Annual Report

2012

Note:
Telefónica Czech Republic, a.s., hereinafter also as "Telefónica CR" or "Company"
Telefónica Group, hereinafter also as "Telefónica"
Telefónica Czech Republic Group, hereinafter also as "Telefónica CR Group" or "Group"
Telefónica Slovakia, s.r.o., hereinafter also as "Telefónica Slovakia"

Explanation:
The Telefónica Czech Republic Group includes Telefónica Czech Republic, a.s., and its subsidiaries.
The international Telefónica Group comprises companies in Europe, Africa and Latin America.

Table of Contents Pages

INDEPENDENT AUDITOR'S REPORT TO THE SHAREHOLDERS OF Telefónica Czech Republic, a.s.

ERNST & YOUNG

INDEPENDENT AUDITOR'S REPORT

To the Shareholders of Telefónica Czech Republic, a.s.:

I. We have audited the consolidated financial statements of Telefónica Czech Republic, a.s. and its subsidiaries ("the Group") as at 31 December 2012 presented in the annual report of Telefónica Czech Republic, a.s. ("the Company") on pages 85 - 154 on which we have issued an auditors' report dated 13 February 2013 presented in the annual report on pages 89 - 90. We have also audited the separate financial statements of the Company as at 31 December 2012, which are presented in the annual report of the Company on pages 155 - 219 on which we have issued an auditors' report dated 13 February 2013, presented in the annual report of the Company on pages 159 - 160 (both referred further as "financial statements").

II. We have also audited the consistency of the annual report with the financial statements described above. The management of Telefónica Czech Republic, a.s. is responsible for the accuracy of the annual report. Our responsibility is to express, based on our audit, an opinion on the consistency of the annual report with the financial statements.

We conducted our audit in accordance with International Standards on Auditing and the related implementation guidance issued by the Chamber of Auditors of the Czech Republic. Those standards require that we plan and perform the audit to obtain reasonable assurance as to whether the information presented in the annual report that describes the facts reflected in the financial statements is consistent, in all material respects, with the financial statements. We have checked that the accounting information presented in the annual report on pages 7 - 84 and 220 - 226 is consistent with that contained in the audited financial statements as at 31 December 2012. Our work as auditors was confined to checking the annual report with the aforementioned scope and did not include a review of any information other than that drawn from the audited accounting records of the Company. We believe that our audit provides a reasonable basis for our opinion.

Based on our audit, the accounting information presented in the annual report is consistent, in all material respects, with the financial statements described above.

III. In addition, we have reviewed the accuracy of the information contained in the report on related parties of Telefónica Czech Republic, a.s. for the year ended 31 December 2012 presented in the annual report of the Company on pages 228 - 236. The management of Telefónica Czech Republic, a.s. is responsible for the preparation and accuracy of the report on related parties. Our responsibility is to issue a report based on our review.

We conducted our review in accordance with the applicable International Standard on Review Engagements and the related Czech standard No. 56 issued by the Chamber of Auditors of the Czech Republic. Those standards require that we plan and perform the review to obtain moderate assurance as to whether the report on related parties is free from material misstatement. The review is limited primarily to enquiries of company personnel, to analytical procedures applied to financial data and to examining, on a test basis, the accuracy of information, and thus provides less assurance than an audit. We have not performed an audit and, accordingly, we do not express an audit opinion.

A member firm of Ernst & Young Global Limited
Ernst & Young Audit, s.r.o. with its registered office at Karlovo náměstí 10, 120 00 Prague 2,
has been incorporated in the Commercial Register administered by the Municipal Court
in Prague, Section C, entry no. 88504, under Identification No. 26704153.

Based on our review, nothing has come to our attention that causes us to believe that the report on related parties of Telefónica Czech Republic, a.s. for the year ended 31 December 2012 is materially misstated.

Ernst & Young

Ernst & Young Audit, s.r.o.
License No. 401
Represented by partner

Radek Pav
Auditor, License No. 2042

19 March 2013
Prague, Czech Republic

2. Interview with Luis Malvido, the Chairman of the Board of Directors

How has the year 2012 been for you?

The market of telecommunication services in the Czech Republic saw many changes in 2012. The year brought us a number of market leaderships and we have also strengthened our position of the leader in the field of digital innovations. This involved, for instance, the commercial launch of the 4G network, which uses the LTE technology, or the arrival of the first virtual operator to the Czech market.

I am pleased that our company has fulfilled the outlook and goals communicated to the financial market and the general public at the beginning of the year. We have delivered on our investment commitments, which totaled CZK 6.2 bn in 2012. We invested primarily to the network development, growth in the capacity and coverage of the 3G network, upgrading the xDSL network and to the process of preparation for the launch of the 4G/LTE technology in the Czech Republic. We also invested in the growth of the 3G network coverage in Slovakia.

How many new customers did you attract in 2012?

We acquired over 140,000 new customers in the mobile segment in 2012, and we also succeeded in attacking the threshold of 5 million mobile customers, nearly 3% morecompared to 2011.

The number of customers using the fixed connection xDSL increased 13,000 in last quarter of 2012. It was the highest growth recorded in that year. Nearly one third of our residential customers already use services of fixed broadband VDSL internet. The service became even more attractive as we had increased the connection speed and launched an attractive offer of internet O_2TV bundles. We captured a full 85% of the total increment in the number of fixed internet service customers in the Czech market last year. We were also able to stabilize the decline in the number of fixed lines to a rate which met our expectations.

Did anything happen in 2012 that you would especially like to mention?

For me personally, it was the arrival of the first virtual operator, BLESKmobil, to the Czech market. Telefónica was the first operator in the Czech market to open its network to a virtual operator. It was an important project for us, and many of our colleagues across the company were involved in it. We needed just three months to launch something that many people said was impossible to do. This step had a significant impact on the market.

Your company's strategy is to inspire people to enjoy their lives more with help of new technology. What specific steps did you take in 2012 in the direction of this strategy?

The year 2012 was a breakthrough year in terms of the care for the customers we have - we focused all our attention on them. I think that the introduction of specially trained advisers to our brand stores was the most important development in this field last year. O_2 Guru assistants provide free help with new technology - not only for O_2 customers but to all people visiting O_2 brand stores. The team of more than 100 O_2 Gurus processed about 150,000 customer requests for assistance in 2012. I think the first position in the chart TOP Responsible Company in the category Responsible Product and Marketing for approach to customers with specific needs was a big achievement, too.

The introduction of (Extra výhody) Priority Moments, our most extensive loyalty programme to date, is yet another proof of our focus on customer experience. The programme, which gives customers the benefit of discounted prices in the network of over 100 retail partners, is open to all customers – business and residential, regardless of their services or usage. I am happy to see that these activities have not only helped us strengthen our position on the Czech market but also accelerated the adoption of state-of-the-art technologies by our customers.

Another important change, I think, came in the pricing of telecommunication services. Our customers got even more service for the same money from us last year, which was a continued trend from previous years. Let me mention the example of our Smart Neon tariffs introduced in the spring: they come with free SMS to own network, in addition to calls and small-screen internet.

What is the percentage of users of the increasingly popular smartphones among your customers?

Smartphones are becoming very popular among our customers. The share of smartphone users increased to more than one fourth of the total customer base as of the end of 2012. Last year smartphones represented 72% of new handsets sold, and the demand for small-screen internet is growing.

Your new product - NFC mobile payments - is a novelty on the Czech market. Why did you decide to support this technology?

The NFC technology gives the customers a number of benefits, and we are happy to be the first operator to offer it to the Czech market. The technology makes it possible to pay quickly and comfortably by holding a mobile telephone to the payment terminal in a shop. Such payments are simple, yet safer, because users have control of their telephones at all times; they can also set the level of security based on their preference.

How do you rate the results of your subsidiary Telefónica Slovakia in 2012?

Telefónica Slovakia again showed some great performance. In 2012 we added 190,000 customers to our base, which means we were the only operator in the market to show growth. Moreover, for the fourth time in a row, Telefónica Slovakia won the Operator of the Year award. Telefónica Slovakia's results in 2012 again positively contributed to the financial performance of the whole Group.

You plan to open the Wayra academy in 2013. What are your expectations of the project?

We want to attract young people and innovative entrepreneurs from the region of Eastern Europe. Telefónica wants to support the establishment of as many new innovative ideas as possible with help of Wayra academies in countries where it has an active presence. Wayra supports and develops innovative ecosystems, which contribute to the economic growth, opening of new employment opportunities in Europe and which will help transform the telecommunications industry.

What are your plans for the year 2013?

The year 2013 will bring many changes and challenges. We will focus on the further development of the LTE network, which will let our customers experience a new dimension of telecommunications services.

We will also continue with the project of upgrading our 3G network to the HSPA+ technology, which will fortify our leadership of the telecommunications market in 2013. We can look forward to a number of positive developments in the network area; we need to, however, look for ways of delivering more network efficiency. As for our fixed services, we will continue investing in xDSL and in the deployment of our optical fiber technology. The ICT field obviously continues to be also a priority for us.

The year 2013 will be a breakthrough year for the Czech telecommunications market. It will see the arrival of new virtual operators and further deployment of 4G networks. We are confident that as we have always been on the cutting edge of innovation, we will maintain our leadership going into the future.

3. Financial and operational highlights

Financial data is based on audited consolidated financial statements prepared in accordance with International Financial Reporting Standards.
All figures, unless otherwise stated, are in CZK millions as at 31 December of each year.

	2012	**2011**
Financials		
Revenues[1]	50,534	52,409
OIBDA – Operating income before depreciation and amortization	19,781	21,790
Operating income	8,344	10,139
Income before taxes	8,156	10,008
Net income	6,776	8,684
Total assets	79,199	88,982
Property, plant and equipment	46,691	51,525
Total equity	60,574	69,097
Financial debts	3,031	3,061
Capital expenditure[2]	6,366	5,856
Operations (end of period)		
Fixed accesses (in thousands)	1,500	1,582
xDSL connections – retail and wholesale (in thousands)	915	872
Pay TV – O_2 TV (in thousands)	141	136
Mobile customers in Czech Republic (in thousands)	5,083	4,942
- of which contract	3,192	3,049
pre-paid	1,891	1,893
Mobile customers in Slovakia (in thousands)	1,354	1,164
Group headcount (end of period)	6,275	6,890
Ratios (in %)		
OIBDA margin (OIBDA/Revenues)	39.1	41.6
Net income/Revenues	13.4	16.6
Capital expenditure/Revenues	12.6	11.2
ROA (Net income/Total assets)	8.6	9.8
ROE (Net income/Equity)	11.2	12.6
Gross gearing (Financial debts/Total equity)	5.0	4.4
Macroeconomic indicators[3]		
Population (in millions)	10.5	10.5
GDP growth (in %)[4]	-1.2	1.9
Inflation (in %)	3.3	1.9
Unemployment (end of period, in %)	9.4	8.6
CZK/USD exchange rate – average over the period	19.6	17.7
CZK/USD exchange rate – end of period	19.1	19.9
CZK/EUR exchange rate – average over the period	25.1	24.6
CZK/EUR exchange rate – end of period	25.1	25.8

[1] Excluding Other income (revenues from non-telecommunications services)
[2] Including WiFi acquisitions
[3] Sources: Czech Statistical Office, Czech National Bank, Ministry of Labour and Social Affairs
[4] At constant 1995 prices, 2012 preliminary figure

4. Calendar of key events in 2012

January

Telefónica CR transferred the allocation of radio frequencies for the fourth digital multiplex to Digital Broadcasting s.r.o. The company started its digital television broadcasting (DVB-T) in Prague, Brno and Ostrava on 27 January 2012.

Telefónica CR expanded the range of services of its customer support call centres in Ústí nad Labem and Ostrava, creating 210 new jobs in total.

February

Telefónica CR published its audited consolidated financial results prepared under International Financial Reporting Standards for the fiscal year 2011. Consolidated revenues reached CZK 52.4 bn; net profit reached CZK 8.7 bn.

The Supervisory Board appointed Ramiro Lafarga Brollo as a new member of the Board of Directors, replacing John McGuigan. Ramiro Lafarga Brollo is at the same time the Chief Executive Officer Telefónica Slovakia, s.r.o.

Telefónica CR signed an agreement to sell 80% of shares in the subsidiary Informační linky, a.s.

Telefónica CR joined an international initiative campaigning for safer internet, and published on its website a helpful guide for parents with tips how to protect children against the risks of the digital world.

March

Telefónica CR plunged into darkness to support, as it had done for a number of years before, Earth Hour, the world's largest campaign against climate change.

Telefónica CR launched the lowest price guarantee for selected handsets in its network of brand stores.

The Company's customers, who use its prepaid mobile service, were given the option to top up their credit with their payment card via an automated voice system if their balance dips below CZK 50.

April

An Ordinary General Meeting of shareholders of Telefónica CR was held. The shareholders approved, among other things, a reduction of the share capital by way of reducing, by CZK 13 from CZK 100, the nominal value of each share, and the payment of a dividend of CZK 27 per share of a to-date nominal value of CZK 100, before tax.

O_2 TV Video Library celebrated three million downloaded movies.

Telefónica CR introduced the O_2 Guru concept to its brand stores. A team of employees with special training is there to assist and inspire people for new technologies.

O_2 Experience Centre, the largest and most modern O_2 brand store in the Czech Republic, opened its doors in the Chodov shopping centre.

Telefónica secured the most coveted certification in the area of cloud services - VMware vCloud Powered Services. Telefónica CR was the first company in the region of Central and Eastern Europe to have the certificate.

May

Based on the resolutions adopted by the General Meeting and the Board of Directors, Telefónica CR commissioned UniCredit Bank AG, London Branch to carry out a share buy-back programme. The buying process started on 18 May.

Telefónica CR, as one of the leading system integrators in the Czech Republic, forged a partnership with the incubator Inovacentrum of the Czech Technical University (ČVUT).

The Company expanded its data tariff proposition and introduced a special tariff Facebook, which has preferential rates for accessing the world's largest social network.

A year after the increase of fixed internet speeds via VDSL launch, more than 18% customers accessed the internet via this service.

June

Telefónica CR became the first operator in the Czech Republic to go live with a fourth-generation mobile communication LTE (Long Term Evolution) network.

Telefónica CR started offering an e-bill with a free call itemisation to new customers.

Telefónica CR started testing eCall, a service of automatic emergency service (112) from cars.

The Company presented new tariff bundles Smart NEON, which include mobile voice, small-screen internet and unlimited on-net SMS.

July

Customers of xDSL fixed internet access service (O_2 Home Internet) benefited from a new technology, IPv6, from Telefónica CR. The IPv6 protocol makes sure that there is a sufficient number of IP addresses.

In partnership with Coca-Cola, the Company launched its summer campaign, in which prepaid customers could get mobile credit with a purchase of a beverage with a competition sticker. The credit could be doubled in a unique competition, which had customers looking for QR codes in their towns.

August

In cooperation with Visa Europe, Komerční banka and Samsung, Telefónica CR became the first operator to launch a commercial operation of mobile payments via the NFC (Near Field Communication) technology.

David Melcon, Finance and Control Director Telefónica Europe, joined Telefónica CR as Director, Finance Division, on 1 August. As of the same date he was also appointed a member of the Board of Directors, and, on 30 August, he was elected its 1st Vice-chairman.

Telefónica increased the speed of O_2 Home Internet to 40 Mbps. More than one million households were within the reach of the VDSL service.

September

The Company started offering Priority Moments, a new programme of discounts and benefits with more than 100 retail and service partners, sports facilities and entertainment centres across the Czech Republic, to all its customers.

The subsidiary Bonerix Czech Republic entered into an agreement to acquire five parts of businesses of the Global Care group. The acquisition strengthened Telefónica CR's position in the area of employee programme administration.

Telefónica CR overhauled and simplified the format of its monthly bill for mobile and fixed services.

October

Telefónica was recognized as the best partner of Cisco, the world leader in network technology, for its Hosting service.

The Company was pronounced Sodexo Employer of the Year 2012 in the ICT category in Prague, and came third in the national competition.

The Company expanded its mobile data tariffs and introduced special Email and Navigation tariffs for easy access to email and helpful navigation in the field.

Telefónica CR teamed up with Ringier Axel Springer CZ to start the first virtual mobile operator in the Czech Republic offering a 2G and 3G service. The new operator started offering its services under the brand BLESKmobil on 7 November.

November

José María Álvarez-Pallete tendered his resignation from the position of Chairman and member of the Supervisory Board. Eva Castillo, Chairwoman of the Board and CEO Telefónica Europe, became the new Supervisory Board Chairwoman. Vladimír Dlouhý resigned from his membership in the Supervisory Board. The Supervisory Board co-opted Jesús Pérez de Uriguen to succeed him.

Telefónica CR completed the programme of buying back 2% of its own shares for the total of CZK 2,483 m.

December

Telefónica announced the launch of Wayra accelerator in Prague, to support innovative technology projects and help them to the market, and opened the process of registering applications. Selected technology project ideas with receive funding help, modern offices and training.

01

About Telefónica Group

Telefónica is and will always be leader in innovation. Our team is aspiring to victory in the prestigious **Ocean Race**.

5. About Telefónica Group – introduction

Telefónica is one of the world‘s leading integrated operators in the telecommunications sector, providing communication, information and entertainment solutions, with presence in Europe and Latin America. Telefónica Group operates in 25 countries. As of December 2010, Telefónica’s total number of customers was 316 million. Telefónica’s growth strategy is focused on the markets in which it has a strong foothold: Spain, Europe and Latin America.

Telefónica Group stands in seventh position in the Telco sector worldwide in terms of market capitalisation, in first among European integrated operators and in 17th position in the Eurostoxx 50 rankings, composed of Europe’s blue chip companies (March 2013).
Telefónica is a 100% private company with more than 1.5 million direct shareholders. Its stock trades on the continuous market on the Spanish Stock Exchanges and on those in London, New York, Lima and Buenos Aires.

Telefónica has one of the most international profiles in the sector with more than 76% of its business outside its home market and a reference point in the Spanish and Portuguese speaking market.

In Latin America, Telefónica served more than 212 million customers as of the end of 2012, thus becoming the leading operator in Brazil, Argentina, Chile and Peru. Telefónica Group also has substantial operations in Colombia, Costa Rica, Ecuador, El Salvador, Guatemala, Mexico, Nicaragua, Panama, Puerto Rico, Uruguay and Venezuela. In Europe, Telefónica owns operating companies in Spain, the United Kingdom, Ireland, Germany, the Czech Republic and Slovakia, providing services to 103 million customers as of the end of 2012.

Telefónica in figures

- 316 million accesses (103 million Europe; 212 million Latin America) (December 2012)
- Presence in 25 countries of the world (6 in Europe; 15 in Latin America[1]; the group is active in two other countries through its strategic alliances[2])
- 129,942 employees (39% in Europe; 70% in Latin America; 1% in other countries) (December 2012)
- Revenues: EUR 62,356 m (2012)
- OIBDA: EUR 21,231 m (2012)
- Net profit: EUR 3,928 m (2012)
- The world’s largest integrated telecommunications operator measured by number of accesses
- The largest integrated operator in Europe measured by market capitalisation
- Among the world’s 150 largest companies measured by market capitalisation
- Most admired Telco company outside USA (Fortune Global 500)

1 Including the USA and Puerto Rico
2 China and Italy

Telefónica – leader in the telecommunications market in Latin America

Argentina	
Number of accesses	24.1 m
Fixed line market	1.
Mobile market	2.
Brazil	
Number of accesses	91.4 m
Fixed line market	2.
Mobile market	1.
Central America	
Number of accesses	10.0 m
Fixed line market	–
Mobile market	3.
Colombia	
Number of accesses	14.1 m
Fixed line market	2.
Mobile market	2.

Chile	
Number of accesses	13.1 m
Fixed line market	1.
Mobile market	1.
Ecuador	
Number of accesses	5.0 m
Fixed line market	–
Mobile market	2.
Mexico	
Number of accesses	20.3 m
Fixed line market	–
Mobile market	2.
Peru	
Number of accesses	20.3 m
Fixed line market	1.
Mobile market	1.
Uruguay	
Number of accesses	1.8 m
Fixed line market	–
Mobile market	2.
Venezuela	
Number of accesses	11.7 m
Fixed line market	–
Mobile market	2.
Total number of accesses	212 m

* Data from December 2012

Note: Central America includes Guatemala, Panama, El Salvador, Nicaragua and Costa Rica. The number of accesses includes narrowband service provided by Terra Brasil and Terra Colombia and broadband service provided by Terra Brasil, Telefónica de Argentina, Terra Guatemala and Terra México.

Telefónica – a strong player on the European market

Spain	
Number of accesses	43.1 m
Fixed line market	1.
Mobile market	1.
United Kingdom	
Number of accesses	23.8 m
Fixed line market	–
Mobile market	2.
Germany	
Number of accesses	25.4 m
Fixed line market	4.
Mobile market	4.
Ireland	
Number of accesses	1.6 m
Fixed line market	–
Mobile market	2.
Czech Republic	
Number of accesses	7.9 m
Fixed line market	1.
Mobile market	2.

Slovakia	
Number of accesses	1.3 m
Fixed line market	–
Mobile market	3.
Total number of accesses	103 m

* Data from December 2012

Telefónica was founded in 1924 in Spain and has been growing global. Telefónica has a regional and integrated management model. The key to the company's structure lies in extending its client focus, its leveraging scales and its strategic and industrial alliances.

The different operations of the Telefónica Group in 25 countries are organised into two geographical regions: Europe and Latin America, and the global business unit, Telefónica Digital.

Corporate Centre

Within this organisational structure, Telefónica's Corporate Centre is responsible for its global and organisational strategies, its corporate policies, management of common activities, and coordinating the activity of business units.

Telefónica Europe

Includes operations in Germany, Slovakia, Spain, Ireland, the UK and the Czech Republic.

Telefónica Latinoamérica

Includes operations in Argentina, Brazil, Chile, Colombia, Costa Rica, Ecuador, El Salvador, Guatemala, Mexico, Nicaragua, Panama, Peru, Uruguay and Venezuela.

Telefónica Digital

Telefónica Digital is a global business division of Telefónica. Its mission is to seize the opportunities within the digital world and deliver new growth for Telefónica through research & development, venture capital, global partnerships and digital services such as cloud computing, mobile advertising, M2M and eHealth. Telefónica Digital has 100% ownership of Jajah, Terra, Tuenti and giffgaff. It is headquartered in London with regional centres in Silicon Valley, São Paolo, Madrid, Barcelona and Tel Aviv.

Alliances and other shareholdings

Telefónica operates in China and Italy through shareholdings China Unicom and Telecom Italia.

Integrated decentralised model of governance

It is Telefónica's goal to maximise the value of its activities at all levels – global, regional and local. The model of organisation puts the customer at the heart of the company's focus, sets out the role of innovation in revenue generation and in the transformation into a better-performing enterprise.

Local

Spain, Argentina, Brazil, Chile, Colombia, Ecuador, El Salvador, Guatemala, Mexico, Nicaragua, Panama, Peru, Uruguay, Venezuela, Germany, Ireland, United Kingdom, Czech Republic, Slovakia

- Customer Experience Model
- Single Point of Sales Model
- Integrated Production Model

Regional

Telefónica Europe, Telefónica Latinoamérica, Telefónica España

- Support, governance, synergy

Global

Telefónica

- New Engaged Corporate Model
- Innovation
- Transformation

Structure of the Telefónica Group

Key Holdings of the Telefónica Group detailed by regional business units

Telefónica España

Telefónica de España	100.0
Telefónica Móviles España	100.0
Telyco	100.0
Telefónica Telecomunic. Públicas	100.0
T. Soluciones de Informatica y Comunicaciones de España	100.0
Acens Technologies	100.0
Iberbanda	100.0
Tuenti	91.4

Telefónica Latinoamérica

Telefónica Móviles Perú	100.0
Telefónica de Argentina	100.0
Telefónica Móviles Argentina	100.0
Telefónica Móviles Chile	100.0
Telefónica Móviles México	100.0
Telefónica Móviles Guatemala	100.0
Telefónica Venezolana	100.0
Otecel	100.0
Telefónica Móviles Panamá	100.0
Telefónica Móviles Uruguay	100.0
Telefonía Celular Nicaragua	100.0
Telefónica Costa Rica	100.0
Telefónica Móviles El Salvador	99.2
Telefónica del Perú	98.5
Telefónica Chile	97.9
Telefónica Brasil (1)	73.9

(1) Includes 100% of Vivo

Telefónica Europe

Telefónica United Kingdom	100.0
Telefónica Germany	76.8
Telefónica Ireland	100.0
Be	100.0
T. Intern. Wholesale Serv. (TIWS)	100.0
Telefónica Czech Republic (1)	69.4
Tesco Mobile	50.0

(1) Includes 100% of Telefónica Slovakia

Other stakes

Telefónica de Contenidos (Spain)	100.0%
Telco SpA (Italy) [1]	46.2%
DTS. Distribuidora de Televisión Digital	22.0%
Hispasat	13.2%
Portugal Telecom [2]	2.0%
China Unicom (Hong Kong) Limited (China)	5.0%
BBVA	0.8%
Amper	5.8%

1 Through Telco, Telefónica holds an indirect stake in Telecom Italia of approximately 10.36% in ordinary shares (with voting rights). After discounting saving shares (azioni di risparmio), which do not confer control rights, the indirect interest of Telefónica in Telecom Italia was 7.15%.

2 Real interest of the Telefónica Group. With minority shareholdings disregarded, Telefónica's interest would be in the range of 10%.

02

Report by the Board of Directors

We always give customers something extra. All our 6.5 million customers enjoy their **Priority Moments** with us, which give them benefits with more than a hundred of our partners. Discounts on resort services in the mountains are only one such example.

EXTRA výhody

6. Board of Director’s report on business activity

6.1 Telefónica Czech Republic Group

6.1.1 Overview of the Group and the main changes in 2012

The group of Telefónica Czech Republic (Telefónica Group) comprises Telefónica Czech Republic, a.s. (Telefónica CR or the Company) and several other subsidiaries. In 2012, the majority of the Group’s services were provided within the territory of the Czech Republic. Through a wholly-owned subsidiary Telefónica Slovakia, s.r.o. (Telefónica Slovakia), the Group has been offering mobile services to customers in Slovakia since 2007.

The breakdown of consolidated revenues (excluding revenues from non-telecommunications services) was the following:

In CZK m	**Year ended 31 December**	
	2012	**2011**
Czech Republic	46,202	49,380
Slovakia	4,834	3,862
Other countries	32	29
Consolidation adjustments	-534	-862
Consolidated revenues total	**50,534**	**52,409**

Several changes, aimed at improving the management efficiency and focus on the core business, occurred in the structure of the Telefónica CR Group during 2012. As part of the consolidation of ICT operations, the subsidiary Telefónica O2 Business Solutions, spol. s r.o., was merged into Telefónica CR. A contribution of a part of a business from Telefónica CR into the subsidiary Internethome, s.r.o., concentrated all WiFi access activities into the subsidiary. With regard to the market trend of the growing demand for broadband internet, at the expense of voice, Telefónica CR decided to spin off a part of its business – the organisation unit of information and assistance services – into a newly incorporated subsidiary Informační linky, a.s. A divestment of 80% of shares in the subsidiary followed. Aiming to expand its portfolio and strengthen the market position in the area of employee programmes, giving corporate customers a corresponding standard of care, the subsidiary Bonerix Czech Republic, s.r.o., bought five parts of businesses from Global Care. For more details and an overview of subsidiary and affiliate companies please refer to the section Subsidiary and affiliate companies and other ownership interests.

Telefónica CR is the largest integrated telecommunications operator in the Czech Republic, offering a comprehensive range of both fixed and mobile voice, data and internet services in the Czech Republic. In September 2006 it also started offering O_2 TV, a digital television service. In the past years, the Company significantly expanded its IT and ICT operations, becoming one of the leaders in the Czech market in this segment. In addition to traditional, often one-off solutions for government clients, Telefónica CR started actively promoting standard ICT services to corporate customers.

The Company also provided a wholesale service to other operators of public telecommunications networks and providers of public telecommunications services in the Czech Republic and abroad. In October, the Company entered into a contract with the publishing house Ringier Axel Springer CZ, which gave rise to the first virtual mobile operator in the Czech Republic. The new operator started offering its service, under the commercial brand BLESKmobil, on 7 November 2012.

In the fiercely competitive marketplace of 2012, Telefónica CR focused on improving the standard of its service and on the development and marketing of new products and services in areas with a high growth potential, as the customer demand and market trends commanded. Those areas included fixed and mobile broadband internet connectivity, mobile voice and ICT services. During 2012 the Company also expanded its product portfolio to include innovative payment services (mobile payments using the NFC technology and Mobito mobile wallet service).

In order to further improve customer satisfaction and reduce churn, the Company introduced several customer-centric activities, which set it firmly apart from the competition. Its brand stores started offering the service of the so-called O_2 Gurus, consultants with special training, who helped customers with and inspired them to use new technology. In 2012 the Company opened two O_2 Experience Centres. The brand stores offer the option of trying out the latest technologies and devices in one place. Customers of prepaid mobile services benefited from a new campaign by Telefónica CR together with Coca-Cola, which gave them a chance to get free credit with a purchase of a bottle of the beverage with a competition label. The Company also launched Priority Moments, a programme open to all customers, which gave them benefits and discounts with more than 100 partners nationwide.

In the area of working with the communities, Telefónica CR forged ahead, through the O_2 Foundation, with its Think Big programme. Its goal is to help informal groupings of young people make their ideas and projects to improve or change their communities come true.

In the area of research and development, in 2012 Telefónica CR drew on the expertise and experience of Telefónica Digital, a division of the Telefónica Group which explores the potential of new opportunities for growth and focuses on improving existing products and services. In collaboration with Telefónica Digital, Telefónica CR introduced several innovative payment and ICT/Cloud services in 2012. Also in 2012, Telefónica Digital started Wayra, an accelerator of innovation in the Czech Republic, whose mission is to foster innovation and new online and information and communication technology (ICT) projects. The Telefónica CR Group did not invest any internal funds in research and development in 2012, as per the standard IAS 38 – Intangible Assets.

The Company also focused its investments on projects, programmes and initiatives to improve the quality of life of its employees. These included employee benefits and remuneration, training and personal development, social responsibility and healthcare. The Company won the ICT category in the Sodexo Employer of the Year 2012 Awards; it also finished third in the national category and first in Prague.

In Slovakia, the Telefónica CR Group continued to successfully market its simple and transparent tariffs O_2 Fér for consumers and O_2 Moja Firma designed especially for self-employed and SME customers. In 2012 the Company added O_2 Paušál, a new tariff for higher-spending consumers, to its portfolio. The attractiveness of this proposition has helped Telefónica Slovakia maintain the fast rate of growth, which in turn strengthened its position in the Slovak mobile market.

The total number of customers of the Telefónica CR Group was the following:

In thousands	As at 31 December	
	2012	2011
Retail	**2,658**	**2,688**
Fixed accesses	**1,500**	**1,582**
Traditional telephony access[1)]	1,137	1,292
Naked access	286	238
Voice over IP	77	52
Internet and data	**1,017**	**970**
Dial-up access[2)]	88	101
Broadband access[3)]	810	783
Other[4)]	119	86
Pay TV	**141**	**136**
Wholesale	**160**	**145**
Local Loop Unbundling	47	48
Wholesale xDSL access	105	89
Other[5)]	8	8
FIXED ACCESS – CZECH REPUBLIC	**2,818**	**2,833**
Contract customers	3,192	3,049
Prepaid customers	1,891	1,893
MOBILE CUSTOMERS – CZECH REPUBLIC	**5,083**	**4,942**
Contract customers	659	498
Prepaid customers	695	666
MOBILE CUSTOMERS - SLOVAKIA	**1,354**	**1,164**
GROUP'S CUSTOMERS TOTAL	**9,255**	**8,939**

1) PSTN (including payphones) x1; ISDN2 x 1; ISDN30 x 30
2) Dial-up and ISDN2 x 1 customers
3) xDSL
4) Leased lines, WiFi, symmetric digital subscriber lines, IP data lines
5) Wholesale leased lines

Restructuring programme

Also in 2012, Telefónica CR continued to implement restructuring and cost optimisation measures aimed at achieving a greater operational efficiency. Restructuring projects were focused especially on the simplification of the organisation structure and on the elimination of duplicate positions, consolidation and optimisation of call centres, reducing the number of and simplification of applications and systems in use, and on process optimisation. Some restructuring projects resulted in a transfer of activities to outsourcing partners. More than 500 employees were laid off in connection with the restructuring, bringing the total headcount of the Group down 8.9% to 6,275. The cost of the restructuring, of which severance formed a large part, reached CZK 265 m in 2012.

Total headcount of the Telefónica CR Group in 2012 in regional breakdown was the following:

	As at 31 December	
	2012	**2011**
Telefónica Czech Republic, a.s. [1)]	5,861	6,340
Telefónica O2 Business Solutions, spol. s r.o. [1)]	0	154
Employees in the Czech Republic	**5,861**	**6,494**
Telefónica Slovakia, s.r.o.	414	396
Employees in Slovakia	**414**	**396**
Group employees total	**6,275**	**6,890**

[1)] The merger through consolidation of Telefónica O2 Business Solutions, spol. s r.o., into Telefónica Czech Republic, a.s., was registered in the Commercial Register on 1 July 2012, which wound up Telefónica O2 Business Solutions, spol. s r.o. All corporate assets, including any rights and obligations under labour law relationships, have been transferred to Telefónica Czech Republic, a.s.

Share buy-back

On 19 April, the General Meeting of Telefónica Czech Republic, a. s., approved the programme of buying back own ordinary shares to the limit of 32,208,989 shares, i.e. 10% of the total number of ordinary shares of the Company, over a period of five years, for the minimum and maximum price of CZK 150 and CZK 600 per share, respectively. Following the General Meeting decision, the Board of Directors decided on 9 May 2012 to move the programme into implementation. The Company's Board of Directors also approve the plan to propose to the General Meeting, after the buy-back programme is completed, to cancel the bought shares, in conjunction with a proposal to reduce the Company's share capital by the amount equalling the sum of the shares thus acquired. The objective of the programme was to improve the capital structure of the Company.

The Company gave a mandate to UniCredit Bank AG, London Branch, to buy the shares. The mandate authorised a buy-back of shares, as part of the buy-back programme, to the limit of 6,441,798 ordinary shares of the Company, which represents 2% of the total ordinary shares issued. The share buy-back was executed on the European regulated market on which the Company's shares are listed for trading (Prague Stock Exchange); the mandate issued to UniCredit Bank AG, London Branch, allowed the bank to use the services of a securities trader licensed for trading on this market.

The buying commenced on 18 May 2012 and was completed on 27 November 2012. As at 31 December 2012, the Company owned a total of 6,441,798 ordinary shares. The sum of the amounts for which the shares had been acquired reached CZK 2,483 m. The lowest price was CZK 344 per share; the highest was CZK 418 per share. No shares were alienated during 2012.

6.1.2 Telefónica Slovakia

As at 31 December 2012, the number of Telefónica Slovakia customers reached 1,354 ths, of which 659 ths customers were on contracts. This represents a year-on-year growth of the customer base by 16.3%. Since the free Number Portability service had been made available in November 2008, until 31 December 2012, more than 503 ths numbers were ported to the O_2 network in Slovakia.

The revenues of Telefónica Slovakia reached CZK 4,834 m in 2012, compared to CZK 3,862 m in 2011. Telefónica Slovakia also improved its operating profit before depreciation (OIBDA) to CZK 1,373 m in 2012, from CZK 685 m in 2011.

Also in 2012, Telefónica Slovakia continued to successfully market its simple and transparent tariffs O_2 Fér for consumers and O_2 Moja Firma designed especially for self-employed and SME customers. In April 2012 Telefónica Slovakia added four price-point varieties of O_2 Paušál, a new no-commitment tariff for consumers, to its portfolio. Even in its lowest price-point iteration, the price plan comes with unlimited SMS to all networks in Slovakia, bonus redeemable against the purchase of a new handset, whose amount depends on the selected price-point, and a per-minute billing of calls to all networks after the free minutes are used up. O_2 Paušál thus became one of the factors contributing to the increase of the share of contract customers in the total customer base by 5.9 percentage points to 48.7% over the course of 2012.

During 2012 Telefónica Slovakia worked intensively on rolling out its 3G network and improving its coverage. At the end of the year, over a half of the Slovak population (53%) was already within the reach of broadband data from O_2. At the beginning of August, Telefónica Slovakia was the first operator in Slovakia to start a pilot commercial operation of 4G mobile internet (LTE) in selected municipalities in the west of the country.

An independent survey by Ipsos Tambor carried out jointly with Telefónica Slovakia revealed that Telefónica Slovakia had yet again the highest customer satisfaction index score among all mobile operators in Slovakia.

6.1.3 Risk management

Risk management is one of the primary management tools for effective governance of companies in the Group. Its purpose is to render support in accomplishing the Company's vision and strategy. All companies in the Telefónica Group applied in 2012 the same risk management model which fully conforms to the best international practice in the field of corporate governance and the COSO II framework (Committee of Sponsoring Organizations of the Treadway Commission). Close cooperation with other members of the Telefónica Group contributed to further improvements in the risk management system, which is an integral part of the Group's internal control system.

Telefónica CR identified risks based on an assessment of the relevant management levels and suggestions made by the division Risk Management and Internal Audit and other units of the Group, and evaluated them in terms of their potential financial impact and likelihood of materialisation. Where the value of a risk exceeds a set limit, the risk is included in the risk catalogue of the Company.

Also in 2012, the Risk Management unit was responsible for the methodology and risk management system on the Group level. The governing bodies – the Board of Directors and the Supervisory Board, or, where appropriate, the Audit Committee – were informed on a monthly basis of all major risks to which the Company was exposed, and of the ways the risks were mitigated.

The Risk Management unit also handles the risks of Telefónica Slovakia; the risks are managed according to the common methodology of the Telefónica Group.

The Company may encounter the following risks associated with the conduct of its business:

Commercial (market) risks

The general economic climate has a major influence over the Company's business. Any uncertainty regarding future economic prospects may dampen demand from customers.
The Company operates in a highly regulated marketplace. Regulatory interventions on the European (European Commission) and the national (CTO) level may have a negative impact on the Company's business.

The Company's business may be also negatively influenced by the fierce market competition and ongoing technology progress. New products and technologies may cause existing products and services to become obsolete; they may have also a negative bearing on the profitability of traditional voice and data services.

Financial and credit risks

The Company is exposed to various types of financial risk, in particular risks of the fluctuation of the exchange rates of currencies or interest rates.

The Company is also faced with the risk of losses stemming from defaults on payment and delivery terms contracted with partners, e.g. receivables from customers or sales agents.

Operating risks

The Company is exposed to risks associated with a sudden disruption of service due to network failure or information system downtime. Such service interruptions may negatively influence customer satisfaction and revenues, and make the Company liable to bear extra maintenance costs or sanctions from government authorities. The Company is also dependent on a small number of key suppliers of essential products and services (e.g. mobile handsets or network equipment).

The Company is also implicated in several litigation cases whose outcome cannot be predicted. If the decision is negative to the Company, its costs may increase, which would in turn have a negative effect on its bottom line.

The above risks are regularly monitored and managed in a way that corresponds to the nature of the risk, with the view of limiting the potential impact on the Company's results.

6.2 The telecommunications market in the Czech Republic

6.2.1 Trends in the market of fixed services

In the area of fixed access, the telecommunications market in the Czech Republic in 2012 was characteristic mainly of increases in the speed of broadband home internet and lower prices due to bundled services.

In January, Telefónica CR introduced an acquisition promotion of xDSL tariffs Internet Optimal and Internet Aktiv for consumers. All new customers could get Internet Optimal for CZK 500 and Internet Aktiv for CZK 600 per month, if they committed to 12 months of service. Starting from the 13th month, the list price of CZK 750 and CZK 850 per month for Internet Optimal and Internet Aktiv, respectively, would be charged. The promotion went on for the full first half of the year 2012.

From January until the end of April 2012, UPC Česká republika, a.s. (UPC) ran promotions on all types of internet service. The first 12 months of a 10 Mbps and a 25 Mbps service could be had for CZK 299 and CZK 399 per month, respectively. The 50 Mbps and 100 Mbps services attracted a 50% discount from UPC for the first four months of subscription.

In early May, UPC revamped its internet tariffs. The speed of the slowest tariff went up from 1,024/256 kbps to 2,000/512 kbps. The price remained (CZK 199 per month), but it no longer included the modem rental fee. UPC harmonised the modem rental fee across all tariffs at CZK 49 per month, and up to CZK 69 per month for a WiFi modem. The customer paid a one-off connection fee of CZK 1,000.

In May, UPC stopped offering the 10 Mbps and 25 Mbps tariffs. In lieu of these, it introduced a new 30 Mbps tariff, which joined the existing 60 Mbps and 120 Mbps services. During May, UPC ran promotions for new customers of all these tariffs (UPC Fiber Power 30, UPC Fiber Power 60, UPC Fiber Power 120). UPC also had a promotion for business customers, which went on until 30 June 2012.

Telefónica CR increased the speed of O_2 Home Internet to 40 Mbps in the highest tariff. More than a million of household were within the reach of the VDSL service.

Also T-Mobile Czech Republic, a.s. (T-Mobile) responded to the trend of increasing speed, and changed its xDSL parameters. From 1 September 2012, T-Mobile gradually increased the transmission speeds of fixed internet access. For tariffs with the original speed of up to 16/1 Mbps, T-Mobile started offering them at 20/2 Mbps; tariffs with the speed of up to 25/2 Mbps originally were increased to up to 40/2 Mbps. Wherever it was technically feasible, T-Mobile increased the speed automatically for the customer.

GTS Czech s.r.o. responded in kind and from 11 September 2012 it increased the speeds of its xDSL services by the same margins.

6.2.2 Trends in the market of mobile services

The Czech market of mobile telecommunications saw many changes, including changes in the ownership of some operators or their parts, in 2012. Brand new services were introduced and the market players' propositions changed considerably over the period. Operators invested significantly into their customer care and loyalty schemes.

In February 2012, Telefónica CR divested an 80% stake in its subsidiary Informační linky a.s., which it had previously formed at the beginning of the year.

T-Mobile and Huawei Technologies signed an outsourcing contract for the construction and maintenance of mobile networks.

In October 2012, Air Telecom a.s. bought MobilKom, which operates the U:fon mobile network, for CZK 21 m. The company offers mobile internet and voice services based on CDMA technology. In May 2012, the company presented its new tariff Volání za korunu. Customers paid CZK 200 per month and their on-net and off-net calls within the Czech Republic were charged at CZK 1 per minute.

In October, Telefónica CR and Ringier Axel Springer CZ jointly started up BLESKmobil, a new MVNO, whose service went live on 7 November. The first MVNO with a 2G and a 3G service was the harbinger of other new MVNOs, whose arrival to the market is expected in 2013. In addition to BLESKmobil, Telefónica CR has concluded an agreement with Tesco to form a joint project that will lead to a launch of the second MVNO in the Czech Republic. The new mobile virtual operator will start offering its services in the second half of 2013.

The market proposition saw many changes in connection with the preparation for the arrival of fourth generation (LTE) networks and in connection with the enhancement of data networks and the related growing number of smartphones in the networks of all operators. Operators offered higher FUP; data was included in new tariffs; and the competition grew fiercer, in the prepaid segment included – especially as BLESKmobil came to the market at the end of the year.

Vodafone Czech Republic, a.s. (Vodafone) rebuilt its data tariff proposition in February. The FUP for the daily small-screen internet tariffs increased from 5 MB per day to 25 MB per day, and the price increased from CZK 17 per day to CZK 25 per day.

In June 2012, Vodafone expanded its mobile internet offer by including two new tariffs with a higher FUP - 4 GB and 10 GB, which were designed for access from a notebook.
In August 2012, Vodafone launched Fair Tariffs, which combine mobile voice, SMS and data, and offer per-second charging.

During April, T-Mobile brought out new free-minute tariffs With Us. The customer receives a number of free minutes for calling, and a number of free SMS. The tariff comes with free calls and SMS to the T-Mobile network within set hours; higher tariffs offered additional benefits, including, as was the case with the highest tariff, unlimited calls to all networks. The subscription to any of the tariffs included free small-screen internet.

In November, T-Mobile launched its Christmas proposition Volejte zadara (Free Calls). Contract customers were offered free on-net calls or a 30% discount on their monthly subscription, depending on their chosen tariff.

From March 2012, Telefónica CR started offering O_2 Pohoda, a new tariff for customers under 26 years of age, for CZK 180 per month. The subscription came with 40 free minutes of calling to all networks and 100 free SMS.

In the second quarter of 2012, Telefónica CR introduced Smart Neon, tariffs bundling together mobile voice and small-screen internet. The new ‘smart tariffs’ were based on the original Neon tariffs. The customer could choose between free call minutes to all networks or a lower free call allowance and a discount on a new mobile phone.

During 2012, Telefónica CR also expanded its portfolio of data tariffs built around one type of application – navigation, email or Facebook, for instance.

On 18 June 2012, Telefónica CR presented new tariffs of Internet on Your Mobile+ for smartphones. All new tariffs came with unlimited SMS to the O_2 network; there were tariffs both for prepaid and contract customers.

The regulation of roaming prices accounted for a number of changes in the roaming proposition in the Czech market.

Vodafone announced its new Roaming for A Day plan for customer using Tailor Made Tariffs. Customers could use free units that came with their domestic tariffs also in 41 countries of Europe. Customers could use free minutes, SMS and data allowance for a one-off price of CZK 99 per day. Roaming for A Day could be activated from 28 May 2012.

T-Mobile offered Travel&Surf, a new roaming data tariff. The mobile internet service could be subscribed for a day, a week or for a whole month.

In July 2012, Telefónica CR started offering Volání bez hranic, a new roaming tariff, in which outgoing and incoming calls cost CZK 3.90 per minute and an SMS costs also CZK 3.90.

Also the area of customer care went through significant changes. In April, Telefónica CR launched its nationwide project O_2 Guru – the deployment of specially trained consultants in brand stores, to give free assistance to O_2 customers as well as to customers of competitive operators.

Telefónica CR manifested its focus on improving customer experience when it introduced, in September 2012, its new loyalty programme O_2 Priority Moments, to all its customers. The principle of the programme is that customers order SMS codes that give them various discounts. The codes can be comfortably requested, among other ways, via a convenient mobile app.

Vodafone started its own loyalty bonus scheme called Vodafone Menu, which gave customers discounts on various products and services. The scheme is free and open to all Vodafone customers.

UPC, too, launched a bonus programme for its customers in October. Residential customers who had been with UPC for at least three months, wanted to stay with the provider and had no arrears, could get 10-55% off the list price of products and services of selected retailers. The programme, Dolce Vita, also offered UPC products at lower rates.

6.2.3 Regulation

Several changes occurred in 2012 in the regulatory environment which governs the field of electronic communications in the Czech Republic. The most material changes included the following:

1) changes in the legislation;
2) changes in the areas of markets analysis and product regulation;
3) changes in the Universal Service provision and in the government's policy and support of broadband internet access.

Below are the main changes to the legislation in the area of electronic communications:

1) promulgation of the Act No. 19/2012 Coll., amending Act No. 216/1994 Coll., the Arbitration Act, as amended, and other related laws, including the Act No.127/2005 Coll., on electronic communications, and on the amendment to some related laws (Electronic Communications Act), as amended, and some other laws;
2) completion of the implementation of the revised regulatory framework for electronic communications networks in the Czech law:
    a. Directive 2009/136/EC of the European Parliament and of the Council amending Directive 2002/22/EC on universal service and users' rights relating to electronic communications networks and services; Directive 2002/58/EC concerning the processing of personal data and the protection of privacy in the electronic communications sector and Regulation (EC) No 2006/2004 on cooperation between national authorities responsible for the enforcement of consumer protection laws;
    b. Directive 2009/140/EC of the European Parliament and of the Council amending Directive 2002/21/EC on a common regulatory framework for electronic communications networks and services, Directive 2002/19/EC on access to, and interconnection of, electronic communications networks and associated facilities, and Directive 2002/20/EC on the authorisation of electronic communications networks and services;
    c. Regulation (EC) No 1211/2009 of the European Parliament and of the Council establishing the Body of European Regulators for Electronic Communications (BEREC) and the Office, through the Act No. 468/2011 Coll., amending the Act No. 127/2005 Coll., on electronic communications, and on the amendment to some related laws (Electronic Communications Act), as amended, and some other laws, which came into effect on 1 January 2012;
3) promulgation of the Act No. 273/2012 Coll., amending the Act No. 127/2005 Coll., on electronic communications, and on the amendment to some related laws (Electronic Communications Act), as amended, and some other laws, which concerns the issue of storing the operating and localisation data for the purposes of their disclosure to the law enforcement.

Telefónica CR was involved in the preparation of the above legislation by providing consultation either directly or on the platform of industry associations of telecommunications operators or through its parent company Telefónica S.A.

Relevant markets analysis and product regulation

Telefónica CR continued to meet its duties with which it was tasked based on the relevant markets analysis undertaken by the Czech Telecommunication Office (CTO) in previous periods.

The consultancy commissioned by the CTO continued with the development of the "LRIC methodology, including a model for the termination of calls in fixed public network". The CTO used the model results to set the maximum prices for the service of call termination in fixed public networks in 2013 and beyond. As part of the notification process for the price decision the European Commission requested an extension of the period for review of the cost-based model, and the price decision was not issued in 2012.

In June 2012, the CTO published a price decision, which, with effect from 15 July 2012, set the maximum price for call termination in public mobile networks at CZK 0.55 per minute, down from CZK 1.08 per minute previously. The new price was applied to existing contracts from 15 September 2012. The CTO, together with the consultancy firm, progressed with the development of the LRIC cost-based model for the service of call termination in public mobile networks. The result of the cost calculation for the call termination in mobile networks as per the new model was reflected in a price decision of the CTO issued in December 2012. The CTO set the maximum regulated prices at CZK 0.41 per minute with effect from 1 January 2013, and CZK 0.27 per minute with effect from 1 July 2013. The maximum price of CZK 0.41 has to be applied to existing contracts no later than by 1 March 2013.

In June 2012, the CTO published a price decision regulating the prices of local loop unbundling, bringing down the monthly rental prices of copper wire access to CZK 197 (down from CZK 242) for full access to the loop, and CZK 39 (down from CZK 41) for shared access.

The CTO continued the third round of analysis of the relevant market no. 5 – wholesale broadband access in electronic communications networks. The first draft of the analysis was notified to the European Commission, which then exercised its right of veto. Telefónica CR anticipates that the second draft will be tendered in 2013.

Furthermore, the CTO commenced the analysis of the following markets in 2012:
market no. 1 – access to a public telephone network at fixed location;
market no. 2 – call origination in a public telephone network at fixed location;
market no. 4 – wholesale (physical) access to network infrastructure (including shared or full local loop unbundling) at fixed location;
and market no. 8 – access and call origination in public mobile telephone networks.

Regulation of international roaming

A new regulation of international roaming, which defines the regulated roaming prices until 2022, was passed by the European Parliament and the Council of Ministers in the first half of 2012. The adopted roaming regulation brought down further, with effect from 1 July 2012, the regulated roaming voice and SMS prices, expanded the scope of regulation to roaming data services, and strengthened the protection of the end users.

With effect from 1 July 2012, Telefónica CR cut the retail incoming call rates to CZK 2.30 per minute; the outgoing call price fell to CZK 8.70 per minute; one SMS is priced at CZK 2.60; and the price per 1 MB of data has been newly set at CZK 20.

Imposition of duties related to the Universal Service

Telefónica provided the following services during 2012 as part of meeting its duties imposed by the CTO in relation to the Universal Service provision:

(a) the public payphone service;
(b) access to the public telephone service, of the same quality as for other end users, for people with disabilities, namely by means of special terminal equipment;
(c) special price plans for persons with disabilities, which are different from the regular price plans provided under the standard commercial terms and conditions.

For the service under (a), the CTO issued a decision charging Telefónica CR with the duty to provide for the service in municipalities under 4,999 residents by the end of 2012, and in municipalities under 1,999 residents by the end of 2014.

Regarding the services under (b), the CTO decided that Telefónica CR had the duty to offer special terminal equipment to the designated categories of people with disabilities as part of the Universal Service for a period of three years from 15 July 2012.

As to the services under (c), the Czech Telecommunications Office imposed on Telefónica CR the duty to offer special pricing under the Universal Service obligation, for a period of three years commencing on 2 July 2011.

Funding of the Universal Service

In the middle of 2012, Telefónica CR submitted a claim for compensation for the loss incurred as a result of Universal Service provision (including the loss incurred as a result of offering special price plans for people with disabilities) in 2011. The CTO then proceeded with verifying the amount of the loss and examining the supporting documents, and made the payment, of CZK 55 million for the loss incurred as a result of the Universal Service provision and of CZK 103 million for the loss incurred as a result of special price plan provision, in December 2012.

Furthermore, the loss incurred as a result of the Universal Service provision in 2006 was fully reimbursed in 2012, in the amount of CZK 280 million (Telefónica CR's share was CZK 143 million).

State policy and support in the area of broadband internet access

In March 2012, the CTO published a proposal for a tender for frequencies of 800 MHz, 1800 MHz and 2.6 GHz. The proposal was put through a process of public consultation, inviting comments. The use of these frequencies for the development of mobile broadband internet access is one of the vehicles for achieving the goals set out in the State Policy in the Area of Electronic Communications – Digital Czech Republic. After the processing of the comments, on 12 July 2012 the CTO invited interested parties to register, and the electronic auction commenced on 12 November 2012. In addition to Telefónica CR, the following companies participated in the auction: Vodafone Czech Republic, a.s., T-Mobile Czech Republic, a.s., and PPF Mobile Services, a.s. The Czech government has made it public that it intends to use a part of the auction proceeds to support the development of broadband internet. On 8 March 2013, the tender was cancelled by the CTO without a result.

In April 2012, the European Commission commenced a public consultation on the EU Initiative to Reduce the Cost of Rolling out High Speed Communication Infrastructure in Europe. Another public consultation on the Community Guidelines for the Application of State Aid Rules in Relation to the Rapid Deployment of Broadband Networks was started in June 2012, with the final version of the Guidelines published in December 2012. The Guidelines expanded the state aid rules to cover the possibility of using state aid for the deployment of broadband networks even in areas, in which such networks already exist.

6.3 Consumer segment

In 2012, Telefónica CR focused 100% of its attention on the existing customer base. The Company came out with two new services: O_2 Guru and O_2 Priority Moments. These activities have improved the Company's position in the Czech market in terms of customer satisfaction and have led to a faster adoption of modern technology by our customers.

O_2 Guru consultants with special training provided free assistance with new technology in the brand stores – and not just to O_2 customers but to all who visited an O_2 brand store. Over the course of 2012, more than one hundred consultants saw to over 150 thousand requests for assistance. O_2 Gurus are also present online and on social networks where they take questions from users via Facebook and Twitter. Video tutorials on the O_2CZ YouTube channel, in which O_2 Gurus demonstrate how to configure the most widely used mobile services, have also proven to be highly popular with viewers.

In September 2012, Telefónica CR launched Priority Moments, a new loyalty scheme for all customers – regardless whether the customer has a prepaid card, a mobile contract, whether they are a fixed access or internet-only customer. The programme is also open to all whose O_2 number is registered to their employer. No club card is required – a mobile phone serves as a pass. Benefits from Priority Moments were available to close to 6.5 million O_2 customers. They could choose from a range of almost one hundred benefits with different partners of the programme. Smartphone owners could also download a special mobile application which makes claiming the benefits very easy as it allows putting in filters to see only options of interest. The application will also show the customer the most direct route to the chosen benefit on a map. In 2012, customers generated 1,153,000 discount codes and saved more than 162 million Czech crowns through O_2 loyalty schemes.

6.3.1 Internet

After the launch of the VDSL service in May 2011, when the maximum speed in the O_2 network went up to 25 Mbps, Telefónica CR continued to invest in broadband internet also in 2012.

In September 2012, the Company again increased the speed of home internet from the original maximum of 25/2 Mbps to 40/2 Mbps. The service was accelerated also in other locations in the Czech Republic within the reach of VDSL, where further speed increases were technically feasible. The most popular tariff Optimal now comes with the maximum speed of 20/2 Mbps, up from 16/1 Mbps originally, all for the same price.

More than 180 thousand of our customers with tariffs Optimal and Aktiv benefited from the higher speeds. The highest download speed of 30–40 Mbps became newly available to approximately one million O_2 lines.

The number of customers using the faster VDSL service increased by more than 100 thousand year on year. These were mainly customers who took advantage of the O_2 proposition and increased the speed of their Home Internet service. At the end of 2012, Telefónica CR had approximately 200 thousand VDSL customers.

In addition to the standard promotion of Internet Optimal for CZK 500 (up to 25/2 Mbps) and Aktiv for CZK 600 (up to 40/2 Mbps), in the second half of 2012 Telefónica CR offered also economically priced Home Internet bundles. All bundled products with O_2TV or tablet Prestigio retailed for CZK 650 a month for 12 months.

