

HALF-YEAR REPORT 2008

A *Telefónica* company

O<sub>2</sub>



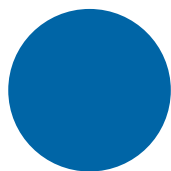






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LETTER FROM THE CHAIRMAN OF THE BOARD OF DIRECTORS

HALF-YEAR REPORT 2008

# Letter from the Chairman of the Board of Directors

## To Our Shareholders

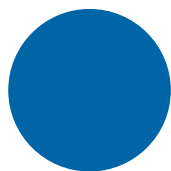
I want to use this opportunity to review the developments in the Telefónica O2 Czech Republic Group in the first half of 2008. Our activities in this period followed the strategy and goals we have set for the whole year at its beginning. We also had to face up to the ever increasing competition and, last but not least, our results were affected by the less favourable macroeconomic environment in the Czech Republic. Despite the challenging operational environment, we succeeded in maintaining a solid growth and a healthy profit margin.

In the fixed line segment, we have continued to slow down the rate of decline in the number of lines. In the first half of 2008, the decrement of fixed lines fell 33% year on year, which also helped to slow the rate of decrease in the volume of voice traffic generated by our customers in the fixed line network.

Our success was aided by the continuing increase in the number of the ADSL high-speed internet users and IPTV digital television and improved offer for both services. In the case of O<sub>2</sub> Internet ADSL we abolished the volume-based data transmission limits for new and existing customers. Our O<sub>2</sub> TV offer was expanded by two new programming bundles: O<sub>2</sub> TV Styl Plus, which is targeted to lovers of fashion and gourmets, and O<sub>2</sub> TV Hudba Plus for music fans. Families where different members want to watch different programmes can now benefit from Multi, which allows watching different channels on two television sets. O<sub>2</sub> Internet ADSL and O<sub>2</sub> TV



SALVADOR ANGLADA GONZALEZ  
CHAIRMAN



LETTER FROM THE CHAIRMAN OF THE BOARD OF DIRECTORS

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became the platform for offering other bundles of converged services which are gaining popularity with an increasing number of customers. At the end of June 2008, we had more than 142 thousand users of these services.

In the mobile segment, we continued to focus on migrating prepay customers to contracts. At the end of June, contract customers made up 45.7% of the mobile customer base. We are on a good track to meeting our target of 50% at the end of 2010. The increase in the share of contract customers has helped to boost voice traffic and reflects positively on the monthly ARPU. With the goal to further stimulate voice traffic in our mobile network in mind, we launched a new concept of voice tariffs. The simple and straightforward O<sub>2</sub> NEON flat-rate tariffs give our customers all the benefits included in the monthly subscription fee, without having to pay anything extra. The tariff O<sub>2</sub> [:kùl:] designed with our young customers in mind lets users send SMS to the O<sub>2</sub> mobile network for free – for as long as the tariff is activated. In less than two months, more than 50 thousand our customers opted for one of the new tariffs.

Business, self-employed and small/home office customers benefited from an expanded portfolio of mobile e-mail access. BlackBerry Business Mail combines the advantages of existing services (BlackBerry and O<sub>2</sub> Business Mail). BlackBerry Business Mail connects the user with the company resources without the need to have a BlackBerry and a mail server in the company. We also supported the promotion of O<sub>2</sub> Office Connector, a product which brokers remote access to company documents via regular mobile handsets.

As part of our managed service portfolio, which is the pillar of our ICT solution proposition, we began to market O<sub>2</sub> Managed Hosting service to our customers. We expect that especially in the fourth quarter, ICT services will substantially increase their contribution to the total revenues in the fixed line segment.

In the first half of the year in Slovakia, we continued to focus mainly on the stabilisation of our prepay customer base. We also continued to roll out our own GSM network, to reduce our reliance on the network of T-Mobile based on the national roaming arrangement. At the end of June 2008 we were able to carry more than half of the voice traffic generated by our customers in our network.

In the first half of the year we also successfully concluded the process of the sale of a portfolio of real estates located in various parts of the Czech Republic, of which a certain part we will lease back. The conclusion of the transaction has underscored our aim to pursue our core business, it being primarily telecommunications. The divestment also reflected positively on our consolidated financial results for the first half of the year.

Looking at our financial results, I have to emphasise the effect of the changing macroeconomic environment. I am referring primarily to the growing inflation and the slowing retail retail sales. Despite these negative influences, we managed to maintain a solid growth and a healthy profit margin. In the first half of the year, the consolidated revenues grew 0.7% year on year and reached CZK 31.3 billion. The mobile



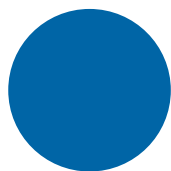
segment, despite the slower rate of growth, played a key role. The mobile revenues in the Czech Republic grew 4.5%. The fixed line segment saw an improving trend in the first half of the year. The revenues from this segment fell only 5.4% year on year despite the lower contribution from the ICT services segment, which – due to several big government contracts – was exceptionally strong in the second quarter of the last year. Owing to our ability to keep the costs which are controllable under control, the total operating costs of the Group, including Slovakia, in the first half of 2008 grew 3.4% year on year, and a mere 0.7% in the second quarter alone. That, together with the positive effects of the property sale, which amounted to more than CZK 700 million, has contributed to a 1% increase of OIBDA. The consolidated OIBDA margin performance of the Group remained on the level of the first half of the last year at 46%. As a result of the slight OIBDA increase, the continuing decline in depreciation and the low financial cost, the net profit grew 18.6% year on year and reached CZK 5.8 billion.

I am glad that also after the close of the first half of the year I can confirm our expectations for the whole of 2008. We project that our business revenues will grow 2%–4% year on year, and the consolidated OIBDA, without any extraordinary items, will record a growth of 0%–2%.



Salvador Anglada Gonzalez

Chairman of the Board of Directors of Telefónica O2 Czech Republic



CALENDAR OF THE MAIN EVENTS

HALF-YEAR REPORT 2008

# Calendar of the main events

## January

Telefónica O2 Czech Republic (Telefónica O2 or the Company) launched a new service concept, the so-called O<sub>2</sub> Managed Services – a comprehensive ICT solution for all types of users. Telefónica O2 was also the first to offer a managed hosting service O<sub>2</sub> Managed Hosting.

## February

Telefónica O2 published its audited consolidated financial results prepared under International Financial Reporting Standards (IFRS) for the fiscal year 2008. The financial results included also the results of Telefónica O2 Slovakia.

Jaime Smith Bastera resigned from the office of member of the Board of Directors of Telefónica O2 and Salvador Anglada Gonzalez was elected into the position of Chairman of the Board of Directors. Jaime Smith Bastera was then co-opted into the Supervisory Board and elected Chairman of the Supervisory Board.

A lease was signed for an arena in Prague. The contract with the owner and operator of the arena, BESTSPORT, gave Telefónica O2 the right to use the official name O<sub>2</sub> arena, as well as many other marketing privileges.

The number of O<sub>2</sub> TV customers exceeded the 80 thousand mark.

Telefónica O2 became General Partner of Live Nation. A five-year contract gives Telefónica O2 the right to participate at events organised by Live Nation in the Czech Republic.

## March

O2 stores welcomed already more than 10 million people.

O<sub>2</sub> arena got a new face – the logo and graphics of Telefónica O2 now decorates the exterior and interior of the arena.

## April

An Ordinary General Meeting of Telefónica O2 was held. The shareholders approved, amongst other things, the payment of dividends from a part of net profit from 2007 and a part of the reserve fund, in the amount of CZK 50 per share.

Telefónica O2 published its unaudited consolidated financial results for the first quarter of 2008, prepared under International Financial Reporting Standards (IFRS). The financial results included also the results of Telefónica O2 Slovakia.

With effect from 1 April, Telefónica O2 abolished the data limits for all speed variants of its O<sub>2</sub> Internet ADSL service.

Telefónica O2 opened a new hosting centre in Hradec Králové. Its technical parameters rank this centre among the most sophisticated hosting facilities in Europe.

Telefónica O2 launched a unique service – Kvídovo volání, which lets the user enjoy one minute of free calling to any mobile and fixed-line number in the Czech Republic after they listen to a short advertising message.

## May

Telefónica O2 launched O<sub>2</sub> NEON, a brand new concept of mobile tariffs on the Czech market. Depending on the chosen tariff, customers can call or send SMS completely free-of-charge, without having to pay anything extra.

With young customers in mind, Telefónica launched another new tariff – O<sub>2</sub> [:kúl:], which comes with unlimited free SMS to the O<sub>2</sub> mobile network.

Telefónica O2 concluded a master agreement on the sale of a part of its real property portfolio with Bohemia Real Estate Investments.

## June

Telefónica O2 and Apple signed an agreement for the distribution of the 3<sup>rd</sup> generation network capable iPhone.

Already 613 thousand of calls have been made through Kvídovo volání.

The Centaurus constellation includes also Cen X-3, a neutron star. Neutron stars result during a supernova explosion, when forces, which a man would find hard to imagine, impress electrons into nuclei of atoms; these, and the protons, are then transformed into neutrons. The mass equivalent to several our Suns is compressed into a sphere of only about 20–30 kilometres across. The result is a neutron star of unfathomable density – one cubic millimetre weighs millions of tons.





# Board of Director's Report on Business Activity

## The Czech telecommunications market in the first half of 2008

The first half of the year in the telecommunications market in the Czech Republic only confirmed the trends of 2007.

