DIRECTORS' REPORT
NETIA S.A. GROUP
for the year ended December 31, 2012

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This Directors' Report presents the financial results of Netia S.A. ("Netia", the "Company", the "Issuer") and the consolidated financial results for the Netia S.A. Group ("Netia Group").

1 Characteristics of the Netia Group

1.1 The Netia Group structure

The consolidated financial statements as at and for the year ended December 31, 2012 include the financial statements of the Company and the following subsidiaries:

- InterNetia Holdings Sp. z o.o. Group
- Net 2 Net Sp. z o.o.
- Netia 2 Sp. z o.o.
- Netia Brand Management Sp. z o.o.
- Telefonia DIALOG Sp. z o.o. Group.

The financial statements of the InterNetia Holdings Sp. z o.o. Group include the financial statements of InterNetia Holdings Sp. z o.o. ("InterNetia Holdings") and its subsidiaries:

- Internetia Sp. z o.o. and its wholly-owned subsidiaries: STI Sp. z o.o and Sanetja Sp. z o.o.
- UNI-Net Poland Sp. z o.o.

The financial statements of the Telefonia DIALOG Sp. z o.o. Group include the financial statements of Telefonia DIALOG Sp. z o.o. (transformed from Telefonia DIALOG S.A. on April 30, 2012) and its wholly-owned subsidiary Petrotel Sp. z o.o.

Changes within the Netia Group's structure

Acquisitions

On February 14, 2012, Internetia Sp. z o.o., ("Internetia") the Company's subsidiary, concluded an agreement for the acquisition of 42 (not in thousands) shares in the share capital of Elpro-Elektronika Profesjonalna Waldemar Nitka Sp. z o.o. ("Elpro"), each with the nominal value of PLN 1,000 (not in thousands), which represent 100% of the share capital and confer the right to 100% of the votes at the general meeting of shareholders. The total price for all Elpro shares has been set at PLN 2,202.

On March 7, 2012, Internetia Sp. z o.o, the Company's subsidiary, concluded an agreement for the acquisition of 150 (not in thousands) shares in the share capital of STI Sp. z o.o. ("STI"), each with the nominal value of PLN 500 (not in thousands), which represent 100% of the share capital and confer the right to 100% of the votes at the general meeting of shareholders. The total price for all STI shares has been set at PLN 1,623.

On May 29, 2012, Internetia Sp. z o.o, the Company's subsidiary, concluded an agreement for the acquisition of 100 (not in thousands) shares in the share capital of Sanetja Sp. z o.o. ("Sanetja"), each with the nominal value of PLN 100 (not in thousands), which represent 100% of the share capital and confer the right to 100% of the votes at the general meeting of shareholders. The total price for all Sanetja shares has been set at PLN 1,556.

Mergers with subsidiaries

On May 11, 2012 Internetia Sp. z o.o. merged with its wholly-owned subsidiaries Saite Sp. z o.o., Netsystem Sp. z o.o. and ZAX Sp. z o.o. The merger was carried out through the transfer of the acquired company's assets to Internetia (merger by acquisition) without any increase in Internetia's share capital and without any share exchanges.

On July 31, 2012 Telefonia Dialog Sp. z o.o. („Dialog") merged with its wholly-owned subsidiary Avista Media Sp. z o.o. ("Avista"). The merger was carried out through the transfer of the acquired company's assets to Dialog (merger by acquisition) without any increase in Dialog's share capital and without any share exchanges.

On August 31, 2012 Netia merged with its wholly-owned subsidiary CDP Netia Sp. z o.o. (previously operating under the name Crowley Data Poland Sp. z o.o., "Crowley"). The merger was carried out through the transfer of the acquired company's assets to Netia (merger by acquisition) without any increase in Netia's share capital and without any share exchanges.

On August 31, 2012 Internetia Sp. z o.o. merged with its wholly-owned subsidiaries Silesia Multimedia Sp. z o.o., Sieci Multimedialne Intergeo Sp. z o.o. and ComNet ITT Sp. z o.o. The merger was carried out through the transfer of the acquired company's assets to Internetia (merger by acquisition) without any increase in Internetia's share capital and without any share exchanges.

On November 30, 2012 Internetia Sp. z o.o. merged with its wholly-owned subsidiaries Elpro and E-IMG Internet Multimedia Group Sp. z o.o. The merger was carried out through the transfer of the acquired company's assets to Internetia (merger by acquisition) without any increase in Internetia's share capital and without any share exchanges.

1.2 Information on basic products and services

The Netia Group provides various voice telephony and data transmission services. These services include switched, fixed-line voice telephone services (including domestic long-distance, international long-distance and fixed-to-mobile services), Integrated Services Digital Network ("ISDN"), Voice over Internet Protocol ("VoIP"), voice mail, dial-up and fixed-access Internet, leased lines and frame relay and MPLS services. The Netia Group also offers wholesale services (including the wholesale termination of in-bound traffic, ducts, dark fiber and co-location services), services based upon intelligent networks (free phone, split charge and premium rate services) and provides broadband Internet access with ADSL technology. These services are offered over Netia's own copper or fiber networks and, selectively, over network facilities leased from other operators.

Since 2006, the Netia Group has been providing voice and broadband services using WIMAX technology running over 3.6 – 3.8 GHz frequencies that were acquired by the Group in 2005.

Taking advantage of the opportunities arising from changes in the regulatory environment, the Company concluded a bitstream access agreement ("BSA") with Telekomunikacja Polska S.A. ("TP SA") and commercially launched its broadband Internet access services over TP SA's network in January 2007. During 2007 the Company began offering Netia voice services to TP SA customers including the arrangement whereby the customer pays a monthly fee to Netia as well as the hitherto call by call charges. Netia pays a line rental fee to TP SA under the Wholesale Line Rental (WLR) administrative decision issued by the telecommunications regulator (Urząd Komunikacji Elektronicznej, "UKE"). During 2008 Netia began to install its own equipment in the TP SA network nodes using a form of regulated access called Local Loop Unbundling (LLU) and began connecting customers using this form of regulated access.

In September 2008 the Company acquired Tele2 Polska Sp. z o.o. ("Tele2 Polska", merged with Netia in February 2009), a company providing voice and broadband services Poland-wide on the basis of regulated access to the TP SA network, including call by call, WLR and BSA.

The Netia Group is also expanding the footprint of its own network and broadband customer base by acquiring local fast ethernet operators. Since the beginning of 2007, the Netia Group has acquired 37 (not in thousands) such operators with a total of 129,808 (not in thousands) active customers. Additionally, the Netia Group has acquired 10,723 (not in thousands) customers and local access networks from other Ethernet operators.

To further broaden Netia's product offer, including convergent services, Netia started offering mobile services in September 2008. Netia provides its mobile service based on a Mobile Service Provider Agreement with P4 Sp. z o.o. ("P4"), enabling Netia to buy mobile services wholesale from P4 and resell them as Netia branded mobile services. In the third quarter of 2009, the scope of this cooperation was expanded to cover mobile broadband services as well as mobile handset based voice and data services.

Netia introduced IPTV services into its offering during 2011 and is gradually upgrading its copper and Ethernet access networks using VDSL and fibre to the building (FTTB) technology to deliver faster broadband.

The Netia Group is also engaged in the installation and supply of specialized mobile radio communication services (public trunking) in Poland through its subsidiary UNI-Net Poland Sp. z o.o. (established in May 2009 through a corporate separation from UNI-Net Sp. z o.o.).

In December 2011 Netia acquired Telefonia DIALOG S.A. ("Dialog",which was transformed into Telefonia DIALOG Sp. z o.o. on April 30, 2012) with its subsidiaries Avista Media Sp. z o.o. ("Avista", merged with Dialog in July 2012) and Petrotel Sp. z o.o. ("Petrotel") (together, the "Dialog Group") and Crowley Data Poland Sp. z o.o ("Crowley", later CDP Netia Sp. z o.o., merged with Netia in August 2012), two other Polish alternative operators, which increased materially the size of the Netia Group. Dialog and Petrotel provide a similar range of telecommunication services to Netia and serve business and residential customers. Crowley was providing telecommunications services exclusively to business customers. Avista was providing call center services mainly for Dialog but also for some third party customers.

The Netia Group's revenues in 2012 and 2011 are presented below:

	Year ended December 31, 2012	**Share in total revenues**	**Year ended December 31, 2011**	**Share in total revenues**
	(PLN)	%	(PLN)	%
Direct voice, including:	948,455	44.7%	737,373	45.6%
Monthly fees	*662,808*	*31.2%*	*516,707*	*31.9%*
Calling charges	*284,904*	*13.4%*	*220,051*	*13.6%*
Indirect voice	34,976	1.6%	22,469	1.4%
Data	765,658	36.1%	604,188	37.3%
Interconnection revenue	109,588	5.2%	77,602	4.8%
Wholesale services	136,242	6.4%	124,375	7.7%
Other telecommunication revenue	113,789	5.4%	48,014	3.0%
	2,108,708	**99.4%**	**1,614,021**	**99.8%**
Radio communication services	3,540	0.2%	4,352	0.2%
Other services	9,108	0.4%	430	0.0%
	2,121,356	**100.0 %**	**1,618,803**	**100.0 %**

1.3 Sales market (not in thousands)

The Netia Group operates on the telecommunications services market with its predominant focus on fixed broadband, fixed telephony, FTA (free to air) and pay TV content distribution as well as mobile convergent offers. The sales market for these products has recently been becoming increasingly homogenous with multi-play integrated offers playing a major part in consumer preferences.

Following the market liberalization in 2006 and introduction of services based on bit-stream access (BSA), wholesale line rental (WLR), and local loop unbundling (LLU) the Netia Group is able to offer Internet access and voice services, nationwide, via the incumbent's copper network. In 2008 Netia acquired Tele2 Polska, a fixed line telephony operator mainly rendering services via WLR to its residential customers. In 2011 Netia further increased its scale through the acquisitions of Telefonia Dialog and Crowley Data Poland alternative operators, the first of which mainly operates on its own proprietary network in voice, TV and broadband segments as well as in WLR segment while the second operates mainly in corporate and SoHo/SME segment. All acquisitions contribute heavily to Netia Group's attained scale of operations in the Polish telecommunications services market in both, residential clients and corporate customers' segments.

The fixed broadband services market increased from around 6.3 million services at 2011 year end to 6.6 million services at the end of 2012. The penetration of fixed broadband reached 47% of households in 2012 and is expected to continue to grow. Fixed line telephony services decreased from approximately 8.8 million lines at the end of 2011 to 8.3 million at the end of 2012 and is continuing to shrink. The penetration of fixed line telephony in Poland was approximately 59% of households at the end of 2012. The pay TV market in Poland increased from 11,5 million services in 2011 to reach more than 11,8 million services in total in 2012, mainly dominated by cable and DTH offerings.

Although some market share has been lost during 2012, the Netia Group maintained its position as the leading alternative for broadband services to the national telecom operator (TP SA). The Netia Group's broadband subscriber base - including recent acquisitions - decreased to 874,778 at December 31, 2012 from 911,570 a year earlier. The Netia Group estimates that its share of total broadband market subscribers has decreased from 14.4% to 13.3% during the past twelve months. Furthermore, at December 31, 2012 the Netia Group had 1,643,904 fixed line telephony subscribers of which 647,775 were connected over own proprietary networks, while 869,196 were served over WLR access and 126,933 were served over LLU voice over IP. The Netia Group estimates that its share of total fixed voice telephony market has decreased from 19.9% to 19.8% during the past twelve months.

The Netia Group has its own access networks built out in areas covering approximately 16% of households in Poland. At the end of 2012, Netia served 400,431 broadband customers using the wholly owned copper, Ethernet and fiber networks. The country-wide backbone network and the ability to upgrade the existing access network allows the Group to broaden its operations, simultaneously obtaining independence from the networks of other operators and regulatory regime. Simultaneously, the Netia Group continues to invest significant capital expenditure into a modernization of its own copper and Ethernet networks converting last miles into NGA ("Next Generation Access") standard allowing the customers to receive high speed broadband and attractive TV content. As of December 31, 2012 the Netia Group had approximately 1,040 thousand homes passed on NGA networks including Telefonia Dialog (PON, FTTB, VDSL). On top, the Netia Group had circa 376 thousand IPTV ready homes passed where it can render 3play services.

As of December 31, 2012, Ethernet networks acquired by the Netia Group since mid-2007 provided broadband access to a total of 121,005 mostly residential customers as compared to 132,532 customers at December 31, 2011, with approximately 621 thousand homes passed in total. During 2012 the Netia Group acquired three further Ethernet networks with 4,921 active customers and around 18,180 homes passes as compared to nine acquisitions (including both purchases of companies and asset transfers) with 22,823 active customers and 103,832 homes passed in 2011.

Netia is currently focused on upgrading Ethernet networks to NGA standards already acquired and will therefore likely acquire new networks at a much slower rate than seen in the past. Additionally, a significant margin decrease in regulated access products (particularly on BSA and WLR) will trigger a probable defocus from proactive sales of BSA- and WLR-based services, which are delivered to our customers over the wholesale access to the incumbent's network, limiting our sales activities in this regard to customer retention only. This will limit Netia's addressable sales market significantly with a focus mainly on own network homes passed and LLU unbundled nodes.

At the end of 2012 Netia provided TV services to 79,285 customers as compared to 50,712 customers as at December 31, 2011. The Netia Group constantly expands its TV offering with a new content and functionalities and additionally upgrades its own access networks, including NGA upgrades on own copper network ("VDSL") and Ethernet networks ("FTTB"), with a view to develop the offsetting revenue stream from 3play services (voice + broadband Internet + TV) for its Residential customers. The TV services are rendered by Netia both in IPTV and smooth streaming technology, which expands the availability of its 3play bundle offer outside the IPTV network, combining high quality of TV signal with lower bandwidth requirements.

In 2012 Netia continued to extend the reach of its LLU-based services. Netia had over 700 unbundled nodes at December 31, 2011, passing nearly 5 million homes. Netia served 182,726 customers over LLU as at December 31, 2012 as compared to 184,229 at December 31, 2011. The total LLU subscriber base includes 119,199 gross customers migrated from lower margin bit-stream ("BSA") services.

The Netia Group runs its operations within one geographical area,that is the territory of Poland.

The Netia Group renders its services both to corporate and residential customers. TP S.A. "Łącza" was the largest supplier for the Netia Group. TP S.A. "Łącza" is not a related party to the Company.

1.4 Development perspectives for the Netia Group's operations

Growth prospects (not in thousands)

Following the acquisitions of Telefonia Dialog and Crowley Data Poland in December 2011, the Netia Group increased its scale of operations by over 30% in terms of revenues and more than 40% in terms of total services. Moreover, with an ambitious amount of synergies to be extracted from integrating the operations, the Netia Group anticipated further growth in operational and net profitability together with capital expenditure optimization and thus a progressive free cash flow increase.

However, while the integration synergies exceeded the preliminary estimates, delivering 98 million PLN of opex and capex savings already in 2012 and are expected to deliver 130 million PLN annually from 2014 onwards, the economic slowdown observed during 2012 alongside tougher competition and pricing pressure from the competitors, especially in the Residential market segment, resulted in a weakening outlook for revenue, margins and the number of services (RGUs – Revenue Generating Units) in 2013 and beyond. In particular, the negative market trends were visible in 2012 in the fixed-line voice telephony, which had been experiencing customer losses due to fixed-to-mobile substitution, while the fixed-broadband market became relatively stagnant. The TV product line, though growing at the anticipated rate, remains subscale and will contribute to top line and margin restoration only in the years to come. Deterioration of trading conditions was particularly noticeable in the off-network services, which suffered significantly from shrinking margins. As a result, Netia Group forecasts to record a 9.3% decline in 2013 revenue versus 2012, an 11.2% decline in Adjusted EBITDA and a 10.2% decline in Adjusted operating free cash flow (Adjusted OpFCF).

In order to respond to the above challenges, the Company is targeting 2013 as a year of transitioning to greater on-network sales focus and increased sales of on-net broadband and TV services. Successful implementation of this revised commercial approach is expected to stabilize financial performance of the Residential segment in 2014 and beyond. Given the on-going strong performance of the Business segments (combining the Corporate, SOHO/SME and Carrier segments), Netia expects them to be the main growth engine in the nearest future and intends to focus strongly on developing services for its business customers.

Operationally Netia Group constantly expands its TV offering with a new content and functionalities and additionally upgrades its own access networks, including NGA upgrades on own copper network ("VDSL") and Ethernet networks ("FTTB"), with a view to develop the offsetting revenue stream from 3play services (voice + broadband Internet + TV) for its Residential customers. Thanks to the ongoing infrastructure upgrade the Netia Group offers from late 2011 a competitive Internet Protocol Television ("IPTV") product together with Digital Terrestrial Television ("DTT") and Video on Demand ("VOD") to complement the offering grid. Furthermore, in mid-2012 Netia introduced smooth streaming technology, which expands the availability of its 3play bundle offer outside the IPTV network, combining high quality of TV signal with lower bandwidth requirements. The existing backbone network together with access networks in all major Polish cities and towns country-wide empowers the Netia Group to deliver a full package of 3play services in most locations once the NGA upgrade is completed. As at December 31, 2012, the Company covered in total 1,040 thousand households with its NGA networks. Moreover, Netia Group covered a further 376 thousand IPTV ready homes passed within its network coverage based on ADSL2+ technology. Combined with NGA ready homes passed, all of which can deliver IPTV services, the Netia Group had approximately 1.4 million IPTV ready homes passed in its proprietary network coverage. Our priority in this area is to strongly increase our customer base penetration with multi-play services including TV and over-the-top ("OTT") solutions by both, targeting new customers in our coverage areas as well as cross-sell to the existing customer base.

Selective access networks upgraded to NGA standard will facilitate new service portfolio development characterized in particular by a relatively higher profitability potential in future thanks to multi-play service uptake and increased ARPUs per customer. A key priority is to continue to boost the proportion of our customer base taking more than one service from Netia, especially in 3play packages, as this drives profitability through the proportionate reduction in back office expenses. Given a significant margin decrease in regulated access, we will defocus from proactive sales of BSA- and WLR-based services, which are delivered to our customers over wholesale access to the incumbent's network, limiting our sales activities in this regard to customer retention.

The next element of our strategy is related to maintaining as well as building up whenever possible our position in the Business segments. We will focus on the most attractive areas in the Corporate segment, aiming to improve profitability while limiting incremental capital expenditure. In the future we will aim to acquire a higher proportion of data related contracts than we have achieved in the recent past in order to accelerate growth in the Corporate and SOHO/SME market. In the Carrier segment our goal is to increase the utilization of existing capacity and other assets by selectively pursuing projects that require limited investment and which are considered low risk for the returns available. Acquisition of Crowley Data Poland is yet another important addition to the corporate market segment operations of the Netia Group, which now possesses also a unique LMDS microwave radio uplink technology, thanks to which the provisioning time of services to corporate clients together with a backup connection solution should shorten significantly, building an extra competitive advantage.

In late 2012 we implemented a new internal project "4Sails", examining the way of functioning of our sales forces. The project's goal is to analyze quality and efficiency of the existing sales processes, their support systems and methods of co-operation with our external partners. This in turn will allow Netia Group to work out the key initiatives, which will be implemented during 2013 with an aim to fully seize the opportunities arising from the Telefonia Dialog and Crowley Data Poland acquisitions. 2013 will be focused on various activities related to this project and will involve all employees of the Netia Group. We expect that the project, which is conducted in co-operation with Deloitte, will revolutionize the way of thinking of the whole selling process including the range of the tools used, products' placement and the communications of our offerings.

A critical enabler for successful accomplishment of Netia's growth plans is an organizational culture. We have defined such corporate values, in common to all New Netia employees, as trust, audacity, excellence and pride, by which we would like to guide our work. Thanks to those values we would like to build such Netia brand attributes as simplicity, inventiveness, value and passion. Our objective is to maintain a spirit of dynamism and proactivity at Netia, which will enable us to effectively face the challenges posed by the market and our competitors.

Netia will remain dedicated to its 2020 Strategy, targeting the combined KPI of 2.0 services per subscriber in the Home and SoHo SME segments. To achieve this goal, Netia will continue to cross-sell new services, in particular IPTV and IP protocol based television (delivered over Microsoft Smooth Streaming^{TM}) to its existing customer base as well as target new customer volumes with a competitively superior product offering in 3play. Further product quality improvements in the television area, fine tunning of the content offer and adding new widgets and TV-related functionalities will remain critical to reaching the goal.

Network Infrastructure (not in thousands)

Continuous change of telecommunication market and expansion of Netia client base (also due to acquisitions of Ethernet ISPs, Crowley and Dialog networks) results in dynamic development of Netia backbone network capacity. While use of modern technology allows to fully utilize potential of Netia's own and leased fibre infrastructure it also makes it possible to expand geographically.

Development of broadband access network is realized both by capacity upgrades of existing BSA and LLU points of interconnect with TP and the construction of new point of interconnects enabling access to TP IP DSLAM-s. Until the end of 2011, Netia invested heavily in BSA extension and construction of LLU access nodes in the TP SA network. At December 31, 2012, 713 LLU nodes had been deployed. This LLU network give Netia access to almost 5.0 million TP access lines Poland–wide. Implementation of modern technologies in LLU nodes enables delivery of advanced services requiring broadband access (i.e TV, VoD, VoiP, MPLS). Investments in regulated access has now been slowed down as the number of customers is no longer growing and, according to Management's analysis, all potentially profitable LLU nodes have already been rolled out.

Development of Netia's own broadband access based on copper infrastructure is focused on implementation of NGA (Next Generation Access Network) based on VDSL2 technologies allowing increase of bandwidth delivered to the customer by several times up to 80Mb/s. Acquisition of Ethernet networks is followed by gradual upgrades of their infrastructure in terms of capacity delivered to access nodes required by modern services i.e. IPTV and in terms of enabling remote management and automatic service provisioning of new services in these networks. As a result of upgrades Netia Ethernet networks built in FTTB (Fiber To The Building) technology will be able to deliver up to 100Mb/s capacity to each customer.

Netia will continue its plan of developing new and modernizing existing infrastructure of acquired Dialog Network based on VDSL and FTTH technologies. To strengthen market position, in parallel, Netia also develops infrastructure competencies around modern, IP based multimedia and communication services such as IPTV, VoD, CDN, etc.) dedicated to residential and business market. IP/MPLS core infrastructure acts as a common denominator for all delivery scenarios, unifies deployment process and lowers development and network maintenance costs. Essential part of our network development is concentrated on delivery of CPE dedicated to Netia customers Netia Spot (WiFi router) oraz Netia Player.