The year 2012 was a turning point for mobile internet, as Telefónica CR implemented a number of innovations. In June 2012, the Company became the first operator in the Czech Republic to start a commercial operation of the LTE technology. The fourth generation mobile communication network covered the municipality of Jesenice (district Praha-západ) and its surroundings, with close to ten thousand residents. The LTE signal also covered approximately a half of the Chodov shopping centre in Prague – home to O_2 Experience Centre, the largest and most high-tech O_2 brand store. From 19 June 2012, the first customers could get their hands on one of the two types of LTE-enabled devices with a SIM card, and start taking full advantage of the potential of this technology. O_2 offered three LTE Mobile Internet tariffs, with prices starting from CZK 333 per month.

In November 2012, Telefónica CR offered its customers, as part of the mobile data tariffs Internet on Your Mobile +, also unlimited SMS in the O_2 network.

Customers using only one type of connectivity could access selected services like email, Facebook or navigation exclusively through O_2 in the Czech Republic. The data limit (FUP) for all tariffs for accessing applications is 150 MB.

6.3.2 Fixed access and IPTV

As in the previous years, in the fourth quarter of 2012 the Company recorded an increase in the number of fixed broadband internet and a slower rate of decline in the number of fixed accesses.

During 2012 Telefónica CR continued offering its special acquisition offer of an economically priced bundle of internet and television for CZK 650 per month for 12 months. For this price, the customer got broadband internet with a speed of up to 20 Mbps and O_2TV Flexi digital television with up to 48 channels. The promotion has helped O_2TV maintain its long-term trend of positive net customer additions compared to the competition. The number of O_2TV customers went up 3.5% year on year.

In addition to a choice of channels and programmes, O_2TV offers also other services: Video Library, TV Archive or the free playback service O_2TV Recording. In April 2012, the Video Library celebrated three million legal movie downloads. In July 2012, an O_2TV Recording application for Android smartphones was made available, with 36,500 downloads via the application recorded to year 2012 end. The Recording app for iPhone was also redesigned and made available also for the iPad.
The number of customers using fixed access internet from Telefónica CR went up 4.5% (from 876,000 to 918,000) year on year (January 2012 vs. January 2013), and the digital television service O_2 TV saw a 3.5% increase (from 137,000 to 142,000) over the same period.

6.3.3 Mobile services

The portfolio of tariffs was significantly revamped in June 2012 with the introduction of Smart Neon S through to XXL tariffs. The 'smart' tariffs incorporated all the advantages of the previous Neon S – XXL tariffs, i.e. unlimited calls within the O_2 network, and newly added small-screen internet and unlimited on-net SMS. On top of that, customers could choose between free call minutes extra to all networks or a cut-priced new handset. Upon activation of any of the 'smart' tariffs (Neon S – XXL) by 31 August, customers received 30-50% off the Neon list price. The discount on the tariff was good if the customer – regardless whether they chose extra airtime or a cut-price new handset – committed to 24 months of service. 'Smart' tariffs were brought out by O_2 at the same time as the new roaming price plan Volání bez hranic, with outgoing and incoming calls abroad charged at CZK 3.90 per minute, with the same rate for 1 roaming SMS, after 2 July.

The broad range of tariffs was expanded to include a selection of tariffs for young people under 26 years of age, who could choose from three economically priced tariffs: Pohoda, Chytrá Pohoda and Chytrý [:kůl:]. Chytrá Pohoda came with extra small-screen internet and unlimited SMS within the O_2 network, plus 100 SMS to all other networks. With Chytrý [:kůl:], the customer would, for an extra CZK 100, get small-screen internet and double the number, i.e. 120 free minutes. The 'smart' tariffs for young people gave young customers their choice of the most used services in one postpaid tariff: free call minutes, small-screen internet and unlimited on-net SMS.

6.4 Business and SME

In 2012, Telefónica CR focused in further developing its service model for small and medium enterprises based on a differentiated approach to customer care based on customer value. The service model has been gradually expanded to include a dedicated team of special 'on-call' consultants, whose role is to improve the personalised approach to care and, by extension, the customer satisfaction.

We continued to improve under our customer retention initiative, which significantly reduced the churn rate. At the same time we focused on retaining the customer's value during renegotiation of contract terms through up-sell and cross-sell activities.

6.4.1 Internet

In 2012 we concentrated on rolling out the VDSL technology to our ADSL internet customers, which was a service used by more than a third of our customer base at the end of the year. We also increased the VDSL speed up to 40 Mbps. Customers of VDSL internet are now considerably more satisfied, which has positively reflected on customer attrition in favour of the competition.

6.4.2 Fixed access

We supported the sales of xDSL connectivity and fixed VoIP voice, which lets our customers call without limits to all fixed numbers in the Czech Republic, with a choice of bundles. The proposition included xDSL and IPTP (IP telephone line using VoIP technology) bundles, or a higher end bundle of free calls to all mobile and fixed numbers in the Czech Republic. Our IPTP customers could also subscribe to the bundle O_2 Unlimited International, which, for a surcharge of CZK 100, gave them up to 1,000 minutes of international calls.

6.4.3 Mobile services

The year 2012 in the residential and SME segment was the year of mobile internet, which grew significantly in usage. We helped this trend with the launch of our new portfolio of Smart Neon and Smart Business tariffs, which, as a standard, come with smartphone data connectivity. This has helped to attract a greater number of small-screen internet users, increasing their share in our customer base by close to 50%.

6.5. Corporate and government

6.5.1. Telecommunication services

Telefónica CR sees itself as a technology company that breaks through the barrier between telecommunications and IT. It is not important how the customer's request is carried out – by means of a telecommunications or IT solution, or any combination of the two, as long as it is done. To this end, the Company divides its activities in this area into the following four areas:

1) **Productivity** – looking for ways of increasing employee performance through cloud, email or voice solutions.

2) **Improving the effectiveness of business processes** – monitoring of business processes which preset the biggest bottlenecks for the customer, and simplifying them and making them more effective with the help of Telefónica CR's technology, solutions and services.
3) **Infrastructure** – designing and implementing the most reliable and effective infrastructure of data centres, computer systems and the related technology.
4) **Customer care** – looking for ways how to give the customer tailor-made care with maximum benefit and value.

Customer satisfaction is Telefónica CR's ultimate priority. Telefónica CR is the market leader in the medium business and corporation segment for customer satisfaction; since 2010 its CSI index has been steadily improving, by 10 points overall. The Company's sales representatives are permanently rated as the best in the market. The other major strengths contributing to the high customer satisfaction include professional customer care, keeping customers informed, and the service functionality. The POTR (Project Operational Trust & Reliability) project of Telefónica CR helped to reduce the number of errors in billing, and, related to that, the number of billing-related complaints, and in 2012 the Company also introduced a new and simpler billing format.

In June 2012, Telefónica CR' **hardware portal**, www.firemnitelefony.cz, went live; it helps customers with choosing and buying subsidised and unsubsidised hardware, managing their bills, orders and facilitates the complaints procedure. This has led to a major saving of time and money. The customer can manage his account online from this desk or anywhere, via any web-enabled device. The offer of options at the hardware portal of Telefónica CR is at present the broadest by far among the telecommunications operators in the Czech market. In 2012 Telefónica CR sold more than 51,000 units of goods via the hardware portal. The portal was actively used by more than 9,000 customers. Telefónica CR is confident that the portal will attract more satisfied customers who will benefit from saving time and spending less – which is our main goal.

Telefónica CR also continued with **O_2 Exclusive** in 2012. The programme for the Company's most valued accounts operates on the principle that the more services the customer is subscribing to from one operator, the more added value there should be for him. Business customers, who choose Telefónica CR as their only provider of all the main telecommunication services, benefit from the highest standard of care, expertise of our most experienced specialists who regularly optimise the usage of the services for the customer, quality guarantees, warranty meetings and loyalty bonuses.

In 2012 Telefónica CR served close to 4,000 customers through O_2 Exclusive. The benefits under the Quality Guarantee in O_2 Exclusive were expanded by a structured monthly report of meeting SLA-guaranteed indicators and of the usage of their lines. More customers are now benefiting from the services of a dedicated Service Level Manager as part of being a member of O_2 Exclusive.

Also in 2012, Telefónica CR started offering computers to its customers as a service, which took the form of two key products: the so-called **Počítače bez starostí** and **O_2 Desktop** offer a choice of device type and model (desktop PC, thin client, notebook or tablet). **O_2 Virtual Desktop** is a service offering virtual computing capacity in a data centre. Customers are spared of the cost of ownership, running overheads are minimal, and the performance is scalable to the customer's needs. The service comes with a 24/7 fast and quality service and a choice of financing options (one-off acquisition or operational leading). Both products can be combined with **O_2 Web Security Gateway**, a security function which defends from malicious attracts and code from the internet around the clock. O_2 Web Security Gateway also helps with improving employee productivity through the feature of access configuration to websites, social networks, online games, etc. Telefónica CR is one of the market leaders in Car Control in the Czech Republic. **O_2 Car Control** is a user-friendly service of fleet management and control, including the mileage and fuel consumption. Customers can save up to 20% of their total fleet running costs. In 2012

Telefónica CR, reflecting on the current market trends, considerably simplified it O_2 Car Control proposition and cut the prices of the units and accessories. Two mobile applications for Android were launched in 2012: Car Control Mobile (mobile version of the Car Control portal) and Car Terminal (driver-controller communication application). A new website conforming to a modern user standard also went live: www.carcontrol.cz. In 2012, Telefónica CR had more than 45 thousand active O_2 Car Control units. A major customer Povodí Ohře, státní podnik, also decided to use the service and installed the system in all its company cars, as did the Municipal Police České Budějovice, for example.

In 2012, Telefónica CR signed up a number of large corporate and government customers. As a strategic partner, Telefónica CR aims to support the customers' core business and operations. This approach has also won the confidence of GE Money Bank, which extended a contract for all telecommunication services.

Also in 2012, Telefónica CR took over the MLAN in the branch network of Komerční banka, thus proving that managing the whole infrastructure and the services between the customer data centre and the employee terminals is viable and possible.

Telefónica CR operates a WAN for Saint-Gobain in the Czech Republic and in Slovakia; in 2012 the partnership was extended to include the international MPLS in Hungary and Romania, which together represent the interconnection of approximately 50 locations.

Already in the past years, Telefónica CR was a reliable and exclusive telecommunications partner to G4S. G4S signed new mobile service, fixed voice and data contracts in 2012, and became a member of O_2 Exclusive.

In 2012 Telefónica CR teamed up with Digital Broadcasting for the project of a TV signal broadcasting via a multiplexer. The construction was successfully completed under a very ambitious schedule.

Tristone Flowtech, a global producer of car parts, became a customer of our O_2 WAN service in 2012. It is one of the largest projects of this type in the history of Telefónica CR.

In 2012 Telefónica CR also operated and developed E-Agri for the Ministry of Agriculture of the Czech Republic, and the related application infrastructure (register maintenance and development).

Another major customer, the Czech Army, renewed its mobile services contract with Telefónica CR, and expanded the service to include more than 8,000 SIM cards, in 2012.

Telefónica CR continued to provide services to regions in 2012:
Communication infrastructure contract with the Zlín region, specifically WAN construction and the delivery of active components and service; construction of a data centre and the delivery of communication infrastructure (MAN and project management) for the South Bohemia region; fixed voice and mobile voice service for the South Moravia region; fixed voice and fixed data, in addition to mobile voice as before, for the Hradec Králové region and its 150 organisations.

In September 2012, Telefónica CR introduced **O_2 Priority Moments**, a new bonus scheme. The scheme is open to all consumer and business customers of the Company, including the customers of fixed voice, data and O_2 TV customers, and does not require registration. The scheme extends discounts on products and services of the Company and of third party partners. The scheme has been received with enthusiasm – customers appreciate the benefits and the possibility of becoming a partner with their own proposition.

6.5.2 ICT

Keeping true to the three-year strategy adopted in 2011, also this segment continued to successfully develop in 2012. Telefónica CR secured two key certificates, which are important for the customer in the selection of a provider of cloud computing services: VMware vCloud Powered and Cisco Certified Gold Partner. Both certificates attests to Telefónica CR’s capability in the form of a sufficiently high number of experienced professionals, which, to the customer, represents a guarantee of quality of the solutions and services offered. The data centres started preparation for Tier 3+ s certification so that the Company can be the first in the Czech Republic to offer the services of fully certified data centres.

The O_2 Cloud service portal went live, giving customers a way how to interactively, expediently and flexibly build up a virtual data centre tailored to their needs. New services were brought out to the market: O_2 Web Security Gateway, an online security solutions for businesses, and a corporate version of the ICT solution O_2 Virtual Desktop and O_2 Desktop, which give customers significant cost economies in IT acquisition and operation, but also allow for flexible scalability of IT performance and costs to the customer’s current need.

O_2 Car Control, a service which has given Telefónica CR leadership in fleet management services in the Czech Republic, and which helps businesses manage close to 50 thousand fleet cars today, continued to enjoy popularity with customers. Also in 2012, new ICT services entered a stage of development, with their market debut planned for 2013.

A dedicated customer support centre for ICT services and a dedicated ICT pre-sales team were instituted. A sales team focused exclusively on selling ICT began to form at the end of the year. Given the specific nature of ICT sales, a dedicated sales team and customer support are an important step forward in the direction of the customers.

6.6 Wholesale services

National wholesale services

The trend of economising continued to hold sway in 2012 over both the business and the consumer segment. The pricing pressures have lead to a higher demand for migration to a cheaper product portfolio, e.g. from the leased line service to an Ethernet-based service. This has in turn caused the average monthly revenue per service to decline.

Despite this situation, the Company managed to increase the number of higher value added xDSL access services. The total revenues did not see a significant month-on-month fluctuations. More demand for higher transmission speeds focused our attention on high-speed Ethernet services, which has led to a boom in this segment.

In 2012, Telefónica CR recorded a net year-on-year increase in the number of xDSL connections of 18%, which was aided by the higher speeds of VDSL profiles up to 40 Mbps introduced in September. The prices of these products also went down at the same time.

In 2012 we strengthened our leadership in the area of infrastructure services for the connection of access aggregation BTS of mobile operators. Projects started in 2011 continued, and similar projects were started in 2012, which are scheduled for completion in 2013-2014. Also, academic networks continued to be rolled out and their service delivered.

International wholesale services

International data and internet

The growing demand for international transmission capacity of our partners means also an increased demand for transmission capacity from us. The services of international IP connectivity and Ethernet-based services also saw a growth.

International voice services

In commercial terms, we delivered on the targets set for 2012. We strengthened our leadership position in the area of transit voice service for a number of mobile and fixed access providers abroad. We increased the number of our direct interconnection lines with new mobile and fixed access operators, using also the VoIP technology for interconnection.

Compared to 2011, the transit voice traffic went up 15%. Transit traffic saw a significant increase, in particular to South-east Europe and CIS. We succeeded in maintaining the high quality of voice services offered by the Company.

In the segment of international services, we continued to build up our cooperation with the international operator TIWS (Telefónica International Wholesale Services) within the Telefónica Group.

Information and directory services

The year 2012 saw the successful development of a technology interface for partners who provide, or plan to provide in the future, voice information and directory services using numbers in the 118x range. The financial targets have been achieved.

In the area of services for people with disabilities, the capacity and technical quality of the unique service Deaf Call were significantly increased. The number of calls processed by the service grew 20% compared to 2011.

Public payphones

Optimisation of the public payphone network

The Company forged ahead with the process of optimisation of the public payphone network. The total number of payphones went down to 14,800 payphones in 2012.

In the second quarter of 2012, the Company started directly selling advertising space on public payphone facilities, thus becoming, with 12,000 spaces, one of the leading providers of outdoor advertising space. A large number of locations are occupied with our own advertising for the Think Big project.

In 2012, the Company continued the provision of the public payphone service as part of the Universal Service obligation laid down by the CTO. The Company was mandated, after evaluation of tenders submitted to the CTO, to provide the service also in the future years.

We managed to meet the commercial targets for 2012, despite the strong pressure from the declining regulated interconnection prices, in particular the mobile termination rates.

6.7 Network interconnection

The fixed access network of Telefónica CR was in 2012 interconnected with 16 networks of fixed access providers, and 3 networks of mobile access providers in the Czech Republic. The mobile network was interconnected with 10 networks of fixed access providers and 3 networks of mobile access providers. The volume of interconnected voice traffic remained approximately the same as in the previous years.

In the area of Local Loop Unbundling, the previous years' upward trend continued to rally –in terms of both the number of new orders for services and cancellation requests.

The number of users of services of other operators using our Wholesale Line Rental (WLR) service also grew. On the other hand, the number of CS/CPS clients dropped significantly over the course of 2012, but the traffic volume held steady. The CS/CPS services are nowadays used mostly by corporate clients of operators whose networks are interconnected with ours.

6.8 Payment services

Telefónica CR has been providing payment services to its customers in keeping with the Act No. 284/2009 Coll., on the payment system, already since 1 November 2009. The services allow customers raise a payment order and use their mobile device or fixed line to pay for goods or services provided by third parties. The customer has a choice of several methods of payments; the most widely used method is via Premium SMS, which, in 2012, was opted for by 430 thousand customers per month on average. Using SMS to pay public transport fare or for paid parking were among the most commonly used such services. The number of towns where public transport fare can be paid by SMS grew to 9. The number of places where private or public parking can be paid by SMS grew by a third to the present 34. DMS, the donor SMS, is a special project which makes it easy to contribute to a charity of choice. The so-called Audiotex (Premium-rate Telephone Number) service was the second most popular payment method, with an average monthly payment per customer of CZK 980. The total of funds used to pay for goods and services, via the two aforementioned methods of payment, reached CZK 823 m in our network alone in 2012.

Also in 2012, Telefónica CR, in collaboration with other mobile operators, members of the Association of Mobile Network Operators, continued its campaign 'Plať mobilem' (www.platmobilem.cz, 'Pay with Your Mobile'). Its role is to promote mobile transactions in the amount between CZK 10 and CZK 1,500 that can be made using a mobile data capable mobile telephone. An innovation introduced in the second half of the year now makes it possible to authorise a mobile payment also online from a PC. Telefónica CR offers the service, m-platba, in its portfolio.

The year 2012 was key also from the point of contactless mobile using the NFC technology. In 2012, Telefónica CR was the first to launch such a service on a commercial basis. The first NFC payment project was implemented in partnership with Visa Europe, Komerční banka and Samsung.

Before NFC went live, Telefónica CR and its partners had been pursuing a pilot project since 2011, aimed at demonstrating the readiness of the NFC technology for a fully-fledged deployment. The pilot has unveiled a number of interesting findings, e.g. more than two thirds of transactions were below limit, meaning less than CZK 500 in value. For such payments the user does not have to (by default; the user may choose a different setting) make a second authorisation, so the payment is swift. This was the main logic behind the NFC payments project – to present a faster alternative to paying by card, especially when low amounts are concerned.

NFC cards in mobile devices also have the undisputed advantage that a mobile device is almost always about the person of its owner. A survey undertaken at the Heathrow Airport London revealed that people find out that they have lost their mobile or notebook the fastest – usually within 20 minutes. They start to miss their bag, wallet or keys only after 2-4 hours. A mobile phone is usually also the item they are most willing to make a return journey for – close to 90% of respondents, while only 40% would go back for a wallet.

The year 2012 was a turning point regarding the availability of the NFC technology to the end user. The distribution of NFC-enabled devices started, so by the end of 2012, 50 thousand of our customers had NFC in their pocket. We expect a surge in the number of NFC-enabled devices in the years to come.

6.9 Comments on the financial results

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

Consolidated financial results

Revenues, Operating Costs and OIBDA

The total consolidated revenues reached CZK 50.5 bn in 2012, down 3.6% year on year. This represent a lower year-on-year decline compared to the one reported in 2011 (-5.7%), in line with the Group's guidance provided at the beginning of the year[1]. This improvement was a result of the higher contribution of revenues from ICT and business solutions and the continuous revenue growth in Slovakia (CZK 4.8 bn in 2012 compared to CZK 3.9 bn in 2011). At the same time, revenues in 2012 continued to be impacted by the prevailing competitive pressures largely in the corporate and SMB mobile segments, and by the regulatory measures (mobile termination rates - the MTR - cuts and lower roaming prices). Other income reached CZK 498 m in 2012, up 2.3% year on year. The main item in this category was the net profit from the sale of 80% of shares in the subsidiary Informační linky, a.s., which exceeded CZK 200 m. Despite the customer base growth and expansion of business activities, the total consolidated operating costs grew only slightly, by 0.4% year on year, reaching CZK 31.2 bn in 2012, as a result of the Group's continuous focus on efficiencies in this area.

The operating income before depreciation and amortization (OIBDA) amounted to CZK 19.8 bn, down 9.2% year on year. OIBDA adjusted for guidance[2] declined 8.9% year on year, reaching CZK 20.9 bn in 2012, while the corresponding OIBDA margin[3] declined 2.4 percentage point year on year, in line with the Group's guidance[4] provided at the beginning of the year, to reach 41.4% in 2012. This represents an above-average margin in comparison with other telecommunication operators in the CEE region, and is a result of a focus on cost efficiency and the positive and growing OIBDA in Slovakia (CZK 1.4 bn in 2012, up from CZK 685 m in 2011).

Operating Income, Income before Tax and Net Income

The consolidated operating income and consolidated income before tax went down 17.7% and 18.5% year on year and reached CZK 8.3 bn and CZK 8.2 bn, respectively, in 2012.
The consolidated net income amounted to CZK 6.8 bn in 2012, down 22.0% year on year. Excluding the impact of the deferred tax in Slovakia booked in 2011 (CZK 709 m), the net income would have declined 15.0% year on year, largely due to the decline of OIBDA, which was not fully compensated by lower depreciation and amortization.

Property, plant and equipment

The net book value of property, plant and equipment reached CZK 46.7 bn at 31 December 2012, compared to CZK 51.5 bn at the end of 2011. The major items included ducts, cables and related

[1] An improvement compared to 2011
[2] OIBDA excluding royalty fees and management fees (2011: CZK 1,166 m, 2012: CZK 1,138 m)
[3] OIBDA excluding royalty fees and management fees over revenues
[4] Limited margin erosion

plant (CZK 25.6 bn), land, buildings and construction (CZK 10.3 bn), and communication technology and related equipment (CZK 9.6 bn), which includes mainly exchanges and transmission equipment. The Group continuously monitors the effective utilisation of its assets reflecting the development on the telecommunication market and technological changes. The Group intends to dispose of any obsolete assets or assets, which are not directly employed in connection with its core business activities. In 2012, the Group achieved a total gain from the sale of the above fixed assets amounting to CZK 285 m.

Cash and Debt levels

On 31 December 2012, the Group's consolidated financial debts (long-term and short-term) amounted to CZK 3.0 bn, broadly in line with the 2011 year-end situation. During the year the Group successfully refinanced its loan repayable in 2012. More information on debt refinancing is disclosed in section Other information for shareholders and investors. The amount of cash and cash equivalents reached CZK 3.0 bn as at the end of 2012.

Capital expenditure

The total consolidated capital expenditure (CapEx, excluding additions from WiFi acquisitions) amounted to CZK 6.2 bn in 2012, up 11.1% year on year, in line with the Group's full year guidance (up to CZK 6.2 bn). The Group continued to direct investments into further capacity expansion and improvement of the quality of its mobile broadband network, in line with the growing demand for mobile data services. In addition, CapEx was spent on a further expansion of the 3G network coverage. At the end of December 2012, the Company's 3G network covered close to 80% of the population. Additionally, the Company focused its investments into the capacity enhancement in its fixed broadband networks. In Slovakia, CapEx in 2012 was largely spent on 3G network expansion and investments into systems improvement. At the end of December 2012, Telefónica Slovakia covered already 53% of the population with its 3G technology. Detailed information on capital expenditure in 2012 is disclosed in section Other information for shareholders and investors.

Cash Flow

The total consolidated free cash flows[5] declined 23.6% year on year and reached CZK 11.5 bn in 2012; a combination of a 16.1% decline in cash from operating activities, largely due to the OIBDA decline, and a 4.5% increase in cash used in investing activities, which was driven by lower proceeds from the disposal of property, plant and equipment and intangible assets. In addition, payments on temporary financial investments (CZK 250 m) impacted the cash used in investing activities. This represents a temporary warranty paid by the Company in connection with its participation in the spectrum auction.

Overview of consolidated revenues

The total consolidated revenues in 2012 reached CZK 50.5 bn, down 3.6% year on year, mainly due to the further cuts in the mobile termination rates, lower roaming prices and the continued strong competitive pressures.

The revenues from voice services (voice – outgoing, interconnection and other wholesale services) reached CZK 16.9 bn in 2012, down 7.2% year on year. Outgoing voice revenues declined 7.9% to reach CZK 9.6 bn due to a lower volume of voice traffic generated in the fixed network, more minutes bundled in the monthly subscription charges and the competitive pressure on per-minute rates. The revenues from interconnection and other wholesale services amounted to CZK 7.3 bn in 2012, down 6.2% year on year, on the back of the mobile termination rates cuts in the Czech

[5] Net cash from operating activities and net cash used in investing activities

Republic and Slovakia, and lower roaming revenues, which have not been fully compensated by the higher transit revenues.

The total volume of mobile traffic[6] carried in the O_2 network in the Czech Republic reached 9,592 million minutes in 2012, up 7.1% year on year; it was supported by successful propositions for both contract and prepaid customers. Voice traffic generated in the fixed network declined 12.7% year on year in 2012, down to 1,315 million minutes, due to the continued trend of voice access losses and the effect of fixed-to-mobile substitution.

The revenues from monthly charges declined 2.9% year on year to CZK 12.5 bn in 2012, largely due to the lower number of fixed voice lines and competitive pressures on monthly charges pricing. This has not been fully compensated by a growth in the contract customer base in the Czech Republic and Slovakia.

The total mobile customer base in the Czech Republic reached 5,083 thousand at the end of December 2012, a 2.9% increase year on year. This performance has been driven by sustained contract customers' growth, whose number went up 4.7% year on year, reaching 3,192 thousand at the year-end. This growth continued to be supported by customers migrating from the prepaid to the contract services, strong customer additions in the corporate segment, growing smartphone penetration and the sustained low rate of churn. At the end of December 2012, contract customers accounted for 62.8% of the base, up 1.1 percentage point year on year. The number of prepaid customers reached 1,891 thousand at the end of December 2012, basically flat year on year, largely due to the higher gross additions and lower number of migrations to contract services as a result of the Company's successful propositions and activities focused on improving customer care with a view of achieving higher customer satisfaction.

The mobile blended monthly average churn rate in the Czech Republic reached 1.8% in 2012, posting a year-on-year decrease of 0.1 percentage point, which was driven by improvements in the churn rate of contract customers. In this segment, the churn rate was maintained at the low level of 1.0%, representing a 0.1 percentage point decline.

In 2012, the mobile blended average revenue per user (ARPU)[7] was CZK 388.5, down 8.3% year on year. Excluding the impact of mobile termination rates (MTR) cuts, the total ARPU would have declined by 6.0%. Continuous voice ARPU dilution, driven by the persistent competitive pressures and the lower spend evolution, were the key drivers in the decline. The contract ARPU reached CZK 517.7 in 2012, down 10.4% year on year (- 8.3% year on year excluding the impact of the MTR cuts). The prepaid ARPU decreased 6.6% year on year in 2012, down to CZK 173.9. The data ARPU declined 4.8% year on year, reaching CZK 111.6 in 2012, which was largely due to mobile internet and SMS/MMS bundling in the monthly subscription charges.

The total number of fixed accesses declined 5.2% year on year to 1.5 m at the end of 2012, while net losses were 82 thousand in 2012, down 6.4% from the situation in 2011. This is largely a result of a solid 20.4% year-on-year growth in naked xDSL access, continuous growth of Voice-over-IP lines and a stabilisation in the trend of fixed access decline.

At the end of December 2012, the total number of customers in Slovakia reached 1,354 thousand, posting a 16.3% year-on-year growth. In 2012, their number increased 190.1 thousand. This performance was driven largely by the strong performance in the contract base, supported by the successful promotion of the O_2 Paušál tariff, which targeted higher-value customers. The number of contract customers grew 32.4% year on year, reaching 659 thousand at the end of December 2012,

---

[6] Inbound and outbound, including roaming abroad, excluding inbound roaming
[7] Including inter-segment revenues

while the number of prepaid customers increased 4.3% year on year, closing at 695 thousand. Consequently, the customer mix in Slovakia further improved and contract customers represented already 48.7% of the total customer base at the end of 2012, up 5.9 percentage point year on year.

The total data revenues went down 1.6% year on year and reached CZK 11.3 bn in 2012. Of that, the revenues from leased lines and fixed data services recorded a 12.6% year-on-year decline to CZK 2.5 bn, mainly due to the lower revenues from leased lines, which were not fully compensated by a growth in the IP based data services. Internet revenues were flat year on year at CZK 5.5 bn, as a result of a combination of factors: a growth in the number of xDSL customers, the migration of existing customers to VDSL and the ARPU dilution driven by competitive pressures. The revenues from mobile data grew 7.8% to CZK 2.8 bn. This is a result of the successful marketing campaign focused on the promotion of smartphone sales, which accelerated the smartphone penetration to a level close to 27% at the end of 2012 (up 7 percentage points year on year), and growth in small-screen internet. This has been supported by the launch of new mobile tariffs, which bundle voice and data services in the monthly subscription fee. In addition, the growth in the number of mobile broadband customers in Slovakia, to which the expansion of the 3G network had contributed, also positively reflected on the mobile data revenues.

The number of xDSL accesses reached 915.1 thousand at the end of December 2012, up 5.0% year on year. With regard to VDSL, 260.2 thousand customers have already subscribed for the upgraded service, which represents 32% of the total xDSL residential base and 66% of the total addressable existing base (~ 50% of households). The total number of O_2 TV customers reached 141.4 thousand at the end of 2012, up 4.3% year on year, which is a solid achievement in the stagnant Pay TV market in the Czech Republic.

Other consolidated revenues reached CZK 9.8 bn in total in 2012, same as in 2011. Of that, the revenues from SMS, MMS, PRMS and content services were down 3.8% to CZK 4.6 bn, mainly due to the more integrated SMS/MMS bundling. The revenues from equipment and activation charges reached CZK 1.6 bn in 2012, which translates into a 4.8% year-on-year decline. The revenues from ICT and business solutions reached CZK 2.5 bn, up 8.1% year on year. The Group successfully forged ahead with the marketing of its standard ICT services to business customers (Managed Services/Cloud/Security/Virtual Desktop) to mitigate the dependency on one-off projects, which has helped to sustain revenue growth despite the lower spending in the public sector.

Overview of consolidated operating expenses

Despite the customer growth and the related higher commercial expenses, and the expansion of business activities, the total consolidated operating expenses of Telefónica CR Group were broadly flat year on year, reaching CZK 31.2 bn in 2012. The Group's continued focus on strict financial discipline, which is aimed at further optimisation of the structure, processes and management, was the key driver for that performance.

The consolidated interconnection and roaming expenses went down 3.8% year on year to CZK 8.8 bn in 2012, in line with the lower interconnection revenues; this trend was largely due to the cuts in the mobile termination rates and the roaming prices. The cost of goods sold reached CZK 2.1 bn in 2012, representing a slight 1.9% year-on-year decline. Other direct costs of sales grew 10.6% year on year in total to CZK 3.8 bn. Higher sub-deliveries, which increased 20.8% to CZK 1.2 bn due to the higher volume of sub-deliveries in connection with ICT projects, were the key driver in the growth of other direct costs. Despite the higher commercial activity, commissions went up only 1.3% to CZK 1.8 bn in 2012, due to the focus on efficiencies in the sales area.

Staff costs including redundancy payments reached CZK 5.8 bn in 2012, down 5.5% compared to 2011. Excluding redundancy payments (CZK 265 m in 2012 and CZK 174 m in 2011), the staff costs declined 7.2% year on year, with a positive impact of the restructuring program. The total Group headcount declined 8.9% in 2012, and as at 31 December 2012 it stood at 6,275 employees.

Other operating expenses including capitalized own expenses on fixed assets reached CZK 10.6 bn in 2012, up 5.0% year on year. The higher costs of network & IT repairs and maintenance were the key driver in the growth. This cost category went up 14.5% to CZK 3 bn, due to the outsourcing of IT support services to Telefónica Global Technology in December 2011. The company provides IT support for Telefónica's businesses in the Czech Republic, Slovakia and Germany. However, the expense has been more than compensated by the savings in the related personnel costs. As to other cost categories, it is worth noting the 2.4% decline in the cost of leases, buildings and vehicles to CZK 2.1 bn, which had been brought on by the more efficient utilization of buildings and the car pool optimization. Savings have been recorded also in billing and collection and in the provisions for bad and doubtful debts, which decreased 2.8% year on year in total, down to CZK 808 m. The Group recorded a slightly higher cost of the utilities, which amounted to CZK 1.1 bn in 2012, and was mainly caused by the higher energy prices; measures to reduce energy consumption have not fully compensated the higher costs.

The outlook for 2013

In 2013, the Group will closely monitor customers' needs in the challenging macro-economic environment which can impact their consumption patterns. In addition, the outcome of the spectrum auction may result in significant changes of the mobile market dynamics. Nevertheless, the Group is confident that it will be able to maintain market leadership in its core businesses through a continuous focus on its strengths: the best value and unique fixed and mobile broadband based products and services including a bundled proposition, ICT and digital services with a pro-growth potential.

The Group will keep focusing on a further improvement of the customer relationship area through additional investments in the optimisation and alignment of its systems and processes. These initiatives seek to deliver a lower number of customers's complaints and negative and repeated calls, consequently improving customer experience and satisfaction - which remains the top Group's agenda also in 2013. In line with its strategy to protect its customer base and to mitigate the negative impact of highly competitive market environment on customers' spend, the Group will focus on active execution of customer value management. In the corporate segment, it will aim at increasing the number of exclusive customers to maintain its strong position in this area, supported also by development and promotion of ICT & Digital services (cloud, security, M2M). The Group believes this strategy will help it to limit its dependency on one-off projects, secure sustainable revenues and grow a profitable business.

Additionally, the Group will continue with enhancing its fixed broadband proposition through additional expansion of the upgraded VDSL network coverage by means of selective FTTN investment, in order to strengthen its market position. In mobile broadband, it aims at a further enhancement of its 3G network capacity and quality, including backhaul, to exploit the opportunity of smartphone and data uptake. Moreover, the Group is ready to commence 4G network deployment, which will allow it to keep its competitiveness on the mobile broadband market. The 4G network deployment scope and speed will depend on the outcome of the spectrum auction.

Telefónica Slovakia will continue with its fair and transparent commercial proposition targeting higher-value customer segments. By doing this, the company seeks to achieve a solid growth in the number of subscribers, which would help it increase its market share. At the same time, Telefónica

Slovakia will stay focused on further improvement of its financial performance through lean operation, to compensate for the higher competitive pressures.

The Group expects that mobile non-SMS data revenues, ICT & digital revenues and revenues in Slovakia will remain the key top-line growth drivers also in 2013. At the same time, the mobile revenues will be challenged by additional MTR cuts. In this operational environment, the Group will maintain its focus on improving operational efficiency in all areas of its operation through the execution of the transformation program to protect its solid profitability. The efficiency agenda in 2013 will include further headcount optimization by means of building a leaner and more efficient organisational structure, with increasing the span of control. In addition, the Group will continue to consolidate and optimize its call centres, and streamline and simplify its product portfolio aiming at reducing the number of processes. Additional costs savings will be delivered through a focus on online activities, largely in sales and customer related areas. The Group is confident that the above mentioned measures will help it to maintain best-in-class profitability despite pressures on the revenue performance.

With regard to capital expenditures, the Group will continue to direct its investments primarily into the upgrade and expansion of its fixed and mobile broadband networks, and capacity improvement of the mobile broadband networks, including the deployment of the new 4G network, all with a view of sustaining its competitiveness and delivering future growth.

Based on that, the Group gives following guidance for 2013:

	2012 base	**2013 guidance**
OIBDA margin[8]	41.4%	Limited margin erosion y-o-y on the back of the continuous efficiency agenda
CapEx[9]	CZK 6.2 bn	Less than CZK 6 bn increasing proportion of investments in growth areas (mobile data, LTE and new technologies/ businesses)

[8] OIBDA before brand fees & management fees; 2013 guidance excludes changes in consolidation, includes potential capital gains from non-core asset sales, assuming constant FX rates of 2012

[9] Excluding business acquisitions and excluding investments made in connection with the spectrum licence

03

Corporate social responsibility

We support young people. Our programme **Think Big** motivates and encourages them to change the life around them for better. We help them to show other people what the young generation loves doing.

7. Corporate Social Responsibility (CSR)

7.1 Introduction

Telefónica CR understands corporate responsibility as a way of managing its business in relation to its interest groups. The Company is successful as long as it is capable of making a positive impact on economic, technological and social progress through its activities.

In other words, the way in which the business and financial objectives are met, is just as important as the results themselves. Thus, Telefónica CR sustainability strategy it's implemented across the business through the management of risks in our business, searching for opportunities linked to the impact of our services in society, and through proactive stakeholder engagement.

In 2012, Telefónica CR was included in CEERIUS Sustainability Index 2012 (CEE Responsible Investment Universe). The sustainability index of the Vienna Stock Exchange for Central Europe includes companies which are market leaders based on their community and sustainability oriented qualities. As a member of the Coalition for Transparent Business, Telefónica CR published in 2012 all tenders in which it held some interest. The key partnership with Business for Society and the Business Leaders Forum has helped anchor our CSR strategy. In 2012, Telefónica CR's sustainability activities were recognized with several prestigious awards. In the esteemed TOP Responsible Company 2012, the Company won the Responsible Product and Marketing category with its model of serving customers with disabilities; the Company also came second in Employee Engagement with its employee volunteering programmes. Telefónica CR's Think Big programme also came fourth in the Best Community Project category. Likewise, the fourth place in the Corporate Donor category, measured by the absolute volume of corporate donations in the given year, also went to the Company. Telefónica CR was a partner of the TOP Responsible Small Business category.

Telefónica's sustainability performance is verified independently by Ernst &Young through the annual audit and monitored internally by the Telefónica Governance Committee.

The year 2012 was full of achievements for Telefónica CR in the area of corporate social responsibility: its community programme Think Big, which supports young people in making their ideas of a better community come to life; a successful employee engagement strategy; greater energy efficiency; tackling of challenges facing the society in connection with the opportunities coming with the digital world; improvement in the ethical conduct of employees; and a more sustainable supplier chain. Each of these areas is covered in more detail in the following sections.

7.2. Telefónica Business Principles

Corporate culture and reputation are among the priorities of the Telefónica Group. Our Business Principles is the document which reflects the current priorities of the Telefónica Group.
The Business Principles are a set of 42 principles that Telefónica CR sees as a vehicle for gaining and keeping the trust of customers, shareholders, employees, contractual partners and the public at large. Key principles include: 'no' to corruption regardless of its form; conformity with the law; and protecting information and privacy.

In 2012, Telefónica CR continued to promote the Business Principles among the employees by means of an online course. The course is fully integrated in the standard training portal, with the benefit of improved user comfort. Employees train in the Business Principles every three years; as at 31 December 2012, 94% of all employees held a valid certificate of completion of the Business Principles course.

Employees have the duty to report unethical conduct constituting a breach of the Business Principles which they may come across; the Company guarantees anonymity for the whistleblower by available whistle-blowing tools. Employees can report unethical conduct in several ways: they can choose between an online application, e-mail, letter addressed to the responsible officer (Compliance Officer) or visiting in person. Employees have also the option to approach trained consultants from Human Resources, Security and Legal Affairs. The reports are investigated by Security or Internal Audit in collaboration with the Compliance Officer. There are also instruments of higher instance available: escalation of the report to the Business Principles Office of the parent Telefónica, or the instruments available at the European division of the group, Telefónica Europe. Reporting suspected irregularities in accounting, internal control systems and accounting audit of the Company or the Group is made through a dedicated whistle-blowing channel leading directly to the parent Telefónica. Activities in the area of ethical conduct and Business Principles enjoy a full support from the governing bodies and the executive management; they are supervised by the Ethics and Corporate Social Responsibility Committee and, through this body, by the Supervisory Board. The effectiveness of the whistle-blowing instruments (and of the subsequent investigations) is regularly monitored by the Ethics and Corporate Social Responsibility Committee. The Internal Audit unit of Telefónica CR regularly audits the compliance with the Business Principles.

The Business Principles is a fundamental policy of the Company, which is a part of the Work Regulation and employees are required to comply. The brochure Our Business Principles is given to every new employee upon their commencement of employment as part of their orientation training, in which a special section is dedicated to the Business Principles and to the values of the O_2 brand; the publication can also be downloaded from the Company's intranet and website.

The Business Principles assert that Telefónica CR is a company that is a trustworthy partner to its people and customers alike.

7.3 Market conduct and customer care

Products and services for people with specific needs

As in the previous years, also in 2012 the Company focused on helping and supporting people with specific needs. People with some form of a physical limitation were in the centre of attention this year. In 2012, Telefónica CR continued offering several models of mobile phones designed specifically for senior citizens or people who find it hard to work regular-sized buttons. As a matter of course, the Company offered terminal equipment for people with hearing impairment, as well as devices capable of converting text and voice, from which partially sighted or sightless customers benefit.

The Company also offered Neon Senior, a tariff intended specifically for senior citizens. Telefónica CR also went live with its website www.o2myslimena.cz, where customers get a complete overview of the options the Company offers, and the related terms and conditions. Customers will also find here a special form, which will instantly calculate their disability discount, i.e. how much they will pay for their tariff of choice after the disability discount, and what they need to do to claim the discount. They can also directly arrange an appointment with one of our O_2 Gurus.

The O_2 Guru team, as well as other O_2 brand store staff, went through a special training in communication with customers with some kind of physical disadvantage in 2012. The courses were interactive and had been developed by instructors who have the handicap themselves. Employees of Telefónica CR could thus see for themselves what it is like when the customer is hard of hearing, sightless, or wheelchair-bound in the store. A total of 200 Telefónica CR employees went through the training.

Deaf Call

Also in 2012, the Company continued to operate Deaf Call. Operators processed 30,000 calls from registered users in 2012 and customers base increased 44%. A new communication channel using a DSP telephone went live in the middle of January 2012, which allowed customers to communicate online, in real time, with the help of an online application. Customers could also download the application to their smartphones. From February 2012, Deaf Call started the distribution of sponsored automated voice services (Sazka, Sportka, Šťastných 10, Euromilióny, weather forecast, etc.). In April 2012, Deaf Call launched a dedicated section at www.o2myslimena.cz, which, among other things, let customers use the fast registration feature.

Discounts

Also in 2012, Telefónica CR offered a discount equalling the amount of the state contribution to people with a dependency of the 1st degree, and a discount on the O_2 fixed-line service.
The discount was claimed by a total of 45,418 customers.

INSPO 2012 conference and the competition 'Internet, Mobile Phone and My Handicap'

The Company was again in 2012 the General Partner INSPO: a conference on the 'Internet and Information Systems for Persons with Special Needs', the only event of its kind in the Czech Republic. The Company's representatives presented Deaf Call and Emergency Care services for people with disabilities and senior citizens, which they followed up with a demonstration.
In addition to financial support to the conference, the Company also donated gifts for the speakers and the winners of the writing competition 'Internet, Mobile Phone and My Handicap, whose results were announced at the INSPO conference. The winners walked away with smartphones and two year's worth of free internet.

Telefónica CR's open approach to serving customers with specific needs has earned a victory in the category Responsible Product and Marketing at the 2012 TOP Responsible Company Awards.

Online safety

We help to guide children safely through the world of communication technology

As a provider of communications services, Telefónica CR is committed to using all available means to help eliminate potential risks that come with modern technology. Protecting children and creating a safe environment for them in the world of information and communication technology has always been a key priority with regard to the Company's customers. Several specific actions were taken in the area of child protection.

Supporting projects in the area of child protection

As is already a tradition, in February 2012, the Company joined the celebrations of the International Safer Internet Day, together with the National Centre for Safer Internet. In 2012 we also continued our programme of employee workshops dedicated to the topic of safer internet. A total of 150 employees went through the course.

40 O_2 Gurus, who in Telefónica CR's brand stores help customers to make their devices safer, also received training in safe usage of smartphones and the internet. O_2 Gurus were also helping smartphone users, by means of video tutorials in our YouTube channel, with concrete tips how to keep devices secure.

In April 2012, a facebook campaign called ‘Internet Guard’ helped to promote the tools of parental control and educated the public about the most common risks lurking online. Facebook fans played almost 30,000 games, achieving more than 400% of the compliance expectations.

In 2012, Telefónica CR also linked the section Keep Kids Safe to the homepage of its website www.o2.cz, where parents can find an easy guide with information and tips how to avoid the risks associated with using the internet or smartphones. The same content for parents can be found also at www.o2myslimena.cz.

Also in 2012, Telefónica CR gave its support to a conference of experts, which was held in the Senate of the Czech Parliament and was organised by the National Centre for Safer Internet. The conference was titled ‘Cybercrime – Prevention and Legislation: Parents’ Attitudes Do Nothing to Help The Children!’

The end of 2012 saw already the 10th Cyberspace International Conference, which explored the effects of the internet on the society and which was organised by the Faculty of Law, Masaryk University, in collaboration with the Institute of Law & Technology of the same institution. Telefónica CR was the general partner of the event.

In 2012, Telefónica CR also became general partner of the project ŠIK cz. The Company produced ‘Communication in Your Pocket’, a series in twenty parts, which explored the issues of prevention of risky behaviour of children and teenagers online and with smartphones. Each of the twenty 1.5 minute spots focused on a particular issue and featured O_2 Gurus, who, in a spontaneous and informal way, gave useful tips and information to the viewers. The spots were broadcast in 277 elementary and 103 secondary schools in the Czech Republic. The content reached more than two hundred thousand children and students and is now available on the O_2 YouTube channel for all to view.

Telefónica CR, as signatory of the European Commission’s initiative CEO Coalition to make the Internet a Better Place for Children and following its Statement of Purpose, joined forces with other 30 signatories and worked on the specific actions planned for 2011–2012. In 2012, customers could use a simple and visible button feature on the website www.o2.cz to report possible harmful content of any website directly to the hotline. In 2012, Telefónica CR continued to offer Internet Guard, a product which will protect PCs from viruses, malicious code or unauthorised access to data. Customers could use it to block websites with doubtful content, so the product doubled up also as a parental lock or control over the children’s online habits. Telefónica CR used the IWF list to block websites with child abuse content in 2012.

7.4 Caring for employees and the workplace environment

It is the Company’s long-term strategy in the area of human resources to be ‘a place which is a pleasure to work at’. A new ‘charter’ between the Company and its employees was agreed last year, which describes in detail what the Company plans to achieve in various areas and what should be the contribution of employees towards the goal. Some areas are already well underway, whereas others are scheduled for the next few years, as per the work plans.

	Number of employees as at 31 December 2012
Employees – total	5,861
Women	35.61%
Men	64.39%
Employees with reduced work capacity or disability	0.81%

Organisation unit	**Employees (actual) as at 31 December 2012**
Strategy and Business Development Division	156
Corporate Division	1,081
Consumer Division	1,546
Operations Division	2,110
Corporate Affairs	17
Human Resources	137
Support Services	263
Finance Division	246
Legal, Regulatory & Public Affairs Division	43
Internal Audit and Risk Management	14
Marketing Division	182
Office of the Chief Executive Officer	3
DHL	63
Total	**5,861**

Employee engagement

Reflect

The interest in and the motivation of employees to participate in the internal satisfaction survey remained at the very high level of 91%. The overall Reflect Index was up 2 percentage points year on year. The outcome was regarded by the management as a success, especially as the year ushered in many changes. Effectiveness of the executive team, credibility and availability are areas where there is still a room for improvement.

Global Bravo Awards

As part of its global Bravo strategy, Telefónica introduced Bravo Awards for the best employees of the Company. Employees could nominate themselves or their colleagues for activities that are helping Telefónica CR stay ahead of the telecommunications field.

Improving work-life balance of employees

Telefónica CR realises that giving the employees an option to work from home is a win-win situation for all involved – the employees, the Company and its customers. Any employee, whose job character allowed for this option, could talk to their manager about working from home. Employees working from home have a company mobile and internet connection to facilitate this style of working. The Company also allowed employees, conditional on the relevant manager's consent, to work part-time. Parents of children of pre-school age could also use employee bonuses from the so-called cafeteria, which were redeemable against pre-school care.

Telefónica CR supports, if the nature of the work allows, that moms work part-time. **Starting from 1 September 2012,** our colleagues leaving for their maternity leave can use the option to set a date of return to work with their manager, and claim a contribution of up to CZK 8,000 a month for institutionalised childcare and schooling services.

Education and personal development

Orientation training for new employees

As in the previous years, also in 2012 all new employees attended Welcome Day, a one-day seminar at which they learned a lot of useful information for getting to know and finding their way within the Company. Individual divisions also organised special adaptation courses for their newcomers (business sales, call centres, marketing, etc.) to seamlessly and expediently introduce the new colleague to the job.

Basic management skills

In 2012 we completed the definition of management skill profiles for call centre managers; these serve as an easy tool for the evaluation of achievement of personal development plans, as well as for their planning. We are presently working on the definition of a competence model for brand store managers. At the same time we cooperate with our European colleagues on the development of a general competence matrix, which will eventually apply to individual management levels based on seniority.

Leadership

Leadership and the development of it is the theme of several parallel educational activities. Managers can enrol in the management courses at Telefónica University Barcelona. Also, since 2011, the project People Leaders is available, which combines several development tools – the workshop Leadership Proposition, several feedback-based assessments, Body Concept and a systematic evaluation of achievement of the individual development plans. All senior and middle managers have been through the programme since its start in 2011. The plan is to roll out the programme concept to all operative managers. Another programme which seeks to develop management skills through training and feedback giving, is the so-called Supervisor Academy.

Motivation and remuneration

Employee shares plan

Also in 2012, employees could invest in the shares of Telefónica S.A. This option was chosen by more than 600 employees who can invest up to EUR 1,200 over a period of 12 consecutive months. If the shares are held for a minimum of 12 more months starting from the end of the twelve-month acquisition period, the Company will match every share purchased with one share, subject to the rules of the scheme.

Employee benefits and motivation programmes

Telefónica CR offers a wide range of employee benefits. Employees can choose from financial products, products and services of the Company or various other benefits in the area of health, education and work-life balance. Employees with reduced work capacity also received a voucher for restorative physiotherapy holiday in the value of CZK 10,000 per year. In addition, various competitions were held throughout the year, for the employees to enter – e.g. to mark the launch of campaigns, with the aim of increasing employee participation in the life of the Company.

Health Promoting Enterprise

The year 2012 marked already the eight year of Health Promoting Enterprise. The competition is organised by the State Health Institute in Prague, under the auspices of the Ministry of Health of the Czech Republic. The 'badge' is given for a period of three years – Telefónica CR has been awarded four times already, now reaching Class III, which means 1st place among other entrants. All shortlisted companies have a documented track record of caring for their employees' health, focussing on prevention and activities associated with healthy living.

7.5 Caring for the environment

Environmental protection policy

The commitment of Telefónica CR to keep the footprint of its operations on the environment minimal was also in 2012 anchored in the Company's long-term strategy and the updated Environmental Policy. The Environmental Policy focuses on the elimination, or at least the mitigation, of damage to or degradation of the environment – in its whole or in part and with regard to the Company's sphere of activity; in doing so, the company uses the latest research. Telefónica CR's fundamental principles of environmental protection were coordinated across the Telefónica Group, and helped to deliver on both the group and local objectives and to meet the statutory and other conditions.

Telefónica joined the United Nations' Montreal Protocol. The initiative looks to create a programme which would employ information technology in monitoring of climate change and improving energy efficiency – thus underlining the role new technology plays in sustainable economic growth. The protocol was signed by more than 170 participants of the Symposium on ICTs, the Environment and Climate Change, which was held on the occasion of the World Environment Day on 5 July 2012.

Reducing environmental footprint

In 2012, Telefónica CR forged ahead with its campaign to reduce its own environmental footprint. Compared to 2011, the volume of fuel used for business travel went down 6.5%; gas consumption went down by up to 20.7%; distributed heat consumption went down by up to 3.2%; water consumption was down 19.4%; and 4% less electricity was used.

Certification

Telefónica CR has implemented and certified an environmental management system according to the international standard ISO 14001. We were the first telecommunications company in the Czech Republic to receive the certification already in 2002. The fundamental principles of sustainability were a part of a policy coordinated across the whole Telefónica Group.

Green Company

Also in 2012, Telefónica CR arranged for collection of electrical waste (mobile phones, notebooks, as well as small domestic appliances) and used batteries from employees. The Company also enrolled for the Green Company programme organised by REMA Systém.

Some of our brand stores were in 2012 also collection points for old mobile phones, which were then sent for sustainable recycling. Each such device turned in for recycling has earned a contribution of CZK 25 to the Safety Line from Telefónica CR. In 2012, Telefónica CR encouraged its employees to cycle to work as part of the eponymous campaign. Nine teams enrolled, which clocked up a total of 7,875 km.

Telefónica CR also joined the Earth Hour in 2012. All logos on the Company's buildings were switched off; and the lights in offices and brand stores were dimmed to the necessary minimum. Employees spent more than 4,000 hours of environmental training in 2012.

Green Open Air Festival

Already for the third year running, Telefónica CR, General Partner to Open Air Festival in Panenský Týnec, was in charge of its sustainable format. The sustainability zone O_2 Oasis sought to educate the visitors, through interactive sessions, in the various aspects of the environmental strategy. Waste recycling and an organised clean-up already became a tradition. All these activities helped Telefónica CR and the festival promoter to jointly defending the ‘Commended’ rank in the 2012 Greener Festival Awards.

7.6 Supporting communities

Community-oriented and philanthropic projects were deeply rooted in the Company’s CSR also in 2012. Telefónica CR strived to put its technology to use in helping to improve the quality of life. Already for the tenth year running, O_2 Foundation, which celebrated its 10th anniversary in 2012, was the key instrument in transparent and systemic corporate donorship. During its existence, the foundation’s total donations reached the sum of CZK 171,913,000, of which CZK 5,223,000 came from Telefónica CR’s own employees. Employees also invested a total of 76,720 hours as volunteers in their communities.

The total value of donations, gifts and telecommunications services provided by Telefónica CR to or for the benefit of charitable projects in 2012 exceeded the mark of CZK 50 m.

Think Big

The O_2 Foundation continued with the community programme Think Big in 2012.

The goal of the long-term programme is to support informal groups of young people between 13 and 26 years of age in making their ideas and projects, through which they want to change, improve or create something of value in their own community, into reality.

Grant applications are reviewed by nine regional committees, each comprising two employees of the Company, one expert in non-profit and youth leisure activities, one media representative and one young person already with some experience with implementation of such projects.

The project teams receive, in addition to financial support ranging from CZK 10,000 to CZK 70,000, also a place on a three day course, several O_2 services and mentoring from employees of Telefónica CR.

The second call for projects under the Think Big programme, which was published at the end of 2011, garnered 376 applications. The evaluation committees chose 130 projects. Young people implemented the projects over the course of six months, from March until September 2012. The O_2 Foundation distributed among young people close to CZK 7.5 m in this cycle of grants.

In the third round of grants, which started in May 2012, the O_2 Foundation received 397 applications, of which 174 were successful and received funding. The O_2 Foundation distributed over CZK 9 m among them.

The fourth round of Think Big grants was announced by the O_2 Foundation in autumn 2012 and garnered 484 applications. The chosen projects will be implemented again in spring 2013.

The O_2 Foundation presented the chosen projects all year round on the programme’s website www.o2thinkbig.cz, on its facebook page and in other online and print media. The programme also produced three documentaries about seven successful projects, which were aired by the Czech Television in autumn.

Think Big and a team of selected beneficiaries presented also abroad: at the Campus Party in Berlin and at One Young World conference in Pittsburgh.

Think Big School

At the end of 2012, Telefónica CR started Think Big School, a new programme for young people. Think Big School takes the form of an interactive day for second- and third-year secondary school students, and aims to foster their enterprising spirit, self-confidence, orientation in the world of digital technology and belief in their own ideas. Under guidance of volunteers from the ranks of Telefónica CR employees, students get valuable experience and skills in project management and teamwork. Students work on their idea during the day, produce a website for it with the help of Thimble, and then they present their project before a panel of Telefónica CR employees.

Three one-day pilot days took place in November and December 2012, at which more than 90 students from Czech secondary schools participated.

The plan is to reach out to 1,200 students in 2013.

Safety Line 116 111

The O_2 Foundation celebrated eighteen years as General Partner to the only free and anonymous helpline for children who are faced with a difficult life situation. In 2012, the Think Big programme supported Moneyboxes for Safety Line, a project of young glassmakers from Nový Bor. The Safety Line got 40 original moneyboxes for donations, which were placed in hotel lobbies, and the proceeds were used to cover some of the Safety Line running costs.