One of the trends is the continuing migration of traffic generated in the fixed line networks to mobile networks. The result is a steady decline in the number of fixed lines; however the rate of decline has been slowing down. The number of broadband internet users has been growing, albeit at a slower rate compared to previous periods. It was typical in the fixed line broadband internet market in the first half of 2008 that operators proceeded to abolish the Fair User Policy. Together with Telefónica O2, other operators also took this step. In addition to GTS NOVERA and Telekom Austria, the two companies that communicated their actions in March 2008, České Radiokomunikace, EMEA and SkyNet also abolished their data limits during the first half of the year. The number of customers who opted for one of the service bundles combining voice services, internet access and television has grown in the first half of 2008.

In the mobile segment, the migration of customers from prepay to the contract services continued. Mobile operators promoted tariffs aimed at voice traffic

stimulation and tariffs with low call rates within a defined group. In the first half of 2008, T-Mobile began to market T-Mobile ProfiNet, a converged solution aimed mainly at business customers. The bundle offers mobile, fixed line, voice and data services. MobilKom, which operates a mobile network under the U:fon brand, launched two special tariffs U:fonův úsporný telefon pro seniory, a product targeted to senior citizens, and U:fonova vysílačka, a Push-to-Talk based radio product in a national and a regional variant. U:fon launched its mobile voice service on 16 June.

The first half of 2008 also saw the continuation of the trend of consolidation in the cable market. UPC signed an agreement to purchase a majority stake in Kabelová televize Karviná. The largest alternative fixed line operator has changed ownership. GML Limited, a financial holding, sold the telecommunications group GTS Central European Holding, whose member is also the Czech telecommunications operator GTS Novera, to a consortium of financial investors managed by Columbia Capital, M/C Venture Partners and Innova Capital. The investment group BKS Capital Partners acquired an interest in the cable and internet access providers Telto, HBTv, Amos, Sater, RTV-5 and KTVm during the first half of the year. BKS is planning to consolidate all companies into one and market its service with the brand of Nej-TV. Nej-TV currently covers 24 towns and has approximately 28 thousand customers, which ranks it among the most serious competitors of the largest cable provider UPC, which has approximately one million of customers in the Czech Republic.

## Regulation

Several legislative changes and changes in the area of markets analysis and product regulation occurred in the regulatory environment in the Czech electronic communications market in the first half of 2008. The amendment to the Electronic Communications Act in the part that concerns the duty to store operating and localisation data, amendment to the government regulation for determination of the amount and method of calculation of fees for the use of radio frequencies and numbers, preparation of the next amendment to the Electronic Communications Act in the part that concerns the licences for the use of radio frequencies, financing of the Universal Service, priority of connection during emergencies, the amount of pecuniary sanctions for the violation of duties imposed by the Electronic Communications Act or on the basis thereof, storage operating and localisation data, and the commencement of the public consultation of the European Commission regarding the impact of the European Parliament and Council Regulation on roaming featured among the more important developments.

### **Relevant markets analysis and product regulation**

Telefónica O2 continued to meet its duties imposed on the basis of the relevant markets analysis conducted by the Czech Telecommunications Office (CTO) during 2006. Already in the second half of 2007, the CTO announced the commencement of the second round of analysis of the high-speed internet market. In May 2008, the CTO presented a draft analysis for public consultation; the process should reflect the new trends in the high-speed internet market in the Czech Republic.



In the second quarter of 2008, the CTO published the new regulated Local Loop Unbundling (LLU) prices, which take effect as from 1 July 2008. The monthly rate for a fully unbundled loop fell from CZK 360 per month to CZK 262 per month. The price of shared access fell from CZK 92 per month to CZK 53 per month.

The CTO also issued a General Provision, which determined the relevant markets in the electronic communications sector. The number of relevant markets was reduced from eighteen to seven. In the provision, the CTO has adopted the list of relevant markets from the European Commission Recommendation from 2007.

#### **International roaming regulation**

Telefónica O2 brought down the prices of roaming SMS in the European Union from CZK 10 to CZK 8.40 and prepared economical data roaming packages. Customers can choose products with data allocations from 2 to 250 Mb, depending on their actual need. The European Commission commenced a process to evaluate, by way of a public consultation, the impact of the 2007 Roaming Regulation on the market of electronic communications.

## Telefónica O2 Czech Republic group in the first half of 2008

In line with its strategy and the trends in the market, the activities of the Telefónica O2 Czech Republic Group (Telefónica O2 Group or the Group) in the first half of 2008 concentrated on offering new and improving the existing products and services in high-growth potential areas. In the fixed line segment, these included mainly services based on ADSL high-speed internet access, O<sub>2</sub> TV digital television, ICT services and comprehensive business solutions. In the mobile segment, the Company continued to focus on increasing the attractiveness of its voice tariffs, with the aim to boost voice traffic. Telefónica O2 also actively pursued the migration of prepay customers to contract services, seeking to stimulate the ARPU potential of these customers. High-speed internet access and O<sub>2</sub> TV became the platform for offering a host of converged services. In the first half of 2008, the subsidiary in Slovakia focused on the improvement of its customer structure and on de-activation of inactive or non-paying customers. Telefónica O2 Slovakia also continued to offer innovative services tailored to different customers' calling needs. It also launched its first services targeted to business and SME customers.

During the first half of 2008, the Czech Republic experienced a change in the macroeconomic environment which contrasted with the strong performance in 2007. At the beginning of the year, legislative changes pushed prices up, which caused



a slowdown in the retail sales. This development has impacted also on the results of the Telefónica O2 Group for the first half of the year. In spite of these developments, the Group managed to maintain a solid rate of growth. Furthermore, owing to the management's commitment to efficient management, controllable costs were contained and their rate of growth stayed behind the growth of consumer prices.

#### **Sale of a part of the real estate portfolio**

On 15 May 2008, Telefónica O2 and Bohemia Real Estate Investments signed an agreement on the sale of a part of real property portfolio. The agreement also incorporated a provision of a long-term lease-back of selected properties. The portfolio of divested properties included administrative and technical facilities in the Czech Republic, which Telefónica O2 no longer used or with a limited occupancy. The total area of the portfolio was 632 thousand square metres. Only a selected small part of the divested portfolio will be leased back. Buildings of strategic importance and facilities of high usage will remain in the ownership of Telefónica O2. The Company will continue to analyse the utilization of the properties to ensure they are being beneficially employed. The conclusion of the transaction for the sale of a part of the Telefónica O2 property portfolio confirmed that the Company intends to focus on an efficient operation of properties which are essential for carrying out its core business – telecommunications.

The sale price of the property portfolio exceeded CZK 4 billion. The transaction affected mainly the results of the second quarter of 2008. The profit from the sale,

less the related costs which included mainly the net book value of the properties and other costs associated with the transaction, reached CZK 727 million. The positive effect was felt mainly in the consolidated results for the second quarter and in the consolidated results for the first half of 2008. For additional information on the effect of the real property sale on the consolidated results please refer to Section Comments on the financial results in this Half-year Report. From the second half of 2008 onward, the divestiture will translate into higher costs associated with the lease-back of the facilities and lower depreciation.

## Telefónica O2 Slovakia

Increasing the proportion of contract active customers in the total customer base remains the principal commercial goal of Telefónica O2 Slovakia for 2008. The company also strives to develop its prepaid customer base by offering innovative services.

With the intention to attract young people who like to communicate via SMS, Telefónica O2 Slovakia launched a limited edition prepaid O<sub>2</sub> Karta. The card let the user send SMS to all mobile networks in Slovakia for the reduced price of SKK 1. The offer is not time-limited.



During the first half, Telefónica O2 Slovakia also launched its first offer for the business segment. The postpay tariff O<sub>2</sub> Pre firmu is aimed at small businesses and SMEs. Standard mobile services were expanded to include telemetric services and Virtual Private Network (VPN) services.

In late March 2008, Telefónica O2 Slovakia confirmed that it maintained its 5% market share of active customers in Slovakia based on the application of the three-month activity criterion. The company also succeeded in becoming a part of the automated Mobile Number Portability system. The service had previously been done manually due to the lack of good will on the part of the other two operators.

Telefónica O2 Slovakia also continued in the improvement of its prepay services. The company allowed its prepay customers to recharge their credit in ATMs of the two largest Slovak Banks.

The company's strategy in the operations area continued to be to finish the roll-out of its own network within the next two years, and rely on the national roaming only in locations which are not covered by its own network. In May 2008, Telefónica O2 Slovakia announced that it would start network barring in eight largest Slovak cities. The first city was Banská Bystrica, to be followed soon by Bratislava, Košice, Nitra, Prešov, Trenčín, Trnava and Žilina. Telefónica O2 can reduce its reliance on the network of T-Mobile and on the national roaming arrangement. Already in the first half of 2008, Telefónica O2 Slovakia could carry more than half of the traffic

generated by its customers in its own network. The company also opened an extension of its call centre in Banská Bystrica.

## New products and services

### Voice services

The portfolio of voice services of Telefónica O2 in the first half of the year adhered to the strategy to stimulate mobile voice traffic. In the fixed line segment, the Company concentrated on promoting bundles of converged services built around a voice tariff with unlimited calling to all fixed line networks in the Czech Republic.

Contract customers of mobile services of Telefónica O2 could benefit from a number of promotions, such as free calls to the O2 network in a specific period. The offer was made both to existing customers who decided to switch to the postpay service and to new customers coming from other operators. The offer applied to residential customers as well as to small business and self-employed customers.

In April, Telefónica O2 launched Platí to Kvído, a new service which lets customers call one minute to any mobile and fixed line number in the Czech Republic for free, if they dial the special number 829 829 829 first and listen to a short advertising message. Then they can dial the requested number and the first minute of the call is

free-of-charge. After 45 seconds of the call, the customers are notified of the coming end of the sponsored call.

