Press release

Telefónica Czech Republic – January to June 2013 Financial Results

July 24, 2013

Telefónica Czech Republic, a. s. announces its unaudited financial results for January to June 2013. These results are consolidated and prepared according to International Financial Reporting Standards and fully include the results of Telefónica Slovakia and other smaller operating companies.

<u>Operational Highlights</u>

- **Continuous solid customers' growth in key areas**:
  - **Healthy total mobile customers' growth: +2.3% year-on-year to 5.1 million**, with 113 thousand[1] net additions in H1 2013. Continued **strong contract trading** (95 thousand net adds in the first half of the year[1]) and **low churn** remained the drivers of the growth. **Prepaid base reported positive growth** (+3.0% year-on-year in H1 2013).
  - **Smartphone penetration growing above 30%**, up by 7.5 percentage points year-on-year.
  - **xDSL accesses grew by 3.1% year-on-year reaching 921 thousand**, with VDSL (already over 74% of total accessible base in residential segment) continues helping to manage fixed BB ARPU dilution and maintain churn.
  - **Fixed accesses disconnections in line with previous periods: accesses down 6.6% year-on year in H1 2013.**
- **Consolidated operating revenues** went **down by 5.0% year-on-year** reaching CZK 23,905 million in H1 2013 (-2.4% year-on-year excluding impact of MTR cuts).
- **OIBDA in comparable terms[2] went down 6.9% year-on-year**, while **comparable OIBDA margin[3]** reached solid **39.7%** on the back of **continuous efficiency agenda** (Group OpEx: -4.1% year-on-year in H1) and **growing profitability in Slovakia**. **Guided OIBDA** (excluding brand fees and management fees) reached CZK 9,141 million in H1 2013, **impacted** by **non-recurring items**. OIBDA including brand fees and management fees reached CZK 8,615 million in the quarter.
- **Consolidated free cash flow growing 7.8% year-on-year.**
- **Telefónica Slovakia** maintained its **strong commercial momentum** reporting 14.2% year-on-year subscribers' growth (+74 thousand in H1).
- **2013 full year guidance[4] reiterated.**

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[1] Excluding the impact of inactive customers disconnection in Q1 13 (114 thousand)
[2] OIBDA before brand fees and management fees, excluding CZK 220 million gain from sale of 80% stake in Informační linky, a.s. in H1 2012 and restructuring cost (CZK 223 million in H1 2012, CZK 354 million in H1 2013)
[3] Comparable OIBDA/Operating revenues
[4] OIBDA margin: limited margin erosion year-on-year (2012 base: 41.4%), CapEx: less than CZK 6 billion (excluding business acquisitions and excluding investments for spectrum license)

Consolidated Financial Statements

In H1 2013, consolidated **operating revenues** went down by 5.0% year-on-year to CZK 23,905 million. **Excluding the MTR cuts impact** (CZK 1.08 in 1H 2012, reduced to CZK 0.55 in Q3 2012 and to CZK 0.41 in Q2 2013) they would have **declined 2.4%** year-on-year.

Fixed operating revenues in the Czech Republic declined by 4.2% year-on-year reaching CZK 10,144 million in H1 2013, exhibiting more positive trend compared to 2012, with improved year-on-year dynamics in Q2 2013 compared to Q1 2013.

Mobile operating revenues in the Czech Republic reported 8.7% year-on-year decline to CZK 11,269 million in H1 2013, largely on the back of MTR cuts and intensified competitive pressures with decline in traditional voice and messaging revenues. Conversely, the Company is harvesting the benefits of its data-centric proposition, with **non-messaging data revenues** (excluding CDMA) **growth of 21.4%** year-on-year, significantly boosted in Q2 2013 with introduction of the new FREE tariffs. Excluding the MTR cut impact, mobile operating revenues would go down by 3.3% year-on-year in H1 2013.

Revenues in Slovakia continued to post positive financial performance and recorded a 10.0% year-on-year increase to EUR 102.0 million in the first half of 2013 (+23.1% year-on-year excluding MTR impact).

In H1 2013, the Company has continued in its effort to deliver efficiencies in both commercial and non-commercial areas of its operations. Total consolidated **operating costs** went down by 4.1% year-on-year to CZK 14,781 million in H1 2013. Personnel expenses (excluding restructuring costs) declined by 5.9% year-on-year as the Group continued in its restructuring program focused on building leaner and efficient organisational structure. In H1 2013, the total Group headcount has been optimised by 596 employees. As a result, the Group's headcount reached 5,679 at the end of June 2013, representing 10.9% year-on-year reduction. Moreover, launch of FREE tariffs in Q2 2013 is helping the Company to benefit from further simplification of its business model and eliminate handsets subsidies in consumer segment.

