



Annual Report
for the Year 2013



Techno1ogy

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.

Release notes:

On 29 May 2014, information on pages 95-96 were corrected.

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01

Introduction

1. 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.:

- I. We have audited the consolidated financial statements of Telefónica Czech Republic, a.s. and its subsidiaries ("the Group") as at 31 December 2013 presented in the annual report of Telefónica Czech Republic, a.s. ("the Company") on pages 98 - 163 on which we have issued an auditors' report dated 25 February 2014 presented in the annual report on pages 101 - 102. We have also audited the separate financial statements of the Company as at 31 December 2013, which are presented in the annual report of the Company on pages 164 - 227 on which we have issued an auditors' report dated 25 February 2014, presented in the annual report of the Company on pages 167 - 168 (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 - 97 and 228 - 234 is consistent with that contained in the audited financial statements as at 31 December 2013. 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.

In our opinion, 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 2013 presented in the annual report of the Company on pages 236 - 246. As described in Part F of report on related parties, the Company prepared this report in accordance with Commercial Code. 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.



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 2013 is materially misstated.

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

Radek Pav
Auditor, License No. 2042

28 April 2014
Prague, Czech Republic

A member firm of Ernst & Young Global Limited
Ernst & Young Audit, s.r.o. with its registered office at Na Florenci 2116/15, 110 00 Prague 1 - Nove Mesto, has been incorporated in the Commercial Register administered by the Municipal Court in Prague, Section C, entry no. 88504, under Identification No. 26704153.

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

How do you look back at 2013?

The year 2013 was literally a revolution and success for the Company. It all started with the unveiling of the unlimited FREE tariffs the customers have been calling for – we were the first operator to spearhead the trend and our competition only followed. We are also happy with the way the spectrum auction turned out for us; we will now be able to invest in fourth-generation mobile LTE networks. We have covered a large part of Prague and Brno with the fourth-generation network service using the spectrum we already owned in 2013. The market of virtual operators, of which we have – thanks to our strong partnerships – the largest share, also saw many changes. The year 2013 culminated with the acquisition of a majority stake in the Company by the PPF Group. These, as well as many other developments, helped us strengthen our leadership of the Czech telecommunications market.

I am glad to see that we have delivered on our commitments that we gave to investors and to the public at the start of the year. We met our capital expenditure target – we invested CZK 5.7 billion in 2013, mainly in the development and capacity building of our 3G mobile network, rolling out our 4G network and in improving the coverage of and upgrading our VDSL fixed internet access. We also invested in the expansion of our 3G network service in Slovakia.

What do you regard as the most significant development the past year has brought?

Beyond any doubt, it was the launch of the unlimited FREE tariffs, which triggered an actual revolution in the Czech mobile market. FREE tariffs are a straightforward and transparent proposition to our customers. FREE tariffs stabilised the revenues in the consumer segment and kept the churn rate low. Many customers took the option to benefit from the value offered by the unlimited tariffs and increase their monthly spend.

Already 90% of the consumer base has been migrated to the new FREE tariffs, and we aim to complete the migration of all customers to these tariffs by the end of the first half of 2014. The voice traffic in our network has gone up 27%. Customers of FREE tariffs make on average 66 minutes worth of calls more in a month. Data traffic in the mobile network has increased significantly – it was up nearly 30% in 2013.

Have the FREE tariffs had any effect on the number of customers?

In 2013, we signed up 158 thousand new contract customers, and the FREE tariffs take a large part of the credit. The number of prepaid customers went down slightly year on year, but the decline has been offset by their frequent migration to one of the new unlimited tariffs. At the end of 2013 we recorded 5.1 million of mobile customers, which is three percent more than in the year before.

Our added value lies not only in the unlimited character of our tariffs but also in the network quality and the standard of customer care. We presently have the best 3G network in the country, and we are forging ahead with the deployment of the fourth-generation LTE network. We were the first to come out with LTE in 2012; and the 4G network service is now available in a large part of Prague and Brno.

Extra výhody was introduced more than one year ago. Is the loyalty programme popular with customers?

Since the start of the programme Extra výhody in September 2012, our customers together have saved over CZK 400 million. The programme's popularity surged especially in the run-up to Christmas, when the number of discount codes generated increased tenfold. Already one million customers took advantage of the benefits offered by the programme, which ranks it among the largest loyalty programmes in the Czech Republic.

Which area of your business saw the biggest increase last year?

More and more customers use smartphones. We have bundled a generous data allowance with our FREE tariffs. The volume of mobile data went up 70% year on year. The share of smartphones in the O₂ network reached 35%. Tablet sales also surged in the last quarter; their share in the O₂ network was up 25.5% year on year. Our O₂ Guru assistants, who are all trained especially for the purpose, help all visitors in O₂ stores with these – and not only these – technologies. In 2013, the team of over a hundred O₂ Guru assistants handled almost 400 thousand requests.

How did the Company do in the fixed access market?

Also in 2013 we continued our investments in the VDSL network. The advantages of this technology are now available to 102 thousand customers more than in the previous year. The VDSL technology offers a considerably faster speed, while we have kept the price the same for our customers who are upgrading from the older ADSL access technology.

Just as our FREE tariffs spelled a revolution in the market of mobile services, our innovated O₂ TV was a revolution in its own right in the market of fixed access services. In addition to features which are commonplace in digital television, we are offering our customers a truly unique Playback function, which lets them watch their favourite shows within 30 hours from the original broadcast. As a result, in the declining market of pay TV the number of O₂ TV customers grew 10% year on year to 156 thousand.

What is your view on the results of the spectrum auction in the Czech Republic?

Our Company did very well out of the spectrum auction; we secured all the spectrum we wanted, which is paramount for our future development plans. Ultimately, we got the spectrum at a very good price comparable to other European markets. The results of the spectrum auction allowed us to focus on rolling out the best LTE network in Czech Republic.

What do you make of the fact that the auction did not produce a fourth operator?

The spectrum auction indeed produced no new player in the form of a fourth operator, but the Czech Republic presently has close to 50 virtual operators. In 2012 we were the first one to open our network to BLESKmobil, which is still the most successful virtual operator in the Czech market. We also have MVNO joint ventures with Tesco Stores CR and ČEZ. We are scrupulous in selecting our partners, and this is also the reason why we are still at the top of the virtual operator market in the Czech Republic. We have teamed up with three strong players, together holding an estimated over 60% of the market of virtual operators.

Last year you reached an agreement with T-Mobile on 2G and 3G network sharing. What do you expect the cooperation will bring?

We presently share close to one thousand base transceiver stations for 3G mobile network. We decided to do a follow up of this very successful project from 2011, which was the first of its kind in Europe. The agreement will give our customers improved voice and data coverage. Our services will thus be accessible to a larger base of customers and we will have improved operating efficiency.

In addition to telecommunications services, Telefónica CR is also a provider of IT solutions. What do you regard as the greatest achievement in this area?

Our many years of experience rank us at the forefront of ICT providers in the Czech Republic – both by the scope and diversity of the service we offer and our technological superiority and expertise. In 2013, we secured several important certificates, of which the most prestigious is TIER III certification for our data centres. The centres are managed to an international standard; they use state-of-the-art technology and they can safely accommodate even the most critical applications which require the highest availability. This is why we are the only commercial data centre operator in Central Europe with TIER III certification. The certificate gives assurance that our managed services meet the highest global standard – which makes them unique in the Czech Republic.

What was the year 2013 like for your subsidiary Telefónica Slovakia?

Telefónica Slovakia is going from success to success with every year gone by, and it is reflected also in the Company's financial results. In 2013, Telefónica Slovakia added over 180 thousand new customers and its share of the market reached 23%. Last year, Telefónica Slovakia focused its effort on covering the territory of the Slovak Republic with its own 3G network; at the end of the year it reached already 59.5% of the Slovak population. This, among other things, contributed Telefónica Slovakia's recognition as 'Operator of the Year' for the fifth time in a row.

At the end of 2013, Telefónica, S.A. announced the sale of its share in Telefónica Czech Republic, a.s. to the Czech investment group PPF. What does the change of the majority shareholder mean for the Company?

The new owner will require that we continue with the successful running of our business, as we have done until now. It will also open a new view of all the business areas, which will improve our capacity to respond to changes in the external environment. We will continue to focus on our performance and on delivering on our commitments to customers and shareholders alike.

Moreover, we will continue to be a part of Telefónica Group's partnership programme, which lets also other telecommunications operators benefit from some of the strengths of the Telefónica Group and cooperate in key business areas.

What is the outlook for 2014?

Improving our operating efficiency is our long-term goal, and the year 2013 was a period in which most of the areas we had been working on for a number of years has finally come to pass. All our actions made in 2013 will certainly bear fruit also in the following year.

We will continue investing in areas with a high growth potential such as mobile data and the fourth-generation LTE network. The network sharing arrangement will also help expand the coverage of the 3G network and improve the service quality in the 2G network. We can expect that in 2014 the virtual operator market will undergo consolidation, and that an opportunity to partner with another strong ally in the field of virtual operators will present itself. In the first half of the year we plan to conclude the migration of the consumer base to the FREE tariffs, so that all our customers can take advantage of all the benefits offered by the tariffs. I am confident that we will maintain our leadership of the Czech telecommunications market also in the coming year.

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.

	2013	2012
Financials		
Revenues ¹	47,895	50,534
OIBDA – Operating income before depreciation and amortization	18,477	19,781
Operating income	7,445	8,344
Income before taxes	7,264	8,156
Net income	5,695	6,776
Total assets	73,949	79,199
Property, plant and equipment	41,857	46,691
Total equity	55,749	60,574
Financial debts	3,004	3,031
Capital expenditure ²	5,673	6,366
Operations (end of period)		
Fixed accesses (in thousands)	1,389	1,500
xDSL connections – retail and wholesale (in thousands)	919	915
Pay TV – O ₂ TV (in thousands)	156	141
Mobile customers in Czech Republic (in thousands)	5,102	5,083
- of which contract	3,235	3,192
pre-paid	1,866	1,891
Mobile customers in Slovakia (in thousands)	1,540	1,354
Group headcount (end of period) ³	5,607	6,365
Ratios (in %)		
OIBDA margin (OIBDA/Revenues)	38.6	39.1
Net income/Revenues	11.9	13.4
Capital expenditure/Revenues	11.8	12.6
ROA (Net income/Total assets)	7.7	8.6
ROE (Net income/Equity)	10.2	11.2
Gross gearing (Financial debts/Total equity)	5.4	5.0
Macroeconomic indicators⁴		
Population (in millions)	10.5	10.5
GDP growth (in %) ⁵	(0.9)	(1.2)
Inflation (in %)	1.4	3.3
Unemployment (end of period, in %)	8.2	9.4
CZK/USD exchange rate – average over the period	19.6	19.6
CZK/USD exchange rate – end of period	19.9	19.1
CZK/EUR exchange rate – average over the period	26.0	25.1
CZK/EUR exchange rate – end of period	27.4	25.1

¹ Excluding 'Other' income (revenues from non-telecommunications services)

² Including WiFi acquisitions

³ Including Bonerix subsidiary

⁴ Source: Czech Statistical Office, Ministry of Labour and Social Affairs of the Czech Republic, Czech National Bank

⁵ At constant 1995 prices, 2013 preliminary figure

Even more information



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Board of Director's
report on the business of
the Company

4. Board of Director's report on the business of the Company

In 2013, the Company was a member of the Telefónica Group, 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. The Group has a presence in 24 countries. As of December 2013, Telefónica's total number of customers was 323 million. Telefónica's growth strategy is focused on the markets in which it has a strong foothold: Europe and Latin America. The Group stands in sixth position in the telecommunications sector worldwide in terms of market capitalisation, is first among European integrated operators and in 22th position in the Eurostoxx 50 rankings, composed of Europe's blue chip companies (March 2014). 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.

4.1 Telefónica Czech Republic Group

4.1.1 Overview of the Group and the main changes in 2013

The Telefónica Czech Republic Group (Telefónica CR Group) comprises Telefónica Czech Republic, a.s. (Telefónica CR or the Company) and several other subsidiaries. In 2013, the majority of the Group's services were provided within the territory of the Czech Republic. The Group has been offering mobile services to customers in Slovakia since 2007 through a wholly-owned subsidiary Telefónica Slovakia, s.r.o. (Telefónica Slovakia).

The breakdown of consolidated revenues by region (excluding revenues from non-telecommunications services) was as follows:

In CZK m	Year ended 31 December	
	2013	2012
Czech Republic	43,399	46,202
Slovakia	5,398	4,834
Other countries	28	32
Consolidation adjustments	(930)	(534)
Consolidated revenues total	47,895	50,534

Two changes in the Telefónica CR Group structure occurred in the course of 2013.

In March 2013, Telefónica CR entered into a contract to sell the remaining 20% of shares in Informační linky, a.s. This step followed on the sale of 80% shares of this company in 2012. With the sale transaction completed, Informační linky, a.s. ceased to be a part of the Telefónica CR Group. On 14 March 2013, Telefónica CR signed a shareholder agreement with Tesco Stores ČR, a.s., and a contract on the transfer of ownership interest, by which it became a member in Tesco Mobile ČR s.r.o., with a 50% interest in the company.

Also in March 2013, the sole member of Telefónica Slovakia, s.r.o., approved a reduction of the company's registered capital by way of reducing the nominal value of the member's contribution by the amount of EUR 136,796,563, i.e. from EUR 240,000,000 to EUR 103,203,437. The reduction of the registered capital was recorded in the Commercial Register on 30 July 2013. The reason for the reduction of the registered capital was to improve the capital structure of the company. The amount by which the registered capital had been reduced was used to cover for accumulated losses from the previous accounting periods. Details of the changes and a full overview of subsidiary and affiliated companies are given in section Subsidiaries, associates 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 the Company also started offering O₂ 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.

In the fast-changing market environment, the Company pays close heed to the needs and wishes of its customers. In line with this philosophy, and with the ambition to confirm its leadership innovation and the position of its brand as the market leader, on 11 April the Company started a revolution in the Czech market when it unveiled its new FREE tariffs. These simple and transparent tariffs bring unlimited on-net calling and SMS for all customers. The higher tariff option, FREE CZ, comes with unlimited calls and SMS to all networks and 1 GB data allowance. As a result, the Company has strengthened its present leadership in the market, and it forges ahead with its strategy to be a leader in innovation in the Czech mobile market.

The Company has also been providing a wholesale service to other operators of public telecommunications networks and providers of public telecommunications services in the Czech Republic and abroad.

A new virtual operator, Mobil od ČEZ, started offering its service in the O₂ network on 15 November 2013.

In the area of working with the communities, in 2013 Telefónica CR continued, through the Telefónica 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 become a reality.

In the area of research and development, in 2013 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 2013. Also in 2013, the mobile payment terminal mPO₂S project was launched. It offers a modern, accessible and most importantly mobile solution that allows small and medium businesses to accept payment cards. The project seeks to reduce the number of points of sale where people cannot pay with a card.

In 2013, the Wayra accelerator continued in its mission to foster innovation in the area of internet and new information and communication technology (ICT). In June, Wayra in Prague welcomed the authors of the selected projects. For eight months, it became their home while they worked on their ideas.

The Company incurs internal research and development costs on activities pursuant to § 2, paragraph 1 of Act on Research and Development Support No. 130/2002 Coll.; however, these costs do not meet the criteria for capitalization under IAS 38 Intangible Assets standard for both years 2013 and 2012.

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 triumphed at the 11th edition of the national Sodexo Employer of the Year 2013 Awards.

In Slovakia, Telefónica Slovakia continued to successfully market its simple and transparent tariffs O₂ Fér for residential consumers and O₂ Moja Firma designed especially for self-employed and SME customers. Shortly after coming out with an unbeatable offer of calls and SMS to all European countries at Slovak prices for all customers, Telefónica Slovakia proceeded with the major revamp of its O₂ Fér tariff for contract and prepaid customers in the last three years. The most popular benefit of free on-net calling after the third minute changed to free on-net calling after the first minute. The attractive proposition has helped Telefónica Slovakia to maintain its dynamics of growth. The company further strengthened its position in the Slovak mobile market; according to a survey carried by an independent agency Ipsos Tambor in collaboration with Telefónica Slovakia, the level of customer satisfaction with the O₂ brand was the highest among all Slovak mobile operators.

The total number of customers of the Telefónica CR Group was as follows:

In thousands	As at 31 December	
	2013	2012
FIXED ACCESS – CZECH REPUBLIC		
Retail		
Fixed accesses		
Traditional telephony access ¹⁾	978	1,137
Naked access	325	286
Voice over IP	86	77
Fixed accesses total	1,389	1,500
Internet and data		
Dial-up access ²⁾	75	88
Broadband access ³⁾	802	810
Other ⁴⁾	108	119
Internet and data total	985	1,017
Pay TV	156	141
Retail total	2,530	2,658
Wholesale		
Local Loop Unbundling	46	47
Wholesale xDSL access	117	105
Other ⁵⁾	7	8
Wholesale total	170	160
FIXED ACCESS TOTAL – CZECH REPUBLIC	2,700	2,818
MOBILE CUSTOMERS – CZECH REPUBLIC		
Contract customers	3,235	3,192
Prepaid customers	1,866	1,891
MOBILE CUSTOMERS TOTAL – CZECH REPUBLIC	5,101	5,083
MOBILE CUSTOMERS – SLOVAKIA	1,540	1,354
Contract customers	774	659
Prepaid customers	766	695
MOBILE CUSTOMERS TOTAL – SLOVAKIA	1,540	1,354
CUSTOMERS TOTAL – GROUP	9,341	9,255

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

In 2013, Telefónica CR Group continued to implement restructuring and cost optimisation measures aimed at achieving a greater operational efficiency. The Group embarked on new projects in many areas of its business. Restructuring projects were focused especially on the streamlining 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 800 employees were laid off in connection with the restructuring, bringing the total headcount of the Group down 12% to 5,607. The cost of the restructuring, of which severance formed a large part, reached CZK 368m in 2013.

The total number of employees of the Telefónica CR Group was as follows:

	As at 31 December	
	2013	2012
Telefónica Czech Republic, a.s.	5,100	5,861
Bonerix, spol. s r.o.	102	90
Employees in the Czech Republic	5,202	5,951
Telefónica Slovakia, s.r.o.	405	414
Employees in Slovakia	405	414
Group employees total	5,607	6,365

Share buy-back

On 19 April 2012, the General Meeting of Telefónica Czech Republic, a. s. approved the share buyback programme 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 initiate the share buyback. 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 first tranche of the share buyback programme was executed in 2012, during which 2% of treasury shares of the Company were acquired. The total of 6,441,798 treasury shares of the Company acquired in the first tranche of 2012 has been cancelled, and a reduction in the Company's share capital by a corresponding amount, i.e. the amount of CZK 560,436,426 was recorded in the Commercial Register as of 15 November 2013.

Following the aforementioned decision of the General Meeting of 19 April 2012, on 26 February 2013 the Company's Board of Directors decided to continue the share buyback programme of ordinary shares of the Company (second tranche), to an additional limit of

6,441,798 ordinary shares, which represents additional 2% of the total of ordinary shares issued by the Company. Mandated by the resolution, the Company commenced acquisition of its shares on 5 March 2013. On 29 October 2013, the Company's Board of Directors decided to stop the share buyback programme, after 5,428,035 shares representing 1.69% of the total ordinary shares issued by the Company had been acquired in 2013. The total price for which the shares were acquired in 2013 was CZK 1,595m, which represents the average price of CZK 294 per share. The 5,428,035 shares bought in 2013 are held by the Company. Currently these shares account for 1.72% of the total issued shares by the Company following the reduction of the share capital on 15 November 2013.

4.1.2 Telefónica Slovakia

As at 31 December 2013, the number of customers of Telefónica Slovakia reached 1.54 million, of which more than 773 thousand were on contracts. This represents a year-on-year growth of the customer base by 13.7%. Since the free Number Portability service had been made available in November 2008, until 31 December 2013, more than 620 thousand numbers were ported to the O₂ network in Slovakia.

The revenues of Telefónica Slovakia reached EUR 207.8 m in 2013, which is a year-on-year growth of 8.1%. Telefónica Slovakia also posted a positive operating profit before depreciation (OIBDA) which was up 21% year on year.

Also in 2013, Telefónica Slovakia continued to successfully market its tariff proposition: O₂ Fér and O₂ Paušál for consumers and O₂ Moja Firma designed especially for self-employed and SME customers.

In January, Telefónica Slovakia introduced, in collaboration with Tatra banka, contactless mobile payments powered by the NFC technology. During 2013, Telefónica Slovakia continuously worked on the improvement of its products and services, as attested by the new roaming offer of calling at Slovak rates in all countries of the European Union, which was open to the subscribers of O₂ Paušál, O₂ Fér and O₂ Moja firma, or on-net calling with the most popular O₂ Fér tariff for free after the first minute.

Telefónica Slovakia also improved and innovated its loyalty programme as Extra výhody and offered its customers something extra – free small-screen internet with O₂ Paušál. These and other benefits swayed more than 114 thousand to port their number to the O₂ network in 2013; as a result, Telefónica Slovakia breached the mark of 1.5 million customers already in November.

During 2013, Telefónica Slovakia focused its effort on covering the territory of the Slovak Republic with its own 3G network; at the end of the year it reached already 59.5% of the Slovak population. At the beginning of December, Telefónica Slovakia successfully completed its 3G network deployment plan – more than 70 new locations were added instead of the original target of 60.

A survey by the independent agency Ipsos Tambor carried out jointly with Telefónica Slovakia revealed that O₂ Slovakia had yet again the highest customer satisfaction index score among all mobile operators in Slovakia.

O₂ customers in Slovakia also voted the company Operator of the Year 2013 for the fifth year running. According to a study Best Employers Slovakia by AonHewitt, Telefónica Slovakia was the best employer of 2013 among large corporations.

4.1.3 Risk management

Risk management is one of the primary management tools for effective governance of the Company.

Its purpose is to render support in accomplishing the Company's vision and strategy.

The risk management model which is being applied 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). The risk management system continues to be developed as an indispensable instrument of internal control.

Risks are identified based on an assessment of the relevant management levels and suggestions made by the division Internal Audit and Risk Management and other units of the Company, and evaluated 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 2013, the Risk Management unit was responsible for the methodology and risk management system on the Company 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 managed.

The Risk Management unit also handles the risks of Telefónica Slovakia; the risks were managed according to the approved methodology.

In the course of its operations, the Company may be exposed to the following risks:

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's business can also be adversely affected by the fierce market competition in all segments, which has been exacerbated by the market activities of virtual mobile operators (the Company teamed up with other partners and launched MVNOs to defend its revenues), and ongoing technology progress. New products and technologies may cause existing products and services to become obsolete; they may also have a negative bearing on the take-

up and profitability of traditional voice and data services. The Company monitors the market trends and develops and markets new products and services which mitigate the above risks.

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. Also in 2013, proceedings conducted by regulatory authorities were monitored and the Company adopts measures to mitigate the impact of such proceedings. The Company also checks the conformity of all its activities with the requirements of the Czech and EU regulatory framework.

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. Standard financial instruments, including hedging against interest rate fluctuations, are applied.

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. Also in 2013, the Company used standard instruments to manage these risks: insurance, deposits, assigning credit limits to partners or scoring of new and existing customers.

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 has implemented such mechanisms that significantly mitigate, and in some cases eliminate, the risk of such disruptions.

At the same time, the Company is dependent on a small number of important suppliers of critical products and services. The Company regularly assesses these suppliers as to the quality of their products and services, and of their financial stability.

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 significantly, which would in turn have a negative effect on its bottom line. The Company is actively involved in the conduct of the proceedings, elaborates corroborating position papers and retains the services of external law firms specialising in the law pertaining to the substance of the dispute.

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

4.2 The telecommunications market in the Czech Republic

4.2.1 Trends in the market of fixed services

In the area of fixed access, the telecommunications market in the Czech Republic in 2013 was characteristic mainly of increases in the speed of broadband home internet and lower prices due to bundled services.

On 27 January 2013, UPC Česká republika, a.s. (UPC) started providing four new fixed voice tariffs called Telefon 30, Telefon 100 and Telefon 200 and Volám pevná. UPC followed up with new triple-play (cable TV, internet and calls) bundles.

In the middle of March, Telefónica CR unveiled three new fixed internet access tariffs, which were offered up to one third more value compared to the previous proposition. The Company started marketing the tariff Start+ for CZK 353 per month; Optimal+ for CZK 505 per month; and Aktiv+ for CZK 606 per month. Telefónica CR also offered its customers an economical xDSL internet access and digital O₂ TV.

In June, Telefónica CR launched its new fixed voice proposition. The names of the tariffs indicated the number of free minutes that came with the tariff: Volání CZ 50 for CZK 430, Volání CZ 80 for CZK 520, Volání CZ 200 for CZK 560, and Volání CZ 500 for CZK 700. The tariffs could be subscribed at a discount in combination with fixed internet.

In September, UPC came out with a new home internet tariff offering a higher download speed of up to 240 Mbps without FUP restrictions. Concurrently, UPC also introduced its more economically-priced proposition to students. In September, UPC started offering a combination of 240 Mbps internet with over one hundred television channels. UPC customers could also subscribe Fiber Power 40+ with data download speed of up to 120 Mbps.

4.2.2 Trends in the market of mobile services

In 2013, the Czech mobile telecommunications market saw many changes, of which the most revolutionary was the introduction of unlimited tariffs, which had been brought to the market first by Telefónica CR. The operators continued with the development of the fourth-generation mobile networks using the LTE technology. A number of new players in the form of virtual operators entered the market landscape.

On 27 January 2013, T-Mobile Czech Republic, a.s. (T-Mobile) came out with its new range of mobile internet bundles offering a bandwidth cap from 150 MB to 30 GB and a speed up to 42 Mbps.

On 21 February, Telefónica CR announced the easing of bandwidth caps for selected data tariffs. The increase concerned the majority of mobile internet users and frequent smartphone users. The tariff for occasional small-screen internet users remained as was.

On 8 March, the CTO ruled to cancel the spectrum auction for 800 MHz, 1,800 MHz and 2,600 MHz, which it had called in 2012. In August 2013, the CTO called a new auction, of which the results were announced in November. All the spectrum which was auctioned off was divided into the three existing operators. Telefónica CR secured the most in-demand 800 MHz spectrum in two blocks (2x5 MHz each); it also acquired three blocks of the 1,800 Mhz spectrum (2x1 MHz each) and four blocks of the 2,600 MHz spectrum (2x5 MHz each).

On 11 April 2013, Telefónica CR launched unlimited tariffs as the first operator in the Czech market. The unveiled proposition included three tariffs: FREE O2 with unlimited on-net calls and SMS for CZK 249 per month; FREE O2 Plus with 120 free minutes and 150 MB data allowance for CZK 499 per month; and FREE CZ with unlimited on-net and off-net calls and SMS and 1 GB data allowance for CZK 749 per month. These prices were for the option with a two-year commitment; the tariff could also be subscribed without a commitment. When the free minutes and SMS included with the tariff are used up, customers will pay CZK 3.50 per minute of call and CZK 1.50 per one SMS. In connection with the launch of the new tariffs, Telefónica CR also introduced changes to its retail proposition of mobile devices. When buying a new device, customers can split the payment into instalments. Subsidies in exchange of minimum monthly spend were abolished.

Two days after the launch of FREE tariffs, Vodafone Czech Republic, a.s. (Vodafone) and T-Mobile also came out with their unlimited proposition. T-Mobile introduced its unlimited tariff *S námi síť nesít*, which included 1 GB data allowance, for CZK 749 per month conditional on a two-year commitment. T-Mobile subsequently raised the data allowance for the highest tariff option to 1.5 GB. Vodafone introduced an unlimited calling and SMS tariff and 600 MB data allowance for CZK 691 per month with a two-year commitment.

Telefónica CR's LTE network expanded to include Prague. From 15 May, a mobile data service at a speed of up to 75 Mbps was made possible due to several dozen of transceivers in the capital city, in particular in Prague 1, Prague 2, Prague 4 and Prague 10. Vodafone went live with its LTE 1 service in Karlovy Vary on 1 July; on the same day, T-Mobile commenced the LTE pilot operation in Prague 4 and Mladá Boleslav. By the end of October, Telefónica CR covered also a large part of Brno with LTE service.

In May, T-Mobile introduced a new international voice and data proposition. Roaming has been split into three main zones; data roaming has also been revamped.

In June, Vodafone started marketing its new prepaid card *Karta na míru*. If the customer topped up for a minimum of CZK 250, all calls for a period of 30 days were automatically charged at CZK 2.50 per minute. The promotion ran until the end of 2013.

On 1 July, Telefónica CR presented its innovated roaming offer to the market. All customers who had activated Eurotarif were automatically given cheaper rates: CZK 7.45 per one minute of an outgoing call (originally CZK 8.70 per minute); CZK 2.15 per one minute of an incoming call (originally CZK 2.30 per minute); and CZK 2.45 per one SMS (originally CZK 2.60). Data downloads under Eurotarif were charged at CZK 14 per one MB (originally CZK 20 per one MB).

In October, Telefónica CR and T-Mobile signed an agreement to share their existing second-generation and third-generation networks.

In September, Vodafone followed up on its recently launched Red tariffs and came out with a proposition for children.

On 8 October 2013, T-Mobile unveiled a new brand, Kaktus, which targets young people. The Kaktus prepaid card offered nine modular bundles. The Kaktus does not charge for Facebook usage.

In October, Telefónica CR launched NA!VÝBĚR, a new prepaid card. The basic per-minute rate, which applied to all networks, was CZK 4.90, and one SMS was for CZK 1.90. After a top up for at least CZK 200, the per-minute rate on calls to all networks was brought down by almost a half to CZK 2.50.

Also in October, Vodafone came out with its new prepaid card called Karta pro partu. The tariff offered a special rate of CZK 1.90 on calls to four on-net numbers of choice.

In December, Vodafone started offering the service of Turbo Internet, a fast data network in the 900 MHz spectrum, which uses the LTE technology (in rural areas) or the 3G network (in urban areas).

Close to 50 new players emerged in the virtual operator market in 2013. Telefónica CR forged a partnership with Tesco Stores, forming the MVNO Tesco Mobile, and with ČEZ, forming the MVNO Mobil od ČEZ.

4.2.3 Regulation

Several changes occurred in 2013 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 which governs the area of electronic communications:

- 1) Adoption of the Act No. 214/2013 Coll. by the Czech Parliament, amending the Act No. 127/2005 Coll., on electronic communications, and on the amendment to some related laws (Electronic Communications Act). The amendment of the Electronic Communications Act imposes on electronic communications services providers (including Telefónica CR) namely the following significant duties relating to contracts

for the provision of a public service of electronic communications and contracts for the connection to a public communications network:

- the duty to allow the customer to cancel a fixed-term contract at the same terms and conditions that apply to open-ended contracts;
- the duty to provide to the customer, in the form the customer had chosen to receive bills, information regarding the way of cancellation of a fixed-term contract, which contains a clause on an automatic renewal, between the third and the first month prior to the expiration of the current term of the contract;
- the duty to state in the contract the amount the customer has to pay in the event of before-term contract cancellation (e.g. a contractual penalty), while the amount to be paid may not exceed one fifth of the sum of flat monthly payments (or minimum charges) remaining until the agreed end of the term of the contract, and the amount corresponding to the cost of the terminal equipment provided to the customer at preferential terms;
- the duty to give the customer a written statement of all contractual requirements as per the law (approximately 26 items); immediately and after each instance of a remote conclusion or amendment of a contract; upon failing to provide information as per this point, the start of the statutory period in which the consumer can cancel the contract or its amendment, which had been concluded remotely or outside commercial premises, is postponed until the moment when the consumer receives the information as per this point in writing.

A breach of any of the above duties will result in an imposition of a fine up to the limit of CZK 20 m by the Czech Telecommunication Office.

- 2) Adoption of the Decree No. 462/2013 Coll., superseding the Decree No. 486/2005 Coll., as amended by the Decree No. 73/2013 Coll., laying down the amount and method of payment of the costs effectively incurred in installing and securing telecommunication terminal equipment for message interception and recording, for maintaining and provision of traffic and location data, and for the provision of information from the database of subscribers to the publicly available telephone service.

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 CTO retracted its draft price decision for call termination in fixed public networks based on a cost-plus model (the so-called BU-LRIC method) after receiving comments from the European Commission in December 2012. The new proposal of regulated maximum prices for the termination of calls in fixed public networks was not released in 2013.

Based on price decisions CEN/7/12.2012-5 and CEN/7/02.2013-1, the maximum regulated price for call termination in mobile public networks was reduced, with effect from 1 January

2013, to CZK 0.41 per minute for new contracts, and, with effect from 1 April 2013 also for existing contracts. The application of the BU-LRIC costing method to the mobile termination rates reduced the maximum regulated prices further to CZK 0.27 per minute, with effect from 1 July 2013. Telefónica CR objected to the costing model used, and employed available legal means in its challenge.

A price decision, CEN/4/06.2013-3, was issued in the first half of the year for the service of Local Loop Unbundling, which reduced the monthly lease charges for the metallic cable from CZK 197 down to CZK 179 for full access, and from CZK 39 down to CZK 30 for shared access.

In 2013, the CTO continued with the third round of the relevant markets analysis and invited comments to draft market analysis papers for market no. 1 – access to a public telephone network at a fixed location; no. 2 – call origination in a public telephone network at fixed location; no. 3 – call termination in each individual public telephone network at a fixed location; no. 4 – wholesale (physical) access to network infrastructure (including shared or full local loop unbundling) at fixed location; no. 5 – wholesale broadband access in electronic communications networks; no. 6 – wholesale terminating segments for leased lines regardless the technology used for making leased or reserved capacity available; no. 7 – call termination in individual mobile telephone networks; and no. 8 – access to and call origination in the public telephone network. Following the markets analysis, the CTO invited comments to its proposal for determination of significant market player (in the relevant market no. 2), its draft decisions imposing certain duties (in the relevant market no. 2), and to its draft price decisions (in relevant markets nos. 2, 4 and 7).

International roaming regulation

A new regulation of international roaming, which defines the regulated roaming services and prices in the EU 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 the regulated roaming voice, SMS and data prices, and strengthened the protection of the end users. As required by the roaming regulation, the Company published its mandatory reference offers.

As of 1 July 2013, retail incoming call rates were adjusted to meet the following maximum regulated prices: CZK 2.18 per minute of an incoming call; CZK 7.47 per minute of an outgoing call; CZK 2.49 per one SMS; CZK 14.01 per 1 MB of data.

