

A dynamic splash of water droplets and bubbles against a dark blue background, creating a sense of movement and freshness.

# Half-year Report 2006

*Telefonica*

O<sub>2</sub>





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Letter from the Chairman of the Board of Directors

### To Our Shareholders,

Let me review the development of our company in the first half of 2006. The past six months were rich in events whose impact we will, in a large part, see in the future period. I mean the announcement of the integration of ČESKÝ TELECOM and Eurotel at the beginning of March and the related actions, and the formation of the new integrated telecommunications company Telefónica O2 Czech Republic on 1 July 2006.

In our considerations of the presentation of our integration plan for the two companies to shareholders at the General Meeting, we relied on thorough analyses and surveys of the Czech telecommunications market, its specifics and customer preferences. We also compared the local market to international markets. We considered what would be the best organisation which would maximise the value of both companies. The result of these analyses was the decision on the integration of both companies of into one telecommunications company of the future.

The analyses produced one thing – Czech customers want an integrated service offer, integrated customer care and a single point of sale. Another reason speaking for the integration is the unique position of the Czech telecommunications market in Europe. The Czech Republic

is spearheading the trend of fixed and mobile convergence. The Czech market is also one of the most developed ones when it comes to fixed-to-mobile substitution. Our research shows that about 70% of the total telephone traffic is generated via mobile connection. This is rather unique in Europe. Another specific attribute of the Czech telecommunications market is the small proportion of Internet connection via ADSL vis-à-vis the cable and especially wireless connection. This situation is primarily the result of the late coming of ADSL technology to the Czech Republic, compared to the Western countries.

An important factor in our deciding about the integration was also the impact of synergies arising from the merger of the two companies. We estimate that savings stemming from the synergies should reach a Net Present Value of EUR 375 – 450 million, i.e. about 2.5 times more than the value of synergetic savings generated by the integration of Telefónica O2 Czech Republic and Telefónica. From the total, about 65% of the synergies should come from revenues where cross-selling was the traditional way of saving; the plan is to consolidate the sales, offer all products and services in a single sales channel, implement integrated processes for churn reduction and improvement of customer retention on the fixed line and the mobile market. The last, however none the least important synergetic area in the revenues is the gradual development and launch of new converged

products and services for all customer segments. As for the synergies on the cost side, the main areas are the sales and marketing where the sales channels will undergo optimisation and back office integration, the networks – where we project operating savings to come from the integration of their operations and maintenance, network supervision and the integration and co-ordination of network planning and construction. In the field of information technology, savings will be generated by the integrated infrastructure and IT service platforms. Synergies will be also generated by way of eliminating duplications in supporting functions which, in addition to procurement, logistics, security and facility management, include also finance, human resources, controlling, communication, etc.

In terms of timing of the integration process, the whole project is planned for three years. The preparatory phase was concluded already in the first half of 2006. Its goal was to elaborate detailed integration plans for the key areas of organisation, with a view to integrating the now separate fixed and mobile units into one fully integrated company. Twelve key integration projects were short-listed from a list of forty-four main integration projects and a new organisation structure was approved; it is designed around customer segments in order to improve the business orientation and provide only the best standard of service. The new structure came into force on 2 July 2006.

The second phase of integration – gradual integration as we have called it – commenced on the same day.

The goals of the first year of the integration were translated into the twelve flagship projects as mentioned above. We will focus primarily on integrating our sales channels and customer care, creating a unified business and corporate sales force, network and IT convergence strategy and on integrating our key finance processes. Another key project of the first year is cultural alignment – definition and implementation of a new corporate culture based on the values of Telefónica and O2. The second half of the year will see the rebranding project which will implement the new commercial brand of Telefónica O2 and its products on the Czech market.

The new company will bring to the customers the best from both companies. Telefónica O2 Czech Republic can also rely on the global know-how of Telefónica and O2 in the area of fixed line and mobile communications. All this translates into tangible benefits for all customers and the information society in the Czech Republic.

Although the integration process has had a major impact on the lives of all our employees, we had to continue to concentrate on our everyday work which we do with one primary aim in mind – to satisfy the needs of our customers to the maximum. Now, let me just briefly

recapitulate the main activities of our company in the first six months of 2006.

Also in this period, customers on the Czech telecommunications market continued to show demand for broadband Internet, data and other value added services, both in the fixed line and in the mobile segment. 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, we successfully defended our leadership among operators. Fixed line penetration has been flat for several years, reaching approximately 31% as at the end of the first half of 2006. Mobile SIM card penetration, on the other hand, was still growing. It reached 112% at the end of the first quarter of 2006 and we expect it to rise further as the number of customers with more than one SIM card grows. As at 30 June 2005, ČESKÝ TELECOM was operating 2.835 million fixed lines. As at the same date, Eurotel registered 4.770 million customers.

To adapt to the market trend, our activities concentrated on stimulating revenues from voice services, development and marketing of new services in growth potential areas such as high-speed Internet access, data services and other value added services. Since the beginning of February, ČESKÝ TELECOM has already increased the speed

of all Internet Express products four times while keeping the same prices. As a result, the number of ADSL connections as at the end of June 2006 reached 386 thousand, up by 112 thousand in the first half of 2006 alone, compared to 62 thousand in the same period of last year. Eurotel announced in April 2006 that it was ready to launch HSDPA technology which increases the real downlink speed in the UMTS third generation mobile network up to 1 Mb/s. The total number of its data customers as at the half of 2006 exceeded the 150 thousand mark. We also prepared some changes in the area of voice services. After the lifting of price regulation for retail voice services, ČESKÝ TELECOM adjusted subscription fees for voice tariffs. This was compensated by a reduction of per-minute prices of long distance calls which were brought down to the level of a local call. We also launched a tariff for unlimited free calling to fixed networks, 24 hours a day. Eurotel, too, came with three new tariffs for customers of its pre-paid service. The customers can choose one which is best suited to their needs and preferences.

The financial results confirmed the positive trends of the second half of 2005. Consolidated revenues reached CZK 30.1 billion in the first half of the year, almost the same amount as in the same period of the last year. Operating costs in the same period fell 3.9% year on year to CZK 16 billion. The result was an OIBDA

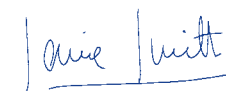
of CZK 14.5 billion, up 5.2% year on year, and an OIBDA margin of 48.5%. The margin was the result of the management's efforts to improve the operating and financial performance by means of savings of operating and capital costs. The net profit showed a year on year growth of 54.7% and reached CZK 4.3 billion in the first six months of 2006, owing primarily to the declining depreciation and financial costs.

In the first half of 2006, the Group directed its investments mainly to growth areas such as ADSL roll-out, and the UMTS and IPTV projects. The total consolidated CAPEX reached CZK 2.7 billion, up 36.8% year on year. The total volume of the Groups' free cash flow was CZK 7.8 billion, down 14.5% year on year, chiefly as a result of the accelerated investment in the growth areas. The Group's consolidated financial debt (long-term and short-term) amounted to CZK 9.7 billion at 30 June 2006. At the same date, the sum of cash, cash equivalents and short-term financial investments reached CZK 11.4 billion. This resulted in net leverage of minus 2% and gross leverage of 11.4%.

Maximum customer satisfaction continues to be our goal also in the second half of 2006; we plan to achieve it by means of our new products and services in the broadband Internet, data and value added services areas. We will maintain our focus on stimulating revenues from voice and traditional data services.

We will pay great attention to the execution phase of the integration process. We envisage the execution will have a neutral impact on our OIBDA in 2006 and that the total revenues and OIBDA will reach the same levels as in 2006.

With the help and market intelligence of our new majority shareholder, Telefónica, and other members of its group, especially O2, we intend to accelerate the implementation of our strategy – to strengthen our leadership on the Czech telecommunications market. In the field of financial management of the ČESKÝ TELECOM Group, our priorities continue to be an above-average level of OIBDA, effective investment and strong free cash flows.



Jaime Smith  
Chairman of the Board of Directors

## Calendar of the main events

**January** The number of users of high-speed Internet via ADSL in the Czech Republic reaches the 275 thousand mark, representing a growth of 175% compared to the last year.

ČESKÝ TELECOM quadruples the speed of Internet connection. Existing customers receive an automatic free-of-charge upgrade, new customers are offered the higher connection speed for the same price.

**February** The number of users of high-speed Internet via a fixed line exceeds the 300 thousand mark.

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

ČESKÝ TELECOM lets its customers pay online for telecommunications services via its e-účt service.

Eurotel launches its Najdi na mapě service on the Eurotel Live! Portal; the service helps users find locations on a map or plan their car journeys in the Czech Republic. The service is available also via 3G wap in the UMTS network.

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

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

Via its subsidiary OMNICOM Praha, ČESKÝ TELECOM is granted another licence for temporary experimental digital television broadcasting.

Eurotel launches Eurotel Web Video volání, a service which lets both contract and pre-paid customers make video calls without a mobile telephone and outside the coverage of the UMTS network.

**April** An Ordinary General Meeting of shareholders of ČESKÝ TELECOM is held. Shareholders approve, inter alia, a proposal by the Board of Directors to pay dividends of CZK 45 per share, before tax, from the profit of 2005 and from the retained profits from previous periods. The General Meeting consents to the transfer of Eurotel's assets to ČESKÝ TELECOM. The General Meeting approves an amendment to the Articles of Association, including the change of the corporate name to Telefónica O2 Czech Republic, a.s.



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

ČESKÝ TELECOM publishes its new structure of tariffs, introducing non-stop calls, a single rate on domestic calls and cheaper calls to mobile numbers.

ČESKÝ TELECOM launches a service which lets the users of Eurotel Go! pre-paid cards pay for credit via the monthly bill for the fixed line.

Eurotel launches Eurotel Navigace, a new service which presents a simple and economical navigation solution for travellers.

Eurotel launches HSDPA technology. An HSDPA-based service, marketed by Eurotel as Internet Speed, lets users download data in the UMTS third generation mobile network at a speed of up to 1024 kbit/s, not only within the UMTS-covered areas in the Czech Republic, but also abroad.

Eurotel begins to market new tariffs and an innovated loyalty scheme to pre-paid service customers.

**May** Czech Telecom Mobile Solution, ČESKÝ TELECOM's mobile work management system, becomes IT Project of the Year 2005.

The number of customers using high-speed mobile Internet connection exceeds the 80 thousand mark. Mobile Internet based on CDMA2000 1xEV-DO technology is now available to 80% of the Czech population.

**June** ČESKÝ TELECOM commences a test operation of IPTV, television reception over a fixed line. The launch of ČESKÝ TELECOM's commercial IPTV is scheduled for the third quarter of 2006.