Young customers of Telefónica O2 can from 1 May enjoy O2 [kùl:], a new tariff which lets the customers send unlimited free SMS to the O<sub>2</sub> mobile network – for as long as the tariff is subscribed – without any extra charges. The tariff O<sub>2</sub> [kùl:] cost only CZK 250 inclusive of VAT per month; in addition to the free SMS in the O<sub>2</sub> network, it comes with 60 of free calls per month to all networks in the Czech Republic, with the possibility to carry over unused minutes into the next month. The new O<sub>2</sub> Pokec Nonstop offered calls to the O<sub>2</sub> mobile network and to fixed line numbers for only CZK 1 inclusive of VAT per minute after the third minute, regardless of the time of day or the day of the week. The offer was good for 6 months and the first three minutes of the call were charged at CZK 15 inclusive of VAT. If the customer prefers SMS over calling, he or she could opt for the new O<sub>2</sub> prepay card with the O<sub>2</sub> TXT tariff, and receive two weeks of free SMS to two numbers in the O<sub>2</sub> mobile network with any top-up of at least CZK 200. The higher the top-up, the more numbers he or she could send free SMS to: the maximum was five O<sub>2</sub> mobile numbers for two weeks with a top-up of CZK 500 and more.

In May, Telefónica O2 became the first operator on the Czech market to launch a new concept of simple and straightforward flat-rate tariffs – branded as O<sub>2</sub> Neon. For a flat monthly fee, customers could enjoy all the benefits of the tariff (e.g. free unlimited calls to the O<sub>2</sub> network or to all networks) of their choice, without having to pay anything

extra. With O<sub>2</sub> NEON XXL, customers pay CZK 3,900 inclusive of VAT and can call to any network, anytime, without limits and any additional charges. Other tariffs in the Neon family included O<sub>2</sub> NEON SMS (free SMS and MMS in the O<sub>2</sub> network on weekends), O<sub>2</sub> NEON S (free weekend calls in the O<sub>2</sub> network), O<sub>2</sub> NEON M (free weekend calls, SMS and MMS in the O<sub>2</sub> network), O<sub>2</sub> NEON L (free weekend and off-peak calls in the O<sub>2</sub> network) and O<sub>2</sub> NEON XL (free calls in the O<sub>2</sub> network non stop). Unlike other promotions, the benefits provided with the tariff were integral to the offer, meaning that the customers could claim the benefits for as long as they subscribed to it. After their launch, the new concept of mobile tariffs O<sub>2</sub> NEON and O<sub>2</sub> [kùl:] have been received with much interest. More than 50 thousand customers subscribed for one of the new tariffs by the end of June.

Telefónica O2 made a similar offer to SMEs. Branded as O<sub>2</sub> Business Unlimited, a new tariff with unlimited calls to all fixed line and mobile networks in the Czech Republic for free – all in one flat monthly fee. The subscription was CZK 3,200 exclusive of VAT. O<sub>2</sub> Business Nonstop Max offered free calls in the O<sub>2</sub> mobile network and to all fixed line networks in the Czech Republic for CZK 1,400 exclusive of VAT; with this tariff, the customers also received 200 free minutes for calling other mobile networks in the Czech Republic.

From May 2008, the maximum price of an SMS sent from an EU member state is EUR 0.32 exclusive of VAT. The rate applies to prepay and contract customers. Incoming SMS are free-of-charge.



## Internet and digital television

In this particular area, Telefónica O2 focused on further improving the quality of service with the aim to add more value to the fixed line and promote further development of broadband internet and O<sub>2</sub> TV digital television. Data limits (FUP) were abolished for ADSL internet. Telefónica O2 also expanded its O<sub>2</sub> TV offer. The two innovated products became the primary building blocks of bundles of converged services. The total number of customers who opted for one of the bundles was approximately 143 thousand at the end of June 2008.

With effect from 1 April 2008, Telefónica O2 abolished the data limits (FUP) for all new and existing customers of O<sub>2</sub> Internet ADSL, including ADSL high-speed internet as part of one of the convenient bundles – O<sub>2</sub> Trio, O<sub>2</sub> Duo and O<sub>2</sub> Duo Mobil – and for the customers of O<sub>2</sub> Internet Komplet and O<sub>2</sub> Internet Komplet Business.

For O<sub>2</sub> TV service, Telefónica O2 introduced two new programming packages – O<sub>2</sub> TV Styl Plus and O<sub>2</sub> TV Hudba Plus. O<sub>2</sub> TV Styl Plus caters to lovers of fashion and gourmets and includes TV Deko, TV Paprika, Zone Club and Fashion TV. O<sub>2</sub> TV Hudba Plus has made all music fans happy with music channels VH1, VH1 Classic, MTV2, MTV Base and Music Box. In February 2008, the TV Archive also expanded to include popular television series of TV Nova: Ulice, Ordinace v Růžové zahradě, Místo v životě II, Na vlastní oči, Občanské judo, Rady ptáka Loskutáka, Volejte Novu.

In addition, Telefónica O2 launched Multi, allowing new and existing customers to watch different channels on two different television sets. No additional activation steps were necessary to start enjoying the comfort of Multi – all that was needed was to order it and the customer automatically received a second set-top-box (for the other television) and a new two-port modem which is required to make Multi work. Multi costs CZK 50 per month, inclusive of VAT. The second set-top-box could be leased or purchased.

From April, Telefónica O<sub>2</sub> provided all citizens in the Czech Republic with an access to the e-government portal via its O<sub>2</sub> Hot Spot service, regardless of whether they are customers or not. O<sub>2</sub> Hot Spot is a form of data transmission; the speeds are high and the service is very user-friendly. O<sub>2</sub> Hot Spot has access points in the strategically most important locations in the Czech Republic – the customer no longer needs to look for a telephone socket to have access to the internet. O<sub>2</sub> Hot Spot transmits all data in a very transparent way; all standard protocols (HTTP, POP3, IMAP4, SMTP, FTP, IPsec, etc.) are supported. Telefónica O2 operates the densest network of hot spots in the Czech Republic. At present, the service covers more than 200 locations. Equipment enabled for the IEEE 802.11b standard and WiFi certification is required for access to the service. A great number of today's modern notebooks and PDAs fall in this category. In the case that a notebook or PDA does not support 802.11b, customers can choose from one of many plug-in devices (e.g. PC cards, USB peripherals, SD or CF cards).

## Converged services

Despite the fact that O<sub>2</sub> Trio and O<sub>2</sub> Duo are definitely gaining popularity, the Company wanted to treat its customers to a special offer, valid from 1 February 2008 and from 1 June 2008 for O<sub>2</sub> Trio and O<sub>2</sub> Duo, respectively. Customers who ordered O<sub>2</sub> Internet ADSL and O<sub>2</sub> TV digital television in the convenient O<sub>2</sub> Trio package received a 6-month free subscription to O<sub>2</sub> Internet ADSL 2 Mb and 800 free minutes a month. O<sub>2</sub> Trio – with three services: O<sub>2</sub> Internet ADSL, O<sub>2</sub> TV digital television and free calls – was offered for CZK 950 inclusive of VAT.

## ICT services

In January, Telefónica O2 began to market O<sub>2</sub> Business Mail to its small business and self-employed customers. Telefónica set up an account for the customers on a Microsoft Exchange mail server. In addition to an e-mail box, it also contains a shared directory and files, contacts or an anti-virus or an anti-spam programme. The customer accesses the virtual office via a mail client, internet browser or a mobile telephone. Provide the domain is not already registered. Every customer can choose his own as he or she likes or needs. Telefónica was offering O<sub>2</sub> Business Mail in two variants: the basic service O<sub>2</sub> Business Mail Standard offered up to 100 Mb of data for only CZK 125 monthly fee, and the upper-end O<sub>2</sub> Business Mail Profi allowed 500 Mb of data and a free mail client licence for MS Outlook 2003 or 2007, all for CZK 299 per month. The capacity of the service could be flexibly upgraded – each additional 100 Mb cost CZK 100. The activation and installation of the service were free-of-charge.

At the beginning of February 2008, Telefónica O2 started to offer BlackBerry E-mail Start, a new variant of BlackBerry, which ranks among the most popular mobile office solutions on the Czech market. The zero-charged monthly subscription makes BlackBerry E-mail Start unique in the context of the Czech mobile communications market. After activation, the customer paid only the actual volume of data. Another new service in the BlackBerry family was BlackBerry Business Mail which combines the advantages of existing services (O<sub>2</sub> BlackBerry and O<sub>2</sub> Business Mail) and gives a full connectivity to company resources without having to have a BlackBerry and mail server in the company. It is a BlackBerry add-on to the existing service O<sub>2</sub> Business Mail. The standard O<sub>2</sub> Business Mail Profi subscription in combination with a BlackBerry tariff gives customers a complete access to the company e-mail, with full benefits of mobile synchronisation.

In addition to promoting BlackBerry services, Telefónica O2 restored its offer of the O<sub>2</sub> Office Connector service for remote access to company documents and utilities such as the calendar or e-mail. The service did not require the customer to purchase a special mobile handset. Only the installation of a simple application in an existing mobile telephone was necessary. Selected handsets were already set up for immediate use of O<sub>2</sub> Office Connector. The fact that the service can be used on a wide range of mobile telephones makes it very flexible. Moreover, customers could purchase attractively priced mobile handsets enabled for the service.



As regards the portfolio of the so-called managed services targeted mainly to corporate customers, Telefónica O2 added a new service, O<sub>2</sub> Managed Hosting, to the range. The service comprises of three components: Managed Data Storage gives customers a free use of a dedicated disc space for storing from hundreds to thousands of GB of data; Managed Server Hosting offers a server computing capacity of a defined quality in a defined period of time, and comes with system administration up to the level of the lower operating system, including planning and implementation of change requests; and finally, Managed Backup & Restore copies all stored data to a back-up medium to cover for the event of data loss in the primary repository and for data recovery. It comes with sufficient back-up hardware and software capacity and includes administration.