Imposition of duties related to the Universal Service

Telefónica provided the following services during 2013 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 charged Telefónica CR with the duty to provide the service in municipalities under 1,999 residents from 1 January 2013. In municipalities over 2,000 and under 4,999 residents, the Company is bound to operate one public payphone or similar equipment if the location in question is not covered with a GSM signal of sufficient quality. The arrangement under (a) applies until the end of 2014.

Regarding the services under (b), the CTO decided that the Company 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 Company continued to meet its duty to offer special pricing to nominated categories of persons with disabilities under the Universal Service obligation imposed by the CTO, for a period of three years commencing on 2 July 2011.

Funding of the Universal Service

In mid-2013, Telefónica CR submitted 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 2012. The CTO proceeded to verify the amount of the claim and examine the underlying documents supplied with the claim. The payments in the amount of CZK 50,136,727 and CZK 96,813,185 to cover for the loss incurred as a result of the Universal Service Provision and for the loss incurred as a result of provision of special pricing, respectively, were remitted by the CTO in November 2013.

State policy and support in the area of broadband internet access

With respect to the objectives stated by the European Commission in the Digital Agenda for Europe, the Czech government approved an updated version of its digital policy - Digital Czech Republic 2.0. To meet the objectives of the state policy, the CTO carried out a survey of penetration of the country with infrastructure for broadband internet access. The conclusions of this survey will be used as one of the arguments for decisions on the potential application of state aid to the deployment of new generation networks. Keeping with the objectives of the Digital Czech Republic 2.0, the CTO also published General rules and recommendations for the use of data traffic management in the provision of Internet access service, which is to become one of the fundamental instruments in support of compliance with the network neutrality principles.

After the spectrum auction for 800 MHz, 1,800 MHz and 2.6 GHz had been cancelled and a new auction had been called, the government's plan to use a part of the proceeds from the auction in support of the development of broadband internet was not pursued in 2013. The possible earmarking, by government decision, of some of the proceeds from the spectrum auction to the cause of broadband internet development would not happen before 2014.

Structural funding from the EU continued to support various projects in the area of ICT development in public institutions as well as in the private sector.

The European Commission put for public consultation its draft regulation on measures to reduce the cost of deployment of high-speed electronic communications networks.

The Czech government continued with the drafting of operational programmes of the EU Structural Funds for the programming period 2014 –2020. The ICT area falls, for the most part, under the Operational Programme Enterprise and Innovation for Competitiveness, which plans to fund, through subsidies, the rollout of broadband internet networks.

The Company is constantly monitoring funding options offered to customers by the Structural Funds, and modifies its products and services so that they are eligible for subsidies. Telefónica CR also successfully participated in tenders for projects co-funded from the Structural Funds.

Telefónica CR is a member of prominent industry associations that work to develop the market in electronic communications in the Czech Republic: ICTU (Association for Information Technologies and Telecommunications), APMS (Association of Mobile Network Operators), ČAT (Czech Telecommunications Association) and ČAEK (Czech Association of Electronic Communications).

The Company is also a member of several other structures that are important for its activities: HK ČR (Chamber of Commerce of the Czech Republic), SDT (Association for Telematics in Transport) and others.

4.3 Consumer segment

In the consumer segment, the launch of the new unlimited FREE tariffs was the most significant market-changing moment in the Czech telecommunications landscape of 2013. With the new tariffs, customers no longer have to pay attention to who they are calling and when. At the end of 2013, close to one million customers subscribed to one of the new FREE tariffs, and because of ‘no limits’, they called 65% more than before.

O₂ TV playback function was another important innovation which Telefónica CR introduced to the Czech telecommunications market. The function allows for playing back any programme within 30 hours of its original broadcast time. At the same time, any programme can be paused and rewind at any time while it is playing. Customers are no longer hostages of the TV guide and they can enjoy their favourite programme also after it has been aired.

Also in 2013, Telefónica CR focused on customer experience. O₂ Guru consultants with special training provided free assistance with new technology in the brand stores – and not just to O₂ customers but to all who visited an O₂ brand store. Over the course of 2013, more than one hundred consultants saw to over 400 thousand requests for assistance. O₂ Guru Gurus are also present online and on social networks where they take questions from users via Facebook and Twitter.

The Company offered its customers many benefits via its loyalty programme Extra výhody, which was launched in autumn 2012. Customers could choose from a wide range of discounts with partners in a number of areas. In 2013, customers generated more than 2.2 million discount codes. During the existence of the programme, customers have saved close to CZK 400 m. All customers are eligible for discounts – regardless of whether they have a prepaid card, postpaid tariff, fixed line or an internet connection. Customers do not need a club card, they can enjoy O₂ Extra Výhody just with the mobile phone.

4.3.1 Internet

After the acceleration of the VDSL service in September 2012, when the maximum speed in O₂ network was increased to 40 Mbps, Telefónica CR continued to invest in the development of broadband internet also in 2013.

During the year, the Company increased the coverage of the VDSL network to include 120 thousand homes using remote DSLAMs. The highest download speed of 30–40 Mbps thus became available to just under one million households in the Czech Republic.

The number of customers using the faster VDSL service increased by more than 102 thousand year on year. The new customers recruited mainly from those who took advantage of the O₂ offer to upgrade their O₂ Home Internet to a higher speed. At the end of 2013, Telefónica CR registered approximately 362 thousand customers using the VDSL broadband internet service.

From the middle of March 2013 Telefónica CR has been marketed three new fixed internet access tariffs. The new tariffs preserve the economical monthly flat subscription fee for the whole duration of the commitment. The most demand from customers has been in Internet Optimal+ comes with the download speed up to 20 Mbps for CZK 505 per month. In addition to the standard proposition of Internet Optimal+ and Internet Aktiv, Telefónica CR offered also economically priced bundles of Home Internet and O₂ TV.

In 2013, Telefónica CR forged ahead with the deployment of the fastest LTE data network (4G) in the Czech Republic. In 2012, the Company was the first to bring LTE to the Czech market, and in 2013 it was again the first to cover most of Prague and Brno with the service.

The whole O₂ 3G network now runs faster thanks to the deployment of the new HSDPA and HSPA+ standard in some locations. The theoretical maximum speed in the whole O₂ 3G network increased to 14.4 Mbps, even to 21 Mbps or 42 Mbps in some locations. The actual speed is contingent on the type of modem and mobile device used.

The Company also continued with the implementation of Circuit Switch Fallback, which is a technology allowing for LTE data and mobile voice. Live operation is planned for the first quarter of 2014.

At the end of the year, the Christmas campaign reached out to O₂ customers with the attractive proposition of 3G tablet Samsung Galaxy Tab 2 with mobile internet from CZK 397 per month. The offer was valid for O₂ customers of selected voice tariffs, fixed internet access or O₂ TV.

4.3.2 Fixed access and IPTV

In 2013, the O₂ TV digital television service underwent a major overhaul. As of 15 July, the Company introduced a new user environment with the unique Playback function, which allows for viewing any program within 30 hours from its original broadcast; the program can also be paused or rewound back to start from the beginning at any time while it is being played. Another innovation lets the viewer make their own order of channels or record a programme. The new O₂ TV now also comes with a new stylish set-top box.

The migration of the base of 140 thousand existing O₂ TV customers began at the end of September 2013, and it was scheduled to be completed at the end of March 2014. The migration of the existing customer base into the new environment is unique in the fact that it does not require that the customers replace the set-top box as it is done remotely.

The new O₂ TV platform delivered a long-term positive trend in net customer adds compared to the competition. The number of O₂ TV thus increased 10.3% year on year.

The content proposition of O₂ TV was also enhanced considerably during the year; 32 new channels were added, including some in HD quality. All O₂ TV customers were treated to Slovak Sport.TV2 with broadcasts of the Premiere League for free until the end of the year, courtesy of the Company. In 2013, Telefónica CR was the only distributor of this attractive channel content.

Also the O₂ Videotéka (video on demand) was also revamped and it now gives the customer a choice from a catalogue of more than one thousand titles.

The number of customers using fixed internet access from Telefónica CR went up 0.4% (from 915 thousand to 919 thousand) year on year (December 2012 vs. December 2013), while the number of O₂ TV digital television increased 10.3% (from 141 thousand to 156 thousand).

4.3.3 Mobile services

In January 2013, the Company came out with its new roaming proposition Volání bez hranic, which offered very economical roaming calls and SMS also to prepaid customers. Incoming and outgoing calls are charged at CZK 3.90 per minute, and the same rate applies to one SMS.

In April Telefónica CR redraw the landscape of the mobile market when it unveiled its new unlimited FREE tariffs. There were three tariffs to choose from: FREE O2 with unlimited on-net calls and SMS for CZK 249 per month; FREE O2 Plus with 120 free minutes and 150 MB data allowance for CZK 499 per month; and FREE CZ with unlimited on- and off-net calls and SMS and 1 GB data allowance for CZK 749 per month. Customers could subscribe any of the tariffs at a discount of CZK 100 if they had any other services from the Company. Telefónica CR also gave CZK 50 off to young people under 26 years of age and senior citizens of 60 years of age and older.

At the same time as the FREE tariffs, Telefónica CR introduced O₂ Mobil, which gave customers the option to split the price of a new mobile phone or tablet into instalments over

time. Those wishing to take advantage of O₂ Mobil can choose how much they want to pay when they sign the contract. The remaining amount is split over the course of the next 24 months. No additional interest or charges apply.

A month after the launch of the FREE tariffs, the Company started marketing weekly bundles of unlimited calls, SMS and internet to prepaid customers. In 2013, several tens of thousands people took advantage of the bundled proposition.

In summer 2013, Telefónica CR ran its second promotion with Coca-Cola, the producer of soft beverages. For every code printed on the reverse side of a 0.5 litre Coca-Cola bottle, customer received five minutes of free calls to all network and another five minutes for a friend. More than 1.2 million minutes were given away during the promotion; the under 19 age group was the most represented amongst those who participated.

In October, Telefónica CR started marketing NA!VÝBĚR, its new prepaid card, which, after every top-up gives the customer a benefit of his choice for the next 30 days. Customers could choose from on-net calls charged at CZK 1.90 per minute, 100 free SMS to all networks, free on-net calls on weekends or calls to all networks charged at CZK 2.50 per minute.

In November, the Company offered its customers Mobile Internet at a discounted monthly subscription fee: Mobile Internet M for CZK 202; Mobile Internet L for CZK 303; Mobile Internet XL for CZK 555. Existing customers were eligible for the cut-price Mobile Internet if they had at the same time also any of selected voice tariffs (FREE or Neon), Home Internet or O₂ TV. The promotion was also open to customers who subscribed any of these services at the same time as Mobile Internet.

4.4 Corporations and government

The integration of small and medium business customers into Telefónica CR's Corporate Division significantly improved the customer experience. The network of sales representatives has been bolstered; sales representatives are now ready to help their clients in the field and on the line, and they also regularly contact their clients. The integration also produced improvements in processes and made them more effective, which has in turn helped reduce the number of claims by more than 60%. Customers can now reach the customer service easier and faster; the call is not routed to an interactive voice response system but to live operators who are standing by to attend to any request from business customers. As for new business acquisition, in 2013 the Company won a number of major contracts, especially in government and banking.

4.4.1 Telecommunications services

The area of mobile services saw a revolution in the form of the FREE tariffs on the consumer side of the market, hand in hand with VARIO profiles for medium business and corporate customers. The mobile VARIO proposition follows the current trend in information and

telecommunication technology, allowing a greater degree of customization of services to suit different sizes of businesses.

More than 50% of business customers switched to VARIO tariffs in 2013, and it had a positive effect on customer satisfaction. VARIO tariffs also helped to more than double the penetration of Internet on Your Mobile.

In the area of fixed internet access, Telefónica CR concentrated on improving the availability of symmetrical internet connection (Internet Business), with 700 new locations added.

A new product range of new-generation fixed services which, in addition to connectivity, natively include also an independent back-up, virtual pabx switchboard and a cloud-based security solution, pro-active functionality for dealing with service downtime and a secure remote access to the corporate network.

The VoIP platform has also been revamped and now allows the provision of more sophisticated services, such as those of a call centre, or the integration of a fixed line with the Outlook client.

As part of the migration of premium rate numbers to a new platform, the portfolio was significantly streamlined, with the services now having better availability due to a geographically independent redundancy built into the system.

The Company came to an agreement with Orange Business Services, a global TELCO provider for the Société Générale group, that the all-inclusive telecommunications contract for Komerční banka, a.s. would be extended for an additional period of 60 months.

In the area of government, the Company forged ahead with its strategy of increasing the penetration of basic services (mobile voice, fixed voice and internet) in the regions. Telefónica CR connected additional organisations in the region of Pardubice and South Moravia, and won a public contract in the region of Hradec Králové.

Two elections were held in 2013: presidential elections in January and early parliamentary elections in October. In both instances Telefónica CR was the provider of data communication to the Czech Statistical Office with a network of more than 550 data collection locations covering all of the Czech Republic.

Moreover, the Company added another 10% to the number of polling stations to which it provides a telephone connection with the supervising election committees – either via mobile connection, which was the preferred solution, or via a fixed line.

4.4.2 ICT

Telefónica CR is a technology company well positioned for meeting the needs of discerning customers in the area of telecommunications, IT or a combination of these two. In 2013, the Company continued to strengthen its strong position as a provider of telecommunications and IT services.

The many years of experience and global know-how of the Telefónica Group rank the Company on the vanguard among ICT providers in the Czech Republic, both in terms of the scope and diversity of service and the technological superiority and expertise. In 2013 Telefónica CR secured several key certificates: TIER III certification for all O₂ data centres; it also qualified for the programme VMware Service Provider – Premium; defended its Microsoft GOLD partner status; and successfully recertified to the new version ISO 20000 standard.

The process of TIER III certification is very demanding and complex; only about 350 data centres are certified globally. O₂ data centres are the only commercial data centres in Central Europe to have TIER III certification. O₂ data centres are also the only TIER III certified data centres in the Czech Republic which operate on a commercial basis. They are managed according to superior and robust international standards and deploy state-of-the art technology; they are situated outside flood zones and are protected against fire and other natural disasters. They have the capability to host even the most critical applications which require the highest degree of availability. Telefónica CR's data centres also meet the criteria of PCI DSS (Payment Card Industry Data Security Standard) for manipulation with data of payment card holders.

In 2013, Telefónica CR started offering modular Housing services – a proposition of data centre services for all clients regardless of their size. The Company's data centres now offer also a comprehensive scale of service options (dedicated racks) ranging from 3U to 42U, and from UU to 4U in the case of shared racks.

In 2013, Telefónica CR introduced the service Mobile Device Management, which is an efficient tool for mobility management in organisations, management and implementation of security policies in connection with mobile devices, and that for the whole lifecycle of such devices in the organisation's environment. On the O₂ Mobile Device Management platform, an organisation can systematically and comprehensively manage the ever-increasing stock of its various mobile devices, wherever in the world they happen to be. The platform is a centralised solution for the management of mobile devices, it gives a global overview of the mobile environment in real time. It supports the implementation of a consistent security policy across the whole IT and mobile device landscape and makes compliance with all security requirements possible. Data transmission is completely secure and, because of content supervision, the platform protects against loss of sensitive data. It has also automated a number of processes connected to implementation of security solutions in organisations and to the integration, management and de-commissioning of mobile devices in the IT environment of an organisation. The O₂ Mobile Device Management platform is a cloud computing solution, which makes for a very fast deployment and commissioning.

Telefónica CR's O₂ Mobile Device Management was awarded as Product of the Year 2013 from ComputerWorld magazine.

The Company came out with a version of O₂ Car control designed specifically for smaller businesses and integrated advanced security functions into the application; the service is the

only one of its kind in the country to offer this functionality, which also makes Telefónica CR customers eligible to reduced insurance rates. Customers can now be notified of speeding violations committed by their drivers, or if a vehicle travels outside a specified area.

4.4.3 Customer care

Customer satisfaction is a key priority for the Company. Telefónica CR constantly strives to improve it through offering the best services in the market hand in hand with the best customer care.

Also in 2013, Telefónica CR continued to develop its hardware portal (www.firemnitelefony.cz), which it launched in 2012. In addition to functionality that guides the customer through the process of selection and purchase of subsidised and unsubsidised hardware, manage his bills, place orders and lodge complaints, the portal has been expanded to include new features, such as a revamped product menu and dynamic filters which help customers with choosing equipment by defined parameters, functionality and technology; the English version of the portal went live, as did the shopping cart chat. Dozens of tweaks which had originated from customers themselves, their behaviour, research and internal testing were implemented. In 2013, purchases in the value of CZK 502.6 m (excluding VAT) were made through the portal, and the sale of handsets via the portal accounted for 42% of all handset sales of the Company.

In 2013, O₂ Exclusive, a programme for the Company's most valued customers who chose Telefónica CR as their provider of most of the telecommunications services, was expanded to include also ICT services and other innovations.

In addition to benefits such as Exclusive care, Guaranteed service quality, regular warranty meetings and lower prices on mobile devices, the customer can now ask for ICT consulting. Specialists will analyse the IT in the customer's company for free and, if necessary, make suggestions how to make corporate ITC more effective and efficient. This benefit also comes with an offer of ICT training and courses for IT professionals from the exclusive partners. Customers have a choice of consulting areas: Architecture, Networking, ITIL, Security and Project Management from a catalogue of ICT consulting. As part of O₂ Exclusive, the customer can also try out some data or ICT services such as Cloud, VDI, M2M, Web Security Gateway or Car Control free of charge for a month.

Another innovation to Exclusive Care is the so-called Exclusive Doma (Exclusive Home), which of this programme, guarantees the best level of care also for services the customers use at home. An exclusive customer can nominate several of his executives or family members who will receive the same premium standard of care and will be served by the corporate line without waiting, with a guaranteed standard and quality of care.

A special 'payment summary report' goes out every month to customers who are members of O₂ Exclusive, giving them an overview of all their payments for the past month and charted trend of the previous six months.

As part of its guaranteed quality promise, Telefónica CR makes a regular monthly report to the customer, detailing the usage of all customer's lines and the delivery against the Service-level Agreement (SLA) by which the Company is bound to the customer.

Last but not least, the Company innovated its cut-price hardware proposition and expanded its service portfolio to include, among other things, O₂ Desktop, as well as many other services.

As at the end of 2013, Telefónica CR had over four thousand O₂ Exclusive customers, for the most part from the Medium and Top Corporate segments.

The programme O₂ Extra výhody expanded its range of benefits and discounts to include also those which are more suitable for business customers. Business customers can now claim the benefits from the programme for their private or business use. Corporate customers can not only enjoy the benefits of the programme but they can also become its partner and offer their products and services.

In 2013, Telefónica CR went live with Moje O₂, an online self-service shop for business customers.

Business customers visiting www.mojeO2.cz will find their electronic bill and a self-service function to view and manage their mobile and fixed access services. Each user who is registering/logging in Moje O₂ for business customers can be assigned a role by his company, which mandates him to perform specific actions at Moje O₂.

4.5 Wholesale services

National wholesale services

The long-term trend of rising demand for higher quality and faster xDSL service in the wholesale market again led to an increase in the total number of services. The year-on-year increase in the number of xDSL accesses reached 12%. At the same time, the number of VDSL accesses more than doubled; at the end of the year, VDSL accesses accounted for 23% of total accesses.

The declining market prices of telecommunication services significantly impacted also on the wholesale leased lines and Ethernet-based services. Despite the increasing connection speeds, numbers of accesses and the acquisition new business, these services are seeing a stagnating revenue trend.

The year 2013 also saw a number of contracts for large infrastructure projects either won or successfully bid for in tender – either in progress or reaching conclusion. The most prominent projects were those for mobile operators and for the academic network CESNET.

International wholesale services

International data and internet

The growing demand for international transmission capacity generated demand from Telefónica CR's international wholesale partners for transmission capacity provided by the Company. The volume of international IP connectivity of Telefónica CR grew as did the volume of Ethernet-based and IP MPLS services.

International voice services

The Company continues to be the leading provider of transit voice services in the region to a number of mobile, fixed and VoIP access operators from other countries. Compared to the previous year, the volume of traffic grew by more than 20% and reached 3 billion minutes. The volume of transit calls increased significantly in the O₂ network - terminating not only in countries of Eastern Europe, in particular the CIS, but also in some African and Asian countries. The Company managed to maintain a high standard of its voice services, which helped it strengthen its leadership among transit operators in the region of Central and Eastern Europe.

Public payphones

The Company continued with the optimisation of its network of public payphones. The total number of public payphones was reduced to 13,200 in 2013.

Also in 2013, 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.

4.6 Network interconnection

As at 31 December 2013, Telefónica CR's fixed access network in the Czech Republic was interconnected with 14 networks of fixed access providers and with three networks of mobile access providers. Analogously, the mobile network was interconnected with the networks of 10 fixed access providers and with the networks of three mobile access providers. A direct interconnection of the fixed access network with that of UPC was successfully negotiated and implemented, which led to a drop in the transit traffic via GTS Czech. Despite the interconnection of the fixed access networks, the volume of voice traffic went down slightly, especially the volume of outgoing traffic from the O₂ network; however the volume of traffic in the interconnected mobile networks surged after the introduction of the FREE tariffs, both on the incoming and the outgoing side. The total balance of interconnection payments is positive. On 1 September 2013, a new Number Portability process for mobile and fixed networks was negotiated with operators and successfully implemented.

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

The number of users of services of other operators using the Wholesale Line Rental (WLR) service from Telefónica CR did not change in any significant way in 2013.

The number of CS/CPS clients continued to fall in terms of both their number and the volume of traffic. CS/CPS services are nowadays used mostly by corporate clients of operators whose networks are interconnected with the networks of Telefónica CR.

4.7 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. In 2013, customers in the O₂ network paid for goods and services worth close to CZK 800 m. The customer has a choice of several methods of payments; the most widely used method is via Premium SMS, which, in 2013, was opted for on average by 395 thousand customers per month. 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 12. For instance, the service was introduced in Brno, the metropolis of South Moravia.

The number of places where private or public parking can be paid for with a Premium SMS has grown (to the total of 38 locations), and the possibility of payment of the regulation fee at general teaching hospitals in Prague, Benešov, Pilsen and Zlín was introduced. DMS, the donor SMS, is a special project which makes it easy to contribute to a charity of choice. In August 2013 Telefónica CR decided to provide DMS (donor SMS) service to Fórum dárců, o.s. free of commission.

The so-called Audiotex (Premium-rate Telephone Number) service was the second most popular payment method. In February 2013, a new consumer law came into force which banned the Audiotex service from being used for as a marketing and payment platform in relation to consumer loans. In order to improve the customer experience of this payment method, Telefónica CR subsequently extended the aforementioned restriction also to business loans.

Also in 2013, Telefónica CR collaborated with other mobile operators on the platform of the Association of Mobile Network Operators in support of the campaign ‘Plat’ mobilem’ (Pay with Your Mobile, www.platmobilem.cz). The campaign promotes mobile transactions in the amount between CZK 10 and CZK 1,500 that can be made using a mobile data capable mobile telephone. Telefónica CR offers the service, m-platba, in its portfolio. The website www.platmobilem.cz also informs customers of the main principles and applications of mobile payments.

The year 2012 saw Telefónica CR enter – as the first mobile operator in the Czech Republic – the market of payment cards, when it implemented the first edition of contactless payment cards for the mobile phone for Komerční banka. In 2013, Telefónica CR entrenched its position as the market leader in NFC technology in the mobile phone, and became the first, in

collaboration with GE Money Bank, the service of installation of a mobile payment card over the air – through a remote data connection over the mobile network directly to the customer's SIM card. The new way of service installation (of the mobile payment card) has helped greatly to simplify the process of card delivery for the bank and for the customer. The customer can now order the card from the comfort of their home via internet banking, and the new card is then remotely installed directly in the mobile phone. Telefónica CR has had a big share in GE Money Bank's gold medal for the NFC-capable mobile payment card at the Zlatá koruna awards for the Most Innovative Payment Product of 2013.

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.

During the course of 2013, the number of Telefónica CR customers with an NFC-enabled phone capable of mobile payments has increased threefold and reached 150 thousand. While in 2012 only one brand (Samsung) produced NFC-enabled phones capable of mobile payments, in 2013 other brands (Sony, HTC) followed suit.

Worldwide, the Telefónica Group operates around 300 thousand payment terminals which process 600 million payment transactions every year. After an analysis of the potential of the Czech market, a pilot phase of project of mPO₂S – mobile payment terminal – was started. It is a mobile solution for accepting payment cards, designed especially for small and medium businesses that presently do not meet the qualification criteria for a POS terminal from the five acquiring banks, and thus cannot offer the possibility of paying with a card to their customers. The new solution is modern, accessible and, most importantly, mobile. It aims to reduce the number of points of sale where people cannot pay with a physical or a mobile card. This product has earned Telefónica CR a MasterCard Award for Acquiring Innovation of 2013.

4.8 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 47.9 bn in 2013, down 5.2% year on year. The decline was driven by the continued competitive pressures, especially in the corporate and SMB mobile segments, and by regulatory measures (mobile termination rate/MTR cuts and

lower roaming prices). These negative impacts were mitigated in part by the growth of revenues from data services and by the continuing revenue growth in Slovakia (CZK 5.4 bn in 2013 compared with CZK 4.8 bn in 2012).

Other income including capitalized own expenses on fixed assets reached CZK 867 m in 2013, down 23% year on year. The main item in this category in 2012 was the net profit from the one-off 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 declined 5.0% year on year, reaching CZK 30.3 bn in 2013, as a result of the Group's continued focus on efficiencies in this area.

The operating income before depreciation and amortization (OIBDA) in 2013 amounted to CZK 18.5 m, down 6.6% year on year, which is less than the year-on-year decline in 2012 (- 9.2%). OIBDA adjusted for guidance⁶ declined 6.4% year on year, reaching CZK 19.6 bn in 2013 (an improvement compared with the -8.9% decline in 2012), while the corresponding OIBDA margin⁷ grew 0.1 percentage point year on year (an improvement compared with the - 2.4 percentage points in 2012), reaching 41.5% and beating the Group's guidance⁸ given at the beginning of the year. This represents an above-average margin in comparison with other telecommunication operators in the CEE region, and comes as a result of a focus on cost efficiency and the growing OIBDA in Slovakia (CZK 1.8 bn in 2013, up from CZK 1.4 bn in 2012).

Operating Income, Income before Tax and Net Income

The consolidated operating income and consolidated income before tax went down 10.8% and 10.9% year on year, respectively (in 2012 17.7% and 18.5%, respectively) and reached CZK 7.4 bn and CZK 7.3 bn, respectively, in 2012. The consolidated net income amounted to CZK 5.7 bn in 2013, down 16% year on year (down -22% in 2012). The key driver was the declining OIBDA, which was not fully compensated by the lower depreciation and amortization.

Property, plant and equipment

The net book value of property, plant and equipment reached CZK 41.9 bn as at 31 December 2013, compared with CZK 46.7 bn at the end of 2012. The major items included ducts, cables and related plant (CZK 21.6 bn), land, buildings and construction (CZK 9.9 bn), and communication technology and related equipment (CZK 9.5 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 changes in technology. The Group intends to dispose of any obsolete assets or assets, which are not directly employed in connection with its core business activities. In 2013, the Group achieved a total gain of CZK 62 m from the sale of the above fixed assets.

⁶ OIBDA excluding royalty fees and management fees (2012: CZK 1,138 m, 2013: CZK 1,111 m)

⁷ OIBDA excluding royalty fees and management fees over revenues

⁸ Limited margin erosion (2012: 41.4%)

Cash and Debt

As at 31 December 2013, the Group's consolidated financial debts (long-term and short-term) amounted to CZK 3 bn, with no change from the end of 2012. Further details are given in section Other information for shareholders and investors. At the same time, cash and cash equivalents reached CZK 3.90 bn at the end of the period.

Capital expenditure

The total consolidated capital expenditure (CapEx) reached CZK 5,673 m in 2013, down 10.9% year on year. The Company continued to focus on efficient investments in growth areas. These include mainly further capacity expansion and improvement of the quality of the mobile broadband network, in line with the growing demand for mobile data services. In the first half of 2013, the Company commenced the deployment of its LTE network in its existing 1,800 MHz band spectrum, and on 15 May 2013 it launched LTE service in selected parts of Prague, followed by LTE rollout in Brno in October 2013. Additionally, the Company directed its investments into the capacity enhancement in its fixed broadband networks by expanding its VDSL network. Detailed information on capital expenditure in 2013 is disclosed in section Other information for shareholders and investors.

Cash Flow

The total consolidated free cash flows⁹ grew 3.2% year on year and reached CZK 11.584 m in 2013; a combination of a 0.4% growth in cash from operating activities, largely due to the focus on working capital management and lower interest and tax payments, and a 4.9% decrease in cash used in investing activities, despite lower proceeds from the disposal of property, plant and equipment and intangible assets (the 2012 result was positively impacted by the proceeds from the one-off sale of 80% of shares in the subsidiary Informační linky, a.s., to the amount of CZK 220 m). This result has been positively influenced by a decrease in CapEx, and the impact of the bid bond guarantee paid by the Company in the third quarter in connection with its participation in the spectrum auction held in 2013.

Overview of consolidated revenues

The total consolidated revenues in 2013 reached CZK 47.9 bn, down 5.2% year on year, mainly due to 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, monthly and one-off charges from voice services) reached CZK 25.9 bn in 2013, down 12% year on year. Outgoing voice revenues declined 16.5% to reach CZK 8.0 bn, as a result of 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 6.8 bn in 2013, down 7.0% year on year, on the back of the mobile termination rate cuts in the Czech

⁹ 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 higher transit revenues. Revenues from monthly and one-off charges from voice services amounted to CZK 11.1 bn in 2013, down 11.5% year on year, 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.

In terms of usage, the total mobile traffic¹⁰ carried in the O₂ network in the Czech Republic reached 10,782 million minutes in 2013, up by 12.4% year on year, supported by the success of the unlimited FREE and Vario tariff proposition. Voice traffic generated in the fixed network declined 15.1% year on year to 1,120 million minutes in 2013; this has been driven by the continued decline in the number of fixed voice lines and fixed-to-mobile traffic substitution.

The total mobile customer base in the Czech Republic reached 5.1 million at the end of December 2013, which represents a 2.6% year-on-year increase¹¹. Total net additions amounted to 132 thousand, excluding the adjustment due to good traction in the contract segment throughout 2013. The contract customer base grew 4.9%⁶ year on year in 2013, reaching 3.2 million. Net additions reached 158 thousand during the year, excluding the impact of the disconnection. The growth was fostered mainly by solid trading, sustained low churn and customers migrating from the prepaid to the contract segment after the launch of the FREE tariffs in April 2013. The number of prepaid customers reached 1.9 million at the end of December 2013, down 1.3% year on year as a result of the ongoing migration to the contract segment.

The blended monthly average churn rate reached 2.2% in 2013, while the contract churn was at 1.4%, with the effect of the above-mentioned adjustment in the customer base. Excluding the impact of disconnection of inactive customers, the churn remained low at 1.1%. The prepaid churn stood at 3.6% in 2013.

In 2013, the mobile blended average revenue per user (ARPU)¹² was CZK 325.2, down 16.3% year on year, mainly as a result of the mobile termination rate (MTR) cuts, and lower effective prices of the outgoing traffic due to the initial dynamics of the adoption of the new FREE tariffs by customers (initial optimisation followed by migration to a higher tariff) and the introduction of the Vario business proposition. Excluding the impact of MTR cuts, total ARPU would have declined 10.7%. Contract ARPU went down 16.4% year on year to reach CZK 433 in 2013. Prepaid ARPU decreased 17.1% year on year to CZK 144.1. The average data ARPU went down 1.5% in 2013 to CZK 110.0, which was caused mainly by the lunch of mobile internet bundled with voice, and the greater SMS/MMS allowance offered with the new FREE tariffs.

The total number of fixed accesses declined 7.4% year on year reaching 1,389 thousand at the end of December 2013, with 111 thousand net losses during the twelve-month period. The

¹⁰ Inbound and outbound, including roaming abroad, excluding inbound roaming

¹¹ Excluding the impact of inactive customers disconnection in Q1 2013 (114 thousand)

¹² Including inter-segment revenues

absolute number of disconnections was decreasing throughout the 2013; with 32 thousand in the first quarter and 23 thousand in the fourth.

In 2013, the total number of customers in Slovakia exceeded 1.5 million, and 1.54 million customers at the end of December 2013, which represents a 13.7% year-on-year growth. Their number increased by more than 185 thousand in 2013, with 68 thousand net additions in the fourth quarter as a result of the maintained solid growth dynamic in the contract and prepaid customer bases. The number of contract customers grew 17.4% year on year to 774 thousand at the end of December 2013 (115 thousand net adds in 2013), while the number of prepaid customers increased 10.2% year on year and closed at 766 thousand. The share of contract customers in Slovakia was at 50.3% of the total customer base at the end of December 2013, up 1.6 percentage point year on year).

The total data revenues grew 0.7% year on year and reached CZK 11.4 bn in 2013. Of that, the revenues from leased lines and fixed data services recorded a 12.9% year-on-year decline to CZK 2.2 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 declined 4.1% year on year, reaching CZK 5.3 bn, as a result of ARPU dilution driven by competitive pressures. The revenues from mobile data grew 24.1% to CZK 3.5 bn. This is a result of a successful marketing campaign focused on the promotion of smartphone sales, which accelerated the smartphone penetration to a 35% level at the end of 2013 (up 8 percentage points year on year), and growth in small-screen internet. This has been supported by the launch of new FREE 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 919 thousand at the end of December 2013, up slightly by 0.4% year on year, yet showing further improvement in xDSL access composition. In respect of VDSL, 362 thousand customers (up 39% year on year) have already subscribed for the upgraded service. VDSL reported 102 thousand net additions in 2013, out of which 72 thousand are net additions in the residential base, which represents 44% of the total xDSL residential base and 87% of the total addressable existing residential base (approx. 50% of all households). The total number of O₂ TV customers reached 156 thousand at the end of December 2013, growing 10.3% year on year, thanks to the new innovative IPTV platform launched in the third quarter of the year, which has been very well received by customers (13 thousand net additions in the second half of 2013).

Other consolidated revenues from telecommunications reached CZK 10.6 bn in total in 2013, which is a year-on-year increase of 8.4%. Of this, the revenues from SMS, MMS, PRMS and content services were down 8.5% to CZK 4.2 bn, mainly due to the more integrated SMS/MMS bundling. The revenues from equipment and activation charges reached CZK 2.0 bn in 2013, which translates into a 29% year-on-year growth. The revenues from ICT and business solutions reached CZK 2.5 bn, same as in 2012. 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 growth in the number of customers and the related higher commercial expenses, and the expansion of business activities, the total consolidated operating expenses of Telefónica CR Group went down 5.0% year on year, reaching CZK 30.0 bn in 2013. 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 of the performance.

