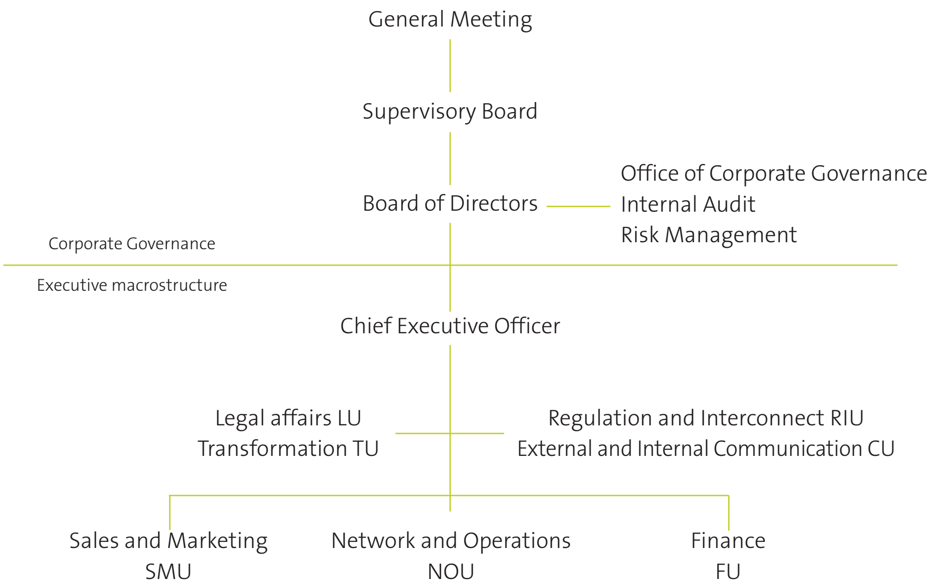
Subsidiaries in which ČESKÝ TELECOM has direct ownership of more than 10% of the registered capital

CORPORATE NAME	REGISTERED CAPITAL	OWNERSHIP INTEREST OF ČESKÝ TELECOM
Eurotel Praha, spol. s r.o.	CZK 1,211,000,000	100 %
SPT TELECOM (Czech Republic) Finance B.V.	EUR 18,151	100 %
OMNICOM Praha, spol. s r.o.	CZK 10,000,000	100 %
CZECH TELECOM Austria GmbH	EUR 35,000	100 %
CZECH TELECOM Germany GmbH	EUR 25,000	100 %
CZECH TELECOM Slovakia s.r.o.	SK 200,000	100 %
CenTrade, a.s.	CZK 2,000,000	100 %
AUGUSTUS, spol. s r.o.	166,000	39,76 %

As at 31 March 2006

Organisation chart of ČESKÝ TELECOM
(as at 31 March 2006)

In mid-2005, in connection with the conclusion of the process of the for-consideration transfer of the stake held by the National Property Fund of the Czech Republic to Telefónica the Board of Directors of ČESKÝ TELECOM decided to modify the executive macrostructure of the company, including appointments to the designated positions. The new structure is shown by the chart below.



Governing bodies of ČESKÝ TELECOM

(as at 31 March 2006)

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 company's 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 8 – 14 of ČESKÝ TELECOM'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 company's Articles of Association. As a rule, the Supervisory Board meets once every calendar month, but at least twelve 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 three years. Basic information about the Supervisory Board and its authority can be found in Articles 21 – 26 of the Articles of Association.

Board of Directors
The five-member Board of Directors is a statutory body which manages the business of the company and acts on its behalf. The Board of Directors decides on all corporate affairs which, by law or the Articles of Association, are not reserved for the General Meeting of the Supervisory Board. As a rule, the Board of Directors meets once every calendar month, but at least 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 three years. Basic information on the Board of Directors and its authority can be found in Articles 15 – 20 of the 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 a Finance and Audit Committee and a Staff and Remuneration Committee. Members of committees are elected and recalled by the Supervisory Board. The tenure of a member of a committee is one year. 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 27 of the Articles of Association. As at the end of 2005, the company had the following committees of the Supervisory Board:

- Finance and Audit Committee,
- Staff and Remuneration Committee,
- Ethics and Social Responsibility Committee.

Jaime Smith Basterra

Juraj Šedivý

Petr Slováček

Board of Directors of ČESKÝ TELECOM
(as at 31 March 2006)

Jaime Smith Basterra (*1965)
Chairman of the Board of Directors

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. Since December 2002, he was Chief Financial Officer of Telefónica de España. Since June 2005 he has been Chief Executive Officer and Chairman of the Board of Directors of ČESKÝ TELECOM. He serves as member of the Board of Directors of O2 plc.

Juraj Šedivý (*1962)
First Vice Chairman of the Board of Directors

Graduated from the Faculty of Mechanical Engineering at Nitra University in 1984 and from Comenius University in Bratislava in 1990. He worked as an assistant professor and research associate in the field of vehicle mechanics until 1991. He went on to get his MBA degree from the Rochester Institute of Technology, New York, in 1993 and in the same year joined Johnson & Johnson Inc., USA. His involvement in the telecommunications industry dates back to 1996, when he became Financial Director of Globtel (now Orange), a subsidiary of France Telecom in the Slovak Republic. In late 1997 he joined ČESKÝ TELECOM, working in various positions in financial management. Since 2001, he holds the position of Vice-President – Chief Financial Officer. Since 2003 he has been First Vice Chairman of the Board of Directors of ČESKÝ TELECOM.

Petr Slováček (*1959)
Second Vice Chairman of the Board of Directors

Graduated from the Technical University, Prague, with a degree in telecommunications from the Faculty of Electro-technical Engineering. Also holds a postgraduate Master of Business Telecommunications (MBT) degree from the Technical University of Delft in the Netherlands. After graduation he joined the Telecommunications Research Institution, Prague. He joined SPT TELECOM (a legal predecessor of ČESKÝ TELECOM) in 1989, working in switching, technical development, network management projects and OSS. He currently holds the position

Salvador Anglada Gonzalez

Ramon Ros Bigeriego

of Vice-President and Chief Operations Officer. In June 2003 he was elected Second Vice Chairman of the Board of Directors of ČESKÝ TELECOM.

Salvador Anglada Gonzalez (*1965)
Member of the Board of Directors
Graduated from Escuela Superior de Ingenieros Industriales Madrid where he studied in 1983 – 1989 and earned his degree in Industrial Engineering, from Instituto de Empresa Madrid (1993, Master in Business Administration) and from IESE Madrid (Senior MD Master Program PDG). He worked in Telefónica Empresas España and Telefónica de España (2002 – 2005) as Director for Sales and Marketing. In Telefónica Empresas España, a division of Telefónica de España, he was in charge of services for corporate customers. Before joining Telefónica, he held a number of executive positions in Dell Computer (1997 – 2002) and Dow Jones Markets (1994 – 1997). Since June 2005 he has been Chief Executive Officer and Statutory Representative of Eurotel, and member of the Board of Directors of ČESKÝ TELECOM.

Ramon Ros Bigeriego (*1967)
Member of the Board of Directors

Graduated in Business Administration and Management at Universidad Alcala De Henares, and earned a European Masters in Management at ESCP EAP, Paris. Before joining Telefónica, he worked in Banesto, one of the biggest financial corporations in Spain. He joined the Telefónica Group in 1997, and helped establish 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, and since October 2005 he has been member of ČESKÝ TELECOM's Board of Directors and Statutory Representative and Chief Financial Officer of Eurotel.

Changes in the personnel composition of the Board of Directors during 2005:

Gabriel Berdár – recalled by the Supervisory Board from the post of member of the Board of Directors on 23 June 2005

Jaime Smith Basterra – elected by the Supervisory Board to the post of member of the Board of Directors on 23 June 2005, elected to the post of Chairman of the Board of Directors on the same date

Marcela Malivánková – membership terminated by resignation on 15 October 2005

Michal Heřman – elected by the Supervisory Board to the post of member of the Board of Directors on 2 February 2005, recalled by the Supervisory Board from the post of member of the Board of Directors on 23 June 2005

Ramon Ros Bigeriego – elected by the Supervisory Board to the post of member of the Board of Directors effective from 16 October 2005

Salvador Anglada Gonzalez – elected by the Supervisory Board to the post of member of the Board of Directors on 23 June 2005

Fernando Astiaso Laín

Antonio Botas Bañuelos

Pavla Činátlová

Executive management of ČESKÝ TELECOM
(as at 31 March 2006)

Jaime Smith Basterra
Chief Executive Officer

Résumé on page 62.

Juraj Šedivý
Vice-President – Chief Financial Officer

Résumé on page 62.

Petr Slováček
Vice-President and Chief Operations Officer

Résumé on page 62.

Fernando Astiaso Laín (*1961)
Vice-President and Chief Sales & Marketing Officer

Graduated in telecommunications engineering at the Universidad Polytécnica, Madrid and he holds PDG diploma from IESE Business School. He has more than twenty years of experience in technology sectors in companies like Sener, IBM, Cable & Wireless, Unisource and Telefónica. He joined Telefónica de España in 1997 where he worked in various sales and marketing management positions in the SMEs and Corporate segments. Before joining ČESKÝ TELECOM he was SMEs Commercial Director. Now he holds the position of Vice-President and Chief Sales & Marketing Officer in ČESKÝ TELECOM.

Antonio Botas Bañuelos (*1963)
Chief Transformation Officer

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

Pavla Činátlová (*1975)
Chief External and Internal Communication Officer

Graduated from the Faculty of Law, Charles University. Also studied at Purley College, Jakub Chytil

David Šita

London. She held the position of Brand Manager at Kraft Jacobs Suchard and later worked at Mark/BBDO and Pragma Communications. Before joining ČESKÝ TELECOM, she was Marketing and Business Director and a member of the Board of Directors of Setuza. Since September 2003, she has been Chief External and Internal Communication Officer at ČESKÝ TELECOM.

Jakub Chytil (*1961)

Chief Legal Officer

Graduated from the Faculty of Law, Charles University, Prague, where he got his JUDr degree. In 1991 – 1995, he was a junior associate and, later on (1994), an attorney specialising in commercial and civil law, working with international law firms. In 1995 – 2000, he was Corporate Legal Counsel for the Czech and Slovak Republics at Philip Morris ČR and Kraft Foods. In 2000 – 2003, he was the Senior Counsel of Philip Morris International, Lausanne, Switzerland, where he was responsible for the legal affairs of Philip Morris International's subsidiaries in various countries. Since December 2003 he has been Chief Legal Officer at ČESKÝ TELECOM.

David Šita (*1969)

Chief Regulation and Interconnect Officer

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

Governing bodies and executive management of Eurotel
(as at 31 March 2006)

In the course of 2005, by decision of the Board of Directors of ČESKÝ TELECOM as the sole holder of Eurotel, personnel changes were effected in the positions of Statutory Representatives, all members of Eurotel's Supervisory Board were recalled and subsequently, in connection with the amendment to Eurotel's Founder's Deed, the Eurotel's Supervisory Board was dissolved the number of Statutory Representatives of Eurotel was increased from three to four; moreover, the Finance and Audit Committee was renamed to the Audit and Control Committee and the scope of its activities was modified. These steps were taken by the Board of Directors with a view to simplify and make more effective the ČESKÝ TELECOM Group's system of corporate governance and with respect to the performance of the Supervisory Board's key role in the first year of the full ownership control of Eurotel. The Finance and Audit Committee / Audit and Control Committee took over a part of Supervisory Board's agenda in this respect.

Governing bodies of Eurotel

General Meeting (sole member) – the Board of Directors of ČESKÝ TELECOM discharges the functions of this body. The sole member has the four-member Audit and Control Committee as its advisory, controlling and initiative body. Basic information about the position, competence and power of the Audit and Control Committee of Eurotel is set forth in Eurotel's Founder's Deed which is published on Eurotel's websites (www.eurotel.cz, About Us).

Statutory Representatives – a statutory body of Eurotel; the company has four Statutory Representatives.

Personnel composition of the governing bodies of Eurotel

Statutory Representatives – Salvador Anglada Gonzalez, Chief Executive Officer; Martin Bek, Chief Operating Officer; Stanislav Kůra, Chief Strategy and Product Development Officer; Ramon Ros Bigeriego, Chief Financial Officer.

Audit and Control Committee – Juraj Šedivý, Chairman (Vice-President – Chief Financial Officer of ČESKÝ TELECOM); Ramon Ros Bigeriego, Vice Chairman (Chief Financial Officer of Eurotel); Pavel Alexander, member (Director of Internal Audit of ČESKÝ TELECOM); Zdeněk Radil, member (Director of Risk Management of ČESKÝ TELECOM).

Personnel composition of Eurotel's executive management

Andrei Marc Torriani, Chief Commercial Officer, Residential

Diana Dobálová, Chief External and Internal Communications Officer

Martin Bek

Stanislav Kůra

Jaroslav Kubišta, Chief External Affairs Officer
Martin Bek, Chief Operating Officer
Petr Příhoda, Chief Legal Officer
Ramon Ros Bigeriego, Chief Financial Officer
Salvador Anglada Gonzalez, Chief Executive Officer
Stanislav Kůra, Chief Strategy and Product Development Officer
Tomáš Ječný, Chief Commercial Officer, Corporate

Salvador Anglada Gonzalez (*1965)
Statutory Representative

Résumé on page 63.

Martin Bek (*1969)
Statutory Representative

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 as Director for Tax and Accounting, later as 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.

Stanislav Kůra (*1968)
Statutory Representative

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 senior manager responsible for telecommunications in McKinsey & Company in Prague and in Silicon Valley, California. He has fifteen 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 UMTS network and services, and in October 2005 he was appointed Eurotel's Chief Strategy and Product Development Officer and Statutory Representative.

Ramon Ros Bigeriego (*1967)
Statutory Representative

Résumé on page 63.

Report of the Supervisory Board of ČESKÝ TELECOM

In keeping with the Company's Articles of Association, the Supervisory Board of ČESKÝ TELECOM in 2005 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 ČESKÝ TELECOM is done in compliance with the law, Articles of Association and instructions of the General Meeting.

The Supervisory Board continuously monitored the activities of ČESKÝ TELECOM 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 23 February 2006, the Supervisory Board examined the audited annual financial statements for 2005 (unconsolidated and consolidated) prepared under the International and Czech Financial Reporting Standards, and recommended them to the Regular General Meeting for approval.

Signed in Prague on 31 March 2006

Julio Esteban Linares López
Chairman of the Supervisory Board

Julio Esteban Linares López

Luis Lada Díaz

Lubomír Vinduška

Supervisory Board of ČESKÝ TELECOM

Julio Esteban Linares López (*1945)
Chairman of the Supervisory Board

Started as telecommunications engineer with Telefónica in May 1970 and held various positions there before being appointed Head of Telefónica's Technology department in 1984. In April 1990 he was appointed General Manager of Telefónica Investigación y Desarrollo (Telefónica I+D).
In December 1994 he became Deputy General Manager of Telefónica's Marketing and Services Development department, in the commercial area, subsequently moving to the position of Deputy General Manager for Corporate Marketing. In July 1997 he was appointed Chief Executive Officer of Telefónica Multimedia and President of Telefónica Cable and Producciones Multitemáticas. In May 1998 he was appointed General Manager of Strategy and Technology in Telefónica, S.A.'s Corporate Centre. Since January 2000 he has been Executive Chairman of Telefónica de España. His other appointments include: member of the board of The Social Council, Universidad Complutense, Madrid, member of the Board Telefónica, S.A., Secretary of the Executive Committee (from December 2005), member of the Board of Telefónica de España, S.A.U. (from December 2005), member of the Board Telefónica Data Corp, S.A.U. (from May 2005), member of the Board of Directors in O2 plc. In March 2006 he became member of the Advisory Scientific Council of Telefónica I+D. He is also a member of the Board of Sogecable S.A.

Luis Lada Díaz (*1949)
First Vice Chairman of the Supervisory Board

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 and currently is a member of A.P.D. Supervisory Board. In 1989 he was Deputy Director for Technology, Planning and International Services. Later he joined Amper Group, a manufacturer of telecommunications system and equipment, as Director of Planning and Control. He returned to the Telefónica Group in 1993 as Chief Controller for Subsidiaries and Participated Companies. In 1994 he was appointed Chief Executive Officer of Telefónica Móviles de España, S.A., and in September 2000 he went on to become President and Chief Executive Officer of Telefónica Móviles, S.A. until 2004, when he was named Director for Development, Planning and Regulatory Affairs of Telefónica, S.A. In 2005 he was appointed Executive Chairman of Telefónica de España, S.A.U. Now he also serves on the boards of directors of Telefónica, S.A., Telefónica Móviles, S.A. and Telefónica Internacional, S.A.

Vlastimil Barbořák

Alfonso Alonso Durán

Ángel Vilá Boix

Lubomír Vinduška (*1956)
Second Vice Chairman of the Supervisory Board

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

Vlastimil Barbořák (*1953)
member of the Supervisory Board

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

Alfonso Alonso Durán (*1957)
member of the Supervisory Board

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

Ángel Vilá Boix (*1964)
member of the Supervisory Board

Graduated in Industrial Engineering from the Universidad Politécnica de Cataluña (1988) and earned his MBA at the Columbia University (1990). After working as a financial analyst at Citibank NA and consultant at McKinsey & Co. he went to work for Ferrovial and Pasca, two Spanish construction and service companies. In 1997 he joined Telefónica as Group Controller. In 1998 he was promoted to Director for Finance and Controlling at Telefónica Internacional, and later to Business Development Director at Telefónica, S.A. He is a member of Telefónica's Executive Board and member of the Board of Directors of Banco Bilbao Vizcaya Argentaria and Endemol NV.

Pavel Herštík (*1951)
member of the Supervisory Board

Graduated in communication technology from the Secondary Technology School of Electro-technical Engineering. In 1972, Pavel Herštík

Guillermo José Fernández Vidal

Santiago Javier Fernández Valbuena

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 a chief planner. From 1995 to 1996, he was Head of Information Management and branch office Prague 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 managing documents in the Human Resources Unit at ČESKÝ TELECOM. In 2005 he completed a course in international accounting standards. He is Chairman of the Trade Union Steering Committee of ČESKÝ TELECOM.

Guillermo José Fernández-Vidal (*1946)
member of the Supervisory Board

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. At present he is Corporate General Manager of Telefónica, S.A. and member of the board of Telefónica Móviles de España, Telefónica de España and TPI.

Santiago Javier Fernández-Valbuena (*1958)
member of the Supervisory Board

He holds a PhD and Masters (M.S.) in Economics & Finance from Boston's Northeastern University and also has a degree in Economics from the Universidad Complutense, Madrid. He has taught at the Manchester Business School, the Instituto de Empresa, Universidad Complutense, Madrid, and the University of Murcia. Since January 2000 he has been President of the Research Committee of the Spanish Investment Analysts' Association (IEAF) and Head of the Portfolio Management area for the Certificate in International Investment Analysis (CIIA). From 1989 to 1994 he worked at Beta Capital where he was Head of Research, Equity Director and a member of the Investment Committee. From 1994 to 1996 he was General Manager of Société Générale Valores. He joined the Telefónica Group in January 1997 as CEO of Fonditel, the Group's pension fund manager. In July 2002 he was appointed CFO. Since then he has been responsible for a number of other units, including Procurement, Real Estate, Human Resources and Information Technology. He now oversees Mergers & Acquisitions and Associates besides his financial duties.

Miloslav Krch (*1958)
member of the Supervisory Board

Graduated from the Faculty of Electro-Technical Engineering at the University of Technical Engineering, Pilsen. Has been working at ČESKÝ TELECOM and its legal predecessors since 1986. His first position with ČESKÝ TELECOM was a technician at the E10 Exchange in Vlašim in 1986. From 1987 – 1995, he worked as the head of the ATÚ Vlašim telecommunications centre. Later he held the following positions in ČESKÝ TELECOM – specialist in the Department of the Regional Director of MTTÚ RBU Prague; Head of the Maintenance Management Department

Miloslav Krch

Antonio Pedro de Carvalho Viana-Baptista

Javier José Aguilera Arauzo

and Deputy Director for operation of switching and access network systems, Prague; Director of Local Operations, Prague Area. Now he holds the position of Director of Operations, Prague Area.

Antonio Pedro de Carvalho Viana-Baptista (*1957)

member of the Supervisory Board

He holds a degree in Economics from the Catholic University of Lisbon (1980). He also holds a postgraduate degree in European Economics from the Portuguese Catholic University (1981) and an MBA with honors and distinction from Insead, Fontainebleau (1983). From 1985 to 1991 he was a Principal Partner with McKinsey & Co. at their Madrid and Lisbon offices. From 1991 to 1998, he was Executive Director and Board Member of Banco Portugues de Investimento (BPI). Until July 2002, he held the position of President of Telofónica Internacional and Executive President of Telefónica Latinoamérica. Since August 2002 he has been President and Chief Executive Officer of Telefónica Móviles. At the same time he serves on the Board of Directors, Delegate Committee and Executive Committee of Telefónica, S.A., the holding company of the Telefónica Group, and he is also a member of the Board of Directors at Portugal Telecom SGPS.

Javier José Aguilera Arauzo (*1954)

member of the Supervisory Board

He graduated from the Universidad Politécnica of Madrid, 1976, where he qualified as Electromechanical Engineer. He also holds an MBA from Insead-Euroforum, 1993.
In the last 25 years, he linked his professional career with Telefónica where he held the following positions: Chairman of Telefónica Payphones (Cabitel), Chief Commercial Officer at Telefónica Wireline Spain (1998), Chief Operating Officer at Telefónica Móviles España (2000) and Chief Executive Officer of Telefónica Móviles España (2001). Since April 2005 he has been Chief Executive Officer of Telefónica Publicidad e Información.

José María Álvarez-Pallete López (*1963)

member of the Supervisory Board

Graduated with a degree in Economics from the Universidad Complutense, Madrid.
He also studied Economics at the Université Libre de Belgique. In 1987, he began his career at Arthur Young Auditors. In 1988, he joined Benito & Monjardin/Kidder, Peabody & Co., where he held various positions in the research and corporate finance departments. In 1995, he joined Valenciana de Cementos Portland (Cemex) as Head of the Investor Relations and Studies department. In 1996, he was promoted to Financial Manager for the company in Spain, and in 1998 to General Manager for Administration and Financial Affairs for CEMEX Group's interests in Indonesia, headquartered in Jakarta. He joined Telefónica in February 1999 as Chief Financial Officer of Telefónica Internacional. In September of the same year, he became Chief Financial Officer of Telefónica, S.A. On 24 July 2002, he was appointed Chairman and Chief Executive Officer of Telefónica Internacional. He is a member of the following Boards of Directors: Telefónica de España, Telefónica Móviles, Telefónica Móviles España, Telefónica Data, Telefónica Internacional, Telefónica de Argentina, Telesp, Telefónica CTC Chile, Telefónica de Perú, Cointel, Compañía de Teléfonos de Chile Transmisiones Regionales, Telefónica Larga Distancia de Puerto Rico and China Netcom.

Dušan Stareček (*1956)

member of the Supervisory Board

Qualified in Electronic and Electrical Technology at the Technical and Engineering

José María Álvarez-Pallete López

Dušan Stareček

Petr Zatloukal

Secondary School in Rožnov pod Radhoštěm. In 1975, he started work as a technician at Long-distance Cables Administration, Prague (a legal predecessor of ČESKÝ TELECOM). In 1992, he was promoted to the position of Head of External Maintenance in the Transmission Technology Unit. At present, he works as a Specialist for Operation and Maintenance of Digital Telecommunications Technology in Ostrava. He is a member of the Trade Union Steering Committee of ČESKÝ TELECOM.

Petr Zatloukal (*1970)

member of the Supervisory Board

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

Changes in the personnel composition of the Supervisory Board during 2005:

Ivana Krynesová-Gage – recalled by decision of the General Meeting of 23 June 2005
Jan Juchelka – recalled by decision of the General Meeting of 23 June 2005
Jiří Hurych – recalled by decision of the General Meeting of 23 June 2005
Martin Fassmann – recalled by decision of the General Meeting of 23 June 2005
Martin Kovář – recalled by decision of the General Meeting of 23 June 2005
Pavel Kuta – recalled by decision of the General Meeting of 23 June 2005
Petr Polák – recalled by decision of the General Meeting of 23 June 2005
Petr Zatloukal – recalled and subsequently re-elected by decision of the General Meeting of 23 June 2005
Stanislav Bělehrádek – recalled by decision of the General Meeting of 23 June 2005
Zdeněk Hrubý – recalled by decision of the General Meeting of 23 June 2005

Alfonso Alonso Durán – elected a member of the Supervisory Board by the General Meeting of 23 June 2005
Ángel Vilá Boix – elected a member of the Supervisory Board by the General Meeting of 23 June 2005
Antonio Pedro de Carvalho Viana-Baptista – elected a member of the Supervisory Board by the General Meeting of 23 June 2005
Guillermo José Fernández-Vidal – elected a member of the Supervisory Board by the General Meeting of 23 June 2005
Javier José Aguilera Arauzo – elected a member of the Supervisory Board by the General Meeting of 23 June 2005
José María Álvarez-Pallete López – elected a member of the Supervisory Board by the General Meeting of 23 June 2005
Julio Esteban Linares López – elected a member of the Supervisory Board by the General Meeting of 23 June 2005 and elected Chairman by the Supervisory Board on the same date
Luis Lada Díaz – elected a member of the Supervisory Board by the General Meeting of 23 June 2005 and elected First Vice Chairman by the Supervisory Board on the same date
Santiago Javier Fernández-Valbuena – elected a member of the Supervisory Board by the General Meeting of 23 June 2005

ČESKÝ TELECOM's Declaration of Compliance with the Code of Good Corporate Governance based on OECD Principles

Acting on its undertaking to abide by the principles of good corporate governance which dates back to 2001, when it was first published in the Annual Report, in 2005 ČESKÝ TELECOM made progress in implementing international corporate government standards in line with the latest trends. The Board of Directors of ČESKÝ TELECOM is systematically supportive of application of best practice in the field of corporate governance in all subsidiary companies controlled by ČESKÝ TELECOM.

Based on the conclusions of an analysis of the implementation of the principles and recommendations of the updated Code (the 2004 Code of Good Corporate Governance based on OECD Principles, as published by the Czech Securities Commission) in ČESKÝ TELECOM, we can conclude that the undertaking made by the Company in its Declaration in the 2002 Annual Report, i.e. to meet all the criteria of the Code within three years, is being fulfilled, with the exception of those criteria which fall outside the direct control of ČESKÝ TELECOM's governing bodies and are hinge on the decisions of the Company's owners (namely the requirement for a number of independent members of the Supervisory Board). In 2006, we plan to further embed the already implemented corporate governance elements, namely in the form of an amendment to the Company's Articles of Association which will reflect our experience collected in the field of corporate governance over the past two years, changes to the Company's ownership structure and the expected developments in the two areas.

Corporate governance

In 2005, ČESKÝ TELECOM continued to implement the corporate governance model approved by the decision of the shareholders to amend the Articles of Association of the Company in June 2003. This model of corporate governance is based on synergistic collaboration between the executive Board of Directors, comprising exclusively the top managers of ČESKÝ TELECOM and Eurotel, and the Supervisory Board which has extended powers which let it participate in deciding on the Company's principal affairs. An implicit part of the model is the combination of the Chief Executive Officer's function and the function of Chairman of the Board of Directors, the application of institutes of "prior approvals" and "prior standpoints" by the Supervisory Board and the full use of the advisory and initiative role of Supervisory Board's committees.

At the same time, the Company continued to apply the principles of good corporate governance to the whole ČESKÝ TELECOM Group. In connection with the conclusion of the for-consideration transfer of the ownership interest of the National Property Fund of the Czech Republic to Telefónica a number of changes were made in the area of corporate governance in subsidiaries with the view to strengthening and making more effective the corporate governance system of the ČESKÝ TELECOM Group. Eurotel's Supervisory Board was dissolved as it had accomplished its principal role as a controlling, monitoring and reviewing instrument in the first year of full ownership control of Eurotel; a part of its agenda was taken over by the Finance and Audit Committee which became the sole member's instrument. The committee was later renamed Audit and Controlling Committee (see also Section Governing bodies and executive management of Eurotel) as a result of its reformed role and in line with international practice. Amended Memorandum of Association and Articles of Association were adopted in subsidiary companies OMNICOM Praha, spol. s r.o. and CenTrade, a.s., respectively, reflecting on the strengthened ownership role of ČESKÝ TELECOM.

Organisation of corporate governance

The corporate governance model applied in ČESKÝ TELECOM ensured that throughout 2005 the Company had adequate strategic management and the management's actions were effectively monitored by the Board of Directors and the Supervisory Board, thus providing for the responsible discharge of the duties of the governing bodies towards the Company and its shareholders.

The **Ordinary General Meeting** of the Company held on 23 June 2005 did not discuss any principal changes to the system of corporate governance of the Company. A detailed overview of the General Meeting is contained in ČESKÝ TELECOM's 2005 Mid-Year Report and is also available on the Company's website.

In 2005, the **Board of Directors** held fourty-four meetings; the Articles of Association prescribe a minimum of twelve meetings. The higher than usual number of Board of Directors meetings in 2005 is related to, for instance, the finalisation of the process of for-consideration transfer of the majority stake held by the National Property Fund of the Czech Republic and the related activities, changes in the system of corporate governance in subsidiaries, performance-boosting measures, etc. The three + two formula for the staffing of the Board of Directors, where three members of the Board of Directors are members of ČESKÝ TELECOM's top management and two members of the Board of Directors are members of Eurotel's top management – proved good. For a complete overview of all personnel changes in the Board of Directors in 2005 and in the first quarter of 2006, including a complete listing of its members (as at 31 March 2006), please refer to pages 62 and 63 of the Annual Report. The résumés of the members of the Board of Directors, attesting to their competence, professional skills and practical experience, are on pages 62 and 63.

In 2005, the **Supervisory Board** held fourteen meetings; the Articles of Association prescribe a minimum of twelve meetings. In mid-2005, the General Meeting made substantial changes to the personnel composition of the Supervisory Board, replacing nine out of fifteen members. For a complete overview of the personnel changes in the Supervisory Board in 2005 and in the first quarter of 2006, including a complete listing of its members (as at 31 March 2006), please refer to pages 69 – 73 of the Annual Report. The résumés of all the members of the body are on pages 69 – 73. As at 31 December 2005 , the Supervisory Board comprised one member who qualifies as independent under the Code – Petr Zatloukal.

The system and principles for remuneration of members of the Board of Directors and the Supervisory Board of ČESKÝ TELECOM are described in detail in Section 05 of the Annual Report.

The Company Secretary provides information to new members of the board of Directors, Supervisory Board and its committees in respect of the main areas and principles of corporate governance in the ČESKÝ TELECOM Group, as well as all other information and facts they need for dutiful discharge of their powers.

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

As part of the whole process of implementing of and assuring compliance with effective corporate governance processes, and their adequate documentation, and in line with the law and international practice, the position of **Company Secretary** was introduced into the system of corporate governance in ČESKÝ TELECOM; the Company Secretary supports the Board of Directors, Supervisory Board and its committees in the discharge of their powers, and to members of the Board of Directors and the Supervisory Board in the discharge of their duties. Company Secretary's independence is assured by the fact that he reports directly to the Board of Directors which appoints and recalls the Company Secretary based on a previous approval by the Supervisory Board. As part of the effort for more intensive implementation of corporate governance principles also in ČESKÝ TELECOM's subsidiaries, the Company Secretary's authority was extended to the whole ČESKÝ TELECOM Group, in 2005.

In addition to the Company Secretary and the subordinated Office of Corporate Governance, the system of corporate governance in ČESKÝ TELECOM comprises also Internal Audit and Risk Management.

Internal audit provides the Company's governing and executive bodies with independent and professional assessment of the internal control system in the Company and the situation and trends of the given area compared to current best practice, the rules and regulations in force, and work orders and instructions issued, thus helping to continually improve the Company's internal control system. In 2005, Internal Audit carried out eleven audits and a number of other ad hoc controls based on the requirements of the governing bodies and the Chief Executive Officer. The audit conclusions were used by the management to formulate actions to redress the issues identified. Internal Audit monitors their implementation and reports to the governing bodies and the executive management.

Activities of Internal Audit, its main processes, namely those for approvals, are laid down in the Internal Audit Charter which was amended in 2005, to reflect the best international practice. The work of Internal Audit is monitored on a regular basis by the Finance and Audit Committee.

In the area of **risk management**, additional methodological, process and organisation pre-requisites for effective application of the standard risk management system for optimal risk management in ČESKÝ TELECOM and in Eurotel were finalised in 2005. Based on the standard risk management system which conforms to international practice and to the nature of business of the ČESKÝ TELECOM Group, all the key risks in both companies were assessed. As part of the standard process, other previously identified and newly emerged risks are continually evaluated. Outputs from Risk Management are regularly presented to the Finance and Audit Committee for information. More information on Risk Management can be found in Section 02/01.

From mid-2005, the functions and content of the **Corporate Governance Information** Portal were extended, as was its availability. The new version of the portal went live at the beginning of 2006. The portal is fully bilingual (in Czech and English), contains data and basic documents in respect of all ČESKÝ TELECOM's companies and allows for effective administration of ČESKÝ TELECOM and all subsidiaries which together make up the ČESKÝ TELECOM Group. The portal's functions give all members of the statutory and supervisory bodies of ČESKÝ TELECOM and its subsidiaries, as well as to other users authorised by ČESKÝ TELECOM's Board of Directors, secure, safe, both direct and remote access to archived and current documents for discussion at meetings, including outputs from Internal Audit and Risk Management. This tool is a major help to ČESKÝ TELECOM in complying, on its behalf and on the behalf of its subsidiaries, with the requirement of the Code and of best practice for delivery of timely and sufficient information to the governing bodies as an input for their decision-making process.

As a result of the changes stemming from ČESKÝ TELECOM's integration in the Telefónica Group, preparatory work was started in late 2005 and early 2006 for implementation of a whistleblowing channel for submitting initiatives in the finance, accounting and property issues in the ČESKÝ TELECOM Group. Implementation of a whistleblowing channel is for Telefónica a mandatory requirement under the Sarbanes-Oxley Act, U.S. law applicable to companies whose stock is traded on U.S. stock exchanges.

Shareholder relations

ČESKÝ TELECOM declares that in 2005 it took great care to observe all statutory shareholder rights and comply with the principle of equal treatment of all shareholders of a similar standing, while respecting the specific statutory rights of minority shareholders.
The mechanisms and procedures for the support and administration of governance are permanently configured to ensure that shareholders get timely and complete information on the Company in the course of the year (above and beyond the statutory disclosure duty) and to enable them to attend General Meetings without hindrance or limitation (e.g. with regard to time and location).

The Company thus protects shareholders' rights and facilitates the exercise thereof. Using the instruments detailed below, the corporate governance model provides

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

The Board of Directors answered one question put by shareholders at the Ordinary General Meeting of 23 June 2005; no questions were put by shareholders to members of the Supervisory Board or the committee chairpersons.

Transparency and open information policy

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

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

Both the Corporate Governance Section and the Financial Section (the Financial Statements and the Report of Independent Auditor) of the Annual Report contain information on the remuneration and other emoluments paid to members of ČESKÝ TELECOM's governing bodies and on the Company shares in the possession of these persons. Disbursement of remuneration to members of the Board of Directors and of the Supervisory Board and disbursement of discretionary benefits, including liability insurance in connection with the discharge of office of member of a governing body, to members of the Supervisory Board is governed by rules approved by the General Meeting, which the shareholders can find on the Company's website from March 2005 (for more information please refer to Section 05 of the Annual Report).

An integral part of the decision-making processes and practices in ČESKÝ TELECOM'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 statutory bodies of other companies, involvement in commercial transactions and other selected instances are examined in ČESKÝ TELECOM minimally twice a year by a dedicated committee of the Supervisory Board – the Ethics and Social Responsibility Committee (for details, see below Committees established by the governing bodies of the Company).

As per the recommendations from External Auditor, PricewaterhouseCoopers, selected provisions of the Sarbanes Oxley Act were implemented in the course of 2005, and their across-the-board and in-depth application commenced, to meet the duties imposed on Telefónica and its subsidiary companies by the Sarbanes Oxley Act. As in the previous years, also in 2005 ČESKÝ TELECOM won local and international recognition for its efforts in the area of implementing and improving good corporate governance practices. ČESKÝ TELECOM scored a major success at the IR Magazine Awards 2005, winning the award for Best Investor Relations in the Czech Republic. ČESKÝ TELECOM has won the award already third year in a row; it is the only telecommunications Company in central and eastern Europe to have won this award in 2005. This year, the prestigious IR Magazine Awards were presented based on a vote of more than 500 investors, namely portfolio managers and financial analysts. It is the most acclaimed award in the international arena and a token of recognition for excellence in investor relations. Their goal is to identify companies that provide investors with the best services on the domestic, as well as international level. In 2005, ČESKÝ TELECOM was also recognised for the Best 2004 Annual Report in the Czech Republic, in the Commerce and Services category. Also in 2005, ČESKÝ TELECOM has earned an ISO 9001:2000 quality management system certificate in selected areas, this time for the entire Company, following a Company-wide audit by Lloyd's Register Quality Assurance, a renowned British firm.

Committees established by the governing bodies of the Company

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

The Finance and Audit Committee (FAC) has five members. Changes had occurred in the personnel composition of the committee in 2005 – some of them were related to personnel changes in the Supervisory Board. As at the end of 2005, the FAC met in the following composition: Santiago Javier Fernández Valbuena, Chairman; Alfonso Alonso Durán, Vice Chairman; Julio Esteban Linares López, Ángel Vilá Boix and Pavel Herštík, members. Despite the extensive experience, professional qualifications and other competences in the field of accounting and finance, none of the members is a chartered accountant. The committee usually meets once a month, always before a scheduled meeting of the Supervisory Board.
The FAC meets primarily to monitor financial statements and accounting practices in terms of their integrity, reliability and completeness, discuss internal and external audit matters and make recommendations concerning these matters to the Supervisory Board, and monitor the system for the management of financial and other risks. The FAC also invokes the institute of closed consultation with the external auditor. The committee also reviews all request for using the services of the external auditor for non-auditing

activities in the Company. The system was modified, incorporating the rules applied in the Telefónica Group, in late 2005; improvements include, for instance, the implementation of a classification system for services. The committee has access to all Internal Audit outputs, also via the Corporate Governance Information Portal, and meets with the Chief Internal Auditor in closed consultation on as-required basis. In 2005, the committee met twelve times.