2 Major factors for the activities of the Netia Group

2.1 Major risks and threats related to the operational activities

Risk of changes to the Netia Group's strategy

On January 13, 2011 the Company announced the main assumptions of its new long term strategy spanning over the period until year 2020 ("Strategy 2020"). Financial guidance regarding the Strategy 2020 was announced at the same time in order to reflect Netia's long term plans for the further roll out of Local Loop Unbundling ("LLU") as well as the upgrade of select regions of ETTH and copper network to broadband speeds of 30MB and higher (Next Generation Access "NGA"). Following Netia's acquisition of two sizeable telecom assets – Dialog Group and Crowley – in December 2011, the key assumption of strategic financial guidance until 2020 were confirmed. However pricing pressure and falling numbers of active services in the Home segment have resulted in Management modifying its strategy to focus more on own network services and to stop targeting annual RGU growth. No assurance can be given as to whether the remaining strategic initiatives included in Netia's strategy 2020 will be successful and if not, whether they may adversely affect the operating activity of the Netia Group, its financial standing or its overall performance. Furthermore, Netia may seek to introduce new elements to strategy that might materially change expected cash flows or modify the risk profile of the Group.

Risk of changes in the shareholder structure, which may influence business activity

Currently, Netia is not controlled by any strategic investors, and its shares are held by a large number of shareholders. Neither Netia's corporate documents nor the provisions of Polish law provide for any serious restrictions to changes in control over the Company in the event of third parties acquiring a considerable number of shares. Thus, such changes of control may materially affect the composition of the Company's Supervisory Board and the Management Board and, in turn, the strategy and business activity of the Netia Group. Due to the above, the Company cannot guarantee that any adopted strategy of the Netia Group will be pursued in accordance with its initial objectives.

Risk connected with the impact of potential future takeovers and acquisitions of large-scale businesses

Revenues and financial performance of the Netia Group may be materially affected by takeovers of and mergers with other entities that operate large scale telecommunications businesses. Upon the Company's takeover of another entity, the process of fully integrating this entity may carry high risks, e.g. resignation of key employees, the loss of a certain segment of its customers or high costs of the entire integration process including the lack of certain portion of contemplated synergies to be extracted from the acquisition.

The already consolidating, however still relatively fragmented market of alternative operators rendering wire line telephone services may result in continuing consolidation within the Polish market. The Company intends to evaluate potential takeovers and acquisitions whenever such possibilities arise. The performance of such transactions requires the special involvement of the Company's high-ranking managers and may entail high costs connected with the identification and evaluation of the candidates for takeover, the negotiating of agreements and integration of the entities acquired. The Netia Group may require additional funding in order to conduct such transactions.

The benefits from potential takeovers will depend mostly on the extent to which the Netia Group is able to integrate the acquired entities into its structures. Future company acquisitions may entail acquiring existing liabilities and the risk of undisclosed liabilities. The Netia Group cannot guarantee that beneficial takeover possibilities will arise in the future, nor, if such possibilities arise, that they will result in the successful integration of the acquired entities with the Netia Group. Failure to integrate the acquired entities into the structures of the Netia Group and / or the failure to generate the expected operating and strategic synergies may adversely affect the operations and financial standing of the Netia Group.

Specifically in regard to the above described risks, in December 2011 Netia announced that it had closed the transactions of the acquisition of the two large scale telecommunication entrepreneurs: Telefonia Dialog and its subsidiaries and Crowley Data Poland. Management estimates potential annual synergies from these acquisitions at the level of PLN 130.000 and expects that all projects necessary to deliver such synergies can be completed within two and a half years from the respective dates of acquisition. Management cannot exclude that possibility that revisions to the synergy targets or timing may be necessary as the integration proceeds. All other general risks described above in this risk factor fully apply to the Dialog Group and Crowley.

Specific risks associated with the acquisition of Dialog S.A.

In addition to general risks inherent in acquisitions of businesses of significant scale relative to the buyer, the acquisition of Dialog is associated with certain risks specific to this integration:

- Full integration will require migration of Dialog billing and customer relationship management systems onto the Netia platform. This process is expected to take at least until late 2013 and certain material operational synergies are dependent on this migration being successful. Problems with the migration might lead to problems with billing and customer service for all or a significant part of the customer base.

- Netia is in the middle of a three year project to upgrade its core business IT platforms in a "Network Architecture Project". As part of this project, a Customer Relationship Management system should be selected for implementation in 2014 following the systems migration described above. Selecting and implementing a system that will satisfy the legacy requirements of both Netia and Dialog creates significant logistical and operational challenges.

- Dialog customers are billed their monthly fees in arrears whereas Netia customers are billed in advance as in most other telecom operators in Poland. Migrating to a single set of billing rules may prove difficult as Dialog customers may need to pay two months subscription in one month in order to be consistent with Netia policy, potentially leading to significant customer dissatisfaction.

- Significant elements of Dialog's network are located on leased premises. Should Dialog cease to be able to lease these properties at reasonable cost or at all, significant costs may be incurred to relocate or replace the affected infrastructure.

- Dialog has made significant investments in Passive Optical Networks ("PON") in recent years on the basis that a significant part of the investment will be reimbursed from European Union funds by Polish Agency for Enterprise Development ("PARP"). As at December 31, 2012 most reimbursements were recovered, however several commitments by Dialog towards PARP are still to be achieved. Given market conditions and the project of integrating with Netia, some of these requirements may not be achieved and the refunds may not be received in the amounts originally planned by Dialog. No assets have been recognized in respect to these grants in the acquisition balance sheet of Dialog and the PLN 16,596 already received has been provided for until such time that its long term retention becomes reasonably certain.

Management can give no assurance that one or more of the above risks may not result in the Netia Group suffering significant additional costs or reduced cash flows.

Risks relating to the acquisition, integration and development of Ethernet network operators

An important element of Netia's strategy to expand its broadband subscriber base is the acquisition of Ethernet network operators. Our plans require that these companies, which typically have no more than 5,000 customers at the time of acquisition, are integrated into Netia's core operations. We aim to continue to grow the subscriber bases connected to the networks that we acquire and to upsell their customers voice and TV services in addition to the internet access that they currently purchase. We cannot provide any assurance that we will be successful in implementing this strategy in whole or in part in any or all of the Ethernet networks that we have acquired or will acquire. Costs of integration may exceed our plans or we may discover undisclosed liabilities post acquisition. Customers may prove reluctant to switch to services provided by Netia directly or unwilling to switch to Netia voice or TV services from their current providers. Moreover the price of such Ethernet networks may increase to the point that further acquisitions are uneconomic, making it more difficult for Netia to reach its subscriber growth objectives. Failure to fully implement our strategy in regard to Ethernet network operators may adversely affect the operations and financial standing of the Netia Group.

Technological risk

The telecommunications sector is an area witnessing dynamic technological changes. In designing and expanding its networks, the Netia Group uses the latest technical solutions. However, it is not possible to predict how the Netia Group's operations may be affected by technological advances in the field of wireless, mobile transmission, voice services based on cable television telephony and multimedia services provided over Internet by third-party – OTT (Over The Top). In particular, the business activities of the Netia Group may be affected by the trend to provide telecom services via wireless or portable platforms, with wireless broadband access and fourth generation mobile cellular telephone systems equipped with IP. Due to the difficulties in predicting future regulatory environment and exact market potential, Netia may sometimes invest in technologies that ultimately do not deliver the expected returns. When such a situation occurs, it can have a negative impact on our results and financial condition.

Risks related to the uptake of new services and the financial returns available from investment in upgraded networks

During the first half of 2011, Netia has piloted the introduction of upgraded broadband speeds to its copper and Ethernet ("ETTH") networks and adding television and content services to its offering. Whilst these pilots have delivered promising results and the Group has decided to continue investing, no assurance can be given that these upgrade projects will be successful as financial results obtained in the future from such investments implemented on a wide scale may differ significantly from the results of those pilots.

The speed of roll-out and relative performance of fast mobile broadband networks (such as HSDPA and LTE), the speed of upgrade of cable networks and the incumbent's own investment plans may have a significant impact on the relative attractiveness of our broadband and television offers and sales results. Furthermore, our new content services may turn out to be inferior to those of key competitors and we may not be able to meet sales targets or ARPU targets as a result.

Risk associated with property rights

In order to deliver services to its customers, Netia owns, leases or uses properties through "rights of way" easements. In some cases the property rights are unclear or Netia may be unaware of the defects in the property rights used by the Company and Management can give no assurance that legal issues or challenges will not occur from time to time. This may result in Netia incurring significant costs to protect its rights or to move its infrastructure. Similarly, the leases may unexpectedly be cancelled by lessors with the result that Netia incurs significant expenses to relocate its network elements.

Foreign currency risk

Approximately 40% of Netia's annual capital investment programme and up to 10% of typical operating expenses are either invoiced in foreign currencies or are invoiced in Polish Złoty based on price lists expressed in foreign currencies. Netia operates a Risk Management Committee that decides, from time to time, to hedge these exposures to foreign currency risks and if so, the proportion of the exposure to be hedged. Whilst Netia's hedging activities are designed always to reduce Netia's exposure to earnings volatility through changes in exchange rates (i.e. Netia does not speculate), we can give no assurance that entering into hedging transactions will result in higher earnings or cash-flows than if we had not hedged the Company's currency exposures.

Interest rate risk

Netia's long term borrowings are all Polish Zloty denominated and the interest paid depends on floating WIBOR rates and a margin that is dependent on the Group's financial leverage. To mitigate the risk of higher WIBOR rates leading to worse financial results, Netia's Risk Management Comitee may decide to swap some or all interest rate risk into fixed rates coupons. Whilst Netia's hedging activities are designed always to reduce Netia's exposure to earnings volatility through changes in exchange rates (i.e. Netia does not speculate), we can give no assurance that entering into hedging transactions will result in higher earnings or cash-flows than if we had not hedged the Company's interest rate exposures.

The level of profits and distributable reserves in Netia S.A. may differ materially from those of the Netia Group

With the acquisition of Dialog Group and Dialog Sp. z o.o. in particular, the Netia Group has acquired a material profitable subsidiary that Netia does not intend to merge into Netia S.A. over the medium term for operational reasons. As a result, projections show that a significant part of the Netia Group's earnings will accrue to Dialog Sp. z o.o. and that Netia S.A. operating profits shall be materially below those of Netia Group as a whole.

In these circumstances the level of distributable reserves in Netia S.A., which stood at PLN 480,636 on December 31, 2012 and the result for the year for Netia S.A. which was a profit of PLN 225,004 in 2011 and a loss of PLN 94,175 in 2012, are likely to diverge from these of Netia Group as a whole. Whilst Netia shall take reasonable steps to ensure that profits and cash flows flow up to the parent company over time, Management can provide no assurance that Netia S.A. will always be in a position to pay a dividend or make other distributions to shareholders when the Netia Group as a whole records a net profit for a given year.

Netia S.A.'s earnings have historically been highly volatile and continued volatility may inhibit the Company's ability to pay dividends in predictable amounts in the future.

Net profits and losses of Netia S.A. have historically been very volatile with significant profits and losses recorded in different years due to various non-cash accounting issues that depend critically on Management's judgments about the Netia Group's future prospects. These non-cash accounting issues are principally:

- Annual impairment testing net book values of goodwill and non-current assets against Management's latest cash flow projections for the business,

- Estimates of future economic lives of non-current assets, which has a direct impact on the annual depreciation and amortization charges that constitute the Group's largest single expense,
- Valuation of deferred tax assets.

Changes in the business, legal or regulatory environment can lead to material changes in Management's estimates and lead to material fluctuations in the above three non-cash items between years.

If Netia S.A. records a net loss in a given year this reduces distributable reserves and this may lead to Management being unable to recommend a dividend in respect of such a year.

Risk of employment termination by key executives and difficulties related to the recruitment of new, competent executives

The activity of the Netia Group is dependent on the quality of the work of its staff and employees in executive positions. The Management Board cannot guarantee that the possible termination of employment by some of its key executives will not adversely affect the financial standing and performance of the Netia Group, which, should some of its executives terminate their employment, may then lack executives with sufficient knowledge and experience in the field of management and operating activity. Changes in composition at the Company's executive levels may result in disruptions in the Netia Group's business activity.

Risk resulting from changes in the Telecommunications Law

The current Telecommunications Law came into force on September 3, 2004, except for certain regulations that came into force on January 1, 2005 in result of implementation of so-called "2002 directives package". On July 6, 2009, the act on the amendment of the Telecommunications Law and other acts entered into force. The purpose of the above-mentioned amendment was to further harmonize Polish provisions with the legal framework of the European Union.

A further amendment of the Telecommunications Law entered into force on July 20, 2010. According to this latest amendment, the definition of "subscriber" was changed, so that it now covers also users of services who have not concluded a written contract for the provision of telecommunications services. After the entry of this law into force, the obligations of telecommunications undertakings with regard to the conclusion, amendment, and performance of contracts apply to these users as well. Netia, as well as other telecommunications entrepreneurs, was obliged to adjust its standard client contracts to the new requirements within six months following the entry of the amendment into force.

On June 2, 2011, an amendment of the Telecommunications Law came into force, with regard to provisions concerning rules for verification whether fees for telecommunications access calculated by an operator with significant market power on the basis of justified or incurred costs are correct.
Pursuant to the amended law, as far as imposition of obligation to set fees on the basis of justified costs is concerned, in the absence of the auditor's opinion on the consistency of an annual regulatory accounting statement and the results of cost calculation with the binding regulations, or in case of a negative opinion or a qualified positive opinion, as well as in case of occurrence of significant discrepancies between the amount of fees calculated by an operator and established by the President of UKE on the basis of an auditor's opinion, the President of UKE establishes the amounts of fees for telecommunications access or their maximum or minimum levels, using methods specified in a decision designating an operator as holding significant market power and imposing an obligation to calculate fees for telecommunications access taking account of justified costs recovery.

As far as obligation to calculate fees on the basis of incurred costs is concerned, in a decision designating an operator as holding significant market power the President of UKE specifies methods of verification and calculation of fees. In order to verify whether the fees set by an operator on whom an obligation to calculate fees on the basis of incurred costs was imposed are correct, the President of UKE may apply the methods of fees verification specified in this decision. If the executed verification reveals that the amount of fees set by an operator is incorrect, the President of UKE establishes the amount of fees or their maximum or minimum level taking account of the promotion of efficiency and sustainable competition as well as the assurance of maximum benefits for end users. The fees shall be established in a separate decision.

Management Board is unable to assure neither that application of the amended regulations will not affect the costs of activity of the Companies from the Group, nor that whether – and when, as well as in what way – it will ensure the change of the amount of fees for telecommunications access to be borne by Netia after the end of this period.

On December 4, 2011, the amendment of the Telecommunications Law entered into force pursuant to which premium rate services providers were obliged, inter alia, to provide their subscribers with the right to block access to these services free of charge. In May 4th, 2012 new regulations have entered into force obliging the providers of these services to inform subscribers that the limit of payments due for such services that was established by them in their contracts was exceeded. The Management Board is unable to assure that the regulations after coming into force will be uniformly interpreted by the regulatory bodies and that this interpretation will allow for provision of premium rate services without requiring increase of costs of adjustment of the Companies from the Group to the obligations stipulated therein.

On July 17, 2010 the act „for the support of the development of telecommunications networks and services" (hereinafter referred to as "the Act on Development") entered into force. One of the goals of the act is to improve the investment process in telecommunications infrastructure. It authorizes municipalities to construct infrastructure and telecommunications networks, to make it available, and to provide telecommunications services in areas where the demand of end users is not satisfied by commercially provided access to telecommunications services. In such a case, subject to consent of the President of UKE, Internet access services can be provided for prices lower than market prices, and even for free, if the provision of services in a given area under such preferential conditions will not lead to a distortion of effective and equal competition.

Furthermore, if in order to satisfy group needs of the municipal community, the making available of the infrastructure and provision of services is entrusted to a telecommunications entrepreneur, and due to economic conditions the performance of this activity in a given area will not be financially profitable, the entrepreneur may use the municipal infrastructure for fees that will not recover its full construction cost. The cost borne due to the provision of telecommunications services in that area can be partially co-financed by the municipality.

The Act on Development imposed the following obligations on the selected groups of entities:

- real estate owners, real estate perpetual usufructuaries and real estate administrators – the obligation to ensure access to the building as well as to the place in a building in which the cables supplied to the premises in the building are gathered; the access is to be ensured in order to ensure telecommunications and to the benefit of telecommunications entrepreneur which supplied the building with the public telecommunications network;

- owners of the telecommunications ducts situated on the real estate or in the building – the obligation to make the telecommunications ducts accessible for telecommunications undertaking which has no possibility to use another, existing telecommunications ducts;

- owner of telecommunications cable supplied to or distributed within the building – the obligation to make the whole or a part of this cable accessible for telecommunications undertaking in case the supply of another telecommunications cable to the building is not possible;

In case no agreement describing the conditions for access to the infrastructure is executed, the President of UKE may, upon a motion of any of the parties, issue a decision substituting the agreement.

The Management Board is unable to assure that the agreements on the access to infrastructure, concluded by Companies from the Netia Group in the scope of ownership rights to the cable and ducts infrastructure as well as the rights concerning real estate, will be in each case established with interested telecommunications undertaking in accordance with the principle of freedom of contract, without the necessity to settle the technical or financial conditions of co-operation by the President of UKE.

Under the Act on Development the President of UKE is also authorized to issue a decision obliging an operator authorized to use assigned frequencies in an area indicated by the President of UKE in a specified manner.

The Act on Development introduces the possibility of new sources of competition for Netia from municipalities and other interested entities and the risk of overbuild of our existing networks.

On October 12, 2012 Sejm passed an amendment to the Act on Development, also amending the Telecommunications Law in the area of co-usage of infrastructure. The amendment came into force on December 16, 2012. The aim of the amendment is to streamline the process of building telecommunication networks, in particular regional broadband networks and sharing real estate and buildings in order to install telecommunication infrastructure, but the amendment introduces more rigorous conditions that determine exercising obligation of gaining access to the real estates and the existing connections and the telecommunication infrastructure in the buildings by operators. New regulation amended also other Telecommunications Law regulation, regarding access to the infrastructure.

The Management Board is unable to assure that, in spite of intentions of legislator to facilitate investment process, the changes to the provisions will not cause opposite effects and will not cause difficulties in constructing telecommunication networks and the use of infrastructure belonging to other entities.

On November 16, 2012, the Sejm passed amendments to the Telecommunications Act and some other acts including the Act on Development (hereinafter referred to as "Amendment"), aiming to implement the amendments of the 2002 Directives package, that entered into force in the EU in December 2009 and were to be transposed until May 2011. Most of the new regulations came into force on January 21, 2013. The Amendment, among other issues, forbids to enter into a first agreement to provide telecommunications services for private persons longer than 24 months and obliges telecommunications entrepreneurs to extend their offer addressed to end users to include no longer than 12 month contracts. The Amendment allowed to conclude contracts electronically using the form available on the website of the service provider. At the same time the Amendment broadens the obligatory content of contract for the provision of telecommunications services, and creates obligations with regard to network safety, including the prevention of unsolicited communications (spam).

Telecommunications undertakings are required to adjust the conditions of the contracts, including these stipulated in rules and regulations concerning the provision of publicly available telecommunications services or in price list of telecommunications services within 5 months of coming the Amendment into force, i.e. until June 21, 2013.

The Amendment regulated also specified principles of responsibility of telecommunications undertakings for delay in number portability or for number portability incompatibly with the will of the subscriber. In case of porting the number breaching the deadline established in Telecommunications Law, the undertaking that the subscriber is terminating the contract with , is obliged to pay the compensation in the amount of ¼ of the total monthly fees calculated according to the bills for the last three settlement periods, unless the impossibility to port the number occurred due to the reasons related to IT system managed by the President of UKE. In case when the porting the number has not occurred due to the reasons related to the current service provider, he is entitled to reimbursement of paid compensation in whole or in part from the entity responsible for the delay. In case of porting the number without consent of the subscriber, the subscriber is entitled to compensation from the new service provider in the amount of ½ of the average monthly fees calculated according to the bills for the last three settlement periods for each day from the activation of the number in the new network.

The Management Board is unable to assure that regulation on principles of responsibility of undertakings who take part in number portability process, will not cause the abuse of these regulations, and in effect will not became the grounds for disputes related to enforcement of claims, including recourse claims between operators or service providers, rising from possible faults in realization of subscriber right to port numbers.

The Amendment also introduces new obligations regarding protection of telecommunications secrecy, network security, including acting against distribution of unsolicited content by service users. It excludes the obligation of the President of UKE to assign undertaking obligated to provide universal service. This competence now depends on decision of the President of UKE, based on the evaluation of availability, quality and affordability of the set of universal services in a given area. In case of lack of offers which met the conditions of contest for the undertaking assigned to realize the obligation to provide universal service or individual services, the President of UKE will assign a telecommunications undertaking providing such service or services, taking into account its economic and technical ability to provide these services on given area, ensuring availability of services and the need to support the fair and effective competition. In the decision obligating to provide universal service the President of UKE can impose on assigned undertaking an obligation to apply special tariffs for this service, maximum prices or unified tariffs.

The Management Board is unable to assure that none of the Companies of the Netia Group will be obligated to provide universal service on any area of Poland and, in that case, that such company will not be forced to provide such service on unprofitable conditions requiring financing the cost of provided universal services, on given area until reimbursement of such cost in the amount of subsidy determined by the President of UKE in other decision.

In addition, the Amendment granted the President of UKE new competence to establish in a decision imposing obligation to provide conditions of access to the infrastructure, set forth therein, in case of need to ensure effective competition. The Amendment obligates telecommunications undertaking being the addressee of such decision to provide access to infrastructure under conditions which cannot be worse than conditions set forth in such decision. In case when the contract for access to the infrastructure will not be concluded within 30 days of filing the motion for access to the infrastructure, the President of UKE, acting ex officio or in effect of filing the motion, can issue decision which replaces the contract, as was possible before the Amendment.

In the Management Board opinion, the competence to impose obligation to provide access to the infrastructure under conditions which cannot be worse than conditions set forth in decision of the President of UKE on telecommunications undertakings which do not hold SMP position on the market of wholesale (physical) access to network infrastructure exceeds limitations set by the European law. In the Management Board opinion the real market needs due to state of development of effective competition, which should be taken into account by the President of UKE in the course of issuing decisions, most of all require interference of the President of UKE in enforcement of telecommunications access related to regulated services, provision of which is obligation the telecommunications undertaking holding SMP position on most of relevant markets. The Management Board is unable to assure that the President of UKE, using the new regulation, will not limit the tendency of market participants to invest in infrastructure and that none of the Companies of the Netia Group will not be obligated to provide access to its infrastructure under unprofitable conditions, before the defective regulation will be amended or reversed.