Cost of sales decreased 2.9% year on year, reaching CZK 14.3 bn. The consolidated interconnection and roaming expenses went down 6.2% year on year to CZK 8.3 bn in 2013, 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 2.3 bn in 2013, which is a 9.5% year-on-year growth, related to growth of smartphones popularity and their representation in the sales mix. Other direct costs of sales declined slightly by 2.3% year on year to CZK 3.7 bn.

Staff costs including redundancy payments reached CZK 5.4 bn in 2013, down 6.9% compared with 2012. Excluding redundancy payments (CZK 368 m in 2013 and CZK 265 m in 2012), the staff costs declined 9.1% year on year, with a positive impact of the restructuring programme. The total Group headcount went down 770 in 2013; as at 31 December 2013 it stood at 5,607 employees, recording a 11.9% year-on-year decline.

Other operating expenses reached CZK 10.5 bn in 2012, down 6.6% year on year. This decline was driven mainly by lower network & IT repairs and maintenance costs. This cost category went down 12.2% to CZK 2.7 bn, as the efficiencies from the outsourcing of IT support services to Telefónica Global Technology materialised. Savings have been recorded also in billing and collection and in the provisions for bad and doubtful debts, which decreased 14.7% year on year in total, down to CZK 690 m, as a result of the launch of the new FREE tariffs. The Group recorded a slightly higher cost of the utilities, which amounted to CZK 1.2 bn in 2013, and was mainly caused by a further growth in energy prices; energy-efficiency measures have not fully compensated for the higher costs.

Outlook for 2014

In 2014, the Company will closely monitor customers' needs in a challenging macro-economic environment which can impact their consumption patterns. The Company is confident that it will be able to maintain market leadership in its core businesses through a continuous focus on its strengths: by far the best value proposition and unique fixed and mobile broadband based products and services including product bundles, the new O₂ TV, ICT solutions and digital services with a high potential of growth.

The Company will keep its focus on a further improvement of the customer relationship area through additional investments into the optimisation and improvement of its systems and processes, building on the benefits enabled by the FREE tariffs. These initiatives seek to

deliver a lower number of customer complaints and negative and repeated calls, consequently improving customer experience and satisfaction – which remains the top Company's agenda also in 2014. In line with its strategy to protect its customer base and to mitigate the negative impact of highly competitive market environment on the customer 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 Company believes this strategy will help it to limit its dependency on one-off projects, secure sustainable revenues and grow a profitable business.

Additionally, the Company 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. The Company will forge ahead with the deployment of its LTE network in the newly acquired spectrum, which will help it drive new customer proposition and maintain its competitiveness in the mobile broadband market; the Company will also continue the implementation of the new extended network sharing agreement to drive further internal efficiencies.

Telefónica Slovakia will continue with its successful 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 Company expects that mobile non-SMS data revenues, ICT & digital revenues and revenues in Slovakia will remain the key top-line growth drivers also in 2014. At the same time, the mobile revenues will be challenged by additional MTR cuts. In this operating environment, the Company will maintain its focus on improving operational efficiency in all areas of its operations through the execution of the transformation programme to protect its solid profitability. The efficiency agenda in 2014 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 Company 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 Company is confident that the above-mentioned measures will help it maintain best-in-class profitability despite pressures on the revenue performance.

With regard to Capex, the Company will continue to direct its investments primarily into the upgrade and expansion of its fixed and mobile broadband networks, and capability improvement of the mobile broadband networks, including the deployment of the new 4G network, to sustain its competitiveness and delivering future growth.

2014 Investor Guidance

Based on that, the Company is providing the following guidance for 2014:

	2013 base	2014 guidance
Revenues ¹³	-6.5% y-o-y	Still declining but improving trend
CapEx ¹⁴	CZK 5.7 bn	CapEx up to the previous year level, increasing proportion of investments into growth areas (mobile data, LTE and new technologies/businesses)

¹³ Group Operating Revenues

¹⁴ Group Capex. Excluding investments for spectrum license and business acquisitions

In the right place at the right time



03

Calendar of key events

5. Calendar of key events

January

Telefónica CR started offering the roaming tariff Volání bez hranic also to prepaid customers. A single flat rate of CZK 3.90 is applied to all traffic – outgoing and incoming calls and SMS.

Together with its partners GE Money Bank and MasterCard, Telefónica CR introduced mobile payments using a mobile phone enabled for contactless NFC technology and offered the service to the market.

February

Telefónica CR joined the international initiative Safer Internet Day.

A meeting of the Supervisory Board approved certain changes in its personnel composition.

Telefónica CR raised bandwidth caps for selected mobile data tariffs and the speed after reaching the bandwidth cap.

Telefónica CR published its audited consolidated financial results prepared under International Financial Reporting Standards for the fiscal year 2012.

March

The Czech Telecommunication Office (CTO) ruled to cancel the auction for spectrum bands of 800, 1,800 and 2,600 MHz.

Telefónica CR debuted the campaign Chytrý život (Smart Life), which gives customers tips for useful applications.

Telefónica CR started offering three types of fixed internet access, which are up to one third more economical than the previous proposition.

The management of Tesco Stores CR and Telefónica CR announced a joint venture to launch Tesco Mobile, a virtual operator, in the Czech market.

Jindřich Fremuth became Director, Residential Division, Telefónica CR. His previous position within the Company was Director, Online Channels, Channel Strategy and Commercial Planning.

Telefónica CR, as it had done for a number of years before, joined the Earth Hour, the world's largest campaign against climate change. The Company dimmed the lights in its buildings and stores.

The Board of Directors of Telefónica CR decided to continue with the programme of acquisition of own shares to the additional limit of 6,441,798 shares, which is another two percent of the total of own shares issued by the Company.

April

Telefónica CR became the first operator in the Czech market to revolutionize its proposition by introducing unlimited mobile FREE tariffs.

An Ordinary General Meeting of shareholders of Telefónica CR was held.

The CTO released the draft conditions of a new spectrum auction for 800, 1,800 and 2,600 MHz for public consultation.

May

Telefónica CR's LTE network expanded to include Prague. Several dozen of transmitters in the capital started offering mobile data transmission at the speed of up to 75 Mbps.

Changes to the personnel composition of the Supervisory Board and the Audit Committee were approved.

Telefónica Foundation announced its already fifth call for projects for the Think Big programme.

The Company offered unlimited calling and SMS also to prepaid customers if they activate one of the weekly FREE bundles.

A committee of experts, entrepreneurs and investors selected 10 projects for the Prague-based Wayra Academy from the 20 shortlisted; two more teams qualified for the Wayra Academy in London.

The online self-service point Moje O₂ became available also to self-employed and small business customers.

June

Telefónica CR claimed victory in the 11th edition of the national competition Sodexo Employer of the Year.

The Wayra Prague accelerator welcomed the first batch of authors of the best-rated projects and became their home for the next eight months, so that their ideas could be developed and ultimately implemented.

Elections of members of the Supervisory Board elected by employees were successfully held in the period 13–18 June 2013.

July

Digital television O₂ TV was innovated to offer many new features, including playing back any programme within 30 hours from the original airtime.

August

Telefónica CR, in collaboration with partners, commenced the pilot deployment of mobile POS terminals mPO₂S. The portable payment solution was designed to meet the demand from small businesses, independent trades and professions which had before not been able to accept payment cards.

The CTO called a new spectrum auction for 800, 1,800 and 2,600 MHz frequencies.

Telefónica CR and T-Mobile Czech Republic went into talks on the consolidation of existing second- and third-generation networks, as a follow-up to the very successful third-generation network sharing project from 2011–2012.

September

Czech mobile operators, including Telefónica CR, decided to provide DMS (donor SMS) service to Fórum dárců, o.s. free of commission. As a result, non-profit organisations will get more money from fundraising campaigns.

October

Telefónica, S.A. the majority shareholder of Telefónica CR, announced that it had been considering strategic options with respect to its stake in Telefónica CR, including talks with the investment group PPF.

Telefónica CR and T-Mobile Czech Republic signed network sharing agreement with respect to second- and third-generation networks. The partnership will ensure that the territory of the Czech Republic is covered with 2G and 3G service, whilst improving the mobile network operating efficiency of both operators.

The Company forged ahead with covering the Czech Republic with the fastest broadband internet which uses the LTE technology. The LTE service launched in Brno on 31 October.

Telefónica CR came to an agreement with ČEZ to form a new virtual mobile operator. The MVNO started offering its service under the brand Mobil od ČEZ on 15 October.

The Board of Directors of Telefónica CR passed a decision to stop the programme of buying back the Company's own shares.

November

Telefónica, S.A. announced that it had agreed to sell a majority stake in Telefónica CR to the investor PPF Group. The group will pay EUR 2,467 bn (CZK 63.6 bn) for a 65.9% shareholding, which includes also Telefónica Slovakia.

In the spectrum auction called as part of a tender by the CTO, Telefónica CR secured the most in-demand 800 MHz spectrum in two blocks (2x5 MHz each); it also acquired three blocks of

the 1,800 Mhz spectrum (2x1 MHz each) and four blocks of the 2,600 MHz spectrum (2x5 MHz each). The total cost of the spectrum acquisition was CZK 2.8 bn.

Telefónica CR announced that, as of 15 November 2013, its share capital was reduced by the amount of CZK 560,436,426 by way of cancellation of 6,441,798 own shares.

The Company started offering the option of digital signature in its brand stores, which lets customers sign digital documents in their own hand. The solution is expected to gradually replace written contracts.

December

Telefónica Slovakia announced that it would distribute, for the first time, a share of its profits amounting to EUR 32.8 m from its retained earnings accounts to Telefónica CR, the sole shareholder.

Telefónica CR and GE Money Bank introduced another innovation to the NFC technology. GE Money Bank clients can install a payment card in their mobile remotely, without having to wait for the physical delivery of a new SIM card.

The Supervisory Board of Telefónica CR discussed and accepted the resignation of František Schneider from his membership in the Board of Directors.

Connected to those we love



04

Corporate Social
Responsibility (CSR)

6. Corporate Social Responsibility (CSR)

6.1 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 is presently being 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 2013, Telefónica CR was included in CEERIUS Sustainability Index (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. The Company's strong relationship with Business for Society and the Business Leaders Forum has helped anchor its CSR strategy. In 2013, Telefónica CR's sustainability activities were recognized in the prestigious TOP Responsible Company 2013 Awards; the Company became the third most responsible large corporation in the Czech Republic. ŠIK CZ presented a 'lifesaver' plaque to the Company. The campaign promoting the Telefónica Foundation's Think Big programme received an APRA (Association of Public Relations Agencies) award. At the Czech Public Relations Award, the same programme of the Telefónica Foundation placed second in the category Corporate Social Responsibility and Philanthropy.

Telefónica CR became partner of the TOP Responsible Company Awards for the category TOP Responsible Small Business. The Company was also the partner of the category Best Medium-sized Non-profit 2013 of the Non-profit of the Year 2013 Awards presented by the Nadace rozvoje občanské společnosti.

Telefónica Group's sustainability performance is verified independently by Ernst & Young through the annual audit.

The year 2013 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 environmental sustainability. Each of these areas is covered in more detail in the following sections.

6.2 Telefónica CR Business Principles

Corporate culture and reputation are among the priorities of Telefónica CR. Our Business Principles is a document which reflects the current priorities of Telefónica CR. It is 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.

Also in 2013, 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 2013, 97% 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, calling the responsible officer (Compliance Officer) via telephone or visiting in person. The reports are investigated by Security or Internal Audit in collaboration with the Compliance Officer.

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.

Our 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 O₂ 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.

6.3 Market conduct and customer care

Products and services for people with specific needs

As in the previous years, also in 2013 the Company focused on helping and supporting people with specific needs. People with some form of a physical limitation and senior citizens were in the centre of attention this year. In 2013, 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 new revolutionary FREE tariffs

also include discounts for senior citizens and customers with disabilities. Also in 2013, Telefónica CR kept up-to-date the website www.o2myslimena.cz, where customers can find out what the Company offers and what are the eligibility criteria. There is also a special form where they can instantly find their disability discount – i.e. what is the price of the tariff of choice after discount, and what needs to be done to become eligible. They can also directly make an appointment with an O₂ Guru. In 2013, the brand store staff went through a special training in communication with customers with some kind of physical disadvantage. The courses were interactive and had been developed by instructors who themselves have the handicap. 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. Employees were also instructed in using transcription, using TexMee application and Line for hearing impaired people, for the benefit of customers with hearing disability.

Line for people with hearing impairment

Also in 2013, the Company continued to operate Line for hearing impaired people. Operators processed 30 thousand calls from registered users in 2013, and the customer base increased 22.5%. Line for hearing impaired people was innovated in 2013 with the addition of an international variant of the service. Customers with full or partial loss of hearing could use operators to assist them in four languages: English, German, Russian and Spanish. The operators helped them deal with any issues during a business or private travel abroad – finding lost luggage, communicating with a doctor, booking a hotel. A new facebook page of the line for people with hearing impairment went live. From 2013, customers can now use Skype as another communication channel.

Discounts

Also in 2013, 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 O₂ fixed-line service. The discount was claimed by a total of 48,150 customers.

INSPO 2013 conference and the competition ‘Internet, Mobile Phone and My Handicap’

The Company was again in 2013 the General Partner of the 12th year of 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 Line for hearing impaired people.

In addition to co-funding 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 free internet connection. Conference participants had the opportunity not only to learn about the latest developments in the area of digital technology which helps them lead a more independent and fuller life, but also consult directly at INSPO with an O₂ Guru assistant about any issues with their smartphones.

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 safety

As is already a tradition, in February 2013 the Company joined the celebrations of the International Safer Internet Day, together with the National Centre for Safer Internet. The series of employee workshops and online seminars dedicated to the topic of online safety with respect to children continued in 2013.

In February 2013, a facebook campaign called 'Strážce internetu' helped to promote the tools of parental control and educated the public about the most common risks lurking online. Telefónica CR's website www.o2.cz features a section called Keep Kids Safe, where parents can easily find a lot of information and guidance how to avoid risks associated with using internet or smartphones. The same content can also be found at www.o2myslimena.cz.

Also in 2013, Telefónica CR was partner 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. This edition of the conference was headlined Preventing Cyber Crime.

The end of 2013 saw already the 11th International Cyberspace 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 2013, Telefónica CR also continued as general partner to ŠIK CZ. The Company also continued producing the series 'Communication in Your Pocket', which explores the issues of prevention of risky behaviour of children and teenagers online and with smartphones; it also produced a new series in sixteen parts called 'Become Responsible – It's Quick and Easy', which educates about responsible behaviour of businesses and individuals. The spots were broadcast in 277 elementary and 103 secondary schools in the Czech Republic. The content reached more than 200 thousand children and students. Also in 2013, customers could report, through a simple-to-use and visible button on the www.o2.cz website, any potentially harmful content directly to the hotline. In 2013, Telefónica CR continued to offer Internet Guard, which is a product that protects computers against viruses, malware or data security breaches. With Internet Guard, the customer can block websites with unsuitable content, so the product serves also as parental lock or control over the online browsing of children. Telefónica CR used the IWF list to block websites with child abuse content in 2013.

6.4 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'. To this end, a number of activities are planned each year, which seek to improve the motivation and satisfaction of employees. The successful achievement of these goals was crowned with the victory in the prestigious Employer of the Year 2013 competition.

	Number of employees as at 31
Employees – total	5,100
Women	37.50%
Men	62.50%
Employees with reduced work capacity or disability	1.00%

Employee engagement

Reflect

The total of 92% of employees participated in the annual employee satisfaction and motivation survey Reflect 2013, which is 1% more than in the previous year. The overall Reflect index was up one percentage point and broke a historic record – despite the many changes introduced in 2013. Moreover, all survey areas saw an improvement in the way they are perceived.

BE MORE Awards

BE MORE Awards, a part of the Telefónica Group's *BE MORE* strategy, was launched, replacing the *Bravo Awards*. As part of this programme, all employees of the Company could nominate their colleagues – individually or as teams – who had made an extraordinary contribution to the achievement of the *BE MORE* strategy. The best employees were presented with awards in autumn 2013.

Improving work-life balance

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. 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 kindergarten pre-school care. A contribution towards individual pre-school care was introduced.

Telefónica CR supports, if the nature of the work allows, that moms work part-time. Also in 2013, the Company continued with the programme which gives mothers leaving for their maternity leave the option to agree with their manager to return to work immediately after their maternity leave, and claim, after their return, a childcare contribution of up to CZK 8,000 a month.

Education and personal development

Orientation training for new employees

Fast adaptation of new employees continued to be the Company's priority also in 2013. Telefónica CR invited all new employees to another edition of the Welcome Day, which, using unconventional and entertaining forms, aims to introduce the newcomers to the basic facts about the Company and equip them with as much practical information to find their way around during their first days on the job.

Individual divisions also run their own on-the-job adaptation programmes, each lasting between one and six months and are tied to the career development map (applies to positions in call centres, retail and in the Business Division). The adaptation programmes are aimed at bringing the newcomer up to the maximum level of performance in the shortest time.

Basic management skills

The company has a comprehensive programme of management training. In 2013, the Management Academy started offering a long-term development of basic management skills for the first management level of the Company. The programme comes in two mutations: for new managers and for experienced operative managers.

Leadership

Leadership and the development of it is the theme of several parallel educational activities. Also in 2013, managers took part in the management courses at Telefónica University Barcelona. Also, since 2011, People Leaders is available, which is a project that 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. By the end of 2013, all senior and middle managers have been through the programme since its start in 2011. The development of another long-term programme, Leadership Academy, for the middle and senior management has been completed; the programme will be implemented in mid-2014. Regular courses for executive management are also a part of the Company's leadership development programme. The development of future leaders is included in the local talent management programme.

Motivation and remuneration

Employee shares plan

In 2013, employees could invest up to EUR 1,200 into Telefónica, S.A. shares. More than 600 employees took up the opportunity to enrol for the employee shares plan. If the conditions of the programme are met, the Company will match each share purchased one share.

Employee benefits and motivation programmes

Employees of the Company have a choice of a wide range of benefits. In 2013, the new employee benefit portal offered, for instance, products and services of the Company, financial

products and benefits for their leisure, health and education. Employees with reduced work capacity also received a voucher for restorative physiotherapy holiday in the value of CZK 10 ths. 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.

6.5 Caring for the environment

Environmental protection policy and certification of the Company

The commitment of Telefónica CR to keep the footprint of its operations on the environment minimal was also in 2013 anchored in the Telefónica Group's long-term strategy and the updated Environmental Policy. The Environmental Policy sets the goal of mitigating the damage to and the impact on the environment as a result of the Company's operations, to the Company's sphere of activity; in doing so, the Company uses the latest research. Telefónica CR's fundamental principles of environmental protection helped to deliver on both the group and local objectives and to meet the statutory and other conditions.

Telefónica CR has implemented and certified an environmental management system according to the international standard ISO 14001. In 2002, the Company became the first telecommunications provider in the Czech Republic to receive the certification. In June 2013, a re-certification audit of the whole integrated management system was carried out, and the validity of the Company's certificates, including the one for the environmental management system, was extended as a result.

Reducing environmental footprint

The Company's actions to protect the environment followed a positive trend in 2013. Compared to the previous year, the fuel consumption went down 15.2%; the volume of gas consumed went down 9.2%; the volume of water used from public water distribution systems went down 13.6%. There was also a significant reduction in the volume of waste generated by the Company – both the total volume of waste (down 29.7%) and the volume of mixed communal waste (down 12.8%).

Activities in the area of environmental protection and employee participation

Also in 2013, O₂ brand stores collected old mobile phones for sustainable recycling. For each device turned in, Telefónica CR made a donation of CZK 25 to the Safety Line. Telefónica CR is still enrolled in the Green Company programme by REMA Systém, and arranges for collection of old electrical and electronic waste (mobile phones, notebooks, as well as small domestic appliances) and batteries.

Telefónica CR also joined the Earth Hour in 2013. All logos on the Company's buildings were switched off; and the lights in offices and brand stores were dimmed to the necessary minimum.

Telefónica CR also continued with its ongoing campaign which aims to motivate employees to behave sustainably. Also in 2013, employees systematically attended e-learning and in-class courses in sustainability. Together it was over 5,500 training hours. Moreover, in 2013 employees could study selected environmental issues in more depth with the help of an intranet series which ran for several months and culminated with a knowledge quiz. An internal campaign 'Save Paper', which ran in the last quarter of 2013, appealed with employees to significantly cut their use of paper. Internal communication channels broadcast advice and tips how to save paper and make the most economical use of printers. A competition for the 'biggest paper saver' was held in parallel. The campaign was very well received, and the paper consumption was down 31.8% in the period in question. The campaign clearly became a good example of responsible and sustainable business practice.

6.6 For the community

Supporting communities

Community-oriented and philanthropic projects were deeply rooted in the Telefónica CR's CSR also in 2013. The Company strived to put its technology and know-how to use in helping to improve the quality of life. The Telefónica Foundation was the umbrella instrument for all activities supporting transparent and systemic corporate donorship. The total sum of all donations, financial or in-kind, including telecommunication services, from Telefónica CR in 2013 exceeded CZK 30 m.

The foundation concentrated on three main pillars of activities: helping the young generation, which includes the programmes Think Big and Think Big School; employee participation – employees can actively or financially participate in the building of community life, and through internal fundraisers, grants and volunteering, they can help non-profit organisations; providing means of technology to the community – in this respect, the foundation and Telefónica CR are long-standing partners to Sdružení Linka bezpečí which operates the Safety Line, and Centrum Elpida which operates the Senior Line.

Think Big

In 2013, the Telefónica Foundation continued with the community programme Think Big. The goal of the long-term programme is to support informal groups of young people between 15 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 ths to CZK 70 ths, also a place on a three day course teaching them key competences relevant to their project (self-confidence, project management, communication, creativity, innovation and

digital literacy), a package of several O₂ services and mentoring from employees of Telefónica CR.

The fourth call for Think Big projects at the end of 2012 attracted 484 applications, from which the committees of evaluators selected 155 projects. Over the course of six months between March and September 2013, the young people made their projects a reality. In this round of grants, the Telefónica Foundation distributed close to CZK 7.8 m among young people.

The fifth round of the grant programme, which was announced in May 2013, the Telefónica Foundation collected 370 applications, and 159 projects chosen to receive funding support for their implementation were chosen. The Telefónica Foundation distributed over CZK 7.8 m in funding of the projects.

The sixth call for Think Big projects was announced by the Telefónica Foundation in autumn 2013 and it attracted a record number of 655 applications. The implementation of selected projects will start in February 2014. This Think Big call introduced an innovation: project applications are now made at two levels. Level 1 is for newcomers to the programme and less experienced young people (their projects could qualify for funding up to CZK 10 ths), and Level 2 is for those who had already qualified for a grant in the past, and now have a new project or want to build on their original idea (grants of up to CZK 70 ths). Another change came in that Level 1 was open also to individual applicants.

As from 2013, the programme also features the so-called Think Big Ambassadors. 11 successful young people who had participated in Think Big became Think Big Ambassadors and continue to develop the programme's strategy and promote the programme to the public at various festivals, youth events and in the media, e.g. in Mixxxer at Óčko TV. The Telefónica Foundation also offered them a programme of courses, especially in soft skills, which was organised in partnership with Vacation School Lipnice.

The effective communication of the programme was recognized with an award from APRA (Association of Public Relations Agencies). The Telefónica Foundation also placed second in the category Corporate Social Responsibility and Philanthropy at the Czech Public Relations Awards.

Think Big and a hand-picked group of its participants were given an opportunity to present the programme and their projects on the international scene: at the Campus Party in London and at the conference One Young World in Johannesburg, South Africa.

Think Big School

The programme Think Big School, which the Telefónica Foundation launched at the end of 2012, continued also in 2013.

Think Big School is a programme for second and third grade secondary school students; it aims to foster their enterprising spirit and cultivate their digital skills. It teaches project management, teamwork and communication. Under guidance of volunteers from the ranks of

Telefónica CR employees, teams of students work on an idea, design a website in the online web design tool Thimble, shoot a video and present their final project to a committee of the Company's employees. The total of 1,300 students from 80 secondary schools from all parts of the Czech Republic participated in the programme in 2013. More about the programme here: www.thinkbigschool.cz.

Volunteer programmes for employees

One of 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 Telefónica Foundation.

A total of 2,373 employees volunteered in their communities in 2013.

In 2013, 1,493 employees donated a total of CZK 1,196,381 in the successful fundraising campaigns.

The solidarity of employees also helped make the life easier for 14 people. A donation of CZK 379,170 allowed them to purchase much needed health aids and contributed towards recuperative care. Employee donations also went to benefit the Safety Line, Senior Line and the victims of floods.

Employees of the Company regularly participated in volunteering events and donated their time, knowledge and skills. The total of 1,180 employees spent 14,885.5 hours of their work time on community-building activities; and 239 employees donated 11,702 hours of their free time.

Telefónica CR continued to support corporate teambuilding events turned into volunteer events – managers and their teams worked in non-profit organisations. In 2013, 380 employees (13 teams) donated over 3,040 hours of work to non-profit organisations.

A volunteer weekend in aid of children from the Pyšely children's home was also held in 2013. Employees had four opportunities to join the Telefónica Foundation's Give Blood campaign. They could also become mentors or evaluators of Think Big project applications or Think Big School projects, and help clean up after the devastating floods.

As is already a tradition, the Telefónica International Volunteer Day was held in autumn. A record number of 667 employees helped out in 30 non-profit organisations.

In 2013, a total of 1,195 employees spent over 26 thousand hours of their time working in their communities.

On Easter and Christmas markets, which were organised by the Telefónica Foundation in 11 of the Company's buildings in the Czech Republic, products hand-made by people with disabilities in sheltered workshops were sold to employees. In 2013, employees spent over to CZK 390 ths on products from 50 sheltered workshops.

International volunteering project Volunteering Holidays

Volunteer activities of employees in 2013 again transcended the limits of the Czech Republic as four employees of the Company participated in the international volunteer programme Volunteering Holidays implemented by Telefónica in Latin America: three were helping Colombia and one in Ecuador. The employees used two weeks of their holiday allowance for this purpose.

Give Blood with Telefónica Foundation

The traditional volunteer blood donation campaign was held in the Company's premises in 2013. Over the course of four days, 124 employees (some repeatedly) gave more than 101 litres of blood. The project Give Blood with Telefónica Foundation has a partner in the Military University Hospital Prague.

Safety Line 116 111

The Telefónica Foundation was still the General Partner to the only free and anonymous helpline for children who are faced with a difficult life situation. The funding helps to keep the emergency hotline free of charge. The foundation also supported the Safety Line at the so-called Forget-me-not Days in the spring (17 May–1 June) and on the occasion of the International Missing Children's Day. By associating its name to the campaign, the organisation aspired to draw attention to the problem of lost and missing children, of whom several thousand are searched for by the Czech police every year.

The total sum of funds raised through selling the symbolic forget-me-not blossoms was CZK 508,769, which is 49% more than in the previous year. Employees of Telefónica CR in Prague and Ústí nad Labem could buy forget-me-nots at their workplace; the tokens were also sold at the O₂ brand store in Chodov shopping centre in Prague.

Senior Line

The Telefónica 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

Telefónica Foundation helped to keep the service free. In 2013, Think Big supported the intergenerational project Cvak. The idea for the project came from the participants of an arts course at Matela Studio who shared a passion for photography. They decided to promote their hobby among senior citizens for whom they organised photography courses with a final exhibition of works. In the pipeline there is also a collective photo book doubling as a catalogue of all the exhibitions.

As part of the series of Christmas philanthropy events employees of the Company, Elpida presented its project 10 deka Bulgakova (10 decagrams of Bulgakov) to sell second-hand books by weight to help fund its operations.

Conclusion

Telefónica Foundation plans to continue help young people through its Think Big grant programme, organise volunteering activities and run fundraisers and grants for the employees of Telefónica CR in 2014; it will also uphold its partnership with the Senior Line and the Safety Line.

Always first in innovation



05

Corporate governance

7. Corporate governance

7.1 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 O₂ commercial brand regardless of ownership relationships within the Telefónica Group. Telefónica, S.A. was the majority shareholder of the Company with a 70.83% shareholding. In November 2013, an agreement to sell the majority shareholding in the Company by Telefónica, S.A. to the financial group PPF was announced. The transaction received an approval from the European Commission in the middle of January 2014, and it was settled as of 28 January 2014. The PPF group acquired a 65.9% stake in Telefónica Czech Republic, a.s., which included also 100% in the subsidiary Telefónica Slovakia, s.r.o. and other ownership interests of the Company. Telefónica, S.A. retained 4.9% of shares and remains an industry and commercial partner for a period of up to four years.

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 (contingent on approval by the Supervisory Board).

7.2 Subsidiaries, associates and other ownership interests

The structure and number of companies in the Telefónica CR Group changed in 2013 from the situation described in the 2012 Annual Report. Below are the changes that occurred in the reported period:

Informační linky, a.s.

In March 2013, Telefónica CR signed an agreement to sell the remaining 20% of shares in Informační linky, a.s. This move followed the sale of 80% of shares in the company in 2012. As a result, Informační linky, a.s. effectively ceased to be a part of the Telefónica Czech Republic Group.

Internethome, s.r.o.

Pavel Jiroušek resigned from his position as statutory representative as of 16 January 2014. Tomáš Elbl was appointed his successor.

MOPET CZ a.s.

On 6 November 2013, Telefónica CR signed an agreement to transfer shares with Česká spořitelna, a.s., under which the Company sold its whole ownership interest of 14.29% in MOPET CZ a.s. to Česká spořitelna, a.s.

Tesco Mobile ČR s.r.o.

On 14 March 2013, Telefónica CR entered into a shareholder agreement with Tesco Stores ČR, a.s., and an agreement to transfer the ownership interest, under which it became a member in Tesco Mobile ČR s.r.o. holding 50% of the company. James Edward McQuillan was appointed CEO on 13 December 2013, succeeding Lucie Hadaričová. On 14 April 2014, statutory representatives David Melcon Sanchez-Friera and Felix Geyr were recalled; Tomáš Kouřil and Tomáš Budník were appointed new statutory representatives.

Telefónica Slovakia, s.r.o.

In March 2013, the sole member of the company approved a reduction of its registered capital by the amount of EUR 136,796,563, i.e. from EUR 240,000,000 to EUR 103,203,437. The reduction of the registered capital was recorded in the Commercial Register on 30 July 2013. The reason for the reduction of the registered capital was to improve the capital structure of the company. The amount by which the registered capital had been reduced was used to cover for accumulated losses from the previous accounting periods.

On 11 December 2013, František Schneider resigned from his membership in the Supervisory Board; Jakub Chytil was appointed into the Supervisory Board on 13 December 2013.

The following changes occurred in the personnel composition of the Supervisory Board in the period from the beginning of 2014 to the closing day of the Annual Report: David Melcon, Martin Bek and Jakub Chytil resigned from membership in the Supervisory Board on 31 January 2014, and Martin Štefunko, Jan Tomaník and Martin Vlček were appointed to the Supervisory Board.

For more detail on the subsidiary please refer to section Telefónica Slovakia.

SUBSIDIARY COMPANIES				
Company name	Registered business	Company ID 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 103,203,437	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%

OWNERSHIP INTERESTS IN OTHER COMPANIES				
Company name	Registered business	Company ID 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%
Tesco Mobile ČR s.r.o.	Manufacturing, trade and services not included in Annexes 1-3 of the Trade Licensing Act	29147506	CZK 200,000	50.00%
Tesco Mobile Slovakia, s.r.o.**	Trade agency; services agency; business, organisation and economic consultancy	36863521	EUR 5,000	50.00%

* Telefónica CR does not control the company.

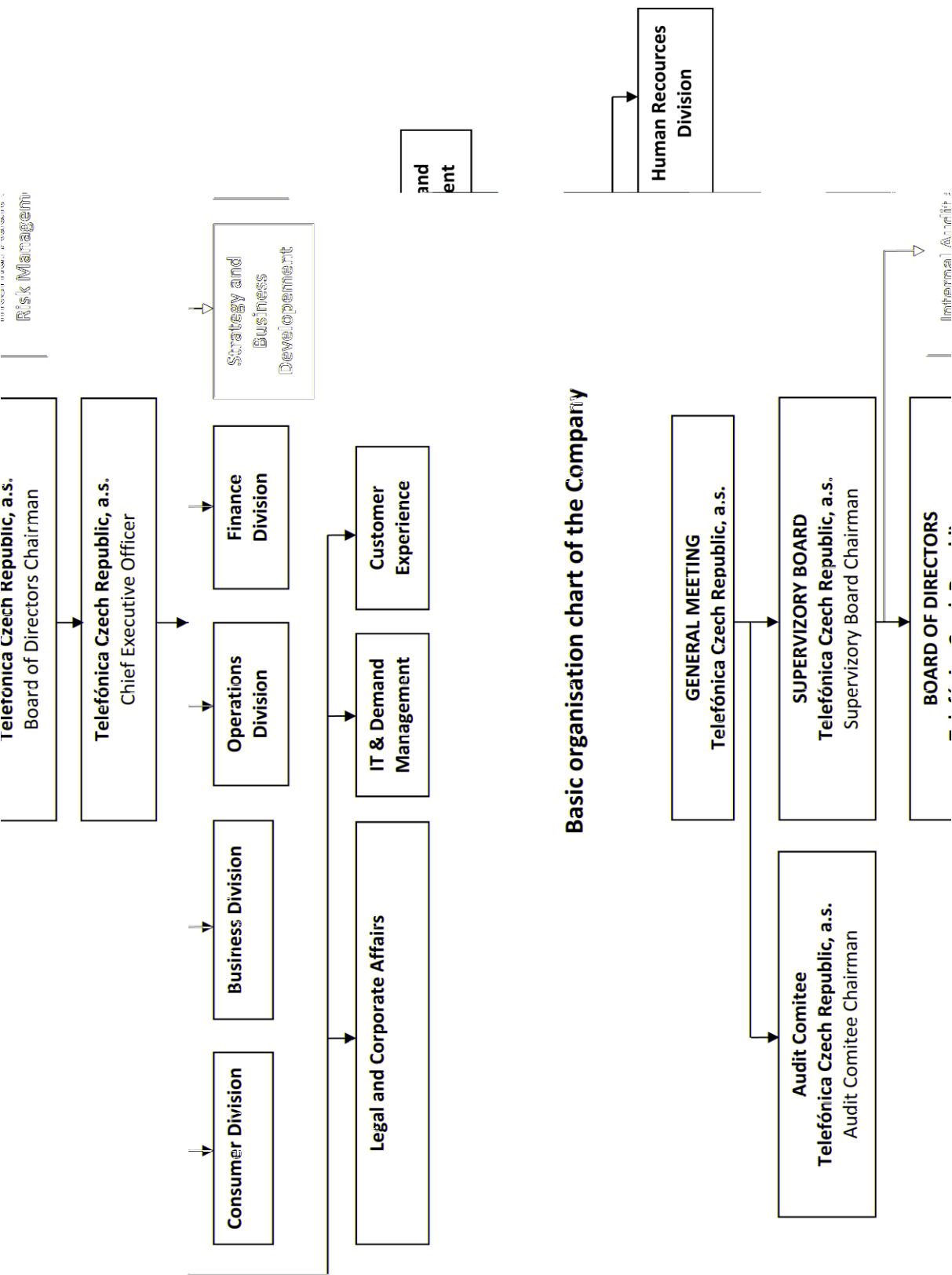
** Owned through the subsidiary Telefónica Slovakia, s.r.o.