The Company also continued to promote not only the new O<sub>2</sub> Managed Server Hosting and O<sub>2</sub> Managed Dedicated Server services, but also the very successful O<sub>2</sub> Kompletní kancelář (O<sub>2</sub> Complete Office) and O<sub>2</sub> Počítačové řešení (O<sub>2</sub> IT Solution) services (mobile office and IT solution, respectively). The latter service has earned the right to use the label IT Service of the Year in the poll for the best IT product organised by the magazine Computerworld.

## Commented financial results

In this section we present and comment on the consolidated financial results of the Telefónica O2 Group including the results of Telefónica O2 Slovakia and DELTAX Systems. The results were prepared according to International Financial Reporting Standards (IFRS).

### Consolidated Financial Statements

#### Revenues, operating costs and OIBDA

Consolidated revenues reached CZK 31.3 billion in 1H 2008, up 0.7% yoy, being flat at CZK 15.9 billion in 2Q alone. Consolidated business revenues grew 1.1% yoy to CZK 31.2 billion in 1H 2008 and 0.6% to CZK 15.8 billion in 2Q. The Czech mobile business with 5.4% service revenues growth in 1H 2008 and 4.1% growth in 2Q alone was the key driver of this performance. Business revenues in the domestic fixed segment went down 5.4% yoy in 1H 2008 and 5% in the quarter. From the total gain from sale of fixed assets which was CZK 764 million, CZK 727 million related to the sale of a part of the Company's real estate portfolio announced in May 2008. The total consolidated operating costs reached CZK 17.8 billion in 1H 2008, up 3.4% yoy, with only a 0.7% growth in 2Q alone. Consolidated OIBDA thus amounted to CZK 14.3 billion in 1H 2008, up 1% yoy and CZK 7.6 billion (+6.5% yoy) in 2Q alone. OIBDA margin (OIBDA over Business revenues) reached 46% and 48.1% in 1H

and 2Q 2008 compared to 46% and 45.4% in the same periods of 2007. The Slovak operation diluted OIBDA margin by less than 3 p.p. in 1H 2008.

#### **Depreciation and Amortization**

Consolidated depreciation and amortization amounted to CZK 6.6 billion in 1H 2008, resulting into a decline of 12.1% yoy.

#### **Operating Income, Income before tax and Net income**

Consolidated operating income and consolidated income before tax went up 15.6% yoy and 16.5% yoy reaching CZK 7.8 billion in 1H 2008, on the back of the growth in OIBDA and continuing decrease in consolidated depreciation and amortization. Consolidated net income amounted to CZK 5.8 billion, up 18.6% yoy in 1H 2008 with a 30.4% growth to CZK 3.4 billion in 2Q alone.

#### **CAPEX**

Total consolidated CAPEX amounted to CZK 2.4 billion in 1H 2008, down 12.1% and reached CZK 1.6 billion in 2Q alone. CAPEX was invested mainly in the GSM network rollout and systems deployment in Slovakia; in the Czech Republic it was spent on mobile broadband and GSM networks capacity and coverage increase, ADSL and IPTV rollout, fixed access network improvement and information systems upgrade.

#### **Free Cash Flows**

In 1H 2008, the Groups' free cash flows amounted to CZK 5.3 billion, down 45.3% yoy. The downward trend was driven mainly by an increase in income tax paid due to differences in the timing of 2007 corporate income tax liability settlement, the CZK 2 billion payment related to the dispute with T-Mobile and higher CAPEX accounted for in 4Q 2007 which was paid in 1H 2008.

#### **Cash and Debt levels**

The Group's consolidated financial debt (long-term and short-term) amounted to CZK 9 billion on 30 June 2008. The amount of cash and cash equivalents and short term financial investments reached CZK 15.1 billion at the end of 2Q 2008. This resulted in net leverage of minus 8.5% and gross leverage of 12.3% compared to minus 0.4% and 11.2%, respectively, as at 31 December 2007. In July, i.e. after the close of 1H 2008, the Company redeemed domestic bonds in the total value of CZK 6 billion.



## Czech Republic Overview

The Company's activities in the second quarter of 2008 continued to focus on new and enhanced products and services in the growth areas. These include broadband based services including bundles, ICT and comprehensive customer solutions in the fixed segment. In the mobile segment Telefónica O2 continued to focus on voice traffic stimulation and marketing of its mobile data services. In addition, the Company continued to encourage prepaid to contract migration with the aim of developing the ARPU potential of these customers.

### **CZ Mobile Segment Overview<sup>1</sup>**

Total business revenues in the mobile segment increased by 4.5% yoy in 1H 2008 to CZK 16.6 billion with a 3% growth to CZK 8.4 billion in 2Q alone. Mobile service revenues went up 5.4% yoy to 15.9 billion in 1H 2008 and 4.1% to CZK 8.1 billion in the quarter.

Revenues from voice services (monthly fees, traffic and interconnection) increased in total by 3.5% yoy to CZK 12.3 billion in 1H 2008.

The total number of registered mobile customers increased 6% yoy to 5,186 thousand at 30 June 2008. The total number of contract customers reached 2,369 thousand at the same date, up 292 thousand yoy, representing 14.1% growth following the active prepaid to

contract migration strategy. Net adds of contract customers amounted to 63 thousand in 2Q 2008 and contract customers accounted for 45.7% of the total customer base at the end of June 2008, up from 42.4% a year ago and 43.8% at 2007 year end.

The number of prepaid registered customers amounted to 2,817 thousand at the end of June 2008 and was flat compared to the same day last year, while it decreased by 36 thousand in 2Q 2008 alone. According to the methodology, which defines a prepaid customer as one having generated a revenue in the last 3 months, the number of mobile active prepaid customers as at 30 June 2008 was 2,366 thousand.

The blended monthly average churn rate reached 1.6% in 1H 2008, down from 1.7% in 1H 2007, while it was 1.5% in 2Q 2008, 0.2 p.p. down compared to 1Q 2008.

Revenues from monthly fees increased by 9.1% yoy to CZK 3.8 billion in 1H 2008, driven by a 14.1% yoy growth in the contract customer base. In 2Q alone, this category of revenues went up 8.9% yoy to CZK 1.9 billion.

Traffic revenues increased by 1.8% yoy to CZK 5.9 billion in 1H 2008, on the back of a 12% growth in outgoing traffic volumes. Average MOU per subscriber improved to 120 minutes in 1H 2008, up from 115 minutes in the same period of 2007 (122 minutes in 2Q 2008 compared to 117 minutes in 1Q 2008 and 120 minutes in 2Q 2007), mainly due to the growing number of contract customers generating higher average traffic per customer and the attractiveness of tariffs designed to stimulate traffic which

<sup>1</sup> Figures are shown net of inter-segment charges between the fixed and mobile segments.



were well accepted among the customers. By the end of June 2008, over 50 thousand customers subscribed one of the O<sub>2</sub> NEON or O<sub>2</sub> Cool tariffs, the flat rate based tariffs introduced in May.

Interconnection revenues (excluding revenues from the Company's fixed segment) amounted to CZK 2.6 billion in 1H 2008, down by 0.5% yoy. They fell 2.1% in 2Q alone mainly due to the decrease in revenues from roaming visitors due to the reduction in EU termination rates.

In 1H 2008, blended monthly ARPU<sup>1</sup> reached CZK 516, up 0.4% yoy from CZK 514 in 1H 2007 (CZK 523 in 2Q 2008 compared to CZK 529 in 2Q 2007). Contract monthly ARPU reached CZK 858 in 1H 2008, compared to CZK 914 in 1H 2007 (-6.1% yoy), while it was CZK 862 in 2Q 2008, down from CZK 918 in 2Q 2007. The main reason for the lower contract ARPU is the dilution caused by customer migration from the prepay to the contract segment. Prepay monthly ARPU decreased by 1.2% yoy to CZK 240 in 1H 2008 from CZK 243 in 1H 2007 (CZK 251 and CZK 243 in 2Q 2007 and 2Q 2008).

Total revenues from value added services (including SMS, MMS and content) increased 10.1% yoy to CZK 2.5 billion in 1H 2008 (+10.8% yoy in 2Q alone compared to 9.4% yoy growth in 1Q) as a result of the growing volume of SMS and MMS messages. In 1H 2008, O<sub>2</sub> customers sent and received in total 1,621 million SMS, up 8% yoy.

<sup>1</sup> Including inter-segment revenues.

Revenues from Internet and Data recorded a 9.6% yoy increase and reached CZK 1 billion in 1H 2008 (+6.8% yoy to CZK 505 million in 2Q alone). The total number of data customers (GPRS, CDMA and UMTS flat rate) increased 19.6% to 212 thousand at 30 June 2008 with 7 thousand net additions in 2Q alone. Data ARPU improved by 3.7% yoy to CZK 112 in 1H 2008. Due to the growth in the number of mobile data customers, non-SMS data ARPU represented 44% of total data ARPU in 1H and 2Q 2008 compared to 42% in the same periods of 2007.

#### **CZ Fixed Segment Overview<sup>2</sup>**

Total business revenues in the fixed line segment went down 5.4% to CZK 14.1 billion in 1H 2008 and 5% to CZK 7.2 billion in 2Q alone compared to a 5.9% yoy decrease in 1Q. This improvement has been achieved despite weaker performance of ICT business, which reported strong revenues in 2Q 2007. The strong performance in Q2 2007 was driven mainly by several government contracts which were booked in that period. The Company expects ICT to contribute more to fixed revenues in 4Q this year. Traditional fixed revenues (access and voice services) confirmed a positive trend of a slowdown in fixed telephony accesses and traffic and fell 10.3% yoy in 1H 2008, with a 12.4% and 8.2% yoy decline in 1Q and 2Q 2008.

