



Annual Report 2009

A *Telefonica* company

O₂

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Independent auditors' report to the shareholders of Telefónica O2 Czech Republic, a.s.

I. We have audited the consolidated financial statements of Telefónica O2 Czech Republic, a.s. and its subsidiaries ("the Group") as at 31 December 2009, presented in the annual report of Telefónica O2 Czech Republic, a.s. ("the Company") on pages 98–159, on which we have issued an auditors' report dated 19 February 2010, presented in the annual report on page 101. We have also audited the separate financial statements of the Company as at 31 December 2009, which are presented in the annual report of the Company on pages 160–220 on which we have issued an auditors' report dated 19 February 2010, presented in the annual report of the Company on page 162 (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 O2 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 6–96 and 221–226 is consistent with that contained in the audited financial statements as at 31 December 2009. Our work as auditors was confined to checking the annual report with the aforementioned scope and did not include a review of any information other than that drawn from the audited accounting records of the Company. We believe that our audit provides a reasonable basis for our opinion.

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

III. In addition, we have reviewed the accuracy of the information contained in the report on related parties of Telefónica O2 Czech Republic, a.s., for the year ended 31 December 2009, presented in the annual report of the Company on pages 227–236. The management of Telefónica O2 Czech Republic, a.s., is responsible for the preparation 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 implementation guidance 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 O2 Czech Republic, a.s., for the year ended 31 December 2009 is materially misstated.



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



Brian Welsh
Partner



Radek Pav
Auditor,
Licence No. 2042

31 March 2010
Prague,
Czech Republic

Financial and operational highlights

Financial data are 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.

	2009	2008
Financials		
Revenues	59,889	64,709
OIBDA – Operating income before finance costs, tax, depreciation and amortization ¹	27,076	28,312
Operating income	15,075	15,380
Income before taxes	14,877	15,348
Net income	11,666	11,628
Total assets	92,768	103,623
Property, plant and equipment	57,545	63,429
Total equity	73,879	78,168
Financial debts	3,131	3,196
Capital expenditure	6,489	8,088
Operations (end of period)		
Fixed telephony accesses (x 1,000)	1,771	1,893
ADSL connections (x 1,000)	725	631
Pay TV – O ₂ TV (x 1,000)	138	115
Mobile registered customers in Czech Republic (x 1,000)	4,945	4,802
– of which contract	2,815	2,519
pre-paid	2,130	2,283
Active mobile customers in Slovakia (x 1,000)	553	325
Group headcount	8,687	9,096
Ratios (in %)		
OIBDA margin (OIBDA/Revenues)	45.2	43.8
Net income/Revenues	19.5	18.0
Capital expenditure/Revenues	10.8	12.5
ROA (Net income/Total assets)	12.6	11.2
ROE (Net income/Equity)	15.8	14.9
Gross gearing (Financial debts/Total equity)	4.2	4.1
Macroeconomic indicators²		
Population (in millions)	10.5	10.4
GDP growth (in %) ³	(4.1)	2.3
Inflation (in %)	1.0	6.3
Unemployment (end of period, in %)	9.2	6.0
CZK/USD exchange rate – average over the period	19.1	17.0
CZK/USD exchange rate – end of period	18.4	19.3
CZK/EUR exchange rate – average over the period	26.4	24.9
CZK/EUR exchange rate – end of period	26.5	26.9

¹ Including impairment charge and gain from sale of non-current assets. In 2008, the Group posted an impairment charge of CZK 86 million, compared to CZK 23 million in 2009; gain from sale of non-current assets reached CZK 855 million in 2008 compared to CZK 422 million in 2009.

² Sources: Czech Statistical Office, Czech National Bank, Ministry of Labour and Social Affairs.

³ At constant 1995 prices.

Letter from the Chairman of the Board of Directors



To Our Shareholders

Let me use this opportunity to review the activities, development and the results of the Telefónica O2 Czech Republic Group in 2009. The past year, in particular from the second quarter, marked a significant turnaround for the worse in the macroeconomic environment in the Czech Republic. This negatively translated into a change in the behaviour, and in particular in the greater economizing of our mobile customers, and, by extension, pressed our revenues down. As in the previous years, our activities focused on accommodating – to the maximum extent possible – the wishes of our customers. This strategy proved to be paramount in the recessed economic environment as it helped us to mitigate the effects of the external factors. Our successful market proposition consisting of new and innovated services, which were very positively received by the market, helped us to maintain our rate of growth of our customer base both in the fixed and the mobile segments. Our simple and clear offer has brought us more customers in Slovakia, as well as improved financial performance.

Our services were targeted at responding to the trends in the highly competitive telecommunications market in the Czech Republic. Demand for fixed and mobile services based on broadband internet access, data services, digital television over a fixed line and converged services was among the trends that were still growing strong. At the same time we focused on maintaining our revenues from mobile voice services by means of active migration of customers to post-paid services. In the area of IT and business solutions we completed the integration of our activities in this segment into one organisation unit of business solutions, and the merger of our subsidiaries active in this field of business. As a result we strengthened our position among ICT providers in the Czech marketplace. Thanks to the above-mentioned activities we also confirmed our innovation leadership in the segment of integrated business solutions, and maintained our primacy in the Czech telecommunications market.

In the financial area we concentrated on compensating, to the maximum extent possible, for the negative effects of the economic environment; our continued drive for efficiency helped us maintain operating profitability and deliver on our OIBDA and operating cash flow targets.

And now, allow me to delve deeper into a review of the developments of the past year – our accomplishments – and into our expectations from 2010.

In the fixed access segment we continued to focus on slowing down the rate of decline in this area by means of adding more value to the fixed line. In May we introduced a brand new concept of services for the residential segment. Unlike the previous offer of service bundles affiliated with a voice tariff, the new concept was built on our O₂ Internet and O₂ TV services, without the requirement to pay additional fixed line fees. Customers could choose from a menu of bonus services to complement either of the main two services, or to subscribe to any other fixed or mobile service with a discount. A similar proposition was prepared also for our business and corporate customers. The new service concept began to bear fruit in the second half of the year – by bringing new customers to O₂ Internet and helping to slow down the decline in the number of fixed lines. The number of retail ADSL connections increased by 99 thousand in 2009, which is up 40.1% on the year 2008. The number of cancelled fixed lines fell at the same time to 123 thousand, compared to 176 thousand in the previous year.

For our business customers, whose behaviour showed a shift in preference from traditional fixed voice services to mobile voice and Voice over IP services, we prepared O₂ Neomezené volání, a modern voice solution in the form of a converged voice service. The new service came with unlimited fixed and mobile calls for a flat monthly fee. I am confident that the service will help in countering the trend of declining voice traffic generated from fixed lines and in increasing the penetration of broadband internet.

In the mobile segment we continued to concentrate on migrating customers from the pre-paid service to contracts by means of active promotion and improving the offer of unlimited O₂ NEON tariffs. The new tariff O₂ NEON L+ came with unlimited calls to any number in the O₂ network on weekends and off-peak. We responded to the market demand for having expenditure under full control by offering O₂ ZERO, a new tariff unique on the Czech market, which did not require any commitment or payment of monthly subscription fees. The price for calls, SMS and MMS were a single rate to all networks at any time of day. As a result of these activities, the number of contract customers went up 11.7% in 2009, and their proportion in the total customer base reached 56.9% at the end of the year. The incremental increase of their overall share also helped us in maintaining the growth rate of voice traffic.

During the year 2009, owing in particular to the success of new tariffs O₂ NA!PIŠTE and O₂ NA!HLAS, we significantly slowed down the rate of decline in the number of pre-paid customers. If the customer topped up credit regularly, they could choose from several bonuses including cheaper calls and SMS in our network on weekends and in the evening. Our offer of 100% extra credit NA!VÍC gave new customers who topped up for the first time a bonus of 100% of the value of their top-up. With the aim of stimulating the activity of our pre-paid customers we organised a competition Dobij a vyhrať, followed up by another programme, Odměna za dobití. After each top-up, customers could, depending on the amount of their top-up, claim a prize or get a discount on future O₂ services. As a result, the decline in the number of pre-paid customers in 2009 fell 39.8% year on year.

We responded to the fast-growing demand for internet connectivity in a mobile telephone by accelerating investment in the expansion of our mobile 3G network based on the UMTS/HSDPA technology. During the year we gradually covered all 13 regional capitals with the service, while GPRS, EDGE and HSCSD services were available in other parts of the Czech Republic. At the end of 2009 we had the broadest portfolio of mobile data services, which gave us a significant competitive edge on the other mobile operators in the Czech Republic. The expansion of our 3G network coverage was accompanied by an acquisition offer to new customers who could get O₂ Mobilní Internet for a cut-rate price – either as a standalone service or in combination with other services within our new service concept. In the area of mobile data services we started offering our BlackBerry service to all our customers; it had previously been available only to business customers.

In the area of ICT services we pursued the development of Managed Services: IP Centrex, Managed LAN and WAN. We were also very deeply involved in implementing modern technology in the sectors of government and public administration. We won a tender to implement, in close partnership with Česká pošta, the project for an information system of data boxes, which became a breakthrough project in the area of eGovernment.

The success of our simple and easy to understand tariffs O₂ Fér in Slovakia helped us increase the customer base and improve its quality. During the past year, the number of customers increased by 228 thousand to 553 thousand, and our market share of the Slovak mobile market went up to

almost 10% as a result. Our revenues and financial performance increased, too. We committed to our long-term plans for Slovakia by increasing the registered capital of Telefónica O2 Slovakia by approximately EUR 150 million to EUR 200 million.

As I already mentioned at the beginning, the financial performance in 2009 was negatively affected by the unfavourable macroeconomic climate and also by mobile termination fees which went down. Another factor that impacted on the year-on-year comparison of revenues for 2009 were the Universal Service revenues. Total consolidated revenues reached CZK 59.9 billion in 2009, which is down 7.4% on the previous year. Business revenues fell 7.3% to CZK 59.8 billion. Our operating cost efficiency measures in commercial and non-commercial areas and the effects of booking several one-off items accounted for a 9.7% decline in consolidated operating costs. As a result, the consolidated Operating Income before Depreciation and Amortisation (OIBDA) fell 4.4% to CZK 27.1 billion, which is a slower decline compared to revenues. The result was an OIBDA margin of 45.2%, compared to 43.8% in 2008. This helped us maintain an above-average operating profitability in comparison with other operators in the region of Central and Eastern Europe. The continuing decrease of depreciation of tangible and intangible assets and the lower income tax rate compensated for the lower OIBDA and resulted in an increase of 0.3% of the consolidated net profit for 2009, which reached CZK 11.7 billion. As I already mentioned above, our investment in 2009 was directed at the expansion of the 3G network coverage. We also continued to invest in areas with a potential for growth, which include mainly the development of ADSL and IPTV technologies. We also made investments in information systems and technology, with a view of improving the efficiency of individual processes and, by extension, our operating efficiency. The total capital expenditure fell 19.8% year on year in 2009, down to CZK 6.5 billion.

In 2010 we will keep our focus on satisfying the needs of our customers through offering new products and innovating our existing services. I am confident that we will keep on adding customers at the same rate as in 2009, and stay ahead of the competition in this respect. We will continue to concentrate on active promotion and improvement of our consumer proposition, expanding our portfolio of fixed and mobile bundles with a view to stabilising the downward trend in the area of fixed lines. We will also continue in our active promotion of simple tariffs that bring a lot of value to the customer. Our activities will deliver a growth in the number of customers and raise the bar of our financial performance.

We expect that the challenging environment affected by the economic recession and precarious political situation, in which the consumer behaviour is hard to predict, will last at least for the first half of 2010. Mobile revenues will be under the additional strain of falling mobile termination fees. In addition to the above activities aimed at satisfying the needs of our customers, we will continue to exercise operating cost saving measures in the commercial and non-commercial area, with a view to maximise free cash flow generation, which is among our strategic priorities.



Luis Antonio Malvido
Chairman of the Board of Directors

Calendar of key events in 2009

January

Telefónica O2 won a tender to supply a comprehensive service portfolio to DHL across the whole of Europe. In the next five years, the Company will manage the delivery of communication services in 28 European countries.

Telefónica O2 signed a framework agreement with Pražská správa nemovitostí and Central Group for the sale of its former headquarters in Olšanská ulice in Prague.

The project O₂ Místo na střídače was awarded the Best Sport and Entertainment Sponsorship Campaign in the prestigious international Red Ball Awards, and topped the chart in the poll of employees of the global network Ogilvy Action.

February

Telefónica O2 published its audited consolidated financial results prepared under International Financial Reporting Standards for the fiscal year 2008. Consolidated revenues reached CZK 64.4 billion. Consolidated net profit grew to CZK 11.6 billion.

At the GSMA Mobile World Congress in Barcelona, Telefónica O2, in collaboration with the transport authority of the town of Pilsen, presented the first ever multiplication type NFC (Near Field Communication) project in the world based on the MIFARE™ technology.

The Christmas microsite of Telefónica O2 won two prestigious international awards. The site was voted Site of the Day in polls at online servers FWA (Favourite Website Awards) and Design Licks.

March

Telefónica O2 introduced a new tariff O₂ neomezené volání designed for business customers; the tariff comes with unlimited fixed line and mobile calls covered by the monthly subscription fee, and fixed line calls are carried via IP telephony.

Telefónica O2 launched the website Chci do O2, designed for people who are looking for a job with the Company.

April

An Ordinary General Meeting of shareholders of Telefónica O2 Czech Republic was held. The shareholders approved, among other things, a proposal of the Board of Directors for the payment of a dividend of CZK 50 per share, and resolved to institute an Audit Committee as an independent body of the Company.

Telefónica O2 introduced two new tariffs O₂ NA!PIŠTE and O₂ NA!HLAS for pre-paid customers. The tariffs come with very competitive prices on calls and a choice of several bonus options.

During the first half of the year, the service Kvídovo volání was used to make 16 million calls.

The number of visitors to the directory services website 1188 reached the 1 million mark.

The mobile tariffs O₂ NEON and O₂ [:kúl:] were subscribed by more than 500 thousand customers.

May	Telefónica O2 launched a new concept of consumer services, which was built around the broadband internet access service O₂ Internet, digital television O₂ TV or the voice service O₂ Volání. Telefónica O2 marketed these services separately or in a combination with other fixed line or mobile services from its portfolio. Telefónica O2 and the transport authority of the town of Pilsen launched a new concept of a multifunctional chip card, Plzeňská karta, which is integrated in a mobile handset. Telefónica O2 became the exclusive telecommunications partner of a new media project of PPF. Telefónica O2 equipped Futuroom, the central training room, and Newspoint chain of regional communication cafes with communication technologies and fast internet access, and provided special products, such as O₂ TV, for news purposes.
June	The Board of Directors of Telefónica O2 approved an increase of the registered capital of its subsidiary Telefónica O2 Slovakia by means of a pecuniary contribution in the amount of EUR 150,209,121.69 to the total of EUR 200,000,000.00, with effect from 1 July 2009. Telefónica O2 joined the international employee programme Proniño and gave its patronage to FAIR TRADE, the worldwide campaign to stop child labour by promoting fair and equitable trade.
July	Telefónica O2 introduced O₂ ZERO, a tariff with no monthly subscription fees and no commitment, which came with a single rate on calls to all networks and gave customers a way of keeping their costs under control. Telefónica O2 donated CZK 1 million to the organisation People in Need, which used the funds to mitigate the consequences of floods in affected areas. The O₂ Foundation gave its support to the campaign of Linka bezpečí and matched the yield from donor SMS sent in by people for benefit of Linka bezpečí between 1 July and 15 September.
August	Telefónica O2 offered its customers registered in the O₂ Extra programme a new service, O₂ Záloha, for remote back-ups of user data from a mobile telephone. With effect from 1 August, Michal Urválek was appointed Executive Director, Human Resources at Telefónica O2, and assumed responsibility for the implementation of strategic human resources projects within Telefónica Europe. The merger through consolidation of DELTAX Systems into the successor organisation Telefónica O2 Business Solutions was completed.
September	For the ninth year running, Telefónica O2 was the general partner of the classical music festival Struny podzimu. At the same time, the Company promoted the charitable aspect of the event by partnering the festival with Linka seniorů.

October

Juraj Šedivý was succeeded as Chief Executive Officer of Telefónica O2 Slovakia by John McGuigan, Executive Director for Customer Service at Telefónica O2 UK, who at the same time became member of the Board of Directors of Telefónica O2.

Jesús Pérez de Uriguen became 1st Vice Chairman of the Company's Board of Directors.

Telefónica O2 announced its development strategy for the sector of healthcare, which is based on the high technology eHealth concept.

O₂ Enterprise Security, a new service, gave business customers a way to protect their products and data from malicious use and unauthorised manipulation by means of user identification via a mobile telephone.

November

Telefónica O2 started marketing another mobile handset by Emporia, TALK premium, designed for senior citizens and people with disabilities. For every handset sold, the O₂ Foundation contributed CZK 100 to Linka seniorů.

Telefónica O2 started to provide the service for making payments using a mobile telephone or the fixed line.

December

Telefónica O2 announced its partnership with VCCP of the United Kingdom, an above-the-line advertising agency.

O₂ Managed WAN won the prestigious title IT Product of the Year in the category of online and related services, which is annually given by Computerworld magazine.

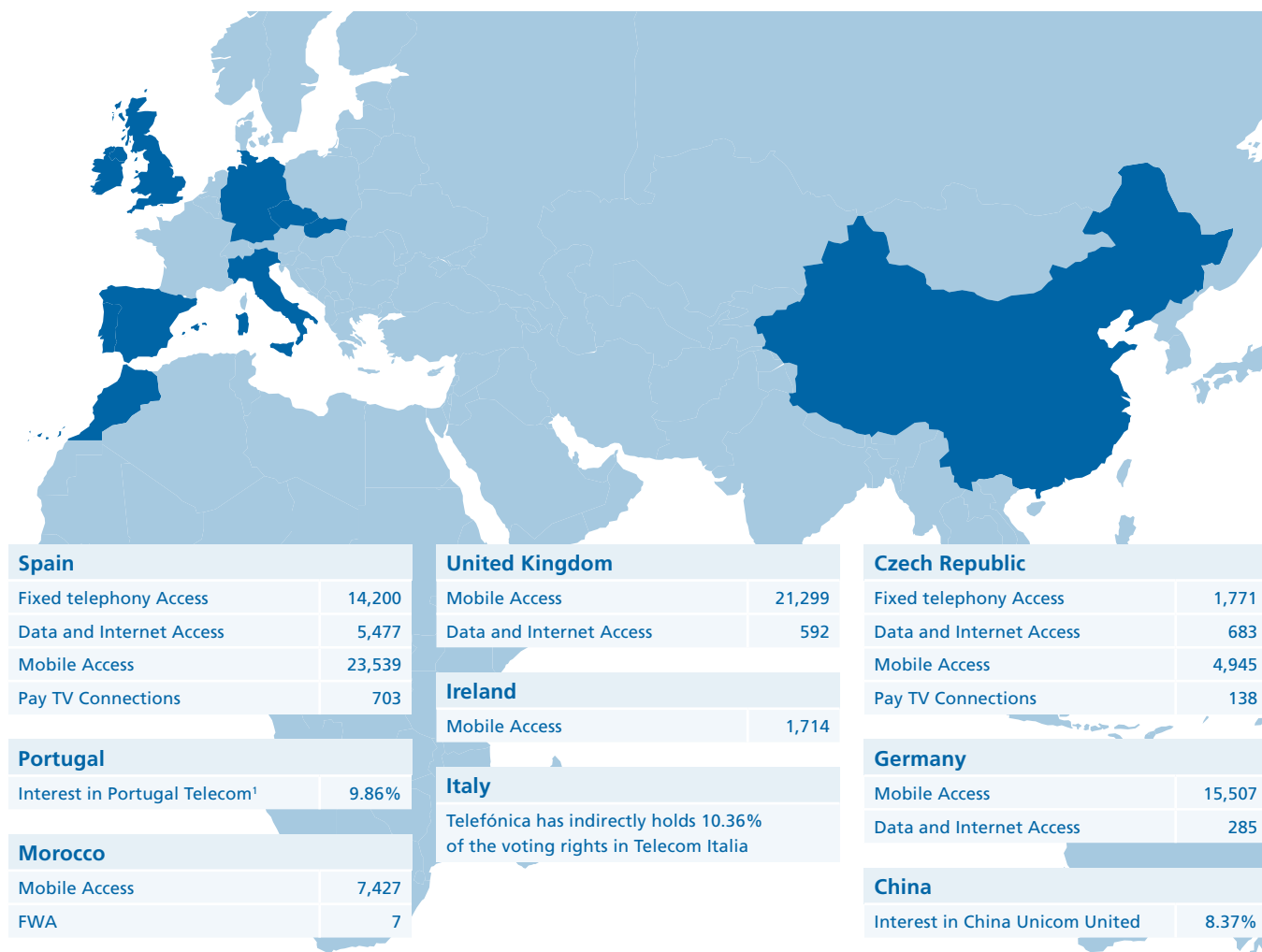
Telefónica O2 Slovakia was recognized as the mobile operator of the year 2009.

About Telefónica Group

In 2008, the group adopted an integrated decentralised governance model, through which it strives for maximum exploitation of the potential of all business units. Telefónica's operations are divided into three regions – Spain, Latin America and Europe. The group maintains an optimal revenue distribution in the regions, and 64% of all revenues are generated in other than the home market.

Telefónica in figures

- Presence in 25 countries
- More than 263 million customers
- 202 million mobile customers
- Over 40 million fixed accesses
- More than 13.5 million of high-speed internet connections
- 2.5 million of pay TV customers
- EUR 56.731 billion of revenues
- 64% of revenues generated in markets outside Spain
- More than 255,000 employees



* Data as at 31 December 2009

¹ Real interest of the Telefónica Group. With minority shareholdings disregarded, the actual ownership interest would be in the range of 10%.

Mexico	
Mobile Access	17,401
Fixed Wireless Access (FWA)	334

Central America	
Fixed telephony Access	445
Data and Internet Access	13
Mobile Access	5,807

Venezuela	
Mobile Access	10,531
FWA	1,214
Pay TV Connections	63

Columbia	
Fixed telephony Access	1,640
Data and Internet Access	420
Mobile Access	8,965
Pay TV Connections	127

Peru	
Fixed telephony Access	2,971
Data and Internet Access	768
Mobile Access	11,458
Pay TV Connections	686

Brazil	
Fixed telephony Access	11,254
Data and Internet Access	2,638
Mobile Access	51,744
Pay TV Connections	487

Uruguay	
Mobile Access	1,615

Argentina	
Fixed telephony Access	4,608
Data and Internet Access	1,238
Mobile Access	15,932

Chile	
Fixed telephony Access	2,028
Data and Internet Access	783
Mobile Access	7,525
Pay TV Connections	285



Corporate Centre

The Corporate Centre is responsible for the global and organisational strategy, corporate policies, management of joint activities and coordination of business unit operations. In 2008, the Corporate Centre reinforced its relationships with the organisation units by way of a reorganisation project, which gave rise to two organisation units dedicated to innovation and transformation, respectively; the units were established to give a stronger impetus to the drive for revenues and performance.

Telefónica España

Telefónica was founded in 1924 in Spain, however (since 2008), the home country is no longer the main market of the company. The company's main operations are in Latin America. Telefónica España is well appointed in all main market segments; it provides fixed telephony services (including pay TV), mobile and data services, broadband internet access, and has – via its subsidiary Meditel – investments in Morocco.

Telefónica Latinoamérica

Telefónica Latinoamérica has operations in 13 countries of Latin America – Argentina, Brazil, Chile, Ecuador, El Salvador, Guatemala, Colombia, Mexico, Nicaragua, Panama, Peru, Uruguay and Venezuela, where it provides the services of mobile and fixed telecommunications, internet access and pay TV. Additionally, Telefónica International Wholesale Services provides wholesale telecommunications services to a global standard. Its portfolio spans voice, data, IP, satellite, corporate and mobile services, and its optical network connects Latin America, United States and Europe. Telefónica is also actively pursuing ancillary business in Puerto Rico and in the United States.

Telefónica Europe

Telefónica O2 Europe plc changed its name to Telefónica Europe plc on 1 June 2008. The change came as an organic part of the integration process, two years after the company's integration in the group. The new corporate name structure follows the same pattern as in all the other regions – Telefónica España, Telefónica Latinoamérica and Telefónica Europe. With operations in the United Kingdom, Ireland, Germany, Czech Republic and Slovakia, Telefónica Europe provides the services of mobile and fixed telecommunications and broadband internet access.

On December 3, 2009, Telefónica's subsidiary in Germany, Telefónica Deutschland GmbH ("Telefónica Deutschland"), signed an agreement to acquire all of the shares of German company HanseNet Telekommunikation GmbH ("HanseNet"). On February 16, 2010, the Telefónica Group completed the acquisition of 100% of the shares of HanseNet.

Partnerships and other shareholding

Telefónica is present in China, Italy and Portugal, by means of shareholdings in China Unicom, Telecom Italia, and Portugal Telecom, respectively.

Other companies in the group

Atento offers the services of Customer Relationship Management via its network of contact centres. It has operating platforms in Spain, Argentina, Brazil, Chile, Colombia, United States, Morocco, Mexico, Peru, Puerto Rico, Czech Republic, Uruguay and Venezuela.

T-gestiona provides comprehensive administrative and financial support in the area of human resources, real property, logistics and distribution, consulting in the area of ERP processes and systems, and the services of a comprehensive back office. It operates in Spain, Argentina, Brazil, Chile and Peru.

Telefónica I+D is a research and innovation company in the field of technology. The volume of funds invested in innovation and development has made it the largest private research and development centre in Spain, and it is also the European leader in terms of participation in ICT research projects. It has operations in Spain, Brazil and Mexico.

Integrated decentralised model of governance

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

Integrated decentralised model of governance

Local

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

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

Regional

Telefónica Europe, Telefónica Latinoamérica, Telefónica España

- Support, governance, synergy

Global

Telefónica

- New Engaged Corporate Model
- Innovation
- Transformation

Group structure

Telefónica's organisation evolves around three regional business divisions, and builds on the strategic and industry alliances in China, Italy and Portugal.

Telefónica España

	Share in %
Telefónica de España	100%
Telefónica Móviles España	100%
Telyco	100%
Telefónica Telecomunic. Públicas	100%
T. Soluciones de Informática y Comunicaciones de España	100%
Iberlanda	58.94%

Telefónica Latinoamérica

	Share in %
Telesp ¹	87.95%
Telefónica del Perú	98.34%
Telefónica de Argentina	100%
TLD Puerto Rico	98%
Telefónica Chile ²	97.89%
Telefónica Telecom	52.03%
Telefónica USA	100%
T. Intern. Wholesale Serv. (TIWS) ³	100%
Brasilcel ⁴	50%
T. Móviles Argentina	100%
T. Móviles Perú	100%
T. Móviles Mexiko	100%
Telefónica Móviles Chile	100%
T. Móviles El Salvador	99.08%
T. Móviles Guatemala	100%
Telcel (Venezuela)	100%
T. Móviles Colombia	100%
Otecel (Ecuador)	100%
T. Móviles Panamá	100%
T. Móviles Uruguay	100%
Telefonía Celular Nicaragua	100%
T. Móviles Soluciones y Aplicac. (Chile)	100%

¹ In real terms, the ownership interest (share) is 88.01%.

² Telefónica Internacional de Chile, S.A., owns 44.98%, and Inversiones Telefónica Internacional Holding Ltd. owns 51.86%. On 9 January 2009, after the second acquisition was completed, the share of the Telefónica Group in the Chilean company has risen to 97.89%.

³ Telefónica, S.A., holds 92.51%, and Telefónica DataCorp holds 7.49%.

⁴ A joint venture which globally integrates the branch Vivo, S.A., through participation in Vivo Participações, S.A. (63.54%).

Telefónica Europe

	Share in %
Telefónica O2 UK	100%
Telefónica O2 Germany ¹	100%
Telefónica O2 Ireland	100%
Max	100%
Be	100%
Groups 3G (Germany) ²	100%
Telefónica O2 Czech Republic ¹	69.41%
Telefónica O2 Slovakia ³	100%

¹ A company in which the group has a stake through Telefónica, S.A.

² A company in which the group has a stake through Telefónica O2 Germany.

³ A company in which the group has a stake through Telefónica O2 Czech Republic.

Other interests

	Share in %
3G Mobile AG (Switzerland)	100%
Group Atento	100%
Telefónica de Contenidos – content services (Spain)	100%
Mobipay Internacional	50%
Telco SpA (Italy) ¹	49.18%
IPSE 2000 (Italy) ²	39.92%
Lycos Europe	32.10%
Hispasat	13.23%
Portugal Telecom ³	9.86%
China Unicom Limited (Hong Kong, China)	8.37%
ZON Multimedia ⁴	5.46%
BBVA	0.98%
Amper	6.10%

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

² Companies in which Telefónica Móviles España has a direct or an indirect interest.

³ Real interest of the Telefónica Group. With minority shareholdings disregarded, Telefónica's interest would be in the range of 10%.

⁴ Real interest of the Telefónica Group. With minority shareholdings disregarded, Telefónica's interest would be in the range of 5.46%.

For more information please visit: www.telefonica.es/accionistaseinversiones

Board of Directors' Report on Business Activity

Telefónica O2 Czech Republic Group

Overview of the Group and the main changes in 2009

As at 31 December 2009, the group of Telefónica O2 Czech Republic (Telefónica O2 Group) comprised Telefónica O2 Czech Republic, a.s. (Telefónica O2, Company) and several other subsidiaries. The Group's services were provided mostly on the territory of the Czech Republic and in Slovakia. Through a wholly-owned subsidiary Telefónica O2 Slovakia, the Group has expanded its business to Slovakia, and on 2 February 2007 launched commercial operation. In 2007, Telefónica O2 acquired 100% of DELTAX Systems a.s. (DELTAX Systems). During 2009, DELTAX Systems was liquidated as a legal entity and merged in the successor company Telefónica O2 Business Solutions, spol. s r.o. (formerly Telefónica O2 Services, spol. s r.o.).

Telefónica O2 is the largest integrated telecommunications operator and offers a comprehensive range of both fixed and mobile voice, data and internet services in the Czech Republic. In September 2006 it also started offering an IPTV service (O₂ TV), and in 2007 it significantly expanded its IT and ICT operations (comprehensive business communications solutions). It also offers its network infrastructure for lease by other operators of public and private networks and services.

The retail business in the Czech Republic focused on two main customer segments – business and consumers. The business segment included corporate, business and government sub-segments. Telefónica O2 also provides services on wholesale basis to other public telecommunications network providers and to providers of public telecommunications services both in the Czech Republic and abroad.

As at 31 December 2009, Telefónica O2 Group comprised the following subsidiary companies and affiliates:

Companies incorporated in the Czech Republic					
Object of the company	Identification number	Area of business	Registration number	Registered/share capital	Share of the issuer in the registered/share capital in %
Telefónica O2 Business Solutions, spol. s r.o.	Prague 10, Vršovice, Kodaňská 1392, postal code 100 00	Data services and consulting in the field of telecommunications	45797111	CZK 10,000,000	100%
CZECH TELECOM Austria GmbH	/o Vienna CityTax Steuerberater GmbH, Wagramer St, Sien, 1220 Austria	Data transmission services	FN 229578s	EUR 35,000	100%
CZECH TELECOM Germany GmbH	Kennedyallee 97a, Frankfurt am Main, 60596 Germany	Data transmission services	HRB 51503	EUR 25,000	100%
Telefónica O2 Slovakia, s.r.o.	Einsteinova 24 Bratislava Postal code 851 01, Slovakia	Operation of a public telecommunications network; provision of a public telecommunications service and the service of leased lines	35848863	EUR 200,000,000	100%
Affiliated companies					
AUGUSTUS, spol. s r.o.	Prague 10-Vinohrady, Na zájezdu 1935/5, postal code 101 00	Consulting and brokerage activity in non-telecommunication disciplines	49356160	CZK 166,000	39.76%
První certifikační autorita, a.s.	Prague 9-Libeň, Podvinný mlýn 2178/6, postal code 190 00	Certification services in the area of electronic signature	26439395	CZK 20,000,000	23.25%

On 30 November 2007, the process of liquidation of Centrade, a.s. v likvidaci, was completed. The company was deleted from the Commercial Register on 22 August 2008. During the fourth quarter of 2007, SPT TELECOM (Czech Republic) Finance B.V. initiated preparatory steps for its voluntary liquidation. The main legal steps leading to the liquidation of the company were made by the end of 2008, and the company was deleted from the Commercial Register on 9 February 2009.

In December 2008, the Board of Directors of Telefónica O2 approved the schedule of actions leading to the merger through consolidation of the wound-up undertaking DELTAX Systems a.s. with the successor undertaking Telefónica O2 Services, spol. s r.o. The merger resulted in the cessation of DELTAX Systems. The assets of DELTAX Systems, its rights and obligations, including rights and obligations under the labour law, passed to the successor company. The merger became

legally conclusive on the day of the registration of the company in the Commercial Register which was 1 August 2009. The planned integration of both companies is a fit the Group's strategy to vest all activities in the field of ICT services and integrated business solutions in one business services business unit, which will be a part of the parent company. The goal was to claim the highest position among the leading providers of ICT in the Czech Republic. Telefónica O2 Business Solutions is now the only provider in the Czech market offering a full scope of ICT solutions – fixed and mobile telecommunications (voice and data), terminal equipment, network infrastructure, development and implementation of proprietary software based on the customer's requirement, security, system integration, full operation and maintenance of all technologies, outsourcing of selected services, assistance with the specification of new requirements and training of employees. The integration of ICT services in one organisation has simplified the management and process model and improved resource utilisation and operational effectiveness.

In June 2009, the Board of Directors of Telefónica O2 approved an increase of the registered capital of Telefónica O2 Slovakia by way of a pecuniary contribution of EUR 150,209,121.69. The company's registered capital of EUR 49,790,878.31 thus increased to EUR 200,000,000.00. The increase became effective on 19 August 2009.

As at 31 December 2009, the total of fixed lines operated by Telefónica O2 in the Czech Republic reached 1.771 million, and the number of mobile customers reached 4.945 million. As at the same date, the Company registered also 677 thousand retail ADSL connections and 138 thousand O₂ TV customers. The number of mobile customers of Telefónica O2 Slovakia increased to 553 thousand as at the end of 2009.

On 19 January 2009, Telefónica O2 entered into a framework agreement with Pražská správa nemovitostí and Central Group regarding the sale of its former headquarters in Olšanská ulice in Prague. The sale concerned the land lot No. 4 with an area of 12.5 thousand of square metres, which is zoned for building, and two administrative buildings of the former headquarters in Olšanská ulice – numbers 3 and 5. The transaction showed in the Company's bottom line for the first quarter of 2009 a one-off gain from the sale of the real property, amounting to CZK 348 million and was booked as incremental cash.

At the beginning of the month of May, Telefónica O2 entered into an agreement with T-Mobile to settle disputes related to prices for interconnection of the two operators' networks in the period between 1 January 2001 and 31 December 2001. Based on the agreement, T-Mobile refunded to Telefónica O2 a fixed amount of approximately CZK 1 billion. At the same time, all litigation by both parties in relation to this matter was stopped. The transaction showed in the Company's bottom line for the second quarter of 2009 in the form of lower operating costs and incremental cash.

During 2009, Telefónica O2 also negotiated conciliation with Tele2 EUROPE S.A. and ended the mutual dispute in the Czech Republic. Tele2 retracted its lawsuit. Telefónica O2 is no longer exposed to any risk in connection with the amount of CZK 2,141,603,909 originally claimed by Tele2 EUROPE in the dispute from 2005.

Telefónica O2 Slovakia

As at 31 December 2009, Telefónica O2 Slovakia registered a total of 553 thousand customers, of which 196 thousand were contract customers. This represents a year on year increase of 69.9%. During 2009, Telefónica O2 Slovakia had more than 90 thousand applications for porting of a number from another operator's network into its network, which was more than three times

the number from 2008. Thanks to the company's efforts, the time needed for porting of a number was, effective from 1 September 2009, shortened from 25 days originally to 5 days at present. The shortened number portability process has proven itself as an effective market competition tool and became a significant growth impulse for the third operator. By decision of the regulator, mobile interconnection rates fell 30% in 2009, which represent a significant decline compared to the previous period and is seen as a sign of the improving regulatory environment in Slovakia.

Also in 2009, Telefónica O2 Slovakia marketed its O₂ Fér tariff with all its original parameters – simplicity, clarity and economy – preserved. In the case of O₂ Fér, which was launched in September 2008, the same terms and conditions apply both for contract and pre-paid customers. O₂ Fér is simultaneously offered without a commitment and the need to pay monthly subscription fees. O₂ Fér comes with a single rate on calls and SMS to all numbers in all networks in Slovakia. From September 2009, the single call and SMS rate was expanded also to calls from Slovakia to all fixed and mobile networks in the Czech Republic. O₂ Fér has become the best-seller of the Slovak mobile market.

In March 2009, Telefónica O2 Slovakia successfully launched its new tariff O₂ Data Neomezeně, which, for a flat monthly fee, offers unlimited mobile internet in the network of Telefónica O2 Slovakia – without the user having to watch the volume of transmitted data. The company also expanded its portfolio by adding two special top-up packages with discount rate minutes. In September 2009, Telefónica O2 Slovakia introduced the most extensive portfolio of mobile telephones in the Slovak market. Customers can opt having the price of the handset split into instalments or pay the whole amount in a single payment.

A number of joint-venture projects were launched in 2009. The most important among those, a joint-venture TESCO mobile with TESCO Stores was inspired by positive experience of partnership between Telefónica O2 and TESCO in the United Kingdom and Ireland. The two other partners – Nay and Swan – are established companies in the Slovak market. They had their own extensive distribution network and a broad client base, thanks to which Telefónica O2 quickly and effectively penetrated new segments of the market.

At the end of 2009, Telefónica O2 Slovakia recorded the highest customer satisfaction levels in its history; the Customer Satisfaction Index (CSI) reached to the record score of 84. Also owing to this fact, the company increased its longstanding lead in the area of customer satisfaction before its competitors: to 5.1 points (Orange) and 7.4 points (T-Mobile). An independent poll of users ranked Telefónica O2 Slovakia the Mobile Operator of the Year.

The company invested in the development of its online distribution channels for services, handsets and credit top-ups. Other major investments went into the project for improving the efficiency of the company's Customer Relationship Management (CRM). Telefónica O2 Slovakia continued in the expansion of its distribution network, which, in addition to own brand stores and franchises, now includes a special sales channel: the distributor network.

The company also continued in the roll-out of its proprietary network. At the end of 2009, the number of BTS reached 917, of which 70 BTS were added during 2009. As a result, Telefónica O2 Slovakia covered 93% of the Slovak population with the signal of its network. At the same time, 85% of all traffic was carried over the proprietary network, with 15% of traffic carried based on the national roaming arrangement.

Risk management

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

Risks are identified based on an assessment of the relevant management levels and suggestions made by Risk Management, Internal Audit and other units of the Group, and are 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 2009, Risk Management unit was responsible for the methodology and risk management system on the Group level. The governing bodies – the Board of Directors and the Supervisory Board, or, where appropriate, its Audit Committee – were informed on a monthly basis of all major risks to which the Group was exposed, and of the ways the risks were mitigated.

The Risk Management unit also handles the risks of Telefónica O2 Slovakia; the risks are managed according to the common methodology of the Telefónica Group.

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

Commercial (market) risks

Possible losses caused by market uncertainty, developments in the market or competitive environment, changes in the legislation, which includes also regulatory intervention. Regulatory actions taken by the European Commission may have a significant bearing on the Company's bottom line.

Financial risks

Risks stemming from the fluctuations in the value of financial instruments, in particular the exchange rates of currencies or interest rates.

Credit risks

Risks of exposure to defaulting business partners or customers, e.g. receivables from customers or distributors. The number of defaulting partners may increase in conjunction with the continuing economic recession.

Operating risks

Risks of possible losses caused by incidents relating to processes, human resources, network elements and information systems, or by external factors.

The telecommunications market in the Czech Republic

The developments in the Czech telecommunications market in 2009 were marked by the declining economy, which translated in an across-the-board slump in revenues from telecommunications services. The decline was not as significant as in other sectors, but, compared to the previous period of growth, it was prominent. According to Company's estimates, the telecommunications market in the Czech Republic contracted by approximately 5% on the previous year.

Revenues from the fixed line market recorded a year-on-year slump of approximately 9%, while the mobile market revenues were down by approximately 6% – in stark comparison to a growth of approximately 3% in 2008. Fixed line penetration reached 36% as at the end of 2009, continuing the downward trend of previous years. Mobile penetration (measured by the number of registered SIM cards with a 13 month activity criterion), on the other hand, exceeded 130% (an accurate figure cannot be determined due to differences in the Czech operators' methodologies of accounting for mobile customers), which is among the highest penetration rates in Europe.

Among European Union member states, the Czech Republic has for a long time been in the upper echelon of countries with the highest volumes of voice traffic in mobile networks. This, however, did not stop the fixed-to-mobile substitution and the proportion of mobile voice traffic continued to grow also in 2009. According to Company's estimates, 83% of all voice traffic generated in 2009 was in the mobile networks, which translates into a 2 p.p. year-on-year growth.

The demand for data and internet services and for value added services also continued to grow.

Trends in the fixed line market

In 2009, the revenues from fixed lines reached approximately CZK 48 billion, which spells a year-on-year decline of approximately 9%. The fall of the voice revenues was partly offset by the growing revenues from broadband internet, IT services and business solutions.

The year 2009 was marked by a general economic recession and operators sought to respond to the market needs by focusing on products and services that let the customer save costs, economize and have a maximum control over expenditure.

In May 2009, Telefónica O2 presented a brand new concept of consumer services. It spelled the end of the previous concept based on combining voice and other services in pre-set bundles; in its stead, a flexible combination of broadband internet with other fixed line and mobile services came to the market. The new concept lets the customer choose only those services they really use, and save at the same time.

Combinations of mobile and fixed line services were offered also by Vodafone, as part of its OneNet corporate proposition, and T-Mobile – branded as ProfiNet.

The market of paid and free television was developing at full speed. The cable television market continued in its consolidation – a trend driven mainly by RIO Media a.s. and Nej-TV. Paid television operators added new channels to their portfolios, including HDTV programmes. The coverage of the Czech Republic by the terrestrial digital television technology DVB-T increased further during the year. Despite competitive pressures, O₂ TV has found its market and as at the end of the year it had 138 thousand subscriptions.

Several major changes occurred in the fixed line market in 2009: in April, T-Mobile Czech Republic, a.s. (T-Mobile) announced a take-over of consumer and small business clients of GTS NOVERA s.r.o (GTS Novera), which decided to focus exclusively on the corporate market and pulled out from the consumer and small business segments altogether. The take-over of customers was concluded in the autumn. T-Mobile simultaneously announced a deal with České Radiokomunikace a. s. (České radiokomunikace) for the take-over of its consumer client base. This transaction was concluded in December by T-Mobile taking over all assets in the small and medium enterprise (SME), small/home office (SoHo) and residential segments, including the relevant infrastructure and employees of České radiokomunikace who worked on the commercial and operating side in the aforementioned segments. The acquisition meant that T-Mobile could start offering services of the fixed line and become the largest alternative operator with a DSL proposition. České radiokomunikace announced that it wished to pursue the core areas of its business – television and radio broadcasting and operation of the broadcasting infrastructure, including wholesale and corporate telecommunications services.

At the end of the year, GTS Novera announced a deal with Centrum Holdings s.r.o. to transfer approximately 40 thousand email and web accounts of the Raz Dva service. České radiokomunikace also announced its plans to cover, by the end of 2009, 25 Czech towns with its wireless broadband internet service operated on the WiMAX platform.

WiFi internet connectivity continued to hold a strong position in the Czech Republic. As at the end of the year, the number of its customers (including FTTx) stood at approximately 780 thousand. Due to the high number of WiFi service providers, the quality of connection varied greatly. Some WiFi providers began to invest in the FTTx infrastructure.

The installation of a new cable distribution system, EuroDOCSIS 3.0, by UPC Česká republika, a.s. (UPC) in 2009 meant that the company could add new connection speeds to its existing portfolio. From September it started offering 50 and 100 Mb/s download speeds. Several weeks later it came out with a significantly slower 1 Mb/s option in an effort to capture new customers and light users with this economy alternative. UPC later began to offer this starter internet tariff for free to the subscribers of the cable television service. UPC also continued to expand its television channel portfolio, added High Definition (HD) channels and digitalised its television service.

Trends in the mobile market

The size of the mobile market in the Czech Republic measured by revenues reached approximately CZK 82 billion in 2009, which represents a year-on-year drop of approximately 6%.

Despite the recession of the Czech economy, all mobile operators recorded additions to its customer base in 2009. The net additions (of active customers in the case of Telefónica O2 and of registered customers in the case of T-Mobile and Vodafone) reached 299 thousand in 2009, compared to 406 thousand in 2008.

Telefónica O2 experienced a year-on-year increase of 3% in active users, whose number grew to the total of 4,945 thousand. The share of active customers in the total market cannot be determined as T-Mobile and Vodafone apply a different methodology of accounting for customers and publish only the figure of registered customers.

Operators responded to the market need by offering products which allowed cost optimisation and maximum control over expenditure. Telefónica O2 expanded the offer of its O₂ NEON tariffs by adding the new O₂ NEON L+ tariff, and increased the number of free minutes and

simultaneously reduced the price per minute of call for its O₂ NEON XL tariff. The Company also introduced new tariffs for the pre-paid market: O₂ NA!PIŠTE and O₂ NA!HLAS, with calls and SMS priced only CZK 0.50.

In July, Telefónica O2 became the first Czech operator to offer a tariff free of all monthly fees and commitment in the form of its O₂ ZERO, which gave the customer full control over their expenditure.

As part of its economizing package, Vodafone started offering Výdaje pod kontrolou, a programme with services like FlexiStrop, FlexiLimit or Chytrý přehled.

The year 2009 saw also the success of unlimited or discounted communication within a pre-set group (e.g. O₂ Přátelé, O₂ Navzájem, T-Mobile Rodina, T-Mobile Přátelé v síti or Přátelé síť nesít, Vodafone Přátelé ze všech sítí).

The developments of recent years in the mobile market confirm the trend of the growing demand for mobile broadband internet. All operators invested in the modernisation of their existing networks and deployed the UMTS/HSDPA technology in order to be able to offer the highest quality broadband internet connectivity. Telefónica O2 continued in the roll-out of its new generation mobile network (3G) operating on the UMTS/HSDPA platform. Before the end of the year, all 13 regional capitals, i.e. almost 30% of all Czech population, were covered with the service, and Telefónica O2 thus became the only operator in the Czech market to offer broadband mobile data connectivity with speeds of up to 3.6 Mb/s.

