Interim report

Telefónica Czech Republic – January to March 2012 Financial Results

May 10, 2012

Telefónica Czech Republic, a.s. announces its unaudited financial results for January to March 2012. These results are consolidated and prepared according to International Financial Reporting Standards and fully include the results of Telefónica Slovakia, Telefónica O2 Business Solutions, Internethome and other smaller operating companies.

Operational Highlights

- **Solid commercial momentum** in focused areas maintained despite continued intense competition:
  - **Strong contract mobile customers' growth maintained: +6.1% year-on-year**, with 27.5 thousand net additions in 1Q 2012, helped by continued **good trading** and **low churn**.
  - **Smartphone penetration growth maintained,** reaching **21.3%** (+1.8 p.p. q-o-q, +7.5 p.p. y-o-y)
  - **xDSL accesses grew by 6.6% year-on-year reaching 883 thousand**, with VDSL (already 18% of total FBB base) helping to improve the experience of the existing base, manage fixed BB ARPU and decrease the churn.
  - **Decline in fixed accesses continued to decelerate: accesses down 5.1% year-on year**, with 26.1 thousand net losses in 1Q 2012 (12.6% deceleration year-on-year).
- **Consolidated business revenues** (-3.2% year-on-year in 1Q 2012) **show improvement for the 3rd consecutive quarter** on the back of **better mobile service revenue performance** and continued **growth of revenue in Slovakia**.
- **Guided OIBDA[1] margin decreased by 0.8 percentage points year-on-year** in 1Q 2012, **reaching solid 40.5%** on the back of **continuous efficiency agenda in CZ, sale of non-core business, growing OIBDA in SK and selective and rational investments in the commercial area to secure future growth**.
- **Telefónica Slovakia** maintained its **strong commercial momentum** reporting 28.4% year-on-year subscribers' growth (+52.8 thousand in 1Q) and further **improving its financial performance**.
- **2012 full year guidance reiterated for all metrics[2].**
- **AGM approved 2011 Shareholder remuneration and share buy-back program; Board of Directors approved initiation of up to 2% share buy-back execution.**

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[1] OIBDA before brand fees & management fees (CZK 249 million in 1Q 2011 and CZK 274 million 1Q 2012) Over Business revenues; 2012 guidance excludes changes in consolidation, includes potential capital gains from non core asset sales, assuming constant FX rates of 2011

[2] Business Revenues: improving trends compared to 2011 (2011 base: -5.7% year-on-year), OIBDA margin: limited margin erosion year-on-year (2011 base: 43.7%), CapEx: up to CZK 6.2 billion (excluding business acquisitions).

"I am pleased that our performance in the first quarter of 2012 was in accordance with our plans. Positive results of churn and customer value management initiatives led to spend stabilisation of our mobile residential customers. In addition, we sustained customers' growth in key areas, thus reinforcing our market position. Our continuous smartphone focused marketing activities resulted in further sales growth and penetration in our customer base, and positively impacted our mobile internet revenue performance. In Slovakia, we maintained solid customers' growth helping us to further improve financial performance. Consequently, our consolidated business revenues reported improvement for the third consecutive quarter. ," says Jesús Pérez de Uriguen, the Chief Financial Officer and the First Vice-Chairman of the Board of Directors of Telefónica Czech Republic when commenting on the operator's financial results. *"We continued our transformation program aimed at a leaner organisational structure, which shall help us to further improve our operational efficiency. As a result of our selective and rational commercial investments into future growth, efficiencies in non-commercial areas and growing profitability in Slovakia, our margin reached 40.5%.* ", he adds.