ČESKÝ TELECOM records 375 thousand new telephone lines with an Internet connection via ADSL technology. High-speed Internet is now available already in 1,581 locations, representing more than 90% of all fixed lines in the Czech Republic.

Eurotel announces lower roaming prices. The summer promotion cuts the roaming rates on calls from all networks in selected destinations abroad by almost 60%. Eurotel also introduces a simpler system for roaming charging.

Eurotel expands the services on the information and entertainment portal Eurotel Live! accessible in the UMTS network and introduces lower rates for the service of online traffic cameras and mobile TV. Eurotel's customers can now also enjoy two general information channels from the iDNES and iHNed news servers.

# Board of Director's report on business activity



### The Czech telecommunications market in the first half of 2006

The development on the Czech telecommunications market in the first half of 2006 confirmed the trend of the past periods, including the demand for data, Internet and other valued-added services which has been growing at the expense of the traditional voice services which are in decline. In the period in question, the penetration of telephony using Internet connectivity (VoIP) has been markedly growing, owing in particular to the low price (if both parties to the call are using the Internet, the call is free-of-charge), increasing number of Internet users (greater penetration of xDSL services) and the expanding number of operators offering the service.

The products and services of the ČESKÝ TELECOM Group, or Telefónica O2 Czech Republic as of 1 July 2006 (the Group), have adapted to these trends; in the first half of 2006, the Group launched several new services with higher added values. The Group's activities continued to focus on implementation and improvement of new technologies for data transmission and high-speed Internet access, the area where ČESKÝ TELECOM and Eurotel have successfully defended their market leadership.

Changes occurred also on the part of the competition, both in the fixed line and in the mobile segment. GTS

Novera accomplished the first phase of integration of operators acquired by the parent group GTS CEH in late January and in early February 2006. On 1 April 2006, Contactel was re-named to GTS Novera Contact; NEXTRA Czech Republic to GTS Novera Next; and Telenor Network to GTS Novera Tel. As of 1 July 2006, these companies merged and GTS Novera Contact, GTS Novera Next and GTS Novera Tel ceased to exist. GTS Novera became their legal successor.

On 3 May 2006, Radiokomunikace (České radiokomunikace) announced its take-over of Tele2. This has made České radiokomunikace the largest alternative telecommunications operator in the Czech Republic with a clientele in the range of hundreds of thousands. The process of Tele2 take-over in the Czech Republic was concluded on 1 June 2006, the day when České radiokomunikace received an approval from the Office for the Protection of Competition. In the mobile segment, the corporate name of Oskar Mobil changed to Vodafone Czech Republic on 1 February 2006. The commercial brand of Oskar changed to Vodafone on the same day.

Despite the fact that mobile customer penetration reached 112% at the end of the first quarter of 2006, Eurotel managed to achieve a year on year increase in the number of its customers, even in the fiercely competitive environment of the Czech mobile market, by almost

350 thousand to 4.770 million as at 30 June 2006, i.e. up by 7.9%. The year on year increase by 458 thousand in the number of contract customers represents 36.1% more than the year before. The total number of contract customers as at the end of the first half of 2006 reached 1.727 million; the share of these customers in the total customers grew to 36.2%, compared to 28.7% as at the end of June 2005. The growth in the number of contract customers is the result of the active migration policy from the prepaid to the postpaid segment, with the aim to better explore the ARPU potential of these customers.

### Regulation

The legislative framework of the regulatory environment on the Czech electronic communications market is laid down in the Act No. 127/2005 Coll., on electronic communications and on amendment of related laws, as amended (Electronic Communications Act), which was enacted last year, and in the related bylaws (government regulations, decrees, general provisions) in the area of radio and television broadcasting, and, lastly, in the Act No. 231/2001 Coll., on radio and television broadcasting (Radio and Television Broadcasting Act). The Electronic Communications Act was amended in the course of the first half of 2006; the amendments related to the issues of construction and real estate, the Universal Service and emergency numbers. An amendment

to the Radio and Television Broadcasting Act was also passed, primarily to accommodate the transition to terrestrial digital broadcasting. During the first half of 2006, all pricing decisions were revoked and substituted by new ones which incorporate the results of the market analysis (see below).

### Analysis of the relevant markets

According to the recently enacted Electronic Communications Act, regulatory remedies can be imposed only on entities with significant market power (SMP). SMP entities are identified and remedies are imposed, based on the results of market analysis performed by the Czech Telecommunications Office (CTO) and in accordance with the Electronic Communications Act. These remedies are the principal drivers of regulation on the electronic communications market.

The above-mentioned remedies may take the form of pricing regulation and the imposition of the duty to give access to specific network elements, the duty of non-discrimination, etc. These remedies also affect the area of interconnection.

The market analysis, as well as the remedies, were in progress in the first half of 2006. As at the end of June 2006, nine out of the total of eighteen relevant markets were analysed. Analyses of the markets which

are the most relevant for ČESKÝ TELECOM have all been concluded.

**Market No. 1** – access to the public telephone network from a fixed point for non-enterprising natural persons – ČESKÝ TELECOM was identified as SMP entity. Cross financing of the Mini tariff was abolished.

**Market No. 2** – access to the public telephone network from a fixed point for legal and enterprising natural persons – ČESKÝ TELECOM was identified as SMP entity.

**Market No. 3** – publicly available national telephone service provided in a fixed point for non-enterprising natural persons – ČESKÝ TELECOM was identified as SMP entity.

**Market No. 8** – call origination in the public telephone network in a fixed point – ČESKÝ TELECOM was identified as SMP entity. The maximum price for call origination was set at CZK 0.30 (peak) / CZK 0.15 (off-peak) per minute in the local exchange (originally CZK 0.31 and 0.16, respectively).

**Market No. 9** – call termination in individual public telephone networks provided in a fixed point – each provider of the service of call termination in his own network is identified as SMP entity. The maximum price for call termination was set at CZK 0.30 (peak) / CZK 0.15 (off-peak) per minute in the local exchange (originally CZK 0.31 and 0.16, respectively).

**Market No. 11** – full wholesale access to (unbundling of) the metallic subscriber loop of shared access to the metallic subscriber loop or to the part of the metallic subscriber loop for the purpose of provision of electronic communications service – ČESKÝ TELECOM was identified as SMP entity. The maximum price was set at CZK 360 (originally CZK 403) for full unbundling and at CZK 92 (originally CZK 158) for shared access.

**Market No. 16** – call termination in individual public mobile telephone networks – each provider of the service of call termination in his own network is identified as SMP entity. The maximum price for call termination was set at 2.99 (originally CZK 3.11).

#### Extension of the existing licence, transfers of frequencies and numbers

As a result of the integration of ČESKÝ TELECOM and Eurotel, the licence was formally extended to include mobile services and networks in the scope of business of ČESKÝ TELECOM as from 1 July 2006. The CTO consented to the two companies concluding agreements which transferred Eurotel's rights from the allocation of radio frequencies and its rights for using its numbers to ČESKÝ TELECOM.

#### Universal Service

According to the statutory deadline imposed by the Electronic Communications Act, the CTO had

the duty to define the scope and new detailed terms and conditions for the provision of the Universal Service components, and to select one or more Universal Service providers, by the end of January 2006. Based on the results of tenders, the CTO issued a decision by the end of the first half of 2006, designating ČESKÝ TELECOM the provider of the following components:

- regular publication of directories of the public telephone service subscribers and the access of users to the directories,
- directory service accessible to the end users,
- public payphone service.

Pending the commencement of provision of the other Universal Service components as per the Electronic Communications Act, ČESKÝ TELECOM remains the Universal Service provider according to the conditions of the regulatory framework laid down in the Telecommunications Act, the related bylaws and telecommunications licences.

#### Mobile Number Portability

As was the requirement of the relevant laws, Mobile Number Portability was launched in the Czech Republic on 15 January.

### Telefónica O2 Czech Republic group in the first half of 2006

Until 30 June 2006, ČESKÝ TELECOM, a.s. (ČESKÝ TELECOM), Eurotel Praha, spol. s r.o. (Eurotel) and other subsidiaries made up a strong telecommunications group (the Group) which was the only group in the Czech Republic capable of offering a comprehensive portfolio of voice, data and Internet services, both in the fixed line and the mobile segment. It also offered access to its network infrastructure for operators and providers of public and private networks and services. As at 30 June 2006, the total fixed lines operated by ČESKÝ TELECOM reached 2.845 million; as at the same date, Eurotel recorded 4.770 million customers. Both companies have thus confirmed their leadership on the fixed line and the mobile markets.

#### Integration

The integration process commenced on 1 March 2006, when the Board of Directors and Supervisory Board of ČESKÝ TELECOM decided on the merger of Eurotel and ČESKÝ TELECOM into one company. The Board of Directors at the same time announced that it would request an approval of the integration and the adoption of Telefónica O2 Czech Republic, a.s. (Telefónica O2 Czech Republic), as the new corporate name, by the General Meeting of 27 April 2006. Shareholders at the General Meeting approved both proposals. The Prague Municipal

Court's decision of 20 June 2006 which came into legal force on 21 June 2006 wound up Eurotel Praha, spol. s r.o., without liquidation and transferred the assets of Eurotel Praha, spol. s r.o., to the sole member, ČESKÝ TELECOM, a.s. As of the same date, the corporate name of ČESKÝ TELECOM, a.s., changed to Telefónica O2 Czech Republic, a.s. The new company, Telefónica O2 Czech Republic, brings customers the best from the both merged operators – in particular Eurotel's leadership in innovation, its flexibility, expertise and customer intelligence and orientation, its long-term relationship with its customers and the premium quality, high-capacity fixed network of ČESKÝ TELECOM. The new company can also rely on the global know-how of Telefónica and O2 in the area of fixed and mobile communications. All this translates into tangible benefits for all customers and into an asset to the information society in the Czech Republic. The whole integration process is managed and co-ordinated by the Integration Department, a part of the Transformation and Convergence Unit. The Integration Department provides for a smooth progress of integration projects based on the defined integration strategy and schedule, for the co-ordination of integration projects in co-operation with other departments and units, and for the management of the integration plan, including the co-dependencies and integration risks. The integration benefits and synergies, the milestones and targets of the integration process are accomplished by regular reporting on the progress

of the integration to the executive management. The co-operation ensures that the integration process is well co-ordinated, information is shared and any problems are resolved without delay. The integration process was divided into two main phases – preparation and gradual integration (execution). The preparation phase set out to elaborate detailed integration plans for the key areas of organisation, combining the now separate fixed line and mobile units into one integrated company over the course of four years. Out of the forty-four key integration projects defined by the individual commercial, operating and supporting units, twelve projects were short-listed and approved by the executive management as the company's flagship projects.