Revenues from traditional access decreased 16.2% yoy to CZK 4.2 billion in 1H 2008 (down 15.7% in 2Q and 16.6% in 1Q) on the back of a 12.2% decline in the number

<sup>2</sup> Figures are shown net of inter-segment charges between the fixed and mobile segments.



of fixed telephony accesses, of which the Company recorded 1,938 thousand at the end of June 2008, mainly as a result of the strong fixed to mobile substitution effect. However, the decline in fixed telephony accesses decelerated between 2Q 2007 and 2Q 2008. The net lines decrease reached 58 thousand in 2Q 2008 compared to 73 thousand in 1Q 2008 and 81 thousand in 2Q 2007. Lines net losses in 1H 2008 improved by 33% yoy. This is a result of higher gross adds and lower number of disconnections following the Company's effort to enhance the quality of fixed lines through broadband and bundled offers. The total number of customers subscribing to one of the bundled products (O<sub>2</sub> Duo, O<sub>2</sub> Trio and O<sub>2</sub> Duo Mobil) reached approximately 143 thousand at the end of June 2008.

Revenues from traditional voice services (voice traffic and interconnection) fell in total 4.1% to CZK 4.4 billion in 1H 2008 but were flat in 2Q 2008 compared to 2Q 2007 compared to 8% yoy decline in 1Q. Revenues from voice traffic declined by 8.1% yoy to CZK 2.2 billion in 1H 2008, as a result of lower voice traffic generated by our customers, which decreased at the same time by 14.6% yoy to 1,226 million minutes. In 2Q alone, voice traffic revenues decreased 6.3% yoy and traffic went down 12.9% yoy. Interconnection revenues (excluding revenues from the Company's mobile segment) were flat in 1H 2008 and reached CZK 2.3 billion (-6.1% and +6.5% yoy in 1Q and 2Q alone) which was driven by a decrease in revenues from incoming voice, which was compensated by international transit traffic and an increase in the number of ULL.

Revenues from Internet & Broadband increased in total by 8.3% yoy to CZK 2.1 billion in 1H 2008 (+6.9% in 2Q alone) as a result of a 13.9% growth in revenues from broadband based services (ADSL, IPTV and content) confirming the Company's strategy to focus on ADSL and IPTV based services and premium content. Revenues from broadband services reached CZK 2 billion in 1H 2008, up 13.9% yoy. Of this, CZK 1.9 billion represented revenues from retail broadband (up 17.5% yoy) and CZK 175 million from wholesale ADSL services (down 14.2% yoy). The total number of ADSL accesses (retail and wholesale) reached 598 thousand at 30 June 2008, compared to 527 thousand a year ago (up 13.5% yoy). The total number of O<sub>2</sub> TV's customers increased to 98 thousand at the end of 2Q 2008.

Revenues from data services decreased in total by 3.5% yoy to CZK 2 billion in 1H 2008 as a result of a 18.6% decline in revenues from leased lines to CZK 891 million, while revenues from data network services increased 13.8% yoy to CZK 1.1 billion due to a growth in the number of IP Connect and IP VPN connections.

Revenues from ICT services and business solutions (including a contribution from the recently acquired DELTAX Systems) reached CZK 832 million in 1H 2008, up 2.7% yoy, while they were down 15.2% yoy in 2Q alone. In 2Q 2007, this category of revenues benefited from several projects for government customers. Equipment sales amounted to CZK 207 million, down 4.6% yoy due to the lower number of units sold and special discount offers. Other business revenues were up 23.8% yoy to the level of CZK 416 million.

## Slovakia

In 2Q 2008, the key activities in Slovakia continued to focus on improving further the customer mix towards more valuable customers and disconnecting non-active or non-paying customers. In postpaid segment Telefónica O2 Slovakia launched promotions which adjusted to the customer calling pattern and were more advantageous to both the customers calling above and below monthly threshold of minutes included in the monthly fee. In prepay, the Company introduced SMS promotion and on-net calling promotion targeting student and other communities. Furthermore in June Telefónica O2 Slovakia launched a roaming promotion enabling economical calling from most visited summer holiday destinations.

As expected and previously reported, a part of the prepay customers acquired in the initial year of commercial operation were using the service irregularly resulting in a limited activity level. Number of registered (3 months activity criteria) prepay customers reached 320 thousand while the number of contract customers was 75 thousand resulting in 395 thousand registered mobile customers in Slovakia at 30 June 2008. Applying the criterion taking into account the revenue generating transactions in the last 3 months, the number of mobile active prepay customers reached 200 thousand.

Telefónica O2 Slovakia continued to rollout its own network infrastructure and by the end of June 2008 the company has put 635 BTS into operation, which enabled

it to capture more than 70% of the customer traffic generated within its network. In April, the company also opened an extension of its call centre in Banská Bystrica.

## Group Operating Expenses

Total Group operating costs (including the Slovak operation) amounted to CZK 17.8 billion in 1H 2008, up 3.4% yoy, while they were up only 0.7% yoy to CZK 9 billion in 2Q alone. This confirms the Group's effort focused on efficient operating expenditure.

Supplies expenses grew 0.2% yoy to CZK 8.2 billion in 1H 2008 with a 3% decrease in 2Q alone. Interconnection costs increased by 6% yoy to CZK 5.7 billion in 1H 2008 and by 4.6% in the quarter driven by interconnection charges recorded in Slovakia and higher outgoing mobile traffic in the Czech Republic. Cost of goods sold went down 5.4% yoy to CZK 1.5 billion. Other supplies decreased by 16.9% to CZK 1.1 billion in 1H 2008 and by 26.9% yoy in the quarter on the back of decline in subcontracts for ICT projects.

Personnel costs, including headcount reduction costs, amounted to CZK 3.6 billion in 1HQ 2008, down 0.2% yoy, while they fell 2.5% yoy in 2Q alone. The total number of Group employees (including DELTAX) reached 9,320 at 30 June 2008, down 0.5% yoy. Telefónica O2 Czech Republic headcount went down 4.2% yoy to 8,598 at that day.



The cost of external services increased 7.3% yoy in total and reached CZK 5.4 billion in 1H 2008 with a 6.2% growth in 2Q alone. Marketing and sales in total went down 1.7% yoy to CZK 1.6 billion. Network & IT repairs and maintenance decreased by 6.1% yoy to CZK 1.2 billion in 1H 2008 as a result of continuing synergies from fixed/mobile integration and improved efficiency in IT services outsourcing. Rentals, buildings and vehicles costs reached CZK 1.1 billion, up 32.7% yoy mainly due to the higher rental and service costs related to the relocation to the new headquarters, rental costs of DELTAX, rental costs incurred in Slovakia and increasing proportion of leased cars, while utilities supplies increased 20.8% yoy to CZK 477 million on the back of electricity price increases and the impact of the Slovak operation. Other external services including consultancy fees, call centers and other external services went down 18.6% yoy to CZK 766 million in 1H 2008 with a 27.5% decrease in the quarter.

Taxes, comprising taxes other than income tax, fees and provisions increased by 65% yoy to CZK 528 million mainly as a result of bad debt provisions created in Slovakia in 1Q, while their amount decreased significantly in 2Q.

## Outlook for the second half of 2008

In the fixed line business, the Company's effort will continue to focus on slowing down of the fixed lines cancellation rate. The Company believes in continuing the enhancement of ADSL and IPTV propositions that will further increase the value of the fixed line and eventually reduce churn. Broadband services will be the fundamental product in the bundles. We see a strong potential in the area of ICT and integrated customer solutions primarily for corporate and government customers; the Company will continue to focus its efforts in this area also in 2H 2008. As mentioned earlier, the ICT revenues are expected to contribute more in the fourth quarter. The acquisition of DELTAX Systems will further strengthen the Company's position on the fast growing ICT market. The strategy in the mobile segment continues to focus on ARPU sustainment via onward prepay to contract migration and growing non-SMS mobile data and Internet revenues through broadband based services.

The Company will continue to lend support the gradual deployment of the Slovak operation. Commercial activities in Slovakia will primarily focus on the improvement of customer mix via increasing proportion of contract customers and the acquisition of new ones with the aim to stimulate their activity. After the expected and previously reported disconnections of certain part of the prepay customers acquired in the initial year of the commercial operation in 1H 2008, the company expects a regular churn level.