Senior Line

The O_2 Foundation continued in its support to Senior Line operated by Elpida Plus o.p.s. Senior citizens could dial the number 800 200 007 and share their concerns and joys, consult on various issues – health, legislation, psychology and welfare – with the operators. The funding from O_2 Foundation helped to keep the service free. In 2012, Think Big supported the intergenerational project The Wall 537 Faces, in which students of a secondary art school created a unique wall with portraits of senior citizens, the aim of which was to communicate street art to the older generation. The project was recognised by the European Commission as a ‘best practice’ in the Year of Ageing and Intergenerational Solidarity in 2012.

Stop Bullying!

The O_2 Foundation continued as a partner of Stop Bullying! in 2012. The foundation was the General Partner of the online counselling service at www.minimalizacesikany.cz.

Volunteer programmes for employees

Telefónica CR’s primary goals in the area of its socially responsible activities is to promote corporate volunteering – to create opportunities for its own employees to take part in community projects and help with the projects of the O_2 Foundation.

A total of 1,842 employees volunteered in their communities in 2012.

In 2012, 871 employees donated a total of CZK 624,945 in the successful fundraising campaigns.

The solidarity of employees also helped make the life easier for 31 people. A donation of CZK 476,764 allowed them to purchase much needed health aids. Employee donations also went to benefit the Safety Line, Senior Line and children in South America.
Employees regularly participated in volunteer events and helped with their time, knowledge and skills.

Telefónica CR continued to support corporate teambuilding events turned into volunteer events – managers and their teams worked in non-profit organisations. In 2012, 589 employees (20 teams) donated over 4,700 hours of work to non-profit organisations.

Four volunteer weekends were held during the year; employees could also volunteer to ‘Give Blood with O_2 Foundation’ or to become mentors in the Think Big programme.

As is already a tradition, the Telefónica International Volunteer Day was held in autumn. 514 employees helped out in 23 non-profit organisations.

In 2012, a total of 1,142 employees spent 23,576 of their time working in their communities.

On Easter and Christmas markets, which were organised by the O_2 Foundation in eleven of the Company’s buildings in the Czech Republic, products hand-made by people with disabilities in sheltered workshops were sold to employees. In 2012, employees spent close to CZK 400,000 on products from fifty sheltered workshops.

International Volunteer Programme Volunteering Holidays

Volunteer activities of employees in 2012 again transcended the limits of the Czech Republic as three employees of the Company participated in the international volunteer programme Volunteering Holidays implemented by Telefónica in Latin America. Employees used their own holiday allowance to go and help, each investing more than 336 hours of their time.

Altogether 99 volunteers hailing from twenty countries where Telefónica operates were sent to Ecuador, Brazil, Guatemala, Argentina and Colombia. After arriving to their destination, their role was to add meaningful content to the free time of children who, once their school finishes, either roam the streets or have to work.

Give Blood with O_2 Foundation

The traditional volunteer blood donation campaign was held in the Company’s premises in 2012. Over the course of four days, 120 employees (some repeatedly) gave more than 98 litres of blood. The project Give Blood with O_2 Foundation has a partner in the Military University Hospital Prague. The O_2 Foundation plans to continue this project also in 2013.

04

Corporate governance

O2 is one of the brand leaders in the Czech Republic. We will continue to build our best image in the industry.

8. Corporate governance

8.1 Corporate governance of the Telefónica Czech Republic Group

In terms of organisation, Telefónica CR is a part of Telefónica's European division (Telefónica Europe), which holds all companies that use the O_2 commercial brand regardless of ownership relationships within the Telefónica Group. No significant changes occurred in the ownership structure of the Company Telefónica S.A., still holding a 69.41% stake, remains the majority shareholder.

Telefónica CR's ownership rights in its subsidiary companies are exercised by the Board of Directors. Personnel changes in the statutory and supervisory bodies of subsidiary companies and in companies in which Telefónica CR holds an ownership interest (in positions occupied by the Company's representatives) are approved by the Board of Directors of the Company.

Telefónica CR has a position of Company Secretary is at the executive level in the new Corporate Governance Model of Telefónica CR formally combined with that of General Counsel (Director, Legal, Regulatory and Public Affairs).

8.2 Subsidiaries, associates and other ownership interests

The structure and number of companies in the Telefónica Czech Republic Group changed in 2012 from the situation described in the 2011 Annual Report. Below are the changes that occurred in the reported period:

Telefónica O2 Business Solutions, spol. s r.o.

In February 2012, the Board of Directors of Telefónica CR approved the project to merge the subsidiary Telefónica O2 Business Solutions, spol. s r.o., by consolidation into Telefónica Czech Republic, a.s. In April 2012, the project of a national merger elaborated by the Board of Directors of Telefónica CR together with the statutory executives of Telefónica O2 Business Solutions, spol. s r.o. was written up in the form of a notarial record. On 1 July 2012, the merger was recorded in the Commercial Register, which effectively wound up Telefónica O2 Business Solutions, spol. s r.o., with all its business assets, including any rights and obligations under labour law relationships, having been transferred to Telefónica Czech Republic, a.s.

Informační linky, a.s.

In February 2012, Telefónica CR entered into an agreement to sell 80% of shares in its subsidiary Informační linky, a.s. The agreement also contained an option for the sale of the remaining 20% in the company. This step came after the incorporation of Informační linky, a.s., on 1 January 2012, by way of spinning off a part of the business – the unit Information and Assistance Services, which operates the numbers 1180, 1181 and 1188.

Internethome, s.r.o.

In May 2012, the Board of Directors of Telefónica CR decided to increase the registered capital of Internethome, s.r.o., from CZK 200,000 to CZK 67,765,000. The registered capital was increased by an in-kind contribution of parts of the business of Telefónica CR. The transfer to Internethome, s.r.o. was effected based on an agreement to contribute a part of the business, which was approved by decision of the General Meeting on 19 April 2012.

Bonerix s.r.o.

On 26 June 2012, Telefónica CR entered into a contract to transfer an ownership interest, which made it the sole member in Bonerix Czech Republic s.r.o., a company with the registered capital of CZK 200,000. In September 2012, the Board of Directors of Telefónica CR decided to change the company name to Bonerix s.r.o.; an agreement was concluded at the same time, under which Bonerix s.r.o. acquired five parts of businesses of the Global Care group: Global Care, s.r.o., TMT Czech, a.s., Hermod, a.s., Česká servisní a správní, a.s., LAKENSIS, a.s. The transaction value exceeded CZK 300 m. This has entrenched the Company's position in the area of employee programme management; its goal is to offer global clients and the participants in their employee programmes the standard of care they expect. Global Care group had a base of approximately 70 thousand participants in employee programmes, with whom it had direct contracts for telecommunications services. This situation has been rectified; furthermore, the capacity and know-how of Telefónica Czech Republic makes it possible to extend quality care in the area of employee programmes also to other corporate clients.

Telefónica Slovakia, s.r.o.

In November 2012, the Board of Directors of Telefónica CR decided to institute a supervisory board in Telefónica Slovakia, with David Melcon, Martin Bek and František Schneider as members. The supervisory board was instituted with regard to the requirements of the Slovak National Bank attached to the licence for payment services. For more information about the subsidiary please refer to the section on Telefónica Slovakia.

SUBSIDIARY COMPANIES				
Company name	**Registered business**	**Identification no.**	**Registered/share capital**	**Telefónica CR's share**
CZECH TELECOM Austria GmbH	Public service of leased lines over a fixed telecommunication network	FN 229578s	EUR 35,000	100.00%
CZECH TELECOM Germany GmbH	Leased lines	HRB 51503	EUR 25,000	100.00%
Telefónica Slovakia, s.r.o.	Operation of a public telecommunication network; public telecommunication service of leased lines	35848863	EUR 240,000,000	100.00%
Internethome, s.r.o.	Provision of WiFi internet access	24161357	CZK 67,765,000	100.00%
Bonerix s.r.o.	Operation of a public mobile communications network; public telephony; data transmission; internet access	24215554	CZK 200,000	100.00%

AFFILIATE COMPANIES				
Company name	**Registered business**	**Identification no.**	**Registered/share capital**	**Telefónica CR's share**
AUGUSTUS, spol. s r.o.*	Consultancy and agency in the non-telecommunications area	49356160	CZK 166,000	39.76%
První certifikační autorita, a.s.	Certification services in the field of electronic signature	26439395	CZK 20,000,000	23.25%
MOPET CZ a.s.	Real-time mobile payment services	24759023	CZK 104,000,000	14.29%
Informační linky, a.s.	Manufacturing, trade and services not listed in annexes 1-3 to the Trade Licensing Act	24200077	CZK 150,000,000	20.00%
Tesco Mobile Slovakia, s.r.o.**	Trade agency; service agency; trade, organisation and economic consultancy	36863521	EUR 5,000	50.00%

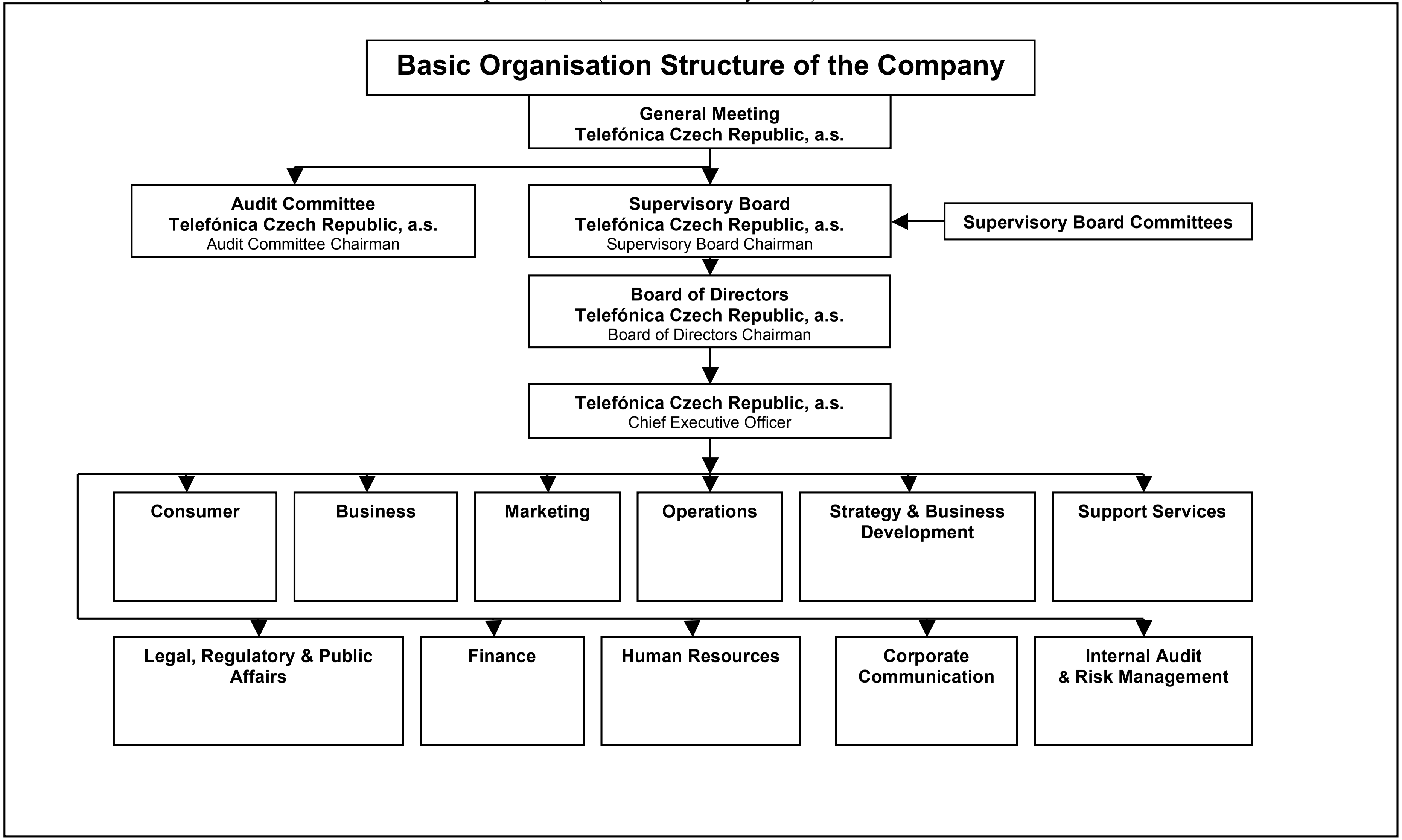
* Telefónica CR does not control the company.
** Owned through the subsidiary Telefónica Slovakia, s.r.o.

8.3 The organisation of Telefónica CR

No principal changes occurred in the organisation structure of the Company in 2012 from the situation described in the 2011 Annual Report and the 2012 Half-year Report.

The first executive level of the organisation is divided into divisions and specialised units led by employees of the Company, including all director positions.

Executive macrostructure of Telefónica Czech Republic, a.s. (as at 31 January 2013)



8.4 Governing bodies and Executive management of the Company

Telefónica CR has the following governing bodies:

- General Meeting
- Board of Directors
- Supervisory Board and its committees
- Audit Committee

8.4.1 General Meeting

The General Meeting is the supreme governing body of the Company in matters related to its business, organisation and operations. The General Meeting is called by the Board of Directors at least once a year, to take place within six months from the last day of the accounting period. It is convened by way of a written invitation sent to all shareholders no later than 30 days prior to the date of the General Meeting. The General Meeting constitutes a quorum if shareholders holding shares or equivalent securities with the nominal value exceeding a half of the share capital of the Company are present. Voting is by ballot signed by the voter. The General Meeting decides by a simple majority of votes present; any changes to the Articles of Association are decided by a two-thirds majority of all votes present.

The General Meeting has the exclusive authority to:

- approve the Rules of Procedure of the General Meeting;
- decide on amendments to these Articles of Association, unless any change which occurred under any other legal circumstances is involved;
- decide on an increase of the share capital or on the authorisation of the Board of Directors pursuant to Art. 210 of the Commercial Code (i.e. on the authorisation of the Board of Directors to decide on an increase of the share capital) or on the option to offset a pecuniary receivable due from the Company against receivable of payment of the subscription price of shares;
- decide on the reduction of the share capital;
- decide on issue of bonds, where the decision by the General Meeting is required by the Commercial Code;
- decide to wind up the Company with liquidation, appoint and dismiss the liquidator, including determination of the amount of his/her remuneration, approve proposed distribution of the liquidation balance;
- decide on transformation of the Company, unless the law stipulates that the Board of Directors is authorized to make such decision;
- decide on a change in class of shares and any change in the rights attached to individual classes of shares;
- decide on changes in the type and form of shares;
- elect and dismiss the members of the Supervisory Board, except for the members of the Supervisory Board elected by employees pursuant to the provisions of Art. 200 of the Commercial Code;
- approve regular and extraordinary financial statements and consolidated financial statements and, in cases set forth by law, also interim financial statements, decide upon the distribution of profits or other own resources or cover of losses, determine the amount and payment date of royalties, and the amount and payment date of dividends, and approve rules for usage of undistributed profits;
- decide to increase the Reserve Fund;

- discuss a Board of Directors' annual report on the Company's business activity, and on the situation of the Company's assets as part of the annual report according to the Act No. 563/1991 Coll. on Accounting, as amended (Act No. 563/1991 Coll.);
- approve agreements set forth in Art. 67a of the Commercial Code;
- decide on the establishment and the use of other funds created from profits;
- decide on approval of the rules of remuneration to members of the Board of Directors, the Supervisory Board and the Audit Committee and stipulation of remuneration to members of the Board of Directors, the Supervisory Board and the Audit Committee and the due date of payment thereof;
- decide on approval of control agreements, profit transfer agreements and silent partnership agreements and changes thereto, if the Company concludes such agreements;
- decide on approval of agreements on the discharge of the office of members of the Supervisory Board and the rules for provision of non-claim perquisites to members of the Supervisory Board of the Company;
- decide on the determination of an auditor to carry out mandatory audits or to audit other documents where the determination is required by law;
- elect and dismiss of the members of Audit Committee;
- decide on approval of agreements on the discharge of the office of members of the Audit Committee and the rules for provision of non-claim perquisites to members of the Audit Committee; and
- decide on approval of financial assistance if such approval is required by law.

General Meetings in 2012

The Ordinary General Meeting of Telefónica CR was held on 19 April 2012. The supreme governing body of the Company approved the following:

- The Company's financial statements and the consolidated financial statements for the year 2011 prepared under the International Financial Reporting Standards (IFRS). Both sets of statements were recommended by the Board of Directors of the Company for approval, and audited by the auditor Ernst & Young, which gave both sets of statements an unqualified opinion.
- Distribution of profit and the payment of a dividend. The proposal was based in a diligent analysis by the Board of Directors of the Company's results in the past period, the present balance sheet situation and the expected future results of the Company, including investment plans and future cash flow generation estimates.
- The payment of dividends from the profit for the year 2011, amounting to CZK 7,633,074,030.17, and from a part of the retained earnings of the previous periods, amounting to CZK 1,063,353,269.83, totalling CZK 8,696,427,300. This represents a dividend of CZK 27 per share before tax.
- A reduction of the Company's share capital by way of a reduction of the nominal value of each share by CZK 13 from CZK 100 and by CZK 130 from CZK 1,000 originally. The distribution of the total amount of CZK 4,187,168,700, which represents the amount of the reduction of the share capital, among all shareholders of the Company (as per the situation on the day of the registration of the reduction of the Company's share capital in the Commercial Register, which was 14 November 2012), commenced on 14 December 2012. All information concerning the reduction of the share capital is available on the Company's website (www.telefonica.cz)
- An amendment to the Company's Articles of Association. Some of the amendments were brought on by the recent amendments to the Commercial Code. Other changes related to the powers of the Company's Board of Directors: the Board's duty to seek a prior approval of the Supervisory Board with (i) acquisition of the Company's own shares; (ii) entering into a legal contract for the transfer of a business or a part of a business or for a lease of a business; and (iii) the election, nomination or recall of members of statutory and supervisory bodies in

subsidiary companies or other companies in which the Company holds an ownership interest. The number of members of the Supervisory Board was changed from fifteen originally to twelve. Last but not least, the procedure rules for the passing of decisions by the Board of Directors, Supervisory and the Audit Committee were simplified.
- A buy-back of the Company's own shares to the limit of 10% from the total issue of 322,089,890 ordinary shares with the nominal value of CZK 100 before the reduction, i.e. to the limit of 32,208,989 ordinary shares (for details please refer to section Overview of the Group and the main changes in 2012 – Share buy-back)
- A contribution of a part of the business in the subsidiary Internethome, s.r.o.; the contribution took the form of the organisation unit of Telefónica CR which provided WiFi internet access. Internethome, s.r.o. was incorporated in 2011 to provide the same service.
- The General Meeting also confirmed membership of members of the Supervisory Board and the Audit Committee (for details please refer to sections Supervisory Board and Audit Committee).

A detailed overview of the conclusions of the Ordinary General Meeting is given on the Company's website (www.telefonica.cz). Information about the amount of the dividend, the record and the disbursement days is given in this Annual Report in section Other information for shareholders and investors.

8.4.2 Board of Directors

The seven-member Board of Directors is a statutory body that manages the business of the Company and acts on its behalf. The Board of Directors decides on all corporate affairs which, by law or the Articles of Association, are not reserved for the General Meeting or the Supervisory Board. As a rule, the Board of Directors meets once every calendar month, but at least 12 times in the course of a calendar year. Members of the Board of Directors are elected and recalled by the Supervisory Board. The tenure of a member of the Board of Directors is 5 years. The Board of Directors has a quorum if a simple majority of its members is present at the meeting.

The Board of Directors has the particular authority to:
- secure the business activities and ensure the operational management of the Company;
- approve the Rules of Procedure of the Board of Directors;
- execute the employer's rights;
- convene the General Meeting;
- provide for the preparation of and submit to the General Meeting for discussion the matters coming under the authority of the General Meeting;
- execute the General Meeting resolutions in accordance with law and the Articles of Association;
- ensure that the accounts and documents of the Company are kept with due and proper care, in line with applicable laws and regulations;
- submit to the Supervisory Board for review the Company's regular, extraordinary or, as the case may be, interim financial statement, always in its consolidated as well as unconsolidated form, and the proposal for distribution of profit or the other Company's resources or for coverage of losses, and the report by the Board of Directors pursuant to the provisions of Art. 66a (9) of the Commercial Code;
- decide on the conclusion of agreements establishing business companies and cooperatives, agreements establishing associations or interest groups, and on capital investment in business companies or cooperatives; on acquisition, cessation, and alienation of participations in other business companies or cooperatives, without limitation to having their registered office in the Czech Republic;
- use the retained earnings in accordance with the principles set forth by the General Meeting;

- decide on use of the Funds of the Company in accordance with the principles set forth by the General Meeting;
- prepare the report of the Board of Directors on the business activity of the Company and on its assets in accordance with the provisions of Art. 192 (2) of the Commercial Code, the annual report according to the provisions of Art. 21 of the Act No. 563/1991 Coll., the provisions of Art. 118 of the Act No. 256/2004 Coll., including the report by the Board of Directors pursuant to the provisions of Art. 66a (9) of the Commercial Code, the half-year report pursuant to the provisions of Art. 119 of the Act No. 256/2004 Coll., the interim report or equivalent quarterly information in accordance with the provisions of Art. 119a of the Act No. 256/2004 Coll., and the summary explanatory report pursuant to the provisions of Art. 118 (8) of the Act No. 256/2004 Coll.;
- formulate the commercial policy;
- lay down the principles for the collective agreement;
- use on the distribution of the Reserve Fund;
- grant and withdraw the power of proxy;
- organize, in compliance with the Commercial Code, election or dismissal of members of the Supervisory Board by the employees, and approve the election rules for such election or dismissal;
- lay down the rules for the creation and use of the Social Fund on the basis of collective bargaining;
- enter into an agreement with the auditor on the statutory audit or, if applicable, on other services to be rendered by the auditor;
- discuss the audit report with the auditor.

Meetings of the Board of Directors in 2012

In 2012, the Board of Directors met nineteen times.

Personnel composition of the Board of Directors

Luis Antonio Malvido (*1964)
Chairman of the Board of Directors since 1 February 2010
Member of the Board of Directors since 1 February 2010

Graduated in Industrial Engineering at the Instituto Technológico de Buenos Aires. Joined Telefónica in the late 1980s during the privatisation process as a member of a team for the valuation of the target company. Afterwards he worked in various positions in customer service, sales, business development and strategic planning in Telefónica. In June 1998 he was appointed Vice President and Chief Executive Director at Telefónica Móviles Argentina, Unifón, where he was responsible for the start-up of the company, its merger with another regional operator and for the establishment of a nation-wide mobile operator. From January 2005 he was President and Chief Executive Director of Telefónica Venezuela, Movistar and later he became a President of the Quality Committee in Latin America. From January 2008 he was Chief Executive Director at TeleSP, the Telefónica fixed subsidiary in Brazil. In February 2010 he was appointed Chief Executive Officer and Chairman of the Board of Directors of Telefónica Czech Republic.

David Melcon Sanchez-Friera (*1970)
1st Vice-chairman of the Board of Directors since 30 August 2012
Member of the Board of Directors since 1 August 2012

David Melcon has a degree in Economics and Business Administration from the Universidad de Zaragoza (Spain), and a Masters degree in Auditing and Business Analysis at Universidad Complutense, Madrid. David is a senior finance professional with over 15 years senior management experience in the telecommunications industry. In addition he has extensive experience of financial planning and performance management, M&A; transactions, investment appraisal and financial operations in Latam, Spain, UK and rest of Europe. He has a wide variety of experience in key leadership roles implementing global projects to adapt the business to the changing market conditions. Starting his career at Arthur Andersen in 1996 he joined Telefonica in 2001. He brings vast experience from senior finance roles throughout the Telefonica Group. David joined Telefonica Europe in 2007 and held the position of Finance and Control Director. He was a member of the Board of Directors of Telfin Investments Ireland (2010-2012) and was a member of the Supervisory Board of Hansenet (2010–2011). Since 2012 he is a member of the Supervisory Board of Telefónica Slovakia, s.r.o.

Petr Slováček (*1959)
2nd Vice-chairman of the Board of Directors since 14 June 2008
Member of the Board of Directors since 13 June 2003
Re-elected on 14 June 2008

Graduated from the Technical University, Prague, with a degree in telecommunications from the Faculty of Electro-technical Engineering. Also holds a postgraduate Master of Business Telecommunications (MBT) degree from the Technical University of Delft in the Netherlands. After graduation he joined the Telecommunications Research Institute, Prague, he joined SPT TELECOM (the legal predecessor of Telefónica Czech Republic) in 1989, working in switching, technical development, network management projects and OSS. In 2005–2007 he was Statutory Executive of the subsidiary Telefónica O2 Business Solutions. In June 2008 he was re-elected 2nd Vice-chairman of the Board of Directors of Telefónica Czech Republic. He currently holds the position of Director, Operations Division.

Martin Bek (*1969)
Member of the Board of Directors since 27 April 2006
Re-elected on 28 April 2011

Studied foreign trade at the University of Economics, Prague, and completed his studies at the European Business School, Paris, where he majored in Finance. He worked in various French companies: ABC International, DRT International and later Guérard Viala Prague as senior consultant and tax advisor. From 1996, he worked at ČESKÝ TELECOM (the legal predecessor of Telefónica Czech Republic) as Director for Tax and Accounting, later as Executive Director for Planning and Controlling. In April 2004 he was appointed Statutory Executive of Eurotel Praha, spol. s r.o. (the legal predecessor of Telefónica Czech Republic), and from September 2004 was Eurotel's Chief Operating Officer. He presently holds the position of Director, Division Support Services in Telefónica Czech Republic. He has been a member in Glaciera s.r.o. since 1993; member and statutory executive in NOVELLO s.r.o; he has been is a member of the Board of Trustees of the O_2 Foundation since 2004; in 2009–2012 he was statutory representative of Telefónica O2 Business Solutions, spol. s r.o.; and member of the supervisory board of the subsidiary Telefónica Slovakia, s.r.o. since 2012.

Jakub Chytil (*1961)
Member of the Board of Directors since 27 April 2006
Re-elected on 28 April 2011

Graduated from the Faculty of Law, Charles University, Prague, where he got his JUDr. degree. In 1991–1995, he was a junior associate and, later on, an attorney specialising in commercial and civil law, working with international law firms. In 1995–2000, he was a Legal Counsel for the Czech and

Slovak Republic at Philip Morris ČR and Kraft Foods. In 2000–2003, he was the Senior Counsel of Philip Morris International, Lausanne, Switzerland, where he was responsible for the legal affairs of Philip Morris International's subsidiaries in various countries. Since his arrival to ČESKÝ TELECOM (the legal predecessor of Telefónica Czech Republic) in December 2003 he has been in the position of Director, Legal Affairs, Company Secretary since May 2006, and since 2011 he has been Director, Legal and Regulatory and Public Affairs Division. He is also a member of the Board of Trustees of the O_2 Foundation.

Ramiro Lafarga Brollo (*1969)
Member of the Board of Directors since 17 February 2012

Graduated from Universidad Católica Argentina in 1992 with specialisation in Accounting. He received his degree of Master in Economics & Business Administration from Escuela Superior de Economía y Administración de Empresas (ESEADE) in Buenos Aires. Also holds a postgraduate Master degree in Telecommunications from Universidad San Andres in Buenos Aires. Ramiro started his career in Telecom Personal (Cellular Operator in Argentina) as a member of Pricing & Strategic Marketing team. Afterwards, he moved to a role of Marketing Manager in Smartcom PCS (Chile). Since his arrival to Movistar Chile (First Mobile Telecom Operator) in 2002, he managed the marketing, sales and contact centre teams as Marketing & Customer Director and later was promoted to Commercial General Director. In 2008, he became Commercial Vice President of Massive Segment in Telefónica de Sao Paulo (First Fixed Telecom Operator in Brasil). The last position he held before his assignment in Telefónica Slovakia was the position of Commercial Director in Telefónica Chile, where he was responsible for the marketing and sales over residential and business segments in mobile and fixed operations. Ramiro joined Telefónica Slovakia, s.r.o. in November 2011 as Statutory Representative and Chief Executive Officer.

František Schneider (*1967)
Member of the Board of Directors since 4 November 2010

Graduated in Artificial Intelligence at the University of West Bohemia, Pilsen, and went on to start his professional career in Vikomt CZ. From 1997 he worked in Dell Computer, where started as Director for Sales to Small and Medium Enterprises, Czech and Slovak markets. In 2001 he became Business Development Manager for Eastern Europe, Middle East and Africa, where he managed development projects aimed at effective capture of the corporate market. This job took him also to Israel, Turkey, Saudi Arabia, United Arab Emirates and Russia. In 2003 he went to Greece to manage the start-up of a new branch for which he also designed a medium-term business development plan. From May 2004 he was managing director for the Czech and Slovak markets and statutory executive of Dell Computer. He joined Telefónica Czech Republic in April 2008 as Executive Director, Corporate Sales, and presently holds the position of Director, Business Division. In 2007–2011 he was a member of the board of trustees of the endowment fund Srdce na dlani; from July until September 2012 he was statutory executive of Bonerix s.r.o.; and since 2012 he has been member of the supervisory board in the subsidiary Telefónica Slovakia, s.r.o.

8.4.3 Supervisory Board

The Supervisory Board is a supervisory body of the Company. It has twelve members and it supervises the discharge of the powers by the Board of Directors in managing the business of the Company. The Supervisory Board meets as necessary, once in a quarter as a rule, but at least four times in the course of a calendar year. Two thirds of the Supervisory Board members are elected and recalled by the General Meeting; one third of the Supervisory Board members are elected and recalled by employees of the Company. Members of the Supervisory Board are elected for tenure of five years. The Supervisory Board has a quorum if a simple majority of its members is present at the meeting.

The Supervisory Board has the particular authority to:

- review the regular, extraordinary and consolidated or, as the case may be, interim financial statements and proposals for distribution of profits or the other Company's resources or for coverage of losses, and to submit its standpoint to the General Meeting;
- elect and recall members of the Board of Directors;
- approve agreements on the discharge of the office of members of the Board of Directors in compliance with the provisions of Art. 194 (1) of the Commercial Code;
- decide on approval of the rules for provision of non-claim perquisites to members of the Board of Directors of the Company in compliance with the provisions of Art. 194 (1) of the Commercial Code;
- convene the extraordinary General Meeting, if the interests of the Company so require, and propose any necessary measures to the General Meeting;
- submit to the General Meeting and to the Board of Directors its standpoints, recommendations, proposals and results of its inspection activities;
- review the exercise of the powers of the Board of Directors, based on the request of the shareholders who have shares which nominal value amounts to at least 3% of the share capital, in respect of the matters determined in the application;
- on the request from shareholders who have shares whose nominal value amounts to at least 3% of the share capital, exercise the right to compensation for damage incurred by the Company vis-à-vis a member of the Board of Directors;
- decide on issues concerning remuneration and other benefits for Supervisory Board or Audit Committee members insofar as stipulated by law, Articles of Association, individual agreements on the discharge of the office or rules approved by the General Meeting;
- review Board of Directors report under Art. 66a (9) of the Commercial Code; to inform the General Meeting of the review of this report and to submit its standpoint to the General Meeting.

The Supervisory Board gives to the Board of Directors its prior consent in matters related to the issuing of shares or other debt instruments; intra-group cooperation agreements; investments in or disposal of ownership interests in other companies that involve more than one quarter of the equity of the Company; termination of employment with more than ten percent of the Company's employees; transformation of the Company; conclusion of agreements on the transfer of assets; disposal of property exceeding one quarter of equity; and the appointment of the Company Secretary.

Meetings of the Supervisory Board in 2012

In 2012, the Supervisory Board of Telefónica CR met five times.

Personnel composition of the Supervisory Board:

María Eva Castillo Sanz (*1962)
Chairwoman of the Supervisory Board since 5 November 2012
1st Vice-chairwoman of the Supervisory Board since 4 November 2010
Member of the Supervisory Board since 7 May 2010

Eva Castillo holds BA Degrees in Business, Economics and Law from Universidad Pontificia de Comillas (E– 3) in Madrid. Since September 2012 she is Chairwoman and CEO of Telefónica Europe. She is also member of the Board of Telefónica, S.A., member of the Executive Committee of Telefónica, S.A., Chairwoman of the Supervisory Board of Telefónica Germany, Chairwoman of the Supervisory Board of Telefónica Czech Republic, member of the Board of Directors of Old Mutual, Plc., member of the Board of Directors of Bankia, and member of the board of the Comillas-ICAI Foundation. Until December 2009, she headed Merrill Lynch Global Wealth

Management business operations in Europe, the Middle East and Africa (EMEA). She was a member of the Merrill Lynch EMEA Executive Committee, the Global Wealth Management Executive and Operating Committees. Prior to the mentioned position, she served as head of Merrill Lynch Global Markets & Investment Banking in Iberia as well as President of Merrill Lynch Spain (October 2003), and before that as Chief Operating Officer for Equity Markets in Europe, Middle East and Africa. Ms. Castillo joined Merrill Lynch in 1997 as head of Equity Markets for Spain and Portugal. In 1999 she was promoted to Country Manager for Spain and Portugal and in 2000 she became CEO of Merrill Lynch Capital Markets España. Before joining Merrill Lynch, she worked for Goldman Sachs in London for 5 years in the International Equity Markets Department. Prior to this she worked for 5 years at the Spanish broker Beta Capital in the Sales and Equity Research Department.

Lubomír Vinduška (*1956)
2nd Vice-chairman of the Supervisory Board since 23 July 2008
Member of the Supervisory Board elected by employees since 1998
Re-elected by employees on 29 June 2008

Graduated in radio 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 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, 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 Czech Republic and Chairman of the Prague Trade Union Steering Committee. In 2005 and 2009 he completed courses in International Financial Reporting Standards and financial relations within a group of companies. In the last five years he was not a member of any other governing, executive or supervisory bodies outside Telefónica Czech Republic.

Patricia Cobian Gonzalez (*1975)
Member of the Supervisory Board since 8 November 2011 (co-opted)
Elected by the General Meeting on 19 April 2012

Patricia Cobian is Business Development Director for Telefónica Europe, in charge of strategic initiatives, new business opportunities, transformation and the coordination with Telefónica Digital and Telefónica Global Resources. Since September 2012 she has been a member of the Telefónica Deutschland Supervisory Board, she is a member of the O2 plc Board and is Chairwoman of the Telefónica Deutschland Remuneration Committee. Prior to that, she was Business Manager for Telefónica Europe's Chairman and CEO. She joined the Telefónica Group in 2006 as Vice President for Strategy and Development for O_2 group. Prior to joining the Telefónica Group, Patricia spent seven years with McKinsey & Company, where she was a member of the Telecommunications and Corporate Finance practices in the Madrid, New York and London offices. She started her career at Hewlett-Packard in the Financial Services Division. Patricia holds a MSc. in Industrial Engineering from Universidad Pontificia Comillas – ICAI, Madrid.

Tomáš Firbach (*1976)
Member of the Supervisory Board elected by employees since 29 June 2008

Graduated in Management and Economics in Transportation from the Czech Technical University, Faculty of Transportation. After his graduation in 1999 he worked in JSJ as information systems manager. In 2001 he joined Eurotel Praha (the legal predecessor of Telefónica Czech Republic) as network planning specialist. In 2004–2005 we worked in ČD Telekomunikace (presently ČD Telematika, a.s.) as business consultant. He has been with Telefónica Czech Republic since 2005, presently in the position of Senior Key Account Manager – Team Leader. In the last five years he was not a member of any other governing, executive or supervisory bodies outside Telefónica Czech Republic.

Pavel Herštík (*1951)
Member of the Supervisory Board elected by employees since 1994
Re-elected by employees on 29 June 2008

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 worked in the field of work procedure planning, evaluation and work efficiency measurement. 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 Senior Specialist in the area of management and administration of management documents. In 2005 and 2009 he completed courses in international accounting standards and intra-holding relationships. 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 Czech Republic. In the last five years he was not a member of any other governing, executive or supervisory bodies outside Telefónica Czech Republic.

Maria Pilar López Álvarez (*1970)
1st Vice-chairwoman of the Supervisory Board since 13 February 2013
Member of the Supervisory Board since 26 July 2007
Re-elected on 27 July 2012

A graduate of Business Studies, she joined Telefónica after working for several years at JP Morgan in London and New York where she worked her way up to Vice President. She joined the Telefónica Group 1999 in Telefónica de España's Strategic Planning Department. In May 2000 she was appointed Director of Management Control at Telefónica, S.A. Two years later she joined Telefónica Móviles S.A. to head up its Management Control function. In October 2006 she was promoted to Director of Strategy and Business Development at Telefónica de España. In March 2007 she was appointed Chief Financial Officer of Telefónica Europe plc. and she serves on the board of Telefónica Europe. In 2012 she was appointed a Non-executive Director at Wolseley Plc. and a member of the Audit, Remuneration and Nominations Committees. In 2012 she was also appointed a member of the Supervisory Board of Telefonica Deutschland Holding AG.

Enrique Medina Malo (*1972)
Member of the Supervisory Board since 8 November 2011 (co-opted)
Elected by the General Meeting on 19 April 2012

Holds a law degree from Carlos III University of Madrid and was admitted to the Spanish Government Legal Services in 1997. From 2002 to 2004 he was appointed General Director for Legislation of the Ministry of Science & Technology. He has been Chief Legal Officer of the Spanish Broadcasting Corporation. Until 2006, he served as State Lawyer for the Public Administration, Ministry of Science and Technology, Ministry of Industry and Energy and the High Court of Cataluña. He joined Telefónica on 2006, as Public Law Manager and afterwards Telecommunications and Information Society Legal Affairs Manager being the responsible of regulation and competition legal issues. On 2008 he was appointed Chief Legal Officer of

Telefónica, S.A., reporting to the Group's General Counsel. From September 2011 he has held the position of General Counsel of Telefónica Europe. Nowadays he serves on the board of Telefónica Europe, plc, mmO2 plc, O2 Holding Ltd, O2 Europe Ltd and Wayra UK Ltd and he is member of the Supervisory Board of Telefónica Deutschland Holding AG.

Jesús Pérez de Uriguen (*1970)
Member of the Supervisory Board since 5 November 2012

Graduated in Business Administration at University of Maryland at College Park in 1992, with specialisation in Finance and Accounting, where he got his degree of Bachelor of Science in Business and Management. In 1993, he earned his MBA degree at Instituto de Empresa in Madrid. Before joining Telefónica Czech Republic he worked in Bank of America, Arthur Andersen, Jazz Telecom, S.A., and Telefónica Móviles, S.A. At these companies he gained extensive experience in the telecommunications and finance area – he was responsible for planning, management control, etc. Lastly, he worked in the position of CFO in Telefónica Centroamérica for nearly four years. He was member of the Board of Directors of Telefónica Moviles in Panamá, El Salvador, Nicaragua and Guatemala. From 2008 until August 2012 he was Director, Finance Division and 1st Vice-chairman of the Board of Directors in Telefónica Czech Republic. At present he is Finance and Control Director at Telefónica Europe.

Javier Santiso Guimaras (*1969)
Member of the Supervisory Board since 19 April 2012

Javier Santiso is Global Affairs and New Ventures Director in Telefonica S.A., previously Managing Director of the Telefónica Europe Chairman & CEO's Office and before that Director of the Innovation Funds of Telefónica. He is the Founder of Amerigo, the venture capital funds network for Latin America and Europe powered by Telefónica. From 1996 to 2001 he has been Managing Director of Indosuez (Cédit Agricole Investment Bank now). In 2001 he joined BBVA as managing Director and Chief Economist for Emerging Markets. In 2005 he became Director General of the OECD and Chief Economist of the OECD Development Centre. In 2010 he joined Telefónica as Director in Telefónica International Chairman's Office. He has been also in Advisory Board for Emerging Markets of Pfizer (New York), of Lazard Frères Gestion (Paris), and consultant for the Inter-American Development Bank (Washington), Exane BNP Paribas, Société Générale and Suez GDF. He is professor of ESADE Business Scholl, founder of Startup Spain and Member of ESADE BAN board (ESADE Business Angels Network). He studied in Paris, Oxford and Boston at Sciences Po and HEC School of Management, Oxford University and Harvard University. In 2009 he has been awarded as one of the Young Global Leaders by the World Economic Forum (Davos). In 2011 Foreign nominated Javier Santiso as one of the most influential ibero-american thinkers. He is a member of the World Economic Forum Global Councils and of the Aspen Institute.

Dušan Stareček (*1956)
Member of the Supervisory Board elected by employees since 29 June 2008

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 (the legal predecessor of Telefónica Czech Republic). At present, he works as Specialist for Operation and Maintenance of Digital Telecommunications Technology in Ostrava. He is member of EWC (European Works Council) at Telefónica Europe plc. He serves as Vice-chairman of the Ethics and Corporate Social Responsibility Committee of Telefónica Czech Republic. In the last five years he was not a member of any other governing, executive or supervisory bodies outside Telefónica Czech Republic.

Ángel Vilá Boix (*1964)
Member of the Supervisory Board since 23 June 2005
Re-elected on 24 June 2010

Ángel Vilá (Barcelona, 1964) is General Manager for Finance and Corporate Development and member of the Executive Committee at Telefónica, S.A. Mr Vilá joined Telefónica in 1997 as Group Controller, moving on to become CFO of Telefónica Internacional, where he led the Telebras privatisation team. In 2000, he was appointed Group Head of Corporate Development. In this position, he executed landmark corporate acquisitions such as O2 plc and Brasilcel/Vivo and took part in the initial investment of Telefonica in China Netcom. Other significant transactions would include Telco SpA and ČESKÝ TELECOM, as well as the disposals of Airwave and TPI. From 2010, Mr. Vilá also oversaw the Affiliates group, comprising Atento, T- Gestiona and Telefónica Contenidos. Prior to joining Telefónica, he held positions at Citigroup, McKinsey&Co, Ferrovial and Planeta. Ángel Vilá is member of the Board of Directors of Telco SpA (Italy), Telefónica Deutschland, Telefónica Digital, Telefónica Contenidos, Telefónica Czech Republic and Digital Plus. He previously served on the Boards of BBVA, Endemol, Atento, CTC Chile and Terra Lycos, and the Advisory panel of Macquarie MEIF funds. Ángel Vilá graduated in Industrial Engineering from Universitat Politècnica de Catalunya and holds a MBA from Columbia University (New York).

Changes in the personnel composition of the Supervisory Board

During 2012 and at the beginning of 2013 until the closing deadline of the Annual Report, the following changes occurred in the personnel composition of the Supervisory Board:

Antonio Botas Bañuelos
- resigned on his membership in the Supervisory Board with effect from 17 February 2012

Petr Gazda
- resigned on his membership in the Supervisory Board with effect from 19 April 2012

José María Álvarez-Pallete López
- confirmed as member of the Supervisory Board at the General Meeting of 19 April 2012
- resigned on his membership and the position of Chairman of the Supervisory Board with effect from 5 November 2012

Patricia Cobian Gonzalez
- confirmed as member of the Supervisory Board at the General Meeting of 19 April 2012

Enrique Medina Malo
- confirmed as member of the Supervisory Board at the General Meeting of 19 April 2012

Maria Pilar López Álvarez
- re-elected as member of the Supervisory Board at the General Meeting of 19 April with effect from 27 July 2012

Vladimír Dlouhý
- resigned on his membership in the Supervisory Board with effect from 5 November 2012

Jesús Pérez de Uriguen

- co-opted as member of the Supervisory Board on 5 November 2012 pending the date of the next General Meeting

Javier Santiso Guimaras

- resigned on his membership in the Supervisory Board with effect from 13 February 2013

Antonio Manuel Ledesma Santiago

- co-opted as member of the Supervisory Board on 13 February 2013 pending the date of the next General Meeting

Committees of the Supervisory Board

The Supervisory Board institutes committees as its advisory and initiative bodies. Committees of the Supervisory Board are an inherent part of corporate governance. The Supervisory Board always institutes a Nomination and Remuneration Committee. Committee members are elected and recalled by the Supervisory Board, and their tenure is two and half years. Only Supervisory Board members may be elected as members of Supervisory Board committees.

The Nomination and Remuneration Committee has five members and makes recommendations in respect of particularly all matters relating to personnel changes in the Board of Directors, Audit Committee, Supervisory Board and the Supervisory Board committees. The committee also has the authority to review the remuneration and other benefits granted to members of the governing bodies, and to monitor and assess their performance.

The committee met twice in 2012.

Members: Maria Pilar López Álvarez (Chairwoman), Patricia Cobian Gonzalez (Vice-chairwoman), María Eva Castillo Sanz (member) and Enrique Medina Malo (member). No other Supervisory Board member was appointed to the vacant member position in 2012.

The Ethics and Corporate Social Responsibility Committee is a voluntary committee of the Supervisory Board with six members, whilst observing the rule that a half of the committee members are always Supervisory Board members elected by the employees, and the other half Supervisory Board members elected by the General Meeting. Every year, the committee addresses the issue of a potential conflict of interest; members of the Board of Directors, Audit Committee, Supervisory Board, executive management and members of the governing bodies in subsidiary companies are examined in this respect. The committee regularly monitors compliance with the Company's Business Principles, and the functioning of the confidential whistle-blowing channel, and it is regularly informed about the activities undertaken as part of the Compliance Programme for the prevention of the risk of unethical conduct. Another primary sphere of interest for the committee is the promotion of socially responsible behaviour on the part of the Company.

The committee met three times in 2012.

Members: Pavel Herštík (Chairman), Dušan Stareček (Vice-chairman), María Eva Castillo Sanz (member), Tomáš Firbach (member) and Enrique Medina Malo (member). No other Supervisory Board member was appointed to the vacant member position in 2012.

8.4.4 Audit Committee

The Audit Committee has five members and it is an autonomous body of the Company. Members of the Audit Committee are elected and recalled by the Company's General Meeting. They may be elected from the members of the Supervisory Board or from persons external to the Company. The Audit Committee members are elected for a period of five years and may be re-elected. The General Meeting may also elect up to 6 substitute members of the Audit Committee, designating the order of their succession. The Audit Committee meets as necessary, once in a quarter as a rule, but at least four times in the course of a calendar year. The Audit Committee has a quorum if a simple majority of its members is present at the meeting.

The Audit Committee has the particular authority to:

- monitor the process of compilation of the financial statements and the consolidated financial statements;
- evaluate the effectiveness of the Company's internal controls, internal audit and risk management system;
- monitor the process of the statutory audit of the financial statements and the consolidated financial statements;
- review the independence of the statutory auditor and the audit firm, and the provision of non-audit services to the Company by the audit firm;
- recommend an auditor;
- receive from and discuss with the auditor all and any information, declarations and communications as per the applicable laws.

Meetings of the Audit Committee in 2012

The Audit Committee met four times in 2012. Meetings of the Audit Committee are, as a rule, called for the same day as Supervisory Board meetings, which allows the Supervisory Board members to use the results and conclusions from the Audit Committee in their deliberations.

Personnel composition of the Audit Committee

María Eva Castillo Sanz (*1962)
Chairwoman of the Audit Committee since 12 May 2011
Member of the Audit Committee since 7 May 2010
(résumé in section Supervisory Board)

Maria Pilar López Álvarez (*1970)
Vice-chairwoman of the Audit Committee since 8 November 2011
Member of the Audit Committee since 3 April 2009
(résumé in section Supervisory Board)

Pavel Herštík (*1951)
Member of the Audit Committee since 3 April 2009
(résumé in section Supervisory Board)

Javier Santiso Guimaras (*1969)
Member of the Audit Committee since 5 November 2012
Substitute member of the Audit Committee since 19 April 2012
(résumé in section Supervisory Board)

Jaime Smith Basterra (*1965)
Member of the Audit Committee since 3 April 2009

Graduated in Economics and Business Administration (BA, Universidad Comercial Deusto, Spain) and holds an MA in Finance and Investments (Exeter University, UK). Before joining Telefónica, he worked in the financial sector for a Spanish brokerage firm, and for Banesto (BSCH Group) as Director for Global Equities in its fund management division. He joined the Telefónica Group in 1999 as Director for Financial Planning at Telefónica Internacional, and was promoted to Chief Financial Officer in December of the same year. In October 2000, he was appointed Controller of the Telefónica Group. From December 2002 he held the position of Chief Financial Officer of Telefónica de España. In June 2005 he was made Chief Executive Officer and Chairman of the Board of Directors of ČESKÝ TELECOM (now Telefónica Czech Republic). In June 2007 he was promoted to Chief Executive Officer of Telefónica O2 Germany GmbH. Since June 2009 he was made Director of Subsidiaries and Industrial Alliances of Telefónica, S.A. From October 2010 he is Director of Telefónica Mobile Operations in Mexico, Central America and Venezuela. From 2006 to 2009 he was also a member of the Board of Directors of Telefónica Europe plc. In 2008–2010 he served as Chairman of the Supervisory Board of Telefónica Czech Republic and from November 2010 until February 2011 was a member of Supervisory Board of Telefónica Czech Republic.

Changes in the personnel composition of the Audit Committee

During 2012 and at the beginning of 2013 until the closing deadline of the Annual Report, the following changes occurred in the personnel composition of the Audit Committee:

Vladimír Dlouhý
- confirmed as member of the Audit Committee at the General Meeting of 19 April 2012
- resigned from his membership in the Audit Committee with effect from 5 November 2012

Javier Santiso Guimaras
- elected substitute member of the Audit Committee at the General Meeting of 19 April 2012
- assumed his membership in the committee on 5 November 2012
- resigned from his membership in the Audit Committee with effect from 13 February 2013

Jaime Smith Basterra
- resigned from his membership in the Audit Committee with effect from 13 February 2013

8.4.5 Executive management

The executive management of the Company is nominally listed below:

Luis Antonio Malvido (*1964)
Chief Executive Officer
(résumé in section Board of Directors)

David Melcon Sanchez-Friera (*1970)
Director, Finance Division
(résumé in section Board of Directors)

Petr Slováček (*1959)
Director, Operations Division
(résumé in section Board of Directors)

Martin Bek (*1969)
Director, Support Services Division
(résumé in section Board of Directors)

Jakub Chytil (*1961)
Director, Legal, Regulatory and Public Affairs Division, Company Secretary
(résumé in section Board of Directors)

František Schneider (*1967)
Director, Business Division
(résumé in section Board of Directors)

Jiří Dvorjančanský (*1969)
Director, Marketing Division

Jiří Dvorjančanský graduated from the Czech Technical University in Prague and also holds a D.E.A. degree from National Polytechnique Institut in Grenoble, France. He subsequently earned his EMBA in the Executive MBA Programme at Thunderbird School of Global Management in Prague. He joined Telefónica Czech Republic from Deutsche Telekom Group where he worked for 11 years in various executive positions in the field of sales and marketing. He was also Executive Director, Marketing Division at T-Mobile Czech Republic; he was later promoted to the same top executive position in T-Mobile Germany; between March 2008 and May 2009 he also served as member of the board of directors. His international experience also includes membership in the Supervisory Board of T-Mobile UK and a standing membership in the International Marketing Board of T-Mobile Group. Jiří Dvorjančanský joined Deutsche Telecom from the position of Sales Director at COTY.

Dana Dvořáková (*1965)
Director, Corporate Communication

Graduated from the University of Economics, Prague, completed her postgraduate education in Corporate Communication at the Erasmus University, Rotterdam, and earned her MBA from the University of Pittsburgh in the United States. She started her professional career as a journalist writing about the economy for Hospodářské noviny and MF Dnes, later she managed public relations and marketing in large corporations (ČESKÝ TELECOM, Všeobecná úvěrová banka, ČSA and Unipetrol). In 2009 she was recognised as PR Manager of the Year by the Association of Czech PR Agencies. In May 2011 Dana Dvořáková was appointed Director, Corporate Communication Division, in Telefónica Czech Republic. She is responsible for corporate communication, CSR and the O_2 Foundation. Since January 2013 she has been member of the executive board of the Safety Line Association.

Ctirad Lolek (*1973)
Director, Human Resources Division

Graduated from the Palacký University in Olomouc, where he studied sociology and andragogy with a specialisation in HR management. After graduation he worked in several positions in human resources for multinational companies such as Kapa Karton Morava and EPCOS. In 2001 he was appointed HR director for The Timken Company, where he oversaw the start-up of a new plant in the Czech Republic; later he managed HR activities in Central and Eastern Europe. In 2008 he joined ArcelorMittal Ostrava as HR Director – he was responsible for HR strategy and management, served on the Board of Directors and, after two and half years started as HR Director of the Luxembourg-based division ArcelorMittal Long Carbon Europe. He joined Telefónica Czech

Republic in 2011 as Director, Human Resources Division. In this position he is responsible for the management of human resources in the Czech Republic and in Slovakia. Ctirad Lolek has extensive experience in HR management; he is an expert in personnel management, especially in HR strategy planning, including performance and talent management, leadership development, employee relations and internal communication. In 2006-2012 he was a member of the board of the health insurance fund Metal-Aliance.

Luis Aldo Martin (*1962)
Director, Consumer Division

Luis Aldo Martin graduated in Construction Engineering from Universidad Católica Argentina in 1987. Later he continued with his postgraduate studies at Universidad de Ciencias Empresariales y Sociales (University of Business Administration and Social Sciences) which he completed in 1997 with a Masters degree in Marketing and Strategic Management. Before joining Telefónica, he worked for 12 years for ESSO S.A. Petrolera Argentina. In this multinational oil and gas company he progressed through various positions and areas, including retail, project management, sales coordinator supervisor, retail director, retail business development director, etc. Later he worked for two years in Tambos San Isidro Labrador S.A., which produced ice cream and operated zoological gardens, where he, as retail project director, succeeded in expanding substantially the retail network, improving the quality of products and enhancing customer experience. He also successfully managed a project of development of the Temaiken zoo. Luis Aldo Martin joined Telefónica in 2000 in the department of channel partners in Telefónica Móviles Argentina S.A. and its Movistar brand. In this position he built and managed a network of 1,400 points of sale across Argentina. In 2006–2008 he worked as Operations Director for Norte region in Argentina. Before coming to the Czech Republic he managed sales and distribution, including direct and partner channels in the region and the country. In the last five years he was not a member of any other governing, executive or supervisory bodies outside Telefónica Czech Republic.

Felix Geyr (*1972)
Director, Strategy and Business Development Division

He joined the Telefónica Group in 2006, first as director for corporate strategy in Telefónica O2 UK, where he was a member of the CEO's team and supervised strategic planning in the company. In recent years he led the Home and Broadband Division, which is responsible for consumer product and service development and mobile broadband. Felix Geyr was born in Germany but spent most of his working career in Great Britain where he also earned his MBA degree at the Cranfield School of Management. Before he started working for Telefónica, he was director for strategy of digital media and music at BBC Worldwide.

8.5 Rules for the remuneration of persons with executive powers

The group of persons with executive powers in Telefónica CR includes the following executives: members of the Board of Directors, the Chief Executive Officer and those members of the executive management of the Company (see section Executive management) who are not members of the Board of Directors (persons who make decisions in the Company, which can affect the future development and the corporate strategy of the Company, and who have access to insider information).

The remuneration of members of the Board of Directors is governed by the rules for the remuneration of members of the Board of Directors, which are approved by the Supervisory Board of the Company. The Nomination and Remuneration Committee reviews and proposes the adequacy of the remuneration systems and any changes thereto.

The remuneration of members of the Supervisory Board, including the members of Supervisory Board committees, as well as the award of any other perquisites to Supervisory Board members, is governed by the rules for the remuneration and granting of non-claim benefits, which are approved by the General Meeting of the Company.

The remuneration rules provide specific amounts of remuneration for individual categories of members of the Board of Directors and of the Supervisory Board (including the Supervisory Board committees), i.e. the remuneration which a regular member, vice-chairman and chairman of the body are entitled to, as well as other conditions for the granting of the remuneration. Each member of the Board of Directors/Supervisory Board is entitled to the whole amount of remuneration on the condition that he/she makes a claim for it; if the member of the Board of Directors/Supervisory Board does not make a claim for the whole amount of remuneration, he/she will be remunerated only in the extent in which a claim was made.

In 2012, no changes occurred in the principles for remuneration of members of the Company's governing bodies as they were described in the 2011 Annual Report.

Basic information about the remuneration rules, including a list of non-claim benefits, for members of the Board of Directors and the Supervisory Board and of the members of the Supervisory Board committees is given below. The full text of the new Rules for the Remuneration of Members of the Governing Bodies of Telefónica CR is published in the Czech and English languages on the Company's website (www.telefonica.cz).