T-Mobile began the modernisation of its GSM network at the beginning of the year. The goal is to deploy the EDGE technology across the network, which should be completed in mid-2010. T-Mobile simultaneously announced that it was gearing up to accommodate the arrival of new technologies, such as the new generation networks or IP services. At the end of the year, T-Mobile announced the launch of its 3G network pilot operation, trialling the HSPA technology supplied by Nokia Siemens Networks. The pilot service was available in all locations in Prague and went live for all customers in January 2010. Its roll-out to the regional capitals of the Czech Republic is expected within the next two years.

In March 2009, Vodafone launched a commercial operation of its 3G network in parts of Prague 9 and 10. Huawei was chosen in July as Vodafone's new supplier for the construction of the 3G network and infrastructure and for an upgrade of the 2G EDGE network. According to Vodafone's statement, the company will focus on the construction of a 3G network in Prague and Brno as a priority.

Pre-paid services started emerging in the mobile broadband internet market in the Czech Republic towards the end of the year. The mobile operator MobilKom, a.s., whose services are marketed under the brand name of U:fon, introduced a pre-paid card; the customer paid for a USB modem and received a usage credit of a certain value. A fixed amount was subtracted from the credit for every day the customer went online, and when used up, the credit could be topped up. Vodafone came out with a similar offer at the end of 2009.

In December 2009, MobilKom announced a major turnaround of its strategy for the U:fon brand. It intends to start a wholesale operation and transform itself into a low-cost provider with a focus on mobile data. The new strategic focus also resulted in the closedown of U:fon brand stores.

Regulation

Several changes occurred in 2009 in the legislative 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 relevant markets analysis and product regulation;
- 3) changes in the Universal Service provision and in the government's policy and support of broadband internet access.

Major changes in the legislation which governs the area of electronic communications include the following:

- commencement of the application of the European Parliament and Council (EC) directive on audiovisual media services in the national law (by way of an amendment to the radio and television broadcasting legislation and the enactment of a law on audiovisual media services);
- preparation of subsequent amendments to the Electronic Communications Act which concern the permission for use of radio frequency bands, Universal Service, priority connection in emergencies;
- issuance of a Government Regulation No. 228/2009 Coll., amending Regulation No. 154/2005 Coll., on the determination of the amount and method of calculation of the charges for using radio frequencies and numbers, as amended;
- issuance of a Decree No. 267/2009 Coll., amending Decree No. 117/2007 Coll., on the numbering plans of electronic communication networks and services, as amended by Decree No. 231/2008 Coll.;
- issuance of a European Commission and Council (EC) Regulation No. 544/2009, amending Regulation (EC) No. 717/2007 on roaming on public mobile telephone networks in the Community, and Directive No. 2002/21/EC on a common regulatory framework for electronic communications networks;
- issuance of a European Parliament and Council (EC) Directive No. 2009/214/EC, amending Council Directive No. 87/372/EEC on the frequency bands to be reserved for the coordinated introduction of public pan-European cellular digital land-based mobile communications in the Community;
- approval of a revised new regulatory framework on electronic communications by the European Parliament and Council (EC), taking the form of:
 - i. issuance of a European Parliament and Council (EC) Directive No. 2009/136/EC, amending Directive 2002/22/EC on universal service and users' rights relating to electronic communications networks and services, Directive No. 2002/58/EC concerning the processing of personal data and the protection of privacy in the electronic communications sector, and Regulation (EC) No. 2006/2004 on cooperation between national authorities responsible for the enforcement of consumer protection laws;
 - ii. issuance of a European Parliament and Council (EC) Directive No. 2009/140/EC, amending Directive 2002/21/EC on a common regulatory framework for electronic communications networks, Directive 2002/19/EC on access to, and interconnection of, electronic communications networks, and Directive 2002/20/EC on the authorization of electronic communications networks and services; and
 - iii. issuance of a European Parliament and Council (EC) Regulation No. 1211/2009 establishing the Body of European Regulators for Electronic Communications (BEREC) and the Office.

Telefónica O2 raised comments on the European Commission's proposal for the review of the new EU regulatory framework for electronic communications services in the discussion of the European Parliament committees. The Company was also contributed to the preparation of

the above legislative amendments through its involvement in the process of expert or public consultations, either directly – through industry associations of telecommunications operators, or through the parent company.

The passing of the new Payment Services Act also directly concerned the Company. The provision of these services – previously known as “third party services”, of Telefónica O2, which allowed the customers to order and buy goods and services of third parties, was concerned primarily by the following laws:

- Act No. 284/2009 Coll., on the Payment System, which incorporates in particular the European Parliament and Council Directive 2007/64/EC on payment services in the internal market, European Parliament and Council Directive 2005/60/EC on the prevention of the use of the financial system for the purpose of money laundering and terrorist financing, to be amended by the European Parliament and Council Directive 2009/110/EC on the taking up, pursuit and prudential supervision of the business of electronic money institutions,
- Act No. 285/2008 Coll., on selected measures against the legalisation of the proceeds from crime and terrorist financing.

Telefónica O2 previously provided the services based on a CTO licence under the Electronic Communications Act, and under the Civil and Commercial Codes.

Relevant markets analysis and product regulation

Telefónica O2 continued to meet its duties with which it was tasked based on the relevant markets analysis undertaken by the Czech Telecommunications Office (CTO) in 2006 and 2008.

During 2008 and 2009, the CTO analysed markets which the European Commission excluded from the list of the so-called relevant markets. The analyses resulted in a gradual cancellation of regulatory powers, especially in the retail voice markets.

In January 2009 the CTO published new regulated wholesale prices for call termination in mobile networks. Effective from February 2009, the price per minute of call went down from CZK 2.99 to CZK 2.65, and from 1 July 2009 it went down further to CZK 2.31.

The CTO commenced a second round of analysis of selected wholesale markets and the retail market of access to a public telephone network in a fixed point. In May the European Commission published a recommendation for the regulation of prices for call termination in fixed and mobile networks in the Community.

Regulation of international roaming

The European Parliament and Council passed a new regulation concerning the roaming regulation in the European Union. Retail prices for incoming calls went down from 22 cents to 19 cents per minute with effect from July; the price of an outgoing call went down from 46 cents to 43 cents per minute; the price of an SMS sent within the Community went down to 11 cents. The regulation at the same time promulgated the limit on wholesale prices for calls, SMS and data services.

Internet access

A CTO decision from 28 January 2009 introduced, with effect from May 2009, a new ADSL internet access service (the so-called naked ADSL), in which the end user does not need to subscribe to a fixed point telephone network access service for the purpose of using a publicly

available telephone service. Telefónica O2 took advantage of this opportunity and introduced the service as part of its new service concept for the consumer segment, which was launched in May 2009.

Imposition of duties related to the provision of the Universal Service

Telefónica O2 provided the following services during 2008 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
- d) ancillary services to the service of access to the public telephone service at a fixed point of the public telephone network:
 - payment of the charge for connection to the public telephone network in instalments – consumers only;
 - free-of-charge selective blocking of outgoing calls;
 - free-of-charge itemised billing – consumers only.

Based on a CTO decision, services under point (d) were excluded from the scope of the Universal Service with effect from 30 July 2009. The services continued to be offered commercially, outside the Universal Service provision.

CTO issued an amendment to its earlier decision concerning services under point (a).

The amendment has led to a significant reduction in the number of public payphones operated as part of the Universal Service in the second half of 2009 and onwards.

Universal Service

In the first half of 2009, CTO issued a decision concerning the amount of net costs for services included in the scope of Universal Service in 2007. The decision has not yet become final and legally conclusive as the other operators who have the duty to contribute towards covering for the losses incurred as a result of Universal Service provision appealed against the CTO decision.

During 2009, Telefónica O2 claimed with the CTO a payment for services included in the scope of the Universal Service in 2008. In the second half of 2009, the CTO reviewed documents supplied by Telefónica O2 in order to verify the amount of the claim.

On 17 December 2009, a CTO decision concerning the amount of loss incurred as a result of providing special price plans for persons with disability; the loss is compensated directly from the state budget. The loss was quantified at CZK 136,201,450 and reimbursed to Telefónica O2 on 23 December 2009.

Government policy and support in the area of broadband access

The government of the Czech Republic decided not to use funds earmarked by the European Union for the execution of the so-called European Economic Reconstruction Plan for the development of broadband internet infrastructure but for other activities in the sphere of rural development. In September 2009, the European Commission published Community Guidelines for the application of State aid rules in relation to rapid deployment of broadband networks, which addressed the possibilities of using public funds for the development of ICT infrastructure.

Telefónica O2, both independently and as a member of various associations, participated in the discussion on the application of funds from the European Economic Reconstruction Plan and the text of the Community Guidelines for the application of State aid rules in relation to rapid deployment of broadband networks.

The Company is constantly monitoring options offered to customers by structural funds, and modifies its products and services so that they are eligible for subsidies. Telefónica O2 has simultaneously been calling for observance of specific state aid rules in order to protect the market competition from undue distortion.

Networks and technologies

Also in 2009, Telefónica O2 operated the largest fixed and mobile telecommunications network in the territory of the Czech Republic.

Investments in the mobile networks were directed mainly at a comprehensive upgrade of the next generation network (3G), increasing of data transmission speeds, modernisation of the GSM network technology and on adding extra capacities to accommodate the growing voice and data traffic. The new generation mobile network based on the UMTS/HSPA technology was expanded to cover not only Prague and Brno, as it had been until now, but also all other regional capitals. All BTS with UMTS capability in Prague and Brno were fitted with HSDPA technology, which boosts the data transmission speed to up to 3.6 Mb/s. The number of BTS in the UMTS network grew to 1,364 by the end of 2009, compared to 927 at the end of 2008. The coverage of the population increased significantly – from 16.5% in 2008 to 26.6% at the end of 2009. The CDMA network for broadband data services was also expanded – albeit at a smaller scale: 11 new BTS were added and their number at the end of 2009 reached 466, which gave 90.4% coverage of the population, compared to 89.8% in the previous year. Data traffic carried in mobile networks increased dramatically – at peak times it reached three times the volume in 2008. Tracking this trend, investments were made to add extra transmission capability in the networks.

Simultaneously to the 3G network roll-out, locations receiving the new technology also went through an upgrade of the 2nd generation GSM network technology. Further increases in the volumes of voice traffic and the need to connect new developments (residential, commercial and industrial) resulted in 288 new BTS being added in 2008. Their total number as at the end of the year reached 4,783. The coverage of the population was 98.9%. During 2009, more than 32 thousand non-configuration orders were carried out in the mobile network, up 85% compared to the previous period. These orders provide for network capacity and quality during the implementation of a new network technology and at the time of traffic density changes, as well as in response to the needs of providing for qualitative parameters of the network.

In the area of fixed networks, a substantial part of all investments went into the development of broadband internet and IPTV. To accommodate demand, the capacity of access points was strengthened, as were the capacities of transmission lines in the IP/MPLS backbone network. The number of ADSL access points reached 2,402, compared to 2,257 in 2008. In 2009, a total of 133 IP DSLAMs were commissioned, which made O₂ TV available in all 2,196 locations. In the first quarter of 2009, as a result of the process of upgrading the nominal ADSL connection speeds, the speeds of 8 Mb/s and 16 Mb/s were added. The total installed port capacity grew to 976,700, which translates into a year-on-year increase of 8.6%. The share of access ports installed on IP DSLAM equipment for O₂ TV increased to 56% as at the end of 2009, compared to 51% as at the end of 2008. A total of 757,079 ports were occupied at the end of 2009 (up 13.9% on the previous year).

The access network continued to be expanded, especially to accommodate the demand for connectivity from new customers in newly built residential, commercial and industrial developments. The access network consisted of metallic cables spanning the whole territory of the country, with the addition of optical cables and radio relay systems. As at the end of 2009, the total length of metallic cables was 303.4 thousand km (up 2.4 thousand km on the previous year). The optical network capacity continued to increase, driven by the growing volume of traffic generated by broadband customers, demand for connectivity from corporate customers and, in selected cases, also by the need to connect newly developed areas. The total length

of optical cables, including those laid in conduit systems reached 31,204 km at the end of the year, compared to 30,785 km in 2008. The total length of optical cables reached 975,802 km (up 29,069 km on the previous year).

Investments in voice technology were of a largely maintenance character in 2009, as the traffic in the voice network was flat and did not call for extra capacity. In addition to two international and six transit exchanges, a total of 138 HOST exchanges and 2,384 Remote Subscriber Units (RSU) were operational in the fixed telephone network at the end of 2009.

As part of the implementation of a regional management model, network sections of Telefónica O2 in the Czech Republic and in Slovakia were joined in June 2009 into one organisation, which allows for better utilisation of resources and knowledge of both divisions, and for the harmonisation of technologies of both countries.

Voice services

In the area of mobile voice services in 2009, Telefónica O2 continued its focus on offering simple and easy to understand tariffs, reflecting on the needs of the customers at the challenging time of the economic slowdown. The goal was to offer such services that would help customers in their economizing – achieving savings and having maximum control over their expenditure. This helped the Company increase the total voice traffic generated in its mobile network by 11.1% to 8,155 million of minutes. In the segment of fixed access, the Company concentrated on the promotion of its new service concept built around the broadband internet service O₂ Internet, with options to subscribe to various voice tariffs for unlimited calls to all fixed line networks in the Czech Republic.

In addition to innovations for contract customers of mobile services, who were offered, among other things, also a new tariff from the family of unlimited tariffs O₂ NEON, O₂ NEON L+, or the unique O₂ ZERO without a commitment and monthly subscription, Telefónica O2 in 2009 focused also on always offering something new to pre-paid customers – such as bonuses for regular credit top-ups.

From February, both new and existing contract customers of mobile services could activate O₂ Neomezené zprávy if they already subscribed to O₂ NEON and O₂ NEON Basic. For a monthly fee of CZK 190 they could send SMS and MMS to all networks in the O₂ mobile and fixed line network in the Czech Republic.

O₂ ZERO, a tariff launched in June, was a unique proposition to the Czech market. It contained neither a commitment nor the requirement to pay monthly subscription fees. The prices for calls, SMS and MMS to all networks were flat – regardless of the network and the time of day. Customers could also set a maximum monthly limit in order to have their expenditure fully under control, and were free to adjust the limit at any time.

In October 2009, Telefónica expanded its offer of successful unlimited tariffs O₂ NEON by adding a new tariff – O₂ NEON L+. For CZK 950 inclusive of VAT per month, the customer make unlimited calls to any number in the O₂ network on weekends and off-peak, in addition to getting 300 free minutes for calling any number in any network of choice, regardless of the time of day. The tariff O₂ NEON XL was also made more attractive as its free minutes increased from 400 to 600. Furthermore, the per-minute price for calls was reduced from CZK 3.90 to CZK 2.90.

Customers of pre-paid mobile services of Telefónica O2 could, from 1 April 2009, subscribe to new tariffs O₂ NA!PIŠTE and O₂ NA!HLAS. Anybody who topped up their credit by CZK 300 or more could choose one of the three bonuses on offer: weekend calls in the O₂ mobile network for CZK 0.50 per minute, evening calls in the O₂ mobile network for CZK 0.50 per minute, SMS in the O₂ mobile network for CZK 0.50/1 SMS on weekends. The bonus could be changed for another upon any subsequent top-up of CZK 300 or more; of course, the customer could choose to stay with the original option. Customers who, in the period between 15 June and 31 August, bought one of the new pre-paid cards O₂ NA!PIŠTE or O₂ NA!HLAS, received a special bonus of 100% of credit upon the first top-up, which they could use for calls and SMS. A one-time top-up by CZK 300–1,000 qualified for the bonus.

A competition Dobij a vyhraj (Top up and Win) was launched on 23 February. All O₂ customers who topped up their credit – in any of the available ways – were automatically entered in the competition. After topping up, the customer received an SMS with a competition code

which, if checked against the site www.dobijavyhraj.cz, immediately informed the customer of a potential win. The prizes included merchandise and discounts on O₂ services and were differentiated based on the amount of the top-up. The competition was followed by the campaign Odměna za dobití (Top-up Reward) which was launched on 3 October.

During 2009, Telefónica O2 registered a change in the pattern of behaviour of its business customers who, to a larger extent than before, limited their use of traditional fixed voice services in favour of mobile voice and Voice-over-IP services. In February, Telefónica O2 responded by introducing a new proposition aimed at this customer segment – a convergent voice service branded as O₂ Neomezené volání. The service was the first in the Czech Republic to have made it possible to make unlimited calls from the fixed and mobile network for a flat monthly fee. The business customer assigned a suitable tariff to employees, pre-defining the type of calls which can be made for CZK 0 per minute. Unlimited calls to all fixed lines in the Czech Republic (CZK 330 exclusive of VAT per month) and to mobile numbers (CZK 350 per month) were already included in the basic tariff. No charge applied to calls within the company. Calls from the fixed line were carried using IP telephony and the monthly subscription fee included, in addition to usage, also a rental of an IP telephone and the design of a virtual PABX exchange for every subscriber.

In March, the Company began offering a teleconference service to those customers who do not own the required infrastructure and did not want to rent it. To start a videoconference, one needs only O₂ Konference, any mobile telephone and to send an activation SMS. The provider then connects and carries the conference call between the parties. The service is charged at a rate equivalent to a standard call and it can be used both in Czech and in English.

Internet, data and value added services

In the area of fixed internet access, in May Telefónica O2 introduced a revamped offer with an ADSL broadband internet option which already included access (fixed line rental) and did not require a separate provision (the so-called naked ADSL). O₂ Internet became the backbone of Telefónica O2's new proposition to the consumer market, which let customers combine services into bundles freely, based on their actual need. The new service concept is described in detail in Section Convergent services.

At the end of 2009, Telefónica O2 had the broadest portfolio of mobile data access services, which gave it an evident competitive edge on the other mobile operators in the Czech Republic. The CDMA technology was available to 90.4% of the Czech population at the end of 2009. The UMTS/HSDPA 3G mobile network was significantly expanded in coverage during 2009. In addition to Prague and Brno, the benefits of the fastest mobile internet and broadband data transmission could be enjoyed by residents of all 13 regional capitals, with GPRS, EDGE and HSCSD service available in the remaining parts of the country. The roll-out of the 3G network coverage was supported with a campaign to acquire new customers – O₂ Mobilní Internet could be activated for CZK 600 inclusive of VAT per month.

Simultaneously to expanding its new generation mobile network coverage, Telefónica O2 also introduced a new USB data modem to its portfolio. The modem works in all O₂ networks (GPRS, EDGE, UMTS, HSDPA) and, as in the case of the Combo modem, is capable of recognising the fastest service available in the given location and connects via it to the internet. The modem is also very portable and easy to install.

From 1 February, all customers receive a new anti-virus protection in the form of a professional product F-Secure Profi Antivir. The service was designed for both the new and existing customers of all variants of the broadband internet service O₂ Internet, as well as to mobile customers. The new anti-virus protection was free-of-charge for the whole duration of their usage of the service.

In the first half of the year, the Company made its BlackBerry service available to all customers. The service was previously marketed only to business customers. In order to use BlackBerry Internet Service, one needed only to own a BlackBerry handset and to activate the BlackBerry Email tariff. For a monthly fee of CZK 299, it included unlimited internet connectivity, including sending and receiving email. The service can also be roamed internationally provided the BlackBerry Email Roaming is activated and data roaming is allowed.

Convergent services

Telefónica O2 launched a new concept of consumer services in May. The new concept lets the customer to freely and flexibly combine services from a diverse portfolio of fixed access and mobile services. The customer has the liberty to design a service package to suit their exact need. That was a principal change from the previous concept in which customers chose from a set of already configured service bundles, always with a fixed voice tariff. Telefónica O2 expects that the new service concept will help to stop the decline in the number of residential customers – by attracting new customers who did not want to commit to fixed line subscription in order to have internet connectivity. The Company also believes that the high modularity of fixed and mobile services will increase the average revenue per household.

The concept is based on the broadband internet service O₂ Internet, which the Company offered from CZK 750 per month (O₂ Internet 8 Mb/s). The other building block services were the digital television O₂ TV (from CZK 650 per month for O₂ TV Komfort) and the voice services O₂ Volání (from CZK 520 for O₂ Volání 300). The customer could supplement O₂ Internet with free bonus services already included in the monthly subscription fee for the basic service: O₂ TV Start with 11 television programmes and the Video Library and TV Archive access, and O₂ Navzájem, which offers free calls between two O₂ mobile numbers. The new service concept also offered a number of fixed access and mobile services at discounted prices. In addition to O₂ Internet, the customer could subscribe, for instance, to O₂ Mobilní internet for CZK 150 per month (standard listed price CZK 750), O₂ TV Komfort for CZK 400 (standard listed price CZK 650) or the voice tariff O₂ Volání (starting from CZK 120). Customers who were also subscribed to any of the unlimited O₂ NEON mobile tariffs received a discount of CZK 100 per month on O₂ Internet or the digital television service O₂ TV.

A similar offer was prepared by Telefónica O2 also for customers in the business and corporate segment. These customers could order the basic O₂ Internet service for CZK 750 per month, and choose supplementary services according to their requirement. In addition to O₂ Mobilní internet, they could get a cut-rate fixed IP address, a larger capacity email box or more hosting space for their online presentation.

In 2009, Telefónica O2 also introduced a time-limited offer of O₂ Internet in combination with O₂ Mobilní Internet for a total price of CZK 750. Customers who were simultaneously subscribed to any of the mobile O₂ NEON tariffs received an additional discount of CZK 100.

Payment services

In connection with the coming into effect of the new Act No. 284/2009 Coll., on the payment system, Telefónica O2 started offering payment services to its customers from 1 November 2009. Payment services from Telefónica O2 allowed customers to make payment orders for electronic money transfer or to pay for goods or services provided by third parties using their mobile telephone or fixed line. A customer could choose among several methods of making a payment: by means of a short text or multimedia message charged at a higher rate (the so-called SMS/MMS), calling a number charged at a higher rate (the so-called Audiotex service) or by means of a dial-up data transmission (the so-called Datarif). Telefónica O2 provided these services to its customers based on an authorisation to do business in the area of electronic communications and certification from the CTO.

Paying using a mobile telephone or a fixed line is fast becoming popular in the Czech Republic. The average number of customers using payment services in the network of Telefónica O2 was approximately 620 thousand per month. In the hands of customers, the mobile telephone became a means of payment for an increasingly broad portfolio of goods and services. Customers of Telefónica O2 use the service to pay, for example, for small goods like DVD/CD and various services; buying public transport tickets, paying for parking or buying travel insurance were among the most frequently used options.

The new law which transposes European directives in this area further specified the conditions of provision of services which had already been offered by Telefónica O2 – including an added emphasis on consumer protection and prevention of money laundering. A special licence issued by the Czech National Bank also gave mobile operators in particular unprecedented leeway to develop new services which had previously been reserved only for the holders of banking licences.

ICT services and business solutions for the central and local government

In the past five years, the area of information and communication technologies in the Czech Republic experienced a major leap forward, and Telefónica O2 was on the vanguard of the trend. ICT services, formerly playing a more of a supporting role in organisations, have become an integral part of companies and institutions.

Telefónica O2 successfully integrated its vast experience from the telecommunications area with progressive IT know-how and became one of the leading ICT providers in the Czech marketplace.

The expansion and improvement of the quality of the ICT service portfolio was aided also by the merger of two subsidiaries Telefónica O2 Services and DELTAX Systems into a new subsidiary Telefónica O2 Business Solutions

In 2009, Telefónica O2 was intensively involved in the technological development of central and local government. Having won a tender, Telefónica O2 implemented in close collaboration with Česká pošta the ISDS (Data Box) project which is a breakthrough effort in the field of eGovernment.

The data boxes are data depositories and serve the purpose of delivering electronic documents by public law authorities or of interacting with these authorities. From 1 November 2009, public law authorities are now obliged to use the data boxes for communication with those entities that had a data box activated. Legal persons registered in the Commercial Register, legal persons established by law and public law authorities had a data box activated as an obligation; other legal persons and all natural persons could request a free-of-charge activation at the Ministry of Interior. For the Czech public administration, the project was a major step towards a new, virtual era.

During 2009, the Company supported the development of the so-called 'Managed Services': IP Centrex, Managed LAN and WAN, which represent an excellent springboard for future development of ICT services of this kind in the Czech Republic.

In the following years, Telefónica O2 will focus on promoting the development of new services for the government and for the corporate segment, and on expanding of its comprehensive ICT service portfolio.

National and international wholesale services

The year 2009 saw a culmination of the market consolidation trend in the Czech Republic, which was driven by the worsening macroeconomic trends. T-Mobile and Vodafone followed in the strategic footsteps of Telefónica O2 and embarked on a course of gradual transformation from purely mobile into comprehensive providers of telecommunications services, with a broader portfolio of options, including fixed access. The operators responded to the economic developments by an increasingly strict cost control and by implementation of economizing measures. In the wholesale market, this demonstrated itself in the form of increased pressures to drive down the prices, a higher rate of migration to services with a lower ARPU and the general stagnation of demand for services.

Telefónica O2 also presented an innovated portfolio of products. Following changes in the legislation, the Company began to offer the so-called naked ADSL, in which the alternative provider purchased only the ADSL line, without the need for a telephone connection. Together with the increased demand for leases of transmission infrastructure on the part of mobile operators, the service acted, to an extent, as a stimulus in the wholesale telecommunications market in the second half of 2009. The year 2009 also saw a revived interest in Ethernet data services. A large part of new services sold was, however, only a result of migration from the traditional service of leased lines.

In the area of international data and internet services, the growing demand for international transmission capacity on the part of international partners has produced additional requests for extra capacity, especially for international IP connectivity. Telefónica O2 registered a growing demand and increased sales of high-capacity international leased lines (Lambda 2.5 and 10 Gbps). The Company's own international IP connectivity also increased. In collaboration with other members in the Telefónica group and other international partners, Telefónica O2 successfully implemented several rather large international VPN projects; it also expanded its functional integration collaboration with Telefónica International Wholesale Services. The economic recession caused a downturn in the demand for new international leased lines; existing lines were cancelled by customers and there were also pressures to drive down the prices.

In the area of wholesale international voice services, Telefónica O2 further strengthened its leading position in the markets of Central and Eastern Europe. The Company increased the number of direct lines interconnecting it with other mobile and fixed line operators in Europe and beyond, and it shifted its attention to Russia and the Middle East. Compared to 2008, the volume of transit services was up 5% and reached a record of nearly 1.5 billion minutes. The Company also expanded its proposition to mobile operators – it added a service of video call transit to foreign mobile networks.

At the end of 2009, the fixed line network of Telefónica O2 was interconnected with the networks of seventeen operators of fixed networks of public electronic communications, and its mobile network was interconnected with the networks of eleven operators of public electronic communications in the Czech Republic.

Comments on the financial results

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

Consolidated financial results

Revenues, Operating Costs and OIBDA

The consolidated revenues reached CZK 59.9 billion in 2009, down 2.4% year on year, while the consolidated business revenues declined 7.3% year on year to reach CZK 59.8 billion. Gains from the sale of non-current assets reached CZK 422 million in 2009, compared to CZK 855 million in 2008. This decline was a result of lower non-recurring gain from sales in 2009 compared to 2008. As described in section Overview of the Group and the main changes in 2009 of this Annual report, in January 2009, the Company sold its former headquarters with a one-off gain of CZK 342 million, while in 2008 it disposed of a part of its portfolio of real properties in various parts of the country, with a gain of approximately CZK 727 million. The total consolidated operating costs reached CZK 34.0 billion in 2009, down 9.7% year on year as a result of strict financial discipline and some non-recurring items. The resulting consolidated operating income before depreciation and amortization OIBDA amounted to CZK 27.1 billion in 2009, down 4.4% year on year, thus lower decline than for revenues. OIBDA adjusted for guidance¹ went down 3.9% year on year to CZK 27.9 billion in 2009, which was within the guidance range of 0% to -4%. Comparable OIBDA², excluding non-recurring items in the year, went down 5.3% year on year to CZK 26.3 billion. The OIBDA margin (OIBDA over revenues) reached 45.2% in 2009, compared to 43.8% in 2008.

Depreciation and Amortization

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

Operating Income, Income before Tax and Net Income

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

Cash and Debt levels

On 31 December 2009, the Group's consolidated financial debts (long-term and short-term) amounted to CZK 3.1 billion, 2.0% down compared to 2008 year-end. The amount of cash and cash equivalents reached CZK 1.3 billion at the end of 2009, down from CZK 7.1 billion the year before. The combination of the cash and debt balances resulted in a net leverage³ of 2.5% and a gross leverage⁴ of 4.2% as at the end of 2009, compared to minus 5.0% and 4.1%, respectively, as at 31 December 2008.

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

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

³ Long and short term financial debts less cash and cash equivalents over equity.

⁴ Long and short term financial debts over equity.

Capital Expenditure

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

Overview of Consolidated Revenues

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

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

In the highly penetrated mobile market in the Czech Republic, the total mobile customer base increased by 3.0% year on year and reached 4,945 thousand at the end of 2009. The number of contract customers went up 11.7% year on year, reaching 2,814 thousand at the end of 2009 with 295 thousand net additions in the year (+7.1% year on year). This solid performance was driven by the steady uptake of O₂ NEON tariffs and the customer migration from the prepaid to the contract segment. At the end of 2009, contract customers represented 56.9% of the base (+4.5 p.p. year on year). The number of prepaid active customers reached 2,130 thousand at the end of 2009, down 6.7% year on year. It is worth highlighting the improvement in the trend of the prepaid customer base net losses in 2009: in 2009, the prepaid customer base decreased by 153 thousand, which was 39.8% less than in the previous year. This is a result of a successful customer proposition NA!VÍC, which motivated customers to regular top-ups.

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

In terms of usage, mobile traffic⁵ carried in the Czech Republic grew 11.1% year on year to 8,155 million minutes in 2009 due to the higher contract base and successful proposition of O₂ NEON tariffs.

In 2009, the blended ARPU⁶ reached CZK 514, down 9.1% year on year, largely due to customers optimizing their behaviour and the MTR cuts. The contract ARPU reached CZK 753 in 2009, down 14.3% year on year. The customer migration from the prepaid to the contract tariffs contributed to contract ARPU dilution. The prepaid ARPU decreased by 12.1% year on year to CZK 223 in 2009, which was a consequence of customers optimizing their behaviour in the current economic environment and of the migration of high value prepaid customers to contracts. However, in the fourth quarter 2009 the prepaid ARPU improved to CZK 224 from CZK 222 in the third quarter.

⁵ Inbound and outbound, excluding inbound roaming and roaming abroad.

⁶ Including inter segment revenues.

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

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

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

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

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

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

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

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

The revenues from Internet (including monthly and one-off charges), mobile data and IPTV grew 14.6% in total on the previous year and reached CZK 7.4 billion in 2009 which is largely a result of the market success of the new broadband centric proposition and the growth in the O₂ Internet and O₂ TV customer base. The number of retail ADSL accesses reached 677 thousand at the end of 2009, up 17.0% year on year, with 99 thousand net additions in the year (+40.1% year on year), propelled by intensive commercial activities around the broadband centric proposition. The total number of O₂ TV customers reached 138 thousand at the end of 2009, up 20.2% on the previous year. On the contrary, the revenues from mobile data declined slightly due to customers optimising their spending in the challenging economic environment.

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

Overview of Consolidated Operating Expenses

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

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

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

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

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

The outlook for 2010

In 2010, the Company will stay closely focused on meeting the needs of its customers by way of improving its services and delivering new products. In particular, the Company will continue with active marketing of its mobile O₂ NEON tariffs and VPN based tariffs for the business and corporate customers, by which it plans to sustain the commercial momentum achieved in 2009. This will lead to further improvements in the customer mix. In line with its 3G coverage expansion strategy, the Company will focus on improving its new mobile broadband and data services. The Company plans to achieve maximum capitalization of its competitive advantage of having the widest 3G network coverage and the most advanced portfolio of mobile data services. In the fixed line business, the Company's effort will stay focused on active marketing and enhancement of the broadband centric proposition launched in May 2009, including the offer of a more varied portfolio of fixed/mobile bundles, which will in turn stabilize the current trend in fixed accesses, and help the Company again outperform the fixed broadband and mobile contract markets.

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

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

In 2010⁷, the Group expects OIBDA⁸ to decline between -5% and -9% and Capital Expenditure to be around CZK 6 billion.

⁷ 2010 guidance excludes changes in consolidation, assuming constant FX rates of 2009.

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

Corporate Social Responsibility (CSR)

Also in 2009, Corporate Social Responsibility was an integral part of the business of Telefónica O2. The Company continued to apply its long-term policy of being considerate to its environment. The Company also endeavoured to cater to the needs of the community and to use its market position for its benefit. Building of trust, win-win partnerships and a dialogue with all stakeholders were the pillars of the Company's CSR policy.

Ernst & Young Audit & Advisory performed an audit across the Telefónica Group, which examined key CSR areas (environment, ethics, employee relations, customer relations, supplier relations and community relations). The audit conclusions were used in the planning of goals and action plans for the year ahead. CSR objectives were presented to the Company's Board of Directors and Ethics and Corporate Social Responsibility Committee. The Company published a brochure in electronic form, in which it gave a summary of all CSR activities in 2009.

A group-wide survey focused on the perception of Telefónica O2 in the eyes of the public, the so-called RepTrak, was carried out on an ongoing basis during the whole year. The survey helped to define CSR priorities and manage the Company's reputation.

Business principles and compliance

In 2009, Telefónica O2 continued to implement ethical business principles which have always been a part of its philosophy. Business Principles apply across the whole Telefónica Group; their role is to ensure that all employees and routine activities of the Company observe the corporate values and principles. The compliance with Business Principles is regularly monitored by Internal Audit. In case of a suspected violation of the Business Principles, employees could contact specially trained advisors from Human Resources, Security and Legal Affairs, or to use the confidential helpline. The Ethics and Corporate Social Responsibility, which is a supervisory body for CSR, was kept regularly informed of how the Company handled reports of suspected violations of the Business Principles.

An information campaign in relation to the Business Principles continued also in 2009.

An online course in the area of competition law, which was launched in March 2008, and another covering the Business Principles, were available to employees for training and education purposes in the area of ethics and compliance. The Business Principles course was mandatory for designated employees; as at 31 December 2009, the completion rate among those, for which the course was mandatory, was 73.95%. A new course in the area of privacy protection was put online in September 2009, again as mandatory for designated employees, and as at 31 December 2009 the completion rate was 65.97% of the obligated participants.

The Business Principles brochure was given to every new employee as part of the induction training; its full text was also available online on the Company's intranet and website.

Market presence and customer relations

Customer experience

Achieving the best customer experience continued to be one of the three main pillars of Telefónica O2's strategy in 2009. The needs and satisfaction of customers were continually monitored using ongoing or one-off surveys, global analyses and qualitative market research – such as focus groups, store exits, feedback left by customers concerning whether their requests had been resolved by the call centre or how they had been satisfied with the service.

The survey results were used to define key objectives for the Company. As a result, the Company focused mainly on the implementation of a new CRM system, optimisation of key processes and services, such as mobile delivery, employing a pro-active approach to the customer.

In May 2009, Telefónica O2 commissioned its new CRM system, which had been implemented with a view to giving the Company more tools to more effectively address the needs of its customers. It is a company-wide software system which interfaced and put under one umbrella the legacy systems of the fixed and mobile businesses. The Company now has a way of seeing all products and services used by a customer in one place. The transition to the new system, and its stabilisation, gives the Company a promise for the future that it will be able to respond to the needs of every customer in a targeted way – by offering products and services that the customer has an actual need for and that are of value to them, including the option of a discount if a combination of fixed and mobile products is subscribed. Telefónica O2 also wanted to let the customer manage their products and services online, by way of a self-service function.

The Company responded to the market need by dividing customer care in call centres in a way which increases availability of the call centre. The Company simultaneously focused on improving the quality of call processing through certification and specialisation of operators along product, process and system knowledge lines. Business customers now can have their requirements addressed in the evening or on weekends. The Company also launched a non-stop line (24/7) for resolving urgent mobile-related issues of corporate customers.

Products and services for people with specific needs

In 2009, Telefónica O2 introduced an improved handset model Emporia Talk Premium. It is a very simple and easy-to-use mobile handset designed with senior users or people with disabilities in mind, who would find it difficult to use a standard mobile telephone. Emporia offers easy access to individual functions via lateral buttons. All keys and buttons are large, as is the backlit display which makes it very easy to read digits and letters. The handset also has an improved sound transmission technology. Telefónica O2 marketed this handset in an economical bundle with half-price credit or the O₂ Neon S tariff at a discount. From each Emporia handset sold, Telefónica O2 donated CZK 100 in support of Helpline for Senior Citizens (Linka seniorů). For the part of the campaign which ran in November and December 2009, O2 Foundation raised CZK 16,830 for Helpline for Senior Citizens.

Deaf Call

Also in 2009, Telefónica O2 continued to operate Deaf Call (Hovor pro neslyšící), a service which lets deaf customers really communicate in the case of emergency or in various life situations – when making a medical appointment, ordering a repairman or consulting directory services. At the end of the year the Company added email to the number of ways in which people with

hearing impairment can communicate with the operators; the email address is neslysici@o2.com. A special call centre puts through calls from deaf people to the hearing, and vice versa. The service is available 24 hours a day and was used by 11,529 customers.

Discounts

In 2009, Telefónica O2 continued to provide a discount on O₂ fixed line service to people with a dependency of the 1st degree – in spite of the fact that the Czech government no longer subsidises the discount. The Company also preserved the option for people with disabilities to rent a special telephone set. In 2009, the accumulated discount given on the grounds of disability accounted for CZK 108 million; the state contribution to people with disabilities was CZK 120 million.

Also in 2009, rehabilitated persons and members of the resistance movement were eligible for discounts. The total of discounts provided to these persons in 2009 reached CZK 42.4 million.

Competition Internet Makes My Life Easy

In 2009, Telefónica O2 organised a competition titled Internet Makes My Life Easy, for best projects and activities with social themes, in collaboration with the local authorities in the towns of Pilsen and Ostrava. The goal was to promote the uptake of modern technology with a view to facilitating communication between providers of social services. The prizes included free mobile data connectivity for two years and the necessary hardware.

Responding to emergencies

In the summer of 2009 Telefónica O2 responded to an emergency caused by floods and prepared special programmes for people living in the stricken areas, which helped them deal with the immediate effects of the disaster.

Safe online

Telefónica O2 continued to focus on online safety in 2009. It offered a special anti-virus programme F-Secure Profi Antivirus with all its ADSL and mobile data subscriptions

Mobile telephones and health

In 2009, Telefónica O2 invested in research of the effects of mobile telephones on human health: through the Association of Mobile Network Operators it participated in the development of a special website dedicated to the subject, www.zdraviamobil.cz, and in the production of a brochure Answers in your pocket – Mobile telephones, base stations and health.

We help to guide children through the world of communication technology

As a provider of communications services, Telefónica O2 is committed to use all available means to help eliminate potential risks that come with modern technologies. Protecting children and creating a safe environment for them in the world of information and communication technologies has always been a key priority. Several specific actions were taken in the area of child protection. Telefónica O2 adopted a policy dealing with marketing to children, which

summarises the principles respected in all its marketing activities. In 2009, the Company also started blocking websites with child pornographic content. All websites that were made illegal in all EU countries were blocked in the O₂ network.

A mobile telephone for children

In 2009, the Company started carrying Samsung S3030 Tobí, a mobile telephone designed specially for children and their safety, on its portfolio. The telephone has special functions – such as the SOS call or text message for emergency situations. The telephone came with a pre-paid SIM card with a default blocking of premium SMS and premium calls, and with an information brochure about how to use modern technology safely and where to turn to in the case of an emergency. The number of Safety Line (Linka bezpečí) was also pre-programmed into the address book of the handset.

Promoting events for the benefit of children

In February 2009, the Company joined the celebrations of the International Safer Internet Day, together with the National Centre for Safer Internet, gave its support to the pan-European campaign directed at combating cyberbullying. Telefónica O2 was also member of an advisory committee of the Saferinternet project. The Company also donated prizes to Mobil Story, a competition on the subject of cyberbullying.

In the spring 2009 Telefónica O2 also gave its patronage to the international conference on safer internet for children, which was organised by the Ministry of interior and the European Commission under the Czech Presidency of the EU.

In November 2009 the Company's representatives participated in a discussion organised by the Security Policy Department of the Ministry of Interior in collaboration with the Office for Foreign Relations and Information, which was dedicated to the issues of illegal and inappropriate content on the internet.

Already the seventh year of Cyberspace, an international conference about the effects internet on the society, organised by the Law Faculty of Masaryk University in collaboration with the Faculty of Social Sciences of the same institution, was held at the end of 2009, and Telefónica O2 was the general partner of the event.

The Company's representatives also lectured on the benefits and dangers of modern technology for the Juniroom project. Juniroom seeks to guide children from 10 to 16 years of age in safe usage of the internet and mobile telephones.

Caring for employees and the workplace environment

In the area of human resources, the company has always strived for O2 to be “a place which is a pleasure to work at”. In 2008, Telefónica O2 made a pledge to employees, in which it defined in clear terms what it intends to achieve and deliver in specific areas. In 2009 the Company then went on to implement the steps in the direction of delivering on the promise.

Employee structure

	As at 31 December 2009
Employees total	8,020
of which women	2,784
of which men	5,236
of which employees with physical handicap or disability	62

Employees by division

Division – unit	As at 31 December 2009
Business Division (corporate and SME customers)	1,007
Consumer Division	2,107
Operations Division	3,465
Wholesale Division	63
External Relations	24
Strategy and Product Development	292
Human Resources	82
Support Services	349
Finance Division	382
Legal Affairs	51
Internal Audit and Risk Management	17
Government and Business Solutions	132
DHL	43
Office of the Chief Executive Officer	6
Total	8,020

Employee engagement

Reflect

The interest and motivation of employees to participate in the employee satisfaction survey grew year on year by 1% and reached 90%. The overall Reflect index stayed at the level of the year 2008. The management considered the outcome as good, especially with regard to the fact that many important changes occurred during the year. Several surveyed areas showed a positive trend: the My Manager, My Work and Development and Atmosphere indices improved by one point and were ranked as the Company's strong points. The Top Management Index dropped by 3 points from the year before; the management will therefore focus more on improving the credibility, availability and effectiveness of the top management team.

Spirit of O₂

As every year, also in 2009 Telefónica O2 recognised the best employees at its annual Spirit of O₂ awards. Employees could either nominate themselves or their colleagues whose accomplishments distinguished them from the rest and who helped keep Telefónica O2 at the forefront of the telecommunications market. An innovation for 2009 was the doubling up of the nominations – in the spring round, the winners were chosen by employees, and in the autumn round, a special jury comprising top executives of the Company selected the best out of the nominees.

Work-life balance programmes

Telefónica O2 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 communication tools (fixed and mobile internet connection and a company mobile telephone) meant that not all activities had to be done from the office. The Company also allowed employees, conditional on the relevant manager's consent, to work part-time. Parents of children of pre-school age could also use employee bonuses from the so-called cafeteria, which were redeemable against pre-school care.

Health

Healthy Company programme of VZP

Všeobecná zdravotní pojišťovna offered its clients – employees of Telefónica O2 – a healthcare programme focused on prevention in those areas that are concerned by their work. The programme, in the total value of CZK 1.4 million, was delivered by Santé, the employee preventive healthcare provider of Telefónica O2. Employees could choose from inoculation against influenza or type A hepatitis, back massages or preventive diagnostics of lifestyle diseases.

Ad hoc health promotion activities

At the end of 2009, the Company provided and organised a campaign of inoculation against the seasonal influenza. In the spring, the Company paid for revaccination of employees against meningitis in those workplaces where the disease was detected in 2008. Therapeutic counselling was also offered to members of any team where a fatal incident happened.

At the end of 2009, the Company trialled NoStress, a new employee health promotion programme. The programme focused on improving the resistance of employees against stress and strengthening their capacity to deal with stressful situations. The course was held in Prague, Kolín and Pardubice for a total of 79 participants.

Education and personal development

Workshops – key behaviour

At the beginning of 2009, four key behaviours necessary for the Company's success in the marketplace were identified: accountability, openness to change, dealing with problems in a cooperative way and customer orientation. All employees were invited to two half-day workshops at which employees from different units of the Company debated the meaning of these behavioural concepts and how they should translate into everyday professional life. In 2009, a total of 2,300 employees participated at the workshops. In 2010, the programme will be evaluated and modified, if required.

Improving line management competences

In 2009, a total of 110 employees (474 persons in total) took part in Leading to Excellence, a programme for the middle management, whose aim was to standardise the management style in the Company. Managing Others, a long-term training for newly appointed supervisors and managers, was launched in the second quarter of 2009; 36 employees completed the programme in 2009.

Motivation programmes and benefits

Despite the challenging economic reality in the marketplace, Telefónica O2 continued the tradition of offering its employees a wide choice of employee benefits – for example financial products, O₂ products and services, benefits promoting the work-life balance and benefits which make life easier for parents of children in pre-school facilities. Employees with reduced work capacity also received a voucher for rehabilitative physiotherapy in the value of 2 x CZK 10,000 per year. A total of 69 employees received the vouchers in 2009.

The employee benefits menu is updated every year with regard to the demand. Retail partners in the Good Shopping programme offered discounts on services (e.g. restorative spa treatments, healthcare, physiotherapy, etc.). The programme included specially-priced offerings from more than sixty partners in 2009.

Employer of the Year

In 2009, the Company won third place in the main category of the Employer of the Year Awards. The professional jury placed the Company three positions higher from 2008.

Caring for the environment

Environmental policy

The commitment of Telefónica O2 to keep the footprint of its operations on the environment minimal in 2009 was anchored in the Company's Environmental Policy. It focuses on the elimination, or at least the mitigation, of damage to or degradation of the environment – in its whole or in part; In doing so, the company uses the latest research. Telefónica O2's fundamental principles of environmental protection were coordinated across the Telefónica Group and helped to deliver on both the group and local objectives and meet the statutory and other conditions.