Consolidated Financial Statements

Consolidated **business revenues** went down by 3.2% year-on-year to CZK 12,451 million in 1Q 2012, thus showing improvement for the 3rd consecutive quarter (-5.4% year-on-year in 3Q 2011 and -4.0% year-on-year in 4Q 2011). This improvement is a result of stabilisation in mobile residential spend, better performance in mobile data revenues and continuing revenue growth in Slovakia. At the same time, revenues continued to be impacted by prevailing competitive pressure largely in corporate and SMB mobile segments and lower MTR year-on-year. Fixed business revenues in the Czech Republic declined by 6.2% year-on-year reaching CZK 5,292 million in 1Q 2012, lower rate of decline compared to the same period in the previous year (-8.3% year-on-year in 1Q 2011) . Mobile revenues in the Czech Republic continued to improve performance trends seen already in the second half of 2011 and in 1Q 2012 they declined by 5.0% to CZK 6,101 million. Excluding the impact of MTR cuts, the decline rate would have been at -2.9%, the best quarterly performance since 4Q 2010, due to already mentioned better spend in residential segment and mobile data revenues growth. At the same time, revenues in Slovakia continued with solid growth and recorded a 27.0% year-on-year increase reaching EUR 43.9 million in 1Q 2012 (+34.6% year-on-year, excluding MTR impact).

In 1Q 2012, the Company has continued in its effort to deliver efficiencies in all areas of its operations via further transformation of its organisation. Hence it executed additional phase of its restructuring program, focused on establishment of a more effective organisational structure by reducing the number of organizational layers across the whole company. In addition the transformation aims at further streamlining and simplifying processes. As a result of the restructuring program, the Company booked restructuring costs of CZK 169 million in 1Q 2012 (CZK 158 million in 1Q 2011). In 1Q 2012, the total Group headcount has been further optimised with a reduction of 179. Consequently, headcount reached 6,711 at the end of March 2012, representing a 10.2% year-on-year reduction. In addition, it is worth mentioning the positive impact coming from the 2011 and 2012 restructuring programs on personnel expenses, which went down by 9.0% year-on-year in 1Q 2012. Despite the above mentioned efficiencies in non-commercial areas, total consolidated **operating costs** increased slightly by 1.0% year-on-year reaching CZK 7,914 million in 1Q 2012 (+0.7% excluding brand fees and management fees) largely due to increased selective commercial investments, different phasing of ICT projects and higher network & IT costs, which were influenced by the outsourcing of IT support services to Telefónica Global Technology in December 2011.

Guided Operating income before depreciation and amortization (OIBDA)[3] decreased by 5.1% year-on-year, reaching CZK 5,049 million in 1Q 2012. At the same time **guided OIBDA margin** decreased slightly by 0.8 p.p. year-on-year, in line with full year guidance[4], reaching a solid 40.5%, on the back of already mentioned focus on cost efficiency, improving profitability in Slovakia and helped by sale of non-core business, not fully compensating higher commercial activities. On 29th February 2012, the Company announced that it had signed a sale and purchase agreement related

[3] In terms of the 2012 guidance calculation, OIBDA excludes brand fees and management fees (CZK 249 million in 1Q 2011 and CZK 274 million 1Q 2012), 2012 guidance excludes changes in consolidation, includes potential capital gains from sales of non-core asset, assuming constant FX rates of 2011.

[4] 2012 guidance: "limited margin erosion y-o-y", 2011 base: 43.7%, OIBDA before brand fees & management fees/Business revenues; 2012 guidance excludes changes in consolidation, includes potential capital gains from non core asset sales, assuming constant FX rates of 2011

to 80% of the shares of its subsidiary Informační linky, a.s. The agreement contained an option for the acquisition of the remaining 20% of shares. The net gain from the sale of 80% of shares reached CZK 220 million. **Reported OIBDA** reached CZK 4,775 million in 1Q 2012, -5.8% year-on-year.

Depreciation and amortization charges were broadly flat year-on-year in 1Q 2012. Consolidated **net income** amounted to CZK 1,622 million in 1Q 2012, down by 6.8% year-on-year, largely due to the decline in OIBDA, which was not fully offset by lower income tax expenses.