Board of Directors and Chief Executive Officer

Remuneration

The rules for the remuneration of members of the Company's Board of Directors stipulate a two-component flat monthly remuneration, which comprises the following:

- an amount covering mandatory payments (e.g. taxes, health insurance contributions, etc.) which a member of the Board of Directors is liable to pay due to the fact that they are covered by a liability insurance for any damage arising from the performance of a member of the Board of Directors, and mandatory payments arising from the provision of the amount as per this sentence. The amount depends on the amount of insurance premium attributable to the member of the Board of Directors; the overall amount is calculated using methods common in the business of insurance;

- an amount attributable to the individual categories of members of the Board of Directors for the number of meetings attended: (i) member of the Board of Directors: CZK 25,000; (ii) Vice-chair of the Board of Directors: the amount as in (i) plus CZK 10,000; Chair of the Board of Directors: the amount as in (ii) plus CZK 10,000. In 2012, the members of the Board of Directors did not claim their remuneration for meetings.

The Chief Executive Officer is also entitled by virtue of his/her function to additional remuneration which comprises a basic gross salary and a performance-related bonus. The performance-related bonus is granted to the Chief Executive Officer conditional on delivering on the targets set for the CEO for the calendar year in question. These targets are directly correlated to the annual budget and business plan approved by the Board of Directors. The targets represent the key performance indicators of both financial and non-financial nature (e.g. delivering the projected operating profit, achieving the revenue targets, attaining a higher level of customer satisfaction). The performance-related bonus may, in aggregate for the calendar year, reach 80% of the total annual income if the targets are achieved to a standard level. Other non-pecuniary benefits are connected with the relocation of the executive from his/her home country to the Czech Republic (accommodation in Prague, flights for visiting the family, contributions towards school fees at the international school in Prague, international health insurance).

The remuneration due to persons who are members of the Board of Directors by virtue of performing an executive (management) function in Telefónica CR comprises two components: a gross basic salary and a performance-related bonus awarded in relation to delivery on specific annual targets. The methods of target setting, performance evaluation and control are governed by the same rules and procedures as in the case of the Chief Executive Officer. The performance-related bonus may, in aggregate for the calendar year, reach 50% of the total annual income if the targets are achieved to a standard level. The overall performance of the persons in their management positions is assessed by the Chief Executive Officer.

Compensation for the commitment to a non-competition covenant

A member of the Board of Directors may, in their agreement for discharge of the office of a member, commit to the so-called non-competition covenant, i.e. a pledge not to do business, after the termination of the office, either individually or for the benefit of another person, in the field of telecommunications in the Czech Republic (nor in the field of advisory or consulting services related to the same), unless such business is done in another member of the Group. The agreement for discharge of the office of a member (including the non-competition covenant) must be approved by the Supervisory Board of the Company.

The non-competition covenant is accepted for a period of six months as of the termination of office. The Company is obliged to provide to the member of the Board of Directors in question, for committing to the non-competition covenant, compensation amounting to six times the average flat remuneration as laid down in the Rules for the Remuneration of Members of the Board of Directors, in an amount attributable to one member of the Board of Directors, in the month preceding the month in which the member of the Board of Directors terminated their position in the Board of Directors; the fact that any member of the Board of Directors has or has not made a claim to their remuneration is not considered in the calculation of the average flat remuneration.

In-kind benefits

The Company, as the policy holder, contracted an insurance policy covering against damage caused in relation to the performance of designated functions; the insured persons (i.e. persons whose functions are covered by the policy) may include members of the Board of Directors. The total insurance premium paid by the Company is evenly divided amongst the insured persons and the amount calculated per insured person constitutes their income.

Members of the Board of Directors are not provided with cars for private use in connection with their duties as members. The Chief Executive Officer is provided with a car both for work and private use. Other executive members of the Company's Board of Directors are, by virtue of their executive function, entitled to the same benefit.

Supervisory Board

Remuneration

The rules for the remuneration of members of the Company's Supervisory Board stipulate a two-component monthly flat remuneration, which comprises the following:

- an amount covering mandatory payments (e.g. taxes, health insurance contributions, etc.) which the member of the Supervisory Board is liable to pay due to the fact that they are covered by a liability insurance for any damage arising from the performance of a member of the Supervisory Board, and mandatory payments arising from the provision of the amount as per this sentence. This amount depends on the amount of insurance premium attributable to the member of the Supervisory Board; the overall amount is calculated using methods common in the business of insurance;

- an amount attributable to the individual categories of Supervisory Board members for the number of meetings attended: (i) member of the Supervisory Board: CZK 40,000; (ii) Vice-chair of the Supervisory Board: the amount as in (i) plus CZK 20,000; Chair of the Supervisory Board: the amount as in (ii) plus CZK 20,000.

If a member of the Supervisory Board is at the same time member of any of the committees established by the Supervisory Board, they are entitled to remuneration for working in the committee, which is construed as a bonus per meeting of the committee, as follows: (i) member of the committee: CZK 10,000; (ii) vice-chair of the committee: the amount as in (i) plus CZK 12,000; (iii) chair of the committee: the amount as in (ii) plus CZK 15,000.

Compensation for the commitment to a non-competition covenant

A member of the Supervisory Board may, in their agreement for discharge of the office of a member, commit to the so-called non-competition covenant, i.e. a pledge not to do business, after the termination of the office, either individually or for the benefit of another person, in the field of telecommunications in the Czech Republic (nor in the field of advisory or consulting services related to the same), unless such business is done in another member of the Group. The agreement for discharge of the office of a member (including the non-competition covenant) must be approved by the General Meeting.

The non-competition covenant is accepted for a period of six months as of the termination of office. The Company is obliged to provide to the Supervisory Board member in question, for committing to the non-competition covenant, compensation amounting to six times the average flat remuneration as laid down in the Rules for the Remuneration of Members of the Supervisory Board, in an amount attributable to one Supervisory Board member, in the month preceding the month in which the Supervisory Board member terminated their position in the Supervisory Board; the fact that any Supervisory Board member has or has not made a claim to their remuneration is not considered in the calculation of the average flat remuneration.

In-kind benefits

The Company, as the policy holder, contracted an insurance policy covering against damage caused in relation to the performance of designated functions; the insured persons (i.e. persons whose functions are covered by the policy) may include members of the Supervisory Board. The total insurance premium paid by the Company is evenly divided amongst the insured persons and the amount calculated per insured person constitutes their income.

The Supervisory Board Chairman and Vice-chairman are, according the Rules approved by the General Meeting, entitled to a car (class D or E) for work and private use. This benefit has not been claimed since mid-2005.

Other benefits

The company also granted the following benefits to members of the Board of Directors and to members of the Supervisory Board:

- voice and data services and products of the Company for business and private use (excluding doing business in one’s own name);
- ICT equipment (mobile telephone, desktop PC or notebook, PDA, including accessories) for business and private use (excluding doing business in one’s own name);

- payment card (in the case of the Supervisory Board and the Audit Committee, only the chair and vice-chair were eligible; the benefit has not been claimed in 2012);
- medical care

The above benefits were granted to persons in the position of member of the Board of Directors by virtue of having an executive (management) position in the Telefónica Czech Republic Group, for the compliance with the duties arising from their functions. In the case of Supervisory Board members, awarding of in-kind benefits is governed by the rules for the award of non-claim benefits to members of the relevant governing body.

Audit Committee

The remuneration rules for members of the Audit Committee, as well as the rules for the granting of non-claim benefits, which were approved by the General Meeting of the Company in 2009, remained without change in 2012. In 2012, Audit Committee members received from the Company a pecuniary income amounting to CZK 4,426,793 and in-kind income in the value of CZK 790,901, of which the amount of CZK 348,000, and no in-kind income, was for the membership in the Audit Committee. Audit Committee members did not receive any pecuniary or in-kind incomes from entities controlled by Telefónica CR in 2012. In 2012, all Audit Committee members had a valid agreement for the performance of office concluded with the Company, which stipulated their right to compensation for the commitment to a non-competition covenant after their tenure expires.

8.6 Other information related to persons with executive powers

Overview of pecuniary and in-kind incomes of persons with executive powers

Information about pecuniary and in-kind incomes received in the accounting period by persons with executive powers from Telefónica CR and entities controlled by it.

(in CZK)	Pecuniary incomes	Of which royalties	In-kind incomes
Board of Directors total	78,747,534	0	11,030,070
- of which by virtue of membership in the Board of Directors of the Company	519,935	0	1,168,216
Supervisory Board total	10,374,420	0	2,473,259
- of which by virtue of membership in the Supervisory Board of the Company	5,090,308	0	2,032,758
Executive Management of Telefónica CR[1]	33,398,015	0	6,953,433

In 2012, members of the Board of Directors and Supervisory Board received no pecuniary or in-kind income from entities controlled by Telefónica CR.

Information on the ownership of Company shares by persons with executive powers

Information on the number of shares issued by Telefónica CR and held by statutory bodies or their members, persons with executive powers; information on option and similar agreements; information on individual transactions concluded by the said persons in the accounting period

[1] Executive Management category includes the income of persons listed in section Executive Management. Income of persons who are at the same time members of the Board of Directors are accounted for in the Board of Directors total category.

	Number of shares
Board of Directors	0
Supervisory Board	100
Audit Committee[2]	0
Other persons with executive powers – Executive Management of Telefónica CR[3]	0

Conflict of interest of persons with executive powers

No conflict of interest was found in relation to members of the Board of Directors, Supervisory Board and executive management; no member has been, in the last five years, lawfully sentenced for fraud, nor been – as a statutory or supervisory body – a party to insolvency proceedings, nor been subject to receivership or liquidation, nor charged or sanctioned by statutory or regulatory bodies.

Information on agreements for discharge of the office of a member concluded between members of the Board of Directors, the Supervisory Board and the Audit Committee

In 2012, all members of the Board of Directors and of the Supervisory Board, with the exception of the Supervisory Board member (Jesús Pérez de Uriguen) who was co-opted by the Supervisory Board on 5 November 2012, were bound by a valid agreement for discharge of the office of a member, which stipulates the eligibility for compensation for members who had committed to the non-competition covenant after the termination of their office.

8.7 Information on corporate governance codes of the Company

The Company has been meeting all the main criteria and observing the principles and recommendations of the Czech Code of Good Corporate Governance based on OECD Principles, which was published in 2004 (the Code). The Code is available at the website of the Ministry of Finance of the Czech Republic (www.mfcr.cz). An exception to this rule are the principles of Good Corporate Governance that are not in direct control of the Company's governing bodies and are dependent on the decisions of its owners (in particular the criterion concerning the number of independent members of the Supervisory Board). The Board of Directors regularly oversees the good practice of Corporate Governance in subsidiaries controlled by Telefónica CR.

8.8 Information on internal control principles and procedures

As part of performing internal controls in the area of financial reporting, the Company has implemented the key requirements of the Sarbanes-Oxley Act (SOX), which it is bound to respect – principally as a result of the fact that the shares of the parent Telefónica, S.A. are listed on the US capital markets. Twice a year the Company performs an evaluation of its internal controls in the area of financial reporting in the scope of the regulatory framework introduced by SOX Section 404, including an evaluation of the controlling mechanism in the area of the Company's information systems that could have a potential impact on the bottom line of the Company. The audits verify the standard of the description, configuration and take the form of walkthrough tests

[2] Shares held by members of the Audit Committee who are also members of the Supervisory Board, are accounted for in the Supervisory Board total category.

[3] Executive Management category includes the shares held by executives in the positions that members of the Executive Management of Telefónica CR (see sub-section Executive management). The shares held by those members of the Board of Directors who, at the same time, qualify as Executive Management are accounted for in the Board of Directors total category.

and compliance tests of transactions, as well as the effectiveness of controlling mechanisms in the area of financial reporting. The audit results are consulted with the external auditor of the Company. The audits performed in 2011 concluded that the internal controls, as applied, were of a standard which meets the SOX requirements. The quarterly declaration of the management (Chief Executive Officer and Director, Finance Division) attesting to the veracity of the information contained in the financial statements, implementation and application of effective internal controls, and other matters required by SOX Section 302 (including the information about any changes in the Company's accounting policy, one-off/extraordinary or material items having an impact on the Company's results for the quarter, and the overview of material reserves created by the Company in order to cover for its contingent risks and liabilities – e.g. from litigation) form an integral part of the SOX compliance procedures in the general area of Corporate Governance.

The above documents are presented internally to the Board of Directors and to the Audit Committee for review and discussion.

In 2012, the internal audit and risk management function in the Company continued to be developed; the organisation of these functions (which are consolidated into one organisation unit), the line management of the Chief Executive Officer and the functional subordination of Internal Audit (in accordance with the International Standards for the Professional Practice of Internal Auditing) to the Audit Committee and the Board of Directors remained as before.

Internal Audit represents an important instrument of Corporate Governance and it provides the Company's governing and executive bodies with independent and professional assessment of the Company's internal control system and the situation and trends in the given area compared to current best practice, the rules and regulations in force, and work orders and instructions issued. In 2012, Internal Audit and Risk Management carried out 47 audits and controls (including the regular audit of internal controls required by SOX 404) as per the annual plan of Internal Audit or as mandated by the governing bodies and the Chief Executive Officer. In addition to performing audits and controls in Telefónica CR, the Internal Audit unit also acts as internal auditor of Telefónica Slovakia and other subsidiary companies in the Telefónica Czech Republic Group. The audit conclusions were used by the management to formulate actions to redress the issues identified. Internal Audit monitors the implementation of such actions and reports to the governing bodies and the executive management. The activities of Internal Audit and its main processes are laid down in the Internal Audit Charter of Telefónica Czech Republic, which also stipulates the principle of independence of the Internal Audit function and the principle of objectiveness of internal auditors. The work of Internal Audit is monitored on a regular basis by the Audit Committee which discusses audit reports and other reporting presented by Internal Audit. The Internal Audit Charter stipulates the Audit Committee's participation in the preparation and approval of the annual plan of internal audits; the Audit Committee also approves the annual budget of Internal Audit and its annual performance evaluation. The Director of Internal Audit & Risk Management has full access to the Audit Committee and is present for the discussion of audit reports and other outputs of Internal Audit & Risk Management at meetings of the governing bodies of the Company.

Since the year 2007, the Internal Audit and Risk Management unit of Telefónica Czech Republic, is certified in quality by the Institute of Internal Auditors (IIA). This certification assesses Internal Audit activity's conformity to The IIA's International Standards for the Professional Practice of Internal Auditing (Standards). During the course of 2012, the Institute of Internal Auditors (IIA) carried out an independent assessment for the purposes of re-certification, as per the Standards.

In 2012, the Company forged ahead with the development of its risk management function and in its harmonisation with the methodology and practice within the global Telefónica Group, which creates more space for the sharing of experience and knowledge in the area of mitigation of specific risks with the parent company and other members of the Group. The risk management system covers all areas of operations of Telefónica CR, including its subsidiary Telefónica Slovakia, and provides for the identification, assessment and mitigation of risks, which it continues to monitor throughout. For more details please refer to section Risk management.

8.9 Information relating to matters according to the Capital Market Undertakings Act

Information relating to matters according to Section 118(5) of the Act No. 256/2004 Coll., the Capital Market Undertakings Act (CMUA), and information which is a part of a summary report compiled according to the requirement of Section 118(8) of the CMUA:

a) Information about the issuer's equity capital structure, including shares not admitted for trading on the regulated market in a European Union Member State, including any potential qualification of different types of shares or similar securities representing a share in the issuer, and the share in the share capital of each type of share or similar security representing a share in the issuer

Standalone equity structure of Telefónica CR as at 31 December 2012 was as follows:

	(in CZK m)
Share capital	28,022
Own shares	(2,483)
Share premium	24,374
Fund for share-related payments	31
Funds	6,450
Retained earnings	6,793
Total	**63,187**

The Company's share capital as at 31 December 2012 was CZK 28,021,821,300 and was fully paid up. The share capital is made up of the following shares:

A. Type: ordinary
Form: registered
Kind: booked
Number of shares: 322,089,890 shares
Nominal value: CZK 87
Total volume of issue: CZK 28,021,820,430
ISIN: CZ0009093209

B. Type: ordinary
Form: registered
Kind: booked
Number of shares: 1 share
Nominal value: CZK 870
Total volume of issue: CZK 870
ISIN CZ0008467115

The rights and obligations related to the registered share which represents a share in Telefónica CR are set out in Article 5 of the Articles of Association of the Company.

The General Meeting of the Company, which was held on 19 April 2012, passed a resolution which effected a reduction of the share capital. On 17 October 2012, a decision of the Municipal Court in Prague became final and conclusive, based on which the reduction of the Company's share capital, as per the resolution of the General Meeting, was recorded in the Commercial Register on 14 November 2012. The share capital was reduced by a total of CZK 4,187,168,700 by way of a proportional reduction of the nominal value of all shares of the Company. The nominal value of each of the 322,089,890 shares went down CZK 13 from CZK 100 to CZK 87; the nominal value of the CZK 1,000 share went down CZK 130 to CZK 870. The total amount by which the share capital was reduced, i.e. CZK 4,187,168,700, was paid out to the shareholders of the Company.

The registered shares in the nominal value of CZK 87 were listed for trading on the following markets:

Market	**Note**
Prague Stock Exchange (Burza cenných papírů Praha, a.s.)	On the main market (until 29 November 2012), on the Prime market (from 30 November 2012)
RM-SYSTÉM, česká burza cenných papírů a.s.	
The London Stock Exchange	In the form of Global Depository Receipts (GDR). The depository for the GDR is The Bank of New York Mellon, ADR Division, 101 Barclay Street, West New York, NY 10286, USA; the custodian is Komerční banka, a.s., Na Příkopě 33, čp. 906, 114 07 Prague 1.

A full wording of the Terms and Conditions of the Share Issue – the document which is the source of this summary – is available at the registered address of the security issuer.

The registered share in the nominal value of CZK 870 was not listed for trading on any regulated market in a European Union Member State.

b) Information about transferability of securities

Only the statutory requirements need to be met for a transfer of shares and Global Depository Receipts. The Company's Articles of Association impose no further restrictions on the transferability of the shares and there are no other restrictions for reasons that would be on the part of the Company.

c) Information about significant direct and indirect shares in the voting rights of the issuer

Key shareholders of Telefónica CR as at 31 December 2012:

	Shareholder	**Address**	**% of share capital**
1	Telefónica, S.A.	Gran Vía 28, 28013 Madrid, Španělské království	69.41%
2	Telefónica Czech Republic, a.s. (own shares)	Za Brumlovkou 266/2, Praha 4-Michle, 140 22, Česká republika	2.00%
2	Investment funds and individual shareholders	-	28.59%

As at 31 December 2012, the share of Telefónica, S.A., in the voting rights of Telefónica Czech Republic, a.s., according to the provision of Section 122 of the Capital Market Undertakings Act was 69.41%.

d) Information about the holding of shares with special rights, including the description of these rights

The Company has not issued any securities with special rights, only ordinary shares as per point a) above.

e) Information about restrictions of voting rights

Voting rights are attached to all shares issued by the Company and may be restricted or excluded only in instances set out in the law. The Company is not aware of any such statutory restriction or exclusion of voting rights. The Company's Articles of Association do not stipulate any restriction of voting rights; there are no other restrictions for reasons that would be on the part of the Company.

f) Information about agreements between shareholders or owners of securities representing a share in the issuer, which could restrict the transferability of shares or similar securities representing a share in the issuer, or of voting rights, if such information is known to the issuer

The Company has no knowledge of any agreements between shareholders, which could restrict the transferability of shares or voting rights.

g) Information about special rules for the election and recall of the statutory body, amendment to the articles of association or similar document of the issuer

Members of the Board of Directors are elected and recalled by the Supervisory Board of the Company. The eligibility conditions for election to the Board of Directors are laid down in the law; the Articles of Association do not contain any restriction beyond the statutory scope; there are no other restrictions for reasons that would be on the part of the Company.

Two thirds of members of the Supervisory Board are elected and recalled by the General Meeting of the Company; one third is elected and recalled by the Company's employees. The eligibility conditions for election to the Supervisory Board are laid down in the law; the Articles of Association contain only a single condition beyond the statutory scope – that the Chief Executive Officer may not be elected as member of the Supervisory Board. There are no other restrictions for reasons that would be on the part of the Company.

h) Information about special powers of members of the statutory body, in particular about their authorisation as per Sections 161a and 210 of the Commercial Code

Members of the Board of Directors hold no special powers; some acts by the Board o Directors require, as per Article 14(4) of the Company's Articles of Association, a previous consent by the Supervisory Board.

i) Information about important contracts, which the issuer is a party to and which will come into effect, change or expire upon a change in the issuer's control as a result of a take-over bid, and about the effects thereof, with the exception such contracts whose disclosure would bear a serious harm for the issuer, which, however, does not reduce other duties of disclosure of such information under this law or under other laws

The Company has not entered into any contracts that will come into effect, change or expire upon a change in the issuer's control as a result of a take-over bid.

j) Information about contracts between the issuer and the members of the statutory body or employees, by which the issuer is bound in the event of the termination of their office or employment in connection with a take-over bid

No contracts were concluded between the Company and the members of its Board of Directors or its employees, by which the Company would be bound in the event of the termination of their office or employment in connection with a take-over bid.

k) Information about any programmes based on which the employees and members of the statutory body of the company can acquire shares, share options or other rights at preferential terms, and about how the rights associated with these securities are exercised

No programmes exist for members of the Board of Directors or employees of the Company based on which they could acquire shares, share options or other rights of the Company at preferential terms.

l) Information about payments remitted to the state for mining licences, provided the core business of the issuer is in the mining sector

With regard to the fact that the Company has no business in the mining sector, this declaration is not applicable.

05

Financial part

Special clients deserve exceptional care. We appreciate loyalty.
Our best-in-class service to business customers shows that you are always in the focus of our attention.

Consolidated financial statements

9. Financial part

9.1 Consolidated financial statements for the year ended 31 December 2012 prepared in accordance with International Financial Reporting Standards

Content Pages

GENERAL INFORMATION

Telefónica Czech Republic, a.s. Group (Group) consists of Telefónica Czech Republic, a.s. (Company) and its subsidiaries: Telefónica Slovakia, s.r.o., Bonerix s.r.o., Internethome, s.r.o., CZECH TELECOM Germany GmbH and CZECH TELECOM Austria GmbH.

The Company has the form of a joint stock company and is incorporated and domiciled in the Czech Republic. The address of its registered office is Za Brumlovkou 266/2, Prague 4, 140 22, Czech Republic.

The Group is a member of the Telefónica Group of companies (Telefónica Group) with the parent company, Telefónica, S.A. (Telefónica).

The Company is the principal supplier of fixed line telecommunication services and is one of three suppliers of mobile telephone services in the Czech Republic.

The number of employees employed with the Group amounted in average to 6,502 in 2012 (2011: 7,297).

The Company's shares are traded on the Prague Stock Exchange.

The consolidated financial statements were approved for issue by the Company's Board of Directors on 13 February 2013.

Reduction of the Company's share capital

In accordance with the resolution on reduction of the Company's share capital adopted by the General Meeting of the Company held on 19 April 2012, the reduction of the Company's share capital was registered into the Commercial Register on 14 November 2012. The nominal value of each share with the nominal value of CZK 100 was decreased by CZK 13 per share and each share with the nominal value of CZK 1,000 was decreased by CZK 130. As at 31 December 2012, the amount of the Company's share capital equaled to CZK 28,021,821,300.

Share buyback

Following the resolution of the Company's General Meeting held on 19 April 2012 regarding the share buyback programme (up to 10% of ordinary shares within 5 years), the Board of Directors approved on 9 May 2012 the acquisition of 2% of the total number of ordinary shares issued by the Company (share buyback). On 18 May 2012, the Company instructed the selected broker to acquire 2% of the total number of ordinary shares issued by the Company (i.e. 6,441,798 ordinary shares).

Acquisition of Bonerix s.r.o.

On 31 August 2012, the Company, via its subsidiary Bonerix s.r.o., signed the agreement related to the acquisition of five parts of the enterprises of Global Care Group (Global Care, s.r.o., TMT Czech, a.s., Hermod, a.s., Česká servisní a správní, a.s., LAKENSIS, a.s.).

Acquisition of WiFi operators

During 2012, the Group continued with the process of acquisition of WiFi network infrastructure, customer portfolios and related assets from local providers of WiFi internet access by WiFi technology. The transactions were executed as acquisitions of the part of the enterprise by Internethome, s.r.o.

Restructuring

During 2012, the Group continued to implement its restructuring and cost-optimization activities aimed at further improvement of its operational efficiency. The Group launched new projects in various areas of its operations. These projects were focused on the streamlining of the organisation structure, including the reduction of duplicate positions; call centres consolidation and optimization; reduction of the number of applications and systems in use, including the related processes optimisation. Some restructuring projects have led to a transfer of the activities to outsourcing partners. During the restructuring process more than 500 employees were made redundant and the Group incurred restructuring costs of CZK 265 million (see Note 2).

Cooperation with Genpact Czech s.r.o.

In 2012, the Group has started a five-year cooperation with the company Genpact Czech s.r.o., one of the world's leading companies in the field of accounting and administrative services. Most of the activities carried out by the Group's accounting department were transferred to Genpact Czech s.r.o. as of 14 May 2012. Employees performing these activities were transferred to the employment of Genpact Czech s.r.o.

Research and development activities

During 2012, the Group drew on the knowledge and experience of Telefónica Digital, a division of the Telefónica Group, which seeks to exploit new growth opportunities while strengthening the portfolio of products and services. As a result of the cooperation with Telefónica Digital, the Group brought several innovations in the area of financial and ICT/Cloud services to the market in 2012. In late 2012, Telefónica Digital launched its Wayra program in the Czech Republic and Slovakia, which is aimed at supporting innovation in the segment of Internet and new information and communication technologies (ICT). In 2012, the Group made no internal investments in research and development according to IAS 38 Intangible assets.

BLESKmobil

The Company entered into an agreement with publishing house Ringier Axel Springer CZ to start up the first virtual mobil operator in the Czech Republic. The service is offered under the BLESKmobil brand through one pay-as-you-go tariff.

Informační linky, a.s.

On 1 January 2012 the subsidiary Informační linky, a.s. was founded by a non-monetary contribution of part of the enterprise. On 29 February 2012, 80% of shares of the subsidiary Informační linky, a.s. was sold to Hapalo Estates s.r.o. The share purchase agreement includes call option relating to sale of remaining 20% of shares. The Company has recognized the net profit exceeding CZK 200 million. Informační linky, a.s. provides information and asistance service on telephone numbers 1180, 1181 and 1188.

INDEPENDENT AUDITOR'S REPORT TO THE SHAREHOLDERS OF Telefónica Czech Republic, a.s.

INDEPENDENT AUDITOR'S REPORT

To the shareholders of Telefónica Czech Republic, a.s.:

We have audited the accompanying consolidated financial statements of Telefónica Czech Republic, a.s., and its subsidiaries ("the Group") which comprise the consolidated balance sheet as at 31 December 2012, and the consolidated statement of total comprehensive income, consolidated statement of changes in equity and consolidated statement of cash flows for the year then ended, and a summary of significant accounting policies and other explanatory notes.

Management's Responsibility for the Consolidated Financial Statements

Management of Telefónica Czech Republic, a.s., is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with International Financial Reporting Standards as adopted by the European Union, and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audit. We conducted our audit in accordance with the Act on Auditors and International Standards on Auditing as amended by implementation guidance of the Chamber of Auditors of the Czech Republic. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including an assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of the Group as at 31 December 2012, and its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards as adopted by the European Union.

Ernst & Young Audit, s.r.o.
License No. 401
Represented by partner

Radek Pav
Auditor, License No. 2042

13 February 2013
Prague, Czech Republic

CONSOLIDATED STATEMENT OF TOTAL COMPREHENSIVE INCOME

For the year ended 31 December 2012

In CZK million	Notes	Year ended 31 December 2012	Year ended 31 December 2011
Revenues from voice services	2	16,913	18,218
Monthly charges		12,531	12,900
Data services	2	11,296	11,477
Other revenues	2	9,794	9,814
Revenues		**50,534**	**52,409**
Other income	2	498	487
Interconnection and roaming expenses		(8,820)	(9,165)
Cost of goods sold		(2,128)	(2,170)
Other cost of sales	2	(3,791)	(3,429)
Other expenses	2	(10,646)	(10,142)
Staff costs	2	(5,838)	(6,179)
Impairment reversal/(loss)		(28)	(21)
Operating income before depreciation and amortization ("OIBDA")		**19,781**	**21,790**
Depreciation and amortisation	7, 8	(11,437)	(11,651)
Operating profit		8,344	10,139
Finance income	3	103	313
Finance costs	3	(291)	(444)
Profit before tax		8,156	10,008
Corporate income tax	4	(1,380)	(1,324)
Profit for the year		**6,776**	**8,684**
Other comprehensive income			
Translation differences		(65)	110
Other comprehensive income, net of tax		(65)	110
Total comprehensive income, net of tax		**6,711**	**8,794**
Profit attributable to:			
Equity holders of the Company	5	6,776	8,684
Total comprehensive income attributable to:			
Equity holders of the Company		6,711	8,794
Earnings per share (CZK) – basic*	5	21	27

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

CONSOLIDATED BALANCE SHEET
As at 31 December 2012

In CZK million	Notes	31 December 2012	31 December 2011
ASSETS			
Property, plant and equipment	7	46,691	51,525
Intangible assets	8	20,330	20,658
Investment in associate	22	29	22
Other financial assets	11	112	149
Deferred tax asset	15	673	746
Non-current assets		**67,835**	**73,100**
Inventories	10	487	488
Receivables	11	7,732	8,273
Income tax receivable	4	101	165
Cash and cash equivalents	12	3,044	6,955
Current assets		**11,364**	**15,881**
Non-current assets classified as held for sale	7	**-**	**1**
Total assets		**79,199**	**88,982**
EQUITY AND LIABILITIES			
Ordinary shares	20	28,022	32,209
Treasury shares	20	(2,483)	-
Share premium		24,374	24,374
Retained earnings, funds and reserves		10,661	12,514
Total equity		**60,574**	**69,097**
Long-term financial debts	14	3,000	-
Deferred tax liability	15	3,206	3,736
Non-current provisions for liabilities and charges	16	29	26
Non-current other liabilities	13	87	108
Non-current liabilities		**6,322**	**3,870**
Short-term financial debts	14	31	3,061
Trade and other payables	13	12,235	12,882
Income tax liability	4	5	5
Provisions for liabilities and charges	16	32	67
Current liabilities		**12,303**	**16,015**
Total liabilities		**18,625**	**19,885**
Total equity and liabilities		**79,199**	**88,982**

The consolidated financial statements were approved by the Board of Directors on 13 February 2013 and were signed on its behalf by:

Luis Antonio Malvido
Chairman of the Board of Directors
Chief Executive Officer

David Melcon Sanchez-Friera
1st Vice Chairman of the Board of Directors
Director, Finance Division

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY
For the year ended 31 December 2012

In CZK million	Notes	Share capital	Share premium	Treasury shares	Foreign exchange translation reserve	Equity settled share based payments reserve	Funds*	Retained earnings	Total
At 1 January 2011		**32,209**	**24,374**	**-**	**(162)**	**38**	**6,452**	**10,265**	**73,176**
Currency translation differences – amount arising in period		-	-	-	110	-	-	-	110
Profit for the year		-	-	-	-	-	-	8,684	8,684
Total comprehensive income		-	-	-	**110**	-	-	**8,684**	**8,794**
Capital contribution and other transfers		-	-	-	-	18	-	(7)	11
Dividends declared in 2011	6	-	-	-	-	-	-	(12,884)	(12,884)
At 31 December 2011		**32,209**	**24,374**	**-**	**(52)**	**56**	**6,452**	**6,058**	**69,097**
At 1 January 2012		**32,209**	**24,374**	**-**	**(52)**	**56**	**6,452**	**6,058**	**69,097**
Currency translation differences – amount arising in period		-	-	-	(65)	-	-	-	(65)
Profit for the year		-	-	-	-	-	-	6,776	6,776
Total comprehensive income		-	-	-	**(65)**	-	-	**6,776**	**6,711**
Capital contribution and other transfers		-	-	-	-	(25)	47	(53)	(31)
Dividends declared in 2012	6	-	-	-	-	-	-	(8,696)	(8,696)
Treasury share acquisition	20	-	-	(2,483)	-	-	-	91	(2,392)
Share capital increase/(decrease)	20	(4,187)	-	-	-	-	-	72	(4,115)
At 31 December 2012		**28,022**	**24,374**	**(2,483)**	**(117)**	**31**	**6,499**	**4,248**	**60,574**

* Refer to Note 20 regarding amounts not available for distribution.

CONSOLIDATED STATEMENT OF CASH FLOWS
For the year ended 31 December 2012

In CZK million	Notes	Year ended 31 December 2012	Year ended 31 December 2011
Cash flow from operating activities			
Cash received from operations		54,592	56,452
Cash paid to suppliers and employees		(35,428)	(33,886)
Dividends received		5	5
Net interest and other financial expenses paid	12	(150)	(101)
Taxes paid		(1,783)	(1,938)
Net cash from operating activities		**17,236**	**20,532**
Cash flow from investing activities			
Proceeds from disposals of property, plant and equipment and intangible assets		322	601
Payments on investments in property, plant and equipment and intangible assets		(5,671)	(5,953)
Payments on investments in WiFi acquisition		(148)	(141)
Payments made on financial investments		(18)	(22)
Payments on temporary financial investments		(250)	-
Net cash used in investing activities		**(5,765)**	**(5,515)**
Cash flow from financing activities			
Dividends paid		(8,848)	(12,878)
Capital decrease	20	(4,115)	-
Cash payments to owners for acquisition of treasury shares	20	(2,483)	-
Proceeds from loans		3,000	-
Repayments of loans, borrowings and promissory notes	14	(2,912)	(2)
Net cash used in financing activities		**(15,358)**	**(12,880)**
Effect of foreign exchange rate changes on collections and payments		**(24)**	**20**
Net increase / (decrease) in cash and cash equivalents during the period		**(3,911)**	**2,157**
CASH AND CASH EQUIVALENTS AT THE BEGINNING OF THE PERIOD		**6,955**	**4,798**
CASH AND CASH EQUIVALENTS AT THE END OF THE PERIOD	12	**3,044**	**6,955**
BALANCE AT THE BEGINNING OF THE PERIOD		**6,955**	**4,798**
Cash on hand and at banks		6,932	4,774
Other cash equivalents		23	24
BALANCE AT THE END OF THE PERIOD	12	**3,044**	**6,955**
Cash on hand and at banks		3,025	6,932
Other cash equivalents		19	23

ACCOUNTING POLICIES

Content Pages

A Basis of preparation

The principal accounting policies applied in the preparation of the consolidated financial statements are set out below. The policies have been consistently applied to all years presented, unless otherwise stated.

The consolidated financial statements were prepared in accordance with International Financial Reporting Standards (IFRS) and all applicable IFRSs adopted by the EU. IFRS comprise standards and interpretations approved by the International Accounting Standards Board (IASB) and the IFRS Interpretations Committee (IFRS IC).

Effective from 1 January 2005, a change in the Czech Act on Accounting No. 563/1991 Coll. requires the Group to prepare its consolidated financial statements in accordance with IFRS adopted by the EU (Regulation (EC) No 1606/2002). At the balance sheet date, there are no differences in the IFRS policies applied by the Group, and IFRS adopted by the EU.

The consolidated financial statements were prepared under the historical cost convention except for non-current assets held for sale, inventory held at net realizable value, financial derivatives, share based payment liability and certain assets and liabilities acquired during business combinations, as disclosed in the accounting policies below.

The preparation of consolidated financial statements in conformity with IFRS required the Group to use certain critical accounting estimates. It also required estimates be used in the process of applying the Group's accounting policies. The areas involving a higher degree of judgement or complexity, or areas where assumptions and estimates are significant to the consolidated financial statements are disclosed in Note U.

The amounts shown in the consolidated financial statements are presented in millions Czech crowns (CZK), if not stated otherwise.

Adoption of new or revised IFRS standards and interpretations (includes standards and interpretations applicable for the Group)

In 2012, the Group applied the below stated standards, interpretations and amendments, which are relevant to its operations. Adoption of the interpretations and amendments has no effect on the financial performance or position of the Group.

IAS 12 Income Taxes – Amendment (effective 1 January 2012)

The amendment clarifies the determination of deferred tax on investment property measured at fair value and introduces a rebuttable presumption that deferred tax on investment property measured using the fair value model in IAS 40 should be determined on the basis that its carrying amount will be recovered through sale. It includes the requirement that deferred tax on non-depreciable assets that are measured using the revaluation model in IAS 16 should always be measured on a sale basis.

The adoption of the amendment did not have any impact on the Group's financial position, performance or its disclosures.

IFRS 7 Financial Instruments: Disclosures — Enhanced Derecognition Disclosure Requirements (effective 1 July 2011)

The amendment requires additional disclosure about financial assets that have been transferred but not derecognised to enable the user of the Group's financial statements to understand the relationship with those assets that have not been derecognised and their associated liabilities. In addition, the amendment requires disclosures about the entity's continuing involvement in derecognised assets to enable the users to evaluate the nature of, and risks associated with, such involvement.

The Group does not have any assets with these characteristics so there has been no effect on the presentation of its financial statements.

New IFRS not effective as at 31 December 2012 (includes standards applicable for the Group)

At the date of preparation of the accompanying consolidated financial statements, the following IFRS had been published, but their application was not mandatory. The Group intends to adopt those standards when they become effective.

Standards and amendments		**Mandatory application: annual periods beginning on or after**
IAS 1	Presentation of Items of Other Comprehensive Income (Amendment)	1 July 2012
IFRS 7	Disclosures — Offsetting Financial Assets and Financial Liabilities — Amendments to IFRS 7	1 January 2013
IFRS 9	Financial Instruments: Classification and Measurement	1 January 2015
IFRS 10	Consolidated Financial Statements	1 January 2013
IFRS 11	Joint Arrangements	1 January 2013
IFRS 12	Disclosure of Interests in Other Entities	1 January 2013
IFRS 13	Fair Value Measurement	1 January 2013
IAS 19	Employee benefits (Revised)	1 January 2013
IAS 27	Separate Financial Statements (as revised in 2011)	1 January 2013
IAS 28	Investments in Associates and Joint Ventures (as revised in 2011)	1 January 2013
IAS 32	Offsetting Financial Assets and Financial Liabilities — Amendments	1 January 2014

The Group is currently assessing the impact of the application of these standards and amendments. Based on the analyses made to date, the Group estimates that their adoption will not have a significant impact on the consolidated financial statements in the initial period of application.

The Group is currently monitoring the development in the area of IFRSs being prepared in regards to leases and revenue recognition, which are planned for submission in 2013 or later.

B Group accounting

Consolidation

Subsidiary undertakings, which are those companies in which the Company, directly or indirectly, has an interest of more than one half of the voting rights or otherwise has power to exercise control over the operations, have been consolidated. Subsidiaries are consolidated from the date on which control is transferred to the Group (date of acquisition) and are no longer consolidated from the date when the Group ceases to have control.

A business combination is accounted for using the acquisition method. The consideration transferred for the acquisition of the business combination is the fair value of the assets transferred, the liabilities incurred and the equity interests issued by the Group. The consideration transferred includes the fair value of any asset or liability resulting from a contingent consideration arrangement. Acquisition related costs are expensed when incurred. The excess of the consideration transferred, the amount of any non-controlling interest in the acquiree and the acquisition-date fair value of any previous equity interest in the acquiree over the fair value of the Group's share of the identifiable net assets acquired is recorded as goodwill. The excess of the fair value of the Group´s share of the identifiable net assets acquired over the considerations transferred, the amount of any non-controlling interest in the acquiree and the acquisition-date fair value of any previous equity interest in the acquiree is recorded as gain in profit or loss on the acquisition date. For detail refer to Note E Intangible assets and also to Note 8.

Intercompany transactions and balances among the Group companies are eliminated unless the transaction provides evidence of an impairment of the asset transferred. The accounting policies for subsidiaries are changed, where necessary, to ensure consistency with the policies adopted by the Group and another companies within the Group.

Intercompany transactions and balances between the Group and Telefónica companies for the period after the transfer of majority ownership to Telefónica, S.A. are not eliminated. They are identified, disclosed and measured for the disclosure purposes and elimination procedures of the majority shareholder – Telefónica, S.A. (see Note 21).

C Foreign currencies

(i) Functional and presentation currency

Items included in the financial statements of each entity in the Group are measured using the currency of the primary economic environment in which the entity operates ("the functional currency"). The consolidated financial statements are presented in Czech crowns (CZK), which is the Group's presentation currency.

(ii) Transactions and balances

Foreign currency transactions are translated into the functional currency using the exchange rates prevailing at the date of the transaction. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation of monetary assets and liabilities denominated in foreign currencies are recognised in profit or loss, except when deferred in other comprehensive income as qualifying cash flow hedges. Such balances of monetary items are translated at period-end exchange rates. Non-monetary items that are measured in terms of historical cost in a foreign currency are translated using the exchange rate at the date of the transaction. Non-monetary items that are measured at fair value in a foreign currency are translated using the exchange rates at the date when the fair value was determined.

(iii) Group companies

Profit or loss of foreign entities are translated into the Group's reporting currency at the average exchange rates for the year and their balance sheets are translated at the exchange rates ruling on 31 December. Exchange differences arising from the translation of the net investment in foreign entities and of borrowings and other currency instruments designated as hedges of such investments are taken to other comprehensive income. When a foreign entity is sold, such exchange differences are recognised in profit or loss as part of the gain or loss on sale.

D Property, plant and equipment

All property, plant and equipment are initially recorded at cost and, except for freehold land, are subsequently carried at its cost less any accumulated depreciation and accumulated impairment losses. Freehold land is subsequently stated at cost less any accumulated impairment charges.

Property, plant and equipment acquired in business combinations are stated at their acquisition costs (which are equal to their fair value at the date of acquisition) less accumulated depreciation and accumulated impairment charges.

Property, plant and equipment include all costs directly attributable to bringing the asset to working condition for its intended use. With respect to the construction of the network, this comprises every expenditure up to the customers' premises, including the cost of contractors, materials, direct labour costs and interest cost incurred during the course of construction.

Subsequent costs are recognised as property, plant and equipment only if it is probable that future economic benefits associated with the item will flow to the Group and the cost can be measured reliably.

Repairs and maintenance costs are expensed as incurred.

Items of property, plant and equipment that are retired are not intended for sale and are not expected to create any future economic benefits or are otherwise disposed of, are eliminated from the balance sheet, along with the corresponding accumulated depreciation. Any gain or loss arising from retirement or disposal is included in net operating income, i.e. net gain or loss is determined as the difference between the net disposal proceeds, if any, and the carrying amount of the item.

Items of property, plant and equipment, excluding freehold land, are depreciated from the time they are available for use, using the straight-line method. Depreciation ceases at the earlier of the date the asset is either de-recognised or at the date the asset is classified as held for sale.

Depreciation does not cease, when the asset becomes temporarily idle or retired from active use, unless the asset is fully depreciated.

Estimated useful lives adopted in the consolidated financial statements are as follows:

	Years
Freehold buildings	up to 40
Cable and other related plant	10 to 25
Exchanges and related equipment	up to 25
Other fixed assets	up to 20

Freehold land is not depreciated as it is deemed to have an indefinite life.

The assets' residual values and useful lives are reviewed, and adjusted if appropriate, at each balance sheet date.

An asset's carrying amount is written down immediately to its recoverable amount if the asset's carrying amount is greater than its estimated recoverable amount (refer to Note G Impairment of assets).

E Intangible assets

Intangible assets include computer software, purchased goodwill, licences and customer bases. Computer software mainly represents the external acquisition costs of the Group's information systems that are intended for use within the Group. Generally, costs associated with developing or maintaining computer software programs are recognised as an expense as incurred. However, costs that are directly associated with identifiable and unique software products controlled by the Group and that have a probable economic benefit exceeding the cost beyond one year, are recognised as intangible assets. Computer software costs recognised as assets are amortised using the straight-line method over their useful lives, generally from one to five years.

Intangible assets acquired in business combinations are stated at their acquisition costs (which are equal to their fair value at the date of acquisition) less accumulated amortisation and accumulated impairment charges and are amortised on a straight-line basis over their estimated useful lives. Customer bases are amortised over a period of the remaining average terms of the binding contracts or period over which production units are generally obtained from the asset by an entity.

Acquired licences are recorded at cost and amortised on a straight-line basis over the remaining life of the licence (i.e. over 15 to 20 years), from the start of commercial service, which best reflects the pattern by which the economic benefits of the intangible assets will be utilised by the Group.

Intangible assets with an indefinite useful life are not amortised. They are subject to the regular impairment reviews (see Note 8 and Note 9).

Goodwill, arising from the purchase of subsidiary undertakings and interests in associates and joint ventures, represents the excess of the fair value of the purchase consideration over the fair value of the net assets acquired. Goodwill is not amortised but is tested for impairment at least annually or anytime there are indications of a decrease in its value.

The Group reviews at least at the balance sheet date the useful lives of intangible assets that are not amortised to determine whether events and circumstances continue to support an indefinite useful life assessment for that asset. If they do not, the change in the useful life assessment from indefinite to finite is accounted for as a change in an accounting estimate.

On the balance sheet date, carrying amounts, residual values and the useful lives of assets are reviewed, revised and if necessary prospectively amended and accounted for as a change in an accounting estimate.

Intangible assets that are no longer in use and no future economic benefits are expected or that are disposed of for any other reason are de-recognised from the balance sheet together with the corresponding accumulated amortisation (for amortised assets only). All gains or losses arising in this respect are recognised in net operating income, i.e. net gain or loss is determined as the difference between net disposal proceeds, if any, and the carrying amount of the asset.

Intangible assets, with the exception of assets with an indefinite useful life, are amortised using the straight-line method from the time they are available for use. Amortisation ceases at the earlier of the date the asset is de-recognised, the date the asset is classified as having the indefinite useful life or the date the asset is classified as held for sale.

F Non-current assets classified as held for sale

The Group classifies separately in the balance sheet a non-current asset (or disposal group) as held for sale if its carrying amount will be recovered principally through a sale transaction rather than through continuing use. For this to be the case, the asset (or disposal group) is available for immediate sale in its present condition subject only to terms that are usual and customary for sales of such assets (or disposal groups), its sale is highly probable and sale is expected within one year.

The Group measures a non-current asset (or disposal group) classified as held for sale at the lower of its carrying amount and fair value less costs to sell.

The Group recognizes an impairment loss for any initial or subsequent write-down of the asset (or disposal group) to fair value less costs to sell and is accounted for as an impairment loss with impact on profit or loss of the relevant period.

From the moment the asset is classified as held for sale and eventually revalued, it ceases to be depreciated/amortised and is reviewed only from impairment point of view.

Any gain from any subsequent increase in fair value less costs to sell, but not in excess of the cumulative impairment loss that has been recognized, is determined and is accounted for in profit or loss.

G Impairment of assets

Property, plant and equipment and other assets, including goodwill and intangible assets, are reviewed for impairment losses whenever events or changes in circumstances indicate that the carrying amount may not be recoverable or at least on an annual basis for goodwill and for intangibles with an indefinite useful life and for intangibles not yet in use. An impairment loss is recognised for the amount by which the carrying amount of the asset exceeds its recoverable amount, which is the higher of an asset's net selling price and value in use. For the purposes of assessing impairment, assets are grouped at the lowest level, for which there are separately identifiable cash flows (cash-generating units).

Impairment losses are recognised in expenses when incurred. A previously recognised impairment loss is reversed (except for the Goodwill impairment loss) only if there has been a change in the assumptions used to determine the asset's recoverable amount since the last impairment loss was recognised. If that is the case the carrying amount of the asset is increased to its recoverable amount. That increased amount cannot exceed the carrying amount that would have been determined, net of depreciation, had no impairment loss been recognised for the asset in prior years. Such reversal is recognised in profit or loss in the period in which the reversal occurs.

The Group makes an assessment at least at each balance sheet date whether there is any indication that an impairment loss may no longer exist, may have decreased or may have increased. If any such indication exists, the Group estimates a recoverable amount of the assets and compares to the carrying value (net of the impairment allowance). In assessing whether there is any indication that the impairment loss recognised in the past may no longer exist, the Group considers both external and internal sources of information (asset's market value, changes expected in the market, including technological, economic or legal changes, market interest rates, significant changes with effect on the Group in the extent to which, or manner in which, the assets are used or are expected to be used, evidence available from internal reporting indicating economic performance of assets etc.). Where an estimate of recoverable amount is calculated, there is a number of management assumptions used.

H Investments and other financial assets

The Group classifies its financial assets into the following categories: financial assets at fair value through profit or loss, held-to-maturity investments, loans and receivables and available-for-sale financial assets.

Financial assets that are acquired principally for the purpose of generating a profit from short-term fluctuations in price are classified as financial assets at fair value through profit or loss and are included in current assets. During 2012 and 2011, the Group did not hold any financial assets in this category.

Investments with a fixed maturity that management has the intent and ability to hold to maturity are classified as held-to-maturity and are disclosed as current or non-current assets, depending on the period in which the settlement will take place.

Loans and receivables are financial assets with fixed or determinable payments that are not quoted in an active market and are measured at amortised cost using an effective interest rate method and are disclosed as current or non-current assets, depending on the period in which the settlement will take place.

Investments intended to be held for an indefinite period of time, which may be sold in response to needs for liquidity or changes in interest rates, are classified as available-for-sale; these are included in non-current assets unless management has expressed the intention of holding the investment for less than 12 months from the balance sheet date or unless they will need to be sold to raise operating capital, in which case they are included in current assets.

The management determines the appropriate classification of its investments at the time of the purchase and re-evaluates such designation on a regular basis, as required under IAS 39.

All purchases and sales of investments are recognised on the trade date, which is the date that the Group commits to purchase or sell the asset. The cost of purchase includes all transaction costs. Financial assets at fair value through profit or loss and available-for-sale investments are subsequently carried at fair value, whilst held-to-maturity investments are carried at amortised cost using the effective interest rate method. Realised and unrealised gains and losses arising from changes in the fair value of financial assets at fair value through profit or loss are included in profit or loss in the period in which they arise. On the contrary, unrealised gains and losses arising from changes in the fair value of available-for-sale investments are included in other comprehensive income in the period in which they arise, except for impairment losses, until the financial asset is de-recognised, at which time the cumulative gain or loss previously recognised in other comprehensive income is recognised in profit or loss.

Impairment of financial assets

The Group assesses at each balance sheet date whether financial assets or groups of financial assets are impaired.

(1) Assets carried at amortized costs

If there is objective evidence that an impairment loss on loans and receivables or held to maturity investments carried at amortised cost has been incurred, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows discounted at the financial asset's original effective interest rate. The carrying amount of the asset is reduced either directly or through use of an allowance account. The amount of the loss is recognised in profit or loss.

The Group first assesses whether objective evidence of impairment exists individually for financial assets that are individually significant, and individually or collectively for financial assets that are not individually significant. If it is determined that no objective evidence of impairment exists for individually assessed financial assets, whether significant or not, it is included in a group of financial assets with similar credit risk characteristics and that group of financial assets is collectively assessed for impairment. Assets that are individually assessed for impairment and for which an impairment loss is or continues to be recognised are not included in a collective assessment of impairment.

If, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised, the previously recognised impairment loss is reversed. Any subsequent reversal of an impairment loss is recognised in profit or loss and only to the extent that the carrying amount of the financial asset does not exceed its amortised cost at the reversal date.

In relation to trade receivables, a provision for impairment is made when there is objective evidence (such as the probability of insolvency) that the Group will not be able to collect all of the amounts due under the original terms of the invoice. The carrying amount of the receivable is reduced through use of an allowance account. Impaired debts are derecognised when they are assessed as uncollectible or sold.

(2) Available-for-sale financial assets

If this asset is impaired, the cumulative loss that had been previously recognised (due to fair value revaluation) in other comprehensive income shall be removed from other comprehensive income and recognised in profit or loss even though the financial asset has not been derecognised.

The amount of the cumulative loss that is removed from other comprehensive income and recognised in profit or loss shall be the difference between the acquisition cost (net of any principal repayment and amortisation) and the current fair value, less any impairment loss previously recognised in profit or loss.

Reversals of impairment losses on debt instruments are reversed through profit or loss, if the increase in fair value of the instrument can be objectively related to an event occurring after the impairment loss was recognised in profit or loss.

De-recognition of financial assets

A financial asset is de-recognised when:

a) the rights to receive cash flow from the asset have expired,
b) the Group retains the right to receive cash flow from the asset, but has assumed an obligation to pay them in full without material delay to a third party under a "pass-through" arrangement, or

c) the Group has transferred its rights to receive cash flows from the assets and either has transferred substantially all the risks and rewards of the asset, or has neither transferred nor retained substantially all the risks and rewards of the asset, but has transferred control of the asset.

I Leases

The determination of whether an arrangement is, or contains a lease is based on the substance of the arrangement at inception date of whether the fulfilment of the arrangement is dependent on the use of specific asset or assets and the arrangement conveys a right to use the assets.

Leases under which a significant portion of the risks and benefits of ownership are effectively retained by the lessor are classified as operating leases. Payments made under operating leases are charged to profit or loss on a straight-line basis over the period of the lease.

When an operating lease is terminated before the lease period has expired, any payment that is required to be made to the lessor by way of penalty is recognised as an expense in the period in which termination takes place.

Leases of property, plant and equipment where the Group bears substantially all the risks and rewards of ownership are classified as finance leases. Finance leases are capitalized at the inception of the lease at the lower of the fair value of the leased property or the present value of the minimum lease payments. Each lease payment is allocated between the liability and finance charges so as to achieve a constant rate of interest. The corresponding lease obligations, net of finance charges, are included in other long-term payables (depending on maturity).

The interest element of the finance cost is charged to profit or loss over the lease period so as to produce a constant periodic rate of interest on the remaining balance of the liability for each period. If there is a reasonable certainty that the lessee will obtain ownership by the end of the lease term, the period of expected use is the useful life of the asset; otherwise the property, plant and equipment acquired under finance leases are depreciated over the shorter of the useful life of the asset or the lease term.

J Inventories

Inventory is stated at the lower of cost or net realisable value. Costs of inventories include the purchase price and related costs of acquisition (transport, customs duties and insurance). The cost of inventory is determined using weighted average cost. Net realisable value is the estimate of the selling price in the ordinary course of business, less the costs of completion and selling expenses.

K Trade receivables

Trade receivables are carried at original invoice amount less allowance for impairment of these receivables. Such allowance for impairment of trade receivables is established if there is objective evidence that the Group will not be able to collect all amounts due according to the original terms of the receivables. The amount of the allowance is the difference between the carrying amount and the recoverable amount, being the present value of expected cash flows, discounted at the initial market rate of interest for similar borrowers. Cash flows relating to short-term receivables are usually not discounted. The amount of the allowance is recognized in profit or loss.

L Cash and cash equivalents

Cash and cash equivalents are carried in the balance sheet at cost. For the purposes of the statement of cash flows, cash and cash equivalents comprise cash on hand, deposits held at call with banks, other short-term highly liquid investments with original maturities of three months or less, and bank overdrafts. Bank overdrafts are shown within borrowings in current liabilities section of the balance sheet.

M Financial debt

Borrowings are recognised initially as the proceeds received, net of transaction costs incurred. In subsequent periods, borrowings are stated at amortised cost using the effective interest rate method; any difference between proceeds (net of transaction costs) and the redemption value is recognised in profit or loss over the period of the borrowings.

Borrowings are classified as current liabilities unless the Group has an unconditional right to defer settlement of the liability for at least 12 months after the balance sheet date.

Borrowing costs on debts used to finance the acquisition and construction of qualifying assets are capitalized during the period of time that is required to complete and prepare the asset for its intended use. Other borrowing costs are expensed.

N Current and deferred income taxes

Taxation expense represents both current and deferred taxation, where appropriate.

Current income tax assets and liabilities for the current and prior periods are measured at the amount expected to be recovered from or paid to the taxation authorities. The tax rates and tax laws, used to compute the amount are those that are enacted or substantively enacted by the balance sheet date in the relevant country.

Income tax relating to items recognised directly in other comprehensive income is recognised in other comprehensive income and not in profit or loss.

Deferred income taxation is calculated using the liability method applied to all temporary differences arising between the tax basis of assets and liabilities and their carrying values for financial reporting purposes. Currently enacted tax rates and laws expected to apply when the asset is realised or the liability is settled are used to determine the deferred income tax.

The principal temporary differences arise from differences in the tax and accounting values of property, plant and equipment, impairment of receivables and allowance for obsolete and slow moving inventories, non tax deductible allowances and provisions, unused tax credits and, in relation to acquisitions, on the difference between the fair values of the net assets acquired and their tax base.

Deferred income tax assets are recognised to the extent that it is probable that future taxable profit will be available against which the temporary differences can be utilised.

The Group accounts for the tax consequences of transactions and other events in the same way that it accounts for the transactions and other events themselves. Thus, for transactions and other events recognised in profit or loss, any related tax effects are also recognised in profit or loss. For transactions and other events recognised in other comprehensive income, any related tax effects are also recognised in other comprehensive income. Similarly, the recognition of deferred tax assets and liabilities in a business combination affects the amount of goodwill.