The Staff and Remuneration Committee (SRC) has five members and concentrates on reviewing personnel changes in ČESKÝ TELECOM's Board of Directors and committees and in the governing bodies of its subsidiary companies, as well as on matters relating to the remuneration of members of ČESKÝ TELECOM's governing bodies, reviewing the manager contracts and salary packages of the Chief Executive Officer and other members of the Board of Directors. In 2005, the committee met eight times. Changes were made to the SRC's composition only as a direct result of the personnel changes in the Supervisory Board. As at the end of 2005, the SRC consisted of: Julio Esteban Linares López, Chairman; Santiago Javier Fernández Valbuena, Vice Chairman, and members Luis Lada Díaz, Guillermo José Fernández Vidal and Javier José Aguilera Arauzo. The SRC duly performed its duties stipulated by the Code of Corporate Governance and the usual tasks of committees of this kind and purpose.

The Ethics and Social Responsibility Committee (ESRC) has increased the number of its members from six to eight in the course of 2005. In addition to issues concerning conflicts of interests, the committee monitors compliance with the Code of Ethics by ČESKÝ TELECOM employees and reviews the ethical conduct and social responsibility of the Company as a whole. Changes were made to the ESRC's composition only as a direct result of the personnel changes in the Supervisory Board and in connection with the increased number of its members. As at the end of 2005, the committee consisted of: Pavel Herštík, Chairman; Petr Zatloukal, Vice Chairman; Vlastimil Barbořák, Dušan Stareček, Julio Esteban Linares López, Ángel Vilá Boix, Guillermo José Fernández Vidal and Javier José Aguilera Arauzo, members. In 2005, the committee met four times. As far as conflicts of interests are concerned, the committee twice reviewed the affirmations of the members of the Company's governing bodies and of managers in the so-called designated positions, as well as of members of the statutory bodies and supervisory bodies of ČESKÝ TELECOM's subsidiary companies. No questionable issues suggesting a conflict of interest were identified.

The Advisory Committee on Strategy and Capital Participations (SAC) was dissolved by decision of the Supervisory Board in September 2005. In 2005, the committee discussed professional issues in relation to the strategy and the business plan of ČESKÝ TELECOM and its subsidiaries, particulary those of Eurotel reviewing strategic risks and fundamental business decisions. The Supervisory Board decided on the dissolution of the committee with the logic that, given the significance of issues discussed on the SAC platform, whose meetings were usually attended also by other Supervisory Board members, the topics would better be discussed directly in Supervisory Board Meetings or, if required, special workshops of the Supervisory Board would be organised. The step was taken in line with the process of optimisation and performance improvement of activities of the Supervisory Board and its committees.

Company policy towards partners

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


04

Financial section

Consolidated financial statements for the year ended 31 December 2005

Prepared in accordance with International Financial Reporting Standards

Contents

GENERAL INFORMATION

ČESKÝ TELECOM, a.s. Group (the Group) consists of ČESKÝ TELECOM, a.s. (the Company), its subsidiaries, SPT TELECOM (Czech Republic) Finance B.V., OMNICOM Praha, spol. s r.o., CenTrade, a.s., CZECH TELECOM Germany GmbH, CZECH TELECOM Austria GmbH, CZECH TELECOM Slovakia, s.r.o. and Eurotel Praha, spol. s r.o. (Eurotel), including its subsidiary, a 100% owned Hungarian registered limited liability company, Trigo Global Services Ltd. (process of voluntary liquidation has been finalised in April 2005 and the dissolution of the company Trigo Global Services is completed).

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

The average number of employees in the Group was 10,541 in 2005 (2004: 12,215).

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

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

These consolidated financial statements have been approved for issue by the Board of Directors on 23 February 2006.

Relationship with the Czech state, privatisation and acquisition process

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

The Group supplies telecommunication services to and acquires services from various state-owned entities, agencies and companies in which the Czech state holds the majority shareholding. All such transactions are made on normal commercial terms and conditions that are no more favourable than those available to other customers and suppliers. In aggregate, the state-owned entities, agencies and companies comprise one of the Group's largest customers. In providing services to these entities, agencies and companies, ČESKÝ TELECOM, a.s. conducts business with them as separate customers. Services provided to any one governmental entity, agency or state-owned company do not represent a significant component of the Group's revenues.

In June 2004 the Czech Government, via its agency, the National Property Fund, selected a consortium CSFB and Česká spořitelna, a.s. to act as an advisor for the privatisation of its 51.1% stake in ČESKÝ TELECOM, a.s.

In December 2004 based on the advisor recommendation, the Czech government approved the start of the privatization process. The privatisation process of the 51.1% stake in the Company was finalized in the first half of 2005, when the new acquirer, Telefónica, S.A. (Telefónica), offered the highest price for the majority – CZK 82.6 billion, i.e. CZK 502 per one ordinary share. Subsequently the National Property Fund and Telefónica, S.A. signed a take-over agreement on 12 April 2005 and Telefónica, S.A. paid 10% of the purchase price to an escrow bank account.

The acquisition process was completed on 16 June 2005, after Telefónica, S.A. paid the remaining 90% of the purchase price, and the National Property Fund transferred the 51.1% stake in the Company to Telefónica, S.A.

Telefónica, S.A. applied effectively its control at the general meeting, which took place on 23 June 2005.

In June 2005 Telefónica, S.A. submitted to the Czech Securities Commission for its approval a mandatory tender offer for 48.9% of the share of ČESKÝ TELECOM, a.s. in accordance with the Czech commercial code No. 513/1991 Sb., § 183b. The price proposed by Telefónica for approval to the Czech Securities Commission amounted to CZK 456 for each ordinary share, paid in cash. The Czech Securities Commission approved such a tender offer, including the proposed price, on 20 July 2005. The tender offer terminated on 19 September 2005.

The total amount of the additionally acquired shares following the tender offer was 58.8 million shares (i.e. 18.3% of shares), which amounted to the consideration given of CZK 26.8 billion. Afterwards the Telefónica interest in ČESKÝ TELECOM increased from 51.1% to 69.4% of the common stock.

The Group has been included in the Group Telefónica since the finalisation of the take-over. Mutual transactions of supplies of telecommunication services take place amongst Telefónica companies. All these transactions are made on normal commercial terms and conditions that are no more favourable than those available to other customers and suppliers.

INDEPENDENT AUDITORS' REPORT

TO THE SHAREHOLDERS OF ČESKÝ TELECOM, a.s.

We have audited the accompanying financial statements of ČESKÝ TELECOM, a.s. and its subsidiaries (the Group), which comprise the consolidated balance sheet as at 31 December 2005 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. These financial statements are the responsibility of the Group's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with International Standards on Auditing. Those Standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our 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 2005, and of its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards as adopted by the EU.

Ernst & Young

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

Magdalena Souček
Auditor, License No. 1291

23 February 2006
Prague, Czech Republic

CONSOLIDATED INCOME STATEMENT

(in CZK million)	Notes	Year ended 31 December 2005	31 December 2004
Revenue	2	61,040	61,538
Gains from sale of non-current assets		116	245
Internal expenses capitalized in fixed assets	2	594	665
Operating expenses	3	(33,249)	(32,987)
Impairment loss	8,9,10	(1,261)	(56)
Depreciation and amortisation	8,9	(17,808)	(20,845)
Operating profit		**9,432**	**8,560**
Interest income	4	46	80
Interest expense	4	(748)	(1,236)
Other finance income/(costs)	4	18	753
Profit before income tax		**8,748**	**8,157**
Taxes on income	5	(2,500)	(2,428)
Profit for the year		**6,248**	**5,729**
Attributable to:			
Equity holders of the Company	6	**6,249**	**5,732**
Minority interest	30	(1)	(3)
Earnings per share (CZK) – basic*	6	19	18

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

CONSOLIDATED BALANCE SHEET

(in CZK million)	Notes	31 December 2005	31 December 2004
ASSETS			
Property, plant and equipment	8	88,003	99,345
Intangible assets	9	22,846	25,008
Available-for-sale investments	13	58	59
Held-to-maturity investments	13	29	31
Investment in associate	29	11	12
Other financial assets	12	412	366
Non-current assets		**111,359**	**124,821**
Inventories	11	716	713
Receivables and prepayments	12	8,013	8,286
Income tax receivable		124	166
Available-for-sale investments	13	-	117
Held-to-maturity investments	13	-	78
Cash and cash equivalents	14	3,639	480
Current assets		**12,492**	**9,840**
Non-current assets classified as held for sale	8	**360**	-
Total assets		**124,211**	**134,661**
EQUITY AND LIABILITIES			
Ordinary shares	24	32,209	32,209
Share premium		30,816	30,816
Retained earnings, funds and reserves		31,950	25,674
		94,975	**88,699**
Minority interest	30	-	**6**
Total equity		**94,975**	**88,705**
Borrowings	16	9,324	16,799
Deferred taxes	17	5,721	6,041
Non-current provisions for liabilities and charges	19	2,111	1,566
Non-current other liabilities		1,265	1,790
Non-current liabilities		**18,421**	**26,196**
Borrowings	16	101	8,671
Trade and other payables	15	9,840	9,485
Income tax liability		251	738
Provisions for liabilities and charges	19	623	866
Current liabilities		**10,815**	**19,760**
Total liabilities		**29,236**	**45,956**
Total equity and liabilities		**124,211**	**134,661**

These consolidated financial statements were approved by the Board of Directors on 23 February 2006 and were signed on its behalf by:

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

Juraj Šedivý
1st Vice-Chairman of the Board of Directors
and Chief Financial Officer

CONSOLIDATED STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY

(in CZK million)	Notes	Share capital	Share premium	Hedging reserve	Foreign exchange translation reserve	Funds*	Retained earnings	Minority interest	Total
Balance at 1 January 2004 as previously stated		32,209	30,816	(2)	9	5,628	21,488	9	90,157
Effect of change in accounting policy for connection fees	2	-	-	-	-	-	(2,016)	-	(2,016)
Effect of change in accounting policy for connection cost	2	-	-	-	-	-	398	-	398
Effect of change in accounting policy of Eurotel		-	-	-	-	-	(40)	-	(40)
Balance at 1 January 2004 as restated		**32,209**	**30,816**	**(2)**	**9**	**5,628**	**19,830**	**9**	**88,499**
Fair value losses (net of tax) - cash flow hedges	26	-	-	(45)	-	-	-	-	(45)
Currency translation differences - amount arising in year		-	-	-	4	-	-	-	4
Changes in statutory reserves and other movements		-	-	-	-	-	(6)	-	(6)
Net income/(expense) recognised directly in equity		-	-	(45)	4	-	(6)	-	(47)
Dividends related to the year 2003	7	-	-	-	-	-	(5,476)	-	(5,476)
Net profit		-	-	-	-	-	5,732	-	5,732
Minority interest		-	-	-	-	-	-	(3)	(3)
Balance at 31 December 2004		**32,209**	**30,816**	**(47)**	**13**	**5,628**	**20,080**	**6**	**88,705**
Fair value gains (net of tax) - cash flow hedges	26	-	-	36	-	-	-	-	36
Currency translation differences - amount arising in year		-	-	-	(13)	-	-	-	(13)
Changes in statutory reserves and other movements		-	-	-	-	405	(401)	(5)	(1)
Net income/(expense) recognised directly in equity		-	-	36	(13)	405	(401)	(5)	22
Dividends related to the year 2004	7	-	-	-	-	-	-	-	-
Net profit		-	-	-	-	-	6,249	-	6,249
Minority interest		-	-	-	-	-	-	(1)	(1)
Balance at 31 December 2005		**32,209**	**30,816**	**(11)**	**-**	**6,033**	**25,928**	**-**	**94,975**

* Refer Note 24 regarding amounts not available for distribution.

CONSOLIDATED CASH FLOW STATEMENT

(in CZK million)	Notes	Year ended 31 December 2005	31 December 2004
Cash flows from operating activities			
Cash generated from operations	27	27,760	28,813
Interest paid		(889)	(1,248)
Interest received		47	75
Income tax paid		(3,262)	(2,655)
Net cash from operating activities		**23,656**	**24,985**
Cash flows from investing activities			
Purchase of property, plant and equipment		(4,044)	(5,612)
Purchase of intangible assets		(1,156)	(508)
Proceeds from sales of property, plant and equipment		235	618
Proceeds from marketable securities		184	265
Net cash used in investing activities		**(4,781)**	**(5,237)**
Cash flows from financing activities			
Proceeds from borrowings		11,580	20,942
Repayment of borrowings		(27,393)	(39,374)
Dividends – paid		-	(5,479)
Net cash used in financing activities		**(15,813)**	**(23,911)**
Net increase/(decrease) in cash and cash equivalents		**3,062**	**(4,163)**
Cash and cash equivalents at beginning of year		480	4,649
Effects of exchange rate changes		(4)	(6)
Cash and cash equivalents at the year end	14	**3,538**	**480**

ACCOUNTING POLICIES

Index to 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.

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

Effective from 1 January 2005, a change in the Czech Act on Accounting No. 563/1991 Coll requires the Group to prepare its consolidated financial statements in accordance with IFRS that have been adopted by the EU (Regulation (EC) No 1606/2002). At this particular time, due to the endorsement process of the EU, and the activities of the Group, there is no difference in the policies applied by the Group between IFRS and IFRS that have been adopted by the EU.

The consolidated financial statements have been prepared under the historical cost convention except for non-current assets held for sale, financial derivatives, available for sale investment securities, share based payment liability and certain assets and liabilities acquired during business combinations, as disclosed in the accounting policies below.

The preparation of financial statements in conformity with IFRS requires the use of certain critical accounting estimates. It also requires 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 U.

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

Adoption of standards
In 2004, the Group early adopted the IFRS below, which are relevant to its operations:

IAS 1 (revised 2003) Presentation of Financial Statements
IAS 2 (revised 2003) Inventories
IAS 8 (revised 2003) Accounting Policies, Changes in Accounting Estimates and Errors
IAS 10 (revised 2003) Events after Balance Sheet Date
IAS 16 (revised 2003) Property, Plant and Equipment
IAS 17 (revised 2003) Leases
IAS 21 (revised 2003) The effects of Changes in Foreign Exchange Rates
IAS 27 (revised 2003) Consolidated and Separate Financial Statements
IAS 28 (revised 2003) Investments in Associates
IAS 33 (revised 2003) Earnings per Share
IFRS 2 (issued 2004) Share-based Payments

The early adoption of IAS 1, 2, 8, 10, 16, 17, 21, 27, 28, 33 and IFRS 2 before the effective date did not result in substantial changes to the Group's accounting policies:

IAS 1 had affected the presentation of minority interest and other disclosures.
IAS 2, 8, 10, 16, 17, 27 and 33 had no material effect on the Group's accounting policies.

IAS 21 had no material effect on the Group's accounting policies. The functional currency of each of the consolidated entities has been re-evaluated based on the guidance in the revised standard. All the Group entities have the same functional currency as their measurement currency. The Group's presentation currency is the same as the parent's functional currency, which is the CZK. The financial statements of the foreign entities have been translated into the presentation currency.

The early adoption of IFRS 2 has resulted in a change in the accounting policy for share-based payments. Since the adoption of IFRS 2, the Group measures the fair value of the liability for cash settled share-based payment transaction with any change in the value recognised in the income statement for the period (Note 25).

The Group did not have any share appreciation rights prior to the application of IFRS 2.

All changes in the accounting policies had been made in accordance with the transition provisions or have been applied retrospectively in accordance with the respective standards.

All standards adopted by the Group require retrospective application other than:

IAS 16 – the exchange of property, plant and equipment is accounted at fair value prospectively. There has been no substantial exchange of property, plant and equipment during the years 2004 and 2005.
IAS 21 – the prospective accounting for goodwill and fair value adjustments as part of foreign operations.

Adoption of new and revised standards and interpretations from 1 January 2005
The Group has adopted these revised and new standards from 1 January 2005:

IAS 24 (revised 2003) Related Party Disclosures
IAS 32 (revised 2004) Financial Instruments: Disclosure and Presentation
IAS 36 (revised 2004) Impairment of Assets
IAS 38 (revised 2004) Intangible Assets
IAS 39 (revised 2004) Financial Instruments: Recognition and Measurement
IFRS 3 (issued 2004) Business Combinations
IFRS 5 (issued 2004) Non-current Assets Held for Sale and Discontinued Operations

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

IFRIC 1 (issued 2001) Changes in Existing Decommissioning, Restoration and Similar Liabilities

The later adoption of the above-mentioned standards has resulted in the following changes:

IAS 24 (revised 2003) has affected the identification of related parties, the form of disclosure and some other related party disclosures including the disclosure of key management personnel compensation.

In addition as the Company used to be majority owned by the National Property Fund of the Czech Republic (year 2004 and part of 2005), the implementation of this standard required disclosure of transactions with entities, where the National Property Fund had majority ownership or significant influence at that time.

IAS 39 (revised 2004) has resulted in a change in the fair value measurement of Available-for-sale financial assets whereby the Group is required to recognise gains and losses resulting from fair value measurement directly in equity.

IFRS 3, IAS 36 (revised 2004), IAS 38 (revised 2004) has resulted in the Group changing its accounting policy for goodwill. Until 31 December 2004 goodwill was:

- Amortised on a straight line basis over a period of 20 years, and
- Assessed for an indication of impairment at each balance sheet date.

In accordance with the provisions of IFRS 3:

- The Group has ceased amortisation of the previously recognized goodwill from 1 January 2005. The amount of the annual amortization in 2004 charge was CZK 708 million.
- Accumulated amortisation as at 31 December 2004 was eliminated with a corresponding decrease in the cost of goodwill (CZK 767 million).
- Since the year ending 31 December 2005 onwards, goodwill has been tested annually for impairment, as well as when there are indications of impairment.

This policy has been applied prospectively, i.e. since 1 January 2005.

The Group reassessed the useful lives of its intangible assets and the categorisation of previously recognized intangible assets in accordance with the provisions of IAS 38 and IFRS 3. The useful lives of intangible assets were assessed at the individual asset level as having either a finite or indefinite life. Intangible assets having indefinite useful lives are not amortised from 1 January 2005, but annually tested for impairment, at least at the balance sheet date, as well as when there are indications of impairment. The Group did not adjust the corresponding carrying amount and any change is accounted for as a change in accounting estimate in accordance with IAS 8.

This policy has been applied prospectively, since 1 January 2005.

IFRS 5 changed the Group's policy in the presentation and measurement of fixed assets held for sale and discontinuing operations. This standard requires assets that meet the criteria of held for sale to be measured at the lower of carrying amount and fair value less costs to sell and depreciation of such identified assets is ceased next month after such identification. Assets that meet the criteria of held for sale are presented separately on the face of the balance sheet and the results of discontinued operations presented separately in the income statement.

This policy has been applied prospectively, since 1 January 2005.

Issued standards and interpretations, but not early adopted by the Group:
IFRS 6 (issued in 2004, effective date 1 January 2006) Exploration for and Evaluation of Mineral Resources - this standard does not apply to the activities of the Group.

IFRS 7 (issued in 2005, effective date 1 January 2007) Financial Instruments: Disclosures - the Group does not expect any material effect relating to the adoption of this standard.

Amendments to IAS 1 (issued 2005, effective date 1 January 2007) Presentation of financial statements, Capital disclosures – the Group does not expect any material effect relating to the adoption of this amendment.

IFRIS 4 (effective date 1 January 2006) Determining whether an Arrangement contains a Lease - the Group does not expect any material effect relating to the adoption of this standard.

IFRIS 5 (issued 2004, effective date 1 January 2006) Rights to Interests arising from Decommissioning, Restoration and Environmental Rehabilitation Funds - this standard does not apply to the activities of the Group.

IFRIS 6 (issued 2005, effective date 1 December 2005) Liabilities Arising from Participating in a Specific Market - Waste Electrical and Electronic Equipment - this standard does not apply to the activities of the Group.

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. More information is disclosed in Note D Intangible assets and also in 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 in the Group.

Intercompany transactions and balances between the Group and Telefónica companies for the period after the transfer of the 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

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.

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.

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 is initially recorded at cost and, except for freehold land, is 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 derecognised 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 programmes are recognised as an expense as incurred. However, costs that are directly associated with identifiable and unique software products controlled by the Group and that have a probable economic benefit exceeding the cost beyond one year, are recognised as intangible assets. Computer software costs recognised as assets are amortised using the straight-line method over their useful lives, generally one to five years.

Intangible assets acquired in business combinations are stated at their acquisition costs (which are equal to their fair value at the date of acquisition) less amortisation and impairment charges and amortised on a straight-line basis over their estimated useful lives. Customer bases are amortised over a period of the remaining average terms of the binding contracts (only the postpaid customer base is recognised as a separate intangible asset).

Acquired licences are recorded at cost and amortised on a straight-line method basis over the remaining life of the licence (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 there is not expected any future economic benefits or that are disposed of for any other reason are derecognised from the balance sheet together with corresponding accumulated depreciation (for amortised assets only). All gains or losses arising in this respect are recognised in net operating income, i.e. net gain or loss is determined as the difference between net disposal proceeds, if any, and the carrying amount of the asset.

Intangible assets, with the exception of assets with indefinite useful life, are amortised using the straight-line method from the time they are available for use. Amortisation ceases at the earlier of the date the asset is derecognised, 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

Beginning 1 January 2005, in the balance sheet, the Group classifies separately 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 impairment with impact in the income statement of the relevant period.

From the moment the asset is classified as held for sale and eventually reevaluated, it ceases to be depreciated/amortized 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 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).

All assets are annually reviewed for the impairment indicators, at least at the balance sheet date.

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 2004 and 2005, 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 the express 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 and of available-for-sale investments 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 derecognised, 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. On the grounds of immateriality equity investments in associates are recorded at cost less a provision for diminution in value.

Impairment of financial assets

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

(1) Assets carried at amortized costs

If there is objective evidence that an impairment loss on loans and receivables or held to maturity investments carried at amortised cost has been incurred, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows discounted at the financial asset's original effective interest rate. The carrying amount of the asset is reduced either directly or through use of an allowance account. The amount of the loss is recognised in the income statement.

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

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

(2) Available-for-sale financial assets

If this asset is impaired, an amount comprising the difference between its acquisition cost (net of any principal repayment and amortisation) and its current fair value, less any impairment loss previously recognised in profit or loss, is transferred from equity to the income statement. 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.

Derecognition of financial assets

A financial asset is derecognised when:

- the rights to receive cash flow from the asset have expired,

- 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
- the Group has transferred its rights to receive cash flows from the assets and either has transferred substantially all the risks and rewards of the asset, or has neither transferred nor retained substantially all the risks and rewards of the asset, but has transferred control of the asset.

H Leases

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

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

Leases of property, plant and equipment where the Group has 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. 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 provision for impairment of these receivables. Such provision 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 provision 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 provision 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 Borrowings

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 Deferred income taxes

Taxation expense represents both current and deferred taxation, where appropriate. 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 provision for obsolete and slow moving inventories, non tax deductible provisions, unused tax credits and, in relation to acquisitions, on the difference between the fair values of the net assets acquired and their tax base.

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

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

N Employee benefits

(1) Pension obligations

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

(2) Redundancy and termination benefits

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

(3) Bonus plans

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

O Share-based compensation

The Company operated a cash-settled, share-based compensation plan for members of the Board of Directors and the Supervisory Board (see Note 25). The fair value of the services received in exchange for the grant of the rights is recognized as an expense. The total amount to be expensed over the vesting period was determined by reference to the fair value of the rights granted. At each balance sheet date, the Company revised its estimates of the number of rights that were expected to become exercisable. It recognized the impact of the revision of original estimates, if any, in the income statement.

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.

R 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 shall be measured reliably and it is probable that the economic benefits associated with the transaction will flow to the Group. If necessary, revenue is split into separately identifiable components.

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

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

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

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

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

If a transaction is considered to meet conditions of 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.

(i) Fixed line telephony revenues

Revenue is recognized as follows:

Domestic and international call revenues

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

Subscription revenues

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

Revenues from sales of prepaid cards

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

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

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

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

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

Both, postpaid 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
Eurotel derives roaming revenue as a result of airtime and other services used by the Eurotel's customers roaming on partners' networks in other countries and vice versa. Amounts receivable from and payable to roaming partners are netted and settled 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.

(iii) 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 on a regular basis.

(iv) Internet and data services

The Group earns revenue from providing Internet services. Revenue from such services is recognised at the time the service is provided.

(v) Dividend income

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

yRevenue is recognised as interest accrues (using the effective interest method).

S 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.

T Financial instruments

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

Financial risk management

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

The Group does not conduct any speculative trading activities.

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

(i) Foreign exchange risk

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

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

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

(ii) Interest rate risk

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

(iii) Credit risk

Concentrations of credit risk, with respect to trade accounts receivable, are limited due to the large number of customers. However, substantially all trade receivables are concentrated within the Czech Republic. Although the Group does not currently foresee higher credit risk associated with these receivables, repayment is significantly impacted by the financial stability of the national economy. Derivative counterparties and cash transactions are limited to high credit quality financial institutions. The Group has policies that limit the amount of credit exposure to any one financial institution.

(iv) Liquidity risk

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

Accounting for derivative financial instruments and hedging activities

Derivative financial instruments are initially recognised in the balance sheet at cost and subsequently are remeasured at their fair value. The method of recognising the resulting gain or loss is dependent on the nature of the item being hedged. On the date a derivative contract is entered into, the Group designates certain derivatives as either (1) a hedge of the fair value of a recognised asset or liability (fair value hedge), or (2) a hedge of a forecasted transaction or of a firm commitment (cash flow hedge).

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

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

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

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

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

The fair values of various derivative instruments used for hedging purposes are disclosed in Note 20. Movements on the hedging reserve in shareholder's equity are shown in Note 26.

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.

U 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:

(i) 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 2,360 million, advances paid for income taxes amount to CZK 2,232 million and the net deferred tax liability is CZK 5,721 million.

(ii) Goodwill

The Group assesses at each reporting date whether there is any indication that goodwill may be impaired taking into consideration both internal and external sources of information. However goodwill does not generate cash flows independently of other assets or groups of assets and the assessment of its carrying value is significantly impacted by the management's assessment of the performance and expected future performance of the operation to which the goodwill relates. From 1 January 2005 the Group implemented IFRS 3, which requires goodwill to be 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.

(iii) 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.

(iv) 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 the yearly basis.

V Reclassifications

Certain reclassifications have been made to prior period balances in order to make the presentation consistent with the current period. These reclassifications have no impact on consolidated net income or shareholders equity.

W Change in accounting policy

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

Connection fees are deferred and recognised in the income statement over the estimated average customer relationship period on the basis of degressive accounting method. For the periods starting 2005 the Group estimates the customer relationship period being 13 years (16 years as at 1 January 2004).

As at 1 January, the Company deferred revenues relating to the connection fees from periods before 2004 in the amount of CZK 2,696 million that would be recognised as revenues in following periods. In 2004, the Company recognised the total revenues relating to the connection fees in the amount of CZK 520 million.

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

In 2004 the Company previously reported the following amounts in the Income Statement:

(in CZK million)	Year ended 31 December 2004 as previously stated
Revenues	62,141
Depreciation and amortisation	(20,748)
Profit before income taxes	7,914
Taxes on income	(2,349)
Profit	5,565
Earnings per share (CZK)	17

In 2004 the Company previously reported the following amounts in the Balance Sheet:

(in CZK million)	1 January 2004 as previously stated	31 December 2004 as previously stated
Property, plant and equipment – cost	215,710	217,670
Property, plant and equipment – accumulated depreciation and impairment provision	(105,390)	(118,835)
Property, plant and equipment – net book value	**110,320**	**98,835**
Retained earnings	**(27,123)**	**(27,168)**
Deferred revenue – current	(1,681)	(908)
Deferred revenue – non current	-	-
Deferred tax liability	(7,674)	(6,567)

The Company's tax rate was 28% for 2004, and 31% for prior periods.

For detailed information see Note 2.

(ii) Premium rate lines

During 2005 the management identified certain transactions, which meet conditions of an agency arrangement. The revenue from these transactions was recognized in 2004 income statement on a gross basis. Starting from 2005 the revenue is recognised only at the amount of the commission received/realised. The management believes that the new policy is preferable, gives more relevant information about the effects on transactions and will be consistent with the telecommunication industry practice. Such policy is also in accordance with the Telefónica Group policy. As a result of retrospective application of this policy, revenues and operating expenses for the year ended 31 December 2004 were reduced by CZK 282 million.

(iii) Eurotel

In 2005 Eurotel adopted EITF 00-21 Accounting for Revenue Arrangements with Multiple Deliverables. Offered products may include deliverables such as a handset, activation and airtime and then 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. The financial impact of adoption of EITF 00-21 on the financial position of the Eurotel is described in the following table (in CZK million):

Adjustments to equity:	1 January 2004	31 December 2004
Equity	(40)	(70)

Adjustments to income statement:	For the year ended 31 December 2004
Net profit	(30)

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 CONSOLIDATED FINANCIAL STATEMENTS

Index to the notes to the consolidated financial statements

1 Segment information

The Group comprises two main business segments, as follows:

- Fixed – Network communications services using a fixed network provided by ČESKÝ TELECOM, a.s. and other consolidated subsidiaries,
- Mobile – Mobile communications services provided by Eurotel Praha, spol. s r. o.

Revenue of the Group is predominantly derived from domestic trading activities and as a result, segment reporting is only shown on the basis of business segments.

Year ended 31 December 2005 (in CZK million)	Fixed	Mobile	Group
Revenues	32,278	30,029	62,307
Inter-segment sales	(415)	(852)	(1,267)
Total consolidated revenues	31,863	29,177	61,040
Gains from sale of non-current assets	116	-	116
Work performed by the Group and capitalized	366	228	594
Costs	(17,874)	(16,642)	(34,516)
Inter-segment purchases	852	415	1,267
Total consolidated costs	(17,022)	(16,227)	(33,249)
Impairment charge	(465)	(796)	(1,261)
Depreciation	(10,705)	(4,325)	(15,030)
Amortisation	(1,837)	(941)	(2,778)
Total consolidated depreciation and amortization	(12,542)	(5,266)	(17,808)
Operating profit	**2,316**	**7,116**	**9,432**
Interest and other financial costs (net)			(684)
Profit before tax			**8,748**
Tax			(2,500)
Profit after tax			**6,248**
Minority interest			1
Net profit			**6,249**
Assets (excluding Goodwill and non-current assets held for sale)	79,150	31,381	110,531
Goodwill on purchase of additional ownership interest in Eurotel	-	13,320	13,320
Non-current assets held for sale	360	-	360
Total assets	**79,510**	**44,701**	**124,211**
Trade and other payables	(5,116)	(4,724)	(9,840)
Loans obtained to acquire additional ownership interest in Eurotel	-	-	-
Other liabilities	(16,677)	(2,719)	(19,396)
Total liabilities	**(21,793)**	**(7,443)**	**(29,236)**
Capital expenditure	2,258	3,814	6,072

Year ended 31 December 2004 (in CZK million)	**Fixed**	**Mobile**	**Group**
Revenues	33,810	29,027	62,837
Inter-segment sales	(395)	(904)	(1,299)
Total consolidated revenues	33,415	28,123	61,538
Gains from sale of non-current assets	245	-	245
Work performed by the Group and capitalized	451	214	665
Costs	(18,321)	(15,965)	(34,286)
Inter-segment purchases	904	395	1,299
Total consolidated costs	(17,417)	(15,570)	(32,987)
Impairment charge	(56)	-	(56)
Depreciation	(11,372)	(4,224)	(15,596)
Amortisation	(3,045)	(2,204)	(5,249)
Total consolidated depreciation and amortization	(14,417)	(6,428)	(20,845)
Operating profit	**2,221**	**6,339**	**8,560**
Interest and other financial costs (net)			(403)
Profit before tax			**8,157**
Tax			(2,428)
Profit after tax			**5,729**
Minority interest			3
Net profit			**5,732**
Assets (excluding Goodwill)	88,078	33,263	121,341
Goodwill on purchase of additional ownership interest in Eurotel	-	13,320	13,320
Total assets	**88,078**	**46,583**	**134,661**
Trade and other payables	(5,046)	(4,439)	(9,485)
Loans obtained to acquire additional ownership interest in Eurotel	-	(8,378)	(8,378)
Other liabilities	(25,107)	(2,986)	(28,093)
Total liabilities	**(30,153)**	**(15,803)**	**(45,956)**
Capital expenditure	2,602	3,205	5,807

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 (Český telekomunikační úřad). The rates applied in 2005 and 2004 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. The 2001 price amendment to an agreement governing interconnect arrangements with Eurotel has not yet been agreed upon (see Note 21).

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)	Year ended 31 December 2005	31 December 2004
Call and airtime revenues	18,543	21,115
Subscription and access revenues	17,042	17,154
Connection fees	783	632
SMS and MMS	2,751	2,750
Internet and Data services	5,267	3,572
Value added services	1,175	1,191
Interconnect revenues	10,230	9,180
Leased circuits	2,615	2,739
Equipment sales and sales of materials	1,937	2,041
Other revenues*	697	1,164
Total revenues	**61,040**	**61,538**

* Other revenues in 2005 include several non-recurring items including insurance settlements and universal service compensation in the total amount CZK 5 million (2004: CZK 530 million).

Revenues from related parties are disclosed in Note 28.

Connection fees
In 2005, the Company changed its accounting policy for revenue recognition of connection fees relating to the activation of the fixed line for all periods starting from 1996. This change in accounting policy has been accounted for retrospectively, and the comparative statements for 2004 have been restated. The effect of the change on 2004 is stated below. Opening retained earnings as at 1 January 2004 have been reduced by CZK 1,618 million, which is the amount of the adjustment relating to periods 1996 - 2004.

Together with above-mentioned connection fee and retroactive change in accounting policy the Group identified associated connection costs that met the definition of subsequent costs increasing the carrying amounts of property, plant and equipment and these were capitalised. Such connection costs were related to the prior periods (periods before 2004), nevertheless the retrospective capitalization resulted in the increase in carrying amount of fixed assets and associated depreciation with the following effect on 2004 figures.

Effect on 2004 financial statements

(in CZK million)	
Increase in revenues	317
Increase in depreciation and amortisation	(34)
Increase in income tax (deferred tax)	(89)
Increase in profit	**194**

Increase in property, plant and equipment (in CZK million):	
Cost	680
Accumulated depreciation	(229)
Net book amount	**451**

Increase in liabilities as at 31 December 2004 by CZK 1,875 million (CZK 2,379 million of deferred revenues less deferred tax of CZK 504 million). Decrease in retained earnings as at 31 December 2004 by CZK 1,424 million.

Effect on periods prior to 2004

(in CZK million)	
Decrease in prior profits:	
Decrease in revenue	(2,696)
Decrease in income tax (deferred tax)	680
Increase in prior profits:	
Decrease in operating expenses resulting from capitalised connection costs	680
Increase in depreciation and amortisation	(195)
Increase in income tax (deferred tax)	(87)
Decrease in profit	**(1,618)**

Increase in property, plant and equipment as at 1 January 2004:

(in CZK million)	
Cost	680
Accumulated depreciation	(195)
Net book amount	**485**

Increase in liabilities as at 1 January 2004 by CZK 2,103 million (CZK 2,696 million of deferred revenues less deferred tax of CZK 593 million).

Decrease in retained earnings as at 1 January 2004 by CZK 1,618 million.

Internal expenses capitalized in fixed assets

	Year ended	
(in CZK million)	31 December 2005	31 December 2004
Material	343	428
Labour	251	237
Total	**594**	**665**

3 Operating expenses

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

(in CZK million)	Year ended 31 December 2005	31 December 2004
Wages and salaries*	5,437	5,144
Redundancy payments	260	380
Social security contributions (Note 18)	1,830	1,784
Staff welfare costs	240	299
Total staff costs	7,767	7,607
Payments to other network operators	9,798	8,981
Equipment and material cost of sales	3,583	3,873
Commissions	849	721
Subcontractors	251	107
Material and energy consumed	1,771	2,013
Repairs and maintenance	2,598	2,809
Advertising and promotion	1,659	1,733
Operating lease payments and building expenses	1,282	1,294
Consultancy	498	686
Trade receivables – impairment charge for bad and doubtful debts	423	253
Other operating expenses**	2,770	2,910
Total operating expenses	**33,249**	**32,987**

* 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 40 million in relation to such non-competition clauses in 2005 (2004: CZK 23 million).
** Other operating expenses in 2005 include costs reflecting regulatory decisions of CZK 279 million (2004: CZK 436 million), the contingency reserve against the compensation of universal service and other non-recurring expenses in the total amount of CZK 85 million (2004: CZK 207 million).

Purchases from related parties are disclosed in Note 28.

4 Interest and other finance costs (net)

(in CZK million)	Year ended 31 December 2005	31 December 2004
Interest expense:		
Interest incurred on loans and bonds	748	1,236
Interest capitalized	-	-
Net interest expense	748	1,236
Interest income	(46)	(80)
Interest expense (net)	702	1,156
Other financial charges	218	82
Fair value losses / (gains) on financial instruments:		
Derivative financial instruments	(119)	132
Available-for-sale investments	-	7
Other investments	-	3
Other losses on financial instruments:		
Held-to-maturity investments	-	-
Net foreign exchange transaction gains	(117)	(977)
Other financial income (net)	(18)	(753)
Net finance costs	**684**	**403**

5 Tax

(in CZK million)	Year ended 31 December 2005	31 December 2004
Total income tax expense is made up of:		
Current income tax charge	2,818	3,736
Deferred income tax credit (Note 17)	(318)	(1,308)
Taxes on income	**2,500**	**2,428**

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)	Year ended 31 December 2005	31 December 2004
Profit before tax	8,748	8,157
Income tax charge calculated at the statutory rate of 26% (2004: 28%)	2,275	2,284
Income not subjected to tax	(65)	(82)
Expenses not deductible for tax purposes	410	637
Reduction of deferred taxes resulting from reduction in tax rate (Note 17)	-	(96)
Other	(112)	(251)
Investments allowances	(8)	(64)
Taxes on income	**2,500**	**2,428**
Effective tax rate	29%	30%

6 Earnings per share

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

	Year ended 31 December 2005	31 December 2004
Weighted number of ordinary shares in issue	322,089,900	322,089,900
Net profit attributable to shareholders (in CZK million)	6,249	5,732
Basic earnings per share (CZK)	19	18

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

7 Dividends

(in CZK million)	31 December 2005	31 December 2004
Dividends (including withholding tax)	-	5,476

Dividends include withholding tax on dividends paid by the Company to its shareholders. There has been no interim dividend paid in respect of 2005. Approval of the 2005 profit and the decision regarding the amount of any dividend payment for the 2005 financial year will take place at the Annual General Meeting scheduled for 20 April 2006.