Moreover, the Amendment extends the obligation to provide facilities for disabled persons onto all telecommunications undertakings, increases the information obligations with regard to Subscribers as well as extends the obligation to transfer data concerning telecommunications activity of a given telecommunications undertaking to the President of UKE. The Amendment reduces the data retention period to 12 months. It also change the rules of calculating (and provide increase) of maximum rates for the use of radio frequencies, however draft government regulation setting realistic rates do not provide a significant increase in relation of frequencies used by the companies of Netia Group.

The Management Board is unable to assure that in the future rates for the use of radio frequencies by the Companies of the Netia Group will not increase by a larger amount nor that the amended rules for establishing the fees for extending the reservation of frequencies will not cause increase cost of provided services related to the frequencies used by the companies of Netia Group on the base of reservation which will require in the near future extending for the further period of time. The Management Board believes that most of the changes described above are likely to result in increased costs of running the business for the Netia Group.

Before the day of election to Sejm and Senat in October 2011 the Minister of Infrastructure has also commenced consultations of the draft law on conversion of payments due to fees for licenses granted to mobile public telecommunications network operators. The draft law provided for, inter alia, conversion of part of payments into investments. It follows from the information made public by the President of UKE, Ms Magdalena Gaj who was before February 1, 2012 Undersecretary of State in the Ministry of Administration and Digitalization that the Government abandoned conducting legislative process of this draft of law.

Consultations have been also commenced with regard to "The Guidelines for the draft law on Interministerial Operator of the Information and Communications Technology System ("ICT System)" (hereinafter referred to as "the Guidelines") that provide for establishment of an Interministerial Operator of the ICT System. This entity would be an obligatory service provider for government agencies as well as a number of other entities whose subjective scope was not specified. This concept would lead to establishment of an entity enjoying a statutory monopoly which would constitute a serious exclusion of competition in this scope as well as in Management Board's opinion breach of both the European Union and national regulations. As a result of preference of the ICT network operator as projected in the Guidelines the alternative operators, including Netia, would lose the possibility to provide services to government bodies and agencies which would lead to lower effectiveness of use of their businesses potential and in turn to decline of revenues with regard to services provided to Clients in this sector.

The KIGEiT submitted its statement in the consultations of the Guidelines expressing its disapproval of the proposed solutions. Neither the Guidelines of law nor the draft law were published in the Public Information Bulletin of the Ministry of Administration and Digitalization. The Management Board, however, is unable to assure that in future the Guidelines will not be reflected in any draft legal act.

At the present stage it cannot be determined whether the projected regulations will enter into force, and in such case, what their impact on conditions of doing business by the Companies from the Netia Group will be.

Risks resulting from the obligation to provide universal services

The telecommunications law stipulates that the obligation to provide universal service should be designated by the President of UKE following completion of a tender procedure. The President of UKE issued a decision designating TP S.A. to provide universal service until May 8, 2011. Telecommunications undertakings, whose relevant annual revenue from telecommunications activity exceeds PLN 4,000, are obliged to participate in financing of the universal service obligation. The exact participation amount of a telecommunications undertaking obliged to pay subsidy will be established by virtue of the President of UKE decision and cannot exceed 1% of revenues of a given telecommunications undertaking in a given calendar year.

TP S.A. filed with the President of UKE applications for awarding subsidy towards incurred costs of universal service provision. The applications cover subsidy towards costs incurred in the period from May 8, 2006, until May 8, 2011, i.e. the whole period of obligation to provide universal service by TP S.A. The total amount claimed by TP S.A. on all applications for 2006-2011 was PLN 1,106,994. The last application was filed by TP S.A. on 29 June 2012 and included a request for subsidy for the period from January 1, 2011 to May 8, 2011 in the amount of PLN 33,837.

In May 2011, the President of UKE issued decisions by virtue of which TP S.A. was awarded subsidies towards incurred costs of several services falling within the scope of universal service as follows:

- in 2006 - amounting to PLN 745 - due to provision of facilities for customers with disabilities
- in 2007 - amounting to PLN 1,269 - due to provision of facilities for customers with disabilities
- in 2008 - amounting to PLN 1,830 - due to provision of facilities for customers with disabilities
- in 2009 - amounting to PLN 63,150 - due to provision of facilities for customers with disabilities as well as provision of telephone services with use of public pay phones.

By virtue of a decision issued on September 7, 2011, the President of UKE upheld the decisions awarding subsidies towards incurred costs of universal service for years 2006-2009. TP S.A. challenged the decisions of the President of UKE before the Voivodeship Administrative Court (further "WSA"). WSA dismissed the complaints of TP S.A. against the decisions granting subsidy towards costs of provision of universal service in 2006 - 2009. TP S.A. appealed against sentences regarding subsidies for 2006 and 2007.

The Management Board is convinced of the validity of the issued judgements, but cannot assure that appeals filed by TP S.A. shall be dismissed by Supreme Administrative Court and the amounts of subsidies shall not be increased.

On January 10, 2012 the President of UKE issued decisions by virtue of which TP S.A. was awarded subsidies towards incurred costs of several services falling within the scope of universal service for 2010 amounting to PLN 55,102 due to provision of facilities for customers with disabilities as well as provision of telephone services with use of public pay phones. This decision was upheld in decision of April 11, 2012. TP S.A. challenged those decisions before the WSA. WSA dismissed the complaint of TP S.A. against the decision granting subsidy towards costs of provision of universal service in 2010.

The Management Board is convinced of the validity of the issued judgment, but cannot assure that an appeal, in case of a filing by TP S.A. shall be dismissed by Supreme Administrative Court and the amounts of subsidies shall not be increased.

Jointly for the provision of universal service within the years 2006 – 2010 TP S.A. was awarded the total amount of PLN 122,096.

A decision regarding subsidy towards costs of provision of universal service in the period from January 1, 2011 till May 8, 2012 has not been issued.

Despite the fact that so far the applications of TP SA for subsidies towards costs of universal service provision within 2006-2010 have been only partially admitted, the Management Board is unable to assure neither that TP SA will not be finally awarded the subsidy for 2011, nor that the amount of the subsidy will not be established as higher than awarded in proportion to the sums claimed by the TP SA for the previous years.

The exact amount of share in the subsidies to costs of universal services to be payable by each telecommunications undertaking requires the President of UKE to issue individual decisions. Until the date of approval of these consolidated financial statement companies of the Netia Group have received no such decisions.

The total amount of potential obligation of Companies of the Netia Group, estimated by the Management Board taking into account their market shares in 2006 – 2011, decisions of the President of UKE, in which the amounts of subsidies towards the costs of providing universal service in years 2006 – 2010 were granted in the total amount of PLN 122,096 and estimated amount of potential subsidy to the cost of USO for the year 2011, is PLN 7,156. In this amount, the companies of the Netia Group have made a provision for covering potential obligations under the subsidy for universal service provided in the years 2006 – 2011.

Should TP S.A. prevail in any of mentioned litigation, the USO liability in respect to 2006 – 2011 could still rise materially above the amount provided to date.

(All amounts in thousands, except as otherwise stated)

On the basis of the full amount of subsidies claimed by TP S.A. and of the Company's estimations concerning revenues of telecommunications services providers that may participate in subsidies towards universal services, the amount of subsidy towards universal service that might conceivably be claimed by TP S.A. from the Netia Group amounts to approximately PLN 56,838 for the period from 2006 until 2011 inclusive as follows:

	Maximum subsidies	Provision
	PLN	PLN
2006	6,293	34
2007	10,862	63
2008	9,202	80
2009	11,964	3,199
2010	13,888	2,840
2011	4,629	940
	56,838	**7,156**

Pursuant to the decision of the President of UKE designating TP S.A. to provide universal service the above obligation of TP S.A. expired as of May 8, 2011. No undertaking obliged to provide USO as of May 8, 2011 has been designated to date according to the published position of the President. Nevertheless, on October 16, 2012 the President of UKE has begun consultations of new model of USO. At this stage of the Regulatory work on the model, the Management Board cannot assure that a new model of USO will not be associated with additional costs to be incurred by Netia Group.

No assurance can be also given that Management's best estimate of USO provision for 2006-2011 will be sufficient or that the President of UKE will not make full or partial awards to TP S.A. in respect to 2011 in the future or that TP S.A. will not be successful in its appeal measures against decisions regarding subsidies for years 2006-2010 and the size of the subsidies will not be increased.

Risks related to holding a position of SMP

The President of the UKE issued the decision, whereby it has designated Netia, Dialog and Petrotel, as telecommunications operators holding significant market power in the market for call termination in its fixed public telephone network, in the area of the network where the termination is executed. At the same time, UKE imposed regulatory obligations that relate to:

- providing access to the network (including the use of network elements and associated facilities to the extent they are used to provide call termination services in the fixed public telephone network of Netia, Dialog and Petrotel),
- non-discrimination (obligation not to discriminate between telecommunications operators with regard to telecommunications access to the call termination services in its fixed public telecommunications network, in particular to offer the same conditions in comparable circumstances, as well as to offer the services and to provide the information on the conditions not less favorable than used within own enterprise or in relations with affiliates);
- transparency (comprising the publication of the information in matters concerning provision of telecommunications access with regard to the provision of call termination services in the fixed public telecommunications network of Netia, Dialog and Petrotel, on technical specifications of networks and telecommunications equipment, network characteristics, terms and conditions of the services and of the use of networks, as well as on the fees).

In the performance of the obligation imposed on Netia, Dialog and Petrotel, in the above mentioned decisions of the President of the UKE, Netia, Dialog and Petrotel published information on the conditions of telecommunications access with regard to call termination services in the fixed public telephone network of Netia by posting them on the internet site of Netia, at: http://www.netia.pl/files/netia_dla_korporacji/oferta_ic_netii_-_01.07.2012.pdf

Dialog at:
http://dialog.pl/sites/default/files/files/download/Informacja_w_sprawie_dost%C4%99pu_telekomunikacyjnego_do_sieci_Telefonii_DIALOG.pdf.

and Petrotel at:
http://www.petrotel.pl/userfiles/file/regulaminy%20g%C5%82%C3%B3wne/UKE.pdf

The published documents contain information as required in the Decision of the President of the UKE, necessary for the preparation by the interested entrepreneurs of an application pertaining to the provision of telecommunications access with regard to call termination services in the fixed public telephone network of Netia, Dialog and Petrotel.

The President of UKE is obliged to perform market analysis not less often than every 2 years. Given that this period lapsed, the President initiated a procedure for the determination of the market for the termination of calls in Netia's, and Dialog network, determination of Netia's, Dialog's and Petrotel's market power in that market, and evaluation whether there are reasons to uphold, amend, or waive Netia's, Petrotel's and Dialog's regulatory obligations.

No assurance can be given as to whether Netia, Dialog or Petrotel will not be obliged to perform some other duties set out in the Telecommunications Law imposed on a telecommunications operator holding significant market power in the market with respect to call termination services in the fixed public telephone network, or whether in the future a significant market power of another company of the Netia Group in this market is not determined or whether a significant market power of any company of the Netia Group in another wholesale market is not determined, as well as that any company of the Netia Group will not be subject to regulatory obligations specified in Telecommunications Law.

Interconnection rates depend on the policy of UKE

The President of UKE issued a decision amending the agreement between Netia and TP S.A. on interconnection of networks in which it established the level of asymmetry of rates for call termination on Netia's network in relation to the rates for call termination on TP S.A. 's network. According to the above-mentioned decision, rates for the services will become symmetrical by January 1, 2014.

The Management Board is unable to give any assurance that the term for achieving rate symmetry for call termination in Netia's network in relation to the rates for call termination in TP S.A. 's network, will not be accelerated or otherwise changed by the President of UKE or the court settling the appeal raised by the TP S.A.. Should such an adverse ruling occur, it would be likely to have a material adverse impact on Netia's profit margins.

The President of UKE issued decision by virtue of which it established the rules of asymmetry for termination of calls in the network Dialog in relation to rates for termination of calls in the network TP S.A. According to this decision from January 1, 2014 rates for these services will be symmetric. Dialog appealed against this decision to SOKIK. Despite the Management Board is convinced of validity of the appeal, there is no certainty whether it will be accepted by the Court.

TP S.A. also appealed against this decision, demanding symmetry of termination rates or, alternatively asymmetry of termination rates differentiated in three tariff periods, instead of one tariff period. Despite the Management Board is convinced that there are no grounds for this appeal, there is no certainty whether it will be rejected by the Court.

TP S.A. filed an application to the President of UKE for amendment of rates for call termination in Netia's and Dialog's public fixed telephone networks by differentiation of the amounts of rates for each tariff period. The President of UKE by virtue of issued Decision refused the change of the Contracts pursuant to the applications of TP S.A. Despite the fact, that the decisions were issued in accordance with previous regulatory practice, the Management Board cannot assure that SOKIK will dismiss the TP S.A. appeals as well as decision refusing the change of FTR in Netia network and that the decisions will remain in force.

TP S.A. also filed with the President of UKE for the issuance of decision:
1) replacing the change of the contract on interconnection between Netia and TP S.A., by setting a flat rate for termination of calls of Netia's network in the amount symmetric to the rates of termination of calls in TP S.A.;
2) replacing the change of the contract on interconnection between Dialog and TP S.A. , by setting a flat rate for termination of calls of Dialog's network in the amount symmetric to the rates of termination of calls in TP S.A.;
3) replacing the change of the contract on interconnection between Netia and TP S.A. through making fees symmetric for use of Netia's infrastructure for the purposes of connection of the network to the fees for the use of TP S.A. infrastructure;.

By the virtue of decisions of June 21, 2012, the President of UKE dismissed the TP S.A. 's applications for setting flat rates for termination of calls to Netia's and Dialog's networks. TP S.A. has submited an appeal against the President of UKE decision to SOKiK.

TP S.A. also submitted appeal against the decision of the President of UKE on conditions (and fees) of use of Dialog's infrastructure for the purposes of connection of the network. SOKIK dismissed TP S.A. appeal. However, the Management Board cannot assure that appeal, in case of filing it by TP S.A. shall not be successful and that the settlements rules set forth by the President of UKE will remain in force.

The Management Board believes that currently there are no grounds for application of rates for termination of calls in the networks of the companies of the Group and use of their infrastructure for the purposes of the connection of the networks at the amount as claimed by TP S.A. One cannot assure, however, that the amount of these rates will not be changed in the future (by the decision of the President of UKE or court ruling), including that the amount of the rate of termination of calls in the Netia and Dialog network will not be amended before the end of the term following from the decision of the President of UKE, i.e. before January 1, 2014.
TP S.A. has also filed with the President of UKE for the issuance of decision replacing the change of the contract on interconnection between Netia and TP S.A. which includes defining fees for number portability. The Management Board believes that defining fees for number portability in accordance with TPSA's motion is not justified, however the Management Board is not able to assure that TP S.A. 's claims will not be taken into account by President of UKE and the costs of using LLU by Netia will not increase as an effects of decision which will be issued in this case.

TP S.A. has also filed with the President of UKE for the issuance of decision replacing the contracts for telecommunications access with Netia, Dialog and Petrotel in order to adjust interconnection rules to the current TP S.A. reference offer providing frame terms of telecommunications access with regard to calls initiation and termination, wholesale access to TP network, access to subscribers lines in the mode ensuring both full and shared access, as well as access to subscriber lines through telecommunications network loops intended for the purposes of sale of broadband data transmission services. In the course of negotiation both Netia and Dialog demanded inclusion in negotiated contract the current and valid regulatory obligations imposed on TP, as well as the rules and conditions on telecommunications access which already exist on the grounds of contracts and decisions issued by the President of UKE. Although the Management Board is convinced the negotiation positions of Netia and Dialog and statements filed in proceedings before the President of UKE started in result of TP S.A. motions, were legitimate, it cannot assure that the conditions of telecommunications access related to each of regulated services, established accordingly with TP S.A. current reference offer will not be less attractive than conditions which are now in force. In particular, it cannot be assured that the President of UKE will not issue decisions partially or fully accepting TP S.A. motions and in such case, that terms and conditions on regulated services will not become less favourable and costs of TP S.A. regulated services will not increase.

Risk of changes of UKE decisions and changes in UKE's approach to regulations

The conditions of performing telecommunications services by the Netia Group are in part set out in decisions issued by the President of UKE and most of them are immediately enforceable. The Management Board is unable to exclude the risk that the decisions will not be reversed or amended by the court nor that the terms of telecommunications access established therein will not be changed by the President of UKE during the period within which the Group's Companies make use of the regulatory conditions introduced by such decisions. The Management Board cannot assure, that in such a case, costs of providing services by the Netia Group will not increase and that operators providing wholesale services based on such decisions will not raise the claims against the Netia Group.

Moreover, on February 1, 2012 a new President of UKE was appointed for a five year term of office and on April 15, 2012, a new Vice President of UKE.

On November 27, 2012 the President of UKE published the regulatory strategy for the term of office – "Regulatory Strategy until 2015" (hereinafter "Strategy"). According to the Strategy the main goal of the President of UKE is the improvement of service's quality and the development of new generation telecommunications infrastructure (NGN, NGA) of high bandwidth for the purposes of counteracting the digital exclusion and executing the Digital Agenda in relation to Poland. The President of UKE plans to execute its prerogatives stemming from Telecommunications Law, including in particular market analysis, in particular markets for call termination in each undertaking's network, the review of regulatory obligations imposed on undertakings and symmetry of fixed terminations rates (FTR) and mobile termination rates (MTR).

At this stage of realizing the strategy of the President of UKE, taking also into account the general area of interest of new President of UKE, it cannot be assured whether and to what extent in the period of time set forth in the Strategy the conditions of telecommunications access will be changed, as well as the obligations imposed on companies of Netia Group, in particular on markets for call termination on fixed networks. One cannot exclude the possibility that unless some of decisions issued by the President of UKE will lead to growth on fees for telecommunications access and new risks and challenges for the companies of Netia Group, not foreseen elsewhere in these risk factors.

Risks relating to regulatory access rates

On October 22, 2009 the President of UKE and TP S.A. signed an agreement laying down rules for the performance by TP S.A. of obligations with regard to telecommunications access ("The Settlement Agreement between the President of UKE and TP S.A. "). The Settlement Agreement provides that the fees for individual services in the scope of telecommunications access that follow from the applicable reference offers will be valid until January 31, 2012. This general rule in effect froze the cost of unbundled local loop services and wholesale line rental voice services.

On the basis of a draft understanding, constituting an appendix to the Settlement Agreement between the President of UKE and TP, Netia and TP S.A. executed a separate understanding ("Understanding") on the December 23, 2009. The Understanding provides that the rates for specific services in the scope of telecommunications access, arising from reference offers, shall be binding until December 31, 2012. As the Understanding has not been noticed by any party, it was prolonged for unspecified period of time.

The wholesale rates for broadband access (BSA) were established at a fixed level taking account of retail prices in TP S.A. offer binding on October 10, 2009. Possible further decrease of rates established in the above manner, as well as wholesale rates paid to TP S.A. since implementation of new speeds to its BSA Offer, are controlled by a margin squeeze test („MS test") and price squeeze test („PS test"), rules for carrying out of which were established by the President of UKE ("MS/PS test").

Netia was surprised that TP S.A.'s new prices for the lowest transmission speeds somehow passed the margin squeeze tests carried out by the President of UKE. In view of the President of UKE's opinion that the TP S.A. retail offers examined with the use of the the MS test do not constitute price discrimination of Alternative Operators and may be used with the current wholesale fees for BSA services, i.e. the fees calculated on the basis of a "retail-minus" methodology but expressed in nominal values, Netia has had its costs verified by an independent auditor, and after simulating the margin squeeze test, using the audited costs. On the basis of the received outcome of the test it still seems surprising that the TP S.A. retail offers for the lowest transmission speeds should pass the margin squeeze test.

On February 9, 2011, the President of UKE published a position indicating amendments to the MS/PS Test procedure that were introduced after carrying out consultations with the market players.

Within the amended MS test procedure, an operator that passed his relevant cost data to the President of UKE for the purposes of carrying out of MS test is provided with access to information on average costs accepted for the test. After market launch of a retail offer that underwent the MS test, an operator that passed his relevant cost data to the President of UKE is also granted right to access data included in TP S.A. application for carrying out of the MS test, i.e.: the price accepted for the test, as well as the validity period of an agreement concluded on the basis of this offer. Upon motion of such an operator the President of UKE is obliged to carry out the MS test concerning TP S.A. retail offer one more time.

If the MS test outcome indicates that the relation between prices included in the retail offer launched into the market and wholesale rates applied by TP SA is discriminatory towards operators using wholesale services, then, according to the changed rules of MS test procedure, TP SA is obliged to withdraw this retail offer from the market. In case of non-performance of this obligation by TP S.A. prices set out in it will constitute a basis for calculation of wholesale rates on the basis of "retail-minus" methodology.

In the opinion of the Management Board, the amendments to the procedure of the MS test, comparing with the previously binding procedure, increase protection of operators using TP S.A. network, including Netia, against price discrimination.

Netia submitted to the President of UKE its cost data regarding the fiscal year 2010 for the purpose of MS test concerning examination of new TP S.A. retail offers. The submitted data are based on the results of the auditor's verification of the correctness of methodology applied for these costs calculation. The President of UKE considered them actual and reliable, accepted them and decided that they will be taken into account in the process of application to MS and PS tests. Similarly, Netia submitted to the President of UKE its cost data regarding the fiscal year 2011.The President of UKE considered them actual and reliable.

After having conducted with market participants subsequent agreements concerning the procedure of conduct of MS test, the President of UKE decided on January 24, 2012 not to introduce major modifications in the existing procedure. The introduced changes do not affect the rules for applying the MS test.

On June 22, 2012, the President of UKE published the statement amending the rules of performing the PS tests. In the statement President of UKE stated that in the process of analysis the TPS.A. 's retail offers which have no equivalent in wholesale regulated services, the TP S.A.'s wholesale costs shall be taken into account. In President of UKE opinion, such costs, as audited are reliable. KIGEiT communicated to the President of UKE that TP S.A.'s cost data relating to services that are beyond the scope of reference offer are in fact the projected costs and are not audited, while the alternative operators accessing the TP S.A. network should have guaranteed possibility at least to respond to the data projected by TP S.A. KIGEiT took legal actions to change the statement of the President of UKE, but in each and every case the President of UKE has refused to consider of KIGEiT's demands. KIGEiT has also submitted to the European Commission for intervention against changing MS/PS tests procedure without any consultation with Altnets, including Netia.

Although the Management Board is convinced of the validity of arguments taken by KIGEiT, the Management Board cannot assure that President of UKE shall amend its statement published on June 22, 2012, and, in particular, that the President of UKE shall allow to verify the costs data used in PS test.

On January, 2013, the President of UKE launched the consultation of next amendment of statement on rules regarding MS and PS tests. The proposed amendments consider inter alia acceptable range of modification of TP S.A. retail offer tested with MS/PS test, which does not require retesting, conducting test on the grounds of TP S.A. data and deadlines for providing prices of new retail services.