Consolidated **CapEx** (excluding business acquisitions) reached CZK 974 million in 1Q 2012, down by 13.7% year-on-year. The Company continued to direct investments into the further capacity expansion and improvement of the quality of its 3G network including backhaul. In addition, CapEx was spent on further expansion of 3G network coverage, including coverage of currently unserved areas on the basis of the network sharing contract with T-Mobile. At the end of March 2012, the Company covered 1,724 towns and cities in the Czech Republic with its 3G network, representing close to 74% of the population. Additionally, the Company focused its investments into upgrading its fixed broadband networks including selective fibre investments aiming at strengthening its position in the highly competitive fixed broadband market in the Czech Republic and improving customer experience. In Slovakia, CapEx was largely spent on additional network investments.

Group free cash flows decreased by 20.0% year-on-year reaching CZK 2,278 million in 1Q 2012, as a combination of **15.2% decline in cash from operating activities**, due to a decrease in OIBDA and different phasing in working capital cash movements, and a 7.2% decrease in cash used in investing activities, largely driven by proceeds on disposal of 80% of shares of its subsidiary Informační linky.

The consolidated **financial debt** amounted to CZK 3,082 million at 31 March 2012, broadly in line with the end of 2011. At the same time, **cash and cash equivalents** reached CZK 9,243 million, up from CZK 6,955 million at the end of 2011.

CZ Mobile Business Overview[5]

Similarly to the second half of 2011, the dynamics of the mobile business continued to improve in 1Q 2012 on the back of improvements in residential spend and better data performance, while tough competition in SMB and corporate segments continued to dilute financial performance. In addition, MTR cuts (-21.2% year-on-year[6]) impacted mobile revenues during this period. In the commercial area, the Company maintained solid subscribers' growth in the contract segment supported by customers' demand for its mobile broadband proposition and improving churn, despite intense competitive pressure. In the mobile internet area, the Company recorded positive results from its marketing campaign focused on promotion of smartphone sales, in which it guaranteed the best prices for the best selling smartphones. As a result, smartphone sales

[5] Figures are shown net of inter-segment charges between fixed and mobile businesses
[6] From CZK 1.37 to CZK 1.08 in July 2011

represented 62% of total handset sales in 1Q 2012 and smartphone penetration grew further reaching 21.3% at the end of March 2012, up by 1.8 percentage points quarter-on-quarter.

The total **mobile customer base** reached 4,938 thousand at the end of March 2012, a 2.3% year-on-year increase. This performance has been driven by **contract customers**, whose number went up 6.1% year-on-year reaching 3,077 thousand with 27.5 thousand net additions during the quarter. This growth continued to be supported by customers migrating from the prepaid to the contract segment, positive contribution of mobile broadband customers' growth, increasing smartphone penetration and lower churn. At the end of March 2012, contract customers accounted already for 62.3% of the base (+2.2 percentage points year-on-year), the highest figure ever. The number of **prepaid customers** reached 1,861 thousand at the end of March 2012, down by 3.4% year-on-year.

The blended monthly average **churn rate** reached 1.87% in 1Q 2012 posting a 0.1 percentage point year-on-year decrease. This is a result of year-on-year improvement in contract churn which reached 1.05% in 1Q 2012, down 0.2 percentage points year-on-year. Prepaid churn was flat year-on-year posting 3.19% in 1Q.

In terms of usage, total **mobile traffic**[7] carried by the customers in the Czech Republic reached 2,330 million minutes in 1Q 2012, up by 7.9% year-on-year, supported by successful contract proposition offering double minutes within their tariffs.