7.3 The organisation of Telefónica CR

The first executive line of the organisation chart is divided into divisions and specialist units, which are headed by Company employees in the position of Director. In 2013, no substantial changes occurred in the organisation of the Company from the situation described in the 2012 Annual Report. Divisions Consumer, Business, Marketing, Operations, Strategy and Business Development, Support Services, Legal, Regulatory and Public Affairs, Finance, Human Resources, Corporate Communication and Internal Audit and Risk Management were in a direct reporting line to the Chief Executive Officer.

In February 2014, changes were effected in the organisation of the Company as a whole and its divisions, in order to streamline and make the organisation more effective. The responsibilities of the Business Division and the Consumer Division were enhanced, by making them directly responsible not only for the commercial strategy but also for the marketing strategy. The Marketing Division has been subordinated to these two divisions; New Business Development has been made a part of the Strategy and Business Development Division. The IT function has been transferred from the Operations Division into the direct reporting line of the Chief Executive Officer. The Support Services Division and Corporate Communication were consolidated into divisions Operations, Finance, Human Resources and Legal and Corporate Affairs.

Basic organisation chart of Telefónica Czech Republic, a.s. (as at 11 February 2014):



7.4 Governing bodies and executive management of the Company

Telefónica CR has the following governing bodies:

- General Meeting;
- Board of Directors;
- Supervisory Board;
- Audit Committee.

7.4.1 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 particular 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. 511 et seq. of the Business Corporations Act (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 Business Corporations Act;
- decide to wind up the Company with liquidation, appoint and dismiss the liquidator, 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 to transform the shares as securities into booked shares, or booked shares into securities, or decide on the change of the form of shares;
- elect and dismiss the members of the Supervisory Board;

- 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;
- discuss a Board of Directors' annual report on the Company's business, 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 contracts for transfer or pledging or mortgaging of a business establishment or any such part thereof that would result in a material change in the structure of the establishment or a material change in the subject of the business or operations of the Company;
- decide on approval of the rules of remuneration to members of the Supervisory Board and the Audit Committee and stipulation of remuneration to members of the Supervisory Board and the Audit Committee;
- decide on approval of silent partnership, any changes thereto or termination thereof, if the Company concludes such agreements;
- decide on approval of executive service agreements for members of the Supervisory Board and the rules for provision of perquisites to members of the Supervisory Board of the Company, to which there is no right arising from the law, executive service agreement as approved by the General Meeting, or from an internal regulation approved by the General Meeting,
- decide on 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 and substitute members of Audit Committee;
- decide on approval of executive service agreements for members of the Audit Committee and the rules for provision of perquisites to members of the Audit Committee, to which there is no right arising from the law, agreement on the performance of the office as approved by the General Meeting, or from an internal regulation approved by the General Meeting;
- decide on approval of financial assistance if such approval is required by law, and
- decide on instructions for members of the Board of Directors, or any other body of the Company, in accordance with the law and these Articles of Association.

General Meetings

22 April 2013

The Ordinary General Meeting of Telefónica CR was held on 22 April 2013 and approved the following:

- The Company's financial statements and the consolidated financial statements for the year 2012 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 unconsolidated profit for the year 2012 and retained earnings from previous periods. 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 2012, amounting to CZK 5,911,412,358.38, and from a part of the retained earnings of the previous periods, amounting to CZK 530,385,641.62, totalling CZK 6,441,798,000. This represents a dividend of CZK 20 before tax per each share in the nominal value CZK 87. A dividend of CZK 200 before tax will be due on the share in the nominal value CZK 870.
- The distribution of a part of the share premium, amounting up to the limit of CZK 3,220,899,000, among the shareholders. Each share in the nominal value CZK 87 will attract a payment of CZK 10 before tax; the amount of CZK 100 before tax will be paid to the share in the nominal value CZK 870.
- A reduction of the share capital by way of cancelling 2% of own shares acquired by Telefónica CR in 2012 as part of its share buy-back programme. The share capital will be reduced by CZK 560 m in total. The cancelled shares were acquired for CZK 2,483 m. The share premium will be reduced by the amount of CZK 1,922 m, which is the difference between the acquisition price and the nominal value of the cancelled shares.
- An amendment to the Articles of Association of the Company. The main changes included the addition of consumer credit providing and mediation to the registered business of the Company. Furthermore, the numbers of members of some governing bodies changed: the number of members of the Supervisory Board changed from the present twelve to nine; the number of members of the Nomination and Remuneration Committee went down from the present five to three. The changes concerning the governing bodies went into effect as of 30 June 2013.
- A change in the rules for awarding non-claim perquisites to members of the Supervisory Board and to members of the Audit Committee.
- The General Meeting also confirmed by vote members of the Supervisory Board and members of the Audit Committee, and elected new members (for details see below).

A detailed overview of the conclusions of the General Meeting is given on the Company's website (www.telefonica.cz, or www.ico60193336.cz). Information about the amount of the dividend, the record and the disbursement days is given in this Annual Report in section 10. Other information for shareholders and investors.

12 March 2014

Before the closing date of the Annual Report, an Ordinary General Meeting of the Company was held on 12 March 2014 and approved the following:

- Recall of three members of the Supervisory Board; confirmation by election the membership of the co-opted Supervisory Board members and election of new Audit Committee members (for details see below).

- Executive service agreements with newly elected Supervisory Board and Audit Committee members.
- An amendment to the Articles of Association of the Company, with the main changes being: a reduction in the number of members of the Company's statutory bodies, and a more flexible procedure for termination of their service; abolishment of the rule that one third of seats in the Supervisory Board would be filled with deputies elected by employees of the Company; abolishment of the mandatory allocations from the profit to the reserve fund; greater involvement of the Supervisory Board in the approval of major decisions; and removal of the position of Company Secretary from the Articles of Association. Other changes were introduced mainly to comply with the Business Corporations Act.

A detailed overview of the conclusions of the General Meeting is given on the Company's website (www.telefonica.cz, or www.ico60193336.cz).

7.4.2 Board of Directors

The 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 five years. The Board of Directors has a quorum if a simple majority of its members is present at the meeting. In 2013, the Board of Directors had seven members. As part of the amendment to the Articles of Association, the number of members of the Board of Directors of the Company has been reduced to five by decision of the General Meeting as of 12 March 2014.

The Board of Director has the particular authority to:

- operate the business and ensure the operational management of the Company;
- approve the Rules of Procedure of the Board of Directors;
- execute the rights of employer through its authorised member;
- convene the General Meeting;
- prepare and submit to the General Meeting for discussion the matters coming under the authority of the General Meeting;
- implement the General Meeting resolutions in accordance with law and these Articles of Association;
- ensure due and proper keeping of accounts and Company documents, in line with applicable legal 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. 82 of the Business Corporations Act;
- use retained earnings in line with the decision of the General Meeting;

- decide in accordance with the law on the use of the Funds of the Company;
- prepare the report of the Board of Directors on the business of the Company and on its property in accordance with the provisions of Art. 436(2) of the Business Corporations Act, the annual report according to the provisions of Art. 21 of the Act on Accounting, the provisions of Art. 118 of the Capital Markets Undertakings Act, including the report by the Board of Directors pursuant to the provisions of Art. 82 of the Business Corporations Act, semi-annual report pursuant to the provisions of Art. 119 of the Capital Markets Undertakings Act, interim report or equivalent quarterly information in accordance with the provisions of Art. 119a of the Capital Market Undertakings Act and a summary explanatory report pursuant to the provisions of Art. 118(8) of the Capital Markets Undertakings Act;
- set the Company's business policy;
- stipulate principles for the collective agreement;
- decide on the use of the Reserve Fund;
- grant and withdraw proxy;
- stipulate the rules for the creation and use of the Social Fund on the basis of collective bargaining;
- enter into an agreement on mandatory audit or, if applicable, on other services to be rendered with the auditor;
- discuss the audit report with the auditor.

Meetings of the Board of Directors in 2013

The Board of Directors had 20 meetings in 2013.

Members of the Board of Directors as at 31 December 2013

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 Tecnológico 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 until 30 January 2014

Member of the Board of Directors since 1 August 2012 until 30 January 2014

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 Latin America, 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. In the last five years he was also member of the governing bodies in other corporations¹.

Petr Slováček (*1959)

Member of the Board of Directors since 13 June 2003, re-elected on 15 June 2013

2nd Vice-chairman of the Board of Directors from 14 June 2008 until 12 March 2014

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 previous commercial name of Telefónica Czech Republic) in 1989, working in switching, technical development, network management projects and OSS. He presently holds the position of Director, Operations Division at Telefónica Czech Republic, a.s. In the last five years he was also member of the governing bodies in other corporations².

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 previous commercial name 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. (a subsidiary company, later merged with 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; he has been a member of the

¹ Telfin Investments Ireland, Hansenet, Telefónica Slovakia, s.r.o., Tesco Mobile ČR s.r.o.

² Telefónica O2 Business Solutions, spol. s r.o.

Board of Trustees of the O₂ Foundation (formerly Telefónica Foundation) since 2004. In the last five years he was also member of the governing bodies in other corporations³

Jakub Chytil (*1961)

Member of the Board of Directors since 27 April 2006 until 30 January 2014

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 previous commercial name 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 Corporate Affairs Division. He is also a member of the Board of Trustees of the O₂ Foundation (formerly Telefónica Foundation). In the last five years he was also member of the governing bodies in other corporations⁴.

Ramiro Lafarga Brollo (*1969)

Member of the Board of Directors since 17 February 2012 until 30 January 2014

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.

Changes in the personnel composition of the Board of Directors

During 2013 and at the beginning of 2014 until the closing date of the Annual Report, the following changes occurred in the personnel composition of the Board of Directors:

Petr Slováček

- re-lected member the Board of Directors by the Supervisory Board on 15 June 2013

³ Telefónica Slovakia, s.r.o.

⁴ Telefónica Slovakia, s.r.o.

- re-elected 2nd Vice-chairman on the Board of Directors meeting of 27 June 2013
- the position of 2nd Vice-chairman of the Board of Directors was abolished by decision of the General Meeting (as part of the amendment of the Articles of Association) as of 12 March 2014

František Schneider

- resigned from his membership in the Board of Directors with effect from 20 December 2013

David Melcon Sanchez-Friera

- resigned from his membership in the Board of Directors with effect from 30 January 2014

Jakub Chytil

- resigned from his membership in the Board of Directors with effect from 30 January 2014

Ramiro Lafarga Brollo

- resigned from his membership in the Board of Directors with effect from 30 January 2014

Members of the Board of Directors

As from 31 January 2014, the Board of Directors of the Company has the following members:

Luis Antonio Malvido (*1964)

Chairman of the Board of Directors
(for résumé see above)

Martin Vlček (*1977)

Vice-chairman of the Board of Directors since 19 March 2014

1st Vice-chairman of the Board of Directors from 31 January 2014 until 19 March 2014

Member of the Board of Directors since 31 January 2014

Graduated from University of Economics in Prague in 2001. He worked as external consultant to PPF and PMU CZ a.s. In 2002–2011 he worked at Penta Investments as investment manager and later as Director of the retail chain Pet Center. Since February 2014 he's a member of the Supervisory board of Telefónica Slovakia, s.r.o. At present he is Investment Director PPF a.s. in charge of the group's investment in Telefónica CR. He has been a member of governing bodies in other corporations⁵ and in the last five years he was also member of the governing bodies in other corporations⁶.

Martin Bek (*1969)

Member of the Board of Directors
(for résumé see above)

⁵ Jiná sauna s.r.o., LEKIA a.s.

⁶ PetCenter CZ s.r.o., REAL AB a.s., PHARMAGEON, a.s., RIVERHIL a.s., ALICELA a.s., OAKFIELD a.s., Lekárna u Polikliniky a.s., REAL I a.s., SIMPSONS a.s., Česká lékárna, a.s.

Michal Frankl (*1963)

Member of the Board of Directors since 31 January 2014

Graduated from College of Banking (BICB) in Prague and Janek Jesenský Law School. After 1989 he had his own finance software development company. In 1996 he was elected member of the Czech Parliament. Later he was appointed Deputy Minister of Finance for Taxes, Duties and IT. He was also Deputy Minister of Informatics responsible in particular for the field of electronic communications and postal services. He is one of the principal authors of the Electronic Communications Act No. 127/2005 Coll. Until his election as member of the Company's Board of Directors he was an independent finance and tax consultant. He has been a member of the Board of Trustees of the O₂ Foundation (formerly Telefónica Foundation) since February 2014. In the last five years he was also member of the governing bodies in other corporations⁷. He has been a member of governing bodies in other corporations⁸.

Petr Slovák (*1959)

Member of the Board of Directors

(for résumé see above)

7.4.3 Supervisory Board

The Supervisory Board is a supervisory body of the Company 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. Supervisory Board members shall be elected and dismissed by the General Meeting 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. In 2013, the Supervisory Board had nine members; as part of the amendment to the Articles of Association, the number of members of the Supervisory Board of the Company has been reduced to three by decision of the General Meeting as of 12 March 2014.

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 executive service agreements for members of the Board of Directors in compliance with the provisions of Art. 438(2) of the Business Corporations Act;
- decide on approval of remuneration to members of the Board of Directors according to the provisions of Art. 61(1) of the Business Corporations Act;

⁷ Council of the Czech Telecommunications Office, Evropské školicí centrum, o.p.s., Evropská konsolidační, a.s.

⁸ MAIN Apartment House, s.r.o., MAIN management, s.r.o.

- convene a 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 1% of the share capital, in respect of the matters determined in the application, and review the relevant shareholders of the outcome of the review in accordance with the law;
- based on the request of the shareholders who have shares which nominal value amounts to at least 1% of the share capital, claim the right for compensation for damages incurred by the Company vis-à-vis a member of the Board of Directors or the Supervisory Board, or the meeting of any duties arising from a settlement agreement pursuant to the provisions of Art. 53(3) of the Business Corporations Act, or the final payment of the subscription price, against a shareholder who is in delay with the payment;
- decide on issues concerning benefits for the Supervisory Board members or the members of the Audit Committee insofar as it is in accordance with law;
- review Board of Directors report under Art. 82 of the Business Corporations Act; to inform the General Meeting of the review of this report and to submit its standpoint to the General Meeting;
- prohibit the Board of Directors from taking certain actions.

The following matters of the Board of Directors are subject to a prior consent of the Supervisory Board: issue of securities; disposal of an ownership interest or exercising the voting rights in a controlled company, or in a company in which the Company holds an ownership interest; investments or other expenditures in excess of CZK 50 m; termination of employment of employees who represent more than 10% of the total workforce; transformation of the Company; disposal of the Company's assets whose value exceeds CZK 50 m; entering into and terminating contracts with key personnel of the Company, i.e. those reporting directly to the Chief Executive Officer; drafting of and changes to the annual financial and business plan; agreements to accept or provide financing in excess of CZK 50 m; securing Company's receivables above CZK 50 m; large contracts; significant changes to the organisation of the Company; disbursement of any of the Company's own funds; establishment and use of Company funds.

Meetings of the Supervisory Board in 2013

The Supervisory Board of Telefónica CR had four meetings in 2013.

Members of the Supervisory Board as at 31 December 2013

María Eva Castillo Sanz (*1962)

Chairwoman of the Supervisory Board from 5 November 2012 until 19 January 2013

Member of the Supervisory Board since 7 May 2010 until 29 January 2014

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 five years in the International Equity Markets Department. Prior to this she worked for five years at the Spanish broker Beta Capital in the Sales and Equity Research Department.

Maria Pilar López Álvarez (*1970)

1st Vice-chairwoman of the Supervisory Board from 13 February 2013 until 28 January 2014

Member of the Supervisory Board since 26 July 2007 until 28 January 2014

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 Telefónica Deutschland Holding AG.

Lubomír Vinduška (*1956)

2nd Vice-chairman of the Supervisory Board from 23 July 2008 until 12 March 2014

Member of the Supervisory Board since 29 June 2008 until 12 March 2014

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, a.s.

Jesús Pérez de Uriguen (*1970)

Member of the Supervisory Board from 5 November 2012 until 29 January 2014

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. At present he is Finance and Controlling Director at Telefónica Europe.

Antonín Botlík (*1972)

Member of the Supervisory Board from 30 June 2013 until 12 March 2014

Graduated from VŠDS Žilina, Faculty of Electrical Engineering, Department of Telecommunication Technology. He has been with Telefónica Czech Republic, a.s. (and its legal predecessors) since 1995, presently in the position of Supervisor. He worked in IT network administration, as specialist in the Consumer Division, specialist in accounts control and he was team leader in the department of colliding orders. In the last five years he was not a member of any other governing, executive or supervisory bodies outside Telefónica Czech Republic, a.s.

Jiří Trupl (*1963)

Member of the Supervisory Board from 30 June 2013 until 12 March 2014

Graduated in Radio Technology from the Faculty of Electrical Engineering, Czech Technical University in Prague. He has been with Telefónica Czech Republic, a.s. (and its legal predecessors) since 1987, presently as senior specialist in data fund management. He is Deputy Chairman of the Telefónica Czech Republic's Trade Union Coordination Committee and also chairs the Trade Union Coordination Committee South Bohemia. He is also a member of the European Works Council at Telefónica Europe. In the last five years he was not a member of any other governing, executive or supervisory bodies outside Telefónica Czech Republic, a.s.

Antonio Ledesma Santiago (*1972)

Member of the Supervisory Board from 13 February 2013 until 28 January 2014

Graduated in Economics from the Salamanca University and holds an MBA from IESE Business School in Barcelona, which he got in 1998. Before joining the Telefónica Group, Antonio Ledesma worked for several years at JP Morgan Chase in Investment Banking Division in Madrid, where his specialty was mainly mergers and acquisitions consulting. In 2002 he started work in Corporate Development at Telefónica S.A., and until 2012 he worked in various positions in which he was responsible for mergers and acquisitions in the Telefónica Group. He was also involved in the acquisition of mmO2 plc, and Telefónica Deutschland IPO. In November 2012 he was appointed Director of the Office of the Chair of the Board and Chief Executive Officer Telefónica Europe.

Francisco de Borja de Nicolás Benito (*1976)

Member of the Supervisory Board from 23 April 2013 until 29 January 2014

Graduated from the bachelor programme at CUNEF (Universidad Complutense de Madrid) and earned his MBA at IESE (Universidad de Navarra). Since 2000, when he joined Telefónica, he worked in various positions in management control, finance and strategy in the mobile and fixed operations. Since 2011 until the present he has been Director for Strategic Planning and Project Approval at Telefónica Europe.

Ivan Varela Sanchez (*1972)

Member of the Supervisory Board from 7 May 2013 until 28 January 2014

Graduated in Economics from U.P.Comillas – ICADE in 1994 and later got his M.B.A. from the New York University – Stern in 2001. He joined Telefónica in 2004, and occupied several management positions in marketing and sales, strategy and business development for Telefónica Latin-America. In 2008 he was appointed director for strategic planning in the consumer fixed business unit. In 2011 he transferred to Telefónica Group's corporate strategy field, where he worked until 2012 when he moved to London as Director of Strategic Priorities for Telefónica Europe. Before joining Telefónica, he started his professional career in Andersen Consulting (Accenture) and after earning his MBA, he worked for the strategic management consulting firm McKinsey & Co.

Changes in the personnel composition of the Supervisory Board

During 2013 and at the beginning of 2014 until the closing date of the Annual Report, the following changes occurred in the personnel composition of the Supervisory Board:

- Javier Santiso Guimaras resigned from his membership in the Supervisory Board on 13 February 2013; he was succeeded by Antonio Manuel Ledesma Santiago who was co-opted into the Supervisory Board pending the next General Meeting.
- The General Meeting of 22 April 2013 resolved to confirm Jesús Pérez de Uriguen and Antonio Manuel Ledesma Santiago as members of the Supervisory Board. The General Meeting also elected Francisco de Borja de Nicolás Benito as a new member of the Supervisory Board.

- Ángel Vilá Boix, Patricia Cobian Gonzalez and Enrique Medina Malo resigned from their membership in the Supervisory Board on 6 May 2013; Ivan Varela Sanchez was co-opted by the Supervisory Board as of the same date.
- The five-year term of Lubomír Vinduška, Pavel Herštlík, Dušan Stareček and Tomáš Fírbach, all members of the Supervisory Board elected by employees, expired on 29 June 2013.
- Elections of members of the Supervisory Board elected by employees were held in the period 13–18 June 2013. A total of 3,711 employees of the Company took part in the elections, which represents 63.04% of the total eligible votes. Lubomír Vinduška, Antonín Botlík and Jiří Trupl were legitimately elected by employees as members of the Supervisory Board for a five-year term commencing on 30 June 2013.
- On 19 July 2013, the Supervisory Board re-elected Lubomír Vinduška as its 2nd Vice-chairman.
- On 19 July 2013, the Supervisory Board resolved to reduce the number of members of the Ethics and Corporate Social Responsibility Committee, from six to four. Antonín Botlík, Jiří Trupl, Francisco de Borja de Nicolás Benito and Ivan Varela Sanchez were elected members of the committee as of the same date.
- María Pilar López Álvarez (also as 1st Vice-chairwoman of the Supervisory Board), Antonio Manuel Ledesma Santiago and Ivan Varela Sánchez resigned from their membership in the Supervisory Board as from 28 January 2014. Substitute Supervisory Board members Martin Štefunko, Vladimír Mlynář and Ladislav Bartoniček were co-opted to the Supervisory Board.
- A day later, on 29 January 2014, María Eva Castillo Sanz (also as Chairwoman of the Supervisory Board), Francisco de Borja de Nicolás Benito and Jesús Pérez de Uriquen also resigned from their membership in the Supervisory Board.
- The General Meeting of 12 March 2014 confirmed Martin Štefunko, Ladislav Bartoniček and Vladimír Mlynář as members of the Supervisory Board. The General Meeting also recalled Lubomír Vinduška, Jiří Trupl and Antonín Botlík from the Supervisory Board.

Members of the Supervisory Board

As from 12 March 2014, the Supervisory Board of the Company has the following members:

Martin Štefunko (*1977)

Chairman of the Supervisory Board since 24 March 2014

Confirmed by election at the General Meeting on 12 March 2014

Co-opted into the Supervisory Board and elected its Chairman on 29 January 2014

Holds a Ph.D. in Economic Theory and History of Economic Thinking from the University of Economics in Bratislava, where he also got is M.A. in Finance, Banking and Investment. He also studied in Austria at Johann Kepler University (Banking and Finance) and at Mises Institute, Auburn University, USA (Economic Theory). From 2001 Martin Štefunko worked at Penta Investments, and from 2004 he was Investment Director responsible for managing investment projects. In this capacity he managed a number of important acquisitions and business ventures of the Penta group in retail, healthcare, energy and engineering. Since 2009

he has been in a high executive position at PPF; presently as Director, Investment Division. He is a member of the Supervisory Board of PPF Group N.V., member of the Board of Directors of PPF a.s., the main consultancy of the PPF group, and he chairs the Supervisory Board of PPF banka. Since 2011 he has been member of the Supervisory Board of Energetický a průmyslový holding, a.s., and since 2012 he has been Chairman of the Supervisory Board of EP Energy, a.s. In the last five years he was also member of the governing bodies in other corporations⁹.

Ladislav Bartoníček (*1964)

Vice-chairman of the Supervisory Board since 24 March 2014

Confirmed by election at the General Meeting on 12 March 2014

Co-opted into the Supervisory Board and elected its 1st Vice-chairman on 29 January 2014

Graduated from the Faculty of Electrical Engineering, Czech Technical University in Prague. In 1991 he joined PPF investiční společnost, a.s., as Executive Director; in 1993 he graduated from the Rochester Institute of Technology in New York. From 1996 until September 2006 he was Chief Executive Officer of Česká pojišťovna a.s. and later Chairman of the Board of Directors. In 2007 he was appointed CEO and member of the Board of Directors of Generali PPF Holding N.V. (GPH), one of the largest insurance groups in Central and Eastern Europe and a joint-venture of PPF and Assicurazioni Generali. He was CEO GPH until March 2013, and he is still member of the Board of Directors. At present he chairs the Supervisory Board of Energetický a průmyslový holding (EPH), he is member of the Board of Directors of Slovenský plynárenský priemysel (SPP) and from 1 March 2014 he is CEO at SOTIO a.s., a biotechnology company in the PPF group. He is Vice-chairman of the Board of Directors in GOPAS, a.s., B.I.G., a.s. and B.I.G. Public Relations, a.s. He is also Statutory Executive of B.I.G. Prague /Business Information Group/ s.r.o. He has been also a shareholder of the PPF group since 2007. In the last five years he was also member of the governing bodies in other corporations¹⁰.

Vladimír Mlynář (*1966)

Member of the Supervisory Board since 12 March 2014 (co-opted on 29 January 2014 and confirmed by election at the General Meeting on 12 March 2014)

He has been in a high executive position in the PPF group, where he is responsible for Public Relations and the group's activities vis-à-vis the public sector, since August 2010. After a successful career as journalist, he went into politics in 1998, where he was until 2005, holding several ministerial appointments and also as member of the Czech Parliament; in 2010 he was also chief advisor to the Prime Minister. In 2008–2009 he worked for Telefónica O2 Czech Republic, a.s. He is member of the Supervisory Board of PPF a.s, and member of the Board of Directors of Eustream Slovakia. Since 2014 he has been member of the Board of Directors of Bestsport Services, a.s. He has been a member of the Board of Trustees of the O₂

⁹ HELATIA a.s., TES VSETÍN, a.s., FORTUNA sázky a.s., FORTUNA GAME a.s., Česká lékárna, a.s., CLANTON a.s., REAL AB a.s.

¹⁰ Nadační fond pro podporu vzdělávání v pojišťovnictví

Foundation (formerly Telefónica Foundation) since February 2014. In the last five years he was also member of the governing bodies in other corporations ¹¹.

Supervisory Board committees

In 2013, the Supervisory Board had two committees: Nomination and Remuneration Committee and the Ethics and Corporate Social Responsibility Committee. Committee members were appointed and recalled by the Supervisory Board for a service tenure of two and half years.

As of 30 June 2013, the **Nomination and Remuneration Committee** had three members (five until then) and made 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 had 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 had two meetings in 2013. As at 31 December 2013, the committee had the following members: Maria Pilar López Álvarez (Chairwoman), Jesús Pérez de Uriquen (Vice-chairman) and Antonio Manuel Ledesma Santiago.

Following the resignation of Supervisory Board members from their membership (for details see section Supervisory Board above), the seats on the committee had been vacant after 29 January 2014. By decision of the General Meeting of 12 March 2014, the Nomination and Remuneration Committee was deleted from the Articles of Association, and the Supervisory Board of 24 March 2014 dissolved the committee. Topics within the Nomination and Remuneration Committee's authority shall be discussed directly by the Supervisory Board, which in view of the fact that the Supervisory Board has only three members is more effective than the existence of the committee.

As of 19 July 2013, the **Ethics and Corporate Social Responsibility Committee** had four members (six until then); a half of the seats were occupied by Supervisory Board members elected by employees. As every year, the committee addressed 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 were examined in this respect. The committee also monitored compliance with the Company's Business Principles, and the functioning of the confidential whistle-blowing channel, and it was 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 had two meetings in 2013. As at 31 December 2013, the committee had the following members: Antonín Botlík (Chairman), Jiří Trupl (Vice-chairman), Francisco de Borja de Nicolás Benito (member) and Ivan Varela Sanchez (member).

After the resignation of Supervisory Board members Francisco de Borja de Nicolás Benito and Ivan Varela Sanchez from their membership on 28 and 29 January 2014, respectively, and

¹¹ SAZKA sázková kancelář, a.s.

following the recall of Lubomír Vinduška, Jiří Trupl and Antonín Botlík by the General Meeting of 12 March 2014, the seats on the committee had been vacant. The Supervisory Board of 24 March 2014 ruled to abolish the committee; on the same day, a Social Dialogue Board was instituted by decision of the Supervisory Board as a new platform for dialogue with employees, in which members of the Company's governing bodies and employee deputies are represented.

7.4.4 Audit Committee

The Audit Committee 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 three 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 committee had five members in 2013. as part of the amendment to the Articles of Association, the number of members of the Audit Committee been reduced to three by decision of the General Meeting as of 13 March 2014.

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 2013

The Audit Committee met four times in 2013. 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.

Members of the Audit Committee as at 31 December 2013

Maria Pilar López Álvarez (*1970)

Chairwoman of the Audit Committee from 6 May 2013 until 28 January 2014
(for her résumé see section Supervisory Board)

Jesús Pérez de Uriguen (*1970)

Vice-chairman of the Audit Committee from 6 May 2013 until 28 January 2014
(for his résumé see section Supervisory Board)

Pavel Herštlík (*1951)

Member of the Audit Committee from 3 April 2013 until 28 January 2014

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, a.s.

Antonio Manuel Ledesma Santiago (*1972)

Member of the Audit Committee from 23 April 2013 until 28 January 2014
(for his résumé see section Supervisory Board)

Francisco de Borja de Nicolás Benito (*1976)

Member of the Audit Committee from 6 May 2013 until 28 January 2014
(for his résumé see section Supervisory Board)

Changes in the personnel composition of the Audit Committee

During 2013 and at the beginning of 2014 until the closing date of the Annual Report, the following changes occurred in the personnel composition of the Audit Committee:

- Jesús Pérez de Uriguen and Antonio Manuel Ledesma Santiago were elected as members of the Audit Committee on the General Meeting of 22 April 2013. The General Meeting also elected substitute members Francisco de Borja de Nicolás Benito, Lubomír Vinduška and Ivan Varela Sanchez.
- María Eva Castillo Sanz tendered her resignation from the position of Chairwoman and member of the Audit Committee as of 6 May 2013. Francisco Borja de Nicolás Benito, previously a substitute member, stepped in to fill the vacancy.
- On 6 May 2013, the committee elected Maria Pilar López Álvarez as its Chairwoman and, on the same date, Jesús Pérez de Uriguen as its Vice-chairman.
- On 28 January 2014, Maria Pilar López Álvarez (also as Chairwoman of the committee), Jesús Pérez de Uriguen (also as Vice-chairman of the committee), Pavel Herštlík, Antonio Manuel Ledesma Santiago and Francisco de Borja de Nicolás Benito resigned from their

membership in the Audit Committee. The substitute Audit Committee members Lubomír Vinduška and Ivan Varela Sanchez tendered their resignation as of the same date.

- The General Meeting of 12 March 2014 elected Martin Štefunko, Ondřej Chaloupecký and Radek Neužil as members of the Audit Committee.

Members of the Audit Committee

As from 12 March 2014, the Audit Committee has the following members:

Martin Štefunko (*1977)

Chairman of the Audit Committee since 24 March 2014

Member of the Audit Committee since 12 March 2014

(for his résumé see section Supervisory Board)

Radek Neužil (*1970)

Vice-chairman of the Audit Committee since 24 March 2014

Member of the Audit Committee since 12 March 2014

Graduated in Law with a LL.M. degree from the Law Faculty, Masaryk University, and got his Ing. degree at the Faculty of Engineering, Economics and Engineering Production Management, Technical University. He is an expert in regulation of free trades and professions. Since 1993 he has been Secretary to the Chamber of Tax Advisors of the Czech Republic, which he represents in Confédération Fiscale Européenne (CFE) and in other organisations. He has been a member in Paski clu, v.o.s., since 1995. Since 2009 he has been member of the Council Presidium for Public Audit Oversight, and Chairman of the Committee for Audit Cooperation and Coordination, which he represents in the European Group of Auditors' Oversight Bodies, which is an advisory body to the European Commission. Since 2011 he has been member of section Audit and Tax Consultancy, Ministry of Finance Commission for the Accounting and Audit Policy Planning and Development. As of the same year he has been also a member of the Board of Directors of the Charles University in Prague. In 2013 he became member of the Audit Committee in ČEZ a.s. In the last five years he was also member of the governing bodies in other corporations¹².

Ondřej Chaloupecký (*1972)

Member of the Audit Committee since 12 March 2014

Graduated in Information Technology from the University of Economics in Prague, Faculty of Informatics and Statistics in 1997. In 2010 he completed an EMBA programme at the University of Pittsburgh. Before joining PPF group he worked in the tax department of PricewaterhouseCoopers. He is member of the Chamber of Tax Advisors of the Czech Republic. He joined PPF group in 2002 and he is presently responsible for the area of taxes; he is member of the Supervisory Board of PPF a.s. and chairs the Supervisory Board in PPF reality a.s. and Moranda, a.s. In the last five years he was also member of the governing bodies in other corporations¹³.

¹² Daňová akademie s.r.o.

¹³ EUC holding a.s.

7.4.5 Executive management

The executive management of the Company as at 31 December 2013 had the following members:

Luis Antonio Malvido (*1964)

Chief Executive Officer

(for his résumé see section Board of Directors)

David Melcon Sanchez-Friera (*1970)

Director, Finance Division

(for his résumé see section Board of Directors)

Petr Slovák (*1959)

Director, Operations Division

(for his résumé see section Board of Directors)

Jakub Chytil (*1961)

Director, Legal and Corporate Affairs

(for his résumé see section Board of Directors)

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. Since 2011 he has been member of the Board of Trustees of the O₂ Foundation (formerly Telefónica Foundation). In the last five years he was also member of the governing bodies in other corporations¹⁴.

Martin Bek (*1969)

Director, Support Services

(for his résumé see section Board of Directors)

¹⁴ health insurance company Metal-Alliance

Jindřich Fremuth (*1975)

Director, Consumer Division

Appointed Director, Consumer Division in March 2013. He joined Telefónica CR in 2009 as Director, Online Channels, where he was responsible for the planning and execution of the Company's online strategy, management of online tools and application development. In 2011 he took over the responsibility for the consumer distribution channel strategy, which plays a major role in the development of customer care. Before joining Telefónica CR, he worked for 10 years in various marketing and sales positions. As consultant at McKinsey&Company, he specialised in telecommunications and technology projects, and worked for leading corporations in Europe and in the Middle East in particular. Previously he was Managing Director Euro RSCG 4D (Havas Group) whose business is digital marketing, direct marketing and sales support. Jindřich Fremuth graduated from the University of Economics in Prague.