KIGEiT, which participates in consultation, objects to the draft amendments of MS/PS test. The Management Board is unable to assure that the President of UKE will accept KIGEiT's statement and will not amend MS/PS testing rules.

The Management Board is also unable to assure that the MS/PS test procedures currently implemented and their possible future amendments will sufficiently guarantee TP S.A. price non-discrimination and effective protection against narrowing Netia's margin which can lead to loss of profits, cash flows or Netia market share. The Management Board is unable to assure that the President of UKE acceptance of TP S.A. retail offers on the grounds of MS/PS tests effects, and offering such services by TP S.A. will not cause loss of Netia's and Dialog' share in net connections and decrease of growth rate and thus will not cause risk of non-reaching our strategic and financial objectives.

The draft of the President of UKE decision establishing fees on market for provision of wholesale broadband access services (Market 5) and the draft of decision accepting amendment of OR provides growth in some of fees for broadband acces and reduction of others. Although the Management Board is convinced that growth in fees for particular bandwidths (BSA services options) is groundless, it cannot be excluded that in case of issuance the decision establishing fees for broadband access higher that current fees adopted in relation between Netia and TP S.A., such decision will be reversed or amended by the court.
The Management Board is unable to assure that new prices stemming from mentioned above drafts will not lead to loss of profitability of services provided by Netia as well as cash flows and loss of market share.

Management can give no assurance that the MS/PS test regime as currently implemented by UKE will be effective in ensuring Netia's margins are not squeezed and that this may in turn lead to a loss of profitability and cash flows and/or a loss of market share.

Risks related to amendments to reference offers

Beyond reach of Netia's own network, provision of telecommunications services by the Netia Group is conditional upon access to the network of TP S.A.
According to Telecommunications Law and the decisions of the President of UKE, TP S.A. is obliged to provide telecommunications access to telecommunications entrepreneurs, such as Netia, to its network and to offer frame terms and conditions of contracts on telecommunications access to its network for particular wholesale services, not worse than the terms and conditions specified in TP reference offers approved by the President of UKE.

On September 29, 2010, by virtue of a decision of the President of UKE, a new Reference offer providing frame terms of telecommunications access with regard to calls initiation and termination, wholesale access to TP network, access to subscribers lines in the mode ensuring both full and shared access, as well as access to subscriber lines through telecommunications network loops intended for the purposes of sale of broadband data transmission services, was introduced (hereinafter referred to as the "RO"). The RO laid down frame terms of contracts for all kinds of telecommunications services that are currently used by Netia under contracts and decisions issued upon reference offers. The RO superseded all currently valid reference offers, apart from the offer for the lease of telecommunications fibers.

The RO introduced new solutions to cooperation of network providers, so far not included in telecommunications access regulations, including:

1) unification of rules and timeframes of regulated services provision;
2) regulation of terms of broadband service access (BSA) with IP DSLAM technology;

3) introduction of electronic form of communication with TP in the form of IT System Interface into the network providers cooperation.

The RO also introduced significant increases in the fees for fixed line number portability.

KIGEiT and TP S.A. filed for re-consideration of the case concluded by issuance of RO.

Upon such reconsideration, on April 5, 2011, the President of UKE issued a decision by virtue of which it amended the RO by reducing several fees, i.e.:

a) due to LLU services provision, inter alia due to:
- connection of subscriber's line to TP S.A. network within launch of the Non-active Line - from PLN 63.4 to 39.48 (not in thousands);
- launch of service provided on the Active Line (switch-over of a pair of cables, servicing of orders for line) - from PLN 55.51 to 46.98 (not in thousands);
- service deactivation (switch-over of a pair of cables, servicing) - from PLN 21.21 to 18.28 (not in thousands);
- as well as due to number portability in such a way that its present amount remained not higher than the one binding prior to issue of the RO;

b) as well as BSA, inter alia due to:
- launch of service on the Subscriber's Line - from PLN 40.98 to 38.68 (not in thousands);
- change of Service Options – from PLN 45.22 to 34.07 (not in thousands);
- Service deactivation - from PLN 40.98 to 38.68 (not in thousands).

The RO does not provide for a fee due to cooperation between operators.
The procedure of MS test was amended, according to the position of the President of UKE of February 9, 2011.

TP S.A. introduced an appeal against the decision approving RO. WSA stated that the decision is in fact decision on regulatory obligations, therefore the competent court should not be administrative court but common court. The KIGEiT, the President of UKE and TP S.A. appealed against this ruling. NSA reversed the decision of WSA, but WSA against issued the same ruling.

By a decision of September 4, 2011, the President of UKE amended the RO with regard to conditions for BSA telecommunications access with use of VDSL technology.

The Management Board cannot assure that the conditions established in the RO by the decision of the President of UKE will not be in future amended or reversed.

Due to the fact that the RO regulates the terms and rules of co-operation of TP S.A. with other telecommunications undertakings differently than compared to the binding relations with Netia, the Management Board cannot assure that the agreed terms on which Netia uses access to the network of TP S.A. will not be changed or deteriorated in the future with the aim to ensure competitiveness comparing with other alternative operators.

TP S.A. filed with the President of UKE a draft offer setting out frame terms of LLU services provision with regard to FTTx access. The offer that will be approved of by the President of UKE in this scope will make up frame terms of using LLU stipulated in the RO. TP S.A. also applied for amendment of the RO in the scope of BSA access including as regards application of Ethernet level, and also for modification of the BSA service in option with capacity 10 Mbit/s and canceling options: 1, 2 and 6 Mbit/s, since April 1, 2012. TP S.A. amended its application and withdrew it in relation to cancelation of 1, 2 and 6 Mbit/s options. The President of UKE conducted the consultation proceeding regarding the amendment of the OR in relation to BSA modification in option with capacity 10Mbit/s without canceling options: 1, 2 and 6 Mbit/s. At this stage of proceedings it cannot be predicted to what extent and when shall the projected conditions be adopted by the President of UKE to OR and how it will affect the conditions of doing business by Netia. The Management Board is unable to assure that fees for BSA services projected in draft of decision approving OR shall not be approved in the President of UKE decision and in effect that expenses related to access services will not rise.

TP S.A. applied also for approval of reference offer with regard to leased lines. Finally the President of UKE made minor modifications to an offer in the scope of using of analog lines. This change is not expected to significantly affect the conditions of doing business by Netia.

In the Understanding as of December 23, 2009, Netia and TP S.A. agreed that the amount of service rates for access to TP S.A. network will remain unchanged until December 31, 2012, which is why by that time any change to methodology of rates calculation into calculating them taking account of incurred costs would not affect settlement rules between Netia and TP S.A. due to access to local loop and local sub-loop built according to copper technology. Despite the fact, that Understanding is still binding, the Management Board cannot assure that no circumstances leading to increase of the amount of costs of using LLU service by Netia will not emerge in future.
The Management Board cannot assure, as well, that rules of access to LLU built using fiber technology will be sufficient for ensuring Netia the opportunity to use of access to fiber local loop in TP S.A. 's network on a mass scale.

Moreover, on January 31, 2012, the President of UKE obliged TP S.A. to change RO, i.a. in the scope of liquidation of tariff periods O1, O2, and O3 (it also concerns calculation of flat rate interconnection) and definition of fees for number portability. In consequence, the changed RO in accordance with the decision of the President of UKE may raise costs of using services of termination of calls in TP S.A. 's network by Companies of the Netia Group. In the proceeding regarding the amendment of the offer in relation to origination and termination in TP S.A., network, including the fees for services provided on these markets, the growth in fees for connection termination and for flat interconnection rate is provided.

KIGEiT has appealed against this resolution as far as liquidation of tariff periods O1, O2 and O3 is concerned. The Management Board is convinced of validity of the appeal, however it cannot assure that it will be accepted by the President of UKE.

TP S.A. has also filed an application to the President of UKE for amendment of RO in relation to premium rate services provided within wholesale access to TP S.A. network (WLR). In management Board opinion not every amendments proposed by TP S.A. are necessary to perform duties stemming from amendment of Telecommunications Law related to provision of premium rate services. However, the Management Board cannot assure that the President of UKE shall not approve the RO amendment in a manner that will not increase the cost of WLR.

Risks related to the decisions of the President of UKE on the service of termination of calls in mobile networks (hereinafter referred to as "MTRs") (not in thousands)

In January and February 2009 the President of UKE issued temporary decisions amending agreements on the interconnection of networks concluded by Netia and Dialog with Polska Telefonia Cyfrowa S.A., Netia and Polkomtel Sp. z o.o. as well as Netia and Polska Telefonia Komórkowa Centertel Sp. z o.o. by lowering the mobile termination rates (MTRs) in public mobile telephone networks of the above-mentioned mobile networks operators to the level of PLN 0.2162 per minute. In June and July 2009 the President of UKE issued decisions (which replaced the above-mentioned temporary decisions) on the amendment of the interconnection agreements, concluded by Netia and Dialog with the above-mentioned operators, by setting the MTR at the level of PLN 0.1677 per minute. The same MTR was defined by President of UKE in the decision amending agreements on the interconnection of networks concluded by Petrotel with Polkomtel.

Polska Telefonia Komórkowa Centertel Sp. z o.o., Polkomtel Sp. z o.o. and Polska Telefonia Cyfrowa S.A. appealed against the temporary decisions of the President of UKE. The lower court reversed the temporary decision amending MTRs stipulated in the agreement between Polska Telefonia Cyfrowa S.A and Netia. The Appellate Court rejected Netia's and President of UKE appeals by the ruling issued in June 29, 2012. Netia filed the cassation complaint to the Supreme Court. The Management Board cannot assure that the Supreme Court shall accept this appeal for recognition and the ruling reversing the decision shall be reversed.

The temporary decision changing MTR rates specified in the contract between Polska Telefonia Cyfrowa S.A. and Dialog was also repealed. Dialog appealed against this ruling.

The court reversed also the final and temporary decision changing MTR specified in contract between Petrotel and Polkomtel. Petrotel appealed against these rulings.

The agreements with Polska Telefonia Komórkowa Centertel Sp. z o.o., Polkomtel Sp. z o.o. and Polska Telefonia Cyfrowa S.A. (hereinafter the "MTR Agreement") were concluded by most of Alternative Operators being members of the KIGEiT, including Netia and Dialog. According to the MTR Agreement the forementioned mobile operators confirmed MTR paid in accordance with the President of UKE decision and limited the possibility of requesting retrospective claims. In effects of these agreements Polska Telefonia Komórkowa Centertel Sp. z o.o. and Polkomtel Sp. z o.o withdrew their appeals and these proceedings were discontinued.

Despite the fact that MTR Agreement was concluded between Netia, Dialog and Polska Telefonia Cyfrowa S.A., the Management Board cannot also assure that Polska Telefonia Cyfrowa S.A. shall not make claims related to results of mentioned proceedings. The Management Board cannot predict the result of proceeding regarding such claims. Also, it cannot be excluded that Polkomtel sp. z o.o. will forward with claims against Petrotel in case of final and valid revocation of the decision.

Along with other market participants, Netia, Dialog and Petrotel have made significant cuts in its customer tariffs for calls to mobile operators on the basis of the Regulator's MTR decision. In the event that the court raises the MTR rates once more, Companies of the Netia Group will be unlikely to be able to pass on the higher costs to its customers through higher tariffs. No assurance can be given that possible damages claims against the Regulator would be taken into consideration by the courts.

The President of UKE issued decisions stipulating the amount of MTRs to be paid to Polska Telefonia Komórkowa Centertel Sp. z o.o., Polkomtel Sp. z o.o. and Polska Telefonia Cyfrowa S.A.: as of July, 1, 2011 – at the level of PLN 0.1520 per minute and as of July 1, 2012 – at the level of PLN 0.1223 per minute, as well as the amount of MTRs to be paid to P4 Sp. z o.o., calculated on the basis of an index of asymmetry in relation to the remaining rates. Moreover, these decisions stipulate investment obligations of individual mobile networks operators in the so called "white areas", i.e. areas with low population density, excluded from GSM network coverage.

In MTR Agreements concluded by Netia and Dialog with mentioned mobile network operators the MTR provided by mentioned decisions were confirmed.

In August 2012 the President of UKE has published to consultation the drafts of new decisions decreasing MTRs to be paid at the symmetrical level to PolskaTelefonia Komórkowa Centertel Sp. z o.o., Polkomtel Sp. z o.o., Polska Telefonia Cyfrowa S.A. and P4 sp. z o.o., as of January,1, 2013 at the level of PLN 0.0826/ min and as of July, 1, 2013 at the level of PLN 0.0429/minute.

Draft decisions were sent to the consolidation proceedings before the European Commission in September 2012.

On December 14, 2012, the President of UKE issued decisions establishing MTR accordingly with consulted drafts. The new financial settlements stemming from these decisions were adopted in relations between Polkomtel Sp. z o.o., PolskaTelefonia Komórkowa Centertel Sp. z o.o and Polska Telefonia Cyfrowa S.A. with Netia and Dialog only as regards first of the MTR ratio at the level of PLN

0,0826/minute, which is effective until June 30, 2013. The amended contract between Netia and P4 Sp. z o.o. provides also next MTR at the level of PLN 0,0429/minute, effective from July 1, 2013.

The Management Board cannot assure that Polkomtel Sp. z o.o., PolskaTelefonia Komórkowa Centertel Sp. z o.o and Polska Telefonia Cyfrowa S.A. will perform the obligations imposed on them in relation to MTR at the level of PLN 0,0429/minute by concluding annexes adopting this MTR with the companies of Netia Group before the date provided in the mentioned decisions. If the mobile operators refuse to perform the decision, the companies of Netia Group will file the motions for issuance of the decisions with new MTR, which decisions will replace the contracts in this respect.

The Management Board also cannot assure that in case of filing the appeals against mentioned decisions providing MTR PLN 0,0826/minute and PLN 0,0429/minute, the court will not suspend the enforcement of these decisions or will not finally reverse these decisions and that such suspension or reversal will not affect the financial settlements with mobile operators,in particular that these operators will not pursue the claims against Netia and Dialog.

In case the mobile operators potentially obtain final court orders against the Netia's Group Companies the Management Board cannot assure that the Netia's Group Companies' regress claims against the State Treasury will be successful.

Risk related to reversal of President of UKE decisions stipulating conditions of the access to IN services in Netia and Dialog networks for mobile networks users

The President of UKE issued decisions stipulating conditions of access to IN services in Netia and Dialog networks for Polska Telefonia Cyfrowa S.A. and Polkomtel Sp. z o.o. users.

The Court of Appeal in Warsaw reversed these decisions stipulating access to IN services in Netia and Dialog networks for Polska Telefonia Cyfrowa S.A. users. Netia and Dialog have received the justifications of the rulings. Netia and Dialog submitted cassation complaints against the judgments of the Court of Appeal. The Management Board cannot assure that the Supreme Court shall accept these appeals for recognition and the ruling reversing the decision shall be reversed.

Polkomtel Sp. z o.o. has also appealed against the decisions stipulating conditions of the access to IN services in Netia and Dialog networks for users of Polkomtel Sp. z o.o. network. The Management Board cannot assure that the decision will not be reversed as a result of Polkomtel Sp. z o.o. appeals.

The Management Board cannot assure that agreements stipulating conditions of the access to IN services in Netia and Dialog networks for Polska Telefonia Cyfrowa S.A. and Polkomtel Sp. z o.o. users will be concluded, and if these enterprises shall not make claims related to results of mentioned proceedings. The Management Board cannot predict the result of proceeding regarding any eventual claims.

Risks related to the analysis of relevant markets

According to the Telecommunications Law, the President of UKE performs an analysis of telecommunications services market („relevant market") not less often than every 2 years and upholds, modifies or waives regulatory obligations imposed on an entrepreneur, who as a result of a previous analysis has held a significant market power.

TP S.A. holds significant market power in individual wholesale markets countrywide and is obliged, in particular, to provide telecommunications access to other entrepreneurs, under non-discriminatory terms.

On December 30, 2010, the President of UKE issued a decision defining a market, in which TP S.A. was so far obliged to provide access to local loop or a local sub-loop in copper technology, as a market of wholesale (physical) access to network infrastructure service provision (including full and shared access) in a fixed location, designated TP S.A. as holding a significant market power on the relevant market, as well as imposed regulatory obligations on TP S.A.

By virtue of the President of UKE decision TP S.A. was obliged to maintain telecommunications access to local loop and sub-local loop, as well as to provide access to the telecommunications ducts or to dark fibers, and - in case of lack of possibility of access provision for an operator applying for access to the above elements of infrastructure – to provide access to local loop and local sub-loop using fiber technology.

So far TP S.A. had an obligation to calculate costs and set telecommunications fees taking account of justified costs. This was replaced in the decision by an obligation to set fees taking account of incurred costs. The method TP S.A. is obliged to apply, allows for recovery of costs actually incurred in the process of telecommunications access provision and not justified costs i.e. costs that a hypothetical telecommunications undertaking would incur if it operated on a fully competitive market, with scope of activity and demand for its services comparable to those specific for an actually existing telecommunications undertaking obliged to run costs calculation.

In the opinion of the Management Board the amendment of the imposed obligation concerning method of calculation of costs of telecommunications access provision introduced by the President of UKE's decision is premature. No circumstances arose on the market that could justify application of the method of costs calculation taking account of incurred costs and not justified costs.

KIGEiT filed an appeal with SOKiK against the President of UKE's decision of December 30, 2010. In spite of its conviction of validity of the claims raised in the appeal, the Management Board is unable to assure that the decision will be changed in the scope of the appeal.

Netia and TP S.A. agreed that fees for telecommunications access in relation to LLU will not rise until December 31, 2012 which is why by that time any change to methodology of rates calculation into calculating them taking account of incurred costs would not affect settlement rules between Netia and TP S.A. in regard to LLU. The Management Board cannot assure that in case of issuance a decision establishing fees for LLU higher than fees currently adopted in relation between Netia and TP S.A., that such decision will be reversed or amended in this regard by the court and that the necessity to adopt new fees which are higher than current fees, will not lead to loss of profitability of services provided by Netia, reduced cash flows and loss of market share.

In December 2012, the European Commission published the draft of recommendation providing average fee for access to the local loop in the amount of 8-10 Euro (not in thousands), effective from January, 2017. Despite the criticism of the draft regulation, which was justified also by the perspective of significant growth in retail prices of telecommunications services, which criticism was addressed from European telecommunications undertakings competing with incumbents to Neelie Kroes (vice – president of European Commission) and the Management Board conviction that the draft does not take into account real economic and regulatory situation in particular Member States, it cannot be assured that European Commission will not decide to launch consultation proceeding of the recommendation in order to further works on implementation its guidelines. At this stage of proceeding it cannot be determined whether and in what form the Commission recommendation will be finally issued and if the recommendation will be amended before January 1, 2017 and how it will affect the conditions of doing business by the Netia.

On April 28, 2011 the President of UKE issued a decision holding TP S.A. as having a significant market power in the market for provision of wholesale broadband access services. The analysis of the President of UKE included the national market, within which regulatory obligations of TP S.A. in the areas of separate groups of municipalities were differentiated. The decision also provides for change of obligation to establish telecommunications access fees according to cost calculation, from the method based on justified costs to incurred costs. Eleven municipalities were excluded from the national market area.

On July 27, 2011 the President of UKE commenced consultation and consolidation proceedings concerning a draft decision identifying a broadband access market within the administrative borders of eleven municipalities: Warszawa, Płońsk, Nowy Dwór Mazowiecki, Lublin, Zielona Góra, Bielawa, Olsztyn, Łomża, Białystok, Elbląg, Braniewo and stating that within the areas of these municipalities effective competition is present and no SMP undertaking operates.

On February 1, 2012, the President of UKE commenced consultation proceedings of the draft decision, in which it defines the relevant market as the market for provision of wholesale broadband access services, states that there is no competition on this market, TP S.A. has significant position on this market, and in this connection imposes regulatory obligations on TP S.A. Within administrative borders of four municipalities: Toruń, Lublin, Warszawa and Wrocław, in the area of which the competition distortions are in the opinion of the President of UKE significantly less important than in the rest of the country's market area, imposes on TP S.A. the obligation to assure telecommunication access along with obligation to keep realized access and obligation of non-discrimination. On March 26, 2012 within consolidation proceeding the President of UKE provided the draft of decision to the Body of European Regulators for Electronic Communications (BEREC) and national regulatory authorities in other member states.

The European Commission has started an in-depth investigation and has issued a serious doubts letter concerning the project of the decision in the scope of measures of the access to TP S.A.'s FTTH infrastructures proposed by Polish Regulator. President of UKE may work with the Commission and BEREC on regulatory rules of the access to TP S.A.'s FTTH infrastructures for three months. In the other case, President of UKE will not be allowed to issue the decision based on the project.

On August 27, 2012 the European Commission presented to the President of UKE position that decision shall be improved by imposing on TP S.A. obligation of using cost oriented rule with regard to the FTTH access or by establishing alternative measures of competition protection (an improved transparency obligation regarding FTTH, replicability requirement also for FTTH-based retail products and accounting separation obligation covering also FTTH products).

On September 11, 2012 in the letter to Ms Neelie Kroes, vice-president of the European Commission, the President of UKE withdrew from a proposed regulation of the market for wholesale broadband access. Then the president of UKE presented draft of other resolution concluding the existence of effective competition and abolishing TP S.A. regulatory obligations on this market on the area of 11 polish municipalities. The European Commission notified serious doubts regarding correctness of drafted resolution and drew the attention of the President of UKE inter alia on the facts of the case contemplated under the drafted resolution, which are based on outdated data, coming from market analysis performed by the President of UKE in 2009, whereas in the moment of drafting the resolution the President of UKE had access to data from further analysis of this market. KIGEiT filed the statement to the President of UKE and the European Commission pointing the mentioned issue of outdated data and noted also other incorrectness of projected resolution, which, in the opinion of the Management Board excluded the possibility to issue the resolution in accordance to its draft. The European Commission obliged the President of UKE to withdraw the draft of the regulation. On February 8, 2013 the President of UKE published the information that the Regulatory Body has been going to conduct the new analysis of the market 5, taking into consideration the Commission's guidelines. In the opinion of the Management, relevant markets, including broadband access markets within the area of the municipalities comprised in the drafts of the President's of UKE decisions, are not developed sufficiently to allow for geographical or technological differentiation of TP S.A. regulatory obligations, nor are there any grounds, to hold that on the area of individual municipalities the regulatory obligations imposed on TP S.A. should be limited.

However, it cannot be said what will be the results of the new broadband market analysis and what kind of regulatory measures about access to the TP S.A. infrastructure will be set (including FTTH access). As a result, it cannot be predicted, what access conditions and on what area of Poland will be applied in the future. It also cannot be predicted how those changes will affect the existing ability of the Netia Group to offer services with the use of this type of access to the network of TP S.A.