On **fully comparable basis** (i.e. excluding non-recurring items mentioned below), **OIBDA** would have **declined by 6.9%** year-on-year, while the **comparable OIBDA margin** would have reached 39.7% in H1 2013, down 0.8 percentage points year-on-year. Guided OIBDA margin[5] reached 38.2% in H1 2013, while in Q2 2013 it was 39.9%, showing substantial improvement over Q1 2013 (+3.4 percentage points). **Guided Operating income before depreciation and amortization (OIBDA)[6]** reached CZK 9,141 million in H1 2013, down 10.3% year-on-year. The year on year performance has been impacted by positive impact of the CZK 220 million gain from the sale of non-core assets in H1 2012 (80% stake in Informační linky, a.s.) and higher

[5] OIBDA excluding brand fees & management fees / Operating revenues

[6] In terms of the 2013 guidance calculation, OIBDA excludes brand fees and management fees, 2013 guidance excludes changes in consolidation, includes potential capital gains from sales of non-core asset, assuming constant FX rates of 2012.

restructuring costs booked in H1 2013 (CZK 354 million) compared to H1 2012 (CZK 223 million). Reported OIBDA (including brand fees and management fees) reached CZK 8,615 million in the first half of the year.

Depreciation and amortization charges went down by 3.0% year-on-year reaching CZK 5,517 million in H1 2013. Consolidated **net income** excluding aforementioned non-recurring items in H1 2012 and H1 2013 **declined by 15.7%** year-on-year largely due to a decline in comparable OIBDA. Reported net income amounted to CZK 2,393 million, down by 26.5% year-on-year.

Consolidated **CapEx** reached CZK 2,208 million in H1 2013, slightly **up by 1.6%** year-on-year. The Company continued to focus on efficient investments into growth areas. These include largely further capacity expansion and improvement of the quality of mobile broadband network, in line with growing demand for mobile data services. In H1 2013, the Company commenced deployment of LTE network in existing 1,800 MHZ band spectrum, launching LTE services in selected parts of Prague since 15th May 2013 followed by LTE rollout in Brno in Q4 2013. Additionally, the Company focused its investments into the capacity enhancement in its fixed broadband networks and VDSL expansion.

Consolidated **free cash flows surged by 7.8%** year-on-year reaching CZK 4,642 million in the period of January to June 2013. Cash from operating activities recorder positive development (+2.1 % year-on-year) due to focus on working capital cash management, lower interest and income tax payments. Cash used in investing activities decreased by 5.6% year-on-year as a result of combination of lower proceeds on disposal of fixed assets (H1 2012 impacted by proceeds on disposal of 80% of shares of subsidiary Informační linky, a. s. worth CZK 240 million), and a 4.8% decrease in payments for CapEx.

The consolidated **long-term financial debt** amounted to CZK 3,000 million at the end of June 2013, flat compared to the end of 2012. At the same time, **cash and cash equivalents** reached CZK 6,922 million.

CZ Mobile Business Overview

The Company continuously monitors its customers' needs and demands in changing market environment. In line with this approach, on 15th April, the Company substantially simplified its mobile tariff portfolio and launched new FREE Tariffs. These simple and price transparent tariffs bring the customers more value via unlimited on-net calls and SMS in each package, while the FREE CZ tariff offers unlimited all-net calls and SMS and 1GB data package on top of that. The reaction of the market to new unlimited tariffs was very positive and clearly demonstrated the shift of customers from price to value-oriented and as at June 30th nearly one third of residential contractual base has migrated to new tariffs. Moreover, the Company has strengthened its already leading position in the market and continues in its commitment to be innovation leader in the Czech mobile market.

The underlying trend of financial performance has not changed in Q2 compared to Q1 2013 (Q2 MGSR excluding impact of MTR cuts declined by 5.3% year-on-year compared to 5.2% decline in Q1) as a combination of high-spend customers' optimization, offset by the upsell of lower spending customers.

In the mobile internet area, the Company continued in its support of smartphone sales via introduction of instalment model, keeping best price guarantee proposition for bestselling smartphones and the data proposition in its new FREE tariffs. As a result, smartphone sales represented close to 70% of total handset sales in H1 2013, with the share of smartphones increasing Q2 over Q1 2013 and smartphone penetration[7] with further growth reaching 30.4% at the end of June 2013, up by 7.5 percentage points year-on-year.

It should be highlighted that since the beginning of 2013, the Company has applied a more conservative activity criteria for reporting mobile customers, which has led to the disconnection of 114 thousand mobile contract customers on the reported customer base, effective since January 1, 2013, with no impact on revenues.