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 Telekom 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 was responsible for corporate communication, CSR and the O₂ Foundation (formerly Telefónica Foundation).

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.

Vít Šubert (*1970)

acting Director, Business Division

Joined Telefónica CR in 2011 as Director, ICT & Presales. In this capacity he was responsible for the planning and execution of the Company's ICT strategy. Before joining Telefónica CR, he worked for several years in marketing and sales; first as Regional Marketing Director at Dell, later as Executive Director for the Czech Republic and Slovakia at LG Electronics. For over two years he was also Executive Director for the Czech Republic and Slovakia at Nextra. Since 2007 he has been member of the Board of Trustees of Srdce na dlani foundation. He started his career in ČESKÝ TELECOM (the previous commercial name of Telefónica CR) in 1997. As the head of the Internet OnLine division he was directly involved in the launch of the first commercial internet service in the Czech Republic.

Personnel changes in the executive management

In the period from the beginning of 2014 until the close date of the Annual Report, the following personnel changes occurred in the executive management:

- following the dissolution of some divisions, Martin Bek, Jiří Dvorjančanský and Dana Dvořáková left their posts as directors;
- Martin Vlček was appointed acting Director, Finance Division, after the departure of David Melcon Sanchez-Friera;
- Gustav Grundin was appointed Director, Strategic Division, after the departure of Felix Geyr;
- Tomáš Budník was appointed Director of the newly instituted IT & Demand Management.

7.5 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 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 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. 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 2013, the General Meeting ruled to change the rules for the remuneration of members of the Supervisory Board and the Audit Committee, to bring them more in line with the needs of the members and with the Company's cost optimisation programme.

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 on the Company's website (www.telefonica.cz, or www.ico60193336.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 serving as 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 ths; (ii) Vice-chair of the Board of Directors: the amount as in (i) plus CZK 10 ths; Chair of the Board of Directors: the amount as in (ii) plus CZK 10 ths.

In 2013, 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 undertaking of a non-competition covenant

A member of the Board of Directors may, in their executive service agreement, commit to the so-called non-competition covenant, i.e. a pledge not to do business, after the termination of the service, 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 executive service agreement (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 service. 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 serving as 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 to which individual categories of Supervisory Board members are eligible: (i) member: CZK 40 ths; (ii) vice-chair: the amount as in (i) plus CZK 20 ths; chair: the amount as in (ii) plus CZK 20 ths.

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 ths; (ii) vice-chair of the committee: the amount as in (i) plus CZK 12 ths; (iii) chair of the committee: the amount as in (ii) plus CZK 15 ths.

Members of the Supervisory Board elected by the General Meeting of 12 March 2014 will claim remuneration in a minimal scope: members will claim CZK 4 ths; Vice-chairman will claim CZK 5 ths and Chairman will claim CZK 6 ths.

Compensation for the undertaking of a non-competition covenant

A member of the Supervisory Board may, in their executive agreement, commit to the so-called non-competition covenant, i.e. a pledge not to do business, after the termination of the service, 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 executive service agreement (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 service. 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.

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 for business and private use (excluding doing business in one's own name);
- 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

In 2013, Audit Committee members received from the Company a pecuniary income amounting to CZK 3,515,036 and in-kind income in the value of CZK 272,709, of which the amount of CZK 127,000, 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 2013. In 2013, all Audit Committee members had an executive service agreement concluded with the Company, which stipulated their right to compensation for the commitment to a non-competition covenant after their tenure expires.

7.6 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 controlled undertakings:

(in CZK)	Pecuniary incomes	Of which royalties	In-kind incomes
Board of Directors total	72,349,314	0	8,042,792
- of which by virtue of membership in the Board of Directors of the Company	454,419	0	998,956
Supervisory Board total	9,719,130	0	1,693,056
- of which by virtue of membership in the Supervisory Board of the Company	4,908,790	0	1,426,460
Executive Management of Telefónica CR ¹⁾	30,834,464	0	3,578,527

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.

In 2013, members of the 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:

	Number of shares	Of which royalties	In-kind incomes
Board of Directors	0	0	11,030,070
Supervisory Board	0	0	1,168,216
Audit Committee ²⁾	100	0	2,473,259
Other persons with executive powers – Executive Management of Telefónica CR ³⁾	0	0	2,032,758

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.

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 work contracts and similar contracts concluded between members of the Board of Directors, the Supervisory Board and the Audit Committee

In 2013, all members of the Board of Directors and of the Supervisory Board were bound by a valid executive service agreement, which stipulates the eligibility for compensation for members who had committed to the non-competition covenant after the termination of their office. Members of the Supervisory Board elected by employees did not have an executive service agreement concluded in June 2013 as such agreements must be approved by the General Meeting and by the end of 2013.

7.7 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 2013 it was 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.

7.8 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. In 2013, the Company twice performed 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 verified the standard of the description, configuration and take the form of walkthrough tests and compliance tests of transactions, as well as the effectiveness of controlling mechanisms in the area of financial reporting. The audit results were consulted with the external auditor of the Company.

The audits performed in 2013 concluded that the internal controls, as applied, were of a standard which meets the SOX requirements. The quarterly declaration of the 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 2013, the internal audit and risk management function in the Company continued to be practised; at the beginning of 2014, the organisation of these functions was made a part of the direct reporting line of the Supervisory Board, as part of the Company's reorganisation.

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 2013, Internal Audit and Risk Management carried out 55 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. Audit findings are 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 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 & 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.

7.9 Information required by the Capital Markets 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

The equity structure of Telefónica CR as at 31 December 2013 was as follows:

	(in CZK m)
Share capital	27,461
Treasury shares	(1,596)
Share premium	19,349
Fund for share-related payments	38
Funds	6,450
Retained earnings	6,328
Total	58,030

The Company's share capital as at 31 December 2013 was CZK 27,461,384,874 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: 315,648,092 shares
 Nominal value: CZK 87
 Total volume of issue: CZK 27,461,384,004
 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 approving a programme of acquisition of own ordinary shares to improve the Company's capital structure. The total of 6,441,798 treasury shares of the Company, which had been acquired in the first tranche of the programme in 2012, were cancelled in 2013, and the Company's share capital has been reduced proportionately by the amount of CZK 560,436,426; the reduction was recorded in the Commercial Register as of 15 November 2013. At the same time, the share premium was reduced by the amount of CZK 1,992,071,504, which is the balance between the purchase price of the cancelled ordinary shares and their nominal value.

The General Meeting, which was held on 22 April 2013, passed a resolution approving the distribution of a part of the share premium of the Company among its shareholders. The share premium was thus reduced by the amount of CZK 3,103,743,110.

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.)	
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 33/906, 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 Company.

The registered share in the nominal value of CZK 870 was not listed for trading on any regulated market in Europe.

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 2013:

	Shareholder	Address	% of share capital
1	Telefónica, S.A.	Gran Vía 28, 28013 Madrid, Kingdom of Spain	70.83%
2	Telefónica Czech Republic, a.s. (treasury shares)	Za Brumlovkou 266/2, Praha 4 – Michle, 140 22, Czech Republic	1.72%
3	Investment funds and individual shareholders	–	27.45%

As at 31 December 2013, 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 72.07%.

In November 2013, an agreement to sell the majority shareholding in the Company by Telefónica, S.A. to the financial group PPF was announced. The transaction received an approval from the European Commission in the middle of January 2014, and it was settled as of 28 January 2014.

Key shareholders of Telefónica CR since 28 January 2014:

	Shareholder	Address	% of share capital
1	PPF Arena 2 B.V.	Strawinskylaan 933, Amsterdam, Kingdom of the Netherlands	65.93%
2	Telefónica, S.A.	Gran Vía 28, 28013 Madrid, Kingdom of Spain	4.90%
3	Telefónica Czech Republic, a.s. (treasury shares)	Za Brumlovkou 266/2, Praha 4 – Michle, 140 22, Czech Republic	1.72%
4	Investment funds and individual shareholders	–	27.45%

Since 28 January 2014, the share of PPF Arena 2 B.V., in the voting rights of Telefónica Czech Republic, a.s., according to the provision of Section 122 of the Capital Market Undertakings Act was 67.09%. The share of Telefónica, S.A. in the voting rights was 4.98%.

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 Company, 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 of 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 executive service 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 executive service 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.

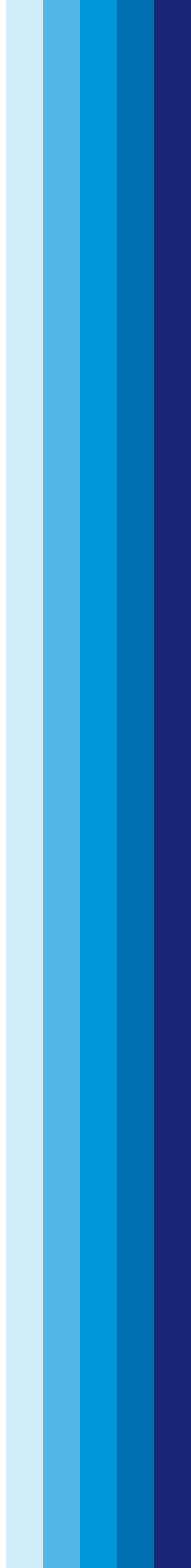
Information within reach



06

Financial part

Consolidated financial statements



8. Financial part

8.1 Consolidated financial statements for the year ended 31 December 2013 prepared in accordance with International Financial Reporting Standards

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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 Group operates a joint venture Tesco Mobile ČR s.r.o. with Tesco Stores ČR a.s.

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 was a member of the Telefónica Group of companies (Telefónica Group) with the parent company, Telefónica, S.A. (Telefónica) as at 31 December 2013.

The Company is the largest integrated telecommunications provider in the Czech market providing fully converged services.

The number of employees employed by the Group amounted in average to 5,876 in 2013 (2012: 6,502).

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 25 February 2014.

Sale to PPF Group

In November 2013 Telefónica reached an agreement with PPF Group (through PPF Arena 2 B.V.) to sell 65.9% of the Company's shares. The transaction involves all the Company's interests including Telefónica Slovakia, s.r.o. Both companies are allowed to trade under the O2 brand for a maximum of four years. They may also join Telefónica's Partners Programme, an initiative offering partner operators the opportunity to benefit from Telefónica's scale and cooperate on key business areas.

Reduction of the Company's share capital

In accordance with the resolution on reduction of the Company's share capital adopted by the Annual General Meeting of the Company held on 22 April 2013, the reduction of the Company's share capital was recorded into the Commercial Register on 15 November 2013. The Company's share capital was reduced by way of cancellation of 6,441,798 own ordinary shares with nominal value of CZK 87 (i.e. by CZK 560,436,426). Subsequently, the cancelled own ordinary shares were deleted from the statutory register. As at 31 December 2013, the amount of the Company's share capital equaled to CZK 27,461,384,874.

Share buyback

Following the resolution of the Annual 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 adopted on 26 February 2013 a resolution to continue with the acquisition of own ordinary shares (share buyback) to the extent of 6,441,798 of ordinary shares (i.e. up to 2% of the total ordinary shares issued by the Company as of that date). The Board of Directors adopted the decision to stop the acquisition of its own shares with effect from 29 October 2013.

LTE broadband mobile data network

In the year 2013 the auction part of the tender for the awarding the rights to use radio frequencies in the 800 MHz, 1800 MHz and 2600 MHz spectrum bands ended for both the Czech Republic and the Slovak Republic. These bands are necessary for the development of a new generation LTE network (4G). Telefónica Czech Republic, a.s. succeeded in the tender in above mentioned bands. Telefónica Slovakia, s.r.o. auctioned off frequency allotments in the 800 MHz and 1800 MHz bands.

This spectrum combination will allow the Company to build the highest speed and quality network in the Czech Republic. The Company has already covered a significant part of Prague and Brno with the LTE network. The Company will start rolling out the 4G network in new locations in the Czech Republic in the first half of year 2014.

Frequency allotments auctioned by Telefónica Slovakia, s.r.o will simplify the deployment of 4G networks in the country and enable the high-speed mobile internet will also be available in remote areas where broadband access is currently limited.

Agreement to share 2G and 3G networks

In October 2013 the Company has signed an agreement with T-Mobile Czech Republic a.s. to share their current 2G and 3G mobile networks. The deal has been made in order to achieve the optimal coverage in the Czech Republic and efficiencies in 2G and 3G networks and technologies. The transaction will bring tangible benefits to the customers, especially in the form of better services and coverage. The deal builds upon the very successful 3G network sharing scheme, which both companies already implemented in 2011-2012.

Restructuring

Over the course of 2013, the Group continued to implement its restructuring and cost-optimization activities aimed at further improving its operating efficiency. The Group 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 centres consolidation and optimization; reduction of the number of applications and systems in use including optimisation of the related processes. Some restructuring projects have led to a transfer of the activities to outsourcing partners. More than 800 employees were made redundant during the restructuring process, and the Group incurred restructuring costs of CZK 368 million (see Note 2).

INDEPENDENT AUDITOR'S REPORT



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 2013, 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

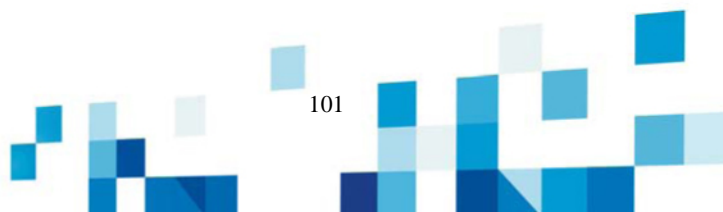
Management of Telefónica Czech Republic, a.s. is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with International Financial Reporting Standards as adopted by the European Union, and for such internal control as management determines is 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 2013, 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

25 February 2014

Prague, Czech Republic

A member firm of Ernst & Young Global Limited
Ernst & Young Audit, s.r.o. with its registered office at Na Florenci 2116/15, 110 00 Prague 1 - Nove Mesto,
has been incorporated in the Commercial Register administered by the Municipal Court in Prague,
Section C, entry no. 88504, under Identification No. 26704153.

CONSOLIDATED STATEMENT OF TOTAL COMPREHENSIVE INCOME

For the year ended 31 December 2013

In CZK million	Notes	Year ended 31 December 2013	Year ended 31 December 2012
Revenues	2	47,895	50,534
Other income	2	867	1,127
Expenses	2	(30,274)	(31,852)
Impairment loss		<u>(11)</u>	<u>(28)</u>
Operating income before depreciation and amortization (OIBDA)		18,477	19,781
Depreciation and amortisation	7, 8	<u>(11,032)</u>	<u>(11,437)</u>
Operating profit		7,445	8,344
Finance income	3	148	103
Finance costs	3	(323)	(291)
Results attributed to joint venture		<u>(6)</u>	<u>-</u>
Profit before tax		7,264	8,156
Corporate income tax	4	<u>(1,569)</u>	<u>(1,380)</u>
Profit for the year		5,695	6,776
Other comprehensive income			
Items that may be reclassified subsequently to profit or loss			
Translation differences		<u>373</u>	<u>(65)</u>
Other comprehensive income, net of tax		<u>373</u>	<u>(65)</u>
Total comprehensive income, net of tax		6,068	6,711
Profit attributable to:			
Equity holders of the Company	5	5,695	6,776
Total comprehensive income attributable to:			
Equity holders of the Company		6,068	6,711
Earnings per share (CZK) – basic*	5	18	21

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

CONSOLIDATED BALANCE SHEET

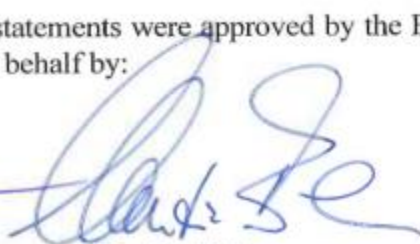
As at 31 December 2013

In CZK million	Notes	31 December 2013	31 December 2012
ASSETS			
Property, plant and equipment	7	41,857	46,691
Intangible assets	8	20,008	20,330
Investment in associate	21	9	29
Other financial assets	10	169	112
Deferred tax asset	14	417	673
Non-current assets		62,460	67,835
Inventories	9	536	487
Receivables	10	7,062	7,732
Income tax receivable	4	1	101
Cash and cash equivalents	11	3,890	3,044
Current assets		11,489	11,364
Total assets		73,949	79,199
EQUITY AND LIABILITIES			
Ordinary shares	19	27,461	28,022
Treasury shares	19	(1,596)	(2,483)
Share premium		19,349	24,374
Retained earnings, funds and reserves		10,535	10,661
Total equity		55,749	60,574
Long-term financial debts	13	3,000	3,000
Deferred tax liability	14	2,735	3,206
Non-current provisions for liabilities and charges	15	26	29
Non-current other liabilities	12	64	87
Non-current liabilities		5,825	6,322
Short-term financial debts	13	4	31
Trade and other payables	12	12,199	12,235
Income tax liability	4	155	5
Provisions for liabilities and charges	15	17	32
Current liabilities		12,375	12,303
Total liabilities		18,200	18,625
Total equity and liabilities		73,949	79,199

The consolidated financial statements were approved by the Board of Directors on 25 February 2014 and were signed on its behalf by:



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



Martin Bek
Member
of the Board of Directors



David Melcon Sanchez-Friera
Chief Financial Officer

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

For the year ended 31 December 2013

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 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)
Distribution declared in 2012	6	-	-	-	-	-	-	(8,696)	(8,696)
Treasury share transactions	19	-	-	(2,483)	-	-	-	91	(2,392)
Share capital increase/(decrease)	19	(4,187)	-	-	-	-	-	72	(4,115)
At 31 December 2012		28,022	24,374	(2,483)	(117)	31	6,499	4,248	60,574
At 1 January 2013		28,022	24,374	(2,483)	(117)	31	6,499	4,248	60,574
Currency translation differences – amount arising in period		-	-	-	373	-	-	-	373
Profit for the year		-	-	-	-	-	-	5,695	5,695
Total comprehensive income		-	-	-	373	-	-	5,695	6,068
Capital contribution and other transfers		-	-	-	-	7	43	(36)	14
Distribution declared in 2013	6	-	(3,221)	-	-	-	-	(6,442)	(9,663)
Treasury share transactions	19	-	118	(1,596)	-	-	-	234	(1,244)
Cancellation of treasury shares	19	(561)	(1,922)	2,483	-	-	-	-	-
At 31 December 2013		27,461	19,349	(1,596)	256	38	6,542	3,699	55,749

* Refer to Note 19 regarding amounts not available for distribution.

CONSOLIDATED STATEMENT OF CASH FLOWS

For the year ended 31 December 2013

In CZK million	Notes	Year ended 31 December 2013	Year ended 31 December 2012
Cash flow from operating activities			
Cash received from operations		53,719	54,592
Cash paid to suppliers and employees		(34,936)	(35,428)
Dividends received		5	5
Net interest and other financial income/expenses paid	11	(23)	(150)
Taxes paid		(1,463)	(1,783)
Net cash from operating activities		17,302	17,236
Cash flow from investing activities			
Proceeds from disposals of property, plant and equipment and intangible assets		72	322
Payments on investments in property, plant and equipment and intangible assets		(5,584)	(5,921)
Payments on investments in WiFi acquisition		(53)	(148)
Payments made on financial investments		(10)	(18)
Returned warranty deposit for spectrum auction		250	-
Paid warranty deposit for spectrum auction		(375)	(250)
Repayments of loans made to joint ventures		12	-
Provisions of loans made to joint ventures		(30)	-
Net cash used in investing activities		(5,718)	(6,015)
Cash flow from financing activities			
Dividends paid		(6,191)	(8,598)
Capital decrease	19	(3,104)	(4,115)
Cash payments to owners for acquisition of treasury shares	19	(1,596)	(2,483)
Proceeds from loans		-	3,000
Repayments of loans, borrowings and promissory notes	13	-	(2,912)
Net cash used in financing activities		(10,891)	(15,108)
Effect of foreign exchange rate changes on collections and payments		153	(24)
Net increase / (decrease) in cash and cash equivalents during the period		846	(3,911)
CASH AND CASH EQUIVALENTS AT THE BEGINNING OF THE PERIOD		3,044	6,955
CASH AND CASH EQUIVALENTS AT THE END OF THE PERIOD	11	3,890	3,044
BALANCE AT THE BEGINNING OF THE PERIOD		3,044	6,955
Cash on hand and at banks		3,025	6,932
Other cash equivalents		19	23
BALANCE AT THE END OF THE PERIOD	11	3,890	3,044
Cash on hand and at banks		3,874	3,025
Other cash equivalents		16	19

ACCOUNTING POLICIES

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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 V.

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

In order to clarify and enhance quality of presented information, without changing accounting policies, the Group decided to simplify certain parts of the financial statements. Simplifications mainly concern statement of total comprehensive income, notes concerning revenues and costs and property, plant and equipment.

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

In 2013, the Group adopted 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.

Amendments to IFRS 7 Disclosures – Offsetting Financial Assets and Financial Liabilities

The Group has applied the amendments to IFRS 7 Disclosures – Offsetting Financial Assets and Financial Liabilities for the first time in the current year. The amendments to IFRS 7

require entities to disclose information about rights of offset and related arrangements for financial instruments under an enforceable master netting agreement or similar arrangement.

The amendments have been reflected in notes to the financial statements.

IFRS 13 Fair Value Measurement

IFRS 13 defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction in the principal (or most advantageous) market at the measurement date under current market conditions. Fair value under IFRS 13 is an exit price regardless of whether that price is directly observable or estimated using another valuation technique. Also, IFRS 13 includes disclosure requirements.

The application of IFRS 13 has not had any material impact on the amounts recognised in the financial statements.

Amendments to IAS 1 Presentation of Items of Other Comprehensive Income

The amendments introduce new terminology, whose use is not mandatory, for the statement of comprehensive income and income statement. The amendments to IAS 1 retain the option to present profit or loss and other comprehensive income in either a single statement or in two separate but consecutive statements. However, the amendments to IAS 1 require items of other comprehensive income to be grouped into two categories in the other comprehensive income section: (a) items that will not be reclassified subsequently to profit or loss and (b) items that may be reclassified subsequently to profit or loss when specific conditions are met.

Other than the above mentioned presentation changes, the application of the amendments to IAS 1 does not result in any impact on profit or loss, other comprehensive income and total comprehensive income.

New IFRS not effective as at 31 December 2013 (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
IFRS 9 Financial Instruments	1 January 2015
IFRS 10 Consolidated Financial Statements	1 January 2014
IFRS 11 Joint Arrangements	1 January 2014
IFRS 12 Disclosure of Interests in Other Entities	1 January 2014

IAS 27 Separate Financial Statements	1 January 2014
IAS 28 Investments in Associates and Joint Ventures	1 January 2014
IAS 32 Offsetting Financial Assets and Financial Liabilities — Amendments	1 January 2014
IAS 36 Recoverable Amount Disclosures for Non-Financial Assets	1 January 2014
IAS 39 Novation of Derivatives and Continuation of Hedge Accounting	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.

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 F 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.

C Investment in joint ventures and associates

A joint venture is a contractual arrangement whereby the Group and other parties undertake an economic activity that is subject to joint control (i.e. when the strategic financial and operating policy decisions relating to the activities of the joint venture require the unanimous consent of the parties sharing control).

In relation to its interest in a joint arrangement, the Group recognises joint ventures, that are accounted for using the equity method.

An associated undertaking is an enterprise where the Group has significant influence, which is the power to participate in the financial and operating policy decisions, but not exercise control.

Associates are accounted for using the equity method.

D 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.

E 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 H Impairment of assets).

F Intangible assets

Intangible assets of the Group 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 of the Group 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).

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.

G 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.

H 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 inflows (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.

I 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 2013 and 2012, 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. During 2013 and 2012, the Group did not hold any investments in this category.

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.

J 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.

K 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.

L 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.

M 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.

N 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.

O 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 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.

P Employee benefits

(1) Pension insurance and supplementary pension insurance

The Group remits contributions to the state pension insurance scheme at the statutory rates applicable during the period which are based on gross salaries. The contributions to the state budget for the funding of the state pension insurance correspond to the defined contribution plans. The contribution expense is charged to profit or loss in the same period as the related salary expense. The Group also makes contributions to defined supplementary pension insurance schemes operated by external pension funds. These contributions are charged to profit or loss in the period to which the contributions relate. The Group has no further payment obligations once the contributions have been paid.

(2) Redundancy and severance payments

Employees whose employment was terminated before term citing statutory reasons are entitled for redundancy and severance payment. The Group recognises provision for redundancy and severance payments when it is demonstrably committed to terminate the employment of current employees according to a detailed formal plan without the possibility of opt-out. Severance payments falling due more than 12 months after the balance sheet date are discounted to present value. The Group presently has no redundancy and severance obligations falling due more than 12 months after the balance sheet date.

(3) Bonus plans

The Group recognises employee bonuses related to the given accounting period in accordance with the expectations of achievement of the targets of the Group, which take into consideration key performance indicators such as turnover or free cash flow after adjustments. The Group recognises a provision where the Group is contractually obliged to grant bonuses or where there is a past practice that has created constructive obligation.

Q 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.

R 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.

S Revenue and expenses

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. Commission payments to dealers for activations, various marketing promotions and other activities are included in the costs of sales for the period.

Revenue and expenses are recognized on an accrual basis; i.e. when the flow of goods or services takes place, regardless of when the payment or collection is being made.

Voice, data and internet

Revenues from voice, data and internet services entail tariff fee plus a variable rate. Both wireline and wireless traffic is recognized as revenue as service is provided.

Free minutes

The Group offers customers free minutes with their choice of price plan. Free unused minutes at the end of the month can 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.

Revenues from prepaid cards

Revenues arising from prepaid call card are deferred until the customer uses the credit on the card to pay for the relevant calls or other services. Revenue from prepaid cards is recognised at the time of usage of airtime and other services.

Equipment sales and sale of other goods

Revenue from the sale of telephone equipment 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. Revenues are thus recognized when the product or service is delivered to the distributor or to the end customer. Losses arising from the sale of handsets due to discount are recognised at the date of sale.

Information and communication technology and construction contracts

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.

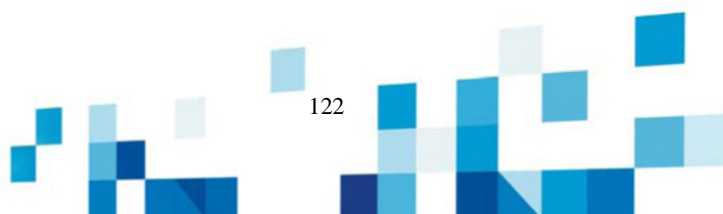
Revenue from fixed price construction contracts (long-term contracts) is recognised using the percentage of completion method, measured by reference to the percentage of actual cost incurred to date to estimated total costs of the contract. A loss expected from the construction contract is recognised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

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. Revenue is recognised when services are provided.

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.

Multiple element arrangements

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.

Gross and net revenue recognition

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 whether a transaction is considered to meet conditions of an agency arrangement. In such cases, the revenue is recognised only at the amount of the commission received/realised. The Group may enter agency relationship when providing premium SMS, audiotex or other services.

Dividend income

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

Interest income

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

Instalment sales

Revenue attributable to the sale 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.

T 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.

U 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 13.

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).

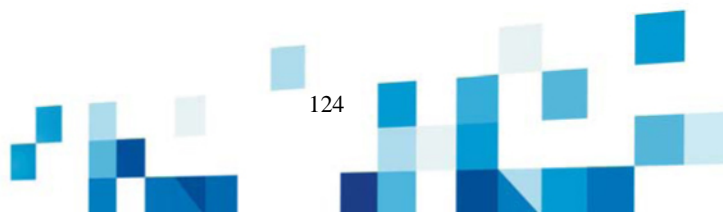
The Group's objective in managing its exposure to foreign currency fluctuations is to minimize earnings and cash flow volatility associated with foreign exchange rate changes.

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

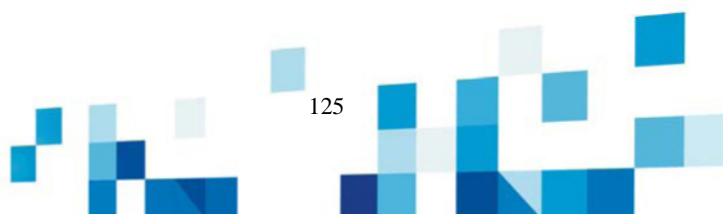
Credit risk concentration, with respect to trade accounts receivable, is limited due to the large number of customers. However, substantially all trade receivables are concentrated within the Czech Republic and the Slovak Republic. Although the Group does not currently foresee a dramatically higher credit 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 10. 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).

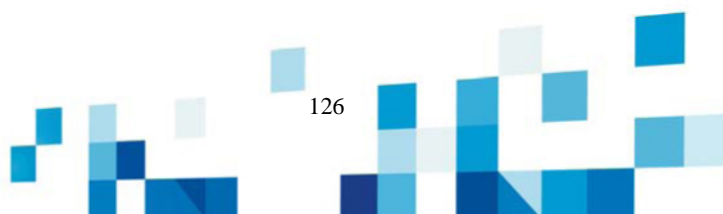
Changes in the fair value of derivatives that are designated and qualified as fair value hedges and that are highly effective are recorded in profit or loss, along with changes in the fair value of the hedged asset or liability that is attributable to the hedged risk.

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.

V 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:

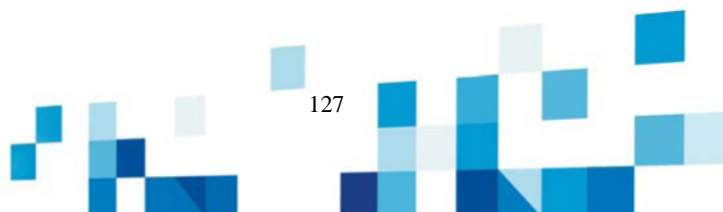
(1) Income taxes and deferred taxes

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 14).

(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 E Property, plant and equipment and Note F 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 8).

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 16 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 15). 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

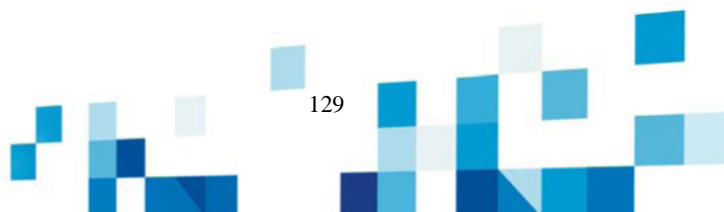
Trade receivables are carried at original amount less bad debt allowance. The bad debt provision is estimated according to historical experience and individual assessment. Details regarding the determination of receivables impairment are stated in Note L Trade receivables.

W Change in accounting policy

No significant changes in accounting policies were applied in 2013 and 2012.

X 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.



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1 Segment information

Operating segments recognised by the Group are as follows:

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

The Company newly reports separately the information about Telefónica Slovakia, an operating segment which in 2013 met the quantitative and qualitative thresholds. Its reported revenues constitute more than 10 % of the combined revenues of all operating segments. The operating results of the Telefónica Slovakia segment are regularly controlled and reviewed by the accounting unit's chief officer who holds the power to make decisions about resource allocation to the segment and to assess its performance.

Year ended 31 December 2013 In CZK million	Czech Republic		Slovak Republic	
	Fixed	Mobile	Telefónica Slovakia	Group
Revenues	20,605	22,856	5,398	48,859
Other income	540	302	18	860
Inter-segment sales	(484)	(340)	(133)	(957)
Total consolidated income	20,661	22,818	5,283	48,762
Total consolidated costs	(13,279)	(13,687)	(3,308)	(30,274)
Impairment charge	(8)	(3)	-	(11)
Depreciation and amortization	(7,015)	(3,533)	(484)	(11,032)
Operating income	359	5,595	1,491	7,445
Net financial loss				(175)
Results attributed to joint venture				(6)
Profit before tax				7,264
Corporate income tax				(1,569)
Profit for the year				5,695
Assets (excluding goodwill)	34,915	21,560	3,975	60,450
Goodwill	179	13,320	-	13,499
Total assets	35,094	34,880	3,975	73,949
Trade and other payables	(5,352)	(5,377)	(1,470)	(12,199)
Other liabilities	(3,901)	(2,095)	(5)	(6,001)
Total liabilities	(9,253)	(7,472)	(1,475)	(18,200)
Capital expenditure including WiFi acquisition	3,080	2,135	458	5,673

Year ended 31 December 2012 In CZK million	Czech Republic		Slovak Republic	
	Fixed	Mobile	Telefónica Slovakia	Group
Revenues	21,705	24,967	4,832	51,504
Other income	812	292	15	1,119
Inter-segment sales	(431)	(451)	(80)	(962)
Total consolidated income	22,086	24,808	4,767	51,661
Total consolidated costs	(13,448)	(15,236)	(3,168)	(31,852)
Impairment charge	(20)	(7)	(1)	(28)
Depreciation and amortization	(7,366)	(3,632)	(439)	(11,437)
Operating income	1,252	5,933	1,159	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	23,075	3,930	65,702
Goodwill	177	13,320	-	13,497
Total assets	38,874	36,395	3,930	79,199
Trade and other payables	(5,108)	(5,863)	(1,264)	(12,235)
Other liabilities	(3,241)	(3,143)	(6)	(6,390)
Total liabilities	(8,349)	(9,006)	(1,270)	(18,625)
Capital expenditure including WiFi acquisition	3,076	2,882	408	6,366

The inter-segment pricing rates applied in 2013 and 2012 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.

As at 31 December 2013, the net book value of fixed assets deployed in the Slovak Republic amounted to CZK 2,791 million (2012: CZK 2,591 million).

2 Revenues and costs

Revenues	Year ended	Year ended
In CZK million	31 December 2013	31 December 2012
Revenues from voice services	25,903	29,444
Revenues from data services	11,371	11,296
Other telecommunication revenues	10,621	9,794
Total revenues	47,895	50,534
Other income	867	1,127

Other income contains own work capitalized. In the financial statements for the year ended 31 December 2012, this item was presented in category Other expenses. In order to match internal and external reporting, this item is presented within category Other income for years ended 31 December 2013 and 2012.

Revenues from related parties are disclosed in Note 20.

Expenses	Year ended	Year ended
In CZK million	31 December 2013	31 December 2012
Supplies	(14,307)	(14,739)
Staff costs	(5,436)	(5,838)
External services	(9,631)	(10,242)
Provisions for bad debts and inventories	(456)	(523)
Other expenses	(444)	(510)
Total expenses	(30,274)	(31,852)

Supplies include mainly these types of costs: interconnection and roaming expenses, cost of goods sold, subdeliveries, commissions and other cost of sales.