Netia and TP S.A. established that the amount of rates for access to TP S.A. network within BSA will remain unchanged until December 31, 2012, which is why until this time, the change of methodology of setting fees into its calculation taking account of incurred costs would not have no impact on settlement rules between Netia and TP S.A. due to provision of access BSA lines unbundled according to the rules binding until the date of issue of the respective decision.

The Management Board cannot assure that in case of issuance the decision establishing fees for BSA higher than fees currently adopted in relation between Netia and TP S.A., such decision will be reversed or amended in this regard by the court and that the necessity to adopt new fees which are higher than current fees, will not lead to loss of profitability of services provided by Netia, cash flows and loss of market share.

On October 16, 2012 the European Commission began consultation on telecoms markets Recommendation. The Management Board cannot assure that change of the telecoms markets Recommendation as a result of applying it by Regulatory Body in Poland, will not lead to an increase in the cost of telecommunications access or decrease of conditions of telecommunications access.

Risks related to Tele2 Polska's business

In February 2009 the President of UKE issued the decision fining Tele2 Polska with the amount of PLN 500 for the exchange of traffic between Tele2 Polska and TP S.A. in breach of conditions of the so-called "flat interconnection rate". SOKiK reversed decision of the President of UKE. The President of UKE appealed against this ruling. The Court of Appeal dismissed the appeal filed by the President of UKE.

Risks related to Dialog's business

TP S.A. has summoned Dialog to pay the amount of PLN 667 (including interests) for account of outstanding receivables arising from the use of telecommunication access to the TP S.A.'s network by Dialog. Despite the fact that in the Management Board's opinion TP S.A.'s claims are at least partly unjustified, it cannot be assured that in case of court proceedings they will not be taken into account or that Dialog's claims for payment against TP S.A. arising from the contracts and decisions on telecommunication access or using Dialog's infrastructure by TP S.A. will be paid in the amount of exceeding the amount TP S.A.'s claims.

Moreover, TP S.A. has issued invoices for transit to ported numbers. These invoices cover fees for period between January 1, 2012 and June 30, 2012. Dialog claims the invoices are unjustified because neither interconnection agreement nor agreement on number portability provide separate title for the charging fees for such service. Nonetheless, TP S.A. filed for payment and on October 12, 2012 an order for payment was issued, including the charge for the transit to ported numbers for the period January-June 2012, amounting to PLN 1,274 and statutory interest. The order for payment has expired on November 5, 2012 upon the submission of objections submitted by Dialog. Moreover, TP S.A. has issued invoices for transit to ported numbers. These invoices cover fees for period between July 1, 2012 and October 31, 2012, amounting to PLN 768,6 (including interests). Despite the fact that in the Management Board's opinion TP SA's claims are unjustified, it cannot be assured neither that they will not be granted by the court, nor that Dialog's claims for payment against TP SA will be paid in the amount of exceeding the amount TP SA's claims.

Despite the fact that in the Management Board's opinion the claim covered by Dialog's complaint, in the case of which the court has issued the order for payment by TP SA to Dialog amounting to PLN 40,461 and statutory interests for the penalties for not deleting failures on WLR links' on the dates described in the President's of UKE decisions, is valid, it cannot be assured that, in the light of objection submitted by TP S.A., the court will approve Dialog's claim and TP S.A. will pay Dialog the amounting covered by the order of payment in total or at least in part of it, which will be higher than potentially payable TP S.A.'s claims against Dialog.

Netia filed for payment of PLN 49,800 against TP S.A. due to non deleting failures on WLR links' on the dates described in the President's of UKE decisions. On December 21, 2012. The court issued order for payment. The Management Board cannot assure that, in the light of objection submitted by TP S.A., the court will approve Netia claim and TP S.A. will pay Netia the amounting covered by the order of payment in total or at least in part of it.

Risks arising from the presumption of the powers of the organizations for the collective administration of the rights of authors of neighboring rights.

The Law on Copyrights and Related Rights defined (hereinafter referred to as "Law on Copyrights") a presumption, that the organizations for the collective administration of the rights of authors of neighboring rights (hereinafter referred to as "OZZ") are entitled to give consent (grant license) to rebroadcast TV channels via cable networks and are entitled to collect remuneration for the hereinabove rebroadcasting in scope of the copyrights managed by certain OZZ. Tables of remuneration of the use of works or objects of related rights covered with collective management are established on the percentage basis in relation to the gross revenue earned by the operator from the rebroadcasting of the TV channels and are approved by the Copyrights Commission (Komisja Prawa Autorskiego; hereinafter referred to as "KPA") upon the application for the approval submitted by OZZ to KPA. KPA is also entitled to settle disputes connected with concluding of the contracts between OZZ and cable network operators.

The obligation of obtaining from OZZ the channels' rebroadcasting license following from The Law on Copyrights and Related Rights is contrary to the legal regulations of the EU Directive No 93/83/EWG. EU legislator compulsory excluded the said obligation in case where the cable networks operators are granted with this license directly by the TV channels' broadcasters. According to the constitutional principle of the EU law dominance over the Polish law, there is no need to obtain the additional OZZ's license in scope of the rights already granted directly by the broadcasters. Bearing in mind the practice of dealings in Poland, the Management Boards may not guarantee that the above mentioned UE law principle shall apply to Dialog, Netia and Petrotel. However, this contradiction in law does not exclude the statutory, resulting from The Law on Copyrights and Related Rights, obligation imposed upon the rebroadcasting operators to pay the so-called additional remuneration of the use of works or objects of related rights covered with collective management for the benefit of OZZs.

As regards the TV channels' rebroadcasting, it is Polish Filmmakers Association (hereinafter referred to as "SFP") that is widely entitled to represent the producer's rights and is involved in collective copyright management. However, as long as it is not proved which works or objects of related rights are covered with collective management by Authors' Association "ZAIKS" and others OZZ, it is not possible to determine the scope of the hereinabove presumption arising from The Law on Copyrights and Related Rights and if in case of the TV channels' rebroadcasting without the agreement with Authors' Association "ZAIKS" or other OZZ, on the basis of the Polish law, OZZs shall be entitled to request abandonment of further TV channels' rebroadcasting by Netia, Dialog or Petrotel effectively and payment of the compensation in the amount of triple amount of the remuneration due OZZ.

KPA had determined the remuneration of the use of works or objects of related rights covered with collective management of SFP in the amount of 1.6% and covered with collective management of Authors' Association "ZAIKS" in the amount of 0.6% (in UPC's case) and 0.9% (in Sat-Film case), but Commission judgments were appealed. In consequence the said remunerations in amounts defined by KPA are not in force. Polish Chamber for Electronic Communication has started negotiations with certain six OZZs aimed at concluding the general agreement. SFP and SAWP are among the said OZZs. The proposed (by OZZs) rate is 4% jointly for the benefit of all six OZZs. Moreover, some of the OZZs have applied jointly to KPA to approve the table of remuneration of the use of works or objects of related rights covered with collective management amount to 4%. At this stage, the Management Board may not foresee the result of neither these KPA's proceedings nor the negotiations of the general contract conducted by PIKE, in particular it is not possible to predict the amount of OZZ's remunerations, which will be defined, if it is higher or lower than jointly 4% or separately 1.6% (SFP) and 0.6-0.9% (Authors' Association "ZAIKS") and when this fact has an influences on accounting conditions between Netia, Dialog and Petrotel and OZZs.

According to the agreement currently in force, Dialog pays for the benefit of SFP the remuneration in the amount 2.2% of revenue earned by Dialog from rebroadcasting of the TV channels. The agreement between Dialog and Authors' Association "ZAIKS" is terminated, however Dialog paid in favour of Authors' Association "ZAIKS" the advance payments in the amount 0.6% of revenue earned by Dialog from rebroadcast of the TV channels and this OZZ accepted these payments till May 2012. Dialog also terminated the agreement with ZPAV (The Polish Society of the Phonographic Industry) effective on May 31, 2011. Simultaneously ZPAV didn't accept the proposed advance payments in the amount of 0.06% and in June 2012 requested to Dialog to cease all non-contractual payments as it shall be returned into Dialog's bank account. In order to avoid payment fees for rebroadcasting some works to both Artists Performing Music and Music-Verbal Works Association SAWP (hereinafter the SAWP) and Union of Performing Artist STOART (hereinafter the STOART) Dialog has served notices of termination with respect to agreements establishing current settlement rules with these organizations. Establishing the rights to represent by SAWP and STOART the property rights to works rebroadcasted by Dialog will require to point relevant organization by KPA and, in dispute cases, pursuing the mediation proceedings by KPA. In March 2012 SAWP took legal action against Dialog in order to conclude a settlement on payment of the remuneration in the amount of 48 PLN as a compensation of non-contractual use of works or objects of related rights covered with collective management during a period from 1st of September 2011 until February 29, 2012. Dialog proposed the percentage rate according to art. 110 of The Law on Copyrights and Related Rights as it takes into account the income amount of the use of works. This proposal was rejected by SAWP and as a consequnce SAWP suggested the rate exclusively with reference to the number of subscribers. SAWP denied to accept the SAWP's advance payments in the amount of 25% of the expected remuneration and declared that such payments shall go toward the SAWP's claims and the lack of the SAWP's written declaration to conclude the agreement on SAWP's conditions shall be treated as the lack of will to respect the rights represented by SAWP that will force SAWP to pursue claims through the courts together with statutory interest.

In the Management Board opinion, the SAWP claims in relation to the number of subscribers are not justified, in particular taking into consideration fact that during the negotiations of the general contract conducted by SAWP with other OZZ and PIKE, the OZZ, including SAWP, proposed the jointly rate of 4% of revenue received from rebroadcasting of the works, the copyrights of which they represent. At this stage, the Management Board may not foresee the amount of remuneration of OZZ and if the remuneration shall not be higher than jointly 4% of revenue received from rebroadcasting for above mentioned OZZ.

Netia carries activities aiming to regulate with SFP and ZAIKS in the scope of copyrights they manage the compensation rules for rebroadcasting of TV channels. Despite this fact, SFP summoned Netia to pay the amount of 2.2% of gross revenue earned by Netia from rebroadcasting of the TV channels during the period between August 1st, 2009 and December 31st, 2011 and proposed that the said rate shall apply for the future settlements between Netia and SFP. In December 2012 Netia and SFP have started negotiations of the remuneration rate for the rebroadcasting of TV channels via IP technology in the Netia's network.

Even though Netia doesn't provide activity in TVC technology and Management Board is convinced of that the amounts of compensation demanded by OZZ are unjustified, it couldn't be guaranteed that Netia , Dialog and Petrotel shall not be obliged to pay to SFP such amount of compensation demanded by OZZ until KPA approves the lower rate of the remuneration or the general contract with PIKE is concluded and the settlement rules with OZZ shall be amended on one of these grounds.

At this stage of Netia's activity of TV channels' rebroadcasting, taking into account the circumstances that it is conducted via IP technology, not cable technology, and taking also under consideration the legal and the factual doubts concerning the scope of the power of each OZZ and also lack of the approved SFP's and ZAIKS's tables of remuneration of the use of works or objects of related rights covered with collective management, it couldn't be predicted what the final part of the revenue earned from providing TV services by Netia, Dialog and Petrotel, they will be obliged to pay to OZZ. However, the Management Board is convinced of that, the total final amount of these receivables is expected to be lower than paid to OZZ by cable operators. On the basis of the resolutions of the disputes between cable networks operators and OZZs and tables of remuneration of the use of works or objects of related rights to be approved by KPA, Management Board estimates that total definitive amount of the remuneration to be paid by cable network operators to OZZ may be up to 4% of revenue earned by them.

Under the cinematography law of June 30 2005 the Polish Film Institute (Polski Instytut Sztuki Filmowej -PISF) summoned Netia and Dialog to pay the remuneration in the amount 1,5 % of revenue earned by Netia and Dialog from fees for an access to TV channels rebroadcasted by Netia and Dialog and from fees for rebroadcasting services.
According to the cinematography law of June 30 2005 the abovementioned remuneration shall be paid by two categories of entities: cable television operators and digital platform operators.
In the Management Board opinion as long as Netia and Dialog rebroadcast TV channels via IP technology both of them are not obliged to pay the abovementioned remuneration demanded by PISF.

However the Management Board cannot assure that in case PISF does not share the abovementioned opinion of the Management Board and will sue Netia or Dialog for the abovementioned remuneration starting the court proceedings the court judgment in these cases will be compliant with the abovementioned opinion of the Netia's Management Board and neither Netia nor Dialog will be obliged to pay PISF the demanded remuneration.

Other regulatory risks

The President of the UKE is regularly carrying out inspections of compliance of the companies from the Netia Group with the provisions of the Telecommunications Law and using frequency and numbering conditions. In cases provided for in the Telecommunications Law, the President of UKE may fine the companies from the Group with a fine up to 3% of revenues of the previous calendar year.

The Management Board cannot assure that with regard to all inspection procedures UKE agrees that the position of Netia and the activities of the Netia Group are consistent with regulatory requirements and the law to the extent that eliminates the risk of a fine.

President of UKE is also authorized to conduct the mediation proceedings in order to find amicable solution of the disputed interests between the subscribers that are consumers and provider of telecommunication services.

Although strategic aim of Netia Group is special solicitude about comfort of subscribers using or intending to use Group Companies services, the Management Board cannot ensure that undertaken efforts made by Members of the Netia Group or other operators acting on their behalf, won't be evaluated by President of UKE as requiring additional benefits for the subscribers, set out in mediation proceeding. However the entering into the mediation proceeding depends on decision made by the Management Board, taking into account point of view of President of UKE justifying such need, is crucial for such decision.

The President of UOKiK is entitled, inter alia, to conduct proceedings concerning compliance of standard terms and conditions applied by the Companies belonging to the Group with requirements stemming from the law on protection of competition and consumers, as well as other regulations aiming at protecting consumers' interest. In cases provided for in the law on protection of competition and consumers the President of UOKiK may impose on the Companies belonging to the Group a fine amounting up to 10% of their income earned in the preceding calendar year.

The Management Board is unable to assure that within the scope of the explanatory proceedings the President of UOKiK will consider standard terms and conditions applied by the Companies belonging to the Group to be compliant with the respective legal requirements, thus excluding the risk of fine imposition.

The business conducted by the Companies of the Netia Group is also subject to control by other regulatory authorities and to inspections based on the relevant laws and within the scope of the granted to such authorities. If such regulatory authorities determine that the Companies of the Netia Group are not acting in compliance with the respective laws the regulatory authorities may impose various administrative sanctions on the Companies of the Netia Group as prescribed in the relevant laws, including monetary fines or orders prohibiting/compelling the Companies of the Netia Group to perform certain actions.

The Management Board cannot assure that with regard to all inspection procedures the authorities conducting the control agree that the position of Netia or other companies of the Netia Group and the activities of the Netia Group are consistent with regulatory requirements and the law to the extent that eliminates the risk of a fine and prohibition of performing the activity being a subject of a control.

Risk of collective suits

On July 19, 2010, a law on prosecution of claims in collective procedure, which provides for possibility of bringing an action to the court by a group of at least 10 people, came into force. A judgment passed as a result of such a suit regards all the members of such a group. The Management Board cannot exclude risk of bringing such actions against the Company in the future.

Risk of growth of competition as market converge

The Company's current core offerings are voice telephony and broadband data services. In addition to the incumbent and other alternative operators, mobile operators and cable operators provide significant competition for both types of service.

Moreover cable operators and TP S.A. also offer television and content services and some cable operators now offer quadruple play bundles including mobile telephony. Certain satellite TV operators are responding to the situation by also moving into the resale of fixed telephony and/or broadband thereby further increasing the competition to Netia's core services. Companies of the Netia Group intend to respond to this competitive pressure and convergence of product offerings by itself offering television services over upgraded networks. However no assurance can be given that this tendency of operators of different types of infrastructure to offer similar multi-service bundles will not lead to the gradual erosion of margins, profitability and cash flows.

In addition, significant new operators may enter the Polish market or mergers between existing market participants may significantly alter the competitive landscape in a way that might materially deteriorate Netia's competitive position.

Risk of competition from TP S.A. and TP S.A. obedience to the UKE decisions

TP S.A. occupies a leading position in Poland among operators offering fixed telephony services. At the same time its position in the market of data transmission is well established. In the scope of cable phone services, Netia Group has to face competition from TP S.A. in all the geographic areas it operates on. TP S.A. is a much larger entity than Netia Group and possesses far broader backbone and access network. TP S.A. is engaged in many years' relations with numerous clients that constitute a target client group of Netia Group.

Infrastructure exploited by TP S.A. in the main cities of the country is comparable in terms of advancement of applied technologies to the infrastructure of Netia Group. However, TP S.A. may also make use of the offer of its main subsidiary unit, the Orange mobile network operator, as well as of TV services, in a manner that Netia currently would not be able to copy. One cannot exclude that aggressive competition from TP S.A. will have a significant adverse effect on Netia Group revenues and its operating activities outcomes.

TP S.A. is the owner of local access networks (local loops) and offers access to these local loops networks to other operators on terms that in many cases make it unprofitable to connect client to the network. However, since 2006 the Regulator has issued decisions establishing reference offers for access to TP S.A. networks that currently is regarded by Netia to be commercially profitable. Due to the above in 2006 and in 2010 Netia signed a cooperation agreement with TP S.A. enabling Netia to offer Internet access to TP S.A. clients on the basis of regulatory TP S.A. wholesale offer called bit stream access. In June 2007 Netia and TP S.A. concluded networks interconnection agreements that complexly regulate terms of cooperation between operators. This agreement also applies to cooperation with TP S.A. in the scope previously addressed in separate agreements on networks interconnection concluded by companies from Netia Group, whose rights and obligations Netia entered into under regulations of the code of commercial partnerships and companies. By virtue of the Settlement Agreement Netia acknowledged this rule on January 22, 2010, placing with TP S.A. a binding statement on regarding the interconnection agreement between Netia and TP S.A. of June 30, 2007, as the basis for serving all of the Netia services users in the scope of networks interconnection. In January 2007 the President of UKE issued a decision on amendment of interconnection agreement between TP S.A. and Premium Internet – a company belonging to Netia Group (which in 2008 merged with Tele 2 Polska, the latter in February 2009 merged with Netia), in the scope of wholesale line rental (WLR). The decision of the President of UKE introduced a basis for a new form of access to TP S.A. network enabling Netia Group to offer voice services to TP S.A. clients. In October 2008 a WLR decision in favor of Netia was issued, as well. Moreover, in April 2007 Netia concluded an agreement with TP S.A. on full and shared local loop unbundling, with use of which Netia Group offers voice and data transmission services, and in the future plans to pay different value-added services such as interactive TV service (IPTV). Whereas the key commercial terms of these services provision laid down in the Regulator's decisions are currently attractive, still the operational cooperation with TP S.A. aiming at provision and maintenance of such services for end users will require closer cooperation than it used to be in the past.

The Settlement Agreement between the President of UKE and TP S.A. expired at the end of 2012. The Management Board is not able to guarantee that TP S.A. will cooperate on an adequate level of engagement, nor that the regulatory body will react forcing TP S.A. to realize the cooperation. Moreover, we are unable to give assurance that change of market situation, future court judgments or regulatory body decisions will not cause that currently existing possibilities of services provision for clients through use of TP S.A. access networks to be no longer profitable from the commercial point of view.

Possible future competition from new generation networks

The most modern fixed line telephony networks being deployed around Europe by incumbent operators and by cable TV operators utilize fiber to the curb (FTTC), fiber to the building (FTTB) or fiber to the home (FTTH) to significantly increase bandwidth delivered to the end user. New built Networks based on IP protocols may gradually eliminate the traditional telephony equipment and copper access cables and will replace it by fiber optic cables and new generation optical transmission systems. Moreover, many incumbents are lobbying to receive relief from regulatory obligations for a period of time in order to improve their returns from such large investments. In the future it may also become possible for public authorities or public/private partnerships to gain access to investment subsidies that could lead to new sources of competition from NGN networks. New generation networks (NGNs), if deployed in Poland, could materially deteriorate the economic returns Netia plans to earn from regulatory access products such as bitstream, WLR and LLU. Management can give no assurance that NGN networks will not be deployed in Poland by entities having access to public funding not available to Netia and, if this does occur, whether the regulator will ensure alternative network operators such as Netia enjoy fair access to such a network on acceptable economic terms.

Competition from cellular mobile telephone operators

In recent years, services offered by cellular telephone operators have negatively affected wire line telephone operators. This stems largely from mobile substitution, whereby subscribers choose to make telephone calls using their mobile phones in preference over fixed telephones, resulting either in less traffic or disconnections for fixed line operators. Mobile substitution becomes more pronounced as mobile tariffs decline, as they have in recent years, converging with traditionally lower cost fixed line tariffs. Similar substitution effects may also apply to broadband services, given the increased take-up of mobile broadband services offered by mobile operators.

To help mitigate the losses to mobile operators, Netia has begun to offer convergent products via a wholesale mobile service provider agreement to take mobile services, both voice and broadband, from P4 that Netia may then resell under the Netia brand to Netia customers.

Since 2008, certain Polish mobile operators have been marketing fixed internet access services via the fixed access network of TP S.A., on the basis of regulated bitstream access decisions. This represents a significant new source of competition for market share in the fixed broadband market.

Competition from cable operators

Over the last several years, competition for voice and Internet services has increased from cable television operators. Triple play bundles (voice telephony, Internet access and cable television) have proven to be particularly challenging. However, Netia is reviewing alternatives to combat this threat. Specifically, IPTV offers fixed line telephone operators the ability to compete directly with cable television operators. The market importance of IPTV and related services (such as video on demand) is continually being analyzed in the context of Netia's strategy to expand its share of the broadband market. The Company is working on solutions to provide profitable TV services to its customers and expects that such services should reduce churn and increase margins per customer. However no assurance can be given that Netia will be successful in implementing a profitable TV service business model. Should such services be insufficiently well received by our existing and potential customers, it may adversely affect our revenues and margins in the future.

Market consolidation

Market consolidation through acquisitions remains an effective way for fixed line operators to strengthen their market position by utilizing the effects of scale. In the past Netia has successfully acquired several telecommunications operators making it the market leader for consolidation.

Whilst acquisitions of large scale telecommunications businesses are not crucial to the Company's strategy, Netia continues to closely monitor the situation of all its main altnet competitors and may choose to try to acquire one or more of these competitors in the future if the opportunity arises. Some acquisitions may consume a considerable portion of Netia's financial resources and no assurance can be given that expected synergies from such acquisitions will be reached as planned.

Certain potential acquisition targets, should they become available for sale, would require Netia to raise significant amounts of financial indebtedness and / or to issue new shares or equity related instruments in order to fund a transaction. The Management Board cannot guarantee that such funding will be available when needed on acceptable terms or that such an acquisition would not significantly increase the funding risk profile of the Netia Group.