The total **mobile customer base** reached 5,082 thousand at the end of June 2013, a 2.3% year-on-year increase, despite aforementioned disconnection of contract base. Total net additions amounted to 113 thousands excluding the adjustment leveraged on both, good traction in the contract segment throughout the H1 2013 and positive performance of the prepaid segment in Q1 2013. **Contract customers** grew by 1.9% year-on-year reaching 3,173 thousand. Net additions during the half of the year excluding the impact of the disconnection reached 95 thousand, with an accelerated figure of 52 thousand in Q2 2013. This growth was fostered mainly by solid trading, sustained low churn, and customers migrating from the prepaid to the contract segment as an effect of FREE tariffs introduction in April 2013. The number of **prepaid customers** reached 1,909 thousand at the end of June 2013, up 3.0% year-on-year, with positive net additions of 18 thousand in the first half of the year.

The blended monthly average **churn rate** reached 2.2% in H1 2013, while contract churn was at 1.6% impacted by the commented adjustment in the customer base. Excluding the adjustment contract churn continued to be low at 1% (flat year-on-year). Prepaid churn slightly increased by 0.1 percentage point to 3.3%.

In terms of usage, total **mobile traffic**[8] carried by our customers in the Czech Republic reached 5,133 million minutes in H1 2013, up by 8.4% year-on-year, supported by successful adoption of unlimited FREE Tariffs.

In H1 2013, **total mobile ARPU** declined by 14.9% year-on-year to CZK 337.4, impacted largely by MTR cuts, and lower effective prices for outgoing traffic due to initial dynamics of new tariffs adoption by customers (initial optimization vs. consecutive up-sell). Excluding the impact of MTR cuts, total ARPU would have declined by 9.4%. **Contract ARPU** went down by 15.2% year-on-year in comparable terms reaching CZK 449.7 in the quarter. **Prepaid ARPU** decreased by 14.2% year-on-year to CZK 151.

Total **mobile operating revenues** in the Czech Republic declined by 8.7% year-on-year to CZK 11,269 million in H1 2013. At the same time, mobile gross service revenues went down by

[7] Smartphones as % of total handsets base
[8] Inbound and outbound, including roaming abroad, excluding inbound roaming

11.0% year-on-year to reach CZK 10,363 million. Continuous competitive pressures leading to lower spend together with MTR cuts continued to be the key drivers for the decline. Excluding the impact of mobile termination rate cuts, mobile gross service revenues would decline by 5.3% year-on-year in the first half of the fiscal year. Mobile originated voice revenues declined by 9.7% year-on-year to CZK 6,469 million, while messaging (SMS & MMS) were 19.7% lower due to lower effective per unit price. Terminated revenues went down by 31.4% year-on-year to CZK 1,150 million in H1 2013, largely impacted by MTR cuts not fully compensated by higher incoming traffic. On the other hand, non-messaging data considerably improved by 13.1% year-on-year (+21.4% excl. CDMA) reaching CZK 1,627 million, supported by growing revenues from mobile internet, and remained the key growth driver of mobile revenues.

CZ Fixed Business Overview

In the first six months of 2013, the Company continued to report solid commercial and financial performance on the back of healthy growth of voice wholesale revenues, as well as via successful proposition of its VDSL service to the broadband customer base in highly competitive and slowing market. In addition, continuous migration of existing ADSL customers to the VDSL service keeps helping the Company to manage fixed broadband ARPU dilution and sustain low churn.

The total number of **fixed accesses** declined by 6.6% year-on-year reaching 1,439 thousand at the end of June 2013, with 61 thousand net losses during the half year. The Company managed to moderately decelerate disconnections of fixed voice accesses in Q2 2013 compared to Q1 2013.

The number of **xDSL accesses** reached 921 thousand at the end of H1 2013, up by 3.1% year-on-year together with further improvement in xDSL accesses composition. In respect of VDSL, 310 thousand customers (49.5% year-on-year) have already subscribed for the upgraded service (50 thousand net additions in the first half of the year), which represents 37% of the total xDSL residential base and 74% of the total addressable existing residential base (~ 50% of households). The total number of **O_2 TV customers** reached 142 thousand at the end of H1 2013, +2.1% year-on-year.

Total **fixed operating revenues** went down by 4.2% year-on-year reaching CZK 10,144 million in H1 2013, while in Q2 2013 alone they declined only by 2.9% year-on-year mainly due to significant growth in voice wholesale revenues and surge in ICT business. Revenues from voice retail services continued in trend and fell by 17.8% year-on-year, in line with performance in previous periods, reaching CZK 2,359 million, due to continuing fixed telephony line losses. Voice wholesale revenues improved by 16.1% year-on-year in H1 2013 to CZK 2,229 million, while Internet & broadband revenues (incl. IPTV) declined by 2.6% year-on-year to CZK 3,054 million in H1 2013, resulting from competitive ARPU pressures compensated by the combination of xDSL customer growth and migration of customers to VDSL. ICT revenues went up 3.2% year-on-year to CZK 1,028 million, with a significant 11.4% growth in Q2. This performance has been driven by higher revenues from recurring managed services, in line with the Company's strategy to focus on proposition of innovative ICT solutions to mitigate dependency on one-off projects for the public sector.