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
Year ended 31 December 2005						
Opening net book amount	15,665	50,745	28,610	2,731	1,594	99,345
Additions	361	633	2,761	579	4,736	9,070
Disposals and other movements	(117)	2	(129)	(15)	(4,301)	(4,560)
Assets classified as held for sale	(358)	-	(1)	(1)	-	(360)
Depreciation charge	(750)	(4,203)	(8,785)	(1,292)	-	(15,030)
Impairment charge	(307)	(36)	(101)	(1)	(17)	(462)
Closing net book amount	**14,494**	**47,141**	**22,355**	**2,001**	**2,012**	**88,003**
At 31 December 2005						
Cost	22,204	99,201	90,879	10,757	2,022	225,063
Accumulated depreciation and impairment provision	(7,710)	(52,060)	(68,524)	(8,756)	(10)	(137,060)
Net book amount	**14,494**	**47,141**	**22,355**	**2,001**	**2,012**	**88,003**
Year ended 31 December 2004						
Opening net book amount	16,143	53,900	34,446	3,736	2,592	110,817
Additions	564	1,042	3,367	806	4,725	10,504
Disposals and other movements	(164)	(4)	(249)	(206)	(5,701)	(6,324)
Depreciation charge	(844)	(4,193)	(8,954)	(1,605)	-	(15,596)
Impairment charge	(34)	-	-	-	(22)	(56)
Closing net book amount	**15,665**	**50,745**	**28,610**	**2,731**	**1,594**	**99,345**
At 31 December 2004						
Cost	22,826	98,670	90,126	11,151	1,616	224,389
Accumulated depreciation and impairment provision	(7,161)	(47,925)	(61,516)	(8,420)	(22)	(125,044)
Net book amount	**15,665**	**50,745**	**28,610**	**2,731**	**1,594**	**99,345**

Land and buildings, plant and equipment with a carrying value of CZK 1,220 million (2004: CZK 2,648 million) were pledged as collateral for CZK 5,300 million of provided borrowings. The borrowings were fully paid off in 2005, but the cancellation of the pledge is still in process (see Note 16).

No borrowing costs were capitalized during the years 2005 and 2004.

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

	Year ended	
(in CZK million)	31 December 2005	31 December 2004
Land and buildings	358	-
Communication exchanges and related equipment	1	-
Other non-current assets	1	-
Total	**360**	-

Assets intended for sale in most cases represent administration buildings with land that became vacant due to the optimization of the Group's processes and which the Group will not use in the future and it is expected their sale will take place within one year. In 2005, no intended sale of assets was withdrawn (i.e. all reported assets classified as intended for sale have been and still are intended for sale).

In 2005, the Group achieved a total gain from the sale of the above assets amounting to CZK 58 million. The total net sales were CZK 131 million and the carrying amount was CZK 73 million.

As at 31 December 2005, the total recognised loss from the impairment / decrease in value of assets classified as held for sale was CZK 104 million out of which CZK 97 million related to assets still held for sale at the balance sheet date. With regard to assets for which a loss from decrease in value was recognised, cancellation/reverse of the impairment of loss from decrease in value was not occurred.

Cost of fully depreciated property, plant and equipment was CZK 35,091 million as at 31 December 2005.

The impairment charge recorded in 2005 represents mainly correction of value of special constructions, which were idle.

9 Intangible assets

(in CZK million)	Goodwill	Licences	Software	Other	Total
Year ended 31 December 2005					
Opening net book amount	13,320	5,668	4,318	1,702	25,008
Additions	-	-	1,416	-	1,416
Disposals and other movements	-	-	(1)	-	(1)
Amortisation charge	-	(174)	(2,315)	(289)	(2,778)
Impairment charge	-	-	(13)	(786)	(799)
Closing net book amount	**13,320**	**5,494**	**3,405**	**627**	**22,846**
At 31 December 2005					
Cost	13,320	6,073	21,225	2,829	43,447
Accumulated amortisation and impairment provision	-	(579)	(17,820)	(2,202)	(20,601)
Net book amount	**13,320**	**5,494**	**3,405**	**627**	**22,846**
At 1 January 2005					
Cost as previously stated	14,179				
Elimination of accumulated amortisation as at 1 January 2005	(859)				
Accumulated amortisation as previously stated	(859)				
Elimination of accumulated amortisation	859				
Net carrying amount	**13,320**				
Year ended 31 December 2004					
Opening net book amount	14,028	5,820	6,595	2,739	29,182
Additions	-	-	1,074	-	1,074
Disposals and other movements	-	-	1	-	1
Amortisation charge	(708)	(152)	(3,352)	(1,037)	(5,249)
Impairment charge	-	-	-	-	-
Closing net book amount	**13,320**	**5,668**	**4,318**	**1,702**	**25,008**
At 31 December 2004					
Cost	14,179	6,073	20,232	2,829	43,313
Accumulated amortisation and impairment provision	(859)	(405)	(15,914)	(1,127)	(18,305)
Net book amount	**13,320**	**5,668**	**4,318**	**1,702**	**25,008**

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

Acquired licences are represented by rights to operate the UMTS, GSM and NMT cellular networks. The original 450 MHz and GSM operating licenses were granted for a period of twenty years from the signing of the agreement for the original 450 MHz license in 1991 and from the granting of the GSM license in 1996 for use of the 900 spectrum. In 1999, 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 eleven years. Carrying value of GSM 900 license is as at 31 December 2005 CZK 215 million (2004: CZK 235 million) and carrying value of GSM 1800 license is CZK 184 million (2004: CZK 201 million). In 2002, Eurotel renewed its 450 MHz license; the current license enables Eurotel to offer any internationally recognized public mobile telecommunication services on frequency of 450 MHz. Eurotel currently provides on this frequency voice services under NMT standard and broadband Internet access services using CDMA technology. The license is currently valid for the remaining period of six years. Carrying value of NMT 450 license is CZK 162 million (2004: CZK 195 million). In December 2001, Eurotel acquired the UMTS license, which has been granted for a period of twenty years. Under the license, Eurotel was provided with deferred payment terms by the Czech Telecommunication Office (CTU) to finance the license acquisition. In December 2003, 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, Eurotel agreed to pay the UMTS obligation in full during 2004 in exchange for a forgiveness of 2003 and 2004 interest on the deferred payments provided as part of the UMTS license agreement. Carrying value of UMTS license is CZK 3,671 million (2004: CZK 3,690 million). UMTS license was put into commercial use on December 1, 2005 when it also started to be amortized.

No borrowing costs were capitalized during the years 2005 and 2004.

Cost of fully depreciated intangible assets was CZK 11,496 million as at 31 December 2005.

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

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

10 Impairment of fixed assets

Intangible assets

Brand names acquired through business combination in 2003 with Eurotel

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

As at 30 June 2005 the carrying amount of brand names before the impairment charge was CZK 1,567 million (CZK 1,567 million as at 31 December 2004).

Fixed assets of ČESKÝ TELECOM, a.s.

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 (CGU).

As at 31 December 2005 and 2004 the management of the Company reviewed the existence of indicators (both external and internal), which would indicate that the impairment provision made in 2003 is no longer relevant and should be reversed. The management did not identify any of these indicators being fulfilled and, accordingly, the impairment provision was not reversed as at 31 December 2005 and 2004.

11 Inventories

(in CZK million)	31 December 2005	31 December 2004
Construction material	35	57
Cables	159	181
Other inventory including goods for resale	522	475
	716	**713**

The inventories noted above are stated net of a provision of CZK 187 million (2004: CZK 207 million), reducing the value of the inventories to their net realisable value. The total carrying amount of inventories carried at fair value less costs to sell amounts to CZK 227 million (2004: CZK 144 million). The amount of inventories recognised as an expense is CZK 4,195 million (2004: CZK 4,317 million).

12 Receivables and prepayments

(in CZK million)	31 December 2005	31 December 2004
Domestic trade receivables (net)	6,238	6,153
Foreign currency trade receivables (net)	620	648
Other debtors (net)	449	722
Prepayments	706	761
VAT receivable	-	2
	8,013	**8,286**

Trade receivables are stated net of a provision for impaired receivables of CZK 3,218 million (2004: CZK 3,164 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 28.

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 2005 and 2004 the Group has the following non-current balances, which are classified as other financial assets:

(in CZK million)	31 December 2005	31 December 2004
Long-term credits	185	126
Advance payments for long-term expenses	227	240
	412	**366**

Long-term trade credits include interest bearing credit (interest 5.9%) amounting to CZK 83 million (2004: CZK 88 million).

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

Available-for-sale investments

(in CZK million)	2005	2004
At beginning of year	176	433
Revaluation deficit	(1)	(7)
Additions	4	13
Disposals	(121)	(263)
At end of year	**58**	**176**
Non-current	58	59
Current	-	117
	58	**176**

Held-to-maturity investments

(in CZK million)	2005	2004
At beginning of year	109	133
Exchange differences	(2)	-
Revaluation deficit	-	-
Additions	1	5
Matured	(79)	(29)
At end of year	**29**	**109**
Non-current	29	31
Current	-	78
	29	**109**

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.

14 Cash and cash equivalents

(in CZK million)	31 December 2005	31 December 2004
Cash balances	322	242
Short-term bank deposits and cash equivalents	3,317	238
Cash and cash equivalents	**3,639**	**480**

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

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

(in CZK million)	31 December 2005	31 December 2004
Cash and cash equivalents	3 639	480
Bank overdrafts and other short-term borrowings (Note 16)	(101)	-
Balance at the end of period	**3 538**	**480**

15 Trade and other payables

(in CZK million)	31 December 2005	31 December 2004
Trade creditors in local currency (net)	4,524	3,728
Trade creditors in foreign currencies (net)	766	727
Other taxes and social security	205	226
Deferred revenue	1,585	1,626
Employee wages and benefits	397	452
VAT payable	308	368
Accrued expenses	194	340
Other creditors	60	78
Other liabilities	1,788	1,773
Derivative instruments (Note 20)	13	167
	9,840	**9,485**

Payables to related parties are disclosed in Note 28.

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 Borrowings

(in CZK million)	31 December 2005	31 December 2004
Bank loans and overdrafts in local currency (a)	101	2,100
International financial institution loans in foreign currencies (b)	-	1,110
Bank loans and overdrafts in foreign currencies (a)	3,337	12,272
Bonds in local currency (c)	5,987	9,988
	9,425	**25,470**
Repayable:		
Within one year	101	8,671
Between one and two years	-	2,565
Between two and five years	5,987	10,340
After five years	3,337	3,894
Total non-current	9,324	16,799
	9,425	**25,470**

(a) Bank loans and overdrafts include overdrafts of CZK 101 million denominated in the local currency (2004: CZK 0 million) and CZK 0 million in foreign currencies (2004: CZK 0 million).

Short-term borrowings as at 31 December 2004 consist of loans drawn under bilateral short-term facilities.

In November 2003, the Company raised a syndicated credit facility in the total amount of EUR 850 million equivalent, with a final maturity day on 21 November 2008. The purpose of the loan was to finance the acquisition of the remaining 49% ownership interest in Eurotel and general corporate purposes of the Group. As at 31 December 2005 the outstanding amount of the loans under the credit facility was EUR 0 million (2004: EUR 275 million) and CZK 0 million (2004: CZK 0 million). The terms and conditions of the credit facility agreement, inter alia, require the Group to maintain certain gearing and interest cover ratios of earnings before interest, tax, depreciation and amortisation to net borrowings and interest payable.

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

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

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

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

At 31 December 2005, the Group had approximately CZK 10,224 million of available undrawn credit facilities (2004: CZK 9,386 million).

Loans with a maturity within one year and denominated in a foreign currency have a total value of EUR 0 million (2004: EUR 84 million).

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

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

(in CZK million)	31 December 2005	31 December 2004
At fixed rate	9,324	25,470
At floating rate	101	-
Total	**9,425**	**25,470**

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

31 December 2005 (in CZK million)	Carrying amounts	Fair values
Bank loans	3,438	4,086
Bonds	5,987	6,154
Total	**9,425**	**10,240**

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

Effective interest rates	31 December 2005	31 December 2004
Bank loans and overdrafts in local currency	2.51%	2.79%
International financial institution loans in foreign currencies	n/a	6.80%
Bank loans and overdrafts in foreign currencies	6.64%	3.88%
Bonds in local currency	3.50%	3.92%

The Group meets the criteria for debt covenants required by the creditors. International financial institution loans in foreign currencies have been secured by the Czech Republic (represented by the Ministry of Finance of the Czech Republic) and as a result, certain movables and real estates have been pledged for the benefit of the Czech Republic (see Note 8).

Other loans are not secured. The carrying value of assets pledged is as follows:

(in CZK million)	31 December 2005	31 December 2004
Land and buildings	7	687
Plant and equipment	1,213	1,961
Total	**1,220**	**2,648**

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

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 24% (26% in 2004), long term deferred taxes were calculated at 24% (24% in 2004).

(in CZK million)	2005	2004
At 1 January	6,041	7,069
Income statement credit (Note 5)	(318)	(1,308)
Tax on fair value gains	(2)	(2)
Other movements*	-	282
At the end of period	**5,721**	**6,041**

* 2004 disclosure represents other impacts due to differences between actual and booked estimate of current income tax payable in 2003.

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 2005	31 December 2004
Deferred tax assets	(1,493)	(2,197)
Deferred tax liabilities	7,214	8,238
Total	**5,721**	**6,041**

The deferred tax asset includes CZK 462 million (2004: CZK 504 million) recoverable in less than twelve months and CZK 1,031 million (2004: CZK 1,693 million) recoverable after more than twelve months. The deferred tax liability includes CZK 915 million (2004: CZK 736 million) payable in less than twelve months and CZK 6,299 million (2004: CZK 7,502 million) payable in more than twelve months.

The deferred tax is determined by these components:

	Consolidated balance sheet		Consolidated income statement	
(in CZK million)	2005	2004	2005	2004
Amount relating to the origination and reversal of temporary differences from:				
property, plant and equipment and intangible assets	7,004	7,594	(599)	(844)
trade receivables, inventories and other differences	(1,280)	(1,551)	281	(365)
Revaluations of cash flow hedges	(3)	(2)	-	-
Revaluations of available for sale investment to the fair value	-	-	-	(3)
Amount relating to unrecognised tax loss	-	-	-	-
Amount relating to changes in tax rates	-	-	-	(96)
Total	**5,721**	**6,041**	**(318)**	**(1,308)**

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

(in CZK million)	31 December 2005	31 December 2004
Revaluation of cash flow hedges	(2)	(2)
Unrealised gain on available for sale investments	-	-
Total	**(2)**	**(2)**

The deferred tax amounts shown in the balance sheet relate to temporary differences arising from the tax bases and carrying amounts of assets and liabilities as follows:

(in CZK million)	31 December 2005	31 December 2004
Property, plant and equipment and intangible assets	7,004	7,594
Trade receivables, inventories and other items	(1,283)	(1,553)
Total	**5,721**	**6,041**

18 Government social security and pension schemes

The Group is legally required to make contributions to government health, retirement benefit and unemployment schemes. During 2005 and 2004, 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 1,830 million in 2005 (2004: CZK 1,784 million). Employees contribute 12.5% (2004: 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 65 million (2004: CZK 81 million). These contributions were charged as an operating expense.

In accordance with an annually renegotiated collective labour agreement, the Company is required to pay CZK 25,000 or CZK 90,000 on retirement depending on the length of the employee's service, who have completed not less than five years continuous service. These benefits are restricted to those employees who retire during the period for which the labour agreement is in place. The Company is not under any legal or constructive obligation to continue providing such benefits beyond the period of such agreement and therefore, no provisions beyond the period of the agreement are recognised in the financial statements. Payments made during the year 2005 relating to employee retirement amounted to CZK 0.1 million (2004: CZK 0.1 million) and were charged as an operating expense.

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

19 Provisions for liabilities and charges

Short-term Provisions

(in CZK million)	Regulatory and court decisions	Employee redundancy costs	Employee-related costs	Share-based compensation	VAT assessments	Benefit loyalty provision	Other	Total
At 1 January 2004	-	109	-	-	185	497	39	830
Additions during the year	-	-	186	60	-	392	277	915
Utilised during the year	-	(109)	-	-	(185)	(400)	(185)	(879)
At 31 December 2004	-	-	**186**	**60**	-	**489**	**131**	**866**
Additions during the year	20	10	331	190	-	441	203	1,195
Reclassification	-	-	-	-	-	-	7	7
Utilised during the year	-	-	(398)	(250)	-	(474)	(323)	(1,445)
At 31 December 2005	**20**	**10**	**119**	-	-	**456**	**18**	**623**

Long-term Provisions

(in CZK million)	Regulatory and court decisions	Other	Total
At 1 January 2004	935	-	935
Additions during the year	674	-	674
Utilised during the year	(43)	-	(43)
At 31 December 2004	**1,566**	-	**1,566**
Additions during the year	576	4	580
Reclassification	-	12	12
Utilised during the year	(44)	(3)	(47)
At 31 December 2005	**2,098**	**13**	**2,111**

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

Benefit loyalty provision

Benefit loyalty provision covers the cost of equipment, accessories, gifts and services provided to participants in the Eurotel'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 242 million within one year and CZK 214 million from one year up to three years.

The amount of a provision is the present value of the expenditures expected to be required to settle the obligation (CZK 473 million).

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

VAT assessment
In January 2002, value added tax assessments were received in the amount of CZK 158 million that were paid in November 2003. Eurotel was required to pay interest and penalties of CZK 185 million on the assessed VAT that were accumulated during periods prior to the payment in November 2003. In 2003, a provision for interest and penalties of CZK 185 million was created in the consolidated financial statements. During the year 2004 the provision was released as CZK 134 million was waived by the Ministry of finance and CZK 51 million was paid by Eurotel.

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

20 Financial instruments

Net fair values of derivative financial instruments

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

Contracts with positive fair value

(in CZK million)	31 December 2005	31 December 2004
Total	-	-

Contracts with negative fair value

(in CZK million)	31 December 2005	31 December 2004
Instruments not qualifying as hedges:		
Interest rate swaps	2	-
Forward foreign exchange contracts	-	4
Cash flow hedges:		
Interest rate swaps	-	11
Forward rate agreements	-	-
Forward foreign exchange contracts	11	27
Fair value hedges:		
Structures involving currency options	-	8
Forward foreign exchange contracts	-	117
Total (Note 15)	**13**	**167**

21 Contingencies

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

Interconnect arrangements

The Company has not yet agreed a 2001 price amendment to an agreement with 2 mobile operators in the Czech Republic (T-Mobile Czech Republic a.s. and Eurotel Praha, spol. s r. o.) governing interconnect arrangements. Whilst in December 2003 the Czech Telecommunication Office (CTU) effectively ruled in favour of the amounts claimed by the mobile operators (i.e. CZK 899 million for T-Mobile Czech Republic a.s. and CZK 1,154 million for Eurotel Praha, spol. s r.o., the outstanding amount is bearing interest of 0.05% per day), the management believes that the amounts are not substantiated and are without merit. The Company subsequently obtained adjournment of the decision execution and lodged an appeal. However, based on the legal environment in the Czech Republic, management estimated maximum probable outflow related to this dispute and such outflow is fully provided in the financial statements. The management is confident that all risks, which may arise as a result of these litigations, are adequately provided for in the financial statements. No further disclosure is deemed appropriate as it could prejudice the Company's position in the dispute.

On 30 June 2005, Oskar Mobil a.s. filed a petition with the Metropolitan Court in Prague against the Company for damages in the amount of CZK 538 million with appurtenances and for returning the unjustified enrichment of CZK 117 million with appurtenances. The Company is alleged to have failed to transmit the traffic to networks operated by other mobile operators according to respective interconnection agreements. The petition was only unofficially delivered from Oskar Mobile a.s. and was not served by the court. The management believes that the claim is without merit and as a result, no provision has been made in the financial statements for this matter.

Office for the Protection of Economic Competition proceedings

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

The Company is a subject to administrative proceeding by the Office for the Protection of Economic Competition (UOHS) relating to alleged abuse of dominant position on the market of wholesale and retails broadband. UOHS rendered resolution dated 3 December 2004 imposing a fine to the Company in the total amount of CZK 90 million. The Company lodged an appeal in December 2004 and obtained adjournment of the decision execution. The matter is fully provided in the financial statements.

The Company is subject to administrative proceeding by the Office for the protection of Economic Competition (UOHS) related to alleged abuse of dominant position consisting in the alleged discrimination against competitors on the market of leased circuits. The proceedings were dismissed unresolved on 1 October 2004. This decision was appealed by other participants and hence the proceeding is still pending. Maximum penalty UOHS could impose is limited by 10% of turnover for the year preceding UOHS resolution. The management of the Company is confident that the risk of adverse decision of UOHS in this case is not probable and, accordingly, no provision is made for this matter in the financial statements.

Other legal matters

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 anti competition law by the Company in connection with offering pricing plans since January 2002. The amount of the claim is CZK 2,142 million with appurtenances. No hearing has been ordered in the matter yet. The Company provided to the court extensive defense along with proposed items of evidence proving the legal perfectness 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 affect on net income exceeding the amount of provision already made in the financial statements. No further disclosure is deemed appropriate as it could prejudice the Company's position in the dispute.

The Company is prosecuted by AUGUSTUS spol. s r.o. for an alleged loss of profit in the principal amount of approximately CZK 183 million with appurtenances (totaling approximately additional CZK 257 million as of the end of 2005) 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. The management believes that all risks, which may arise as a result of this litigation, are adequately provided for in the financial statements. No further disclosure is deemed appropriate as it could prejudice the Company's position in the dispute.

The Company is a defendant in a case filed by administrator in bankruptcy of a company Microna Týn a.s. claiming payment orders in the total amount of CZK 99 million with appurtenances (total claim as at 31 December 2005 amounts to CZK 129 million) due to inclusion of a building leased by the Company in the leaser's bankrupt's estate. The Company provided the court with detailed analysis of legal facts and as the management believes that the claim is not substantiated, no provision was created in the financial statements for this matter.

The Company is a defendant in several other significant legal cases claiming from the Company in total amount of CZK 118.3 million plus appurtenances. The management believes that the risk of loosing these cases is less than probable and no provision was made in the financial statements.

Eurotel is a defendant in a case filed by Oskar Mobil, a.s. in May 2004 asserting causes for alleged breach of the antitrust law by Eurotel. No hearing has been ordered until now. Based on the currently available information, the management does not believe the resolution of this legal proceeding will have a material adverse effect on net income.

22 Commitments

Operating leases

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

(in CZK million)	31 December 2005	31 December 2004
No later than 1 year	991	1,093
Later than 1 year and not later than 5 years	1,827	1,995
Later than 5 years	1,383	1,644
Total	**4,201**	**4,732**

The total lease payments relating to operating leasing of property, plant and equipment recognised as an expense in 2005 were CZK 1,123 million (2004: CZK 1,132 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 consolidated results of operations, financial position, or cash flow and therefore are not accounted.

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 2005 were CZK 229 million (2004: CZK 353 million).

Capital commitments

(in CZK million)	31 December 2005	31 December 2004
Capital expenditure contracted but not provided for in the financial statements	1,541	1,948

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

23 Service concession arrangements

The Group operates telecommunication services in accordance with licences that were granted for the provision of telecommunication services:

The Company:

During 2005, several changes took place in the regulated environment of electronic communications in the Czech Republic. Out of these, the most significant was the replacement of Act No. 151/2000 Coll., on telecommunications and on changes of other acts, in the valid wording (further Act on telecommunications) by Act No. 127/2005 Coll., on electronic communications and on amendments of some of the relating acts, in the valid wording (further Act on electronic communications) effective from 1 May 2005 and the enforcement of other relating regulations (government regulations, notices, public provisions).

Until 12 August 2005, the Company carried its business activities based on a telecommunication licence for the setting up and running of a public telecommunication network and a telecommunication licence for the provision of public telephone services through a public fixed telecommunication network which among others regulates the provision of a universal service. Under the Act on electronic communications, as of 1 September 2005, the validity of all telecommunication licences and approvals according to general licences terminated.

From 12 August 2005, the Company performs communication activities under the Act on electronic communications based on a notification to and a certificate from the Czech Telecommunication Office. In accordance with Section 13 of the Act on electronic communications, on 12 of August 2005, the Company delivered a notification to the Czech Telecommunication Office on the performance of a communication activity, which is under Section 8 of this Act a business activity in electronic communications. Relating documentation required by the Act on electronic communications was provided on 29 September 2005. Subsequently, on 11 October 2005, the Czech Telecommunication Office issued a certificate confirming that a notification on the performance of a communication activity was received.

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

- Public fixed network of electronic communications,
- Public network for the transfer of radio and TV signal,
- Public fixed telephone network,
- Publicly accessible telephone services,
- Other voice services,
- Rent of circuits,
- Transmission of radio and TV signal,
- Transfers of data,
- Internet access services.

In accordance with the deadline given by the Act on electronic communications, the Czech Telecommunication Office should determine the scope and new detail conditions for the provision of each particular service within the universal service including the selection of one or several providers by the end of January 2006. On 21 December 2005, the Czech Telecommunication Office issued, based on the results of a tender, a decision according to which the Company was determined as the provider of the following particular services:

- Periodic issuance of telephone directories with numbers of participants of the publicly accessible telephone service and access of end users to these directories in accordance with Section 38, Para 2, letter c) of the Act on electronic communications;
- Information service on the numbers of participants of the publicly accessible telephone service in accordance with Section 38, Para 2, letter d) of the Act on electronic communications.

Until new particular services within the universal service are released under the Act on electronic communications, the Company remains the provider of a universal service in accordance with the conditions of the previous regulation framework given by the Act on telecommunications, relating regulations and telecommunications licences.

Eurotel:

Eurotel provides mobile telecommunication services in the 900 and 1800 MHz frequency bands under the Global System for Mobile Communication (GSM) and in the 450 MHz frequency band under the Nordic Mobile Telephone (NMT) standard (collectively, mobile services). Eurotel also provides broadband mobile access to Internet using CDMA2000 1*EV-DO (Code-Division Multiple Access Evolution Data Optimized CDMA) technology in the 450 MHz frequency band. Eurotel operates services based on Universal Mobile Telecommunications System (UMTS) standard since December 1, 2005. Mobile license 450 MHz, mobile license GSM and UMTS have remaining life 6, 11 and 16 years, respectively. UMTS licence was put in use as of December 1, 2005. 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 Eurotel can benefit from the use of these licenses in the future.

The original 450 MHz and GSM operating licenses were granted for a period of twenty years from the signing of the agreement for the original 450 MHz license in 1991 and from the granting of the GSM license in 1996 for use of the 900 spectrum. In 1999, 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 eleven years. In 2002, Eurotel renewed its 450 MHz license; the current license enables Eurotel to offer any internationally recognized public mobile telecommunication services on a frequency of 450 MHz. Eurotel currently provides on this frequency voice services under NMT standard and broadband Internet access services using CDMA technology. The license is currently valid for the remaining period of six years.

In December 2001, Eurotel acquired the UMTS license, which has been granted for a period of twenty years. Under the license, Eurotel was provided with deferred payment terms by the Czech Telecommunication Office (CTU) to finance the license acquisition. In December 2003, 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, Eurotel agreed to pay the UMTS obligation in full during 2004 in exchange for a forgiveness of 2003 and 2004 interest on the deferred payments provided as part of the UMTS license agreement.

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

24 Share capital and reserves

	31 December 2005	31 December 2004
Nominal value per ordinary share (CZK)	100	100
Number of shares	322,089,890	322,089,890
Nominal value per share with special rights (CZK)*	1,000	1,000
Number of shares*	1	1
Ordinary shares (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 the Company's 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). Since than the share has not borne special decision-making rights.

At 31 December 2004, shareholdings in the Company were as follows:	
The National Property Fund of the Czech Republic	51.1%
Other shareholders	48.9%

At 31 December 2005, shareholdings in the Company were as follows:	
Telefónica, S.A.	69.4%
Other shareholders	30.6%

Funds include a statutory reserve fund of CZK 6,025 million (2004: CZK 5,620 million) that is not distributable under ruling legislation.

25 Share-based payments

On 24 June 2004 the Group granted 2,207,000 share appreciation rights (SARs) to selected members of the Board of Directors and the Supervisory Board in accordance with the Compensation Plan approved by the annual general meeting of shareholders. An extraordinary general meeting of the shareholders of ČESKÝ TELECOM, a.s., which took place on 3 February 2005, approved changes to the rules governing remuneration for members of the Supervisory Board of ČESKÝ TELECOM, a.s., whereby it cancelled the compensation plan for the members of this corporate body of the Company. An adjustment for this was included in the financial statements for 2005. In addition after the take-over and transfer of the majority ownership to the new shareholder, Telefónica, S.A., all outstanding SARs were exercised and settled/paid in cash in accordance with the prior Compensation Plan. The financial effect is stated as follows:

Employee benefit expenses (wages and salaries) (in CZK million)	2005	2004
SARs granted to the Board of Directors and Supervisory Board	190	60
Closing balance of provision for share-based compensation	-	60

Further details of the SARs relating to the exercise are as follows:

	2005		2004	
	Number of SARs	Exercise price	Number of SARs	Exercise price
Outstanding at start of year	2,207,000	n/a	-	-
Granted	-	-	2,207,000	n/a
Cancelled (Supervisory Board)	857,000	-	-	-
Exercised – date of expiration 31 March	1,350,000	-	-	-
(rights granted 24 June 2004)	131,250	119.88	-	-
(rights granted 27 October 2004)	37,500	54	-	-
Subtotal – date of cessation of NPF ownership	168,750	n/a	-	n/a
(rights granted 24 June 2004)	918,750	210.08	-	-
(rights granted 27 October 2004)	262,500	151.61	-	-
Subtotal	1,181,250			
Outstanding at end of year	-		2,207,000	

The Group has neither prepared nor granted any other share based payments during the period ended 31 December 2005.

The conditions, numbers, terms and estimated fair and intrinsic value of vesting and exercise were as follows:

The SARs provided those eligible, at the date the rights are exercised, the right to receive cash payments calculated based on a formula reflecting any appreciation in the Company's share price (preceding six-month average) from the inception date of the plan. The inception date for the determination of the option base price was 31 December 2003 (preceding six months average). The SARs were conditional on the board member remaining in the employment of the Company throughout the vesting period. The SARs vest and were exercisable during 2005 and 2006 unless there was a decrease or cessation of the NPF ownership of shares in the Company or a board member's employment with the Company was terminated for reasons other than personal decision or breach of duty. In these events the SARs were exercisable immediately. The SARs were settled once exercised.

Condition and numbers

Type of arrangement	Share appreciation rights (SARs)
Date of grant (approval of the Compensation Plan by general meeting)	24 June 2004
Number granted	2,207,000
	(300,000 SARs were granted on 27 October 2004)
Exercise price	n/a
Option base price at the base date	CZK 270.50 (base date 31 December 2003)
	CZK 337.70 (base date 27 October 2004)
Contractual life	between 9 and 30 months
Vesting conditions	being member of the Board of Directors / Supervisory Board over the contractual life
Settlement	Cash
Expected volatility*	29.3%
Expected risk-free interest rate**	2.6 – 3.2%
Expected departures – forfeitures	0.0%
Expected dividend (dividend yield)***	0.0%
Valuation method	Monte Carlo
Valuation model	Black-Scholes

* The expected volatility for the SARs is based on historical volatility determined from daily share price movements over past year.
** Expected daily risk-free rates are assumed to be constant and equal to daily forward rates calculated from zero-coupon CZK yield curve.
*** Measurement of the SARs fair value considers net dividends paid in 2004.

Numbers, terms, fair and intrinsic value as at 31 December 2004
The granted SARs used to be exercisable in eight fixed terms during the year 2005, 2006 at eight equal portions of granted rights or immediately by cessation of NPF ownership.

Date of expiration	31 March 2005	30 June 2005	31 October 2005	31 December 2005
Number of rights granted (24 June 2004)	238,375	238,375	238,375	238,375
Fair value (CZK)	83.62	97.99	101.98	104.63
Number of rights granted (27 October 2004)	37,500	37,500	37,500	37,500
Fair value (CZK)	17.8	36.95	49.16	54.28

Date of expiration	31 March 2006	30 June 2006	31 October 2006	31 December 2006
Number of rights granted (24 June 2004)	238,375	238,375	238,375	238,375
Fair value (CZK)	109.13	113.18	118.18	120.20
Number of rights granted (27 October 2004)	37,500	37,500	37,500	37,500
Fair value (CZK)	61.23	67.15	74.23	77.27

The intrinsic value of rights granted on 24 June 2004 was CZK 76.62 for each right and CZK 9.41 for rights granted on 27 October 2004.

26 Hedging reserve

(in CZK million)	
Balance at 1 January 2004	**(2)**
Fair value losses in period	(50)
Fair value losses transfer to net profit	2
Deferred tax on fair value losses	3
Balance at 31 December 2004	**(47)**
Fair value losses in period	(36)
Fair value losses transfer to net profit	72
Deferred tax on fair value losses	-
Balance at 31 December 2005	**(11)**

27 Cash generated from operating activities

	Year ended	
(in CZK million)	31 December 2005	31 December 2004
Net profit	6,248	5,729
Adjustments for:		
Tax (Note 5)	2,500	2,428
Depreciation (Note 8)	15,030	15,596
Amortisation (Note 9)	2,778	5,249
Impairment loss (Note 8, 9, 10)	1,261	56
Disposals of obsolete assets	76	197
Profit on sale of property, plant and equipment	(111)	(245)
Net interest and other charges	702	1,156
Foreign exchange (gains)/losses (net)	(347)	(1,183)
Fair value changes	(119)	134
Increase in provisions	73	528
Operating cash flow before working capital changes	28,091	29,645
Decrease/(increase) in trade and other receivables	(555)	307
Decrease/(increase) in inventories	(211)	12
(Decrease)/increase in trade and other payables	435	(1,151)
Cash generated from operations	**27,760**	**28,813**

28 Related party transactions

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

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

The Group provides services to all related parties on normal commercial terms. Sales and purchase transactions with related parties are based on contractual agreements negotiated on normal commercial terms and conditions and at market prices. Outstanding balances of assets and liabilities are unsecured, interest free (excl. financial assets used for financing) and the settlement occurs either in cash or by offstetting. 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:

There were no transactions with the parent companies in 2005 and 2004.

II. Other related parties – Telefónica Group:

(all tabular amounts in CZK million)

Sales of services	Year ended	
and goods	31 December 2005	31 December 2004
Telefonica companies	61	-

Purchases of services	Year ended	
and goods	31 December 2005	31 December 2004
Telefónica companies	32	-

Receivables	31 December 2005	31 December 2004
Telefónica companies	39	-

Payables	31 December 2005	31 December 2004
Telefónica companies	8	-

The list of the Telefónica companies with which the Group had any transaction in 2005 includes the following entities: Data España, S.A.U., Telefónica de España, S.A.U., Telefónica Deutschland GMBH, PT COMUNICACOES, S.A., and Infonet Services Corporation, Inc.

III. Other related parties – State entities controlled by NPF*:

(all tabular amounts in CZK million)

Sales of services and goods	Year ended 31 December 2005	Year ended 31 December 2004
State controlled entities	56	157

Purchases of services and goods	Year ended 31 December 2005	Year ended 31 December 2004
State controlled entities	116	251

Receivables	31 December 2005	31 December 2004
State controlled entities	2	23

Payables	31 December 2005	31 December 2004
State controlled entities	75	65

* NPF did not hold any shares in the Company after 16 June 2005, and accordingly the respective related party sales and purchases have been prepared for period from 1 January 2004 to 16 June 2005. The state controlled entities include all companies that are owned by the State through NPF Czech Republic. Entities controlled by NPF consist of number of commercial (joint stock or limited liability) companies operating across different industries, and they do not include the government or governmental bodies. Accordingly, transactions with ministries and other state agencies are not treated as related party transactions.

IV. Other related parties

a) Key management compensation

Members of the Board of Directors and of the Supervisory Board of the Company were provided with benefits as follows:

(in CZK million)	Year ended 31 December 2005	Year ended 31 December 2004
Salaries and other short-term benefits	254	143
Board share on profit	-	-
Stock appreciation rights (Note 25)	190	60
Non-competition clause	6	2
Termination benefits	58	-
Capital life insurance	16	9
Personal indemnification insurance	16	15
Total	**540**	**229**

b) Loans to related parties

Loans to members of Board of Directors and Supervisory Board:

(in CZK million)	2005	2004
Beginning of the year	-	1
Loans advanced during the year	-	-
Loans repayments received	-	(1)
Interest charged	-	-
Interest received	-	-
End of the year	**-**	**-**

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

29 Principal subsidiary undertakings

	Name	Group's interest	Country of incorporation	Activity
1.	Eurotel Praha, spol. s r.o.	100%	Czech Republic	Mobile telephony and internet services
2.	OMNICOM Praha, spol. s r.o.	100%	Czech Republic	Network and consultancy services in telecommunications
3.	SPT TELECOM (Czech Republic) Finance B.V.	100%	Netherlands	Financing other entities in the Group
4.	CZECH TELECOM Germany GmbH	100%	Germany	Data transmission services
5.	CZECH TELECOM Austria GmbH	100%	Austria	Data transmission services
6.	CZECH TELECOM Slovakia, s.r.o.	100%	Slovakia	Data transmission services
7.	CenTrade, a.s.	100%	Czech Republic	E-business company providing market place services

On 20 December 2001 Eurotel acquired a 100% ownership interest in a Hungarian registered limited liability company, Trigo Global Services Ltd. (Trigo) for CZK 1 million. The subsidiary was engaged in the contracting of labour services to Eurotel for periods prior to January 2004. In September 2004, Trigo commenced the process of voluntary liquidation. On April 8, 2005 the process of liquidation was finished and assets were transferred to Eurotel (amounts of assets transferred are not material to the Group's consolidated results). Currency translation adjustment upon complete liquidation of an investment in Trigo, the amount attributable to that entity and accumulated in the translation adjustment component of equity (CZK 13 million) was removed from the separate component of equity and was reported as part of the gain on liquidation of the investment. At the date of liquidation goodwill was fully written off.