The Consumer Division is represented by three flagship integration projects. *Marketing Intelligence and Campaign Management* is a project aimed at building a common data warehouse, including its superstructure functionality. This will help optimise and more efficiently manage the everyday activities such as marketing campaigns and churn predictions. The other two flagship projects of the division are *Point of Sale Integration and Customer Care Integration*. The Business Division has two major projects – *Developing Integrated F-M Corporate Sales Force* and *Implement Unified F-M Business Sales Force and Customer Care*. Their implementation began in the first half of 2006 and the projects aim to create a unified sales organization, including the customer care model.

*Products 2006 – 2007* is the flagship project of the *Product Development Division*. It aims to develop selected converged products and their launch on the market.

Three integration flagships were defined within the Operations division. With regard to the complexity of the area, they are structured as programs consisting of individual projects. The *IT Infrastructure and Operations Program* focuses on identification of the key platforms and applications, taking into account their long-term development and integration plans with a view to prepare their consolidation, including their interfaces, and to increase the effectiveness of IT operations. The aim of the second program, *ICT Convergence Strategy*, is to define the key network platforms for the area of Broadband, voice and multi-media services; in the second stage it aims to propose possible integration and development scenarios. The third is the *Network Operations Program* focused on the integration of network operation and on increasing its effectiveness.

The last three flagship projects were selected from the section of horizontal projects, projects defined by support units, which impact on all divisions of the company. The goal of *Key Finance Processes Alignment* project is the unification and re-design of the processes in the areas of controlling, purchasing, accounting and accounts / receivable. Integration

of the business plans and budgets, as well as the consolidation of ERP systems / SAP also falls into the scope of this project. Another very important flagship project from this section is *Cultural Alignment*. The aim of the project is to develop and deploy a new company culture based on the values of Telefónica and O2. *Rebranding* is the last flagship project in the fleet. The project aims to introduce and implement the new brand of Telefónica O2 Czech Republic and of its products on the Czech market. The final approval of all twelve flagship projects has closed the preparatory phase and marked the beginning of the phase of gradual integration.

### **New products and services**

#### **Fixed line segment**

In the area of voice services, ČESKÝ TELECOM prepared several changes for residential customers. Effective from 1 April 2006, the price of a long-distance call was brought down to the level of a local call. It effectively reduced usage prices by up to 53%. ČESKÝ TELECOM also reduced the price of a call to the mobile network for all tariffs by up to 28%. Peak and off-peak hours were defined for calling to mobile networks, as it is the case for calling to fixed networks.

On 1 April 2006, ČESKÝ TELECOM introduced Telefon Nonstop, a new tariff which offers free-of-charge calling

to all fixed networks 24 hours a day. Compared to other tariffs, it also offers cheaper calls to mobile networks and cheaper international calls. The monthly subscription to this tariff was set at CZK 639 exclusive of VAT; ČESKÝ TELECOM ran a promotion, which offered the tariff to customers without the subscription fee for the first month. About 5 thousand customers subscribed to this tariff by the end of the first half of 2006.

On 11 May 2006, subscription to all the five basic voice tariffs increased; the increases were in the range from 14.2% (Telefon Volno Plus) to 22.6% (Telefon Standard). Changes occurred also in the Telefon Mini tariff. Its monthly subscription increased by 19% to CZK 199 exclusive of VAT, which is still a rather low level compared to other tariffs. The price of call was reduced to the level of Telefon Standard (approximately by 50%), and a flat fee of CZK 5 exclusive of VAT is presently charged for each call made with the Telefon Mini tariff. This tariff also newly offers the option to subscribe to top-up packages and Carrier Selection and Carrier Pre-selection. If subscribing to the Telefon Expres Mini tariff for CZK 299 exclusive of VAT, customers could also order one of the Internet Expres high-speed Internet connections.

In the area of voice services to SMEs, ČESKÝ TELECOM recorded an increase in the sales of colour lines

in the first half of 2006. It is attributed also to the new offer of a range of colour lines introduced on 1 June 2006; the product is now offered in several alternatives – Ekonom, Efektiv and Elite, with a view to increase the penetration of less affluent customers by offering a lower price. The basic product, Ekonom, is cheaper than the original portfolio of colour lines.

In the first half of the year, Internet services continued to be one of the priority areas of business of ČESKÝ TELECOM. ČESKÝ TELECOM quadrupled the speed of all Internet Expres services on 1 February 2006, while keeping the original pricing. For Internet Expres Impuls, the basic service, the speed increased from 128/64 kb/s to 512/128 kb/s, for Internet Expres Ideal from 512/128 kb/s to 2,048/256 kb/s, for Internet Expres Sprint from 1,024/256 kb/s to 3,072/256 kb/s and for Internet Expres Maxi, the premium service, from 2,048/256 kb/s to 4,096/512 kb/s. The periodicity for observing the Fair User Policy also changed – the weekly limits were consolidated into a single monthly limit. Also the method of Fair User Policy application changed; the new rules stipulate that the connection speed is restricted only after the whole monthly data limit is exhausted, meaning that the two-step speed restriction no longer exists. Connection speed was increased for 95% of customers using ADSL-based Internet connection by the end of April 2006. During May, the speed upgrade was completed

also for the remaining 5% of customers. The speed upgrade for Internet Expres services stimulated customer demand for high-speed Internet. After the upgrade, the number of orders rose sharply: in the period from 1 February until the end of March, the average weekly orders exceeded 8 thousand. A record number of orders – 10 thousand – was recorded in the tenth week. A record number of installations – 10 thousand again – was recorded in the eleventh week. The total ADSL connections reached 386 thousand at the end of June 2006, up by 222 thousand (135%) yoy and by 112 thousand from the beginning of the year.

From 1 February 2006, ČESKÝ TELECOM's business customers can enjoy unlimited high-speed Internet in the form of Internet Expres Extreme. Speeds from 512/128 kb/s to 4,096/512 kb/s were available for prices starting at CZK 899 up to CZK 1,799 exclusive of VAT. ČESKÝ TELECOM also recorded an increasing demand from business customers for security services and other value added services. To meet the demand, Internet Expres Business Pack was created, as a package combining Internet connectivity, the PC Strážce security service and an economical IP address for CZK 899 exclusive of VAT.

In the area of data services, ČESKÝ TELECOM continued to develop new VPN products branded as VPN Expres,

and value added services to complement the traditional data services, in the first half of 2006. In April 2006, the company commercially launched the premium VPN Expres service – Komfort, and in May, the medium end service branded as Optimum. The launch of the low end service, Lite, is envisaged for the third quarter of 2006.

ČESKÝ TELECOM is a long-standing partner of the government and local government, providing the public sector with all kinds of telecommunications services. All key ministries and government agencies all the way down to the lowest echelons of the government and local government are customers of ČESKÝ TELECOM. The company develops dedicated solutions for public sector customers, with special technology and pricing.

#### Mobile segment

In mid-2006, Eurotel launched a new tariff for pre-paid service customers; with this tariff, Go customers could send SMS messages for as little as CZK 0.20. From 23 January until 31 March, customers who wished to switch from the competition or from the pre-paid service to one of the contracts could activate one of the tariffs and sign a 24-commitment contract with Eurotel. They could keep their number and were eligible for a special benefits package – calling for free after minute three on weekends and up to 400 free minutes a month for calling to all networks.



After the slashing of handset prices in February, Eurotel came with a guarantee of the lowest handset prices on the Czech market. If a customer of Eurotel bought a mobile handset in a brand store and proved within fourteen days that the same handset model could be bought cheaper somewhere else, his account was credited with the balance plus 10% from the balance. This offer extended both to all existing and new customers of post-paid and pre-paid services.

On April 2006, Eurotel introduced new pre-paid tariffs and an innovated loyalty scheme. Go TXT tariff is aimed primarily on customers who prefer SMS and MMS communication. Such customers can select one number where they can send an unlimited number of SMS for free. The tariff and its activation costs CZK 35 per week. Another new tariff is Go MIX for customers who frequently and regularly charge their credit. The last of the new tariffs is Go FAJN, developed especially for people who like to call and send SMS to all networks, yet they do not wish to be bound by a contract. Customers who switched from competition and brought their number received a free Go set.

As of April 2006, customers of ČESKÝ TELECOM and Eurotel can charge Go credit for their mobile telephone via a fixed line. In April and May, 10% extra was given as a bonus for each charge-up.

At the end of June and beginning of July 2006, Eurotel decided to terminate the operation of its NMT network in the 450 MHz frequency. The end of the voice traffic on the analogous technology meant that all T!P voice services running on this obsolete technology were also phased out. Customers using these services were given the option to switch to GSM and UMTS services in Eurotel's network. They could keep their numbers and tariffs, and they were eligible for the package of benefits for migrating customers.

In June 2006, Eurotel slashed the roaming rates on calls from all networks in selected holiday destinations by almost 60% in the summer. It also introduced a simpler roaming charging model. Global destinations were divided into zones, each attracting very competitive, easy-to-understand roaming rates.

Another new development of the first half of 2006 was the launch of Eurotel Web Video volání, a service which lets both contract and pre-paid customers make video calls without a handset and outside the UMTS signal coverage.

In April 2006, Eurotel announced it was ready to launch HSDPA technology which boosts the real data downlink speed in the UMTS third generation mobile network up to 1,024 kbit/s, and not only in the UMTS-covered

areas in the Czech Republic, but also in a growing number of foreign destinations. Eurotel began to market the mobile data service branded as Internet Speed and packaged with a PCMCIA data card. The total number of users of the Internet for Everyone service using GPRS, UMTS or HSDPA technology exceeded the 100 thousand mark as at the end of the first half of 2006; of this number, UMTS/HSDPA connections made up almost a tenth.

In the first half of 2006, Eurotel built up the network for high-speed Internet access via CDMA in 53 locations. This type of Internet connection as part of the Internet for Everyone service was used at the end of the first half of 2006 by 85 thousand customers. New customers could also benefit from a promotion which ran until the end of June, offering a package of a cheaper CDMA modem and a Dell or Hewlett-Packard notebook PC.

In April, Eurotel launched Eurotel Navigace, a simple and economical navigation solution for travellers. Another innovation was Hokej TV, a service of online broadcasting of ice hockey matches to a mobile telephone.