Slovakia

In H1 2013, Telefónica Slovakia reported solid commercial and financial performance. At the end of June 2013, the total **number of customers** reached 1,428 thousand, posting a 14.2% year-on-year growth. Their number increased by 74 thousand in the first half of the year, thanks to the solid performance of the contract customers as well as the prepaid segment growth. The number of **contract customers** grew by 23.4% year-on-year reaching 709 thousand at the end of June 2013 (+50 thousand in H1), while the number of **prepaid customers** increased by 6.4% year-on-year ending up at 719 thousand. Consequently, the customer mix in Slovakia further improved and contract customers represented nearly half of all customers (49.7% of the total customer base at the end of H1 2013, up by 3.7 percentage points year-on-year.)

In terms of financial performance, the **total operating revenues** of Telefónica Slovakia in local currency increased by 10.0% year-on-year reaching EUR 102 million in H1 2013. Excluding the impact of MTR cuts, the growth rates would be 23.1%, fuelled by customer growth, refreshed proposition, improving customer mix and the Company's focus on acquiring higher value customers. At the same time, OIBDA of Telefónica Slovakia went up by 24.3% year-on-year to EUR 31.4 million, resulting in healthy 30.7% OIBDA margin. **Contract ARPU** reached EUR 15.4, while **prepaid ARPU** was at EUR 7.3.

Realisation of Share Buyback Program

The Annual General Meeting of the Company held on 19th 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 the total number of the Company's ordinary shares. 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 26th February 2013, a resolution to continue with own ordinary shares acquisition (share buyback) program in the extent of up to 6,441,798 of the ordinary shares, i.e. up to 2 % of the total ordinary shares issued by 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. Following the above resolutions, the Company commenced the purchase of its own shares on 5th March 2013. By 30th June, it repurchased in total 2,935,513 shares representing 0.91% of the total ordinary shares issued by the Company. The total purchase price amounted to CZK 867 million, resulting in average price of CZK 295 per share.

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).

Contacts

Investor Relations
Telefónica Czech Republic, a.s.
investor_relations@telefonica.com
t +420 271 462 076

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.

CONSOLIDATED INCOME STATEMENT	Jan – Jun 2013	Jan – Jun 2012
Operating revenues	23,905	25,165
Other recurring revenues	50	53
Revenues	**23,955**	**25,218**
Internal expenses capitalized in fixed assets	274	331
Operating expenses	(14,781)	(15,412)
Other operating income/(expenses)	(334)	(163)
Gain on sale of fixed assets	31	238
Impairment reversal/(loss)	(5)	(18)
OIBDA	**9,141**	**10,194**
Brand fees & management fees	(526)	(513)
OIBDA after brand fees & management fees	**8,615**	**9,681**
Depreciation and amortization	(5,517)	(5,688)
Operating Income	**3,098**	**3,993**
Net financial income (expense)	(86)	(107)
Results attributed to joint venture	(6)	0
Income before tax	**3,007**	**3,886**
Income tax	(614)	(632)
Net Income	**2,393**	**3,254**

CONSOLIDATED BALANCE SHEET	30.6.2013	31.12.2012
Non-current assets	**64,438**	**67,835**
- Intangible assets	6,495	6,833
- Goodwill	13,500	13,497
- Property, plant and equipment and investment property	43,772	46,691
- Long-term financial assets and other non-current assets	104	141
- Deferred tax assets	567	673
Current assets	**14,457**	**11,364**
- Inventories	423	487
- Trade and other receivables	7,097	7,730
- Current tax receivable	2	101
- Short-term financial investments	13	3
- Cash and cash equivalents	6,922	3,044
Non-current assets classified as held for sale	**1**	**0**
Total assets	**78,896**	**79,199**
Equity	**52,615**	**60,574**
Non-current Liabilities	**5,957**	**6,322**
- Long-term financial debt	3,000	3,000
- Deferred tax liabilities	2,850	3,206
- Long-term Provisions	37	29
- Other long-term liabilities	71	87
Current Liabilities	**20,323**	**12,303**
- Short-term financial debt	5	31
- Trade and Other payables	8,661	9,982
- Current income tax payable	68	5
- Short-term provisions and other liabilities	11,588	2,285
Liabilities assoc. with non-current assets classified as held for sale	**0**	**0**
Total Equity and Liabilities	**78,896**	**79,199**