On 29 January 2004 Eurotel acquired a 23.25% ownership in a Czech joint stock company, První certifikační autorita, a.s. (PCA) for CZK 10 million, which was recorded as an associate investment. PCA is engaged in the development and implementation of information systems, electronic signatures certification and safety solutions for e-business for third parties.

M.I.A. a.s., a subsidiary of the Company entered into liquidation proceedings on 1 March 2004. The liquidation was finalized on 13 January 2005.

30 Minority interest

(in CZK million)	2005	2004
At 1 January	6	9
Elimination impact*	(5)	-
Share of net loss of subsidiaries	(1)	(3)
At 31 December	**-**	**6**

*Impact of the elimination of liquidated companies from consolidation.

31 Post balance sheet events

There were no events, which have occurred subsequent to the year-end, which would have a material impact on the financial statements at 31 December 2005.

Financial statements for the year ended 31 December 2005

Prepared in accordance with International Financial Reporting Standards

Contents

GENERAL INFORMATION

ČESKÝ TELECOM, a.s. (the Company) is a joint stock company and is incorporated and domiciled in the Czech Republic. The address of its registered office is Olšanská 55/5, Prague 3, 130 34, Czech Republic.

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

The average number of employees in the Company was 8,018 in 2005 (2004: 9,712).

These financial statements have been approved for issue by the Board of Directors on 23 February 2006.

Relationship with the Czech state, privatisation and acquisition process

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

The Company supplies telecommunication services to and acquires services from various state-owned entities, agencies and companies in which the Czech state holds the majority shareholding. All such transactions are made on normal commercial terms and conditions that are no more favourable than those available to other customers and suppliers. In aggregate, the state-owned entities, agencies and companies comprise one of the Company's largest customers. In providing services to these entities, agencies and companies, ČESKÝ TELECOM, a.s. conducts business with them as separate customers. Services provided to any one governmental entity, agency or state-owned company do not represent a significant component of the Company's revenues.

In June 2004 the Czech Government, via its agency, the National Property Fund, selected a consortium CSFB and Česká spořitelna, a.s. to act as an advisor for the privatisation of its 51.1% stake in ČESKÝ TELECOM, a.s.

In December 2004 based on the advisor recommendation, the Czech government approved the start of the privatisation process. The privatisation process of the 51.1% stake in the Company was finalized in the first half of 2005, when the new acquirer, Telefónica, S.A. (Telefónica), offered the highest price for the majority CZK 82.6 billion, i.e. 502 CZK per one ordinary share. Subsequently the National Property Fund and Telefónica signed a take-over agreement on 12 April 2005 and Telefónica paid 10% of the purchase price to an escrow bank account.

The acquisition process was completed on 16 June 2005, after Telefónica, S.A. paid the remaining 90% of the purchase price, and the National Property Fund transferred the 51.1% stake in the Company to Telefónica, S.A.

Telefónica, S.A. applied effectively its control at the general meeting, which took place on 23 June 2005.

In June 2005 Telefónica, S.A. submitted to the Czech Securities Commission for its approval a mandatory tender offer for 48.9% of the share of the Company in accordance with the Czech commercial code No. 513/1991 Sb., § 183b. The price proposed by Telefónica for approval to the Czech Securities Commission amounted to CZK 456 for each ordinary share, paid in cash. The Czech Securities Commission approved such a tender offer, including the proposed price, on 20 July 2005. The tender offer terminated on 19 September 2005.

The total amount of the additionally acquired shares following the tender offer was 58.8 million shares (i.e. 18.3% of shares), which amounted to the consideration given of CZK 26.8 billion. Afterwards the Telefónica interest in the Company increased from 51.1% to 69.4% of the common stock.

The Company has been included in the Group Telefónica since the finalisation of the take-over. Mutual transactions of supplies of telecommunication services take place amongst Telefónica companies. All these transactions are made on normal commercial terms and conditions that are no more favourable than those available to other customers and suppliers.

INDEPENDENT AUDITORS' REPORT

TO THE SHAREHOLDERS OF ČESKÝ TELECOM, a.s.

We have audited the accompanying financial statements of ČESKÝ TELECOM, a.s., (the Company) presented in the annual report of the Company on pages 144 – 200 and our audit report dated 23 February 2006 stated the following:

We have audited the accompanying financial statements of ČESKÝ TELECOM, a.s., (the Company) which comprise the balance sheet as at 31 December 2005 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. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with International Standards on Auditing. Those Standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements give a true and fair view of the financial position of the Company as at 31 December 2005, and of its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards as adopted by the EU.

In addition, we have reviewed the accuracy of the information contained in the report on related parties of ČESKÝ TELECOM, a.s. for the year ended 31 December 2005 on pages 235 – 257. The management of ČESKÝ TELECOM, 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 ČESKÝ TELECOM, a.s. for the year ended 31 December 2005 is materially misstated.

We have also reviewed the consistency of the annual report of ČESKÝ TELECOM, a.s. on pages 4 – 81 and 203 – 226 with the above-mentioned financial statements. The management of ČESKÝ TELECOM, a.s. is responsible for the accuracy of the annual report. Our responsibility is to express, based on our review, an opinion on the consistency of the annual report with the financial statements.

We conducted our review 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 review 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 respects, with the financial statements. We believe that our review provides a reasonable basis for our opinion.

In our opinion, the information presented in the annual report is consistent, in all material respects, with the above-mentioned financial statements.

Ernst & Young

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

Magdalena Souček
Auditor, License No. 1291

25 April 2006
Prague, Czech Republic

INCOME STATEMENT

(in CZK million)	Notes	Year ended 31 December 2005	31 December 2004
Revenue	2	32,275	33,809
Gains from sale of non-current assets		116	245
Internal expenses capitalized in fixed assets	2	361	451
Operating expenses	3	(18,115)	(18,760)
Impairment loss	8,9,10	(465)	(56)
Depreciation and amortisation	8,9	(12,523)	(14,398)
Operating profit		**1,649**	**1,291**
Interest and dividend income	4	7,016	8,031
Interest expense	4	(748)	(1,236)
Other finance income/(costs) (net)	4	28	703
Profit before income tax		**7,945**	**8,789**
Taxes on income	5	(781)	(537)
Profit for the year	6	**7,164**	**8,252**
Earnings per share (CZK) – basic*	6	22	26

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

BALANCE SHEET

(in CZK million)	Notes	31 December 2005	31 December 2004
ASSETS			
Property, plant and equipment	8	68,797	78,613
Intangible assets	9	1,726	3,085
Available-for-sale investments	13	58	59
Held-to-maturity investments	13	29	31
Investment in subsidiaries	29	29,516	29,488
Other financial assets	12	252	268
Non-current assets		**100,378**	**111,544**
Inventories	11	216	266
Receivables and prepayments	12	4,954	5,072
Income tax receivable		-	-
Available-for-sale investments	13	-	117
Held-to-maturity investments	13	-	78
Cash and cash equivalents	14	2,342	214
Current assets		**7,512**	**5,747**
Non-current assets classified as held for sale	8	**360**	-
Total assets		**108,250**	**117,291**
EQUITY AND LIABILITIES			
Ordinary shares	24	32,209	32,209
Share premium		30,816	30,816
Retained earnings, funds and reserves		21,349	14,180
Total equity		**84,374**	**77,205**
Borrowings	16	9,324	16,799
Deferred taxes	17	3,409	3,183
Non-current provisions for liabilities and charges	19	3,580	2,829
Non-current other liabilities	15	1,262	1,776
Non-current liabilities		**17,575**	**24,587**
Borrowings	16	35	8,671
Trade and other payables	15	5,858	5,846
Income tax liability		249	736
Provisions for liabilities and charges	19	159	246
Current liabilities		**6,301**	**15,499**
Total liabilities		**23,876**	**40,086**
Total equity and liabilities		**108,250**	**117,291**

These financial statements were approved by the Board of Directors on 23 February 2006 and were signed on its behalf by:

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

Juraj Šedivý
1st Vice-Chairman of the Board of Directors
and Chief Financial Officer

STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY

(in CZK million)	Notes	Share capital	Share premium	Hedging reserve	Funds*	Retained earnings	Total
Balance at 1 January 2004 as previously stated		32,209	30,816	(2)	5,506	7,525	76,054
Effect of change in accounting policy for connection fees	2	-	-	-	-	(2,016)	(2,016)
Effect of change in accounting policy for connection cost	2	-	-	-	-	398	398
Balance at 1 January 2004 as restated		**32,209**	**30,816**	**(2)**	**5,506**	**5,907**	**74,436**
Fair value losses (net of tax) - cash flow hedges	26	-	-	(5)	-	-	(5)
Changes in statutory reserves and other movements		-	-	-	-	(2)	(2)
Net expense recognised directly in equity		-	-	(5)	-	(2)	(7)
Dividends related to the year 2003	7	-	-	-	-	(5,476)	(5,476)
Net profit		-	-	-	-	8,252	8,252
Balance at 31 December 2004		**32,209**	**30,816**	**(7)**	**5,506**	**8,681**	**77,205**
Fair value gains (net of tax) - cash flow hedges	26	-	-	7	-	-	7
Changes in statutory reserves and other movements		-	-	-	405	(407)	(2)
Net income/(expense) recognised directly in equity		-	-	7	405	(407)	5
Net profit		-	-	-	-	7,164	7,164
Balance at 31 December 2005		**32,209**	**30,816**	**-**	**5,911**	**15,438**	**84,374**

* Refer Note 24 regarding amounts not available for distribution.

CASH FLOW STATEMENT

(in CZK million)	Notes	Year ended 31 December 2005	31 December 2004
Cash flows from operating activities			
Cash generated from operations	27	14,458	15,023
Interest paid		(887)	(1,247)
Interest received		22	29
Income tax paid		(1,046)	(71)
Net cash from operating activities		**12,547**	**13,734**
Cash flows from investing activities			
Purchase of property, plant and equipment		(1,556)	(1,929)
Purchase of intangible assets		(498)	(508)
Proceeds from sales of property, plant and equipment		227	609
Proceeds from marketable securities		184	265
Dividends – received and other proceeds from investments		7,000	8,000
Net cash used in investing activities		**5,357**	**6,437**
Cash flows from financing activities			
Proceeds from borrowings		11,580	20,942
Repayment of borrowings		(27,393)	(37,088)
Dividends – paid		-	(5,479)
Net cash used in financing activities		**(15,813)**	**(21,625)**
Net increase/(decrease) in cash and cash equivalents		**2,091**	**(1,454)**
Cash and cash equivalents at beginning of year		214	1,667
Effects of exchange rate changes		2	1
Cash and cash equivalents at the year end	14	**2,307**	**214**

ACCOUNTING POLICIES

Index to 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 have been prepared in accordance with International Financial Reporting Standards (IFRS) for the first time. The Company first adopts IFRS in 2005, with a date of transition to IFRS of 1 January 2004. Its last financial statements under previous Czech GAAP were for the year ended 31 December 2004. The disclosures required by IFRS 1 (First-time Adoption of International Financial Reporting Standards) concerning the transition from Czech GAAP to IFRS are given in Note V (Reconciliation of the Company's equity for the date of transition to IFRS, the Company's equity at the end of the latest period presented in the Company's most recent annual financial statements and the Company's profit for the same period under previous GAAP and IFRS).

These financial statements have been prepared in accordance with International Financial Reporting Standards and all applicable IFRS that have been 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 that have been adopted by the EU (Regulation (EC) No 1606/2002). At this particular time, due to the endorsement process of the EU, and the activities of the Company, there is no difference in the policies applied by the Company between IFRS and IFRS that have been 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 23 February 2006.

The financial statements have been prepared under the historical cost convention except for non-current assets held for sale, financial derivatives and available for sale investment securities.

The Company historically prepared and presented its consolidated financial statements under IFRS. Due to this fact, the Company elected to use in its first IFRS financial statements the exemption described in paragraph 24 and 25 of IFRS 1. As a result, the Company measured its assets and liabilities in its opening balance sheet date at the same carrying amounts used for consolidated financial statements, except for consolidation and business combination adjustments.

Given the usage of exemption mentioned above, the comparative 2004 balances correspond with the balances included in the consolidated financial statements with the exclusion of adjustments made for consolidation and business combination procedures.

The preparation of financial statements in conformity with IFRS requires the use of certain critical accounting estimates. It also requires 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 U.

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

For preparation of 2005 financial statements and its comparatives for 2004 the Company adopted IFRS shown below in order to be consistent with adopted IFRS and accounting policy by preparing consolidated financial statements.

Adoption of standards

For 2004, the Company early adopted the IAS/IFRS below, which are relevant to its operations.

IAS 1 (revised 2003) Presentation of Financial Statements
IAS 2 (revised 2003) Inventories
IAS 8 (revised 2003) Accounting Policies, Changes in Accounting Estimates and Errors
IAS 10 (revised 2003) Events after Balance Sheet Date
IAS 16 (revised 2003) Property, Plant and Equipment
IAS 17 (revised 2003) Leases
IAS 21 (revised 2003) The effects of Changes in Foreign Exchange Rates
IAS 27 (revised 2003) Consolidated and Separate Financial Statements
IAS 28 (revised 2003) Investments in Associates
IAS 33 (revised 2003) Earnings per Share
IFRS 2 (issued 2004) Share-based Payments

The adoption of IAS 1, 2, 8, 10, 16, 17, 21, 27, 28, 33 and IFRS 2 before the effective date did not result in substantial changes to the Company's accounting policies:

IAS 1 had affected the presentation of minority interest and other disclosures.
IAS 2, 8, 10, 16, 17, 27 and 33 had no material effect on the Company's accounting policies.
IAS 21 had no material effect on the Company's accounting policies. The Company's presentation currency is the same as the functional currency, which is the CZK.

The early adoption of IFRS 2 has resulted in a change in the accounting policy for share-based payments. Since the adoption of IFRS 2, the Company measures the fair value of the liability for cash settled share-based payment transaction with any change in the value recognised in the income statement for the period (Note 25).

The Company did not have any share appreciation rights prior to the application of IFRS 2.

All changes in the accounting policies had been made in accordance with the transition provisions or have been applied retrospectively in accordance with the respective standards.

All standards adopted by the Company require retrospective application other than:

IAS 16 – the exchange of property, plant and equipment is accounted at fair value prospectively. There has been no substantial exchange of property, plant and equipment during the years 2004 and 2005.
IAS 21 – the prospective accounting for goodwill and fair value adjustments as part of foreign operations.

Adoption of new and revised standards and interpretations from 1 January 2005

The Company has adopted these revised and new standards from 1 January 2005:

IAS 24 (revised 2003) Related Party Disclosures
IAS 32 (revised 2004) Financial Instruments: Disclosure and Presentation
IAS 36 (revised 2004) Impairment of Assets
IAS 38 (revised 2004) Intangible Assets
IAS 39 (revised 2004) Financial Instruments: Recognition and Measurement
IFRS 3 (issued 2004) Business Combinations
IFRS 5 (issued 2004) Non-current Assets Held for Sale and Discontinued Operations

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

IFRIC 1 (issued 2001) Changes in Existing Decommissioning, Restoration and Similar Liabilities.

The adoption of the above-mentioned standards has resulted in the following changes:

IAS 24 (revised 2003) has affected the identification of related parties, the form of disclosure and some other related party disclosures including the disclosure of key management personnel compensation. In addition as the Company used to be majority owned by the National Property Fund of the Czech Republic (year 2004 and part of 2005), the implementation of this standard required disclosure of transactions with entities, where the National Property Fund had majority ownership or significant influence at that time.

IAS 39 (revised 2004) has resulted in a change in the fair value measurement of Available-for-sale financial assets whereby the Company is required to recognise gains and losses resulting from fair value measurement directly in equity.

The Company reassessed the useful lives of its intangible assets and the categorisation. The useful lives of intangible assets were assessed at the individual asset level as having either a finite or indefinite life. Intangible assets having indefinite useful lives are not amortised, but annually tested for impairment, at least at the balance sheet date, as well as when there are indications of impairment.

IFRS 5 determines the Company's policy in the presentation and measurement of fixed assets held for sale and discontinuing operations. This standard requires assets that meet the criteria of held for sale to be measured at the lower of carrying amount and fair value less costs to sell and depreciation of such identified assets is ceased next month after such identification. Assets that meet the criteria of held for sale are presented separately on the face of the balance sheet and the results of discontinued operations presented separately in the income statement. This policy has been applied since 1 January 2005 according to the transitional provisions of the relevant standard and used exemption of IFRS 1.

All changes in the accounting policies had been made in accordance with the transition provisions or have been applied retrospectively in accordance with the respective standards and IFRS 1.

Issued standards and interpretations, but not early adopted by the Company:
IFRS 6 (issued in 2004, effective date 1 January 2006) Exploration for and Evaluation of Mineral Resources. This standard does not apply to the activities of the Company.

IFRS 7 (issued in 2005, effective date 1 January 2007) Financial Instruments: Disclosures – the Company does not expect any material effect relating to the adoption of this standard.

Amendments to IAS 1 (issued 2005, effective date 1 January 2007) Presentation of financial statements, Capital disclosures – the Company does not expect any material effect relating to the adoption of this amendment.

IFRIC 4 (effective date 1 January 2006) Determining whether an Arrangement contains a Lease – the Company does not expect any material effect relating to the adoption of this standard.

IFRIC 5 (issued 2004, effective date 1 January 2006) Rights to Interests arising from Decommissioning, Restoration and Environmental Rehabilitation Funds. This standard does not apply to the activities of the Company.

IFRIC 6 (issued 2005, effective date 1 December 2005) Liabilities Arising from Participating in a Specific Market – Waste Electrical and Electronic Equipment. This standard does not apply to the activities of the Company.

B Foreign currency translation

(i) Functional and presentation currency
Items included in the financial statements 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 is initially recorded at cost and, except for freehold land, is subsequently carried at its cost less any accumulated depreciation and accumulated impairment losses. Freehold land is subsequently stated at cost less impairment charges.

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

Repairs and maintenance are expensed as incurred.

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

Items of property, plant and equipment, excluding freehold land, are depreciated from the time they are available for use, using the straight-line method. Depreciation ceases at the earlier of the date the asset is derecognised 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	3 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 Note F Impairment of assets).

D Intangible assets

Intangible assets include primarily computer software. 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 programmes 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 with indefinite useful life are not amortised. They are subject to the regular impairment reviews.

The Company reviews 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 lifes 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 there is not expected any future economic benefits or that are disposed of for any other reason are derecognised from the balance sheet together with corresponding accumulated depreciation (for amortised assets only). All gains or losses arising in this respect are recognised in net operating income, i.e. net gain or loss is determined as the difference between net disposal proceeds, if any, and the carrying amount of the asset.

Intangible assets, with the exception of assets with indefinite useful life, are amortised using the straight-line method from the time they are available for use. Amortisation ceases at the earlier of the date the asset is derecognised, 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

Beginning 1 January 2005, in the balance sheet, the Company classifies separately non-current assets (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 impairment with impact in the income statement of the relevant period.

From the moment the asset is classified as held for sale and eventually reevaluated, 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 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 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).

All assets are annually reviewed for the impairment, at least at the balance sheet date.

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 2004 and 2005, the Company did not hold any financial assets in this category.

Investments with a fixed maturity that the 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 the 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.

The 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 and of available-for-sale investments 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 assets are derecognised, at which time the cumulative gain or loss previously recognised in equity is recognised in the income statement.

Investments in subsidiaries are those investments, where the Company has the control over the entity. Control is the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities. Such investments in subsidiaries that are not classified as held for sale in accordance with IFRS 5 are accounted for at cost less provision for diminution in value.

An associated undertaking is an enterprise where the Company has significant influence, which has the power to participate in the financial and operating policy decisions, but not exercise control. Equity investments in associates are recorded at cost less a provision for diminution in value.

Impairment of financial assets

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

(1) Assets carried at amortized costs

If there is objective evidence that an impairment loss on loans and receivables or held to maturity investments carried at amortised cost has been incurred, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows discounted at the financial asset's original effective interest rate. The carrying amount of the asset is reduced either directly or through use of an allowance account. The amount of the loss is recognised in the income statement.

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

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

(2) Available-for-sale financial assets

If this asset is impaired, an amount comprising the difference between its cost and its current fair value, less any impairment loss previously recognised in profit or loss, is transferred from equity to the income statement. 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.

Derecognition of financial assets

A financial asset is derecognised when:

- the rights to receive cash flow from the asset have expired,
- 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
- the Company has transferred its rights to receive cash flows from the asset and either has transferred substantially all the risks and rewards of the asset, or has neither transferred nor retained substantially all the risks and rewards of the asset, but has transferred control of the asset.

H Leases

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

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

Leases of property, plant and equipment where the Company has 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. The property, plant and equipment acquired under finance leases is 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 and 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 provision for impairment of these receivables. Such provision 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 provision 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 provision 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 Borrowings

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 Deferred income taxes

Taxation expense represents both current and deferred taxation, where appropriate. 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 provision for obsolete and slow moving inventories and non tax-deductible provisions.

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.

N Employee benefits

(1) Pension obligations

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

(2) Redundancy and termination benefits

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

(3) Bonus plans

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

O Share-based compensation

The Company operated a cash-settled, share-based compensation plan for members of the Board of Directors and the Supervisory Board (see Note 25). The fair value of the services received in exchange for the grant of the rights is recognized as an expense. The total amount to be expensed over the vesting period was determined by reference to the fair value of the rights granted. At each balance sheet date, the Company revised its estimates of the number of rights that were expected to become exercisable. It recognized the impact of the revision of original estimates, if any, in the income statement.

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.

R Revenue recognition

Revenue, shown net of Value Added Tax and any discounts, 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 shall be measured reliably and it is probable that the economic benefits associated with the transaction will flow to the Company. If necessary, revenue is split into separately identifiable components.

The Company offers customers free minutes for selected price based on chosen customer plan. Free unused minutes at the end of the month might be rolled over to the following month. The Company is not obliged to reimburse 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:

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

Revenue is recognized as follows:

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

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

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

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

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

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 on a regular basis.

Internet and data services
The Company earns revenue from providing Internet services. Revenue from such services is recognised at the time the service is provided.

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

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

S 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.

T Financial instruments

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

Financial risk management

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

The Company does not conduct any speculative trading activities.

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

(i) Foreign exchange risk

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

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

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

(ii) Interest rate risk

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

(iii) Credit risk

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

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

(iv) Liquidity risk

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

Accounting for derivative financial instruments and hedging activities

Derivative financial instruments are initially recognised in the balance sheet at fair value on the date a derivative contract is entered into and subsequently are remeasured at their fair value. The method of recognising the resulting gain or loss is dependent on the nature of the item being hedged. On the date a derivative contract is entered into, the Company designates certain derivatives as either (1) a hedge of the fair value of a recognised asset or liability or of a firm commitment (fair value hedge), or (2) a hedge of highly probable forecast transactions (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 26.

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.

U 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:

(i) 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 633 million, advances paid for income taxes amount to CZK 384 million and the net deferred tax liability is CZK 3,409 million.

(ii) 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.

(iii) 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 the yearly basis.

V Reconciliation

This is the first year that the Company has presented its financial statements under IFRS. The following disclosures are required in the year of transition. The last financial statements under Czech accounting standards (CAS) were prepared for the year ended 31 December 2004 and the date of the transition to IFRS was therefore 1 January 2004.

Reconciliation of the Company's equity reported under Czech accounting standards (CAS) to its equity under IFRS for the following dates:

(i) 1 January 2004 (the date of transition to IFRS)

(in CZK million)	
Equity as at 1 January 2004 in accordance with CAS	75,820
Difference between CAS and IFRS deferred tax	(164)
Change in accounting policy for connection fees	
and costs (see Note 2)	(1,618)
Reclassification of the social and bonuses fund	(34)
Difference in financial investments	433
Other effects	(1)
Equity as at 1 January 2004 in accordance with IFRS	**74,436**

(ii) 31 December 2004 (the end of the latest period presented in the Company's most recent annual financial statements under Czech accounting standards)

(in CZK million)	
Equity as at 31 December 2004 in accordance with CAS	78,381
Difference between CAS and IFRS deferred tax	(162)
Change in accounting policy for connection fees and costs (see Note 2)	(1,424)
Reclassification of the social and bonuses fund	(22)
Difference in financial investments	433
Other effects	(1)
Equity as at 31 December 2004 in accordance with IFRS	**77,205**

Reconciliation of the Company's profit reported under Czech accounting standards (CAS) to its profit under IFRS for the year ending 31 December 2004 (the latest period in the Company's most recent annual financial statements):

(in CZK million)	
Profit for the year ended 31 December 2004 in accordance with CAS	8,091
Difference between Czech and IFRS deferred tax	3
Change in accounting policy for connection fees and costs (see Note 2)	194
Reclassification of the social and bonuses fund	(27)
Other differences in financial instruments	(9)
Profit for the year ended 31 December 2004 in accordance with IFRS	**8,252**

Explanation of material adjustments for above mentioned reconciliation:

Change in accounting policy for connection fee

The Company has changed the revenue recognition policy for connection fees since 2005 and accounted it for as a change in accounting policy under IAS 8 – Accounting Policies, Changes in Accounting Estimates and Errors by preparing consolidated financial statements under IFRS. The adjustment was not applied retrospectively for the CAS financial statements thus neither adjusted CAS opening balances nor CAS profit for 2004. When preparing these IFRS financial statements, above mentioned policy has been applied since the date of the transition. Further details are described in Note X and Note 2.

W Investments in subsidiary and associated undertakings

A subsidiary is an enterprise that is controlled by the Company, which means that the Company has the power to govern the financial and operating policies so as to obtain benefits from its activities.

An associated undertaking is an enterprise where the Company has significant influence, which is the power to participate in the financial and operating policy decisions, but not exercise control.

Equity investments in subsidiaries and associates are recorded at cost less a provision 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.

X Change in accounting policy

(1) Connection fees and related costs

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

Connection fees are deferred and recognised in the income statement over the estimated average customer relationship period on the basis of degressive accounting method. For the periods starting 2005 the Company estimates the customer relationship period being 13 years (16 years as at 1 January 2004).

As at 1 January, the Company deferred revenues relating to the connection fees from periods before 2004 in the amount of CZK 2,696 million that would be recognised as revenues in following periods. In 2004, the Company recognised the total revenues relating to the connection fees in the amount of CZK 520 million.

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

In 2004 the Company previously reported the following amounts in the separate income statement, which was used for preparation of audited consolidated financial statements:

(in CZK million)	Year ended 31 December 2004 as previously stated
Revenues	34,368
Depreciation and amortisation	(14,364)
Profit before income taxes	8,506
Taxes on income	(448)
Profit	8,058
Earnings per share (CZK)	25

In 2004 the Company previously reported the following amounts in the balance sheet, which was used for preparation of audited consolidated financial statements:

(in CZK million)	1 January 2004 as previously stated	31 December 2004 as previously stated
Property, plant and equipment – cost	182,783	181,963
Property, plant and equipment – accumulated depreciation and impairment provision	(95,133)	(103,801)
Property, plant and equipment – net book value	**87,650**	**78,162**
Retained earnings	**(13,029)**	**(15,604)**
Deferred revenue – current	(530)	(25)
Deferred revenue – non current	-	-
Deferred tax liability	(4,232)	(3,686)

The Company's tax rate was 28% for 2004, and 31% for prior periods.

For detailed information see Note 2.

(2) Premium rate lines

During 2005 the management identified certain transactions, which meet conditions of agency arrangement. The revenue from these transactions was recognized in 2004 income statement on a gross basis. Starting from 2005 the revenue is recognised only at the amount of the commission received/realised. The management believes that the new policy is preferable, gives more relevant information about the effects on transactions and will be consistent with the telecommunication industry practice. Such policy is also in accordance with the Telefónica Group policy. As a result of retrospective application of this policy, revenues and operating expenses for the year ended 31 December 2004 were reduced by CZK 282 million.

Y Operating profit

Operating profit is defined as profit before financial results and taxes and represents profit from the business operations. Financial results consist of interest income, dividends 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

Index to the notes to the financial statements

1 Segment information

The Company operates in one main business and territory segment:

Network communications services using a fixed network provided by the Company in the Czech Republic.

Revenue of the Company is predominantly derived from domestic trading activities.

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

	Year ended	
(in CZK million)	31 December 2005	31 December 2004
Capital expenditure	2,249	2,597

2 Revenue and Internal expenses capitalized in fixed assets

Revenue

	Year ended	
(in CZK million)	31 December 2005	31 December 2004
Call revenues	7,285	9,708
Subscription revenues	11,154	11,828
Connection fees	702	520
Internet and Data services	3,671	2,720
Value added services	887	964
Interconnect revenues	4,723	3,832
Leased circuits	2,661	2,785
Equipment sales and sales of materials	447	380
Other revenues*	745	1,072
Total revenues	**32,275**	**33,809**

* Other revenues include several non-recurring items including insurance settlements and universal service compensation in the total amount CZK 5 million (2004: CZK 530 million).

Revenues from related parties are described in Note 28.

Connection fees

In 2005, the Company changed its accounting policy for revenue recognition of connection fees relating to the activation of the fixed line for all periods starting from 1996. This change in accounting policy has been accounted for retrospectively, and the comparative statements for 2004 have been restated. The effect of the change on 2004 is stated below. Opening retained earnings as at 1 January 2004 have been reduced by CZK 1,618 million, which is the amount of the adjustment relating to periods 1996 – 2004.

Together with above-mentioned connection fee and retroactive change in accounting policy the Company identified associated connection costs that met the definition of subsequent costs increasing the carrying amounts of property, plant and equipment these and were capitalised. Such connection costs were related to the prior periods (periods before 2004), nevertheless the retrospective capitalization resulted in the increase in carrying amount of fixed assets and associated depreciation with the following effect on 2004 figures.

Effect on 2004 financial statements

(in CZK million)	
Increase in revenues	317
Increase in depreciation and amortisation	(34)
Increase in income tax (deferred tax)	(89)
Increase in profit	**194**

Increase in property, plant and equipment (in CZK million):	
Cost	680
Accumulated depreciation	(229)
Net book amount	**451**

Increase in liabilities as at 31 December 2004 by CZK 1,875 million (CZK 2,379 million of deferred revenues less deferred tax of CZK 504 million). Decrease in retained earnings as at 31 December 2004 by CZK 1,424 million.

Effect on periods prior to 2004

(in CZK million)	
Decrease in prior profits:	
Decrease in revenue	(2,696)
Decrease in income tax (deferred tax)	680
Increase in prior profits:	
Decrease in operating expenses resulting from capitalised connection costs	680
Increase in depreciation and amortisation	(195)
Increase in income tax (deferred tax)	(87)
Decrease in profit	**(1,618)**

Increase in property, plant and equipment as at 1 January 2004: (in CZK million)	
Cost	680
Accumulated depreciation	(195)
Net book amount	**485**

Increase in liabilities as at 1 January 2004 by CZK 2,103 million (CZK 2,696 million of deferred revenues less deferred tax of CZK 593 million).

Decrease in retained earnings as at 1 January 2004 by CZK 1,618 million.

Internal expenses capitalized in fixed assets

	Year ended	
(in CZK million)	**31 December 2005**	**31 December 2004**
Material	338	428
Labour	23	23
Total	**361**	**451**

3 Operating expenses

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

(in CZK millions)	Year ended 31 December 2005	31 December 2004
Wages and salaries*	3,795	3,886
Redundancy payments	260	380
Social security contributions (Note 18)	1,265	1,341
Staff welfare costs	238	259
Total staff costs	5,558	5,866
Payments to other network operators	4,935	4,625
Equipment and material cost of sales	438	561
Commissions	222	350
Subcontractors	251	107
Material and energy consumed	1,254	1,351
Repairs and maintenance	1,713	1,852
Advertising and promotion	577	554
Operating lease payments and building expenses	535	575
Consultancy	331	425
Trade receivables – impairment charge for bad and doubtful debts	185	349
Other operating expenses**	2,116	2,145
Total operating expenses	**18,115**	**18,760**

* 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 40 million in relation to such non-competition clauses in 2005 (2004: CZK 21 million).

** Other operating expenses in 2005 include costs reflecting regulatory decisions of CZK 498 million (2004: CZK 655 million), the contingency reserve against the compensation of universal service and other non-recurring expenses in the total amount of CZK 85 million (2004: 352 million).

Purchases from related parties are disclosed in Note 28.

4 Interest and other finance income (net)

(in CZK millions)	Year ended 31 December 2005	31 December 2004
Interest expense:		
Interest incurred on loans and bonds	748	1,236
Interest capitalized	-	-
Net interest expense	748	1,236
Interest income	(16)	(31)
Interest expense (net)	732	1,205
Dividends income	(7,000)	(8,000)
Other financial charges	184	119
Fair value losses/(gains) on financial instruments:		
Derivative financial instruments	(119)	124
Available-for-sale investments	-	7
Other investments	-	3
Other losses on financial instruments:		
Held-to-maturity investments	-	-
Net foreign exchange transaction (gains)/losses	(93)	(956)
Other finance income (net)	(28)	(703)
Net finance income	**(6,296)**	**(7,498)**

5 Tax

(in CZK millions)	Year ended 31 December 2005	31 December 2004
Total income tax expense is made up of:		
Current income tax charge	557	992
Deferred income tax charge/(credit) (Note 17)	224	(455)
Taxes on income	**781**	**537**

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 millions)	Year ended 31 December 2005	31 December 2004
Profit before tax	7,945	8,789
Income tax charge calculated at the statutory rate of 26% (2004: 28%)	2,066	2,461
Income not subjected to tax	(1,820)	(2,256)
Expenses not deductible for tax purposes	324	353
Reduction of deferred taxes resulting from reduction in tax rate (Note 17)	-	(83)
Other	211	82
Investments allowances	-	(20)
Taxes on income	**781**	**537**
Effective tax rate	10%	6%

6 Earnings per share

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

	Year ended 31 December 2005	31 December 2004
Weighted number of ordinary shares in issue	322,089,900	322,089,900
Net profit attributable to shareholders (in CZK million)	7,164	8,252
Basic earnings per share (CZK)	22	26

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

7 Dividends

(in CZK millions)	Year ended 31 December 2005	31 December 2004
Dividends (including withholding tax)	-	5,476

Dividends include withholding tax on dividends paid by the Company to its shareholders. There has been no interim dividend paid in respect of 2005. Approval of the 2005 profit and the decision regarding the amount of any dividend payment for the 2005 financial year will take place at the Annual General Meeting scheduled for 20 April 2006.

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
Year ended 31 December 2005						
Opening net book amount	9,570	50,745	16,247	1,435	616	78,613
Additions	61	633	773	305	1,752	3,524
Disposals and other movements	(109)	2	44	(7)	(1,772)	(1,842)
Assets classified as held for sale	(358)	-	(1)	(1)	-	(360)
Depreciation charge	(331)	(4,203)	(5,365)	(787)	-	(10,686)
Impairment charge	(307)	(36)	(101)	(1)	(7)	(452)
Closing net book amount	**8,526**	**47,141**	**11,597**	**944**	**589**	**68,797**
At 31 December 2005						
Cost	13,959	99,201	60,284	7,349	589	181,382
Accumulated depreciation and impairment provision	(5,433)	(52,060)	(48,687)	(6,405)	-	(112,585)
Net book amount	**8,526**	**47,141**	**11,597**	**944**	**589**	**68,797**
Year ended 31 December 2004						
Opening net book amount	10,009	53,900	20,925	2,285	1,239	88,358
Additions	172	1,042	1,216	438	2,082	4,950
Disposals and other movements	(145)	(4)	(230)	(224)	(2,683)	(3,286)
Depreciation charge	(432)	(4,193)	(5,664)	(1,064)	-	(11,353)
Impairment charge	(34)	-	-	-	(22)	(56)
Closing net book amount	**9,570**	**50,745**	**16,247**	**1,435**	**616**	**78,613**
At 31 December 2004						
Cost	14,856	98,670	60,823	7,731	621	182,701
Accumulated depreciation and impairment provision	(5,286)	(47,925)	(44,576)	(6,296)	(5)	(104,088)
Net book amount	**9,570**	**50,745**	**16,247**	**1,435**	**616**	**78,613**

Land and buildings, plant and equipment with a carrying value of CZK 1,220 million (2004: CZK 2,648 million) have been pledged as collateral for CZK 5,300 million of provided borrowings. The borrowings were fully paid off, but the cancellation of the pledge is still in process (see Note 16).

No borrowing costs were capitalized during the years 2005 and 2004.

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

	Year ended	
(in CZK million)	31 December 2005	31 December 2004
Land and buildings	358	-
Communication exchanges and related equipment	1	-
Other non-current assets	1	-
Total	**360**	-

Assets intended for sale in most cases represent administration buildings with land, that became vacant due to the optimisation 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 1 year. In 2005, no intended sale of assets was withdrawn (i.e. all reported assets classified as intended for sale have been and still are intended for sale).

In 2005, the Company achieved a total gain from the sale of the above assets amounting to CZK 58 million. The total net sales were CZK 131 million and the carrying amount was CZK 73 million.

As at 31 December 2005, the total recognised loss from the impairment / decrease in value of assets classified as held for sale was CZK 104 million out of which CZK 97 million related to assets still held for sale at the balance sheet date. With regard to assets for which a loss from decrease in value was recognised, cancellation/reverse of the impairment of loss from decrease in value was not occurred.

Cost of fully depreciated property, plant and equipment was CZK 28,923 million as at 31 December 2005.

The impairment charge recorded in 2005 represents mainly correction of value of special constructions, which were idle.

