

## Comments on the financial results

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In this section we present and comment on the consolidated financial results of the Telefónica O2 Group prepared in accordance with International Financial Reporting Standards (IFRS).

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### Consolidated financial results

#### Revenues, Operating Costs and OIBDA

The consolidated revenues reached CZK 59.9 billion in 2009, down 2.4% year on year, while the consolidated business revenues declined 7.3% year on year to reach CZK 59.8 billion. Gains from the sale of non-current assets reached CZK 422 million in 2009, compared to CZK 855 million in 2008. This decline was a result of lower non-recurring gain from sales in 2009 compared to 2008. As described in section Overview of the Group and the main changes in 2009 of this Annual report, in January 2009, the Company sold its former headquarters with a one-off gain of CZK 342 million, while in 2008 it disposed of a part of its portfolio of real properties in various parts of the country, with a gain of approximately CZK 727 million. The total consolidated operating costs reached CZK 34.0 billion in 2009, down 9.7% year on year as a result of strict financial discipline and some non-recurring items. The resulting consolidated operating income before depreciation and amortization OIBDA amounted to CZK 27.1 billion in 2009, down 4.4% year on year, thus lower decline than for revenues. OIBDA adjusted for guidance<sup>1</sup> went down 3.9% year on year to CZK 27.9 billion in 2009, which was within the guidance range of 0% to -4%. Comparable OIBDA<sup>2</sup>, excluding non-recurring items in the year, went down 5.3% year on year to CZK 26.3 billion. The OIBDA margin (OIBDA over revenues) reached 45.2% in 2009, compared to 43.8% in 2008.

#### Depreciation and Amortization

The consolidated depreciation and amortization amounted to CZK 12.0 billion in 2009, resulting in a 7.2% decline year on year.

#### Operating Income, Income before Tax and Net Income

The consolidated operating income and consolidated income before tax went down 2.0% year on year and 3.1 % year on year, and reached CZK 15.1 billion and CZK 14.9 billion, respectively, in 2009, on the back of a decline in OIBDA and slightly higher net finance expenses, which were not fully compensated by the lower depreciation and amortisation charge. The consolidated net income amounted to CZK 11.7 billion, up 0.3% year on year in 2009, due to combination of above mentioned factors and the income tax which was lower by 13.7%.

#### Cash and Debt levels

On 31 December 2009, the Group's consolidated financial debts (long-term and short-term) amounted to CZK 3.1 billion, 2.0% down compared to 2008 year-end. The amount of cash and cash equivalents reached CZK 1.3 billion at the end of 2009, down from CZK 7.1 billion the year before. The combination of the cash and debt balances resulted in a net leverage<sup>3</sup> of 2.5% and a gross leverage<sup>4</sup> of 4.2% as at the end of 2009, compared to minus 5.0% and 4.1%, respectively, as at 31 December 2008.

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<sup>1</sup> In terms of guidance calculation, OIBDA excludes impairment loss (CZK 86 mil. in 2008 and CZK 23 mil. in 2009) and brand fees (CZK 626 mil. in 2008 and CZK 754 mil. in 2009), in constant FX rate.

<sup>2</sup> Comparable terms growth excludes brand fees, impairment loss and non-recurring items (2008: real estate sale of CZK 727 mil. and Universal Service of CZK 500 mil.; 2009: real estate sale of CZK 342 mil., Universal Service of CZK 181 mil. and settlement agreement with T-Mobile of CZK 1,027 mil.), in constant FX rate.

<sup>3</sup> Long and short term financial debts less cash and cash equivalents over equity.

<sup>4</sup> Long and short term financial debts over equity.

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### Capital Expenditure

The total consolidated capital expenditure amounted to CZK 6.5 billion in 2009, down 19.8% year on year. As in the previous years, investments in 2009 selectively targeted at the growth areas of the business. As mentioned earlier in this Annual Report, during 2009 Telefónica O2 expanded the coverage of its 3G network from Prague and Brno to all 13 key regional cities. In the fixed business, investments were directed towards boosting the speed, availability and quality of ADSL, IPTV, Voice over IP and value added services in connection with the growing customer base, improvements of the fixed access network and upgrading of the information systems. In Slovakia, the Company continued in the network rollout and systems deployment. By the end of 2009, Telefónica O2 Slovakia had put in operation 917 BTS and its network thus covered almost 93% of the population, which is approximately twice of what the terms of the licence require.

### Overview of Consolidated Revenues

The total consolidated revenues in 2009 reached CZK 59.9 billion, down 7.4% year on year and were negatively impacted by the challenging environment and mobile termination rate (MTR) cuts. In addition, revenues from Universal Service negatively impacted the year-on-year revenue comparison in the second half and full year 2009.

The total consolidated voice revenues (voice-outgoing, interconnection and other wholesale services, monthly and one-off charges from voice services and connection charges) amounted to CZK 38.7 billion in 2009, down 8.8 % year on year.