Green Company

Telefónica O2 continually worked with its suppliers, gradually raising the bar they have to meet, in order to promote the ideas of environmental protection in its external environment. The company itself was on the vanguard – its Green Company programme involved employees in protecting the environment

Reducing our environmental footprint

The Company continued in its successful campaign to reduce its negative footprint on the environment. In providing for its operations, Telefónica O2 in 2009 consumed more than 3% less electricity, more than one third of natural gas and water compared to 2008. Also compared to 2008, the total volume of polluting emissions released into air from heat and power generating sources and from vehicles was also reduced; for instance the consumption of heating oils dropped by more than 21% year on year, of distributed heat by more than 37% and the number of kilometres driven in company cars by more than 7%. At the same time, the Company succeeded in further reducing the amount of waste it produces – by 24% on the previous year. Of communal waste alone, the waste production was 26% lower, and of hazardous waste it was down 66%.

The way the Company cares for the environment showed also in other areas – for instance, recycled materials and environmentally friendly materials were being used for packaging.

Certification

The Company's activities in the environmental area were regularly audited, both internally and with respect to suppliers. The standard of environmental protection is certified according to ISO 14001 international standard. Telefónica O2 is the only telecommunications operator in the Czech Republic to have this certificate.

Promotion of environmental actions

In 2009, Telefónica O2 again focused on the social sphere, in which it actively tried to promote the principles of environmental responsibility. The social project *Nechte svůj starý mobil pomáhat* (Let Your Old Mobile Help), the proceeds of which were donated to Safety Line, was among key activities of this kind. The project generated CZK 44,801 for Safety Line in 2009. The Company also donated prizes in the value of CZK 60,000 to the 16th Grand Recyclable Waste Collection Competition which was organised under the auspices of the Czech Ministry of Environment for kindergartens and elementary schools in the Czech Republic.

Promoting activities for the benefit of the community

Supporting community projects and philanthropy in 2008 were deeply rooted in the company's CSR. Telefónica O2 strived to put its technology to use in helping to improve the quality of life. Already for the eighth year running, O₂ Foundation was the key instrument in transparent and systemic corporate donorship.

In 2009, the Company was nominated in the 6th year of TOP filantrop, which is an award given by the Donors Forum in recognition of exemplary socially responsible corporate behaviour. Telefónica O2 was among the TOP 10 of corporate donors in the Czech Republic; measured by the volume of invested funds, it ranked tenth in the category TOP 10 Philanthropist of 2009. Philanthropic activities are measured using the LBG (London Benchmarking Group) Standard Responsible Company, which is a comprehensive and standardised system for the assessment of corporate philanthropy. The first ever Personality of the Year award was presented on the same occasion. It is sponsored by O₂ and recognises individuals who had made an outstanding contribution to the development and promotion of Corporate Social Responsibility, for personal engagement in the non-profit or philanthropy sector in the Czech Republic.

The total value of donations, gifts and telecommunications services provided by Telefónica O2 to or for the benefit of community projects in 2009 exceeded the mark of CZK 30 million.

O₂ Foundation Award

In the 8th year of its regional grant programme, the O₂ Foundation continued the tradition and distributed more than CZK 10 million among 55 NGO projects, from which more than 7 thousand children and young people benefited. The grants for amounts ranging from CZK 50,000–400,000 were awarded to projects in aid of socially and physically disadvantaged children and youth, their leisure activities, education and to projects aimed at eliminating barriers and problems in communication. The civic association Sense and Sensitivity was awarded the 2009 O₂ Foundation Award – it was recognised for its exemplary support of grandparents raising their grandchildren. The O₂ Foundation Award of CZK 1 million expresses a special recognition to a project that the Board of Trustees of the Foundation has found appealing for its effort to change the established social habits and open tabooed social topics.

Safety Line 116 111

Already for 15 consecutive years, the O₂ Foundation was the general partner of this only national free and anonymous helpline for children in difficult life situations. In 2009, the O₂ Foundation was also general partner of Safety Line benefit concert, which celebrated its 15th anniversary. Television viewers sent donor SMS to Safety Line, raising more than CZK 1.1 million. The O₂ Foundation then matched the amount. The benefit yielded CZK 3,654,660, with Telefónica O2 becoming the largest donor with CZK 1.5 million donated through the O₂ Foundation.

Helpline for Senior Citizens

The O₂ Foundation continued in its support to Helpline for Senior Citizens (Linka seniorů) operated by Elpida Plus. Senior citizens could dial the number 800 200 007 and share their concerns and joys, consult on various issues – health, legislation, psychology and welfare. The helpline answered almost 16,000 calls, of which more than 3,300 were of serious nature, in 2009. Financial assistance from the O₂ Foundation helped to keep the service free of charge.

Stop Bullying

The programme celebrated a major success in 2009: the civic association Aisis, the programme coordinator, qualified for a grant from the European Social Fund to roll out the campaign to dozens new schools in the Czech Republic. The O₂ Foundation, which initiated the project in 2005 and funded it for five years, accomplished its longstanding ambition to raise the society's awareness of this serious subject, and to offer effective tools to schools and thus contribute to rooting out bullying among children. The extra funding will make it possible to give free long-term training in fighting bullying to teachers in additional 60 schools over the next three years.

In 2009, the O₂ Foundation also contributed towards the publication of a practical guide for parents on how to spot and stop bullying. A comprehensive survey of cyberbullying among Czech children was carried out in the second half of the year. The survey showed that the term cyberbullying was not well known by Czech children; a more detailed research confirmed that 10% of children did encounter cyberbullying in the recent months. The survey results surprisingly did not confirm the hypothesis that cyberbullies' real identity is often unknown – 78% of children stated that the bully had been a classmate. Only 8% of children confided in a teacher. The survey concluded that cyberbullying was directly related to the climate in the class or school.

Impact of O₂ Foundation activities on the general public

A survey of the public was carried out in the spring of 2009, which focused on the activities of the O₂ Foundation and their relevance. The survey was carried out by Factum Invenio and involved a million of respondents. The general recognition of the O₂ Foundation in the population was 10.4%. More than 70% of respondents who recognised the brand stated that the O₂ Foundation distributed tens of millions of Czech crowns every year to help children. 39% of respondents knew that the O₂ Foundation concerned itself with the issues of bullying in elementary schools. In the future, O₂ Foundation should focus namely on violence among elementary school pupils – it came recommended by 68.9% of the respondent group. The survey confirmed the relevance of the foundation's effort to fight bullying in schools.

The majority of the Czech population (90%) was convinced that corporations should use a part of their profits to help the needy (answers indicating a strong and prevalent agreement with the proposed statement). The O₂ Foundation also helped the overall image of Telefónica O2: 49% of the population stated that thanks the O₂ Foundation made Telefónica O2 more attractive to them (answers indicating a strong agreement with the proposed statement: 15%; answers indicating a prevalent agreement with the proposed statement: 34%).

Volunteer programmes for employees

The activities of the O₂ Foundation are based on the voluntary work of employees of the Company.

In 2009, a record 1,995 employees worked for O₂ Foundation as volunteers – the largest number of all companies in the Telefónica Europe group.

Financial donations from Telefónica O2 employees increased significantly: 1,676 employees donated almost CZK 1.3 million to the O₂ Foundation; the largest amount, CZK 474,383, was raised for the liquidation of damages caused by vast floods that devastated North Moravia in June 2009. The money was used mainly for the construction of emergency housing for flood victims in Životice. Telefónica O2 matched the amount to the total of CZK 1 million. Employees

also raised funds for Safety Line and Helpline for Senior Citizens and individual families in material distress, and donated CZK 380,000 to the emergency transplant and neonatal units of Motol hospital to buy vital function monitors and special pumps.

Employees regularly participated in volunteer events and helped with their time, knowledge and skills.

Corporate teambuilding events turned into volunteer events – managers and their teams worked in non-profit organisations. In 2009, 116 employees donated 956 hours of work for non-profit organisations. 98 employees donated their personal free time: they spent 1,096 hours working with children from children's homes organising their leisure activities, and 288 hours helping selected non-profits. They also spent 1,820 hours assisting the foundation's principal grant programme – they sat on regional committees and selected the best projects, among which the O₂ Foundation distributed CZK 10 million.

The O₂ Foundation also recognised those employees of the Company who were active volunteers in their personal free time. Their service to the community earned CZK 460,000 to 23 employees in 2009, which was in turn donated to the non-profit organisations they worked with on a long-term basis.

Easter and Christmas markets organised by the O₂ Foundation in its buildings in the Czech Republic products hand-made by people with disabilities in sheltered workshops were sold to employees. In 2009, employees spent CZK 582,000 on products from sixty sheltered workshops.

Proniño international volunteer programme

Volunteer activities of employees in 2009 again transcended the limits of the Czech Republic as six employees of the Company participated in the international volunteer programme Proniño implemented by Telefónica in Latin America. Altogether thirty volunteers hailing from all countries where Telefónica had presence were sent to Ecuador, Brazil, El Salvador and Peru in 2009. After arriving to their destination their role was to add meaningful content to the free time of children who, once their school finishes, either roam the streets or have to work.

Give Blood with O₂

Also the project Give Blood with O₂ continued, seeking to promote voluntary blood donorship in the Czech Republic. During the year, more than 360 employees participated and collectively donated 160 litres of blood.

Fair Trade

The project Be Fair with O₂, which focused on promoting Fair Trade products and services, continued also in 2009. The biggest success in this respect was that Fair Trade products were included in the catalogue of promotional items and Fair Trade catering found its way into the options for internal catering which is ordered for events with business partners. The Company also donated a display stand in the value of CZK 75,000 to a Fair Trade partner for the promotion of Fair Trade products. Fair Trade products were also used as courtesy gifts for conference participants and as Christmas gifts for business partners. The value of gifts in 2009 was just under CZK 700,000. In 2009, employees could also buy Fair Trade products at cut-rate prices through the e-shop, and order Fair Trade and ethnic catering for various corporate events.

Corporate Governance

Corporate governance of the Telefónica O2 Czech Republic Group

In 2009, a new independent body, the Audit Committee, was added to the already implemented corporate governance model and the tools and procedures of corporate governance in Telefónica O2 and its subsidiaries continued to be improved. As in previous years, the opportunities for sharing experience and learning from best practice examples in the Telefónica Group were used.

In terms of organisation, Telefónica O2 is a part of Telefónica's European division (Telefónica Europe), which holds all companies that use the O₂ commercial brand regardless of ownership relations. No significant changes occurred in the ownership structure of the Company; Telefónica S.A., holding a 69.41% stake, remains the majority owner.

Telefónica O2's ownership rights in its subsidiary companies, save for those incorporated in foreign jurisdictions, are exercised by the Board of Directors of Telefónica O2 Czech Republic acting in the capacity of the sole member. Persons with power of attorney given by the Board of Directors of the parent company exercise the ownership rights in foreign subsidiaries within the limits of the mandate approved by the Company's Board of Directors. Personnel changes in the subsidiary companies' statutory and supervisory bodies (in positions occupied by the Company's representatives) are approved by the Board of Directors of the Company and, in accordance with the Articles of Association, they are also subject to prior approval by the Supervisory Board of the Company, whose decisions are made in consideration of the opinion given by the Nomination and Remuneration Committee.

Subsidiary and associated companies (as at 15 March 2010)

No principal changes occurred in 2009 in the structure and number of members of the Telefónica O2 Czech Republic Group with respect to the situation described in the 2008 Annual Report and the 2009 Half-year Report of Telefónica O2. Changes which occurred in the period in question are set out below:

- the Board of Directors of Telefónica O2 decided that with effect from 1 July 2009 the registered capital of the subsidiary Telefónica O2 Slovakia, s.r.o., would be increased by way of a pecuniary contribution, to reach the total of EUR 200,000,000;
- as of 1 August 2009, the process of the merger through consolidation of Telefónica O2 Business Solutions, spol. s r.o. (the successor company) and DELTAX Systems a.s. (the now defunct company) was formally concluded by a record of the merger in the Commercial Register.

Corporate name	Registered capital	The share of Telefónica O2 Czech Republic, a.s.
Telefónica O2 Slovakia, s.r.o.	EUR 200,000,000	100.00%
Telefónica O2 Business Solutions, spol. s r.o.	CZK 10,000,000	100.00%
CZECH TELECOM Austria GmbH	EUR 35,000	100.00%
CZECH TELECOM Germany GmbH	EUR 25,000	100.00%
První certifikační autorita, a.s.	CZK 20,000,000	23.25%
AUGUSTUS, spol. s r.o.*	CZK 166,000	39.76%

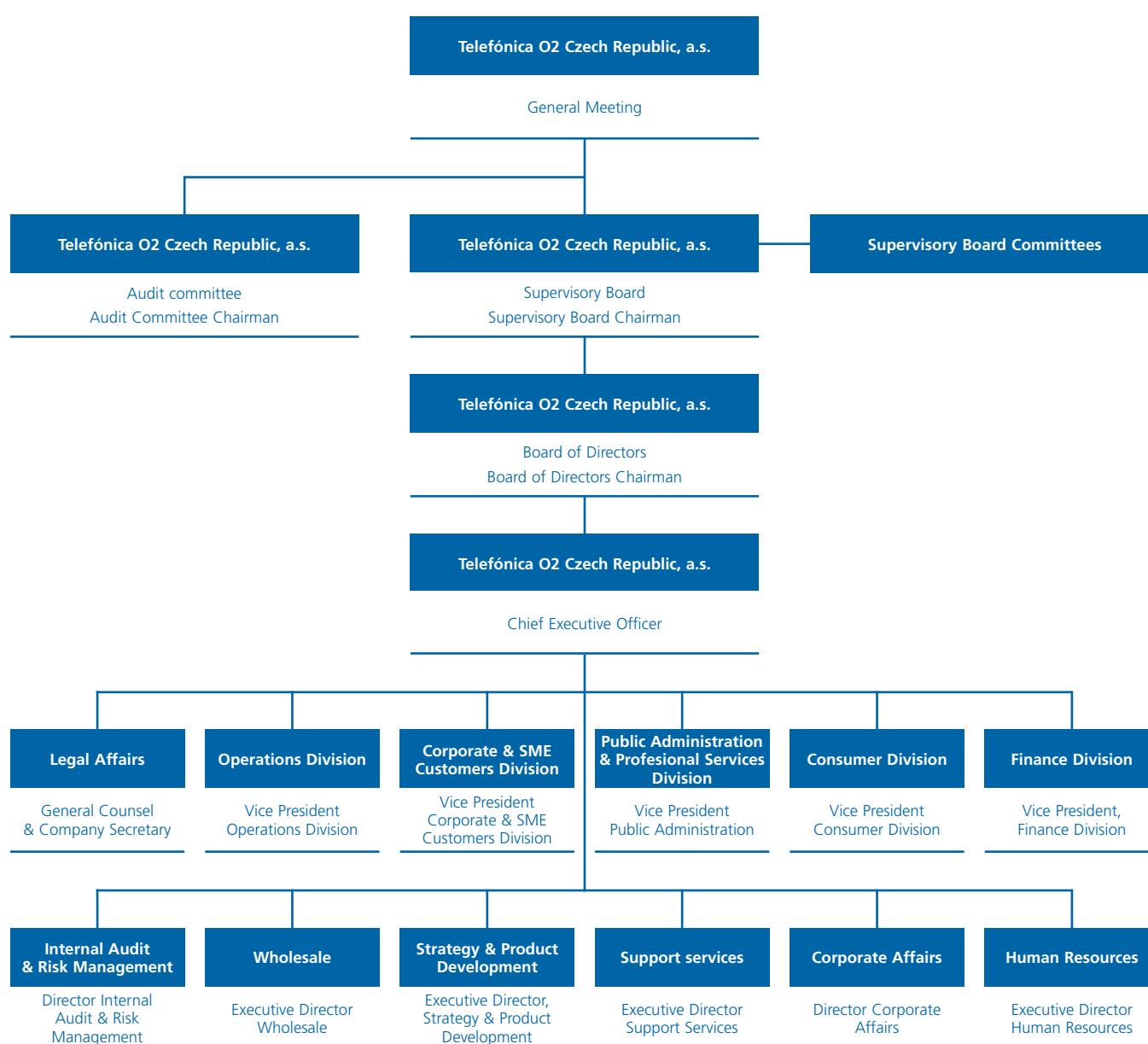
* Telefónica O2 Czech Republic, a.s. does not control this company.

The organisation chart of Telefónica O2

The optimisation of the organisational and governance architecture of the Company continued in 2009, helping the Company run better and more efficiently.

On the first level of executive line macrostructure, the Regulation unit was transferred in October 2009 from the Public Affairs and Regulation unit into Legal Affairs. Given the strategic importance that improving customer experience has for the Company's further development, a new unit, Customer Journey, was established in August 2009 in the direct reporting line of the Chief Executive Officer; this small department seeks to promote change and improve the culture of customer orientation in the Company.

Executive macrostructure of Telefónica O2 Czech Republic (as at 15 March 2010)



Governing bodies of Telefónica O2 Czech Republic (as at 15 March 2010)

General meeting	The General Meeting, which comprises the Company's shareholders, decides on fundamental business, organisational and operating matters. Its authority and powers are determined by the Commercial Code and the Articles of Association. As a rule, the Board of Directors convenes the General Meeting once a year. Basic information on the General Meeting and its status and authority can be found in Articles 7–13 of the Company's Articles of Association.
Audit committee	The Audit Committee has six members and is an independent governing body of the Company, with special powers in matters relating to the statutory audit, compilation and auditing of financial statements and the evaluation of effectiveness of the internal control system of the Company. Members of the Audit Committee are appointed and recalled by the General Meeting of the Company; only members of the Supervisory Board or persons external to the Company may be members of the Audit Committee. The tenure of Audit Committee members is five years. The Audit Committee shall meet as needed, usually once in a quarter, but at least four times in the course of a calendar year. Basic information about the Audit Committee and its power can be found in Articles 26a–26f of the Company's Articles of Association.
Supervisory board	The Supervisory Board has fifteen members and supervises the discharge of the Board of Directors' powers and the running of the Company's business. Its composition, authority and powers are determined by the Commercial Code and the Articles of Association. As a rule, the Supervisory Board meets once in a quarter, but at least four times in the course of a calendar year. Two thirds of the Supervisory Board members are elected and recalled by the General Meeting, one third of the Supervisory Board members are elected and recalled by employees of the Company. Members of the Supervisory Board are elected for tenure of five years. Basic information about the Supervisory Board and its authority can be found in Articles 20–25 of the Company's the Articles of Association.
Board of directors	The seven-member Board of Directors is a statutory body which manages the business of the Company and acts on its behalf. The Board of Directors decides on all corporate affairs which, by law or the Articles of Association, are not reserved for the General Meeting or the Supervisory Board. As a rule, the Board of Directors meets once every calendar month, but at least 12 times in the course of a calendar year. Members of the Board of Directors are elected and recalled by the Supervisory Board. The tenure of a member of the Board of Directors is 5 years. Basic information on the Board of Directors and its authority can be found in Articles 14–19 of the Company's Articles of Association.

Committees of the Supervisory Board

Under its powers, the Supervisory Board sets up committees as its advisory and initiative bodies. Committees of the Supervisory Board are an inherent part of corporate governance. The Supervisory Board always institutes a Nomination and Remuneration Committee. Members of committees are elected and recalled by the Supervisory Board. The tenure of a member of a committee is 2.5 years. Committees established by the Supervisory Board can comprise only members of the Supervisory Board. The scope of authority of the Supervisory Board's committees is set out in Article 26 of the Company's Articles of Association.

Company has the following committees of the Supervisory Board:
Nomination and Remuneration Committee;
Ethics and Corporate Social Responsibility Committee.

Board of Directors (as at 15 March 2010)



Luis Antonio Malvido (*1964)

Chairman

Graduated in Industrial Engineering at from the Instituto Tecnológico de Buenos Aires. Joined Telefónica in the 1980s during the privatisation process as a member of a team for the valuation of the target company. Afterwards he worked in various customer service, sales, business development and strategic planning positions in Telefónica. In June 1998 he was appointed Vice President and 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 Executive Director of Telefónica Venezuela, Movistar and later he became member of the Management Committee of Telefónica Latam, where he was also President of the Regional Quality Committee. From January 2008 he was Executive Director at TeleSP, a Telefónica subsidiary in Brazil. In February 2010 he was appointed Chief Executive Officer and Chairman of the Board of Directors of Telefónica O2 Czech Republic, and simultaneously also member of the board of Telefónica Europe.



Jesús Pérez de Urquien (*1970)

1st Vice Chairman

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 O2 Czech Republic, a.s. he worked in Bank of America, Arthur Andersen, Jazz Telecom, S.A., and Telefónica Moviles, S.A. Jesús collected extensive experience in the telecommunications and finance area at these companies – 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 Board of Directors of the operations of Telefónica Moviles in Panamá, El Salvador, Nicaragua and Guatemala. Now he holds the position of Vice President, Finance Division, in Telefónica O2 Czech Republic.



Petr Slováček (*1959)

2nd Vice Chairman

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 Institution, Prague, he joined SPT TELECOM (the legal predecessor of Telefónica O2 Czech Republic) in 1989, working in switching, technical development, network management projects and OSS. In June 2008 he was re-elected 2nd Vice Chairman of the Board of Directors of Telefónica O2 Czech Republic. He currently holds the position of Vice President, Operations Division.



Martin Bek (*1969)

Member

Studied foreign trade at University of Economics, Prague, and completed his studies at the European Business School, Paris, where he majored in Finance. He worked for ABC International, DRT International and later at Guérard Viala Prague as senior consultant and tax advisor. From 1996, he worked at ČESKÝ TELECOM (the legal predecessor of Telefónica O2 Czech Republic) as Director for Tax and Accounting, later as Executive Director for Planning and Controlling. In April 2004 he was appointed Statutory Representative of Eurotel Praha, spol. s r.o. (the legal predecessor of Telefónica O2 Czech Republic) and since September 2004 he has been Eurotel's Chief Operating Officer. Now he holds the position Executive Director Support Services in Telefónica O2 Czech Republic. He is a member of the Board of Trustees of O₂ Foundation (Nadace O₂).



John Gerald McGuigan (*1960)

Member

Before joining O2, John was the Chief Executive of NHS24, a telephone triage service for Scotland and held this position for 2 years. He joined Telefónica O2 UK in 2007 and was general manager for the consumer segment in three sites: Glasgow, Preston Brook and Bury. Since 2009 has been appointed Chief Executive Officer of Telefónica O2 Slovakia.



Jakub Chytil (*1961)

Member

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 December 2003 he has been in the position of General Counsel at ČESKÝ TELECOM (the legal predecessor of Telefónica O2 Czech Republic) and since May 2006 he has also been in the position of the Company Secretary. He is a member of the Board of Trustees of O₂ Foundation (Nadace O₂).



Jose Severino Perdomo Lorenzo (*1971)

Member

José joined Telefónica in Spain in 2006, holding responsibilities in the areas of Business Intelligence and Commercial Development, until September 2008, when he moved to the Czech operation. Previously, he gained his expertise in McKinsey and Co, where, over 6 years he focused in the areas of Telecommunications and Marketing. José initiated his professional career in 1996 as an engineer in Sener (Madrid) and The Boeing Company (Los Angeles). Now he holds the position of Vice President, Consumer Division, in Telefónica O2 Czech Republic.

Personnel composition of the Board of Directors of Telefónica O2 Czech Republic, a.s., as at 15 March 2010

Name	Function	Member since
Luis Antonio Malvido	Chairman of the Board of Directors	1 February 2010
Jesús Pérez de Uriguen	1 st Vice Chairman of the Board of Directors	1 May 2008
Petr Slováček	2 nd Vice Chairman of the Board of Directors	14 June 2008
Martin Bek	Member of the Board of Directors	27 April 2006
John Gerald McGuigan	Member of the Board of Directors	27 October 2009
Jakub Chytil	Member of the Board of Directors	27 April 2006
Jose Severino Perdomo Lorenzo	Member of the Board of Directors	24 February 2009

Information about the term of office of Board of Directors members is given in sub-section Governing bodies of Telefónica O2 Czech Republic.

All changes in the personnel composition in the Board of Directors in the first half of 2009 were described in the 2008 Annual Report and in the 2009 Half-year Report.

The following changes occurred in the personnel composition of the Board of Directors in the second half of 2009 and in the period from 1 January to 15 March 2010:

Juraj Šedivý	his office of a member of the Board of Directors was terminated upon the discussion of his resignation in the Supervisory Board on 27 October 2009
John Gerald McGuigan	elected member of the board of Directors by the Supervisory Board of 27 October 2009
Salvador Anglada Gonzalez	his office of a member of the Board of Directors was terminated upon the discussion of his resignation in the Supervisory Board on 31 January 2010
Luis Antonio Malvido	elected member of the board of Directors by the Supervisory Board of 31 January 2010

Executive management (as at 15 March 2010)

The executive management of the company comprises the following top managers:

Luis Antonio Malvido (*1964)

Chief Executive Officer

(résumé in section Board of Directors)

Jesús Pérez de Uriguen (*1970)

Vice President, Finance Division

(résumé in section Board of Directors)

Petr Slováček (*1959)

Vice President, Operations Division

(résumé in section Board of Directors)

Martin Bek (*1969)

Executive Director, Support Services

(résumé in section Board of Directors)

Jakub Chytil (*1961)

General Counsel and Company Secretary

(résumé in section Board of Directors)

Jose Severino Perdomo Lorenzo (*1971)

Vice President, Consumer Division

(résumé in section Board of Directors)



Stanislav Kůra (*1968)

Executive Director, Strategy and Product Development

Graduated from the Brno Technical University, School of Civil Engineering, studied project management at the Cranfield Institute of Technology, UK, and went on to earn his MBA at the London Business School. He worked in managerial positions at UNISYS in London and in Prague, at Idom, a Deloitte & Touche subsidiary, and as a junior partner responsible for telecommunications in McKinsey & Company in Prague and in Silicon Valley, California. He has 15 years of experience in the fields of telecommunications and IT. He joined Eurotel Praha, spol. s r.o. (the legal predecessor of Telefónica O2 Czech Republic) in April 2005 as Director for Broadband Services with overall responsibility for implementation of the UMTS network and services, and in October 2005 he was appointed Eurotel's Chief Strategy and Product Development Officer and Statutory Representative. After the integration of ČESKÝ TELECOM and Eurotel and inception of Telefónica O2 Czech Republic his responsibility has extended beyond strategy and product development to include operation of information and advertising-based services.

**František Schneider (*1967)****Vice President, Corporate and SME Division**

He joined Telefónica O2 Czech Republic, a.s., in April 2008, first as Executive Director, Corporate Sales, and later was appointed Vice President, Corporate & SME Division. He graduated in Artificial Intelligence at the University of West Bohemia, Pilsen, and went on to start his professional career in Vikomt CZ. From 1997 he worked in Dell Computer, where started as Director for Sales to Small and Medium Enterprises, Czech and Slovak markets. In 2001 he became Business Development Manager for Eastern Europe, Middle East and Africa, where he managed development projects aimed at effective capture of the corporate market. This job took him also to Israel, Turkey, Saudi Arabia, United Arab Emirates and Russia. From May 2004 he was Managing Director of the Czech and Slovak division.

**David Šita (*1969)****Vice President, Public Administration**

He graduated from the University of Economy in Prague, also holds MBA at the US Business School accredited by the Rochester Institute of Technology, New York. Previously he worked in the banking and financial sectors, at GE Capital Bank and he also managed a small brokerage firm. He joined ČESKÝ TELECOM (the legal predecessor of Telefónica O2 Czech Republic, a.s.) in 2000 as a manager and later director in finance departments. In 2003 he left finance for the field of Regulation and Regulated Wholesale services as Executive Director. He continued in this role after the acquisition by the Telefónica O2 Czech Republic. In January 2008 he was appointed as Executive Director, Public Affairs and Regulation. Effective from February 1st 2009 he became Vice President of Public Administration and Professional Services Organisation Unit. He is a Chairman of the Board of Trustees of O₂ Foundation (Nadace O₂).

**Michal Urválek (*1963)****Executive Director, Human Resources**

Graduated at the Faculty of Law at Charles' University in Prague. He joined Telefónica O2 in August 2009 from his position as Head of Human Resources for RWE CZ Group, where he also held Board functions in sales and services organizations. He spent several years working in media and communications in the Czech Republic and Great Britain. He has devoted most part of his professional life to personnel management, the information technology, telecommunications, and energy sectors.

Report by the Supervisory Board



In keeping with the Company's Articles of Association, the Supervisory Board of Telefónica O2 Czech Republic in 2009 supervised the discharge of the Board of Directors' powers and the running of the Company's business. Supervisory Board members have the power to inspect all documents and records concerning the Company's activities; check whether the accounting records are kept to reflect the reality; determine whether the business of Telefónica O2 Czech Republic is done in compliance with the law, Articles of Association and instructions of the General Meeting.

The Supervisory Board continuously monitored the activities of Telefónica O2 Czech Republic and key decisions made by the Board of Directors and the management. Further, the Supervisory Board dealt with the suggestions raised by its committees and its members individually. The Board of Directors and the management provided the Supervisory Board with the documentation and information necessary for the discharge of its functions in accordance with the legislation and the Articles of Association. The Supervisory Board collaborated closely with the Audit Committee of Telefónica O2 Czech Republic in all key issues falling into the competencies of these both bodies of the company.

At its meeting of 22 February 2010, the Supervisory Board examined the audited annual financial statements for 2009 (unconsolidated and consolidated) prepared under the International Financial Reporting Standards. The Supervisory Board reviewed also the Board of Directors' proposal for distribution of Company profit for 2009 and retained Company profit from previous years, and as the case may be, other available own resources of the Company and determination of royalties for 2009. In both cases the Supervisory Board provided recommendation for the General Meeting to approve them.

Signed in Prague on 22 February 2010

A handwritten signature in blue ink, reading "Jaime Smith Basterra". The signature is written in a cursive style and is positioned above a horizontal line.

Jaime Smith Basterra
Chairman of the Supervisory Board

Supervisory Board



Jaime Smith Basterra (*1965)

Chairman

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



Alfonso Alonso Durán (*1957)

1st Vice Chairman

Holds a BA degree in Economics from the Universidad Autónoma Madrid, and an MBA from IESE Business School Barcelona. He started his professional career in 1974 with Banco de Bilbao as manager/controller. He joined Telefónica as economist and worked in several departments: internal audit, accounts, infrastructure, international communications, financial controlling and cost management in the Spanish fixed business unit. In 1999 he left Telefónica de España for Telefónica, S.A., as Deputy Director for Planning and Management Control. In 2003, he became General Manager for Strategy, Budget and Control. In 2008 took the position of Director of Operations in the corporation and became in the same year Director of Transformation in charge of Purchases, Technology, Information systems and Strategy and Innovation to Transform in the scope of the operative integration of the business units of Telefónica.



Lubomír Vinduška (*1956)

2nd Vice Chairman

Graduated in radio and communication 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 O2 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 O2 Czech Republic, and Chairman of the Prague Trade Union Steering Committee.



Luis Lada Díaz (*1949)

Member

He holds a degree in telecommunications engineering and joined the Telefónica Group in 1973 in the Research and Development Department, rising through the ranks to hold various managerial and executive positions within the group. In 1989 he was Deputy Director for Technology, Planning and International Services. Later he joined Amper Group, a manufacturer of telecommunications system and equipment, as Director of Planning and Control. He returned to the Telefónica Group in 1993 as Chief Controller for Subsidiaries and Participated Companies. In 1994 he was appointed Chief Executive Officer of Telefónica Móviles de España, S.A., and in September 2000 he went on to become President and Chief Executive of Telefónica Móviles, S.A. until 2004, when he was named Director for Development, Planning and Regulatory Affairs of Telefónica, S.A. In 2005 he was elected Executive Chairman of Telefónica de España, S.A.U. Until he left his executive positions in Telefónica in July 2006, he had served on the Boards of Directors of Telefónica, S.A., Telefónica Móviles, S.A., Telefónica Internacional, S.A. and other Telefónica Group's corporations, and currently is a member of several foundations and think-tank Groups in Spain, Professor "Ad Honorem" of the Polytechnic University of Madrid, Member of the Royal Academy of Engineering, the Scientific Advisory Board of Telefónica Research & Development (TID, S.A.) and the Telefónica Latinoamérica Advisory Board; and Member of the Boards of Directors of INDRA Sistemas S.A., Telefónica I+D, Telcel (Telefónica Venezuela), Ydilo Advanced Voice Solutions, S.A.



Maria Pilar López Álvarez (*1970)

Member

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. Pilar 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. On 1st March 2007, she was appointed Chief Financial Officer of Telefónica O2 Europe plc (now Telefónica Europe plc).



Enrique Used Aznar (*1941)

Member

Enrique Used Aznar acts as a member of the Board of Directors of Telefónica Internacional, Telefónica of Brasil (Telesp) and Telefónica Perú. He is also a member of the Assembly Directive of IESE of Madrid, vice chairman of Spanish Association for Cancer Research and Patron of Cancer Science Foundation. He has also served as Executive Chairman of Telefónica Internacional S.A., Telefónica Servicios Móviles and Telefónica I+D, as executive vice chairman of TPI Páginas Amarillas, Telefónica of Chile and Telintar (investor from Argentina), and as member of the Boards of Directors of Telefónica, Telefónica of Argentina, AT&T Network System International and Ericsson Spain. He holds a degree in telecommunications engineering from Universidad de Madrid, and a degree from IESE (Business Management).



Ángel Vilá Boix (*1964)

Member

Graduated in Industrial Engineering from the Universitat Politècnica de Catalunya (1988) and holds a MBA from Columbia University (New York, 1990). After working as a financial analyst at Citibank NA and consultant at McKinsey & Co. he went to work for Ferrovial and Pacsa, two Spanish construction and service companies. In 1997 Mr. Vilá joined Telefónica as Group Controller, being promoted in 1998 to CFO at Telefónica Internacional and, subsequently, to Managing Director of Corporate Development at Group level. Mr. Vilá is Vice Chairman of the Board of Directors of Telco SpA (Italy) and member of the European Advisory Panel of Macquarie's MEIF 1, 2, 3 Funds. He previously served on the Boards of Banco Bilbao Vizcaya Argentaria (BBVA), CTC Chile, Cablevisión Argentina, Terra Lycos, Indra SSI, Telefónica Sistemas, Telefónica Data, Atento and Catalana d'Iniciatives.



Anselmo Enriquez Linares (*1965)

Member

Simon Linares having joined from Diageo where he was HR Director for the leading premium drinks company's Africa region, took up his position on 1 July 2008 as a new Group Human Resources Director and is responsible for the company's businesses in Europe outside of Spain, and also serves as a Member of the Board at Telefónica Europe plc. Simon has significant experience in management development at an international level thanks to his previous roles as HR Director for Africa and Iberia regions at Diageo. Prior to Diageo, Simon worked for a number of major companies in the financial services and consumer goods industries, including Barclays, Lloyds TSB and Grand Metropolitan. British born with Spanish parents, Simon is bilingual in English and Spanish. His global career experience has included responsibility for regions as diverse as Thailand, Latin America and North America. He currently resides in London.



Antonio Botas Bañuelos (*1963)

Member

He earned his Bachelor degree at Universidad Complutense in law and a Master degree in Economics and Business Administration (MBA) at IESE in Barcelona. He has twenty years of experience in management, operative and strategic marketing and co-ordination of large multinational teams, and he has worked in international markets, namely those in the Americas and Europe. He worked as Marketing Manager in Royal Insurance, which he joined after leaving Johnson & Johnson. He joined the Telefónica Group in 1995 and he worked for Telefónica Publicidad e Información, Doubleclick Iberoamérica, Terra and Terra Lycos in positions ranging from Chief Sales and Marketing Officer to Executive Vice President for New Business. From 2005 until August 2007 he worked as Chief Transformation and Convergence Officer in Telefónica O2 Czech Republic. Since September 2007 he holds the position of Managing Director Product Development & Brand Management at Telefónica O2 Germany GmbH & Co. OHG. He is member of the Supervisory Board of Telefónica O2 Czech Republic since April 2008. In 2010 he took the position of Director of International Coordination Global Marketing in Telefónica S.A.



Guillermo José Fernández Vidal (*1946)

Member

He holds a degree in Industrial Engineering and Computer Science and in 1989 he joined Telefónica, first as a manager and later he was promoted to Commercial Director (1992–1995) and General Manager of Companies of Telefónica (1995–1999). In 1999 he was appointed Chief Executive Officer of Telefónica Data and President of Telefónica Data España. In the same year he was also a member of statutory bodies at Telefónica Móviles, Telefónica de España, Vía Digital and Portugal Telecom. In 2003 he was appointed General Manager for Subsidiaries. From 2004 to 2005 he was General Manager for Commercial Development and Affiliates at Telefónica, S.A. In 2005 he was appointed as Corporate General Manager of Telefónica, S.A. and member of the board of Telefónica Móviles de España, Telefónica de España and TPI. He is presently advisor to Telefónica, S.A.



Eduardo Andres Julio Zaplana Hernández-Soro (*1956)

Member

Eduardo Zaplana has a degree in law and was the President of the regional Government of Valencia from 1995 to 2002. He has been a member of the Spanish Parliament and Senator, as well as the Spanish Minister for Labour and Social Affairs and government spokesman from 2002 to 2004. Among other official posts, he has also been President of the Commission for Regional Policy and Structural Funds, member of the Bureau and first Vice President at the Committee of the Regions (CoR). In April 2008, Telefónica appointed Eduardo Zaplana as the Company's representative for Europe. Telefónica has an office in Brussels and operations in the UK, Germany, Ireland, the Czech Republic and Slovakia. Mr. Zaplana is a member of the Board of Directors of Telefónica Europe plc from July 2008. In December 2008, Telefónica has carried out a reorganization of its directive structure to strengthen the sections depending from the Chairman, and specifically the Technical General Secretariat, and it has created a new position of Associate to the Technical Secretary General. This position will be occupied by Eduardo Zaplana, who widens in this way its field of action from his previous position related only to one of the geographical areas, Europe.



Petr Gazda (*1965)

Member

Graduated in Economics and Management (BA) from the Business College Ostrava. He has been with Telefónica O2 Czech Republic (and its legal predecessors) since 1991; he presently works as Network Operations Director for Regions; previously: 1991–2006 Eurotel Praha; 1988–1991 ČESKÝ TELECOM; 1986–1988 AŽD Praha, specialist; 1983–1984 AŽD Praha, electrical engineer. In the last five years he was not a member of any other statutory or supervisory bodies except for the Supervisory Board of Telefónica O2 Czech Republic, a.s.



Pavel Herštlík (*1951)

Member

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 O2 Czech Republic and member of the European Works Council of the European division of the Telefónica Group. He has not, for the last five years, been a member in another supervisory body of another company.



Tomáš Fírbach (*1976)

Member

Graduated in Management and Economics in Transportation from the Czech Technical University, Department of Transportation. After his graduation in 1999 he worked in JSJ spol. s r.o. as information systems manager. In 2001 he joined Eurotel Praha, spol. s r.o. (the legal predecessor of Telefónica O2 Czech Republic) as network planning specialist. In 2004–2005 we worked in ČD Telekomunikace, a.s. (presently ČD Telematika, a.s.) as business consultant. He has been with Telefónica O2 Czech Republic since 2005, working as Senior Product Manager for fixed line data services. In the last five years he was not a member of any other statutory or supervisory bodies except for the Supervisory Board of Telefónica O2 Czech Republic, a.s.



Dušan Stareček (*1956)

Member

Qualified in Electronic and Electrical Technology at the Technical and Engineering Secondary School in Rožnov p. Radhoštěm. In 1975, he started work as a technician at Long-distance Cables Administration, Prague (the legal predecessor of ČESKÝ TELECOM). In 1992, he was promoted to the position of Head of External Maintenance in the Transmission Technology Unit (the legal predecessor of Telefónica O2 Czech Republic). At present, he works as Specialist for Operation and Maintenance of Digital Telecommunications Technology in Ostrava. He is a member of the Trade Union Steering Committee of Telefónica O2 Czech Republic, Chairman of KOV MORAVA and member of EWC (European Works Council) at Telefónica Europe plc.

Personnel composition of the Supervisory Board of Telefónica O2 Czech Republic, a.s. as at 15 March 2010

Name	Function	Member since
Jaime Smith Basterra	Chairman of the Supervisory Board	21 April 2008
Alfonso Alonso Durán	1 st Vice Chairman of the Supervisory Board	23 June 2005
Lubomír Vinduška	2 nd Vice Chairman of the Supervisory Board	29 June 2008
Luis Lada Díaz	Member of the Supervisory Board	23 June 2005
María Pilar López Álvarez	Member of the Supervisory Board	21 April 2008
Enrique Used Aznar	Member of the Supervisory Board	3 April 2009
Ángel Vilá Boix	Member of the Supervisory Board	23 June 2005
Anselmo Enriquez Linares	Member of the Supervisory Board	3 April 2009
Antonio Botas Bañuelos	Member of the Supervisory Board	21 April 2008
Guillermo José Fernández Vidal	Member of the Supervisory Board	23 June 2005
Eduardo Andres Julio Zaplana Hernández-Soro	Member of the Supervisory Board	3 April 2009
Petr Gazda	Member of the Supervisory Board	29 June 2008
Pavel Herštík	Member of the Supervisory Board	29 June 2008
Tomáš Fírbach	Member of the Supervisory Board	29 June 2008
Dušan Stareček	Member of the Supervisory Board	29 June 2008

Information about the term of office of Supervisory Board members is given in sub-section Governing bodies of Telefónica O2 Czech Republic.

All changes in the personnel composition in the Board of Directors in 2009 were described in the 2008 Annual Report and in the 2009 Half-year Report. No changes occurred in the personnel composition of the Board of Directors in the second half of 2009.

No changes occurred in the personnel composition of the Supervisory Board in 2009 and in the period from 1 January to 15 March 2010.

Audit Committee (as at 15 March 2010)

Alfonso Alonso Durán (*1957)

Chairman

(résumé in section Supervisory Board)

Ángel Vilá Boix (*1964)

Vice Chairman

(résumé in section Supervisory Board)

Pavel Herštík (*1951)

Member

(résumé in section Supervisory Board)

Maria Pilar López Álvarez (*1970)

Member

(résumé in section Supervisory Board)

Jaime Smith Basterra (*1965)

Member

(résumé in section Supervisory Board)

Enrique Used Aznar (*1941)

Member

(résumé in section Supervisory Board)

Personnel composition of the Audit Committee of Telefónica O2 Czech Republic, a.s. as at 15 March 2010

Name	Function	Member since
Alfonso Alonso Durán	Chairman of the Audit Committee	3 April 2009
Ángel Vilá Boix	Vice Chairman of the Audit Committee	3 April 2009
Pavel Herštík	Member of the Audit Committee	3 April 2009
Maria Pilar López Álvarez	Member of the Audit Committee	3 April 2009
Jaime Smith Basterra	Member of the Audit Committee	3 April 2009
Enrique Used Aznar	Member of the Audit Committee	3 April 2009

Information about the term of office of Audit Committee members is given in sub-section Governing bodies of Telefónica O2 Czech Republic.

Principles of remuneration of persons with executive powers in the issuer

The group of persons with executive powers in Telefónica O2 includes the following executives: members of the Board of Directors, the Chief Executive Officer and those members of the executive management of the Company (sub-section Executive management) who are not members of the Board of Directors (persons who make decisions in the issuer, which can affect the future development and the corporate strategy of the issuer, and who have access to insider information).

The remuneration of members of the Board of Directors and the Supervisory Board (including the Supervisory Board committees), as well as the granting of other benefits to members of the Supervisory Board (and the Supervisory Board committees), are governed by the rules for the remuneration and provision of non-claim perquisites which are approved by the Company's General Meeting. The approval of the rules for provision of non-claim perquisites to members of the Board of Directors is, as per the Company's Articles of Association (Article 20(3d)), in the competence of the Company's Supervisory Board. The adequacy of the system of remuneration (and other benefits) and any modifications thereto are reviewed and proposed by the Nomination and Remuneration Committee of the Supervisory Board (see sub-section Committees established by the governing bodies of the Company below).

The rules of remuneration provide specific amounts of remuneration for individual categories of members of the Board of Directors and of the Supervisory Board (including the Supervisory Board committees), i.e. remuneration which a regular member, vice-chair and chair of the body are entitled to, as well as other conditions for its granting. Each member of the Board of Directors/Supervisory Board is entitled for the 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.

With respect to the situation described in the 2008 Annual Report, the only changes made to the remuneration principles for members of the Company's governing bodies were those required by or as a result of the institution of the Audit Committee as a new independent body of the Company. In the case rules for remuneration of the Supervisory Board member, the change is only technical; the dissolution of the Audit and Control Committee required that the relevant provisions concerning the remuneration for working in the committee be deleted. The other rules remained unaffected. The Ordinary General Meeting of the Company in 2009 also decided to update the Rules for Provision of Non-claim Perquisites to Supervisory Board Members. The rules dated back to 2003, and the amendment concerned the consolidation of items dealing with communication and IT equipment into one, while the financial limit for this benefit was simultaneously reduced by a significant margin; another change concerned the deletion of the item Capital Life Insurance.

Basic information about the rules for the remuneration, including a list of provided non-claim perquisites, 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 O2 is published in the Czech and English languages on the Company's website.

The Board of Directors and Chief Executive Officer

a) Remuneration

The rules for the remuneration of members of the Company's Board of Directors, whose key principles are outlined above, implement 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 Board of Directors is liable to pay due to the fact that they are covered by a liability insurance for any damage arising from the performance of a member of the Board of Directors, and mandatory payments arising from the provision of the amount as per this sentence. The amount depends on the amount of insurance premium attributable to the member of the Board of Directors; the overall amount is calculated using methods common in the business of insurance;
- an amount attributable to the individual categories of members of the Board of Directors for the number of meetings attended: (i) member of the Board of Directors: CZK 25,000; (ii) Vice Chair of the Board of Directors: the amount as in (i) increased by CZK 10,000; Chair of the Board of Directors: the amount as in (ii) increased by CZK 10,000.

The Chief Executive Officer is also entitled by virtue of his/her function to additional remuneration which comprises the following components:

- basic gross salary;
- performance-related bonus;
- compensation of the balance between the health insurance benefits and 100% of the average daily wage.

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 against these targets is evaluated by the Board of Directors and discussed by the Nomination and Remuneration Committee; the audited financial results and, in the case of customer experience, independent (external) surveys form the basis for consideration. 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). In the event of temporary work incapacity, the Company will compensate to the Chief Executive Officer, for each day of the work capacity, the balance between the health insurance benefits and the 100% of the average daily salary.

The remuneration due to persons who are members of the Board of Directors by virtue of performing an executive (management) function in Telefónica O2 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 40% or 50%, respectively, 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.

b) Compensation for the commitment to a non-competition covenant

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

Compensation for the commitment to the non-competition covenant is based on the following principles:

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

Upon terminating his/her employment, the Chief Executive Officer is bound by the non-competition covenant covering the whole Telefónica Group.

c) In-kind benefits**Damage liability insurance**

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.