9 Intangible assets

(in CZK million)	Software	Other	Total
Year ended 31 December 2005			
Opening net book amount	3,085	-	3,085
Additions	491	-	491
Disposals and other movements	-	-	-
Amortisation charge	(1,837)	-	(1,837)
Impairment charge	(13)	-	(13)
Closing net book amount	**1,726**	**-**	**1,726**
At 31 December 2005			
Cost	16,898	-	16,898
Accumulated amortisation and impairment provision	(15,172)	-	(15,172)
Net book amount	**1,726**	**-**	**1,726**
Year ended 31 December 2004			
Opening net book amount	5,646	-	5,646
Additions	482	-	482
Disposals and other movements	2	-	2
Amortisation charge	(3,045)	-	(3,045)
Closing net book amount	**3,085**	**-**	**3,085**
At 31 December 2004			
Cost	16,745	92	16,837
Accumulated amortisation and impairment provision	(13,660)	(92)	(13,752)
Net book amount	**3,085**	**-**	**3,085**

No borrowing costs were capitalized during the years 2005 and 2004.

All of the intangible assets are amortised and are subject to annual impairment testing and revision of useful life.

Cost of fully depreciated intangible assets was CZK 10,190 million as at 31 December 2005.

10 Impairment of fixed assets

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 (CGU).

As at 31 December 2005 and 2004 the management of the Company reviewed the existence of indicators (both external and internal), which would indicate that the impairment provision made in 2003 is no longer relevant and should be reversed. The management did not identify any of these indicators being fulfilled and, accordingly, the amount of impairment provision was not reversed as at 31 December 2005 and 2004.

11 Inventories

(in CZK million)	31 December 2005	31 December 2004
Construction material	35	57
Cables	159	181
Other inventory including goods for resale	22	28
	216	**266**

The inventories noted above are stated net of a provision of CZK 122 million (2004: CZK 139 million), reducing the value of the inventories to their net realisable value. The total carrying amount of inventories carried at fair value less costs to sell amounts to CZK 152 million (2004: CZK 4 million). The amount of inventories recognised as an expense is CZK 857 million (2004: CZK 661 million).

12 Receivables and prepayments

(in CZK million)	31 December 2005	31 December 2004
Domestic trade receivables (net)	3,801	4,001
Foreign currency trade receivables (net)	564	484
Other debtors (net)	147	132
Prepayments	442	455
	4,954	**5,072**

Trade receivables are stated net of a provision for impaired receivables of CZK 1,882 million (2004: CZK 1,854 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 28.

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 2005 and 2004 the Company has the following non-current balances, which are classified as other financial assets:

(in CZK million)	31 December 2005	31 December 2004
Long-term credits	36	36
Advance payments for long-term expenses	216	232
Total	**252**	**268**

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

Available-for-sale investments

(in CZK million)	2005	2004
At beginning of year	176	433
Revaluation deficit	(1)	(7)
Additions	4	13
Disposals	(121)	(263)
At end of year	**58**	**176**
Non-current	58	59
Current	-	117
	58	**176**

Held-to-maturity investments

(in CZK million)	2005	2004
At beginning of year	109	133
Exchange differences	(2)	-
Revaluation deficit	-	-
Additions	1	5
Matured	(79)	(29)
At end of year	**29**	**109**
Non-current	29	31
Current	-	78
	29	**109**

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.

14 Cash and cash equivalents

(in CZK million)	31 December 2005	31 December 2004
Cash balances	18	38
Short-term bank deposits	2,324	176
Cash and cash equivalents	**2,342**	**214**

As at 31 December 2005 the Company's cash equivalents partially consisted of short-term bank promissory notes that are economically equivalent to bank term deposits.

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

(in CZK million)	31 December 2005	31 December 2004
Cash and cash equivalents	2,342	214
Bank overdrafts and other short-term borrowings (Note 16)	(35)	-
Balance at the end of period	**2,307**	**214**

15 Trade and other payables

(in CZK million)	31 December 2005	31 December 2004
Trade creditors in local currency (net)	2,489	2,510
Trade creditors in foreign currencies (net)	585	512
Other taxes and social security	148	170
Deferred revenue	719	631
Employee wages and benefits	180	222
VAT payable	235	163
Accrued expenses	194	339
Other creditors	29	32
Other liabilities	1,277	1,131
Derivative instruments (Note 20)	2	136
	5,858	**5,846**

Payables to related parties are disclosed in Note 28.

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

16 Borrowings

(in CZK million)	31 December 2005	31 December 2004
Bank loans and overdrafts in local currency (a)	35	2,100
International financial institution loans in foreign currencies	-	1,110
Bank loans and overdrafts in foreign currencies (a)	3,337	12,272
Bonds in local currency (b)	5,987	9,988
	9,359	**25,470**
Repayable:		
Within one year	35	8,671
Between one and two years	-	2,565
Between two and five years	5,987	10,340
After five years	3,337	3,894
Total non-current	9,324	16,799
	9,359	**25,470**

(a) Bank loans and overdrafts include overdrafts of CZK 35 million denominated in the local currency (2004: CZK 0 million) and CZK 0 million in foreign currencies (2004: CZK 0 million).

Short-term borrowings as at 31 December 2004 consist of loans drawn under bilateral short-term facilities.

In November 2003, the Company raised a syndicated credit facility in the total amount of EUR 850 million equivalent, with a final maturity day on 21 November 2008. The purpose of the loan was to finance the acquisition of the remaining 49% ownership interest in Eurotel (see Note 29) and general corporate purposes of the Company. As at 31 December 2005 the outstanding amount of the loans under the credit facility was EUR 0 million (2004: EUR 275 million) and CZK 0 million (2004: CZK 0 million). The terms and conditions of the credit facility agreement, inter alia, require the Company to maintain certain gearing and interest cover ratios of earnings before interest, tax, depreciation and amortisation to net borrowings and interest payable.

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

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

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

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

At 31 December 2005, the Company had approximately CZK 8,290 million of available undrawn credit facilities (2004: CZK 7,786 million).

Loans with a maturity within one year and denominated in a foreign currency have a total value of EUR 0 million (2004: EUR 84 million).

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

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

(in CZK million)	31 December 2005	31 December 2004
At fixed rate	9,324	25,470
At floating rate	35	-
Total	**9,359**	**25,470**

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

31 December 2005 (in CZK million)	Carrying amounts	Fair values
Bank loans	3,372	4,020
Bonds	5,987	6,154
Total	**9,359**	**10,174**

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

Effective interest rates	31 December 2005	31 December 2004
Bank loans and overdrafts in local currency	2.22%	2.79%
International financial institution loans in foreign currencies	n/a	6.80%
Bank loans and overdrafts in foreign currencies	6.64%	3.88%
Bonds in local currency	3.50%	3.92%

The Company meets the criteria for debt covenants required by the creditors.

International financial institution loans in foreign currencies are secured by the Czech Republic (represented by the Ministry of Finance of the Czech Republic) and certain movables and real estates. Other loans are not secured. The carrying value of assets pledged is as follows:

(in CZK million)	31 December 2005	31 December 2004
Land and buildings	7	687
Plant and equipment	1,213	1,961
Total	**1,220**	**2,648**

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

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 24% (26% in 2004), long term deferred taxes were calculated at 24% (24% in 2004).

(in CZK million)	2005	2004
At 1 January	3,183	3,640
Income statement charge/(credit) (Note 5)	224	(455)
Tax on fair value gains	2	(2)
At the end of period	**3,409**	**3,183**

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 2005	31 December 2004
Deferred tax assets	(1,131)	(1,660)
Deferred tax liabilities	4,540	4,843
Total	**3,409**	**3,183**

The deferred tax asset includes CZK 309 million (2004: CZK 337 million) recoverable in less than twelve months and CZK 822 million (2004: CZK 1,323 million) recoverable after more than twelve months. The deferred tax liability includes CZK 475 million (2004: CZK 353 million) payable in less than twelve months and CZK 4,065 million (2004: CZK 4,490 million) payable in more than twelve months.

The deferred tax is determined by these components:

	Balance sheet		Income statement	
(in CZK million)	2005	2004	2005	2004
Amount relating to the origination and reversal of temporary differences from:				
property, plant and equipment and intangible assets	4,475	4,719	(244)	(156)
trade receivables, inventories and other differences	(1,066)	(1,534)	468	(213)
Revaluations of cash flow hedges	-	(2)	-	-
Revaluations of available for sale investment to the fair value	-	-	-	(3)
Amount relating to unrecognised tax loss	-	-	-	-
Amount relating to changes in tax rates	-	-	-	(83)
Total	**3,409**	**3,183**	**224**	**(455)**

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

(in CZK million)	31 December 2005	31 December 2004
Revaluation of cash flow hedges	2	(2)
Unrealised gain on available for sale investments	-	-
Total	**2**	**(2)**

The deferred tax amounts shown in the balance sheet relate to temporary differences arising from the tax bases and carrying amounts of assets and liabilities as follows:

(in CZK million)	31 December 2005	31 December 2004
Property, plant and equipment and intangible assets	4,475	4,719
Trade receivables, inventories and other items	(1,066)	(1,536)
Total	**3,409**	**3,183**

18 Government social security and pension schemes

The Company is legally required to make contributions to government health, retirement benefit and unemployment schemes. During 2005 and 2004, 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 1,265 million in 2005 (2004: CZK 1,341 million). Employees contribute 12.5% (2004: 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 61 million (2004: CZK 78 million). These contributions were charged as an operating expense.

In accordance with an annually renegotiated collective labour agreement, the Company is required to pay CZK 25,000 or CZK 90,000 on retirement depending on the length of the employee's service, who have completed not less than five years continuous service. These benefits are restricted to those employees who retire during the period for which the labour agreement is in place. The Company is not under any legal or constructive obligation to continue providing such benefits beyond the period of such agreement and therefore, no provisions beyond the period of the agreement are recognised in the financial statements. Payments made during the year 2005 relating to employee retirement amounted to CZK 0.1 million (2004: CZK 0.1 million) and were charged as an operating expense.

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

19 Provisions for liabilities and charges

Short-term Provisions

(in CZK million)	Regulatory and court decisions	Employee redundancy costs	Employee-related costs	Share-based compensation	Other	Total
At 1 January 2004	-	109	-	-	-	109
Additions during the year	-	-	186	60	-	246
Utilised during the year	-	(109)	-	-	-	(109)
At 31 December 2004	**-**	**-**	**186**	**60**	**-**	**246**
Additions during the year	20	10	331	190	10	561
Utilised during the year	-	-	(398)	(250)	-	(648)
At 31 December 2005	**20**	**10**	**119**	**-**	**10**	**159**

Long-term Provisions

(in CZK million)	Regulatory and court decisions
At 1 January 2004	1,979
Additions during the year	893
Utilised during the year	(43)
At 31 December 2004	**2,829**
Additions during the year	795
Utilised during the year	(44)
At 31 December 2005	**3,580**

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

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

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

20 Financial instruments

Net fair values of derivative financial instruments

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

Contracts with positive fair value

(in CZK million)	31 December 2005	31 December 2004
Total	-	-

Contracts with negative fair value

(in CZK million)	31 December 2005	31 December 2004
Instruments not qualifying as hedges:		
Interest rate swaps	2	-
Cash flow hedges:		
Interest rate swaps	-	11
Fair value hedges:		
Structures involving currency options	-	8
Forward foreign exchange contracts	-	117
Total (Note 15)	**2**	**136**

21 Contingencies

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

Interconnect arrangements

The Company has not yet agreed a 2001 price amendment to an agreement with 2 mobile operators in the Czech Republic (T-Mobile Czech Republic a.s. and Eurotel Praha, spol. s r.o.) governing interconnect arrangements. Whilst in December 2003 the Czech Telecommunication Office (CTU) effectively ruled in favour of the amounts claimed by the mobile operators (i.e. CZK 899 million for T-Mobile Czech Republic a.s. and CZK 1,154 million for Eurotel Praha, spol. s r.o., the outstanding amount is bearing interest of 0.05% per day), the management believes that the amounts are not substantiated and are without merit. The Company subsequently obtained adjournment of the decision execution and lodged an appeal. However, based on the legal environment in the Czech Republic, management estimated maximum probable outflow related to this dispute and such outflow is fully provided in the financial statements. The management is confident that all risks, which may arise as a result of these litigations, are adequately provided for in the financial statements. No further disclosure is deemed appropriate as it could prejudice the Company's position in the dispute.

On 30 June 2005, Oskar Mobil a.s. filed a petition with the Metropolitan Court in Prague against the Company for damages in the amount of CZK 538 million with appurtenances and for returning the unjustified enrichment of CZK 117 million with appurtenances. The Company is alleged to have failed to transmit the traffic to networks operated by other mobile operators according to respective interconnection agreements. The petition was only unofficially delivered from Oskar Mobile a.s. and was not served by the court. The management believes that the claim is without merit and as a result, no provision has been made in the financial statements for this matter.

Office for the Protection of Economic Competition proceedings

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

The Company is a subject to administrative proceeding by the Office for the Protection of Economic Competition (UOHS) relating to alleged abuse of dominant position on the market of wholesale and retails broadband. UOHS rendered resolution dated 3 December 2004 imposing a fine to the Company in the total amount of CZK 90 million. The Company lodged an appeal in December 2004 and obtained adjournment of the decision execution. The matter is fully provided in the financial statements.

The Company is subject to administrative proceeding by the Office for the protection of Economic Competition (UOHS) related to alleged abuse of dominant position consisting in the alleged discrimination against competitors on the market of leased circuits. The proceedings were dismissed unresolved on 1 October 2004. This decision was appealed by other participants and hence the proceeding is still pending. Maximum penalty UOHS could impose is limited by 10% of turnover for the year preceding UOHS resolution. The management of the Company is confident that the risk of adverse decision of UOHS in this case is not probable and, accordingly, no provision is made for this matter in the financial statements.

Other legal matters

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 anti competition law by the Company in connection with offering pricing plans since January 2002. The amount of the claim is CZK 2,142 million with appurtenances. No hearing has been ordered in the matter yet. The Company provided to the court extensive defence along with proposed items of evidence proving the legal perfectness 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 affect on net income exceeding the amount of provision already made in the financial statements. No further disclosure is deemed appropriate as it could prejudice the Company's position in the dispute.

The Company is prosecuted by AUGUSTUS spol. s r.o. for an alleged loss of profit in the principal amount of approximately CZK 183 million with appurtenances (totalling approximately additional CZK 257 million as of the end of 2005) 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. The management believes that all risks, which may arise as a result of this litigation, are adequately provided for in the financial statements. No further disclosure is deemed appropriate as it could prejudice the Company's position in the dispute.

The Company is a defendant in a case filed by administrator in bankruptcy of a company Microna Týn a.s. claiming payment orders in the total amount of CZK 99 million with appurtenances (total claim as at 31 December 2005 amounts to CZK 129 million) due to inclusion of a building leased by the Company in the leaser's bankrupt's estate. The Company provided the court with detailed analysis of legal facts and as the management believes that the claim is not substantiated, no provision was created in the financial statements for this matter.

The Company is a defendant in several other significant legal cases claiming from the Company in total amount of CZK 118.3 million plus appurtenances. The management believes that the risk of loosing these cases is less than probable and no provision was made in the financial statements.

22 Commitments

Operating leases

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

(in CZK million)	31 December 2005	31 December 2004
No later than 1 year	306	332
Later than 1 year and not later than 5 years	901	971
Later than 5 years	182	149
Total	**1,389**	**1,452**

The total lease payments relating to operating leasing of property, plant and equipment recognised as an expense in 2005 were CZK 389 million (2004: CZK 410 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 consolidated results of operations, financial position, or cash flow and therefore are not accounted.

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 2005 were CZK 229 million (2004: CZK 353 million).

Capital commitments

(in CZK million)	31 December 2005	31 December 2004
Capital expenditure contracted but not rovided for in the financial statements	338	431

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

23 Service concession arrangements

The Company operates telecommunication services in accordance with licences that were granted for the provision of telecommunication services.

During 2005, several changes took place in the regulated environment of electronic communications in the Czech Republic. Out of these, the most significant was the replacement of Act No. 151/2000 Coll., on telecommunications and on changes of other acts, in the valid wording (further Act on telecommunications) by Act No. 127/2005 Coll., on electronic communications and on amendments of some of the relating acts, in the valid wording (further Act on electronic communications) effective from 1 May 2005 and the enforcement of other relating regulations (government regulations, notices, public provisions).

Until 12 August 2005, the Company carried its business activities based on a telecommunication licence for the setting up and running of a public telecommunication network and a telecommunication licence for the provision of public telephone services through a public fixed telecommunication network which among others regulates the provision of a universal service. Under the Act on electronic communications, as of 1 September 2005, the validity of all telecommunication licences and approvals according to general licences terminated.

From 12 August 2005, the Company performs communication activities under the Act on electronic communications based on a notification to and a certificate from the Czech Telecommunication Office. In accordance with Section 13 of the Act on electronic communications, on 12 August 2005, the Company delivered a notification to the Czech Telecommunication Office on the performance of a communication activity, which is under Section 8 of this Act a business activity in electronic communications. Relating documentation required by the Act on electronic communications was provided on 29 September 2005. Subsequently, on 11 October 2005, the Czech Telecommunication Office issued a certificate confirming that a notification on the performance of a communication activity was received.

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

a) Public fixed network of electronic communications,
b) Public network for the transfer of radio and TV signal,
c) Public fixed telephone network,
d) Publicly accessible telephone services,
e) Other voice services,
f) Rent of circuits,
g) Transmission of radio and TV signal,
h) Transfers of data,
i) Internet access services.

In accordance with the deadline given by the Act on electronic communications, the Czech Telecommunication Office should determine the scope and new detail conditions for the provision of each particular service within the universal service including the selection of one or several providers by the end of January 2006.

On 21 December 2005, the Czech Telecommunication Office issued, based on the results of a tender, a decision according to which the Company was determined as the provider of the following particular services:

- Periodic issuance of telephone directories with numbers of participants of the publicly accessible telephone service and access of end users to these directories in accordance with Section 38, Para 2, letter c) of the Act on electronic communications;
- Information service on the numbers of participants of the publicly accessible telephone service in accordance with Section 38, Para 2, letter d) of the Act on electronic communications.

Until new particular services within the universal service are released under the Act on electronic communications, the Company remains the provider of a universal service in accordance with the conditions of the previous regulation framework given by the Act on telecommunications, relating regulations and telecommunications licences.

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

24 Share capital and reserves

	31 December 2005	31 December 2004
Nominal value per ordinary share (CZK)	100	100
Number of shares	322,089,890	322,089,890
Nominal value per share with special rights (CZK)*	1,000	1,000
Number of shares*	1	1
Ordinary shares (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 the Company's 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. Since then the share has not borne special decision-making rights.

At 31 December 2004, shareholdings in the Company were as follows:	
The National Property Fund of the Czech Republic	51.1 %
Other shareholders	48.9 %

At 31 December 2005, shareholdings in the Company were as follows:	
Telefónica, S.A.	69.4 %
Other shareholders	30.6 %

Funds include a statutory reserve fund of CZK 5,903 million (2004: CZK 5,498 million) that is not distributable under ruling legislation.

25 Share-based payments

On 24 June 2004 the Company granted 2,207,000 share appreciation rights (SARs) to selected members of the Board of Directors and the Supervisory Board in accordance with the Compensation Plan approved by the annual general meeting of shareholders. An extraordinary general meeting of the shareholders of ČESKÝ TELECOM, a.s., which took place on 3 February 2005, approved changes to the rules governing remuneration for members of the Supervisory Board of ČESKÝ TELECOM, a.s., whereby it cancelled the compensation plan for the members of this corporate body of the Company. An adjustment for this was included in the financial statements for 2005. In addition after the take-over and transfer of the majority ownership to the new shareholder, Telefónica, S.A., all outstanding SARs were exercised and settled/paid in cash in accordance with the prior Compensation Plan. The financial effect is stated as follows:

Employee benefit expenses (wages and salaries) (in CZK million)	2005	2004
SARs granted to the Board of Directors and Supervisory Board	190	60
Closing balance of provision for share-based compensation	-	60

Further details of the SARs relating to the exercise are as follows:

	2005		2004	
	Number of SARs	Exercise price	Number of SARs	Exercise price
Outstanding at start of year	2,207,000	n/a	-	-
Granted	-	-	2,207,000	n/a
Cancelled (Supervisory Board)	857,000	-	-	-
Exercised – date of expiration 31 March	1,350,000	-	-	-
(rights granted 24 June 2004)	131,250	119.88	-	-
(rights granted 27 October 2004)	37,500	54	-	-
Subtotal – date of cessation of NPF ownership	168,750			
(rights granted 24 June 2004)	918,750	210.08	-	-
(rights granted 27 October 2004)	262,500	151.61	-	-
Subtotal	1,181,250			
Outstanding at end of year	-		2,207,000	

The Company has neither prepared nor granted any other share-based payments during the period ended 31 December 2005.

The conditions, numbers, terms and estimated fair and intrinsic value of vesting and exercise were as follows:

The SARs provided those eligible, at the date the rights are exercised, the right to receive cash payments calculated based on a formula reflecting any appreciation in the Company's share price (preceding six-month average) from the inception date of the plan. The inception date for the determination of the option base price is 31 December 2003 (preceding six months average). The SARs were conditional on the board member remaining in the employment of the Company throughout the vesting period. The SARs vest and are exercisable during 2005 and 2006 unless there is a decrease or cessation of the NPF ownership of shares in the Company or a board member's employment with the Company is terminated for reasons other than personal decision or breach of duty. In these events the SARs are exercisable immediately. The SARs are settled once exercised.

Condition and numbers

Type of arrangement	Share appreciation rights (SARs)
Date of grant (approval of the Compensation Plan by general meeting)	24 June 2004
Number granted	2,207,000
	(300,000 SARs were granted on 27 October 2004)
Exercise price	n/a
Option base price at the base date	CZK 270.50 (base date 31 December 2003)
	CZK 337.70 (base date 27 October 2004)
Contractual life	between 9 and 30 months
Vesting conditions	being member of the Board of Directors / Supervisory Board over the contractual life
Settlement	Cash
Expected volatility*	29.3%
Expected risk-free interest rate**	2.6 – 3.2%
Expected departures – forfeitures	0.0%
Expected dividend (dividend yield)***	0.0%
Valuation method	Monte Carlo
Valuation model	Black-Scholes

* The expected volatility for the SARs is based on historical volatility determined from daily share price movements over past year.
** Expected daily risk-free rates are assumed to be constant and equal to daily forward rates calculated from zero-coupon CZK yield curve.
*** Measurement of the SARs fair value considers net dividends paid in 2004.

Numbers, terms, fair and intrinsic value as at 31 December 2004

The granted SARs used to be exercisable in eight fixed terms during the year 2005, 2006 at eight equal portions of granted rights or immediately by cessation of NPF ownership.

Date of expiration	31 March 2005	30 June 2005	31 October 2005	31 December 2005
Number of rights granted (24 June 2004)	238,375	238,375	238,375	238,375
Fair value (CZK)	83.62	97.99	101.98	104.63
Number of rights granted (27 October 2004)	37,500	37,500	37,500	37,500
Fair value (CZK)	17.8	36.95	49.16	54.28

Date of expiration	31 March 2006	30 June 2006	31 October 2006	31 December 2006
Number of rights granted (24 June 2004)	238,375	238,375	238,375	238,375
Fair value (CZK)	109.13	113.18	118.18	120.20
Number of rights granted (27 October 2004)	37,500	37,500	37,500	37,500
Fair value (CZK)	61.23	67.15	74.23	77.27

The intrinsic value of rights granted on 24 June 2004 was CZK 76.62 for each right and CZK 9.41 for rights granted on 27 October 2004.

26 Hedging reserve

(in CZK million)	
Balance as at 1 January 2004	**(2)**
Fair value losses in period	(10)
Fair value losses transfer to net profit	2
Deferred tax on fair value losses	3
Balance as at 31 December 2004	**(7)**
Fair value losses in period	-
Fair value losses transfer to net profit	10
Deferred tax on fair value losses	(3)
Balance as at 31 December 2005	**-**

27 Cash generated from operating activities

	Year ended	
(in CZK million)	31 December 2005	31 December 2004
Net profit	7,164	8,252
Adjustments for:		
Tax (Note 5)	781	537
Dividend income	(7,000)	(8,000)
Depreciation (Note 8)	10,686	11,353
Amortisation (Note 9)	1,837	3,045
Impairment loss (Note 8, 9)	465	56
Disposals of assets	26	134
Profit on sale of property, plant and equipment	(111)	(245)
Net interest and other charges	732	1,205
Foreign exchange gains (net)	(323)	(1,162)
Fair value changes	(119)	134
Increase in provisions	124	827
Operating cash flow before working capital changes	14,262	16,136
Decrease/(increase) in trade and other receivables	(68)	83
Increase in inventories	(161)	(39)
(Decrease)/increase in trade and other payables	425	(1,157)
Cash generated from operations	**14,458**	**15,023**

28 Related party transactions

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

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

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

The following transactions were carried out with related parties:

I. Parent company:

There were no transactions with the parent companies in 2005 and 2004.

II. Other related parties – Telefónica Group:

(all tabular amounts in CZK million)

Sales of services and goods	Year ended 31 December 2005	Year ended 31 December 2004
Telefónica companies	29	-

Purchases of services and goods	Year ended 31 December 2005	Year ended 31 December 2004
Telefónica companies	18	-

Receivables	31 December 2005	31 December 2004
Telefónica companies	24	-

Payables	31 December 2005	31 December 2004
Telefónica companies	7	-

The list of the Telefónica companies with which the Company had any transaction in 2005 includes the following entities: Telefónica Data España, S.A.U., Telefónica de España, S.A.U., Telefónica Deutschland GMBH, PT COMUNICACOES, S.A., and Infonet Services Corporation, Inc.

III. Other related parties – State entities controlled by NPF*:

(all tabular amounts in CZK million)

Sales of services and goods	Year ended 31 December 2005	Year ended 31 December 2004
State controlled entities	11	25

Purchases of services and goods	Year ended 31 December 2005	Year ended 31 December 2004
State controlled entities	58	103

Receivables	31 December 2005	31 December 2004
State controlled entities	2	5

Payables	31 December 2005	31 December 2004
State controlled entities	75	50

* NPF did not hold any shares in the Company after 16 June 2005, and accordingly the respective related party sales and purchases have been prepared for period from 1 January 2004 to 16 June 2005. The state controlled entities include all companies that are owned by the State through NPF Czech Republic. Entities controlled by NPF consist of number of commercial (joint stock or limited liability) companies operating across different industries, and they do not include the government or governmental bodies. Accordingly, transactions with ministries and other state agencies are not treated as related party transactions.

IV. Subsidiaries:

(all tabular amounts in CZK million)

Sales of services and goods	Year ended 31 December 2005	31 December 2004
Eurotel Praha, spol. s r.o.	415	388
Other companies within the Group	20	37
	435	425

Purchases of services and goods	Year ended 31 December 2005	31 December 2004
Eurotel Praha, spol. s r.o.	852	899
Other companies within the Group	115	107
	967	1,006

Receivables	31 December 2005	31 December 2004
Eurotel Praha, spol. s r.o.	17	79
Other companies within the Group	20	53
	37	132

Payables	31 December 2005	31 December 2004
Eurotel Praha, spol. s r.o.	744	835
Other companies within the Group	17	24
	761	859

V. Other related parties:

a) Key management compensation

Members of the Board of Directors and of the Supervisory Board of the Company were provided with benefits as follows:

(in CZK million)	Year ended 31 December 2005	31 December 2004
Salaries and other short-term benefits	168	140
Board share on profit	-	-
Stock appreciation rights (Note 25)	190	60
Non-competition clause	6	2
Termination benefits	38	-
Capital life insurance	16	9
Personal indemnification insurance	14	14
Total	**432**	**225**

b) Loans to related parties

Loans to members of Board of Directors and Supervisory Board:

(in CZK million)	2005	2004
Beginning of the year	-	1
Loans advanced during the year	-	-
Loans repayments received	-	(1)
Interest charged	-	-
Interest received	-	-
End of the year	**-**	**-**

The Company provided no other loan to related parties.

29 Principal subsidiary undertakings

	Name	Company's interest	Country of incorporation	Activity
1.	Eurotel Praha, spol. s r.o.	100%	Czech Republic	Mobile telephony and internet services
2.	OMNICOM Praha, spol. s r.o.	100%	Czech Republic	Network and consultancy services in telecommunications
3.	SPT TELECOM (Czech Republic) Finance B.V.	100%	Netherlands	Financing other entities in the Group
4.	CZECH TELECOM Germany GmbH	100%	Germany	Data transmission services
5.	CZECH TELECOM Austria GmbH	100%	Austria	Data transmission services
6.	CZECH TELECOM Slovakia s.r.o.	100%	Slovakia	Data transmission services
7.	CenTrade, a.s.	100%	Czech Republic	E-business company providing market place services

Investments in subsidiary undertakings comprise ordinary shares and are stated at cost less provision for impairment.

As at 31 December 2005:	Number of shares	Nominal value	Cost	Book value	2005 net profit/(loss) (unaudited)	Net assets (unaudited)
Foreign subsidiaries		EUR	CZK million	CZK million	EUR thousand	EUR thousand
SPT TELECOM (Czech Republic) Finance B.V. (Netherlands)		18,151	1	1	3	1,076
CZECH TELECOM Germany GmbH		25,000	27	27	33	965
CZECH TELECOM Austria GmbH		35,000	10	10	67	452
		SKK			SKK thousand	SKK thousand
CZECH TELECOM Slovakia s.r.o.		200,000	-	-	3,928	7,578
Czech subsidiaries		CZK million			CZK million	CZK million
OMNICOM Praha, spol. s r.o.		10	30	30	5	29
CenTrade, a.s.	1,000	600	519	-	(4)	(2)
Eurotel Praha, spol. s r.o.*		1,211	29,448	29,448	5,388	22,852
			30,035	29,516		

* Eurotel Praha, spol. s r.o. - audited data were prepared for the period of 12 months ended 31 December 2005.

As at 31 December 2004:	Number of shares	Nominal value	Cost	Book value	2004 net profit/(loss)	Net assets
Foreign subsidiaries		EUR	CZK million	CZK million	EUR thousand	EUR thousand
SPT TELECOM (Czech Republic) Finance B.V. (Netherlands)		18,151	1	1	-	1,074
CZECH TELECOM Germany GmbH		25,000	28	28	22	933
CZECH TELECOM Austria GmbH		35,000	11	11	114	385
		SKK			SKK thousand	SKK thousand
CZECH TELECOM Slovakia s.r.o.		200,000	-	-	2,094	4,200
Czech subsidiaries		CZK million			CZK million	CZK million
M.I.A., a.s. v likvidaci*	100	1	83	-	in liquidation	-
OMNICOM Praha, spol. s r.o.		10	30	-	4	24
CenTrade, a.s.	865	519	519	-	(111)	2
Eurotel Praha, spol. s r.o.**		1,211	29,448	29,448	6,555	24,448
			30,120	**29,488**		

* M.I.A., a.s. went to liquidation on 1 March 2004. The liquidation was finalized on 13 January 2005.
** Eurotel Praha, spol. s r.o. - audited data were prepared for the period of 12 months ended 31 December 2004.

The Company has concluded controlling agreements with the following subsidiary:

OMNICOM Praha, spol. s r.o.

The movement in the provision for diminution in value of investments in subsidiaries and associated undertakings are analysed as follows:

(in CZK million)	2005	2004
Opening balance at 1 January	632	727
Charge for the year	-	40
Disposal for the year	(113)	(135)
Closing balance at 31 December	**519**	**632**

In 2005 the Company received a dividend payment from its share in Eurotel Praha, spol. s r.o. in the net amount of CZK 7,000 million (2004: CZK 8,000 million).

30 Post balance sheet events

There were no events, which have occurred subsequent to the year-end, which would have a material impact on the financial statements at 31 December 2005.

05

Information on the registred
security issuer

Information on the registered security issuer

Contents

Note: Information in this section of the Annual Report for 2005 is based on financial statements prepared in accordance with the provisions of the Czech Accounting Act, the Capital Market Undertakings Act and other relevant legislation of the Czech Republic, unless otherwise indicated.

Information on the registered security issuer

Basic information:

Corporate name:	ČESKÝ TELECOM, a.s. (ČESKÝ TELECOM, company)
Registered address:	Olšanská 55/5, 130 34 Prague 3
Company identification number:	60193336
Taxpayer registration number:	CZ60193336
Date of incorporation:	16 December 1993
Legally existing from:	1 January 1994
Duration of the company:	the company was founded for an indefinite period of time
Legal form:	joint-stock company
Statute of law under which the 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

Company's object:

Until 12 August 2005, ČESKÝ TELECOM had carried out its business based on a telecommunications licence to build and operate a public telecommunications network and based on a telecommunications licence to provide a public telephone service on the public fixed line telecommunications network, which, among other things, covers the Universal Service provision. According to the Act on Electronic Communications, all telecommunications licences and certificates under general licences ceased to be in force as from 1 September 2005.

From 12 August 2005, ČESKÝ TELECOM has carried out its telecommunications business under the Act on Electronic Communications based on a notification and certification from the CTO. In keeping with the provisions of Section 13 of the Act on Electronic Communications, ČESKÝ TELECOM notified the CTO on 12 August 2005 of its electronic communications services which constitute doing business in electronic communications as per Section 8 of the Act. On 29 September 2005, ČESKÝ TELECOM supplemented the notification with other documents required by the Act on Electronic Communications. On 29 September 2005, ČESKÝ TELECOM supplemented the notification with other documents required by the Act on Electronic Communications. Subsequently, on 11 October 2005, ČESKÝ TELECOM received a certification from the CTO which confirmed that it had duly notified its electronic communications services. Electronic communications services include the following:

a) Public fixed electronic communications network
Territorial coverage: Czech Republic
b) Public radio and television broadcasting network
Territorial coverage: Czech Republic
c) Public fixed telephone network
Territorial coverage: Czech Republic
d) Publicly available telephone service
The service is publicly available.
Territorial coverage of the service: Czech Republic
e) Other voice services
The service is publicly available.
Territorial coverage of the service: Czech Republic
f) Leased lines
The service is publicly available.
Territorial coverage of the service: Czech Republic
g) Radio and television signal broadcasting
The service is publicly available.
Territorial coverage of the service: Czech Republic

h) Data transmission services
The service is publicly available.
Territorial coverage of the service: Czech Republic
i) Internet access services
The service is publicly available.
Territorial coverage of the service: Czech Republic
j) Other voice services
The service is not publicly available.
Territorial coverage of the service: Czech Republic

To comply with the deadline stipulated in the Act on Electronic Communications, the CTO should determine the scope and new detailed conditions for the provision of individual elements of the Universal Service by the end of January 2006, including the selection of one or more providers. Based on the results of a tender, the CTO decided on 21 December 2005 that ČESKÝ TELECOM would be the provider of the following components of the Universal Service:

- regular publication of telephone directories in the area of the public telephone service and provision of access of users to these directories under Section 38(2c) of the Act on Electronic Communications,
- directory information service in the area of the public telephone service and provision of access of users to the information service under Section 38(2d) of the Act on Electronic Communications.

Pending the launch of the other Universal Service components as per the Act on Electronic Communications, ČESKÝ TELECOM remains the only Universal Service Provider under the conditions of the Regulatory Framework set forth in the Act on Electronic Communications, the related bylaws and telecommunications licences.

Securities issued:

A. Shares
(as at 31 December 2005)
The Company's share capital is CZK 32,208,990,000. The share capital is fully paid up.

The share capital comprises the following shares:

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 ČESKÝ TELECOM 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 2005)

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 ČESKÝ TELECOM 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 3.5% 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
Date of issue:	9 July 2008
Issuer's pre-payment option:	–
Issue administrator:	Česká spořitelna, a.s.
Administrator's commercial premises:	Národní 27, 110 00 Prague 1

Public markets where the bonds of ČESKÝ TELECOM are listed for trading:

Market	Note
the 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.

Changes in 2005:
On 15 July 2005, in keeping with the Terms and conditions of the Bond Issue ISIN CZ 0003501306, the issuer redeemed bonds in the total nominal value of CZK 4,000,000,000.

Holding structure:
Structure of main shareholders of ČESKÝ TELECOM
(as at 31 December 2005)

	Shareholder	Adress	Share in the capital
1	Telefónica, S.A.	Gran Vía 28, 28013 Madrid, Kingdom of Spain	69.4%
2	Investment funds and individual shareholders	–	30.6%

Entities which control or could control the issuer, including details on their share which entitles them to vote (if known to the issuer):

Information valid from 1 January 2005 to 16 June 2005

Controlling entity:	The National Property Fund of the Czech Republic registered at the Commercial Register of the Prague Municipal Court, Section A.LXII, File 174
Registration date:	2 August 1991
Registered address:	Rašínovo nábřeží 42, 128 00 Prague 2
Identification number:	41692918

The controlling entity held shares of the controlled entity in the aggregate nominal value of 51.1% of the share capital of the controlled entity. The total share in the voting rights of the controlled entity pursuant to Section 183d (1) of the Commercial Code was 51.1%.

Information valid from 17 June 2005 to 28 September 2005

Controlling entity:	Telefónica, S.A.
Registered address:	Gran Vía 28, 28013 Madrid, the Kingdom of Spain
Identification number:	A 28015865

The controlling entity held shares of the controlled entity in the aggregate nominal value of 51.1% of the share capital of the controlled entity. The total share in the voting rights of the controlled entity pursuant to Section 183d (1) of the Commercial Code was 51.1%.

Information valid from 29 September 2005 to 31 December 2005

Controlling entity:	Telefónica, S.A.
Registered address:	Gran Vía 28, 28013 Madrid, the Kingdom of Spain
Identification number:	A 28015865

The controlling entity held shares of the controlled entity in the aggregate nominal value of 69.4% of the share capital of the controlled entity. The total share in the voting rights of the controlled entity pursuant to Section 183d (1) of the Commercial Code was 69.4%.

Diagram of interconnection of the controlling entities:

Before the sale of shares held by the NPF CR:
ČESKÝ TELECOM, a.s. ← 51.1% NPF CR
↑
Other investors 48.9%

After the sale of shares held by the NPF CR to Telefónica:
ČESKÝ TELECOM, a.s. ← 51.1% Telefónica, S.A.
↑
Other investors 48.9%

After the settlement of the mandatory share buy-back offer:
ČESKÝ TELECOM, a.s. ← 69.4 % Telefónica, S.A.