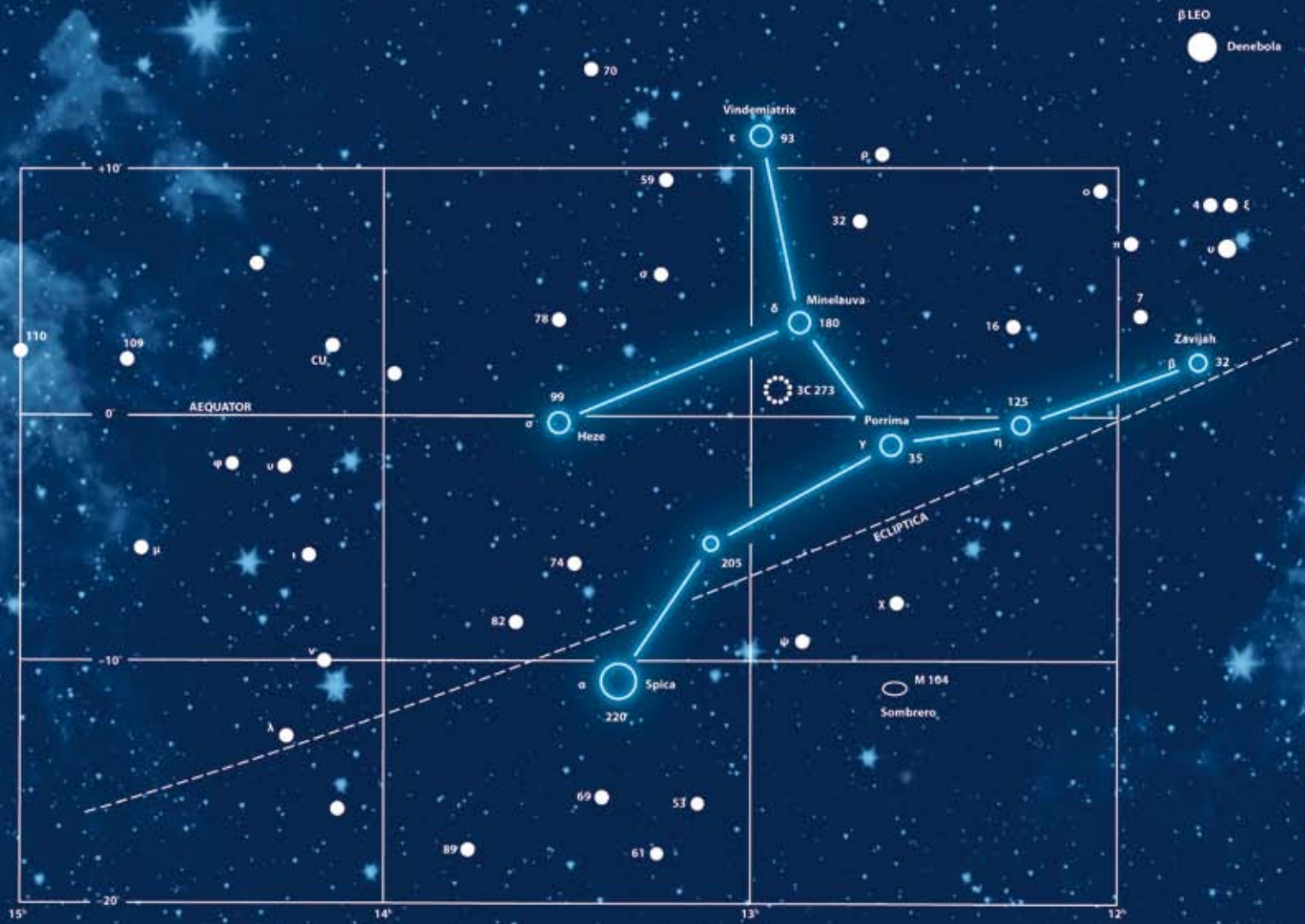
The main aspects of the financial management of the Telefónica O2 Czech Republic Group will remain focused on profitable growth, efficient and selective CAPEX levels and strong free cash flows.

With regard to the presented results for the first half of 2008 and in the context of a more challenging operating environment, the Group will reach its 2008 full year guidance range. In 2008 we expect Group revenues<sup>1</sup> to grow 2 to 4% and OIBDA<sup>2</sup> to grow in the range of 0% to 2% compared to 2007. CAPEX is expected to be around CZK 9 billion in total.

<sup>1</sup> In terms of guidance calculation, Revenues represent business revenues only.

<sup>2</sup> In terms of 2008 guidance calculation, OIBDA excludes other exceptional revenues/expenses not foreseeable in 2008. For the purposes of comparison, the equivalent other exceptional revenues/expenses registered in 2007 are also deducted from the reported figures (the only unforeseeable expense deducted from 2007 OIBDA was the impairment charge).

The constellation of Virgo boasts the brightest and at the same time the closest of the known quasars – 3C 273. A quasar is an extremely powerful black hole – a space object whose gravitational pull is so intensive that nothing that chances across its path can ever leave. The appearance of flare is caused by stars that are being pulled into the bottomless gravitational well in the centre of the quasar. Quasar 3C 273 is approximately 2,000,000,000,000 times brighter than our Sun.



# Corporate governance

In the first half of 2008, the Company continued to apply and further improve the corporate governance model described in the 2006 and 2007 Annual Reports. Compliance with the requirements of the Code of Good Corporate Governance based on OECD Principles, which was adopted in 2004, improving the efficiency of corporate governance administration and implementation of the best practice across the whole Telefónica Group remains among the priorities.

In the period in question, the Board of Directors met eleven times and the Supervisory Board met three times. As concerns the committees established by the Supervisory Board, the Nomination and Remuneration Committee and the Ethics and Corporate Social Responsibility Committee met once, and the Audit and Control Committee met twice.

An Ordinary General Meeting of Telefónica O2 was held on 21 April 2008. The supreme governing body of the Company approved the financial statements and the consolidated financial statements of the Company for the year 2007, both prepared according to International Financial Reporting Standards (IFRS) and audited by the audit firm Ernst & Young. The shareholders approved the Board of Directors' proposal to pay dividends in the amount of CZK 9,662,697 thousand from a part of the 2007 profits, and dividends from a part of the reserve fund, which the Company may use at its discretion, in the amount of CZK 6,441,798 thousand, which altogether are dividends in the amount of CZK 16,104,495 thousand, i.e. a dividend of CZK 50 per share before tax. The proposed amount of dividends is based on an in-depth



analysis of the Company's past performance, its current balance sheet situation and its expected future performance. The proposal is also fully conformant to the investment strategy of the Company, i.e. to focus investments in high growth potential areas (broadband internet, mobile services, services for the corporate segment and the investment in Slovakia), and is fully in line with the intentions repeatedly declared by the Board of Directors to distribute surplus cash balances to shareholders instead of cash accumulation.

The General Meeting also approved the Board of Directors' proposal to amend the Company's Articles of Association; the majority of the suggested amendments were to improve and enhance the governance processes: no longer applicable activities were deleted from the declared business of the Company, and the new provisions governing the remuneration of the Board of Directors and Supervisory Board members will grant greater flexibility to the General Meeting in deciding on the remuneration rules. The number of members of the Board of Directors was brought down from nine to seven, the minimal required number of Supervisory Board meetings during the year was also amended, and the General Meeting was given new powers to decide on the creation and usage of the reserve fund. The rules for remuneration of the Board of Directors and Supervisory Board members amended General Meeting, which take effect from 1 July 2008, change the method for determination of remuneration due to members of these bodies. The members are divided into three categories – regular member, Vice-Chairman and Chairman, and the General Meeting resolves on the amount of remuneration due to each

category. The General Meeting approved the total remuneration for the first half of the year, which equalled a half of the total amount of remuneration applicable in 2007. The General Meeting also approved the conclusion of an agreement on the discharge of the office of Supervisory Board member between the Company and all members of the Supervisory Board. The reason for this action was a technical change in the construction of the pecuniary compensation granted by the Company in exchange for undertaking of non-competition after the office of the Supervisory Board member expires and he or she leaves the Telefónica Group; the change arose from the amended rules for remuneration of the Supervisory Board members.

Personnel changes in the governing bodies of Telefónica O2 in the period January–March 2008 are listed in the 2007 Annual Report (Section Corporate Governance). In the subsequent period until the end of June 2008, the personnel changes in the Supervisory Board and in the Board of Directors were the result of a decision of the Ordinary General Meeting and of the Supervisory Board. The General Meeting confirmed by vote Maria Pilar López Álvarez, who replaced Catherine Jane Keers after her resignation, as member of the Supervisory Board after she was co-opted on 26 July 2007; Vivek Dev as member of the Supervisory Board after he was co-opted on 25 October 2007, replacing Sohail Qadri after his resignation; and Jaime Smith Basterra as member of the Supervisory Board after he was co-opted on 21 February 2008, replacing Peter Anthony Erskine after his resignation from the Supervisory Board. The General Meeting also elected as member of the Supervisory Board Antonio Botas Bañuelos, who replaced Julio Esteban Linares López after his resignation from



office at the meeting of the Supervisory Board held on 21 April 2008 in the morning. At the meeting held on 21 April 2008 after the conclusion of the General Meeting, the Supervisory Board confirmed Jaime Smith Basterra as Chairman of the Supervisory Board, and elected Alfonso Alonso Durán into the vacated position of the First Vice-Chairman of the Supervisory Board. At the same meeting, the Supervisory Board discussed the resignation of Petr Zatloukal and accepted the proposal to terminate his membership as of 23 June 2008. Eduardo Zaplana, the Telefónica's representative for Europe, was nominated to replace Petr Zatloukal. The Supervisory Board also discussed and approved personnel changes in the Company's Board of Directors – it acknowledged the resignation of member Ramón Ros Bigeriego on the grounds of his transfer to an executive position in Telefónica O2 Europe, and effective from 1 May 2008 it elected Jesús Pérez de Uriguen as new member; Jesús Pérez de Uriguen was also appointed Vice-President, Finance Division of Telefónica O2. With effect from 14 June 2008, the Supervisory Board also re-elected Petr Slováček and Juraj Šedivý as members of the Board of Directors; later they were confirmed by the Board of Directors' decision as its Vice-Chairmen. As part of the corporate matters handled by the Supervisory Board, the governing body also approved the conclusion of an agreement on the discharge of the office of Board of Directors member between the Company and all members of the Board of Directors, on the same grounds as in the above case of agreements for members of the Supervisory Board. Elections of Supervisory Board members elected by employees of Telefónica O2 were held in June 2008. Effective from 29 June 2008, Lubomír Vinduška, Pavel Heršтик, Petr Gazda, Tomáš Fírbach and Dušan Stareček became new members of the Supervisory Board.

Compared to the situation as at 31 March 2008 published in the 2007 Annual Report, no changes occurred in the executive macrostructure of Telefónica O2. In the executive management of the Company, there was a change in the person of the Vice-President, Finance Division (see above); with this one exception, the personnel composition published in the last Annual Report reflected the situation in the period in question.