Capital life insurance

No capital life insurance has been contracted for members of the Board of Directors in relation to their duties as members.

Car

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 management position, entitled to the same benefit.

The Supervisory Board

a) Remuneration

The rules for the remuneration of members of the Company's Supervisory Board, whose key principles are outlined above, implement 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 he/she is covered by a liability insurance for any damage arising from the performance of a member of the Supervisory Board, and mandatory payments arising from the provision of the amount as per this sentence. This amount depends on the amount of insurance premium attributable to the member of the Supervisory Board; the overall amount is calculated using methods common in the business of insurance;
- an amount attributable to the individual categories of Supervisory Board members for the number of meetings attended: (i) member of the Supervisory Board: CZK 40,000; (ii) Vice Chair of the Supervisory Board: the amount as in (i) increased by CZK 10,000; Chair of the Supervisory Board: the amount as in (ii) increased by CZK 10,000.

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

b) Compensation for the commitment to a non-competition covenant

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

Compensation for the commitment to the non-competition covenant is based on the following principles:

- the non-competition covenant is accepted for a period of six months as of the termination of office;
- the Company is obliged to provide to the member of the Supervisory Board 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 member of the Supervisory Board, in the month preceding the month in which the member of the Supervisory Board terminated their position in the Supervisory Board; the fact that any member of the Supervisory Board has or has not made a claim to their remuneration is not considered in the calculation of the average flat remuneration.

c) In-kind benefits

Damage liability insurance

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.

Capital life insurance – this discretionary benefit was deleted by decision of the General Meeting of 3 April 2009 from the Rules for the Provision of Non-Claim Perquisites to Supervisory Board Members as part of the amendment to this policy. For the part of the year 2009 before the date of the General Meeting, no endowment insurance was contracted for the benefit of Supervisory Board members.

Car

The Supervisory Board Chair and Vice Chair are, according the Rules approved by the General Meeting, entitled to a higher middle class car for work and private use. This benefit has not been claimed since mid-2005.

Other benefits

The company also granted the following benefits to members of the Board of Directors (including the Chief Executive Officer) 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);
- communication and IT equipment (mobile telephone, desktop PC or notebook, PDA, including accessories) for business and private use (excluding doing business in one's own name);
- VISA payment card (in the case of the Supervisory Board, only the Chairman and Vice Chairmen were eligible; the benefit has not been claimed in 2009);
- healthcare.

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 O2 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 discretionary benefits to members of the relevant governing body.

Other information relating to persons with executive powers

Information about all pecuniary and in-kind incomes accepted in the accounting period by persons with executive powers (with the exception of persons who make decisions in the issuer, which can affect the future development and the corporate strategy of the issuer, and who have access to insider information) from Telefónica O2 and entities controlled by it

(in CZK)	Pecuniary income	Of which royalties	In-kind income
Board of Directors – total	76,373,681	–	35,832,175
– of which by virtue of membership in the issuer's Board of Directors	460,716	–	1,679,937
Supervisory Board – total	10,955,706	–	4,001,137
– of which by virtue in the issuer's Supervisory Board	5,289,434	–	3,599,865

The above stated persons with executive powers received no pecuniary or in-kind income from entities controlled by Telefónica O2 in 2009.

For the sake of reporting continuity with regard to data published in annual reports of Telefónica O2 in the past years, we chose to go beyond the scope of the statutory disclosure requirement and include below also information about all pecuniary income received in the accounting period by members of the executive management of the Company.

(in CZK)	Pecuniary income	Of which royalties	In-kind income
Executive management ¹	26,442,095	–	6,604,747

¹ The category Executive Management of the Company includes income of persons listed in the sub-section Executive Management; the income of these persons who are at the same time members of the Board of Directors is shown in the table above, line Board of Directors – total

Information on the number of shares issued by Telefónica O2 and held by statutory bodies or their members, persons with executive powers, including persons related to these persons, information on option and similar agreements, information on individual transactions concluded by the said persons in the accounting period

	Number of shares
Board of Directors	–
Supervisory Board	100
Audit Committee ¹	–
Other persons with executive powers – Executive management ²	–
Persons related to persons with executive powers	100

¹ The shares held by members of the Audit Committee who are members of the Supervisory Board are included in the Supervisory Board total category.

² The Executive management category includes the shares held by executives in the positions that members of the Executive Management of Telefónica O2 (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 included in the Board of Directors total category.

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 with the issuer

In 2009, all members of the Board of Directors and of the Supervisory Board were bound by a valid agreement for discharge of the office of a member, which stipulates the eligibility for compensation for members who had committed to the non-competition covenant after the termination of their office.

Telefónica O2's Declaration of Compliance with the Code of Good Corporate Governance based on OECD Principles (2004)

Telefónica O2 made a commitment to the principles of Good Corporate Governance already in its 2001 Annual Report; it has been making regular statements in its annual reports, concerning the progress of implementation of the principles of Good Corporate Governance in its practices. The Company has been meeting all the main criteria and observing the principles and recommendations of the Czech Code of Good Corporate Governance based on OECD Principles, which was published in 2004 (the Code). The Code is available at the website of the Ministry of Finance of the Czech Republic (www.mfcr.cz). An exception to this rule are the principles of Good Corporate Governance that are not in direct control of the Company's governing bodies and are dependent on the decisions of its owners (in particular the criterion concerning the number of independent members of the Supervisory Board). The Board of Directors regularly oversees the good practice of Corporate Governance in subsidiaries controlled by Telefónica O2.

Corporate Governance

The proven Corporate Governance model, which Telefónica O2 has been developing continually since 2006, was changed in April 2009 by decision of the General Meeting which passed an amendment to the Company's Articles of Association that led to the institution of a new independent body – the Audit Committee. The model, as per the Articles of Association, is based on interaction between the executive Board of Directors, made up exclusively of executive managers of the Telefónica O2 Group, and the Supervisory Board. The Supervisory Board has powers to control key decision-making processes (using the mechanism of "prior standpoints" of the Supervisory Board to selected issues) and monitor other important aspects of the Company's operation. The powers of the Supervisory Board and their discharge make a full and active use of advisory and initiative roles of the Supervisory Board's committees. The controlling, supervisory and review function in the model of Corporate Governance in Telefónica O2 has been strengthened by the independent position of the Audit Committee. An integral part of the model is the combination of the Chief Executive Officer's function with the function of Chairman of the Board of Directors, which the Company finds efficient and acceptable given the strong role of the Audit Committee and the active involvement of its committees.

Organisation of Corporate Governance

The activities of the governing bodies of the Company in 2009 confirmed the relevance and effectiveness of the Corporate Governance model of Telefónica O2, including its fast adaptation to the existence of the independent Audit Committee with broad powers – which resulted in a higher quality of Corporate Governance in the Company.

An Ordinary General Meeting of the Company was held on 3 April 2009. The agenda of the Company's supreme governing body comprised standard items relating to the operations of the joint-stock company, and matters relating to the institution of the Audit Committee as a new body of the Company. The proposed amendment to the Company's Articles of Association included, in addition to insertion of provisions dealing with the institution of the Audit Committee and the dissolution of the Audit and Control Committee, which had been a mandatory committee established by the Supervisory Board. Other amendments to related articles concerned, for example, the extra powers granted to the General Meeting, especially in the matter of nominations to the Audit Committee, and in relation to awarding bonuses and other benefits to members of this body. Newly the General Meeting now also has the authority

to pass a decision on the selection of the external auditor of the Company to carry out the obligatory audit. Telefónica O2 was the first corporation in the Czech Republic to have responded to the adoption of the EU Directive 2006/43/EC on statutory audit of annual accounts and consolidated annual accounts into the Czech national law (by way of the Czech law on auditors), and already before the legislative process was completed, it modified its Corporate Governance model. More information about the Audit Committee is given below. A detailed overview of the conclusions of the Ordinary General Meeting is available on the Company's website and was also published in the 2009 Half-year Report. Information about the dividends, the record and disbursement dates for the dividend payment is given in section Other information for shareholders and investors of this Annual Report. The decision making procedure at the General Meeting is outlined in the Company's Articles of Association (Articles 10 and 11); the Articles of Association are available on the Company's website (see also sub-section Transparency and open information policy) and also form a part of the Rules of Procedure of the General Meeting, the key principles of which are highlighted in sub-section Shareholder relations; the sub-section Governing bodies of Telefónica O2 Czech Republic details information on the scope of authority of the supreme governing body of the Company.

The Board of Directors held twenty five meetings in 2009, thus complying with the duty to hold a minimum of twelve meetings each year. The personnel changes in the Board of Directors in the period January-March 2009 were detailed in the 2008 Annual Report. In October 2009, the Supervisory Board discussed a resignation of Juraj Šedivý, the 1st Vice Chairman of the Board of Directors, from his membership in the Board of Directors (Mr. Šedivý's decision to leave the Telefónica Group also meant that he stepped back as the Statutory Representative and Chief Executive Officer of the subsidiary Telefónica O2 Slovakia, s.r.o.); in his stead, the Supervisory Board elected John McGuidan as member of the Board of Directors. John McGuidan also succeeded Juraj Šedivý in both of his previous positions in Telefónica O2 Slovakia. Jesús Pérez de Urquien was elected 1st Vice Chairman of the Board of Directors. On 1 February 2010, the previously announced alternation in the position of Chief Executive Officer of Telefónica O2 took place; Salvador Anglada Gonzalez, who is leaving for an executive position in the parent Telefónica, S.A., was succeeded by Luis Antonio Malvido, who was also elected member, and subsequently also Chairman of the Board of Directors of the Company. The full list of members of the Board of Directors, including their professional résumés, and the personnel changes in the Board of Directors are given in sub-section Board of Directors.

The decision making procedure at meetings of the Board of Directors is laid down in the Company's Articles of Association (Articles 16–18); the activities of the Board of Directors observe the Rules of Procedure. Both documents are available on the Company's website (see also sub-section Transparency and open information policy).

The Supervisory Board held five meeting in 2009, which was in accordance with the Company's Articles of Association. The practice has settled on the most effective pattern of regular quarterly meetings (February, April, July, October) dedicated, among other things, to the discussion of regular (periodic) financial statements given by the Company to its shareholders; in addition, one meeting is held primarily in preparation for the General Meeting. The personnel changes in the Supervisory Board in the period January-March 2009 are detailed in the 2008 Annual Report. In the remaining period of 2009 and in the first quarter of 2010 (until 15 March 2010), no personnel changes occurred in the Supervisory Board; only the Ordinary General Meeting of the Company, which was held on 3 April 2009, the membership of co-opted members of this body were confirmed by election at the Ordinary General Meeting which was held on 3 April 2009. The members were: Eduardo Andres Julio Zaplana Hernández-Soro, Anselmo Enriquez Linares and Enrique Used Aznar. The full list of personnel changes in the Supervisory

Board in the given period, including its current personnel composition as at 15 March 2010 and professional résumés of all members of this body, is given in sub-section Supervisory Board. None of the Supervisory Board members as at 15 March 2010 met the criterion of independence.

The decision making procedure at meetings of the Supervisory Board is laid down in the Company's Articles of Association (Articles 22–24); the activities of the Supervisory Board observe the Rules of Procedure. Both documents are available on the Company's website (see also sub-section Transparency and open information policy).

The Audit Committee (AC) of the Company is an independent body of the Company holding special powers in matters relating to statutory audit, compilation and auditing of the financial statements and assessing the effectiveness of the internal control system of the Company. The position and scope of authority of the AC are laid down in Article 26a of the Company's Articles of Association. The committee has six members; by decision of the Ordinary General Meeting of 3 April 2009, the following members were elected: Alfonso Alonso Durán, Ángel Vilá Boix, Jaime Smith Bastera, Pavel Herštík, Maria Pilar López Álvarez and Enrique Used Aznar, all members of the Company's Supervisory Board. Alfonso Alonso Durán and Ángel Vilá Boix, respectively, were elected Chairman and Vice Chairman of the AC. The full list of members of the Audit Committee is given also in sub-section Audit Committee. Since its institution on 3 April 2009, the AC held three meetings: in April, July and October (i.e. once in a quarter). Previously in 2009, the predecessor body, the Audit and Control Committee of the Supervisory Board (see sub-section Committees established by the governing bodies of the Company below), held two meetings. The Audit Committee is in close contact with the external auditor and also with the Internal Audit and Risk Management Unit. The committee receives and evaluates information about matters that could jeopardise the independence of the external auditor or the process of auditing the Company's accounts, which includes, among other things, also the mechanism of mandatory review of proposals for engaging the services of the external auditor for non-auditing activities in the Company by the Audit Committee, prior to their possible approval by the Company's Board of Directors. The AC has the authority to make recommendations to the General Meeting which selects the external auditor for the statutory audit. Other key activities of the AC include the review of audit reports presented by the Internal Audit and, as per the Internal Audit Charter, the related mandatory participation in the setting and approval of the annual plan of internal audits, approval of the Internal Audit budget and the annual evaluation of the performance of the Internal Audit Unit. Via the CG Portal (see below), members of the AC have a non-stop access to all current and archived documents and reports from Internal Audit and Risk Management.

The rules for the remuneration of the Audit Committee are based on the rules for the remuneration of members of the Supervisory Board; however the remuneration principle (a set amount for each meeting of the committee) and the individual amounts of remuneration for the performance of the office of a member, vice chair and chair of the committee stay the same as in the case of the dissolved Audit and Control Committee of the Supervisory Board. The rules for the remuneration of members of the Audit Committee, whose key principles are outlined above, implement 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 Audit Committee is liable to pay due to the fact that they are covered by a liability insurance for any damage arising from the performance of a member of the Audit Committee, 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 Audit Committee; the overall amount is calculated using methods common in the business of insurance;

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- an amount attributable to the individual categories of Audit Committee members for the number of meetings attended: (i) member of the Supervisory Board: CZK 20,000; (ii) Vice Chair of the Supervisory Board: the amount as in (i) increased by CZK 12,000; Chair of the Supervisory Board: the amount as in (ii) increased by CZK 15,000.

In 2009, members of the Audit Committee received pecuniary income in the amount of CZK 2,490,516, and in-kind income in the amount of CZK 1,519,209 from the Company; of these amounts, CZK 120,000 for membership in the Audit Committee and no in-kind income. In 2009, members of the Audit Committee did not receive any pecuniary or in-kind income from companies controlled by Telefónica O2.

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

Compensation for the commitment to the non-competition covenant is based on the following principles:

- the non-competition covenant is accepted for a period of six months as of the termination of office;
- the Company is obliged to provide to the member of the Audit Committee in question, for committing to the non-competition covenant, compensation equalling the amount to which members of the Supervisory Board are eligible, i.e. 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 member of the Audit Committee, in the month preceding the month in which the member of the Audit Committee terminated their position in the Audit Committee; the fact that any member of the Supervisory Board has or has not made a claim to their remuneration is not considered in the calculation of the average flat remuneration.

The rules for provision of non-claim perquisites to members of the Audit Committee are a modified form of the updated rules for awarding discretionary benefits to members of the Supervisory Board of the Company (the benefits include the same voice and data services and products of the Company for business and private use, communication and IT equipment, damage liability insurance for members of governing bodies and healthcare; the committee chair is also entitled to a company payment card). The rules for provision of non-claim perquisites to members of the Audit Committee stipulate the principle according to which a member of the committee who is at the same time a member of the Supervisory Board of the Company cannot claim the same item (form) of benefit twice – only once.

The decision making procedure at meetings of the Audit Committee is laid down in the Company's Articles of Association (Articles 26c–26e); the activities of the Audit Committee observe the Rules of Procedure. Both documents are available on the Company's website (see also sub-section Transparency and open information policy).

For the sake of expedient and effective acquaintance with the Company, new members of the Board of Directors, Audit Committee, the Supervisory Board and its committees have, already upon assuming their function, a special set of comprehensive and structured Corporate

Governance information and documents available to them, as well as having access to all other current and archived documents which they may require for the due discharge of their function. The information is disseminated via the Corporate Governance Portal of the Telefónica O2 Group (CG Portal).

The previously existing position of Company Secretary is at the executive level in the new corporate governance model of Telefónica O2 formally combined with that of General Counsel. The Company Vice-Secretary assists in and provides for the Corporate Governance processes in the Telefónica O2 Czech Republic Group; the Company Vice-Secretary is the secretary to the Board of Directors, the Audit Committee and to the Supervisory Board and its committees.

As part of performing internal controls in the area of financial reporting, the Company has implemented the key requirements of the Sarbanes-Oxley Act (SOX), which it is bound to respect – principally as a result of the fact that the shares of the parent Telefónica, S.A. are listed on the US capital markets. Twice a year the Company performs an evaluation of its internal controls in the area of financial reporting in the scope of the regulatory framework introduced by SOX Section 404, including an evaluation of the controlling mechanism in the area of the Company's information systems that could have a potential impact on the bottom line of the Company. The audits verify the standard of the description, configuration and 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 are discussed with the external auditor of the Company. The audits performed in 2009 concluded that the internal controls, as applied, were of a standard which meets the SOX requirements. The quarterly declaration of the management (Chief Executive Officer and Vice President, 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 2009, the internal audit and risk management function in the Company continued to be developed; the organisation of these functions (which are consolidated into one organisation unit), the line management of the Chief Executive Officer and the functional subordination to the Corporate Governance area in the Company (in the first quarter of 2009 to the Audit and Control Committee and later to the Audit Committee) remained as before. From 1 April 2009, Andrés Romero Dexeus was appointed Director, Internal Audit and Risk Management, based on a recommendation by the Audit and Control Committee and the positive standpoint of the Supervisory Board. Mr. Romero's résumé is given in half-year report 2009.

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 2009, Internal Audit and Risk Management carried out 41 audits and controls (including the regular audit of internal controls per SOX 404 requirement), 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 O2, the Internal Audit unit also acts as internal auditor of Telefónica O2 Slovakia. The audit conclusions were used by the management to

formulate actions to redress the issues identified. Internal Audit monitors the implementation of such actions and reports to the governing bodies and the executive management. The work of Internal Audit is monitored on a regular basis by the Audit Committee (by the Audit and Control Committee in the first quarter of 2009). The activities of Internal Audit and its main processes are laid down in the Internal Audit Charter of Telefónica O2 Czech Republic, which also stipulates the principle of independence of the Internal Audit function and the principle of objectiveness of internal auditors. The Charter was last amended in July 2009; the change was only technical and related to the institution of the Audit Committee as an independent body of the Company.

In 2009, the Company continued in the development of its Risk Management function and in its harmonisation with the methodology and practice in the global Telefónica Group, which creates more space for the sharing of experience and knowledge in the area of mitigation of specific risks with the parent company and other members of the Group. The risk management system covers all areas of operations of Telefónica O2, including its subsidiary Telefónica O2 Slovakia, and provides for the identification, assessment and mitigation of risks, which it continues to monitor throughout. The Board of Directors and the Supervisory Board receive regular monthly reports containing information about key risks and their development over time. The Audit Committee is concerned with the risk management primarily from the point of assessing its effectiveness and adequacy (whether the key risks of the Company are adequately identified and managed); to this end, the committee receives regular reports from the Risk Management Unit of Telefónica O2 Czech Republic, and information about the methods used, the processes of risk management, etc. More information about risk management is given in sub-section Risk management of the Annual Report.

An electronic platform, the so-called CG Portal, is operated and continually developed in Telefónica O2 Czech Republic. It supports the exercise of powers of all governing bodies and provides for efficient administration of Corporate Governance in Telefónica O2 Czech Republic and its group. It is a comprehensive and modern solution with archiving, distribution, organisation, education and information functions, which are used both by regular employees and the members of the governing bodies of the Company and its subsidiaries. The system supports the configuration of several levels of access privileges and has a secure remote access to all data through fixed line and mobile technology. The instrument confers equal access to archived and current documents and information to all members (executive and non-executive) of the relevant governing bodies, irrespective of any local or time limitations. The document management system of the Company stores several dozens of thousand open domain and classified documents (both in Czech and in English); in addition to the minutes of meetings, the system also stores internal audit reports and risk reports, information about the Telefónica O2 Czech Republic Group and its subsidiaries, etc. For more detail of the content and the main functions of CG Portal please refer to the 2006 Annual Report. The portal is currently used also as a platform for supporting and administrating other activities in the general sphere of Corporate Governance. It is mainly the agenda of the Business Principles (including the operation of a confidential whistle-blowing channel for reporting of suspected ethical malpractices), and other priority areas of the Company's Compliance Programme. The focus of attention is on risk prevention; to this end, the Company employs online courses as a primary instrument. The results achieved in this area in 2009 are recapitulated in sub-section Business principles and compliance.

Shareholder relations

A strict compliance with all the statutory rights of shareholders, commitment to the principle of equal treatment of all shareholders of a similar standing, while respecting the specific statutory rights of minority shareholders belong among the key guiding principles of Corporate Governance of Telefónica O2. In 2009, too, the Company fully honoured its commitment to the

shareholders. Moreover, it went beyond practice usual in the Czech Republic and beyond its statutory duties and published ahead of time on its website a set of proposals and documents which were presented to the Ordinary General Meeting of the Company.

The Company is scrupulous about the timely and full information to all shareholders about the developments in the Company, its financial results and business plans; in doing so, the Company has always strived and managed to exceed the scope of minimum statutory disclosure. The Company uses its website as the main platform for communication (section About Us). The Company publishes regular press releases with the quarterly financial results and announces all significant events and developments.

When organising General Meetings, the Company proceeds in a way that guarantees the compliance with all the statutory conditions and with the Articles of Association, whilst observing to the maximum extent possible the requirements of the Code which concern the rights of shareholders and their fair treatment. The Company publishes the date of the General Meeting well in advance on its website; the date, time and venue of the General Meeting are chosen on the merit of ready access and availability. The Rules of Procedure of the General Meeting, despite the fact that they haven't deviated from the standard language, are approved at each meeting of the governing body. Despite the fact that they have not deviated from the standard language the shareholders have not made any motions to amend the Rules of Procedure. The Rules of Procedure allow shareholders to participate effectively in decision-making on fundamental changes in the Company and to ask questions and seek information on matters included on the agenda of the General Meeting. The draft Rules are available to shareholders on the Company's website and in Telefónica O2 headquarters on the day of the publication of the date of the General Meeting. The proposal of the Rules of Procedure for the upcoming General Meeting was, also in 2009, available to the shareholders on the Company's website and at its registered address already upon the publication of the announcement of the General Meeting. The Rules of Procedure of the General Meeting contains the following main provisions:

- Shareholders can exercise their rights at the General Meeting either in person or by proxy; they can vote on the proposed items on the agenda, receive, in accordance with the Commercial Code, explanations in matters relating to the Company, or any undertakings controlled by it, as the case may be, provided the explanation is necessary for understanding the matter addressed by the General Meeting, and they also have the right in accordance with the Commercial Code to raise proposals and counterproposals. Shareholders may lodge a protest against a decision of the General Meeting and demand that it be recorded in the Minutes of the General Meeting.
- As a rule, any requests for explanation, proposals, counterproposals and protests must be made by shareholders in writing, and filed with the information centre. Upon making the motion it must be specified whether it is a request for explanation, proposal, counterproposal or a protest. Any requests for explanation, proposals, counterproposals and protests submitted in writing must be legibly undersigned by the shareholder in question or their proxy.
- In keeping with the Commercial Code and the Company's Articles of Association, the Board of Directors is obliged to provide an explanation upon request, in matters concerning the agenda of the General Meeting.
- At the General Meeting, a proposal by convener of the General Meeting is subjected to a vote first; if not passed, other proposals and counterproposals relating to the point in question are voted on, in the order in which they were submitted. As soon as a motion is passed, other counterproposals are not subjected to a vote. The Chairperson of the General Meeting is obliged to ensure that, prior to voting at the General Meeting, the shareholders are informed of all proposals and counterproposals made by shareholders in relation to the item of the agenda of the General Meeting which is put to a vote.

Also in 2009, all the necessary documents were available to all shareholders in print form, in two languages (Czech and English). The shareholders had the opportunity to study the principal documents (financial statements, report on the relationships with related undertakings, and any proposed amendments to the Articles of Association that may be on the agenda) within the statutory period prior to the date of the General Meeting in the premises of the Company's headquarters; upon registration for the General Meeting, they received a full file of documents to be discussed at the meeting, including an overview of statements to be made by members of the Board of Directors in respect of the main points on the agenda. All the documents for the General Meeting and other relevant documents (e.g. the Articles of Association) were available to the shareholders also at the information centre which the Company operates for its shareholders at every General Meeting. Each point on the agenda was voted on separately, after the discussion on that point had been concluded. In addition to members of the Board of Directors and of the Supervisory Board (including its committees), as well as the representatives of the external auditor, were also available to take questions from shareholders throughout the General Meeting. A public notary is present for the whole duration of the General Meeting.

All motions (questions, requests for explanation, counterproposals and proposals) made by shareholders during the Ordinary General Meeting of 3 April 2009 (twenty one in total) were adequately addressed by the members of the Board of Directors and subsequently they were, together with the answers, recorded in the Minutes of the General Meeting. Shareholders did not raise any questions to Supervisory Board members, the chairpersons of the Supervisory Board committees and to representatives of the Statutory Auditor.

Transparency and open information policy

Telefónica O2 scrupulously and diligently complies with all national and community laws and the principles of the Code. In line with its mandatory duties and voluntary commitments, Telefónica O2 continually and pro-actively provides shareholders and investors with all vital information on its business, financial standing, ownership structure and governance issues. Furthermore, the Company is very scrupulous in seeing that all price-sensitive information and facts are disclosed in a full and timely manner. The Company also publishes various information beyond the scope of the disclosure duties on its website, and intends to continue its open information policy toward shareholders. The Company strives to provide the shareholders and investors with everything they may need for making qualified decisions regarding the ownership of the Company stock, and in voting at General Meetings. To this end, the Company uses various information channels and instruments: print media (Commercial Bulletin, Hospodářské noviny, annual and half-year reports, etc.), but more importantly the means of electronic communications, especially the Company website. The website (particularly the section About Us) provides investors and shareholders with all corporate documents and various information about the Company in the Czech and English languages. The Company regards the electronic platform for disseminating information as key, especially since many of its shareholders are international legal and natural persons; the website facilitates access to information about the Company, especially for the international institutional investors and for small shareholders. This in turn improves their opportunities for their active, effective and valid participation in the decisions relating to the matters of the Company.

The policy of transparency dictates that the Company makes sufficient disclosure about the remuneration of members of the Board of Directors and the Supervisory Board of the Company (and of the Supervisory Board committees). This matter is addressed in detail in sub-section Principles of remuneration of persons with executive powers in the issuer, which describes and explains the principles of the system for the remuneration of members of the Board of Directors,

the Supervisory Board and other persons, and iterates other emoluments provided by the Company to these persons. The subsequent section (Other information relating to persons with executive powers) gives an account of benefits claimed in the past period. The Company's website contains the current and previous versions of documents in this area (Rules for the Remuneration of Members of the Board of Directors, Rules for the Remuneration of Members of the Supervisory Board, Rules for the Granting of Discretionary Benefits to Members of the Supervisory Board). Members of the Board of Directors and of the Supervisory Board are entitled only to emoluments approved by the General Meeting, while the consideration of the adequacy and mechanisms of the remuneration system, and any changes thereto, are in the remit of the Nomination and Remuneration Committee of the Supervisory Board. The same principle and scope of transparency apply to the remuneration of the newly instituted Audit Committee as an independent body of the Company (information about the rules for the remuneration of members of this committee, and the value of pecuniary and in-kind benefits granted to members of the Audit Committee in 2009 is given in sub-section Organisation of Corporate Governance).

In line with its Business Principles, Telefónica O2 practices a zero tolerance of conflicts of interest. The procedures for the consideration and decisions in the governing bodies are aligned in a way that prevents members of the governing bodies from voting on matters which could compromise their impartiality (affiliated transactions). Potential conflicts of interests stemming from membership in the governing bodies of other companies, involvement in commercial transactions and other defined situations are subject to a regular review by the Ethics and Corporate Social Responsibility Committee (see sub-section Committees established by the governing bodies of the Company below).

The Company is scrupulous about the prevention of insider trading for unlawful personal enrichment in trading in the Company's shares; in this respect, it is compliant with the applicable community and Czech laws, as well as with rules adopted by the UK Financial Services Authority. The Company has adopted a strict internal policy, which sets the limits for the disposal of shares issued by the Company or by undertakings that it controls. Telefónica O2 keeps a regularly updated list of persons (members of governing bodies, employees, external persons) who would qualify as insiders in possession of such information.

Committees established by the governing bodies of the Company

The Supervisory Board committees have been an integral part of the Company's system of Corporate Governance since 1996 and continue to play a major role in discharging the powers of the Supervisory Board. In the definition of the remit and role of the committees, the Company observes the Code and the Commission Recommendation 2005/162/EC on the role of non-executive or supervisory directors of listed companies and on the committees of the (supervisory) board, which was amended by Recommendation 2009/38/EC from April 2009. Basic information about the committees established by the Supervisory Board is given in sub-section Governing bodies of Telefónica O2 Czech Republic.

The decision making procedure at meetings of the committees of the Supervisory Board is laid down in the Company's Articles of Association (Article 26); the activities of the committees observe the Rules of Procedure. All documents are available on the Company's website (see also sub-section Transparency and open information policy).

The Audit and Control Committee (ACC) worked in Telefónica O2 until 3 April 2009, when it was dissolved by decision of the Ordinary General Meeting which passed an amendment to the Company's Articles of Association; in its stead, the Audit Committee was instituted as an

independent body of the Company. The ACC had five members and in the first quarter of 2009 (until 3 April 2009) it had the following members: Alfonso Alonso Durán, Chairman; Ángel Vilá Boix, Vice Chairman; Maria Pilar López Álvarez, Jaime Smith Basterra and Pavel Herščík, members. No member of the committee had been a certified accountant; all ACC members nevertheless met, by virtue of their education, professional path, practical experience and continued education in the field, all the requirements for due discharge of the office of a member of this key committee. The role and scope of the ACC authority were described in the Company's 2008 Annual Report (Section Corporate Governance). In 2009 (until 3 April 2009) the ACC held two meetings.

The Nomination and Remuneration Committee (NRC) has five members and is, as per the Articles of Association, a mandatory committee of the Supervisory Board. The committee reviews in particular all matters relating to personnel changes in the Board of Directors, the Audit Committee, the Supervisory Board and the Supervisory Board committees. The committee also gives a standpoint on any nomination proposals for vacancies in the governing bodies of members of the Telefónica O2 Czech Republic Group. The NRC's remit extends to reviewing the remuneration and other benefits granted to members of the Board of Directors and the Supervisory Board. The committee continually monitors and assesses the performance of members of the Board of Directors, the Audit Committee, the Supervisory Board and its committees; in this respect, the NRC also assesses the need for and promotes further education of members of the governing bodies, in particular in professional disciplines and languages.

The committee held two meetings in 2009. The NRC worked in the same composition throughout the year. As at the end of 2009, the committee had the following members: Jaime Smith Basterra, Chairman; Alfonso Alonso Durán, Vice Chairman Luis Lada Díaz, Guillermo José Fernández Vidal and Anselmo Enriquez Linares, members.

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

The committee held two meetings in 2009 and worked in the same composition throughout the year. As at the end of 2009 the ECSRC had the following members: Pavel Herščík, Chairman; Dušan Stareček, Vice Chairman; Jaime Smith Basterra, Tomáš Fírbach, Luis Lada Díaz and Guillermo José Fernández Vidal, members.

Company policy towards stakeholders

Telefónica O2 values Corporate Social Responsibility (CSR) as an integral part of its operations and business. Given the scope and volume of the Company's CSR initiatives, the Annual Report now contains a separate section (Corporate Social Responsibility (CSR)) dedicated to Corporate Social Responsibility.

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

The figures and information relating to matters under Sections 118(5a)–118(5l) of the Act No. 256/2004 Coll., the Capital Market Undertakings Act (CMUA):

- a) Information about the issuer's equity capital structure, including shares not admitted for trading on the regulate 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 O2 as at 31 December was as follows:

(in CZK millions)	
Share capital	32,209
Share premium	24,374
Hedge fund	–
Fund for share-related payments	36
Funds	6,450
Retained earnings	14,721
Total	77,790

The Company's share capital as at 31 December 2009 was CZK 32,208,990,000 and was fully paid up.

The share capital is made up of the following shares:

- | | | |
|----|---------------------|--------------------|
| A. | Type: | ordinary share |
| | Form: | bearer share |
| | Kind: | booked |
| | Number of shares: | 322,089,890 shares |
| | Nominal value: | CZK 100 |
| | Total issue volume: | CZK 32,208,989,000 |
| | ISIN: | CZ0009093209 |
| B. | Type: | ordinary share |
| | Form: | registered share |
| | Kind: | booked |
| | Number of shares: | 1 share |
| | Nominal value: | CZK 1,000 |
| | Total issue volume: | CZK 1,000 |

As of the effective date of the agreement on the transfer of shares between Telefónica S.A. (Telefónica) and the National Property Fund of the Czech Republic, the registered share has lost the special rights which were attached to it pursuant to the provisions of Article IV (2) of Act No. 210/1993 Coll., amending Act No. 92/1991 Coll., on the conditions of transfer of state property to other entities, as amended.

The rights and obligations related to the registered share which represents a share in Telefónica O2 are set out in Article 5 of the Articles of Association of the Company.

The bearer shares in the nominal value of CZK 100 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.	On the main market
London Stock Exchange	In the form of Global Depositary Receipts (GDR). The depository for the GDR is The Bank of New York Mellon, ADR Division, 101 Barclay Street, West New York, NY 10286, USA; the custodian is Komerční banka, a.s., Na Příkopě 33, čp. 906, 114 07 Prague 1.

A full wording of the Terms and Conditions of the Share Issue – the document which is the source of this summary – is available at the registered address of the security issuer. The registered share in the nominal value of CZK 100 was not listed for trading on any regulated market in a European Union Member State.

b) Information about transferability of securities

Only the statutory requirements need to be met for a transfer of shares and Global Depositary 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 O2 as at 31 December 2009:

	Shareholder	Address	% of share capital
1	Telefónica, S.A.	Gran Vía 28, 28013 Madrid, the Kingdom of Spain	69.41%
2	Investment funds and individual shareholders	–	30.59%

As at 31 December 2009, the share of Telefónica, S.A., in the voting rights of Telefónica O2 Czech Republic, a.s., according to the provision of Section 122 of the Capital Market Undertakings Act was 69.41%.

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

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

e) Information about restrictions of voting rights

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

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

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

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

Members of the Board of Directors are elected and recalled by the General Meeting 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 office or employment in connection with a take-over bid.

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

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

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

Financial part (Audit)

Consolidated financial statements for the year ended 31. December 2009

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General information

Telefónica O2 Czech Republic, a.s. Group (the "Group") consists of Telefónica O2 Czech Republic, a.s. (the "Company") and its subsidiaries: Telefónica O2 Slovakia, s.r.o., Telefónica O2 Business Solutions, spol. s r.o. (formerly Telefónica O2 Services, spol. s r.o.), SPT TELECOM (Czech Republic) Finance B.V., CZECH TELECOM Germany GmbH and CZECH TELECOM Austria GmbH.

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

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

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

The number of employees employed with the Group amounted in average to 8,974 in 2009 (2008: 9,258).

The Company's shares are traded on the Prague Stock Exchange and London Stock Exchange (GDRs).

These consolidated financial statements were approved for issue by the Company's Board of Directors on 19 February 2010.

Provision of mobile telecommunication services in Slovakia

Telefónica O2 Slovakia, s.r.o. (the "Telefónica O2 Slovakia"), a 100 % subsidiary company of Telefónica O2 Czech Republic, a.s., was awarded the 3rd mobile license in Slovakia in September 2006.

The license allows Telefónica O2 Slovakia to use frequencies GSM 900 MHz, GSM 1800 MHz, UMTS and F5 29 GHz for the period of 20 years for providing telecommunication services in the Slovak Republic.

The operation in Slovakia is considered as an organic expansion of the Telefónica Group business in the region and is utilizing synergies with the Company operations. The leverage of the Czech operations is expected in areas of network (development, monitoring, support), IT, procurement and back office (finance, HR, legal).

Telefónica O2 Slovakia launched its commercial service in February 2007 offering prepaid voice, SMS (Short Message Service) and GPRS (General Packet Radio Service) data in the GSM (Global System for Mobile communications) spectrum. In September 2007, Telefónica O2 Slovakia launched its postpaid services. In August 2007, Telefónica O2 Slovakia also launched its UMTS (Universal Mobile Telecommunication System) network with a limited coverage.

In 2006, Telefónica O2 Slovakia signed a national roaming agreement with T-Mobile Slovensko, a.s. It provides Telefónica O2 Slovakia with the ability to offer full network coverage to its customers immediately from commercial launch even before the construction of its own network is finished. The strategy of the Telefónica O2 Slovakia is to build own network coverage in areas where it is economically feasible.

The top priority of Telefónica O2 Slovakia has been a gradual fulfilment of the license conditions, gaining a base of active customers and aiming to provide the telecommunications market with innovations and technological advances as the first company on the market.

Merger of DELTAX Systems a.s. with Telefónica O2 Business Solutions, spol. s r.o.

In December 2008, the Board of Directors of the Company approved the plan to merge Telefónica O2 Business Solutions, spol. s r.o. with DELTAX Systems a.s. This merger became effective as at 1 January 2009 after the fulfillment of all legal conditions performed in the year 2009. Telefónica O2 Business Solutions, spol. s r.o. became the legal successor while DELTAX Systems a.s. was dissolved without liquidation. The assets, rights and obligations including labour rights and duties were transferred to the successor.

Liquidation of subsidiary SPT TELECOM (Czech Republic) Finance B.V. in liquidation

During the fourth quarter of 2007, SPT TELECOM (Czech Republic) Finance B.V. in liquidation commenced preparatory steps for the process of voluntary liquidation. Until the end of 2008, the key legal steps for dissolution of the Company have been executed. As of 9 February 2009, the registration of the company was cancelled from the Commercial Register.

Independent auditor's report

To the shareholders of Telefónica O2 Czech Republic, a.s.:

We have audited the accompanying consolidated financial statements of Telefónica O2 Czech Republic, a.s. and its subsidiaries ("the Group"), which comprise the consolidated balance sheet as at 31 December 2009 and the consolidated statement of comprehensive income, consolidated statement of changes in equity and consolidated cash flow statement 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. This responsibility includes: designing, implementing and maintaining internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

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 International Standards on Auditing and 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 auditors' judgment, including the 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 consolidated financial statements give a true and fair view of the financial position of the Group as of 31 December 2009, and of 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.
Licence No. 401
Represented by



Brian Welsh
Partner



Radek Pav
Auditor,
Licence No. 2042

19 February 2010
Prague,
Czech Republic

Consolidated statement of comprehensive income

for the year ended 31 December 2009

In CZK million	Notes	Year ended 31 December 2009	Year ended 31 December 2008
Revenue	2	59,889	64,709
Gains from sale of non-current assets	8	422	855
Internal expenses capitalized in fixed assets	2	787	484
Operating expenses	3	(33,999)	(37,650)
Impairment loss	8, 9, 10	(23)	(86)
Depreciation and amortisation	8, 9	(12,001)	(12,932)
Operating profit		15,075	15,380
Interest income	4	167	449
Interest expense	4	(263)	(406)
Other finance expense (net)	4	(102)	(75)
Profit before income tax		14,877	15,348
Taxes on income	5	(3,211)	(3,720)
Profit for the year		11,666	11,628
Other comprehensive income			
Gains proceeding from cash flow hedges	24	–	24
Translation differences		151	(215)
Income tax effect	24	–	(4)
Other comprehensive income, net of tax		151	(195)
Total comprehensive income, net of tax		11,817	11,433
Profit attributable to:			
Equity holders of the Company	6	11,666	11,628
Total comprehensive income attributable to:			
Equity holders of the Company		11,817	11,433
Earnings per share (CZK) – basic*	6	36	36

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

Consolidated balance sheet

as at 31 December 2009

In CZK million	Notes	31 December 2009	31 December 2008
ASSETS			
Property, plant and equipment	8	57,545	63,429
Intangible assets	9	22,477	22,348
Investment in associate	26	9	11
Other financial assets	12	285	378
Non-current assets		80,316	86,166
Inventories	11	618	779
Receivables and prepayments	12	9,773	9,240
Income tax receivable		697	226
Cash and cash equivalents	13	1,269	7,116
Current assets		12,357	17,361
Non-current assets classified as held for sale	8	95	96
Total assets		92,768	103,623
EQUITY AND LIABILITIES			
Ordinary shares	23	32,209	32,209
Share premium		24,374	24,374
Retained earnings, funds and reserves		17,296	21,585
Minority interest		–	–
Total equity		73,879	78,168
Long-term financial debts	15	3,044	3,098
Deferred taxes	16	3,333	3,300
Non-current provisions for liabilities and charges	18	24	403
Non-current other liabilities	14	21	176
Non-current liabilities		6,422	6,977
Short-term financial debts	15	87	98
Trade and other payables	14	12,092	17,686
Income tax liability		–	9
Provisions for liabilities and charges	18	288	685
Current liabilities		12,467	18,478
Total liabilities		18,889	25,455
Total equity and liabilities		92,768	103,623

These consolidated financial statements were approved by the Board of Directors on 19 February 2010 and were signed on its behalf by:



Jakub Chytil
Member of the Board of Directors
General Counsel and Company Secretary



Jesús Pérez de Urquien
1st Vice Chairman of the Board of Directors
Vice President, Finance Division

Consolidated statement of changes in shareholders' equity

for the year ended 31 December 2009

In CZK million	Notes	Share capital	Share premium	Hedging reserve	Foreign exchange translation reserve	Equity settled share based payments reserve	Funds*	Retained earnings	Total
At 1 January 2008		32,209	30,816	(20)	9	–	6,452	13,326	82,792
Fair value gains (net of tax) cash flow hedges	24	–	–	20	–	–	–	–	20
Currency translation differences – amount arising in year		–	–	–	(215)	–	–	–	(215)
Net profit		–	–	–	–	–	–	11,628	11,628
Total comprehensive income		–	–	20	(215)	–	–	11,628	11,433
Equity restructuring	23	–	(6,442)	–	–	–	6,442	–	–
Transfer from reserve fund to retained earnings	23	–	–	–	–	–	(6,442)	6,442	–
Capital contribution		–	–	–	–	47	–	–	47
Dividends declared in 2008	7	–	–	–	–	–	–	(16,104)	(16,104)
At 31 December 2008		32,209	24,374	–	(206)	47	6,452	15,292	78,168
At 1 January 2009		32,209	24,374	–	(206)	47	6,452	15,292	78,168
Currency translation differences – amount arising in year		–	–	–	151	–	–	–	151
Net income and expense recognised directly in equity		–	–	–	151	–	–	–	151
Net profit		–	–	–	–	–	–	11,666	11,666
Total comprehensive income		–	–	–	151	–	–	11,666	11,817
Capital contribution and other transfers		–	–	–	–	(9)	–	7	(2)
Dividends declared in 2009	7	–	–	–	–	–	–	(16,104)	(16,104)
At 31 December 2009		32,209	24,374	–	(55)	38	6,452	10,861	73,879

* Refer to Note 23 regarding amounts not available for distribution.

Consolidated cash flow statement

for the year ended 31 December 2009

In CZK million	Notes	Year ended 31 December 2009	Year ended 31 December 2008
Net profit		11,666	11,628
Non-cash adjustments for:			
Income tax	5	3,211	3,720
Depreciation	8	9,977	10,994
Amortisation	9	2,024	1,938
Impairment loss	8, 9, 10	23	86
Disposals of obsolete assets		3	114
Profit on sale of property, plant and equipment		(476)	(840)
Net interest and other income (charges)		96	(45)
Foreign exchange gains (net)		(95)	(239)
Fair value changes		(89)	(15)
Change in provisions and allowances		(1,871)	(828)
Operating cash flow before working capital changes		24,469	26,513
Working capital adjustments:			
Increase in trade and other receivables		(1,086)	(731)
Decrease/(increase) in inventories		153	(275)
(Decrease)/increase in trade and other payables		(2,387)	1,314
Cash flows from operating activities		21,149	26,821
Interest paid		(237)	(487)
Interest received		169	367
Income tax paid		(3,659)	(4,859)
Net cash from operating activities		17,422	21,842
Cash flows from investing activities			
Purchase of property, plant and equipment		(5,346)	(4,695)
Purchase of intangible assets		(2,729)	(2,221)
Proceeds from sales of property, plant and equipment		891	4,586
Proceeds from marketable securities		–	24
Cash purchase of financial investments		–	(30)
Cash acquired from purchase of financial investments		2	107
Dividends received		5	2
Net cash used in investing activities		(7,177)	(2,227)
Cash flows from financing activities			
Proceeds from borrowings		–	650
Repayment of borrowings		(5)	(6,645)
Dividends – paid		(16,087)	(16,080)
Net cash used in financing activities		(16,092)	(22,075)
Net decrease in cash and cash equivalents		(5,847)	(2,460)
Cash and cash equivalents at beginning of year		7,116	9,576
Cash and cash equivalents at the year end	13	1,269	7,116

Accounting policies

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A) Basis of preparation

The principal accounting policies applied in the preparation of these consolidated financial statements are set out below. These 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 International Financial Reporting Interpretations Committee ("IFRIC").

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 year-end, there is no difference in the policies applied by the Group between IFRS 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 financial statements in conformity with IFRS required the Group to use certain critical accounting estimates. It also required management to exercise its judgement in the process of applying the Group's accounting policies. The areas involving a higher degree of judgement or complexity, or areas where assumptions and estimates are significant to the consolidated financial statements are disclosed in Note U.

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

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

In 2009, the Group applied the below stated standards, interpretations and amendments, which are relevant to its operations. Adoption of the interpretations and amendments has no effect on the financial performance or position of the Group:

IFRS 2 Amendment (issued 2008, effective date 1 January 2009) Share-based Payments

The amendment clarifies the definition of a vesting condition and prescribes the treatment for an award that is cancelled. This amendment has no material impact on the Group's financial statements.

IFRS 7 Financial Instruments: Disclosures (issued 2009, effective date 1 January 2009)

The amendment requires additional disclosure about fair value measurement and liquidity risk. Fair value measurements related to items recorded at fair value are to be disclosed by source of inputs using a three level fair value hierarchy, by class, for all financial instruments recognised at fair value. The amendment also clarifies the requirements for liquidity risk disclosures with respect to derivative transactions and assets used for liquidity management.