↑

Other investors 30.6 %

Changes in 2005:
On 16 June 2005, Telefónica acquired the shares of ČESKÝ TELECOM which accounted for 51.1% of the share in the voting rights and the company's share capital. Subsequently, Telefónica made a mandatory share buy-out offer to all shareholders of the company, which was settled on 29 September 2005. These facts are taken into consideration and described in the above profiles of the controlling entities. Compared to the accounting period of 2004, there was a change on the part of shareholders acting in concert.

URL: www.telecom.cz

Information on the activities and objects of the registered security issuer

Main areas of business of the issuer, new products and services:
ČESKÝ TELECOM owns, constructs and operates a prevalent part of the uniform telecommunications network in the Czech Republic. The main area of the issuer's business is the provision of public telephone services on the public fixed telecommunications network. For details please refer to the Board of Directors Report on Business Activity in this Annual Report.

Revenues of the issuer for the two accounting period by type of activities (in CZK million):

	2005	2004
Call revenues	7,285	9,708
Subscription revenues	11,154	11,828
Connection fees	702	520
Internet and Data services	3,671	2,720
Value added services		
Interconnect revenues	4,723	3,832
Leased circuits	2,661	2,785
Equipment sales and sales of materials	447	380
Other revenues	745	1,072
Total revenues	**32,275**	**33,809**

Registered address of the company's organisation unit with more than 10% share of the Company's total revenues:
The issuer does not have any organisation units registered in the Commercial Register which would hold at least 10% share of the total revenues, production or services provided by the issuer.

Immovable property in ownership of the company:
The issuer owns immovable property used mostly for operating the company's business for which it is licensed under the existing legislation.

As at 31 December 2005 (in CZK millions)	Cost	Accumulated depreciation and adjusting items	Net book value
Land	484	(11)	473
Buildings and structures	112,676	(57,482)	55,194
Buildings and houses	12,695	(4,657)	8,038
Public pay-phone booths	780	(765)	15
Telecommunications cables, overground and underground	98,502	(51,624)	46,878
Other	699	(436)	263

As at 31 December 2005	Number	Area in m^2
Buildings and structures	2,147	1,188,089
Land	4,205	1,570,099

Net book value of pledged property:

As at 31 December 2005	(in CZK millions)
Buildings and land	7
Plan and equipment	1,213
Total	**1,220**

See Borrowings which forms a part of the Financial Statements for the year ended 31 December 2005 on page 184 of the Annual Report.

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

1) Patents and licenses
The issuer has licence agreements for the following software products: application middleware (Miracle, BEA), database environment (Oracle, Microsoft), operating systems (Hewlett-Packard, SUN and Microsoft), workstation software (Microsoft), customer care and billing software (Amdocs) and BSS (SAP).

2) Industrial and commercial contracts
The issuer 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, NextraOne Czech, Amdocs Development Limited, Hewlett-Packard, Huawei Technologies Co.

3) Financial contracts
See Borrowings which forms a part of the Financial Statements for the year ended 31 December 2005 on page 184 of the Annual Report.

Information on litigation, administrative proceedings or arbitration instigated in the course of the last two accounting periods, which had or could have a significant bearing on the issuer's financial situation:

Information on litigation, administrative proceedings or arbitration instigated in the course of the last two accounting periods, which had or could have a significant bearing on the issuer's financial situation is listed in the Notes to the Consolidated Financial Statements for the year ended 31 December 2005 – see Note 21 Contingencies on page 189 of the Annual Report.

Investments:

Principal investments of the issuer for the last two accounting period (in CZK millions)

	2005	2004
Switching technology	40	154
Transmission technology	363	528
Access network	590	774
Buildings	106	188
Data network	416	187
Other – support systems	734	766
Total investments (non-financial)	**2,249**	**2,597**

All of the above major investments of the issuer were made in the Czech Republic and financed from the issuer's own cash and from loans.

In 2005, the company continued to implement a conservative investment policy with a clear accent on achieving maximum effectiveness of investment. The structure of capital expenditure reflected the current customer requirements for premium data communication services. A major success arrived in the form of Internet Expres, a broadband Internet access service. In 2005, ČESKÝ TELECOM successfully increased the number of ADSL lines by 173 thousand. As at the end of 2005, the total number of ADSL lines was 274 thousand, compared to 101 thousand at the end of 2004. Customers of ČESKÝ TELECOM make up approximately 80% of all ADSL lines. This result was achieved by the attractive value proposition to customers, but also due to the expansion of the number of locations where the service is available to 1,322; the network of locations now covers more than 90% of all fixed lines. In the area of regulatory compliance, due investments were made to satisfy the current requirements of the regulator.

Financial investments of the issuer for the past two accounting periods (in CZK millions):

	2005	2004
Financial investments	0	0

Major investments expected in the future

The next period, from 2006 to 2008, will continue to see a conservative investment policy focussed on efficiency and implementation of new technology in order to deliver on the key strategic goal – maintaining the leadership on the Czech telecommunications market. In the next period, all efforts will concentrate on improving the level of customer satisfaction with broadband access to the Internet, launching a host of services on the IPTV platform and on the provision of a broad portfolio of IP-based services. Investments will be made to accommodate regulatory requirements; in the near term future, such investment will come primarily as a result of the Act on Electronic Communications coming into force.

Information on the research and development policy in the current accounting period:
In 2005, ČESKÝ TELECOM spent in total CZK 6,162 thousand (2004: CZK 9,755 thousand), of which no amounts were capitalised. The development expenses include externally developed information systems and technology, data and system architecture and applications integration.

Main risk factors in the financial management of the Group:
See Financial Risk Management on page 168 of the Consolidated Financial Statements for the year ended 31 December 2005, which form a part of the Annual Report.

Interruption of business:
No interruption of business occurred.

Acting on bids for take-over:
By its decision of 19 July 2005, the Securities Commission approved the mandatory share buy-out offer made by Telefónica, S.A. This offer was published in Hospodářské noviny and Mladá Fronta DNES on 29 July 2005, was binding from 30 July 2005 until 19 September 2005 and settled on 29 September 2005. Based on the settlement of the mandatory offer, the controlling entity now holds a 69.4% in the voting rights of the controlled entity.

Average number of employees:

Type of operation	2005	2004
Management and administration	2,375	3,424
Operation and maintenance	3,559	3,860
Construction and installation	–	–
Information technology	369	433
Transport	24	43
Procurement and logistics	153	296
Sales and marketing	1,521	1,618
Maintenance of buildings	11	29
Other support and auxiliary operations	6	9
Total	**8,018**	**9,712**

Information on statutory bodies and their members, and on members of the corporate supervisory bodies and the executive management, as at 31 March 2006:
See Sections 03/05, 03/06 and 03/09 of the Annual Report (pages 62 – 65 and 69 – 73).

Information on the financial position of the registered security issuer

Changes in equity in the last three accounting periods
(in CZK millions):

Year	2005	2004
Share capital	32,209	32,209
hare premium	30,816	30,816
Hedging reserve	–	(7)
Funds from profit	5,911	5,506
Retained earnings	15,438	8,681
Total equity	**84,374**	**77,205**

Profit/loss after tax (under International Financial Reporting Standards) per share:

	2005	2004
Profit/loss after tax (in CZK million)	7,164	8,252
Number of shares [1]	322,089,900	322,089,900
Profit/loss on ordinary activities of the issuer after tax attributable to one share in the nominal value of CZK 100 (in CZK)	22	26

[1] The registered share in the nominal value of CZK 1,000 was, for the sake of comparability, accounted for as 10 shares in the nominal value of CZK 100.

Consolidated profit/loss after tax (under International Financial Reporting Standards) per share:

	2005	2004
Profit/loss after tax (in CZK million)	6,248	5,729
Number of shares [1]	322,089,900	322,089,900
Profit/loss on ordinary activities of the issuer after tax attributable to one share in the nominal value of CZK 100 (in CZK)	19	18

[1] The registered share in the nominal value of CZK 1,000 was, for the sake of comparability, accounted for as 10 shares in the nominal value of CZK 100.

Dividends for the last three periods:

At the Ordinary General Meeting of 13 June 2003 held in Prague, the shareholders approved a dividend payment for the year 2002, in the total amount of CZK 18.5 billion, i.e. CZK 57.50 per share of nominal value of CZK 100 and CZK 575 per share of nominal value of CZK 1,000. At the Ordinary General Meeting of 24 June 2004 held in Prague, the shareholders approved dividends for 2003 totalling CZK 5.476 billion, i.e. CZK 17 per share of nominal value of CZK 100 and CZK 170 per share of nominal value of CZK 1,000. No dividend was paid by the issuer for the accounting period 2004. Potential payment of dividends for the accounting period of 2005 will be decided at the issuer's Ordinary General Meeting scheduled for 27 April 2006 in Prague.

Loans and bonds issued:

Loans and bonds issued broken down to short and long term:

(in CZK millions)	As at 31 December 2005
Short-term loans and bonds (maturing within 1 year)	35
Long-term loans and bonds	9,324
Total	**9,359**

Loans and bonds issued:

	Currency	Total loan in the currency	Outstanding in the currency as at 31 December 2005	Outstanding in CZK as at 31 December 2005	Redemption
Private Placement – debt instrument	EUR	115,040,673	115,040,673	3,336,754,728	2012
Bond issue (Dluhopisy 3,50 % / 2008) [1]	CZK	6,000,000,000	5,987,151,194	5,987,151,194	2008
Syndicated loan [2]	EUR	145,273,206	0	0	2008
	CZK	3,360,000,000	0	0	

EUR/CZK exchange used in the table for conversion purposes (as at 31 December 2005) is CZK 29.005/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.

Changes in 2005:
10 September 2005 – according to the loan agreement, the whole outstanding amount was prepaid to the European Investment Bank (referred to as European Investment Bank – Loan II in the 2004 Annual Report). The loan was drawn in September 1994 with a maturity of 15 years.

25 December 2005 – according to the loan agreement, the whole outstanding amount was prepaid to the European Investment Bank (referred to as European Investment Bank – Loan I in the 2004 Annual Report). The loan was drawn in June 2003 with a maturity of 15 years.

The loans are repaid in accordance with the relevant loan agreements or the Terms and Conditions of Issue. As at 31 December 2005, ČESKÝ TELECOM had no overdue loan obligations.

Entities in which the issuer directly or indirectly owns at least 10% of the consolidated equity or at least 10% of the consolidated profit or loss of the consolidated whole:

Corporate name:	Eurotel Praha, spol. s r.o.
Registered address:	Vyskočilova 1442/1b, 140 21 Prague 4
Identification number:	15268306
Object:	Construction and operation of the public mobile telecommunications network and provision of mobile telecommunications services in the scope and under conditions laid down in the Licence
Registered capital:	CZK 1,211,000,000
Interest share:	direct 100% ownership

Commercial undertakings in which the issuer directly owns more than 10 % of the registered/share capital:
(as at 31 December 2005)

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.	Na Zájezdu 5,100 00 Prague 10	Consulting and brokerage activity in nontelecommunication disciplines	49356160	CZK 166,000	39.57%
CenTrade, a.s.	Křižíkova č.p. 237, 186 00 Prague 8	e-business and electronic marketplace services	26513731	CZK 600,000,000	100%
Eurotel Praha, spol. s r.o.	Vyskočilova 1442/1b, 140 21 Prague 4	See above	15268306	CZK 1,211,000,000	100%
OMNICOM Praha, spol. s r.o.	Bartákova 1121/3, 140 00 Prague 4	Data services and telecommunications consulting	45797111	CZK 10,000,000	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.	Gutleutstrasse 120, 60327 Frankfurt am Main, Germany	Data transmission services	HRB 51503	EUR 25,000	100%
CZECH TELECOM Slovakia s.r.o.	Kutlíkova 17, 852 50 Bratislava 5 – Petržalka, Slovakia	Data transmission services	35848863	SKK 200,000	100%

Eurotel Praha, spol. s r.o., is a provider of public telecommunications services; companies in Austria, Germany and Slovakia also hold licenses for provision of public telecommunications services.

Changes in 2005:
Based on agreements with SAP ČR and Citicorp Overseas Investment Corporation on the transfer of shares, the issuer increased its stake in CenTrade, a.s., from 86.5% to 100%, on 28 April 2005.

For more information see the Notes to the financial statements for the year ended 31 December 2005, Note No. 29 – Principal subsidiary undertakings, which form a part of the Annual Report.

Commercial undertakings in which the issuer indirectly owns more than 10% of the share/registered capital:
(as at 31 December 2005)

Corporate name	Registered address	Identification number	Object	Registered capital	Issuer's share in the registered capital in %
Trigo Global Services Consulting Ltd.[1]	Szombathely 9700, Malom u. 7. I./3, Hungary	–	recruitment services, consulting, property management and other unspecified services	USD 10,000	Eurotel Praha, spol. s r. o., holds 100% of the registered capital of the company

[1] On 20 December 2001, Eurotel became 100% owner of Trigo Property Management Limited liability company. The company was incorporated on 29 December 2000. On 16 September 2002, the company changed its name from Trigo Property Management Limited Liability Company to Trigo Global Services Consulting Ltd. In September 2004, the company went into voluntary liquidation. The liquidation process was concluded on 8 April 2005 and the company's assets were transferred to Eurotel.

Information on the business and financial situation expected in the next accounting period

See pages 26 and 55 of the Annual Report.

Information on all pecuniary and in-kind income accepted in the accounting periods by executive managers and Supervisory Board members from the issuer and from entities controlled by the issuer

(in CZK thousands)	Pecuniary income	Of which royalties	In-kind income
Board of Directors total	509,915	–	7,064
– of which on the ground of being a member of the Board of Directors	253,195	–	4,401
Supervisory Board total	23,542	–	28,490
– of which on the ground of being a member of the Supervisory Board	17,679	–	26,743
Management [1]	161,832	–	1,905

[1] The Management category includes income of managers whose positions meet the definition of Section 27(5) of the Labour Code. Income of those members of the Board of Directors who, at the same time, qualify as Management is included in the Board of Directors total category.

Information on the number of shares issued by the issuer held by statutory bodies or their members, other executive managers of the issuer and by Supervisory Board members, including persons related to these persons, information on option and similar agreements, information on individual transactions concluded by the said persons in the accounting period

	Number of shares
Board of Directors [1]	
Supervisory Board	300
Management [2]	440

[1] This category includes also shares held by members of the Board of Directors who are at the same time managers of the company (these shares are not included in the Management category).
[2] The Management category includes income of managers whose positions meet the definition of Section 27 (5) of the Labour Code.

Principles of remuneration of executive managers of the 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 ČESKÝ TELECOM Board of Directors (Rules) which were approved by the Ordinary General Meeting of 24 June 2004. The Rules envisage that the remuneration will consist of three 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,
- a special motivation bonus – the compensation plan which determined the disbursement of the special motivation bonus was terminated (collectively for all members of the Board of Directors) as of 17 June 2005, when the specific conditions under points (d) (i) and (e) of the Rules were met. The decisive factor was the expiration of the ownership interest of the National Property Fund of the Czech Republic in ČESKÝ TELECOM and the subsequent

origination of the duty of the new majority shareholder Telefónica, S.A. to make a mandatory share buy-out offer in respect of ČESKÝ TELECOM. The principles of the compensation plan are outlined in the 2004 Annual Report of ČESKÝ TELECOM (Section 8 – Information on the listed security issuer).

The actual amounts of the flat remuneration and of the extraordinary bonus are determined by the Supervisory Board acting on recommendation of the Staff and Remuneration Committee. The flat remuneration and the extraordinary bonus for 2005 could total a maximum (for the whole Board of Directors) of CZK 2.5 million, an amount approved by the Ordinary General Meeting held on 23 June 2005. The same aggregate amount is applicable also to 2006 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:

- a basic gross salary,
- a performance-related bonus,
- disbursement of the balance between the health insurance benefits and 100% of the average daily wage.

b) Compensation for commitment to the non-competition covenant

A member of the Board of Directors may, in their agreement for discharge of the office of a member, commit to the so-called non-competition covenant, i.e. a pledge not to do business, after the termination of the office, either individually or for the benefit of another person, in the field of telecommunications in the Czech Republic (nor in the field of advisory or consulting services related to the telecommunications industry). The agreement for discharge of the office of a member (including the non-competition covenant) must be approved by the General Meeting.

Compensation for commitment to the non-competition covenant is based on the following principles:

- The non-competition covenant is accepted for a period of six months as of the termination of office.
- The company is obliged to provide to the member of the Board of Directors in question, for committing to the non-competition covenant, compensation corresponding to a half of the proportional share (i) of the total annual amount of remuneration to members of the Board of Directors approved by the General Meeting, and (ii) the number of members of the Board of Directors as per the company's Articles of Association. All 5 present members of the Board of Directors accepted the non-competition covenant.

After termination of the 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 policyholder, contracted an insurance policy covering against damage caused in relation to the performance of designated functions; the insured persons (i.e. persons whose functions are covered by the policy) can be also members of the Board of Directors. The total insurance premium paid by the company is evenly divided amongst the insured persons and the amount calculated per insured person constitutes their income.

Endowment insurance

No endowment insurance has been contracted for members of the Board of Directors in relation to their discharge of office.

Car
In relation to the discharge of their office, members of the Board of Directors are not provided with cars for private use. As per the Rules approved by the General Meeting, the Chief Executive Officer is provided with a car both for work and private use.

2. Supervisory Board

a) Remuneration
Members of the Supervisory Board are remunerated in accordance with the Rules for Remuneration of Members of the ČESKÝ TELECOM Supervisory Board (Rules) which were amended by the Extraordinary General Meeting of 3 February 2005. The Rules envisage that the remuneration will consist 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 and of the extraordinary bonus are determined by the Supervisory Board acting on recommendation of the Staff and Remuneration Committee. The flat remuneration and the extraordinary bonus for 2005 could total a maximum (for the whole Supervisory Board) of CZK 17.5 million, an amount approved by the Ordinary General Meeting held on 23 June 2005. The same aggregate amount is applicable also to 2006 unless the General Meeting decides otherwise. As per the Rules, the extraordinary bonus is given for performance of special assignments.

b) Compensation for commitment to the non-competition covenant
A member of the Supervisory Board may, in their agreement for discharge of the office of a member, commit to the so-called non-competition covenant, i.e. a pledge not to do business, after the termination of the office, either individually or for the benefit of another person, in the field of telecommunications in the Czech Republic (nor in the field of advisory or consulting services related to the telecommunications industry). The agreement for discharge of the office of a member (including the non-competition covenant) must be approved by the General Meeting.
Compensation for commitment to the non-competition covenant is based on the following principles:
- The non-competition covenant is accepted for a period of six months as of the termination of office;
- The company is obliged to provide to the member of the Supervisory Board in question, for committing to the non-competition covenant, compensation corresponding to a half of the proportional share (i) of the total annual amount of remuneration to members of the Supervisory Board approved by the General Meeting, and (ii) the number of members of the Supervisory Board as per the company's Articles of Association. All 15 present members of the Supervisory Board accepted the non-competition covenant.

c) In-kind benefits
Damage liability insurance
The Company, as the policyholder, 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 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 policyholder, contracted endowment insurance for the benefit of some members of the Supervisory Board. According to the Rules approved by the Ordinary General Meeting of 13 June 2003, the endowment policy may be contracted to the maximum amount corresponding to a double of the annual remuneration of a Supervisory Board member. The specific terms and conditions of insurance are determined by the Supervisory Board, with the following applicable at present:

- The ceiling for determination of the insured amount is calculated as pro rata share (i) from the total annual remuneration of members of the Supervisory Board as approved by the General Meeting, and (ii) 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 policyholder (and payer of the premium).

In 2005, twelve Supervisory Board members became beneficiaries of endowment insurance (of which 6 were present members and 6 were former members).

Car

The Supervisory Board Chairman and Vice Chairmen are, with accordance to 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.

Other benefits

The Company also disbursed the following benefits to members of the Board of Directors (including the CEO) and of the Supervisory Board:

- service telephone lines,
- mobile telephones,
- computing equipment,
- a VISA payment card (in the case of the Supervisory Board, only the Chairman and Vice Chairmen are eligible; benefit has not been claimed since mid-2005,)
- health care.

The benefits were given to the persons in questions in relation to their performance of the duties attached to their office.

The principles of remuneration of members of the Board of Directors and of the Supervisory Board, including discretionary benefits, are published in the full version on the company's website.

Information on fees paid to auditors in the accounting period

Costs incurred by ČESKÝ TELECOM in connection with activities of PricewaterhouseCoopers, the external auditor, in 2005:

Type of service	Fees (in CZK thousands)
Audit	1,140
Other audit-related advisory services	1,305
Other services	4,878
Total	**7,323**

Costs incurred by the ČESKÝ TELECOM Group in connection with activities of PricewaterhouseCoopers, the external auditor, in 2005:

Type of service	Fees (in CZK thousands)
Audit	2,923
Other audit-related advisory services	4,680
Other services	5,314
Total	**12,917**

Costs incurred by ČESKÝ TELECOM in connection with activities of Ernst & Young, the external auditor, in 2005:

Type of service	Fees (in CZK thousands)
Audit	11,500
Other audit-related advisory services	-
Other services	13,907
Total	**25,407**

Costs incurred by the ČESKÝ TELECOM Group in connection with activities of Ernst & Young, the external auditor, in 2005:

Type of service	Fees (in CZK thousands)
Audit	14,830
Other audit-related advisory services	-
Other services	22,657
Total	**37,487**

Information on persons responsible for the Annual Report and for verification of the financial statements

Jaime Smith Basterra, Chairman of the Board of Directors and Chief Executive Officer of ČESKÝ TELECOM, a.s.,
Juraj Šedivý, 1st Vice Chairman of the Board of Directors and Chief Financial Officer of ČESKÝ TELECOM, 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.

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

Juraj Šedivý
1st Vice Chairman of the Board of Directors
and Chief Financial Officer

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Information for shareholders

Shareholders[1]

Telefónica, S.A.	69.4 %
Investment funds and individual shareholders	30.6 %

[1] As at 31 December 2005

Privatisation of the company
On 16 June 2005, privatisation of 51.1% stake of the National Property Fund of the Czech Republic (NPF) to Telefónica, S.A. (Telefónica) was concluded. Based on results of a tender where Telefónica bid the highest purchase price (CZK 82.6 billion, i.e. CZK 502 per share), the NPF and Telefónica signed an agreement on transfer of the majority shareholding on 12 April 2005. Telefónica subsequently deposited 10% of the purchase price. The remaining 90% were paid on 16 June 2005 – the day when the NPF effected the actual transfer of shares, making Telefónica the majority shareholder of ČESKÝ TELECOM.

Mandatory share buy-out offer to minority shareholders
Following approval by the Securities Commission, Telefónica paid heed to its statutory duty and on 29 July 2005 it made an offer to minority shareholders to buy out their shares for CZK 456 per share. The offer was good from 30 July to 19 September 2005. As a result, Telefónica acquired additional 18.3% shares, raising its shareholding in ČESKÝ TELECOM to 69.4%.

Shares

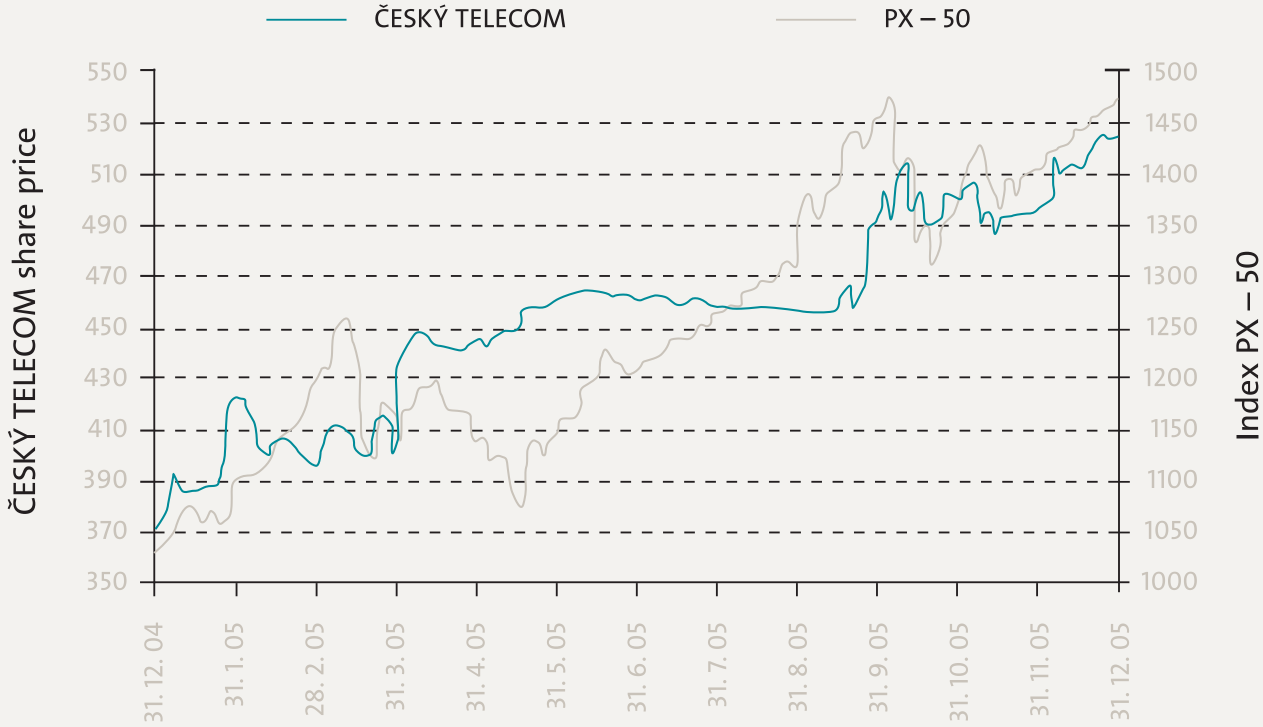
	2005	2004
Number of shares (in millions)	322.1	322.1
Net profit/(loss) per share (in CZK) [1]	19.4	17.8
Maximum share price (in CZK) [2]	526.6	396.8
Minimum share price (in CZK) [2]	377.7	283.5
Share price at the end of the period (in CZK) [2]	524.5	369.2
Market capitalisation (in CZK billions) [2]	168.9	118.9

[1] Consolidated net profit under IFRS
[2] Source: Prague Stock Exchange

In 2005, ČESKÝ TELECOM 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 2005 was CZK 288.3 billion compared to CZK 121 billion in 2004, which represents a year on year increase by 138%. Trading in ČESKÝ TELECOM shares measured by the total volume of trades made up 27.7% of all trades on the PSE stock market. ČESKÝ TELECOM shares were the second most traded issue on the PSE in 2005, after the shares of ČEZ, the power utility company. The average daily volume of trades in ČESKÝ TELECOM shares in 2005 was CZK 1.1 billion.

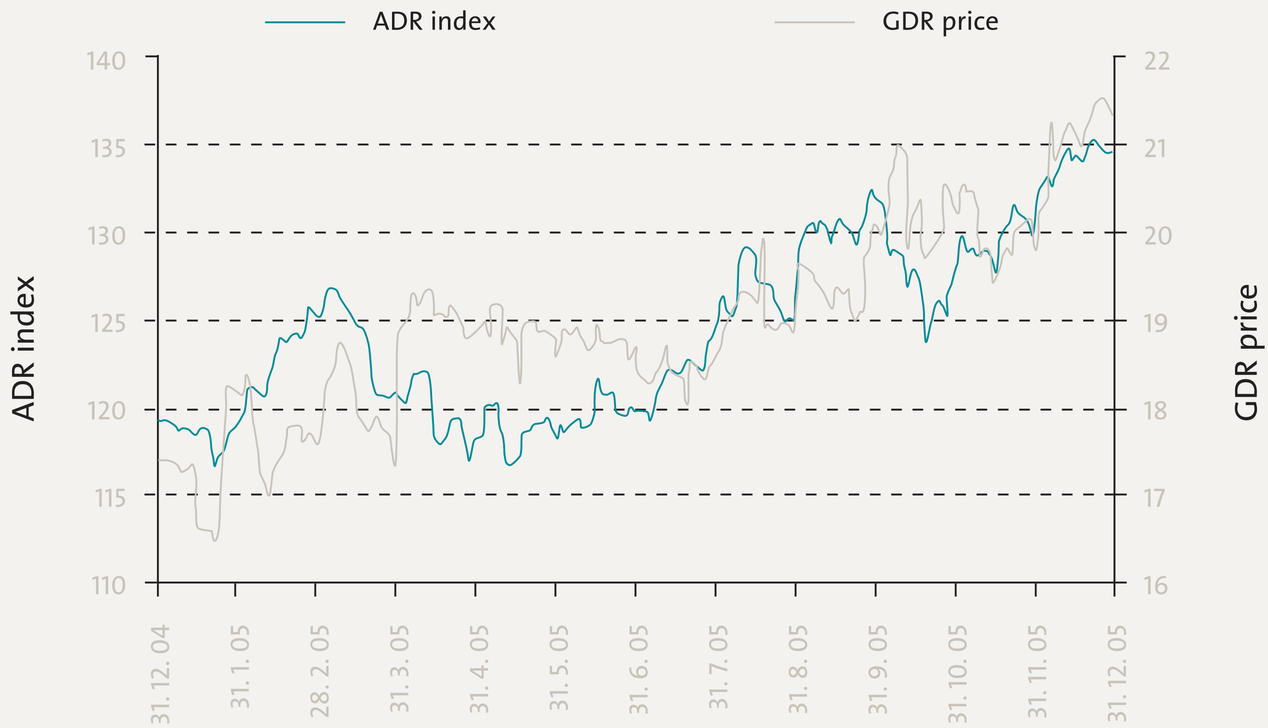
As at 30 December 2005, the market capitalisation reached CZK 168.9 billion compared to CZK 118.9 billion as at the end of 2004. The share price of ČESKÝ TELECOM as at the end of 2005, compared to the closing price on the last PSE trading day in 2004, grew by 42.1% to CZK 524.50. The share price reached its maximum of CZK 526.60 on 27 December 2005, and its minimum of CZK 377.70 on 3 January 2005, the first trading day in 2005. The average share price was CZK 454.67 in 2005 compared to CZK 327.38 in 2004.

Development of the share price of ČESKÝ TELECOM and PX – 50 Index in 2005



Trading of ČESKÝ TELECOM shares on the London Stock Exchange (LSE), in the form of Global Depository Receipts (GDR), followed a similar trend – the average price being USD 18.98 in 2005, compared to USD 12.76 in 2004. As at the end of 2005, the GDR price grew year on year by 28.8% to USD 21.30.

GDR price development on LSE in 2005



Dividend

At the Ordinary General Meeting of 13 June 2003 held in Prague, the shareholders approved a dividend payment from the 2002 net profit of ČESKÝ TELECOM and part of the retained earnings from previous years, in the total amount of CZK 18.5 billion, i.e. CZK 57.50 per share of nominal value of CZK 100 and CZK 575 per share of nominal value of CZK 1,000. The record day for the payment of dividends was 27 June 2003 and the disbursement date 6 October 2003.

At the Ordinary General Meeting of 24 June 2004 held in Prague, the shareholders approved dividends for 2003 totaling CZK 5.476 billion, i.e. CZK 17 per share of nominal value of CZK 100 and CZK 170 per share of nominal value of CZK 1,000. The record day for the payment of dividends was 9 July 2004 and the disbursement date 20 October 2004.

The company did not pay any dividend in 2005.

General Meeting of Shareholders

The Ordinary General Meeting of Shareholders of ČESKÝ TELECOM will be held on 27 April 2006.

Financial calendar

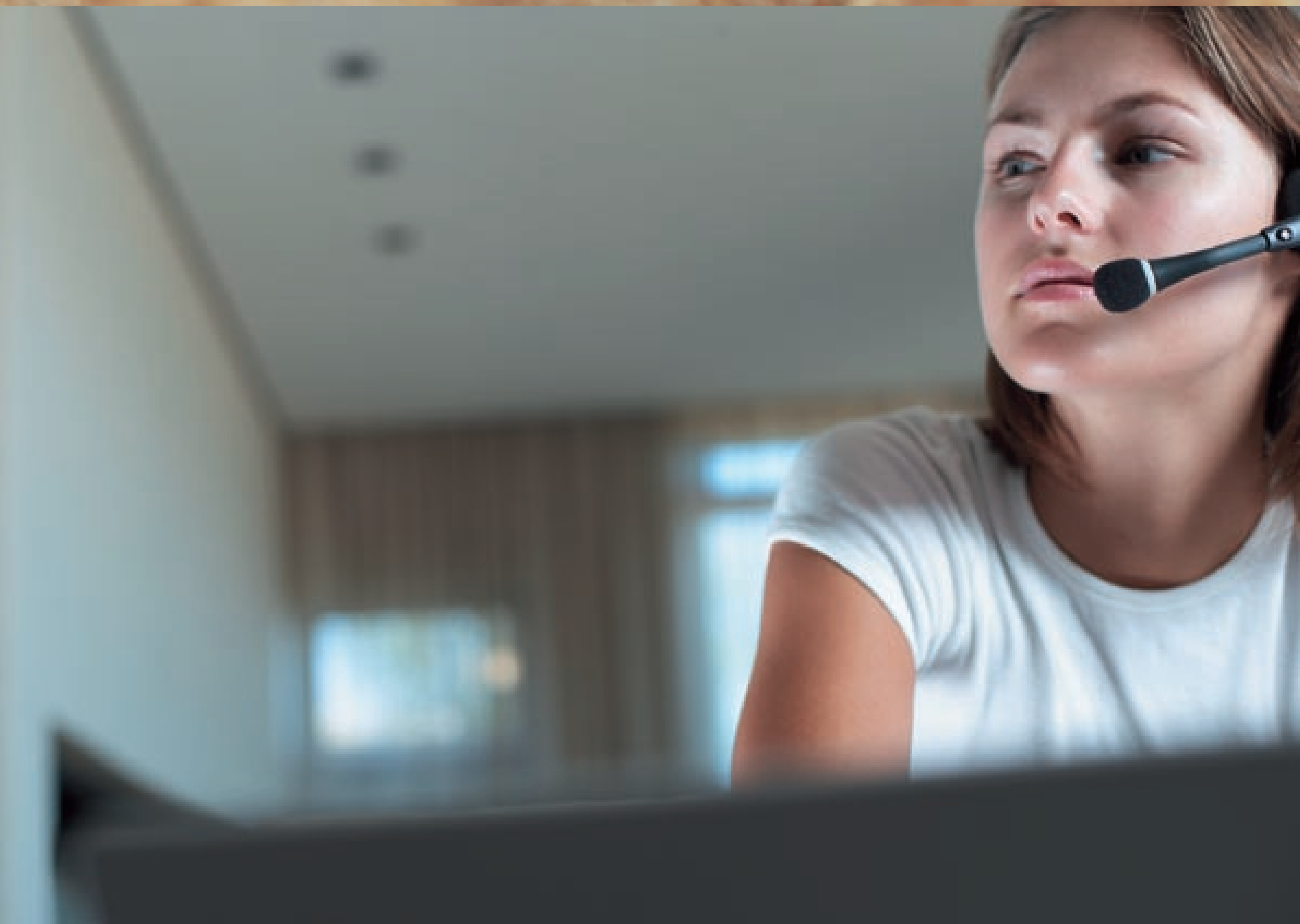
Date of release of current results

For the first quarter of 2006	27 April 2006
For the first half of 2006	31 July 2006 at the latest
For three quarters of 2006	31 October 2006 at the latest
For the year 2006	Preliminary results – 28 February 2007 at the latest
	Audited results – 2 April 2007 at the latest

Institutional investors and shareholders may contact

Investor Relations

Tel.:	+420 271 462 076
Fax:	+420 271 469 825
E-mail:	investor.relations@ct.cz
URL:	www.telecom.cz
Address:	ČESKÝ TELECOM, a.s. Olšanská 5/55 30 34 Praha 3