All material information and documents relating to corporate governance of Telefónica O2 are available to shareholders and other interested parties on the Company's website ([www.cz.o2.com](http://www.cz.o2.com)).

In the first half of 2008, no changes occurred in the subsidiary and affiliated companies from the situation described in the 2007 Annual Report of Telefónica O2.

## Personnel composition of the Supervisory Board of Telefónica O2 Czech Republic

(as at 1 July 2008)

Name	Office
Jaime Smith Basterra	Chairman of the Supervisory Board
Alfonso Alonso Durán	First Vice-Chairman of the Supervisory Board
Luis Lada Díaz	member of the Supervisory Board
Maria Pilar López Álvarez	member of the Supervisory Board
Vivek Dev	member of the Supervisory Board
Ángel Vilá Boix	member of the Supervisory Board
Andrew Harley	member of the Supervisory Board
Antonio Botas Bañuelos	member of the Supervisory Board
Guillermo José Fernández Vidal	member of the Supervisory Board
Lubomír Vinduška	member of the Supervisory Board
Pavel Herštík	member of the Supervisory Board
Dušan Stareček	member of the Supervisory Board
Tomáš Fírbach	member of the Supervisory Board
Petr Gazda	member of the Supervisory Board

As at 1 July 2008, the fifteen-member Supervisory Board had one unfilled position of a member and an unfilled position of Second Vice-Chairman of the Supervisory Board.

## Personnel composition of the Board of Directors of Telefónica O2 Czech Republic

(as at 1 July 2008)

Name	Office
Salvador Anglada Gonzalez	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
Jesús Pérez de Uriguen	member of the Board of Directors
José Fernando Astiaso Laín	member of the Board of Directors
Martin Bek	member of the Board of Directors
Jakub Chytil	member of the Board of Directors



**JESÚS PÉREZ DE URIGUEN**  
MEMBER

## Résumé of the new member of the Board of Directors of Telefónica O2 Czech Republic

### Jesús Pérez de Uriguen

Graduated in Business Administration at University of Maryland at College Park in 1992, expertise in Finance and Accounting, where he got his degree of Bachelor of Science in Business and Management. In 1993, he achieved MBA degree at Instituto de Empresa in Madrid. Before joining Telefónica O2 Czech Republic, a.s. he worked in Bank of America, Arthur Andersen, Jazz Telecom, S.A., and Telefónica Moviles, S.A. Jesús earned great experience in telecommunication and finance area at these companies – he was responsible for planning, management control etc. Lastly, he worked at the position of CFO in Telefónica Centroamérica in Panama for nearly four years. Now he holds an appointment of Vice President, Finance Division, in Telefónica O2 Czech Republic, a.s.

## Résumés of new members of the Supervisory Board of Telefónica O2 Czech Republic

### Antonio Botas Bañuelos

He earned his Bachelor degree at Universidad Complutense in law and a Master degree in Economics and Business Administration (MBA) at IESE. He has more than seventeen years of experience in operative and strategic marketing, management and co-ordination of large multinational teams, and he has worked in international markets, namely those in the Americas. He worked as Marketing Manager in Royal Insurance, which he joined after leaving Johnson & Johnson. In the Telefónica Group he worked for TPI, Doubleclick Iberoamérica and then in Terra in positions ranging from Chief Sales and Marketing Officer to Executive Vice-President for Central Marketing and Global Sales. From 2005 until August 2007 he worked as Chief Transformation and Convergence Officer and till February 2008 was member of the Board of Directors at Telefónica O2 Czech Republic. Since September 2007 he holds the position of Managing Director Product Development & Brand Management at O2 Germany GmbH & Co. OHG.

### Tomáš Fírbach

Graduated from the Czech Technical University in Prague, Faculty of Transport, Department of Economics and Management of Transport and Telecommunications. Joined Telefónica O2 Czech Republic (and its legal predecessors) in 2005, and at present he holds the position of Senior Product Manager; 2004–2005 ČD Telekomunikace, a.s.,



**ANTONIO BOTAS BAÑUELOS**  
MEMBER



**TOMÁŠ FIRBACH**  
MEMBER



**PETR GAZDA**  
MEMBER



**PAVEL HERŠTIK**  
MEMBER

Business Consultant; 2001–2004 Eurotel Praha, spol. s r.o., Network Design Specialist; 1999–2001 JSJ spol. s r.o., IS Manager.

### Petr Gazda

Graduated Economics and Management from the Business School Ostrava with a B.A. degree. Joined Telefónica O2 Czech Republic, a.s. (and its legal predecessors) in 2006, at present he holds the position of Network Operation Director – Regions; 1991–2006 Eurotel Praha, spol. s r.o.; 1988–1991 ČESKÝ TELECOM, a.s.; 1986–1988 AŽD Praha, administrator; 1983–1984 AŽD Praha, electrical engineer.

### Pavel Heršтик

Graduated in Communication Technology from the Secondary Technology School of Electrotechnical Engineering. In 1972, he started working as a telephone test centre technician in Ředitelství telekomunikací Praha (Telecommunications Headquarters, Prague). For the next 20 years (1975–1995), he was a planner and later became chief planner. From 1995 to 2005, he was Head of Information Management and went on to become Head of the Management, Organisation and Administration Department. At present, he is a Senior Specialist in the area of management and administration of management documents in the Human Resources and Support Services Unit of Telefónica O2 Czech Republic. In 2005 he completed a course in International Accounting Standards. In 2007 he was certified under the National Certification Programme for Corporate Ethics and Culture. He is Chairman of the Trade Union Steering Committee of Telefónica O2 Czech Republic.

## Dušan Stareček

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

## Lubomír Vinduška

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



**DUŠAN STAREČEK**  
MEMBER



**LUBOMÍR VINDUŠKA**  
MEMBER

The constellation of Sagittarius is the home to SGR 1806-20. It is a magnetar – a neutron star with an extremely powerful magnetic field. In this respect, SGR 1806-20 ranks among the largest known-to-humankind sources of magnetic radiation. During a one-second explosion, the star radiates as much energy into space as our Sun manages in 100,000 years. The magnetic field of a magnetar of standard size would still erase the magnetic strip data of a credit card over a distance of 200,000 kilometres.





# 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 millions.

## Consolidated income statement

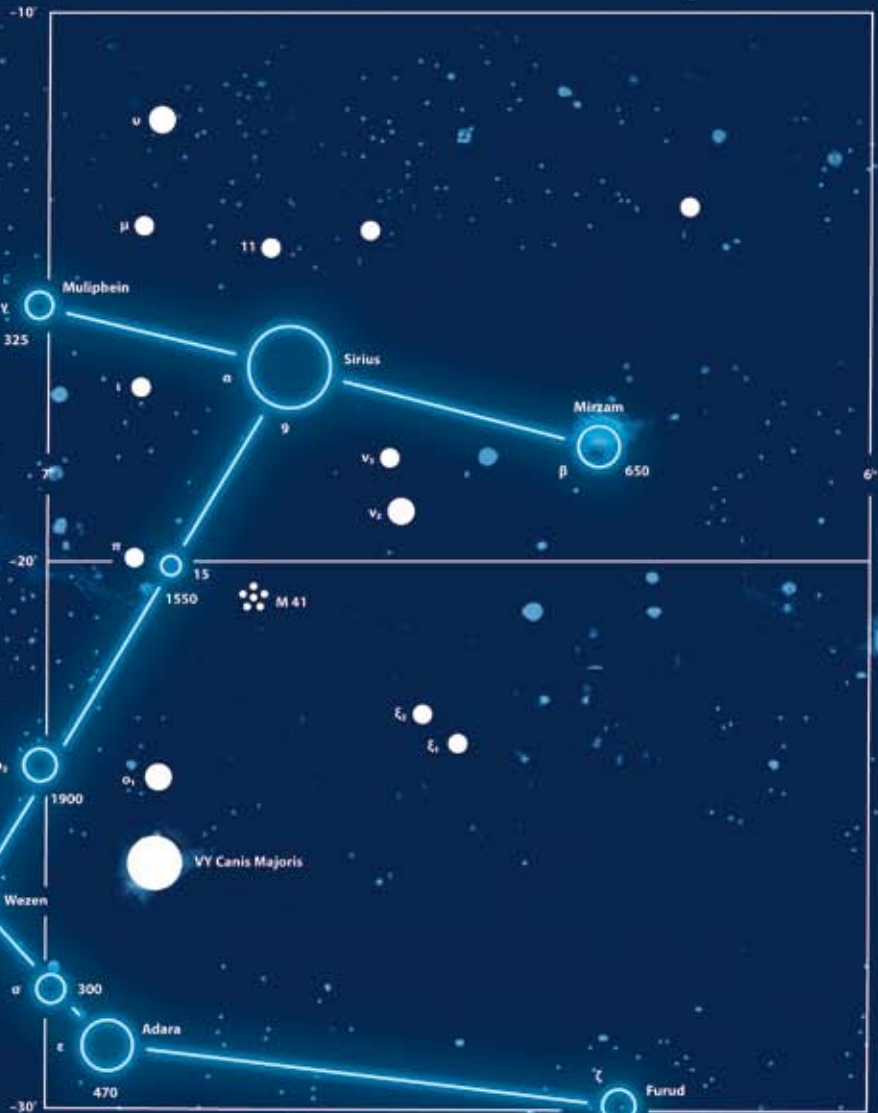
	Period ended	
	30 June 2008	30 June 2007
Revenue	31,301	31,085
Gain from sale of non-current assets	764	32
Internal expenses capitalized in fixed assets	199	291
Operating expenses	(17,852)	(17,237)
Impairment loss	(87)	10
Depreciation and amortisation	(6,570)	(7,471)
<b>Operating profit</b>	<b>7,755</b>	<b>6,710</b>
Interest income	(241)	(217)
Interest expense	253	174
Other financial income (net)	(15)	(13)
<b>Profit before income tax</b>	<b>7,752</b>	<b>6,654</b>
Taxes on income	(1,951)	(1,763)
<b>Profit for the year</b>	<b>5,801</b>	<b>4,891</b>
Attributable to:		
Equity holders of the Company	5,801	4,891
Minority interest	–	–
Earnings per share (CZK) – basic*	18	15