This adoption affects certain disclosures in the notes to the Group financial statements.

IFRS 8 Operating Segments (issued 2006, effective date 1 January 2009)

The standard replaces IAS 14 Segment Reporting and requires entities to disclose segment information based on the information reviewed by the entity's chief operating decision maker. The adoption of the standard has no impact on the current presentation and disclosure of the segment information.

IAS 1 Amendment (issued 2007, effective date 1 January 2009) Presentation of financial statements

The amendment to the standard separates owner and non-owner changes in equity. In addition, the Standard introduces a statement of comprehensive income: presenting all items of income and expense recognised in the income statement, together with all other items of recognised income and expense, either in one single statement, or in two linked statements. This revised standard has been adopted in the current financial period for the Group financial statements.

IAS 23 Amendment (issued 2007, effective date 1 January 2009) Borrowing Costs

The amendment requires the Group to capitalise borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset. Since the Group has already applied this policy as an allowed alternative treatment before the effective date of this amendment, there is no impact on the financial position of the Group.

IAS 27 Consolidated and Separate Financial Statements – Cost of an Investment in a Subsidiary, Jointly Controlled Entity or Associate – Amendments (issued 2008, effective date 1 January 2009)

IAS 27 is amended for the following changes in respect of the holding companies separate financial statements:

- i) The deletion of the "cost method". Making the distinction between pre- and post-acquisition profits is no longer required. All dividends are recognized in profit or loss. However, the payment of such dividends requires the entity to consider whether there is an indicator of impairment; and
- ii) In case of reorganisations where a new parent is inserted above an existing parent of the group (subject to meeting specific requirements), the cost of the subsidiary is the previous carrying amount of its share of equity items in the subsidiary rather than its fair value.

There is no material effect relating to the adoption of these amendments on the Group financial statements.

IFRIC 13 Customer Loyalty Programmes (issued 2007, effective date 1 July 2008)

This interpretation addresses the accounting by entities that provide their customers with incentives to buy goods or services by providing awards as part of the sale transaction. The interpretation requires the entity that grants the awards to account for the sales transaction that gives rise to the award credits as a multiple element transaction and allocate the fair value of the consideration received or receivable between the award credits granted and the other components of the revenue transaction.

This adoption affects current accounting policy in respect of change of the fair value awards measurement and change in the presentation in the financial statements. This also affects certain disclosures in the notes to the consolidated financial statements.

This adoption has not any material impact on the financial results in the year 2009.

Standards and interpretations issued and endorsed by the European Union but not early adopted by the Group (includes standards and interpretations applicable for the Group)

Revised IFRS 3 Business Combinations (issued 2008, effective date 1 July 2009)

The standard introduces changes in the accounting for business combination that will have an impact on the amount of goodwill recognised, the reported results in the period that an acquisition occurs and on future reported results. The Group is currently assessing the impact of the application of this standard. The Group will apply IFRS 3 (Revised) prospectively to all business combinations from 1 January 2010.

IAS 27 Consolidated and Separate Financial Statements – Amendment (issued 2008, effective date 1 July 2009)

The most significant changes to IAS 27 are as follows:

- i) Changes in the ownership interest of a subsidiary (that do not result in a loss of control) are accounted for as an equity transaction and have no impact on goodwill nor give rise to a gain or loss.
- ii) Losses incurred by the subsidiary are allocated between the controlling and non-controlling interests (previously referred to as “minority interest”); even if the losses exceed the non-controlling equity investment in a subsidiary.
- iii) On loss of control of a subsidiary, any retained interest is remeasured to fair value and this has impact on the gain or loss recognized on disposal.

There is not any material effect expected relating to the adoption of this amendment on the Group financial statements.

Standards and interpretations issued but not endorsed by the European Union and neither early adopted by the Group nor effective (includes standards and interpretations applicable for the Group)

IFRS 2 Amendment (issued 2009, effective date 1 January 2010) Share-based Payments

The amendment is concerning the accounting for group cash-settled share-based payment transactions. The amendment clarifies how an individual subsidiary in a group should account for some share-based payment arrangements in its own financial statements. In these arrangements, the subsidiary receives goods or services from employees or suppliers but its parent or another entity in the group must pay those suppliers.

This amendment will not have any material impact on the Group financial statements.

IFRIC 18 Transfers of Assets from Customers (issued 2009, effective 1 July 2009)

This interpretation provides guidance on how to account for items of property, plant, and equipment received from customers, or cash that is received and used to acquire or construct specific assets. This interpretation is only applicable to such assets that are used to connect the customer to a network or to provide ongoing access to a supply of goods or services or both.

The Group has assessed the impact of the application of this interpretation, there will be no impact on the consolidated financial statements.

IFRS 5 Amendment (issued 2009, effective 1 January 2010) Non-current Assets Held for Sale and Discontinued Operations – Disclosure

This amendment was issued in order to clarify the disclosure requirements in respect of non-current assets (or disposal groups) classified as held for sale or discontinued operations. Also clarifies that the general requirements of IAS 1 still apply.

The Group does not expect any material changes to the disclosure in the notes to the consolidated financial statements.

IFRS 8 Amendment (issued 2009, effective 1 January 2010) Operating Segments – Disclosure

Minor textual amendment to the standard and amendment to the basis for conclusions, to clarify that an entity is required to disclose a measure of segment assets only if that measure is regularly reported to the chief operating decision-maker.

The Group does not expect any material changes to the disclosure in the notes to the financial statements resulting from this amendment.

IAS 1 Amendment (issued 2009, effective 1 January 2010) Presentation of Financial Statements

The amendment specifies current / non-current classification of convertible instruments and clarifies that the potential settlement of a liability by the issue of equity is not relevant to its classification as current or non-current. By amending the definition of current liability, the amendment permits a liability to be classified as non-current (provided that the entity has an unconditional right to defer settlement by transfer of cash or other assets for at least 12 months after the accounting period) notwithstanding the fact that the entity could be required by the counterparty to settle in shares at any time.

This amendment will not have any material impact on the Group financial statements.

IAS 7 Amendment (issued 2009, effective 1 January 2010) Statement of Cash Flows

Amendment to require that only expenditures that result in a recognized asset in the statement of financial position can be classified as investing activities. This amendment will have no impact on the Group financial statements, since this treatment is already applied by the Group.

IAS 36 Amendment (issued 2009, effective 1 January 2010) Impairment of Assets

Amendment to clarify that the largest cash-generating unit (or groups of units) to which goodwill should be allocated for the purposes of impairment testing is an operating segment as defined by par. 5 of IFRS 8 Operating Segments. The Group is currently assessing the impact of the application of this amendment on the consolidated financial statements.

IAS 38 Amendments (issued 2009, effective 1 January 2010) Intangible Assets

The first amendment clarifies the effect of the decision in IFRS 3 (Revised) on the accounting for intangible assets acquired in a business combination.

The second amendment clarifies the description in IAS 38, 40 and 41 of valuation techniques commonly used by entities when measuring the fair value of intangible assets acquired in a business combination that are not traded in active markets.

The Group is currently assessing the impact of these amendments. The Group will apply IAS 38 Amendments together with IFRS 3 (Revised) prospectively to all business combination from 1 January 2010.

IFRS 5 Amendment (issued 2008, effective 1 July 2009) Non-current Assets Held for Sale and Discontinued Operations

The amendment clarifies that all of subsidiary's assets and liabilities are classified as held for sale if a partial disposal sale plan results in loss of control. Relevant disclosure should be made for this subsidiary if the definition of a discontinued operation is met. A consequential amendment to IFRS 1 states that these amendments are applied prospectively from the date of transition to IFRS.

The Group will apply the IFRS 5 (Amendment) prospectively to all partial disposals of subsidiaries from 1 January 2010.

IFRS 9 Financial Instruments (issued in 2009, effective date 1 January 2013)

This standard specifies classification and measurements of financial assets.

The Group is currently assessing the impact of standard. The Group will apply IFRS 9 from 1 January 2013.

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 and are no longer consolidated from the date when the Group ceases to have control.

A business combination is accounted for using the purchase method of accounting. An acquisition is accounted for at its cost, being the amount of cash and cash equivalents paid in exchange for control over the net assets of an acquired company, plus any costs directly attributable to the acquisition. The excess of the cost of acquisition over the fair value of the net assets of the subsidiary acquired is recorded as goodwill. For detail refer to Note E Intangible assets and also to Note 9.

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

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

The ultimate parent company of the Telefónica O2 Czech Republic, a.s. Group is Telefónica, S.A.

C) Foreign currencies

(i) Functional and presentation currency

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

(ii) Transactions and balances

Foreign currency transactions are translated into the functional currency using the exchange rates prevailing at the date of the transaction. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation of monetary assets and liabilities denominated in foreign currencies are recognised in the statement of comprehensive income, except when deferred in equity 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

The comprehensive income and cash flow statements 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 shareholders' equity. When a foreign entity is sold, such exchange differences are recognised in the statement of comprehensive income as part of the gain or loss on sale.

D) Property, plant and equipment

All property, plant and equipment are initially recorded at cost and, except for freehold land, are subsequently carried at its cost less any accumulated depreciation and accumulated impairment losses. Freehold land is subsequently stated at cost less 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 depreciation and 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 cost 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. Subsequent costs are recognised as decrease of accumulated depreciation if only useful life is extended.

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 de-recognised or 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 these consolidated financial statements are as follows:

	Years
Freehold buildings	up to 40
Cable and other related plant	5 to 25
Exchanges and related equipment	up to 10
Other fixed assets	2 to 10

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

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

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

E) Intangible assets

Intangible assets include computer software, purchased goodwill, licenses, trade names, customer base and roaming contracts. 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 one to five years.

Intangible assets acquired in business combinations are stated at their acquisition costs (which are equal to their fair value at the date of acquisition) less amortisation and 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.

Acquired licenses are recorded at cost and amortised on a straight-line basis over the remaining life of the license (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 9 and Note 10).

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

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

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

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

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

F) Non-current assets classified as held for sale

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

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

The Group recognizes an impairment loss for any initial or subsequent write-down of the asset (or disposal group) to fair value less costs to sell and is accounted for as an impairment loss with impact on the statement of comprehensive income 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 impairment is only being determined.

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 the statement of comprehensive income.

G) Impairment of assets

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

Impairment losses are recognised in expenses when incurred. A previously recognised impairment loss is reversed (except for the Goodwill impairment loss) only if there has been a change in the estimates 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 as a reduction in the expenses in the period in which the reversal occurs.

H) Investments and other financial assets

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

Financial assets that are acquired principally for the purpose of generating a profit from short-term fluctuations in price are classified as financial assets at fair value through profit or loss and are included in current assets. During 2009 and 2008, 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.

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 the statement of comprehensive income 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 equity 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 equity is recognised in the statement of comprehensive income.

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 the statement of comprehensive income.

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 the statement of comprehensive income 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) directly in equity shall be removed from equity 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 equity 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 the statement of comprehensive income.

De-recognition of financial assets

A financial asset is de-recognised when:

- a) the rights to receive cash flow from the asset have expired,
- b) the Group retains the right to receive cash flow from the asset, but has assumed an obligation to pay them in full without material delay to a third party under a "pass-through" arrangement, or
- c) the Group has transferred its rights to receive cash flows from the assets and either has transferred substantially all the risks and rewards of the asset, or has neither transferred nor retained substantially all the risks and rewards of the asset, but has transferred control of the asset.

I) Leases

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

Leases under which a significant portion of the risks and benefits of ownership are effectively retained by the lessor are classified as operating leases. Payments made under operating leases are charged to the statement of comprehensive income 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 on the finance balance outstanding. 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 the statement of comprehensive income 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.

A sale and lease back transaction involves the sale of an asset and the leasing back of the asset. Within the Group's operations the selling price of the asset and lease payments are independent and established at fair value. Therefore the gain from the sale of the asset and the lease payments are accounted as two separate transactions.

J) Inventories

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

K) Trade receivables

Trade receivables are carried at original invoice amount less allowance for impairment of these receivables. Such allowance for impairment of trade receivables is established if there is objective evidence that the Group will not be able to collect all amounts due according to the original terms of 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 the statement of comprehensive income.

L) Cash and cash equivalents

Cash and cash equivalents are carried in the balance sheet at cost. For the purposes of the cash flow statement, 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 on the balance sheet.

M) Financial debt

Borrowings are recognised initially at 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 the statement of comprehensive income 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.

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

N) Current and deferred income taxes

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

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

Income tax relating to items recognised directly in equity is recognised in equity and not in the statement of comprehensive income.

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 the statement of comprehensive income, any related tax effects are also recognised in the statement of comprehensive income. 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.

O) Employee benefits

(1) Pension obligations

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

(2) Redundancy and termination benefits

Redundancy and termination benefits are payable when employment is terminated before the normal retirement or contract expiry date. The Group recognises redundancy and termination benefits when it is demonstrably committed to terminate the employment of current employees according to a detailed formal plan without possibility of withdrawal. Benefits falling due more than 12 months after the balance sheet date are discounted to present value. There are no redundancy and termination benefits falling due more than 12 months after the balance sheet date.

(3) Bonus plans

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

P) Share-based compensation

During 2006, the Group introduced performance compensation systems linked to the market value of shares of the parent company, Telefónica, S.A. Certain compensation plans are settled in cash, while the 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 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 shares granted 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 the statement of comprehensive income for the period, if appropriate.

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

Q) Provisions

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

R) Revenue recognition

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

The Group offers customers free minutes for a selected price based on a chosen customer plan. Free unused minutes at the end of the month might be rolled over to the following month. The 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 Group recognises revenue for free minutes in the period when the related services are provided and consumed, if material. Any rollover minutes are deferred and recognised when the minutes are used or the option expires.

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

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

The relative strength of each indicator is considered when concluding which accounting treatment to use for principal/agency arrangement.

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

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

(1) Fixed line business revenues

Revenue is recognized as follows:

Domestic and international call revenues

Domestic and international call revenues are recognised in the statement of comprehensive income at the time the call is made.

Universal service

The Group is obliged to render certain fixed line telephony services defined by the Act on Electronic Communications. The Group follows the accounting policy of Telefónica Group. Until March 2008, the Group recognised revenues using netto principle and recognised revenues when the contribution was received. From April 2008 until June 2009 the Group reported revenue using gross principle and recognised the compensation when CTO approved the total compensation and decided about percentage shares and absolute amounts of other operators contributions. As a result of further favourable development in smoothing of the recovery process and associated environment, since July 2009 the Group started to recognise the compensation of revenues attributable to the Group on standard accrual basis while keeping the gross principle of recording.

Subscription revenues

Revenue is recognised in the statement of comprehensive income in the period in which the services are rendered.

Revenues from sales of prepaid cards

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

Connection fees

Connection fees, arising from the connection of the customers to the Company's network, are deferred and recognised in the statement of comprehensive income over the estimated average customer relationship period on the basis of the degressive accounting method.

Equipment sales and other sale of goods

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

Local loop unbundling

Revenue from access to the local loop unbundling is deferred in the statement of comprehensive income and recognised in the period in which the service is rendered. Regular monthly fee is recognised on the straight line basis in the period when the service is consumed. Revenue from the preparation of the location (collocation) for an alternative operator is recognized upfront in the statement of comprehensive income when it occurs.

(2) Mobile business revenues

The Group earns mobile services revenue from customers usage of the Group's network, interconnection and roaming – collectively, "Mobile service revenue". The Group also earns revenue from the sale of mobile telephone equipment and accessories as well as from activation fees.

Airtime revenues

Postpaid customers are billed monthly in arrears for airtime revenues. Revenue from post-paid customers is recognised as their airtime and other services are used. Prepaid customers recharge a credit, which entitles them to a certain value of airtime and other services. Revenue from prepaid customers is deferred and recognized as the airtime and other services are used. Upon termination of the customer contract or expiration of voucher (up to 14 months), all deferred revenue for unused airtime is recognized in income.

Both, post-paid and prepaid products may include deliverables such as a handset, activation and airtime and that are defined as arrangements with multiple deliverables. The arrangement consideration is allocated to each deliverable, based on its fair value. Revenue allocated to the identified deliverables in each revenue arrangement is recognized based on the same recognition criteria of the individual deliverables at the time the product or service is delivered.

Equipment sales and mobile services

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

Roaming revenues

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.

Costs

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

(3) Interconnect revenues

Interconnect revenues are derived from calls and other traffic that originate in other domestic and foreign operators' network but use the Group's network. These revenues are recognised in the statement of comprehensive income 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 other domestic and foreign operators' for calls and other traffic that originate in the Group's network but use other domestic and foreign operators' network. Amounts receivable from and payable to other domestic and foreign operators are netted and settled net on a regular basis.

(4) Internet, IPTV and data services

The Group earns revenue from providing Internet services, IPTV and other data services. Revenue from such services is recognised at the time the service is provided.

(5) Dividend income

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

(6) Interest

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

(7) Instalment sales

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

S) Dividend distribution

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

T) Financial instruments

Financial instruments carried on the balance sheet include cash and bank balances, investments, receivables, payables, borrowings and derivatives. Detailed figures are described in Note 15.

Financial risk management

The Group's 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,
- c) net investment in 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 long term debt denominated in EUR and net payables in EUR or USD. Just 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:

- a) floating interest rate bearing cash investments and debt instruments,
- b) fair value of debt on fixed interest rate.

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 are on fixed rates. The Group may sometimes use interest rate swaps and forward rate agreements to manage a mix of fixed and variable rate debts.

(iii) Liquidity risk

The Group's essential objective of liquidity risk management is to have ready access to 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 focusing 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 funding continuity and flexibility is managed through maintaining the possible use of bank overdrafts or bilateral credit lines.

(iv) Credit risk

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

The Group trades only with recognized, creditworthy third parties. It is the Group's policy that all customers who wish to trade on credit terms are subject to credit verification procedures. In addition, receivable balances are monitored on an ongoing basis with the result that the Group's exposure to bad debts is not significant. The maximum exposure is the carrying amount as disclosed in Note 12. There are no significant concentrations 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 to credit risk 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 Department 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),
- b) prevention: scoring of new customers – checking procedures (Black Lists, External Debtors Register, other information), set up the limits or/and collection of the deposit according to customer segments, products and set up the credit limits for indirect sales partners (dealers, distributors, retailers) for purchase of our products, „securing” of credit limits (deposits, receivables insurance, bill of exchange, pledge of real estate, bank guarantee etc.). Guarantees are either in cash (deposits) or there are special procedures to collect cash for the other securing tools (insurance etc.),
- c) collection: reasonable, effective and continual collection process is the additional tool of bad debts decrease and prevention as well.

New credit management activities during last years

During last years the Group introduced new credit management activities such as:

- a) of the connection to the external Debtors Register Solus (sharing debtors data with other members – banks, other telecommunication operators, leasing companies etc.),
- b) of the credit management best practice from the merge of the fixed and mobile business in all company activities,
- c) checking of the new activation by using of integrated Black Lists,
- d) implementation of strict activation rules for all distribution channels.

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 qualify as fair value hedges and that are highly effective are recorded in the statement of comprehensive income, 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 equity. 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 equity are transferred from equity and included in the initial measurement of the cost of the asset or liability. Otherwise, amounts deferred in equity are transferred to the statement of comprehensive income and classified as revenue or expense in the same periods during which the hedged firm commitment or forecasted transaction affects the statement of comprehensive income.

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 the statement of comprehensive income.

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 equity at that time remains in equity and is recognised when the committed or forecasted transaction ultimately is recognised in the statement of comprehensive income. However, if a committed or forecasted transaction is no longer expected to occur, the cumulative gain or loss that was reported in equity is immediately transferred to the statement of comprehensive income.

The Group documents at the inception of the transaction the relationship between hedging instruments and hedged items, as well as its risk management objective and strategy for undertaking various hedge transactions. This 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.

The fair values of various derivative instruments used for hedging purposes are disclosed in Note 19. Movements on the hedging reserve in shareholder's equity are shown in Note 24.

Fair value estimation

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

U) Critical accounting estimates and judgments

The Group makes estimates and assumptions concerning the future. 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 year are discussed below:

(1) Income taxes and deferred taxes

The Group created 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-deductible expenses 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. As at 31 December 2009, the total amount of provision for current income taxes is CZK 3,248 million, advances paid for income taxes amount to CZK 3,945 million and the net deferred tax liability is CZK 3,333 million.

In October 2007, the new Czech legislation was enacted, by which the corporate income tax rate was reduced from 24 % to 21 %, 20 % and 19 % for the fiscal years ending in 2008, 2009 and 2010, respectively (see Note 5).

(2) Goodwill

The Group tests at each reporting date goodwill for an impairment. 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. At 31 December 2009 the carrying amount of goodwill is CZK 13,448 million (See Note 9).

(3) Provisions and contingent liabilities

As set out in Note 20 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 will be required to settle the obligation and a reliable estimate can be made of the amount of the obligation. 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) Interconnect

The Group provides and enters into the contracts for interconnect services and the revenue is recognised on the basis of the reasonable estimation of expected amount. Such estimation is regularly reviewed, however the final agreement and invoicing can be with some operators stated on up to a yearly basis.

(5) Impairment of the fixed line business assets

The Group makes an assessment at each balance sheet date whether there is any indication that an impairment loss recognised for the fixed line business assets in prior years 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 indicators (decline of asset's market value, changes expected in the market, including technological changes etc.). Where an estimate of recoverable amount is calculated, there is a number of management assumptions about future business performance, which may, ultimately, differ from reality.

Based on the assessment performed by the Company, no increase or decrease of the previously recognised impairment of fixed line business assets was recognised in 2009 and 2008 (see Note 8 and 10).

(6) Operating lease commitments – Group as lessee

In 2007 the Group changed its headquarters and moved to the new premises, where the Group has entered into the commercial property leases. The Group has determined, based on an evaluation of the terms and conditions of the arrangements, that the lessor retains all the significant risks and rewards of the ownership and therefore the Group accounts for the contract as an operating lease.

(7) Advertising and promotional activities

The Group recognizes the expenditures on advertising and promotional activities as an expense when they incurred. Both production costs and advertising and promotional materials are immediately expensed when received.

V) Change in accounting policy

No significant changes in accounting policies were applied in 2009 and 2008.

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 include primarily bank charges), fair value losses and gains on financial instruments and foreign exchange gains and losses.

Notes to the consolidated financial statements

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1) Segment information

Business segments recognised by the Group are as follows:

- Fixed – network communications services using a fixed network and IS/ICT services provided by the Company and other consolidated subsidiaries,
- Mobile – mobile communications services provided by the Company and by Telefónica O2 Slovakia

Year ended 31 December 2009 In CZK million	Fixed	Mobile*	Group
Revenues	27,387	33,500	60,887
Inter-segment sales	(394)	(604)	(998)
Total consolidated revenues	26,993	32,896	59,889
Gains from sale of non-current assets	422	–	422
Internal expenses capitalised in fixed assets	525	262	787
Costs	(15,323)	(19,674)	(34,997)
Inter-segment purchases	604	394	998
Total consolidated costs	(14,719)	(19,280)	(33,999)
Impairment charge	(17)	(6)	(23)
Depreciation	(7,040)	(2,937)	(9,977)
Amortisation	(850)	(1,174)	(2,024)
Total consolidated depreciation and amortization	(7,890)	(4,111)	(12,001)
Operating profit	5,314	9,761	15,075
Interest and other financial costs (net)			(198)
Profit before tax			14,877
Tax			(3,211)
Profit after tax			11,666
Minority interest			–
Net profit			11,666
Assets (excluding goodwill and non-current assets held for sale)	51,455	27,770	79,225
Goodwill	128	13,320	13,448
Non-current assets held for sale	95	–	95
Total assets	51,678	41,090	92,768
Trade and other payables	4,826	7,266	12,092
Other liabilities	3,129	3,668	6,797
Total liabilities	7,955	10,934	18,889
Capital expenditure	3,256	3,233	6,489

* Standalone Revenues of Telefónica O2 Slovakia of CZK 1,961 million included.

Year ended 31 December 2008			
In CZK million	Fixed	Mobile**	Group
Revenues	30,484	35,419	65,903
Inter-segment sales	(423)	(771)	(1,194)
Total consolidated revenues	30,061	34,648	64,709
Gains from sale of non-current assets	855	–	855
Internal expenses capitalised in fixed assets	338	146	484
Costs	(18,717)	(20,127)	(38,844)
Inter-segment purchases	771	423	1,194
Total consolidated costs	(17,946)	(19,704)	(37,650)
Impairment charge	(83)	(3)	(86)
Depreciation	(7,263)	(3,731)	(10,994)
Amortisation	(654)	(1,284)	(1,938)
Total consolidated depreciation and amortization	(7,917)	(5,015)	(12,932)
Operating profit	5,308	10,072	15,380
Interest and other financial costs (net)			(32)
Profit before tax			15,348
Tax			(3,720)
Profit after tax			11,628
Minority interest			–
Net profit			11,628
Assets (excluding goodwill and non-current assets held for sale)	37,863	52,216	90,079
Goodwill	128	13,320	13,448
Non-current assets held for sale	96	–	96
Total assets	38,087	65,536	103,623
Trade and other payables	6,199	11,487	17,686
Other liabilities	3,739	4,030	7,769
Total liabilities	9,938	15,517	25,455
Capital expenditure	4,312	3,776	8,088

** Standalone revenues of Telefónica O2 Slovakia of CZK 1,141 million included.

Revenue of the Group is predominantly derived from domestic trading activities and as a result, segment reporting is only shown on the basis of business segments. With respect to the issue of IFRS 8 Operating segments and the deep integration process from the past convergence of fixed and mobile operations, the Group has analysed criteria for segment identification. The adoption of the standard has not led to a change in the reported segments.

The inter-segment pricing rates applied in 2009 and 2008 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) Revenue and Internal expenses capitalized in fixed assets

Revenue In CZK million	Year ended 31 December 2009	Year ended 31 December 2008
Voice – outgoing	13,162	15,301
Interconnection and other wholesale services	9,973	10,428
Monthly and one-off charges from voice services	15,370	16,412
Connection charges	147	295
SMS & MMS & Value added services	4,898	5,080
Leased lines and fixed data services	3,509	3,866
Internet (including monthly and one-off charges), mobile data services and IPTV	7,406	6,463
IT and business solutions	2,760	2,308
Equipment and activation fee	1,545	2,045
Other telecommunication revenues	981	2,253
Other revenues	138	258
Total revenues	59,889	64,709

Categories of revenues were rearranged in order to improve the presentation of revenues.

Revenues from related parties are disclosed in Note 25.

The aggregate future minimum lease payments under non-cancellable operating leases, where the Company is a lessor and give rise to future revenues consist of the buildings and other telecommunication equipment rentals as follows:

In CZK million	31 December 2009	31 December 2008
No later than 1 year	146	185
Later than 1 year and not later than 5 years	605	754
Later than 5 years	156	198
Total	907	1,137

Internal expenses capitalized in fixed assets In CZK million	Year ended 31 December 2009	Year ended 31 December 2008
Material	15	79
Labour	772	405
Total	787	484

3) Operating expenses

The following items have been included into the operating expenses:

Operating expenses In CZK million	Year ended 31 December 2009	Year ended 31 December 2008
Wages and salaries*	5,057	5,163
Redundancy payments	161	160
Social security contributions (Note 17)	1,642	1,626
Staff welfare costs	262	157
Total staff costs	7,122	7,106
Interconnection and roaming	11,381	11,989
Cost of goods sold	2,308	3,258
Contents	266	220
Customer loyalty program	77	363
Sub-deliveries	1,298	1,213
Commissions	1,212	1,213
Telecom services	232	198
Other cost of sales	672	1,127
Billing and collection	422	399
Marketing	1,576	1,927
Call centres	426	305
Network & IT repairs and maintenance	2,414	2,529
Rentals, buildings and vehicles	2,190	2,168
Utilities supplies	1,087	1,081
Consultancy and professional fees	184	270
Other external services	174	1,245
Provision for bad and doubtful debts and inventories	478	530
Taxes (other than income tax)	447	423
Other operating expenses	33	86
Total operating expenses	33,999	37,650

* Certain Group employees (including the Board of Directors) with specialised know how, or who have access to business secrets, or who are considered important to the development of the business, are bound by non-competition restrictions, for a maximum period of 12 months from the date of termination of their employment with the Group. The Group paid CZK 14 million in relation to such non-competition clauses in 2009 (2008: CZK 11 million).

Categories of costs were rearranged in order to improve the presentation of costs.

Statutory auditor's fees for the year ended 31 December 2009 were as follows:

In CZK million	Year ended 31 December 2009	Year ended 31 December 2008
Statutory audit	25	23

Purchases from related parties are disclosed in Note 25.

4) Interest and other finance income and expense

In CZK million	Year ended 31 December 2009	Year ended 31 December 2008
Financial income		
Interest income	167	449
Gain for derivatives of fair value	71	65
Other financial income	1,067	1,333
Total financial income	1,305	1,847
Financial expenses		
Interest expenses	(263)	(406)
Other financial expenses	(1,240)	(1,473)
Total financial expenses	(1,503)	(1,879)
Net financial loss	(198)	(32)

5) Income tax

In CZK million	Year ended 31 December 2009	Year ended 31 December 2008
Total income tax expense is made up of:		
Current income tax charge	3,178	3,777
Deferred income tax credit (Note 16)	33	(57)
Taxes on income	3,211	3,720

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 2009	Year ended 31 December 2008
Profit before tax	14,877	15,348
Income tax charge calculated at the statutory rate of 20 % (2008: 21 %)	2,975	3,223
Expenses not deductible for tax purposes	151	164
Tax related to prior periods	(69)	22
Unrecognised tax losses	154	311
Taxes on income	3,211	3,720
Effective tax rate	22 %	24 %

6) 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 year.

	31 December 2009	31 December 2008
Weighted number of ordinary shares in issue	322,089,900	322,089,900
Net profit attributable to shareholders (in CZK million)	11,666	11,628
Basic earnings per share (CZK)	36	36

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

7) Dividends

In CZK million	31 December 2009	31 December 2008
Dividends declared (including withholding tax)	16,104	16,104

Dividends include withholding tax on dividends paid by the Company to its shareholders. There has been no interim dividend paid in respect of 2009. Approval of the 2009 profit and the decision regarding the amount of any dividend payment for the 2009 financial year will take place at the Annual General Shareholders Meeting.

8) Property, plant and equipment

In CZK million	Land and buildings	Ducts, cables and related plant	Communication exchanges and related equipment	Other fixed assets	Capital work in progress including advances paid	Total
At 31 December 2009						
Opening net book amount	10,764	36,227	11,187	1,891	3,360	63,429
Additions	562	760	2,273	871	4,307	8,773
Disposals and other movements	995	398	(1,334)	(103)	(4,435)	(4,479)
Assets classified as held for sale	(185)	(3)	–	–	–	(188)
Depreciation charge	(712)	(4,238)	(4,096)	(931)	–	(9,977)
Impairment charge	–	–	(1)	–	(12)	(13)
Closing net book amount	11,424	33,144	8,029	1,728	3,220	57,545
At 31 December 2009						
Cost	19,954	101,175	88,248	9,646	3,252	222,275
Accumulated depreciation and impairment allowance	(8,530)	(68,031)	(80,219)	(7,918)	(32)	(164,730)
Net book amount	11,424	33,144	8,029	1,728	3,220	57,545
At 31 December 2008						
Opening net book amount	14,080	39,710	13,207	2,003	2,809	71,809
Additions	672	769	2,923	1,076	5,630	11,070
Disposals and other movements	24	–	(8)	(7)	(5,066)	(5,057)
Acquisition impact	–	–	–	2	–	2
Assets classified as held for sale	(3,285)	(25)	(6)	–	–	(3,316)
Depreciation charge	(678)	(4,206)	(4,927)	(1,183)	–	(10,994)
Impairment charge	(49)	(21)	(2)	–	(13)	(85)
Closing net book amount	10,764	36,227	11,187	1,891	3,360	63,429
At 31 December 2008						
Cost	17,718	99,982	91,788	10,486	3,385	223,359
Accumulated depreciation and impairment allowance	(6,954)	(63,755)	(80,601)	(8,595)	(25)	(159,930)
Net book amount	10,764	36,227	11,187	1,891	3,360	63,429

As at 31 December 2009, the carrying value of non-depreciated assets amounted to CZK 214 million (2008: CZK 241 million).

No property, plant and equipment were pledged as at 31 December 2009.

No borrowing costs were capitalized during the years 2009 and 2008.

The Group reviewed useful lives of assets in 2009 and adjusted when appropriate. This review did not have a material impact on the financial results in 2009. Change in estimate of useful life of assets has been made prospectively since 1 January 2010.

The Group reports and classifies the following assets held for sale at the balance sheet date:

In CZK million	Land and buildings	Communication exchanges and related equipment	Other fixed assets	Total
At 31 December 2009				
Opening net book amount	96	–	–	96
Disposals and other movements	(179)	–	–	(179)
Impairment charge	(10)	–	–	(10)
Assets re-classified as held for sale	188	–	–	188
Closing net book amount	95	–	–	95
At 31 December 2009				
Cost	804	120	76	1,000
Accumulated depreciation and impairment allowance	(709)	(120)	(76)	(905)
Net book amount	95	–	–	95
At 31 December 2008				
Opening net book amount	327	1	–	328
Disposals and other movements	(3,540)	(7)	–	(3,547)
Impairment charge	(1)	–	–	(1)
Assets re-classified as held for sale	3,310	6	–	3,316
Closing net book amount	96	–	–	96
At 31 December 2008				
Cost	789	187	6	982
Accumulated depreciation and impairment allowance	(693)	(187)	(6)	(886)
Net book amount	96	–	–	96

Assets intended for sale in most cases represent administration buildings with land, that became vacant due to the Group's optimization process and which the Group will not use in the future and it is expected that their sale will take place within one year.

The non-current assets classified as held for sale are presented in the fixed segment.

In 2009, the Group achieved a total gain from the sale of the above fixed assets amounting to CZK 422 million (2008: CZK 855 million) and total losses in amount CZK 14 million (2008: CZK 59 million).

In 2008 and at the beginning of 2009, the Group completed the substantial part of a real estate usage optimisation process. In 2008, as part of this process, the Group sold a portfolio of administrative and technological buildings located throughout the whole Czech Republic. Net gain from the sale of the real estate portfolio amounted to CZK 727 million. A small portion of the real estate was leased back on the long term basis. In January 2009, the Group sold a construction site and two administrative buildings of the former headquarters in Olšanská street in Prague with a net gain exceeding CZK 300 million.

Cost of fully depreciated property, plant and equipment was CZK 69,937 million as at 31 December 2009 (2008: CZK 59,597 million).

9) Intangible assets

In CZK million	Goodwill	Licences	Software	Total
At 31 December 2009				
Opening net book amount	13,448	4,425	4,475	22,348
Additions	–	–	2,161	2,161
Disposals and other movements	–	(2)	(6)	(8)
Amortisation charge	–	(394)	(1,630)	(2,024)
Closing net book amount	13,448	4,029	5,000	22,477
At 31 December 2009				
Cost	13,448	6,223	26,478	46,149
Accumulated amortisation and impairment allowance	–	(2,194)	(21,478)	(23,672)
Net book amount	13,448	4,029	5,000	22,477
At 31 December 2008				
Opening net book amount	13,320	4,816	3,669	21,805
Additions	–	–	2,371	2,371
Disposals and other movements	–	15	(38)	(23)
Acquisition impact	128	–	5	133
Amortisation charge	–	(406)	(1,532)	(1,938)
Closing net book amount	13,448	4,425	4,475	22,348
At 31 December 2008				
Cost	13,448	6,226	24,601	44,275
Accumulated amortisation and impairment allowance	–	(1,801)	(20,126)	(21,927)
Net book amount	13,448	4,425	4,475	22,348

The Group reviewed useful lives of assets in 2009 and adjusted when appropriate. This review did not have a material impact on the financial results.

Goodwill

Goodwill in amount of CZK 13,320 million resulted from the acquisition of the remaining 49% ownership interest in Eurotel Praha spol. s r.o. ("Eurotel"). The initially recognized goodwill of CZK 14,087 million resulted from comparison of cost of business combination of CZK 29,215 million and fair value of net assets acquired of CZK 15,128 million. Until 31 December 2004 goodwill was amortised on a straight line basis over a period of 20 years and assessed for an indication of impairment at each balance sheet date.

Due to a revision of IFRS 3, IAS 36 and IAS 38 the Group ceased amortisation of the previously recognized goodwill from 1 January 2005. Accumulated amortisation as at 31 December 2004 was eliminated with a corresponding decrease in the cost of goodwill (CZK 767 million). Since the year ending 31 December 2005 onwards, goodwill is classified as an asset with indefinite useful life which has been tested annually for the impairment, as well as when there are indications of impairment. There is no other intangible asset with indefinite useful life.

The Group performed impairment tests and as result of the test the Group did not recognize any impairment losses of goodwill in 2009 and 2008. The impairment test involves determining the recoverable amount of 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 Group internal perspective. Value in use is determined based on cash flow budgets, which are based on the medium-term business plan for a period of 3 years, which has been approved by the management and which is valid when the impairment test is performed. This business plan is based on the 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 an appropriate growth rates. Key assumptions on which management has based its determination of business plan and growth rates include development of gross domestic product, interest rates, nominal wages, average revenue per user ("ARPU"), customer acquisition and retention costs, churn rates, capital expenditure, market share, growth rates and 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 most sensitive to the following assumptions:

Estimated growth rate – the basis used to determine the value assigned to estimated growth rate is the forecast of the market and regulatory environment, where the Group conducts its business.

Discount rate – discount rates reflect management's estimate of the risk specific to the cash generating unit. The basis used to determine the value assigned is weighted average of cost of capital ("WACC").

Licences

Acquired licences are represented by rights to operate the UMTS, GSM and NMT cellular networks in the Czech Republic. The original 450 MHz and GSM operating licenses were granted for a period of twenty years from the signing of the agreement for the original 450 MHz license in 1991 and from the granting of the GSM license in 1996 for use of the 900 spectrum. In 1999, Eurotel acquired an additional GSM 1800 spectrum under its existing GSM license. In 2002, the GSM license to both spectrums was renewed and is currently valid for the remaining period of seven years.

In 2002, Eurotel renewed its 450 MHz license; the current license enables the mobile segment to offer every internationally recognized public mobile telecommunication services on frequency of 450 MHz. Mobile segment currently provides on this frequency voice services under NMT standard and broadband Internet access services using CDMA technology. The NMT license is currently valid for the remaining period of two years.

In December 2001, Eurotel acquired the UMTS license, which has been granted for a period of twenty years. Under the license, Eurotel was provided with deferred payment terms by the Czech Telecommunication Office ("CTO") to finance the license acquisition. In December 2003, Eurotel signed an amendment to its original UMTS license agreement, by which the original launch of the service was extended by one year. According to the terms of this new amendment, Eurotel agreed to pay the UMTS obligation in full during 2004 in exchange for a forgiveness of 2003 and

2004 interest on the deferred payments provided as part of the UMTS license agreement. UMTS license was put into commercial use on 1 December 2005 when it also started to be amortized.

With respect to the operation launch in 2007, the license for GSM and UMTS networks was awarded to Telefónica O2 Slovakia on 7 September 2006 for SKK 150 million (EUR 4.1 million).

Carrying value of licences:

In CZK million	31 December 2009	31 December 2008
GSM 900 license	474	546
GSM 1800 license	382	440
NMT 450 license	26	33
UMTS license	3,019	3,268
GSM and UMTS license – TO2 Slovakia	128	138
Total	4,029	4,425

No borrowing costs were capitalized during the years 2009 and 2008.

Cost of fully amortised intangible assets was CZK 16,403 million as at 31 December 2009 (2008: CZK 16,846 million).

All of the Group's intangible assets with finite lives are amortised and are subject to an annual review of impairment indicators and revision of useful life.

10) Impairment of fixed assets

Fixed assets of the fixed line business

During 2003, external factors relating to the telecommunication market and regulatory environment namely uncertainty regarding tariff rebalancing, termination charges for internet dial-up interconnection charges and other regulatory decisions in the Czech Republic led the management to assess and adjust the recoverable amount of the fixed line segment assets. The fixed line segment assets constitute one cash-generating unit (the "CGU").

Value in use has been calculated by a method of cumulated discounted cash flows for a period limited by average useful life of the CGU's key assets. Primarily, the following assumptions have been used in the impairment testing model: actual business plan, estimation of consecutive development of key indicators (revenues, margin, investments etc.) in the analyzed period, discount rate derived from weighted average cost of capital.

As at 31 December 2009, the management of the Company reviewed the indicators which would indicate that the impairment allowance of fixed line business assets made in 2003 is no longer relevant and should be adjusted upwards and downwards. Upon the review, a recoverable amount of the fixed line business assets (impairment test model) was estimated. Based on this assessment performed, the management believes that the value of the existing fixed network assets is fairly stated and does not differ substantially from the assets' recoverable amount as at 31 December 2009.

Value in use as at 31 December 2009 has been calculated using the same methodology as in the year 2003.

11) Inventories

In CZK million	31 December 2009	31 December 2008
Telecommunication material	159	114
Cables	31	47
Other inventory including goods for resale	404	607
Finished products and work in progress	24	11
Total	618	779

The inventories noted above are stated net of an allowance of CZK 68 million (2008: CZK 64 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 55 million (2008: CZK 31 million). The amount of inventories recognised as an expense is CZK 2,765 million (2008: CZK 4,059 million).

12) Receivables and prepayments

In CZK million	31 December 2009	31 December 2008
Trade receivables (net)	8,464	7,794
Other debtors (net)	402	650
Prepayments	799	759
Other financial assets – short-term	–	14
Derivative instruments	108	23
Total	9,773	9,240

Trade receivables are stated net of bad debt provision of CZK 3,661 million (2008: CZK 3,457 million). In order to preserve the tax-deductible status of the bad debt expense, the Group's trade receivables are not written off and removed from the primary books and records until certain statutory collection requirements have been satisfied.

The Group reviewed and adjusted the bad debts provision policy in 2009 according to collection rates of accounts receivables. This review resulted in a release of provisions in the amount of CZK 215 million.

Receivables from related parties are disclosed in Note 25.

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 2009	8,464	3,579	321	207	131	50
At 31 December 2008	7,794	5,101	552	–	30	36

Bad debt provisions	In CZK million
At 1 January 2008	3,291
Additions	1,057
Retirements/amount paid	(891)
At 31 December 2008	3,457
Additions	963
Retirements/amount paid	(759)
At 31 December 2009	3,661

The Group's historical experience regarding the collection of accounts receivable is consistent with the recorded allowances. Due to these factors, the management believes that no additional credit risk beyond the amounts provided for is inherent in the Group's trade receivables.

As at 31 December 2009 the Group presented non-current assets of CZK 285 million (2008: CZK 378 million) consisting of long-term credits and advance payments for long-term expenses, which are classified as other financial assets.

13) Cash and cash equivalents

In CZK million	31 December 2009	31 December 2008	Interest rate
Cash at current bank accounts	169	330	Floating
Cash at cash-pooling structures (inter-company)	1,100	6,344	Floating
Short-term bank deposits	–	442	Fixed
Total cash and cash equivalents	1,269	7,116	

As at 31 December 2008, the Group's cash equivalents partially consisted of short-term bank promissory notes that were economically equivalent to bank term deposits and interest bearing deposits maturing in three months or less.

Since April 2006, the Group entered into mutual Telefónica Group cash-pooling, which enables the Telefónica Group good financial governance and effective operating free cash flow. The short-term deposits conditions are based on the arm's length principle. The short-term deposits are classified as cash equivalents.

At 31 December 2009, the Group had available equivalent of CZK 4,115 million (2008: CZK 5,425 million) of undrawn committed facilities.

For the purposes of the cash flow statement, the year-end cash and cash equivalents comprise only the following component:

In CZK million	31 December 2009	31 December 2008
Cash and cash equivalents	1,269	7,116

As of 31 December 2009 no cash and cash equivalents were pledged.

14) Trade and other payables

In CZK million	31 December 2009	31 December 2008
Trade creditors (net)	3,912	6,776
Related party loans	–	3,249
Other taxes and social security	198	196
Deferred revenue	1,032	1,054
Employee wages and benefits	784	794
VAT payable	598	479
Other creditors	297	406
Accruals	5,271	4,732
Total payables	12,092	17,686
Other non-current liabilities	21	176

In 2008 the related party loans included an intercompany loan in amount of CZK 3,194 million provided to Telefónica O2 Slovakia by the company Telfisa Global, BV (see Note 25).

As at 31 December 2009 other non-current liabilities include primarily principals and liabilities with maturity in more than 12 months. As at 31 December 2008 other non-current liabilities include primarily deferred revenues from connection fees, which were expected to be taken to income in more than 12 months from the balance sheet date.

15) Financial debt

In CZK million	31 December 2009	31 December 2008
Bank loans in foreign currencies (a)	3,044	3,098
Bonds in local currency (b)	–	5
Total borrowings	3,044	3,103
Accrued interest including commitment fees	84	86
Derivatives	3	7
Other financial debt	87	93
Total financial debt	3,131	3,196
Repayable:		
Within one year	87	98
Between two and five years (total non-current)	3,044	3,098
Total financial debt	3,131	3,196

- a) In July 1997, the Company raised a private placement in the total amount of EUR 127.8 million with a maturity date on 30 July 2012. As at 31 December 2009, the outstanding amount of the foreign currency loan amounts to EUR 115 million. As at 31 December 2009 the Group does not utilize bank overdrafts.
- b) In 2003, the Group issued CZK 6,000 million of bonds with an interest rate 3.50 % p.a. and it was fully repaid at a maturity date of 9 July 2008.

For all borrowings, interest has been charged at commercial rates.

The Group's loan interest rate allocation after taking into account interest rate swaps was as follows:

In CZK million	31 December 2009	31 December 2008
At fixed rate	3,044	3,103

The fair values of borrowings are based on discounted cash flows using a discount rate based upon the borrowing rate that the Board of Directors expects to be available to the Group at the balance sheet date. The carrying amounts of short-term borrowings approximate their fair value.

Effective interest rates	2009	2008
Bank loans in foreign currencies	6.64 %	6.64 %
Bonds in local currency	–	3.50 %

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 2009 based on contractual undiscounted payments.