### Commented financial results

This section presents the financial results of the ČESKÝ TELECOM Group, predecessor of the Telefónica O2 Czech Republic Group. Until 30 June 2006, the group comprised ČESKÝ TELECOM, Eurotel and several other smaller companies. Effective as of 1 July 2006, Eurotel was dissolved without liquidation and the business assets of Eurotel were transferred to the sole member, ČESKÝ TELECOM. Effective as of the same date, the corporate name of ČESKÝ TELECOM was changed to Telefónica O2 Czech Republic.

### Consolidated Financial Statements

Consolidated revenues (business and recurring revenues) reached CZK 30.1 billion in the first half of 2006, down 0.1% yoy, and down 0.7% yoy in Q2 alone. Total consolidated operating costs reached CZK 16 billion, down by 3.9% yoy. Similarly to the period of the first three months of 2006, the amount of one-off items included in the results for Q2 was negligible. Consolidated OIBDA amounted to CZK 14.5 billion, up by 5.2% yoy and confirmed strong performance. OIBDA margin (OIBDA over business revenues) reached 48.5% in the first half 2006, compared to 45.9% in the same period of 2005.

Consolidated depreciation and amortization in the first six months of 2006 amounted to CZK 8.4 billion, down by 8.3% yoy. Consolidated operating income

and consolidated income before tax went up by 32.6% yoy and 40.3% yoy to reach CZK 6.1 billion and CZK 5.9 billion respectively for the first half of 2006, on the back of the decrease in consolidated depreciation and amortization and financial expenses. Consolidated net income amounted to CZK 4.3 billion, up by 54.7% yoy.

In the first half of 2006, the Group focused its investments on the growth areas. Total consolidated CAPEX amounted to CZK 2.7 billion, up 36.8% yoy. While CAPEX in the fixed line business increased by 22% yoy to CZK 1.2 billion and was spent largely on ADSL rollout and IPTV, CAPEX in Eurotel increased by 52.1% to CZK 1.5 million, mainly due to the investments made in the UMTS network. Despite increased CAPEX due to the accelerated rollout of ADSL in the first half of 2006 compared to the same period of 2005, we confirm our 2006 full year guidance of CAPEX / Revenues ratio at 10 to 12%.

The total amount of the Groups' free cash flows amounted to CZK 7.8 billion in the first half of 2006, down by 14.5% yoy. Operating cash flows went down 4.6% yoy, while accelerated investments into growth areas which resulted in investment cash outflows increasing by 38.5% compared to the same period of 2005.

The Group's consolidated financial debt (long-term and short-term) amounted to CZK 9.7 billion at 30 June 2006,

close to the figure at the end of 2005 and down by 43.8% compared to the same day last year. At the same date, the amount of cash, cash equivalents and short-term financial investments reached CZK 11.4 billion. This resulted in net leverage of minus 2% and gross leverage of 11.4% compared to 17.7% and 18.8% at the end of June 2005.

### Fixed Line Business Overview\*

Company's activities in the fixed line business in the first half of 2006 were primarily focused on the development and marketing of new Internet and data services. This helped to actively respond to the continuing demand from customers for broadband Internet, data and other value added services. The revenues from broadband Internet, data and other telco services accounted for 24.3% of business revenues in the first half of 2006, compared to 22.1% in the same period of the previous year. At the same time, the company continued to concentrate on revenue retention in traditional voice and data services. Total business revenues decreased by 5.1% to CZK 15.2 billion, while in Q2 they decreased by 4.7% yoy compared to a 5.5% decrease in Q1. This was driven mainly by a decline in traditional voice services which had not been fully compensated by the increase in broadband Internet based services, data and value added services.

\* ČESKÝ TELECOM standalone, i.e. excluding minor subsidiary companies, before consolidation adjustments

To be consistent with the other companies in the Telefónica Group, ČESKÝ TELECOM changed its methodology for the calculation of fixed telephony accesses as of 30 June 2006. Under this methodology two-channel ISDN is counted as one access, while previously it was counted as two accesses. The overall number of fixed telephony accesses based on the new methodology reached 2,835 thousand, down by 7.8% yoy. The overall number of ČESKÝ TELECOM's fixed accesses as originally calculated amounted to 2,992 thousand at the end of June 2006, down 7.9% compared to 30 June 2005. As a result of the decrease in accesses, revenues from traditional access decreased by 4.7% yoy to CZK 5.6 billion. While in Q1 this category of revenues decreased by 7.1% yoy, in Q2 was recorded a 2.3% yoy decrease. The increase in monthly charges as of 1 May 2006 helped to this improvement.

Revenues from traditional voice services (voice traffic and interconnection) declined in total by 8.7% yoy to CZK 5 billion. Revenues from voice traffic declined by 19.1% yoy to CZK 2.6 billion. This is a result of lower voice traffic generated by ČESKÝ TELECOM's customers in the first half of 2006, which decreased by 5.4% yoy. The continuing fixed to mobile substitution, lower number of fixed lines and fiercer competition are the main drivers behind the decreasing voice traffic. However,

the unification of local and long distance rates effective as of 1 April 2006 caused an increase of 5.1% in the long distance traffic generated by our customers in the first half of 2006.

Interconnection revenues increased by 6.4% to CZK 2.4 billion in the first half of 2006, in line with the trend in Q1.

Revenues from broadband services amounted to CZK 1.3 billion in the first half of 2006, up by 52.4% yoy. Of this, CZK 1.1 billion represented revenues from retail broadband and CZK 190 million from wholesale services. ČESKÝ TELECOM recorded 113 thousand net adds to ADSL accesses in the first six months of 2006 compared to 62 thousand net adds in the same period of 2005. This progressive increase was supported by successful marketing campaign launched on 1 February 2006 when ČESKÝ TELECOM introduced its offer of four times faster broadband connections for the same price. By the end of June 2006, the speed has been increased at nearly 100% of all ADSL accesses operated by ČESKÝ TELECOM. The total number of ADSL accesses reached 386 thousand at 30 June 2006, compared to 274 thousand at the end of 2005 and 163 thousand at 30 June 2005. Out of total accesses, 326 thousand (84.5%) represented ČESKÝ TELECOM's retail accesses.

Revenues from dial up (narrowband) Internet decreased by 52.8% yoy to CZK 329 million. Dial up Internet traffic went down by 55.7% yoy to 767 million minutes in the first six months of 2006, as a result of continuing dial up traffic migration to ADSL broadband Internet access and other fast Internet service alternatives. Dial up Internet represents a decreasing proportion of Internet revenues with limited downside potential.

Revenues from data services decreased by 5.4% yoy to CZK 2.1 billion, mainly due to the declining leased lines revenues which went down by 10.8% yoy to CZK 1.2 billion. Revenues from data network services increased by 2.9% yoy and reached CZK 898 million due to the growth of IP Connect and IP VPN connections and the introduction of new ADSL based data services.

Equipment revenues amounted to CZK 318 million, down by 8.6% yoy, as a consequence of lower equipment sales. Revenues from IT services and business solutions reached CZK 226 million in the first half of 2006 compared to CZK 50 million in the same period of 2005.

The fixed line operating costs amounted to CZK 8.6 billion, down by 7.8% yoy in the first six months of 2006, largely as a result of one-off items included in Q2 2005 operating costs.

Supplies expenses grew by 6% yoy to CZK 3.3 billion. Interconnection costs decreased slightly by 1.6% to CZK 2.4 billion, cost of goods sold were flat and amounted CZK 148 million, while other supplies increased by 41.6% to CZK 799 million due to higher consumption of capitalized material (which has neutral impact on OIBDA).

Personnel costs, including headcount reduction costs, amounted to CZK 2.5 billion, down by 16.6% yoy in the first half of 2006, as a result of a 5.9% yoy decrease in ČESKÝ TELECOM's headcount to 7,466 at the end of June 2006 and the one-off items included in personnel costs for the first six months of 2005.

The cost of external services decreased in total by 13.8% yoy mainly as a result of decrease in other external services and reached CZK 2.7 billion in the first half of 2006. Marketing and sales went up by 23.8% yoy to CZK 406 million due to higher marketing activities related to new high-speed Internet offer, network & IT repairs and maintenance increased slightly by 3.1% yoy to CZK 831 million. Rental, building and vehicle costs reached CZK 399 million, almost the same as in the first half of 2005 and utilities (material and energy) supplies increased by 6.7% yoy to CZK 271 million, due to the higher consumption of heating and gas effected by longer winter period. Other external services including consultancy fees

and other external services went down by 42% yoy to CZK 759 million as a consequence of one-off items accounted for in the first half of 2005 and the overall savings in other items. Taxes, comprising taxes other than income tax, fees and provisions increased by 5.9% yoy to CZK 143 million, mainly due to an increase in bad debt provisions.

OIBDA in fixed line business including business revenues, other revenues, non-recurring revenues and costs amounted to CZK 7.1 billion in the first half of 2006, up by 1.2% yoy, representing an OIBDA margin (OIBDA over business revenues) of 46.5%, compared to 43.6% in the first half of 2005.

#### Mobile Business Overview\*

Similarly to the fixed line business, the main focus of the mobile business was on the offer of the new data, Internet and value added services including content, while improving the attractiveness of traditional voice packages with the aim of increasing voice traffic. This strategy is clearly reflected in Eurotel's financial and operational results for the first half of 2006. In addition, the company followed an active migration policy from the prepaid to postpaid segment with the aim to better explore the ARPU potential of these customers.

\* Eurotel standalone, before consolidation adjustments

Total business revenues of Eurotel increased by 5% yoy to CZK 15.3 billion. Data revenues (revenues from value added services, Internet & Data) accounted for 20.3% of service revenues in the first half of 2006 compared to 18.4% in the same period of the previous year.

Eurotel's revenues from voice services (monthly fees, traffic and interconnection) increased in total by 2.5% yoy to CZK 11.5 billion.

The total number of Eurotel's customers amounted to 4,770 thousand at the end of June 2006, which represents a 7.9% yoy increase. The net additions reached 94 thousand in the first half of 2006 (75 thousand in Q2 and 19 thousand in Q1), compared to 26 thousand in the same period of 2005. The number of contract customers (GSM, CDMA and NMT) reached 1,727 thousand, up by 458 thousand yoy, which represents 36.1% growth following the active prepaid to contract migration strategy of Eurotel. Despite the fact that SIM card penetration has been continuously growing and exceeded 112% of the population at the end of March 2006, the net additions of contract customers reached 181 thousand in the first half of 2006. Contract customers accounted for 36.2% of the total customer base, compared to 33% at the end of 2005 and 28.7% at the end of June 2005.

The migration of customers from prepaid to contract segment continued also in Q2 2006. As a result, the number of prepaid customers decreased by 9 thousand in Q2 2006 compared to 78 thousand in Q1 2006. The total number of prepaid customers amounted to 3,043 thousand at the end of June 2006, showing a decrease of 108 thousand (3.4%) compared to the same date of the previous year. Under the methodology, which defines a prepaid customer as customer generating revenue in the last three months, the number of Eurotel's prepaid customers amounted to 2,717 thousand at 30 June 2006, down by 4% yoy.