07

Glossary of terms and acronyms

ADSL – Asymmetric Digital Subscriber Line
ARPU – an indicator – average monthly revenues from services per user, excluding roaming visitors
ATM (Asynchronous Transfer Mode used for data) – video and voice transmission
Benefit – a customer loyalty program for post-paid customers of Eurotel, offering a range of bonuses on a point-based system
Business – a price plan package of ČESKÝ TELECOM designed for the SME segment, with free domestic voice and dial-up Internet minutes
Business Profit – new voice solutions of ČESKÝ TELECOM for the business segment, offering the best tariffs
Carrier Broadband – a data service of ČESKÝ TELECOM
CDMA (Code Division Multiple Access) – a modern digital technology for wireless data and Broadband Internet
Colour lines – premium rate numbers
CS/CPS – Carrier Selection/Carrier Pre-selection
CTO – Czech Telecommunications Office
Data Expres – see Eurotel Data Expres
Data Nonstop – see Eurotel Data Nonstop
Dedicated hosting – rental of hardware for customer applications
Dohled 24 – a service of ČESKÝ TELECOM, offering a comprehensive security solution, building surveillance and a number of additional features
DOMAIN OnLine – a domain registration service of ČESKÝ TELECOM
DVB-T (Digital Video Broadcasting Terrestrial) – digital television broadcast over a network of terrestrial transmitters
DWDM – Dense Wave Digital Multiplexing
e-účet – a service of ČESKÝ TELECOM, offering online access to a bill for telecommunications services
EBIT – Earnings before Interest and Tax
EBITDA – Earnings before Interest, Tax, Depreciation and Amortisation
EDGE (Enhanced Data Rates for GSM Evolution) – a fast data transmission technology
Eurotel Bronz – a new package of services of Eurotel for post-paid customers with the lowest subscription fee and free minutes
Eurotel Car Control – a service of Eurotel for business customers, helping them control the movement of their vehicles or the fuel consumption
Eurotel Data Expres – a service of Eurotel for high-speed Internet access
Eurotel Data Nonstop – a price plan of Eurotel for unlimited mobile Internet access via the GPRS technology, designed for post-paid customers
Eurotel Diamant – a new package of services of Eurotel for post-paid customers, with the highest number of free minutes and with call and SMS prices starting from CZK 1
Eurotel Gold – a new package of services of Eurotel for post-paid customers, with the cheapest rates on calling within the Eurotel network
Eurotel Live! – A portal of Eurotel's entertainment and information content services distributed via WAP, SMS, MMS or video; allows also for instant ordering of these and other services online at www.eurotel-live.cz or via WAP
Eurotel Mobile Exchange Plus – a mobile solution of Eurotel for business customers, built on the Microsoft Windows Mobile platform, developed by a strategic alliance of Eurotel, ČESKÝ TELECOM and Microsoft
Eurotel Platinum – a new package of services of Eurotel for post-paid

customers, with special low rates on calls
Eurotel Pohoda – a special package of services of Eurotel designed for students
Eurotel Přepínám – a service of Eurotel using the Push To Talk technology, simulating a short-wave radio in a mobile telephone
Eurotel Silver – a new package of services of Eurotel for post-paid customers
Eurotel SMS – a new package of services of Eurotel for post-paid customers, with 150 free SMS
Eurotel Spolu – a service of Eurotel, allowing customers call up to three numbers in the Eurotel network 25% cheaper
Eurotel Start – a new service of Eurotel for pre-paid Go customers who plan to switch to a post-paid tariff
Expres Klik – a service of ČESKÝ TELECOM, allowing to temporarily increase the speed of connection to the Internet
FMCA – Fixed-Mobile Convergence Alliance
FR – see Frame Relay
Frame Relay – a protocol and a service used particularly for LAN networking
Fraud Protect – a security system of ČESKÝ TELECOM, protecting against telecommunications fraud and unlawful profiting at the expense of the company and its customers
GDR – Global Depository Receipt
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
IASB – International Accounting Standards Board
IFRIC – International Financial Reporting Interpretations Committee
InfoLimit – an additional service to a main telephone line, and one of the tools for combating dial-up Internet fraud
Internet Broadband – a Broadband Internet access service of ČESKÝ TELECOM designed for residential customers and small enterprises
Internet Doma – a package of services of Eurotel, for unlimited broadband Internet access for residential customers and small enterprises
Internet Expres – a broadband Internet access service of ČESKÝ TELECOM, combined with economical voice tariffs, all for one flat monthly fee
Internet Expres Doma – a service of ČESKÝ TELECOM for residential customers offering economical weekly data limits
Internet Expres Hit – a service of ČESKÝ TELECOM, offering Internet access with the speed 256/64 kb/s to customers who are considering getting a high-speed Internet connection
Internet Expres Optimal – a service of ČESKÝ TELECOM offering Internet access with the speed 1,024/256 kb/s for a monthly subscription of CZK 799
Internet Hosting – a new service of ČESKÝ TELECOM for unlimited Internet access with a dedicated bandwidth
Internet Kombi – a package of services of Eurotel for unlimited Internet access with a speed of up to 4 Mb/s

Internet Kredit – a new Internet access service of ČESKÝ TELECOM with a selected monthly data traffic quota
Internet Mobil – a package of services of Eurotel for unlimited Internet access with a speed of up to 384 kb/s
Internet Pro – a package of services of Eurotel for unlimited Internet access with a speed of up to 1 Mb/s
Internet Speed – a package of services of Eurotel for unlimited Internet access with a speed of up to 1 Mb/s
IP Connect – a service for IP protocol based data communication
IP Connect Remote – a new service of ČESKÝ TELECOM, giving customers remote access to their corporate network from any point with Internet access
IP MPLS (Internet Protocol Multi-Protocol Label Switching) – an Internet protocol for connection of foreign branches of Czech companies to their data networks; it is used for the international version of the IP Connect service
IPTV – Internet Protocol Television
ISDN (Integrated Services Digital Network) – a digital network powering modern and quality services of telephony, Fast Internet and high-speed data transmission
IP VPN (Internet Protocol Virtual Private Network) – a service of intra-corporate data or voice over IP communication
Corporate Mobile Access – a service of ČESKÝ TELECOM allowing for remote access to the corporate network using mobile GPRS or CDMA technology
LL – Leased Lines
LSE – London Stock Exchange
MI – Ministry of Informatics of the Czech Republic
MMS – a multimedia format for mobile data transmission
MOU – an indicator – average minutes of use per month per customer
NMT (Nordic Mobile Telephony) – a technology standard for mobile telephony networks using the 450 MHz frequency
NPF – National Property Fund of the Czech Republic
Number portability – a service allowing the customer to switch to another operator and keep the existing telephone number
OIBDA – Operating Income before Depreciation and Amortisation
OPEC – Office for the Protection of Economic Competition, an anti-monopoly authority
PC Strážce – a service of ČESKÝ TELECOM, providing a comprehensive protection of the PC, data and communication against malicious code, unauthorised access and hidden attacks from the Internet
PKI (Public Key Infrastructure) – a tool for protection of personal data
PPPoE – Point to Point Protocol over Ethernet for high-speed Internet access
PSTN – Public Switched Telephony Network
Push To Talk – a technology simulating a short-wave radio in a mobile telephone
ROA – Return on Assets
ROE – Return on Equity
SARs – Stock Appreciation Rights
SDH – Synchronous Digital Hierarchy
Server hosting – lease of area capacity or racks in a hosting centre
SMS – a format for short text messages used in mobile telephony
SUALL – Shared Unbundled Access to the Local Loop
Telefon Start – a price plan of ČESKÝ TELECOM, containing 60 minutes of free local and long distance calls to fixed line networks in the Czech Republic, peak and off-peak

Telefon Volno – a price program of ČESKÝ TELECOM, offering free off-peak, weekend and holiday calls to fixed line networks in the Czech Republic and lower call rates than Telefon Start

Telefon Volno Plus – a price program of ČESKÝ TELECOM, offering free off-peak, weekend and holiday calls to fixed line networks in the Czech Republic and 60 minutes of free peak-time local and long distance calls to fixed line networks in the Czech Republic

UMTS (Universal Mobile Telecommunications System) – a standard for the so-called 3rd generation mobile networks approved for use in Europe; the UMTS network will support a wide range of multimedia services (e.g. videoconferencing and high-speed data transmission)

VoD – Video on Demand

VoIP – Voice over Internet Protocol

WAP (Wireless Application Protocol) – a protocol for displaying selected web pages on a mobile telephone display

Webhosting – lease of server capacity for web presentation

Wi-Fi – a technology for wireless Internet access


Schedule

Report of the Board of Directors of ČESKÝ TELECOM

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 2005 (pursuant to provisions of Section 66a of Act No. 513/1991 Coll., the Commercial Code, as amended)

ANNUAL REPORT SCHEDULE

Contents

Schedules

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 controlled by the same controlling entity (Report) is prepared for the last accounting period, i.e. for the period started 1 January 2005 and ended 31 December 2005.

Part B
Entities forming the Holding

Section I.
Identification details of the controlled entity – ČESKÝ TELECOM, a.s.

The company is registered in the Commercial Register of the Municipal Court in Prague, Section B, Enclosure 2322.

Registration date:	1 January 1994
Corporate name:	ČESKÝ TELECOM, a.s.
Registered address:	Olšanská 55/5, 130 34 Prague 3
Identification number:	60 19 33 36
Legal form:	Joint-stock company

Section II.
Identification details of the controlling entities

Compared to the accounting period 2004, changes occurred in 2005 on the part of the controlling entities, as shown below:

Information valid from 1 January 2005 to 16 June 2005

Controlling entity:	**The National Property Fund of the Czech Republic (NPF)** registered at the Commercial Register of the Prague Municipal Court, Section A.LXII, File 174
Registration date:	2 August 1991
Registered address:	Rašínovo nábřeží 42, 128 00 Prague 2
Identification number:	41692918

The controlling entity held shares of the controlled entity in the aggregate nominal value of 51.1% of the share capital of the controlled entity.

The total share in the voting rights of the controlled entity pursuant to Section 183d (1) of the Commercial Code was 51.1%.

Diagram of interconnection with the controlling entity:

ČESKÝ TELECOM, a.s. ← 51.1% NPF

↑

Other investors 48.9%

Information valid from 17 June 2005 to 28 September 2005

Controlling entity: **Telefónica, S.A.**
Registered address: Gran Vía 28, 28013 Madrid, the Kingdom of Spain
Identification number: A 28015865

The controlling entity held shares of the controlled entity in the aggregate nominal value of 51.1% of the share capital of the controlled entity.

The total share in the voting rights of the controlled entity pursuant to Section 183d (1) of the Commercial Code was 51.1%.

ČESKÝ TELECOM, a.s. ← 51.1% Telefónica, S.A.

↑

Other investors 48.9%

Information valid from 29 September 2005 to 31 December 2005

Controlling entity: **Telefónica, S.A.**
Registered address: Gran Vía 28, 28013 Madrid, the Kingdom of Spain
Identification number: A 28015865

The controlling entity held shares of the controlled entity in the aggregate nominal value of 69.4% of the share capital of the controlled entity.

The total share in the voting rights of the controlled entity pursuant to Section 183d (1) of the Commercial Code was 69.4%.

ČESKÝ TELECOM, a.s. ← 69.4% Telefónica, S.A.

↑

Other investors 30.6%

Section III.
Interconnected entities

Entities controlled by the National Property Fund of the Czech Republic and by Telefónica, S.A.

a) Lists of entities controlled by the National Property Fund of the Czech Republic and by Telefónica, S.A. form Schedules No. 1A and 1B of this Report. The list was compiled from inputs sent by the National Property Fund of the Czech Republic, Telefónica, S.A., and verified using information from the Commercial Register and other available sources.

b) Lists of entities controlled by entities controlled by the National Property Fund of the Czech Republic and by Telefónica, S.A., form Schedules No. 2A and 2B of this Report. The lists were compiled from available information.

Part C
Contracts and agreements between holding entities which were concluded in the accounting period of 2005, and contracts and agreements concluded in the past and which were the ground for performance provided thereunder in the applicable accounting period

Section I.
Contracts and agreements between the controlled entity and the controlling entities

No contract was made between the controlled entity and the controlling entities in the applicable period and no performance was provided between the controlled entity and the controlling entities in the applicable period.

Section II.
Contracts and agreements between the controlled entity and other entities controlled by the National Property Fund of the Czech Republic and by Telefónica, S.A., including information on performance and counter-performance provided

Telecommunications services

As part of its business objective, the controlled entity provided the following telecommunications services to some of the entities listed in Schedules No. 1A/B and 2A/B of this Report, for which it received pecuniary counter-performance, and the price was set according to the current price list as a regulated or unregulated price. The services were the following:

- public telephony service and other services additional to the telephony service as a part of the universal service, for instance call centre services and directory services;
- other value-added telecommunications services, for instance Zelená linka, Memobox, Barevné linky, audiotex;
- publication of telephone directories;
- euroISDN;
- lease of digital and analogue lines;
- data services, for instance ATM, Frame Relay, packet-switched services;
- high speed Internet access and Internet access service;
- Internet 2005 – for Internet Service Providers (ISP);
- lease of terminal equipment.

Information on contractual partners and contracts concluded in provision of telecommunications services are regarded by the controlled entity as trade secret according to the Commercial Code and internal governance regulations. Execution of these agreements for provision of telecommunication services for consideration to the controlled entity did not result in any damage incurred by the controlled entity.

Supply of media

Contracts for supply of electricity, natural gas and water to the controlled entity were concluded in 2005 and in the years before with interconnected entities listed in Schedule No. 3. The controlled entity provided pecuniary counter-performance for this performance, according to applicable price lists.

Other leases

In a limited scope, contracts for lease, in particular of poles for telecommunications lines, were concluded between the controlled entity as the lessee and interconnected entities-lessors listed in Schedule No. 4 in 2005 and prior to 1 January 2005.

In a limited scope, contracts for lease, in particular of cable duct holes, cable ducts and collectors, were concluded between the controlled entity as the lessor and interconnected entities-lessees listed in Schedule No. 4 in 2005 and prior to 1 January 2005.

Construction and assembly work

In 2005, contracts were concluded between the controlled entity and interconnected entities listed in Schedule No. 5 for delivery of construction and assembly work by the interconnected entities for pecuniary performance provided by the controlled entity.

Sale of goods and services

In 2005, contracts were concluded between the controlled entity and interconnected entities listed in Schedule No. 6 for sale of goods and services by the controlled entity, for instance sale of terminal equipment, for pecuniary performance provided by the interconnected entities. In 2005, contracts were concluded between the controlled entity and interconnected entities listed in Schedule No. 7 for sale of goods and services by the interconnected entity, for instance for a buy-back of network, repairs and purchase of spare parts for motor vehicles, maintenance check-ups of transformers, training, accommodation, for pecuniary performance provided by the controlled entity.

Project and geodetic services

In 2005, contracts were concluded between the controlled entity and interconnected entities listed in Schedule No. 8 for project and geodetic services, for instance for geodetic surveys of standard utility networks, supplied by the interconnected entities, for pecuniary performance provided by the controlled entity.

Repairs and maintenance of buildings, facility management

In 2005, contracts were concluded between the controlled entity and interconnected entities listed in Schedule No. 9 for repairs and maintenance of buildings, for instance for connection to and disconnection from the power mains and facility management, supplied by the interconnected entities, for pecuniary performance provided by the controlled entity.

Conclusion

Details of contracts concluded are regarded by the controlled entity as trade secret, 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 2005 between the controlled entity and other interconnected entities, under which performance and counter-performance was given, or in connection with provision of performance and counter-performance in 2005 under contracts and agreements concluded prior to 1 January 2005. Performance provided in 2005 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 2005

In accounting period 2005, no legal acts were done between the controlled entity and the controlling and interconnected entities in the interest of or instigated by these controlling or interconnected entities, resulting in a damage or profit, advantage or disadvantage.

Part E
Measures between holding entities in the accounting period 2005

In accounting period 2005, no measures were done between the controlled entity and the controlling and interconnected entities in the interest of or instigated by these controlling or interconnected entities, resulting in a damage or profit, advantage or disadvantage.

Part F
Conclusion

a) The Report was prepared by the Board of Directors of the controlled entity, ČESKÝ TELECOM, a.s., and approved at the meeting of the Board of Directors held on 29 March 2006.

b) The Report was prepared using data and information obtained from the controlling and other interconnected entities, information from the Commercial Register, other available documents, and using results of examinations of relationships between the controlled entity and the controlling and other interconnected entities. The Board of Directors of the controlled entity, ČESKÝ TELECOM, 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, ČESKÝ TELECOM, 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 Annual Report for 2005. 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 29 March 2006

ČESKÝ TELECOM, a.s. – controlled entity

Board of Directors

Jaime Smith Basterra
Chairman of the Board of Directors

Juraj Šedivý
1st Vice Chairman of the Board of Directors

Schedule No. 1 A

List of joint-stock companies directly controlled by NPF CR with a share interest 40 – 100% in the period from 1 January 2005 to 16 June 2005

Name of the joint-stock company	Identification number	Share capital in CZK thousands	NPF share in CZK thousands	% held by NPF	Note
KONAX, a.s. v konkurzu	46347801	90,671.000	39,989.000		
Severočeské mlékárny, a.s., v konkurzu	48291749	30,228.000	12,326.000	40.78	
UNITEX, a.s.	49969358	51,707.000	26,887.000	52.00	Acquisition of shares by decision of the Municipal Court in Prague of 10 October 2003 and by decision of the Higher Court in Prague of 20 April 2004
Ormilk, a.s., v konkurzu	60109092	183,070.000	86,028,000	46.99	
Severočeské doly, a.s.	49901982	9,000,055.000 9,080,631.000	4,985 692.000 5,066 268.000	55.40 until 19 February 2005 55.79 from 19 February 2005 onwards	* other entities controlled by Severočeské doly, a.s. – See Schedule No. 2A
České aerolinie, a.s.	45795908	2,735,510.000	1,556,980.000	56.92	NPF voting rights limited by the Articles of Association to 49.9% * other entities controlled by ČSA, a.s. – See Schedule No. 2A
AERO HOLDING, a.s. v likvidaci	00002127	1,572,580.000	972,332.800	61.83	
UNIPETROL, a.s.	61672190	18,133,476.400	11,422,403.800	62.99	Transfer of shares on 24 May 2005, as of then zero holding; other entities controlled by Unipetrol, a.s.- See Schedule No. 3
PRESTA výr. st. hmot a.s., v konkurzu	46708944	146,643.000	96,960.000	66.12	Transfer of shares on 4 January 2005, as of then zero holding
ČEZ, a.s.*	45274649	59,221,084.300	40,040,789.700	67.61	* other entities controlled by ČEZ, a.s. – See Schedule No. 2A
Teplotechna Praha, a.s., v konkurzu	60192933	129,681.000	95,345.000	73.52	
SEVAC, a.s., v likvidaci	60192968	211,849.000	167,054.000	78.86	In bankruptcy since 30 February 2002
HOLDING KLADNO, a.s., v konkurzu	45144419	7,500,000.000	7,263,533.000	96.85	
STAZAP, a.s.	45280100	69,180.000	69,180.000	100.00	Transfer of shares on25 May 2005, as of then zero holding
Silnice Teplice, a.s., v konkurzu	47285583	7,347.000	7,347.000	100.00	
MERO ČR, a.s.	60193468	8,430,921.000	8,430,921.000	100.00	Also controls (100 %) of MERO Pipeline, Gmbh
ČEPRO, a.s.	60193531	2,660,000.000 5,660,000.000	2,660,000.000 5,660,000.000	100.00	Share capital increased on 10 November 2005; also controls (49%) of BAUFELD – ekologické služby s.r.o.
OSINEK, a.s.t	00012173	15,833,918.000	15,833,918.000	100.00	Other entities controlled by OSINEK a.s. – See Schedule No. 2A

Name of the joint-stock company	Identification number	Share capital in CZK thousands	NPF share in CZK thousands	% held by NPF	Note
PPP Centrum, a.s.	00013455	37,469.000	37,469.000	100.00	
PAL, a.s.	00211222	237,006.000	237,006.000	100.00	Also controls (44%) of Výzkumný a zkušební ústav, a.s.,
LETKA, a.s.	25134132	961,000.000 1,211,000.000	961,000.000 1,211,000.000	100.00	Share capital changed on 29 September 2005
THERMAL – F, a.s.	25401726	439,550.000	439,550.000	100.00	
Dřevařské závody Borohrádek – F, a.s.	25288016	48,500.000	48,500.000	100.00	

Schedule No. 1 B

List of joint-stock companies directly controlled by Telefónica, S.A. with a share interest 40 – 100 % in the period from 17 June 2005 to 31 December 2005.

Corporate name	Registered address	% held by Telefónica, s.a.
TELEFÓNICA PUBLICIDAD E INFORMACIÓN, S.A.	AVDA. DE MANOTERAS, 12-28050 MADRID, SPAIN	59.90
ALIANCA ATLANTICA HOLDING, B.V.	STRAWINSKYLAAN 1725, 1077 XX AMSTERDAM, NETHERLANDS	50.00
TELEFÓNICA FACTORING ESTABLECIMIENTO FINANCIERO DE CREDITO, S.A.	PEDRO TEIXEIRA, 8-28020 MADRID, SPAIN	50.00
TERRA NETWORKS, S.A.	NICARAGUE, 54-08029 BARCELONA, SPAIN	75.87
TELEFÓNICA MÓVILES, S.A.	GOYA, 24-MADRID, SPAIN	71.03
TELEFÓNICA INTERNATIONAL, S.A.	GRAN VÍA, 28-28013 MADRID, SPAIN	99.88
TELEFÓNICA INTERNATIONAL WHOLESALE SERVICES AMERICA, S.A.	LUIS A. DE HARRERA, 1248 PISO 4-MONTEVIDEO, URUGUAY	100.00
TELEFÓNICA GESTION DE SERVICIOS COMPARTIDOS (ARGENTINA), S.A.	TUCUMAN 1, PISO 18 CIUDAD DE BUENAS AIRES, ARGENTINA	99.99
TELEFÓNICA GESTION DE SERVICIOS COMPARTIDOS (PERU), S.A.C.	SHELL, 310-MIRAFLORES LIMA, PERU	99.99
TELEFÓNICA GESTION DE SERVICIOS COMPARTIDOS MEXICO, S.A.	BLVD. DÍAZ ORDAZ PTE N 123 2, COL. SANTAMARIA-6465 MONTERREY, MEXICO	99.99
TELEFÓNICA GESTION DE SERVICIOS COMPARTIDOS, S.A.	GRAN VÍA, 28-28013 MADRID, SPAIN	100.00
TELEFÓNICA B2B LICENCING, INC.	1221 BRICKELL AVENUE SUITE 600-33131 MIAMI-FLORIDA, USA	100.00
TELEFÓNICA INTERNACIONAL USA INC.	1221 BRICKELL AVENUE SUITE 600-33131 MIAMI-FLORIDA, USA	100.00
TELEFÓNICA EUROPE, B.V.	STRAWINSKYLAAN 1259,TOWER D,12TH FLOOR 1077XX-AMSTERODAM, NETHERLANDS	100.00
TELEFÓNICA EMISIONES, S.A.	GRAN VÍA, 28-28013 MADRID, SPAIN	100.00
TELEFÓNICA PARTICIPACIONES, S.A.	GRAN VÍA, 28-28013 MADRID, SPAIN	100.00
COMMUNICAPITAL GESTIÓN, S.A.U.	GRAN VÍA, 28-28013 MADRID, SPAIN	100.00
VENTURINI ESPAÑA, S.A.	VÍA AUGUSTA, 117-08006 BARCELONA, SPAIN	100.00
FISATEL MEXICO, S.A.	LOMAS DE CHAPULTEPEC-11000 MEXICO CITY, MEXICO	100.00
TELEFÓNICA FINANZAS PERÚ, S.A.C.	CUIDAD DE LIMA, PERU	100.00
TELEFÓNICA FINANZAS, S.A.	GRAN VÍA, 30-4 PLTA.-28013 MADRID, SPAIN	100.00
CASIOPEA REASEGURADORA, S.A.	6D, ROUTE DE TREVES, L-2633 SENNINGERBERG,LUXEMBOURG	100.00
COMPANIA ESPAÑOLA DE TECHNOLOGIA, S.A.	VILLANUEVA, 2 DUPLICADO PLANTA 1 OFICINA 23-28001 MADRID, SPAIN	100.00
COMMUNICAPITAL INVERSIONES, S.A.U.	GRAN VÍA, 28-28013 MADRID, SPAIN	100.00
TELEFÓNICA INVESTIGACIÓN Y DESARROLLO, S.A.	EMILIO VARGAS,6-28043 MADRID, SPAIN	100.00
ATENTO N.V.	LOCATELLIKADE,1-1076 AZ AMSTERDAM, NETHERLANDS	91.35
ATESECO COMUNICACIÓN, S.A.	GRAN VIA, 28-28013 MADRID, SPAIN	100.00
TELEFÓNICA CAPITAL, S.A.	GRAN VIA, 28-28013 MADRID, SPAIN	100.00
TELEFÓNICA INGENIERÍA DE SEGURIDAD, S.A.	CONDESA DE VENADITO,1-28027 MADRID, SPAIN	100.00
TELEFÓNICA DE ESPAÑA, S.A.U.	GRAN VÍA, 28 -28013 MADRID, SPAIN	100.00
TELEFÓNICA DATACORP, S.A.U.	GRAN VÍA, 28-28013 MADRID, SPAIN	100.00
ENDOMOL HOLDING, N.V.	BERGWEG 70,1217 SC HILVERSUM,NETHERLANDS	99.70
TELEFÓNICA DE CONTENIDOS, S.A.U.	PASEO DE LA CASTELLANA, 141-28046 MADRID, SPAIN	100.00
ČESKÝ TELECOM, A.S.	OLŠANSKÁ 55/5, 130 34 PRAHA 3, CZECH REPUBLIC	69,4

Schedule No. 2A

Interconnected entities and entities controlled by them, with a share interest of NPF CR greater than 40% in the period between 1 January 2005 and 16 June 2005.

1.	**ČEPRO a.s., identification number 60193531, was, in accounting period 2005, the controlling entity in respect of**		
	BAUFELD – ekologické služby s.r.o.	identification number 49681036	(49% ownership interest).
2.	**České aerolinie a.s., identification number 45795908, was, in accounting period 2005, the controlling entity in respect of**		
	ČSA Airtours a.s.	identification number 61860336	(100% ownership interest)
	Slovak Air Services s.r.o.	identification number 31373844	(100% ownership interest)
	Amadeus Marketing ČSA, s.r.o.	identification number 49680030	(65% ownership interest)
	ČSA Services, s.r.o.	identification number 25085531	(100% ownership interest)
	ČSA Support s.r.o.	identification number 25674285	(100% ownership interest)
3.	**UNIPETROL, a.s., identification number 61672190, was, in accounting period 2005 (until 24 May 2005), the controlling entity in respect of**		
	KAUČUK, a.s.	identification number 25053272	(100% ownership interest) – controls another entity
	CHEMOPETROL, a.s.	identification number 25003887	(100% ownership interest) – controls other entities
	BENZINA a.s.	identification number 60193328	(100% ownership interest) – controls other entities
	UNIPETROL RAFINÉRIE a.s.	identification number 25025139	(100% ownership interest)
	Výzkumný ústav anorganické chemie, a.s.	identification number 62243136	(100% ownership interest)
	UNIPETROL TRADE a.s.	identification number 25056433	(100% ownership interest) – controls other entities
	SPOLANA a.s.	identification number 45147787	(81.78% ownership interest) – controls another entity
	PARAMO, a.s.	identification number 48173355	(73.5% ownership interest) – controls other entities
	ČESKÁ RAFINÉRSKÁ, a.s.	identification number 62741772	(51% ownership interest) – controls other entities
	ALIACHEM a.s.	identification number 60108916	(38.79% ownership interest – acting in concert with AGROBOHEMIE a.s.) – controls other entities
	CELIO a.s.	identification number 48289922	(40.53% ownership interest – acting in concert with CHEMOPETROL, a.s.)

The following entities controlled by UNIPETROL, a.s., identification number 61672190, were, in accounting period 2005 (until 24 May 2005), controlling entities in respect of

3.1.	**ČESKÁ RAFINÉRSKÁ, a.s., identification number 62741772, was, in accounting period 2005, the controlling entity in respect of**		
	ČESKÁ RAFINÉRSKÁ SLOVAKIA s.r.o.	identification number 35777087	(100% ownership interest)
	CRC POLSKA Sp. z.o.o., v likvidaci		(100% ownership interest)
3.2.	**PARAMO, a.s., identification number 48173355, was, in accounting period 2005, the controlling entity in respect of**		
	Paramo Trysk, a.s.	identification number 64259790	(100% ownership interest)
	MOGUL SERVIS, a.s., v likvidaci	identification number 25634151	(100% ownership interest)
	MOGUL MORAVA, a.s., v likvidaci	identification number 60742160	(100% ownership interest)
	MOGUL TANK-PLUS a.s., v likvidaci	identification number 62526774	(98.33% ownership interest)
	MOGUL SLOVAKIA, s.r.o.	identification number 36222992	(100% ownership interest)
	PETRA SLOVAKIA s.r.o., v likvidaci	identification number 31600191	(70% ownership interest)
3.3.	**BENZINA a.s., identification number 60193328, was, in accounting period 2005, the controlling entity in respect of**		
	BENZINA Trade a.s.	identification number 26135710	(100% ownership interest)
	PETROTRANS, a.s.	identification number 25123041	(100% ownership interest)
	ČS Žilina s.r.o.	identification number 35807539	(100% ownership interest)
	ČS Smižany s.r.o.	identification number 35808306	(100% ownership interest)
	ČS Milhosť s.r.o.	identification number 35807547	(100% ownership interest)
3.4.	**CHEMOPETROL, a.s., identification number 25003887 was, in accounting period 2005, the controlling entity in respect of**		
	B.U.T., s.r.o.	identification number 25005120	(100% ownership interest)
	UNIPETROL DOPRAVA, a.s.	identification number 64049701	(100% ownership interest)
	HC CHEMOPETROL, a.s.	identification number 64048098	(70.95% ownership interest)

	Chemická servisní, a.s.	identification number 25492110	(100% ownership interest)
	POLYMER INSTITUTE BRNO, spol. s r.o.	identification number 60711990	(100% ownership interest)
	CELIO, a.s.	identification number 48289922	(40.53% ownership interest)
3.5.	**KAUČUK, a.s., identification number 25053272, was, in accounting period 2005, the controlling entity in respect of**		
	K-PROTOS, a.s.	identification number 25617214	(100% ownership interest)
3.6.	**SPOLANA a.s., identification number 45147787, was, in accounting period 2005, the controlling entity in respect of**		
	NeraPharm, spol. s.r.o.	identification number 26499258	(100% ownership interest)
3.7.	**UNIPETROL TRADE a.s., identification number 25056433, was, in accounting period 2005, the controlling entity in respect of**		
	ALIACHEM ITALIA S.r.l.		(90% ownership interest)
	UNIPETROL POLSKA Sp. z.o.o.		(100% ownership interest)
	MOGUL, d.o.o. – Slovenia		(100% ownership interest)
	DP MOGUL UKRAJINA		(100% ownership interest from 3 April 2003)
	ALIACHEM VERWALTUNGS GmbH		(100% ownership interest)
	UNIPETROL DEUTSCHLAND GmbH – indirect control		(100% held by ALIACHEM VERWALTUNGS GmbH)
	ALIAPHARM GmbH FRANKFURT – indirect control		(100% held by ALIACHEM VERWALTUNGS GmbH)
	UNIPETROL CHEMICAL IBERICA S.A.		(100% ownership interest)
	CHEMAPOL (SCHWEIZ) AG		(100% ownership interest)
	UNIPETROL AUSTRIA GmbH		(100% ownership interest)
	UNIPETROL (UK) Ltd.		(100% ownership interest)
	ALIACHEM BENELUX B.V.		(100% ownership interest)
	UNIPETROL FRANCE, S.A.		(96.72% ownership interest)
3.8.	**ALIACHEM a.s., identification number 60108916, was, in accounting period 2005, the controlling entity in respect of**		
	OSTACOLOR s.r.o.	identification number 25937421	(100% ownership interest)
	SYNTHESIA a.s.	identification number 26014343	(100% ownership interest)
	FATRA-HIF, s.r.o.	identification number 48584355	(100% ownership interest)
	Energetika Chropyně, a.s.	identification number 25517074	(100% ownership interest)
	OSTACOLOR POLSKA Sp. z.o.o.		(100% ownership interest)
	Výzkumný ústav organických syntéz a.s.	identification number 60108975	(98.74% ownership interest)
	FATRA, a.s.	identification number 27465021	(100% ownership interest)
4.	**MERO ČR, a.s., identification number 60193468 was, in accounting period 2005, the controlling entity in respect of**		
	MERO Pipeline GmbH (Federal Republic of Germany		(100% ownership interest)
5.	**OSINEK, a.s., identification number 00012173 was, in accounting period 2005, the controlling entity in respect of**		
	VÍTKOVICE STEEL, a.s.	identification number 25874942	(99% ownership interest – sold to Evraz during the accounting period 2005) – controls other entities
	ČEPS, a.s.	identification number 25702556	(51% ownership interest) – controls another entity

The following entities controlled by OSINEK, a.s., identification number 00012173, was, in accounting period 2005, controlling entities in respect of

5.1.	**VÍTKOVICE STEEL, a.s., identification number 25874942, was, in accounting period 2005, the controlling entity in respect of**		
	VÍTKOVICE – Servis Centrum, a.s. v likvidaci,	identification number 25824341	(97.96% ownership interest)
	VÍTKOVICE STEEL Polska Sp. z.o.o.		(100% ownership interest)
	VÍTKOVICE INTERNATIONAL GmbH		(Federal Republic of Germany; 100% ownership interest)
5.2.	**ČEPS, a.s., identification number 25702556, was, in accounting period 2005, the controlling entity in respect of**		
	ENIT, a.s.	identification number 25426796	(100% ownership interest)

6.	**Severočeské doly a.s., identification number 49901982 (sold to ČEZ, a.s. during the accounting period 2005), was, in accounting period 2005, the controlling entity in respect of**		
	Skládka Tušimice, a.s.	identification number 25005553	(98% ownership interest)
	SD – Vrtné a trhací práce, a.s.	identification number 25022768	(100% ownership interest)
	SD – Autodoprava, a.s.	identification number 25028197	(100% ownership interest)
	SD – Humatex, a.s.	identification number 25458442	(100% ownership interest)
	SD – 1. strojírenská, a.s.	identification number 25437127	(100% ownership interest)
	SD – Kolejová doprava a.s.	identification number 25438107	(100% ownership interest)
	SHD-KOMES, a.s.	identification number 44569891	(46.33% ownership interest)
	PRODECO, a.s.	identification number 25020790	(50.5% ownership interest)
	ENETECH a.s.	identification number 25448731	(50% ownership interest)
7.	**ČEZ, a.s., identification number 45274649, was, in accounting period 2005, the controlling entity in respect of**		
	ČEZ Správa Majetku, s.r.o.	identification number 26206803	(100% ownership interest)
	CEZTel, a.s.	identification number 25107950	(100% ownership interest)
	ČEZ ENERGOSERVIS spol. s.r.o.	identification number 60698101	(100% ownership interest)
	ČEZ FINANCE B.V. (The Netherlands)		(100% ownership interest)
	ČEZ Bulgaria EAD		(100% ownership interest)
	ČEZ Magyarország Kft.		(100% ownership interest)
	ČEZ Románia S.R.L.		(100% ownership interest)
	ČEZ Trade Bulgaria EAD		(100% ownership interest)
	COAL Energy		(40% ownership interest)
	ČEZ Distribuce, a.s.		(100% ownership interest)
	ČEZ Distribuční služby, s.r.o.		(100% ownership interest)
	ČEZ Měření, s.r.o.		(100% ownership interest)
	ČEZ obnovitelné zdroje, s.r.o.		(100% ownership interest)
	ČEZ Prodej, s.r.o.		(100% ownership interest)
	Electrica Oltenia, S.A.		(51% ownership interest)
	Elektrorazpredelenie Pleven EAD		(67% ownership interest)
	Elektrorazpredelenie Sofia oblast EAD		(67% ownership interest)
	Elektrorazpredelenie Stolično EAD		
	Elektrospolečnost B.D., spol. s r.o.		
	Elektrovod MATIC, d.o.o.		(100% ownership interest)
	Elektrovod Holding, a.s.		(80% ownership interest
	Energetické opravny, a.s.		(100% ownership interest)
	Rpg Energiehandel GmbH		(100% ownership interest)
	KNAUF Počerady, spol. s r.o.		(40% ownership interest)
	HYDROČEZ, a.s.	identification number 63079852	(100% ownership interest)
	I & C Energo s.r.o.	identification number 49433431	(100% ownership interest) – controls other entities
	ČEZData, s.r.o.	identification number 27151417	(100% ownership interest)
	ČEZ Zákaznické služby, s.r.o.	identification number 26376547	(100% ownership interest)
	Severočeské doly, a.s.		(93.10% ownership – (controlled during a part of the accounting period 2005) interest)
	ČEZ Logistika, s.r.o.	identification number 26840065	(100% ownership interest)
	LOMY MOŘINA spol. s r.o.	identification number 61465569	(51.05% ownership interest)
	ČEZnet, a.s.,	identification number 26470411	(100% ownership interest)
	OSC, a.s.	identification number 60714794	(66.67% ownership interest)
	SIGMA – ENERGO s.r.o.	identification number 60702001	(51% ownership interest)
	Škoda Praha a.s.	identification number 00128201	(100% ownership interest) – controls other entities
	Ústav jaderného výzkumu Řež a.s.	identification number 46356088	(52.46% ownership interest) – controls other entities

Středočeská energetická a.s.	identification number 60193140	(97.72% ownership interest) – controls other entities
Severočeská energetika, a.s.	identification number 49903179	(56.93% ownership interest) – controls other entities
Severomoravská energetika, a.s.	identification number 4767569	(100% ownership interest) – controls other entities
Východočeská energetika, a.s.	identification number 60108720	(100% ownership interest) – controls other entities
Západočeská energetika, a.s.	identification number 49790463	(100% ownership interest) – controls other entities

The following entities controlled by ČEZ, a.s., identification number 45274649, were, in accounting period 2005, controlling entities in respect of

7.1. Západočeská energetika, a.s., identification number 49790463, was, in accounting period 2005, the controlling entity in respect of

Enerfin, a.s., v likvidaci	identification number 25751344	(100% ownership interest)
ESMOS, s.r.o.	identification number 62620673	(100% ownership interest – deleted from the Commercial Register as of 1 May 2005)
PRO ENERGO Plzeň, spol. s r.o.	identification number 64356591	(100% ownership interest)
LINDRONE, spol. s r.o.	identification number 49786105	(100% ownership interest)
Energoreal s.r.o.	identification number 25226924	(100% ownership interest until 29 July 2005, then zero holding)
EN projekt, spol. s r.o.	identification number 25217852	(100% ownership interest until 23 August 2005, then zero holding)
GAZELA plus s.r.o.	identification number 26339404	(50% ownership interest)
SEG s.r.o.	identification number 46883657	(100% ownership interest)
První energetická, a.s.	identification number 61860948	(100% ownership interest – STE, VČE, SČE, ZČE until 18 February 2005, then zero holding)
ČEZ Distribuce, a.s.	identification number 27232425	(100% ownership interest – STE, VČE, SČE, ZČE)
ČEZ Prodej, s.r.o.	identification number 27232433	(100% ownership interest – STE, VČE, SČE, ZČE)

7.2. Východočeská energetika, a.s., identification number 60108720, was, in accounting period 2005, the controlling entity in respect of

VČE – montáže, a.s.	identification number 25938746	(100% ownership interest)
VČE – obnovitelné zdroje, s.r.o.	identification number 25938924	(100% ownership interest)
VČE – transformátory, s.r.o.	identification number 25938916	(100% ownership interest)
ENEST, s.r.o.	identification number 64791327	(67% ownership interest until 6 September 2005)
MojeEnergie, s.r.o.	identification number 27114791	(100% ownership interest)
První energetická, a.s.	identification number 61860948	(100% ownership interest – STE, VČE, SČE, ZČE until 18 February 2005, then zero holding)
ČEZ Prodej, s.r.o.	identification number 27232433	(100% ownership interest – STE, VČE, SČE, ZČE)
ČEZ Distribuce, a.s.	identification number 27232425	(100% ownership interest – STE, VČE, SČE, ZČE)