At 31 December 2009 In CZK million	Less than 3 months	3 to 12 months	1 to 5 years	> 5 years
Interest bearing loans and borrowings	–	202	3,448	–
Trade and other payables (except for deferred revenue)	9,878	1,182	–	–
Derivatives fair value	3	–	–	–
Total	9,881	1,384	3,448	–
Non-current other liabilities	–	–	14	7

At 31 December 2008 In CZK million	Less than 3 months	3 to 12 months	1 to 5 years	> 5 years
Interest bearing loans and borrowings	5	206	3,715	–
Trade and other payables (except for deferred revenue)	14,796	1,836	–	–
Derivatives fair value	7	–	–	–
Total	14,808	2,042	3,715	–
Non-current other liabilities	–	–	169	7

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	
	2009	2008	2009	2008
Financial assets				
Cash and cash equivalents	1,269	7,116	1,269	7,116
Derivatives	108	23	108	23
Other financial assets	285	378	285	378
	Carrying amount		Fair value	
	2009	2008	2009	2008
Financial liabilities				
Interest bearing loans and borrowings:				
Floating rate inter-company borrowings	–	3,249	–	3,249
Fixed rate borrowings	3,128	3,184	3,432	3,503
Issued Bonds	–	5	–	5
Derivatives	3	7	3	7

The fair value of derivatives and borrowings has been calculated by discounting the expected future cash flows at prevailing interest rates.

Fair value hierarchy

As at 31 December 2009, the Group held the following financial instruments measured at fair value:

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 which have a significant effect on the recorded fair value that are not based on observable market data.

Assets measured at fair value

At 31 December 2009	Financial assets at fair value through profit or loss			
	Total	Level 1	Level 2	Level 3
In CZK million				
Foreign exchange contracts – non-hedged	108	–	108	–

Liabilities measured at fair value

At 31 December 2009	Financial liabilities at fair value through profit or loss			
	Total	Level 1	Level 2	Level 3
In CZK million				
Foreign exchange forward contracts – non-hedged	3	–	3	–

During the reporting period ending 31 December 2009, 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	
	2009	2008
FX risk		
Value at Risk*	(298)	(395)
Stress testing*	(56)	(76)
IR risk		
Stress testing*	(76)	(114)

* 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 a negative 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 the floating basis within a time frame of 12 months.

Hedging

The following nominal value of foreign exchange forwards was used by the Group to hedge the currency risk:

	Nominal value In EUR million		Fair value In CZK million	
	2009	2008	2009	2008
Forward exchange contracts	171	19	105	16

16) 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 deferred taxes were calculated at 19 % (20 % in 2008) and long-term deferred taxes were calculated at 19 % (2008:19 %).

In CZK million	2009	2008
At 1 January	3,300	3,353
Income statement tax charge / (credit) (Note 5)	33	(57)
Tax impact on changes in equity	–	4
At 31 December	3,333	3,300

Deferred income tax assets and liabilities are offset when there is a legally enforceable right to set off current tax assets against current tax liabilities and when the deferred income taxes relate to the same fiscal authority.

The following amounts, determined after offsetting, are shown in the consolidated balance sheet:

In CZK million	31 December 2009	31 December 2008
Deferred tax assets	(318)	(656)
Deferred tax liabilities	3,651	3,956
Total	3,333	3,300

The deferred tax asset includes CZK 291 million (2008: CZK 423 million) recoverable in less than twelve months and CZK 27 million (2008: CZK 233 million) recoverable after more than twelve months. The deferred tax liability includes CZK 380 million (2008: CZK 494 million) payable in less than twelve months and CZK 3,271 million (2008: CZK 3,462 million) payable in more than twelve months.

The deferred tax is determined by these components:

In CZK million	Consolidated balance sheet		Consolidated statement of comprehensive income	
	2009	2008	2009	2008
Temporary differences relating to:				
– property, plant and equipment and intangible assets	3,623	3,926	(303)	(570)
– trade receivables, inventories and other differences	(290)	(626)	336	513
Total	3,333	3,300	33	(57)

Deferred income tax related to items charged or credited directly to equity are as follows:

In CZK million	31 December 2009	31 December 2008
Revaluation of cash flow hedges	–	4

17) Government social security and pension schemes

The Group is legally required to make contributions to government health, retirement benefit and unemployment schemes. During 2009 and 2008, the Group paid contributions at a rate of 34 %, 35 % respectively of gross salaries and is not required to make any contributions in excess of this statutory rate. The total amount charged to operating expenses in respect of this scheme was CZK 1,642 million in 2009 (2008: CZK 1,626 million) (Note 3). Employees contribute 11 % (2008: 12.5 %) of their gross salaries.

The Group has a voluntary pension plan for employees under which the Group makes contributions on behalf of the Group's employees to approved pension plan providers, under defined contribution schemes. The Group's contribution depends upon the number of employees joining the scheme and their age profile. During the year the Group made contributions of CZK 57 million (2008: CZK 59 million). These contributions were charged as an operating expense.

In accordance with an annually renegotiated collective labour agreement, the Company is required to pay CZK 25,000 or CZK 90,000 on retirement depending on the length of the employee's service, who have completed not less than five years continuous service. These benefits are restricted to those employees who retire during the period for which the labour agreement is in place. The Company is not under any legal or constructive obligation to continue providing such benefits beyond the period of such agreement and therefore, no provisions beyond the period of the agreement are recognised in the financial statements. Payments made during the year 2009 relating to employee retirement amounted to CZK 0.1 million (2008: CZK 0.1 million) and were charged as an operating expense.

All amounts discussed in the above note are included in staff costs (see Note 3).

18) Provisions for liabilities and charges

In CZK million	Regulatory and court decisions	Employee redundancy costs	Employee related costs	Benefit loyalty provision	Sale of real estate portfolio provision	Other	Total
At 1 January 2009	395	13	142	252	260	26	1,088
Additions during the year	22	58	126	32	68	8	314
Utilised during the year	(380)	(60)	(162)	(284)	(189)	(15)	(1,090)
At 31 December 2009	37	11	106	–	139	19	312
Short-term Provisions 2009	21	11	98	–	139	19	288
Long-term Provisions 2009	16	–	8	–	–	–	24
	37	11	106	–	139	19	312
Short-term Provisions 2008	–	13	134	252	260	26	685
Long-term Provisions 2008	395	–	8	–	–	–	403
	395	13	142	252	260	26	1,088

With the exception of the regulatory and court decisions and other small items 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.

Benefit loyalty provision

Benefit loyalty provision was used to cover the cost of equipment, accessories, gifts and services provided to participants in the mobile segment's loyalty program in exchange for credits awarded primarily for airtime minutes spent. The provision used to be recognized based on past experience of the usage of these credits by loyalty program participants.

Benefit loyalty provision was released due to termination of customer loyalty program in year 2009. There is zero expected outflow of provided benefits. The Group replaced customer loyalty program with other non-cash incentives such as discounts and marketing activities.

Sale of real estate portfolio

The provision was established to cover primarily the costs of future claims relating to the construction deficiencies identified in the real estate portfolio sold (see Note 8).

Regulatory and court decisions

Provision for regulatory and court decisions is made for legal proceedings involving the Group companies (see Note 20).

19) Financial instruments

Net fair values of derivative financial instruments

At the balance sheet date, the total net fair values of derivative financial instruments were as follows:

Forward foreign exchange contracts In CZK million	31 December 2009	31 December 2008
Instruments not qualifying as hedges		
– with positive fair value	108	23
– with negative fair value	(3)	(7)
Total (Note 15)	105	16

20) Contingencies

The Company is involved in several court proceedings which have arisen from the ordinary course of business. Several significant litigations opened in previous years were successfully terminated in 2009 and are listed below, along with other notable legal matters involving the Company:

T-Mobile Czech Republic, a.s. – interconnect litigations

On 29 April 2009, the Company entered into a settlement agreement, whereby all disputes of many years' standing between the Company and T-Mobile Czech Republic a.s. relating to interconnection of public telecommunications networks in 2001 were amicably settled. Based on this agreement, T-Mobile Czech Republic a.s. paid to the Company a sum of CZK 1,053 million. Consequently, both parties cancelled all proceedings relating to the 2001 interconnection disputes.

Vodafone Czech Republic, a.s. – interconnect litigations

I. On 30 June 2005, Vodafone Czech Republic, a.s. (former Český Mobil/Oskar Mobil) brought a petition with the Municipal Court in Prague against the Company for damages in the amount of CZK 538 million with appurtenances and for returning the unjustified enrichment of CZK 117 million with appurtenances. The petition claims that the Company allegedly failed to transmit the traffic to networks operated by other mobile operators according to respective interconnection agreements.

The High Court in Prague confirmed the Company's conclusion that CTO already issued the final decision in favour of the Company and that Vodafone Czech Republic, a.s. was trying to evade this final decision. The Municipal Court in Prague therefore terminated the legal action in September 2008. The High Court in Prague partially confirmed the decision, and the remaining part was dismissed by the Municipal Court in Prague's resolution of 30 September 2009 as unjustified. Based on the progress to date, the Company believes that the High Court will confirm the positive resolution in the appellate proceedings.

II. In May 2004, Vodafone Czech Republic, a.s. filed a petition against Eurotel Praha, spol. s r.o. for damages in the amount of CZK 1,043 million due to an alleged breach of the Competition Protection Act. The decision rendered by the Office for the Protection of Competition, which Vodafone Czech Republic a.s. based the proceedings on, was overruled by the finding of the Constitutional Court on 11 July 2007. The Municipal Court in Prague fully dismissed the unfounded petition on 21 August 2008 as unjustified. The decision was unsuccessfully appealed by Vodafone Czech Republic, a.s. with the High Court in Prague, which finally confirmed by resolution of 6 October 2009 that the petition dismissal was correct.

The Company management considers disclosure of further information on these disputes inappropriate, as it could prejudice the Company's position in these disputes. The Company management is convinced that all risks relating to the litigations are adequately reflected in the financial statements.

The Office for the Protection of Competition

I. The Company was subject to administrative proceeding before the Office for the Protection of Competition (UOHS) relating to the alleged abuse of the dominant position by creating unfair barriers on the market by offering certain price plans for residential customers. With a resolution of 20 April 2005, UOHS imposed a fine on the Company in the total amount of CZK 210 million, which was, after the Company's appeal, consequently reduced to CZK 205 million. After dismissal of a petition and cassation complaint by administrative courts, the Company filed a constitutional complaint with the Constitutional Court in 2009.

The Company management considers disclosure of further information on these disputes inappropriate, as it could prejudice the Company's position in these disputes. The Company management is convinced that all risks relating to the litigation are adequately reflected in the financial statements.

Other legal matters

I. The dispute with TELE 2 was also closed in 2009. TELE 2 s.r.o. sued the Company on 3 February 2005 for an alleged breach of the Competition Protection Act due to offering certain pricing plans from September 2002 until December 2004. The amount of the claim was CZK 2,142 million – with appurtenances. During the course of the proceedings, TELE 2 s.r.o. was succeeded in the role of the plaintiff by TELE 2 EUROPE S.A. The Company provided to the court an extensive defence along with proposed items of evidence proving the legal imperfectness

of the sued case. The Company management adequately reflected the matter in the financial statements. Eventually, the Company and TELE 2 EUROPE S.A. agreed on settlement and terminated their dispute in the Czech Republic. As a result of this settlement there is no longer any risk for the Company with respect to the amount of CZK 2,142 million originally claimed by TELE 2 in 2005. The legal action was withdrawn. The proceeding was finally terminated in July 2009.

Other confidential information may not be disclosed to the public. The Company is bound by confidentiality agreement and has no intent to harm either party's interests by any comments.

II. The Company was sued by AUGUSTUS spol. s r.o. for an alleged loss of profit in the principal amount of approximately CZK 183 million with appurtenances relating to the years 1995–2001. AUGUSTUS spol. s r.o. claims that the Company illegitimately cancelled a contract for issue of phone cards, which was entered into for an unlimited period of time. Based on court decision, the Company paid an amount of CZK 83 million and the corresponding interest in August 2006 (in total approximately CZK 139 million). Both parties subsequently filed an extraordinary appeal against the court judgment. Based on the Company's extraordinary appeal, the Supreme Court annulled all previous judgements in June 2009. The Municipal Court in Prague shall deal with the petition again.

III. Subsequently AUGUSTUS spol. s r.o. filed another petition against the Company regarding the amount of approximately CZK 294 million (status in April 2008). The petition is based again on the contract on phone cards issuing between Telefónica O2 Czech Republic, a.s. and AUGUSTUS spol. s r.o. that was terminated 13 years ago. AUGUSTUS spol. s r.o. brings up a number of new requirements in the petition that are not underpinned by law or contradict each other. It is not even possible to sum up individual claims in the petition to be able to specify the total amount. Telefónica O2 Czech Republic, a.s. takes all steps in the lawsuit to defend thoroughly against this unlawful claim and believes in success in this lawsuit. However, with respect to the claimed amount the Company informs about this proceeding.

Considering the judgement of the Supreme Court and the progress in the matter, the Company management believes that it is not necessary to create or maintain any reserves regarding these disputes.

IV. The Company is a party to other litigations. The total amount of all cases, the individual amount of which exceeds CZK 5 million, totals to CZK 233 million. Even minor litigations are reflected in the financial statement, however, risks relating to these litigations are immaterial.

21) Commitments

Operating leases

The aggregate future minimum lease payments under operating leases are as follows:

In CZK million	31 December 2009	31 December 2008
No later than 1 year	1,453	1,451
Later than 1 year and not later than 5 years	4,900	4,524
Later than 5 years	4,747	6,067
Total	11,100	12,042

The total lease payments relating to operating leasing of property, plant and equipment recognised as an expense in 2009 were CZK 1,496 million (2008: CZK 1,320 million). These lease agreements may contain clauses requiring restoration of the leased site at the end of the lease term. At present, such costs do not have a material impact on the Group's consolidated results of operations, financial position, or cash flow and therefore are not accounted for.

In 2004 the Group entered into a sale and lease back transaction and now leases the majority of its car fleet under operating leases. There are no contingent rent obligations. The lease arrangements include an option to renew the lease after the initial period. Lease payments are fixed and determinable, however they may be increased to reflect inflation and other market conditions such as interest rates changes (e.g. an increase in PRIBOR by more than 2 % over a half year). There are no significant restrictions imposed by these lease arrangements, such as those concerning dividends, additional debt and further leasing. Total future lease payments relating to this contract in 2009 were CZK 371 million (2008: CZK 395 million).

Capital and other commitments

In CZK million	31 December 2009	31 December 2008
Capital and other expenditure contracted but not provided for in the financial statements	5,422	646

The majority of contracted amounts relate to the telecommunications network and service contracts.

22) Service concession arrangements

The Company performs communication activities as defined under the Act on Electronic Communications based on a notification and a certificate from the Czech Telecommunication Office num. 516 as amended by later changes num. 516/1, 516/2 and 516/3.

The communication activities include (territory of the Czech Republic):

- a) public fixed network of electronic communications,
- b) public mobile network of electronic communications,
- c) public network for the transfer of radio and TV signal,
- d) public fixed telephone network,
- e) public mobile telephone network,
- f) publicly accessible telephone services,
- g) other voice services – service is provided as publicly available,
- h) rent of circuits – service is provided as publicly available,
- i) transmission of radio and TV signal – service is provided as publicly available,
- j) transfers of data – service is provided as publicly available,
- k) internet access services – service is provided as publicly available,
- l) other voice services – service is not provided as publicly available,
- m) rent of circuits – service is not provided as publicly available,
- n) transmission of radio and TV signal – service is not provided as publicly available,
- o) transfers of data – service is not provided as publicly available,
- p) internet access services – service is not provided as publicly available.

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 on the basis of radio frequency assignment from 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 CTO valid until 1 January 2022 and in the 450 MHz frequency band using technology CDMA2000 (Code Division Multiple Access – "CDMA"), where on the basis of radio frequency assignment from CTO valid until 7 February 2011 is provided broadband mobile access to Internet.

Validity of radio frequency assignment is possible to prolong for next period on the basis of application submitted to CTO in accordance with the Act on Electronic Communications. Relative to the current regulatory and business environment in the Czech Republic, contractual, legal, regulatory, competitive or other economic factors may limit the period during which the Company can benefit from the use of these radio frequency assignments in the future.

No additional expenses or any limitations connected with renewal of the radio frequency assignments are expected in accordance with the existing interpretation of regulatory provisions.

Provision of electronic communications services in Slovakia

In 2006 Telefónica O2 Slovakia was granted a licence for providing of electronic communications services by the means of the public electronic communications network – GSM and UMTS mobile telephone network within the area of the Slovak Republic. The licence has been granted for 20 years, i.e. until 2026. Validity of the licence is possible to prolong for next period on the basis of application submitted to the Telecommunication Office of the Slovak Republic.

The following obligations were part of the licence:

- a) putting into operation the 800 GSM base stations and to cover 45 % of population by the own network,
- b) launch services in respect of welcome melodies and lease of phones.

These obligations were fulfilled in year 2008.

Imposition of obligations related to provision of universal service

During the year 2009 and 2008, the Company provided the following selective services under CTO imposed obligations to provide universal service:

- a) public pay telephones services,
- b) access for disabled to the public telephone,
- c) supplementary services to service of connection at a fixed location to the public telephone network and the service of access to publicly available telephone services at a fixed location:
 - phased payment of the price for the establishment of connection to the public telephone network for consumer,
 - free selective barring of outgoing calls for the subscribers, and
 - free itemised billing of the price for consumer*,
- d) special price schemes, which are different from the price schemes used under normal business conditions, for low income persons, persons with special social needs and disabled persons.

* Services listed under letter c) above are excluded from the universal service regime on the basis of CTO decision since 30th of July 2009. Providing of these services continues in commercial regime out of universal service.

23) Share capital and reserves

	31 December 2009	31 December 2008
Nominal value per ordinary bearer share (CZK)	100	100
Number of shares	322,089,890	322,089,890
Nominal value per ordinary registered share (CZK)*	1,000	1,000
Number of shares*	1	1
Ordinary shares (in CZK million)	32,209	32,209

* One share owned by the National Property Fund of the Czech Republic bore special decision-making rights in accordance with the statutes of the Company. These special rights included namely decisions regarding the liquidation of the Company, changes in its activities, sale or lease of the Company or of its assets. This share was assigned to Telefónica, S.A. within the transferred 51.1 % stake in the Company. From this date, the share has not borne special decision-making rights.

Shareholdings in the Company were as follows:

	31 December 2009	31 December 2008
Telefónica, S.A.	69.41 %	69.41 %
Other shareholders	30.59 %	30.59 %

Funds include a statutory reserve fund of CZK 6,442 million (2008: CZK 6,442 million) that is not distributable under ruling legislation. Equity settled share based payments reserve is not distributable.

On 21 April 2008 the Annual General Shareholders Meeting approved the restructuring of equity in the form of transfer of CZK 6,442 million from share premium to statutory reserve fund. Further the opening balance of the statutory reserve fund of CZK 6,442 million was transferred to retained earnings and used for distribution of dividend.

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) comply with all relevant legal requirements.

The investment strategy in the light of managing capital of the Company is to direct investment activities in pro-growth areas, i.e. fixed and mobile broadband internet, IPTV, mobile services, public administration, corporate ICT solutions and in the expansion of the mobile services in Slovakia.

At present, the approach that the Company follows is not to retain surplus cash. In the following periods, the Board of Directors will continue to evaluate and carry out an in-depth analysis of the current and anticipated results of the Company, including scheduled and potential investments and cash flow generation and will establish the most adequate capital structure for accomplishment of the plans.

There is no other specific objective.

No changes were made in the objectives, policies or processes during the years 2009 and 2008.

The equity breakdown used in the capital management is following:

In CZK million	31 December 2009	31 December 2008
Capital	73,841	78,121
Equity settled share based payment reserve	38	47
Total	73,879	78,168

25) Hedging reserve

In CZK million	
Balance at 1 January 2008	(20)
Fair value gains in period	24
Fair value losses transfer to net profit	(4)
Balance at 31 December 2008	–
Fair value losses in period	–
Fair value losses transfer to net profit	–
Balance at 31 December 2009	–

25) Related party transactions

The Group provides services to all related parties on normal commercial terms. 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 no allowance or write off was incurred.

The following transactions were carried out with related parties:

I. Parent company:

In CZK million	31 December 2009	31 December 2008
Dividend paid to Telefónica, S.A.	11,179	11,179
Royalty fees (Telefónica, S.A.)	754	626

II. Other related parties – Telefónica Group:

In CZK million	31 December 2009	31 December 2008
a) Sales of services and goods	1,058	704
b) Purchases of services and goods	566	597
c) Capital purchases	54	5
d) Receivables	581	111
e) Payables	874	4,011
f) Short-term receivables (interest)	–	14
g) Interest income	149	374
h) Interest expense	41	92
j) Cash equivalents (Note 13)	1,100	6,344

As at 31 December 2008 the payables included a loan in amount of CZK 3,194 million provided to Telefónica O2 Slovakia by the company Telfisa Global, BV. The loan bore a floating interest based on 1M BRIBOR. In 2009 the total interest expense was CZK 31 million (2008: CZK 91 million). The loan conditions were based on the arm's length principle. The loan was repaid in July 2009 together with related interests.

The list of the Telefónica companies with which the Company had any transaction in 2009 includes the following entities: Telefónica S.A., Telefónica de España, S.A.U., Telefónica O2 Germany GmbH & CO.OHG, Telefónica O2 UK Ltd., Telefónica O2 Ireland Ltd., Telefónica Móviles España, S.A.U., Telefónica Móviles Argentina, S.A., Pléyade Peninsular, O2 Holdings Ltd., Manx Telecom Ltd., Telefónica Móviles Guatemala, S.A., Telefónica Móviles El Salvador, S.A. de C.V., Telefónica Móviles Panamá, S.A., Telefónica Móviles Chile, S.A., Otecel, S.A., Telefónica Móviles Nicaragua, S.A., Telefónica Móviles Columbia, S.A., Telefónica S. de Informática y Comunicaciones de España, S.A.U., Telefónica Investigación y Desarrollo, S.A., Portugal Telecom, S.G.P.S., S.A., Telecom Italia S.p.A., Telfisa Global, BV., Telefónica Finanzas, S.A., Telefónica International Wholesale Services, Telefónica International Wholesale Services II, S.L., Telefónica Gestión de Servicios Compartidos, S.A., Telefónica Factoring E.F.C., S.A., Atento Chequia, Telefónica Compras Electrónica, S.L., Telefónica Móviles Mexico, S.A., Telefónica Móviles del Uruguay, S.A., Telefónica Móviles Peru, S.A., Telefónica Venezuela, S.A., China Unicom (Hong Kong) Limited, Telefónica O2 Business Solutions, spol. s r.o., CZECH TELECOM Germany GmbH, CZECH TELECOM Austria GmbH, Telefónica O2 Slovakia.

III. Other related parties**a) Key management compensation**

Members of the Board of Directors and of the Supervisory Board of the Telefónica O2 Czech Republic, a.s. were provided with benefits as follows:

In CZK million	31 December 2009	31 December 2008
Salaries and other short-term benefits	122	123
Personal indemnification insurance	5	7
Total	127	130

b) Loans to related parties

There were no loans provided to members of Board of Directors and Supervisory Board in 2009 and 2008.

No other loan was provided to related parties by the Group.

26) Principal subsidiary undertakings

		Group's interest	Cost of investment In CZK million	Country of incorporation	Activity
Subsidiaries					
1.	Telefónica O2 Business Solutions, spol. s r.o. (formerly Telefónica O2 Services, spol. s r.o., merged with DELTAX Systems a.s.)	100 %	237	Czech Republic	Network and consultancy services in telecommunications, IT/ICT services
2.	CZECH TELECOM Germany GmbH	100 %	13	Germany	Data transmission services
3.	CZECH TELECOM Austria GmbH	100 %	11	Austria	Data transmission services
4.	Telefónica O2 Slovakia, s.r.o.	100 %	5,081	Slovakia	Mobile telephony, internet and data transmission services
Associates					
5.	První certifikační autorita, a.s.	23 %	9	Czech Republic	Rendering of certification services
6.	AUGUSTUS, spol. s r.o.	40 %	–	Czech Republic	Sales by auctions and advisory services

During the fourth quarter of 2007, SPT TELECOM (Czech Republic) Finance B.V. in liquidation commenced preparatory steps for the process of voluntary liquidation. Until the end of 2008, the key legal steps for dissolution of the company have been executed. The cancellation of the registration from the Commercial Register was performed as of 9 February 2009.

In December 2008, the Board of Directors of the Company approved the plan to merge Telefónica O2 Business Solutions, spol. s r.o. with DELTAX Systems a.s. This merger became effective 1 January 2009 after the fulfillment of all legal conditions performed in the half of 2009. Telefónica O2 Business Solutions, spol. s r.o. became the legal successor while DELTAX Systems a.s. was dissolved without liquidation. The assets, rights and obligations including labour rights and duties were transferred to the successor.

In June 2009, the Board of Directors approved increase of the registered capital of Telefónica O2 Slovakia by a monetary investment in the amount of EUR 150 million from the amount of the registered capital of EUR 50 million to the amount of the registered capital of EUR 200 million. Effective date of increase of the registered capital was 19 August 2009.

The Company has an intention to further increase the registered capital of Telefónica O2 Slovakia by estimated amount of EUR 40 million during 2010.

27) Post balance sheet events

As of 1st February 2010, Chief Executive Officer Salvador Anglada Gonzales was transferred to Telefónica S.A. in Madrid. Luis Antonio Malvido was appointed as a new Chief Executive Officer.

There were no other events, which have occurred subsequent to the year-end, which would have a material impact on the financial statements at 31 December 2009.

Financial statements for the year ended 31 December 2009

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General information

Telefónica O2 Czech Republic, a.s. (the "Company") has a form of a joint stock company and is incorporated and domiciled in the Czech Republic. The address of its registered office is Za Brumlovkou 266/2, Prague 4, 140 22, Czech Republic.

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

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

The number of employees employed with the Company amounted in average to 8,282 in 2009 (2008: 8,542).

The Company's shares are traded on the Prague Stock Exchange and London Stock Exchange (GDRs).

These financial statements were approved for issue by the Company's Board of Directors on 19 February 2010.

Merger of DELTAX Systems a.s. with Telefónica O2 Business Solutions, spol. s r.o.

In December 2008, the Board of Directors of the Company approved the plan to merge Telefónica O2 Business Solutions, spol. s r.o. with DELTAX Systems a.s. This merger became effective as at 1 January 2009 after the fulfillment of all legal conditions performed in the year 2009. Telefónica O2 Business Solutions, spol. s r.o. became the legal successor while DELTAX Systems a.s. was dissolved without liquidation. The assets, rights and obligations including labour rights and duties were transferred to the successor.

Liquidation of subsidiary SPT TELECOM (Czech Republic) Finance B.V. in liquidation

During the fourth quarter of 2007, SPT TELECOM (Czech Republic) Finance B.V. in liquidation commenced preparatory steps for the process of voluntary liquidation. Until the end of 2008, the key legal steps for dissolution of the Company have been executed. As of 9 February 2009, the registration of the company was cancelled from the Commercial Register.

Independent auditor's report

To the shareholders of Telefónica O2 Czech Republic, a.s.:

We have audited the accompanying financial statements of Telefónica O2 Czech Republic, a.s. ("the Company"), which comprise the balance sheet as at 31 December 2009 and the statement of comprehensive income, statement of changes in equity and cash flow statement 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. This responsibility includes: designing, implementing and maintaining internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

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 International Standards on Auditing and 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 auditors' judgment, including the 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 give a true and fair view of the financial position of the Company as of 31 December 2009, and of 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.
Licence No. 401
Represented by



Brian Welsh
Partner



Radek Pav
Auditor,
Licence No. 2042

19 February 2010
Prague,
Czech Republic

Statement of comprehensive income

For the year ended 31 December 2009

In CZK million	Notes	Year ended 31 December 2009	Year ended 31 December 2008
Revenue	2	58,054	63,613
Gains from sale of non-current assets	8	422	855
Internal expenses capitalized in fixed assets	2	660	341
Operating expenses	3	(31,661)	(35,232)
Impairment loss	8, 9,10	(23)	(85)
Depreciation and amortisation	8, 9	(11,688)	(12,714)
Operating profit		15,764	16,778
Interest income	4	165	446
Interest expense	4	(229)	(313)
Other finance (expense)	4	(89)	(121)
Profit before income tax		15,611	16,790
Taxes on income	5	(3,197)	(3,697)
Profit for the year		12,414	13,093
Other comprehensive income			
Gains proceeding from cash flow hedges		–	24
Income tax effect		–	(4)
Total comprehensive income, net of tax		12,414	13,113
Profit attributable to:			
Equity holders of the Parent		12,414	13,093
Total comprehensive income attributable to:			
Equity holders of the Parent		12,414	13,113
Earnings per share (CZK) – basic*	6	39	41

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

Balance sheet

As at 31 December 2009

In CZK million	Notes	31 December 2009	31 December 2008
ASSETS			
Property, plant and equipment	8	55,186	61,198
Intangible assets	9	21,677	21,702
Investment in subsidiaries and associates	26	5,351	1,507
Other financial assets	12	1,311	377
Non-current assets		83,525	84,784
Inventories	11	585	743
Receivables and prepayments	12	9,140	9,248
Income tax receivable		694	225
Cash and cash equivalents	13	1,241	6,972
Current assets		11,660	17,188
Non-current assets classified as held for sale	8	95	96
Total assets		95,280	102,068
EQUITY AND LIABILITIES			
Ordinary shares	23	32,209	32,209
Share premium		24,374	24,374
Retained earnings, funds and reserves		21,207	24,896
Total equity		77,790	81,479
Long-term financial debts	15	3,044	3,098
Deferred taxes	16	3,333	3,299
Non-current provisions for liabilities and charges	18	23	402
Non-current other liabilities	14	19	175
Non-current liabilities		6,419	6,974
Short-term financial debts	15	87	98
Trade and other payables	14	10,710	12,838
Provisions for liabilities and charges	18	274	679
Current liabilities		11,071	13,615
Total liabilities		17,490	20,589
Total equity and liabilities		95,280	102,068

These financial statements were approved by the Board of Directors on 19 February 2010 and were signed on its behalf by:



Jakub Chytil
Member of the Board of Directors
General Counsel and Company Secretary



Jesús Pérez de Uriguen
1st Vice Chairman of the Board of Directors
Vice President, Finance Division

Statement of changes in shareholders' equity

For the year ended 31 December 2009

In CZK million	Notes	Share capital	Share premium	Hedging reserve	Equity settled share based payments reserve	Funds*	Retained earnings	Total
At 1 January 2008		32,209	30,816	(20)	–	6,450	14,970	84,425
Fair value gains (net of tax) – cash flow hedges	24	–	–	20	–	–	–	20
Net profit		–	–	–	–	–	13,093	13,093
Total comprehensive income		–	–	20	–	–	13,093	13,113
Equity restructuring	23	–	(6,442)	–	–	6,442	–	–
Transfer from reserve fund to retained earnings	23	–	–	–	–	(6,442)	6,442	–
Capital contribution		–	–	–	45	–	–	45
Dividends declared in 2008	7	–	–	–	–	–	(16,104)	(16,104)
At 31 December 2008		32,209	24,374	–	45	6,450	18,401	81,479
At 1 January 2009		32,209	24,374	–	45	6,450	18,401	81,479
Net profit		–	–	–	–	–	12,414	12,414
Total comprehensive income		–	–	–	–	–	12,414	12,414
Capital contribution and other transfers		–	–	–	(9)	–	10	1
Dividends declared in 2009	7	–	–	–	–	–	(16,104)	(16,104)
At 31 December 2009		32,209	24,374	–	36	6,450	14,721	77,790

* Refer to Note 23 regarding amounts not available for distribution.

Cashflow statement

For the year ended 31 December 2009

In CZK million	Notes	Year ended 31 December 2009	Year ended 31 December 2008
Net profit		12,414	13,093
Non-cash adjustments for:			
Income tax	5	3,197	3,697
Depreciation	8	9,758	10,838
Amortisation	9	1,930	1,876
Impairment loss	8, 9, 10	23	85
Disposals of obsolete assets		3	109
Profit on sale of property, plant and equipment		(476)	(840)
Net interest and other income (charges)		64	(133)
Foreign exchange losses/(gains) (net)		(195)	39
Fair value changes		(89)	(15)
Change in provisions and allowances		(2,086)	(781)
Operating cash flow before working capital changes		24,543	27,968
Working capital adjustments:			
Increase in trade and other receivables		(394)	(836)
Decrease/(increase) in inventories		146	(279)
Increase/(decrease) in trade and other payables		444	(885)
Cash flows from operating activities		24,739	25,968
Interest paid		(203)	(392)
Interest received		169	367
Income tax paid		(3,632)	(4,833)
Net cash from operating activities		21,073	21,110
Cash flows from investing activities			
Purchase of property, plant and equipment		(4,543)	(4,070)
Purchase of intangible assets		(2,216)	(2,100)
Proceeds from sales of property, plant and equipment		891	4,585
Proceeds from marketable securities		–	24
Cash purchase of financial investments		(3,844)	(30)
Dividends received		11	7
Grant of loan		(1,011)	(40)
Repayment of loan		–	40
Net cash used in investing activities		(10,712)	(1,584)
Cash flows from financing activities			
Proceeds from borrowings		–	650
Repayment of borrowings		(5)	(6,645)
Dividends – paid		(16,087)	(16,080)
Net cash used in financing activities		(16,092)	(22,075)
Net decrease in cash and cash equivalents		(5,731)	(2,549)
Cash and cash equivalents at beginning of year		6,972	9,521
Cash and cash equivalents at the year end	13	1,241	6,972

Accounting policies

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A) Basis of preparation

The principal accounting policies applied in the preparation of these financial statements are set out below. These 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 International Financial Reporting Interpretations Committee ("IFRIC").

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 year-end, there is no difference in the policies applied by the Company between IFRS 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 on 19 February 2010.

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 management to exercise its judgement 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 these financial statements are presented in millions Czech Crowns ("CZK"), if not stated otherwise.

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

In 2009, the Company applied the below stated standards, interpretations and amendments, which are relevant to its operations. Adoption of the interpretations and amendments has no effect on the financial performance or position of the Company:

IFRS 2 Amendment (issued 2008, effective date 1 January 2009) Share-based Payments

The amendment clarifies the definition of a vesting condition and prescribes the treatment for an award that is cancelled. This amendment has no material impact on the Company's financial statements.

IFRS 7 Financial Instruments: Disclosures (issued 2009, effective date 1 January 2009)

The amendment requires additional disclosure about fair value measurement and liquidity risk. Fair value measurements related to items recorded at fair value are to be disclosed by source of inputs using a three level fair value hierarchy, by class, for all financial instruments recognised at fair value. The amendment also clarifies the requirements for liquidity risk disclosures with respect to derivative transactions and assets used for liquidity management.

This adoption affects certain disclosures in the notes to the Company financial statements.

IFRS 8 Operating Segments (issued 2006, effective date 1 January 2009)

The standard replaces IAS 14 Segment Reporting and requires entities to disclose segment information based on the information reviewed by the entity's chief operating decision maker. The adoption of the standard has no impact on the current presentation and disclosure of segment information.

IAS 1 Amendment (issued 2007, effective date 1 January 2009) Presentation of financial statements

The amendment to the standard separates owner and non-owner changes in equity. In addition, the Standard introduces a statement of comprehensive income: presenting all items of income and expense recognised in the income statement, together with all other items of recognised income and expense, either in one single statement, or in two linked statements. This revised standard has been adopted in the current financial period for the Company financial statements.

IAS 23 Amendment (issued 2007, effective date 1 January 2009) Borrowing Costs

The amendment requires the Company to capitalise borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset. Since the Company has already applied this policy as an allowed alternative treatment before the effective date of this amendment, there is no impact on the financial position of the Company.

IAS 27 Consolidated and Separate Financial Statements – Cost of an Investment in a Subsidiary, Jointly Controlled Entity or Associate – Amendments (issued 2008, effective date 1 January 2009)

IAS 27 is amended for the following changes in respect of the holding companies separate financial statements:

- i) The deletion of the "cost method". Making the distinction between pre- and post-acquisition profits is no longer required. All dividends are recognized in profit or loss. However, the payment of such dividends requires the entity to consider whether there is an indicator of impairment; and
- ii) In case of reorganisations where a new parent is inserted above an existing parent of the group (subject to meeting specific requirements), the cost of the subsidiary is the previous carrying amount of its share of equity items in the subsidiary rather than its fair value.

There is no material effect relating to the adoption of these amendments on the Company financial statements.

IFRIC 13 Customer Loyalty Programmes (issued 2007, effective date 1 July 2008)

This interpretation addresses the accounting by entities that provide their customers with incentives to buy goods or services by providing awards as part of the sale transaction. The interpretation requires the entity that grants the awards to account for the sales transaction that gives rise to the award credits as a multiple element transaction and allocate the fair value of the consideration received or receivable between the award credits granted and the other components of the revenue transaction.

This adoption affects current accounting policy in respect of change of the fair value awards measurement and change in the presentation in the financial statements. This also affects certain disclosures in the notes to the financial statements.

This adoption has not any material impact on the financial results in the year 2009.

Standards and interpretations issued and endorsed by the European Union but not early adopted by the Company (includes standards and interpretations applicable for the Company)

Revised IFRS 3 Business Combinations (issued 2008, effective date 1 July 2009)

The standard introduces changes in the accounting for business combination that will have an impact on the amount of goodwill recognised, the reported results in the period that an acquisition occurs and on future reported results. The Company is currently assessing the impact of the application of this standard. The Company will apply IFRS 3 (Revised) prospectively to all business combinations from 1 January 2010.

IAS 27 Consolidated and Separate Financial Statements – Amendment (issued 2008, effective date 1 July 2009)

The most significant changes to IAS 27 are as follows:

- i) Changes in the ownership interest of a subsidiary (that do not result in a loss of control) are accounted for as an equity transaction and have no impact on goodwill nor give rise to a gain or loss.
- ii) Losses incurred by the subsidiary are allocated between the controlling and non-controlling interests (previously referred to as “minority interest”); even if the losses exceed the non-controlling equity investment in a subsidiary.
- iii) On loss of control of a subsidiary, any retained interest is remeasured to fair value and this has impact on the gain or loss recognized on disposal.

There is not any material effect expected relating to the adoption of this amendment on the Company financial statements.

Standards and interpretations issued but not endorsed by the European Union and neither early adopted by the Company nor effective (includes standards and interpretations applicable for the Company)

IFRS 2 Amendment (issued 2009, effective date 1 January 2010) Share-based Payments

The amendment is concerning the accounting for group cash-settled share-based payment transactions. The amendment clarifies how an individual subsidiary in a group should account for some share-based payment arrangements in its own financial statements. In these arrangements, the subsidiary receives goods or services from employees or suppliers but its parent or another entity in the group must pay those suppliers.

This amendment will not have any material impact on the Company financial statements.

IFRIC 18 Transfers of Assets from Customers (issued 2009, effective 1 July 2009)

This interpretation provides guidance on how to account for items of property, plant, and equipment received from customers, or cash that is received and used to acquire or construct specific assets. This interpretation is only applicable to such assets that are used to connect the customer to a network or to provide ongoing access to a supply of goods or services or both.

The Company has assessed the impact of the application of this interpretation, there will be no impact on the financial statements.

IFRS 5 Amendment (issued 2009, effective 1 January 2010) Non-current Assets Held for Sale and Discontinued Operations – Disclosure

This amendment was issued in order to clarify the disclosure requirements in respect of non-current assets (or disposal groups) classified as held for sale or discontinued operations. Also clarifies that the general requirements of IAS 1 still apply.

The Company does not expect any material changes to the disclosure in the notes to the financial statements.

IFRS 8 Amendment (issued 2009, effective 1 January 2010) Operating Segments – Disclosure

Minor textual amendment to the standard and amendment to the basis for conclusions, to clarify that an entity is required to disclose a measure of segment assets only if that measure is regularly reported to the chief operating decision-maker.

The Company does not expect any material changes to the disclosure in the notes to the financial statements resulting from this amendment.

IAS 1 Amendment (issued 2009, effective 1 January 2010) Presentation of Financial Statements

The amendment specifies current / non-current classification of convertible instruments and clarifies that the potential settlement of a liability by the issue of equity is not relevant to its classification as current or non-current. By amending the definition of current liability, the amendment permits a liability to be classified as non-current (provided that the entity has an unconditional right to defer settlement by transfer of cash or other assets for at least 12 months after the accounting period) notwithstanding the fact that the entity could be required by the counterparty to settle in shares at any time.

This amendment will not have any material impact on the Company financial statements.

IAS 7 Amendment (issued 2009, effective 1 January 2010) Statement of Cash Flows

Amendment to require that only expenditures that result in a recognized asset in the statement of financial position can be classified as investing activities. This amendment will have no impact on the Company financial statements, since this treatment is already applied by the Company.

IAS 36 Amendment (issued 2009, effective 1 January 2010) Impairment of Assets

Amendment to clarify that the largest cash-generating unit (or groups of units) to which goodwill should be allocated for the purposes of impairment testing is an operating segment as defined by par. 5 of IFRS 8 Operating Segments. The Company is currently assessing the impact of the application of this amendment on the financial statements.

IAS 38 Amendments (issued 2009, effective 1 January 2010) Intangible Assets

The first amendment clarifies the effect of the decision in IFRS 3 (Revised) on the accounting for intangible assets acquired in a business combination.

The second amendment clarifies the description in IAS 38, 40 and 41 of valuation techniques commonly used by entities when measuring the fair value of intangible assets acquired in a business combination that are not traded in active markets.

The Company is currently assessing the impact of these amendments. The Company will apply IAS 38 Amendments together with IFRS 3 (Revised) prospectively to all business combination from 1 January 2010.

IFRS 5 Amendment (issued 2008, effective 1 July 2009) Non-current Assets Held for Sale and Discontinued Operations

The amendment clarifies that all of subsidiary's assets and liabilities are classified as held for sale if a partial disposal sale plan results in loss of control. Relevant disclosure should be made for this subsidiary if the definition of a discontinued operation is met. A consequential amendments to IFRS 1 states that these amendments are applied prospectively from the date of transition to IFRS.

The Company will apply the IFRS 5 (Amendment) prospectively to all partial disposals of subsidiaries from 1 January 2010.

IFRS 9 Financial Instruments (issued in 2009, effective date 1 January 2013)

This standard specifies classification and measurements of financial assets.

The Company is currently assessing the impact of standard. The Company will apply IFRS 9 from 1 January 2013.

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 the statement of comprehensive income,

except when deferred in equity 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 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 depreciation and 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 cost 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. Subsequent costs are recognised as decrease of accumulated depreciation if only useful life is extended.

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 de-recognised or 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 these financial statements are as follows:

	Years
Freehold buildings	up to 40
Cable and other related plant	5 to 25
Exchanges and related equipment	up to 10
Other fixed assets	2 to 10

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

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

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

D) Intangible assets

Intangible assets include computer software, purchased goodwill, licenses, trade names, customer base and roaming contracts. 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 one to five years.

Intangible assets acquired in business combinations are stated at their acquisition costs (which are equal to their fair value at the date of acquisition) less amortisation and 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.

Acquired licenses are recorded at cost and amortised on a straight-line basis over the remaining life of the license (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 9 and Note 10).

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 the statement of comprehensive income 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 impairment is only being determined.

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 the statement of comprehensive income.

F) Impairment of assets

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

Impairment losses are recognised in expenses when incurred. A previously recognised impairment loss is reversed (except for the Goodwill impairment loss) only if there has been a change in the estimates 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 as a reduction in the expenses in the period in which the reversal occurs.

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 2009 and 2008, 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.

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 the statement of comprehensive income 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 equity 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 equity is recognised in the statement of comprehensive income.

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 the statement of comprehensive income.

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 the statement of comprehensive income 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) directly in equity shall be removed from equity 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 equity 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 the statement of comprehensive income.

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 the statement of comprehensive income 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 on the finance balance outstanding. 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 the statement of comprehensive income 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.

A sale and lease back transaction involves the sale of an asset and the leasing back of the asset. Within the Company's operations the selling price of the asset and lease payments are independent and established at fair value. Therefore the gain from the sale of the asset and the lease payments are accounted as two separate transactions.

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 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 the statement of comprehensive income.

K) Cash and cash equivalents

Cash and cash equivalents are carried in the balance sheet at cost. For the purposes of the cash flow statement, 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 on the balance sheet.

L) Financial debt

Borrowings are recognised initially at 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 the statement of comprehensive income 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.

Interest costs on borrowings 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 directly in equity is recognised in equity and not in the statement of comprehensive income.

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 the statement of comprehensive income, any related tax effects are also recognised in the statement of comprehensive income. For transactions and other events recognised directly in equity, any related tax effects are also recognised directly in equity. Similarly, the recognition of deferred tax assets and liabilities in a business combination affects the amount of goodwill.

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

N) Employee benefits

(1) Pension obligations

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

(2) Redundancy and termination benefits

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

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

(3) Bonus plans

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

O) Share-based compensation

During 2006, the Company introduced performance compensation systems linked to the market value of shares of the parent company, Telefónica, S.A. Certain compensation plans are settled in cash, while the 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 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 shares granted 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 the statement of comprehensive income 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 a present legal or constructive obligation as a result of past events, it is probable that an outflow of resources will be required to settle the obligation, and a reliable estimate of the amount can be made. Where the Company expects a provision to be reimbursed, the reimbursement is recognised as a separate asset but only when the reimbursement is virtually certain.

Q) Revenue recognition

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

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

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

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

- a) the Company is the primary obligor in the arrangement,
 - b) the Company has general inventory risk,
 - c) the Company has price latitude,
 - d) the Company changes the product or performs part of the service,
 - e) the Company has discretion in supplier selection,
 - f) the Company is involved in the determination of product or service specifications,
 - g) Company has credit risk,
-

- h) the Company has the ability to set the terms of the transaction,
- i) the Company has the managerial control over the transaction.

The relative strength of each indicator is considered when concluding which accounting treatment to use for principal/agency arrangement.

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

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

(1) Fixed line business revenues

Revenue is recognized as follows:

Domestic and international call revenues

Domestic and international call revenues are recognised in the statement of comprehensive income at the time the call is made.

Universal service

The Company is obliged to render certain fixed line telephony services defined by the Act on Electronic Communications. The Company follows the accounting policy of Telefónica Group. Until March 2008, the Company recognised revenues using netto principle and recognised revenues when the contribution was received. From April 2008 until June 2009 the Company reported revenue using gross principle and recognised the compensation when CTO approved the total compensation and decided about percentage shares and absolute amounts of other operators contributions. As a result of further favourable development in smoothing of the recovery process and associated environment, since July 2009 the Company started to recognise the compensation of revenues attributable to the Company on standard accrual basis while keeping the gross principle of recording.

Subscription revenues

Revenue is recognised in the statement of comprehensive income in the period in which the services are rendered.