In 1Q 2012, mobile **blended ARPU**[8] was CZK 393.6, down by 7.3% year-on-year, the best year-on-year performance in last five quarters. However this continued to be impacted by MTR cuts and competition. Excluding the impact of MTR cuts, total ARPU in 1Q 2012 would have declined by 6.7% year-on-year. Voice ARPU dilution driven by persisting competition is the key driver for the majority of the decline. **Contract ARPU** reached CZK 530.2 in 1Q 2012, down by 10.0% year-on-year (-9.5% year-on-year excluding the impact from MTR cuts). **Prepaid ARPU** decreased by 6.0% year-on-year in 1Q 2012 reaching CZK 171.1. **Data ARPU** declined by 3.3% year-on-year in 1Q 2012 reaching CZK 111.4, largely due to mobile internet bundling with voice tariffs and continuous SMS/MMS bundling in monthly fees. However pure data ARPU[9]improved 3.3% year-on-year.

Total **mobile business revenues** in the Czech Republic declined by 5.0% year-on-year to CZK 6,101 million in 1Q 2012, showing a lower rate of decline compared to previous quarters (-7.9% year-on-year in 4Q 2011 and -7.2% year-on-year in 3Q 2011), while mobile service revenues went down by 5.0% year-on-year. Already mentioned competitive pressures leading to lower spend in SMB and corporate segments and MTR cuts were the key drivers for the decline. Excluding the mobile termination rate cuts impact, mobile service revenues would decline by 2.8% year-on-year in 1Q 2012, compared to -4.5% in 4Q 2011 and -5.8% in 3Q 2011. Despite fierce competitive pressures, continued growth in the contract customer base and better spend in the residential segment helped to reach 2.0% year-on-year growth in revenues from monthly fees, reaching CZK

[7] Inbound and outbound, including roaming abroad, excluding inbound roaming
[8] Including inter segment revenues
[9] Big screens, small screens, M2M, time/usage based, push email, data roaming

2,046 million. Better residential spend dynamics are reflected in a lower decline in traffic revenues, which decreased by 13.2% year-on-year in 1Q 2012 to CZK 1,504 million, compared to -15.8% year-on-year in 4Q 2011. Interconnection revenues went down by 16.6% year-on-year in 1Q 2012, largely impacted by MTR cuts not fully compensated by higher incoming traffic. Other revenues (including SMS & MMS, data and other business revues) reached in total CZK 1,747 million in 1Q 2012 and were broadly flat compared to the same period in the previous year with more SMS/MMS bundling putting pressure on them, while revenues from mobile internet remain the key growth driver (data revenues: +5.8% year-on-year).

CZ Fixed Business Overview[10]

In 1Q 2012, the fixed business continued to report solid commercial performance in the broadband customer base and fixed accesses seen in 2011, while revenues showed a modest year-on-year quarterly improvement helped by better performance in traditional voice and sustained growth in fixed broadband revenues. Continuous migration of existing ADSL customers to the VDSL proposition launched in May of last year helped the company to better manage fixed broadband ARPU and reduce churn, which is relevant in a highly competitive and slowing fixed broadband market environment.

The total number of **fixed accesses** declined by 5.1% year-on-year reaching 1,556 thousand at the end of March 2012, with 26.1 thousand net losses during the quarter. This reduction is 12.6% than compared to 1Q 2011. This is largely a result of lower traditional telephony lines losses (-47.3 thousand in 1Q 2012, -14.5% year-on-year) and solid growth of naked accesses (+32.4% year-on-year) and voice-over- IP lines (+54.8% year-on-year).

The number of **xDSL accesses** reached 883 thousand at the end of March 2012, up 6.6% year-on-year. In respect of VDSL, already 161.7 thousand customers subscribed for the upgraded service, which represents 21% of the total xDSL residential base and close to 45% of total addressable existing base (~ 50% of households). In 1Q 2012, number of VDSL customers grew by 58.5 thousand. The total number of **O_2 TV customers** reached 138.1 thousand at the end of 1Q 2012, +7.0% year-on-year.