Deferred income tax assets and tax liabilities are offset, if a legally enforceable right exists to set off current tax assets against current income tax liabilities and the deferred income taxes relate to the same taxable entity and the same taxation authority. The same applies for offsetting of current tax assets and liabilities.

O Employee benefits

(1) Pension obligations

Contributions are made to the Government's health, retirement benefit and unemployment schemes at the statutory rates applicable during the period and are based on gross salary payments. The arrangements of the Government's health, retirement benefit and unemployment schemes correspond to the arrangements for defined contribution plans. The Group has no further payment obligations once the contributions have been paid. The expense for the contributions is charged to profit or loss in the same period as the related salary expense. The Group also makes contributions to defined contribution schemes operated by external pension companies. These contributions are charged to profit or loss in the period to which the contributions relate.

(2) Redundancy and termination benefits

Redundancy and termination benefits are payable when employment is terminated before the normal retirement or contract expiry date. The Group recognises provision for redundancy and termination benefits when it is demonstrably committed to terminate the employment of current employees according to a detailed formal plan without possibility of withdrawal.

Benefits falling due more than 12 months after the balance sheet date are discounted to present value. There are no redundancy and termination benefits falling due more than 12 months after the balance sheet date.

(3) Bonus plans

The Group recognises a liability for bonuses based on a formula that takes into consideration certain performance related measures, such as turnover or free cash flow, after certain adjustments. The Group recognises a provision where the Group is contractually obliged or where there is a past practice that has created a constructive obligation.

P Share-based compensation

In 2006, the Group introduced performance compensation systems linked to the market value of shares of the parent company, Telefónica, S.A. Some compensation plans are settled in cash, while others are settled via the delivery of shares.

IFRS 2 is applied to compensation schemes linked to the share price with the following accounting treatment:

Option plans that can be either cash-settled or equity-settled at the option of the employee are recognized at the fair value on the grant date of the liability and equity components of the compound instrument granted.

In the cash-settled share option plan, the total cost of the rights to granted shares are expensed over the period during which the beneficiary earns the full right to exercise the options (vesting period). The total cost of the options is initially measured based on their fair value at the grant date calculated by the Black-Scholes option pricing model, taking into account the terms and conditions established in each share option plan. At each subsequent reporting date, the Group revises its estimate of fair value and the number of options it expects to vest, booking any change in the liability through profit or loss for the period, if appropriate.

For the equity-settled share option plan, fair value at the grant date is measured using the binominal methodology. These plans are expensed during the vesting period with a credit to equity. At each subsequent reporting date, the Group revises its estimate of the number of options it expects to be exercised, with a corresponding adjustment to equity. As the plan will be settled by a physical delivery of equity instruments of the parent, Telefónica, S.A., to the employees, the personnel expense accrued is recognised against equity.

Q Provisions

Provisions are recognised when the Group has either a present legal or constructive obligation resulting from past events, and it is probable that an outflow of resources will be required to settle the obligation assuming that a reliable estimate of the amount can be made. Where the Group expects a provision to be reimbursed, the reimbursement is recognised as a separate asset but only when the reimbursement is virtually certain.

R Revenue recognition

Revenue, shown net of Value Added Tax and any discounts, and after eliminating sales within the Group, comprises goods sold and services provided. Revenues are measured at their fair value of the consideration received or receivable. The amount of revenue is recognised if it can be measured reliably and it is probable that the economic benefits associated with the transaction will flow to the Group. If necessary, revenue is split into separately identifiable components.

The Group offers customers free minutes for a selected price based on a chosen customer plan. Free unused minutes at the end of the month might be rolled over to the following month. The Group is not obliged to reimburse the customer for unused minutes and the option of rolling over any unused minutes is valid for only one month.

The Group recognises revenue for free minutes in the period when the related services are provided and consumed, if material. Any rollover minutes are deferred and recognised when the minutes are used or the option expires.

In assessing whether revenue should be recognised gross, i.e. with separate disclosure of costs to arrive at gross profit, or on a net basis, the Group considers these indicators of gross revenue reporting:

a) the Group is the primary obligor in the arrangement,
b) the Group has general inventory risk,
c) the Group has price latitude,
d) the Group changes the product or performs part of the service,
e) the Group has discretion in supplier selection,
f) the Group is involved in the determination of product or service specifications,
g) the Group has credit risk,
h) the Group has the ability to set the terms of the transaction,
i) the Group has the managerial control over the transaction.

The relative strength of each indicator is considered while deciding the accounting treatment.

If a transaction is considered to meet conditions of an agency arrangement, the revenue is recognised only at the amount of the commission received/realised.

Revenue from fixed price construction contracts (long-term contracts) is recognised using the percentage of completion method, measured by reference to the percentage of actual cost incurred to date to estimated total costs of the contract. A loss expected from the construction contract is recognised as an expense immediately, when it is probable that total contract costs will exceed total contract revenue.

(1) Fixed line business revenues

Revenue is recognized as follows:

Domestic and international call revenues
Domestic and international call revenues are recognised in profit or loss at the time the call is made.

Universal service
The Group is obliged to render certain fixed line telephony services defined by the Act on Electronic Communications. Relevant costs are compensated by the Czech Telecommunications Office (CTO). The Group recognises the compensation using gross principle on standard accrual basis of revenue recognition.

Subscription revenues
Revenue is recognised in profit or loss in the period in which the services are rendered.

Revenues from sales of prepaid cards
Prepaid call card sales are deferred until the customer uses the stored value on the card to pay for the relevant calls. The expiry date for prepaid cards is not longer than 36 months.

Connection fees
Connection fees, arising from the connection of the customers to the Group's network, if material, are deferred and recognised in profit or loss over the estimated average customer relationship period.

Equipment sales and sale of other goods
Revenue from the sale of telephone equipment, accessories and other goods is recognised at the time of sale i.e. when the Group has transferred to the buyer the significant risks and rewards of ownership of the goods.

Local loop unbundling
Revenue from access to the local loop unbundling is deferred in profit or loss and recognised in the period in which the service is rendered. The regular monthly fee is recognised on the straight-line basis in the period when the service is consumed. Revenue from the preparation of the location (collocation) for an alternative operator is recognized upfront in profit or loss when it occurs.

Audiotex
Revenues from audiotex, service offering content to which a special tariff applies and enables to transfer money and to pay for goods or services from the third parties, are recognised using netto principle.

Information and communication technology services
Information and communication technology (ICT) services include complex customer solutions and managed services, mainly system integration, outsourcing services, project solutions and software development. Revenue recognition of such services reflects the substance of the provided service.

(2) Mobile business revenues

The Group generates mobile service revenues from the usage of the Group's network by customers, interconnection and roaming. The Group also earns revenue from the sale of mobile telephone equipment and accessories, as well as from activation fees.

Airtime revenues
Postpaid customers are billed monthly in arrears for airtime revenues. Revenue from post-paid customers is recognised at the time of usage of airtime and other services. Prepaid customers buy credit, which entitles them to a certain value of airtime and other services. Revenue from prepaid customers is deferred and recognised at the time of usage of airtime and other services.

Both post-paid and prepaid products may include deliverables such as a handset, activation and airtime and are defined as arrangements with multiple deliverables. The arrangement consideration is allocated to each deliverable, based on its fair value, but up to consideration received if future cash receipts are contingent on future deliveries. Revenues allocated to the identified deliverables in each revenue arrangement are recognized based on the same recognition criteria which were used for the individual deliverables at the time the product or service was delivered.

Connection fees
Connection fees, arising from the connection of the customers to the Group's network, if material, are deferred and recognised in profit or loss over the estimated average customer relationship period.

Equipment sales and mobile services
Monthly service revenues and revenues from handset sales are recognized as revenue when the product or service is delivered to the distributor or to the end customer. Resulting losses from sale of handsets at a discount are recognised at the date of sale.

Roaming revenues
The mobile segment derives roaming revenue as a result of airtime and other services used by the mobile segment's customers roaming on partners' networks in other countries and vice versa. Amounts receivable from and payable to roaming partners are netted and settled net on a regular basis.

Premium SMS
Revenues from premium SMS, short text messages that enable customers to use their mobile phones to send money transfer requests and pay for goods and services from third parties, are recognised using netto principle.

Costs
Discounts directly related to the sale of equipment, SIM cards and activations are netted against revenue in the period the product is sold to the dealer, distributor or the end customer. Commission payments to dealers for activations, various marketing promotions and other activities are included in the costs of sales for the period.

(3) Interconnection revenues

Interconnection revenues are derived from calls and other traffic that originate in other domestic and foreign operators' network but terminate in or transit the Group's network. These revenues are recognised in profit or loss at the time when the call is received in the Group's network. The Group pays a proportion of the call revenue it collects from its customers to the other domestic and foreign operators' for the calls and other traffic originating in the Group's network, which use other domestic and foreign operators' network. Amounts receivable from and payable to other domestic and foreign operators are netted and settled net on a regular basis.

(4) Internet, IPTV and data services

The Group derives revenue from providing Internet access service, IPTV and other data services. The revenues from such services are recognised at the time the service is provided.

(5) Dividend income

Dividend income is recognized when the right to receive payment is established.

(6) Interest income

Income is recognised as interest accrues (using the effective interest method).

(7) Instalment sales

Revenue attributable to the sales price, exclusive of interest, is recognised at the date of sale. The sale price is the present value of the consideration, determined by discounting the instalments receivable at the imputed rate of interest. The interest element is recognised as revenue as it is earned, using the effective interest method.

S Dividend distribution

Dividend distribution to the Company's shareholders is recognized as a liability in the Group's financial statements in the period in which the dividends are approved by the Company's shareholders.

T Financial instruments

Financial instruments carried on the balance sheet include cash and bank balances, investments, receivables, payables, borrowings and derivatives. Detailed figures are described in Note 14.

Financial risk management

The Group is exposed to a variety of financial risks, including the effects of changes in debt market prices, foreign currency exchange rates and interest rates as a result of ordinary business, debt taken on to finance its business and net investment in foreign operations. The Group's overall risk management focuses on the unpredictability of financial markets and seeks to minimize potential adverse effects on the financial performance of the Group. The Group uses either derivative financial instruments (such as forward and swap contracts) or non-derivative instruments (such as cash instruments) to hedge certain exposures.

The Group does not conduct any speculative trading activities.

Risk management is carried out by the treasury department under approved policies. The Board of Directors provides written principles for overall risk management. In line with these principles, policies exist for specific areas, such as foreign exchange risk, interest rate risk, credit risk, liquidity risk, use of derivative financial instruments and investing excess liquidity.

(i) Foreign currency risk

The Group is exposed to foreign currency risk arising from various currency exposures, primarily with respect to the euro and partially to US dollar:

a) balance sheet items (such as debt, receivables, payables) denominated in foreign currency
b) probable forecasted transactions or firm commitments (such as purchases or sales) denominated in foreign currency, and
c) net investment in the Slovak subsidiary (functional currency differs from CZK).

The Group's objective in managing its exposure to foreign currency fluctuations is to minimize earnings and cash flow volatility associated with foreign exchange rate changes.

The Group primarily hedges the balance sheet foreign currency exposure, mainly net payables in EUR or USD. Only plain-vanilla instruments are currently used for hedging this kind of exposure.

(ii) Interest rate risk

The Group is exposed to interest rate risk arising from floating interest rate bearing cash investments and debt instruments.

The Group's income and operating cash flows are substantially independent of changes in market interest rates. The cash assets and short term debt are currently maintained on floating rates while long term debt instruments could be maintained on both floating and fixed rates. The Group may sometimes use interest rate swaps and forward rate agreements to manage a mix of fixed and variable interest rates.

(iii) Liquidity risk

The Group's essential objective of liquidity risk management is having access to the cash resources sufficient to meet all its cash payment obligations as they fall due, allowing some flexibility. The cash resources consist of generated cash position (maintained in quickly liquid instruments), and committed credit facilities arranged with banks.

The Group is particularly focused on the liquidity profile within the time horizon of the next 12 months considering projected cash flow from operations and maturity structure of both debt obligations and financial investments. The balance between the funding continuity and flexibility is managed through maintaining the option to use bank overdrafts or bilateral credit lines.

(iv) Credit risk

Credit risk concentration, with respect to trade accounts receivable, is limited due to the large number of customers. However, substantially all trade receivables are concentrated within the Czech Republic. Although the Group does not currently foresee a dramatically higher credit risk associated with these receivables, the repayment is significantly impacted by the financial stability of a particular national economy.

The Group trades only with recognized, creditworthy third parties. It is the Group's policy that all customers wishing to trade on credit terms are subject to credit verification procedures. In addition, receivable balances are monitored on an ongoing basis with the resulting into the non significant Group's exposure to bad debts. The maximum exposure is the carrying amount as disclosed in Note 11. There is no significant concentration of credit risk within the Group.

With respect to credit risk arising from the financial assets of the Group, which comprise cash and cash equivalents, available for sale investments and certain derivative instruments, the Group's exposure arises from default of the counterparty, with a maximum exposure equal to the carrying amount of these instruments.

Credit Risk is managed by the Credit Management Unit and is based on three main activities:

a) monitoring of accounts receivables: regular monitoring of payment moral of existing customers and monitoring and analyzing of the receivable aging structure (internal and external indicators of any potential bad debts). Those activities are processed in the integrated system solution for scoring, maintenance and collection of receivables called RMCA.

b) prevention: scoring of new customers – checking procedures (integrated Black List, Solus Debtor Register, other external information databases), limits and/or deposits applied based on the customer segments or the product. Credit limits for indirect sales partners (dealers, distributors, retailers, franchises) for the purchase of our products, collateral security (deposits, receivables insurance, bill of exchange, pledge of real estate, bank guarantee etc).

c) collection process: Credit Management cooperates with Customer Care on the setting up of a reasonable, effective and continual collection process. Collection process competences are divided. Collection from active customers is in the competence of Customer Care; subsequent collection (after the contract is cancelled) is the responsibility of Credit Management.

Accounting for derivative financial instruments and hedging activities

Derivative financial instruments are initially recognised in the balance sheet at cost and subsequently are re-measured at their fair value. The method of recognising the resulting gain or loss is dependent on the nature of the item being hedged. On the date a derivative contract is entered into, the Group designates certain derivatives as either:

a) hedge of the fair value of a recognised asset or liability (fair value hedge), or

b) hedge of a forecasted transaction or of a firm commitment (cash flow hedge).

Changes in the fair value of derivatives that are designated and qualified as fair value hedges and that are highly effective are recorded in profit or loss, along with changes in the fair value of the hedged asset or liability that is attributable to the hedged risk.

Changes in the fair value of derivatives that are designated and qualified as cash flow hedges and that are highly effective are recognised in other comprehensive income. Where the forecasted transaction or firm commitment results in the recognition of an asset or of a liability, the gains and losses previously deferred in other comprehensive income are transferred from other comprehensive income and included in the initial measurement of the cost of the asset or liability. Otherwise, amounts deferred in other comprehensive income are transferred to profit or loss and classified as revenue or expense in the same periods during which the hedged firm commitment or forecasted transaction affects profit or loss.

Certain derivative transactions, while providing effective economic hedges under the Group's risk management policies, either do not qualify for hedge accounting under the specific rules in IAS 39 or the Group has elected not to apply the specific IAS 39 hedge accounting provisions. Changes in the fair value of such derivative instruments that do not qualify for hedge accounting are recognised immediately in profit or loss.

When a hedging instrument expires or is sold, or when a hedge no longer meets the criteria for hedge accounting under IAS 39, any cumulative gain or loss existing in other comprehensive income at that time remains in other comprehensive income and is recognised in profit or loss when the committed or forecasted transaction ultimately is recognised in profit or loss. However, if a committed or forecasted transaction is no longer expected to occur, the cumulative gain or loss that was reported in other comprehensive income is immediately transferred to profit or loss.

The Group documents at the inception of the transaction the relationship between the hedging instruments and the hedged items, as well as its risk management objective and strategy for undertaking various hedge transactions. The process includes linking all derivatives designated as hedges to specific assets and liabilities or to specific firm commitments or forecast transactions. The Group also documents its assessment, both at the hedge inception and on an ongoing basis, whether the derivatives that are used in hedging transactions are highly effective in offsetting changes in fair values or cash flows of hedged items.

Fair value estimation

Except for currency options, the fair values of the derivative financial instruments reflect estimates based on calculations performed using the Group's own discounted cash flow models (using market rates). The fair value of currency options is based on information obtained from external parties, including the Group's bankers.

U Use of estimates, assumptions and judgements

The Group makes forward-looking estimates and assumptions. The resulting accounting estimates will, by definition, seldom equal the related actual results.

Estimates and judgments are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances.

The estimates and assumptions that might have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next years are discussed below:

(1) Income taxes and deferred taxes

The Group creates a provision for current income taxes and in consideration of the temporary differences also for deferred tax. There are many transactions and calculations for which the ultimate tax determination is uncertain during the ordinary course of business and the measurement of deferred tax assets and liabilities reflects the tax consequences that would follow from the manner in which the Group expects to recover or settle the carrying amount of assets and liabilities. Where the final tax-non-deductible/non-taxable items are different from the amounts that were calculated, such differences will impact the current income and deferred tax provisions in the period in which such determination is made (See Note 4 and Note 15).

(2) Property, plant and equipment, intangible assets and goodwill

The accounting treatment of investments in property, plant and equipment and intangible assets entails the use of estimates to determine the useful life for depreciation and amortization purposes and to assess fair value at their acquisition dates for assets acquired in business combinations.

Determining useful life requires making estimates in connection with future technological developments and alternative uses for assets. There is a significant element of judgment involved in making technological development assumptions, since the timing and scope of future technological advances are difficult to predict. Further details are described in Note D Property, plant and equipment and Note E Intangible assets.

When an item of property, plant and equipment or an intangible asset is considered to be impaired, the impairment loss is recognized in profit or loss. The decision to recognize an impairment loss involves estimates of amount of the impairment, as well as analysis of the reasons for the potential loss. Furthermore, additional factors, such as technological obsolescence, the suspension of certain services and other circumstantial changes are taken into account.

The Group evaluates the performance of its cash-generating units regularly to identify potential impairments. Determining the recoverable amount of the cash-generating units also entails the use of assumptions and estimates and requires a significant element of judgment. The Group assesses at the end of each reporting period whether there is any indication that an impairment loss recognised in prior periods for an asset other than goodwill may no longer exist or may have decreased. If any such indication exists, The Group estimates the recoverable amount where an impairment loss recognised in prior periods shall be subject to the reversal (See Note 9).

The Group tests goodwill for impairment at each reporting date. However, goodwill does not generate cash flows independently of other assets or groups of assets and the assessment of its carrying value is significantly impacted by the management's assessment of the performance and expected future performance of the operation to which the goodwill relates. In accordance with the requirement of IAS 36, goodwill is tested annually for its recoverable amount, as well as when there are indications of impairment (See Note 8).

(3) Provisions and contingent liabilities

As set out in Note 17 the Group is a participant in several lawsuits and administrative proceedings including those related to its pricing policies. The Group's treatment of obligations with uncertain timing and amount depends on the management's estimation of the amount and timing of the obligation and probability of an outflow of resources embodying economic benefits that will be required to settle the obligation (both legal or constructive). A provision is recognised when the Group has a present obligation as a result of past events, it is probable that an outflow of resources to settle the obligation will be required and a reliable estimate of the amount of the obligation can be made (See Note 16). Contingent liabilities are not recognised, because their existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the Group. Contingent liabilities are assessed continually to determine whether an outflow of resource embodying economic benefits has become probable. If it becomes probable that an outflow of future economic benefits will be required for an item previously dealt with as a contingent liability, a provision is recognised in the financial statements of the period in which the change in probability occurs.

(4) Receivables

Trade receivables are carried at original amount less bad debt allowance. The bad debt provision is estimated according to historical experience and individual assessment. Details regarding the determination of receivables impairment are stated in Note K Trade receivables.

V Change in accounting policy

No significant changes in accounting policies were applied in 2012 and 2011.

W Operating profit

Operating profit is defined as profit before financial results and taxes and represents profit from the business operations. Financial results consist of interest income, interest expense, other financial expense (which includes primarily bank charges), fair value losses and gains on financial instruments and foreign exchange gains and losses.

NOTES TO THE FINANCIAL STATEMENTS

Content Pages

1 Segment information

Business segments recognised by the Group are as follows:

- fixed - network communication services using a fixed network, WiFi infrastructure and IS/ICT services provided by the Company and other consolidated subsidiaries
- mobile - mobile communication services provided by the Company and by Telefónica Slovakia, s.r.o. and Bonerix s.r.o.

Year ended 31 December 2012 **In CZK million**	**Fixed**	**Mobile***	**Group**
Revenues from voice services	6,294	11,196	17,490
Monthly charges	3,625	8,906	12,531
Data services	8,494	2,802	11,296
Other revenues	3,177	6,617	9,794
Revenues incl. inter-segment sales	21,590	29,521	51,111
Inter-segment sales	(313)	(264)	(577)
Total consolidated revenues	21,277	29,257	50,534
Other income	444	54	498
Total consolidated costs	(13,077)	(18,146)	(31,223)
Impairment charge	(20)	(8)	(28)
Depreciation	(5,935)	(3,218)	(9,153)
Amortisation	(1,431)	(853)	(2,284)
Total consolidated depreciation and amortization	(7,366)	(4,071)	(11,437)
Operating income	1,258	7,086	8,344
Net financial loss			(188)
Profit before tax			8,156
Corporate income tax			(1,380)
Profit for the year			**6,776**
Assets (excluding goodwill)	38,697	27,005	65,702
Goodwill	177	13,320	13,497
Total assets	**38,874**	**40,325**	**79,199**
Trade and other payables	(5,108)	(7,127)	(12,235)
Other liabilities	(3,241)	(3,149)	(6,390)
Total liabilities	**(8,349)**	**(10,276)**	**(18,625)**
Capital expenditure including WiFi acquisition	**3,077**	**3,289**	**6,366**

* Standalone figures of Telefónica Slovakia, s.r.o. included.

Year ended 31 December 2011 **In CZK million**	**Fixed**	**Mobile***	**Group**
Revenues from voice services	6,627	12,256	18,883
Monthly charges	4,298	8,602	12,900
Data services	8,878	2,599	11,477
Other revenues	3,016	6,798	9,814
Revenues incl. inter-segment sales	22,819	30,255	53,074
Inter-segment sales	(318)	(347)	(665)
Total consolidated revenues	22,501	29,908	52,409
Other income	477	10	487
Total consolidated costs	(14,101)	(16,984)	(31,085)
Impairment reversal	(9)	(12)	(21)
Depreciation	(7,164)	(2,079)	(9,243)
Amortisation	(922)	(1,486)	(2,408)
Total consolidated depreciation and amortization	(8,086)	(3,565)	(11,651)
Operating income	782	9,357	10,139
Net financial loss			(131)
Profit before tax			10,008
Corporate income tax			(1,324)
Profit for the year			**8,684**
Assets (excluding goodwill)	40,472	35,057	75,529
Goodwill	133	13,320	13,453
Total assets	**40,605**	**48,377**	**88,982**
Trade and other payables	5,793	7,089	12,882
Other liabilities	3,474	3,529	7,003
Total liabilities	**9,267**	**10,618**	**19,885**
Capital expenditure including WiFi acquisition	**3,456**	**2,400**	**5,856**

*Standalone figures of Telefónica Slovakia, s.r.o. included.

The inter-segment pricing rates applied in 2012 and 2011 were determined on the same basis as rates applicable for other mobile operators and are consistent with rates applied for pricing with other mobile operators.

Capital expenditures comprise additions to property, plant and equipment and intangible assets.

During 2012, Telefónica Slovakia, s.r.o. further strengthened its position on the Slovak mobile market. In line with its strategy to offer simple and transparent services and to focus on the acquisition of customers in residential segment with a higher spend and customers in the small and medium businesses segment, it launched new tariff O_2 Paušál and introduced an enhanced proposition of O_2 Fér, O_2 Filip and O_2 Moje Firma tariffs. Aiming to meet increasing demand of customers for mobile data services, it expanded population coverage of its 3G network to 53% as at the 2012 year-end. This helped to increase total subscribers base in 2012 16.3% year on year to 1,354 thousand. Of that, the number of contract customers grew 32.4% year on year to reach 659 thousand, while the prepaid base increased by 4.3% reaching 695 thousand at the end of 2012. Consequently, the number of contract customers reached 48.7% of the total customer base, representing a 5.9 percentage points increase year-on-year. The market share of Telefónica Slovakia, s.r.o. expressed as the number of customers, improved during 2012 from 18% to over 20%. The growth in the number of customers growth and improvements in the customer mix have led to an increase in revenues which reached CZK 4,834 million in 2012, compared to CZK 3,862 million in 2011. As at 31 December 2012, the net book value of fixed assets deployed in Slovakia amounted to CZK 2,591 million (2011: CZK 2,692 million).

Financial results of the company Telefónica Slovakia, s.r.o.

Due to increased significance of Telefónica Slovakia, s.r.o., the Group presents selected data for the subsidiary. Amounts are prepared in accordance with International Financial Reporting Standards.

In CZK million	Year ended 31 December 2012	Year ended 31 December 2011
Total revenue	4,834	3,862
Operating income before depreciation and amortization („OIBDA”)	1,373	685
Profit for the year	867	990

In CZK million	Year ended 31 December 2012	Year ended 31 December 2011
Total assets	4,813	3,997
Equity	3,512	2,717

2 Revenues and costs

Revenues from voice services In CZK million	Year ended 31 December 2012	Year ended 31 December 2011
Voice - outgoing	9,631	10,453
Interconnection and other wholesale services	7,282	7,765
Total revenues from voice services	16,913	18,218

Data services In CZK million	Year ended 31 December 2012	Year ended 31 December 2011
Leased lines and fixed data services	2,479	2,836
Internet (including monthly and one-off charges)	5,537	5,531
Mobile data	2,802	2,598
IPTV	478	512
Total revenues from data services	11,296	11,477

Other revenues In CZK million	Year ended 31 December 2012	Year ended 31 December 2011
SMS & MMS & PRMS and Contents	4,622	4,806
Equipment and activation charges	1,587	1,667
ICT and business solutions	2,548	2,356
Other telecommunication revenues	1,037	985
Total other revenues	9,794	9,814

Other income In CZK million	Year ended 31 December 2012	Year ended 31 December 2011
Rental and non-telco income	112	83
Gains from fixed assets disposal	285	346
Indemnities, penalties and similar income	101	58
Total other income	498	487

Revenues from related parties are disclosed in Note 21.

Other cost of sales In CZK million	Year ended 31 December 2012	Year ended 31 December 2011
Telco services, Contents and other cost of sales	(791)	(665)
Sub-deliveries	(1,236)	(1,023)
Commissions	(1,764)	(1,741)
Total other cost of sales	(3,791)	(3,429)

Other expenses In CZK million	Year ended 31 December 2012	Year ended 31 December 2011
Billing and collection, provision for bad and doubtful debts	(808)	(831)
Network & IT repairs and maintenance	(3,043)	(2,658)
Rentals, buildings and vehicles	(2,080)	(2,131)
Utilities supplies	(1,137)	(1,126)
Marketing and call centers	(1,663)	(1,642)
Consultancy and professional fees and other external services	(849)	(735)
Royalties and management fees	(1,138)	(1,166)
Administrative fees and other operating expenses	(557)	(524)
Capitalized own expense on fixed assets	629	671
Total other expenses	(10,646)	(10,142)

Staff costs In CZK million	Year ended 31 December 2012	Year ended 31 December 2011
Wages and salaries	(4,043)	(4,285)
Restructuring costs	(265)	(174)
Health and Social security contributions	(1,297)	(1,434)
Staff welfare costs	(233)	(286)
Total staff costs	(5,838)	(6,179)

The Group does not participate in any pension plans.

A restructuring plan covering both employees and members of management was approved and subsequently implemented by the Group during 2012 and 2011. As a result of the restructuring process the Group incurred restructuring costs of CZK 265 million during the year ended 31 December 2012 (2011: CZK 174 million), including redundancy payments of CZK 231 milion (2011: CZK 174 million) and related consultancy costs of CZK 34 million (2011: CZK 0 million).

Statutory auditor's fees were as follows:

In CZK million	Year ended 31 December 2012	Year ended 31 December 2011
Auditor´s fees	21	27

Purchases from related parties are disclosed in Note 21.

3 Finance income and costs

In CZK million	Year ended 31 December 2012	Year ended 31 December 2011
Finance income		
Interest income	82	117
Gain on fair value adjustments of financial instruments (net)	-	185
Foreign exchange gain (net)	12	-
Other finance income	9	11
Total finance income	103	313
Finance costs		
Interest expenses	(160)	(224)
Loss on fair value adjustments of financial instruments (net)	(90)	-
Foreign exchange loss (net)	-	(191)
Other finance costs	(41)	(29)
Total finance costs	(291)	(444)

The Group recognises foreign exchange gains and losses and fair value adjustments on net basis. Comparative figures were adjusted accordingly.

4 Income taxes

In CZK million	Year ended 31 December 2012	Year ended 31 December 2011
Total income tax expense is made up of:		
Current income tax charge	1,857	2,231
Deferred income tax credit (Note 15)	(477)	(907)
Taxes on income	1,380	1,324

The tax on the Group's profit before tax differs from the theoretical amount that would arise using the basic tax rate of the home country of the Group as follows:

In CZK million	Year ended 31 December 2012	Year ended 31 December 2011
Profit before tax	8,156	10,008
Income tax charge calculated at the statutory rate of 19%	1,550	1,902
Not taxable income	(45)	-
Expenses not deductible for tax purposes	91	129
Tax related to prior periods	(100)	59
Tax losses from previous years	-	(57)
Additional tax on profit of Telefónica Slovakia, s.r.o.	12	-
Effect of the first time deferred tax recognition by Telefónica Slovakia, s.r.o.	(11)	(709)
Effect of tax rate change on deferred tax asset by Telefónica Slovakia, s.r.o.	(117)	-
Taxes on income	1,380	1,324
Effective tax rate	17%	13%

As at 31 December 2012 the total amount of provisions for current income taxes is CZK 1,859 million (2011: CZK 2,220 million), advances paid for income taxes amount to CZK 1,955 million (2011: CZK 2,380 million), the net deferred tax liability is CZK 3,206 million (2011: CZK 3,736 million), and the net deferred tax asset is CZK 673 million (2011: CZK 746 million).

5 Earnings per share

Basic earnings per share are calculated by dividing the net profit attributable to shareholders by the weighted average number of ordinary shares in issue during the period. The weighted average number of shares takes into account the weighted average effect of changes in treasury share transactions during the year.

	31 December 2012	31 December 2011
Weighted number of ordinary shares outstanding	319,932,546	322,089,900
Net profit attributable to shareholders (in CZK million)	6,776	8,684
Basic earnings per share (CZK)	21	27

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

The Annual General Meeting on 19 April 2012 approved the ordinary share acquisition programme for the next 5 years, up to a maximum of 10% of the total number of 322,089,890 ordinary shares.

6 Dividends

In CZK million	31 December 2012	31 December 2011
Dividends declared (including withholding tax)	8,696	12,884

Dividends include withholding tax on dividends paid by the Company to its shareholders. There has been no interim dividend paid in respect of 2012. Approval of the 2012 profit and the decision regarding the amount of any dividend payment for the 2012 financial year will take place at the Annual General Shareholder Meeting.

Dividend per share for the years ended 31 December was as follows:

In CZK	Year ended 31 December 2012	Year ended 31 December 2011
Dividend per share (nominal value of CZK 100)	27	40

7 Property, plant and equipment

In CZK million	Land, buildings and construction	Ducts, cables and related plant	Communication technology and related equipment	Other fixed assets	Total
At 31 December 2012					
Opening net book amount	10,976	29,647	9,427	1,475	51,525
Additions	262	858	2,864	382	4,366
Additions from WiFi acquisition	-	-	15	-	15
Disposals	(7)	(3)	(51)	(3)	(64)
Reclassifications and currency differences	6	(14)	24	26	42
Assets classified as held for sale	(11)	-	-	-	(11)
Depreciation charge	(931)	(4,911)	(2,642)	(670)	(9,154)
Impairment charge	-	-	(28)	-	(28)
Closing net book amount	10,295	25,577	9,609	1,210	46,691
At 31 December 2012					
Cost	20,222	103,716	89,752	8,202	221,892
Accumulated depreciation and impairment allowance	(9,927)	(78,139)	(80,143)	(6,992)	(175,201)
Net book amount	10,295	25,577	9,609	1,210	46,691
At 31 December 2011					
Opening net book amount	11,808	33,688	9,314	1,841	56,651
Additions	317	823	2,650	446	4,236
Additions from WiFi acquisition	-	-	30	-	30
Disposals	(27)	(2)	(32)	(4)	(65)
Reclassifications and currency differences	26	(2)	112	2	138
Assets classified as held for sale	(199)	(2)	-	-	(201)
Depreciation charge	(949)	(4,858)	(2,626)	(810)	(9,243)
Impairment charge	-	-	(21)	-	(21)
Closing net book amount	10,976	29,647	9,427	1,475	51,525
At 31 December 2011					
Cost	20,180	102,999	90,460	8,183	221,822
Accumulated depreciation and impairment allowance	(9,204)	(73,352)	(81,033)	(6,708)	(170,297)
Net book amount	10,976	29,647	9,427	1,475	51,525

The net book amount at 31 December 2012 includes CZK 2,117 million of assets under construction (2011: CZK 1,805 million). The assets under construction are spread over all disclosed categories of property, plant and equipment following their nature.

As at 31 December 2012, the carrying value of non-depreciated assets amounted to CZK 179 million (2011: CZK 191 million).

No property, plant and equipment were pledged as at 31 December 2012 and 31 December 2011.

No borrowing costs were capitalized during the years 2012 and 2011.

Classes of property, plant and equipment can be broken down into main categories as follows:

Land, buildings and construction	**Closing balance**	
In CZK million	**31 December 2012**	**31 December 2011**
Buildings *	5,343	5,679

* Majority of buildings are buildings for telecommunication technologies.

Ducts, cables and related plant	**Closing balance**	
In CZK million	**31 December 2012**	**31 December 2011**
Twin cables	18,214	21,539
Terrestrial optic fibre	4,780	5,167

Communication technology and related equipment	**Closing balance**	
In CZK million	**31 December 2012**	**31 December 2011**
Exchanges	1,247	1,235
Transmission equipment	1,472	1,504
IP technology, routers, modems	901	943

Other fixed assets	**Closing balance**	
In CZK million	**31 December 2012**	**31 December 2011**
Information process equipment	846	1,113

The Group did not recognise any assets held for sale as at 31 December 2012 (2011: CZK 1 million in net book value).

In 2012, the Group achieved a total gain from the sale of the above fixed assets amounting to CZK 285 million (2011: CZK 346 million) and total losses of CZK 10 million (2011: CZK 49 million).

Cost of fully depreciated property, plant and equipment was CZK 73,091 million as at 31 December 2012 (2011: CZK 70,470 million).

8 Intangible assets

In CZK million	Goodwill	Licences	Software	Customer portfolio	Total
At 31 December 2012					
Opening net book amount	13,453	3,236	3,767	202	20,658
Additions	-	23	1,460	394	1,877
Additions from WiFi acquisition	44	-	-	64	108
Disposals	-	-	(4)	-	(4)
Reclassifications and currency differences	-	(3)	(38)	15	(26)
Amortisation charge	-	(400)	(1,838)	(45)	(2,283)
Closing net book amount	13,497	2,856	3,347	630	20,330
At 31 December 2012					
Cost	13,497	6,236	27,928	687	48,348
Accumulated amortisation and impairment allowance	-	(3,380)	(24,581)	(57)	(28,018)
Net book amount	13,497	2,856	3,347	630	20,330
At 31 December 2011					
Opening net book amount	13,448	3,628	4,361	-	21,437
Additions	-	-	1,386	-	1,386
Additions from WiFi acquisition	5	-	-	199	204
Disposals	-	(2)	(9)	-	(11)
Reclassifications and currency differences	-	3	33	14	50
Amortisation charge	-	(393)	(2,004)	(11)	(2,408)
Closing net book amount	13,453	3,236	3,767	202	20,658
At 31 December 2011					
Cost	13,453	6,217	26,568	213	46,451
Accumulated amortisation and impairment allowance	-	(2,981)	(22,801)	(11)	(25,793)
Net book amount	13,453	3,236	3,767	202	20,658

Goodwill

Goodwill of CZK 13,320 million resulted from the acquisition of the remaining 49% ownership interest in Eurotel Praha spol. s r.o. (Eurotel). The goodwill initially recognized at CZK 14,087 million resulted from a comparison of the cost of a business combination of CZK 29,215 million, and the fair value of net assets acquired of CZK 15,128 million. Until 31 December 2004, the goodwill had been amortised on a straight line basis over a period of 20 years and assessed for an indication of impairment at each balance sheet date.

Due to a revision of IFRS 3, IAS 36 and IAS 38 the Group ceased amortisation of the previously recognized goodwill from 1 January 2005. Accumulated amortisation as at 31 December 2004 was eliminated with a corresponding decrease in the cost of goodwill (CZK 767 million). Since the year ending 31 December 2005 onwards, goodwill is classified as an asset with an indefinite useful life, which has been tested annually for the impairment, as well as when there are indications of impairment.

The Group performed impairment tests, which did not result in any impairment losses of goodwill, in 2012 and 2011. The impairment test involves a determination of the recoverable amount for the mobile cash-generating unit, which corresponds to the value in use. Value in use is the present value of the future cash flows expected to be derived from the cash-generating unit.

Value in use is determined on the basis of an enterprise valuation model and is assessed from a Group internal perspective. Value in use is derived from the cash flow budgets, which are based on the medium-term business plan for a period of 3 years, have been approved by the management and are valid at the time of the impairment test. The business plan is based on past experience, as well as on future market trends. Further, the business plan is based on general economic data derived from macroeconomic and financial studies. Cash flows beyond the three-year period are extrapolated using appropriate growth rates. Key assumptions, on which the management has based its business plan and growth rates, include the trend of the gross domestic product, interest rates, nominal wages, average revenue per user (ARPU), customer acquisition and retention costs, churn rates, capital expenditure, market share, growth rates and the discount rates.

Any significant future changes in the market and competitive environments could have an adverse effect on the value of the cash-generating units.

The calculations of value in use for all cash-generating units are the most sensitive to the following assumptions:

Estimated growth rate – the forecast of the market and regulatory environment, where the Group conducts its principal business, is the basis for determination of the value assigned to the estimated growth rate.

Discount rate – discount rates reflect the management's estimate of the risk specific to the cash generating unit. Weighted average of cost of capital (WACC) forms the basis for the determination of the discount rate.

There is no other intangible asset with indefinite useful life except for goodwill.

Goodwill on WiFi acquisitions

In accordance with principles of standard IFRS 3, the acquirer measures the identifiable assets acquired and liabilities assumed at their acquisition-date fair values. Identifiable assets and liabilities assumed are recognised separately from goodwill. For this purpose Purchase Price Allocation of all acquired assets and assumed liabilities at their fair values was carried out in all acquired businesses.

By purchasing the network infrastructure, customer base and related assets and liabilities from local providers of WiFi Internet access, a goodwill in the amount of CZK 49 million was recognised. Goodwill is presented separately on the balance sheet and is tested annually for impairment. The goodwill resulted from a comparison of the present value of the purchase price in the amount of CZK 231 million and the fair value of net assets acquired of CZK 182 million.

Licences

Acquired licences represent the rights to operate cellular networks in the Czech Republic, UMTS (Universal Mobile Telecommunication System, the third generation mobile cellular technology for networks), GSM (Global System for Mobile Communication, the second generation technology) and CDMA (Code Division Multiple Access).

To enable its service to go live in 2007, a licence for the GSM and UMTS networks was awarded to Telefónica Slovakia, s.r.o. on 7 September 2006 for SKK 150 million (EUR 4.1 million).

In 2012, the Company acquired the rights for Internet network access using CDMA technology (Code Division Multiple Access) from the Czech Telecommunications Office (CTO) for CZK 23 million. The rights have been granted until 7 February 2018.

In 2012, the Company initiated a pilot project of the fourth generation mobile data technology LTE (Long Term Evolution). The commercial operation of this technology was launched in municipality of Jesenice in July 2012.

In November 2012, the Company has entered the public tender, launched by the CTO, which will allocate the rights to use the radio frequencies in the 800 MHz, 1,800 MHz and 2,600 MHz bands. Originally, these bands were used mainly for the terrestrial television broadcasting. The frequencies are dedicated for the provision of public mobile data services. The application to enter the tender was submitted in September and the auction phase was launched in November. At the year-end of 2012, the tender was still ongoing.

Carrying value of licences:

In CZK million	Valid by	31 December 2012	31 December 2011
GSM 900 licence	2016	258	330
GSM 1800 licence	2016	208	266
CDMA 450 licence	2018	23	13
UMTS licence	2022	2,269	2,519
GSM and UMTS licence – Slovakia	2026	98	108
Total		2,856	3,236

No borrowing costs were capitalized during the years 2012 and 2011.

Cost of fully amortised intangible assets was CZK 19,790 million as at 31 December 2012 (2011 CZK: 18,109 million).

All of the Group's intangible assets with finite lives are amortised and are subject to an annual review of impairment indicators and a review of their useful lives.

9 Impairment of non-current assets

As at 31 December 2012 and as at 31 December 2011, the Group reviewed the indicators of cash-generating units (CGU), i.e. fixed and mobile segment, seeking for any indication of impairment to the CGU's assets. As requested by IAS 36 the Group also performed full impairment testing for CGUs that include goodwill (see Note 8). The assessment and impairment testing carried out as at 31 December 2012 and 2011 confirmed that carrying amounts of non-current assets are supportable.

10 Inventories

In CZK million	31 December 2012	31 December 2011
Telecommunication material	94	134
Goods	393	354
Total	487	488

The inventories stated above are net of an allowance of CZK 60 million (2011: CZK 43 million), reducing the value of the inventories to their net realisable value. The total carrying amount of inventories at net realisable value amounts to CZK 65 million (2011: CZK 47 million). The amount of inventories recognised as an expense is CZK 2,614 million (2011: CZK 2,775 million).

In 2012 and 2011, the Group had no inventories pledged as security for liabilities.

11 Receivables

In CZK million	31 December 2012	31 December 2011
Trade receivables from third parties (net)	6,448	6,912
Group trade receivables	352	350
Prepayments	699	543
Other debtors (net)	233	468
Total	7,732	8,273

Trade receivables and other debtors are stated net of bad debt provision of CZK 3,819 million (2011: CZK 3,718 million).

As at 31 December 2012, other debtors do not contain any restricted cash (2011: CZK 22 million).

Receivables from related parties are disclosed in Note 21.

			Not impaired but overdue			
Trade receivables In CZK million	**Carrying amount**	**Neither Impaired nor overdue**	Less than 90 days	90 and 180 days	180 and 360 days	More than 360 days
At 31 December 2012	6,800	3,035	183	23	26	74
At 31 December 2011	7,262	3,594	246	25	38	67

Bad debt provisions In CZK million	
At 1 January 2011	3,831
Additions	2,519
Retirements/amount paid	(2,632)
At 31 December 2011	3,718
Additions	2,490
Retirements/amount paid	(2,389)
At 31 December 2012	3,819

The Group's historical experience regarding the collection of accounts receivable is consistent with the recorded allowances. Due to these factors, the management believes that no additional credit risk beyond the amounts provided for is inherent in the Group's trade receivables.

As at 31 December 2012, the Group presented non-current financial assets of CZK 112 million (2011: CZK 149 million) consisting of other long-term credits, advance payments for long-term expenses and other holdings, which are classified as other financial assets. As at 31 December 2012 non-current financial assets contained restricted cash of CZK 20 million (2011: CZK 20 million) resulting to the Company, as small payment services provider, from the legal requirements of the regulator Czech National Bank.

12 Cash and cash equivalents

In CZK million	31 December 2012	31 December 2011	Interest rate
Cash at current bank accounts and other cash equivalents	283	192	Floating
Cash at cash-pooling structures (inter-company)	2,761	6,763	Floating
Total cash and cash equivalents	3,044	6,955	

As at 31 December 2012 and 2011, cash equivalents of the Group comprised interest bearing deposits with the maximum maturity of three months.

Since April 2006, the Group has been taking part in Telefónica Group cash-pooling, which is having a positive effect on Telefónica Group's good financial governance and effective cash flow management.

At 31 December 2012, the Group had available equivalent of CZK 1,408 million (2011: CZK 1,884 million) of undrawn committed facilities.

For the purposes of the statement of cash flows, the year-end cash and cash equivalents comprise only the following component:

In CZK million	31 December 2012	31 December 2011
Cash and cash equivalents	3,044	6,955

As at 31 December 2012 and 2011 no cash and cash equivalents were pledged.

In CZK million	Year ended 31 December 2012	Year ended 31 December 2011
Interest paid	(210)	(221)
Interest received	87	111
Bank commissions	(40)	(28)
Other financial income	13	37
Total net interest and other financial expenses paid	(150)	(101)

13 Trade and other payables

In CZK million	31 December 2012	31 December 2011
Trade creditors	9,896	10,334
Tax and social security liability	669	681
Other deferred revenue	319	396
Prepaid cards	461	560
Employee wages and benefits	519	541
Other creditors	371	370
Total payables	12,235	12,882
Other non-current liabilities	87	108

As at 31 December 2012 and 2011, other non-current liabilities were made up primarily of deposits placed by recharging partners for prepaid cards and liabilities with due date in more than 12 months.

14 Financial liabilities and financial assets

In CZK million	31 December 2012	31 December 2011
Debt in local currency	3,000	-
Debt in foreign currencies	-	2,969
Interest obligation and derivatives	31	92
Total financial debt	3,031	3,061
Repayable:		
Within one year	31	3,061
Between two and five years (total non-current)	3,000	-
Total financial debt	3,031	3,061

Term loan facility

On 27 September 2012, the Company signed the CZK 3-billion credit facility jointly arranged by UniCredit Bank Czech Republic, a.s., Česká spořitelna, a.s., Komerční banka, a.s., Citibank Europe plc and Československá obchodní banka, a.s.

The Company used the 4-year term loan facility for refinancing of the debt due in 2012 and will use it for general corporate purposes as well. The loan facility is priced at PRIBOR plus margin 1.75% p.a.

In July 2012 the Company repaid in due course a loan in the amount of EUR 115 million drew in 1997.

The Group's debt interest rate allocation after taking into account interest rate swaps was as follows:

In CZK million	31 December 2012	31 December 2011
At fixed rate	-	2,969
At floating rate	3,000	-

The fair values of borrowings are based on discounted cash flows using a discount rate based upon the borrowing rate estimated by the management of the Group as reachable at the balance sheet date. The carrying amounts of short-term debts approximate their fair value.

Loans are not secured over any assets of the Group.

The table below summarizes the maturity profile of the Group's financial and trade liabilities at 31 December 2012 based on contractual undiscounted payments.

At 31 December 2012 In CZK million	Less than 3 months	3 to 12 months	1 to 5 years	> 5 years
Interest bearing loans and borrowings	29	48	3,179	-
Trade and other payables (except for Other deferred revenue and Prepaid cards)	10,288	1,167	-	-
Total	10,317	1,215	3,179	-
Non-current other liabilities	-	-	81	6

At 31 December 2011 In CZK million	Less than 3 months	3 to 12 months	1 to 5 years	> 5 years
Interest bearing loans and borrowings	2	3,165	-	-
Trade and other payables (except for Other deferred revenue and Prepaid cards)	10,495	1,431	-	-
Total	10,497	4,596	-	-
Non-current other liabilities	-	-	102	6

Fair values

Set out below is a comparison by category of carrying amounts and fair values of all of the Group's financial instruments that are carried in the financial statements.

In CZK million	Carrying amount		Fair value	
	2012	**2011**	**2012**	**2011**
Financial assets				
Cash and cash equivalents	3,044	6,955	3,044	6,955
Short-term loans (incl. accrued interest)	1	5	1	5
Derivatives	2	101	2	101
Other financial assets	112	149	112	149

	Carrying amount		Fair value	
	2012	**2011**	**2012**	**2011**
Financial liabilities				
Interest bearing loans and borrowings (incl. accrued interest)	3,019	3,052	3,019	3,115
Derivatives	12	9	12	9

The fair value of derivatives and borrowings has been calculated by discounting the expected future cash flows at prevailing interest rates.

Fair value hierarchy

The Group uses the following hierarchy for determining and disclosing the fair value of financial instruments by valuation technique:

Level 1: quoted (unadjusted) prices in active markets for identical assets or liabilities.

Level 2: other techniques for which all inputs which have a significant effect on the recorded fair value are observable, either directly or indirectly.

Level 3: techniques which use inputs that have a significant effect on the recorded fair value and that are not based on observable market data.

As at 31 December 2012 and 31 December 2011, the Group held only foreign currency forward and swap contracts classified as Level 2 financial instruments measured at fair value.

During the reporting period ending 31 December 2012 and 31 December 2011, there were no transfers between Level 1 and Level 2 fair value measurements, and no transfers into and out of Level 3 fair value measurements.

Financial risk analysis

The following table demonstrates the sensitivity to a reasonably possible change in foreign exchange rates and interest rates.

In CZK million	Effect on profit before tax	
	2012	2011
FX risk		
Value at Risk*	(145)	(149)
Stress testing*	(42)	(47)
IR risk		
Stress testing*	(29)	(94)

* The Value at Risk (VaR) Model enables the Group estimate the probability of maximum possible loss to the portfolio value in the given time frame which will not be exceeded given the defined reliability level. For conducting a VaR calculation, the Group uses the risk variance and covariance method using the normal distribution (e.g. parametric method). The time frame used is one month with a 95% reliability rate. Considering the importance of net open positions resulting from financial assets and financial liabilities of the Group in individual foreign currencies, the Group models VaR from a position of translation and transaction in EUR and USD.

FX risk used stress scenario represents the immediate loss caused by one-off change in the foreign exchange rate by 1% in an unfavourable direction.

IR risk used stress scenario represents immediate one-off change of interest rates along the whole yield curve by 1% in an unfavourable direction. The calculation of unfavorable impact on Group cash flows (due to an increase in interest expense or drop in interest received relating to financial assets and financial liabilities) is made each month on a floating basis within a 12 month time frame.

Financial derivatives

The following nominal value of foreign exchange contracts was used by the Group to manage the currency risk:

In CZK million	Nominal value		Fair value	
	2012	2011	2012	2011
Foreign exchange contracts	1,387	4,257	(10)	92

15 Deferred income taxes

Deferred income taxes are calculated using currently enacted tax rates expected to apply when the asset is realized or the liability settled.

Short-term and long-term deferred taxes were calculated at 19% for both years 2012 and 2011.

In CZK million	2012	2011
At 1 January	2,990	3,931
Profit or loss tax charge / (credit) (Note 4)	(477)	(907)
Foreign exchange translation reserve	20	(34)
At 31 December	2,533	2,990

In 2012 deferred tax asset in Telefónica Slovakia, s.r.o. amounting to CZK 673 million (2011: CZK 744 million) was recognized resulting mainly from possible utilization of tax losses suffered in prior periods.

The following amounts, determined after offsetting, are shown in the consolidated balance sheet:

In CZK million	31 December 2012	31 December 2011
Deferred tax assets	(959)	(966)
Deferred tax liabilities	3,492	3,956
Total	2,533	2,990

The deferred tax asset includes CZK 668 million (2011: CZK 419 million) recoverable in less than twelve months and CZK 291 million (2011: CZK 547 million) recoverable after more than twelve months. The deferred tax liability includes CZK 650 million (2011: CZK 497 million) to be settled in less than twelve months and CZK 2,842 million (2011: CZK 3,459 million) to be settled in more than twelve months.

The deferred tax is determined by these components:

In CZK million	Consolidated balance sheet		Consolidated profit or loss	
	2012	2011	2012	2011
Temporary differences relating to:				
Tax losses	(384)	(559)	161	(533)
Property, plant and equipment and intangible assets	3,114	3,695	(581)	(458)
Trade receivables, inventories and other differences	(197)	(146)	(57)	84
Total	2,533	2,990	(477)	(907)

As at 31 December 2012 the total amount of unused tax losses from previous years in Telefónica Slovakia, s.r.o. totals to CZK 1,669 million (2011: CZK 3,054 million). At 31 December 2012 all these tax losses are taken into account in the tax asset.

The tax loss in the Slovak Republic generated before 31 December 2009 can be carried forward up to five years, while the tax loss generated after 1 January 2010 can be carried forward up to seven years.

16 Provisions for liabilities and charges

In CZK million	Regulatory and court decisions	Other provisions	Total
At 1 January 2012	24	69	93
Additions during the year	15	370	385
Utilised during the year	(5)	(412)	(417)
At 31 December 2012	**34**	**27**	**61**
Short-term provisions 2012	12	20	32
Long-term provisions 2012	22	7	29
	34	**27**	**61**
Short-term provisions 2011	5	62	67
Long-term provisions 2011	19	7	26
	24	**69**	**93**

With the exception of the regulatory and court decision provisions and other small provisions for which the expected timing of payments is not certain all other provisions are expected to be utilised within the next twelve months from the balance sheet date. Other provisions consist mainly of provision for employee benefits, share-based compensation and untaken holiday.

Regulatory and court decisions

A provision for regulatory and court decisions is made for legal proceedings involving the Group (see Note 17).

17 Contingencies

The Company is involved in a number of legal disputes arising from the usual course of business. Throughout 2012 the Company successfully litigated against lawsuits filed by the third parties in the past. Despite this fact, severeal new speculative legal actions were made against the Company. The main litigation cases involving the Company are shown below.

I. Vodafone Czech Republic a.s. - Interconnection agreement dispute

On 30 June 2005, Vodafone Czech Republic a.s. (formerly Český Mobil/Oskar Mobil) filed a legal action with the Municipal Court in Prague against the Company for damages worth CZK 538 million with accessories, and for the return of unjust enrichment of CZK 117 million with accessories. The allegation against the Company is that it did not transit traffic via the mobile operator thus violating the relevant interconnection agreements. The proceeding was legally closed in favour of the Company in February 2011 but Vodafone Czech Republic a.s. filed an extraordinary appeal over the amount of CZK 26 million, claiming that the decision is incorrect in this extent. The Supreme Court has not decided on extraordinary appeal yet.

II. ÚOHS (Office for the Protection of Economic Competition)

i. Administrative proceedings regarding the alleged abuse of dominant position in the fixed broadband market

The Office for the Protection of Economic Competition (ÚOHS) has been conducting the so-called 'preliminary investigation' since November 2008, to determine whether the Company had abused its dominant position in the broadband market. The Company provided the Office with the requested cooperation while repeatedly stating and proving that it had not held a dominant position in the market and, as such, no abuse could have been committed. Although the demands for information and documents from the Office to the Company during more than two years of the investigation have grown immesurably, during all this time the Company was never allowed to inspect the file to check its content and see how the information was interpreted by the Office. In the light of the above, the Company requested court protection by a legal action filed with the Regional Court in Brno. In December 2010, the Regional Court in Brno preliminarily banned the Office from continuing the preliminary investigation and, in February 2011, issued a verdict stating that the preliminary investigation had to be ceased immediately. The verdict was later confirmed by the Supreme Administrative Court in September 2011. The Office reacted in March 2011 by opening an official administrative procedure regarding the dominant position on the fixed broadband ADSL market. The Company filed its statement with the authority, proving that the Office incorrectly defined the relevant market in which Company allegedly held the dominant position and was alleged to abuse it. The Company's statement citing the fierce competition between technology platforms such as xDSL, cable and WiFi in the Czech Republic was repeatedly corroborated by the Czech Telecommunications Office and the European Commission. The Company also provided the Office with numerous documents proving that all steps taken by the Company had been correct. More records are continuously added to the file. With regard to the extreme length and volume of information, the Company cannot estimate when the procedure against it would be closed. The Office did not promulgate a decision in 2012, despite the fact that the Company has provided the Office with all the necessary evidence and information. It was not possible to make a reliable estimate of the financial impact of this administrative procedure at the closing of the 2011 financial statements or these financial statements.

ii. Proceeding for a penalty of CZK 81.7 million

In December 2009, the Regional Court in Brno cancelled the decision of the Office over a penalty of CZK 81.7 million imposed on the Company in December 2003 by administrative procedure for the alleged abuse of the dominant position in the fixed voice services market. As a consequence of the dismissal, the Company asked the Office to return the penalty plus accessories. Although the principal was returned by the Office, before it was decided on the returning of the accessories, the Supreme Administrative Court had in the meantime cancelled the verdict of the Regional Court in Brno and returned the case (for the third time) back to the Regional Court in Brno. Ultimately, in March 2011 the Regional Court in Brno cancelled the decision regarding the penalty, and returned the case back to the Office for it to provide a legal justification for the penalty in relation to the adjudicated period. Despite the objections of the Company citing insufficient background, the Office issued a new decision imposing a fine CZK 91.9 million on the Company. The Company regards the decision as an impermissible reprisal on the part of the Office, and will start a legal action including a proposal to stay the penalty for the duration of the proceedings.