Moreover, should we be outbid by a competitor on any particular large acquisition opportunity, our position as the leading alternative operator on the Polish telecommunications market and the strategic advantages that this position creates may be materially affected.

WiMAX license requirements

On October 27, 2005 Netia WiMax S.A. (merged with Netia in 2006) and Netia WiMax II S.A. (merged with Netia in 2008) received the reservations of the 3.6-3.8 GHz frequencies, which are used to provide telecommunication services based on the WiMAX technology. The terms of licenses issued to the Company's former subsidiaries require them to meet annual connected capacity milestones in the future, as measured at the end of each year, subject to demand in the territory and population of Poland. Considering changes in the telecommunications market and, in particular, the advent of regulated access to the fixed line network of the incumbent fixed line operator, TP SA, the Company submitted applications to change future territorial and population coverage commitments for WiMax and on October 31, 2007 and on December 13, 2011 the Polish regulator issued decisions reducing the initial milestones. The milestones established for the year 2012 regarding population coverage and area coverage were achieved. In the event that reservation obligations are not met by an operator, the UKE has the power to limit or confiscate the reservation, if the entrepreneur is not able to assure effective use of possessed right. However, historically such measures have rarely been used.

Possible Material Claims (not in thousands)

On June 22, 2011 the European Commission has fined TP S.A. 127 mln Euro for, abuse of dominant position by obstructing access to its wholesale broadband products which took place from August 3, 2005 until at least October 22, 2009. TP S.A. has appealed this judgement. The final judgment in this case may allow Netia to make significant follow-on claims against TP S.A. at some point in the future.

Tax regulations and their interpretation (not in thousands)

Regulations relating to value-added tax, corporate income tax, and payroll (social) taxes have radically changed in comparison to the tax regulations, which existed prior to the economic and political transformation in Poland. The lack of reference to well-established practices and the relatively short period in which these new tax regulations have been in place often results in a lack of clarity and consistency in the regulations. Frequent contradictions in legal interpretations both within government bodies and between companies and government bodies create uncertainties and conflicts. Tax settlements, together with other areas of legal compliance are subject to review and investigation by a number of authorities, which are entitled to impose severe fines, penalties and interest charges. These facts create tax risks in Poland that are substantially more significant than those typically found in countries with more developed tax systems. The tax authorities may at any time inspect the books and records of the Company and may impose additional tax assessments with penalty interest and penalties within 5 years from the end of the year when a tax is due.

In February 2010 the Director of the Tax Chamber in Warsaw ("Tax Chamber Director") issued a decision ("Decision") according to which Netia's corporate income tax due for the year 2003 was set at PLN 34.2 million plus penalty interest of approximately PLN 25.3 million. The decision closed proceedings related to Netia's appeal of a decision of the Director of the Tax Control Office in Warsaw ("UKS Director") according to which Netia's corporate income tax due for the year 2003 was set at PLN 58.7 million plus penalty interest amounting to PLN 41.3 million.

The decision of the Tax Chamber Director was issued despite legal arguments presented by the Company, which claimed that the conclusions delivered by the Tax Control Office were incorrect and groundless. According to the Tax Chamber Director and the UKS Director, Netia understated its taxable income by PLN 247.5 million by excluding from its revenues the accrued and not received interest from loans granted by Netia in earlier years to subsidiaries which subsequently merged with Netia on December 31, 2003. The Director of UKS, as the first instance tax authority, claimed in its earlier decision that Netia understated its taxable income by PLN 303 million.

According to Netia, the decisions of the UKS Director and the Tax Chamber Director are in conflict with the relevant tax regulations. In addition to major procedural faults, Netia believes that the tax authorities' decisions incorrectly interpret and apply a number of material regulations. According to the Company the following are the most important deficiencies:

1. Incorrect interpretation of art. 11 of the CIT Act (which deals with transfer pricing), especially the notion of "services" and "more favorable conditions" and assumption that the non-commencement of the execution procedure constitutes such a service of the lender towards the debtor on non-market conditions. Such interpretation of this provision and its application towards the Company is not justified in the light of the fact that in the decision issued by the tax authorities it was confirmed that loans were granted on market terms; (interest, payment terms, etc.).

2. Failure to consider the absolutely mandatory prohibition on broadening the interpretation of art. 11 of the CIT Act, which covers exceptions from the principle of taxing actual revenue, without special care and consideration of all business, legal and economic circumstances. In the case of Netia the tax authorities did not take into account issues such as:

   - Netia was not able to report interest income in 2003 because even if Netia had received interest from its subsidiaries the amount received would have been spent on the repayment of Netia's interest liabilities (and the repayment of the interest would have been a tax deductible cost);

   - the execution of interest by court enforcement proceedings, which according to the Tax Chamber Director and the UKS Director is the only proper way to proceed when debts remain unpaid, would be inefficient from a business and economic point of view and would have led to the bankruptcy of the subsidiaries. The Company chose the less expensive way, by settling its receivables through merger with its subsidiaries and thereby taking over their operating assets. In parallel to this restructuring, Netia restructured its own liabilities with the external lenders to the group;

   - to assess Netia's conduct of non-commencement of a formal execution procedure (comparable market transaction) in the case of loans granted to its subsidiaries the tax authorities considered exclusively the loan granted by Netia to Millennium Communications; in fact, Netia was involved in numerous litigations with Millennium Communications due to the unsuccessful acquisition of that company by Netia.

3. Ignoring the norms of art. 12 of the CIT act by rejecting in the decision the rule that exclusively interest received constitutes taxable revenue (on the cash basis) and leading to the situation where the tax payer's revenue is assessed in violation of general principles relating to the mode of revenue generation.

4. Netia's taxable losses were settled incorrectly, resulting in a significant overstatement of tax being claimed. Whilst the Tax Chamber Director has recognized some of the Company's corrections to the CIT calculation in respect to 2003, reducing the claimed amount by PLN 15 million, the Company continues to claim other increases in taxable expenses that the Tax Chamber Director has not accepted.

The Tax Chamber Director's decision, which partially upheld the decision of the UKS Director, was enforceable as a decision of the second instance tax authority. The liability of PLN 59.6 million was settled in February 2010, from which PLN 1.3 million was subsequently conceded by the Tax Authority as overpayment.

Netia received opinions from several independent tax and legal advisors, as well as tax law experts, which concluded that the claims of the Directors of the Tax Control Office and the Tax Chamber have no legal grounds. Accordingly, following the payment of the PLN 58.3 million and having recourse to two levels of independent administrative courts in which to obtain a positive ruling, Management took the position during 2010 that recovery through the courts is virtually certain did not recognize the Tax Chamber's decision as a taxation expense for the financial year ended December 31, 2010 and instead treated funds paid over to the tax authorities as an overpayment of tax.

However, having heard Netia's appeal of the decision of the Tax Chamber Director, on 15 March 2011 the Voivodeship Administrative Court ("WSA") in Warsaw announced a judgment with respect to the Decision and the Court dismissed the Company's claim in its entirety. On July 5, 2011 the Company received the written justification of this decision.

Following the WSA decision in favour of the tax office, Management recognizes that there is now only one instance remaining to obtain a favourable ruling and the existence of strong tax opinions is no longer sufficient to maintain the judgment that recovery is virtually certain.

Consequently, in the first quarter of the year 2011 the Company recognized the taxes and related penalty interest already paid in 2010 as an income tax expense relating to the year 2003 of PLN 58,325 thousands.

The Voivodeship Administrative Court's judgment is not final. On August 3, 2011 the Company filed a cassation claim to the Supreme Administrative Court.

On December 30, 2011 and February 22, 2012 Netia received further repayments of PLN 6.4m and PLN 1.4m, respectively, related to penalty interests paid previously by the Company and subsequently conceded by Tax Authority as incorrectly claimed. Netia's claim for PLN 50,401 thousands plus interest is now being treated as a contingent asset in the Group's accounts.

Although the Management are committed to taking all possible legal steps to win this claim and continues to hold the view that the Company's legal arguments are strong, Management can give no assurance that any or all of these amounts will be ultimately recovered from the tax authorities.

2.2 Factors and events having a significant influence on the operations of the Netia Group and the financial results achieved in 2012

Impairment losses

Based on an update of Netia's five-year business plan that takes into account new opportunities and potential threats resulting from changes in the telecommunications environment, Netia performed an impairment test in Q4 2012. The carrying amount of Netia's non-current assets and working capital was compared to the recoverable amount determined on the basis of value-in-use calculations. These calculations use cash flow projections based on assumptions underlying the budget for the next year and an approved updated business plan. As a result of the impairment test of non-current assets as of December 31, 2012 the Netia Group has recognized 79,203 PLN of impairment losses in profit and loss during the year ended December 31, 2012. The cash flow projections, in accordance with international accounting standards, include the current ongoing projects and do not take into account the cash flows expected from new projects planned under Netia's Strategy 2020. These impairment losses decreased goodwill and distributable reserves at December 31, 2012.

The determination of impairment of goodwill and non-current assets is based on estimates of a large number of factors, such as changes in the current competitive conditions, expectations of growth in the telecommunications industry, regulated access and interconnection rates, cost of capital, technological obsolescence and other changes in circumstances that indicate an impairment exists. While the estimation of recoverable amount is based on current assessment of telecommunication market conditions and Management's best estimates and judgment, these estimates include a considerable amount of uncertainty. The actual outcome is uncertain and Management estimates may change in the future to reflect changes in the economic, technological and competitive environment, in which the Company operates.

Deferred tax asset

Following acquisitions in 2011 and the Management's assessment of the recoverability of tax loss carry-forwards and timing differences against future taxable profits, at December 31, 2012 the Netia Group recognized PLN 84,004 of net deferred income tax asset as compared to PLN 108,813 as of December 31, 2011. The decrease concerns mainly the consumption of tax losses against current taxable profits and reduced projections of future operating profitability, resulting in a reduction of various deferred tax assets across the group. Lower than planned taxable profits in Netia SA for 2012 led to a write down of PLN 7,540 of deferred tax assets related to expiring tax losses. Operational restructuring reduced these charges by PLN 20,324 recorded due to the recognition of deferred tax assets arising on the intragroup sale of network assets by Dialog to Netia. This assessment was based on the budget for 2013 and Netia's long term business plan until 2017.

Operational data (not in thousands)

Broadband

Broadband subscribers of Netia Group decreased to 874,778 at December 31, 2012 from 911,570 a year earlier. In 2013 Netia intends to focus on sales of its on-net products, including on-net broadband services. Moreover, the Company has launched a new internal project '4Sails' aimed at improving the execution across the entire sales process. Management is targeting to first stabilise and then to grow the broadband subscriber base as 2013 progresses.

Netia Group provides its broadband services using the following technologies:

Number of broadband ports	**2012**	**2011**
xDSL and FastEthernet over Netia's own fixed-line network	382,540	396,853
Bitstream access	291,621	311,358
WiMAX Internet	17,891	19,130
LLU	182,726	184,229
Others	-	-
Total	**874,778**	**911,570**

Broadband ARPU was PLN 57 in Q4 2012 as compared to PLN 56 in Q4 2011. Netia's conservative pricing policy and focus on higher value customer segments has resulted in a solid ARPU performance over the past year.

Broadband SAC for Old Netia was PLN 174 in Q4 2012 as compared to PLN 178 in Q4 2011 and PLN 199 in Q3 2012. Broadband SAC for New Netia was PLN 178 in Q4 2012.

Local loop unbundling (LLU)

Local loop unbundling (LLU). New Netia served 182,726 customers over LLU as at December 31, 2012 as compared to 184,229 at December 31, 2011 and 184,631at September 30, 2012. During Q4 2012 Netia migrated 1,105 1play and 1,818 2play clients onto LLU, increasing the cumulative gross number of 1play and 2play migrations to 119,199. Organic net disconnections of 4,828 reflects the same competitive pressures that are impacting the overall broadband subscriber base. Nearly all LLU customers originate from Old Netia as Dialog Group had not invested in LLU nodes.

(All amounts in thousands, except as otherwise stated)

At this stage, Netia has effectively concluded its LLU roll-out program with 713 unbundled nodes.

Acquisitions of local Ethernet network operators

As of December 31, 2012, Netia's Ethernet networks provided broadband access to a total of 121,005 mostly residential customers as compared to 124,971 customers at September 30, 2012 and 132,532 customers at December 31, 2011, with approximately 621,000 homes passed. Despite continuing organic net disconnections on the Ethernet network as a whole, Management is observing encouraging organic sales performance on NGA upgraded Ethernet networks and is evaluating opportunities to accelerate the upgrade program in 2013. During 2012 Netia acquired three further Ethernet networks with 4,921 active customers and 18,180 homes passed as compared to nine acquisitions (including both purchases of companies and asset transfers) with 22,823 active customers and 103,832 homes passed in 2011. Netia is currently focused on upgrading Ethernet networks already acquired and will therefore likely acquire new networks at a much slower rate than seen in the past.

NGA network development

As at December 31, 2012, New Netia covered in total 1,040,000 households with its NGA networks, including 139,000 PON HPs, 707,000 VDSL HPs and 194,000 Ethernet FTTB HPs. Moreover, New Netia today covers a further 376,000 IPTV ready HPs within its network coverage based on ADSL2+ technology. Combined with NGA ready HPs, all of which can deliver IPTV services, New Netia today has 1,416,000 IPTV ready HPs in its proprietary network coverage.

New Netia has advanced plans to expand its NGA coverage by another 240,000 or more HPs to reach almost 1,280,000 NGA ready HPs by 2013 year end. Once completed, New Netia should cover in total approximately 1,450,000 IPTV ready HPs (NGA and ADSL2+) which can be reached with 3play service bundles (IPTV + fixed broadband + fixed voice). Furthermore, Netia has introduced smooth streaming technology, which expands the availability of its 3play bundle offer onto networks were Netia does not provide the broadband connection or where line speeds are too slow to support IPTV. Management is presently focusing on optimizing sales, provisioning and maintenance processes around TV services.

Mobile services

New Netia's mobile broadband customer base totalled 30,281 at December 31, 2012 as compared to 30,261 at December 31, 2011 and 32,758 at September 30, 2012. Mobile broadband ARPU for New Netia was PLN 26 in Q4 2012 as compared to PLN 28 in Q4 2011 and PLN 27 in Q3 2012. Mobile voice services totalled 60,219 at December 31, 2012 as compared to 52,002 at December 31, 2011 and 62,043 at September 30, 2012. New Netia's Mobile voice ARPU was PLN 26 in Q4 2012 as compared to PLN 25 in Q4 2011 and PLN 27 in Q3 2012. Mobile broadband has similar economics to BSA services whilst mobile voice has benefited from improved terms of MVNO agreements with partners P4 and Polkomtel.

Voice lines (own network and WLR)

Voice lines (own network, WLR and LLU) in New Netia totalled 1,643,904 at December 31, 2012 as compared to 1,744,723 at December 31, 2011 and 1,677,766 at September 30, 2012. In Q4 2012 Netia recorded a net decrease of 33,862 voice lines versus 36,370 voice lines in Q3 2012. The Company expects the number of fixed voice lines to continue to decline, mainly due to clients churning from traditional direct voice and WLR services.

During 2012, the increasingly aggressive price competition from other providers on the market together with substitution from mobile and migrations to voice bundled with cable TV, has been putting pressure on the subscriber base whilst Netia has been targeting higher ARPU customers and upselling unlimited fixed-line national call bundles in order to attract higher value customers. However, during October 2012 the largest competitor significantly discounted its offers to high value customers and Netia management expects this to have a negative impact on voice ARPU and volume trends going forward. In this context, Management considers the slowdown in net losses seen in Q4 2012 to be encouraging.

Netia is steadily growing its base of relatively low cost VoIP customers, principally in the business segment or over LLU and Ethernet to residential customers. Over time, the Company expects to gradually reduce its reliance on traditional switched telephony, thereby reducing its cost base.

Due to the competitive market conditions and Netia's focus on higher end customers, Netia has switched focus to defending voice revenues as opposed to subscriber numbers.

Netia provides its voice services through the following types of access:

Number of voice lines	**2012**	**2011**
Traditional direct voice	563,753	596,330
Voice over IP*(excl. LLU)*	61,892	42,279
WiMAX voice	14,663	17,603
WLR	869,196	962,322
LLU voice over IP	126,933	126,189
Total	**1,643,904**	**1,744,723**

Voice ARPU per WLR line was PLN 45 in Q4 2012 in New Netia as compared to PLN 46 in Q4 2011 and PLN 45 in Q3 2012.

Voice ARPU per Netia network subscriber line amounted to PLN 46 in Q4 2012 for New Netia as compared to PLN 50 in Q4 2011 and PLN 46 in Q3 2012.

Blended voice ARPU in New Netia was PLN 46 in Q4 2012 as compared to PLN 48 in Q4 2011 and PLN 46 in Q3 2012.

Indirect voice

CPS lines (carrier pre selection) in New Netia totalled 62,241 at December 31, 2012 as compared to 73,696 at December 31, 2011 and 65,249 at September 30, 2012. Netia is focused on the conversion of CPS customers to WLR and is not actively acquiring new CPS customers. CPS clients are not counted in the total New Netia voice subscriber base of 1,643,904 clients as at December 31, 2012.

Indirect voice ARPU per CPS line in New Netia was PLN 37 in Q4 2012 as compared to PLN 49 in Q4 2011 and PLN 42 in Q3 2012. Tariff reductions, reduced call volumes and conversion of higher ARPU customers to Netia's WLR or LLU offers are responsible for the progressive ARPU decline.

2.3 Agreements essential for the Netia Group's operations

A four-year agreement with Ericsson

On August 14, 2012, Netia together with its subsidiaries signed a four-year managed services contract with Ericsson replacing the existing managed services contract signed on August 12, 2010. The contract covers the maintenance and management of the Netia Group's networks, as well as supporting the provision of services to Netia Group's residential and business customers. Whilst similar in scope to the previous agreement, the new agreement covers managed services for the Dialog Group and Crowley networks and, in addition, modifies certain pricing and operational parameters (KPIs) concerning the provision of services by Ericsson to the Netia Group. Based on the agreement 188 of the Netia Group's employees were transferred to Ericsson on the basis of art. 231 of the Labour Code. The cooperation with Ericsson will influence the reduction of maintenance and employment costs, more effective and integrated handling and management of Netia Group's networks and its service delivery. While the extended cooperation with Ericsson represents a material long term commitment on the part of Netia Group, Management does not expect it to have a material impact on profitability or cash flows of the Group over the life of the contract.

3 Financial condition of the Netia Group

3.1 Consolidated statement of financial position

As at December 31, 2012, non-current assets amounted to PLN 2,776,617 (86% of total assets) as compared to PLN 3,100,374 at the end of 2011 (87% of total assets). The main change within non-current assets relates to depreciation and amortization charge of PLN 482,491, decrease in goodwill due to impairment loss of PLN 79,203 and a transfer of property, land and infrastructure of PLN 26,770 to be sold to Tilia SKA to assets held for sale (please refer for details to Note 5a: Critical accounting estimates and judgments: Impairment of goodwill and other non-financial assets in the consolidated financial statements as of December 31, 2012 and Note 2.3 Agreements essential for the Netia Group's operations in the Directors' Report). The above changes were partially offset by capital expenditures of PLN 279,097 incurred during the year ended December 31, 2012.

Current assets (excluding assets held for sale) at December 31, 2012 in the amount of PLN 429,571 decreased by 5% as compared to PLN 452,774 at the end of 2011. The change was mainly attributable to the decrease in the Company's cash balance of PLN 142,702 as of December 31, 2012 and lower balance of receivables as at December 31, 2012 as compared to the end of 2011.

As at December 31, 2012, the equity amounted to PLN 2,296,295, comprising 71% of total equity and liabilities and decreased by 8% as compared to PLN 2,500,373 at the end of 2011. The main changes are the consolidated loss for 2012 of PLN 87,704 and repurchase of own shares of PLN 106,814 (the main factors influencing the net result are described in point "Factors and events having a significant influence on the operations of the Netia Group […]").

Non-current liabilities amounted to PLN 451,066 and decreased as compared to PLN 552,156 at the end of 2011, mainly due to repayment of term loan installments of PLN 130,000 in 2012. The long-term part of the term loan as of December 31,2012 amounted to PLN 384,452 as compared to PLN 514,416 as at the end of the prior year.

As at December 31, 2012, current liabilities amounted to PLN 485,597 and decreased as compared to PLN 500,619 at the end of 2011, mainly due to the repayment of PLN 50,000 of revolving loan on March 15, 2012, which was partially offset by a bank overdraft of PLN 18,751 and interests accrued on the loan of PLN 20,547 as of December 31, 2012.

3.2 Consolidated income statement

Revenue rose by 31% to PLN 2,121,356 for 2012 from PLN 1,618,803m for 2011, driven by the acquisition of Dialog Group and Crowley in December 2011. All operating segments recorded growth, with the Home segment growing by 29% or PLN 242,431, the Corporate segment by 36% or PLN 123,038, the SOHO/SME segment by 41% or PLN 84,377 and the Carrier segment, where certain agreements have expired or are being run down, increasing by 11% or PLN 24,175. Unallocated revenues increased by 371% or PLN 28,532 due to the acquisition of Dialog's subsidiary Petrotel, which continues to be managed as a separate organization.

Telecommunications revenue increased by 31% to PLN 2,108,708 in 2012 from PLN 1,614,021 in 2011 following the addition of Dialog Group and Crowley's customer bases from December 2011. The strongest progress has been seen on other telecommunications revenue which is up by 137% at PLN 113,789 as it includes TV and mobile services. Other telecommunications revenue now represents 5% of total revenue versus 3% in the prior year. The expansion of the Netia Group with Dialog and Crowley has led to only marginal changes in the composition of revenue with direct voice revenue as a share of total telecommunications revenue declining from 46% to 45% relative to 2011 and data revenue declining from 37% to 36% over the same period.

Cost of sales increased by 35% to PLN 1,484,216 from PLN 1,103,029 for 2011 and represented 70% of total revenue as compared to 68% in the prior year. The absolute increase in costs reflects mainly the Dialog Group and Crowley acquisitions.
Depreciation and amortization related to cost of sales increased by 52% to PLN 394,143 as compared to PLN 258,408 for the prior year upon commencing the amortization of Dialog Group's and Crowley's fixed assets and the additional impact from D&A charges on the impairment reversal at Old Netia in Q4 2011.

Network operations and maintenance cost increased by 22% to PLN 647,586 from PLN 530,240 for 2011. This cost category increased less than revenues as Dialog Group is less reliant on fees paid to the incumbent to reach its mainly on-network customer base.

Interconnection charges increased by 27% to PLN 306,056 in 2012 as compared to PLN 240,818 for 2011, rising by less than revenues due to falling mobile termination rates and lower transit volumes.