Voice traffic generated in the fixed network went down by 11.9% year-on-year in 1Q 2012 to 365 million minutes, still impacted by fixed telephony line losses and the fixed to mobile substitution effect. However, the rate of decline continued to decelerate compared to the previous quarters (-13.2% in 4Q 2011and -12.7% in 3Q 2011).

In 1Q 2012, total **fixed business revenues** went down by 6.2% year-on-year reaching CZK 5,292 million, posting lower decline compared to 1Q 2011 (-8.3% year-on-year). Revenues from traditional accesses fell by 15.5% year-on-year reaching CZK 969 million due to continuous fixed telephony lines losses, while revenues from traditional voice revenues went down by 7.0% year-on-year to CZK 1,555 million, largely due to lower revenues from communication traffic (in line with lower voice traffic). Internet & broadband revenues increased in total by 1.4% year-on-year reaching CZK 1,517 million in 1Q 2012, positively impacted by xDSL customer growth and

[10] Figures are shown net of inter-segment charges between fixed and mobile businesses

migration of higher value customers to VDSL. IT services and business solutions revenues were flat year-on-year reaching CZK 468 million in 1Q 2012. The Company keeps focusing on the offer of standard ICT services for business customers (Managed Services/Cloud/Security /Virtual Desktop) to mitigate dependence on one-off projects, which shall help it generating sustainable revenues. At the same time, it will utilise its competitive advantage of provisioning the exclusive care, while leveraging on Telefónica Digital scale.

Slovakia

In 1Q 2012, Telefónica Slovakia reported another strong set of commercial and financial results, which resulted in the further strengthening of its position in the Slovak mobile market. At the same time its performance supported the Group's financial performance. At the end of March 2012, the total **number of customers** reached 1,217 thousand, posting a 28.4% year-on-year growth. In 1Q 2012, their number increased by 52.8 thousand driven largely by strong performance in contract base. The number of **contract customers** grew by 41.7% year-on-year reaching 539 thousand at the end of March 2012, which translates into 40.8 thousand net additions in the quarter, while the number of **prepaid customers** increased by 19.5% year-on-year ending up at 678 thousand. Thus, the customer mix in Slovakia further improved and contract customers represented already significant 44.3% of the total customer base, up 4.2 percentage points year-on-year. In terms of financial performance, the **total revenues** of Telefónica Slovakia in local currency increased by 27.0% year-on-year reaching EUR 43.9 million in 1Q 2012 (+34.6% year-on-year excluding the impact of MTR cuts), fuelled by customer growth and improving customer mix. Thus revenues in Slovakia represented nearly 10% of total Group revenues in 1Q 2012. In 1Q 2012, OIBDA for Telefónica Slovakia further grew compared to previous quarters (+106.2% year-on-year), thus helping to support the Group's profitability. In 1Q 2012, **contract ARPU** reached EUR 16.3, while **prepaid ARPU** was at EUR 8.1.

Realisation of Share Buyback Program

The General Meeting of Telefónica Czech Republic, a.s. held on 19 April 2012 approved the share buyback program, based on which the company is allowed to purchase its own ordinary shares to the extent that it does not exceed 32,208,989 shares, i.e. will not exceed 10% of total number of company ordinary shares. The lowest price at which the Company shall be allowed to acquire its shares is CZK 150 per share. The highest price at which the Company shall be allowed to acquire its shares is CZK 600 per share. The period during which the Company is authorized to acquire its shares shall be 5 years from the date of the General Meeting.

Based on the above-mentioned General Meeting resolution, the Board of Directors adopted, on 9 May 2012, a resolution to commence the share buyback program, after entering into a contract with a brokerage firm chosen for this purpose. The selected brokerage firm will be entitled, upon implementation of the share buyback program, to purchase up to 6,441,798 of the ordinary shares of the company, i.e. up to 2 % of the total outstanding ordinary shares of the company. The brokerage firm shall proceed independently of the company and carry out the purchase with professional care and in the best interests of the company. The Board of Directors also approved the intention to submit to the General Meeting of the company a proposal to cancel the acquired shares, together with a proposal to reduce the registered capital by the amount of the nominal value of the acquired shares.