The blended monthly average churn rate amounted to 1.5% in the first half of 2006, the same as in the first half of 2005, while it was 1.2% in Q2 2006 and 1.8% in Q1 2006.

Revenues from monthly fees increased by 9.5% yoy to CZK 3.1 billion as a result of significant growth in the contract customer base.

Traffic revenues decreased by 1.4% yoy to CZK 5.5 billion, while the traffic usage increased by 19.8% yoy in the first six months of 2006. The reason for this is the 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 the success of traffic stimulation activities.

Interconnection revenues amounted to CZK 2.8 billion in the first half of 2006, up by 2.9% yoy, mainly due a higher volume of incoming traffic and higher per minute revenue.

In Q2 2006, blended ARPU reached CZK 507, up from CZK 490 in the Q1 2006. Blended ARPU for the first half of 2006 reached CZK 498 compared to CZK 503 in the same period of 2005. Contract ARPU reached CZK 989 in Q2 2006 compared to CZK 996 in Q1 2006, while it was CZK 992 and CZK 1,236 in the first half of 2006 and 2005. The main reason for lower contract ARPU is dilution effected by customers migration from prepaid to contract segment. Prepaid ARPU increased from CZK 226 in Q1 2006 to CZK 239 in Q2 2006, while it went down from CZK 240 in the first half 2005 to CZK 232 in the first half of 2006. Average MOU per subscriber recorded a positive development in Q2 2006 with 102 minutes, up from 96 minutes in Q1 2006. Average MOU in the first half of 2006 amounted to 99 minutes, up from 88 minutes in the first half of 2005.

The total revenue from value added services (including SMS, MMS and content) increased by 12.7% yoy

to CZK 2.2 billion. Eurotel customers sent and received in total 1,382 million SMS in the first half of 2006, up by 15.1% yoy.

Revenues from Internet and data recorded a 25.8% yoy increase and reached CZK 779 million. At the end of June 2006, the total number of CDMA based Eurotel Data Express customers amounted to 85 thousand (up by 73.5% yoy) and the total number of Eurotel Data Nonstop customers was 70 thousand (up by 7.7% yoy). Data ARPU reached CZK 105 in the first half of 2006 compared to CZK 97 in the same period of the previous year. Non-SMS data made up 7.9% of service revenues in the first half of 2006 compared to 6.8% in the same period of the previous year.

Equipment sales (including connection fees) were flat in the first half of 2006 and amounted to CZK 710 million.

Other business revenues (IT services and other revenues) increased by 50% to CZK 135 million.

Total operating costs of Eurotel increased by 2% yoy to CZK 8.1 billion in the first half of 2006, mainly as a result of increase in the supplies expense.

Supplies expenses, which comprise interconnection and roaming, cost of goods sold and other supplies reached

CZK 4.7 billion in total, up 7.5% yoy. The major item in this category relates to interconnection and roaming costs, which amounted to CZK 3.1 billion, 10.8% up yoy due to higher traffic to other mobile networks. Cost of goods sold decreased by 2.2% and amounted to CZK 1.4 billion due to the lower number of sold handsets. Other supplies increased by 28.7% to CZK 278 million.

The number of Eurotel's employees as of 30 June 2006 amounted to 2,486, almost same as at the end of June 2005 and at the end of 2005. Staff costs decreased by 22.7% yoy to CZK 948 million, largely as a result of one-off items in the first half of 2005.

The cost of subcontracts in Eurotel decreased by 1.5% yoy to CZK 2.1 billion in the first six months of 2006. We have recorded a decrease in network & IT repairs and maintenance which went down by 22.1% yoy to CZK 374 million and cost of rentals, buildings and vehicles which amounted to CZK 389 million, down by 4.9% yoy. Marketing and sales expenses went up 7.1% yoy to CZK 925 million, utilities supplies went up by 30% and reached CZK 130 million and other subcontracts (consultancy fees and other) went up 1.1% yoy and amounted to CZK 269 million.

Taxes comprising taxes other than income tax, fees and provisions amounted to CZK 385 million in the first half of 2006, which represents a 57.1% yoy increase. The main reason for the increase is rise in bad debts provisions.

OIBDA in the mobile business reached CZK 7.2 billion in the first half of 2006 representing an 8.6% yoy increase with an OIBDA margin of 47.4%, up by 1.6 p.p. yoy.

#### Outlook for the second half of 2006

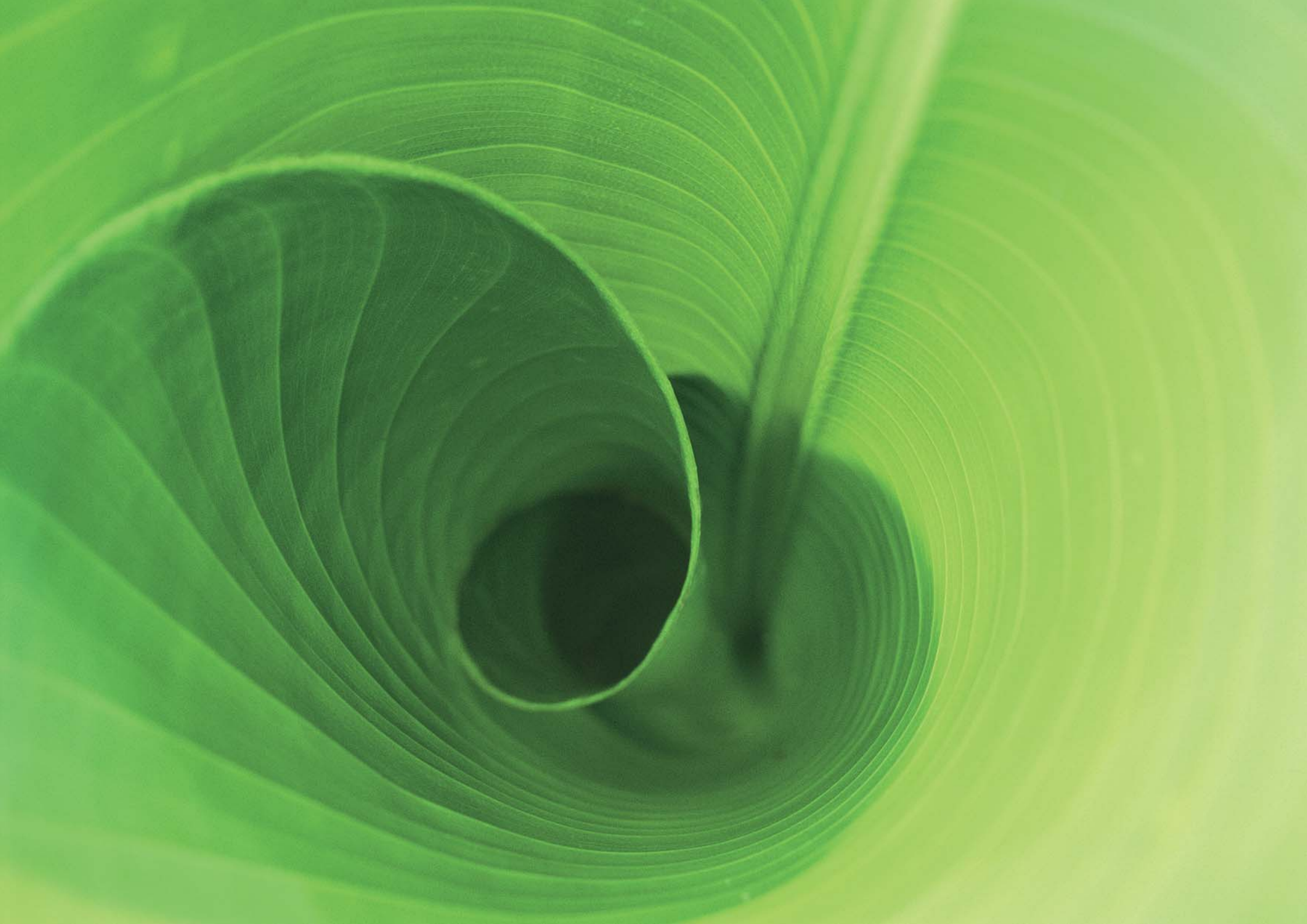
In the second half of 2006, the Telefónica O2 Czech Republic Group will continue to actively address the trends in the Czech telecommunication market, specifically in the areas of broadband, Internet, data and value added services. The primary goal of the Group's activities remains to best meet our customer needs and to enable them to effectively use our services for a competitive price. At the same time, the Group will continue to concentrate on revenue retention in voice and traditional data services.

The new integrated telecommunication company will benefit from experiences of ČESKÝ TELECOM and Eurotel and from global experience and close interaction with Telefónica, O2 and other Telefónica Group of operating companies. Main activities will continue

to focus on 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 new a organizational structure and synergies leading to revenue growth and OPEX and CAPEX savings.

The main areas of the ongoing integration process in the second half of 2006 will be sales channels and customer care integration, rebranding, cultural alignment, central marketing intelligence and campaign management, network and IT convergence strategy, financial processes alignment and the launch of the first convergent products.

The key strategic effort of the management is to maintain the leading position in the Czech telecommunication market. The main aspects of financial management of the Telefónica O2 Czech Republic Group will remain focused on above average OIBDA margins, efficient CAPEX levels and strong free cash flows. We expect to stop the decline of both revenues and OIBDA in 2006 and confirm our guidance for 2006 of flat revenues and OIBDA.



A blue-tinted photograph of a slot canyon. The walls are smooth and undulating, creating a sense of depth and perspective. The light is bright at the opening of the canyon, creating a strong contrast with the darker blue tones of the rock walls. The overall mood is serene and mysterious.

Corporate governance



The first half of 2006 was an important period in the area of corporate governance of ČESKÝ TELECOM, a.s. (ČESKÝ TELECOM), especially with respect to the adoption of the strategic decision to integrate ČESKÝ TELECOM and Eurotel Praha, spol. s r.o. (Eurotel) into one integrated operator. The course of events successfully culminated on 1 July 2006 and ČESKÝ TELECOM was placed into the organisation of the O2 Group within the Telefónica Group. An Ordinary General Meeting of shareholders was held on 27 April 2006; the General Meeting also approved an amendment to the company's Articles of Association and a proposal to change the corporate name of the company to Telefónica O2 Czech Republic, a.s. (Telefónica O2 Czech Republic).