7.3. Středočeská energetická, a.s., identification number 60193140 was, in accounting period 2005, the controlling entity in respect of

ELTRAF, a.s.	identification number 46357483	(52% ownership interest)
ESS, s.r.o.	identification number 25013271	(51% ownership interest
ENPROSPOL, s.r.o.	identification number 25488767	(100% ownership interest)
ČEZ Prodej, s.r.o.	identification number 27232433	(100% ownership interest – STE, VČE, SČE, ZČE)
ČEZ Distribuce, a.s.	identification number 27232425	(100% ownership interest – STE, VČE, SČE, ZČE)
První energetická, a.s.	identification number 61860948	(100 % ownership interest – STE, VČE, SČE, ZČE until 18 February 2005, then zero holding)

7.4. Severočeská energetika, a.s., identification number 49903179, was, in accounting period 2005, the controlling entity in respect of

Energetická montážní společnost Ústí nad Labem, s.r.o.	identification number 62743317	(100% ownership interest)
Energetická montážní společnost Česká Lípa, s.r.o.	identification number 62743333	(49% ownership interest)
Energetická montážní společnost Liberec, s.r.o.	identification number 62743325	(100% ownership interest)
Energozdroj, s.r.o., v likvidaci	identification number 64653382	(50% ownership interest – wound up as of 1 October 2005)

	ENERGOKOV, s.r.o., v konkurzu	identification number 25015621	(100% ownership interest)
	ESS, s.r.o.	identification number 250113271	(51% ownership interest)
	ENROSPOL, s.r.o. Děčín	identification number 25488767	(100% ownership interest)
	ČEZ Prodej, s.r.o.	identification number 27232433	(100% ownership interest – STE, VČE, SČE, ZČE, SME)
	ČEZ Distribuce, a.s.	identification number 27232425	(100% ownership interest – STE, VČE, SČE, ZČE, SME)
	První energetická, a.s.	identification number 61860948	(100% ownership interest – STE, VČE, SČE, ZČE)
7.5.	**Ústav jaderného výzkumu Řež a.s., identification number 46356088, was, in accounting period 2005, the controlling entity in respect of**		
	Centrum výzkumu Řež s.r.o.	identification number 26722445	(100% ownership interest)
	LACOMED, spol. s.r.o.	identification number 46348875	(62.50% ownership interest)
	Ústav aplikované mechaniky Brno, s.r.o.	identification number 60715871	(100% ownership interest)
	Ústav jaderných informací Zbraslav, a.s.	identification number 45270902	(74% ownership interest)
	ENERGOPROJEKT SLOVAKIA, a.s.	identification number 31381570	(100% ownership interest until 27 July 2006)
	WADE, a.s.	identification number 25523520	(50% ownership interest)
	Nuclear Safety/Technology Centre s.r.o.	identification number 27091490	(40% ownership interest)
7.6.	**Severomoravská energetika, a.s., identification number 47675691, was, in accounting period 2005, the controlling entity in respect of**		
	ČEZ Prodej, s.r.o.	identification number 27232433	(100% ownership interest – STE, VČE, SČE, ZČE, SME)
	ČEZ Distribuce, a.s.	identification number 27232425	(100% ownership interest – STE, VČE, SČE, ZČE, SME)
	MSEM, a.s.	identification number 64610080	(100% ownership interest) – also controlled
	ELEKTROSPOLEČNOST B.D. spol. s r.o.	identification number 44739486	(50% ownership interest)
	ENPRO, a.s.	identification number 26831848	(100% ownership interest)
	Energetika Vítkovice, a.s.	identification number 25854712	(100% ownership interest)
	ePRIM, a.s., v likvidaci	identification number 25889567	(100% ownership interest)
	Union Leasing, a.s.	identification number 60792710	(100% ownership interest until 26 October 2005)
	Beskydská energetická, a.s., v likvidaci	identification number 25829491	(100% ownership interest – deleted from the Commercial Register as of 8 September 2005)
	SINIT, a.s.	identification number 25397401	(100% ownership interest)
	Elektrovod Holding, a.s.	identification number 35834111	(50% ownership interest) – also controlled the following entities
	ELV Projekt, a.s.	identification number 35768584	(100% ownership interest)
	ELV-SERVIS, spol. s r.o.	identification number 35702095	(83% ownership interest)
	Elektrovod Stav, s.r.o.	identification number 35872241	(50% ownership interest)
	Elektrovod Osvetlenie, s.r.o.	identification number 36170151	(50% ownership interest)
	Elekrovod Rozvádzače, s.r.o.	identification number 35801859	(70% ownership interest)
	ELTODO Slovakia, s r.o.	identification number 31662030	(50% ownership interest)
	Elektrovod Polska Sp. z o.o.		(50% ownership interest)
	Elektrovod-MATIC d.o.o.	identification number 1837621	(100% ownership interest)
7.7.	**I & C Energo s.r.o., identification number 49433431, was, in accounting period 2005, the controlling entity in respect of**		
	AHV, s.r.o.	identification number 49973762	(100% ownership interest)
	ESE, s.r.o.	identification number 60701935	(34% ownership interest + AHV, s.r.o.)
	GITY MaR, s.r.o.	identification number 60714123	(100% ownership interest from 21 December 2005)
8.	**PAL, a.s., identification number 00 21 12 22, was, in accounting period 2005, the controlling entity in respect of**		
	Výzkumný a zkušební letecký ústav, a.s.	identification number 00010669	(44.61% ownership interest)
9.	**LETKA, a.s., identification number 25134132, was, in accounting period 2005, the controlling entity in respect of**		
	AERO Vodochody, a.s.	identification number 00010545	(53.30% ownership interest)

Schedule No. 2B

Interconnected entities and entities controlled by them, with a share interest of Telefónica Group greater than 40% in the period between 17 June 2005 and 31 December 2005

CORPORATE NAME	REGISTERED ADDRESS	% HELD BY TELEFÓNICA GROUP
TELEFÓNICA PUBLICIDAD E INFORMACIÓN, S.A.	**AVDA. DE MANOTERAS, 12-28050 MADRID**	**59.90**
TELEFÓNICA PUBLICIDAD E INFORMACIÓN EDITA, S.A.U.		+40
TELEFÓNICA PUBLICIDAD E INFORMACIÓN DIRECT, S.L.		+40
EDINET EUROPA, S.A.U.		+40
TELEFÓNICA PUBLICIDAD E INFORMACIÓN INTERNATIONAL, S.A.U.		+40
DIRECTORIES HOLDING, B.V.		+40
PUBLIGUÍAS HOLDING, S.A.		+40
URGE CHILE, S.A.		+40
IPRESORA Y COMERCIAL PUBLIGUÍAS, S.A.		+40
TELEFÓNICA PUBLICIDAD E INFORMACIÓN PERÚ, S.A.C.		+40
TELEFÓNICA PUBLICIDADE E INFORMACAO, LTDA.		+40
11888 SERVICIO CONSULTA TELEFÓNICA, S.A.		+40
ALIANCA ATLANTICA HOLDING, B.V.	**STRAWINSKYLAAN 1725, 1077 XX AMSTERDAM, NETHERLANDS**	**50.00**
TELEFÓNICA FACTORING ESTABLECIMIENTO FINANCIERO DE CRÉDITO, S.A.	**PEDRO TEIXEIRA, 8-28020 MADRID, SPAIN**	**50.00**
TELEFÓNICA FACTORING DO BRASIL, LTD.	**AVDA. PAULISTA, 1106, BRASIL**	
TERRA NETWORKS, S.A.	**NICARAGUE, 54-08029 BARCELONA, SPAIN**	**75.87**
TERRA BUSINESS TRAVEL, S.A.		+40
TERRA LYCOS HOLDING., B.V.		+40
TERRA LYCOS INTANGIBLES, S.A.		+40
TERRA NETWORKS USA, INC.		+40
CENTRO DE INVESTIGACIÓN Y EXPERIMENTACIÓN DE LA REALIDAD VIRTUAL, S.L.		+40
CORPORATION REAL TIME TEAM, S.L.		+40
UNO-BANK, S.A.		+40
TERRA NETWORKS ASOCIADAS, S.L.		+40
MAPTEL NETWORKS, S.A.U.		+40
IFIGENIA PLUS, S.L.		+40
EDUCATERRA, S.L.		+40
ONE TRAVEL COM, INC.		+40
AZELER ATOMOCIÓN, S.A.		+40
RED UNIVERSAL DE MARKETING Y BOINGS ONLINE, S.A.		+40
INICIATIVAS RESIDENCIELES EN INTERNET, S.A.		+40
TERRA NETWORKS ESPAÑA. S.A.		+40
TERRA NETWORKS LATEM E.T.V.E, S.L.		+40
TERRA NETWORKS VENEZUELA, S.A.		+40
TERRA NETWORKS PERÚ, S.A.		+40
TERRA NETWORKS MEXICO HOLDING, S.A.		+40
TERRA NETWORKS MEXICO, S.A.		+40
TELEFÓNICA INTERACTIVA BRASIL, LTDA.		+40
TERRA NETWORKS BRASIL, S.A.		+40
TERRA NETWORKS CHILE, S.A.		+40
TERRA NETWORKS CHILE HOLDING LIMITADA		+40
TERRA NETWORKS GUATEMALA, S.A.		+40
TERRA NETWORKS EL SALVADOR, S.A.		+40
TERRA NETWORKS HONDURAS, S.A.		+40
TERRA NETWORKS COSTA RICA, S.A.		+40
TERRA NETWORKS NICARAGUA, S.A.		+40

TERRA NETWORKS PANAMÁ, S.A.		+40
TERRA NETWORKS CARIBE, S.A.		+40
TERRA NETWORKS ARGENTINA., S.A.		+40
TERRA NETWORKS MAROC, S.A.R.L.		+40
TERRA NETWORKS COLOMBIA HOLDING, S.A.		+40
TERRA NETWORKS COLOMBIA, S.A.		+40
TERRA NETWORKS SERVICOS DE ACCESO A INTERNET E TRADING, LTD.		+40
TELEFÓNICA MÓVILES, S.A.	**GOYA, 24-MADRID, SPAIN**	**71.03**
BRASILCEL, N.V.		+40
VIVO BRASIL COMUNIC.- HOLDING COMPANY		+40
TAGILIO PARTICIPACOES, S.A.		+40
SUDESTESEL PARTICIPACOES, S.A.		+40
AVISTA PART. S.L.		+40
TELE SUDESTE CELULAR PARTICIPACOES, S.A.		+40
TELERJ CELULAR, S.A.		+40
TELEST CELULAR, S.A.		+40
PORTELCOM FIXA, S.A.		+40
SÃO PAULO TELEFÓNICA BRASIL SUL CELULAR PARTICIPACOES, S.A.		+40
PTELECOM BRASIL, S.A.		+40
PORTELCOM PARTICIPACOES, S.A.		+40
TELEFÓNICA MÓVILES EL SALVADOR HOLDING, S.A.		+40
TELEFÓNICA MÓVILES EL SALVADOR,S.A.		+40
TELEFÓNICA MULTISERVICIOS, S.A.		+40
TELEFÓNICA MÓVILES CENTROAMERICA, S.A.		+40
TELEFÓNICA EL SALVADOR, S.A.		+40
TCG HOLDINGS, S.A.		+40
TELEFÓNICA MÓVILES GUATEMALA, S.A.		+40
TELESCUCHA, S.A.		+40
INFRAESTRUCTURA INTERNATIONAL, S.A.		+40
TELEFÓNICA MÓVILES ESPAÑA, S.A.U.		+40
SPIRAL INVESTMENT, B.V.		+40
3G MOBILE AG		+40
SOLIVELLA INVESTMENT, B.V.		+40
IPSE 2000.S.P.A.		+40
GROUP 3 G UMTS HOLDING, GMBH		+40
QUAM, GMBH		+40
OPCOM MOBILE SERVICES, GMBH		+40
TELEFÓNICA MÓVILES INTERACCIONAL, S.A.		+40
TERRA MOBILE BRASIL, LTD.		+40
GROUPO 3G, S.R.L.		+40
OMICRON CETI, S.L.		+40
TELEFÓNICA MÓVILES PUERTO RICO, INC.		+40
TELEFÓNICA MÓVILES USA, INC.		+40
TELCA GESTIÓN GUATEMALA, S.A.		+40
MOBIPAY INTERNATIONAL, S.A.		+40
TELEFÓNICA MÓVILES PERÚ HOLDING, S.AA.		+40
TELEFÓNICA MÓVILES, S.A.C.		+40
TELEFÓNICA MÓVILES ARGENTINA, S.A.		+40
TELEFÓNICA COMUNICACIONES PERSONALES, S.A.		+40
RADIO SERVICIOS, S.A.		+40
TELEFÓNICA DE CENTROAMÉRICA		+40
TELEFÓNICA MÓVILES HOLDING URUGUAY, S.A.		+40
TELEFÓNICA MÓVILES URUGUAY, S.A.		+40
WIRELESS NETWORK VENTURES – HOLDING COMPANY		+40
PAGING DE CENTROAMÉRICA		+40
TELEFÓNICA SOPORTE TECNOLOGIA, S.A.		+40

TELEFÓNICA MÓVILES MEXICO, S.A.	+40
TELEFÓNICA FINANZAS MÉXICO, S.A.	+40
BAJA CELULAR MEXICANA, S.A.	+40
MOVITEL DE NOROESTE, S.A.	+40
MOVISERVICIOS, S.A.	+40
CORPORATIVO INTEGRAL COMUNICACIÓN, S.A.	+40
TELEFONÍA CELULAR DEL NORTE, S.A.	+40
GRUPO CORPORATIVO DEL NORTE, S.A.	+40
CELULAR DEL TELEFONÍA, S.A.	+40
ENLACES DEL NORTE, S.A.	+40
GRUPO DE TELECOMUNICACIONES MEXICANAS, S.A.	+40
PEGASO TELECOMUNICACIONES, S.A.	+40
PEGASO COMUNICACIONES Y SISTEMAS, S.A.	+40
PEGASO PCS, S.A.	+40
PEGASO RECURCOS HUMANOS, S.A.	+40
PEGASO FINANZAS, S.A.	+40
PEGASO FINCO I, S.A.	+40
ACTIVOS PARA TELECOMUNICACIÓN, S.A.	+40
TELECOMUNICACIONES PUNTO A PUNTO MEXICO, S.A.	+40
TELEFÓNICA TELECOMUNICACIONES MEXICO – HOLDING COMPANY	+40
TELEFÓNICA MÓVILES SOLUCIONES Y APLICIONES, S.A.	+40
INVERSIONES TELEFÓNICA MÓVILES HOLDING LIMITADA – HOLDING COMPANY	+40
TEM INVERSIONES CHILE LIMITADA – HOLDING COMPANY	+40
TELEFÓNICA MÓVIL DE CHILE, S.A.	+40
TELEFÓNICA MÓVILES SOLUCIONES, S.A.	+40
TELEFÓNICA MÓVILES ESERVICES LATIN AMERICA, INC.	+40
ECUADOR CELLULAR HOLDINGS, B.V.	+40
BS ECUADOR HOLDINGS, LTD.	+40
OTECEL, S.A.	+40
CELLULAR HOLDINGS (CENTRAL AMERICA) INC.	+40
GUATEMALA CELLULAR HOLDINGS, B.V.	+40
TMG (BVI) HOLDINGS, LTD.	+40
CENTRAM COMMUNICATIONS, LP – HOLDING COMPANY	+40
TEM GUATEMALA LTD. – HOLDING COMPANY	+40
TELEFÓNICA MÓVILES GUATEMALA Y CÍA, S.C.A.	+40
CENTRAL AMERICA SERVIES HOLDING, LTD.	+40
MULTI HOLDING CORPORATION – HOLDING COMPANY	+40
PANAMÁ CELLULARD HOLDINGS, B.V. – HOLDING COMPANY	+40
BELLSOUTH PANAMÁ, LTD.	+40
PANAMÁ CELLULAR HOLDINGS, LLC – HOLDING COMPANY	+40
BSC DE PANAMÁ HOLDINGS, S.R.L.	+40
BSC CAYMAN – GENERAL PARTNERSHIP	+40
TELEFÓNICA MÓVILES PANAMÁ, S.A.	+40
PANAMÁ CELLULAR INVESTMENTS, LLC.	+40
LATIN AMERICAN CELLULAR HOLDINGS, B.V.	+40
ABLITUR, S.A.	+40
REDAMIL, S.A.	+40
ABIATAR, S.A.	+40
COMUNICACIONES MÓVILES DE PERÚ, S.A.	+40
BELLSOUTH NICARAGUA, S.A.	+40
PISANI RESOURCES Y CÍA, LTD.	+40
DORIC HOLDING Y CÍA, LTD.	+40
KALAMAI HOLDINGS, LTD. – HOLDING COMPANY	+40
KALAMAI HOLD. Y CÍA, LTD – HOLDING COMPANY	+40
TELEFONÍA CELULAR DE NICARAGUA, S.A.	+40

TELECOMUNICACIONES BBS, S.R.L.		+40
COMTEL COMUNICACIONES TELEFÓNICAS, S.A.		+40
TELCEL, C.A.		+40
SISTEMAS TIMETRAK, C.A.		+40
SERVICIOS TELCEL, C.S.		+40
TELCEL INTERNATIONAL, LTD.		+40
CORPORACIÓN 271191, C.A.		+40
PROMOCIONES 4222, C.A.		+40
ST. MÉRIDA, C.A.		+40
TELECOMUNICATION SERVICES AND PUBLIC ATENTION		+40
S.T.MARACAIBO, C.A.		+40
S.T. PUNTO FIJO, C.A.		+40
S.T. VALERA, C.A.		+40
S.T. VALENCIA, C.A.		+40
SYRED, T.E.I., C.A.		+40
SERVICIOS TELCEL ACARIGUA, C.A.		+40
SERVICIOS TELCEL BARQUISIMENTO, C.A.		+40
SERVICIOS TELCEL CHARALLAVE		+40
S.T. CUMANA, C.A.		+40
S.T. GUARENAS, C.A.		+40
S.T. LOS TEQUES, C.A.		+40
S.T. MARACAY, C.A.		+40
S.T. MARGARITA, C.A.		+40
S.T. MATURÍN, C.A.		+40
S.T. PUERTO ORDAZ, C.A.		+40
OLYMPIC, LTD.		+40
TELEFÓNICA MÓVILES COLOMBIA, S.A.		+40
BAUTZEN, INC.		+40
COMOVILES, S.A.		+40
COMUNICACIONES TRUNKING, S.A.		+40
PARACOMUNICAR, S.A.		+40
KOBROCOM ELEKTRÓNICA,LTD.		+40
TELEFÓNICA INTERNATIONAL, S.A.	**GRAN VÍA,28-28013 MADRID, SPAIN**	**99.88**
SÃO PAULO TELECOMUNICACOES HOLDING, LTDA. - HOLDING COMPANY		+40
TELECOMUNICACOES DE SÃO PAULO, S.A.		+40
TELEFÓNICA FINANCE LIMITED		+40
TELEFÓNICA DEL PERÚ HOLDING, B.V.		+40
TELEFÓNICA DEL PERÚ, S.A.A.		+40
TELEFÓNICA INTERNATIONAL HOLDING, B.V.		+40
TELEFÓNICA CHILE HOLDING, B.V.		+40
TELEFÓNICA INTERNATIONAL DE CHILE, S.A.		+40
COMPANÍA DE TELECOMUNICACIONES DE CHILE, S.A.		+40
TELEFÓNICA GESTIÓN DE SERVICIOS COMPARTIDOS CHILE, S.A.		+40
COMPANÍA INTERNATIONAL DE TELECOMUNICACIONES, S.A.		+40
TELEFÓNICA HOLDING DE ARGENTINA, S.A.		+40
TELEFÓNICA DE ARGENTINA, S.A.		+40
TELEFÓNICA VENEZUELA HOLDING, B.V.		+40
TELEFÓNICA LARGA DISTANCIA DE PUERTO RICO, INC.		+40
INFONET SERVICES CORPORATION		+40
COMUNICATION TECHNOLOGY, INC.		+40
TELEFÓNICA INTERNATIONAL WHOLESALE SERVICES AMERICA, S.A.	**LUIS A. DE HARRERA, 1248 PISO 4-MONTEVIDEO, URUGUAY**	**100.00**
EMERGIA ARGENTINA, S.A.		+40
EMERGIA PARTICIPACOES, LTD.		+40
EMERGIA BRASIL, LTD.		+40
TELEFÓNICA INTERNATIONAL WHOLESALE SERVICES CHILE, S.A.		+40

TELEFÓNICA INTERNATIONAL WHOLESALE SERVICES PERÚ, S.A.		+40
TELEFÓNICA INTERNATIONAL WHOLESALE SERVICES USA, S.A.		+40
TELEFÓNICA INTERNATIONAL WHOLESALE SERVICES GUATEMALA, S.A.		+40
TELEFÓNICA INTERNATIONAL WHOLESALE SERVICES PUERTO RICO, S.A.		+40
TELEFÓNICA GESTIÓN DE SERVICIOS COMPARTIDOS (ARGENTINA), S.A.	TUCUMAN 1, PISO 18 CIUDAD DE BUENOS AIRES, ARGENTINA	99.99
TELEFÓNICA GESTIÓN DE SERVICIOS COMPARTIDOS (PERU), S.A.C.	SHELL, 310-MIRAFLORES LIMA, PERU	99.99
TELEFÓNICA CENTRO DE COBROS PERÚ, S.A.C.		+40
TELEFÓNICA GESTAO DE SERVICOS COMPARTILHADOS DO BRASIL, LTDA.	RUA DO LIVREMENTO, 66 BALCO IBIRAPUERA-SAO PAULO, BRASIL	99.99
TELEFÓNICA GESTION DE SERVICIOS COMPARTIDOS MEXICO, S.A.	BLVD. DÍAZ ORDAZ PTE N 123 2, COL. SANTAMARIA-6465 MONTERREY, MEXICO	99.99
TELEFÓNICA GESTIÓN DE SERVICIOS COMPARTIDOS EL SALVADOR, S.A.		+40
TELEFÓNICA GESTIÓN DE SERVICIOS COMPARTIDOS GUATEMALA, S.A.		+40
TELEFÓNICA GESTIÓN DE SERVICIOS COMPARTIDOS,S.A.	GRAN VÍA, 28-28013 MADRID, SPAIN	100.00
SOCIEDAD DE COBROS DE BRASIL		+40
TELEFÓNICA PROCESOS Y TECHNOLOGÍA DE LA INFORMACIÓN, S.A.		+40
ZELERIS ESPAÑA, S.A.		+40
TELEFÓNICA B2B LICENCING (USA), INC.	1221 BRICKELL AVENUE SUITE 600-33131 MIAMI-FLORIDA, USA	100.00
TELEFÓNICA INTERNACIONAL USA INC.	1221 BRICKELL AVENUE SUITE 600-33131 MIAMI-FLORIDA, USA	100.00
TELEFÓNICA EUROPE,B.V.	STRAWINSKYLAAN 1259, TOWER D, 12TH FLOOR 1077XX-AMSTERODAM, NETHERLANDS	100.00
TELEFÓNICA EMISIONES,S.A.	GRAN VÍA, 28-28013 MADRID, SPAIN	100.00
TELEFÓNICA PARTICIPACIONES, S.A.	GRAN VÍA, 28-28013 MADRID, SPAIN	100.00
COMMUNICAPITAL GESTIÓN, S.A.U.	GRAN VÍA, 28-28013 MADRID, SPAIN	100.00
VENTURINI ESPAÑA, S.A.	VÍA AUGUSTA, 117-08006 BARCELONA, SPAIN	100.00
VENTURINI, S.A.		+40
FISATEL MEXICO, S.A.	LOMAS DE CHAPULTEPEC-11000 MEXICO CITY, MEXICO	100.00
TELEFÓNICA FINANZAS PERÚ,S.A.C.	LIMA, PERU	100.00
TELEFÓNICA FINANZAS, S.A.	GRAN VÍA, 30-4 PLTA.-28013 MADRID, SPAIN	100.00
CASIOPEA REASEGURADORA, S.A.	6D, ROUTE DE TREVES, L-2633 SENNINGERBERG, LUXEMBOURG	100.00
PLÉIADE PENINSULAR, CORREDURÍA DE SEGUROS Y REASEGUROS DELGRUPO TELEFÓNICA, S.A.		+40
PLÉYADE PERÚ CORREDORES DE SEGUROS, S.A.C		+40
PLÉYADE ARGENTINA, S.A.		+40
TGP BRASIL CORRETORA DE SEGUROS E RESSEGUROS, LTDA.		+40
PLÉYEDE MÉXICO, AGENTE DE SEGUROS DE FINANZAS, S.A.		+40
ALTAIR ASSURANCES, S.A.		+40
SEGUROS DE VIDA PENSIONES ANTARES, S.A.		+40
COMPANIA ESPAÑOLA DE TECNOLOGIA,S.A.	VILLANUEVA, 2 DUPLICADO PLANTA 1 OFICINA 23-28001 MADRID, SPAIN	100.00
CLEON, S.A.		+40
COMMUNICAPITAL INVERSIONES, S.A.U.	GRAN VÍA, 28 - 28013 MADRID, SPAIN	100.00
TELEFÓNICA INVESTIGACIÓN Y DESARROLLO, S.A.	EMILIO VARGAS, 6-28043 MADRID, SPAIN	100.00
TELEFÓNICA INVESTIGACIÓN Y DESARROLLO DE MEXICO, S.A.		+40
TELEFÓNICA PESQUISA E DESENVOLVIMENTO		+40
ATENTO N.V.	LOCATELLIKADE, 1 - 1076 AZ AMSTERDAM, NETHERLANDS	91.35
PROCESOS OPERATIVOS, S.A.		+40
ATENTO TELESERVICIOS ESPAÑA, S.A.		+40
TEMPOTEL, EMPRESA DE TRABAJO TEMPORAL, S.A.		+40
ATENTO SERVICIOS TÉCNICOS Y CONSULTÓRIA, S.L.		+40
SERVICIOS INTEGRALES DE ASISTENCIA Y ATENCIÓN, S.L.		+40

ATENTO BRASIL, S.A.		+40
ATENTO PUERTO RICO, INC.		+40
ATENTO COLOMBIA, S.A.		+40
ATENTO MAROC, S.A.		+40
ATENTO VENEZUELA, S.A.		+40
ATENTO CENTROAMÉRICA, S.A.		+40
ATENTO DE GUATEMALA , S.A.		+40
ATENTO EL SALVADOR, S.A.		+40
ATENTO HOLDING CHILE, S.A. – HOLDING COMPANY		+40
ATENTO ARGENTINA, S.A.		+40
ATENTO CHILE, S.A.		+40
NEXCOM CHILE		+40
ATENTO EDUCACIÓN, LTDA.		+40
ATENTO RESURCOS, LTDA.		+40
ATENTO PERÚ, S.A.C.		+40
ATENTO ITALIA, S.R.L.		+40
ATENTO MEXICANA, S.A.		+40
ATENTO ATENCIÓN Y SERVICIOS, S.A.		+40
ATENTO SERVICIOS, S.A.		+40
ATESECO COMUNICACIÓN, S.A.	GRAN VÍA, 28-28013 MADRID, SPAIN	100.00
TELEFÓNICA CAPITAL, S.A.	GRAN VÍA, 28-28013 MADRID, SPAIN	100.00
FONDITEL PENSIONES ENTIDAD GESTORA DE FONDOS DE PENSIONES, S.A.		+40
FONDITEL VALORES, AGENCIA DE VALORES, S.A.		+40
FONDITEL GESTIÓN, SOCIEDAD GESTORA DE INSTITUCIONES DE INVERSIÓN COLECTIVA, S.A.		+40
TELEFÓNICA INGENIERÍA DE SEGURIDAD, S.A.	CONDESA DE VENADITO, 1-28027 MADRID, SPAIN	100.00
TELEFÓNICA ENGENHARIA DE SEGURANCA (BRAZIL)		+40
TELEFÓNICA INGENIERÍA DE SEGURIDAD MEXICO, S.A.		+40
LOTCA SERVICIOS INTEGRALES, S.L.	GRAN VÍA, 28-28013, MADRID, SPAIN	100.00
TEATEL, S.L.	BEATRÍZ DE BOBADILLA, 3-28040 MADRID, SPAIN	100.00
TELEFÓNICA DE ESPAÑA, S.A.U.	GRAN VÍA, 28-28013 MADRID, SPAIN	100.00
TELEFÓNICA S. DE INFORMÁTICA Y COMUNICACIONES DE ESPAÑA, S.A.U.		+40
TELEFÓNICA MOBILE SOLUTIONS PERÚ, S.A.C.		+40
TELEFÓNICA MOBILE SOLUTIONS BRASIL, LTDA.		+40
TELEFÓNICA SYSTEMAS INGENIÉRIA DE PRODUCTOS GUATEMALA, S.A.		+40
TELEFÓNICA SYSTEMAS EL SALVADOR, S.A.		+40
TELEFÓNICA SOLUCIONES DE OTSOURCING, S.A.		+40
SOLUCIONES TECNOLOGICAS PARA LA ALIMENTACION, S.L.		+40
TELEFÓNICA SOLUCIONES SECTORIALES, S.A.		+40
INTERDOMAIN, S.A.		+40
SODETEL, COMMERCIAL DE SERVICIOS DE TELECOMUNICACIONES, S.A.		+40
PORTEL SERVICIOS TELEMÁTICOS, S.A.		+40
INSTITUTO CANARIO DE TELECOMUNICACIONES		+40
TELEINFORMÁTICA Y COMUNICACIONES, S.A.		+40
TELYCO MARRUECOS, S.A.		+40
TELEFÓNICA TELECOMUNICACOONES PÚBLICAS, S.A.		+40
TELEFÓNICA DATA ESPAÑA, S.A.U.		+40
AGENCIA DE CERTIFICACIÓN ELEKTRÓNICA, S.A.		+40
SEGURVIRTUAL MVS, S.A.		+40
TELEFÓNICA CABLE, S.A.		+40
TELEFÓNICA CABLE MENORCA, S.A.		+40
TELEFÓNICA CABLE GALICIA, S.A.		+40
SOCIEDAD GENERAL DE CABLEVISIÓN CANARIAS, S.A.		+40
TELEFÓNICA DATACORP, S.A.U.	GRAN VÍA, 28-28013 MADRID, SPAIN	100.00
WHOLESALE SERVICES, S.L.		+40
TELEFÓNICA EMPRESAS MEXICO, S.A.		+40

TELEFÓNICA DATE MEXICO HOLDING		+40
KATALYX MEXICO, S.A.		+40
TELEFÓNICA DATA COLOMBIA, S.A.		+40
TELEFÓNICA DATA DO BRASIL, LTDA.		+40
TELEFÓNICA DATA BRASIL HOLDING		+40
TELEFÓNICA EMPRESAS		+40
TELEFÓNICA DATOS DE VENEZUELA, S.A.		+40
TELEFÓNICA DATA CANADA, INC.		+40
TELEFÓNICA DATA USA, INC.		+40
TELEFÓNICA DATA CARIBE		+40
TELEFÓNICA DATA CUBA		+40
TELEFÓNICA EMPRESAS PERÚ, S.A.A.		+40
TELEFÓNICA DATA ARGENTINA, S.A.		+40
TELEFÓNICA SOLUCIONES DE INFORMÁTICA Y COMUNICACIONES, S.L.		+40
TELEFÓNICA DEUTSCHLAND, GMBH		+40
TELEFÓNICA DATA ATLAS, S.A.		+40
KATALYX, INC.		+40
KATALYX BRASIL LTD.		+40
ADQUIRA MEXICO, LTD.		+40
ADQUIRA BRASIL, LTD.		+40
KATALYX TRANSPORTATION BRASIL, LTD.		+40
KATALYX CATALOGUING BRASIL, LTD.		+40
MERCADOR, S.A.		+40
ENDEMOL HOLDING, N.V.	**BERGWEG 70, 1217 SC HILVERSUM, NETHERLANDS**	**99.70**
ENDEMOL INTERNATIONAL, B.V.		+40
ENDEMOL, B.V.		+40
ENDEMOL HOLDING FRANCE – HOLDING COMPANY		+40
ENDEMOL FRANCE HOLDING SAS – HOLDING COMPANY		+40
ENDEMOL NEDERLAND HOLDING, B.V.		+40
ENDEMOL NEDERLAND, B.V.		+40
ENDEMOL INTERNATIONAL DISTRIBUTION		+40
ENDEMOL FINANCE, B.V.		+40
ENDEMOL ARGENTINA, S.A.		+40
ENDEMOL USA, INC.		+40
TRUE ENTERTAINMENT LLC		+40
ENDEMOL MEXICO, S.A.		+40
ENDEMOL GLOBO, S.A.		+40
ENDEMOL BELGIUM, N.V.		+40
ENDEMOL – NEOVISION S.P.Z.O.O.		+40
ENDEMOL PRODUCOES TELVISAS PORTUGAL, LDA.		+40
ENDEMOL SOUTH AFRICA		+40
ENDEMOL DEUTSCHLAND, GMBH		+40
ENDEMOL ITALIA, S.P.A.		+40
POLOMAR, S.P.A.		+40
ENDEMOL UK HOLDING, LTD.		+40
B AND B ENDEMOL		+40
ENDEMOL ESPAÑA HOLDING, S.L.		+40
GESTMUSIC ENDEMOL, S.A.		+40
ZEPPELIN TELEVISION, S.A.		+40
TELEFÓNICA DE CONTENIDOS, S.A.U.	**PASEO DE LA CASTELLANA. 141-28046 MADRID, SPAIN**	**100.00**
TELEFÓNICA MEDIA ARGENTINA, S.A.		+40
ATLÁNDIDA COMUNICACIONES, S.A.		+40
TELEFÓNICA SERVICIOS AUDIOVISUALES, S.A.		+40
TELEFÓNICA SPORT, S.A.		+40
TELEFÓNICA SERVICIOS DE MÚSICA, S.A.U.		+40

ČESKÝ TELECOM, A.S.	OLŠANSKÁ 55/5, 130 34 PRAHA 3, CZECH REPUBLIC	69.40
EUROTEL PRAHA, SPOL. S R.O.		+40
CENTRADE, A.S.		+40
OMNICOM PRAHA, SPOL. S R.O.		+40
CZECH TELECOM GERMANY, GMBH		+40
CZECH TELECOM AUSTRIA, GMBH		+40
CZECH TELECOM SLOVAKIA, S.R.O.		+40
CZECH TELECOM FINANCE, B.V.		+40

Schedule No. 3

List of interconnected entities with which contracts were concluded in 2005 for supply of electricity and which received performance under contract concluded prior to 1 January 2005:

Východočeská energetika, a.s.
Severomoravská energetika, a.s.
Středočeská energetická, a.s.
Severočeská energetika, a.s.
Západočeská energetika, a.s.

Schedule No. 4

List of interconnected entities-lessors with which lease contracts were concluded in 2005 and prior to 1 January 2005:

Západočeská energetika, a.s.
Středočeská energetická, a.s.
Kaučuk, a.s.
ČEZ, a.s.
Severočeské doly a.s.
Ústav jaderného výzkumu Řež a.s.
SDH-KOMES a.s.
Aliachem a.s.

Schedule No. 5

List of interconnected entities with which contracts were concluded in 2005 and prior to 1 January 2005 for delivery of construction and assembly work performed by the interconnected entity:

I & C Energo s.r.o.
Středočeská energetická, a.s

Schedule No. 6

List of interconnected entities with which contracts were concluded in 2005 and prior to 1 January 2005 for sale of goods and services by a controlled entity:

Telefónica Deutschlald, GMBH
Telefónica de España, S.A.U.
ALTAÏR ASSURANCES S.A.
Čepro, a.s.
Baufeld – ekologické služby s.r.o.

Unipetrol, a.s.
Telefónica Investigación y Desarrollo, S.A.
Kaučuk,a.s.
Paramo, a.s.
Alliachem, a.s.
ČEPS,a.s.
Sokolovská uhelná, a.s.
Východočeská energetika, a.s.
Západočeská energetika, a.s.
Středočeská energetická, a.s.
Severomoravská energetika, a.s.
Severočeské doly a.s.
SHD – KOMES, a.s.
ČEZ, a.s
I & C Energo s.r.o.
KOTOUČ ŠTRAMBERK, spol. s r.o.
ČEZnet, a.s.
Paramo, a.s
BENZINA, a.s.
Sokolovská uhelná, a.s.
Ústav jaderného výzkumu Řež a.s.
THERMAL – F, a.s.
ČSA, a.s.

Schedule No. 7

List of interconnected entities with which contracts were concluded in 2005 and prior to 1 January 2005 for sale of goods and services by the interconnected entity:

I & C Energo s.r.o.
Benzina, a.s.
Ústav jaderného výzkumu Řež a.s.
Severočeská energetika, a.s.
Západočeská energetika, a.s.
Severomoravská energetika, a.s.
Východočeská energetika, a.s.
Severočeské doly, a.s.
Středočeská energetická, a.s.

Schedule No. 8

List of interconnected entities with which contracts were concluded in 2005 and prior to 1 January 2005 for project and geodetic services supplied by the interconnected entity:

Středočeská energetická, a.s.

Schedule No. 9

List of interconnected entities with which contracts were concluded in 2005 and prior to 1 January 2005 for repair and maintenance of buildings and for facility management performed by the interconnected entity:

I & C Energo s.r.o

ČESKÝ TELECOM, a.s.
Olšanská 55/5, 130 34 Prague 3, Czech Republic
Tel.: +420 271 411 111, fax: +420 271 469 868
Telephone Services Centre: 800 123 456
CIN: 60193336
www.telecom.cz

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CAUTIONARY STATEMENT: Any forward-looking statements concerning the future economic and financial performance of ČESKÝTELECOM, a.s., contained in this Annual Report are based on assumptions and expectations of the future development of factors having material influence on the future economic and financial performance of ČESKÝ TELECOM, a.s. These factors include, but are not limited to, public regulation in the telecommunications sector, the future macroeconomic situation, and the development of market competition and related demand for telecommunications and other services. The actual development of these factors, however, may be different. Consequently, the actual future results of the economic and financial performance of ČESKÝTELECOM, a.s. could materially differ from those expressed in the forward-looking statements contained in this Annual Report.

Telefónica

www.telefonica.com