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 2013 and 2012. As a result of the restructuring process the Group incurred restructuring costs of CZK 368 million during the year ended 31 December 2013 (2012: CZK 265 million), including redundancy payments of CZK 336 million (2012: CZK 231 million) and related consultancy costs of CZK 32 million (2012: CZK 34 million).

Restructuring costs are included in staff costs.

Statutory auditor's fees during the year ended 31 December 2013 reached CZK 20 million (2012: CZK 21 million).

Purchases from related parties are disclosed in Note 20.

3 Finance income and costs

In CZK million	Year ended 31 December 2013	Year ended 31 December 2012
Finance income		
Interest income	12	82
Gain on fair value adjustments of financial instruments (net)	126	-
Foreign exchange gain (net)	-	12
Other finance income	10	9
Total finance income	148	103
Finance costs		
Interest expenses	(67)	(160)
Loss on fair value adjustments of financial instruments (net)	-	(90)
Foreign exchange loss (net)	(201)	-
Other finance costs	(55)	(41)
Total finance costs	(323)	(291)

The Group recognises foreign exchange gains and losses and fair value adjustments on net basis.

4 Income tax

In CZK million	Year ended 31 December 2013	Year ended 31 December 2012
Total income tax expense is made up of:		
Current income tax charge	1,732	1,857
Deferred income tax credit (Note 14)	(163)	(477)
Income tax	1,569	1,380

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 2013	Year ended 31 December 2012
Profit before tax	7,264	8,156
Income tax charge calculated at the weighted average statutory rate (Note 14)	1,431	1,550
Not taxable income	(3)	(45)
Expenses not deductible for tax purposes	73	91
Tax related to prior periods	(1)	(100)
Tax losses from previous years	2	-
Special tax for regulated business for Telefónica Slovakia, s.r.o.	50	12
Effect of the first time deferred tax recognition by Telefónica Slovakia, s.r.o.	-	(11)
Effect of tax rate change on deferred tax asset by Telefónica Slovakia, s.r.o.	17	(117)
Taxes on income	1,569	1,380
Effective tax rate	22%	17%

As at 31 December 2013 the total amount of provisions for current income taxes is CZK 1,716 million (2012: CZK 1,859 million), advances paid for income taxes is CZK 1,562 million (2012: CZK 1,955 million), the net deferred tax liability is CZK 2,735 million (2012: CZK 3,206 million), the net deferred tax asset is CZK 417 million (2012: CZK 673 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 2013	31 December 2012
Weighted number of ordinary shares outstanding	312,834,249	319,932,546
Net profit attributable to shareholders (in CZK million)	5,695	6,776
Basic earnings per share (CZK)	18	21

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. The Board of Directors adopted the decision to stop the acquisition of its own shares as of 29 October 2013.

6 Dividends and other distribution

In CZK million	31 December 2013	31 December 2012
Dividends declared (including withholding tax)	6,442	8,696
Other distribution	3,221	4,187
Total declared distribution	9,663	12,883

Dividends include withholding tax on dividends paid by the Company to its shareholders. There has been no interim dividend paid in respect of 2013. Approval of the 2013 profit and the decision regarding the amount of any dividend payment for the 2013 financial year will take place at the Annual General Meeting.

The Annual General Meeting, held on 22 April 2013, approved also the distribution of part of the Company's share premium to the shareholders of CZK 10 before tax per share (CZK 3,221 million in total). Own shares are not eligible for the share premium distribution.

In 2012, each share with original nominal value of CZK 100 was decreased by CZK 13 per share and the share with the nominal value of CZK 1,000 was decreased by CZK 130. The total amount to be paid to shareholders as a result of the reduction of the share capital amounted to CZK 4,187 million.

Distribution per share for the years ended 31 December was as follows:

In CZK	Year ended 31 December 2013	Year ended 31 December 2012
Dividend per share (nominal value of CZK 87)	20	27
Other distribution	10	13
Total distribution per share	30	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 2013					
Opening net book amount	10,295	25,577	9,609	1,210	46,691
Additions	316	848	2,162	211	3,537
Disposals	(12)	(5)	(45)	-	(62)
Reclassifications and currency differences	87	21	153	(14)	247
Depreciation charge	(793)	(4,884)	(2,336)	(532)	(8,545)
Impairment charge	-	-	(11)	-	(11)
Closing net book amount	9,893	21,557	9,532	875	41,857
At 31 December 2013					
Cost	20,457	104,321	84,993	7,380	217,151
Accumulated depreciation and impairment allowance	(10,564)	(82,764)	(75,461)	(6,505)	(175,294)
Net book amount	9,893	21,557	9,532	875	41,857
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

The net book amount of PPE as at 31 December 2013 includes CZK 1,655 million of construction in progress (2012: CZK 2,117 million). The assets under construction are spread over all disclosed categories of property, plant and equipment following their nature.

As at 31 December 2013, the carrying value of non-depreciated assets amounted to CZK 178 million (2012: CZK 179 million).

No property, plant and equipment were pledged as at 31 December 2013 and 31 December 2012.

No borrowing costs were capitalized during the years 2013 and 2012.

The Group did not recognise any assets held for sale as at 31 December 2013 and 31 December 2012.

In 2013, the Group achieved a total gain from the sale of the fixed assets amounting to CZK 62 million (2012: CZK 285 million) and total losses of CZK 11 million (2012: CZK 10 million).

Cost of fully depreciated property, plant and equipment was CZK 68,794 million as at 31 December 2013 (2012: CZK 73,091 million).

The Group reviewed the indicators of fixed segment (cash-generating unit, CGU) seeking for any indication of impairment to the CGU's assets, see Note 8.

8 Intangible assets

In CZK million	Goodwill	Licences	Software	Customer portfolio	Total
At 31 December 2013					
Opening net book amount	13,497	2,856	3,347	630	20,330
Additions	-	-	2,136	-	2,136
Reclassifications and currency differences	2	9	19	(1)	29
Amortisation charge	-	(392)	(1,984)	(111)	(2,487)
Closing net book amount	13,499	2,473	3,518	518	20,008
At 31 December 2013					
Cost	13,499	5,936	29,557	685	49,677
Accumulated amortisation and impairment allowance	-	(3,463)	(26,039)	(167)	(29,669)
Net book amount	13,499	2,473	3,518	518	20,008
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

The net book amount of intangible assets as at 31 December 2013 includes CZK 779 million of construction in progress (2012: CZK 1,127 million). The assets under construction are spread over all disclosed categories of intangible assets following their nature.

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). From 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 2013 and 2012. 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 the most recent 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 expenditures, market share, growth rates and the discount rates.

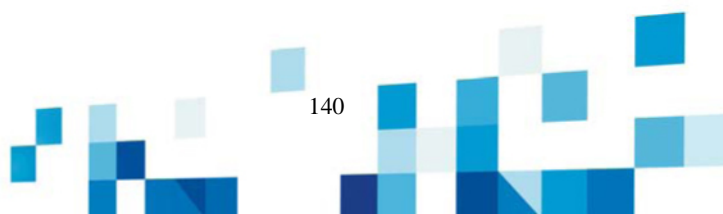
Any significant future changes in the market and competitive environments could have an adverse effect on the value of the cash-generating units.

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. The Group uses zero 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. This rate is calculated using the capital asset pricing model (CAPM), the Group also uses relevant data taken from independent financial analysts as a benchmark. The Group uses WACC at 9,4% (pre-tax).

The Group has no other intangible asset with indefinite useful life except for goodwill.



As at 31 December 2013 and 31 December 2012, the Group reviewed the indicators of fixed segment (cash-generating units, CGU), seeking for any indication of impairment to the CGU's assets. The assessment carried out as at 31 December 2013 and 2012 confirmed that carrying amounts of non-current assets are supportable.

Goodwill on WiFi acquisitions

In accordance with the principles of 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, a Purchase Price Allocation of all acquired assets and assumed liabilities at their fair values was carried out in all acquired businesses.

Goodwill in the amount of CZK 51 million was recognised following acquisition of network infrastructure, customer base and the related assets and liabilities from local providers of WiFi Internet access. Goodwill arised on acquisitions performed till the year 2012. There were no acquisitions in the year 2013. 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 299 million and the fair value of net assets acquired of CZK 248 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.

Carrying value of licences:

In CZK million	Valid by	31 December 2013	31 December 2012
GSM 900 licence	2016	186	258
GSM 1800 licence	2016	150	208
CDMA 450 licence	2018	18	23
UMTS licence	2022	2,019	2,269
GSM and UMTS licence – the Slovak Republic	2026	100	98
Total		2,473	2,856

No borrowing costs were capitalized during the years 2013 and 2012.

Cost of fully amortised intangible assets was CZK 16,616 million as at 31 December 2013 (2012 CZK: 19,790 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.

The Group incurs internal research and development costs on activities pursuant to § 2 paragraph 1 of Act on Research and Development Support No. 130/2002 Coll.; however, these costs do not meet the criteria for capitalization under IAS 38 Intangible Assets standard for both years 2013 and 2012.

9 Inventories

In CZK million	31 December 2013	31 December 2012
Telecommunication material	79	94
Goods	457	393
Total	536	487

The inventories stated above are net of an allowance of CZK 44 million (2012: CZK 60 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 60 million (2012: CZK 65 million). The amount of inventories recognised as an expense is CZK 2,746 million (2012: CZK 2,614 million).

In 2013 and 2012, the Group had no inventories pledged as a security for liabilities.

10 Receivables

In CZK million	31 December 2013	31 December 2012
Trade receivables from third parties (net)	5,629	6,448
Group trade receivables	469	352
Prepayments	774	699
Other debtors (net)	190	233
Total	7,062	7,732

Trade receivables and other debtors are stated net of bad debt provision of CZK 3,946 million (2012: CZK 3,819 million).

Prepayments contain the deposit paid for spectrum auction participation of CZK 375 million (2012: CZK 250 million).

Receivables from related parties are disclosed in Note 20.

Trade receivables In CZK million	Carrying amount	Neither Impaired nor overdue	Not impaired but overdue			
			Less than 90 days	90 and 180 days	180 and 360 days	More than 360 days
At 31 December 2013	6,098	2,869	392	49	6	65
At 31 December 2012	6,800	3,035	183	23	26	74
Bad debt provisions						
In CZK million						
At 1 January 2012						3,718
Additions						2,490
Retirements/amount paid						(2,389)
At 31 December 2012						3,819
Additions						1,889
Retirements/amount paid						(1,762)
At 31 December 2013						3,946

The Group's historical experience regarding the collection of accounts receivable is consistent with the recorded allowances. Because of 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 2013, the Group presented non-current financial assets of CZK 169 million (2012: CZK 112 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 2013 non-current financial assets contained restricted cash of CZK 26 million (2012: CZK 20 million) resulting to the Company, as small payment services provider, from the legal requirements of the regulator Czech National Bank.

Financial instruments that are subject to an enforceable master netting arrangement or similar agreement include particularly roaming and interconnection services. Financial instruments are as follows:

In CZK million	31 December 2013	31 December 2012
Gross amounts of trade receivables from third parties	935	894
Amounts that are set off	(426)	(407)
Net amounts of trade receivables from third parties	509	487

11 Cash and cash equivalents

In CZK million	31 December 2013	31 December 2012	Interest rate
Cash at current bank accounts and other cash equivalents	352	283	Floating
Cash at cash-pooling structures (inter-company) (Note 20)	3,538	2,761	Floating
Total cash and cash equivalents	3,890	3,044	

As at 31 December 2013 and 2012, 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 2013, the Group had available equivalent of CZK 1,454 million (2012: CZK 1,408 million) of undrawn committed facilities.

As at 31 December 2013 and 2012 no cash and cash equivalents were pledged.

Net interest and other financial income/expenses paid are as follows:

In CZK million	Year ended 31 December 2013	Year ended 31 December 2012
Interest paid	(79)	(210)
Interest received	12	87
Bank commissions	(26)	(40)
Other financial incomes	70	13
Total	(23)	(150)

12 Trade and other payables

In CZK million	31 December 2013	31 December 2012
Trade creditors	10,075	9,896
Tax and social security liability	609	669
Other deferred revenue	488	319
Prepaid cards	414	461
Employee wages and benefits	486	519
Other creditors	127	371
Total payables	12,199	12,235
Other non-current liabilities	64	87

Payables to related parties are disclosed in Note 20.

As at 31 December 2013 and 2012, 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.

Financial instruments that are subject to an enforceable master netting arrangement or similar agreement include particularly roaming and interconnection services. Financial instruments are as follows:

In CZK million	31 December 2013	31 December 2012
Gross amounts of trade creditors	996	962
Amounts that are set off	(426)	(407)
Net amounts of trade creditors	570	555

13 Financial liabilities and financial assets

In CZK million	31 December 2013	31 December 2012
Debt in local currency	3,000	3,000
Interest obligation and derivatives	4	31
Total financial debt	3,004	3,031
Repayable:		
Within one year	4	31
Between two and five years	3,000	3,000
Total financial debt	3,004	3,031

Term loan facility

On 27 September 2012, the Company signed a 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 uses it for general corporate purposes as well. The loan facility is priced at 1M PRIBOR plus margin 1.75% p.a. (2012: 3M PRIBOR plus margin 1.75% p.a.).

In July 2012 the Company repaid in a due course a loan in the amount of EUR 115 million drawn in 1997.

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 2013 based on contractual undiscounted payments.

At 31 December 2013

In CZK million	Less than 3 months	3 to 12 months	1 to 5 years	> 5 years
Interest bearing loans and borrowings	16	47	3,112	-
Trade and other payables (excluding Other deferred revenue and Prepaid cards)	9,854	1,443	-	-
Total	9,870	1,490	3,112	-
Non-current other liabilities	-	-	58	6

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 (excluding Other deferred revenue and Prepaid cards)	10,288	1,167	-	-
Total	10,317	1,215	3,179	-
Non-current other liabilities	-	-	81	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	
	2013	2012	2013	2012
Financial assets				
Cash and cash equivalents	3,890	3,044	3,890	3,044
Short-term loans (incl. accrued interest)	18	1	18	1
Derivatives	44	2	44	2
Other financial assets	169	112	169	112
	Carrying amount	Fair value		
	2013	2012	2013	2012
Financial liabilities				
Interest bearing loans and borrowings (incl. accrued interest)	3,004	3,019	3,004	3,019
Derivatives	-	12	-	12

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 2013 and 31 December 2012, 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 2013 and 31 December 2012, 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	
	2013	2012
FX risk		
Value at Risk*	(171)	(145)
Stress testing*	(58)	(42)
IR risk		
Stress testing*	(17)	(29)

* 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	
	2013	2012	2013	2012
Foreign exchange contracts	1,037	1,387	44	(10)

14 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 for the year 2013 at statutory rate 19% for the Czech Republic (2012: 19%) and 22% for the Slovak Republic (2012: 23%).

In CZK million	2013	2012
At 1 January	2,533	2,990
Profit or loss tax charge (Note 4)	(163)	(477)
Foreign exchange translation reserve	(44)	20
Other changes	(8)	0
At 31 December	2,318	2,533

In 2013 a deferred tax asset in Telefónica Slovakia, s.r.o. amounting to CZK 403 million (2012: CZK 673 million) was recognized resulting mainly from the difference between the accounting net book value and the tax net book value of fixed assets. In 2012, a deferred tax asset was recognised resulting mainly from the 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 2013	31 December 2012
Deferred tax assets	(812)	(959)
Deferred tax liabilities	3,130	3,492
Total	2,318	2,533

The deferred tax asset includes CZK 447 million (2012: CZK 668 million) recoverable in less than twelve months and CZK 365 million (2012: CZK 291 million) recoverable after more than twelve months. The deferred tax liability includes CZK 705 million (2012: CZK 650 million) to be settled in less than twelve months and CZK 2,425 million (2012: CZK 2,842 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	
	2013	2012	2013	2012
Temporary differences relating to:				
Tax losses	(33)	(384)	365	161
Property, plant and equipment and intangible assets	2,547	3,114	(532)	(581)
Trade receivables, inventories and other differences	(196)	(197)	4	(57)
Total	2,318	2,533	(163)	(477)

As at 31 December 2013 the total amount of unused tax losses from previous years in Telefónica Slovakia, s.r.o. totals to CZK 165 million (2012: CZK 1,669 million). At 31 December 2013 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 for up to five years, while the tax loss generated after 1 January 2010 can be carried forward for up to four years proportionally.

15 Provisions for liabilities and charges

In CZK million	Regulatory and court decisions	Other provisions	Total
At 1 January 2013	34	27	61
Additions during the year	10	476	486
Utilised during the year	(23)	(481)	(504)
At 31 December 2013	21	22	43
Short-term provisions 2013	7	10	17
Long-term provisions 2013	14	12	26
	21	22	43
Short-term provisions 2012	12	20	32
Long-term provisions 2012	22	7	29
	34	27	61

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 and share-based compensation.

Regulatory and court decisions

A provision for regulatory and court decisions is made for legal proceedings involving the Group (see Note 16).

16 Contingencies and litigations

The Company is involved in a number of legal disputes arising from the usual course of business. Throughout 2013 the Company successfully litigated against lawsuits filed by the third parties in the past. 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 High Court in Prague took the view of the Company that the matter had already once been finally decided by the CTO in favour of the Company, and Vodafone Czech Republic was only trying to circumvent the final decision. The proceedings were 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 declined the extraordinary appeal in June 2013 and the case has finally been closed.

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 immeasurably, 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 2013, despite the fact that the Company has provided the Office with all the necessary evidence and information. As was the case with the 2012 financial statements, it was not possible to make a reliable estimate of the financial impact of this administrative procedure at the closing of the 2013 financial statements.

ii. Proceeding for a penalty of CZK 91.9 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 started a legal action including a proposal to stay the penalty for the duration of the proceedings. The Regional Court in Brno decided on suspension of the payment, however the decision in the merit of the case has not yet been issued.

III. Disputes with AUGUSTUS spol. s r.o.

The Company clearly turned around in its favour the dispute with AUGUSTUS spol. s r.o. and presently concentrates on recovering the amount of unjust enrichment from AUGUSTUS spol. s r.o. 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. The High Court in Prague confirmed the bankruptcy of AUGUSTUS spol. s r.o. in May 2013. The Company is the major creditor with the highest filed and confirmed claim.

IV. 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 a.s. filed an appeal but only in extent of CZK 19.8 million. The High Court in Prague later confirmed that there had not been any contract concluded between CNS a.s. and the Company, and as such there is no claim of CNS a.s. from the contractual relationship. The High Court only ordered the Municipal Court in Prague to decide on possible claims of CNS a.s. arising from the precontractual liability, however no evidence of any such claim has been filed.

V. 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 court started hearings of this case and the hearings continued in 2013, including hearings of experts and witnesses.

VI. BELL TRADE s.r.o. – a claim for CZK 9.7 billion

A legal action for CZK 3.2 billion filed by company BELL TRADE s.r.o. was delivered to the Company in January 2012. The legal action was filed at the District Court in Malacky (the Slovak Republic); 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 s.r.o., 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 s.r.o. filed an appeal. The Regional Court in Bratislava subsequently cancelled the decision and the case stayed with the District Court in Malacky. The Company filed a constitutional complaint against the decisions on the jurisdiction of Slovak courts, but the Constitutional Court has not yet given its decision. The plaintiff filed a motion to raise the claim to CZK 9.7 billion in December 2013.

VII. ČESKÉ RADIOKOMUNIKACE a.s. – a claim for CZK 3.1 billion

A legal action for CZK 3.1 billion filed by České Radiokomunikace a.s. (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 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 2013 represents nearly CZK 25 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.

17 Commitments

The aggregate future minimum lease payments under operating leases (Group is a lessee) and aggregate future minimum lease payments under non-cancellable operating leases (Group is a lessor):

In CZK million	Less than 1 year	1 to 5 years	Over 5 years
Operating leases - lessee	1,281	2,935	2,671
Operating leases - lessor	154	56	-

The total minimum lease payments relating to operating leasing of property, plant and equipment recognised as an expense in 2013 were CZK 1,603 million (2012: CZK 1,611 million). The lease agreements may contain clauses requiring restoration of the leased site at the end of the lease term. The Group estimates present value of future obligatory liquidation and decommissioning costs taking into account changes in network

infrastructure such as network sharing projects. 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.

Capital and other expenditure contracted but not yet included in the financial statements as at 31 December 2013 amounted to CZK 6,344 million, of which CZK 3,908 million represent purchase price (the Company CZK 2,803 million and Telefónica Slovakia, s.r.o. CZK 1,105 million) of spectrum licences (frequencies for the LTE networks). The rest of contracted amounts relate to the telecommunication networks and service contracts.

18 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 (within the 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 the 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 the 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 the 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 the Slovak Republic

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 Regulatory Authority for Electronic Communications and Postal Services.

Imposition of obligations related to the provision of the Universal Service

During 2013, the Company provided the following selective services under CTO imposed obligations to provide Universal Service:

- a) public pay telephone services,
- b) access for persons with disability 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 persons with disability.

Universal Service is reimbursed by the CTO that receives funds from the state budget, which are remitted without delay to the Company's account.

19 Share capital and reserves

	31 December 2013	31 December 2012
Nominal value per ordinary registered share (CZK)	87	87
Number of shares	315,648,092	322,089,890
Nominal value per ordinary registered share (CZK)	870	870
Number of shares	1	1
Ordinary shares (in CZK million)	27,461	28,022

Company's share capital was reduced by the total amount of CZK 561 million by way of cancellation of 6,441,798 shares from the total amount of 11,869,833 own shares. The total purchase price for which the company bought the cancelled shares is CZK 2,483 million. The share premium was reduced by CZK 1,922 million, which represents the difference between the purchase price and the nominal value of the cancelled shares.

Shareholdings in the Company were as follows:

	31 December 2013	31 December 2012
Telefónica, S.A.	70,83%	69.41%
Telefónica Czech Republic, a.s. (treasury shares)	1,72%	2.00%
Other shareholders	27,45%	28.59%

The funds include a statutory reserve fund of CZK 6,535 million (2012: CZK 6,491 million) that is by law not distributable. The equity-settled share based payments reserve of CZK 38 million (2012: CZK 31 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 respect of managing the capital of the Company is to focus its investment activities on areas with a high growth potential, 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 the Slovak Republic. IT systems renewal and upgrade are among other investment activities aiming to simplify and improve processes that will lead to improved operating efficiency.

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 these 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 make an annual analysis of the other options allowing the distribution 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 2013:

In CZK million	31 December 2013
Share capital	27,461
Treasury shares	(1,596)
Share premium	19,349
Funds and reserves	6,488
Retained earnings from previous years	585
Net income for current year	5,743
Total	58,030

20 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 management.

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	31 December 2013	31 December 2012
In CZK million		
Payables	685	751
Comprehensive income	Year ended	Year ended
In CZK million	31 December 2013	31 December 2012
a) Purchases of services and goods	37	47
b) Royalty fees	660	726

The total amount of dividend paid as at 31 December 2013 to Telefónica, S.A. was CZK 4,471 million (2012: CZK 6,036 million). The amount paid due to the other distribution as at 31 December 2013 amounted to CZK 2,236 million (2012: CZK 2,906 million).

II. Other related parties – Telefónica Group and joint ventures:

Balance sheet	31 December 2013	31 December 2012
In CZK million		
a) Receivables	469	352
b) Payables	2,088	2,115
c) Short-term receivables - interest (Note 13)	18	1
d) Cash equivalents (Note 11)	3,538	2,761
Comprehensive income	Year ended	Year ended
In CZK million	31 December 2013	31 December 2012
a) Sales of services and goods	990	821
b) Purchases of services and goods	1,446	1,261
c) Management fees	451	412
d) Interest income	13	65

For the period ended 31 December 2013, capital expenditures with related parties amounted CZK 16 million (2012: CZK 4 million).

The list of the Telefónica companies with which the Group had any transaction in 2013 and 2012 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 Colombia, S.A., Telefónica Móviles Chile, S.A., Otecel, S.A., Telefónica Móviles Nicaragua, S.A., Telefónica Investigación y Desarrollo, S.A., Telecom Italia S.p.A., Telfisa Global BV, Telfisa, Telefónica International Wholesale Services, SL, Telefónica International Wholesale Services II, SL, Telefónica

Compras Electrónica, S.L., Telefónica Móviles Mexico, S.A., Telefónica Móviles del Uruguay, S.A., Telefónica Móviles Perú, S.A.C., 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, S.A., Czech Republic branch, Telefonica Global Technology, S.A., Telefonica Global Services GmbH, Tesco Mobile ČR s.r.o., Telefónica Factoring, E.F.C., S.A., Telefónica Costa Rica S.A., Telefónica Digital España SL., Wayra Czech Republic, s.r.o.

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 2013	31 December 2012
Salaries and other short-term benefits	89	100
Personal indemnification insurance	2	3
Total	91	103

b) Loans to related parties

No loans were provided to members of Board of Directors and Supervisory Board in 2013 and 2012.

No loans were provided by the Group to related parties.

21 Subsidiaries, associates and joint ventures

As at 31 December 2013

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	Slovak Republic	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
Joint ventures					
8. Tesco Mobile ČR s.r.o.	50%	6	Czech Republic	Mobile virtual network operator for prepaid services	Equity method

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	Slovak Republic	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.	13%	20	Czech Republic	Real time mobile payments	Not consolidated

In March 2013, the Company entered into a joint venture agreement with Tesco Stores ČR a.s. related to set-up and operation of Tesco Mobile ČR s.r.o., a mobile virtual operator. The Company has a 50% ownership interest in Tesco Mobile ČR s.r.o. which offers mobile telecommunication services within the Czech Republic.

In 2013, the Company sold its interest in the company MOPET CZ a.s.

Sale to PPF Group

The agreement between Telefónica and PPF Group to sell 65.9% of the Company's shares was approved by the European Commission on mid-January 2014 and was closed on 28 January 2014.

The first vice-chairwoman of the Supervisory Board Maria Pilar López Álvarez and Supervisory Board members Antonio Manuel Ledesma Santiago and Ivan Varela Sanchez resigned from their positions on the board as of 28 January 2014. Three new members, Martin Štefunko, Vladimír Mlynář and Ladislav Bartoníček, were appointed to the positions. The chairwoman of the Supervisory Board María Eva Castillo Sanz and Supervisory Board members Jesús Pérez de Uriguen and Francisco de Borja de Nicolás resigned from their positions as of 29 January 2014. Subsequently, Martin Štefunko was elected the new chairman of the Supervisory Board and Ladislav Bartoníček was elected as the new first vice-chairman.

On 30 January 2014, the Supervisory Board of the Company accepted the resignation of David Melcon Sanchez-Friera from his position as a member and 1st Vice-chairman of the Board of Directors and of Jakub Chytil and Ramiro Lafarga Brollo from their positions as members of the Board of Directors. The Supervisory Board elected Martin Vlček and Michal Frankl as new members of the Board of Directors.

Qualified shareholder convened the Regular General Meeting on 12 March 2014.

LTE broadband mobile data network

Arising from the auction results, the Company expects to receive new spectrum assignments issued by the Czech Telecommunication Office in the first quarter of 2014.

In January 2014, the company Telefónica Slovakia, s.r.o received new spectrum assignments arising from the auction results issued by the Regulatory Authority for Electronic Communications and Postal Services.

For purchase price of spectrum licences see Note 17.

Restructuring

During 2014, 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 2014 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 370 million.

Other

There were no other events which occurred subsequent to the balance sheet date and which would have a material impact on the financial statements as at 31 December 2013.

Financial statements

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

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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 was a member of the Telefónica Group of companies (Telefónica Group) with the parent company, Telefónica, S.A. (Telefónica) as at 31 December 2013.

The Company is the largest integrated telecommunications provider in the Czech market providing fully converged services.

The number of employees employed by the Company amounted in average to 5,376 in 2013 (2012: 6,005).

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 25 February 2014.

Sale to PPF Group

In November 2013 Telefónica reached an agreement with PPF Group (through PPF Arena 2 B.V.) to sell 65.9% of the Company's shares. The transaction involves all the Company's interests including Telefónica Slovakia, s.r.o. Both companies are allowed to trade under the O2 brand for a maximum of four years. They may also join Telefónica's Partners Programme, an initiative offering partner operators the opportunity to benefit from Telefónica's scale and cooperate on key business areas.

Reduction of the Company's share capital

In accordance with the resolution on reduction of the Company's share capital adopted by the Annual General Meeting of the Company held on 22 April 2013, the reduction of the Company's share capital was recorded into the Commercial Register on 15 November 2013. The Company's share capital was reduced by way of cancellation of 6,441,798 own ordinary shares with nominal value of CZK 87 (i.e. by CZK 560,436,426). Subsequently, the cancelled own ordinary shares were deleted from the statutory register. As at 31 December 2013, the amount of the Company's share capital equaled to CZK 27,461,384,874.

Share buyback

Following the resolution of the Annual 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 adopted on 26 February 2013 a resolution to continue with the acquisition of own ordinary shares (share buyback) to the extent of 6,441,798 of ordinary shares (i.e. up to 2% of the total ordinary shares issued by the Company as of that day). The Board of Directors adopted the decision to stop the acquisition of its own shares with effect from 29 October 2013.

LTE broadband mobile data network

In the year 2013 the auction part of the tender for the awarding the rights to use radio frequencies in the 800 MHz, 1800 MHz and 2600 MHz spectrum bands ended. The Company succeeded in the tender in above mentioned bands. These bands are necessary for the development of a new generation LTE network (4G). This spectrum combination will allow the Company to build the highest speed and quality network in the Czech Republic. The Company has already covered a significant part of Prague and Brno with the LTE network. The Company will start rolling out the 4G network in new locations in the Czech Republic in the first half of year 2014.

Agreement to share 2G and 3G networks

In October 2013 the Company has signed an agreement with T-Mobile Czech Republic a.s. to share their current 2G and 3G mobile networks. The deal has been made in order to achieve the optimal coverage in the Czech Republic and efficiencies in 2G and 3G networks and technologies. The transaction will bring tangible benefits to the customers, especially in the form of better services and coverage. The deal builds upon the very successful 3G network sharing scheme, which both companies already implemented in 2011-2012.

Restructuring

Over the course of 2013, the Company continued to implement its restructuring and cost-optimization activities aimed at further improving its operating efficiency. The Company launched new projects in various areas of its operations. These projects focused on 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 optimisation of the related processes. Some restructuring projects have led to a transfer of the activities to outsourcing partners. More than 800 employees were made redundant during the restructuring process, and the Company incurred restructuring costs of CZK 368 million (see Note 2).

INDEPENDENT AUDITOR'S REPORT



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 statement of financial position as at 31 December 2013, 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 notes.

Management's Responsibility for the Financial Statements

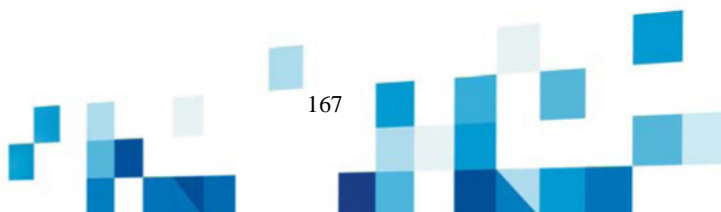
Management is responsible for the preparation and fair presentation of these financial statements in accordance with International Financial Reporting Standards as adopted by the European Union, and for such internal control as management determines is necessary to enable the preparation of financial 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.

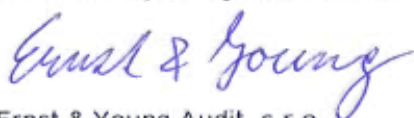
An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including an assessment of the risks of material misstatement of the financial statements, whether due to fraud or 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.



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 2013, 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

25 February 2014
Prague, Czech Republic

STATEMENT OF TOTAL COMPREHENSIVE INCOME

For the year ended 31 December 2013

In CZK million	Notes	Year ended 31 December 2013	Year ended 31 December 2012
Revenues	2	42,609	45,792
Other income	2	840	1,108
Expenses	2	(26,809)	(28,549)
Impairment loss		(11)	(27)
Operating income before depreciation and amortization (OIBDA)		16,629	18,324
Depreciation and amortisation	7, 8	(10,413)	(10,919)
Operating profit		6,216	7,405
Finance income	3	1,058	107
Finance costs	3	(316)	(286)
Profit before tax		6,958	7,226
Corporate income tax	4	(1,215)	(1,301)
Profit for the year		5,743	5,925
Other comprehensive income			
Other comprehensive income, net of tax		-	-
Total comprehensive income, net of tax		5,743	5,925
Profit attributable to:			
Equity holders of the Company	5	5,743	5,925
Total comprehensive income attributable to:			
Equity holders of the Company		5,743	5,925
Earnings per share (CZK) – basic*	5	18	19

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

BALANCE SHEET

As at 31 December 2013

In CZK million	Notes	31 December 2013	31 December 2012
ASSETS			
Property, plant and equipment	7	39,563	44,477
Intangible assets	8	18,870	19,183
Investment in subsidiaries and associates	21	6,419	6,433
Other financial assets	10	166	108
Non-current assets		65,018	70,201
Inventories	9	472	433
Receivables	10	7,730	7,403
Income tax receivable	4	-	100
Cash and cash equivalents	11	3,844	3,017
Current assets		12,046	10,953
Total assets		77,064	81,154
EQUITY AND LIABILITIES			
Ordinary shares	19	27,461	28,022
Treasury shares	19	(1,596)	(2,483)
Share premium		19,349	24,374
Retained earnings, funds and reserves		12,816	13,274
Total equity		58,030	63,187
Long-term financial debts	13	3,000	3,000
Deferred tax liability	14	2,733	3,196
Non-current provisions for liabilities and charges	15	22	26
Non-current other liabilities	12	64	83
Non-current liabilities		5,819	6,305
Short-term financial debts	13	2,044	710
Trade and other payables	12	11,003	10,921
Income tax liability	4	152	-
Provisions for liabilities and charges	15	16	31
Current liabilities		13,215	11,662
Total liabilities		19,034	17,967
Total equity and liabilities		77,064	81,154

The financial statements were approved by the Board of Directors on 25 February 2014 and were signed on its behalf by:



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



Martin Bek
Member
of the Board of Directors



David Melcon Sanchez-Friera
Chief Financial Officer

STATEMENT OF CHANGES IN EQUITY

For the year ended 31 December 2013

In CZK million	Notes	Share capital	Share premium	Treasury shares	Equity settled share based payments reserve	Funds*	Retained earnings	Total
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)
Distribution declared in 2012	6	-	-	-	-	-	(8,696)	(8,696)
Treasury share transactions		-	-	(2,483)	-	-	91	(2,392)
Share capital increase/(decrease)	19	(4,187)	-	-	-	-	72	(4,115)
Effect of Merger of TO2 Business Solutions	19	-	-	-	-	-	95	95
At 31 December 2012		28,022	24,374	(2,483)	31	6,450	6,793	63,187
At 1 January 2013		28,022	24,374	(2,483)	31	6,450	6,793	63,187
Profit for the year		-	-	-	-	-	5,743	5,743
Total comprehensive income		-	-	-	-	-	5,743	5,743
Capital contribution and other transfers		-	-	-	7	-	-	7
Distribution declared in 2013	6	-	(3,221)	-	-	-	(6,442)	(9,663)
Treasury share transactions	19	-	118	(1,596)	-	-	234	(1,244)
Cancellation of treasury shares	19	(561)	(1,922)	2,483	-	-	-	-
At 31 December 2013		27,461	19,349	(1,596)	38	6,450	6,328	58,030

* Refer to Note 19 regarding amounts not available for distribution.