#### **Integration of ČESKÝ TELECOM and Eurotel**

The process of integration commenced already on 1 March 2006, by means of a decision of the governing bodies of ČESKÝ TELECOM and Eurotel to transfer all assets and liabilities of Eurotel Praha, spol. s r.o., to ČESKÝ TELECOM, a.s. The decision was later approved by the General Meeting of ČESKÝ TELECOM and it was formally executed by an entry of the integrated company in the Commercial Register, with effect from 1 July 2006. The new corporate name of the integrated company – Telefónica O2 Czech Republic, a.s. – was entered in the Commercial Register on the same day. The day marked the emergence of the first Czech

telecommunications operator capable of offering all types of communication services to businesses and households alike, without the need to decide for one or the other technology platform.

In connection with the integration of ČESKÝ TELECOM and Eurotel, the Board of Directors approved a new executive macrostructure of the integrated company Telefónica O2 Czech Republic. The executive positions in the integrated entity were filled with managers from the original two companies. For an organigram of the new executive macrostructure and its staffing as at 1 July 2006, please refer below (the macrostructure as at 30 June 2006 is shown in the 2005 Annual Report).

#### **Ordinary General Meeting and the related changes**

Shareholders at the Ordinary General Meeting approved the financial statements and the consolidated financial statements of the company for 2005, both under International Financial Reporting Standards (IFRS) and audited by Ernst & Young. The General Meeting also approved a proposal by the Board of Directors to pay a dividend of CZK 6.782 billion from the profit of 2005 and a dividend of CZK 7.712 billion from the retained profits of the past periods, i.e. CZK 14.494 billion in total and a dividend of CZK 45 per share. The amount of dividends as proposed by the Board of Directors was explained as having grounds in a thorough analysis

of the company's results to date, its balance sheet situation and of the expected financial results. The Board of Directors stated that it expected the dividend be paid in full from the company's own resources, without the need to borrow.

As part of the preparation for the formation of the integrated company, the General Meeting consented to the transfer of assets and liabilities of Eurotel to ČESKÝ TELECOM, and approved a draft agreement on the transfer of assets and liabilities between ČESKÝ TELECOM and Eurotel. In connection with the decision to transfer the assets and liabilities, the General Meeting approved the audited financial statements of ČESKÝ TELECOM and Eurotel for 2005 as the closing financial statements as per the relevant provisions of the Commercial Code and the audited starting balance sheets of ČESKÝ TELECOM and Eurotel as at 1 January 2006.

Another important decision taken at the General Meeting was the approval of an amendment to the company's Articles of Association as proposed by the Board of Directors. In a large part, the changes related to implementation of the latest corporate governance practice and were aimed at improving efficiency and transparency of the working of the governing bodies. Some of the changes came as a result of recommendations of local and international corporate governance

authorities; other changes were enforced by amendments in the legislation, especially in the laws governing electronic communication. Approval of the amendment to the Articles of Association cancelled the special rights attached to the so-called golden share; the rights are now the same as for other ordinary shares. Changes in the names of committees established by the Supervisory Board were also approved; their number stayed the same, only their activities were reformulated to accommodate the latest trends. The Finance and Audit Committee was renamed the Audit and Control Committee and the Staff and Remuneration Committee was renamed the Nomination and Remuneration Committee. The tenure of members of the governing bodies was also extended from three to five years, and the number of members of the Board of Directors was changed from five to nine. The corporate name changed to Telefónica O2 Czech Republic, a.s. (effective from its entry in the Commercial Register).

In connection with ČESKÝ TELECOM's placement in the organisation of the O2 Group, the General Meeting recalled Supervisory Board members Javier José Aguilera Arauzo, Antonio Pedro de Carvalho Viana-Baptista, José María Álvarez-Pallete López and Santiago Javier Fernández Valbuena. Executive managers of the O2 Group Catherine Jane Keers, Peter Anthony Erskine, Gerhard Franz Mayrhofer

and Sohail Qadri were elected new members of the Supervisory Board. The General Meeting also approved a change in the rules for remuneration of members of the ČESKÝ TELECOM Board of Directors – it abolished the special motivation bonus for members of the governing body (approved by the Ordinary General Meeting of 24 June 2004 in connection with the company's privatisation). The other components of remuneration of Board of Directors members remained. The General Meeting also decided on the amount of annual bonuses for members of the Board of Directors and the Supervisory Board, and approved the conclusion of agreements on discharge of office of a Supervisory Board member with new members of the governing body.

At a ČESKÝ TELECOM Supervisory Board meeting which was held on 27 April 2006, changes were made in the chair positions of the Supervisory Board, to reflect the conclusions of the General Meeting – Peter Anthony Erskine became Chairman of the Supervisory Board and Julio Esteban Linares López was elected First Vice-Chairman of the Supervisory Board. Personnel changes occurred also in the composition of the Supervisory Board committees. According to the approved amendment to the company's Articles of Association, the Supervisory Board elected four new members of the ČESKÝ TELECOM Board

of Directors: José Fernando Astiaso Laín, Martin Bek, Jakub Chytil and Antonio Botas Bañuelos.

The up-to-date language of the company's Articles of Association, the personnel composition of the Supervisory Board and the Board of Directors, and the rules of remuneration of members of the governing bodies are published, together with the conclusions of the General Meeting, on the company's website.

In the light of the changes in the corporate governance model in connection with the integration of the company into the group of Telefónica and in connection with the project of the integrated company Telefónica O2 Czech Republic, changes were made also in the organisation of corporate governance. The changes were aimed at facilitating line management of units whilst being true to all the key principles of good corporate governance in the functional management. In order to ensure it, new rules of procedure were adopted for the governing bodies. Internal Audit and Risk Management were integrated and, together with the Office of Corporate Governance, they were taken out from the authority of the Board of Directors. Internal Audit and Risk Management is now reporting directly to the Chief Executive Officer and the Office of Corporate Governance to Legal

Affairs; the function of company Secretary was now formally attached to the function of General Counsel. These measures were implemented in order to harmonise the practice with the practice of the Telefónica Group and of the O2 Group. A new function of company Vice-Secretary was created to assist the good discharge of corporate governance; the company Vice-Secretary is the secretary to the Board of Directors and to the Supervisory Board and its committees.

#### **Changes in other subsidiary companies**

Effective from 8 July 2006, the corporate name of CZECH TELECOM Slovakia s.r.o., a subsidiary company, changed to Telefónica O2 Slovakia s.r.o., to reflect the change in the corporate name of the parent company. No other changes were made in the subsidiary companies.

## Composition of the Board of Directors and the Supervisory Board as at 1 July 2006

### Composition of the Supervisory Board of Telefónica O2 Czech Republic (as at 1 July 2006)

Peter Anthony Erskine, Chairman of the Supervisory Board  
 Julio Esteban Linares López,  
 First Vice-Chairman of the Supervisory Board  
 Lubomír Vinduška,  
 Second Vice-Chairman of the Supervisory Board  
 Luis Lada Díaz, member of the Supervisory Board  
 Catherine Jane Keers, member of the Supervisory Board  
 Sohail Qadri, member of the Supervisory Board  
 Gerhard Franz Mayrhofer,  
 member of the Supervisory Board  
 Ángel Vilá Boix, member of the Supervisory Board  
 Alfonso Alonso Durán, member of the Supervisory Board  
 Guillermo José Fernández Vidal,  
 member of the Supervisory Board  
 Vlastimil Barbořák, member of the Supervisory Board  
 Pavel Herštlík, member of the Supervisory Board  
 Miloslav Krch, member of the Supervisory Board  
 Dušan Stareček, member of the Supervisory Board  
 Petr Zatloukal, member of the Supervisory Board

### Composition of the Board of Directors of Telefónica O2 Czech Republic (as at 1 July 2006)

Jaime Smith Basterra, Chairman of the Board of Directors  
 Juraj Šedivý, First Vice-Chairman of the Board of Directors  
 Petr Slováček,  
 Second Vice-Chairman of the Board of Directors  
 Salvador Anglada Gonzalez,  
 member of the Board of Directors  
 Ramon Ros Bigeriego, member of the Board of Directors  
 José Fernando Astiaso Laín,  
 member of the Board of Directors  
 Martin Bek, member of the Board of Directors  
 Antonio Botas Bañuelos, member of the Board of Directors  
 Jakub Chytil, member of the Board of Directors

### Executive macrostructure of Telefónica O2 Czech Republic (as at 1 July 2006)

Chief Executive Officer (Jaime Smith Basterra)  
 Vice-President – Business Division  
 (José Fernando Astiaso Laín)  
 Vice-President – Consumer Division  
 (Salvador Anglada Gonzalez)  
 Vice-President – Operations Division (Petr Slováček)  
 Vice-President – Finance Division (Juraj Šedivý)  
 Chief Regulation & Interconnect Officer (David Šita)  
 Chief Transformation & Convergence Officer  
 (Antonio Botas Bañuelos)  
 Chief Business Development Officer  
 (Ramon Ros Bigeriego)  
 General Counsel & Company Secretary (Jakub Chytil)  
 Chief Wholesale Officer (Pavel Jiroušek)  
 Chief Public Affairs Officer (Jaroslav Kubišta)  
 Chief Strategy & Product Development Officer  
 (Stanislav Kůra)  
 Chief Human Resources & Support Services Officer  
 (Martin Bek)  
 Chief Internal Audit & Risk Management Officer  
 (Pavel Alexander)

### Organigram of the executive macrostructure of Telefónica O2 Czech Republic (as at 1 July 2006)



### New members of the Supervisory Board elected at the General Meeting of 27 April 2006:



**Peter Anthony Erskine**  
**Chairman of the Supervisory Board**

He became Chairman and Chief Executive Officer of O2 plc on 23 January 2006 following the acquisition of O2 plc by Telefónica, S.A. He was appointed to the Board of Telefónica, S.A. on 25 January 2006. He was formerly a member of the Board of O2 plc and Chief Executive Officer of O2 plc from 2001. He joined O2 from BT where, since March 1993, he held a number of senior positions including Director of BT Mobile, President and Chief Executive of Concert, and, from 1998, Managing Director of BT Cellnet. Prior to joining BT, he was European Vice President of Mars Electronics and Senior Vice President Sales and Marketing for UNITEL. He also served as a member of the Advisory Board of the University of Reading until the start of 2006.