In the highly penetrated mobile market in the Czech Republic, the total mobile customer base increased by 3.0% year on year and reached 4,945 thousand at the end of 2009. The number of contract customers went up 11.7% year on year, reaching 2,814 thousand at the end of 2009 with 295 thousand net additions in the year (+7.1% year on year). This solid performance was driven by the steady uptake of O<sub>2</sub> NEON tariffs and the customer migration from the prepaid to the contract segment. At the end of 2009, contract customers represented 56.9% of the base (+4.5 p.p. year on year). The number of prepaid active customers reached 2,130 thousand at the end of 2009, down 6.7% year on year. It is worth highlighting the improvement in the trend of the prepaid customer base net losses in 2009: in 2009, the prepaid customer base decreased by 153 thousand, which was 39.8% less than in the previous year. This is a result of a successful customer proposition NA!VÍC, which motivated customers to regular top-ups.

The blended monthly average churn rate reached 2.1% in 2009, 0.1 p.p. higher compared with 2008, largely because of the higher prepaid churn.

In terms of usage, mobile traffic<sup>5</sup> carried in the Czech Republic grew 11.1% year on year to 8,155 million minutes in 2009 due to the higher contract base and successful proposition of O<sub>2</sub> NEON tariffs.

In 2009, the blended ARPU<sup>6</sup> reached CZK 514, down 9.1% year on year, largely due to customers optimizing their behaviour and the MTR cuts. The contract ARPU reached CZK 753 in 2009, down 14.3% year on year. The customer migration from the prepaid to the contract tariffs contributed to contract ARPU dilution. The prepaid ARPU decreased by 12.1% year on year to CZK 223 in 2009, which was a consequence of customers optimizing their behaviour in the current economic environment and of the migration of high value prepaid customers to contracts. However, in the fourth quarter 2009 the prepaid ARPU improved to CZK 224 from CZK 222 in the third quarter.

<sup>5</sup> Inbound and outbound, excluding inbound roaming and roaming abroad.

<sup>6</sup> Including inter segment revenues.

The total number of fixed accesses declined 6.5% year on year and reached 1,771 thousand at the end of December 2009, with 19.3 thousand net losses in the fourth quarter helped by the solid uptake of naked accesses following the introduction of our new broadband-centric proposition. For the full year 2009, the Company lost 123 thousand fixed accesses, down from 176 thousand in 2008 (-30.2% year on year).

The voice traffic generated in the fixed network went down 13.6% year on year in 2009 to 2,002 million minutes as a result of continued losses of fixed telephony lines due to mobile substitution.

The total number of active mobile customers in Slovakia reached 553 thousand at the end of December 2009, up 69.9% year on year. The number of contract customers almost doubled (+97.6% year on year) and reached 196 thousand, while the number of prepaid active customers increased 57.8% year on year to 357 thousand at the end 2009. Contract customers represented 35.4% of the total customer base at the end of 2009, up 4.9 p.p. year on year. In 2009, the contract ARPU reached EUR 23.8 and the prepaid ARPU was EUR 8.4.

The consolidated revenues from monthly and one-off charges for voice services went down 6.3% year on year to reach CZK 15.4 billion in 2009. This decline was driven mainly by the lower number of fixed accesses and the introduction of new broadband-based consumer proposition including naked ADSL in May 2009. On the contrary, revenues in the mobile segment improved on the back of continuous growth in the number of contract customers.

The revenues from outgoing voice reached CZK 13.2 billion in 2009, down 14.0% year on year, due to the lower voice traffic generated in the fixed network, a higher proportion of mobile customers on flat rate based tariffs and the lower revenues from roaming.

The revenues from interconnection and other wholesale services declined 4.4% year on year to CZK 10.0 billion, as a result of mainly the 22.7% reduction in MTR and the lower revenues from roaming visitors, which have not been fully offset with a growth in international transit services in fixed line segment.

The revenues from SMS & MMS & value added services decreased 3.6% year on year to CZK 4.9 billion in total, due to the higher revenues from SMS included in monthly charges on the back of the higher number of customers using flat rate based tariffs. In 2009, O2 customers in the Czech Republic sent and received a total of 3,564 million SMS, which translates into a year-on-year increase of 7.0%.

The revenues from leased lines and fixed data services went down 9.2% year on year to CZK 3.5 billion, mainly due to lower revenues from leased lines, which were not fully compensated by a growth in IP based data services.

The revenues from Internet (including monthly and one-off charges), mobile data and IPTV grew 14.6% in total on the previous year and reached CZK 7.4 billion in 2009 which is largely a result of the market success of the new broadband centric proposition and the growth in the O<sub>2</sub> Internet and O<sub>2</sub> TV customer base. The number of retail ADSL accesses reached 677 thousand at the end of 2009, up 17.0% year on year, with 99 thousand net additions in the year (+40.1% year on year), propelled by intensive commercial activities around the broadband centric proposition. The total number of O<sub>2</sub> TV customers reached 138 thousand at the end of 2009, up 20.2% on the previous year. On the contrary, the revenues from mobile data declined slightly due to customers optimising their spending in the challenging economic environment.