Revenues from sales of prepaid cards

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

Connection fees

Connection fees, arising from the connection of the customers to the Company's network, are deferred and recognised in the statement of comprehensive income over the estimated average customer relationship period on the basis of the degressive accounting method.

Equipment sales and other sale of goods

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

Local loop unbundling

Revenue from access to the local loop unbundling is deferred in the statement of comprehensive income and recognised in the period in which the service is rendered. Regular monthly fee is recognised on the straight line basis in the period when the service is consumed. Revenue from the preparation of the location (collocation) for an alternative operator is recognized upfront in the statement of comprehensive income when it occurs.

(2) Mobile business revenues

The Company earns mobile services revenue from customers usage of the Company's network, interconnection and roaming – collectively, "Mobile service revenue". The Company also earns revenue from the sale of mobile telephone equipment and accessories as well as from activation fees.

Airtime revenues

Post-paid customers are billed monthly in arrears for airtime revenues. Revenue from post-paid customers is recognised as their airtime and other services are used. Prepaid customers recharge a credit, which entitles them to a certain value of airtime and other services. Revenue from prepaid customers is deferred and recognized as the airtime and other services are used. Upon termination of the customer contract or expiration of voucher (up to 14 months), all deferred revenue for unused airtime is recognized in income.

Both, post-paid and prepaid products may include deliverables such as a handset, activation and airtime and that are defined as arrangements with multiple deliverables. The arrangement consideration is allocated to each deliverable, based on its fair value. Revenue allocated to the identified deliverables in each revenue arrangement is recognized based on the same recognition criteria of the individual deliverables at the time the product or service is delivered.

Equipment sales and mobile services

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

Roaming revenues

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.

Costs

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

(3) Interconnect revenues

Interconnect revenues are derived from calls and other traffic that originate in other domestic and foreign operators' network but use the Company's network. These revenues are recognised in the statement of comprehensive income 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 other domestic and foreign operators' for calls and other traffic that originate

in the Company's network but use other domestic and foreign operators' network. Amounts receivable from and payable to other domestic and foreign operators are netted and settled net on a regular basis.

(4) Internet, IPTV and data services

The Company earns revenue from providing Internet services, IPTV and other data services.

Revenue from such services is recognised at the time the service is provided.

(5) Dividend income

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

(6) Interest

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

(7) Instalment sales

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

R) Dividend distribution

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

S) Financial instruments

Financial instruments carried on the balance sheet include cash and bank balances, investments, receivables, payables, borrowings and derivatives. Detailed figures are described in Note 15.

Financial risk management

The Company's 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,
- c) net investment in 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 long term debt denominated in EUR and net payables in EUR or USD. Just 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:

- a) floating interest rate bearing cash investments and debt instruments,
- b) fair value of debt on fixed interest rate.

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 are on fixed rates. The Company may sometimes use interest rate swaps and forward rate agreements to manage a mix of fixed and variable rate debts.

(iii) Liquidity risk

The Company's essential objective of liquidity risk management is to have ready access to 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 focusing 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 funding continuity and flexibility is managed through maintaining the possible use of bank overdrafts or bilateral credit lines.

(iv) Credit risk

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

The Company trades only with recognized, creditworthy third parties. It is the Company's policy that all customers who wish to trade on credit terms are subject to credit verification procedures. In addition, receivable balances are monitored on an ongoing basis with the result that the

Company's exposure to bad debts is not significant. The maximum exposure is the carrying amount as disclosed in Note 12. There are no significant concentrations 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 to credit risk 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 Department 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),
- b) prevention: scoring of new customers – checking procedures (Black Lists, External Debtors Register, other information), set up the limits or/and collection of the deposit according to customer segments, products and set up the credit limits for indirect sales partners (dealers, distributors, retailers) for purchase of our products, „securing“ of credit limits (deposits, receivables insurance, bill of exchange, pledge of real estate, bank guarantee etc.). Guarantees are either in cash (deposits) or there are special procedures to collect cash for the other securing tools (insurance etc.),
- c) collection: reasonable, effective and continual collection process is the additional tool of bad debts decrease and prevention as well.

New credit management activities during last years

During last years the Company introduced new credit management activities such as:

- a) implementation of the connection to the external Debtors Register Solus (sharing debtors data with other members – banks, other telecommunication operators, leasing companies etc.),
- b) implementation of the credit management best practice from the merge of the fixed and mobile business in all company activities,
- c) checking of the new activation by using of integrated Black Lists,
- d) implementation of strict activation rules for all distribution channels.

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 the statement of comprehensive income, 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 equity. 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 equity are transferred from equity and included in the initial measurement of the cost of the asset or liability. Otherwise, amounts deferred in equity are transferred to the statement of comprehensive income and classified as revenue or expense in the same periods during which the hedged firm commitment or forecasted transaction affects the statement of comprehensive income.

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 the statement of comprehensive income.

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 equity at that time remains in equity and is recognised when the committed or forecasted transaction ultimately is recognised in the statement of comprehensive income. However, if a committed or forecasted transaction is no longer expected to occur, the cumulative gain or loss that was reported in equity is immediately transferred to the statement of comprehensive income.

The Company documents at the inception of the transaction the relationship between hedging instruments and hedged items, as well as its risk management objective and strategy for undertaking various hedge transactions. This 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.

The fair values of various derivative instruments used for hedging purposes are disclosed in Note 19. Movements on the hedging reserve in shareholder's equity are shown in Note 24.

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 flow models (using market rates). The fair value of currency options is based on information obtained from external parties, including the Company's bankers.

T) Critical accounting estimates and judgments

The Company makes estimates and assumptions concerning the future. 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 year are discussed below:

(1) Income taxes and deferred taxes

The Company created 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-deductible expenses 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. As at 31 December 2009, the total amount of provision for current income taxes is CZK 3,232 million, advances paid for income taxes amount to CZK 3,926 million and the net deferred tax liability is CZK 3,333 million.

In October 2007, the new Czech legislation was enacted, by which the corporate income tax rate was reduced from 24 % to 21 %, 20 % and 19 % for the fiscal years ending in 2008, 2009 and 2010, respectively (see Note 5).

(2) Goodwill

The Company tests at each reporting date goodwill for an impairment. 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. At 31 December 2009 the carrying amount of goodwill is CZK 13,320 million (See Note 9).

(3) Provisions and contingent liabilities

As set out in Note 20 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 will be required to settle the obligation and a reliable estimate can be made of the amount of the obligation. 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) Interconnect

The Company provides and enters into the contracts for interconnect services and the revenue is recognised on the basis of the reasonable estimation of expected amount. Such estimation is regularly reviewed, however the final agreement and invoicing can be with some operators stated on up to a yearly basis.

(5) Impairment of the fixed line business assets

The Company makes an assessment at each balance sheet date whether there is any indication that an impairment loss recognised for the fixed line business assets in prior years 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 indicators (decline of asset's market value, changes expected in the market, including technological changes etc.). Where an estimate of recoverable amount is calculated, there is a number of management assumptions about future business performance, which may, ultimately, differ from reality.

Based on the assessment performed by the Company, no increase or decrease of the previously recognised impairment of fixed line business assets was recognised in 2009 and 2008 (see Note 8 and 10).

(6) Operating lease commitments – Company as lessee

In 2007 the Company changed its headquarters and moved to the new premises, where the Company has entered into the commercial property leases. The Company has determined, based on an evaluation of the terms and conditions of the arrangements, that the lessor retains all the significant risks and rewards of the ownership and therefore the Company accounts for the contract as an operating lease.

(7) Advertising and promotional activities

The Company recognizes the expenditures on advertising and promotional activities as an expense when they incurred. Both production costs and advertising and promotional materials are immediately expensed when received.

U) Investments in subsidiary and associated undertakings

A subsidiary is an enterprise that is controlled by the Company, which means that the Company has the power to govern the financial and operating policies so as to obtain benefits from its activities.

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

Equity investments in subsidiaries and associates are recorded at cost less an allowance for diminution in value.

No consolidation of subsidiaries or associates has been performed as these financial statements are presented on a stand-alone basis. In accordance with the requirements of the Act on Accounting, the Company prepares consolidated financial statements in accordance with IFRS.

V) Change in accounting policy

No significant changes in accounting policies were applied in 2009 and 2008.

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 include primarily bank charges), fair value losses and gains on financial instruments and foreign exchange gains and losses.

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1) Segment information

Business segments recognised by the Company are as follows:

- Fixed – network communications services using a fixed network and IS/ICT services,
- Mobile – mobile communications services.

Year ended 31 December 2009			
In CZK million	Fixed	Mobile	Company
Revenues	27,239	31,813	59,052
Inter-segment sales	(394)	(604)	(998)
Total revenues	26,845	31,209	58,054
Gains from sale of non-current assets	422	–	422
Internal expenses capitalised in fixed assets	456	204	660
Costs	(15,204)	(17,455)	(32,659)
Inter-segment purchases	604	394	998
Total costs	(14,600)	(17,061)	(31,661)
Impairment charge	(17)	(6)	(23)
Depreciation	(7,031)	(2,727)	(9,758)
Amortisation	(842)	(1,088)	(1,930)
Total depreciation and amortization	(7,873)	(3,815)	(11,688)
Operating profit	5,233	10,531	15,764
Interest and other financial income (net)			(153)
Profit before tax			15,611
Tax			(3,197)
Net profit			12,414
Assets (excluding goodwill and non-current assets held for sale)	51,570	30,295	81,865
Goodwill on purchase of additional ownership interest (Eurotel Praha, spol. s r.o.)	–	13,320	13,320
Non-current assets held for sale	95	–	95
Total assets	51,665	43,615	95,280
Trade and other payables	4,938	5,772	10,710
Other liabilities	3,126	3,654	6,780
Total liabilities	8,064	9,426	17,490
Capital expenditure	3,229	2,622	5,851

Year ended 31 December 2008			
In CZK million	Fixed	Mobile	Company
Revenues	30,220	34,587	64,807
Inter-segment sales	(423)	(771)	(1,194)
Total revenues	29,797	33,816	63,613
Gains from sale of non-current assets	855	–	855
Internal expenses capitalised in fixed assets	261	80	341
Costs	(18,432)	(17,994)	(36,426)
Inter-segment purchases	771	423	1,194
Total costs	(17,661)	(17,571)	(35,232)
Impairment charge	(83)	(2)	(85)
Depreciation	(7,255)	(3,583)	(10,838)
Amortisation	(650)	(1,226)	(1,876)
Total depreciation and amortization	(7,905)	(4,809)	(12,714)
Operating profit	5,264	11,514	16,778
Interest and other financial costs (net)			12
Profit before tax			16,790
Tax			(3,697)
Net profit			13,093
Assets (excluding goodwill and non-current assets held for sale)	37,880	50,772	88,652
Goodwill on purchase of additional ownership interest (Eurotel Praha, spol. s r.o.)	–	13,320	13,320
Non-current assets held for sale	96	–	96
Total assets	37,976	64,092	102,068
Trade and other payables	6,163	6,675	12,838
Other liabilities	3,720	4,031	7,751
Total liabilities	9,883	10,706	20,589
Capital expenditure	4,271	2,474	6,745

Revenue of the Company is predominantly derived from domestic trading activities and as a result, segment reporting is only shown on the basis of business segments. With respect to the issue of IFRS 8 Operating segments and the deep integration process from the past convergence of fixed and mobile operations, the Company has analysed criteria for segment identification. The adoption of the standard has not led to a change in the reported segments.

The inter-segment pricing rates applied in 2009 and 2008 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) Revenue and Internal expenses capitalized in fixed assets

Revenue In CZK million	Year ended 31 December 2009	Year ended 31 December 2008
Voice – outgoing	12,578	14,958
Interconnection and other wholesale services	9,380	10,128
Monthly and one-off charges from voice services	15,032	16,200
Connection charges	192	326
SMS & MMS & Value added services	4,669	4,958
Leased lines and fixed data services	3,509	3,866
Internet (including monthly and one-off charges), mobile data	7,376	6,459
IT and business solutions	2,609	2,107
Equipment and activation fee	1,492	1,928
Other telecommunication revenues	901	2,182
Other revenues	316	501
Total revenues	58,054	63,613

Categories of revenues were rearranged in order to improve the presentation of revenues.

Revenues from related parties are disclosed in Note 25.

The aggregate future minimum lease payments under non-cancellable operating leases, where the Company is a lessor and give rise to future revenues consist of the buildings and other telecommunication equipment rentals as follows:

In CZK million	31 December 2009	31 December 2008
No later than 1 year	142	185
Later than 1 year and not later than 5 years	593	754
Later than 5 years	156	198
Total	891	1,137

Internal expenses capitalized in fixed assets In CZK million	Year ended 31 December 2009	Year ended 31 December 2008
Material	15	30
Labour	645	311
Total	660	341

3) Operating expenses

The following items have been included into the operating expenses:

Operating expenses In CZK million	Year ended 31 December 2009	Year ended 31 December 2008
Wages and salaries*	4,592	4,703
Redundancy payments	161	160
Social security contributions (Note 17)	1,510	1,504
Staff welfare costs	228	148
Total staff costs	6,491	6,515
Interconnection and roaming	10,650	11,408
Cost of goods sold	2,225	2,972
Contents	270	235
Customer loyalty program	74	363
Sub-deliveries	1,453	1,335
Commissions	1,116	1,167
Telecom services	205	173
Other cost of sales	583	1,109
Billing and collection	413	399
Marketing	1,220	1,514
Call centres	426	305
Network & IT repairs and maintenance	2,401	2,535
Rentals, buildings and vehicles	1,952	1,973
Utilities supplies	1,037	1,031
Consultancy and professional fees	156	211
Other external services	98	1,166
Provision for bad and doubtful debts and inventories	472	352
Taxes (other than income tax)	386	384
Other operating expenses	33	85
Total operating expenses	31,661	35,232

* Certain Company employees (including the Board of Directors) with specialised know how, or who have access to business secrets, or who are considered important to the development of the business, are bound by non-competition restrictions, for a maximum period of 12 months from the date of termination of their employment with the Company. The Company paid CZK 14 million in relation to such non-competition clauses in 2009 (2008: CZK 11million).

Categories of costs were rearranged in order to improve the presentation of costs.

Statutory auditor's fees for the year ended 31 December 2009 were as follows:

In CZK million	Year ended 31 December 2009	Year ended 31 December 2008
Statutory audit	22	23

Purchases from related parties are disclosed in Note 25.

4) Interest and other finance income and expense

In CZK million	Year ended 31 December 2009	Year ended 31 December 2008
Financial income		
Interest income	165	446
Gain for derivatives of fair value hedges (net)	71	65
Other financial income	1,055	1,306
Total financial income	1,291	1,817
Financial expenses		
Interest expenses	(229)	(313)
Other financial expenses	(1,215)	(1,492)
Total financial expenses	(1,444)	(1,805)
Net financial loss/income	(153)	12

5) Income tax

In CZK million	Year ended 31 December 2009	Year ended 31 December 2008
Total income tax expense is made up of:		
Current income tax charge	3,163	3,755
Deferred income tax credit (Note 16)	34	(58)
Taxes on income	3,197	3,697

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 2009	Year ended 31 December 2008
Profit before tax	15,611	16,790
Income tax charge calculated at the statutory rate of 20 % (2008: 21 %)	3,122	3,526
Expenses not deductible for tax purposes	144	149
Tax related to prior periods	(69)	22
Taxes on income	3,197	3,697
Effective tax rate	20 %	22 %

6) 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 year.

	31 December 2009	31 December 2008
Weighted number of ordinary shares in issue	322,089,900	322,089,900
Net profit attributable to shareholders (in CZK million)	12,414	13,093
Basic earnings per share (CZK)	39	41

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

7) Dividends

In CZK million	2009	2008
Dividends declared (including withholding tax)	16,104	16,104

Dividends include withholding tax on dividends paid by the Company to its shareholders. There has been no interim dividend paid in respect of 2009. Approval of the 2009 profit and the decision regarding the amount of any dividend payment for the 2009 financial year will take place at the Annual General Shareholders Meeting.

8) Property, plant and equipment

In CZK million	Land and buildings	Ducts, cables and related plant	Communication exchanges and related equipment	Other fixed assets	Capital work in progress including advances paid	Total
At 31 December 2009						
Opening net book amount	10,520	36,227	10,116	1,789	2,546	61,198
Additions	322	759	2,074	856	3,924	7,935
Disposals and other movements	813	396	(1,133)	(101)	(3,963)	(3,988)
Assets classified as held for sale	(185)	(3)	–	–	–	(188)
Depreciation charge	(676)	(4,238)	(3,961)	(883)	–	(9,758)
Impairment charge	–	–	(1)	–	(12)	(13)
Closing net book amount	10,794	33,141	7,095	1,661	2,495	55,186
At 31 December 2009						
Cost	19,264	101,172	86,987	9,464	2,527	219,414
Accumulated depreciation and impairment allowance	(8,470)	(68,031)	(79,892)	(7,803)	(32)	(164,228)
Net book amount	10,794	33,141	7,095	1,661	2,495	55,186
At 31 December 2008						
Opening net book amount	14,013	39,710	12,711	1,931	2,434	70,799
Additions	508	769	2,339	1,015	4,500	9,131
Disposals and other movements	–	–	(104)	(15)	(4,375)	(4,494)
Assets classified as held for sale	(3,285)	(25)	(6)	–	–	(3,316)
Depreciation charge	(667)	(4,206)	(4,823)	(1,142)	–	(10,838)
Impairment charge	(49)	(21)	(1)	–	(13)	(84)
Closing net book amount	10,520	36,227	10,116	1,789	2,546	61,198
At 31 December 2008						
Cost	17,459	99,982	90,504	10,315	2,573	220,833
Accumulated depreciation and impairment allowance	(6,939)	(63,755)	(80,388)	(8,526)	(27)	(159,635)
Net book amount	10,520	36,227	10,116	1,789	2,546	61,198

As at 31 December 2009, the carrying value of non-depreciated assets amounted to CZK 214 million (2008: CZK 241 million).

No property, plant and equipment were pledged as at 31 December 2009.

No borrowing costs were capitalized during the years 2009 and 2008.

The Company reviewed useful lives of assets in 2009 and adjusted when appropriate. This review did not have a material impact on the financial results in 2009. Change in estimate of useful life of assets has been done prospectively since 1 January 2010.

The Company reports and classifies the following assets held for sale at the balance sheet date:

In CZK million	Land and buildings	Communication exchanges and related equipment	Other fixed assets	Total
At 31 December 2009				
Opening net book amount	96	–	–	96
Disposals and other movements	(179)	–	–	(179)
Impairment charge	(10)	–	–	(10)
Assets re-classified as held for sale	188	–	–	188
Closing net book amount	95	–	–	95
At 31 December 2009				
Cost	804	120	76	1,000
Accumulated depreciation and impairment allowance	(709)	(120)	(76)	(905)
Net book amount	95	–	–	95
At 31 December 2008				
Opening net book amount	327	1	–	328
Disposals and other movements	(3,540)	(7)	–	(3,547)
Impairment charge	(1)	–	–	(1)
Assets re-classified as held for sale	3,310	6	–	3,316
Closing net book amount	96	–	–	96
At 31 December 2008				
Cost	789	187	6	982
Accumulated depreciation and impairment allowance	(693)	(187)	(6)	(886)
Net book amount	96	–	–	96

Assets intended for sale in most cases represent administration buildings with land, that became vacant due to the Company's optimisation process and which the Company will not use in the future and it is expected that their sale will take place within one year.

The non-current assets classified as held for sale are presented in the fixed segment.

In 2009, the Company achieved a total gain from the sale of the above fixed assets amounting to CZK 422 million (2008: CZK 855 million) and total losses in amount CZK 14 million (2008: CZK 58 million).

In 2008 and at the beginning of 2009, the Company completed the substantial part of a real estate usage optimisation process. In 2008, as part of this process, the Company sold a portfolio of administrative and technological buildings located throughout the whole Czech Republic. Net gain from the sale of the real estate portfolio amounted to CZK 727 million. A small portion of the real estate was leased back on the long term basis. In January 2009, the Company sold a construction site and two administrative buildings of the former headquarters at Olšanská street in Prague with a net gain exceeding CZK 300 million.

Cost of fully depreciated property, plant and equipment was CZK 69,826 million as at 31 December 2009 (2008: CZK 59,556 million).

9) Intangible assets

In CZK million	Goodwill	Licences	Software	Total
At 31 December 2009				
Opening net book amount	13,320	4,287	4,095	21,702
Additions	–	–	1,906	1,906
Disposals and other movements	–	–	(1)	(1)
Amortisation charge	–	(386)	(1,544)	(1,930)
Closing net book amount	13,320	3,901	4,456	21,677
At 31 December 2009				
Cost	13,320	6,073	25,776	45,159
Accumulated amortisation and impairment allowance	–	(2,172)	(21,310)	(23,482)
Net book amount	13,320	3,901	4,456	21,677
At 31 December 2008				
Opening net book amount	13,320	4,686	3,461	21,467
Additions	–	–	2,184	2,184
Disposals and other movements	–	–	(73)	(73)
Amortisation charge	–	(399)	(1,477)	(1,876)
Closing net book amount	13,320	4,287	4,095	21,702
At 31 December 2008				
Cost	13,320	6,073	24,137	43,530
Accumulated amortisation and impairment allowance	–	(1,786)	(20,042)	(21,828)
Net book amount	13,320	4,287	4,095	21,702

The Company reviewed useful lives of assets in 2009 and adjusted when appropriate. This review did not have a material impact on the financial results.

Goodwill

Goodwill in amount of CZK 13,320 million resulted from the acquisition of the remaining 49% ownership interest in Eurotel Praha spol. s r.o. ("Eurotel"). From the effective date of merger with Český Telecom, a.s. this goodwill is presented in the standalone financial statements of the Company. The initially recognized goodwill of CZK 14,087 million resulted from comparison of cost of business combination of CZK 29,215 million and fair value of net assets acquired of CZK 15,128 million. Until 31 December 2004 goodwill was amortised on a straight line basis over a period of 20 years and assessed for an indication of impairment at each balance sheet date.

Due to a revision of IFRS 3, IAS 36 and IAS 38 the Company ceased amortisation of the previously recognized goodwill from 1 January 2005. Accumulated amortisation as at 31 December 2004 was eliminated with a corresponding decrease in the cost of goodwill (CZK 767 million). Since the year ending 31 December 2005 onwards, goodwill is classified as an asset with indefinite useful life which has been tested annually for the impairment, as well as when there are indications of impairment. There is no other intangible asset with indefinite useful life.

The Company performed impairment tests and as result of the test the Company did not recognize any impairment losses of goodwill in 2009 and 2008. The impairment test involves determining the recoverable amount of 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 determined based on cash flow budgets, which are based on the medium-term business plan for a period of 3 years, which has been approved by the management and which is valid when the impairment test is performed. This business plan is based on the 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 an appropriate growth rates. Key assumptions on which management has based its determination of business plan and growth rates include development of gross domestic product, interest rates, nominal wages, average revenue per user (ARPU), customer acquisition and retention costs, churn rates, capital expenditure, market share, growth rates and 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 most sensitive to the following assumptions:

Estimated growth rate – the basis used to determine the value assigned to estimated growth rate is the forecast of the market and regulatory environment, where the Company conducts its business.

Discount rate – discount rates reflect management's estimate of the risk specific to the cash generating unit. The basis used to determine the value assigned is weighted average of cost of capital (WACC).

Licences

Acquired licences are represented by rights to operate the UMTS, GSM and NMT cellular networks in the Czech Republic. The original 450 MHz and GSM operating licenses were granted for a period of twenty years from the signing of the agreement for the original 450 MHz license in 1991 and from the granting of the GSM license in 1996 for use of the 900 spectrum. In 1999, former Eurotel acquired an additional GSM 1800 spectrum under its existing GSM license. In 2002, the GSM license to both spectrums was renewed and is currently valid for the remaining period of seven years. In 2002, former Eurotel renewed its 450 MHz license; the current license enables the mobile segment to offer every internationally recognized public mobile telecommunication services on frequency of 450 MHz. Mobile segment currently provides on this frequency voice services under NMT standard and broadband Internet access services using CDMA technology. The NMT license is currently valid for the remaining period of two years.

In December 2001, former Eurotel acquired the UMTS license, which has been granted for a period of twenty years. Under the license, former Eurotel was provided with deferred payment terms by the Czech Telecommunication Office ("CTO") to finance the license acquisition. In December 2003, former Eurotel signed an amendment to its original UMTS license agreement, by which the original launch of the service was extended by one year. According to the terms of this new amendment, former Eurotel agreed to pay the UMTS obligation in full during 2004 in

exchange for a forgiveness of 2003 and 2004 interest on the deferred payments provided as part of the UMTS license agreement. UMTS license was put into commercial use on 1 December 2005 when it also started to be amortized.

Carrying value of licences:

In CZK million	31 December 2009	31 December 2008
GSM 900 license	474	546
GSM 1800 license	382	440
NMT 450 license	26	33
UMTS license	3,019	3,268
Total	3,901	4,287

No borrowing costs were capitalized during the years 2009 and 2008.

Cost of fully amortised intangible assets was CZK 16,381 million as at 31 December 2009 (2008: CZK 16,829 million).

All of the Company's intangible assets with finite lives are amortised and are subject to an annual review of impairment indicators and revision of useful life.

10) Impairment of fixed assets

Fixed assets of the fixed line business

During 2003, external factors relating to the telecommunication market and regulatory environment namely uncertainty regarding tariff rebalancing, termination charges for internet dial-up interconnection charges and other regulatory decisions in the Czech Republic led the management to assess and adjust the recoverable amount of the fixed line segment assets. The fixed line segment assets constitute one cash-generating unit (the "CGU").

Value in use has been calculated by a method of cumulated discounted cash flows for a period limited by average useful life of the CGU's key assets. Primarily, the following assumptions have been used in the impairment testing model: actual business plan, estimation of consecutive development of key indicators (revenues, margin, investments etc.) in the analyzed period, discount rate derived from weighted average cost of capital.

As at 31 December 2009, the management of the Company reviewed the indicators which would indicate that the impairment allowance of fixed line business assets made in 2003 is no longer relevant and should be adjusted upwards and downwards. Upon the review, a recoverable amount of the fixed line business assets (impairment test model) was estimated. Based on this assessment performed, the management believes that the value of the existing fixed network assets is fairly stated and does not differ substantially from the assets' recoverable amount as at 31 December 2009.

Value in use as at 31 December 2009 has been calculated using the same methodology as in the year 2003.

11) Inventories

In CZK million	31 December 2009	31 December 2008
Telecommunication material	153	114
Cables	31	47
Other inventory including goods for resale	387	578
Finished products and work in progress	14	4
Total	585	743

The inventories noted above are stated net of an allowance of CZK 65 million (2008: CZK 57 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 55 million (2008: CZK 24 million). The amount of inventories recognised as an expense is CZK 2,630 million (2008: CZK 3,708 million).

12) Receivables and prepayments

In CZK million	31 December 2009	31 December 2008
Trade receivables (net)	7,910	7,962
Other debtors (net)	389	563
Prepayments	733	686
Other financial assets – short-term	–	14
Derivative instruments	108	23
Total	9,140	9,248

Trade receivables are stated net of a bad debt provision of CZK 3,448 million (2008: CZK 3,241 million). In order to preserve the tax-deductible status of the bad debt expense, the Company's trade receivables are not written off and removed from the primary books and records until certain statutory collection requirements have been satisfied.

The Company reviewed and adjusted the bad debt provision policy in 2009 according to collection rates of receivables. This review resulted in a release of provisions in the amount of CZK 215 million.

Receivables from related parties are disclosed in Note 25.

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 2009	7,910	3,361	309	20	26	55
At 31 December 2008	7,962	5,134	607	60	139	80

Bad debt provisions	
In CZK million	
At 1 January 2008	3,277
Additions	855
Retirements/amount paid	(891)
At 31 December 2008	3,241
Additions	961
Retirements/amount paid	(754)
At 31 December 2009	3,448

The Company's historical experience regarding the collection of accounts receivable is consistent with the recorded allowances. Due to these factors, the management believes that no additional credit risk beyond the amounts provided for is inherent in the Company's trade receivables.

As at 31 December 2009 the Company presented non-current assets of CZK 1 311 million (2008: CZK 377 million) consisting of a long-term loan of CZK 1 032 million to Telefónica O2 Slovakia, s.r.o other long-term credits and advance payments for long-term expenses, which are classified as other financial assets.

13) Cash and cash equivalents

In CZK million	31 December 2009	31 December 2008	Interest rate
Cash at current bank accounts	141	218	Floating
Cash at cash-pooling structures (inter-company)	1,100	6,344	Floating
Short-term bank deposits	–	410	Fixed
Total cash and cash equivalents	1,241	6,972	

As at 31 December 2008, the Company's cash equivalents partially consisted of short-term bank promissory notes that were economically equivalent to bank term deposits and interest bearing deposits maturing in three months or less.

Since April 2006, the Company entered into mutual Telefónica Group cash-pooling, which enables the Telefónica Group good financial governance and effective operating free cash flow. The short-term deposits conditions are based on the arm's length principle. The short-term deposits are classified as cash equivalents.

At 31 December 2009, the Company had available equivalent of CZK 4,056 million (2008: CZK 4,850 million) of undrawn committed facilities.

For the purposes of the cash flow statement, the year-end cash and cash equivalents comprise only the following component:

In CZK million	31 December 2009	31 December 2008
Cash and cash equivalents	1,241	6,972

As of 31 December 2009 no cash and cash equivalents were pledged.

14) Trade and other payables

In CZK million	31 December 2009	31 December 2008
Trade creditors	3,642	6,141
Other taxes and social security	182	184
Deferred revenue	926	977
Employee wages and benefits	678	712
VAT payable	575	464
Other creditors	296	404
Accruals	4,411	3,956
Total payables	10,710	12,838
Other non-current liabilities	19	175

Payables to related parties are disclosed in Note 25.

As at 31 December 2009 other non-current liabilities include primarily principals and liabilities with maturity in more than 12 months. As at 31 December 2008 other non-current liabilities included primarily deferred revenues from connection fees, which are expected to be taken to income in more than 12 months from the balance sheet date.

15) Financial debts

In CZK million	31 December 2009	31 December 2008
Bank loans in foreign currencies (a)	3,044	3,098
Bonds in local currency (b)	–	5
Total borrowings	3,044	3,103
Accrued interest including commitment fees	84	86
Derivatives	3	7
Other financial debt	87	93
Total financial debt	3,131	3,196
Repayable:		
Within one year	87	98
Between two and five years (total non-current)	3,044	3,098
Total financial debt	3,131	3,196

a) In July 1997, the Company raised a private placement in the total amount of EUR 127.8 million with a maturity date on 30 July 2012. As at 31 December 2009, the outstanding amount of the foreign currency loan amounts to EUR 115 million. As at 31 December 2009 the Company does not utilize bank overdrafts.

b) In 2003, the Company issued CZK 6,000 million of bonds with an interest rate 3.50 % p.a. and it was fully repaid at a maturity date of 9 July 2008.

For all borrowings, interest has been charged at commercial rates.

The Company's loan interest rate allocation after taking into account interest rate swaps was as follows:

In CZK million	31 December 2009	31 December 2008
At fixed rate	3,044	3,103

The fair values of borrowings are based on discounted cash flows using a discount rate based upon the borrowing rate that the Board of Directors expects to be available to the Company at the balance sheet date. The carrying amounts of short-term borrowings approximate their fair value.

Effective interest rates	2009	2008
Bank loans in foreign currencies	6.64 %	6.64 %
Bonds in local currency	–	3.50 %

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 2009 based on contractual undiscounted payments.

At 31 December 2009 In CZK million	Less than 3 months	3 to 12 months	1 to 5 years	> 5years
Interest bearing loans and borrowings	–	202	3,448	–
Trade and other payables (excluding deferred revenue)	8,763	1,021	–	–
Derivatives fair value	3	–	–	–
Total	8,766	1,223	3,448	–
Non-current other liabilities	–	–	12	7
At 31 December 2008 In CZK million	Less than 3 months	3 to 12 months	1 to 5 years	> 5years
Interest bearing loans and borrowings	5	206	3,715	–
Trade and other payables (excluding deferred revenue)	10,456	1,405	–	–
Derivatives fair value	7	–	–	–
Total	10,468	1,611	3,715	–
Non-current other liabilities	–	–	168	7

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	
	2009	2008	2009	2008
Financial assets				
Cash and cash equivalents	1,241	6,972	1,241	6,972
Long-term loans	1,032	–	1,032	–
Derivatives	108	23	108	23
Other financial assets	279	377	279	377
In CZK million	Carrying amount		Fair value	
	2009	2008	2009	2008
Financial liabilities				
Interest bearing loans and borrowings				
Fixed rate borrowings	3,129	3,184	3,432	3,503
Issued Bonds	–	5	–	5
Derivatives	3	7	3	7

The fair value of derivatives and borrowings has been calculated by discounting the expected future cash flows at prevailing interest rates.

As at 31 December 2009 the Company provided a long-term loan in the amount of EUR 39 million (CZK 1,032 million) to Telefónica O2 Slovakia, s.r.o.

Fair value hierarchy

As at 31 December 2009, the Company held the following financial instruments measured at fair value:

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 which have a significant effect on the recorded fair value that are not based on observable market data.

Assets measured at fair value

At 31 December 2009	Financial assets at fair value through profit or loss			
In CZK million	Total	Level 1	Level 2	Level 3
Foreign exchange contracts – non-hedged	108	–	108	–

Liabilities measured at fair value

At 31 December 2009	Financial liabilities at fair value through profit or loss			
In CZK million	Total	Level 1	Level 2	Level 3
Foreign exchange forward contracts – non-hedged	3	–	3	–

During the reporting period ending 31 December 2009, 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	
	2009	2008
FX risk		
Value at Risk*	(298)	(277)
Stress testing*	(56)	(52)
IR risk		
Stress testing*	(82)	(161)

* 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 a negative 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 the floating basis within a time frame of 12 months.

Hedging

The following nominal value of foreign exchange forwards was used by the Company to hedge the currency risk:

	Nominal value In EUR million		Fair value In CZK million	
	2009	2008	2009	2008
Forward exchange contracts	171	19	105	16

16) 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 deferred taxes were calculated at 19 % (20% in 2008) and long-term deferred taxes were calculated at 19 % (2008:19 %).

In CZK million	2009	2008
At 1 January	3,299	3,353
Income statement tax charge / (credit) (Note 5)	34	(58)
Tax on fair value gains	–	4
At 31 December	3,333	3,299

Deferred income tax assets and liabilities are offset when there is a legally enforceable right to set off current tax assets against current tax liabilities and when the deferred income taxes relate to the same fiscal authority.

The following amounts, determined after offsetting, are shown in the balance sheet:

In CZK million	31 December 2009	31 December 2008
Deferred tax assets	(316)	(656)
Deferred tax liabilities	3,649	3,955
Total	3,333	3,299

The deferred tax asset includes CZK 289 million (2008: CZK 423 million) recoverable in less than twelve months and CZK 27 million (2008: CZK 233 million) recoverable after more than twelve months. The deferred tax liability includes CZK 378 million (2008: CZK 493 million) payable in less than twelve months and CZK 3,271 million (2008: CZK 3,462 million) payable in more than twelve months.

The deferred tax is determined by these components:

In CZK million	Balance sheet		Statement of comprehensive income	
	2009	2008	2009	2008
Temporary differences relating to:				
– property, plant and equipment and intangible assets	3,621	3,925	(304)	(571)
– trade receivables, inventories and other differences	(288)	(626)	338	513
Total	3,333	3,299	34	(58)

Deferred income tax related to items charged or credited directly to equity are as follows:

In CZK million	2009	2008
Revaluation of cash flow hedges	–	4

17) Government social security and pension schemes

The Company is legally required to make contributions to government health, retirement benefit and unemployment schemes. During 2009 and 2008, the Company paid contributions at a rate of 34 %, 35 % respectively of gross salaries and is not required to make any contributions in excess of this statutory rate. The total amount charged to operating expenses in respect of this scheme was CZK 1,509 million in 2009 (2008: CZK 1,504 million) (see Note 3). Employees contribute 11 % (2008: 12.5 %) of their gross salaries.

The Company has a voluntary pension plan for employees under which the Company makes contributions on behalf of the Company's employees to approved pension plan providers, under defined contribution schemes. The Company's contribution depends upon the number of employees joining the scheme and their age profile. During the year the Company made contributions of CZK 56 million (2008: CZK 58 million). These contributions were charged as an operating expense.

In accordance with an annually renegotiated collective labour agreement, the Company is required to pay CZK 25,000 or CZK 90,000 on retirement depending on the length of the employee's service, who have completed not less than five years continuous service. These benefits are restricted to those employees who retire during the period for which the labour agreement is in place. The Company is not under any legal or constructive obligation to continue providing such benefits beyond the period of such agreement and therefore, no provisions beyond the period of the agreement are recognised in the financial statements. Payments made during the year 2009 relating to employee retirement amounted to CZK 0.1 million (2008: CZK 0.1 million) and were charged as an operating expense.

All amounts discussed in the above note are included in staff costs (see Note 3).

18) Provisions for liabilities and charges

In CZK million	Regulatory and court decisions	Employee redundancy costs	Employee related costs	Benefit loyalty provision	Sale of real estate portfolio	Other	Total
At 1 January 2009	395	13	134	252	260	27	1,081
Additions during the year	22	58	112	32	68	8	300
Utilised during the year	(380)	(60)	(155)	(284)	(189)	(16)	(1,084)
At 31 December 2009	37	11	91	–	139	19	297
Short-term provisions 2009	21	11	84	–	139	19	274
Long-term provisions 2009	16	–	7	–	–	–	23
	37	11	91	–	139	19	297
Short-term provisions 2008	–	13	127	252	260	27	679
Long-term provisions 2008	395	–	7	–	–	–	402
	395	13	134	252	260	27	1,081

With the exception of the regulatory and court decisions provision and other small items 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.

Benefit loyalty provision

Benefit loyalty provision was used to cover the cost of equipment, accessories, gifts and services provided to participants in the mobile segment's loyalty program in exchange for credits awarded primarily for airtime minutes spent. The provision used to be recognized based on past experience of the usage of these credits by loyalty program participants.

Benefit loyalty provision was released due to termination of customer loyalty program in year 2009. There is zero expected outflow of provided benefits. The Company replaced customer loyalty program with other non-cash incentives such as discounts and marketing activities.

Sale of real estate portfolio

The provision was established to cover primarily the costs of future claims relating to the construction deficiencies identified in the real estate portfolio sold (see Note 8).

Regulatory and court decisions

Provision for regulatory and court decisions is made for legal proceedings involving the Company (see Note 20).

19) Financial instruments

Net fair values of derivative financial instruments

At the balance sheet date, the total net fair values of derivative financial instruments were as follows:

Forward foreign exchange contracts In CZK million	31 December 2009	31 December 2008
Instruments not qualifying as hedges		
– with positive fair value	108	23
– with negative fair value	(3)	(7)
Total (Note 15)	105	16

20) Contingencies

The Company is involved in several court proceedings which have arisen from the ordinary course of business. Several significant litigations opened in previous years were successfully terminated in 2009 and are listed below, along with other notable legal matters involving the Company:

T-Mobile Czech Republic, a.s. – interconnect litigations

On 29 April 2009, the Company entered into a settlement agreement, whereby all disputes of many years' standing between the Company and T-Mobile Czech Republic a.s. relating to interconnection of public telecommunications networks in 2001 were amicably settled. Based on this agreement, T-Mobile Czech Republic a.s. paid to the Company a sum of CZK 1,053 million. Consequently, both parties cancelled all proceedings relating to the 2001 interconnection disputes.

Vodafone Czech Republic, a.s. – interconnect litigations

I. On 30 June 2005, Vodafone Czech Republic, a.s. (former Český Mobil/Oskar Mobil) brought a petition with the Municipal Court in Prague against the Company for damages in the amount of CZK 538 million with appurtenances and for returning the unjustified enrichment of CZK 117 million with appurtenances. The petition claims that the Company allegedly failed to transmit the traffic to networks operated by other mobile operators according to respective interconnection agreements.

The High Court in Prague confirmed the Company's conclusion that CTO already issued the final decision in favour of the Company and that Vodafone Czech Republic, a.s. was trying to evade this final decision. The Municipal Court in Prague therefore terminated the legal action in September 2008. The High Court in Prague partially confirmed the decision, and the remaining part was dismissed by the Municipal Court in Prague's resolution of 30 September 2009 as unjustified. Based on the progress to date, the Company believes that the High Court will confirm the positive resolution in the appellate proceedings.

II. In May 2004, Vodafone Czech Republic, a.s. filed a petition against Eurotel Praha, spol. s r.o. for damages in the amount of CZK 1,043 million due to an alleged breach of the Competition Protection Act. The decision rendered by the Office for the Protection of Competition, which Vodafone Czech Republic a.s. based the proceedings on, was overruled by the finding of the Constitutional Court on 11 July 2007. The Municipal Court in Prague fully dismissed the unfounded petition on 21 August 2008 as unjustified. The decision was unsuccessfully appealed by Vodafone Czech Republic, a.s. with the High Court in Prague, which finally confirmed by resolution of 6 October 2009 that the petition dismissal was correct.

The Company management considers disclosure of further information on these disputes inappropriate, as it could prejudice the Company's position in these disputes. The Company management is convinced that all risks relating to the litigations are adequately reflected in the financial statements.

The Office for the Protection of Competition

I. The Company was subject to administrative proceeding before the Office for the Protection of Competition (UOHS) relating to the alleged abuse of the dominant position by creating unfair barriers on the market by offering certain price plans for residential customers. With a resolution of 20 April 2005, UOHS imposed a fine on the Company in the total amount of CZK 210 million, which was, after the Company's appeal, consequently reduced to CZK 205 million. After dismissal of a petition and cassation complaint by administrative courts, the Company filed a constitutional complaint with the Constitutional Court in 2009.

The Company management considers disclosure of further information on these disputes inappropriate, as it could prejudice the Company's position in these disputes. The Company management is convinced that all risks relating to the litigation are adequately reflected in the financial statements.

Other legal matters

I. The dispute with TELE 2 was also closed in 2009. TELE 2 s.r.o. sued the Company on 3 February 2005 for an alleged breach of the Competition Protection Act due to offering certain pricing plans from September 2002 until December 2004. The amount of the claim was CZK 2,142 million with appurtenances. During the course of the proceedings, TELE 2 s.r.o. was succeeded in the role of the plaintiff by TELE 2 EUROPE S.A. The Company provided to the court an extensive defence along with proposed items of evidence proving the legal imperfectness of the sued case. The

Company management adequately reflected the matter in the financial statements. Eventually, the Company and TELE 2 EUROPE S.A. agreed on settlement and terminated their dispute in the Czech Republic. As a result of this settlement there is no longer any risk for the Company with respect to the amount of CZK 2,142 million originally claimed by TELE 2 in 2005. The legal action was withdrawn. The proceeding was finally terminated in July 2009.

Other confidential information may not be disclosed to the public. The Company is bound by confidentiality agreement and has no intent to harm either party's interests by any comments.

II. The Company was sued by AUGUSTUS spol. s r.o. for an alleged loss of profit in the principal amount of approximately CZK 183 million with appurtenances relating to the years 1995–2001. AUGUSTUS spol. s r.o. claims that the Company illegitimately cancelled a contract for issue of phone cards, which was entered into for an unlimited period of time. Based on court decision, the Company paid an amount of CZK 83 million and the corresponding interest in August 2006 (in total approximately CZK 139 million). Both parties subsequently filed an extraordinary appeal against the court judgment. Based on the Company's extraordinary appeal, the Supreme Court annulled all previous judgements in June 2009. The Municipal Court in Prague shall deal with the petition again.

III. Subsequently AUGUSTUS spol. s r.o. filed another petition against the Company regarding the amount of approximately CZK 294 million (status in April 2008). The petition is based again on the contract on phone cards issuing between Telefónica O2 Czech Republic, a.s. and AUGUSTUS spol. s r.o. that was terminated 13 years ago. AUGUSTUS spol. s r.o. brings up a number of new requirements in the petition that are not underpinned by law or contradict each other. It is not even possible to sum up individual claims in the petition to be able to specify the total amount. Telefónica O2 Czech Republic, a.s. takes all steps in the lawsuit to defend thoroughly against this unlawful claim and believes in success in this lawsuit. However, with respect to the claimed amount the Company informs about this proceeding.

Considering the judgement of the Supreme Court and the progress in the matter, the Company management believes that it is not necessary to create or maintain any reserves regarding these disputes.

IV. The Company is a party to other litigations. The total amount of all cases, the individual amount of which exceeds CZK 5 million, totals to CZK 233 million. Even minor litigations are reflected in the financial statement, however, risks relating to these litigations are immaterial.

21) Commitments

Operating leases

The aggregate future minimum lease payments under operating leases are as follows:

In CZK million	31 December 2009	31 December 2008
No later than 1 year	1,352	1,275
Later than 1 year and not later than 5 years	4,684	3,963
Later than 5 years	4,710	5,720
Total	10,746	10,958

The total lease payments relating to operating leasing of property, plant and equipment recognised as an expense in 2009 were CZK 1,396 million (2008: CZK 1,253 million). These lease agreements may contain clauses requiring restoration of the leased site at the end of the lease term. At present, such costs do not have a material impact on the Company's results of operations, financial position, or cash flow and therefore are not accounted for.

In 2004 the Company entered into a sale and lease back transaction and now leases the majority of its car fleet under operating leases. There are no contingent rent obligations. The lease arrangements include an option to renew the lease after the initial period. Lease payments are fixed and determinable, however they may be increased to reflect inflation and other market conditions such as interest rates changes (e.g. an increase in PRIBOR by more than 2 % over a half year). There are no significant restrictions imposed by these lease arrangements, such as those concerning dividends, additional debt and further leasing. Total future lease payments relating to this contract in 2009 were CZK 344 million (2008: CZK 356 million).

Capital and other commitments

In CZK million	31 December 2009	31 December 2008
Capital and other expenditure contracted but not provided for in the financial statements	5, 422	646

The majority of contracted amounts relate to the telecommunications network and service contracts.

22) Service concession arrangements

The Company performs communication activities as defined under the Act on Electronic Communications based on a notification and a certificate from the Czech Telecommunication Office num. 516 as amended by later changes num. 516/1, 516/2 and 516/3.