**Catherine Jane Keers**  
**member of the Supervisory Board**

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



**Gerhard Franz Mayrhofer**  
**member of the Supervisory Board**

He became Senior Vice-President Consumer Management (Sales, Marketing, Customer Services) and Member of the Board at O2 Germany in April 2004, having been the company's Senior Vice-President Sales & Marketing Consumer previously. He joined O2 Germany (formerly VIAG Interkom) in May 1996 and held several senior positions including Senior Vice-President Product & Services and COO of Interkom Online (subsidiary of VIAG Interkom). Before joining O2 Mr. Mayrhofer was Marketing Manager at Wavetek Testsystems and Product Manager North America at Schlumberger. He also is a member of the curatorship EBS (European Business School) Oestrich-Winkel and the curatorship FGM – Institute for Marketing of the Ludwig-Maximilian-University Munich.



**Sohail Qadri**  
**member of the Supervisory Board**

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

**New members of the Board of the Directors elected the Supervisory Board meeting of 27 April 2006 held after the Ordinary General Meeting:**



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



**Martin Bek**  
**member of the Board of the Directors**  
 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 Executive Director for Tax and Accounting, later as Executive Director for Planning and Controlling. In April 2004 he was appointed Statutory Representative of Eurotel where he had been working as Chief Operations Officer since September 2004. Presently he holds the position of Chief Human Resources & Support Services Officer in Telefónica O2 Czech Republic.



**José Fernando Astiaso Laín**  
**member of the Board of the Directors**  
 Graduated in telecommunications engineering at the Polytechnic University, Madrid and PDG diploma from IESE Business School. Has more than twenty years of experience in technology sectors in companies like Sener, IBM, Cable & Wireless, Unisource and Telefónica. He joined Telefónica de España in 1997 where he held various sales and marketing management positions in the SMEs and Corporate segments. Before joining Telefónica O2 Czech Republic he was SME Commercial Director. Now he holds the position of Vice-President Business Division in Telefónica O2 Czech Republic.



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



Financial section





**Consolidated Financial Results prepared in accordance with International Financial Reporting Standards**

These consolidated financial results have been prepared in accordance with International Financial Reporting Standards (IFRS). These results are unaudited. All amounts are in CZK million.

<b>Consolidated Income statement</b>	<b>Period ended</b>	
	<b>30 June 2006</b>	<b>30 June 2005</b>
Revenue	30,102	30,143
Gain from sale of non-current assets	29	33
Internal expenses capitalized in fixed assets	403	255
Operating expenses	(15,991)	(16,639)
Impairment loss	(38)	(9)
Depreciation and amortisation	(8,443)	(9,212)
<b>Operating profit</b>	<b>6,062</b>	<b>4,571</b>
Interest income	37	16
Interest expense	(216)	(456)
Other financial income	17	75
<b>Profit before income tax</b>	<b>5,900</b>	<b>4,206</b>
Taxes on income	(1,618)	(1,439)
<b>Profit for the year</b>	<b>4,282</b>	<b>2,767</b>
Attributable to		
Equity holders of the company	4,282	2,768
Minority interest	–	1
Earnings per share (CZK) – basic*	13	9

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

Consolidated Balance sheet	30 June 2006	31 December 2005
ASSETS		
Property, plant and equipment	83,007	88,003
Intangible assets	22,123	22,846
Investments in associates	11	11
Available-for-sale investments	–	58
Held-to-maturity investments	29	29
Other financial assets	388	412
<b>Non-current assets</b>	<b>105,558</b>	<b>111,359</b>
Inventories	583	716
Receivables and prepayments	9,058	8,013
Income tax receivable	–	124
Available-for-sale investments	55	–
Other short-term financial assets	8	–
Cash and cash equivalents	11,301	3,639
<b>Current assets</b>	<b>21,005</b>	<b>12,492</b>
<b>Non current assets assigned to be sold</b>	<b>247</b>	<b>360</b>
<b>Total assets</b>	<b>126,810</b>	<b>124,211</b>

	30 June 2006	31 December 2005
<b>EQUITY AND LIABILITIES</b>		
Ordinary shares	32,209	32,209
Share premium	30,816	30,816
Retained earnings and reserves	21,747	31,950
<b>Total equity</b>	<b>84,772</b>	<b>94,975</b>
Long-term financial liabilities	9,268	9,324
Deferred taxes	5,024	5,721
Non-current provisions for liabilities and charges	1,895	2,111
Non-current other liabilities	1,012	1,265
<b>Non-current liabilities</b>	<b>17,199</b>	<b>18,421</b>
Short-term financial liabilities	407	307
Trade and other payables	6,245	6,850
Income tax liability	297	251
Provisions for liabilities and charges	696	623
Other current liabilities	17,194	2,784
<b>Current liabilities</b>	<b>24,839</b>	<b>10,815</b>
<b>Total liabilities</b>	<b>42,038</b>	<b>29,236</b>
<b>Total equity and liabilities</b>	<b>126,810</b>	<b>124,211</b>

These consolidated results were approved by the Board of Directors on 18 July 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 Cash flow statement

	Period ended 30 June 2006	Period ended 30 June 2005
CASH FLOWS FROM OPERATING ACTIVITIES		
Cash generated from operations	13,267	13,808
Interest paid	(2)	(167)
Interest received	68	25
Income tax paid	(2,146)	(1,935)
<b>Net cash from operating activities</b>	<b>11,187</b>	<b>11,731</b>
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchase of property, plant and equipment	(2,798)	(1,981)
Purchase of intangible assets	(644)	(679)
Disposal of property, plant and equipment	68	70
Proceeds from marketable securities	–	125
Grant/payment of loan	(41)	–
<b>Net cash used in investing activities</b>	<b>(3,415)</b>	<b>(2,465)</b>
CASH FLOWS FROM FINANCING ACTIVITIES		
Proceeds from borrowings	–	4,485
Repayment of borrowings	–	(13,269)
<b>Net cash used in financing activities</b>	<b>–</b>	<b>(8,784)</b>
<b>Net increase/(decrease) in cash and cash equivalents</b>	<b>7,772</b>	<b>482</b>
Cash and cash equivalents at beginning of year	3,538	480
Effects of exchange rate changes	(9)	–
<b>Cash and cash equivalents at the year end</b>	<b>11,301</b>	<b>962</b>

**Stand-alone Financial Results prepared  
in accordance with International Financial  
Reporting Standards**

These financial results have been prepared in accordance with International Financial Reporting Standards (IFRS). These results are unaudited. All amounts are in CZK million.

<b>Income statement</b>	<b>Period ended</b>	
	<b>30 June 2006</b>	<b>30 June 2005</b>
Revenue	15,447	16,202
Gain from sale of non-current assets	28	33
Internal expenses capitalized in fixed assets	285	146
Operating expenses	(8,645)	(9,378)
Impairment loss	(38)	(9)
Depreciation and amortisation	(5,559)	(6,597)
<b>Operating profit</b>	<b>1,518</b>	<b>397</b>
Interest income	26	2
Interest expense	(216)	(456)
Other financial income	19	3,042
<b>Profit before income tax</b>	<b>1,347</b>	<b>2,985</b>
Taxes on income	(392)	(355)
<b>Profit for the year</b>	<b>955</b>	<b>2,630</b>
Earnings per share (CZK) – basic*	3	8

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

**Balance sheet**

	30 June 2006	31 December 2005
<b>ASSETS</b>		
Property, plant and equipment	64,922	68,797
Intangible assets	1,306	1,726
Investments in subsidiaries/associates	29,516	29,516
Available-for-sale investments	–	58
Held-to-maturity investments	29	29
Other financial assets	236	252
<b>Non-current assets</b>	<b>96,009</b>	<b>100,378</b>
Inventories	213	216
Receivables and prepayments	4,897	4,937
Available-for-sale investments	55	–
Other short-term financial assets	9	17
Cash and cash equivalents	7,108	2,342
<b>Current assets</b>	<b>12,282</b>	<b>7,512</b>
<b>Non current assets assigned to be sold</b>	<b>247</b>	<b>360</b>
<b>Total assets</b>	<b>108,538</b>	<b>108,250</b>

	30 June 2006	31 December 2005
<b>EQUITY AND LIABILITIES</b>		
Ordinary shares	32,209	32,209
Share premium	30,816	30,816
Retained earnings and reserves	7,808	21,349
<b>Total equity</b>	<b>70,833</b>	<b>84,374</b>
Long-term financial liabilities	9,268	9,324
Deferred taxes	3,161	3,409
Non-current provisions for liabilities and charges	3,475	3,580
Non-current other liabilities	1,007	1,262
<b>Non-current liabilities</b>	<b>16,911</b>	<b>17,575</b>
Short-term financial liabilities	405	230
Trade and other payables	4,173	4,149
Income tax liability	226	249
Provisions for liabilities and charges	185	159
Other current liabilities	15,805	1,514
<b>Current liabilities</b>	<b>20,794</b>	<b>6,301</b>
<b>Total liabilities</b>	<b>37,705</b>	<b>23,876</b>
<b>Total equity and liabilities</b>	<b>108,538</b>	<b>108,250</b>

These consolidated results were approved by the Board of Directors on 18 July 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



## Cash flow statement

	Period ended 30 June 2006	Period ended 30 June 2005
CASH FLOWS FROM OPERATING ACTIVITIES		
Cash generated from operations	6,559	7,488
Interest paid	(2)	(167)
Interest received	43	14
Income tax paid	(662)	(667)
Net cash from operating activities	5,938	6,668
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchase of property, plant and equipment	(1,039)	(828)
Purchase of intangible assets	(124)	(378)
Disposal of property, plant and equipment	65	64
Proceeds from marketable securities	–	125
Grant/payment of loan	(41)	–
Dividends received	–	3,000
<b>Net cash used in investing activities</b>	<b>(1,139)</b>	<b>1,983</b>
CASH FLOWS FROM FINANCING ACTIVITIES		
Proceeds from borrowings	–	4,485
Repayment of borrowings	–	(13,269)
<b>Net cash used in financing activities</b>	<b>–</b>	<b>(8,784)</b>
<b>Net increase/(decrease) in cash and cash equivalents</b>	<b>4,799</b>	<b>(133)</b>
Cash and cash equivalents at beginning of year	2,307	214
Effects of exchange rate changes	2	(1)
<b>Cash and cash equivalents at the year end</b>	<b>7,108</b>	<b>80</b>

The background of the slide is a blurred, abstract composition of green and blue tones. Several prominent, diagonal lines in shades of light green and yellowish-green cut across the frame from the bottom-left towards the top-right, creating a sense of movement and depth. The overall effect is soft and organic, reminiscent of a close-up of grass or reeds in a shallow depth of field.