In spite of the economical downturn and the political situation in the Czech Republic, the consolidated revenues from IT and business solutions went up 19.6% year on year to CZK 2.8 billion. Revenues from equipment and activation fee declined 24.5% to CZK 1.5 billion due to the lower number of handsets and other equipment sold. Other telecommunication revenues went down 56.4% year on year to CZK 981 million, drawn down by lower revenues from Universal Service (CZK 367 million in 2009 compared to CZK 1.3 billion in 2008).

## Overview of Consolidated Operating Expenses

The consolidated operating expenses of the Telefónica O2 Group declined 9.7% year on year and reached CZK 34.0 billion in 2009 due to our strict financial discipline, which was aimed at maximum compensation for the drop in revenues, and the impact of several non-recurring items. Reductions have been reported in the majority of cost categories, both commercial and non-commercial.

The interconnection and roaming expenses declined 5.1% year on year to CZK 11.4 billion in 2009, mainly due to MTR cuts, lower roaming prices and the lower costs associated with international transit services. The cost of goods sold fell 29.2% year on year to CZK 2.3 billion in 2009, as a result of the lower number of handsets sold and lower average cost of equipment. Other costs of sale, which comprise the costs of contents, sub-deliveries, the customer loyalty program, telecom services and other cost of sales, decreased 18.5% in total and reached CZK 2.5 billion in 2009, driven by the continuing decline of costs associated with the Universal Service (CZK 187 million in 2009 and CZK 794 million in 2008); the revenues from the Universal Service declined accordingly.

Total staff costs, including redundancy payments, amounted to CZK 7.1 billion in 2009, which is a stagnating trend compared to 2008 (+0.2% year on year). The total number of Group employees reached 8,687 as at 31 December 2009, which is 4.5% down year on year. The headcount of Telefónica O2 Czech Republic was reduced 4.4% year on year, down to 8,011 as at the same date.

The marketing and sales expenses (marketing and commissions) saw a year-on-year decline of 11.2% in 2009, down to CZK 2.8 billion, due to our continuous effort at efficient marketing expenditure and utilisation of external sales channels. The network & IT repairs and maintenance expenses decreased 4.5% year on year, down to CZK 2.4 billion, as a result of ongoing efficiency improvements in the area of network planning, monitoring and maintenance. The rentals, buildings and vehicle costs reached CZK 2.2 billion, up 1.0% year on year, while the utilities supplies were flat year on year and reached CZK 1.1 billion in 2009. Other external expenses (billing and collection, call centres, consultancy and professional fees and other external expenses, including brand fees), and other operating expenses, reached CZK 1.2 billion in 2009, which is a year-on-year decrease of 46.2%, and were positively impacted by the settlement agreement with T-Mobile for an amount of approximately CZK 1 billion.

Taxes (other than income tax) and provisions for bad and doubtful debts and inventories decreased in total 2.9% year on year and reached CZK 925 million in 2009, and were impacted by the review and adjustment of the bad debts provision policy according to collection rates of accounts receivable.

## The outlook for 2010

In 2010, the Company will stay closely focused on meeting the needs of its customers by way of improving its services and delivering new products. In particular, the Company will continue with active marketing of its mobile O<sub>2</sub> NEON tariffs and VPN based tariffs for the business and corporate customers, by which it plans to sustain the commercial momentum achieved in 2009. This will lead to further improvements in the customer mix. In line with its 3G coverage expansion strategy, the Company will focus on improving its new mobile broadband and data services. The Company plans to achieve maximum capitalization of its competitive advantage of having the widest 3G network coverage and the most advanced portfolio of mobile data services. In the fixed line business, the Company's effort will stay focused on active marketing and enhancement of the broadband centric proposition launched in May 2009, including the offer of a more varied portfolio of fixed/mobile bundles, which will in turn stabilize the current trend in fixed accesses, and help the Company again outperform the fixed broadband and mobile contract markets.

Telefónica O2 Slovakia will continue the active marketing of its "value and simplicity" customer proposition, which helped to outperform the market in 2009, and will again lead to a growth in and an improvement of the customer base and to better financial performance.

The Company expects that the challenging environment induced by the hard to predict economic development and the political situation, which in turn affords only a limited visibility on customer behaviour, to prevail until at least in the first half of 2010. Moreover, the mobile revenues will be hit by additional MTR cuts. In addition to above-mentioned customer focused activities, the Company will stay focused on delivering commercial and non-commercial efficiencies in its operating costs, in order to maximize the cash flow generation, which remains one of the key strategic goals for 2010.

In 2010<sup>7</sup>, the Group expects OIBDA<sup>8</sup> to decline between -5% and -9% and Capital Expenditure to be around CZK 6 billion.

<sup>7</sup> 2010 guidance excludes changes in consolidation, assuming constant FX rates of 2009.

<sup>8</sup> In terms of 2010 guidance calculation, OIBDA excludes brand fees (CZK 754 million in 2009). In addition, 2009 OIBDA base excludes non-recurring items (settlement with T-Mobile, universal service and gain from real estate sale) totalling CZK 1,548 million.