The share buyback program will be realized on the European regulated market on which the company's shares are quoted (Prague). The share buyback program will be carried out in accordance with the relevant legislation of the Czech Republic, in particular with Act No. 513/1991 Coll., the Commecial Code and the Act No. 256/2004 Coll., on Capital Markets, and EU legislation, in particular EC Commission Regulation (EC) No. 2273/2003 (including price and quantity restrictions).

Attachment:
The consolidated balance sheet and income statement of Telefónica Czech Republic prepared in accordance with International Financial Reporting Standards (all figures in CZK million).

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About Telefónica Czech Republic

Telefónica Czech Republic is a major integrated operator in the Czech Republic. It is now operating almost eight million lines, both fixed and mobile, making it one of the world's leading providers of fully converged services. The organization offers the most comprehensive portfolio of voice and data services in this country. It is paying special attention to the exploitation of the growth potential, particularly in the data and Internet sector. Telefónica Czech Republic operates the largest fixed and mobile network including a 3rd generation network, CDMA (for data), and UMTS, enabling voice, data and video transmission. Telefónica Czech Republic is also a notable provider of ICT services.

About Telefónica

Telefónica is one of the largest telecommunications companies in the world in terms of market capitalisation and number of customers. From this outstanding position in the industry, and with its mobile, fixed and broadband businesses as the key drivers of its growth, Telefonica has focused its strategy on becoming a leading company in the digital world. The company has a significant presence in 25 countries and a customer base that amounts more than 300 million accesses around the world. Telefonica has a strong presence in Spain, Europe and Latin America, where the company focuses an important part of its growth strategy. Telefonica is a 100% listed company, with more than 1.5 million direct shareholders.

INCOME STATEMENT	Jan – March 2012	Jan – March 2011
Business revenues	12,451	12,866
Other recurring revenues	17	23
Revenues	**12,468**	**12,889**
Internal expenses capitalized in fixed assets	170	163
Operating expenses	(7,914)	(7,835)
Other operating income/(expenses)	(164)	(154)
Gain on sale of fixed assets	221	8
Impairment reversal/(loss)	(5)	(2)
OIBDA	**4,775**	**5,070**
Depreciation and amortization	(2,872)	(2,874)
Operating Income	**1,903**	**2,195**
Net financial income (expense)	(44)	(27)
Income before tax	**1,859**	**2,168**
Income tax	(237)	(428)
Net Income	**1,622**	**1,740**

BALANCE SHEET	31.03.2012	31.12.2011
Non-current assets	**71,050**	**73,100**
- Intangible assets	6,782	7,205
- Goodwill	13,462	13,453
- Property, plant and equipment and investment property	49,994	51,525
- Long-term financial assets and other non-current assets	127	171
- Deferred tax assets	685	746
Current assets	**17,664**	**15,881**
- Inventories	551	488
- Trade and other receivables	7,708	8,166
- Current tax receivable	148	165
- Short-term financial investments	14	106
- Cash and cash equivalents	9,243	6,956
Non-current assets classified as held for sale	**1**	**1**
Total assets	**88,715**	**88,982**
Equity	**70,611**	**69,097**
Non-current Liabilities	**3,605**	**3,870**
- Long-term financial debt	-	-
- Deferred tax liabilities	3,501	3,737
- Long/Term Provisions	28	26
- Other long/term liabilities	76	107
Current Liabilities	**14,499**	**16,015**
- Short-term financial debt	3,082	3,061
- Trade and Other payables	9,339	10,495
- Current income tax payable	4	5
- Short-term provisions and other liabilities	2,074	2,454
Liabilities assoc. with non-current assets classified as held for sale	**-**	**-**
Total Equity and Liabilities	**88,715**	**88,982**