III. Disputes with AUGUSTUS spol. s r.o.

The Company clearly turned around in its favour the dispute with AUGUSTUS and presently concentrates on recovering the amount of unjust enrichment from AUGUSTUS. Originally, AUGUSTUS spol. s r.o. had sued the Company for an alleged loss of profit in the period from 1995 to 2001 in the amount of CZK 183 million with accessories. AUGUSTUS spol. s r.o. claimed that the Company had unjustifiably terminated the contract for the issue and distribution of phone cards signed for an indefinite period. Based on the decision of the High Court in Prague from August 2006, the Company paid a sum of CZK 83 million plus relevant accessories (total of CZK 139 million). Subsequently, there was a positive turn in the proceedings in the favour of the Company when the Supreme Court based on the Company's appeal cancelled the previous verdicts in June 2009 and the Municipal Court in Prague ultimately dismissed the lawsuit in April 2010. The High Court finally confirmed the dismissal in August 2011. Consequently, the Company filed a lawsuit against AUGUSTUS spol. s r.o. to claim CZK 139 million back. The Municipal Court in Prague decided favourably for the Company in September 2011. AUGUSTUS spol. s r.o. filed an unsuccessful appeal. In the interim it turned out that an amount of at least CZK 94 million had been transferred to third parties based on agreements with the statutory representative. The Company takes all legal steps to secure the property and to avoid additional losses. Municipal court in Prague declared AUGUSTUS bankrupt in November 2012.

IV. MEDIATEL, spol. s r.o. – a claim for CZK 359 million

MEDIATEL, spol. s r.o., which had been cooperating with the Company in the area of phone directory publishing and distribution to all telephone subscribers (under the commercial brand Zlaté stránky) since 1992, filed a legal action against the Company for the compensation of an alleged damage exceeding CZK 359 million in December 2009. The Municipal court in Prague fully dismissed the legal action in January 2012 and the decision is final and conclusive. The dispute has been closed in favour of the Company

V. CNS a.s. – a claim for CZK 137 million

In 2009, employees of CNS a.s., dealing with the development and updates of IT applications, and employees of Telefónica O2 Business Solutions, spol. s r.o. were in negotiations over potential collaboration relating to the operation of data boxes. Ultimately, no agreement had been signed between the parties and, due to commercial reasons, the project had never gone ahead. In August 2010, CNS a.s. mounted a legal action against the Company for damages and lost profit totalling CZK 137.2 million, citing the failure to sign a contract. The Company regards this claim as fabricated and the amount as patently inflated, which can be demonstrated by the fact that, in accordance with the annual profit and loss statement for the year 2009, CNS a.s. generated a yearly profit of less than CZK 5.5 million. The Municipal court in Prague dismissed the legal action in full in December 2012. CNS company has a right to file an appeal.

VI. VOLNÝ, a.s. – a claim for CZK 4 billion

On 28 March 2011, VOLNÝ, a.s. filed a legal action with the Municipal Court in Prague against the Company for an amount exceeding CZK 4 billion, regarding alleged abuse of the dominant position in the market of broadband Internet access for households via ADSL technology. The amount is meant to represent the lost profit for years 2004 to 2010. VOLNÝ, a.s. claims to have had a 30% share of the dial-up Internet market in 2003 and implies in its legal action that it ought to have automatically the same share of the broadband market, which it does not. Allegedly it is due to a margin squeeze applied by the Company on the fix broadband market. The Company replied to the petition in July 2011 by noting that both the claim and the calculations submitted by the claimant were unsubstantiated and by pointing at discrepancies in the petition claims. The lawsuit has not been heard by the Court yet. The court has already started the proceeding in the matter and further oral hearings could be expected during the year 2013.

VII. BELL TRADE s.r.o. – a claim for CZK 3.2 billion

A legal action for CZK 3.2 billion filed by company BELL TRADE was delivered to the Company in January 2012. The legal action was filed at the District Court in Malacky (Slovakia); it alleges that the Company had signed contracts with a company called RVI, a.s. for the delivery of several IT projects back in 2002. BELL TRADE, based in Bratislava, allegedly acquired the claims as an agreed fee for services, through a chain of intermediaries. The Company filed a statement with the District Court in Malacky, refuting the existence of any contract and any services from the performance of which any fees would have arisen to any party. The Company also challenged the jurisdiction of Slovak courts since the dispute has no relation to the Slovak territory. The lack of jurisdiction has finally led to the termination of the proceedings in June 2012 but BELL TRADE filed an appeal which is still waiting to be heard by the Regional Court in Bratislava.

VIII. ČESKÉ RADIOKOMUNIKACE – a claim for CZK 3.1 billion

A legal action for CZK 3.1 billion filed by ČESKÉ RADIOKOMUNIKACE (ČRa) was served to the Company in October 2012. The claimant states that the Company allegedly caused him damage by abusing of the dominant position on the xDSL market, which had impacted ČRa's ability to reach "equitable position on the retail xDSL market". The claimed sum is calculated as a difference between the hypothetical price of the part of the business and the sale price for which the part of the business was actually sold to T-Mobile Czech Republic, a.s. in 2009. The Company considers the claim as fabricated and and this was also communicated to the court in the statement. Any oral hearing in this case has not been ordered yet.

The Company is involved in other legal disputes. The aggregate value of all ongoing disputes over CZK 5 million with a verdict expected in 2012 represents nearly CZK 24 million. The annual profit and loss statement also reflects some minor disputes with a less material risk.

The Company considers disclosing other information regarding the said litigations as not advisable, since it could jeopardize the Company's litigation strategy.

The Group is convinced that all litigation risk has been faithfully reflected in the financial statements.

18 Commitments

Operating leases - lessee

The aggregate future minimum lease payments under operating leases are as follows:

In CZK million	31 December 2012	31 December 2011
No later than 1 year	1,359	1,386
Later than 1 year and not later than 5 years	4,474	4,617
Later than 5 years	3,228	3,981
Total	9,061	9,984

The total minimum lease payments relating to operating leasing of property, plant and equipment recognised as an expense in 2012 were CZK 1,513 million (2011: CZK 1,456 million). The lease agreements may contain clauses requiring restoration of the leased site at the end of the lease term. At present, such costs do not have a material impact on the Group's consolidated results of operations, financial position, or cash flow and therefore are not accounted for.

Operating leases - lessor

The table below shows aggregate future minimum lease payments under non-cancellable operating leases, where the Group is a lessor and which give rise to future revenues consist of the buildings and other telecommunication equipment rentals:

In CZK million	31 December 2012	31 December 2011
No later than 1 year	118	112
Later than 1 year and not later than 5 years	405	409
Later than 5 years	89	90
Total	612	611

Capital and other commitments

In CZK million	31 December 2012	31 December 2011
Capital and other expenditure contracted but not provided for in the financial statements	1,980	1,881

The majority of contracted amounts relate to the telecommunications network and service contracts.

19 Service concession arrangements

The Company performs communication activities as defined in the Act on Electronic Communications based on a notification and a certificate from the Czech Telecommunications Office no. 516 as amended by later changes nos. 516/1, 516/2, 516/3, 516/4, 516/5 and 516/6.

The communication activities include (territory of the Czech Republic):
a) public fixed communications network,
b) public mobile communications network,
c) public access telephone service,
d) other voice services - service is defined as of public access,
e) leased lines - service is defined as of public access,
f) radio and TV signal broadcasting - service is defined as of public access,
g) data transmission - service is defined as of public access,
h) internet access services - service is defined as of public access,
i) other voice services - service is not defined as of public access,
j) leased lines - service is not defined as of public access,
k) radio and TV signal broadcasting - service is not defined as of public access,
l) data transmission - service is not defined as of public access,
m) internet access services - service is not defined as of public access.

The Company provides mobile services of electronic communications in the 900 and 1,800 MHz frequency bands under the Global System for Mobile Communication (GSM) standard and LTE standard (Long Term Evolution) on the basis of radio frequency assignment from CTO valid until 7 February 2016, in the 2,100 MHz frequency band under the Universal Mobile Telecommunications System (UMTS) standard on the basis of radio frequency assignment from CTO valid until 1 January 2022 and in the 450 MHz frequency band using technology CDMA2000 (Code Division Multiple Access - CDMA), where is provided broadband mobile access to Internet on the basis of radio frequency assignment from CTO valid until 7 February 2018.

The radio frequency licence can be extended by another licence period based on an application submitted to the CTO in accordance with the Act on Electronic Communications. On the other hand, the current regulatory and business environment in the Czech Republic, the prevailing contractual, legal, regulatory, competitive or other economic factors may limit the period for which the Company can benefit from the use of these radio frequency assignments in the future.

Provision of electronic communications services in Slovakia

In 2006, Telefónica Slovakia, s.r.o. was granted a licence for the provision of electronic communications services by the means of a public mobile electronic communications network in the 900 MHz, 1,800 MHz and 2,100 MHz band on the territory of the Slovak Republic. The licence has been granted for 20 years, i.e. until 2026. The licence can be extended for an additional period based on an application submitted to the Telecommunications Office of the Slovak Republic.

Imposition of obligations related to the provision of the Universal Service

During 2012 and 2011, the Company provided the following selective services under CTO imposed obligations to provide Universal Service:

a) public pay telephone services,

b) access for disabled persons to the public telephone service, which must be equal to access enjoyed by other end users; such special access takes namely the form of specially adapted telecommunication equipment,

c) special price plans, which are different from the price plans used under standard commercial conditions, for low-income persons, persons with special social needs and disabled persons.

Universal Service is reimbursed by the Czech Telecommunications Office that receives funds from the state budget, which are remitted without delay to the Company's account.

20 Share capital and reserves

	31 December 2012	31 December 2011
Nominal value per ordinary registered share (CZK)	87	100
Number of shares	322,089,890	322,089,890
Nominal value per ordinary registered share (CZK)	870	1,000
Number of shares	1	1
Ordinary shares (in CZK million)	28,022	32,209

The reduction of the Company's share capital was registered into the Commercial Register on 14 November 2012. Each share with the nominal value of CZK 100 was decreased by CZK 13 per share and each share with the nominal value of CZK 1,000 was decreased by CZK 130. As at 31 December 2012, the amount of the Company's share capital equaled to CZK 28,021,821,300.

During year 2012 the Company acquired in ordinary share acquisition programme 6,441,798 treasury shares for CZK 2,483 million.

Shareholdings in the Company were as follows:

	31 December 2012	31 December 2011
Telefónica, S.A.	69.41%	69.41%
Telefónica Czech Republic, a.s. (treasury shares)	2.00%	0.00%
Other shareholders	28.59%	30.59%

The funds include a statutory reserve fund of CZK 6,491 million (2011: CZK 6,442 million) that is by law not distributable. The equity-settled share based payments reserve of CZK 31 million (2011: CZK 56 million) is not distributable.

Capital management

The Company is not subject to any externally imposed capital requirements.

The Company's objectives when managing its capital are:

a) to safeguard the Company's ability to continue as a going concern so that it can provide value for its shareholders, and
b) to comply with all relevant legal requirements.

The investment strategy in the light of managing the capital of the Company is to focus its investment activities in the pro-growth areas, such as the development and improvement of fixed and mobile broadband internet and data networks, mobile services, ICT solutions for corporations and for the public sector, and further expansion and development of mobile services (including data) in Slovakia. IT systems renewal and upgrade are among other investment activities aiming to simplify and improve processes that will lead to improved operational effectiveness.

At present, the Company's policy is not to retain surplus cash and distribute it to shareholders. In the following periods, the Board of Directors will continue to make in-depth analysis and assessment of the current and anticipated results of the Company, including scheduled and potential investments and cash flow generation, and will optimize the capital structure to serve the purpose of achieving the ultimate plans.

There are no other specific objectives.

In the case that the dividend capacity (capped at the retained earnings from previous years and the profit for the current year) is lower than the amount of surplus cash, the Company will, in line with its intention not to hold the surplus cash, make an annual analysis of the other options allowing the distribution of cash surpluses to its shareholders. These options comprise:

a) distribution of the share premium
b) share capital reduction through a decrease of the nominal value of shares
c) share buyback

Standalone equity structure as at 31 December 2012:

In CZK million	**31 December 2012**
Share capital	28,022
Treasury shares	(2,483)
Share premium	24,374
Funds and reserves	6,481
Retained earnings from previous years	868
Net income for current year	5,925
Total	**63,187**

21 Related party transactions

The Telefónica Group is organized into four divisions – two geographic and two global ones.

Two geographic divisions are Telefónica Europe and Telefónica Latin America while the Group belongs to the former.

Two global cross-business divisions are Telefónica Digital and Telefónica Global Resources. Telefónica Digital seeks to strengthen the role of Telefónica in the digital world and exploit all growth opportunities while strengthening the portfolio of products and services. Telefónica Global Resources was created to increase the profitability by using all benefits of global exposure.

The Group operates in roaming, interconnection and telecommunications services in regional divisions. In the area of support services it uses cooperation within global divisions.

The Group cooperates with Telefónica Global Services GmbH in the area of centralized demand aggregation, negotiation activities related to the purchases of selected product categories and services and carrying out centralized commercial supplier managment.

The Group cooperates with Telefónica Global Roaming GmbH in the area of wholesale roaming business, negotiaton and execution of roaming discounts agreements with roaming partners, which enables the Group to be granted discounts by the roaming partners and to grant discounts to the roaming partners.

Sales and purchase transactions with related parties are based on contractual agreements negotiated on normal commercial terms and conditions and at market prices. Outstanding balances of assets and liabilities are unsecured, interest-free (excl. financial assets and liabilities used for financing) and the settlement occurs either in cash or by offsetting. The financial assets balances are tested for the impairment at the balance sheet date, and neither allowance nor write-off were incurred.

The following transactions were carried out with related parties:

I. Parent company:

Balance sheet **In CZK million**	**31 December 2012**	**31 December 2011**
a) Receivables	-	6
b) Payables	751	800

Comprehensive income **In CZK million**	**Year ended** **31 December 2012**	**Year ended** **31 December 2011**
a) Purchases of services and goods	47	40
b) Royalty fees	726	768

The total amount of dividend paid as at 31 December 2012 to Telefónica, S.A. was CZK 6,036 million (2011: CZK 8,943 million). The amount paid due to the share capital reduction as at 31 December 2012 amounted to CZK 2,906 million (2011: CZK 0 million).

II. Other related parties – Telefónica Group:

Balance sheet **In CZK million**	**31 December 2012**	**31 December 2011**
a) Receivables	352	344
b) Payables	2,115	2,202
c) Short-term receivables - interest (Note 14)	1	5
d) Cash equivalents (Note 12)	2,761	6,763

Comprehensive income **In CZK million**	**Year ended** **31 December 2012**	**Year ended** **31 December 2011**
a) Sales of services and goods	821	865
b) Purchases of services and goods	1,261	711
c) Management fees	412	398
d) Interest income	65	76

For the period ended 31 December 2012, capital expenditures amounted CZK 4 million (2011: CZK 1 million).

The list of the Telefónica companies with which the Group had any transaction in 2012 and 2011 includes the following entities: Telefónica S.A., Telefónica de España, S.A.U., Telefónica Germany GmbH& CO.OHG, Telefónica UK Ltd., Telefónica Ireland Ltd., Telefónica Móviles España, S.A.U., Telefónica Móviles Argentina, S.A., O2 Holdings Ltd., Telefónica Germany Customer ServicesGmbH, Telefónica Insurance S.A., Telefónica Móviles Guatemala, S.A., Telefónica Móviles El Salvador, S.A. de C.V., Telefónica Móviles Panamá, S.A., Telefónica Móviles Chile, S.A., Otecel, S.A., Telefónica Móviles Nicaragua, S.A., Telefónica Móviles Columbia, S.A., Telefónica Investigación y Desrrollo, S.A., Telecom Italia S.p.A., Telfisa Global BV, Telfisa, Telefónica International Wholesale Services, Telefónica International Wholesale Services II, S.L., S.A., Atento Chequia, Portugal Telecom, Telefónica Compras Electrónica, S.L., Telefónica Móviles Mexico, S.A., Telefónica Móviles del Uruguay, S.A., Telefónica Móviles Peru, S.A., Telefónica Venezuela, S.A., China Unicom (Hong Kong) Limited, Telefónica Global Roaming GmbH, Vivo, S.A., Telefónica Europe People Services Limited, Jajah Ltd., Telefónica USA, Telefonica Global Technology Chequia, Telefonica Global Technology, Telefonica Global Services GmbH, MOPET CZ a.s., Telefónica Factoring, E.F.C., S.A., Telefónica Costa Rica S.A., Telefónica Soluciones de Informatica y Comunicaciones de España S.A., Telefónica Digital España SL.

III. Other related parties

a) Key management compensation

Members of the Board of Directors and of the Supervisory Board of the Company were provided with benefits as follows:

In CZK million	31 December 2012	31 December 2011
Salaries and other short-term benefits	100	109
Personal indemnification insurance	3	4
Total	103	113

b) Loans to related parties

There were no loans provided to members of Board of Directors and Supervisory Board in 2012 and 2011.

No other loan was provided to related parties by the Group.

22 Principal subsidiary undertakings and associates

As at 31 December 2012

Subsidiaries		Group's interest	Cost of investment in CZK million	Country of incorporation	Activity	Method of consolidation
1.	CZECH TELECOM Germany GmbH	100%	10	Germany	Data transmission services	Full consolidation
2.	CZECH TELECOM Austria GmbH	100%	6	Austria	Data transmission services	Full consolidation
3.	Telefónica Slovakia, s.r.o.	100%	6,116	Slovakia	Mobile telephony, internet and data transmission services	Full consolidation
4.	Internethome, s.r.o.	100%	72	Czech Republic	Provision of WiFi internet access	Full consolidation
5.	Bonerix s.r.o.	100%	200	Czech Republic	Mobile telephony, internet and data transmission services	Full consolidation
Associates						
6.	První certifikační autorita, a.s.	23%	9	Czech Republic	Certification services	Not consolidated
7.	AUGUSTUS, spol. s r.o.	40%	-	Czech Republic	Auction sales and advisory services	Not consolidated
8.	MOPET CZ a.s.	14%	20	Czech Republic	Real time mobile payments	Not consolidated

As at 31 December 2011

	Subsidiaries	Group's interest	Cost of investment in CZK million	Country of incorporation	Activity	Method of consolidation
1.	Telefónica O2 Business Solutions, spol. s r.o.	100%	237	Czech Republic	Network and consultancy services in telecommunications, IT/ICT services	Full consolidation
2.	CZECH TELECOM Germany GmbH	100%	10	Germany	Data transmission services	Full consolidation
3.	CZECH TELECOM Austria GmbH	100%	6	Austria	Data transmission services	Full consolidation
4.	Telefónica Slovakia, s.r.o.	100%	6,116	Slovakia	Mobile telephony, internet and data transmission services	Full consolidation
5.	Internethome, s.r.o.	100%	55	Czech Republic	Provision of WiFi internet access	Full consolidation
	Associates					
6.	První certifikační autorita, a.s.	23%	9	Czech Republic	Certification services	Not consolidated
7.	AUGUSTUS, spol. s r.o.	40%	-	Czech Republic	Auction sales and advisory services	Not consolidated
8.	MOPET CZ a.s.	14%	13	Czech Republic	Real time mobile payments	Not consolidated

In 2012, the Company became the sole shareholder of the new subsidiary Bonerix s.r.o. with the registered capital of CZK 200 thousand. In August 2012, Bonerix s.r.o. acquired five parts of the business of Global Care Group.

In August 2012, the Board of Directors approved an increase of the other equity funds of Bonerix s.r.o. by CZK 200 million in the form of a cash contribution.

In 2012, the investment in MOPET CZ a.s. was increased by CZK 7 million.

23 Post balance sheet events

During 2013, the Company plans to continue implementing additional operational efficiencies and improvements that would lead to further savings in various areas, personnel costs inclusive. This efficiency enhancement programme is the way for the Company to retain the leading position on the market and face the macroeconomic situation in the Czech Republic. The overall 2013 restructuring plan is not yet finalized and available as at date of the issue of the Financial Statements, however, the costs of such programme are expected between CZK 330 million and CZK 390 million.

There were no other events, which have occurred subsequent to the year end, which would have a material impact on the financial statements at 31 December 2012.

Financial statements

9.2 Financial statements for the year ended 31 December 2012 prepared in accordance with International Financial Reporting Standards

Content Pages

GENERAL INFORMATION

Telefónica Czech Republic, a.s. (Company) has the form of a joint stock company and is incorporated and domiciled in the Czech Republic. The address of its registered office is Za Brumlovkou 266/2, Prague 4,.140 22, Czech Republic.

The Company is a member of the Telefónica Group of companies (Telefónica Group) with the parent company, Telefónica, S.A. (Telefónica).

The Company is the principal supplier of fixed line telecommunication services and is one of three suppliers of mobile telephone services in the Czech Republic.

The number of employees employed with the Company amounted in average to 6,005 in 2012 (2011: 6,734).

The Company's shares are traded on the Prague Stock Exchange.

The financial statements were approved for issue by the Company's Board of Directors on 13 February 2013.

Reduction of the Company's share capital

In accordance with the resolution on reduction of the Company's share capital adopted by the General Meeting of the Company held on 19 April 2012, the reduction of the Company's share capital was registered into the Commercial Register on 14 November 2012. The nominal value of each share with nominal value of CZK 100 was decreased by CZK 13 per share and each share with nominal value of CZK 1,000 was decreased by CZK 130. As at 31 December 2012, the amount of the Company's share capital equaled CZK 28,021,821,300.

Share buyback

Following the resolution of the Company's General Meeting held on 19 April 2012 regarding the share buyback programme (up to 10% of ordinary shares within 5 years), the Board of Directors approved on 9 May 2012 the acquisition of 2% of the total number of ordinary shares issued by the Company (share buyback). On 18 May 2012, the Company instructed the selected broker to acquire 2% of the total number of ordinary shares issued by the Company (i.e. 6,441,798 ordinary shares).

Acquisition of Bonerix s.r.o.

On 31 August 2012, the Company, via its subsidiary Bonerix s.r.o., signed the agreement related to the acquisition of five parts of the enterprises of Global Care Group (Global Care, s.r.o., TMT Czech, a.s., Hermod, a.s., Česká servisní a správní, a.s., LAKENSIS, a.s.).

Merger of Telefónica O2 Business Solutions spol. s r.o. into the Company

As of 1 July 2012 the merger of Telefónica O2 Business Solutions spol. s r.o., a subsidiary company, into the Company was filed and registered in the Commercial register. As at 1 July 2012, Telefónica O2 Business Solutions spol. s r.o. ceased to exist and all its assets, including rights and obligations arising from employment relations, passed over to the Company.

Non-monetary contribution into subsidiary Internethome, s.r.o.

On 23 May 2012, in order to consolidate WiFi business into one entity, the Company made a decision regarding the increase of the registered capital (CZK 68 millions) of its subsidiary Internethome, s.r.o. by a way of a non-monetary contribution of part of the enterprise (project WiFi), with an effective date 1 July 2012.

Restructuring

During 2012, the Company continued to implement its restructuring activities and cost-optimization activities aimed at further improvement of its operational efficiency. The Company launched new projects in various areas of its operations. These projects focused on the streamlining of the organisation structure including the reduction of duplicate positions; call centre consolidation and optimization; reduction of the number of applications and systems in use, including related processes optimisation. Some restructuring projects have led to a transfer of the activities to outsourcing partners. During the restructuring process more than 500 employees were made redundant and the Company incurred restructuring costs of CZK 261 million (see Note 2).

Cooperation with Genpact Czech s.r.o.

In 2012, the Company has started a five-year cooperation with the company Genpact Czech s.r.o., one of the world's leading companies in the field of accounting and administrative services. Most of the activities carried out by the Company's accounting department were transferred to Genpact Czech s.r.o. as of 14 May 2012. Employees performing these activities were transferred to the employment of Genpact Czech s.r.o.

Research and development activities

During 2012, the Company drew on the knowledge and experience of Telefónica Digital, a division of the Telefónica Group, which seeks to exploit new growth opportunities while strengthening the portfolio of products and services. As a result of the cooperation with Telefónica Digital, the Company brought several innovations in the area of financial and ICT/Cloud services to the market in 2012. In late 2012, Telefónica Digital launched its Wayra program in the Czech Republic and Slovakia, which is aimed at supporting innovation in the segment of Internet and new information and communication technologies (ICT). In 2012, the Company made no internal investments in research and development according to IAS 38 Intangible assets.

BLESKmobil

The Company entered into an agreement with publishing house Ringier Axel Springer CZ to start up the first virtual mobile operator in the Czech Republic. The service is offered under the BLESKmobil brand through one pay-as-you-go tariff.

Informační linky, a.s.

On 1 January 2012 the subsidiary Informační linky, a.s. was founded by a non-monetary contribution of part of the enterprise. On 29 February 2012, 80% of shares of the subsidiary Informační linky, a.s. was sold to Hapalo Estates s.r.o. The share purchase agreement includes call option relating to sale of remaining 20% of shares. The Company has recognized the net profit exceeding CZK 200 million. Informační linky, a.s. provides information and asistance service on telephone numbers 1180, 1181 and 1188.

INDEPENDENT AUDITOR'S REPORT TO THE SHAREHOLDERS OF Telefónica Czech Republic, a.s.

ERNST & YOUNG

INDEPENDENT AUDITOR'S REPORT

To the shareholders of Telefónica Czech Republic, a.s.:

We have audited the accompanying financial statements of Telefónica Czech Republic, a.s., which comprise the balance sheet as at 31 December 2012, and the statement of total comprehensive income, statement of changes in equity and statement of cash flows for the year then ended, and a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with International Financial Reporting Standards as adopted by the European Union, and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with the Act on Auditors and International Standards on Auditing as amended by implementation guidance of the Chamber of Auditors of the Czech Republic. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including an assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Ernst & Young

Opinion

In our opinion, the financial statements present fairly, in all material respects, the financial position of Telefónica Czech Republic, a.s., as at 31 December 2012, and its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards as adopted by the European Union.

Ernst & Young

Ernst & Young Audit, s.r.o.
License No. 401
Represented by partner

Radek Pav
Auditor, License No. 2042

13 February 2013
Prague, Czech Republic

STATEMENT OF TOTAL COMPREHENSIVE INCOME

For the year ended 31 December 2012

In CZK million	Notes	Year ended 31 December 2012	Year ended 31 December 2011
Revenues from voice services	2	14,346	15,952
Monthly charges		11,695	12,412
Data services	2	10,987	11,275
Other revenues	2	8,764	9,253
Revenues		**45,792**	**48,892**
Other income	2	513	488
Interconnection and roaming expenses		(7,706)	(8,111)
Cost of goods sold		(1,967)	(2,087)
Other cost of sales	2	(3,362)	(3,215)
Other expenses	2	(9,526)	(9,281)
Staff costs	2	(5,393)	(5,690)
Impairment reversal/(loss)		(27)	(9)
Operating income before depreciation and amortization ("OIBDA")		**18,324**	**20,987**
Depreciation and amortisation	7, 8	(10,919)	(11,207)
Operating profit		7,405	9,780
Finance income	3	107	315
Finance costs	3	(286)	(433)
Profit before tax		7,226	9,662
Corporate income tax	4	(1,301)	(2,014)
Profit for the year		**5,925**	**7,648**
Other comprehensive income			
Other comprehensive income, net of tax		-	-
Total comprehensive income, net of tax		**5,925**	**7,648**
Profit attributable to:			
Equity holders of the Company	5	5,925	7,648
Total comprehensive income attributable to:			
Equity holders of the Company		5,925	7,648
Earnings per share (CZK) – basic*	5	19	24

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

BALANCE SHEET
As at 31 December 2012

In CZK million	Notes	31 December 2012	31 December 2011
ASSETS			
Property, plant and equipment	7	44,477	49,276
Intangible assets	8	19,183	19,795
Investment in subsidiaries and associates	22	6,433	6,446
Other financial assets	11	108	145
Non-current assets		**70,201**	**75,662**
Inventories	10	433	446
Receivables	11	7,403	7,905
Income tax receivable	4	100	162
Cash and cash equivalents	12	3,017	6,941
Current assets		**10,953**	**15,454**
Non-current assets classified as held for sale	7	-	1
Total assets		**81,154**	**91,117**
EQUITY AND LIABILITIES			
Ordinary shares	20	28,022	32,209
Treasury shares	20	(2,483)	-
Share premium		24,374	24,374
Retained earnings, funds and reserves		13,274	15,809
Total equity		**63,187**	**72,392**
Long-term financial debts	14	3,000	-
Deferred tax liability	15	3,196	3,735
Non-current provisions for liabilities and charges	16	26	25
Non-current other liabilities	13	83	88
Non-current liabilities		**6,305**	**3,848**
Short-term financial debts	14	710	3,060
Trade and other payables	13	10,921	11,761
Provisions for liabilities and charges	16	31	56
Current liabilities		**11,662**	**14,877**
Total liabilities		**17,967**	**18,725**
Total equity and liabilities		**81,154**	**91,117**

The financial statements were approved by the Board of Directors on 13 February 2013 and were signed on its behalf by:

Luis Antonio Malvido
Chairman of the Board of Directors
Chief Executive Officer

David Melcon Sanchez-Friera
1st Vice Chairman of the Board of Directors
Director, Finance Division

STATEMENT OF CHANGES IN EQUITY

For the year ended 31 December 2012

In CZK million	Notes	Share capital	Share premium	Treasury shares	Equity settled share based payments reserve	Funds*	Retained earnings	Total
At 1 January 2011		**32,209**	**24,374**	**-**	**34**	**6,450**	**14,542**	**77,609**
Profit for the year		-	-	-	-	-	7,648	7,648
Total comprehensive income		**-**	**-**	**-**	**-**	**-**	**7,648**	**7,648**
Capital contribution and other transfers		-	-	-	19	-	-	19
Dividends declared in 2011	6	-	-	-	-	-	(12,884)	(12,884)
At 31 December 2011		**32,209**	**24,374**	**-**	**53**	**6,450**	**9,306**	**72,392**
At 1 January 2012		**32,209**	**24,374**	**-**	**53**	**6,450**	**9,306**	**72,392**
Profit for the year		-	-	-	-	-	5,925	5,925
Total comprehensive income		**-**	**-**	**-**	**-**	**-**	**5,925**	**5,925**
Capital contribution and other transfers		-	-	-	(22)	-	-	(22)
Dividends declared in 2012	6	-	-	-	-	-	(8,696)	(8,696)
Treasury share acquisition	20	-	-	(2,483)	-	-	91	(2,392)
Share capital increase/(decrease)	20	(4,187)	-	-	-	-	72	(4,115)
Effect of Merger of TO2 Business Solutions		-	-	-	-	-	95	95
At 31 December 2012		**28,022**	**24,374**	**(2,483)**	**31**	**6,450**	**6,793**	**63,187**

* Refer to Note 20 regarding amounts not available for distribution.

STATEMENT OF CASH FLOWS

For the year ended 31 December 2012

In CZK million	Notes	Year ended 31 December 2012	Year ended 31 December 2011
Cash flow from operating activities			
Cash received from operations		50,359	53,271
Cash paid to suppliers and employees		(32,284)	(31,249)
Dividends received		5	7
Net interest and other financial expenses paid	12	(147)	(97)
Taxes paid		(1,775)	(1,935)
Net cash from operating activities		**16,158**	**19,997**
Cash flow from investing activities			
Proceeds from disposals of property, plant and equipment and intangible assets		324	609
Payments on investments in property, plant and equipment and intangible assets		(5,088)	(5,725)
Payments made on financial investments		(218)	(77)
Payments on temporary financial investments		(250)	-
Repayments of loans made to subsidiaries		60	342
Provisions of loans made to subsidiaries		(209)	(130)
Net cash used in investing activities		**(5,381)**	**(4,981)**
Cash flow from financing activities			
Dividends paid		(8,848)	(12,878)
Capital decrease	20	(4,115)	-
Cash payments to owners for acquisition of the treasury shares	20	(2,483)	-
Proceeds from loans		3,679	-
Repayments of loans, borrowings and promissory notes	14	(2,911)	-
Net cash used in financing activities		**(14,678)**	**(12,878)**
Effect of foreign exchange rate changes on collections and payments		**(23)**	**22**
Net increase / (decrease) in cash and cash equivalents during the period		**(3,924)**	**2,160**
CASH AND CASH EQUIVALENTS AT THE BEGINNING OF THE PERIOD		**6,941**	**4,781**
CASH AND CASH EQUIVALENTS AT THE END OF THE PERIOD	12	**3,017**	**6,941**
BALANCE AT THE BEGINNING OF THE PERIOD		**6,941**	**4,781**
Cash on hand and at banks		6,922	4,762
Other cash equivalents		19	19
BALANCE AT THE END OF THE PERIOD	12	**3,017**	**6,941**
Cash on hand and at banks		3,002	6,922
Other cash equivalents		15	19

ACCOUNTING POLICIES

Content | Pages

A Basis of preparation

The principal accounting policies applied in the preparation of the financial statements are set out below. The policies have been consistently applied to all years presented, unless otherwise stated.

The financial statements were prepared in accordance with International Financial Reporting Standards (IFRS) and all applicable IFRSs adopted by the EU. IFRS comprise standards and interpretations approved by the International Accounting Standards Board (IASB) and the IFRS Interpretations Committee (IFRS IC).

Effective from 1 January 2005, a change in the Czech Act on Accounting No. 563/1991 Coll. requires the Company to prepare its financial statements in accordance with IFRS adopted by the EU (Regulation (EC) No 1606/2002). At the balance sheet date, there are no differences in the IFRS policies applied by the Company and IFRS adopted by the EU.

The financial statements are the separate financial statements of the Company and meet requirements of IFRS with respect to the preparation of parent's separate financial statements. The Company also issued consolidated financial statements prepared for the same period in accordance with IFRS, which were approved for issue by the Board of Directors.

The financial statements were prepared under the historical cost convention except for non-current assets held for sale, inventory held at net realizable value, financial derivatives, share based payment liability and certain assets and liabilities acquired during business combinations, as disclosed in the accounting policies below.

The preparation of financial statements in conformity with IFRS required the Company to use certain critical accounting estimates. It also required estimates be used in the process of applying the Company's accounting policies. The areas involving a higher degree of judgement or complexity, or areas where assumptions and estimates are significant to the financial statements are disclosed in Note T.

The amounts shown in the financial statements are presented in millions Czech crowns (CZK), if not stated otherwise.

Adoption of new or revised IFRS standards and interpretations (includes standards and interpretations applicable for the Company)

In 2012, the Company applied the below stated standards, interpretations and amendments, which are relevant to its operations. Adoption of the interpretations and amendments has no effect on the financial performance or position of the Company:

IAS 12 Income Taxes – Amendment (effective 1 January 2012)

The amendment clarifies the determination of deferred tax on investment property measured at fair value and introduces a rebuttable presumption that deferred tax on investment property measured using the fair value model in IAS 40 should be determined on the basis that its carrying amount will be recovered through sale. It includes the requirement that deferred tax on non-depreciable assets that are measured using the revaluation model in IAS 16 should always be measured on a sale basis.

The adoption of the amendment did not have any impact on the Company's financial position, performance or its disclosures.

IFRS 7 Financial Instruments: Disclosures — Enhanced Derecognition Disclosure Requirements (effective 1 July 2011)

The amendment requires additional disclosure about financial assets that have been transferred but not derecognised to enable the user of the Company's financial statements to understand the relationship with those assets that have not been derecognised and their associated liabilities. In addition, the amendment requires disclosures about the entity's continuing involvement in derecognised assets to enable the users to evaluate the nature of, and risks associated with, such involvement.

The Company does not have any assets with these characteristics so there has been no effect on the presentation of its financial statements.

New IFRS not effective as at 31 December 2012 (includes standards applicable for the Company)

At the date of preparation of the accompanying financial statements, the following IFRS had been published, but their application was not mandatory. The Company intends to adopt those standards when they become effective.

Standards and amendments		**Mandatory application: annual periods beginning on or after**
IAS 1	Presentation of Items of Other Comprehensive Income (Amendment)	1 July 2012
IFRS 7	Disclosures — Offsetting Financial Assets and Financial Liabilities — Amendments to IFRS 7	1 January 2013
IFRS 9	Financial Instruments: Classification and Measurement	1 January 2015
IFRS 10	Consolidated Financial Statements	1 January 2013
IFRS 11	Joint Arrangements	1 January 2013
IFRS 12	Disclosure of Interests in Other Entities	1 January 2013
IFRS 13	Fair Value Measurement	1 January 2013
IAS 19	Employee benefits (Revised)	1 January 2013
IAS 27	Separate Financial Statements (as revised in 2011)	1 January 2013
IAS 28	Investments in Associates and Joint Ventures (as revised in 2011)	1 January 2013
IAS 32	Offsetting Financial Assets and Financial Liabilities — Amendments	1 January 2014

The Company is currently assessing the impact of the application of these standards and amendments. Based on the analyses made to date, the Company estimates that their adoption will not have a significant impact on the financial statements in the initial period of application.

The Company is currently monitoring the development in the area of IFRSs being prepared in regards to leases and revenue recognition, which are planned for submission in 2013 or later.

B Foreign currencies

(i) Functional and presentation currency

Items included in the financial statements of the Company are measured using the currency of the primary economic environment in which the Company operates ("the functional currency"). The financial statements are presented in Czech crowns (CZK), which is the Company's functional and presentation currency.

(ii) Transactions and balances

Foreign currency transactions are translated into the functional currency using the exchange rates prevailing at the date of the transaction. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation of monetary assets and liabilities denominated in foreign currencies are recognised in profit or loss, except when deferred in other comprehensive income as qualifying cash flow hedges. Such balances of monetary items are translated at period-end exchange rates. Non-monetary items that are measured in terms of historical cost in a foreign currency are translated using the exchange rate at the date of the transaction. Non-monetary items that are measured at fair value in a foreign currency are translated using the exchange rates at the date when the fair value was determined.

C Property, plant and equipment

All property, plant and equipment are initially recorded at cost and, except for freehold land, are subsequently carried at its cost less any accumulated depreciation and accumulated impairment losses. Freehold land is subsequently stated at cost less any accumulated impairment charges.

Property, plant and equipment acquired in business combinations are stated at their acquisition costs (which are equal to their fair value at the date of acquisition) less accumulated depreciation and accumulated impairment charges.

Property, plant and equipment include all costs directly attributable to bringing the asset to working condition for its intended use. With respect to the construction of the network, this comprises every expenditure up to the customers' premises, including the cost of contractors, materials, direct labour costs and interest cost incurred during the course of construction.

Subsequent costs are recognised as property, plant and equipment only if it is probable that future economic benefits associated with the item will flow to the Company and the cost can be measured reliably.

Repairs and maintenance costs are expensed as incurred.

Items of property, plant and equipment that are retired are not intended for sale and are not expected to create any future economic benefits or are otherwise disposed of, are eliminated from the balance sheet, along with the corresponding accumulated depreciation. Any gain or loss arising from retirement or disposal is included in net operating income, i.e. net gain or loss is determined as the difference between the net disposal proceeds, if any, and the carrying amount of the item.

Items of property, plant and equipment, excluding freehold land, are depreciated from the time they are available for use, using the straight-line method. Depreciation ceases at the earlier of the date the asset is either de-recognised or at the date the asset is classified as held for sale.

Depreciation does not cease, when the asset becomes temporarily idle or retired from active use, unless the asset is fully depreciated.

Estimated useful lives adopted in the financial statements are as follows:

	Years
Freehold buildings	up to 40
Cable and other related plant	10 to 25
Exchanges and related equipment	up to 25
Other fixed assets	up to 20

Freehold land is not depreciated as it is deemed to have an indefinite life.

The assets' residual values and useful lives are reviewed, and adjusted if appropriate, at each balance sheet date.

An asset's carrying amount is written down immediately to its recoverable amount if the asset's carrying amount is greater than its estimated recoverable amount (refer to Note F Impairment of assets).

D Intangible assets

Intangible assets include computer software, purchased goodwill, licences and customer bases. Computer software mainly represents the external acquisition costs of the Company's information systems that are intended for use within the Company. Generally, costs associated with developing or maintaining computer software programs are recognised as an expense as incurred. However, costs that are directly associated with identifiable and unique software products controlled by the Company and that have a probable economic benefit exceeding the cost beyond one year, are recognised as intangible assets. Computer software costs recognised as assets are amortised using the straight-line method over their useful lives, generally from one to five years.

Intangible assets acquired in business combinations are stated at their acquisition costs (which are equal to their fair value at the date of acquisition) less accumulated amortisation and accumulated impairment charges and are amortised on a straight-line basis over their estimated useful lives. Customer bases are amortised over a period of the remaining average terms of the binding contracts or period over which production units are generally obtained from the asset by an entity.

Acquired licences are recorded at cost and amortised on a straight-line basis over the remaining life of the licence (i.e. over 15 to 20 years), from the start of commercial service, which best reflects the pattern by which the economic benefits of the intangible assets will be utilised by the Company.

Intangible assets with an indefinite useful life are not amortised. They are subject to the regular impairment reviews (see Note 8 and Note 9).

Goodwill, arising from the purchase of subsidiary undertakings and interests in associates and joint ventures, represents the excess of the fair value of the purchase consideration over the fair value of the net assets acquired. Goodwill is not amortised but is tested for impairment at least annually or anytime there are indications of a decrease in its value.

The Company reviews at least at the balance sheet date the useful lives of intangible assets that are not amortised to determine whether events and circumstances continue to support an indefinite useful life assessment for that asset. If they do not, the change in the useful life assessment from indefinite to finite is accounted for as a change in an accounting estimate.

On the balance sheet date, carrying amounts, residual values and the useful lives of assets are reviewed, revised and if necessary prospectively amended and accounted for as a change in an accounting estimate.

Intangible assets that are no longer in use and no future economic benefits are expected or that are disposed of for any other reason are de-recognised from the balance sheet together with the corresponding accumulated amortisation (for amortised assets only). All gains or losses arising in this respect are recognised in net operating income, i.e. net gain or loss is determined as the difference between net disposal proceeds, if any, and the carrying amount of the asset.

Intangible assets, with the exception of assets with an indefinite useful life, are amortised using the straight-line method from the time they are available for use. Amortisation ceases at the earlier of the date the asset is de-recognised, the date the asset is classified as having the indefinite useful life or the date the asset is classified as held for sale.

E Non-current assets classified as held for sale

The Company classifies separately in the balance sheet a non-current asset (or disposal group) as held for sale if its carrying amount will be recovered principally through a sale transaction rather than through continuing use. For this to be the case, the asset (or disposal group) is available for immediate sale in its present condition subject only to terms that are usual and customary for sales of such assets (or disposal groups), its sale is highly probable and sale is expected within one year.

The Company measures a non-current asset (or disposal group) classified as held for sale at the lower of its carrying amount and fair value less costs to sell.

The Company recognizes an impairment loss for any initial or subsequent write-down of the asset (or disposal group) to fair value less costs to sell and is accounted for as an impairment loss with impact in profit or loss of the relevant period.

From the moment the asset is classified as held for sale and eventually revalued, it ceases to be depreciated/amortised and is reviewed only from impairment point of view.

Any gain from any subsequent increase in fair value less costs to sell, but not in excess of the cumulative impairment loss that has been recognized, is determined and is accounted for in profit or loss.

F Impairment of assets

Property, plant and equipment and other assets, including goodwill and intangible assets, are reviewed for impairment losses whenever events or changes in circumstances indicate that the carrying amount may not be recoverable or at least on an annual basis for goodwill and for intangibles with an indefinite useful life and for intangibles not yet in use. An impairment loss is recognised for the amount by which the carrying amount of the asset exceeds its recoverable amount, which is the higher of an asset's net selling price and value in use. For the purposes of assessing impairment, assets are grouped at the lowest level, for which there are separately identifiable cash flows (cash-generating units).

Impairment losses are recognised in expenses when incurred. A previously recognised impairment loss is reversed (except for the Goodwill impairment loss) only if there has been a change in the assumptions used to determine the asset's recoverable amount since the last impairment loss was recognised. If that is the case the carrying amount of the asset is increased to its recoverable amount. That increased amount cannot exceed the carrying amount that would have been determined, net of depreciation, had no impairment loss been recognised for the asset in prior years. Such reversal is recognised in profit or loss in the period in which the reversal occurs.

The Company makes an assessment at least at each balance sheet date whether there is any indication that an impairment loss may no longer exist, may have decreased or may have increased. If any such indication exists, the Company estimates a recoverable amount of the assets and compares to the carrying value (net of the impairment allowance). In assessing whether there is any indication that the impairment loss recognised in the past may no longer exist, the Company considers both external and internal sources of information (asset's market value, changes expected in the market, including technological, economic or legal changes, market interest rates, significant changes with effect on the Company in the extent to which, or manner in which, the assets are used or are expected to be used, evidence available from internal reporting indicating economic performance of assets etc.). Where an estimate of recoverable amount is calculated, there is a number of management assumptions used.

G Investments and other financial assets

The Company classifies its financial assets into the following categories: financial assets at fair value through profit or loss, held-to-maturity investments, loans and receivables and available-for-sale financial assets.

Financial assets that are acquired principally for the purpose of generating a profit from short-term fluctuations in price are classified as financial assets at fair value through profit or loss and are included in current assets. During 2012 and 2011, the Company did not hold any financial assets in this category.

Investments with a fixed maturity that management has the intent and ability to hold to maturity are classified as held-to-maturity and are disclosed as current or non-current assets, depending on the period in which the settlement will take place.

Loans and receivables are financial assets with fixed or determinable payments that are not quoted in an active market and are measured at amortised cost using an effective interest rate method and are disclosed as current or non-current assets, depending on the period in which the settlement will take place.

Investments intended to be held for an indefinite period of time, which may be sold in response to needs for liquidity or changes in interest rates, are classified as available-for-sale; these are included in non-current assets unless management has expressed the intention of holding the investment for less than 12 months from the balance sheet date or unless they will need to be sold to raise operating capital, in which case they are included in current assets.

The management determines the appropriate classification of its investments at the time of the purchase and re-evaluates such designation on a regular basis, as required under IAS 39.

All purchases and sales of investments are recognised on the trade date, which is the date that the Company commits to purchase or sell the asset. The cost of purchase includes all transaction costs. Financial assets at fair value through profit or loss and available-for-sale investments are subsequently carried at fair value, whilst held-to-maturity investments are carried at amortised cost using the effective interest rate method. Realised and unrealised gains and losses arising from changes in the fair value of financial assets at fair value through profit or loss are included in profit or loss in the period in which they arise. On the contrary, unrealised gains and losses arising from changes in the fair value of available-for-sale investments are included in other comprehensive income in the period in which they arise, except for impairment losses, until the financial asset is de-recognised, at which time the cumulative gain or loss previously recognised in other comprehensive income is recognised in profit or loss.

Impairment of financial assets

The Company assesses at each balance sheet date whether financial assets or groups of financial assets are impaired.

(1) Assets carried at amortized costs

If there is objective evidence that an impairment loss on loans and receivables or held to maturity investments carried at amortised cost has been incurred, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows discounted at the financial asset's original effective interest rate. The carrying amount of the asset is reduced either directly or through use of an allowance account. The amount of the loss is recognised in profit or loss.

The Company first assesses whether objective evidence of impairment exists individually for financial assets that are individually significant, and individually or collectively for financial assets that are not individually significant. If it is determined that no objective evidence of impairment exists for individually assessed financial assets, whether significant or not, it is included in a group of financial assets with similar credit risk characteristics and that group of financial assets is collectively assessed for impairment. Assets that are individually assessed for impairment and for which an impairment loss is or continues to be recognised are not included in a collective assessment of impairment.

If, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised, the previously recognised impairment loss is reversed. Any subsequent reversal of an impairment loss is recognised in profit or loss and only to the extent that the carrying amount of the financial asset does not exceed its amortised cost at the reversal date.

In relation to trade receivables, a provision for impairment is made when there is objective evidence (such as the probability of insolvency) that the Company will not be able to collect all of the amounts due under the original terms of the invoice. The carrying amount of the receivable is reduced through use of an allowance account. Impaired debts are derecognised when they are assessed as uncollectible or sold.

(2) Available-for-sale financial assets

If this asset is impaired, the cumulative loss that had been previously recognised (due to fair value revaluation) in other comprehensive income shall be removed from other comprehensive income and recognised in profit or loss even though the financial asset has not been derecognised.

The amount of the cumulative loss that is removed from other comprehensive income and recognised in profit or loss shall be the difference between the acquisition cost (net of any principal repayment and amortisation) and the current fair value, less any impairment loss previously recognised in profit or loss.

Reversals of impairment losses on debt instruments are reversed through profit or loss, if the increase in fair value of the instrument can be objectively related to an event occurring after the impairment loss was recognised in profit or loss.

De-recognition of financial assets

A financial asset is de-recognised when:

a) the rights to receive cash flow from the asset have expired,

b) the Company retains the right to receive cash flow from the asset, but has assumed an obligation to pay them in full without material delay to a third party under a "pass-through" arrangement, or

c) the Company has transferred its rights to receive cash flows from the assets and either has transferred substantially all the risks and rewards of the asset, or has neither transferred nor retained substantially all the risks and rewards of the asset, but has transferred control of the asset.

H Leases

The determination of whether an arrangement is, or contains a lease is based on the substance of the arrangement at inception date of whether the fulfilment of the arrangement is dependent on the use of specific asset or assets and the arrangement conveys a right to use the assets.

Leases under which a significant portion of the risks and benefits of ownership are effectively retained by the lessor are classified as operating leases. Payments made under operating leases are charged to profit or loss on a straight-line basis over the period of the lease.

When an operating lease is terminated before the lease period has expired, any payment that is required to be made to the lessor by way of penalty is recognised as an expense in the period in which termination takes place.

Leases of property, plant and equipment where the Company bears substantially all the risks and rewards of ownership are classified as finance leases. Finance leases are capitalized at the inception of the lease at the lower of the fair value of the leased property or the present value of the minimum lease payments. Each lease payment is allocated between the liability and finance charges so as to achieve a constant rate of interest. The corresponding lease obligations, net of finance charges, are included in other long-term payables (depending on maturity).

The interest element of the finance cost is charged to profit or loss over the lease period so as to produce a constant periodic rate of interest on the remaining balance of the liability for each period. If there is a reasonable certainty that the lessee will obtain ownership by the end of the lease term, the period of expected use is the useful life of the asset; otherwise the property, plant and equipment acquired under finance leases are depreciated over the shorter of the useful life of the asset or the lease term.

I Inventories

Inventory is stated at the lower of cost or net realisable value. Costs of inventories include the purchase price and related costs of acquisition (transport, customs duties and insurance). The cost of inventory is determined using weighted average cost. Net realisable value is the estimate of the selling price in the ordinary course of business, less the costs of completion and selling expenses.

J Trade receivables

Trade receivables are carried at original invoice amount less allowance for impairment of these receivables. Such allowance for impairment of trade receivables is established if there is objective evidence that the Company will not be able to collect all amounts due according to the original terms of the receivables. The amount of the allowance is the difference between the carrying amount and the recoverable amount, being the present value of expected cash flows, discounted at the initial market rate of interest for similar borrowers. Cash flows relating to short-term receivables are usually not discounted. The amount of the allowance is recognized in profit or loss.

K Cash and cash equivalents

Cash and cash equivalents are carried in the balance sheet at cost. For the purposes of the statement of cash flows, cash and cash equivalents comprise cash on hand, deposits held at call with banks, other short-term highly liquid investments with original maturities of three months or less, and bank overdrafts. Bank overdrafts are shown within borrowings in current liabilities section of the balance sheet.

L Financial debt

Borrowings are recognised initially as the proceeds received, net of transaction costs incurred. In subsequent periods, borrowings are stated at amortised cost using the effective interest rate method; any difference between proceeds (net of transaction costs) and the redemption value is recognised in profit or loss over the period of the borrowings.

Borrowings are classified as current liabilities unless the Company has an unconditional right to defer settlement of the liability for at least 12 months after the balance sheet date.

Borrowing costs on debts used to finance the acquisition and construction of qualifying assets are capitalized during the period of time that is required to complete and prepare the asset for its intended use. Other borrowing costs are expensed.

M Current and deferred income taxes

Taxation expense represents both current and deferred taxation, where appropriate.

Current income tax assets and liabilities for the current and prior periods are measured at the amount expected to be recovered from or paid to the taxation authorities. The tax rates and tax laws, used to compute the amount, are those that are enacted or substantively enacted by the balance sheet date.

Income tax relating to items recognised in other comprehensive income is recognised in other comprehensive income and not in profit or loss.

Deferred income taxation is calculated using the liability method applied to all temporary differences arising between the tax basis of assets and liabilities and their carrying values for financial reporting purposes. Currently enacted tax rates and laws expected to apply when the asset is realised or the liability is settled are used to determine the deferred income tax.

The principal temporary differences arise from differences in the tax and accounting values of property, plant and equipment, impairment of receivables and allowance for obsolete and slow moving inventories, non tax deductible allowances and provisions, unused tax credits and, in relation to acquisitions, on the difference between the fair values of the net assets acquired and their tax base.

Deferred income tax assets are recognised to the extent that it is probable that future taxable profit will be available against which the temporary differences can be utilised.

The Company accounts for the tax consequences of transactions and other events in the same way that it accounts for the transactions and other events themselves. Thus, for transactions and other events recognised in profit or loss, any related tax effects are also recognised in profit or loss. For transactions and other events recognised directly in equity, any related tax effects are also recognised directly in equity. Similarly, the recognition of deferred tax assets and liabilities in a business combination affects the amount of goodwill.

Deferred income tax assets and tax liabilities are offset, if a legally enforceable right exists to set off current tax assets against current income tax liabilities and the deferred income taxes relate to the same taxable entity and the same taxation authority. The same applies for offsetting of current tax assets and liabilities.

N Employee benefits

(1) Pension obligations

Contributions are made to the Government's health, retirement benefit and unemployment schemes at the statutory rates applicable during the period and are based on gross salary payments. The arrangements of the Government's health, retirement benefit and unemployment schemes correspond to the arrangements for defined contribution plans. The Company has no further payment obligations once the contributions have been paid. The expense for the contributions is charged to profit or loss in the same period as the related salary expense. The Company also makes contributions to defined contribution schemes operated by external pension companies. These contributions are charged to profit or loss in the period to which the contributions relate.

(2) Redundancy and termination benefits

Redundancy and termination benefits are payable when employment is terminated before the normal retirement or contract expiry date. The Company recognises provision for redundancy and termination benefits when it is demonstrably committed to terminate the employment of current employees according to a detailed formal plan without possibility of withdrawal. Benefits falling due more than 12 months after the balance sheet date are discounted to present value. There are no redundancy and termination benefits falling due more than 12 months after the balance sheet date.

(3) Bonus plans

The Company recognises a liability for bonuses based on a formula that takes into consideration certain performance related measures, such as turnover or free cash flow, after certain adjustments. The Company recognises a provision where the Company is contractually obliged or where there is a past practice that has created a constructive obligation.

O Share-based compensation

In 2006, the Company introduced performance compensation systems linked to the market value of shares of the parent company, Telefónica, S.A. Some compensation plans are settled in cash, while others are settled via the delivery of shares.

IFRS 2 is applied to compensation schemes linked to the share price with the following accounting treatment:

Option plans that can be either cash-settled or equity-settled at the option of the employee are recognized at the fair value on the grant date of the liability and equity components of the compound instrument granted.

In the cash-settled share option plan, the total cost of the rights to granted shares are expensed over the period during which the beneficiary earns the full right to exercise the options (vesting period). The total cost of the options is initially measured based on their fair value at the grant date calculated by the Black-Scholes option pricing model, taking into account the terms and conditions established in each share option plan. At each subsequent reporting date, the Company revises its estimate of fair value and the number of options it expects to vest, booking any change in the liability through profit or loss for the period, if appropriate.

For the equity-settled share option plan, fair value at the grant date is measured using the binominal methodology. These plans are expensed during the vesting period with a credit to equity. At each subsequent reporting date, the Company revises its estimate of the number of options it expects to be exercised, with a corresponding adjustment to equity. As the plan will be settled by a physical delivery of equity instruments of the parent, Telefónica, S.A., to the employees, the personnel expense accrued is recognised against equity.

P Provisions

Provisions are recognised when the Company has either present legal or constructive obligation resulting from past events, and it is probable that an outflow of resources will be required to settle the obligation assuming that a reliable estimate of the amount can be made. Where the Company expects a provision to be reimbursed, the reimbursement is recognised as a separate asset but only when the reimbursement is virtually certain.

Q Revenue recognition

Revenue, shown net of Value Added Tax and any discounts, and after eliminating sales within the Company, comprises goods sold and services provided. Revenues are measured at their fair value of the consideration received or receivable. The amount of revenue is recognised if it can be measured reliably and it is probable that the economic benefits associated with the transaction will flow to the Company. If necessary, revenue is split into separately identifiable components.

The Company offers customers free minutes for a selected price based on a chosen customer plan. Free unused minutes at the end of the month might be rolled over to the following month. The Company is not obliged to reimburse the customer for unused minutes and the option of rolling over any unused minutes is valid for only one month.