STATEMENT OF CASH FLOWS

For the year ended 31 December 2013

In CZK million	Notes	Year ended 31 December 2013	Year ended 31 December 2012
Cash flow from operating activities			
Cash received from operations		48,193	50,359
Cash paid to suppliers and employees		(31,263)	(32,284)
Dividends received		13	5
Net interest and other financial income/expenses paid	11	(20)	(147)
Taxes paid		(1,425)	(1,775)
Net cash from operating activities		15,498	16,158
Cash flow from investing activities			
Proceeds from disposals of property, plant and equipment and intangible assets		72	324
Payments on investments in property, plant and equipment and intangible assets		(4,981)	(5,338)
Payments made on financial investments		(10)	(218)
Returned warranty deposit for spectrum auction		250	-
Paid warranty deposit for spectrum auction		(375)	(250)
Repayments of loans made to subsidiaries and joint ventures		67	60
Provisions of loans made to subsidiaries and joint ventures		(187)	(209)
Net cash used in investing activities		(5,164)	(5,631)
Cash flow from financing activities			
Dividends paid		(6,191)	(8,598)
Capital decrease	19	(3,104)	(4,115)
Cash payments to owners for acquisition of the treasury shares	19	(1,596)	(2,483)
Proceeds from loans		1,362	3,679
Repayments of loans, borrowings and promissory notes	13	-	(2,911)
Net cash used in financing activities		(9,529)	(14,428)
Effect of foreign exchange rate changes on collections and payments		22	(23)
Net increase / (decrease) in cash and cash equivalents during the period		827	(3,924)
CASH AND CASH EQUIVALENTS AT THE BEGINNING OF THE PERIOD		3,017	6,941
CASH AND CASH EQUIVALENTS AT THE END OF THE PERIOD	11	3,844	3,017
BALANCE AT THE BEGINNING OF THE PERIOD		3,017	6,941
Cash on hand and at banks		3,002	6,922
Other cash equivalents		15	19
BALANCE AT THE END OF THE PERIOD	11	3,844	3,017
Cash on hand and at banks		3,833	3,002
Other cash equivalents		11	15

ACCOUNTING POLICIES

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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.

In order to clarify and enhance quality of presented information, without changing accounting policies, the Company decided to simplify certain parts of the financial statements. Simplifications mainly concern statement of total comprehensive income, notes concerning revenues and costs and property, plant and equipment.

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

In 2013, the Company adopted 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:

Amendments to IFRS 7 Disclosures – Offsetting Financial Assets and Financial Liabilities

The Group has applied the amendments to IFRS 7 Disclosures – Offsetting Financial Assets and Financial Liabilities for the first time in the current year. The amendments to IFRS 7 require entities to disclose information about rights of offset and related arrangements for financial instruments under an enforceable master netting agreement or similar arrangement.

The amendments have been reflected in notes to the financial statements.

IFRS 13 Fair Value Measurement

IFRS 13 defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction in the principal (or most advantageous) market at the measurement date under current market conditions. Fair value under IFRS 13 is an exit price regardless of whether that price is directly observable or estimated using another valuation technique. Also, IFRS 13 includes disclosure requirements.

The application of IFRS 13 has not had any material impact on the amounts recognised in the financial statements.

Amendments to IAS 1 Presentation of Items of Other Comprehensive Income

The amendments introduce new terminology, whose use is not mandatory, for the statement of comprehensive income and income statement. The amendments to IAS 1 retain the option to present profit or loss and other comprehensive income in either a single statement or in two separate but consecutive statements. However, the amendments to IAS 1 require items of other comprehensive income to be grouped into two categories in the other comprehensive income section: (a) items that will not be reclassified subsequently to profit or loss and (b) items that may be reclassified subsequently to profit or loss when specific conditions are met.

Other than the above mentioned presentation changes, the application of the amendments to IAS 1 does not result in any impact on profit or loss, other comprehensive income and total comprehensive income.

New IFRS not effective as at 31 December 2013 (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
IFRS 9 Financial Instruments	1 January 2015
IFRS 10 Consolidated Financial Statements	1 January 2014
IFRS 11 Joint Arrangements	1 January 2014
IFRS 12 Disclosure of Interests in Other Entities	1 January 2014

IAS 27 Separate Financial Statements	1 January 2014
IAS 28 Investments in Associates and Joint Ventures	1 January 2014
IAS 32 Offsetting Financial Assets and Financial Liabilities — Amendments	1 January 2014
IAS 36 Recoverable Amount Disclosures for Non-Financial Assets	1 January 2014
IAS 39 Novation of Derivatives and Continuation of Hedge Accounting	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.

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 of the Company 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 of the Company 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).

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.

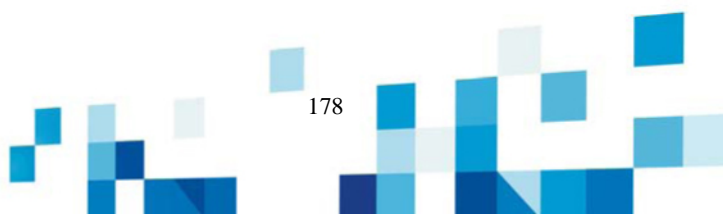
On the balance sheet date, carrying amounts, residual values and the useful lives of assets are reviewed, revised and if necessary prospectively amended and accounted for as a change in an accounting estimate.

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.

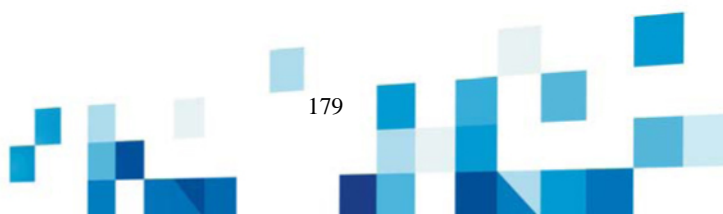
Any gain from any subsequent increase in fair value less costs to sell, but not in excess of the cumulative impairment loss that has been recognized, is determined and is accounted for in profit or loss.

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 inflows (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 2013 and 2012, 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. During 2013 and 2012, the Company did not hold any investments in this category.

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.

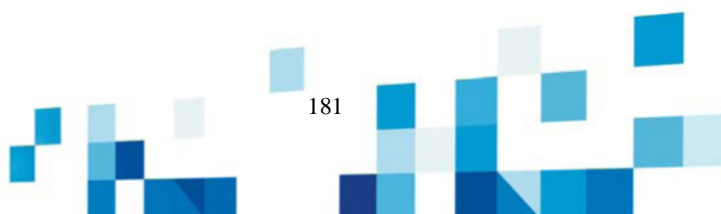
In relation to trade receivables, a provision for impairment is made when there is objective evidence (such as the probability of insolvency) that the Company will not be able to collect all of the amounts due under the original terms of the invoice. The carrying amount of the receivable is reduced through 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 insurance and supplementary pension insurance

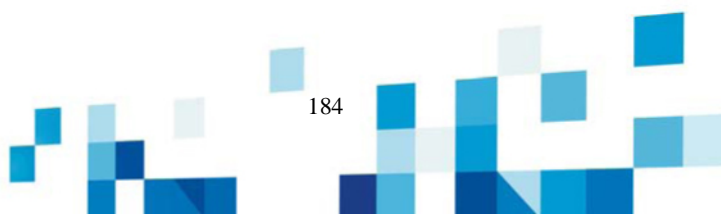
The Company remits contributions to the state pension insurance scheme at the statutory rates applicable during the period which are based on gross salaries. The contributions to the state budget for the funding of the state pension insurance correspond to the defined contribution plans. The contribution expense is charged to profit or loss in the same period as the related salary expense. The Company also makes contributions to defined supplementary pension insurance schemes operated by external pension funds. These contributions are charged to profit or loss in the period to which the contributions relate. The Company has no further payment obligations once the contributions have been paid.

(2) Redundancy and severance payments

Employees whose employment was terminated before term citing statutory reasons are entitled for redundancy and severance payment. The Company recognises provision for redundancy and severance payments when it is demonstrably committed to terminate the employment of current employees according to a detailed formal plan without the possibility of opt-out. Severance payments falling due more than 12 months after the balance sheet date are discounted to present value. The Company presently has no redundancy and severance obligations falling due more than 12 months after the balance sheet date.

(3) Bonus plans

The Company recognises employee bonuses related to the given accounting period in accordance with the expectations of achievement of the targets of the Company, which take into consideration key performance indicators such as turnover or free cash flow after adjustments. The Company recognises a provision where the Company is contractually



obliged to grant bonuses or where there is a past practice that has created 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 and expenses

Revenue, shown net of Value Added Tax and any discounts, 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. Commission payments to dealers for activations, various marketing promotions and other activities are included in the costs of sales for the period.

Revenue and expenses are recognized on an accrual basis; i.e. when the flow of goods or services takes place, regardless of when the payment or collection is being made.

Voice, data and internet

Revenues from voice, data and internet services entail tariff fee plus a variable rate. Both wireline and wireless traffic is recognized as revenue as service is provided.

Free minutes

The Company offers customers free minutes with their choice of price plan. Free unused minutes at the end of the month can 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.

Revenues from prepaid cards

Revenues arising from prepaid call card are deferred until the customer uses the credit on the card to pay for the relevant calls or other services. Revenue from prepaid cards is recognised at the time of usage of airtime and other services.

Equipment sales and sale of other goods

Revenue from the sale of telephone equipment 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. Revenues are thus recognized when the product or service is delivered to the distributor or to the end customer. Losses arising from sale of handsets due to discount are recognised at the date of sale.

Information and communication technology and construction contracts

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.

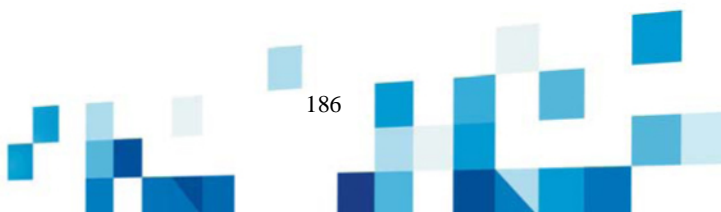
Revenue from fixed price construction contracts (long-term contracts) is recognised using the percentage of completion method, measured by reference to the percentage of actual cost incurred to date to estimated total costs of the contract. A loss expected from the construction contract is recognised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

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. Revenue is recognised when services are provided.

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.

Multiple element arrangements

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.

Gross and net revenue recognition

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 whether a transaction is considered to meet conditions of an agency arrangement. In such cases, the revenue is recognised only at the amount of the commission received/realised. The Company may enter agency relationship when providing premium SMS, audiotex or other services.

Dividend income

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

Interest income

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

Instalment sales

Revenue attributable to the sale 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 13.

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 and the Slovak 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 10. There is no significant concentration of credit risk within the Company.

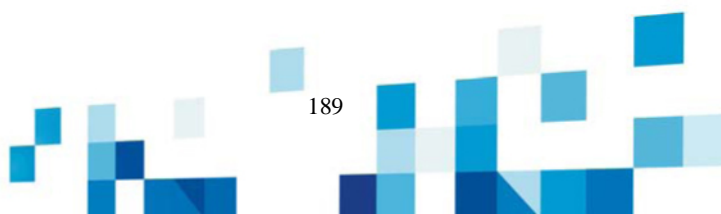
With respect to credit risk arising from the financial assets of the Company, which comprise cash and cash equivalents, available for sale investments and certain derivative instruments, the Company's exposure arises from default of the counterparty, with a maximum exposure equal to the carrying amount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

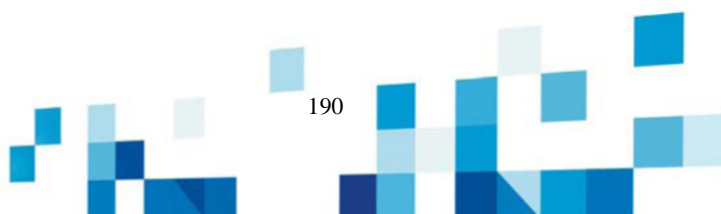
Certain derivative transactions, while providing effective economic hedges under the Company's risk management policies, either do not qualify for hedge accounting under the specific rules in IAS 39 or the Company has elected not to apply the specific IAS 39 hedge accounting provisions. Changes in the 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 14).

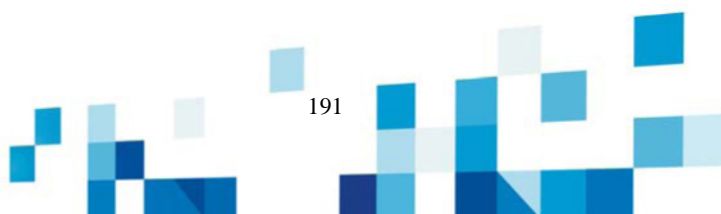
(2) Property, plant and equipment, intangible assets and goodwill

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 8).

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 16 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 15). 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 subsidiaries, joint ventures 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.

A joint venture is a contractual arrangement whereby the Company and other parties undertake an economic activity that is subject to joint control (i.e. when the strategic financial and operating policy decisions relating to the activities of the joint venture require the unanimous consent of the parties sharing control).

In relation to its interest in a joint arrangement, the Company recognises joint ventures that are recorded at cost less an allowance for diminution in value.

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 2013 and 2012.

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

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1 Segment information

Operating segments recognised by the Company are as follows:

- fixed - network communication services using own fix network and ICT services
- mobile - mobile communication services

Year ended 31 December 2013	Fixed	Mobile	Company
In CZK million			
Revenues	20,376	22,705	43,081
Other income	546	294	840
Inter-segment sales	(324)	(148)	(472)
Total income	20,598	22,851	43,449
Total costs	(13,013)	(13,796)	(26,809)
Impairment charge	(8)	(3)	(11)
Total depreciation and amortization	(6,940)	(3,473)	(10,413)
Operating income	637	5,579	6,216
Net financial income			742
Profit before tax			6,958
Corporate income tax			(1,215)
Profit for the year			5,743
Assets (excluding goodwill)	35,006	28,610	63,616
Goodwill	128	13,320	13,448
Total assets	35,134	41,930	77,064
Trade and other payables	(5,341)	(5,662)	(11,003)
Other liabilities	(3,899)	(4,132)	(8,031)
Total liabilities	(9,240)	(9,794)	(19,034)
Capital expenditure	3,074	2,134	5,208

Year ended 31 December 2012	Fixed	Mobile	Company
In CZK million			
Revenues	21,458	24,911	46,369
Other income	817	291	1,108
Inter-segment sales	(313)	(264)	(577)
Total income	21,962	24,938	46,900
 Total costs	 (13,169)	 (15,380)	 (28,549)
 Impairment charge	 (20)	 (7)	 (27)
 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

The inter-segment pricing rates applied in 2013 and 2012 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	Year ended	Year ended
In CZK million	31 December 2013	31 December 2012
Revenues from voice services	22,498	26,041
Revenues from data services	10,990	10,987
Other telecommunication revenues	9,121	8,764
Total revenues	42,609	45,792
 Other income	 840	 1,108

Other income contains own work capitalized. In the financial statements for the year ended 31 December 2012, this item was presented in category Other expenses. In order to match internal and external reporting, this item is presented within category Other income for years ended 31 December 2013 and 2012.

Revenues from related parties are disclosed in Note 20.

Expenses	Year ended	Year ended
In CZK million	31 December 2013	31 December 2012
Supplies	(12,492)	(13,035)
Staff costs	(5,027)	(5,393)
External services	(8,506)	(9,182)
Provisions for bad debts and inventories	(397)	(490)
Other expenses	(387)	(449)
Total expenses	(26,809)	(28,549)

Supplies include mainly these types of costs: interconnection and roaming expenses, cost of goods sold, subdeliveries, commissions and other cost of sales.

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 2013 and 2012. As a result of the restructuring process, the Company incurred restructuring costs of CZK 368 million during the year ended 31 December 2013 (2012: CZK 261 million) including redundancy payments of CZK 336 million (2012: CZK 227 million) and related consultancy costs of CZK 32 million (2012: CZK 34 million).

Restructuring costs are included in staff costs.

Statutory auditor's fees during the year ended 31 December 2013 reached CZK 17 million (2012: CZK 17 million).

Purchases from related parties are disclosed in Note 20.

3 Finance income and costs

In CZK million	Year ended 31 December 2013	Year ended 31 December 2012
Finance income		
Interest income	15	83
Gain on fair value adjustments of financial instruments (net)	126	-
Foreign exchange gain (net)	-	15
Other finance income	<u>917</u>	<u>9</u>
Total finance income	1,058	107
Finance costs		
Interest expenses	(65)	(158)
Loss on fair value adjustments of financial instruments (net)	-	(90)
Foreign exchange loss (net)	(200)	-
Other finance costs	<u>(51)</u>	<u>(38)</u>
Total finance costs	(316)	(286)

The Company recognises foreign exchange gains and losses and fair value adjustments on net basis.

Other finance income contains dividend from the subsidiaries Telefonica Slovakia, s.r.o. of CZK 900 milion (2012: CZK 0 million) and Bonerix s.r.o. of CZK 8 million (2012: CZK 0 million).

4 Income tax

In CZK million	Year ended 31 December 2013	Year ended 31 December 2012
Total income tax expense is made up of:		
Current income tax charge	1,678	1,840
Deferred income tax credit (Note 14)	<u>(463)</u>	<u>(539)</u>
Income tax	1,215	1,301

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 2013	Year ended 31 December 2012
Profit before tax	6,958	7,226
Income tax charge calculated at the statutory rate of 19%	1,322	1,373
Not taxable income	(175)	(45)
Expenses not deductible for tax purposes	69	73
Tax related to prior periods	(1)	(100)
Taxes on income	1,215	1,301
Effective tax rate	17%	18%

As at 31 December 2013 the total amount of provisions for current income taxes is CZK 1,714 million (2012: CZK 1,855 million), advances paid for income taxes is CZK 1,562 million (2012: CZK 1,955 million), the net deferred tax liability is CZK 2,733 million (2012: CZK 3,196 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 2013	31 December 2012
Weighted number of ordinary shares outstanding	312,834,249	319,932,546
Net profit attributable to shareholders (in CZK million)	5,743	5,925
Basic earnings per share (CZK)	18	19

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. The Board of Directors adopted the decision to stop the acquisition of its own shares as of 29 October 2013.

6 Dividends and other distribution

In CZK million	31 December 2013	31 December 2012
Dividends declared (including withholding tax)	6,442	8,696
Other distribution	3,221	4,187
Total declared distribution	9,663	12,883

Dividends include withholding tax on dividends paid by the Company to its shareholders. There has been no interim dividend paid in respect of 2013. Approval of the 2013 profit and the decision regarding the amount of any dividend payment for the 2013 financial year will take place at the Annual General Meeting.

The Annual General Meeting, held on 22 April 2013, approved also the distribution of part of the Company's share premium to the shareholders of CZK 10 before tax per share (CZK 3,221 million in total). Own shares are not eligible for the share premium distribution.

In 2012 each share with original nominal value of CZK 100 was decreased by CZK 13 per share and the share with the nominal value of CZK 1,000 was decreased by CZK 130. The total amount to be paid to shareholders as a result of the reduction of the share capital amounted to CZK 4,187 million.

Distribution per share for the years ended 31 December was as follows:

In CZK	Year ended 31 December 2013	Year ended 31 December 2012
Dividend per share (nominal value of CZK 87)	20	27
Other distribution	10	13
Total distribution per share	30	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 2013					
Opening net book amount	9,444	25,562	8,289	1,182	44,477
Additions	248	827	2,038	189	3,302
Disposals	(12)	(5)	(43)	-	(60)
Reclassifications	14	17	37	(19)	49
Depreciation charge	(724)	(4,882)	(2,069)	(519)	(8,194)
Impairment charge	-	-	(11)	-	(11)
Closing net book amount	8,970	21,519	8,241	833	39,563
At 31 December 2013					
Cost	19,216	104,280	82,474	7,178	213,148
Accumulated depreciation and impairment allowance	(10,246)	(82,761)	(74,233)	(6,345)	(173,585)
Net book amount	8,970	21,519	8,241	833	39,563
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

The net book amount of PPE as at 31 December 2013 includes CZK 1,469 million of construction in progress (2012: CZK 1,871 million). The assets under construction are spread over all disclosed categories of property, plant and equipment following their nature.

As at 31 December 2013, the carrying value of non-depreciated assets amounted to CZK 178 million (2012: CZK 179 million).

No property, plant and equipment were pledged as at 31 December 2013 and 31 December 2012.

No borrowing costs were capitalized during the years 2013 and 2012.

The Company did not recognise any assets held for sale as at 31 December 2013 and 31 December 2012.

In 2013, the Company achieved a total gain from the sale of the fixed assets amounting to CZK 62 million (2012: CZK 283 million) and total losses of CZK 5 million (2012: CZK 6 million).

Cost of fully depreciated property, plant and equipment was CZK 68,481 million as at 31 December 2013 (2012: CZK 72,880 million).

The Company reviewed the indicators of fixed segment (cash-generating unit, CGU) seeking for any indication of impairment to the CGU's assets, see Note 8.

8 Intangible assets

In CZK million	Goodwill	Licences	Software	Customer portfolio	Total
At 31 December 2013					
Opening net book amount	13,448	2,758	2,977	-	19,183
Additions	-	-	1,895	11	1,906
Amortisation charge	-	(385)	(1,834)	-	(2,219)
Closing net book amount	13,448	2,373	3,038	11	18,870
At 31 December 2013					
Cost	13,448	5,782	28,318	11	47,559
Accumulated amortisation and impairment allowance	-	(3,409)	(25,280)	-	(28,689)
Net book amount	13,448	2,373	3,038	11	18,870
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

The net book amount of intangible assets as at 31 December 2013 includes CZK 696 million of construction in progress (2012: CZK 1,014 million). The assets under construction are spread over all disclosed categories of intangible assets following their nature.

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). From 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 2013 and 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.

The Company performed impairment tests, which did not result in impairment losses of goodwill in 2013 and 2012. 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 the most recent 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 expenditures, 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 Company conducts its principal business, is the basis for determination of the value assigned to the estimated growth rate. The Company uses zero 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. This rate is calculated using the capital asset pricing model (CAPM), the Company also uses relevant data taken from independent financial analysts as a benchmark. The Group uses WACC at 9,4% (pre-tax).

The Company has no other intangible asset with indefinite useful life except for goodwill.

As at 31 December 2013 and 31 December 2012, the Company reviewed the indicators of fixed segment (cash-generating units, CGU), seeking for any indication of impairment to the CGU's assets. The assessment carried out as at 31 December 2013 and 2012 confirmed that carrying amounts of non-current assets are supportable.

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.

Carrying value of licences:

In CZK million	Valid by	31 December 2013	31 December 2012
GSM 900 licence	2016	186	258
GSM 1800 licence	2016	150	208
CDMA 450 licence	2018	18	23
UMTS licence	2022	<u>2,019</u>	<u>2,269</u>
Total		2,373	2,758

No borrowing costs were capitalized during the years 2013 and 2012.

Cost of fully amortised intangible assets was CZK 16,262 million as at 31 December 2013 (2012: CZK 19,487 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.

The Company incurs internal research and development costs on activities pursuant to § 2 paragraph 1 of Act on Research and Development Support No. 130/2002 Coll.; however, these costs do not meet the criteria for capitalization under IAS 38 Intangible Assets standard for both years 2013 and 2012.

9 Inventories

In CZK million	31 December 2013	31 December 2012
Telecommunication material	64	74
Goods	<u>408</u>	<u>359</u>
Total	472	433

The inventories stated above are net of an allowance of CZK 42 million (2012: CZK 53 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 60 million (2012: CZK 65 million). The amount of inventories recognised as an expense is CZK 2,409 million (2012: CZK 2,385 million).

In 2013 and 2012, the Company had no inventories pledged as a security for liabilities.

10 Receivables

In CZK million	31 December 2013	31 December 2012
Trade receivables from third parties (net)	4,889	5,800
Group trade receivables	718	505
Prepayments	737	662
Other debtors (net)	1,386	436
Total	7,730	7,403

Trade receivables and other debtors are stated net of a bad debt provision of CZK 3,755 million (2012: CZK 3,672 million).

Prepayments contain the deposit paid for spectrum auction participation of CZK 375 million (2012: CZK 250 million).

Other debtors contain the dividend receivable from the subsidiary Telefónica Slovakia, s.r.o., of CZK 898 milion (2012: CZK 0 million).

Receivables from related parties are disclosed in Note 20.

Trade receivables In CZK million	Carrying amount	Neither impaired nor overdue	Not impaired but overdue			
			Less than 90 days	90 and 180 days	180 and 360 days	More than 360 days
At 31 December 2013	5,607	2,840	287	43	4	35
At 31 December 2012	6,305	2,960	188	24	27	74
Bad debt provisions						
In CZK million						
At 1 January 2012						3,539
Additions						2,472
Retirements/amount paid						(2,339)
At 31 December 2012						3,672
Additions						1,830
Retirements/amount paid						(1,747)
At 31 December 2013						3,755

The Company's historical experience regarding the collection of accounts receivable is consistent with the recorded allowances. Because of 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 2013, the Company presented non-current financial assets of CZK 166 million (2012: CZK 108 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 2013, non-current financial assets contained restricted cash of CZK 26 million (2012: CZK 20 million) resulting to the Company, as small payment services provider, from the legal requirements of the regulator Czech National Bank.

Financial instruments that are subject to an enforceable master netting arrangement or similar agreement include particularly roaming and interconnection services. Financial instruments are as follows:

In CZK million	31 December 2013	31 December 2012
Gross amounts of trade receivables from third parties	835	744
Amounts that are set off	(375)	(342)
Net amounts of trade receivables from third parties	460	402

11 Cash and cash equivalents

In CZK million	31 December 2013	31 December 2012	Interest rate
Cash at current bank accounts and other cash equivalents	312	256	Floating
Cash at cash-pooling structures (inter-company) (Note 20)	3,532	2,761	Floating
Total cash and cash equivalents	3,844	3,017	

As at 31 December 2013 and 2012, 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 2013, the Company had available equivalent of CZK 1,346 million (2012: CZK 1,346 million) of undrawn committed facilities.

As at 31 December 2013 and 2012 no cash and cash equivalents were pledged.

Net interest and other financial income/expenses paid are as follows:

In CZK million	Year ended 31 December 2013	Year ended 31 December 2012
Interest paid	(79)	(210)
Interest received	15	88
Bank commissions	(26)	(38)
Other financial incomes	70	13
Total	(20)	(147)

12 Trade and other payables

In CZK million	31 December 2013	31 December 2012
Trade creditors	9,191	9,041
Tax and social security liability	538	629
Other deferred revenue	470	295
Prepaid cards	261	327
Employee wages and benefits	441	472
Other creditors	102	157
Total payables	11,003	10,921
Other non-current liabilities	64	83

Payables to related parties are disclosed in Note 20.

As at 31 December 2013 and 2012, 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.

Financial instruments that are subject to an enforceable master netting arrangement or similar agreement include particularly roaming and interconnection services. Financial instruments are as follows:

In CZK million	31 December 2013	31 December 2012
Gross amounts of trade creditors	941	897
Amounts that are set off	(375)	(342)
Net amounts of trade creditors	566	555

13 Financial liabilities and financial assets

In CZK million	31 December 2013	31 December 2012
Debt in local currency	3,000	3,000
Intercompany cash-pooling (Note 20)	2,040	679
Interest obligation and derivatives	4	31
Total financial debt	5,044	3,710
Repayable:		
Within one year	2,044	710
Between two and five years	3,000	3,000
Total financial debt	5,044	3,710

Term loan facility

On 27 September 2012, the Company signed a 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 uses it for general corporate purposes as well. The loan facility is priced at 1M PRIBOR plus margin 1.75% p.a. (2012: 3M PRIBOR plus margin 1.75% p.a.).

In July 2012 the Company repaid in a due course a loan in the amount of EUR 115 million drawn in 1997.

In May 2012, the Company and Telefónica Slovakia, s.r.o., a subsidiary company, entered to mutual cash-pooling, which is having a positive effect on Company's cash flow management.

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 2013 based on contractual undiscounted payments.

At 31 December 2013	Less than 3 months	3 to 12 months	1 to 5 years	> 5years
In CZK million				
Interest bearing loans and borrowings	16	2,087	3,112	-
Trade and other payables (excluding Other deferred revenue and Prepaid cards)	8,993	1,279	-	-
Total	9,009	3,366	3,112	-
Non-current other liabilities	-	-	58	6
At 31 December 2012	Less than 3 months	3 to 12 months	1 to 5 years	> 5years
In CZK million				
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

In 2013, the Company did not have any guarantees to third parties (2012: the guarantee in relation to acquisitions made by the Company's subsidiary Bonerix, s.r.o. of CZK 150 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	
	2013	2012	2013	2012
Financial assets				
Cash and cash equivalents	3,844	3,017	3,844	3,017
Short-term loans (incl. accrued interest)	331	212	331	212
Derivatives	44	2	44	2
Other financial assets	166	108	166	108

In CZK million	Carrying amount		Fair value	
	2013	2012	2013	2012
Financial liabilities				
Interest bearing loans and borrowings (incl. accrued interest)	5,044	3,698	5,044	3,698
Derivatives	-	12	-	12

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 2013 and 31 December 2012, 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 2013 and 31 December 2012, 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	
	2013	2012
FX risk		
Value at Risk*	(171)	(145)
Stress testing*	(58)	(42)
IR risk		
Stress testing*	(4)	(16)

* 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	
	2013	2012	2013	2012
Foreign exchange contracts	1,037	1,387	44	(10)

14 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 2013 and 2012.

In CZK million	2013	2012
At 1 January	3,196	3,735
Profit or loss tax charge (Note 4)	(463)	(539)
At 31 December	2,733	3,196

The following amounts, determined after offsetting, are shown in the balance sheet:

In CZK million	31 December 2013	31 December 2012
Deferred tax assets	(386)	(284)
Deferred tax liabilities	3,119	3,480
Total	2,733	3,196

The deferred tax asset includes CZK 353 million (2012: CZK 252 million) recoverable in less than twelve months and CZK 33 million (2012: CZK 32 million) recoverable after more than twelve months. The deferred tax liability includes CZK 695 million (2012: CZK 653 million) to be settled in less than twelve months and CZK 2,424 million (2012: CZK 2,827 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	
	2013	2012	2013	2012
Temporary differences relating to:				
Property, plant and equipment and intangible assets	2,893	3,353	(460)	(499)
Trade receivables, inventories and other differences	(160)	(157)	(3)	(40)
Total	2,733	3,196	(463)	(539)

15 Provisions for liabilities and charges

In CZK million	Regulatory and court decisions	Other provisions	Total
At 1 January 2013	34	23	57
Additions during the year	10	473	483
Utilised during the year	(23)	(479)	(502)
At 31 December 2013	21	17	38
Short-term provisions 2013	7	9	16
Long-term provisions 2013	14	8	22
	21	17	38
Short-term provisions 2012	12	19	31
Long-term provisions 2012	22	4	26
	34	23	57

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 and share-based compensation.

Regulatory and court decisions

A provision for regulatory and court decisions is made for legal proceedings involving the Company (see Note 16).

16 Contingencies and litigations

The Company is involved in a number of legal disputes arising from the usual course of business. Throughout 2013 the Company successfully litigated against lawsuits filed by the third parties in the past. 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 High Court in Prague took the view of the Company that the matter had already once been finally decided by the CTO in favour of the Company, and Vodafone Czech Republic was only trying to circumvent the final decision. The proceedings were 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 declined the extraordinary appeal in June 2013 and the case has finally been closed.

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 immeasurably, 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 2013, despite the fact that the Company has provided the Office with all the necessary evidence and information. As was the case with the 2012 financial statements, it was not possible to make a reliable estimate of the financial impact of this administrative procedure at the closing of the 2013 financial statements.

ii. Proceeding for a penalty of CZK 91.9 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 started a legal action including a proposal to stay the penalty for the duration of the proceedings. The Regional Court in Brno decided on suspension of the payment, however the decision in the merit of the case has not yet been issued.

III. Disputes with AUGUSTUS spol. s r.o.

The Company clearly turned around in its favour the dispute with AUGUSTUS spol. s r.o. and presently concentrates on recovering the amount of unjust enrichment from AUGUSTUS spol. s r.o. 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. The High Court in Prague confirmed the bankruptcy of AUGUSTUS spol. s r.o. in May 2013. The Company is the major creditor with the highest filed and confirmed claim.

IV. 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 a.s. filed an appeal but only in extent of CZK 19.8 million. The High Court in Prague later confirmed that there had not been any contract concluded between CNS a.s. and the Company, and as such there is no claim of CNS a.s. from the contractual relationship. The High Court only ordered the Municipal Court in Prague to decide on possible claims of CNS a.s. arising from the precontractual liability, however no evidence of any such claim has been filed.

V. 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 court started hearings of this case and the hearings continued in 2013, including hearings of experts and witnesses.

VI. BELL TRADE s.r.o. – a claim for CZK 9.7 billion

A legal action for CZK 3.2 billion filed by company BELL TRADE s.r.o. was delivered to the Company in January 2012. The legal action was filed at the District Court in Malacky (the Slovak Republic); 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 s.r.o., 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 s.r.o. filed an appeal. The Regional Court in Bratislava subsequently cancelled the decision and the case stayed with the District Court in Malacky. The Company filed a constitutional complaint against the decisions on the jurisdiction of Slovak courts, but the Constitutional Court has not yet given its decision. The plaintiff filed a motion to raise the claim to CZK 9.7 billion in December 2013.