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

## Consolidated balance sheet

	30 June 2008	31 December 2007
<b>ASSETS</b>		
Property, plant and equipment	64,487	71,809
Intangible assets	21,733	21,805
Investments in associates	11	11
Available-for-sale and Held-to-maturity investments	–	–
Other financial assets	313	566
<b>Non-current assets</b>	<b>86,544</b>	<b>94,191</b>
Inventories	596	853
Receivables and prepayments	13,186	8,555
Income tax receivable	3	1
Available-for-sale and Held-to-maturity investments	24	27
Other short-term financial assets	94	21
Cash and cash equivalents	15,017	9,576
<b>Current assets</b>	<b>28,920</b>	<b>19,033</b>
<b>Non current assets assigned to be sold</b>	<b>129</b>	<b>328</b>
<b>Total assets</b>	<b>115,593</b>	<b>113,552</b>
<b>EQUITY AND LIABILITIES</b>		
Ordinary shares	32,209	32,209
Share premium	24,374	30,816
Retained earnings and reserves	15,937	19,767
<b>Total equity</b>	<b>72,520</b>	<b>82,792</b>
Long-term financial debts	2,749	3,062
Deferred taxes	3,133	3,353
Non-current provisions for liabilities and charges	508	2,150
Non-current other liabilities	308	452
<b>Non-current liabilities</b>	<b>6,698</b>	<b>9,017</b>
Short-term financial debts	6,484	6,207
Trade and other payables	9,861	11,080
Income tax liability	275	870
Provisions for liabilities and charges	1,132	901
Other current liabilities	18,623	2,685
<b>Current liabilities</b>	<b>36,375</b>	<b>21,743</b>
<b>Total liabilities</b>	<b>43,073</b>	<b>30,760</b>
<b>Total equity and liabilities</b>	<b>115,593</b>	<b>113,552</b>

In a distance of 5,000 light years from our Earth, in the Canis Major constellation, there lies VY Canis Majoris. This red hypergiant is the biggest star in the known universe. Compared to our Sun, VY Canis Majoris is 2,000 times bigger in diameter, approximately 500,000 times brighter and it weighs the equivalent of about 10,000,000 Earths. If we put VY Canis Majoris into the middle of our solar system, planets from Mercury to Saturn would instantly disappear in its mass.



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2360

VY Canis Majoris

$\gamma$  Mulliphein 325  
 $\alpha$  Sirius  
 $\beta$  Mirzam 650  
 $\nu$  1550  
 $\delta$  Wezen 1100  
 $\epsilon$  Adara 470  
 $\zeta$  Furud 250  
 $\eta$  Aludra 1300  
 $\sigma_1$  1900  
 $\sigma_2$  1900  
 $\tau$  UW  
 $\upsilon$  UW  
 $\phi$  27  
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# Information for shareholders

The main shareholders of Telefónica O2 as at 30 June 2008:

Telefónica, S.A.	69.41%
Investment funds and individual shareholders	30.59%

## Trading in Telefónica O2 shares

The volume of trading in Telefónica O2 shares on the stock market of the Prague Stock Exchange (PSE) in the first half of 2008 reached CZK 44 billion, compared to CZK 55.1 billion in the first half of 2007. This indicator ranked the company's shares among the top five blue chip stock and made up approximately 10% of all trades. The average volume of trades in the first half of 2008 fell to CZK 340.4 million, compared to CZK 437 million in the first half of the last year. As at 30 June 2008, the market capitalisation of the company reached CZK 156.6 billion. Measured by this indicator, Telefónica O2 ranks third among the companies listed on the PSE stock market and makes up 8.5% of the total market capitalisation of the PSE stock market.

From the beginning of 2008 until 30 June 2008, the share price of Telefónica O2 fell 10.8% to CZK 486.3. The performance of the PSE stock market as measured by the PX index fell 18.3% over the same period, and was down 1,483.5 points. The share price of Telefónica O2 reached its maximum CZK 563.5 in the first half of 2008 on 3 January 2008.

## General Meeting

An Ordinary General Meeting of the company was held in Prague on 21 April 2008. The main conclusions of the General Meeting are recapitulated in the Section Corporate Governance of this Half-year Report.

## Dividends

At the Ordinary General Meeting, the shareholders approved a dividend payment from the 2007 net profit and part of the reserve fund, in the total amount of CZK 16,104.5 million, i.e. CZK 50 per share of nominal value of CZK 100 and CZK 500 per share of nominal value CZK 1,000, before tax. The record day for the payment

of dividends will be 17 September 2008 and the disbursement date 8 October 2008. The dividends will be paid out by Česká spořitelna. After the record date, Česká spořitelna will inform all recorded shareholders in writing of the method of disbursement.

## Institutional relations and shareholders may contact

Investor Relations

Telefónica O2 Czech Republic, a.s., Za Brumlovkou 266/2, 140 22, Praha 4-Michle

Tel.: +420 271 462 076, +420 271 462 169, fax: +420 271 463 566

E-mail: [investor.relations@o2.com](mailto:investor.relations@o2.com), or visit

[www.cz.o2.com/home/cz/aboutUs/investorRelations/index.html](http://www.cz.o2.com/home/cz/aboutUs/investorRelations/index.html)



Our closest star, the Sun, lies in the distance of almost 150 billion of kilometres from our Earth. The Sun comprises almost 99.9% of the total mass of our solar system; more than 330,000 Earths would fit into one Sun. A sphere composed of 99% hydrogen and helium, with temperatures reaching 15,000,000 °C and 1,400,000,000 kilometres in diameter, each second converts 4,000,000 tons of its mass into energy. The second closest-to-the-Earth star is Proxima Centauri. While a ray of light from the Sun takes only 8 minutes to reach our Earth, from Proxima Centauri it takes more than 4 years.





Proxima Centauri

# Glossary of terms and acronyms

**ADSL** Asymmetric Digital Subscriber Line

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

**BlackBerry** a mobile office solution from Telefónica O2 designed for mobile corporate customers

**CDMA** Code Division Multiple Access, a modern digital technology for wireless data and broadband internet

**CTO** Czech Telecommunications Office

**EDGE** Enhanced Data Rates for GSM Evolution, a mobile digital technology with a faster and more reliable data transmission

**GPRS** General Packet Radio Service, a technology for mobile data transmission

**GSM** Global System for Mobile Communication; the most widely deployed digital wireless communication standard for the digital mobile system which globally uses frequencies of 450, 900, 1,800 and 1,900 MHz, and frequencies of 900 and 1,800 MHz in the Czech Republic

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

**HSDPA** High Speed Downlink Packet Access, a superstructure technology for data transmission in the UMTS network, with speeds from 8 to 10 Mb/s

**IFRS** International Financial Reporting Standards

**IPTV** Internet Protocol Television

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

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

**O<sub>2</sub> Duo** a converged service of Telefónica O2 combining unlimited free calls to fixed networks in the Czech Republic and O<sub>2</sub> Internet ADSL, or O<sub>2</sub> TV, for one monthly fee

**O<sub>2</sub> Duo Mobil** a converged service of Telefónica O2 combining O<sub>2</sub> Internet ADSL and a mobile voice tariff in one monthly fee, which already includes the fixed line rental fee

**O<sub>2</sub> Internet ADSL** a high-speed internet service of Telefónica O2, formerly branded as O<sub>2</sub> Internet Expres

**O<sub>2</sub> karta** a SIM card with prepaid credit from Telefónica O2

**O<sub>2</sub> Simple** mobile tariffs of Telefónica O2, which let the customer choose the billed amount according to their anticipated need for mobile communication

**O<sub>2</sub> Smart Roaming** a special roaming tariff, with up to 82% cheaper calls from fourteen holiday destinations (the so-called O<sub>2</sub> Smart zone) compared to the regular roaming prices

**O<sub>2</sub> Smart zóna** fourteen popular holiday destinations where special roaming prices offered as part of O<sub>2</sub> Smart Roaming apply: Croatia, Slovakia, France, Italy, Spain, Cyprus, Malta, Bulgaria, Greece, Egypt, Tunisia, Turkey, Malaysia and Thailand

**O<sub>2</sub> Trio** a converged service of Telefónica O2 combining O<sub>2</sub> Internet ADSL, O<sub>2</sub> TV and unlimited calls to fixed networks in the Czech republic, all for one monthly fee

**O<sub>2</sub> TV** an IPTV service of Telefónica O2; digital television over a fixed line

**OIBDA** Operating Income before Depreciation and Amortisation

**SMS** a short text message format in mobile telephony

**UMTS** Universal Mobile Telecommunications System; a standard for the so-called 3<sup>rd</sup> generation mobile networks

**OPEC** Office for the Protection of Economic Competition, an anti-monopoly authority

**VPN** Virtual Private Network

**WiFi** a local wireless network for accessing the internet



NOTES

HALF-YEAR REPORT 2008



Telefónica O2 Czech Republic, a.s.  
Za Brumlovkou 266/2, 140 22 Prague 4, Czech Republic  
Tel.: +420 271 411 111  
Fax: +420 271 469 868  
Telephone Service Centre: 800 02 02 02  
CIN: 60193336  
[www.cz.o2.com](http://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.



Telefónica O2 Czech Republic, a.s., member of the Telefónica Group