The Company recognises revenue for free minutes in the period when the related services are provided and consumed, if material. Any rollover minutes are deferred and recognised when the minutes are used or the option expires.

In assessing whether revenue should be recognised gross, i.e. with separate disclosure of costs to arrive at gross profit, or on a net basis, the Company considers these indicators of gross revenue reporting:

a) the Company is the primary obligor in the arrangement,
b) the Company has general inventory risk,
c) the Company has price latitude,
d) the Company changes the product or performs part of the service,
e) the Company has discretion in supplier selection,
f) the Company is involved in the determination of product or service specifications,
g) the Company has credit risk,
h) the Company has the ability to set the terms of the transaction,
i) the Company has the managerial control over the transaction.

The relative strength of each indicator is considered while deciding the accounting treatment.

If a transaction is considered to meet conditions of an agency arrangement, the revenue is recognised only at the amount of the commission received/realised.

Revenue from fixed price construction contracts (long-term contracts) is recognised using the percentage of completion method, measured by reference to the percentage of actual cost incurred to date to estimated total costs of the contract. A loss expected from the construction contract is recognised as an expense immediately, when it is probable that total contract costs will exceed total contract revenue.

(1) Fixed line business revenues

Revenue is recognized as follows:

Domestic and international call revenues

Domestic and international call revenues are recognised in profit or loss at the time the call is made.

Universal service

The Company is obliged to render certain fixed line telephony services defined by the Act on Electronic Communications. Relevant costs are compensated by the Czech Telecommunications Office (CTO). The Company recognises the compensation using gross principle on standard accrual basis of revenue recognition.

Subscription revenues

Revenue is recognised in profit or loss in the period in which the services are rendered.

Revenues from sales of prepaid cards

Prepaid call card sales are deferred until the customer uses the stored value on the card to pay for the relevant calls. The expiry date for prepaid cards is not longer than 36 months.

Connection fees

Connection fees, arising from the connection of the customers to the Company's network, if material, are deferred and recognised in profit or loss over the estimated average customer relationship period.

Equipment sales and sale of other goods

Revenue from the sale of telephone equipment, accessories and other goods is recognised at the time of sale i.e. when the Company has transferred to the buyer the significant risks and rewards of ownership of the goods.

Local loop unbundling

Revenue from access to the local loop unbundling is deferred in profit or loss and recognised in the period in which the service is rendered. The regular monthly fee is recognised on the straight line basis in the period when the service is consumed. Revenue from the preparation of the location (collocation) for an alternative operator is recognized upfront in profit or loss when it occurs.

Audiotex

Revenues from audiotex, service offering content to which a special tariff applies and enables to transfer money and to pay for goods or services from the third parties, are recognised using netto principle.

Information and communication technology services

Information and communication technology (ICT) services include complex customer solutions and managed services, mainly system integration, outsourcing services, project solutions and software development. Revenue recognition of such services reflects the substance of the provided services.

(2) Mobile business revenues

The Company generates mobile service revenues from the usage of the Company's network by customers, interconnection and roaming. The Company also earns revenue from the sale of mobile telephone equipment and accessories as well as from activation fees.

Airtime revenues

Postpaid customers are billed monthly in arrears for airtime revenues. Revenue from post-paid customers is recognised at the time of usage of airtime and other services. Prepaid customers buy credit, which entitles them to a certain value of airtime and other services. Revenue from prepaid customers is deferred and recognised at the time of usage of airtime and other services.

Both post-paid and prepaid products may include deliverables such as a handset, activation and airtime and are defined as arrangements with multiple deliverables. The arrangement consideration is allocated to each deliverable, based on its fair value, but up to consideration received if future cash receipts are contingent on future deliveries. Revenues allocated to the identified deliverables in each revenue arrangement are recognized based on the same recognition criteria which we used for the individual deliverables at the time the product or service was delivered.

Connection fees

Connection fees, arising from the connection of the customers to the Company's network, if material, are deferred and recognised in profit or loss over the estimated average customer relationship period.

Equipment sales and mobile services

Monthly service revenues and revenues from handset sales are recognized as revenue when the product or service is delivered to the distributor or to the end customer. Resulting losses from sale of handsets at a discount are recognised at the date of sale.

Roaming revenues

The mobile segment derives roaming revenue as a result of airtime and other services used by the mobile segment's customers roaming on partners' networks in other countries and vice versa. Amounts receivable from and payable to roaming partners are netted and settled net on a regular basis.

Premium SMS

Revenues from premium SMS, short text messages that enable customers to use their mobile phones to send money transfer requests and pay for goods and services from third parties, are recognised using netto principle.

Costs

Discounts directly related to the sale of equipment, SIM cards and activations are netted against revenue in the period the product is sold to the dealer, distributor or the end customer. Commission payments to dealers for activations, various marketing promotions and other activities are included in the costs of sales for the period.

(3) Interconnection revenues

Interconnection revenues are derived from calls and other traffic that originate in other domestic and foreign operators' network but terminate in or transit the Company's network. These revenues are recognised in profit or loss at the time when the call is received in the Company's network. The Company pays a proportion of the call revenue it collects from its customers to the other domestic and foreign operators for the calls and other traffic originating in the Company's network, which use other domestic and foreign operators' network. Amounts receivable from and payable to other domestic and foreign operators are netted and settled net on a regular basis.

(4) Internet, IPTV and data services

The Company derives revenue from providing Internet access service, IPTV and other data services. The revenues from such services are recognised at the time the service is provided.

(5) Dividend income

Dividend income is recognized when the right to receive payment is established.

(6) Interest income

Income is recognised as interest accrues (using the effective interest method).

(7) Instalment sales

Revenue attributable to the sales price, exclusive of interest, is recognised at the date of sale. The sale price is the present value of the consideration, determined by discounting the instalments receivable at the imputed rate of interest. The interest element is recognised as revenue as it is earned, using the effective interest method.

R Dividend distribution

Dividend distribution to the Company's shareholders is recognized as a liability in the Company's financial statements in the period in which the dividends are approved by the Company's shareholders.

S Financial instruments

Financial instruments carried on the balance sheet include cash and bank balances, investments, receivables, payables, borrowings and derivatives. Detailed figures are described in Note 14.

Financial risk management

The Company is exposed to a variety of financial risks, including the effects of changes in debt market prices, foreign currency exchange rates and interest rates as a result of ordinary business, debt taken on to finance its business and net investment in foreign operations. The Company's overall risk management focuses on the unpredictability of financial markets and seeks to minimize potential adverse effects on the financial performance of the Company. The Company uses either derivative financial instruments (such as forward and swap contracts) or non-derivative instruments (such as cash instruments) to hedge certain exposures.

The Company does not conduct any speculative trading activities.

Risk management is carried out by the treasury department under approved policies. The Board of Directors provides written principles for overall risk management. In line with these principles, policies exist for specific areas, such as foreign exchange risk, interest rate risk, credit risk, liquidity risk, use of derivative financial instruments and investing excess liquidity.

(i) Foreign currency risk

The Company is exposed to foreign currency risk arising from various currency exposures, primarily with respect to the euro and partially to US dollar:

a) balance sheet items (such as debt, receivables, payables) denominated in foreign currency,

b) probable forecasted transactions or firm commitments (such as purchases or sales) denominated in foreign currency, and

c) net investment in the Slovak subsidiary (functional currency differs from CZK).

The Company's objective in managing its exposure to foreign currency fluctuations is to minimize earnings and cash flow volatility associated with foreign exchange rate changes.

The Company primarily hedges the balance sheet foreign currency exposure, mainly net payables in EUR or USD. Only plain-vanilla instruments are currently used for hedging this kind of exposure.

(ii) Interest rate risk

The Company is exposed to interest rate risk arising from floating interest rate bearing cash investments and debt instruments.

The Company's income and operating cash flows are substantially independent of changes in market interest rates. The cash assets and short term debt are currently maintained on floating rates while long term debt instruments could be maintained on both floating and fixed rates. The Company may sometimes use interest rate swaps and forward rate agreements to manage a mix of fixed and variable interest rates.

(iii) Liquidity risk

The Company's essential objective of liquidity risk management is having access to the cash resources sufficient to meet all its cash payment obligations as they fall due, allowing some flexibility. The cash resources consist of generated cash position (maintained in quickly liquid instruments), and committed credit facilities arranged with banks.

The Company is particularly focused on the liquidity profile within the time horizon of the next 12 months considering projected cash flow from operations and maturity structure of both debt obligations and financial investments. The balance between the funding continuity and flexibility is managed through maintaining the option to use bank overdrafts or bilateral credit lines.

(iv) Credit risk

Credit risk concentration, with respect to trade accounts receivable, is limited due to the large number of customers. However, substantially all trade receivables are concentrated within the Czech Republic. Although the Company does not currently foresee a dramatically higher credit risk associated with these receivables, the repayment is significantly impacted by the financial stability of a particular national economy.

The Company trades only with recognized, creditworthy third parties. It is the Company's policy that all customers wishing to trade on credit terms are subject to credit verification procedures. In addition, receivable balances are monitored on an ongoing basis with the resulting into the non significant Company's exposure to bad debts. The maximum exposure is the carrying amount as disclosed in Note 11. There is no significant concentration of credit risk within the Company.

With respect to credit risk arising from the financial assets of the Company, which comprise cash and cash equivalents, available for sale investments and certain derivative instruments, the Company's exposure arises from default of the counterparty, with a maximum exposure equal to the carrying amount of these instruments.

Credit Risk is managed by the Credit Management Unit and is based on three main activities:

a) monitoring of accounts receivables: regular monitoring of payment moral of existing customers and monitoring and analyzing of the receivable aging structure (internal and external indicators of any potential bad debts). Those activities are processed in the integrated system solution for scoring, maintenance and collection of receivables called RMCA.

b) prevention: scoring of new customers – checking procedures (integrated Black Lists, Solus Debtors Register, other information), limits and/or deposits applied based on the customer segments or the product. Credit limits for indirect sales partners (dealers, distributors, retailers) for the purchase of our products, collateral security (deposits, receivables insurance, bill of exchange, pledge of real estate, bank guarantee etc.),

c) collection process: Credit Management cooperates with Customer Care on the setting up of a reasonable, effective and continual collection process. Collection process competences are divided. Collection from active customers is in the competence of Customer Care unit; subsequent collection (after the contract is cancelled) is the responsibility of Credit Management.

Accounting for derivative financial instruments and hedging activities

Derivative financial instruments are initially recognised in the balance sheet at cost and subsequently are re-measured at their fair value. The method of recognising the resulting gain or loss is dependent on the nature of the item being hedged. On the date a derivative contract is entered into, the Company designates certain derivatives as either:

a) hedge of the fair value of a recognised asset or liability (fair value hedge), or

b) hedge of a forecasted transaction or of a firm commitment (cash flow hedge).

Changes in the fair value of derivatives that are designated and qualify as fair value hedges and that are highly effective are recorded in profit or loss, along with changes in the fair value of the hedged asset or liability that is attributable to the hedged risk.
Changes in the fair value of derivatives that are designated and qualify as cash flow hedges and that are highly effective are recognised in other comprehensive income. Where the forecasted transaction or firm commitment results in the recognition of an asset or of a liability, the gains and losses previously deferred in other comprehensive income are transferred from other comprehensive income and included in the initial measurement of the cost of the asset or liability. Otherwise, amounts deferred in other comprehensive income are transferred to profit or loss and classified as revenue or expense in the same periods during which the hedged firm commitment or forecasted transaction affects profit or loss.

Certain derivative transactions, while providing effective economic hedges under the Company's risk management policies, either do not qualify for hedge accounting under the specific rules in IAS 39 or the Company has elected not to apply the specific IAS 39 hedge accounting provisions. Changes in the fair value of such derivative instruments that do not qualify for hedge accounting are recognised immediately in profit or loss.

When a hedging instrument expires or is sold, or when a hedge no longer meets the criteria for hedge accounting under IAS 39, any cumulative gain or loss existing in other comprehensive income at that time remains in other comprehensive income and is recognised in profit or loss when the committed or forecasted transaction ultimately is recognised in profit or loss. However, if a committed or forecasted transaction is no longer expected to occur, the cumulative gain or loss that was reported in other comprehensive income is immediately transferred to profit or loss.

The Company documents at the inception of the transaction the relationship between the hedging instruments and the hedged items, as well as its risk management objective and strategy for undertaking various hedge transactions. The process includes linking all derivatives designated as hedges to specific assets and liabilities or to specific firm commitments or forecast transactions. The Company also documents its assessment, both at the hedge inception and on an ongoing basis, whether the derivatives that are used in hedging transactions are highly effective in offsetting changes in fair values or cash flows of hedged items.

Fair value estimation

Except for currency options, the fair values of the derivative financial instruments reflect estimates based on calculations performed using the Company's own discounted cash flows models (using market rates). The fair value of currency options is based on information obtained from external parties, including the Company's bankers.

T Use of estimates, assumptions and judgements

The Company makes forward-looking estimates and assumptions. The resulting accounting estimates will, by definition, seldom equal the related actual results.

Estimates and judgments are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances.

The estimates and assumptions that might have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next years are discussed below:

(1) Income taxes and deferred taxes

The Company creates a provision for current income taxes and in consideration of the temporary differences also for deferred tax. There are many transactions and calculations for which the ultimate tax determination is uncertain during the ordinary course of business and the measurement of deferred tax assets and liabilities reflects the tax consequences that would follow from the manner in which the Company expects to recover or settle the carrying amount of assets and liabilities. Where the final tax-non-deductible/non-taxable items are different from the amounts that were calculated, such differences will impact the current income and deferred tax provisions in the period in which such determination is made (See Note 4 and Note 15).

(2) Property, plant and equipment, intangible assets and goodwill

The accounting treatment of investments in property, plant and equipment and intangible assets entails the use of estimates to determine the useful life for depreciation and amortization purposes and to assess fair value at their acquisition dates for assets acquired in business combinations.

Determining useful life requires making estimates in connection with future technological developments and alternative uses for assets. There is a significant element of judgment involved in making technological development assumptions, since the timing and scope of future technological advances are difficult to predict. Further details are described in Note C Property, plant and equipment and Note D Intangible assets.

When an item of property, plant and equipment or an intangible asset is considered to be impaired, the impairment loss is recognized in profit or loss. The decision to recognize an impairment loss involves estimates of amount of the impairment, as well as analysis of the reasons for the potential loss. Furthermore, additional factors, such as technological obsolescence, the suspension of certain services and other circumstantial changes are taken into account.

The Company evaluates performance of its cash-generating units regularly to identify potential impairments. Determining the recoverable amount of the cash-generating units also entails the use of assumptions and estimates and requires a significant element of judgment. The Company assesses at the end of each reporting period whether there is any indication that an impairment loss recognised in prior periods for an asset other than goodwill may no longer exist or may have decreased. If any such indication exists, The Company estimates the recoverable amount where an impairment loss recognised in prior periods shall be subject to the reversal (see Note 9).

The Company tests goodwill for an impairment at each reporting date. However goodwill does not generate cash flows independently of other assets or groups of assets and the assessment of its carrying value is significantly impacted by the management's assessment of the performance and expected future performance of the operation to which the goodwill relates. In accordance with the requirement of IAS 36, goodwill is tested annually for its recoverable amount, as well as when there are indications of impairment (see Note 8).

(3) Provisions and contingent liabilities

As set out in Note 17 the Company is a participant in several lawsuits and administrative proceedings including those related to its pricing policies. The Company's treatment of obligations with uncertain timing and amount depends on the management's estimation of the amount and timing of the obligation and probability of an outflow of resources embodying economic benefits that will be required to settle the obligation (both legal or constructive). A provision is recognised when the Company has a present obligation as a result of past events, it is probable that an outflow of resources to settle the obligation will be required and a reliable estimate of the amount of the obligation can be made (see Note 16). Contingent liabilities are not recognised because their existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the Company. Contingent liabilities are assessed continually to determine whether an outflow of resource embodying economic benefits has become probable. If it becomes probable that an outflow of future economic benefits will be required for an item previously dealt with as a contingent liability, a provision is recognised in the financial statements of the period in which the change in probability occurs.

(4) Receivables

Trade receivables are carried at original amount less bad debt allowance. The bad debt provision is estimated according to historical experience and individual assessment. Details regarding the determination of receivables impairment are stated in Note J Trade receivables.

U Investments in subsidiary and associated undertakings

A subsidiary is an enterprise that is controlled by the Company, which means that the Company has the power to govern the financial and operating policies so as to obtain benefits from its activities.

An associated undertaking is an enterprise where the Company has significant influence, which is the power to participate in the financial and operating policy decisions, but not exercise control.

Equity investments in subsidiaries and associates are recorded at cost less an allowance for diminution in value.

No consolidation of subsidiaries or associates has been performed as these financial statements are presented on a stand-alone basis. In accordance with the requirements of the Act on Accounting, the Company prepares consolidated financial statements in accordance with IFRS.

V Change in accounting policy

No significant changes in accounting policies were applied in 2012 and 2011.

W Operating profit

Operating profit is defined as profit before financial results and taxes and represents profit from the business operations. Financial results consist of interest income, interest expense, other financial expense (which includes primarily bank charges), fair value losses and gains on financial instruments and foreign exchange gains and losses.

X Merger accounting

Merger of a subsidiary into the Company represents a business combination under common control which is excluded from the scope of IFRS 3 Business Combinations. According to IFRS, the merger becomes effective upon filing and registration in the Commercial register. As soon as the merger becomes effective, assets and liabilities of the subsidiary will become part of the financial statements of the Company.

As at the date of the merger, the assets and liabilities of subsidiary are recognised in the standalone balance sheet of the Company measured at their previous carrying amounts recognized in the consolidated balance sheet of the Company. Intercompany balances are eliminated. Any remaining difference between the equity of a subsidiary and carrying values of acquired assets is adjusted directly against equity.

The financial statements of the merged companies are prepared using the same accounting policies.

NOTES TO THE FINANCIAL STATEMENTS

Content | Pages

1 Segment information

Business segments recognised by the Company are as follows:

- fixed - network communication services using a fixed network and IS/ICT services
- mobile - mobile communication services

Year ended 31 December 2012 In CZK million	Fixed	Mobile	Company
Revenues from voice services	6,406	8,517	14,923
Monthly charges	3,625	8,070	11,695
Data services	8,304	2,683	10,987
Other revenues	3,123	5,641	8,764
Revenues incl. inter-segment sales	21,458	24,911	46,369
Inter-segment sales	(313)	(264)	(577)
Total revenues	21,145	24,647	45,792
Other income	460	53	513
Total costs	(12,812)	(15,142)	(27,954)
Impairment charge	(20)	(7)	(27)
Depreciation	(5,922)	(2,928)	(8,850)
Amortisation	(1,385)	(684)	(2,069)
Total depreciation and amortization	(7,307)	(3,612)	(10,919)
Operating income	1,466	5,939	7,405
Net financial loss			(179)
Profit before tax			7,226
Corporate income tax			(1,301)
Profit for the year			**5,925**
Assets (excluding goodwill)	38,644	29,062	67,706
Goodwill	128	13,320	13,448
Total assets	**38,772**	**42,382**	**81,154**
Trade and other payables	(5,006)	(5,915)	(10,921)
Other liabilities	(3,230)	(3,816)	(7,046)
Total liabilities	**(8,236)**	**(9,731)**	**(17,967)**
Capital expenditure	**2,932**	**2,472**	**5,404**

Year ended 31 December 2011 **In CZK million**	**Fixed**	**Mobile**	**Company**
Revenues from voice services	6,725	9,892	16,617
Monthly charges	4,298	8,114	12,412
Data services	8,776	2,499	11,275
Other revenues	2,942	6,311	9,253
Revenues incl. inter-segment sales	22,741	26,816	49,557
Inter-segment sales	(318)	(347)	(665)
Total revenues	22,423	26,469	48,892
Other income	481	7	488
Total costs	(14,043)	(14,341)	(28,384)
Impairment reversal	(9)	-	(9)
Depreciation	(7,150)	(1,826)	(8,976)
Amortisation	(889)	(1,342)	(2,231)
Total depreciation and amortization	(8,039)	(3,168)	(11,207)
Operating income	813	8,967	9,780
Net financial loss			(118)
Profit before tax			9,662
Corporate income tax			(2,014)
Profit for the year			**7,648**
Assets (excluding goodwill)	40,507	37,290	77,797
Goodwill	-	13,320	13,320
Total assets	**40,507**	**50,610**	**91,117**
Trade and other payables	5,825	5,936	11,761
Other liabilities	3,449	3,515	6,964
Total liabilities	**9,274**	**9,451**	**18,725**
Capital expenditure	**3,198**	**2,007**	**5,205**

The inter-segment pricing rates applied in 2012 and 2011 were determined on the same basis as rates applicable for other mobile operators and are consistent with rates applied for pricing with other mobile operators.

Capital expenditures comprise additions to property, plant and equipment and intangible assets.

2 Revenues and costs

Revenues from voice services In CZK million	Year ended 31 December 2012	Year ended 31 December 2011
Voice – outgoing	7,760	8,964
Interconnection and other wholesale services	6,586	6,988
Total revenues from voice services	14,346	15,952

Data services In CZK million	Year ended 31 December 2012	Year ended 31 December 2011
Leased lines and fixed data services	2,508	2,837
Internet (including monthly and one-off charges)	5,318	5,428
Mobile data	2,683	2,499
IPTV	478	511
Total revenues from data services	10,987	11,275

Other revenues In CZK million	Year ended 31 December 2012	Year ended 31 December 2011
SMS & MMS & PRMS and Contents	3,874	4,219
Equipment and activation charges	1,435	1,593
ICT and business solutions	2,399	2,226
Other telecommunication revenues	1,056	1,215
Total other revenues	8,764	9,253

Other income In CZK million	Year ended 31 December 2012	Year ended 31 December 2011
Rental and non-telco income	132	105
Gains from fixed assets disposal	283	340
Indemnities, penalties and similar income	98	43
Total other income	513	488

Revenues from related parties are disclosed in Note 21.

Other cost of sales In CZK million	Year ended 31 December 2012	Year ended 31 December 2011
Telco services, Contents and other cost of sales	(691)	(612)
Sub-deliveries	(1,281)	(1,134)
Commissions	(1,390)	(1,469)
Total other cost of sales	(3,362)	(3,215)

Other expenses In CZK million	Year ended 31 December 2012	Year ended 31 December 2011
Billing and collection, provision for bad and doubtful debts	(747)	(792)
Network & IT repairs and maintenance	(2,965)	(2,581)
Rentals, buildings and vehicles	(1,821)	(1,906)
Utilities supplies	(1,051)	(1,057)
Marketing and call centers	(1,324)	(1,334)
Consultancy and professional fees and other external services	(610)	(571)
Royalties and management fees	(1,113)	(1,162)
Administrative fees and other operating expenses	(490)	(494)
Capitalized own expense on fixed assets	595	616
Total other expenses	(9,526)	(9,281)

Staff costs In CZK million	Year ended 31 December 2012	Year ended 31 December 2011
Wages and salaries	(3,724)	(3,935)
Rectructuring costs	(261)	(173)
Health and Social security contributions	(1,206)	(1,331)
Staff welfare costs	(202)	(251)
Total staff costs	(5,393)	(5,690)

The Company does not participate in any pension plans.

A restructuring plan covering both employees and members of management was approved and subsequently implemented by the Company during 2012 and 2011. As a result of the restructuring process, the Company incurred restructuring costs of CZK 261 million during the year ended 31 December 2012 (2011: CZK 173 million) including redundancy payments of CZK 227 million (2011: CZK 173 million) and related consultancy costs of CZK 34 million (2011: CZK 0 million).

Statutory auditor's fees were as follows:

In CZK million	Year ended 31 December 2012	Year ended 31 December 2011
Auditor´s fees	17	21

Purchases from related parties are disclosed in Note 21.

3 Finance income and costs

In CZK million	Year ended 31 December 2012	Year ended 31 December 2011
Finance income		
Interest income	83	119
Gain on fair value adjustments of financial instruments (net)	-	185
Foreign exchange gain (net)	15	-
Other finance income	9	11
Total finance income	107	315
Finance costs		
Interest expenses	(158)	(224)
Loss on fair value adjustments of financial instruments (net)	(90)	-
Foreign exchange loss (net)	-	(190)
Other finance costs	(38)	(19)
Total finance costs	(286)	(433)

The Company recognises foreign exchange gains and losses and fair value adjustments on net basis. Comparative figures were adjusted accordingly.

4 Income tax

In CZK million	Year ended 31 December 2012	Year ended 31 December 2011
Total income tax expense is made up of:		
Current income tax charge	1,840	2,215
Deferred income tax credit (Note 15)	(539)	(201)
Taxes on income	1,301	2,014

The tax on the Company's profit before tax differs from the theoretical amount that would arise using the basic tax rate of the home country of the Company as follows:

In CZK million	Year ended 31 December 2012	Year ended 31 December 2011
Profit before tax	7,226	9,662
Income tax charge calculated at the statutory rate of 19%	1,373	1,836
Not taxable income	(45)	-
Expenses not deductible for tax purposes	73	120
Tax related to prior periods	(100)	58
Taxes on income	1,301	2,014
Effective tax rate	18%	21%

As at 31 December 2012 the total amount of provisions for current income taxes is CZK 1,855 million (2011: CZK 2,205 million), advances paid for income taxes amount to CZK 1,955 million (2011: CZK 2,367 million), the net deferred tax liability is CZK 3,196 million (2011: CZK 3,735 million).

5 Earnings per share

Basic earnings per share are calculated by dividing the net profit attributable to shareholders by the weighted average number of ordinary shares in issue during the period. The weighted average number of shares takes into account the weighted average effect of changes in treasury share transactions during the year.

	31 December 2012	31 December 2011
Weighted number of ordinary shares outstanding	319,932,546	322,089,900
Net profit attributable to shareholders (in CZK million)	5,925	7,648
Basic earnings per share (CZK)	19	24

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

The Annual General Meeting on 19 April 2012 approved the ordinary share acquisition programme for the next 5 years, up to a maximum of 10% of the total number of 322,089,890 ordinary shares.

6 Dividends

In CZK million	31 December 2012	31 December 2011
Dividends declared (including withholding tax)	8,696	12,884

Dividends include withholding tax on dividends paid by the Company to its shareholders. There has been no interim dividend paid in respect of 2012. Approval of the 2012 profit and the decision regarding the amount of any dividend payment for the 2012 financial year will take place at the Annual General Shareholder Meeting.

Dividend per share for the years ended 31 December was as follows:

In CZK	Year ended 31 December 2012	Year ended 31 December 2011
Dividend per share (nominal value of 100 CZK)	27	40

7 Property, plant and equipment

In CZK million	Land, buildings and construction	Ducts, cables and related plant	Communication technology and related equipment	Other fixed assets	Total
At 31 December 2012					
Opening net book amount	10,117	29,639	8,085	1,435	49,276
Additions	212	850	2,630	371	4,063
Disposals	(6)	(3)	(48)	(3)	(60)
Reclassifications	4	(14)	62	34	86
Assets classified as held for sale	(11)	-	-	-	(11)
Depreciation charge	(872)	(4,910)	(2,413)	(655)	(8,850)
Impairment charge	-	-	(27)	-	(27)
Closing net book amount	9,444	25,562	8,289	1,182	44,477
At 31 December 2012					
Cost	19,145	103,700	87,553	8,033	218,431
Accumulated depreciation and impairment allowance	(9,701)	(78,138)	(79,264)	(6,851)	(173,954)
Net book amount	9,444	25,562	8,289	1,182	44,477
At 31 December 2011					
Opening net book amount	10,945	33,685	8,108	1,778	54,516
Additions	269	818	2,401	441	3,929
Disposals	(24)	(2)	(30)	(1)	(57)
Reclassifications	2	(2)	73	1	74
Assets classified as held for sale	(199)	(2)	-	-	(201)
Depreciation charge	(876)	(4,858)	(2,458)	(784)	(8,976)
Impairment charge	-	-	(9)	-	(9)
Closing net book amount	10,117	29,639	8,085	1,435	49,276
At 31 December 2011					
Cost	19,125	102,990	88,458	7,986	218,559
Accumulated depreciation and impairment allowance	(9,008)	(73,351)	(80,373)	(6,551)	(169,283)
Net book amount	10,117	29,639	8,085	1,435	49,276

The net book amount at 31 December 2012 includes CZK 1,871 million of assets under construction (2011: CZK 1,569 million). The assets under construction are spread over all disclosed categories of property, plant and equipment following their nature.

As at 31 December 2012, the carrying value of non-depreciated assets amounted to CZK 179 million (2011: CZK 191 million).

No property, plant and equipment were pledged as at 31 December 2012 and 31 December 2011.

No borrowing costs were capitalized during the years 2012 and 2011.

Classes of property, plant and equipment can be broken down into main categories as follows:

Land, buildings and construction	**Closing balance**	
In CZK million	**31 December 2012**	**31 December 2011**
Buildings*	5,265	5,590

* Majority of buildings are buildings for telecommunication technologies.

Ducts, cables and related plant	**Closing balance**	
In CZK million	**31 December 2012**	**31 December 2011**
Twin cables	18,214	21,539
Terrestrial optic fibre	4,765	5,159

Communication technology and related equipment	**Closing balance**	
In CZK million	**31 December 2012**	**31 December 2011**
Exchanges	1,247	1,235
Transmission equipment	1,175	1,196
IP technology, routers, modems	900	941

Other fixed assets	**Closing balance**	
In CZK million	**31 December 2012**	**31 December 2011**
Information process equipment	839	1,098

The Company did not recognise any assets held for sale as at 31 December 2012 (2011: CZK 1 million in net book value).

In 2012, the Company achieved a total gain from the sale of the above fixed assets amounting to CZK 283 million (2011: CZK 340 million) and total losses of CZK 6 million (2011: CZK 42 million).

Cost of fully depreciated property, plant and equipment was CZK 72,880 million as at 31 December 2012 (2011: CZK 70,290 million).

8 Intangible assets

In CZK million	Goodwill	Licences	Software	Total
At 31 December 2012				
Opening net book amount	13,320	3,128	3,347	19,795
Additions	-	23	1,318	1,341
Reclassifications/Effect of Merger	128	-	(12)	116
Amortisation charge	-	(393)	(1,676)	(2,069)
Closing net book amount	13,448	2,758	2,977	19,183
At 31 December 2012				
Cost	13,448	6,096	27,007	46,551
Accumulated amortisation and impairment allowance	-	(3,338)	(24,030)	(27,368)
Net book amount	13,448	2,758	2,977	19,183
At 31 December 2011				
Opening net book amount	13,320	3,514	3,901	20,735
Additions	-	-	1,276	1,276
Disposals	-	-	(9)	(9)
Reclassifications	-	-	24	24
Amortisation charge	-	(386)	(1,845)	(2,231)
Closing net book amount	13,320	3,128	3,347	19,795
At 31 December 2011				
Cost	13,320	6 ,073	25,669	45,062
Accumulated amortisation and impairment allowance	-	(2,945)	(22,322)	(25,267)
Net book amount	13,320	3,128	3,347	19,795

Goodwill

Goodwill of CZK 13,320 million resulted from the acquisition of the remaining 49% ownership interest in Eurotel Praha spol. s r.o. (Eurotel). The goodwill is presented in the standalone financial statements of the Company since the effective date of merger with Český Telecom, a.s. The goodwill initially recognized of CZK 14,087 million resulted from a comparison of the cost of a business combination of CZK 29,215 million and the fair value of net assets acquired of CZK 15,128 million. Until 31 December 2004, the goodwill had been amortised on a straight line basis over a period of 20 years and assessed for an indication of impairment at each balance sheet date.

Due to a revision of IFRS 3, IAS 36 and IAS 38 the Company ceased amortisation of the previously recognized goodwill from 1 January 2005. Accumulated amortisation as at 31 December 2004 was eliminated with a corresponding decrease in the cost of goodwill (CZK 767 million). Since the year ending 31 December 2005 onwards, goodwill is classified as an asset with an indefinite useful life which has been tested annually for the impairment, as well as when there are indications of impairment.

As at 31 December 2012 Goodwill contained CZK 128 million related to the take-over of assets as a part of the project the merger of Telefónica O2 Business Solutions spol. s r.o., a subsidiary company, into the Company (2011: CZK 0 million).

The Company performed impairment tests, which did not result in impairment losses of goodwill in 2012 and 2011. The impairment test involves a determination of the recoverable amount for the mobile cash-generating unit, which corresponds to the value in use. Value in use is the present value of the future cash flows expected to be derived from a cash-generating unit.

Value in use is determined on the basis of an enterprise valuation model and is assessed from a Company internal perspective. Value in use is derived from the cash flow budgets, which are based on the medium-term business plan for a period of 3 years, have been approved by the management and are valid at the time of the impairment test. The business plan is based on past experience, as well as on future market trends. Further, the business plan is based on general economic data derived from macroeconomic and financial studies. Cash flows beyond the three-year period are extrapolated using appropriate growth rates. Key assumptions, on which the management has based its business plan and growth rates, include the trend of gross domestic product, interest rates, nominal wages, average revenue per user (ARPU), customer acquisition and retention costs, churn rates, capital expenditure, market share, growth rates and the discount rates.

Any significant future changes in the market and competitive environments could have an adverse effect on the value of the cash-generating units.

The calculations of value in use for all cash-generating units are the most sensitive to the following assumptions:

Estimated growth rate – the forecast of the market and regulatory environment, where the Group conducts its principal business, is the basis for determination of the value assigned to the estimated growth rate.
Discount rate – discount rates reflect the management's estimate of the risk specific to the cash generating unit. Weighted average of cost of capital (WACC) forms the basis for the determination of the discount rate.

There is no other intangible asset with indefinite useful life except for goodwill.

Licences

Acquired licences represent the rights to operate cellular networks in the Czech Republic, UMTS (Universal Mobile Telecommunication System, the third generation mobile cellular technology for networks), GSM (Global System for Mobile Communication, the second generation technology) and CDMA (Code Division Multiple Access).

In 2012, the Company acquired the rights for Internet network access using CDMA technology (Code Division Multiple Access) from the Czech Telecommunications Office (CTO) for CZK 23 million. The rights have been granted until 7 February 2018.

In 2012, the Company initiated a pilot project of the fourth generation mobile data technology LTE (Long Term Evolution). The commercial operation of this technology was launched in the municipality of Jesenice in July 2012.

In November 2012, the Company has entered the public tender, launched by the CTO, which will allocate the rights to use the radio frequencies in the 800 MHz, 1,800 MHz and 2,600 MHz bands. Originally, these bands were used mainly for the terrestrial television broadcasting. The frequencies are dedicated for the provision of public mobile data services. The application to enter the tender was submitted in September and the auction phase was launched in November. At the year end of 2012, the tender was still ongoing.

Carrying value of licences:

In CZK million	Valid by	31 December 2012	31 December 2011
GSM 900 licence	2016	258	330
GSM 1800 licence	2016	208	266
CDMA 450 licence	2018	23	13
UMTS licence	2022	2,269	2,519
Total		2,758	3,128

No borrowing costs were capitalized during the years 2012 and 2011.

Cost of fully amortised intangible assets was CZK 19,487 million as at 31 December 2012 (2011: CZK 18,015 million).

All of the Company's intangible assets with finite lives are amortised and are subject to an annual review of impairment indicators and review of their useful lives.

9 Impairment of non-current assets

As at 31 December 2012 and as at 31 December 2011, the Company reviewed the indicators of cash-generating units (CGU), i.e. fixed and mobile segment, seeking for any indication of impairment to the CGU's assets. As requested by IAS 36 the Company also performed full impairment testing for CGUs that include goodwill (see Note 8). The assessment and impairment testing carried out as at 31 December 2012 and 2011 confirmed that carrying amounts of non-current assets are supportable.

10 Inventories

In CZK million	31 December 2012	31 December 2011
Telecommunication material	74	124
Goods	359	322
Total	433	446

The inventories stated above are net of an allowance of CZK 53 million (2011: CZK 41 million), reducing the value of the inventories to their net realisable value. The total carrying amount of inventories at net realisable value amounts to CZK 65 million (2011: CZK 47 million). The amount of inventories recognised as an expense is CZK 2,385 million (2011: CZK 2,611 million).

In 2012 and 2011, the Company had no inventories pledged as security for liabilities.

11 Receivables

In CZK million	31 December 2012	31 December 2011
Trade receivables from third parties (net)	5,800	6,413
Group trade receivables	505	463
Prepayments	662	515
Other debtors (net)	436	514
Total	7,403	7,905

Trade receivables and other debtors are stated net of a bad debt provision of CZK 3,672 million (2011: CZK 3,539 million).

As at 31 December 2012, other debtors do not contain any restricted cash (2011 CZK 22 million).

Receivables from related parties are disclosed in Note 21.

			Not impaired but overdue			
Trade receivables In CZK million	**Carrying amount**	**Neither impaired nor overdue**	Less than 90 days	90 and 180 days	180 and 360 days	More than 360 days
At 31 December 2012	6,305	2,960	188	24	27	74
At 31 December 2011	6,876	3,449	210	16	32	59

Bad debt provisions In CZK million	
At 1 January 2011	3,604
Additions	2,492
Retirements/amount paid	(2,557)
At 31 December 2011	3,539
Additions	2,472
Retirements/amount paid	(2,339)
At 31 December 2012	3,672

The Company's historical experience regarding the collection of accounts receivable is consistent with the recorded allowances. Due to these factors, the management believes that no additional credit risk beyond the amounts provided for is inherent in the Company's trade receivables.

As at 31 December 2012, the Company presented non-current financial assets of CZK 108 million (2011: CZK 145 million) consisting of other long-term credits, advance payments for long-term expenses and other holdings, which are classified as other financial assets. As at 31 December 2012, non-current financial assets contained restricted cash of CZK 20 million (2011: CZK 20 million) resulting to the Company, as small payment services provider, from the legal requirements of the regulator Czech National Bank.

12 Cash and cash equivalents

In CZK million	31 December 2012	31 December 2011	Interest rate
Cash at current bank accounts and other cash equivalents	256	178	Floating
Cash at cash-pooling structures (inter-company)	2,761	6,763	Floating
Total cash and cash equivalents	3,017	6,941	

As at 31 December 2012 and 2011, cash equivalents of the Group comprised interest bearing deposits with the maximum maturity of three months.

Since April 2006, the Company has been taking part in Telefónica Group cash-pooling, which is having a positive effect on Telefónica Group's good financial governance and effective cash flow management.

At 31 December 2012, the Company had available equivalent of CZK 1,346 million (2011: CZK 1,802 million) of undrawn committed facilities.

For the purposes of the statement of cash flows, the year-end cash and cash equivalents comprise only the following component:

In CZK million	31 December 2012	31 December 2011
Cash and cash equivalents	3,017	6,941

As at 31 December 2012 and 2011 no cash and cash equivalents were pledged.

In CZK million	Year ended 31 December 2012	Year ended 31 December 2011
Interest paid	(210)	(221)
Interest received	88	140
Bank commissions	(38)	(53)
Other financial income	13	37
Total net interest and other financial expenses paid	(147)	(97)

13 Trade and other payables

In CZK million	31 December 2012	31 December 2011
Trade creditors	9,041	9,605
Tax and social security liability	629	597
Other deferred revenue	295	371
Prepaid cards	327	409
Employee wages and benefits	472	487
Other creditors	157	292
Total payables	10,921	11,761
Other non-current liabilities	83	88

Payables to related parties are disclosed in Note 21.

As at 31 December 2012 and 2011, other non-current liabilities were made up primarily of deposits placed by recharging partners for prepaid cards and liabilities with due date in more than 12 months.

14 Financial liabilities and financial assets

In CZK million	31 December 2012	31 December 2011
Debt in local currency	3,000	-
Debt in foreign currencies	-	2,968
Intercompany cash-pooling	679	-
Interest obligation and derivatives	31	92
Total financial debt	3,710	3,060
Repayable:		
Within one year	710	3,060
Between two and five years (total non-current)	3,000	-
Total financial debt	3,710	3,060

Term loan facility

On 27 September 2012, the Company signed the CZK 3-billion credit facility jointly arranged by UniCredit Bank Czech Republic, a.s., Česká spořitelna, a.s., Komerční banka, a.s., Citibank Europe plc and Československá obchodní banka, a.s.

The Company used the 4-year term loan facility for refinancing of the debt due in 2012 and will use it for general corporate purposes as well. The loan facility is priced at PRIBOR plus margin 1.75% p.a.

In July 2012 the Company repaid in due course a loan in the amount of EUR 115 million drew in 1997.

In May 2012, the Company and Telefónica Slovakia, a subsidiary company, entered to mutual cash-pooling, which is having a positive effect on Company's cash flow management.

The Company's debt interest rate allocation after taking into account interest rate swaps was as follows:

In CZK million	31 December 2012	31 December 2011
At fixed rate	-	2,968
At floating rate	3,679	-

The fair values of borrowings are based on discounted cash flows using a discount rate based upon the borrowing rate estimated by the management of the Company as reachable at the balance sheet date. The carrying amounts of short-term debts approximate their fair value.

Loans are not secured over any assets of the Company.

The table below summarizes the maturity profile of the Company's financial and trade liabilities at 31 December 2012 based on contractual undiscounted payments.

At 31 December 2012 In CZK million	Less than 3 months	3 to 12 months	1 to 5 years	> 5years
Interest bearing loans and borrowings	29	726	3,179	-
Financial guarantee contract	35	115	-	-
Trade and other payables (excluding Other deferred revenue and Prepaid cards)	9,223	1,076	-	-
Total	9,287	1,917	3,179	-
Non-current other liabilities	-	-	77	6

At 31 December 2011 In CZK million	Less than 3 months	3 to 12 months	1 to 5 years	> 5years
Interest bearing loans and borrowings	-	3,165	-	-
Trade and other payables (excluding Other deferred revenue and Prepaid cards)	9,654	1,327	-	-
Total	9,654	4,492	-	-
Non-current other liabilities	-	-	82	6

The Company does not have any guarantees to third parties except for the guarantee in relation to acquisitions made by the Company's subsidiary Bonerix, s.r.o. As at 31 December 2012, the remaining unpaid related liabilities guaranteed by The Company were approximately CZK 150 million (2011: CZK 0 million).

Fair values

Set out below is a comparison by category of carrying amounts and fair values of all of the Company's financial instruments that are carried in the financial statements.

In CZK million	**Carrying amount**			**Fair value**
	2012	**2011**	**2012**	**2011**
Financial assets				
Cash and cash equivalents	3,017	6,941	3,017	6,941
Short-term loans (incl. accrued interest)	212	67	212	67
Derivatives	2	101	2	101
Other financial assets	108	145	108	145

In CZK million	**Carrying amount**			**Fair value**
	2012	**2011**	**2012**	**2011**
Financial liabilities				
Interest bearing loans and borrowings (incl. accrued interest)	3,698	3,051	3,698	3,115
Derivatives	12	9	12	9

The fair value of derivatives and borrowings has been calculated by discounting the expected future cash flows at prevailing interest rates.

Fair value hierarchy

The Company uses the following hierarchy for determining and disclosing the fair value of financial instruments by valuation technique:

Level 1: quoted (unadjusted) prices in active markets for identical assets or liabilities.

Level 2: other techniques for which all inputs which have a significant effect on the recorded fair value are observable, either directly or indirectly.

Level 3: techniques which use inputs that have a significant effect on the recorded fair value and that are not based on observable market data.

As at 31 December 2012 and 31 December 2011, the Company held only foreign currency forward and swap contracts classified as Level 2 financial instruments measured at fair value.

During the reporting period ending 31 December 2012 and 31 December 2011, there were no transfers between Level 1 and Level 2 fair value measurements, and no transfers into and out of Level 3 fair value measurements.

Financial risk analysis

The following table demonstrates the sensitivity to a reasonably possible change in foreign exchange rates and interest rates.

In CZK million	Effect on profit before tax	
	2012	2011
FX risk		
Value at Risk*	(145)	(149)
Stress testing*	(42)	(47)
IR risk		
Stress testing*	(16)	(91)

* The Value at Risk (VaR) Model enables the Company estimate the probability of maximum possible loss to the portfolio value in the given time frame which will not be exceeded given the defined reliability level. For conducting a VaR calculation, the Company uses the risk variance and covariance method using the normal distribution (e.g. parametric method). The time frame used is one month with a 95% reliability rate. Considering the importance of net open positions resulting from financial assets and financial liabilities of the Company in individual foreign currencies, the Company models VaR from a position of translation and transaction in EUR and USD.

FX risk used stress scenario represents the immediate loss caused by one-off change in the foreign exchange rate by 1% in an unfavourable direction

IR risk used stress scenario represents immediate one-off change of interest rates along the whole yield curve by 1% in an unfavorable direction. The calculation of unfavourable impact on Company cash flows (due to an increase in interest expense or drop in interest received relating to financial assets and financial liabilities) is made each month on a floating basis within a 12 month time frame.

Financial derivatives

The following nominal value of foreign exchange contracts was used by the Company to manage the currency risk:

In CZK million	Nominal value		Fair value	
	2012	2011	2012	2011
Foreign exchange contracts	1, 387	4,257	(10)	92

15 Deferred income taxes

Deferred income taxes are calculated using currently enacted tax rates expected to apply when the asset is realized or the liability settled.

Short-term and long-term deferred taxes were calculated at 19% for both years 2012 and 2011.

In CZK million	2012	2011
At 1 January	3,735	3,936
Profit or loss tax charge / (credit) (Note 4)	(539)	(201)
At 31 December	3,196	3,735

The following amounts, determined after offsetting, are shown in the balance sheet:

In CZK million	31 December 2012	31 December 2011
Deferred tax assets	(284)	(218)
Deferred tax liabilities	3,480	3,953
Total	3,196	3,735

The deferred tax asset includes CZK 252 million (2011: CZK 196 million) recoverable in less than twelve months and CZK 32 million (2011: CZK 22 million) recoverable after more than twelve months. The deferred tax liability includes CZK 653 million (2011: CZK 494 million) to be settled in less than twelve months and CZK 2,827 million (2011: CZK 3,459 million) to be settled in more than twelve months.

The deferred tax is determined by these components:

In CZK million	Balance sheet		Profit or loss	
	2012	2011	2012	2011
Temporary differences relating to:				
Property, plant and equipment and intangible assets	3,353	3,852	(499)	(310)
Trade receivables, inventories and other differences	(157)	(117)	(40)	109
Total	3,196	3,735	(539)	(201)

16 Provisions for liabilities and charges

In CZK million	Regulatory and court decisions	Other provisions	Total
At 1 January 2012	22	59	81
Additions during the year	15	367	382
Utilised during the year	(3)	(403)	(406)
At 31 December 2012	**34**	**23**	**57**
Short-term provisions 2012	12	19	31
Long-term provisions 2012	22	4	26
	34	**23**	**57**
Short-term provisions 2011	3	53	56
Long-term provisions 2011	19	6	25
	22	**59**	**81**

With the exception of the regulatory and court decision provisions and other small provisions for which the expected timing of payments is not certain all other provisions are expected to be utilised within the next twelve months from the balance sheet date. Other provisions consist mainly of provision for employee benefits, share-based compensation and untaken holiday.

Regulatory and court decisions

A provision for regulatory and court decisions is made for legal proceedings involving the Company (see Note 17).

17 Contingencies

The Company is involved in a number of legal disputes arising from the usual course of business. Throughout 2012 the Company successfully litigated against lawsuits filed by the third parties in the past. Despite this fact, several new speculative legal actions were made against the Company. The main litigation cases involving the Company are shown below.

I. Vodafone Czech Republic a.s. - Interconnection agreement dispute

On 30 June 2005, Vodafone Czech Republic a.s. (formerly Český Mobil/Oskar Mobil) filed a legal action with the Municipal Court in Prague against the Company for damages worth CZK 538 million with accessories, and for the return of unjust enrichment of CZK 117 million with accessories. The allegation against the Company is that it did not transit traffic via the mobile operator thus violating the relevant interconnection agreements. The proceeding was legally closed in favour of the Company in February 2011 but Vodafone Czech Republic a.s. filed an extraordinary appeal over the amount of CZK 26 million, claiming that the decision is incorrect in this extent. The Supreme Court has not decided on extraordinary appeal yet.

II. ÚOHS (Office for the Protection of Economic Competition)

i. Administrative proceedings regarding the alleged abuse of dominant position in the fixed broadband market

The Office for the Protection of Economic Competition (ÚOHS) has been conducting the so-called 'preliminary investigation' since November 2008, to determine whether the Company had abused its dominant position in the broadband market. The Company provided the Office with the requested cooperation while repeatedly stating and proving that it had not held a dominant position in the market and, as such, no abuse could have been committed. Although the demands for information and documents from the Office to the Company during more than two years of the investigation have grown immesurably, during all this time the Company was never allowed to inspect the file to check its content and see how the information was interpreted by the Office. In the light of the above, the Company requested court protection by a legal action filed with the Regional Court in Brno. In December 2010, the Regional Court in Brno preliminarily banned the Office from continuing the preliminary investigation and, in February 2011, issued a verdict stating that the preliminary investigation had to be ceased immediately. The verdict was later confirmed by the Supreme Administrative Court in September 2011. The Office reacted in March 2011 by opening an official administrative procedure regarding the dominant position on the fixed broadband ADSL market. The Company filed its statement with the authority, proving that the Office incorrectly defined the relevant market in which Company allegedly held the dominant position and was alleged to abuse it. The Company's statement citing the fierce competition between technology platforms such as xDSL, cable and WiFi in the Czech Republic was repeatedly corroborated by the Czech Telecommunications Office and the European Commission. The Company also provided the Office with numerous documents proving that all steps taken by the Company had been correct. More records are continuously added to the file. With regard to the extreme length and volume of information, the Company cannot estimate when the procedure against it would be closed. The Office did not promulgate a decision in 2012, despite the fact that the Company has provided the Office with all the necessary evidence and information. It was not possible to make a reliable estimate of the financial impact of this administrative procedure at the closing of the 2011 financial statements or these financial statements.

ii. Proceeding for a penalty of CZK 81.7 million

In December 2009, the Regional Court in Brno cancelled the decision of the Office over a penalty of CZK 81.7 million imposed on the Company in December 2003 by administrative procedure for the alleged abuse of the dominant position in the fixed voice services market. As a consequence of the dismissal, the Company asked the Office to return the penalty plus accessories. Although the principal was returned by the Office, before it was decided on the returning of the accessories, the Supreme Administrative Court had in the meantime cancelled the verdict of the Regional Court in Brno and returned the case (for the third time) back to the Regional Court in Brno. Ultimately, in March 2011 the Regional Court in Brno cancelled the decision regarding the penalty, and returned the case back to the Office for it to provide a legal justification for the penalty in relation to the adjudicated period. Despite the objections of the Company citing insufficient background, the Office issued a new decision imposing a fine CZK 91.9 million on the Company. The Company regards the decision as an impermissible reprisal on the part of the Office, and will start a legal action including a proposal to stay the penalty for the duration of the proceedings.

III. Disputes with AUGUSTUS spol. s r.o.

The Company clearly turned around in its favour the dispute with AUGUSTUS and presently concentrates on recovering the amount of unjust enrichment from AUGUSTUS. Originally, AUGUSTUS spol. s r.o. had sued the Company for an alleged loss of profit in the period from 1995 to 2001 in the amount of CZK 183 million with accessories. AUGUSTUS spol. s r.o. claimed that the Company had unjustifiably terminated the contract for the issue and distribution of phone cards signed for an indefinite period. Based on the decision of the High Court in Prague from August 2006, the Company paid a sum of CZK 83 million plus relevant accessories (total of CZK 139 million). Subsequently, there was a positive turn in the proceedings in the favour of the Company when the Supreme Court based on the Company's appeal cancelled the previous verdicts in June 2009 and the Municipal Court in Prague ultimately dismissed the lawsuit in April 2010. The High Court finally confirmed the dismissal in August 2011. Consequently, the Company filed a lawsuit against AUGUSTUS spol. s r.o. to claim CZK 139 million back. The Municipal Court in Prague decided favourably for the Company in September 2011. AUGUSTUS spol. s r.o. filed an unsuccessful appeal. In the interim it turned out that an amount of at least CZK 94 million had been transferred to third parties based on agreements with the statutory representative. The Company takes all legal steps to secure the property and to avoid additional losses. Municipal court in Prague declared AUGUSTUS bankrupt in November 2012.

IV. MEDIATEL, spol. s r.o. – a claim for CZK 359 million

MEDIATEL, spol. s r.o., which had been cooperating with the Company in the area of phone directory publishing and distribution to all telephone subscribers (under the commercial brand Zlaté stránky) since 1992, filed a legal action against the Company for the compensation of an alleged damage exceeding CZK 359 million in December 2009. The Municipal court in Prague fully dismissed the legal action in January 2012 and the decision is final and conclusive. The dispute has been closed in favour of the Company.

V. CNS a.s. – a claim for CZK 137 million

In 2009, employees of CNS a.s., dealing with the development and updates of IT applications, and employees of Telefónica O2 Business Solutions, spol. s r.o. were in negotiations over potential collaboration relating to the operation of data boxes. Ultimately, no agreement had been signed between the parties and, due to commercial reasons, the project had never gone ahead. In August 2010, CNS a.s. mounted a legal action against the Company for damages and lost profit totalling CZK 137.2 million, citing the failure to sign a contract. The Company regards this claim as fabricated and the amount as patently inflated, which can be demonstrated by the fact that, in accordance with the annual profit and loss statement for the year 2009, CNS a.s. generated a yearly profit of less than CZK 5.5 million. The Municipal court in Prague dismissed the legal action in full in December 2012. CNS company has a right to file an appeal.

VI. VOLNÝ, a.s. – a claim for CZK 4 billion

On 28 March 2011, VOLNÝ, a.s. filed a legal action with the Municipal Court in Prague against the Company for an amount exceeding CZK 4 billion, regarding alleged abuse of the dominant position in the market of broadband Internet access for households via ADSL technology. The amount is meant to represent the lost profit for years 2004 to 2010. VOLNÝ, a.s. claims to have had a 30% share of the dial-up Internet market in 2003 and implies in its legal action that it ought to have automatically the same share of the broadband market, which it does not. Allegedly it is due to a margin squeeze applied by the Company on the fix broadband market. The Company replied to the petition in July 2011 by noting that both the claim and the calculations submitted by the claimant were unsubstantiated and by pointing at discrepancies in the petition claims. The lawsuit has not been heard by the Court yet. The court has already started the proceeding in the matter and further oral hearings could be expected during the year 2013.

VII. BELL TRADE s.r.o. – a claim for CZK 3.2 billion

A legal action for CZK 3.2 billion filed by company BELL TRADE was delivered to the Company in January 2012. The legal action was filed at the District Court in Malacky (Slovakia); it alleges that the Company had signed contracts with a company called RVI, a.s. for the delivery of several IT projects back in 2002. BELL TRADE, based in Bratislava, allegedly acquired the claims as an agreed fee for services, through a chain of intermediaries. The Company filed a statement with the District Court in Malacky, refuting the existence of any contract and any services from the performance of which any fees would have arisen to any party. The Company also challenged the jurisdiction of Slovak courts since the dispute has no relation to the Slovak territory. The lack of jurisdiction has finally led to the termination of the proceedings in June 2012 but BELL TRADE filed an appeal which is still waiting to be heard by the Regional Court in Bratislava.

VIII. ČESKÉ RADIOKOMUNIKACE – a claim for CZK 3.1 billion

A legal action for CZK 3.1 billion filed by ČESKÉ RADIOKOMUNIKACE (ČRa) was served to the Company in October 2012. The claimant states that the Company allegedly caused him damage by abusing of the dominant position on the xDSL market, which had impacted ČRa's ability to reach "equitable position on the retail xDSL market". The claimed sum is calculated as a difference between the hypothetical price of the part of the business and the sale price for which the part of the business was actually sold to T-Mobile Czech Republic, a.s. in 2009. The Company considers the claim as fabricated and and this was also communicated to the court in the statement. Any oral hearing in this case has not been ordered yet.

The Company is involved in other legal disputes. The aggregate value of all ongoing disputes over CZK 5 million with a verdict expected in 2012 represents nearly CZK 24 million. The annual profit and loss statement also reflects some minor disputes with a less material risk.

The Company considers disclosing other information regarding the said litigations as not advisable, since it could jeopardize the Company's litigation strategy.

The Company is convinced that all litigation risk has been faithfully reflected in the financial statements.

18 Commitments

Operating leases - lessee

The aggregate future minimum lease payments under operating leases are as follows:

In CZK million	31 December 2012	31 December 2011
No later than 1 year	1,261	1,303
Later than 1 year and not later than 5 years	4,342	4,498
Later than 5 years	3,225	3,966
Total	8,828	9,767

The total minimum lease payments relating to operating leasing of property, plant and equipment recognised as an expense in 2012 were CZK 1,355 million (2011: CZK 1,362 million). The lease agreements may contain clauses requiring restoration of the leased site at the end of the lease term. At present, such costs do not have a material impact on the Company's results of operations, financial position, or cash flow and therefore are not accounted for.