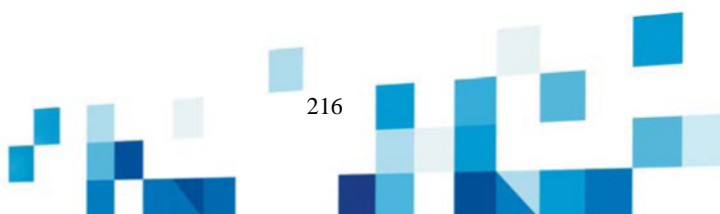
VII. ČESKÉ RADIOKOMUNIKACE a.s. – a claim for CZK 3.1 billion

A legal action for CZK 3.1 billion filed by České Radiokomunikace a.s. (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 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 2013 represents nearly CZK 25 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.



17 Commitments

The aggregate future minimum lease payments under operating leases (Company is a lessee) and aggregate future minimum lease payments under non-cancellable operating leases (Company is a lessor):

In CZK million	Less than 1 year	1 to 5 years	Over 5 years
Operating leases - lessee	1,224	2,847	2,671
Operating leases - lessor	146	53	-

The total minimum lease payments relating to operating leasing of property, plant and equipment recognised as an expense in 2013 were CZK 1,341 million (2012: CZK 1,355 million). The lease agreements may contain clauses requiring restoration of the leased site at the end of the lease term. The Company estimates present value of future obligatory liquidation and decommissioning costs taking into account changes in network infrastructure such as network sharing projects. 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.

Capital and other expenditure contracted but not yet included in the financial statements as at 31 December 2013 amounted to CZK 4,728 million, of which CZK 2,803 million represent purchase price of spectrum licences (frequencies for the LTE networks). The rest of contracted amounts relate to the telecommunication networks and service contracts.

18 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 (within the 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 1800 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 the CTO valid until 7 February 2016, in the 2100 MHz frequency band under the Universal Mobile Telecommunications System (UMTS) standard on the basis of radio frequency assignment from the 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 the 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 2013, the Company provided the following selective services under CTO imposed obligations to provide Universal Service:

- a) public pay telephone services,
- b) access for persons with disability 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 persons with disability.

Universal Service is reimbursed by the CTO that receives funds from the state budget, which are remitted without delay to the Company's account.

19 Share capital and reserves

	31 December 2013	31 December 2012
Nominal value per ordinary registered share (CZK)	87	87
Number of shares	315,648,092	322,089,890
Nominal value per ordinary registered share (CZK)	870	870
Number of shares	1	1
Ordinary shares (in CZK million)	27,461	28,022

Company's share capital was reduced by the total amount of CZK 561 million by way of cancellation of 6,441,798 shares from the total amount of 11,869,833 own shares. The total purchase price, for which the company bought the cancelled shares is CZK 2,483 million. The

share premium was reduced by CZK 1,922 million which represents the difference between the purchase price and the nominal value of the cancelled shares.

Shareholdings in the Company were as follows:

	31 December 2013	31 December 2012
Telefónica, S.A.	70,83%	69.41%
Telefónica Czech Republic, a.s. (treasury shares)	1,72%	2.00%
Other shareholders	27,45%	28.59%

The funds include a statutory reserve fund of CZK 6,442 million (2012: CZK 6,442 million) that is by law not distributable. The equity-settled share based payments reserve of CZK 38 million (2012: CZK 31 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 respect of managing the capital of the Company is to focus its investment activities on areas with a high growth potential, 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 the Slovak Republic. IT systems renewal and upgrade are among other investment activities aiming to simplify and improve processes that will lead to improved operating efficiency.

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 these 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 make an annual analysis of the other options allowing the distribution 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 2013:

In CZK million	31 December 2013
Share capital	27,461
Treasury shares	(1,596)
Share premium	19,349
Funds and reserves	6,488
Retained earnings from previous years	585
Net income for current year	5,743
Total	58,030

20 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 cooperates 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 management.

The Company cooperates with Telefónica Global Roaming GmbH in the area of wholesale roaming business, negotiation 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 2013	31 December 2012
Payables	685	747
Profit or loss In CZK million	Year ended 31 December 2013	Year ended 31 December 2012
a) Purchases of services and goods	35	46
b) Royalty fees	660	726

The total amount of dividend paid as at 31 December 2013 to Telefónica, S.A. was CZK 4,471 million (2012: CZK 6,036 million). The amount paid due to the other distribution as at 31 December 2013 amounted to CZK 2,236 million (2012: CZK 2,906 million).

II. Other related parties – Company's subsidiaries and associates:

Balance sheet In CZK million	31 December 2013	31 December 2012
a) Receivables	256	155
b) Dividend receivable	898	-
c) Payables	173	82
d) Short-term loans provided (Note 13)	313	211
e) Short term intercompany cash - pooling liability (Note 13)	2,040	679
Profit or loss In CZK million	Year ended 31 December 2013	Year ended 31 December 2012
a) Sales of services and goods	781	420
b) Dividend income	908	-
c) Purchases of services and goods	149	67
d) Interest income	3	1
e) Interest costs	2	-

As at 31 December 2013 the Company provided a short-term loan of CZK 278 million (2012: CZK 211 million) to Internethome, s.r.o. (Note 13). The loan bears a floating interest based on 1M PRIBOR. The loan conditions are based on the arm's length principle.

As at 31 December 2013 the Company provided a short-term loan of CZK 35 million (2012: CZK 0 million) to Bonerix s.r.o. (Note 13).

III. Other related parties – Telefónica Group and joint ventures:

Balance sheet	31 December 2013	31 December 2012
In CZK million		
a) Receivables	462	350
b) Payables	1,884	1,940
c) Short-term receivables - interest (Note 13)	18	1
d) Cash equivalents (Note 11)	3,532	2,761

Profit or loss	Year ended	Year ended
In CZK million	31 December 2013	31 December 2012
a) Sales of services and goods	978	805
b) Purchases of services and goods	1,410	1,213
c) Management fees	435	387
d) Interest income	12	65

There were capital expenditures of CZK 17 million carried out with related parties for the period ended 31 December 2013 (2012: CZK 5 million).

The list of the Telefónica companies with which the Company had any transaction in 2013 and 2012 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 Colombia, S.A., Telefónica Móviles Chile, S.A., Otecel, S.A., Telefónica Móviles Nicaragua, S.A., Telefónica Investigación y Desarrollo, S.A., Telecom Italia S.p.A., Telfisa Global BV, Telfisa, Telefónica International Wholesale Services, SL, Telefónica International Wholesale Services II, SL, Telefónica Compras Electrónica, S.L., Telefónica Móviles Mexico, S.A., Telefónica Móviles del Uruguay, S.A., Telefónica Móviles Perú, S.A.C., 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, S.A., Czech Republic branch, Telefonica Global Technology, S.A., Telefonica Global Services GmbH, Tesco Mobile ČR s.r.o., Telefónica Factoring, E.F.C., S.A., Telefónica Costa Rica S.A., Telefónica Digital España SL, Wayra Czech Republic, 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 2013	31 December 2012
Salaries and other short-term benefits	89	100
Personal indemnification insurance	2	3
Total	<u>91</u>	<u>103</u>

b) Loans to related parties

No loans were provided to members of Board of Directors and Supervisory Board in 2013 and 2012.

No loans were provided by the Company to related parties.

21 Subsidiaries, associates and joint ventures

As at 31 December 2013

Subsidiaries	Group'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	Slovak Republic	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
Joint ventures				
8. Tesco Mobile ČR s.r.o.	50%	6	Czech Republic	Mobile virtual network operator for prepaid services

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	Slovak Republic	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.	13%	20	Czech Republic	Real time mobile payments

In March 2013, the Company entered into a joint venture agreement with Tesco Stores ČR, a.s. related to set-up and operation of Tesco Mobile ČR s.r.o., a mobile virtual operator. The Company has a 50% ownership interest in Tesco Mobile ČR s.r.o. which offers mobile telecommunication services within the Czech Republic.

In 2013, the Company sold its interest in the company MOPET CZ a.s.

Sale to PPF Group

The agreement between Telefónica and PPF Group to sell 65.9% of the Company's shares was approved by the European Commission on mid-January 2014 and was closed on 28 January 2014.

The first vice-chairwoman of the Supervisory Board Maria Pilar López Álvarez and Supervisory Board members Antonio Manuel Ledesma Santiago and Ivan Varela Sanchez resigned from their positions on the board as of 28 January 2014. Three new members, Martin Štefunko, Vladimír Mlynář and Ladislav Bartoníček, were appointed to the positions. The chairwoman of the Supervisory Board María Eva Castillo Sanz and Supervisory Board members Jesús Pérez de Uriguen and Francisco de Borja de Nicolás resigned from their positions as of 29 January 2014. Subsequently, Martin Štefunko was elected the new chairman of the Supervisory Board and Ladislav Bartoníček was elected as the new first vice-chairman.

On 30 January 2014, the Supervisory Board of the Company accepted the resignation of David Melcon Sanchez-Friera from his position as a member and 1st Vice-chairman of the Board of Directors and of Jakub Chytil and Ramiro Lafarga Brollo from their positions as members of the Board of Directors. The Supervisory Board elected Martin Vlček and Michal Frankl as new members of the Board of Directors.

Qualified shareholder convened the Regular General Meeting on 12 March 2014.

LTE broadband mobile data network

Arising from the auction results, the Company expects to receive new spectrum assignments issued by the Czech Telecommunication Office in the first quarter of 2014.

For purchase price of spectrum licences see Note 17.

LTE broadband mobile data network

Arising from the auction results, the Company expects to receive new spectrum assignments issued by the Czech Telecommunication Office in the first quarter of 2014.

For purchase price of spectrum licences see Note 17.

Restructuring

During 2014, 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 2014 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 370 million.

Other

There were no other events which occurred subsequent to the balance sheet date and which would have a material impact on the financial statements as at 31 December 2013.

Always at least a step ahead



07

Other information for
shareholders and investors

9. Other information for shareholders and investors

Basic information:

Corporate name:	Telefónica Czech Republic, a.s. (Telefónica CR, the Company)
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 2013

	2013	2012
Number of shares (in millions) ¹⁾	312.8	319.9
Net profit/(loss) per share (in CZK) ²⁾	18.4	18.5
Highest share price (in CZK) ³⁾	333.9	419.0
Lowest share price (in CZK) ³⁾	255.5	315.9
Share price at the end of period (in CZK) ³⁾	295.0	323.6
Market capitalisation (in CZK bn) ³⁾	93.1	104.2

¹⁾ Weighted average number of ordinary shares in circulation over the period

²⁾ Unconsolidated net profit under IFRS

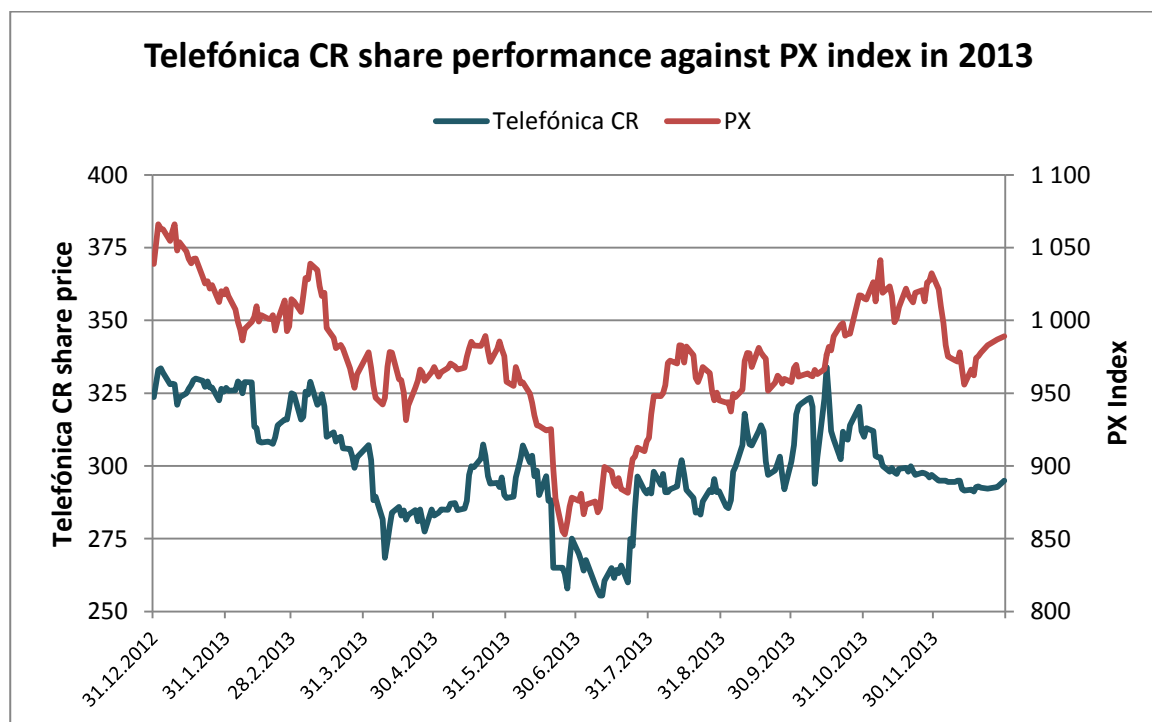
³⁾ Source: Prague Stock Exchange

In 2013, Telefónica CR once again ranked among the most important companies on the Czech capital markets according to market capitalization and trading volumes. The total volume of trades in company shares on the PSE stock market in 2013 was CZK 23.5 bn, compared to CZK 33.7 bn in 2012. Trading in Telefónica CR shares, measured by the total volume of shares traded, made up 13.4% of all trades on the PSE stock market. In 2013, Telefónica CR shares confirmed the position of the fourth most traded issue on the PSE from 2012.

The market capitalisation as at 30 December 2013 (the last trading day on the PSE in 2013) was CZK 93.1 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 2013 reached CZK 295.0, which was down 8.8% year on year, while the PX Index (the main index of the PSE) closed at 989.0 points, which is a year-on-year decline of 4.8%. The main reason for the drop in company shares in 2013 was negative trend in the share price of some telecommunications companies in the Central and Eastern Europe region, which was caused by their announcements of lower dividends. Another factor was

the payment of dividends of CZK 20 per share for the year 2012 (record day fell on 14 October), and the payment of an amount corresponding to reduction of the share premium by CZK 10 (record day fell on 14 October). With the exclusion of these two factors, the share price of Telefónica CR would decline 0.4% over the course of the year. The share price of Telefónica CR reached its maximum of CZK 333.9 on 15 October 2013, and its minimum of CZK 255.5 on 10 July 2013. The average share price in 2013 was CZK 299.6, compared to CZK 380.7 in 2012.

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 a part of 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 ths., 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 a part of 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 ths., 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.

At the Ordinary General Meeting of 22 April 2013 in Prague, the shareholders approved a dividend payment from the profit of 2012 and a part of the retained earnings from previous years in the total amount of CZK 6.442 bn, i.e. CZK 20 per share of nominal value of CZK 87 and CZK 200 per share of nominal value of CZK 870, before tax. The record day for the payment of dividends was 14 October 2014 and the disbursement date 10 November 2013.

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.

In line with this policy, the General Meeting of 19 April 2012 approved a proposal by the Board of Directors to reduce the share capital of the Company proportionately by reducing the nominal value of all Company shares by the total amount of CZK 4,187,168,700. This amount was distributed among the Company's shareholders. The amount of CZK 13 before tax was paid to each share in the nominal value of CZK 87; CZK 130 before tax was paid to the share in the nominal value of CZK 870.

Also in line with this policy, the General Meeting of 22 April 2013 approved a proposal by the Board of Directors to distribute a part of the share premium, to the limit of CZK 3,221 bn, to the shareholders. The amount of CZK 10 before tax was paid to each share in the nominal value of CZK 87; CZK 100 before tax was paid to the share in the nominal value of CZK 870.

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 2013. 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 2013, 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 2013 divided into short-term and long-term (in CZK m):

Short-term (maturing within a year)	4
Long-term	3,000
Total	3,004

Loans, bonds issued and other financial obligations:

	Currency	Balance in CZK m as at 31 December 2013	Redemption
Bank loan	CZK	3,004	2016

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 four 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 2013, Telefónica CR had no overdue loan obligations.

Investments

Principal investments made by Telefónica CR Group in the last two accounting periods
(in CZK m):

	2013	2012
Network & Operations	2,817	3,105
Business Solutions	598	481
IT & Products	953	840
Property & Security	186	193
Subsidiary companies and other investments*	601	1,132
Investments related to Telefónica Slovakia made in the Czech Republic	60	84
Telefónica Slovakia	458	408
Total (excluding acquisition in the Wifi segment)	5,673	6,243
Wifi acquisitions	0	123
Total	5,673	6,366

* 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.

In 2013 Telefónica CR continued to apply its investment policy which follows the main goal of developing and investing in technologies with a high potential of growth; expanding the mobile data network with the deployment of new technology; and increasing the Company's operating efficiency.

The mobile business was dominated in particular by investments in the Best Internet strategy (3G and 4G data technology); the coverage of the population with 3G and 4G service reached approximately 78.6% and 4.54%, respectively, at the end of 2013.

In 2013, Telefónica CR and T-Mobile signed a second- and third-generation (2G and 3G) network sharing agreement. Both companies will cooperate in the deployment of the networks in order to improve the coverage and, in particular, increase the efficiency of network operation. The agreement explicitly excluded the two largest Czech cities – Prague and Brno.

In 2012, Telefónica CR commenced the commercial operation of its 4G network; the service was available to approximately 10 thousand customers. In terms of geographical reach, the service was available in Jesenice near Prague and in approximately half of the area of Chodov shopping centre. In 2013, the Company successfully continued with the roll-out of its LTE service, which uses the spectrum of 1,800 Mhz, in the direction to the Prague city centre. In October 2013, the Company was the first to launch LTE service in the Moravian metropolis; the service was available in the wider city centre and the Brno exhibition grounds.

In the fixed access business, investments went mainly into strengthening of capacities carrying the VDSL service. In 2013, the number of VDSL users went up more than 39% from the previous year, which put the transmission network under a greater strain. In 2013, the Company implemented a

new IPTV platform, which considerably expanded the options of the service for customers, which in turn powered the year-on-year increase in their number by more than 10%.

As for business solutions, the volume of investments followed the trend in business solutions, with projects related to data connectivity and ICT solutions still ruled strong.

The year 2013 was the second year of the programme which goes by the common denominator of 'simplicity'. Its goal is to simplify the product portfolio in particular, but also the processes and, last but not least, the system structure. The project seeks to streamline the service proposition and internal processes with the view to achieving greater efficiency.

The roll-out of the proprietary network, in particular 3G, continued in Slovakia. Investments were directed also at replacement of obsolete equipment and development of a business proposition. At the end of the year, Telefónica Slovakia operated 1,034 2G base transceiver stations; its 2G network reached 95.91% at the end of 2013. Moreover, the company also operated 792 3G base transceiver stations, and its 3G service was available to 59.28% of the population.

Key investments in the future years

In the period 2014–2015, 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 2014 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. 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 2013:

- Consolidated whole (Telefónica CR Group)

Type of service	Fees in CZK m
Audit	20
Other audit-related consultancy	0
Other services	0
Total	20

- 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 2013, the long-term corporate rating of the Telefónica CR Group was BBB- Outlook Negative. The rating reflects the satisfactory business and financial results of Telefónica CR Group and its adequate liquidity, but also the expectations which Standard & Poor's has of the future finance policy of the new majority owner PPF Group.

Financial calendar

Dates of announcement of running financial results

For the first quarter of 2014	14 May 2014
For the first half of 2014	1 August 2014 *
For three quarters of 2014	11 November 2014 *
For the year 2014	28 February 2015 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@telefonica.com
 URL: <http://www.telefonica.cz/vztahy-s-investory/>
 Address: Telefónica CR Czech Republic, a.s.
 Za Brumlovkou 266/2
 140 22 Praha 4

10. 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.

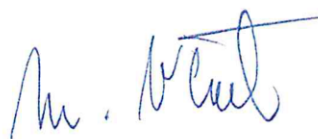
and

Martin Vlček, Vice-chairman of the Board of Directors 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 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 and results.



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



Martin Vlček
Vice-chairman of the Board of
Directors and Director, Finance Division

In Prague on 28 April 2014

Appendix: Report by the Board of Directors of Telefónica Czech Republic, a.s.

The Report of the Board of Directors of Telefónica Czech Republic, a.s.

On Relations Between the Controlling and the Controlled Entity and on Relations among the Controlled Entity and Other Entities controlled by the same Controlling Entity for the Year 2013

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Part D Other legal acts between Holding parties in the fiscal year of 2013

Part E Measures between Holding parties in the fiscal year of 2013

Part F Conclusion

Annex

The list of companies directly or indirectly controlled by Telefónica, S.A. in the period from 1 January 2013 to 31 December 2013

Part A The decisive period

The Report on relations between the controlling and the controlled entity and the relations among the controlled entity and other entities – interconnected entities – controlled by the same controlling entity reflects the latest fiscal year from 1 January 2013 to 31 December 2013.

Part B Parties to the Holding

Section I. The fundamental identification of the controlled entity - Telefónica Czech Republic, a.s. (hereinafter referred to as the Company)

The company is registered in the Commercial Register administrated by the Metropolitan Court in Prague, Section B, Enclosure 2322.

Date of entry: 1 January 1994

Company name: Telefónica Czech Republic, a.s.

Registered office: Praha 4, Michle, Za Brumlovkou 266/2, postcode 140 22

Company ID: 60 19 33 36

Legal form: a joint-stock company

Section II. The fundamental identification of the controlling entity

Controlling entity: Telefónica, S.A.

Registered office: Grand Vía, 28, 28013, Madrid, Spain

Identification No.: A 28015865

The controlling entity owned shares of the controlled entity equalling to 70.83% of the controlled entity's registered capital.

The summarizing review of shares in Telefónica Czech Republic, a.s. as at the last day of the fiscal year, this Report is reflecting:

70.83% Telefónica, S.A.

1.72% Telefonica Czech Republic, a.s. (own shares)

27.45% other investors

Note: On the date of this Report, the Company is controlled by PPF Arena 2 B.V., established in compliance with the Dutch law, having its registered office at Strawinskylaan 993, 1077 XX Amsterdam, the Netherlands, registered in the commercial register of the Chamber of Commerce in Amsterdam, No. 59029765.

As at this date, the entity that is the actual controlling entity on the day of this Report, owns shares of the controlled entity equalling to the nominal value of 65.93 % of the controlled entity's registered capital.

The summarizing review of shares in Telefónica Czech Republic, a.s. as at the day of this Report:

65.93 % PPF Arena 2 B.V.

4.90 % Telefónica, S.A.

1.72 % Telefonica Czech Republic, a.s. (shares)
27.45 % other investors

Section III. Interconnected entities

Entities controlled by Telefónica, S.A.:

The list of relevant entities directly or indirectly controlled by Telefónica, S.A. is attached hereto as Annex. The list was set up based on the supporting documentation provided by Telefónica, S.A. and verified against commercial registers and other available data.

Part C Contracts and agreements between the controlling and the controlled entity and contracts and agreements between the controlled entity and other controlled entities, including information about performance and counter-performance

The following contracts were entered into with the controlling entity and interconnected entities and implemented in the decisive period: providing of IT services (warranty and post-warranty maintenance and system support), IT operation outsourcing contracts, Service Maintenance Centre contract, contracts for providing telecommunications services (providing of transmission capacity), contracts for the sale and installation of telecommunications technologies, network quality level agreements, contracts for cost sharing in various technological areas (“verticals”), contracts for providing a sub-licence to registered trademarks, insurance contracts, contracts for global economies of scale and scope relating to roaming services, contracts for providing services of external call centres, contracts for holding an account in a foreign currency, a contract for Human Resources services, a contract for a global employee shares programme, a contract for delegation of employees, a contracts for processing of tax documents and their registration, contract for fixed electronic communications network monitoring and mobile electronic communications network monitoring, a contract for access to the mobile public electronic communications network, a contract for logistics services, a contract to procure mobile hand-sets, a licence contract for a trademark, a contract for providing temporary services, a partnership contract, a Human Resources Centre of Excellence services contract, the Credit Facility Agreement and the Deposit Agreement.

These contracts were made either with the controlling entity Telefónica, S.A. or with the following interconnected entities: Atento Česká republika a.s., Bonerix s.r.o., Internethome, s.r.o., O2 Holdings Ltd., Telefónica Europe plc, (TELFISA), TELEFONICA GLOBAL TECHNOLOGY S.A. UNIPERSONAL, Telefonica Europe People Services Ltd, Telefónica Finanzas, S.A., Telefónica Global Roaming GmbH, Telefónica Global Services GmbH, Telefónica Insurance S.A., Telefónica International Wholesale Services, S.L., Telefónica International Wholesale Services II S.L., Telefónica UK Ltd., Telefónica Germany GmbH & Co. OHG, Telefónica Slovakia, s.r.o., Telfisa Global, B.V., Wayra Czech Republic, s.r.o.

Considering contracts and agreement made in 2013 between the controlling and the controlled entity and between the controlled entity and other interconnected entities, based on which performance or counter-performance was provided, or considering contracts and agreements made

before 1 January 2013, performance or counter-performance of which was provided in the year 2013, the controlled entity suffered no detriment.

From the perspective of the controlled entity, performance implied by the above-mentioned contracts always corresponded to services provided by third parties on the market in terms of both quality and price, moreover, in numerous cases the Company was taking advantage of synergies and economies of scale and scope agreed upon globally in different areas.

Part D Other legal acts between Holding parties in the fiscal year of 2013

In the fiscal year of 2013, the controlled entity made neither unilateral nor other legal acts in favour of or upon an incentive by the controlling or interconnected entities, which might have brought a benefit or detriment, or advantage or disadvantage to the controlled entity.

Part E Measures between Holding parties in the fiscal year of 2013

In the fiscal year of 2013, the controlled entity made no measures in favour of or upon an incentive by controlling or interconnected entities, which might have brought a benefit or detriment, or advantage or disadvantage to the controlled entity.

Part F Conclusion

(a) This report was prepared by the Board of Directors of Telefónica Czech Republic, a.s. and it was approved at the Board of Directors meeting on 19 March 2014.

(b) The report was prepared based on data and information obtained from the controlling entity in the fiscal year of 2013 and from other interconnected entities, from other available documents and from the review of relations between the controlled entity and the controlling and other interconnected entities. The Board of Directors of the controlled entity, Telefónica Czech Republic, a.s., declares to have collected the above-mentioned data and information with a due care of a manager.

(c) Since it is mandatory for the controlled entity Telefónica Czech Republic, a.s. to make an annual report according to the Accounting Act No. 563/1991 Coll., as amended, this Report shall be attached to the Annual Report 2013. Shareholders will have the possibility to inspect the Report in the same period of time and under the same conditions as the financial statements.

(d) The report is compliant with the Act No. 513/1991 Coll., Commercial Code requirements.

Prague, 19 March 2014.

Telefónica Czech Republic, a.s.

The Board of Directors

Annex

The list of companies directly or indirectly controlled by Telefónica, S.A. in the period from 1 January 2013 to 31 December 2013:

Company name and its legal form	State	% Telefónica Group	Via
Parent company			
Telefónica, S.A.	Spain		
Telefónica Latin America			
Telefónica Internacional, S.A.U.	Spain	100%	Telefónica, S.A. (100%)
Telefónica 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.	Spain	100%	Telefónica Latinoamérica Holding, S.L. (100%)
Telefónica Datacorp, S.A.U.	Spain	100%	Telefónica, S.A. (100%) Telefónica Internacional, S.A.U. (29.43%) Telefónica, S.A. (24.74%) Sao Paulo Telecomunicações Participações, Ltda. (19.73%)
Telefónica Brasil, S.A.	Brazil	73.96%	Telefónica Chile, S.A. (0.06%)
Wireline telephony operator in Sao Paulo	Brazil	73.96%	Telefónica Brasil, S.A. (100%)
Vivo, S.A.	Brazil	73.96%	Telefónica Holding de Argentina, S.A. (47.22%) Telefónica Móviles Argentina Holding, S.A. (42.77%) Telefónica International Holding, B.V. (10.01%)
Compañía Internacional de Telecomunicaciones, 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 de Argentina, S.A.	Argentina	100%	Telefónica, S.A. (1.80%) Telefónica 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.			Latin America Cellular Holdings, B.V. (97.04%) Comtel Comunicaciones Telefónicas,

Company name and its legal form	State	% Telefónica Group	Via
			S.A. (2,87%)
	Venezuela	100%	Telefónica, S.A. (0.09%)
Telefónica Móviles Chile, S.A.			TEM Inversiones Chile Ltda. (99.99%)
	Chile	99.99%	Inversiones Telefónica Internacional Holding Ltda. (53.00%)
Telefónica Chile, S.A.			Telefónica Internacional de Chile, S.A. (44.89%)
	Chile	97.89%	Telefónica Latinoamérica Holding, S.L. (50.18%)
Telefónica del Perú, S.A.A.			Latin American Cellular Holdings, B.V. (48.31%)
	Peru	98.49%	Telefónica del Perú, S.A.A. (99.99%)
Telefónica Móviles Perú, S.A.C.			Telefónica Internacional, S.A.U. (32.54%)
	Peru	98.49%	Olympic, Ltda. (18.95%)
Colombia Telecomunicaciones, S.A. ESP			Telefónica, S.A. (18.51%)
	Columbia	70%	Telefónica, S.A. (100%)
Telefónica Móviles México, S.A. de C.V. (MEXICO)			Telefónica Móviles México, S.A. de C.V. (100%)
	Mexico	100%	Latin America Cellular Holdings, B.V. (68.00%)
Pegaso Comunicaciones y Sistemas, S.A. de C.V.			Telefónica, S.A. (32.00%)
	Mexico	100%	Telefónica Internacional Holding, B.V. (100%)
Telefónica Móviles del Uruguay, S.A.			Telefónica Centroamérica Inversiones S.L. (60%)
	Uruguay	100%	TES Holding, S.A. de C.V. (60%)
Telefónica Larga Distancia de Puerto Rico, Inc.			TCG Holdings, S.A. (39.59%)
	Puerto Rico	100%	Guatemala Cellular Holdings, B.V. (20.41%)
Telefónica Móviles Panamá, S.A.			Telefónica Centroamérica Inversiones S.L. (60%)
	Panama	60%	
Telefónica Móviles Salvador, S.A. de C.V.			
	Salvador	60%	
Telefónica Móviles Guatemala, S.A.			
	Guatemala	60%	
Telefonía Celular de Nicaragua, S.A.			
	Nicaragua	60%	
Otecel, S.A.			
	Ecuador	100%	
Telefónica de Costa Rica TC, S.A.			
	Costa Rica	100%	
Telefónica Holding Atticus, B.V.			
	The Netherlands	100%	

Company name and its legal form	State	% Telefónica Group	Via
Telefónica Europe			
Telefónica Europe plc	Great Britain	100%	Telefónica, S.A. (100%)
MmO2 plc	Great Britain	99.99%	Telefónica Europe plc (99.99%)
O2 Holdings Ltd.	Great Britain	100%	MmO2 plc (100%)
Telefónica Great Britain Ltd.	Great Britain	100%	O2 Networks Ltd. (80.00%) O2 Cedar Ltd. (20.00%)
Tesco Mobile Ltd.	Great Britain	50.00%	O2 Communication Ltd. (50.00%) O2 (Netherlands) Holdings, B.V. (97.06%)
Telefónica O2 Ireland Limited	Ireland	100%	Kilmaine Ltd (2.94%)
O2 (Europe) Ltd.	Great Britain	100%	Telefónica, S.A. (100%)
Telefónica Deutschland Holding, A.G.	Germany	76.83%	Telefónica Germany Holdings Limited (76.83%) Telefónica Deutschland Holding A.G (76.82%) Telefónica Germany Management GmBh (0.01%)
Telefónica Germany GmbH & Co. OHG	Germany	76.83%	
Wireless communications services operator	Germany	76.83%	
Telefónica de España, S.A.U.	Spain	100%	Telefónica, S.A. (100%)
Telefónica Móviles España, S.A.U.	Spain	100%	Telefónica, S.A. (100%)
Acens Technologies, S.L.	Spain	100%	Telefónica de España, S.A.U. (100%)
Telefónica Servicios Integrales de Distribución 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%)
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.	The Czech Republic	70.83%	Telefónica, S.A. (70.83%)
Telefónica Slovakia, s.r.o.	Slovakia	70.83%	Telefónica Czech Republic, a.s.

Company name and its legal form	State	% Telefónica Group	Via (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. (73.14%) Telefónica International Wholesale Services, S.L. (26.86%)
Telefónica International Wholesale Services USA, Inc.	USA	100%	T. International Wholesale Services America, S.A. (100%)
Telefónica Digital España, S.L.	Spain	100%	Telefónica Digital Holdings, S.L. (100%)
Telefónica Digital Inc.	USA	100%	Telefónica Europe plc (100%)
Tuenti Technologies, S.L.	Spain	100%	Telefónica Móviles España, S.A.U. (100%)
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. (100%)
Wayra Brasil Aceleradora de Projetos Ltda.	Brazil	100%	Wayra Investigacion y Desarrollo, S.L. (100%)
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	99,99%	Wayra Investigacion y Desarrollo, S.L. (99.99%)
Terra Networks Brasil, S.A.	Brazil	100%	Sao Paulo Telecomunicações Participações, Ltda. (100%)
Terra Networks México, S.A. de C.V.			

Company name and its legal form	State	% Telefónica Group	Via
	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. (100%)
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%) Enfisar S.A. (20.98%)
Atlántida Comunicaciones, S.A.	Argentina	100%	Telefónica 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%)
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%)

Company name and its legal form	State	% Telefónica Group	Via
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%)
Telefónica Investigación y Desarrollo, S.A.U.	Spain	100%	Telefónica, S.A. (100%)
Telefónica Luxembourg Holding, S.à.r.L.	Luxemburg	100%	Telefónica, S.A. (100%)
Casiopea Reaseguradora, S.A.	Luxemburg	100%	Telefónica Luxembourg Holding, S.à.r.L. (100%)
Telefónica Insurance, S.A.	Luxemburg	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	100%	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%)
Aliança Atlântica Holding B.V.	The Netherlands	93.99%	Telefónica, S.A. (46.995%) Telefónica Brasil, S.A.(46.995%)
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%)

Company name and its legal form	State	% Telefónica Group	Via
Telefónica 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%)
TGestiona Logística, S.A.C.	Peru	100%	Telefónica Gestión de Servicios Compartidos España, S.A. (99.48%) Telefónica del Perú, S.A.A. (0.52%)
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%)
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	66%	Telefónica, S.A. (66%)
DTS Distribuidora de Televisión Digital, S.A.	Spain	22.00%	Telefónica de Contenidos, S.A.U. (22%)
China Unicom (Hong Kong) Limited	China	5.01%	Telefónica Internacional, S.A.U. (5.01%)