Taxes, frequency fees and other expenses increased by 91% to PLN 78,122 in 2012 as compared to PLN 40,912 for 2011, due to the addition of Dialog Group's and Crowley's networks.

Restructuring expenses related to cost of sales were PLN 5,608 in 2012 and were related to the termination of employment contracts under the process of group redundancies, which was announced in April 2011 and started in June 2011 in connection with the integration of Netia, Dialog Group and Crowley into the New Netia Group. This amount includes PLN 3,000 recorded as a contribution to Ericsson costs of restructuring the outsourced network maintenance organization following the transfer of Dialog and Crowley maintenance staff in September 2012.

Costs of goods sold increased by 13% to PLN 11,600 as compared to PLN 10,233 recorded in 2011, as a result of a one-off cost of equipment sold by Petrotel of PLN 3,367 related to a new equipment and service contract with a major customer. Excluding the above mentioned one-off cost, this category was down following lower sales volumes and the introduction of the proprietary Netia Spot routers from June 2011 in Old Netia, which are being capitalized as they are leased rather than sold to customers.

Gross profit for 2012 was PLN 637,140 as compared to PLN 515,774 for 2011. Gross profit margin was 30.0% for 2012 and 31.9% for 2011. Additional depreciation charges arising from the major acquisitions and impairment reversal, together with a falling share of revenue from high margin voice services are responsible for the declining gross margin.

Selling and distribution costs increased by 32% YoY to PLN 392,069 from PLN 297,253 for the last year and represented 18% of total revenue in both 2012 and the prior year. The inclusion of fixed expenditures related to the Dialog Group and Crowley customer operations were the main drivers of this increase.

Salaries and benefits related to selling and distribution cost increased by 38% to PLN 118,592 from PLN 85,638 in the prior year.

Depreciation and amortization related to selling and distribution cost increased by 109% to PLN 59,981 from PLN 28,711 in 2011 mostly due to the amortization of the customer bases of newly acquired companies.

Restructuring expenses related to selling and distribution cost increased to PLN 9,619 from PLN 164 in 2011 and were related to the termination of employment contracts under the process of group redundancies started in June 2011 in connection with the New Netia Group reorganization.

Billing, mailing and logistics costs increased by 23% to PLN 41,431 from PLN 33,728 in 2011 following the Dialog Group and Crowley acquisitions.

Impairment of receivables increased by 81% to PLN 12,644 from PLN 6,976 in 2011 following the Dialog Group and Crowley acquisitions.

Advertising and promotion cost decreased by 21% to PLN 36,663 from PLN 46,610 despite the acquisitions as quick win synergies were implemented from early 2012.

General and administration costs increased by 36% to PLN 207,610 from PLN 152,473 for 2011 and represented 10% of total revenue versus 9% for 2011. The cost increase was driven by the addition of the Dialog Group's and Crowley's expenses and the costs of the integration project to create New Netia. As a result, general and administration costs in 2012 included PLN 25,928 of New Netia integration costs and an additional PLN 7,429 of restructuring costs related to group redundancies under implementation in connection with the New Netia organization.

Adjusted EBITDA (defined as operating profit /(loss) excluding depreciation and amortization as well as significant one-off transactions) was PLN 591,166, up 45% from PLN 408,210 for 2011. Adjusted EBITDA margin was 27.9% as compared to 25.2% in the prior year. Higher Adjusted EBITDA reflects the addition of Dialog Group and Crowley together with initial synergies of approximately PLN 76,200 and savings on acquisition costs, partially offset by falling margins from contracting voice services.

A non-cash impairment charge of PLN 79,203, resulting from the impairment test of Netia Group's non-current assets, was recorded in 2012. The charge was recorded by writing down goodwill attributable to the Residential segment. Upon an update of Netia's five-year business plan that takes into account new opportunities and potential threats resulting from changes in the telecommunications environment, Netia performed an impairment test in Q4 2012. The carrying amount of Netia's non-current assets and working capital was compared to the recoverable amount determined on the basis of value-in-use calculations. These calculations use cash flow projections based on assumptions underlying the budget for the next year and an approved updated business plan. The test resulted in the impairment charge of PLN 79,203 taken against goodwill which was attributable to the Residential segment. In the prior year, New Netia's impairment test produced a reversal of earlier impairment charges of PLN 220,677. Deteriorating prospects for RGU growth and falling voice ARPU expectations have driven this swing in Management's expectations of future cash flows. In addition to the above mentioned impairment test results in 2012 and 2011, New Netia recorded integration costs of PLN 26,276 in 2012 and PLN 1,097 in 2011, restructuring costs of PLN 22,656m in 2012 and PLN 798 in 2011, the costs of M&A projects of PLN 1,504 in 2012 and PLN 10,434 in 2011and universal service obligation provision of PLN 5,104 in 2011. As a result, EBITDA was PLN 461,527 for 2012 as compared to PLN 611,454 for the prior year. EBITDA margin was 21.8% as compared to 37.8% for 2011.
Depreciation and amortization was PLN 482,491, an increase of 56% as compared to PLN 308,756 in 2011, with increases resulting from the acquired fixed assets and acquisition intangibles of the Dialog Group and Crowley and the reversal of impairment recorded in Old Netia in Q4 2011.

Operating loss (EBIT) was PLN 20,964 as compared to an operating profit of PLN 302,698 for 2011. Excluding unusual items described above of PLN 129,639 of costs in 2012 and PLN 203,244 of net gains in 2011, Adjusted EBIT was PLN 108,675 profit for 2012 versus PLN 99,454 profit for 2011.

Net financial cost was PLN 39,942 as compared to net financial income of PLN 14,578 for the prior year. The change was driven by PLN 43,185 of interest on bank loans to finance the Dialog Group's acquisition in December 2011 as part of the swing from a net cash to a net debt position following the two acquisitions.

Income tax charge of PLN 26,798 was recorded in 2012 as compared to income tax charge of PLN 68,490 for 2011. The income charge tax recorded in 2012 was mainly due to reduced projections of future operating profitability, resulting in a reduction of various deferred tax assets across the group. Lower than planned taxable profits in Netia SA for 2012 led to a write down of PLN 7,540 of deferred tax assets related to expiring tax losses. Operational restructuring reduced these charges by PLN 20,324 recorded due to the recognition of deferred tax assets arising on the intragroup sale of network assets by Dialog to Netia. Income tax charge in 2011 included a net PLN 51,863 expensed in relation to the 2003 CIT tax dispute.

Net loss was PLN 87,704 for 2012 versus net profit of PLN 248,786 for 2011.

3.3 Consolidated statement of cash flows

Net cash generated from operating activities by Netia Group amounted to PLN 541,386 as compared to PLN 418,827 in 2011. The increase was principally due to higher adjusted EBITDA generated in 2012 after the acquisition of Dialog Group and Crowley at the end of 2011.

Net cash used for the purchase of fixed assets and computer software was PLN 262,506 and remained on a comparable level to 262,659 PLN the prior year. Other significant spending on investment activities in 2012 were purchases of Ethernet operators, net of cash received of PLN 5,285 and purchase price adjustment to Crowley of PLN 4,323.

Other significant cash outflow items during 2012 in Netia Group included PLN 182,049 of loans and 26,212 PLN of interests and fees repaid and PLN 106,814 of repurchased own shares. As a result net cash used in financing activities in 2012 amounted to PLN 303,505 as compared to PLN 635,822 of net cash provided by financing activities in 2011, when the term and revolving loans of PLN 700,000 were drawn to facilitate the acquisitions of Dialog Group and Crowley.

Cash and cash equivalents at the end of 2012 amounted to PLN 123,951and were net of overdraft balance of PLN 18,751.

3.4 Financial resources management and assessment of the possibility of executing the planned investments

Following its new strategy announcement in April 2007, Netia invested in broadband and other services such that free cash flows was negative in 2007 and 2008. In 2009, the Netia Group began to generate free cash flows once more and this trend of improving cash flows continued into 2012. However the 2013 free cash flows guidance of PLN 300,000 is 10% below the amounts generated in 2012 as the Netia Group tries to compensate for expected fall in revenues and margins by accelerating on-net customer acquisitions. Nevertheless, Management expects Netia to continue be free cash flow positive in the medium term, subject to the impact of any or all risk factors indicated in section "Major risks and threats related to the operational activities. As at December 31, 2012, the Group's equity amounted to PLN 2,296,295 and the Netia Group had working capital of PLN 118,190 inclusive of cash available of PLN 142,702 and overdraft of PLN 18,751. As at December 31, 2012 the Netia Group had senior secured debt of PLN 531,898. Netia's operations were free cash flow generative in 2012 and Management expects this to continue over the medium term. Based on this position, the Management does not believe that events or conditions exist which may cast significant doubt on the Company's ability to continue as a going concern.

A detailed description of risks related to the Netia Group's financial instruments has been presented in the consolidated financial statements (Note 4).

3.5 Loans Agreements

Bank loans

On September 29, 2011, Netia and Internetia Sp. z o.o. (the "Borrowers") executed a loan agreement (the "Agreement") with Rabobank Polska S.A. (the "Facility Agent") and BNP Paribas S.A., BRE Bank S.A., Raiffeisen Bank Polska S.A. and Raiffeisen Bank International AG (jointly with the Facility Agent, the "Lenders"), whereunder the Lenders agreed to extend to the Borrowers a term facility maturing in five years with a total of PLN 650,000, designated for the Company to acquire 19,598,000 (not in thousands) shares Dialog, constituting 100% of its share capital, and a PLN 50,000 revolving facility for general operating purposes. The term loan was drawn on December 16, 2011 and the revolving loan was drawn on December 15, 2011. The revolving loan was repaid in full on March 15, 2012. Term loan instalments paid in 2012 amounted to PLN 130,000. As at December 31, 2012 the value of these loans at amortised cost was PLN 531,898.

The loan accrues annual interest at the rate of 3M WIBOR plus a margin established depending on the level of debt. The terms and conditions of the Agreement comply with market practice and are not different from the terms and conditions generally applied to such types of agreements. The borrowing is measured at amortized cost using an effective interest rate of 7.2%. Total transaction costs included in the calculation of the effective interest rate amounted to PLN 12,511. The carrying amount of the borrowings approximates their fair value and the discount rate for the fair value calculation approximates the effective interest rate.

To secure the Lender's claims under or related to the Agreement, the Borrowers agreed to establish in favour of the Lenders mortgages, financial and registered pledges and to make relevant representations on submission to enforcement, and to execute agreements on assignment as collateral security. The repayment of the loan is secured by the following: two capped mortgages on the right of perpetual usufruct of the Company's real estate at ul. Poleczki 13 in Warsaw, a registered pledge on a set of movables and rights of Netia and Internetia Sp. z o.o., registered pledges and financial pledges on the shares of Internetia Sp. z o.o., Netia Brand Management Sp. z o.o. and Dialog. Moreover, the Borrowers made relevant representations on submission to enforcement up to the amount of PLN 1,050,000.

On March 8, 2012, Netia entered into an overdraft credit facility agreement with BRE Bank S.A. of PLN 50,000. The facility will be disbursed for general operating purposes of the Company. The Company is entitled to become indebted under the facility agreement in the period between March 12, 2012 and December 27, 2012. On December 11, 2012, Netia signed amendment to the overdraft agreement, according to which it is entitled to become indebted until October 30, 2013. The terms and conditions of the agreement comply with market practice and are not different from the terms and conditions generally applied to such types of agreements. The outstanding balance of the overdraft credit as at December 31, 2012, amounted to PLN 18,751.

Moreover, as at December 31, 2011, the Netia Group had outstanding bank loans of PLN 1,583 drawn by the Company's subsidiary Petrotel Sp. z o.o., PLN 36 drawn by the Company's subsidiary Intergeo and PLN 319 drawn by the Company's subsidiary ComNet. The outstanding loans were repaid in full in 2012. Loans drawn by subsidiaries acquired by the Group in 2012: PLN 60 by STI and PLN 51 by Sanetja also were repaid in 2012.

3.6 Bonds issued and warranties and collaterals granted

Bonds issued

On June 1, 2012 Dialog purchased 6 CC series registered bonds issued by Netia, each of a nominal value of PLN 50.000 and of a total nominal value of PLN 300.000 and with maturity date falling on May 31, 2017.

On September 14, 2012 Netia Brand Management Sp. z o.o. purchased 3 DD series registered bonds issued by Netia, each of a nominal value of PLN 5.000 and of a total nominal value of PLN 15.000 and with maturity date falling on August 31, 2017.

On February 15, 2013 Netia Brand Management Sp. z o.o. purchased 3 EE series registered bonds issued by Netia, each of a nominal value of PLN 5.000 and of a total nominal value of PLN 15.000 and with maturity date falling on January 31, 2018.

Warranties and collaterals granted

Netia Group did not grant any warranties or collaterals in 2012, except for described in Note 3.5 Loans Agreements.

4 The Company's supervisory or governing authority

4.1 Rights of the Supervisory and Management Board's members

According to the Company's Statute the bodies of the Company are the General Shareholders' Meeting ("GSM"), the Supervisory Board and the Management Board.

GSM operates in accordance with the rules set forth in the Commercial Companies Code and the Company's Statute. GSM decides in matters provided for in the Commercial Companies Code, and in particular regarding decisions on the division and distribution of profit. No approval of the GSM is required for the purchase or sale of the right of real estate ownership, the right of perpetual usufruct or share in such right, without limitations upon the value of such transaction. The Company has not adopted any by-laws of the GSM. Amendments of the Company's Statute need to be adopted by 3/4 majority of the votes cast.

The Supervisory Board shall consist of up to 9 members. Members of the Supervisory Board shall be elected and dismissed by the GSM for a term of office of 5 years. One member of the Supervisory Board shall be appointed and dismissed by holders of series A1 shares. At all times at least two of the Supervisory Board members shall be "independent".

The competency of the Supervisory Board shall include general supervision of the activities of the Company. Resolutions of the Supervisory Board shall be required in matters provided for in the Commercial Companies Code and:

a) presentation to the Company's GSM of a written report on the results of the Supervisory Board's examination of the Company's financial statements, Management Board report and Management Board's recommendations with respect to the distribution of profits or coverage of losses;
b) the issuance of by-laws for the Management Board and the appointment and removal of the members of the Management Board, setting or changing the compensation and defining other terms and conditions of employment of the Management Board members, as well as setting and changing any incentive plan for the Management Board members and other key employees;
c) approval of business plans and budgets for the Company;
d) granting consent for any transaction whose value exceeds the PLN equivalent of EUR 1,250 in a single or a series of related transactions, or in the course of one year in the case of agreements entered into for unlimited duration or for periods longer than one year;
e) making any investments in or financing the activities of companies whose core and actual scope of business activity does not include telecommunications activity;
f) consent to the commencement, settlement, assignment, compromise or release of any claim of or against the Company in excess of the PLN equivalent of EUR 600 in a single or series of related acts or the equivalent amount in PLN or other currencies;
g) consent to the adoption of a performance stock option plan in accordance with § 5A of the Statute;
h) appointment of the expert auditor to audit the Company's financial statements;
i) provided that the value of the Company's obligations exceeds the PLN equivalent of EUR 100, the conclusion by the Company of any contracts with an Affiliate shall; require the approval of at least one of the independent members. For the purposes of this point, an "Affiliate" shall mean: (i) a member of the Management Board or Supervisory Board of the Company or the cousin or relative of up to the second degree of such member, or an entity controlled by such person or their cousin or relative of up to the second degree; (ii) a shareholder holding shares entitling it to at least 5% of votes at the General Meeting; or (iii) an entity controlled by, controlling or under common control with the persons listed under (i) and (ii); (iv) an entity in which the Company has, directly or indirectly, any equity stakes or voting powers. "Control" shall mean the possibility of exerting influence, whether direct or indirect, on the management or business policy of the controlled entity through holding voting shares in such entity, under a shareholders' agreement, an agreement for official receivership of votes (umowa syndykowania głosów) or in any other similar manner, even if not connected with a written agreement. For the purposes of the above definition, "control" shall not apply to any companies controlled by Netia S.A.

The Management Board of the Company shall consist of up to 10 members. The Supervisory Board shall decide on the number of Management Board members. The Management Board members shall be appointed and dismissed by the Supervisory Board for a term of office of 5 years.
The Management Board shall manage the activities of the Company, shall adopt resolutions necessary for performance of tasks and shall represent the Company before courts, authorities, offices and third parties. The Management Board shall handle the matters, which are not within the exclusive competence of the GSM or the Supervisory Board. Two members of the Management Board acting together or one member of the Management Board acting together with a commercial proxy (prokurent) shall be authorised to make declarations and to sign on behalf of the Company.

The members of the Management Board do not have any rights related to deciding about the issue or redemption of the Company's shares.

4.2 Management Board and Supervisory Board in 2012

Management Board

Effective January 1, 2012 Mr. Piotr Nesterowicz resigned from his position as a member of the Company's Management Board.

Effective March 16, 2012 Mr. Grzegorz Esz resigned from his position as a member of the Company's Management Board.

On April 25, 2012 the Supervisory Board of the Company appointed Mr. Mirosław Suszek as a member of the Management Board with effect from May 1, 2012.

Due to the above changes, as at December 31, 2012 the Company's Management Board consisted of the following members:

- Mirosław Godlewski – President,
- Jonathan Eastick – Chief Financial Officer,
- Tom Ruhan,
- Mirosław Suszek.

Supervisory Board

As at December 31, 2012 and December 31, 2011 the Company's Supervisory Board consisted of the following members:

- Benjamin Duster – Chairman,
- George Karaplis – Vice-Chairman,
- Stan Abbeloos,
- Raimondo Eggink,
- Nicolas Maguin,
- Ewa Pawluczuk,
- Tadeusz Radzimiński,
- Jerome de Vitry.

4.3 Supervisory board's standing committees

Two committees have been acting within the Supervisory Board since April 5, 2006: Audit Committee and the Nomination and Remuneration Committee. During the year 2012 the membership of the committees was as follows:

Audit Committee:

- Raimondo Eggink, the Chairperson of this Committee,
- Tadeusz Radzimiński,
- Ewa Pawluczuk

Nomination and Remuneration Committee:

- Jerome de Vitry, the Chairperson of this Committee,
- Raimondo Eggink - until March 20, 2012
- Ewa Pawluczuk - until March 20, 2012
- Ben Duster - from March 20, 2012
- Tadeusz Radzimiński - from March 20, 2012

In 2009 the Supervisory Board established another standing committee – Capital Investment Committee consisting of:

- George Karaplis - the Chairperson of this Committee,
- Stan Abbeloos,
- Nicolas Maguin
- Jerome de Vitry.

The duties of the Audit Committee include advising the Supervisory Board on issues of proper implementation of the budget and financial reporting standards and internal audit of the Company and the capital group (as defined in the Accounting Act dated 29 September 1994, as amended), including the overall and comprehensive review of the Company's annual and periodic financial statements, both unconsolidated and consolidated, analysing the Company's authorised auditor's letters to the Management Board, monitoring the integrity of the financial information provided by the Company, cooperating with external and internal auditors of the Company, as well as with the Company's departments responsible for audit and checking, reviewing internal control and risk management systems. The Audit Committee meetings are held at least once every quarter prior to the Company's publication of the financial statements.

The duties of the Nominations and Remuneration Committee is to support the Company's achievement of its strategic objectives by presenting the Supervisory Board with opinions and motions related to the shaping of the management structure, including on organisation solutions, the remuneration system and selection of personnel having the qualifications required to ensure success of the Company.

The duties of the Capex Committee are, among others, monitoring key drivers of capital investment spendings within the Netia group in order to be able to properly advise the Supervisory Board on capital investments, reviewing Management's proposals for the annual capital investment budget and monitoring progress on implementation of such budget.

The principles, scope and methods of operation of the Supervisory Board Committees have been regulated in detail in the By-laws of the Supervisory Board of Netia SA.

4.4 System for controlling employee share option plans (not in thousands)

2003 Plan

The 2003 Plan, which expired on December 20, 2012, was aimed at providing incentives which will encourage, retain and motivate highly-qualified people in senior management positions, employees, co-operators, consultants and the members of the Company's Management Board, its associates and subsidiaries to act in the shareholders' interests by granting them options for the Company's series K shares of the new issue. The execution of the Scheme had been entrusted to the Company's Supervisory Board. To the extent provided for in the 2003 Plan, the Supervisory Board, at its exclusive discretion, made decisions relating to, among other things, participation in the 2003 Plan, the allotment of options, and the terms & conditions of their being exercised.

New Plan

On May 26, 2010, the Annual Shareholders Meeting resolved to adopt a set of rules, to be administered by the Company's Supervisory Board, for the issuing of up to 27,253,674 share options to the Management Board and employees of Netia, each option authorising its holder to receive, free of charge, up to ½ of a subscription warrant issued by the Company with the latest possible exercise date of May 26, 2020 (the "New Plan"). Each warrant entitles its holder to subscribe for one series L share for the nominal value of PLN 1, which shall be paid by the Company or its subsidiaries. In order to satisfy the claims arising from the exercise of the options under New Plan, the Shareholders Meeting resolved to authorize the issuance of up to 13,626,837 series L shares.

The New Plan participants are entitled to exercise their stock options on the condition that they continue their engagement with the Netia Group until the vesting date of the stock options (subject to change of control events and the termination of their engagement by the Netia Group without material cause) and the fulfilment of the business criteria set by the Supervisory Board for each year of the New Plan. In the event of termination by the Company, unvested options are retained prorata to the period worked during the vesting period. The proportion of the stock options exercised versus the number of stock options granted shall be equal to the lower of: 100% or the actual performance of the objectives set out as part of the performance criteria approved by the Supervisory Board and applicable in the financial year in which the stock options were granted. Each year within the period following the publication of the financial statements of the Company for the previous financial year and prior to the date of the Annual General Meeting of the Company, the Supervisory Board shall adopt a conditional resolution in which it shall determine the performance level of the business criteria for the previous financial year. The resolution of the Supervisory Board shall enter into force upon the approval of the financial statements of the Company and the Netia Group by the Annual General Meeting of the Company. Such conditional resolution of Supervisory Board regarding the performance criteria for 2011 was taken on April 25, 2012 and the performance level was determined at 58.9%. The resolution came into force on June 19, 2012 and resulted in cancellation of 41.1% options granted in 2011).

The amount of the reduction for the 3,669,000 options granted in 2012 is dependent on the Supervisory Board's assessment of performance against the agreed criteria for 2012. As at the date of this Directors' Report, that assessment had yet to take place.