The communication activities include (territory of the Czech Republic):

- a) public fixed network of electronic communications,
- b) public mobile network of electronic communications,
- c) public network for the transfer of radio and TV signal,
- d) public fixed telephone network,
- e) public mobile telephone network,
- f) publicly accessible telephone services,
- g) other voice services – service is provided as publicly available,
- h) rent of circuits – service is provided as publicly available,
- i) transmission of radio and TV signal – service is provided as publicly available,
- j) transfers of data – service is provided as publicly available,
- k) internet access services – service is provided as publicly available,
- l) other voice services – service is not provided as publicly available,
- m) rent of circuits – service is not provided as publicly available,
- n) transmission of radio and TV signal – service is not provided as publicly available,
- o) transfers of data – service is not provided as publicly available,
- p) internet access services – service is not provided as publicly available.

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 on the basis of radio frequency assignment from 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 CTO valid until 1 January 2022 and in the 450 MHz frequency band using technology CDMA2000 (Code Division Multiple Access – "CDMA"), where on the basis of radio frequency assignment from CTO valid until 7 February 2011 is provided broadband mobile access to Internet.

Validity of radio frequency assignment is possible to prolong for next period on the basis of application submitted to CTO in accordance with the Act on Electronic Communications. Relative to the current regulatory and business environment in the Czech Republic, contractual, legal, regulatory, competitive or other economic factors may limit the period during which the Company can benefit from the use of these radio frequency assignments in the future.

No additional expenses or any limitations connected with renewal of the radio frequency assignments are expected in accordance with the existing interpretation of regulatory provisions.

Imposition of obligations related to provision of universal service

During the year 2009 and 2008, the Company provided the following selective services under CTO imposed obligations to provide universal service:

- a) public pay telephones services,
- b) access for disabled to the public telephone,
- c) supplementary services to service of connection at a fixed location to the public telephone network and the service of access to publicly available telephone services at a fixed location:
 - phased payment of the price for the establishment of connection to the public telephone network for consumer,
 - free selective barring of outgoing calls for the subscribers, and
 - free itemised billing of the price for consumer*,
- d) special price schemes, which are different from the price schemes used under normal business conditions, for low income persons, persons with special social needs and disabled persons.

* Services listed under letter c) above are excluded from the universal service regime on the basis of CTO decision since 30th of July 2009. Providing of these services continues in commercial regime out of universal service.

23) Share capital and reserves

	31 December 2009	31 December 2008
Nominal value per ordinary bearer share (CZK)	100	100
Number of shares	322,089,890	322,089,890
Nominal value per ordinary registered share (CZK)*	1,000	1,000
Number of shares*	1	1
Ordinary shares (in CZK million)	32,209	32,209

* One share owned by the National Property Fund of the Czech Republic bore special decision-making rights in accordance with the statutes of the Company. These special rights included namely decisions regarding the liquidation of the Company, changes in its activities, sale or lease of the Company or of its assets. This share was assigned to Telefónica, S.A. within the transferred 51.1 % stake in the Company. From this date, the share has not borne special decision-making rights.

Shareholdings in the Company were as follows:

	31 December 2009	31 December 2008
Telefónica, S.A.	69.41 %	69.41 %
Other shareholders	30.59 %	30.59 %

Funds include a statutory reserve fund of CZK 6,442 million (2008: CZK 6,442 million) that is not distributable under ruling legislation. Equity settled share based payments reserve is not distributable.

On 21 April 2008 the Annual General Shareholders Meeting approved the restructuring of equity in the form of transfer of CZK 6,442 million from share premium to statutory reserve fund. Further the opening balance of the statutory reserve fund of CZK 6,442 million was transferred to retained earnings and used for distribution of dividend.

Capital management

The Company is not subject to any externally imposed capital requirements.

The Company's objectives when managing its capital are:

- a) to safeguard the Company's ability to continue as a going concern so that it can provide value for its shareholders, and
- b) to comply with all relevant legal requirements.

The investment strategy in the light of managing capital of the Company is to direct investment activities in pro-growth areas, i.e. fixed and mobile broadband internet, IPTV, mobile services, public administration, corporate ICT solutions and in the expansion of mobile services in Slovakia.

At present, the approach that the Company follows is not to retain surplus cash. In the following periods, the Board of Directors will continue to evaluate and carry out an in-depth analysis of the current and anticipated results of the Company, including scheduled and potential investments and cash flow generation and will establish the most adequate capital structure for accomplishment of the plans.

There is no other specific objective.

No changes were made in the objectives, policies or processes during the years 2009 and 2008.

The equity breakdown used in the capital management is following:

In CZK million	31 December 2009	31 December 2008
Capital	77,754	81,434
Equity settled share based payment reserve	36	45
Total	77,790	81,479

24) Hedging reserve

In CZK million	
Balance at 1 January 2008	(20)
Fair value gains in period	24
Fair value losses transfer to net profit	(4)
Balance at 31 December 2008	–
Fair value losses in period	–
Fair value losses transfer to net profit	–
Balance at 31 December 2009	–

25) Related party transactions

The Company provides services to all related parties on normal commercial terms. 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 no allowance or write off was incurred.

The following transactions were carried out with related parties:

I. Parent company:

In CZK million	31 December 2009	31 December 2008
Dividend paid to Telefónica, S.A.	11,179	11,179
Royalty fees (Telefónica, S.A)	754	626

II. Other related parties – Telefónica Group:

In CZK million	31 December 2009	31 December 2008
a) Sales of services and goods	1,306	1,012
b) Purchases of services and goods	1,049	1,041
c) Capital purchases	101	5
d) Receivables	656	480
e) Payables	1,168	4,336
f) Short-term receivables (interest)	0	14
g) Interest income	151	375
h) Interest expense	10	–
i) Long-term loans	1,032	–
j) Cash equivalents (Note 13)	1,100	6,344

The list of the Telefónica companies with which the Company had any transaction in 2009 includes the following entities: Telefónica S.A., Telefónica de España, S.A.U., Telefónica O2 Germany GmbH & CO.OHG, Telefónica O2 UK Ltd., Telefónica O2 Ireland Ltd., Telefónica Móviles España, S.A.U., Telefónica Móviles Argentina, S.A., Pléyade Peninsular, O2 Holdings Ltd., Manx Telecom Ltd., Telefónica Móviles Guatemala, S.A., Telefónica Móviles El Salvador, S.A. de C.V., Telefónica Móviles Panamá, S.A., Telefónica Móviles Chile, S.A., Otecel, S.A., Telefónica Móviles

Nicaragua, S.A., Telefónica Móviles Columbia, S.A., Telefónica S. de Informática y Comunicaciones de Espana, S.A.U., Telefónica Investigación y Desarrollo, S.A., Portugal Telecom, S.G.P.S., S.A., Telecom Italia S.p.A., Telfisa Global, BV., Telefónica Finanzas, S.A., Telefónica International Wholesale Services, Telefónica International Wholesale Services II, S.L., Telefónica Gestión de Servicios Compartidos, S.A., Telefónica Factoring E.F.C., S.A., Atento Chequia, Telefónica Compras Electrónica, S.L., Telefónica Móviles Mexico, S.A., Telefónica Móviles del Uruguay, S.A., Telefónica Móviles Peru, S.A., Telefónica Venezuela, S.A., China Unicom (Hong Kong) Limited, Telefónica O2 Business Solutions, spol. s r.o., CZECH TELECOM Germany GmbH, CZECH TELECOM Austria GmbH, Telefónica O2 Slovakia, s.r.o.

III. Other related parties

a) Key management compensation

Members of the Board of Directors and of the Supervisory Board of the Telefónica O2 Czech Republic, a.s., were provided with benefits as follows:

In CZK million	31 December 2009	31 December 2008
Salaries and other short-term benefits	122	123
Personal indemnification insurance	5	7
Total	127	130

b) Loans to related parties

There were no loans provided to members of Board of Directors and Supervisory Board in 2009 and 2008.

As at 31 December 2009 the Company provides a long-term loan of CZK 1,032 million (EUR 39 million) to Telefónica O2 Slovakia, s.r.o. presented under other financial assets. The loan bears a floating interest based on 1M EURIBOR. The loan conditions are based on the arm's length principle.

No other loan was provided to related parties by the Company.

26) Principal subsidiary undertakings

		Company's interest	Cost of investment In CZK million	Country of incorporation	Activity
Subsidiaries					
1.	Telefónica O2 Business Solutions, spol. s r.o. (formerly Telefónica O2 Services, spol. s r.o., merged with DELTAX Systems a.s.)	100 %	237	Czech Republic	Network and consultancy services in telecommunications, IT/ICT services
2.	CZECH TELECOM Germany GmbH	100 %	13	Germany	Data transmission services
3.	CZECH TELECOM Austria GmbH	100 %	11	Austria	Data transmission services
4.	Telefónica O2 Slovakia, s.r.o.	100 %	5,081	Slovakia	Mobile telephony, internet and data transmission services
Associates					
5.	První certifikační autorita, a.s.	23 %	9	Czech Republic	Rendering of certification services
6.	AUGUSTUS, spol. s r.o.	40 %	–	Czech Republic	Sales by auctions and advisory services

During the fourth quarter 2007, SPT TELECOM (Czech Republic) Finance B.V. in liquidation commenced preparatory steps for the process of voluntary liquidation. Until the end of 2008, the key legal steps for dissolution of the Company have been executed. The cancellation of the registration from the Commercial Register was performed as of 9 February 2009.

In December 2008, the Board of Directors of the Company approved the plan to merge Telefónica O2 Business Solutions, spol. s r.o. with DELTAX Systems a.s. This merger became effective as of day of entry into the Commercial Register on 1 August 2009 after the fulfillment of all legal conditions performed in the half of 2009. Telefónica O2 Business Solutions, spol. s r.o. became the legal successor while DELTAX Systems a.s. was dissolved without liquidation. The assets, rights and obligations including labour rights and duties were transferred to the successor.

In June 2009, the Board of Directors approved increase of the registered capital of Telefónica O2 Slovakia, s.r.o. by a monetary investment in the amount of EUR 150 million from the amount of the registered capital of EUR 50 million to the amount of the registered capital of EUR 200 million. Effective date of increase of the registered capital was 19 August 2009.

The Company has an intention to further increase the registered capital of Telefónica O2 Slovakia, s.r.o. by estimated amount of EUR 40 million during 2010.

27) Post balance sheet events

As of 1st February 2010, Chief Executive Officer Salvador Anglada Gonzales was transferred to Telefónica S.A. in Madrid. Luis Antonio Malvido was appointed as a new Chief Executive Officer.

There were no events, which have occurred subsequent to the year-end, which would have a material impact on the financial statements at 31 December 2009.

Other information for shareholders and investors

Basic information:

Corporate name:	Telefónica O2 Czech Republic, a.s. (Telefónica O2, 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

Bonds issued by Telefónica O2

Bond programme:
Maximum volume of unredeemed bonds: CZK 20,000,000,000
Programme duration: 2002–2012
Maturity of issues in the programme: maximum of 15 years.

As at 31 December 2009, no bond issue was made under the bond programme.

Trading in the shares of Telefónica O2 in 2009

	2009	2008
Number of shares (in millions)	322.1	322.1
Net profit/(loss) per share (in CZK) ¹	38.5	40.6
Highest share price (in CZK) ²	500.0	563.5
Lowest share price (in CZK) ²	359.8	336.0
Share price at the end of period (in CZK) ²	418.0	424.1
Market capitalization (in CZK billions) ²	134.6	136.6

¹ Unconsolidated net profit under IFRS

² Source: Prague Stock Exchange

In 2009, Telefónica O2 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 main stock market of the Prague Stock Exchange (PSE) in 2009 was CZK 65.7 billion compared to CZK 91.1 billion in 2008. Trading in Telefónica O2 Czech Republic shares, as measured by the total volume of shares traded, made up 14.2% of all trades on the PSE stock market. Telefónica O2 shares were the second most traded issue on the PSE in 2009, after ČEZ shares. The average daily volume of trades in company shares in 2009 was CZK 258 million.

As at 30 December 2009 (the last trading day on the PSE in 2009), the market capitalization reached CZK 134.6 billion, ranking Telefónica O2 fourth on the PSE stock market. The share price of Telefónica O2 on the last PSE trading day in 2009 reached CZK 418, which was a decline of 1.44% on the year previous. The share price reached its maximum of CZK 500 on 1 September 2009, and its minimum of CZK 359.8 on 18 February 2009. The average share price in 2009 was CZK 430.6, compared to CZK 475 in 2008.

The above-average dividend yield, aided by the high free cash flow generation and a low level



of debt, still make the shares of Telefónica O2 very attractive to investors.

Trading in Telefónica O2 shares projected over the PX index in 2009

Dividends

At the Ordinary General Meeting of 27 April 2007 held in Prague, the shareholders approved a dividend payment from the 2006 net profit and part of the retained earnings from previous years, in the total amount of CZK 16.104 billion, i.e. CZK 50 per share of nominal value of CZK 100 and CZK 500 per share of nominal value CZK 1,000, before tax. The record day for the payment of dividends was 10 September 2007 and the disbursement date 3 October 2007.

At the Ordinary General Meeting of 21 April 2008 held in Prague, the shareholders approved a dividend payment from a part of the 2007 net profit and a part of the reserve fund which the Company can use at its discretion, in the total amount of CZK 16.104 billion, i.e. CZK 50 per share of nominal value of CZK 100 and CZK 500 per share of nominal value of CZK 1,000, before tax. The record day for the payment of dividends was 17 September 2008 and the disbursement date 8 October 2008.

At the Ordinary General Meeting of 3 April 2009 in Prague, the shareholders approved a dividend payment from a part of the 2008 net profit and part of the retained earnings from previous years in the total amount of CZK 16.104 billion, i.e. CZK 50 per share of nominal value of CZK 100 and CZK 500 per share of nominal value of CZK 1,000, before tax. The record day for the payment of dividends was 9 September 2009 and the disbursement date 7 October 2009.

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, development costs and acquisitions. This approach is in line with the investment strategy of directing investment into pro-growth areas, such as broadband internet access, IPTV, mobile services, business and ICT solutions for the government and the corporate segment and the development of the mobile operation in Slovakia.

Details of patents or licenses, industrial, commercial or financial contracts which have a significant bearing on the business:

1) Patents and licences

Telefónica O2 has licence agreements for the following software products: application middleware (BEA), database environment (Oracle), operating systems (Hewlett-Packard, SUN and Microsoft), workstation software (Microsoft), CRM using Siebel SW (Oracle), customer care and billing software (Amdocs and LHS) and enterprise resource planning software ERP (SAP).

2) Industrial and commercial contracts

Telefónica O2 maintains a diverse portfolio of technology suppliers. The main objective of the Company with respect to the contracted suppliers is to have competition on the supply side. All principal technology supply contracts are awarded by tender.

In 2009, the main suppliers of technology and related services to the Company were IBM Česká republika, Alcatel Czech, AutoCont CZ, Vegacom, Siemens, Accenture Central Europe B.V., Indra, DNS, NextiraOne Czech, Amdocs Development Limited, LHS, Hewlett-Packard and Huawei Technologies Co.

3) Financial contracts

Financial obligations as at 31 December 2009 divided into short-term and long-term (in CZK million):

Short-term (maturing within a year)	87
Long-term	3,044
Total	3,131

Loans, bonds issued and other financial obligations:

	Currency	Total loan in the currency	Outstanding in the currency as at 31 December 2009	Outstanding in CZK as at 31 December 2009
Private Placement – debt instrument	EUR	115,040,673	3,044,551	2012
Other financial obligations			87,309	

EUR/CZK exchange used in the table for conversion purposes (as at 31 December 2009) is CZK 26.465/EUR.

The above loan and the other financial obligations were repaid in accordance with the relevant loan agreements or the Terms and Conditions of Issue. As at 31 December 2009, Telefónica O2 had no overdue loan obligations.

Investments

Main investments made by Telefónica O2 in the last two accounting periods (in CZK million):

	2009	2008
Network & Operations	2,976	3,661
Customer Solutions	707	694
IT & Products	1,206	1,838
Property & Logistics	219	302
Brand stores	17	53
Subsidiary companies and other investments*	527	41
Projects of the Telefónica Group	187	–
Investments related to Telefónica O2 Slovakia made in the Czech Republic	39	197
Telefónica O2 Slovakia	611	1,302
Total	6,489	8,088

* Including additional internal work – capitalized

All principal investments were made in the Czech Republic and in Slovakia, and were financed from own capital and from borrowings.

In 2009, the Company continued to implement an adequate investment policy, which clearly favours the development and support of progressive, customer-oriented technologies that have a growth potential for the future, and emphasises the internal integration and efficiency improvements in the Company.

The structure of investment expenditure reflected the existing customer demands for new trends in telecommunications services with a high standard and quality of execution, and the efforts to complete the integration processes for the delivery of convergent services, aimed at the strengthening of the primacy of the converged operator.

The mobile segment was dominated mainly by investments in the UMTS technology (up 73% on the previous year); the coverage of the population reached 26.6% at the end of 2009. Investments in the 3G area were accompanied by modifications in the existing 2G network (2G swap) and the roll-out of the Mobile Broadband concept (3G + EDGE). In the fixed access segment, investments went mainly into boosting the speed, availability and quality of ADSL, IPTV, Voice over IP and value added services.

In terms of business solutions, the volume of investment in this area increased by approximately 2%; in this respect, data connectivity projects played an important role. In this segment, increased effort was directed towards improving the quality of the service portfolio and customer experience, especially with regard to the leadership in the convergent services market. The flagship project in the segment of business solutions for the government in 2009 was the implementation of the data box system.

In 2009, Telefónica O2 also participated in projects implemented on the level of the global Telefónica Group, which were aimed at improving the hosting capacities of business solutions.

The convergent process integration was represented mainly by investments in information systems, in which the common denominator was to achieve greater customer satisfaction and open doors to new products and services (CRM systems). Investment in the new integrated ERP system (SAP) has helped to achieve a higher rate of internal efficiency in the Company.

In Slovakia, efforts were directed mainly at the construction of the proprietary network, improving the quality of the CRM system and e-applications. Investments in the GSM network were carried out as per the licence and system development requirements. By the end of 2010 Telefónica O2 Slovakia put 917 BTS in operation, of which 70 were commissioned during 2009 (302 in 2008). The network of Telefónica O2 Slovakia covered almost 93% of the population, which is approximately twice of what the terms of the licence require.

Principal future investments

In the period 2010-2011, the Company will continue to implement the standard investment policy for the telecommunications sector, which favours performance increases and the implementation of progressive technologies and customer approaches, aimed at achieving the Company's overall general strategy and increasing the market share in the Slovak telecommunications market.

A key project in the Czech Republic is the country-wide deployment of the Mobile Broadband technology, which will lay foundations for future considerable improvements in the quality, efficiency and coverage of telecommunications and data services.

General Meeting

The Ordinary General Meeting of Telefónica O2 will be held on 7 May 2010 in Prague.

Financial calendar

Date of release of the running financial results

For the first quarter of 2010	12 May 2010*
For the first half of 2010	28 July 2010*
For three quarters of 2010	10 November 2010*
For the year 2010	28 February 2011 at the latest instance

* tentative date

Institutional investors and shareholders please contact

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Address: Telefónica O2 Czech Republic, a.s.

Za Brumlovkou 266/2

140 22 Praha 4

Information on persons responsible for the Annual Report

Luis Antonio Malvido, Chairman of the Board of Directors and Chief Executive Officer of Telefónica O2 Czech Republic, a.s.

Jesús Pérez de Uriguen, Member of the Board of Directors and Vice President, Finance Division, of Telefónica O2 Czech Republic, a.s.

hereby declare that, to their best knowledge, the consolidated Annual Report gives a true and faithful reflection of the financial situation, business activity and the results of the Company and its consolidated whole for the past accounting period, and of the outlook on the future development of the financial situation, business activity and the results.



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



Jesús Pérez de Uriguen
Member of the Board of Directors
and Vice President, Finance Division

Appendix: Report of the Board of Directors of Telefónica O2 Czech Republic, a.s.

On relationships between the controlling and the controlled entity and on relationships between the controlled entity and other entities controlled by the same controlling entity for 2009 (pursuant to provisions of Section 66a art. 9, of Act No. 513/1991 Coll., the Commercial Code, as amended).

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Part A Applicable period

The report pursuant to Section 66a art. 9, of Act No. 513/1991 Coll., the Commercial Code, as amended (Commercial Code) on relationships between the controlling and the controlled entity and on relationships between the controlled entity and other entities – interconnected entities controlled by the same controlling entity (Report) is prepared for the last accounting period, i.e. for the period started on 1 January 2009 and ended on 31 December 2009.

Part B Entities forming a holding

Section I. Identification details of the controlled entity – Telefónica O2 Czech Republic, a .s. (hereinafter referred to as "Company")

The company is registered in the Commercial Register of the Municipal Court in Prague, Section B, Enclosure 2322.

Registration date: 1 January 1994
 Corporate name: Telefónica O2 Czech Republic, a.s.
 Registered address: Prague 4, Michle, Za Brumlovkou 266/2, PSČ 140 22
 Identification number: 60 19 33 36
 Legal form: Joint-stock company

Compared to the fiscal year of 2008, there were no changes in identification data and basic legal facts.

Section II. Identification details of the controlling entity

Controlling entity: Telefónica, S.A.
 Registered address: Gran Vía, 28, 28013 Madrid, Spain
 Identification number: A 28015865

The controlling entity held shares of the controlled entity in the aggregate nominal value of 69.41% of the registered capital of the controlled entity.

The total share in the voting rights of the controlled entity pursuant to Section 183d (1) of the Commercial Code was 69.41%.

Telefónica O2 Czech Republic, a.s.	69.41 % Telefónica, S.A.
	30.59 % Other investors

Section III. Interconnected entities

Entities controlled by Telefónica, S.A.:

The list of entities controlled directly or indirectly by Telefónica, S.A. forms Appendix to this Report. The list was compiled from inputs from Telefónica, S.A. and verified using information from Commercial Registers or other available data.

Part C Contracts and agreements between the controlled entity and the controlling entity and contracts and agreements between the controlled entity and other interconnected entities including details of performance and counter-performance provided thereunder

In the applicable period, contracts for the provision of services, sale and installation telecommunication technology contract, credit contracts, a trademark assignment contract, lease contracts and insurance contracts were concluded with the controlling entity and with interconnected entities.

These contracts were entered into either with the controlling entity Telefónica, S.A. or with the interconnected entities hereunder: Telefónica O2 Business Solutions, spol. s r.o., CZECH TELECOM Austria GmbH, CZECH TELECOM Germany GmbH, Telefónica O2 Slovakia, s.r.o., Telefónica Finanzas, S.A., Telfisa Global, B.V., Altair Assurances, S.A., Telefónica O2 UK Ltd.

Details of contracts concluded are regarded as a trade secret by the controlled entity, according to the Commercial Code and other internal governance documents. The controlled entity has not suffered any damage in connection with contracts and agreements concluded in 2009 between the controlled entity and controlling entity and between controlled entity and other interconnected entities, under which performance and counter-performance was given, or in connection with provision of performance and counter-performance in 2009 under contracts and agreements concluded prior to 1 January 2009. Performance provided under the above contracts did not entail any advantages or disadvantages for the controlled entity and was in an amount corresponding usual conditions.

Part D Other legal acts between holding entities in the accounting period 2009

In accounting period 2009, no legal acts were made by the controlled entity in the interest of or instigated by these controlling or interconnected entities, resulting in a damage or profit, advantage or disadvantage to the controlled entity.

Part E Measures between holding entities in the accounting period 2009

In accounting period 2009, no measures were taken by the controlled entity in the interest of or instigated by these controlling or interconnected entities, resulting in a damage or profit, advantage or disadvantage to the controlled entity.

Part F Conclusion

(a) The Report was prepared by the Board of Directors of the controlled entity, Telefónica O2 Czech Republic, a.s., and approved at the meeting of the Board of Directors held on 31 March 2010.

(b) The Report was prepared using data and information obtained from the controlling entity and other interconnected entities, other available documents, and using results of examinations of relationships between the controlled entity on the one hand and the controlling entity and other interconnected entities on the other hand. The Board of Directors of the controlled entity, Telefónica O2 Czech Republic, a.s., declares that it proceeded with due professional diligence of a manager when collecting the data and information.

(c) With regard to the fact that the controlled entity, Telefónica O2 Czech Republic, a.s., is obliged by law to make an Annual Report pursuant to Act No. 563/1991 Coll., on accounting, as amended, this Report will be attached to the 2009 Annual Report. Shareholders will have the opportunity to read the Report at the same time and under the same conditions as the financial statements.

In Prague, on 31st March 2010

Telefónica O2 Czech Republic, a.s. – controlled entity

Board of Directors

Appendix

List of relevant companies directly or indirectly controlled by Telefónica, S.A.
in the period from 1 January 2009 until 31 December 2009

Name of the company	Country	Telefónica Group	Holding company
Telefónica de España, S.A.U.	Spain	100%	Telefónica, S.A. (100%)
Telefónica Móviles España, S.A.U.	Spain	100%	Telefónica, S.A. (100%)
Telefónica S. de Informática y Comunicaciones de España, S.A.U.	Spain	100%	Telefónica de España, S.A.U. (100%)
Telefónica Soluciones Sectoriales, S.A.	Spain	100%	Telefónica de España, S.A.U. (100%)
Interdomain, S.A.	Spain	100%	Telefónica Soluciones Sectoriales, S.A. (100%)
Teleinformática y Comunicaciones, S.A. (TELYCO)	Spain	100%	Telefónica de España, S.A.U. (100%)
Telyco Marruecos, S.A.	Morocco	54.00%	Teleinformática y Comunicaciones, S.A. (TELYCO) (54.00%)
Telefónica Telecomunicaciones Públicas, S.A.	Spain	100%	Telefónica de España, S.A.U. (100%)
Telefónica Remesas, S.A.	Spain	100%	Telefónica Telecomunicaciones Públicas, S.A. (100%)
Telefónica Salud, S.A.	Spain	51.00%	Telefónica Telecomunicaciones Públicas, S.A. (51.00%)
Iberbanda, S.A.	Spain	58.94%	Telefónica de España, S.A.U. (58.94%)
Telefónica Cable, S.A.	Spain	100%	Telefónica de España, S.A.U. (100%)
Telefónica Internacional, S.A.	Spain	100%	Telefónica, S.A. (100%)
Telefónica International Holding, B.V.	Netherlands	100%	Telefónica International, S.A. (100%)
Latin American Cellular Holdings, B.V.	Netherlands	100%	Telefónica, S.A. (100%)
Telefónica Datacorp, S.A.U.	Spain	100%	Telefónica, S.A. (100%)
Telecomunicações de Sao Paulo, S.A. – TELESP	Brazil	87.95%	Telefónica Internacional, S.A. (65.30%) Sao Paulo Telecomunicações Participações, Ltda. (22.65%)
Brasil Celular, N.V.	Netherlands	50.00%	Telefónica, S.A. (50.00%)
Compañía Internacional de Telecomunicaciones, S.A.	Argentina	100.00%	Telefónica Holding de Argentina, S.A. (50.00%) Telefónica International Holding, B.V. (37.33%) Telefónica Internacional, S.A. (12.67%)
Telefónica de Argentina, S.A.	Argentina	100%	Compañía Internacional de Telecomunicaciones, S.A. (52.70%) Telefónica Internacional, S.A. (24.99%) Telefónica Móviles Argentina, S.A. (19.56%) Telefónica International Holding, B.V. (0.95%) Telefónica, S.A. (1.80%)
Telefónica Móviles Argentina, S.A.	Argentina	100%	Telefónica Móviles Argentina Holding, S.A. (84.60%) Telefónica, S.A. (15.40%)

Name of the company	Country	Telefónica Group	Holding company
Telecomunicaciones Celulares, C.A.	Venezuela	100%	Latin America Cellular Holdings, B.V. (97.21%) Telefónica, S.A. (0.08%) Comtel Comunicaciones Telefónicas, S.A. (2.71%)
Telefónica Móviles Chile, S.A.	Chile	100%	TEM Inversiones Chile Ltda. (100%)
Compañía de Telecomunicaciones de Chile, S.A.	Chile	97.89%	Inversiones Telefónica Internacional Holding Ltda. (53.00%) Telefónica Internacional de Chile, S.A. (44.89%)
Telefónica del Perú, S.A.A.	Peru	98.34%	Telefónica Internacional, S.A. (49.90%) Latin America Cellular Holdings, B.V. (48.28%) Telefónica, S.A. (0.16%)
Telefónica Móviles Perú, S.A.C.	Peru	100%	Telefónica del Perú, S.A.A. (100%)
Colombia Telecomunicaciones, S.A. ESP	Colombia	52.03%	Telefónica Internacional, S.A. (52.03%)
Telefónica Móviles Colombia, S.A.	Colombia	99.99%	Olympic, Ltda. (50.58%) Telefónica, S.A. (49.42%)
Telefónica Móviles México, S.A. de C.V.	Mexico	100%	Telefónica Internacional, S.A. (100%)
Pegaso Comunicaciones y Sistemas, S.A. de C.V.	Mexico	100%	Telefónica Móviles México, S.A. de C.V. (100%)
Telefónica Móviles del Uruguay, S.A.	Uruguay	100%	Latin America Cellular Holdings, B.V. (68.00%) Telefónica, S.A. (32.00%)
Telefónica Larga Distancia de Puerto Rico, INC.	Puerto Rico	98.00%	Telefónica Internacional, S.A. (98.00%)
Telefónica Móviles Panamá, S.A.	Panama	100%	Telefónica, S.A. (56.31%) Panamá Cellular Holdings, B.V. (43.69%)
Telefónica Móviles El Salvador, S.A. de C.V.	El Salvador	99.08%	Telefónica Móviles El Salvador Holding, S.A. de C.V. (99.08%)
Telefónica Móviles Guatemala, S.A.	Guatemala	99.98%	TCG Holdings, S.A. (65.99%) Guatemala Cellular Holdings, B.V. (13.12%) Panamá Cellular Holdings, B.V. (7.27%)
Telefonía Celular de Nicaragua, S.A.	Nicaragua	100%	Latin America Cellular Holdings, B.V. (98.00%) Telefónica Móviles El Salvador Holding, S.A. de C.V. (2.00%)
Otecel, S.A.	Ecuador	100%	Ecuador Cellular Holdings, B.V. (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. (76.85%) Telefónica International Wholesale Services, S.L. (23.15%)
Telefónica International Wholesale Services France, S.A.S.	France	100%	Telefónica International Wholesale Services II, S.L. (100%)
Telefónica International Wholesale Services Argentina, S.A.	Argentina	100%	T. International Wholesale Services America, S.A. (99.94%) Telefónica International Wholesale Services, S.L. (0.06%)
Telefónica International Wholesale Services Brasil Participacoes, Ltd.	Brazil	100%	TIWS Participacoes Ltda (99.99%) Telefónica Internacional, S.A. (0.01%)

Name of the company	Country	Telefónica Group	Holding company
Telefónica International Wholesale Services Perú, S.A.C.	Peru	99.99%	T. International Wholesale Services America, S.A. (99.99%) Telefónica Servicios Integrados S.A.C. (0.01%)
Telefónica International Wholesale Services USA, Inc.	USA	100%	T. International Wholesale Services America, S.A. (100%)
Telefónica International Wholesale Services Puerto Rico, Inc.	Puerto Rico	100%	T. International Wholesale Services America, S.A. (100%)
Telefónica International Wholesale Services Ecuador, S.A.	Ecuador	100%	T. International Wholesale Services America, S.A. (99.99%) Telefónica International Wholesale Services Perú, S.A.C. (0.01%)
Terra Networks Brasil, S.A.	Brazil	100%	Sao Paulo Telecomunicações Participações, Ltda. (100%)
Terra Networks Mexico, S.A. De C.V.	Mexico	100%	Terra Networks Mexico Holding, S.A. de C.V. (99.99%)
Terra Networks Perú, S.A.	Peru	99.99%	Telefónica Internacional, S.A. (99.99%)
Terra Networks Argentina, S.A.	Argentina	100%	Telefónica Internacional, S.A. (99.92%) Telefónica International Holding, B.V. (0.08%)
Terra Networks Guatemala, S.A.	Guatemala	99.99%	Telefónica Internacional, S.A. (99.99%)
Telefónica China, B.V.	Netherlands	100%	Telefónica Internacional, S.A. (100%)
Telefónica Europa			
Telefónica Europe plc	United Kingdom	100%	Telefónica, S.A. (100%)
mmO2 plc	United Kingdom	99.99%	Telefónica Europe plc (99.99%)
O2 Holdings Ltd.	United Kingdom	100%	mmO2 plc (100%)
Telefónica O2 UK Ltd.	United Kingdom	100%	O2 Networks Ltd. (80.00%) O2 Cedar Ltd. (20.00%)
The Link Stores Ltd.	United Kingdom	100%	Telefónica O2 UK Ltd. (100%)
Be Un Limited (Be)	United Kingdom	100%	Telefónica O2 UK Ltd. (100%)
Tesco Mobile Ltd.	United Kingdom	50.00%	O2 Ash Ltd. (50.00%)
O2 (Europe) Ltd.	United Kingdom	100%	Telefónica, S.A. (100%)
Telefónica O2 Germany GmbH & Co. OHG	Germany	100%	Telefónica O2 Germany Verwaltungs GmbH (99.99%) Telefónica O2 Germany Management GmbH (0.01%)
Tchibo Mobilfunk GmbH & Co. KG	Germany	50.00%	Telefónica O2 Germany GmbH & Co. OHG (50.00%)
Telefónica O2 Ireland Ltd	Ireland	100%	O2 (Netherlands) Holdings, B.V. (99.00%) Kilmaine Ltd (1.00%)
Manx Telecom Ltd.	Isle of Man	100%	O2 (Netherlands) Holdings BV (100%)

Name of the company	Country	Telefónica Group	Holding company
Telefónica O2 Czech Republic, a.s.	Czech Republic	69.41%	Telefónica, S.A. (69.41%)
Telefónica O2 Slovakia, s.r.o.	Slovakia	69.41%	Telefónica O2 Czech Republic, a.s. (100%)
Telefónica O2 Business Solutions, spol. s r.o. (CZECH REPUBLIC)	Czech Republic	69.41%	Telefónica O2 Czech Republic, a.s. (100%)
CZECH TELECOM Germany GmbH	Germany	69.41%	Telefónica O2 Czech Republic, a.s. (100%)
CZECH TELECOM Austria GmbH	Austria	69.41%	Telefónica O2 Czech Republic, a.s. (100%)
Telefónica de Contenidos, S.A.U.	Spain	100%	Telefónica, S.A. (100%)
Atlántida Comunicaciones, S.A.	Argentina	100%	Telefónica Media Argentina S.A. (93.02%) Telefónica Holding de Argentina, S.A. (6.98%)
Televisión Federal S.A. – TELEFE	Argentina	100%	Atlántida Comunicaciones S.A. (79.02%)
Telefónica Servicios Audiovisuales, S.A.	Spain	100%	Telefónica de Contenidos, S.A.U. (100%)
Gloway Broadcast Services, S.L.	Spain	100%	Telefónica Servicios Audiovisuales, S.A.U. (100%)
Telefónica Servicios de Música, S.A.U.	Spain	100%	Telefónica de Contenidos, S.A.U. (100%)
Atento Inversiones y Teleservicios, S.A.	Spain	100%	Telefónica, S.A. (100%)
Atento N.V.	Netherlands	100%	Atento Inversiones y Teleservicios, S.A. (100%)
Atento Teleservicios España, S.A.	Spain	100%	Atento N.V. (100%)
Atento Brasil, S.A.	Brazil	100%	Atento N.V. (100%)
Atento Argentina, S.A.	Argentina	100%	Atento Holding Chile, S.A. (97.99%) Atento N.V. (2.01%)
Teleatento del Perú, S.A.C.	Peru	100%	Atento N.V. (83.33%) Atento Holding Chile, S.A. (16.67%)
Atento Chile, S.A.	Chile	99.06%	Atento Holding Chile, S.A. (71.16%) Compañía de Telecomunicaciones de Chile, S.A (26.52%) Telefónica Empresas Chile, S.A. (0.93%) Telefónica larga Distancia, S.A. (0.45%)
Atento Centroamérica, S.A.	Guatemala	100%	Atento N.V. (99.99%) Atento El Salvador, S.A. de C.V. (0.01%)
Terra Networks Asociadas, S.L.	Spain	100%	Telefónica, S.A. (100%)
Red Universal de Marketing y Bookings Online, S.A.	Spain	50.00%	Terra Networks Asociadas, S.L. (50.00%)
Telefónica Learning Services, S.L.U.	Spain	100%	Terra Networks Asociadas, S.L. (100%)
Telefónica Ingeniería de Seguridad, S.A.	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.	Spain	100%	Telefónica, S.A. (100%)
Lotca Servicios Integrales, S.L.	Spain	100%	Telefónica, S.A. (100%)
Fonditel Pensiones, Entidad Gestora de Fondos de Pensiones, S.A.	Spain	70.00%	Telefónica Capital, S.A. (70.00%)
Fonditel Gestión, Sociedad Gestora de Instituciones de Inversión Colectiva, S.A.	Spain	100%	Telefónica Capital, S.A. (100%)
Telefónica Investigación y Desarrollo, S.A. (TIDSA)	Spain	100%	Telefónica, S.A. (100%)

Name of the company	Country	Telefónica Group	Holding company
Telefónica Investigación y Desarrollo de Mexico, S.A. de C.V.	Mexico	100%	Telefónica Investigación y Desarrollo, S.A. (100%)
Telefônica Pesquisa e Desenvolvimento do Brasil, Ltda.	Brazil	100%	Telefónica Investigación y Desarrollo, S.A. (100%)
Casiopea Reaseguradora, S.A.	Luxembourg	100%	Telefónica, S.A. (99.97%) Telefónica Finanzas, S.A. (TELFISA) (0.03%)
Pléyade Peninsular, Correduría de Seguros y Reaseguros del Grupo Telefónica, S.A.	Spain	100%	Casiopea Reaseguradora, S.A. (83.33%) Telefónica, S.A. (16.67%)
Altaïr Assurances, S.A.	Luxembourg	100%	Casiopea Reaseguradora, S.A. (95.00%) Seguros de Vida y Pensiones Antares, S.A. (5.00%)
Seguros de Vida y Pensiones Antares, S.A.	Spain	100%	Telefónica, S.A. (89.99%) Casiopea Reaseguradora, S.A. (10.01%)
Telefónica Finanzas, S.A. (TELFISA)	Spain	100%	Telefónica, S.A. (100%)
Fisatel Mexico, S.A. de C.V.	Mexico	100%	Telefónica, S.A. (100%)
Telfisa Global, B.V.	Netherlands	100%	Telefónica, S.A. (100%)
Telefónica Europe, B.V.	Netherlands	100%	Telefónica, S.A. (100%)
Telefónica Emisiones, S.A.	Spain	100%	Telefónica, S.A. (100%)
Spiral Investments, B.V.	Netherlands	100%	Telefónica Móviles España, S.A.U. (100%)
Solivella Investment, B.V.	Netherlands	100%	Telefónica Móviles España, S.A.U. (100%)
Aliança Atlântica Holding, B.V.	Netherlands	93.99%	Telefónica, S.A. (50.00%) Telecomunicações de Sao Paulo, S.A. – TELESP (43.99%)
Telefónica Gestión de Servicios Compartidos España, S.A.	Spain	100%	Telefónica, S.A. (100%)
Telefónica Gestión de Servicios Compartidos, S.A.	Argentina	99.99%	T. 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%	Compañía de Telecomunicaciones de Chile, S.A (97.89%)
Telefónica Gestión de Servicios Compartidos, S.A.C.	Peru	100%	T. Gestión de Servicios Compartidos España, S.A. (100%)
Cobros Serviços de Gestao, Ltda.	Brazil	99.33%	T. Gestión de Servicios Compartidos España, S.A. (99.33%)
Tempotel, Empresa de Trabajo Temporal, S.A.	Spain	100%	T. Gestión de Servicios Compartidos España, S.A. (100%)
Telefónica Gestao de Serviços Compartilhados do Brasil, Ltda.	Brazil	99.99%	T. Gestión de Servicios Compartidos España, S.A. (99.99%)
Telefónica Gestión de Servicios Compartidos Mexico, S.A. de C.V.	Mexico	100%	T. Gestión de Servicios Compartidos España, S.A. (100%)
Telefónica Servicios Integrales de Distribución, S.A.U.	Spain	100%	T. Gestión de Servicios Compartidos España, S.A. (100%)
Telefónica Compras Electrónicas, S.L.	Spain	100%	T. Gestión de Servicios Compartidos España, S.A. (100%)
Telco, S.p.A.	Italy	46.18%	Telefónica, S.A. (46.18%)

Name of the company	Country	Telefónica Group	Holding company
Telefónica Factoring México, S.A. de C.V. SOFOM ENR	Mexico	50.00%	Telefónica, S.A. (40.50%)
			Telefónica Factoring España, S.A. (9.50%)
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%)

¹ Including impairment charge and gain from sale of non-current assets. In 2008, the Group posted an impairment charge of CZK 86 million, compared to CZK 23 million in 2009; gain from sale of non-current assets reached CZK 855 million in 2008 compared to CZK 422 million in 2009.

² Sources: Czech Statistical Office, Czech National Bank, Ministry of Labour and Social Affairs.

³ At constant 1995 prices.

Glossary of terms and acronyms

ADSL Asymmetric Digital Subscriber Line

ARPU an indicator – average monthly revenues from services per user, excluding roaming visitors

BlackBerry a mobile office solution from Telefónica O2 designed for mobile corporate customers

BTS Base Transceiver Station for relaying signal to mobile telephones

CDMA Code Division Multiple Access, a modern digital technology for wireless data and broadband internet

CSR Corporate Social Responsibility

CTO Czech Telecommunications Office

DSLAM Digital Subscriber Line Access Multiplexer; a gateway to the network of ADSL access provider

e-účt a service offering online access to the fixed line billing balance

EDGE Enhanced Data Rates for GSM Evolution, a mobile digital technology with a faster and more reliable data transmission

FTP File Transfer Protocol; a platform-independent protocol for the transfer of files between computers

GPRS General Packet Radio Service, a technology for mobile data transmission

GSM Global System for Mobile Communication; the most widely deployed digital wireless communication standard for the digital mobile system which globally uses frequencies of 450, 900, 1,800 and 1,900 MHz, and frequencies of 900 and 1,800 MHz in the Czech Republic

HSCSD High-Speed Circuit-Switched Data, a technology for mobile data transmission in the GSM network

HSDPA High Speed Downlink Packet Access, a superstructure technology for data transmission in the UMTS network, with speeds from 8 to 10 Mb/s

HTTP Hypertext Transfer Protocol; an internet protocol for exchanging hypertext documents and other HTML content

ICT Information and Communication Technologies

IFRS International Financial Reporting Standards

IMAP Internet Message Access Protocol an internet protocol for remote access to email

IP Connect a service for communication using the IP protocol

IPsec (IP security) a security enhancement to the IP protocol

IPTV Internet Protocol Television; a television signal broadcast over broadband networks using the IP protocol

IP VP N Internet Protocol Virtual Private Network, a service of intra-corporate data or voice over IP communication

LAN Local Area Network a local network for communication between computers in the network

LTE Long Term Evolution for UMTS; the latest concept of data transmission technology in the 3rd generation mobile networks

MMS a multimedia format for mobile data transmission

My Europe a mobile tariff of Telefónica O2, with free-of-charge incoming calls for roaming users

My Europe SMS a mobile tariff of Telefónica O2, with free-of-charge incoming calls for roaming users

NMT Nordic Mobile Telephony, a technology standard for mobile telephony networks using the 450 MHz frequency

O₂ Business Unlimited a tariff of Telefónica O2 for business customers, offering unlimited calls to all fixed line and mobile network free of charge, as part of the monthly subscription

O₂ Business Nonstop Max a tariff of Telefónica O2 for business customers, offering free calls within the O₂ mobile network and to all fixed line networks in the Czech Republic

O₂ Duo a converged service of Telefónica O2 combining unlimited calls to fixed line networks in the Czech Republic with O₂ Internet ADSL or O₂ TV, all as part of one monthly subscription

O₂ Duo Mobil a converged service of Telefónica O2 combining, as part of one monthly subscription, O₂ Internet ADSL and a mobile voice tariff; the fixed line rental fee is already included

O₂ Fér a service of Telefónica O2 Slovakia, offering a single rate on calls and SMS for the customers of prepaid and contract services, without monthly subscription fee

O₂ Internet ADSL a broadband internet access service of Telefónica O2, formerly branded O₂ Internet Expres

O₂ Internet Komplet a service of Telefónica O2 combining fixed line and mobile services

O₂ Internet Mobil a CDMA mobile service of Telefónica O2

O₂ [:kùl:] a service of Telefónica O2 with fee SMS

O₂ Neomezená linka the first VoIP service of Telefónica O2 for business customers

O₂ Neon a family of flat rate tariffs

O₂ Trio a converged service of Telefónica O2 combining O₂ Internet ADSL, O₂ TV and unlimited calls to fixed networks in the Czech republic, all for one monthly fee

O₂ TV an IPTV service of Telefónica O2; digital television over a fixed line

O₂ TXT a mobile tariff of Telefónica O2 designed for prepaid customers who prefer to communicate via SMS and MMS

OIBDA Operating Income before Depreciation and Amortisation

Platí to Kvído a service of Telefónica O2 which lets customers call for free for a duration of one minute

POP3 Post Office Protocol version 3; an internet protocol used for downloading email messages by the client remotely from the server

RSU Remote Subscriber Unit

SMS Short Message Service; a format of short messages used in mobile telephony

UMTS Universal Mobile Telecommunications System; a standard for the so-called 3rd generation mobile networks

VoIP Voice over Internet Protocol

VP N Virtual Private Network

VP N Expres an IP VPN data service of the former ČESKÝ TELECOM; it is based on the ADSL access technology with aggregation, and the MPLS backbone network

WAN Wide Area Network; a wider computer network giving remote branches full access to data and providing for communication between the headquarters and the branches and within the branch network

WAP Wireless Application Protocol, a protocol for displaying selected web pages on a mobile telephone display

WiFi a local wireless network for accessing the internet

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CAUTIONARY STATEMENT: Any forward-looking statements concerning the future economic and financial performance of Telefónica O2 Czech Republic, a.s. contained in this Annual Report are based on assumptions and expectations of the future development of factors having material influence on the future economic and financial performance of Telefónica O2 Czech Republic, a.s. These factors include, but are not limited to, public regulation in the telecommunications sector, the future macroeconomic situation, and the development of market competition and related demand for telecommunications and other services. The actual development of these factors, however, may be different. Consequently, the actual future results of the economic and financial performance of Telefónica O2 Czech Republic, a.s. could materially differ from those expressed in the forward-looking statements contained in this Annual Report.