Information for shareholders

**Shareholder structure of ČESKÝ TELECOM, a.s.,  
as at 30 June 2006:**

Telefónica, S.A.	69.4%
Investiční funds and individual shareholders	30.6%

**Integration of ČESKÝ TELECOM and Eurotel and the  
change of the corporate name of ČESKÝ TELECOM**

The Prague Municipal Court's decision of 20 June 2006 which came into legal force on 21 June 2006 wound up Eurotel Praha, spol. s r.o., without liquidation and transferred the assets of Eurotel Praha, spol. s r.o., to the sole member, ČESKÝ TELECOM, a.s. as of 1 July 2006. As of the same date, the corporate name of ČESKÝ TELECOM, a.s., changed to Telefónica O2 Czech Republic, a.s. More information on the integration of ČESKÝ TELECOM and Eurotel is given in section Board of Director's Report on Business activity and section Corporate Governance of the Half Year Report.

**Trading in ČESKÝ TELECOM's shares**

The volume of trading in ČESKÝ TELECOM's shares on the stock market of the Prague Stock Exchange (PSE) in the first half of 2006 reached CZK 50.5 billion, which represented approximately 10% of the total trading volume. The average volume of daily trading in the first half of 2006 fell from CZK 1.361 million of last year

to CZK 397.6 million. The market capitalisation reached CZK 154.2 billion as at 30 June 2006.

As at 30 June 2006, the price of ČESKÝ TELECOM's shares on the PSE reached CZK 478.7, i.e. 8.7% less than at the end of 2005, up by 2.8% year on year. The performance of the PSE stock market as measured by the PX index fell by 5.6% in the first half of 2006.

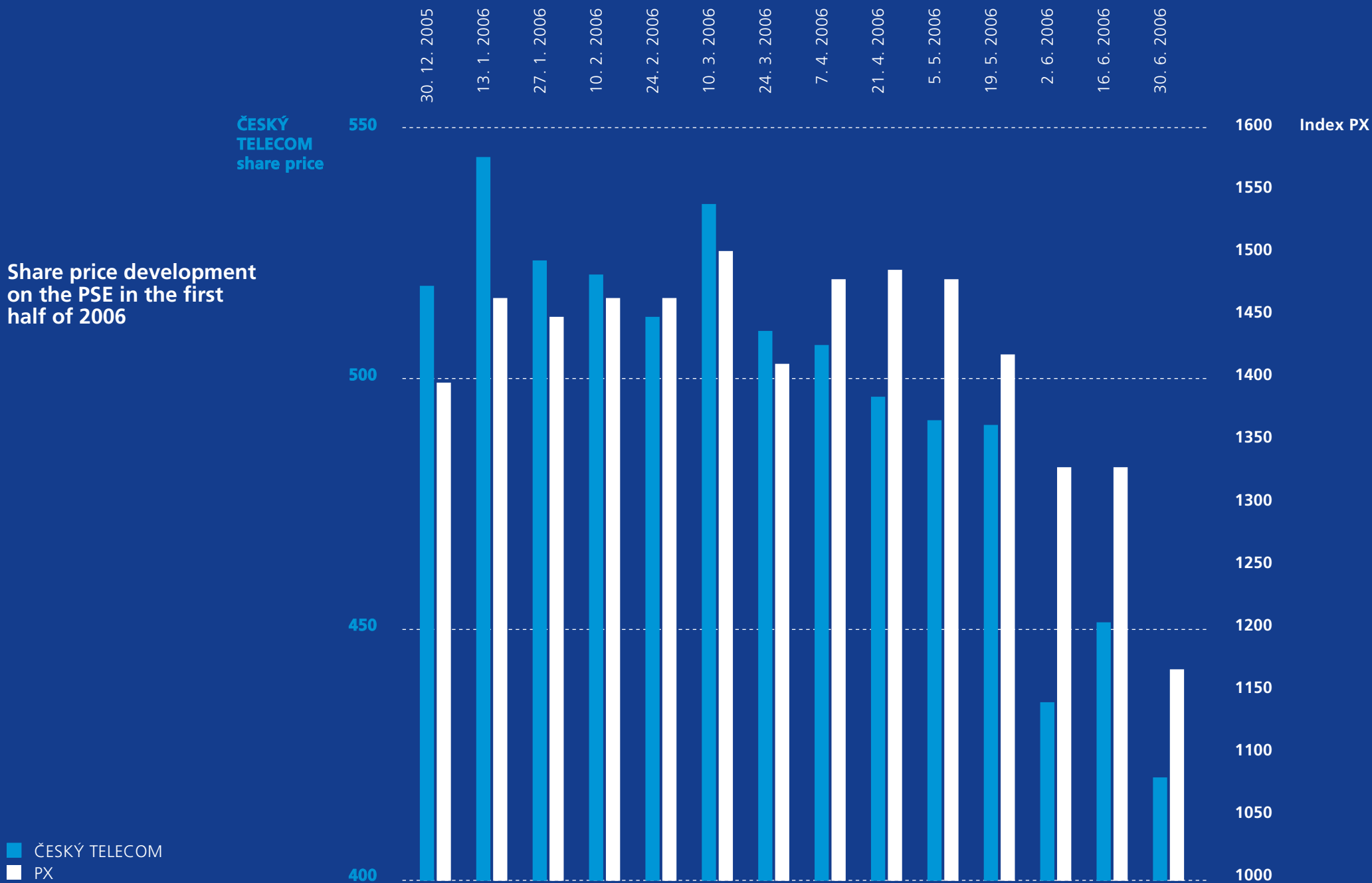
With respect to the change of the corporate name from ČESKÝ TELECOM, a.s., to Telefónica O2 Czech Republic, a.s., the name of the issue ISIN CZ0009093209 in the Prague Stock Exchange and RM-System List of Exchange was changed to TELEFÓNICA O2 C.R. The change extends also to the issue of bonds ČESKÝ TELECOM 3,50/2008, ISIN CZ 0003501355 s, now re-named as TELEF.O2CR 3,50/08 in the List of Exchange.

**General Meeting**

An Ordinary General Meeting was held in Prague on 27 April 2006. Information on the course and conclusions of the General Meeting is available in section Corporate Governance of the Half Year Report.

Institutional investors and shareholders may contact Investor Relations Telefónica O2 Czech Republic, a.s., Olšanská 5/55, 130 34, Praha 3  
Phone: +420 271 462 076, fax: +420 271 469 825  
E-mail: investor.relations@o2.com, URL: www.cz.o2.com

Share price development on the PSE in the first half of 2006



■ ČESKÝ TELECOM  
■ PX





Glossary of terms and acronyms

### Glossary of terms and acronyms

**ADSL** Asymmetric Digital Subscriber Line

**ARPU** an indicator – average monthly revenues from services per user, excluding roaming visitors

**CDMA** Code Division Multiple Access, a modern digital technology for wireless data and Broadband Internet

**Colour lines** premium rate numbers

**CTO** Czech Telecommunications Office

**Data Expres** see Eurotel Data Expres

**Data Nonstop** see Eurotel Data Nonstop

**e-účet** a service of ČESKÝ TELECOM, offering online access to a bill for telecommunications services

**Efektiv** a colour line of ČESKÝ TELECOM

**Elite** a colour line of ČESKÝ TELECOM

**Ekonom** a colour line of ČESKÝ TELECOM

**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 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](http://www.eurotel-live.cz) or via WAP

**Eurotel Navigace** a service of Eurotel – a simple and economical navigation for travellers

**Eurotel Web Video volání** a service of Eurotel, allowing video calling without a mobile telephone and UMTS signal coverage

**Go FAJN** a tariff of Eurotel, offering reduced rates on calls and SMS

**Go MIX** a tariff of Eurotel; if a customer buys a minimum CZK 400 worth of credit in a month, he is eligible for reduced rates for the next calendar month

**Go TXT** a tariff of Eurotel; a customer selects a telephone number to which he can send an unlimited number of SMS for free

**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; 1,800 MHz in the Czech Republic

**HSCSD** High-Speed Circuit-Switched Data, a technology for mobile data transmission in the GSM network

**HSDPA** High Speed Downlink Packet Access, a technology for a faster data transmission in the UMTS network, offering speeds up to 8 – 10 Mb/s

**IFRS** International Financial Reporting Standards

**Internet Expres** a broadband Internet access service of ČESKÝ TELECOM, combined with economical voice tariffs, all for one flat monthly fee

**Internet Expres Business Pack** a service bundle of ČESKÝ TELECOM, containing a high-speed Internet connection, PC Strážce PC security service and a reduced-price IP address

**Internet Expres Extreme** an unlimited Internet access service of ČESKÝ TELECOM for business customers

**Internet Expres Ideal** a high-speed Internet service of ČESKÝ TELECOM with the speed of 2,048/256 kb/s

**Internet Expres Impuls** a high-speed Internet service of ČESKÝ TELECOM with the speed of 512/128 kb/s

**Internet Expres Maxi** a high-speed Internet service of ČESKÝ TELECOM with the speed of 4,096/512 kb/s

**Internet Expres Sprint** a high-speed Internet service of ČESKÝ TELECOM with the speed of 3,072/256 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

**IPTV** Internet Protocol Television

**IP VPN** Internet Protocol Virtual Private Network, a service of intra-corporate data or Voice over IP communication

**ISDN** Integrated Services Digital Network, a digital network powering modern and quality services of telephony, fast Internet and high-speed data transmission

**MMS** a multimedia format for mobile data transmission

**NMT** Nordic Mobile Telephony, a technology standard for mobile telephony networks using the 450 MHz frequency

**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

**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

**SMS** a format for short text messages used in mobile telephony

**Telefon Nonstop** a price program of ČESKÝ TELECOM, with free calls to all fixed networks 24 hours a day

**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 third 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)

**VoIP** Voice over Internet Protocol

**VPN Expres Komfort** a data service of ČESKÝ TELECOM which builds IP VPNs based on ADSL access technology with aggregation and the MPLS backbone network; it is designed for small corporate networks with up to seven network connections and more demand for downloading than sending of data

**VPN Expres Optimum** a data service of ČESKÝ TELECOM which builds IP VPNs based on ADSL access technology with aggregation, MPLS backbone network and a main telephone line shared connection; it is designed for small corporate networks with up to seven network connections in areas with a lower density of access technology and more demand for downloading than sending of data

**WAP** Wireless Application Protocol, a protocol for displaying selected web pages on a mobile telephone display





Telefónica O2 Czech Republic, 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.cz.o2.com

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CAUTIONARY STATEMENT: Any forward-looking statements concerning the future economic and financial performance of Telefónica O2 Czech Republic, a.s., contained in this Half-Year Report are based on assumptions and expectations of the future development of factors having material influence on the future economic and financial performance of Telefónica O2 Czech Republic, 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 Telefónica O2 Czech Republic, a.s., could materially differ from those expressed in the forward-looking statements contained in this Half-Year Report.