Operating leases - lessor

The table below shows aggregate future minimum lease payments under non-cancellable operating leases, where the Company is a lessor and which give rise to future revenues consist of the buildings and other telecommunication equipment rentals:

In CZK million	31 December 2012	31 December 2011
No later than 1 year	113	104
Later than 1 year and not later than 5 years	404	391
Later than 5 years	89	90
Total	606	585

Capital and other commitments

In CZK million	31 December 2012	31 December 2011
Capital and other expenditure contracted but not provided for in the financial statements	1,963	1,881

The majority of contracted amounts relate to the telecommunications network and service contracts.

19 Service concession arrangements

The Company performs communication activities as defined in the Act on Electronic Communications based on a notification and a certificate from the Czech Telecommunications Office no. 516 as amended by later changes no. 516/1, 516/2, 516/3, 516/4, 516/5 and 516/6.

The communication activities include (territory of the Czech Republic):
a) public fixed communications network,
b) public mobile communications network,
c) public access telephone services,
d) other voice services - service is defined as of public access,
e) leased lines - service is defined as of public access,
f) radio and TV signal broadcasting - service is defined as of public access,
g) data transmission - service is defined as of public access,
h) internet access services - service is defined as of public access,
i) other voice services - service is not defined as of public access,
j) leased lines - service is not defined as of public access,
k) radio and TV signal broadcasting - service is not defined as of public access,
l) data transmission - service is not defined as of public access,
m) internet access services - service is not defined as of public access.

The Company provides mobile services of electronic communications in the 900 and 1,800 MHz frequency bands under the Global System for Mobile Communication (GSM) standard and LTE standard (Long Term Evolution) on the basis of radio frequency assignment from CTO valid until 7 February 2016, in the 2,100 MHz frequency band under the Universal Mobile Telecommunications System (UMTS) standard on the basis of radio frequency assignment from CTO valid until 1 January 2022 and in the 450 MHz frequency band using technology CDMA2000 (Code Division Multiple Access - CDMA), where is provided broadband mobile access to Internet on the basis of radio frequency assignment from CTO valid until 7 February 2018.

The radio frequency licence can be extended by another licence based on an application submitted to the CTO in accordance with the Act on Electronic Communications. On the other hand, the current regulatory and business environment in the Czech Republic, the prevailing contractual, legal, regulatory, competitive or other economic factors may limit the period for which the Company can benefit from the use of these radio frequency assignments in the future.

Imposition of obligations related to the provision of the Universal Service

During 2012 and 2011, the Company provided the following selective services under CTO imposed obligations to provide Universal Service:

a) public pay telephone services,

b) access for disabled persons to the public telephone service, which must be equal to access enjoyed by other end users; such special access takes namely the form of specially adapted telecommunication equipment,

c) special price plans, which are different from the price plans used under standard commercial conditions, for low-income persons, persons with special social needs and disabled persons.

Universal Service is reimbursed by the Czech Telecommunications Office that receives funds from the state budget, which are remitted without delay to the Company's account.

20 Share capital and reserves

	31 December 2012	31 December 2011
Nominal value per ordinary registered share (CZK)	87	100
Number of shares	322,089,890	322,089,890
Nominal value per ordinary registered share (CZK)	870	1,000
Number of shares	1	1
Ordinary shares (in CZK million)	28,022	32,209

The reduction of the Company's share capital was registered into the Commercial Register on 14 November 2012. Each share with the nominal value of CZK 100 was decreased by CZK 13 per share and each share with the nominal value of CZK 1,000 was decreased by CZK 130. As at 31 December 2012, the amount of the Company's share capital equaled to CZK 28,021,821,300.

During year 2012 the Company acquired in ordinary share acquisition programme 6,441,798 treasury shares for CZK 2,483 million.

Shareholdings in the Company were as follows:

	31 December 2012	31 December 2011
Telefónica, S.A.	69.41%	69.41%
Telefónica Czech Republic, a.s. (treasury shares)	2.00%	0.00%
Other shareholders	28.59%	30.59%

The funds include a statutory reserve fund of CZK 6,442 million (2011: CZK 6,442 million) that is by law not distributable. The equity-settled share based payments reserve of CZK 31 million (2011: CZK 53 million) is not distributable.

Capital management

The Company is not subject to any externally imposed capital requirements.

The Company's objectives when managing its capital are:

a) to safeguard the Company's ability to continue as a going concern so that it can provide value for its shareholders, and

b) to comply with all relevant legal requirements.

The investment strategy in the light of managing the capital of the Company is to focus its investment activities in the pro-growth areas, such as the development and improvement of fixed and mobile broadband internet and data networks, mobile services, ICT solutions for corporations and for the public sector, and further expansion and development of mobile services (including data) in Slovakia. IT systems renewal and upgrade are among other investment activities aiming to simplify and improve processes that will lead to improved operational effectiveness.

At present, the Company's policy is not to retain surplus cash and distribute it to shareholders. In the following periods, the Board of Directors will continue to make in-depth analysis and assessment of the current and anticipated results of the Company, including scheduled and potential investments and cash flow generation and will optimize the capital structure to serve the purpose of achieving the ultimate plans.

There are no other specific objectives.

In the case that the dividend capacity (capped at the retained earnings from previous years and the profit for the current year) is lower than the amount of surplus cash, the Company will, in line with its intention not to hold the surplus cash, make an annual analysis of the other options allowing the distribution of cash surpluses to its shareholders. These options comprise:

a) distribution of the share premium

b) share capital reduction through a decrease of the nominal value of shares

c) share buyback

Standalone equity structure as at 31 December 2012:

In CZK million	**31 December 2012**
Share capital	28,022
Treasury shares	(2,483)
Share premium	24,374
Funds and reserves	6,481
Retained earnings from previous years	868
Net income for current year	5,925
Total	**63,187**

21 Related party transactions

The Telefónica Group is organized into four divisions – two geographic and two global ones.

Two geographic divisions are Telefónica Europe and Telefónica Latin America while the Company belongs to the former.

Two global cross-business divisions are Telefónica Digital and Telefónica Global Resources. Telefónica Digital seeks to strengthen the role of Telefónica in the digital world and exploit all growth opportunities while strengthening the portfolio of products and services. Telefónica Global Resources was created to increase the profitability by using all benefits of global exposure.

The Company operates in roaming, interconnection and telecommunications services in regional divisions. In the area of support services, the Company uses cooperation within global divisions.

The Company cooperates with Telefónica Global Services GmbH in the area of centralized demand aggregation, negotiation activities related to the purchases of selected product categories and services and carrying out centralized commercial supplier managment.

The Company cooperates with Telefónica Global Roaming GmbH in the area of wholesale roaming business, negotiaton and execution of roaming discounts agreements with roaming partners which enables the Company to be granted discounts by the roaming partners and to grant discounts to the roaming partners.

Sales and purchase transactions with related parties are based on contractual agreements negotiated on normal commercial terms and conditions and at market prices. Outstanding balances of assets and liabilities are unsecured, interest-free (excl. financial assets and liabilities used for financing) and the settlement occurs either in cash or by offsetting. The financial assets balances are tested for the impairment at the balance sheet date, and neither allowance nor write-off were incurred.

The following transactions were carried out with related parties:

I. Parent company:

Balance sheet In CZK million	31 December 2012	31 December 2011
a) Receivables	-	6
b) Payables	747	798

Profit or loss In CZK million	Year ended 31 December 2012	Year ended 31 December 2011
a) Purchases of services and goods (excl. Royalty fees)	46	38
b) Royalty fees	726	768

The total amount of dividend paid as at 31 December 2012 to Telefónica, S.A. was CZK 6,036 million (2011: CZK 8,943 million). The amount paid due to the share capital reduction as at 31 December 2012 amounted to CZK 2,906 million (2011: CZK 0 million).

II. Other related parties – Company´s subsidiaries and associates:

Balance sheet In CZK million	31 December 2012	31 December 2011
a) Receivables	155	143
b) Payables	82	206
c) Short-term loans provided (Note 14)	211	62
d) Short term intercompany cash - pooling liability (Note 14)	679	-

Profit or loss In CZK million	Year ended 31 December 2012	Year ended 31 December 2011
a) Sales of services and goods	420	479
b) Purchases of services and goods	67	341
c) Interest income	1	2

As at 31 December 2011 the Company provided a short term loan of CZK 19 million to Telefónica Slovakia, s.r.o. (Note 14) that in February 2012, Telefónica Slovakia, s.r.o repaid. At 31 December 2012 Company did not provide any loan to Telefónica Slovakia, s.r.o.

As at 31 December 2012 the Company provided a short-term loan of CZK 211 million (2011: CZK 43 million) to Internethome, s.r.o. (Note 14). The loan bears a floating interest based on 1M PRIBOR. The loan conditions are based on the arm´s length principle.

In August 2012, the Board of Directors approved an intercompany loan to Bonerix s.r.o. of up to CZK 150 million, as at 31 December 2012 the loan was not drawn in.

III. Other related parties – Telefónica Group:

Balance sheet **In CZK million**	**31 December 2012**	**31 December 2011**
a) Receivables	350	314
b) Payables	1,940	2,034
c) Short-term receivables - interest (Note 14)	1	5
d) Cash equivalents (Note 14)	2,761	6,763

Profit or loss **In CZK million**	**Year ended** **31 December 2012**	**Year ended** **31 December 2011**
a) Sales of services and goods	805	835
b) Purchases of services and goods	1,213	700
c) Management fees	387	394
d) Interest income	65	76

There were capital expenditures of CZK 5 million carried out with related parties for the period ended 31 December 2012 (2011: CZK 37 million).

The list of the Telefónica companies with which the Company had any transaction in 2012 and 2011 includes the following entities: Telefónica S.A., Telefónica de España, S.A.U., Telefónica Germany GmbH& CO.OHG, Telefónica UK Ltd., Telefónica Ireland Ltd., Telefónica Móviles España, S.A.U., Telefónica Móviles Argentina, S.A., O2 Holdings Ltd., Telefónica Germany Customer Services GmbH,, Telefónica Insurance S.A., Telefónica Móviles Guatemala, S.A., Telefónica Móviles El Salvador, S.A. de C.V., Telefónica Móviles Panamá, S.A., Telefónica Móviles Chile, S.A., Otecel, S.A., Telefónica Móviles Nicaragua, S.A., Telefónica Móviles Columbia, S.A., Telefónica Investigación y Desrrollo, S.A., Telecom Italia S.p.A., Telfisa Global BV, Telfisa, Telefónica International Wholesale Services, Telefónica International Wholesale Services II, S.L., S.A., Atento Chequia, Portugal Telecom, Telefónica Compras Electrónica, S.L., Telefónica Móviles Mexico, S.A., Telefónica Móviles del Uruguay, S.A., Telefónica Móviles Peru, S.A., Telefónica Venezuela, S.A., China Unicom (Hong Kong) Limited, Telefónica Global Roaming GmbH, Vivo, S.A., Telefónica Europe People Services Limited, Jajah Ltd., Telefónica USA, Telefonica Global Technology Chequia, Telefonica Global Technology, Telefonica Global Services GmbH, MOPET CZ a.s., Telefónica Factoring, E.F.C., S.A., Telefónica Costa Rica S.A., Telefónica Soluciones de Informatica y Comunicaciones de España S.A., Telefónica Digital España SL, Telefónica O2 Business Solutions, spol. s r.o., Internethome, s.r.o., CZECH TELECOM Germany GmbH, CZECH TELECOM Austria GmbH, Telefónica Slovakia, s.r.o., Bonerix s.r.o.

IV. Other related parties

a) Key management compensation

Members of the Board of Directors and of the Supervisory Board of the Company were provided with benefits as follows:

In CZK million	31 December 2012	31 December 2011
Salaries and other short-term benefits	100	109
Personal indemnification insurance	3	4
Total	103	113

b) Loans to related parties

There were no loans provided to members of Board of Directors and Supervisory Board in 2012 and 2011.

No other loan was provided to related parties by the Company.

22 Principal subsidiary undertakings and associates

As at 31 December 2012

Subsidiaries		**Company's interest**	**Cost of investment in CZK million**	**Country of incorporation**	**Activity**
1.	CZECH TELECOM Germany GmbH	100%	10	Germany	Data transmission services
2.	CZECH TELECOM Austria GmbH	100%	6	Austria	Data transmission services
3.	Telefónica Slovakia, s.r.o.	100%	6,116	Slovakia	Mobile telephony, internet and data transmission services
4.	Internethome, s.r.o.	100%	72	Czech Republic	Provision of WiFi Internet access
5.	Bonerix s.r.o.	100%	200	Czech Republic	Mobile telephony, internet and data transmission services
Associates					
6.	První certifikační autorita, a.s.	23%	9	Czech Republic	Certification services
7.	AUGUSTUS, spol. s r.o.	40%	-	Czech Republic	Auction sales and advisory services
8.	MOPET CZ a.s.	14%	20	Czech Republic	Real time mobile payments

As at 31 December 2011

Subsidiaries		Company's interest	Cost of investment in CZK million	Country of incorporation	Activity
1.	Telefónica O2 Business Solutions, spol. s r.o.	100%	237	Czech Republic	Network and consultancy services in telecommunications, IT/ICT services
2.	CZECH TELECOM Germany GmbH	100%	10	Germany	Data transmission Services
3.	CZECH TELECOM Austria GmbH	100%	6	Austria	Data transmission Services
4.	Telefónica Slovakia, s.r.o.	100%	6,116	Slovakia	Mobile telephony, internet and data transmission services
5.	Internethome, s.r.o.	100%	55	Czech Republic	Provision of WiFi Internet access
Associates					
6.	První certifikační autorita, a.s.	23%	9	Czech Republic	Certification services
7.	AUGUSTUS, spol. s r.o.	40%	-	Czech Republic	Auction sales and advisory services
8.	MOPET CZ a.s.	14%	13	Czech Republic	Real time mobile payments

In 2012, the Company became the sole shareholder of the new subsidiary Bonerix s.r.o. with the registered capital of CZK 200 thousand. In August 2012, the Bonerix s.r.o. acquired five parts of enterprises of Global Care Group.

In August 2012, the Board of Directors approved an increase of the other equity funds of Bonerix s.r.o. by CZK 200 million in the form of a cash contribution.

In 2012, the investment in MOPET CZ a.s. was increased by CZK 7 million.

23 Post balance sheet events

During 2013, the Company plans to continue implementing additional operational efficiencies and improvements that would lead to further savings in various areas, personnel costs inclusive. This efficiency enhancement programme is the way for the Company to retain the leading position on the market and face the macroeconomic situation in the Czech Republic. The overall 2013 restructuring plan is not yet finalized and available as at date of the issue of the Financial Statements, however, the costs of such programme are expected between CZK 330 million and CZK 390 million.

There were no other events, which have occurred subsequent to the year end, which would have a material impact on the financial statements at 31 December 2012.

06

Other information for shareholders and investors

Telefónica Czech Republic shares offer one of the highest returns in the local equity markets. Invest in them and secure a better future for you and your family.

10. Other information for shareholders and investors

Basic information

Corporate name:	Telefónica Czech Republic, a.s.
Registered address:	Praha 4, Za Brumlovkou 266/2, postal code 140 22
Company identification number:	60193336
Taxpayer registration number:	CZ60193336
Date of incorporation:	16 December 1993
Legally existing from:	1 January 1994
Duration of the company:	the company was founded for an indefinite period of time
Legal form:	joint-stock company
Statute of law under which the issuer was incorporated:	provisions of Section 171(1) and Section 172(2) and (3) of the Commercial Code
Commercial court:	Prague Municipal Court
Commercial court record number:	Section B, File 2322

Trading in Telefónica CR shares in 2012

	2012	2011
Number of shares (in millions) [1)]	319.9	322.1
Net profit/(loss) per share (in CZK) [2)]	18.5	23.7
Highest share price (in CZK) [3)]	419.0	439.6
Lowest share price (in CZK) [3)]	315.9	372.0
Share price at the end of period (in CZK) [3)]	323.6	383.1
Market capitalisation (in CZK bn) [3)]	104.2	123.4

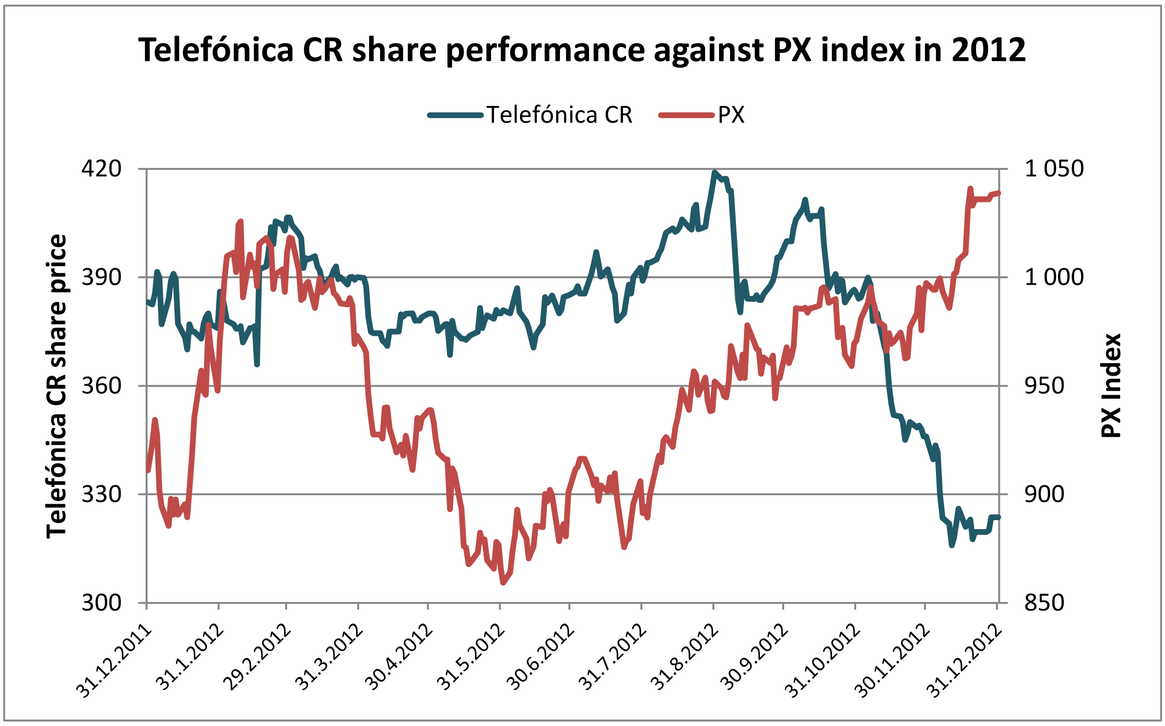
[1)] Weighted average number of ordinary shares in circulation over the period
[2)] Unconsolidated net profit under IFRS
[3)] Source: Prague Stock Exchange

In 2012, Telefónica CR once again ranked among the most important companies on the Czech capital markets according to market capitalization and trading volumes. Until 29 November 2012, the company shares traded on the main stock market of the Prague Stock Exchange (PSE). In connection with transition to the new trading system Xetra® Praha the shares were migrated to the Prime market from 30 November 2012. The total volume of trades in company shares in 2012 was CZK 33.7 bn, compared to CZK 34.0 bn in 2011. Trading in Telefónica CR Czech Republic shares, measured by the total volume of shares traded, made up 13.5% of all trades on the PSE stock market. Telefónica CR shares confirmed in 2012 the position of the fourth most traded issue on the PSE from 2011.

The market capitalisation as at 28 December 2012 (the last trading day on the PSE in 2012) was CZK 104.2 bn, which put Telefónica CR in the fifth position of the PSE stock market. The share price at the end of the last trading day of the year 2012 reached CZK 323.6, which was down 15.5% year on year, while the PX Index (the main index of the PSE) closed at 1,038.7 points, which is a year-on-year increase of 14.0%. The main reason for the drop in company shares in 2012 was the payment of dividends of CZK 27 per share for the year 2011 (record day fell on 12 September), and the payment of an amount corresponding to the reduction of the share capital of CZK 13 per share (record day was 14 November 2012). With the exclusion of these two factors, the share price of Telefónica CR would decline 5.1% over the course of the year. The main drivers of this trend included the negative trend in the share price of some telecommunications companies in the Central and Eastern Europe region, which was in turn caused by announcements of lower dividends in

2012. The share price of Telefónica CR reached its maximum of CZK 419.0 on 31 August 2012, and its minimum of CZK 315.9 on 11 December 2012. The average share price in 2012 was CZK 380.7, compared to CZK 403.8 in 2011.

The above-average dividend yield in comparison with other telecommunications operators in Central and Eastern Europe, aided by the high free cash flow generation and a low level of debt, makes Telefónica CR still a very highly regarded investment opportunity by investors.



Dividends

At the Ordinary General Meeting of 7 May 2010 in Prague, the shareholders approved a dividend payment from the 2009 net profit and a part of the retained earnings from previous years in the total amount of CZK 12.884 bn, i.e. CZK 40 per share of nominal value of CZK 100 and CZK 400 per share of nominal value of CZK 1,000, before tax. The record day for the payment of dividends was 8 September 2010 and the disbursement date 6 October 2010.

At the Ordinary General Meeting of 28 April 2011 in Prague, the shareholders approved a dividend payment from the 2010 net profit and a part of the retained earnings from previous years in the total amount of CZK 12.884 bn, i.e. CZK 40 per share of nominal value of CZK 100 and CZK 400 per share of nominal value of CZK 1,000, before tax. The record day for the payment of dividends was 7 September 2011 and the disbursement date 6 October 2011.

At the Ordinary General Meeting which was held on 19 April 2012 in Prague, the shareholders approved a dividend payment from the profit of 2011 and a part of retained earnings from previous years in the total amount of CZK 8.696 bn, i.e. CZK 27 per share of nominal value of CZK 100 (CZK 87 as from 14 November 2012), before tax, and CZK 270 per share of nominal value of CZK 1,000 (CZK 870 as from 14 November 2012), before tax. The record day for the payment of the dividend fell on 12 September 2012; the disbursement date was set by shareholders to be 10 October 2012.

Dividend policy

The Company does not have an official long-term dividend policy at present. The Company has indicated several times that it did not intend to retain surplus cash. In the following periods, the Board of Directors will make annual proposals for the payment of dividend, based on a diligent analysis of the current and future performance of the Company, including the projected future cash flows and investments, business development costs and acquisition costs. This approach is in line with the investment strategy of directing investment into pro-growth areas, such as improvements to the fixed and mobile broadband service, mobile services, ICT solutions for business and the government, and the development of the mobile operation in Slovakia. Other investment plans include the modernisation and upgrade of IT systems with the view to simplify processes and make them more efficient, with the ultimate goal of greater operating efficiency.

To provide for the eventuality that the dividend capacity (limited by the amount of retained earnings from previous years and the profit of the current year) in the future is lower than the balance of cash surpluses, the Company analyses every year the other options for the distribution of other disposable funds. These options included:

a) Distribution of the share premium;
b) Reduction of the share capital through the decrease of the nominal value of shares;
c) Acquisition of own shares (share buy-back).

As per this plan, the General Meeting of 19 April 2012 approved the Board of Director's proposal to reduce the Company's share capital by a proportional reduction of the nominal value of all company shares. For more information on the reduction of the share capital in 2012 please refer to section 8.9 of this Annual Report.

Details of patents or licenses, industrial, commercial or financial contracts which have a significant bearing on the business:

1) Patents and licences

Telefónica CR has licence agreements for the following software products: application middleware and database environment (Oracle), operating systems (Hewlett-Packard, Oracle and Microsoft), workstation software (Microsoft), CRM (Oracle), customer care and billing software with detailed billing functionality (Amdocs and LHS) and enterprise resource planning software ERP (SAP).

2) Industrial and commercial contracts

Telefónica CR maintained a diverse portfolio of technology suppliers in 2012. The main objective of the Company with respect to the contracted suppliers was to have competition on the supply side. All principal technology supply contracts are awarded by tender.

In 2012, the main suppliers of technology and related services to the Company were IBM Česká republika, Alcatel-Lucent Czech, Nokia Siemens Networks, Accenture Central Europe B. V., Indra, NextiraOne Czech, Amdocs Development Limited, LHS, Cisco, Ericsson, Hewlett-Packard and Huawei Technologies.

3) Financing contracts

Financial obligations as at 31 December 2012 divided into short-term and long-term (in CZK m):

Short-term (maturing within a year)	31
Long-term	3,000
Total	**3,031**

Loans, bonds issued and other financial obligations:

	Currency	Balance in CZK m as at 31 December 2012	Redemption
Bank loan	CZK	3 019	2016
Other financial obligations		12	

On 30 July 2012, Telefónica CR paid off its bank loan (Private Placement) of EUR 115 m in accordance with the terms of the facility.

On 27 September 2012, Telefónica CR signed a loan agreement for CZK 3 bn, underwritten jointly by UniCredit Bank Czech Republic, a.s. (also as the agent), Česká spořitelna, a.s., Komerční banka, a.s., Citibank Europe plc and Československá obchodní banka, a.s. The Company used the 4 year loan to refinance the above debt redeemable in July 2012, and for general purposes of the Company. The interest rate is PRIBOR + 1.75%.

As at 31 December 2012, Telefónica CR had no overdue loan obligations.

Investments

Main investments made by Telefónica CR in the last two accounting periods (in CZK m):

	2012	2011
Network & Operations	3,105	2,779
Business Solutions	481	567
IT & Products	865	948
Property & Security	141	137
Brand stores	27	29
Subsidiary companies and other investments*	1,132	705
Investments related to Telefónica Slovakia made in the Czech Republic	84	63
Telefónica Slovakia	408	393
Total (excluding acquisition in the Wifi segment)	**6,243**	**5,621**
Wifi acquisitions	123	235
Total	**6,366**	**5,856**

* Including additional internal work – capitalized

All principal investments were in the Czech Republic and in Slovakia and were financed from the Company's own resources and from credit. As stated above in this section, in 2012 the Company secured a loan of CZK 3 bn, which was used, among other things, for general corporate purposes including financing of investments. The Company cannot determine without ambiguity, how much of the total loan was used for financing of investments and how much for general operating purposes.

In 2012, Telefónica CR continued to implement an investment policy, which clearly favours the development and support of customer-oriented technologies with a growth potential for the future, and investments leading to a greater operating efficiency. As in the previous years, Telefónica CR invested in projects aimed at internal integration of mobile and fixed line services, and in the modernisation of its technology infrastructure.

The mobile segment was dominated by the continuing investments in the expansion of 3G mobile broadband coverage, increasing data transmission speeds, modernisation of the GSM network and capacity building in order to accommodate the growing traffic. The number of 3G (UMTS/HSPA) base stations grew 430 to the total of 3,031 in 2012. A network sharing project for the 3G network with T-Mobile allowed for a faster coverage of the population with the technology. The network sharing project was completed in 2012. At the end of 2012, the coverage of the Czech population with 3G service (including the network of T-Mobile as part of the network sharing) reached 78.5%. As for the 2nd generation mobile networks (GSM, EDGE), their general overhaul and modernisation was completed already in 2011. With regard to the need for quality signal in selected locations, in 2012 Telefónica CR concentrated on building up the network in particular to cover new motorway and highway sections and industrial and commercial centres. At the end of 2012, the coverage of the Czech population reached 99.4%. The boom in smartphone usage among the Company's customers increased the mobile data traffic in peaks by more than 20% compared to 2011. To accommodate this increase, Telefónica CR directed a major thrust of its investments in building up its network capacity, especially in the 3G network. In 2012 the Company also invested in the strengthening of its backbone network infrastructure and the restructuring of its mobile core components, in which it deployed state-of-the-art technology. Mobile exchanges were gradually replaced by modern Media Gateway technology.

In the fixed segment, the majority of investments were in the further development of and capacity building in the local access network, with a focus on the expansion and improvement of the VDSL service, which the Company brought to the market in 2011. In September 2012, VDSL speeds increased across the board to 20 Mbps or 40 Mbps, subject to the chosen tariff. To accommodate for the demand, the capacity of access points and of the transmission lines in the IP/MPLS backbone network were increased. The number of locations with VDSL access points increased by the end of 2012 to 2,301, compared to 2,266 in 2011.

The Company also continued with its investments in the availability and quality of its IPTV, Voice over IP and value added services. The total installed port capacity in locations went up to 1,339,600, which is a year-on-year increase of 8.5%. The share of access ports installed in equipment enabled for O_2 TV increased to 75% in 2012, compared to 68% at the end of 2011. A total of 950,700 ports were in use at the end of 2012 (4% more than in the previous year).

The access network continued to be built up, especially to accommodate the demand for connection of new customers in new residential, commercial and industrial developments. The access network consisted of metallic cable covering the whole territory of the country; the network was also boosted with optical fibre and radio relay systems. At the end of 2012, the total length of the metallic cable was 308.8 ths km (up 3.7 ths year on year). The optical fibre network capacity continued to rise in line with the growing traffic generated by broadband customers, the demand for business solutions and the connection of corporate customers, and, in selected cases, the optical fibre network was built in new residential developments.

The total length of optical cable, including ground pipe systems, increased over the course of 2012 from 32,439 km to 33,391 km. The total length of optical fibre reached 1,141,012 km (up 65,984 km year on year).

In the business solutions segment, the volume of investments tallied with the projects commissioned by customers; on top there were projects of data connectivity and ICT solutions. Investments in networks managed for large corporate customers made up the most of investments in this segment in 2012.

Infrastructure development and the development of managed services became a major investment area in 2012. The investments focused on the services M2M Platform, O_2 Cloud and Housing, as the market awareness of them, and the demand for them, grew.

In 2012, the Company embarked on a process which was all about simplification. The process covered the product portfolio, procedures and system structure. The focus of investments shifted away from complexity, with a clear goal to make the most of the potential of native functionality of basic systems, with a subsequent change of course towards parametrisation. The Company's aim was to make its proposition to customers easier to follow and its internal infrastructure easier to work with for employees.

In Slovakia, the process of building a proprietary network (mainly 3G) continued. Investments were directed also into the improvement of the quality of the existing CRM systems, e-applications, replacement of obsolete HW and a project-based proposition to the business segment. As at the end of 2012, Telefónica Slovakia operated 1,003 2G base stations, with the 2G network covering 95.5% of the Slovak population at the end of 201. 680 base stations were fitted with 3G network technology. At the end of 2012, the 3G network of Telefónica Slovakia reached 53.1% of the Slovak population.

Key future investments

In the period 2013-2014, the key focus of investments in the Czech Republic will lay in the fixed and mobile broadband area, which is seen as a vehicle for future improvements, greater efficiency and broader uptake of telecommunications and data services. The year 2013 will be a milestone year with regard to the investments in the deployment of the LTE technology. In the area of fixed data services, the Company will focus on developing its xDSL service and revamping its IPTV platform. The Company will also invest in innovative ICT technologies and solutions, which will help broaden the scope of service options for customers. At the same time, it will continue to invest in improving the operating efficiency and in the modernisation of the existing technology infrastructure.

The Slovak operation will continue to pursue a standard investment policy in the telecommunications sector, with an emphasis on efficiency improvements in the area of implementation of progressive technologies and customer policies, in order to deliver on the overall strategy and grow the share of the Slovak telecommunications market.

Fees paid to auditors in the accounting period

The cost of external audit activities performed by Ernst & Young for Telefónica CR in 2012:

- Consolidated whole (Telefónica CR Group)

Type of service	**Fees in CZK m**
Audit	21
Other audit-related consultancy	0
Other services	0
Total	**21**

- Parent company (Telefónica CR)

Type of service	**Fees in CZK m**
Audit	17
Other audit-related consultancy	0
Other services	0
Total	**17**

Rating

Telefónica CR Group has been given a corporate rating by the rating agency Standard & Poor's Financial Services LLC (Standard & Poor's). As at 31 December 2012, the long-term corporate rating of the Telefónica CR Group was BBB Outlook Negative. The rating reflects the rating of Telefónica, S.A., which exercises, according to Standard & Poor's, substantial control over the commercial strategy and financial policy of the Telefónica CR Group. For this reason, the maximum rating Telefónica CR can be given is limited by the rating of its parent entity.

Financial calendar

Dates of announcement of running financial results

For the first quarter of 2013	7 May 2013 *
For the first half of 2013	24 July 2013 *
For three quarters of 2013	7 November 2013 *
For the year 2013	28 February 2014 at the latest

* tentative date

Institutional investors and shareholders please contact

Investor Relations
Tel.: +420 271 462 076, +420 271 462 169
Fax: +420 271 463 566
E-mail: investor.relations@o2.com
URL: http://www.telefonica.cz/vztahy-s-investory/
Address: Telefónica CR Czech Republic, a.s.
Za Brumlovkou 266/2
140 22 Praha 4

11. Information on persons responsible for the Annual Report

Luis Antonio Malvido, Chairman of the Board of Directors and Chief Executive Officer of Telefónica Czech Republic, a.s.

David Melcon Sanchez-Friera, 1st Vice-chairman of the Board of Directors and Director and Director, Finance Division of Telefónica Czech Republic, a.s.

hereby declare that, to their best knowledge, the consolidated Annual Report gives a true and faithful reflection of the financial situation, business activity and the results of the Company and its consolidated whole for the past accounting period, and of the outlook on the future development of the financial situation, business activity and the results.

Luis Antonio Malvido
Chairman of the Board of Directors
and Chief Executive Officer

David Melcon Sanchez-Friera
1st Vice-chairman of the Board of
Directors and Director, Finance
Division

In Prague on 19 March 2013

Appendix: Report by the Board of Directors of Telefónica Czech Republic, a.s.

Appendix: Report by the Board of Directors of Telefónica Czech Republic, a.s.

on relationships between the controlling and the controlled entity, and on relationships between the controlled entity and other entities controlled by the same controlling entity for the year 2012
(pursuant to provisions of Section 66a(9) of the Act No. 513/1991 Coll., the Commercial Code)

Table of contents

Part A Applicable period

The Report pursuant to the provisions of Section 66a(9) of the Commercial Code, on relationships between the controlling and the controlled entity, and on relationships between the controlled entity and other entities controlled by the same controlling entity for the year 2012 (hereinafter "the Report) is presented for the last completed accounting period, i.e. the period started on 1 January 2012 and ended 31 December 2012.

Part B Entities forming the holding

Section I. Identification of the controlled entity Telefónica Czech Republic, a.s. (hereinafter only "the Company")

The company is registered in the Commercial Register of the Municipal Court in Prague, Section B, File 2322.
Registration date: 1 January 1994
Corporate name: Telefónica Czech Republic, a.s.
Registered address: Prague 4, Michle, Za Brumlovkou 266/2, postal code 140 22
Identification number: 60 19 33 36
Legal form: Joint-stock company

Section II. Identification of the controlling entity

Controlling entity: Telefónica, S.A.
Registered address: Gran Vía, 28, 28013 Madrid, Spain
Identification number: A 28015865
The controlling entity held shares of the controlled entity in the aggregate nominal value of 69.41% of the share capital of the controlled entity

Overview of shares in Telefónica Czech Republic, a.s.:	69.41% Telefónica, S.A. 2.00% Telefonica Czech Republic, a.s. (own shares) 28.59% other investors

Section III. Related undertakings

Entities controlled by Telefónica, S.A.:
The list of relevant undertakings controlled directly or indirectly by Telefónica, S.A. forms the Annex to this Report. The list was compiled from inputs from Telefónica, S.A. and verified using information from companies registers or other available data.

Part C Contracts and agreements between the controlled and the controlling entity, and contracts and agreements between the controlled entity and other related parties, including disclosure of any performance and counter-performance provided thereunder.

In the applicable period, contracts between the controlled entity and the controlling entity and the related undertakings were entered into and performed under in the following areas: IT (warranty and post-warranty service and systems support), outsourced IT operations, SMC network management services, telecommunications services (carrier capacity), sale and installation of telecommunications technology, quality assurance in telecommunications networks, fixed-term deposits, organisational support, cost sharing in individual technical areas (technology verticals), trademark sublicensing, insurance, economy of global wholesale conditions for roaming services, services of third party call centres, accounts in foreign currencies, HR services, global employee share plan, secondment of employees, processing and recording of tax documents, monitoring of a fixed electronic communications network and monitoring of a mobile electronic communications network.

The contracts were concluded either with the controlling entity Telefónica S.A., or with the following related undertakings: TELEFONICA GLOBAL TECHNOLOGY S.A. UNIPERSONAL, Telefónica International Wholesale Services, S.L., CZECH TELECOM Austria GmbH, CZECH TELECOM Germany GmbH, Telefónica Slovakia, s.r.o., Bonerix s.r.o., Internethome, s.r.o., Telfisa Global, B.V., O2 Holdings Ltd., Telefónica Insurance S.A., Telefónica UK Ltd., Telefónica Global Services GmbH, Telefónica Global Roaming GmbH, Atento Česká republika a.s., Telefónica Europe plc, Telefónica Finanzas, S.A. (TELFISA), Telefonica Europe People Services Ltd, Telefónica Germany GmbH & Co. OHG.

In keeping with the Commercial Code and other internal governance documents, the details of the contracts are regarded as a trade secret by the controlled entity. The controlled entity has not suffered any damage in connection with contracts and agreements concluded in 2012 between the controlled entity and the controlling entity, and between the controlled entity and other related undertakings, under which performance and counter-performance was given, or in connection with the provision of performance and counter-performance in 2012 under contracts and agreements concluded before 1 January 2012.

In terms of the price and quality, performance provided under the above contracts always corresponded to the customary market conditions for third party services, while on selected occasions the Company benefited from synergies and the possibility to participate in globally negotiated conditions in various areas.

Part D Other legal acts between holding entities in the accounting period of the year 2012

In the accounting period 2012, no other unilateral or other legal acts were made by the controlled entity on behalf of or instigation from the controlling entity or related undertakings, which would result in damage or profit, an advantage or a disadvantage to the controlled entity.

Part E Measures between holding entities in the accounting period of the year 2012

In the accounting period 2012, no measures were taken by the controlled entity on behalf of or instigation from the controlling entity or related undertakings, which would result in damage or profit, an advantage or a disadvantage to the controlled entity.

Part F Conclusion

(a) The Report was made by the Board of Directors of the controlled entity, Telefónica Czech Republic, a.s., and approved at the meeting of the Board of Directors held on 12 March 2013.
(b) The Report was prepared using data and information obtained from the controlling entity and other related undertakings, other available documents, and using results of examinations of relationships between the controlled entity on the one hand and the controlling entity and other related undertakings on the other hand. The Board of Directors of the controlled entity, Telefónica Czech Republic, a.s., declares that it proceeded with the duty of care when collecting the data and information.
(c) With regard to the fact that the controlled entity, Telefónica Czech Republic, a.s., is obliged by law to make an Annual Report pursuant to Act No. 563/1991 Coll., on accounting, as amended this Report will be appended to the 2012 Annual Report. Shareholders will have the opportunity to read the Report at the same time and under the same conditions as the financial statements.

In Prague, 12 March 2013.

Telefónica Czech Republic, a.s.
Board of Directors

Annex

List of companies directly or indirectly controlled by Telefónica, S.A. in the period from 1 January 2012 to 31 December 2012

Company name and legal form	Country	% Telefónica Group	Holding company
Controlling entity:			
Telefónica, S.A.	Spain		
Telefónica Latinoamérica			
Telefónica Internacional, S.A.U.	Spain	100%	Telefónica, S.A. (100%)
Telefonica International Holding, B.V.	The Netherlands	100%	Telefónica Internacional, S.A.U. (100%)
Telefónica Latinoamérica Holding, S.L.	Spain	100%	Telefónica, S.A. (94.59%) Telefónica Internacional, S.A.U. (5.41%)
Telefónica América, S.A.	Spain	100%	Telefónica, S.A. (50.00%) Telefónica Internacional, S.A.U. (50.00%)
Latin American Cellular Holdings, B.V.	The Netherlands	100%	Telefónica Latinoamérica Holding, S.L. (100%)
Telefónica Datacorp, S.A.U.	Spain	100%	Telefónica, S.A. (100%)
Telefónica Brasil, S.A.	Brazil	73.96%	Telefónica Internacional, S.A.U. (29.44%) Telefónica, S.A. (24.73%) Sao Paulo Telecomunicaçoes Participaçoes, Ltda. (19.73%) Telefónica Chile, S.A. (0.06%)
Vivo, S.A.	Brazil	73.96%	Telefónica Brasil, S.A. (100%)
Compañía Internacional de Telecomunicaciones, S.A.	Argentina	100%	Telefónica Holding de Argentina, S.A. (47.22%) Telefónica Móviles Argentina Holding, S.A. (42.77%) Telefónica International Holding, B.V. (10.01%)
Telefónica de Argentina, S.A.	Argentina	100%	Compañía Internacional de Telecomunicaciones, S.A. (51.49%) Telefónica Móviles Argentina, S.A. (29.56%) Telefónica Internacional, S.A. (16.20%) Telefónica, S.A. (1.80%) Telefonica International Holding, B.V.(0.95%)
Telefónica Móviles Argentina Holding, S.A.	Argentina	100%	Telefónica, S.A. (75%) Telefónica Internacional, S.A.U. (25%)
Telefónica Venezolana, C.A.	Venezuela	100%	Latin America Cellular Holdings, B.V. (97.04%) Comtel Comunicaciones Telefónicas, S.A. (2.87%) Telefónica, S.A. (0.09%)
Telefónica Móviles Chile, S.A.	Chile	99.99%	TEM Inversiones Chile Ltda. (99.99%)
Telefónica Chile, S.A.	Chile	97.89%	Inversiones Telefónica Internacional Holding Ltda. (53.00%) Telefónica Internacional de Chile, S.A. (44.89%)

Company name and legal form	Country	% Telefónica Group	Holding company
Telefónica del Perú, S.A.A.	Peru	98.49%	Telefónica Latinoamérica Holding, S.L. (50.18%) Latin American Cellular Holdings, B.V. (48.31%)
Telefónica Móviles Perú, S.A.C.	Peru	98.49%	Telefónica del Perú, S.A.A. (99.99%)
Colombia Telecomunicaciones, S.A. ESP	Columbia	70%	Telefónica Internacional, S.A.U. (32.54%) Olympic, Ltda. (18.94%) Telefónica, S.A. (18.51%)
Telefónica Móviles México, S.A. de C.V. (MÉXICO)	Mexico	100%	Telefónica, S.A. (100%)
Pegaso Comunicaciones y Sistemas, S.A. de C.V.	Mexico	100%	Telefónica Móviles México, S.A. de C.V. (100%)
Telefónica Móviles del Uruguay, S.A.	Uruguay	100%	Latin America Cellular Holdings, B.V. (68.00%) Telefónica, S.A. (32.00%)
Telefónica Larga Distancia de Puerto Rico, Inc.	Puerto Rico	100%	Telefónica Internacional Holding, B.V. (100%)
Telefónica Móviles Panamá, S.A.	Panama	100%	Telefónica, S.A. (56.30%) Panamá Cellular Holdings, B.V. (43.70%)
Telefónica Móviles El Salvador, S.A. de C.V.	Salvador	99.18%	Telefónica El Salvador Holding, S.A. de C.V. (99.18%)
Telefónica Móviles Guatemala, S.A.	Guatemala	100%	TCG Holdings, S.A. (65.99%) Telefónica, S.A. (13.61%) Guatemala Cellular Holdings, B.V. (13.13%) Panamá Cellular Holdings, B.V. (7.27%)
Telefonía Celular de Nicaragua, S.A.	Nicaragua	100%	Latin America Cellular Holdings, B.V. (100%)
Otecel, S.A.	Ecuador	100%	Ecuador Cellular Holdings, B.V. (100%)
Telefónica de Costa Rica TC, S.A.	Costa Rica	100%	Telefónica, S.A. (100%)
Telefónica Holding Atticus, B.V.	The Netherlands	100%	Telefónica Internacional, S.A.U. (100%)
Telefónica Europa			
Telefónica Europe plc	United Kingdom	100%	Telefónica, S.A. (100%)
MmO2 plc	United Kingdom	99.99%	Telefónica Europe plc (99.99%)
O2 Holdings Ltd.	United Kingdom	100%	MmO2 plc (100%)
Telefónica Europe People Services Ltd.	United Kingdom	100%	O2 Holdings Ltd. (100%)
Telefónica UK Ltd.	United Kingdom	100%	O2 Networks Ltd. (80.00%) O2 Cedar Ltd. (20.00%)
Tesco Mobile Ltd. (*)	United Kingdom	50.00%	O2 Communication Ltd. (50.00%)
Telefonica O2 Ireland Limited	Ireland	100%	O2 (Netherlands) Holdings, B.V. (97.06%) Kilmaine Ltd (2.94%)
O2 (Europe) Ltd.	United Kingdom	100%	Telefónica, S.A. (100%)
Telefonica Deutschland Holding A.G.	Germany	76.83%	Telefónica Germany Holdings Limited (76.83%)
Telefónica Germany GmbH & Co. OHG	Germany	76.83%	Telefonica Deutschland Holding A.G (76.82%) Telefónica O2 Germany Management GmbH (0.01%)
Telefónica de España, S.A.U.	Spain	100%	Telefónica, S.A. (100%)
Telefónica Móviles España, S.A.U.	Spain	100%	Telefónica, S.A. (100%)

Company name and legal form	Country	% Telefónica Group	Holding company
Acens Technologies, S.L.	Spain	100%	Telefónica de España, S.A.U. (100%)
Telefónica Soluciones Sectoriales, S.A.U.	Spain	100%	Telefónica de España, S.A.U. (100%)
Teleinformática y Comunicaciones, S.A.U. (TELYCO)	Spain	100%	Telefónica de España, S.A.U. (100%)
Telefónica Serv. de Informática y Com. de España, S.A.U.	Spain	100%	Telefónica de España, S.A.U. (100%)
Telefónica Cable, S.A.U.	Spain	100%	Telefónica de España, S.A.U. (100%)
Iberbanda, S.A.	Spain	100%	Telefónica de España, S.A.U. (100%)
Telefónica Telecomunicaciones Públicas, S.A.U.	Spain	100%	Telefónica de España, S.A.U. (100%)
Telefónica Soluciones de Outsourcing, S.A.	Spain	100%	Telefónica Soluc. de Informática y Com. de España, S.A.U. (100%)
Telefónica Czech Republic, a.s.	Czech Republic	69.41%	Telefónica, S.A. (69.41%)
Telefónica Slovakia, s.r.o.	Czech Republic	69.41%	Telefónica Czech Republic, a.s. (100%)
Other companies			
Telefónica International Wholesale Services II, S.L.	Spain	100%	Telefónica, S.A. (100%)
Telefónica International Wholesale Services, S.L.	Spain	100%	Telefónica, S.A. (92.51%) Telefónica Datacorp, S.A.U. (7.49%)
Telefónica International Wholesale Services America, S.A.	Uruguay	100%	Telefónica, S.A. (74.36%) Telefónica International Wholesale Services, S.L. (25.64%)
Telefónica International Wholesale Services USA, Inc.	United States	100%	T. International Wholesale Services America, S.A. (100%)
Telefónica Digital España, S.L.	Spain	100%	Telefónica (100%)
Jajah Inc.	USA	100%	Telefónica Europe plc (100%)
Tuenti Technologies, S.L.	Spain	91.38%	Telefónica Móviles España, S.A.U. (91.38%)
Wayra Investigacion y Desarrollo, S.L.	Spain	100%	Telefónica Digital Holdings, S.L. (100%)
Wayra Chile Tecnología e Innovación Limitada	Chile	100%	Wayra Investigacion y Desarrollo, S.L. (99.99%) Inversiones Telefónica Móviles Holding Ltda. (0.01%)
Wayra Brasil Aceleradora de Projetos Ltda.	Brazil	100%	Sao Paulo Telecomunicaçoes Participaçoes, Ltda. (98.00%)
WY Telecom, S.A. de C.V.	Mexico	100%	Wayra Investigacion y Desarrollo, S.L. (99.99%) Telefónica Digital Holdings, S.L. (0.01%)
Wayra Argentina, S.A.	Argentina	100%	Telefónica Móviles Argentina, S.A. (90%) Telefónica Móviles Argentina Holding, B.V. (10%)
Wayra Colombia, S.A.S.	Columbia	100%	Wayra Investigacion y Desarrollo, S.L. (100%)
Proyecto Wayra, C.A.	Venezuela	100%	Telefónica Venezolana, C.A. (100%)
Wayra Perú Aceleradora de Proyectos, S.A.C.	Peru	100%	Wayra Investigacion y Desarrollo, S.L. (100.00%)

Company name and legal form	Country	% Telefónica Group	Holding company
Terra Networks Brasil, S.A.	Brazil	100%	Sao Paulo Telecomunicaçoes Participaçoes, Ltda. (100%)
Terra Networks México, S.A. de C.V.	Mexico	99.99%	Terra Networks Mexico Holding, S.A. de C.V. (99,99%)
Terra Networks Perú, S.A.	Peru	99.99%	Telefónica Internacional, S.A.U. (99.99%)
Terra Networks Argentina, S.A.	Argentina	100%	Telefónica Internacional, S.A.U. (99.99%) Telefonica International Holding, B.V. (0.01%)
Terra Networks Guatemala, S.A.	Guatemala	99.99%	Telefónica Internacional, S.A.U. (99.99%)
Telfisa Global, B.V.	The Netherlands	100%	Telefónica, S.A. (100%)
Telefónica Global Activities Holding, B.V.	The Netherlands	100%	Telfisa Global, B.V. (100%)
Telefónica Global Services, GmbH	Germany	100%	Telefónica Global Activities Holding, B.V. (100%)
Telefónica Global Roaming, GmbH	Germany	100%	Telefónica Global Services, GmbH (100%)
Telefónica Compras Electrónicas, S.L.	Spain	100%	Telefónica Global Services, GmbH (100%)
Telefónica de Contenidos, S.A.U.	Spain	100%	Telefónica, S.A. (100%)
Televisión Federal S.A.- TELEFE	Argentina	100%	Atlántida Comunicaciones S.A. (79.02%) Enfisur S.A. (20.98%)
Atlántida Comunicaciones, S.A.	Argentina	100%	Telefonica Media Argentina S.A. (93.02%) Telefónica Holding de Argentina, S.A. (6.98%)
Telefónica Servicios Audiovisuales, S.A.U.	Spain	100%	Telefónica de Contenidos, S.A.U. (100%)
Telefónica On The Spot Services, S.A.U.	Spain	100%	Telefónica de Contenidos, S.A.U. (100%)
Telefónica Broadcast Services, S.L.U.	Spain	100%	Telefónica Servicios Audiovisuales, S.A.U. (100%)
Telefónica Learning Services, S.L.	Spain	100%	Telefónica Digital España, S.L. (100%)
Atento Inversiones y Teleservicios, S.A.U.	Spain	100%	Telefónica, S.A. (100%)
Atento Venezuela, S.A.	Venezuela	100%	Atento Inversiones y Teleservicios, S.A.U. (100%)
Telfin Ireland Ltd.	Ireland	100%	Telefónica, S.A. (100%)
Telefónica Ingeniería de Seguridad, S.A.U.	Spain	100%	Telefónica, S.A. (100%)
Telefónica Engenharia de Segurança do Brasil, Ltda.	Brazil	99.99%	Telefónica Ingeniería de Seguridad, S.A. (99.99%)
Telefónica Capital, S.A.U.	Spain	100%	Telefónica, S.A. (100%)
Lotca Servicios Integrales, S.L.	Spain	100%	Telefónica, S.A. (100%)
Fonditel Pensiones, Entidad Gestora de Fondos de Pensiones, S.A.	Spain	70.00%	Telefónica Capital, S.A. (70.00%)
Fonditel Gestión, Soc. Gestora de Instituciones de Inversión Colectiva, S.A.	Spain	100%	Telefónica Capital, S.A. (100%)

Company name and legal form	Country	% Telefónica Group	Holding company
Telefónica Investigación y Desarrollo, S.A.U.	Spain	100%	Telefónica, S.A. (100%)
Telefónica Investigación y Desarrollo de México, S.A. de C.V.	Mexico	100%	Telefónica Investigación y Desarrollo, S.A. (100%)
Telefónica Luxembourg Holding, S.à.r.L.	Luxembourg	100%	Telefónica, S.A. (100%)
Casiopea Reaseguradora, S.A.	Luxembourg	100%	Telefónica Luxembourg Holding, S.à.r.L. (100%)
Telefónica Insurance, S.A.	Luxembourg	100%	Telefónica Luxembourg Holding, S.à.r.L. (100%)
Seguros de Vida y Pensiones Antares, S.A.	Spain	100%	Telefónica, S.A. (100%)
Telefónica Finanzas, S.A.U. (TELFISA)	Spain	100%	Telefónica, S.A. (100%)
Pléyade Peninsular, Correduría de Seguros y Reaseguros del Grupo Telefónica, S.A.	Spain	100%	Telefónica Finanzas, S.A.U. (TELFISA) (83.33%) Telefónica, S.A. (16.67%)
Fisatel Mexico, S.A. de C.V.	Mexico	100%	Telefónica, S.A. (100%)
Telefónica Europe, B.V.	The Netherlands	100%	Telefónica, S.A. (100%)
Telefónica Finance USA, L.L.C.	USA	0.01%	Telefónica Europe, B.V. (100%)
Telefónica Emisiones, S.A.U.	Spain	100%	Telefónica, S.A. (100%)
Telefónica Global Technology, S.A.U.	Spain	100%	Telefónica, S.A. (100%)
Telefónica Móviles Soluciones y Aplicaciones, S.A.	Chile	100%	Telefónica S.A. (100%)
Aliança Atlântica Holding B.V.	The Netherlands	93.99%	Telefónica, S.A. (50.00%) Telefónica Brasil, S.A. (43.99%)
Telefónica Gestión de Servicios Compartidos España, S.A.	Spain	100%	Telefónica, S.A. (100%)
Telefónica Gestión de Servicios Compartidos Argentina, S.A.	Argentina	99.99%	Telefónica Gestión de Servicios Compartidos España, S.A. (95.00%) Telefónica, S.A. (4.99%)
Telefónica Gestión de Servicios Compartidos de Chile, S.A.	Chile	97.89%	Telefónica Chile, S.A (97.89%)
Telefónica Gestión de Servicios Compartidos Perú, S.A.C.	Peru	100%	T. Gestión de Servicios Compartidos España, S.A. (99.48%) Telefónica del Perú, S.A.A. (0.52%)
Telefónica Transportes e Logística Ltda.	Brazil	99.33%	Telefónica Gestión de Servicios Compartidos España, S.A. (99.33%)
Telefonica Serviços Empresariais do BRASIL, Ltda.	Brazil	99.99%	Telefónica Gestión de Servicios Compartidos España, S.A. (99.99%)
Telefónica Gestión de Servicios Compartidos México, S.A. de C.V.	Mexico	100%	Telefónica Gestión de Servicios Compartidos España, S.A. (100%)
Telefónica Servicios Integrales de Distribución, S.A.U.	Spain	100%	Telefónica Gestión de Servicios Compartidos España, S.A. (100%)
TGestiona Logística, S.A.C.	Peru	100%	Telefónica Gestión de Servicios Compartidos España, S.A. (94.4775%) Telefónica del Perú, S.A.A. (0.5160%) Telefónica Gestión de Servicios Compartidos Perú, S.A.C. (0.0065%)

Company name and legal form	Country	% Telefónica Group	Holding company
Telefónica Gestión Integral de Edificios y Servicios, S.L.	Spain	100%	Taetel, S.L. (100%)
Tempotel, Empresa de Trabajo Temporal, S.A.	Spain	100%	Taetel, S.L. (100%)
Companies consolidated using the equity method			
Telefónica Factoring España, S.A.	Spain	50.00%	Telefónica, S.A. (50.00%)
Telefónica Factoring Do Brasil, Ltd.	Brazil	50.00%	Telefónica, S.A. (40.00%) Telefónica Factoring España, S.A. (10.00%)
Telefónica Factoring Mexico, S.A. de C.V. SOFOM ENR	Mexico	50.00%	Telefónica, S.A. (40.5%) Telefónica Factoring España, S.A. (9.50%)
Telefónica Factoring Perú, S.A.C.	Peru	50.00%	Telefónica, S.A. (40.5%) Telefónica Factoring España, S.A. (9.50%)
Telefónica Factoring Colombia, S.A.	Columbia	50.00%	Telefónica, S.A. (40.5%) Telefónica Factoring España, S.A. (9.50%)
Telco, S.p.A.	Italy	46.18%	Telefónica, S.A. (46.18%)
DTS Distribuidora de Televisión Digital, S.A.	Spain	22.00%	Telefónica de Contenidos, S.A.U. (22%)
China Unicom (Hong Kong) Ltd.	China	5.01%	Telefónica Internacional, S.A.U. (5.01%)

(*) Consolidated using proportional consolidation

In these consolidated financial statements, Telefónica (Germany) GmbH & Co. OHG, complies with the provision of Art. 264b HGB ("Handelsgesetzbuch": the German commercial code), and is exempt in accordance with the stipulations of Art. 264b HGB