4.5 Remuneration paid and payable to the members of the Management Board and the Supervisory Board in 2012

The compensation and related cost of remuneration (including bonuses paid and accrued) of members of the Company's Management and Supervisory Board are presented below:

	PLN
Remuneration of members of the Management Board	
Mirosław Godlewski	2,854
Jonathan Eastick	2,171
Tom Ruhan	1,679
Grzegorz Esz	58
Piotr Nesterowicz	9
Mirosław Suszek	925
	7,696

The above amounts include accruals for special bonuses relating to the successful integration of the Dialog Group and Crowley into New Netia and the realization of synergies in line with the original business case assumptions. Such bonuses are due to be settled in the third quarter of 2013 following a performance assessment of the first 18 months of the integration by the Company's Supervisory Board.

Moreover, upon exercise of the options, Management Board members received the following number of shares with a par value of PLN 1 (not in thousands) per share for which they were not required to pay (PIT and social security cost were incurred by the Company).

	Number of shares (not in thousands)	**PIT and employee ZUS costs incurred by the Company** (PLN)
Mirosław Godlewski	1,389,415	744
Jonathan Eastick	572,188	307
Tom Ruhan	464,632	249
Grzegorz Esz	569,395	305
	2,995,630	1,605

	PLN
Remuneration of current members of the Supervisory Board	
Benjamin Duster	115
George Karaplis	96
Stan Abbeloos	96
Raimondo Eggink	101
Nicolas Maguin	96
Ewa Pawluczuk	101
Tadeusz Radzimiński	115
Jerome de Vitry	120
	840
Remuneration of members of management boards of subsidiaries	1,830
Remuneration of members of supervisory boards of subsidiaries	76
Total	**10,442**

The members of the Company's Management and Supervisory Boards do not collect any additional remuneration for being members of the authorities of the subsidiaries.

In addition, the members of the Management participate in a scheme which consists of awarding bonuses in the form of Netia's shares, under which some of them have received share options.

2003 Plan (not in thousands)

Between the adoption of the employee share option scheme (the "Plan") on April 10, 2003 and its expiry on December 20, 2012, the Supervisory Board approved and issued a total number of 65,738,333 options to members of the Management Board. From the total number of approved options, 36,489,064 were outstanding as at December 31, 2011. During the year ended December 31, 2012 the following changes took place in the number of options granted under the 2003 Plan:

Options	**Year ended December 31, 2012**	**Year ended December 31, 2011**
At the beginning of the period	36,489,064	40,771,814
Exercised	(15,354,814)	(4,282,750)
Resignation from Management Board	(7,344,250)	-
Forfeited/terminated	(13,800,000)	-
At the end of the period	**-**	**36,489,064**

The following changes in the number of options granted to members of the Management Board under Plan 2003 occurred during the year ended December 31, 2012:

	At the beginning of the period	Exercised	Resignation from Management Board	Expiry	At the end of the period
Mirosław Godlewski	12,200,000	(6,200,000)	-	(6,000,000)	-
Jonathan Eastick	9,571,814	(4,171,814)	-	(5,400,000)	-
Tom Ruhan	4,716,500	(2,316,500)	-	(2,400,000)	-
Mirosław Suszek	-	-	-	-	-
Grzegorz Esz	4,166,500	(2,666,500)	(1,500,000)	-	-
Piotr Nesterowicz	5,834,250	-	(5,834,250)	-	-
Total	**36,489,064**	**(23,966,937)**	**(7,334,250)**	**(13,800,000)**	**-**

New Plan (not in thousands)

On May 26, 2010, the Annual Shareholders Meeting resolved to adopt a set of rules, to be administered by the Company's Supervisory Board, for the issuing of up to 27,253,674 share options to the Management Board and employees of Netia Group, each option authorising its holder to receive up to half of one series L share for subscription price per share equal to the nominal value of the shares in the Company i. e. PLN 1, such subscription price to be paid by the Company or its subsidiaries. These share options vest after three years and vesting is also subject to performance conditions. The latest exercise date of these share options may be not later than May 26, 2020. In order to satisfy the claims arising from the exercise of the options under New Plan, the Shareholders Meeting resolved to authorize the issuance of up to 13,626,837 series L shares.

Between the adoption of the New Plan and December 31, 2012 the Supervisory Board granted 4,450,000 options to members of the Management Board under 2011 Plan. From the total number of options granted 2,402,351 options were outstanding as of December 31, 2012. As at December 31, 2012, the weighted average remaining contractual life of the outstanding options was 7.5 years. The outstanding options are exercisable until May 26, 2020. Upon exercise of the options, Netia will issue to each exercising participant the number of shares representing such participant's gain resulting from the exercise of the options, being the difference between the market price of the Company's shares as of the date of exercise of the options and strike price of the options and limited to half of one series L share for one options exercised. Accordingly the participant will not be required to pay the strike price, depending on the agreement, ranging between f PLN 5.23 and PLN 6.16.

Options	**New Plan Year ended December 31, 2012**
At the beginning of the period	1,725,000
Granted	1,725,000
Exercised	-
Resignation from Management Board	(575,000)
Forfeited/terminated	(472,649)
At the end of the period	**2,402,351**

For 2012 the Supervisory Board set performance goals based on the following key performance indicators:

- Revenue
- Adjusted EBITDA
- Operating Free Cash Flow
- Broadband and Television subscriber bases

As at the date of this Directors' Report the supervisory Board was yet to meet to decide on the proportion of 2012 granted options to be retained until vesting by the Management Board members.

In 2011, the Supervisory Board had set performance goals based on the following key performance indicators:

- Revenue
- Adjusted EBITDA
- Operating Free Cash Flow
- Broadband subscriber base

The Supervisory Board assessed Management's performance at 58.9% and 472,649 options granted to Management Board members were cancelled accordingly.

The following changes in the number of options granted to members of the Management Board under New Plan occurred during the year ended December 31, 2012:

	At the beginning of the period	Grant	Resignation from Management Board	Cancelled	At the end of the period
Mirosław Godlewski	575,000	690,000	-	(236,325)	1,028,675
Jonathan Eastick	287,500	345,000	-	(118,162)	514,338
Tom Ruhan	287,500	345,000	-	(118,162)	514,338
Mirosław Suszek	-	345,000	-	-	345,000
Grzegorz Esz	287,500	-	(287,500)	-	-
Piotr Nesterowicz	287,500	-	(287,500)	-	-
Total	**1,725,000**	**1,725,000**	**(575,000)**	**(472,649)**	**2,402,351**

There were no other changes in the number of options granted to members of the Management Board as at the date of filing this report.

The Company recognizes the cost of share-based awards to employees (including share options and RSU) over the vesting period. Due to the above the cost of options granted to the members of the Management Board recorded in the year ended December 31, 2012 and 2011, is as follows:

	Year ended December 31, 2012	**Year ended December 31, 2011**
	PLN	PLN
Mirosław Godlewski	360	151
Jonathan Eastick	180	75
Tom Ruhan	180	75
Grzegorz Esz	90	880
Piotr Nesterowicz	-	134
Mirosław Suszek	95	-
	905	**1,315**

Participation Units in the Change of Control Transaction Bonus Scheme (not in thousands)

On April 25, 2012, the Supervisory Board approved a new bonus plan known as the Change of Control Transaction Bonus (CoCTB) for the Company's Management Board Members. The CoCTB is a cash settled share based bonus scheme under which up to 11,400,000 Participation Units (PUs) may be issued to Management Board Members. Each PU has a strike price of 7,00 zloty per share and a term of 36 months commencing on December 31, 2012. The strike price adjusts upward over time by one percent per month from 31 January 2013 and is reduced by any dividends paid out by the Company ("the Adjusted Strike Price"). In the event that an investor or consortium of investors holds at least 90 % of Netia's equity on or prior to December 31, 2015 ("Trigger Event"), each PU shall be worth the positive difference between the acquisition price paid in a successful tender offering that secures the 90 % share-holding and the Adjusted Strike Price. For the purpose of calculating the value of the PU, the acquisition price is capped at 10 zloty per share. Should a Trigger Event occur after December 31, 2012 and prior to the expiration of the PUs on December 31, 2015, the Company shall pay the cash equivalent of the value of the PUs to each participating Management Board Member who was fulfilling his duties as at December 31, 2012 and has not resigned from his position prior to such Trigger Event. See also Note 40 in consolidated financial statements.

(All amounts in thousands, except as otherwise stated)

As at December 31, 2012, the members of the Management Board held Participation Units in the Change of Control Transaction Bonus Scheme as follows:

	Number of Participation Units
Mirosław Godlewski	3,800,000
Jonathan Eastick	1,900,000
Tom Ruhan	1,900,000
Mirosław Suszek	1,900,000
Total	9,500,000

A further 1,900,000 Participation Units may be assigned by the Supervisory Board.

The members of the Supervisory Board did not hold any options as at December 31, 2012 and as at the date of filing this report.

The Company's Extraordinary General Shareholders Meeting held on July 26, 2010 approved changes of the rules of remunerating the Supervisory Board members dated April 9, 2009. The change of the rules was effective from the day the resolution was adopted.

Due to the changes of rules of remunerating the Supervisory Board Members approved by the Extraordinary General Shareholders Meeting on July 26, 2010, each independent Supervisory Board Member shall receive an annual grant of 15,000 Restricted Stock Units ("RSU"). The first annual RSU grant was made on July 27, 2010 and subsequent grants will occur on the same date in the following years. One third of each grant vests 12, 24 and 36 months after the grant date. One RSU corresponds to one ordinary share in the Company having a value equal to the market price of the Company's shares.

Changes in the number of RSU held by members of the Company's Supervisory Board are presented below:

	December 31, 2011	RSU granted	RSUs exercised	December 31, 2012
Stan Abbeloos	80,000	15,000	(15,000)	80,000
Benjamin Duster	80,000	15,000	(15,000)	80,000
Raimondo Eggink	80,000	15,000	-	95,000
George Karaplis	80,000	15,000	(15,000)	80,000
Nicolas Maguin	80,000	15,000	-	95,000
Ewa Pawluczuk	80,000	15,000	-	95,000
Jerome de Vitry	80,000	15,000	-	95,000
Tadeusz Radzimiński	80,000	15,000	-	95,000
Total RSU	**640,000**	**120,000**	**(45,000)**	**715,000**

The cost of RSU recorded in year ended December 31, 2012 amounted to PLN 411 as compared to PLN 1,217 in 2011:

	Year ended December 31, 2012	**Year ended December 31, 2011**
Stan Abbeloos	62	153
Benjamin Duster	60	153
Raimondo Eggink	34	153
George Karaplis	61	153
Nicolas Maguin	34	153
Ewa Pawluczuk	34	153
Jerome de Vitry	34	153
Tadeusz Radzimiński	92	146
Total cost of RSU	**411**	**1,217**

Upon exercise of the RSU in the year ended December 31,2012, Supervisory Board members received following cash payments:

	Number of RSU exercised	**Remuneration received**
Stan Abbeloos	15	92
Benjamin Duster	15	90
Raimondo Eggink	-	-
George Karaplis	15	90
Nicolas Maguin	-	-
Ewa Pawluczuk	-	-
Jerome de Vitry	-	-
Tadeusz Radzimiński	-	-
Total cost of RSU	**45**	**272**

4.6 Shares held by members of the Management Board and Supervisory Board of the Netia Group

Number of shares held by members of the Management Board (not in thousands)

As at December 31, 2012 and December 31, 2011, the Company's President of the Management Board, Mr. Mirosław Godlewski, together with a company closely related to Mr. Godlewski, held 605,000 and 393,716 Netia shares respectively. During the year ended December 31, 2012, the company closely related to Mr. Godlewski, acquired 1,600,000 shares in Netia S.A. from Mr. Godlewski and subsequently disposed of 1,005,000 shares in Netia. Additionally, Mr. Godlewski directly disposed of 173,131 shares in Netia.

As at December 31, 2012 and December 31, 2011, Mr. Jonathan Eastick – a member of the Company's Management Board – held 450,000 and 499,175 shares of the Company, respectively.

As at December 31, 2012 and December 31, 2011, Mr. Tom Ruhan – a member of the Company's Management Board – and the company closely related to Mr. Tom Ruhan held 555,575 and 592,379 shares of the Company, respectively. During the year ended December 31, 2012, a company closely related to Mr. Ruhan acquired 1,057,011 shares in Netia S.A. from Mr. Ruhan and subsequently disposed of 501,436 shares in Netia S.A. Accordingly, the company closely related to Mr. Ruhan held 555,575 shares in Netia S.A. as at December 31, 2012.

Details of the changes in the number of shares held by members of the Company's Management Board during the year ended December 31, 2012 are presented below:

	December 31, 2011	Received from exercise of options	Reductions in shareholdings	December 31, 2012
Mirosław Godlewski, (including closely related company holdings)	393,716	1,389,415	(1,178,131)	605,000
Jonathan Eastick	499,175	572,188	(621,363)	450,000
Tom Ruhan, (including closely related company holdings)	592,379	464,632	(501,436)	555,575
Mirosław Suszek	-	-	-	-
Total	**1,485,270**	**2,426,235**	**(2,300,930)**	**1,610,575**

Number of shares held by members of the Supervisory Board (not in thousands)

As at December 31, 2012 and December 31, 2011, Mr. Benjamin Duster – Chairman of the Company's Supervisory Board – held nil and 21,000 shares of the Company, respectively.

As at December 31, 2012 and December 31, 2011, Mr. George Karaplis – Vice-Chairman of the Company's Supervisory Board – held nil and 20,000 shares of the Company, respectively.

As at December 31, 2012 and December 31, 2011, Mr. Raimondo Eggink – a member of the Company's Supervisory Board – held 40,000 shares of the Company.

As at December 31, 2012 and December 31, 2011, Mr. Nicolas Maguin, – a member of the Company's Supervisory Board – held 21,300 shares of the Company.

As at December 31, 2012 and December 31, 2011, Mr. Tadeusz Radzimiński – a member of the Company's Supervisory Board – held 20,001 shares of the Company.

As at December 31, 2012 and December 31, 2011, Mr. Jerome de Vitry – a member of the Company's Supervisory Board – held 20,000 shares of the Company.

As at December 31, 2012 and December 31, 2011, Mr. Stan Abbeloos– a member of the Company's Supervisory Board – held nil shares of the Company.

4.7 Agreements concluded by the Company and the members of the Management Board, providing for compensation in the event of their resigning or being dismissed from their positions without a sound reason or when they are dismissed or made redundant due to the Company's merging through acquisition

Under a labour contract the Supervisory Board of Netia granted one member of the Management Board compensation should that person be dismissed from his position without a justified reason. Should that member of the Management Board be dismissed, Netia will be required to pay a one-off severance payment stipulated in the employment agreement, being the equivalent of the three times the monthly salary in the amount of PLN 300, as at December 31, 2012.

Furthermore, an employment contract of another member of the Management Board shall not be terminated without the Supervisory Board's recommendation in the form of resolution. Otherwise the Company will be required to pay a one-off severance payment being the equivalent of the six times the monthly salary in the amount of PLN 377, as at December 31, 2012.

Upon a decision of the Supervisory Board, one of the members of the Management Board who resigns from his position and/or terminates employment and indicates a particular conflict of interest, shall be entitled to receive the severance payment equal to the aggregate amount of monetary compensation due in connection with performance of his duties as the member of the Management Board for the period of one calendar year immediately preceding the year in which the resignation from his position or termination of employment occurred.

Under a labour contract the Supervisory Board of Netia granted one member of the Management Board compensation should that person be dismissed from his position within 12 months from the beginning of his employment in case of a change of control over the Company. Should that member of the Management Board be dismissed in such circumstances, Netia will be required to pay a one-off severance payment stipulated in the employment agreement, being the equivalent of the twelve times the monthly salary. As at December 31, 2012, the severance payment would be PLN 720.

4.8 Changes in the basic management principles of the Netia Group

Changes in the Management Board and Supervisory Board

Changes in the Management Board and Supervisory Board were discussed in point 4.2 above.

Legal and organizational changes

In December 2011 Netia acquired 100% stakes in Dialog Group and Crowley (currently merged into Netia). Management immediately began integrating the Dialog Group and Crowley into the Old Netia organization to build a new operational business that we refer to as New Netia.

New Netia designed a single functional organization during early 2012 and the target management structure was completed in April 2012 with the finalisation of the appointments of 'N-3' managers following the earlier appointment of more senior positions. In April 2012 Netia management announced layoffs across the New Netia Group totaling 519 employees and an intent to propose changes to the employment contracts of a further 129 employees. The reductions were implemented in two waves and were completed by December 31, 2012 with 515 actual redundancies being implemented. As a result of these redundancies, outsourcing and voluntary leaves, the Netia Group's active employment level fell from 2,787 on December 31, 2011 to 2,013 employers on December 31, 2012.

The responsibilities for servicing Dialog and Crowley's customer bases was fully integrated into the Netia Group's four customer segment organization structure during the course of 2012. An exception is Petrotel, a subsidiary of Dialog, which continuous to operate as a stand-alone organization.

On August 14, 2012, Netia together with its subsidiaries signed a four-year managed services contract with Ericsson replacing the existing managed services contract signed on August 12, 2010. The contract covers the maintenance and management of the Netia Group's networks, as well as supporting the provision of services to Netia Group's residential and business customers. Whilst similar in scope to the previous agreement, the new agreement covers managed services for the Dialog and Crowley networks and, in addition, modifies certain pricing and operational parameters (KPIs) concerning the provision of services by Ericsson to the Netia Group. In accordance with the agreement, 188 of the Netia Group's employees (additional to the 519 redundancies planned for FY 2012) were transferred to Ericsson on the basis of art. 231 of the Labour Code. The cooperation with Ericsson is expected to influence the reduction of maintenance and employment costs, bring more effective and integrated fault handling and uniform management of Netia Group's networks and its service delivery.

As part of the integration process, on August 31, 2012 the Netia Group completed a legal merger between the parent company Netia SA and its subsidiary Crowley. As a result of the merger, Crowley's employees became Netia employees and Netia entered into all rights and obligations arising from contracts with Crowley customers. Moreover, on July 31, 2012 Dialog completed a legal merger with its subsidiary Avista Media Sp. z o.o., which was handling Dialog's customer care operations. Due to the strong brand awareness in the localized target market in the area of the city of Płock, Netia decided to keep Petrotel Sp. z o.o., the second subsidiary of Dialog, as a separate organization and legal entity.

This comprehensive integration project which is expected to create a larger, more efficient and more competitive New Netia is progressing smoothly and Management is confident that its upwardly revised synergy targets of PLN 130,000 in annualized synergies, will be achieved once the final projects, mainly related to IT platform migrations, have been completed in H2 2013.

5 Major Shareholders and share capital

5.1 Shareholders holding more than 5% of the votes at the General Shareholders' Meeting of Netia (not in thousands)

Based on the most recent information presented to the Company by its shareholders, as at the date of filing this report, significant blocks of the Company's shares were held by the following entities (the ownership interest and the number of votes are calculated on the basis of the number of shares constituting the Company's share capital as at February 20, 2012):

Third Avenue Management LLC

On May 4, 2012 Third Avenue Management LLC informed the Company that Third Avenue Management LLC had decreased its holdings of the Company's shares from 69,988,577 held on December 9, 2011 constituting 18.12% of the Company's share capital and carrying 18.12% of the total number of votes at the General Shareholders' Meeting of the Company to 61,168,227 constituting 15.84% of the Company's share capital and carrying 15.84% of the total number of votes at the General Shareholders' Meeting of the Company.

On November 21, 2012 Third Avenue Management LLC informed the Company that Third Avenue Management LLC had increased its holdings of the Company's shares from 61,168,227 held on May 4, 2012 constituting 15.84% of the Company's share capital and carrying 18.12% of the total number of votes at the General Shareholders' Meeting of the Company to 69,013,736 constituting 17.87% of the Company's share capital and carrying 17.87% of the total number of votes at the General Shareholders' Meeting of the Company.

ING Otwarty Fundusz Emerytalny and ING Dobrowolny Fundusz Emerytalny

On February 20, 2013 ING Otwarty Fundusz Emerytalny and ING Dobrowolny Fundusz Emerytalny informed the ING Otwarty Fundusz Emerytalny and ING Dobrowolny Fundusz Emerytalny had increased their holdings of the Company's shares from 48,010,027 held by ING Otwarty Fundusz Emerytalny on December 31, 2011 and constituting 12.43% of the Company's share capital and carrying 12.43% of the total number of votes at the General Shareholders' Meeting of the Company to 57,858,758 constituting 14.98% of the Company's share capital and carrying 14.98% of the total number of votes at the General Shareholders' Meeting of the Company.

Subsidiaries of SISU Capital Fund Limited

Subsidiaries of SISU Capital Fund Limited held a total of 44,336,534 of the Company's shares constituting 11.48% of the Company's share capital and representing 11.48% of the total number of votes at the General Shareholders' Meeting. The Company has received no information concerning changes in the number of shares held by Subsidiaries of SISU Capital Fund Limited since February 25, 2011.

Aviva Otwarty Fundusz Emerytalny Aviva BZ WBK

On May 22, 2012 Aviva Otwarty Fundusz Emerytalny Aviva BZ WBK informed the Company that Aviva Otwarty Fundusz Emerytalny Aviva BZ WBK had increased its holdings of the Company's shares from 19,050,023 held on May 17, 2012 constituting 4.93% of the Company's share capital and carrying 4.93 % of the total number of votes at the General Shareholders' Meeting of the Company to 20,243,646 constituting 5.24% of the Company's share capital and carrying 5.24% of the total number of votes at the General Shareholders' Meeting of the Company.

5.2 Share capital (not in thousands)

At December 31, 2011, the Company's share capital consisted of 391,601,064 ordinary shares and 1,000 series A1 shares with a par value of PLN 1 per share. Each ordinary share has one vote at the shareholders' meeting. The holder of 1,000 series A1 shares has the right to nominate one member of the Supervisory Board. The majority of votes of the Supervisory Board elect the Management Board.

In 2012 the Company issued 4,453,840 ordinary series K shares due to three current and three former Management Board members, twelve persons who hold managerial positions and two former managers (none of whom are or were management board members) exercising their rights arising from the key employee share option plan adopted by Netia's Supervisory Board in 2003 (the "2003 Plan").

At December 31, 2011, Netia held 9,775,000 own treasury shares. On December 15, 2011 the Extraordinary General Meeting of the Company resolved to redeem these treasury shares. The redemption was effective from January 30, 2012, when the decrease of the Company's share capital was registered in in the National Court Registry. The redemption of shares in January 2012 resulted in a decrease of share capital by PLN 9,775,000 and a decrease in other supplementary capital by PLN 49,582,145, from which PLN 9,775,000 was transferred to the separate reserve capital of the Company established in accordance with Article 457, §2 of the Commercial Companies Code.

As a result at December 31, 2012, the Company's share capital consisted of 386,279,904 ordinary shares and 1,000 series A1 shares with a par value of PLN 1 per share. Each share had one vote at shareholders' meetings. All shares issued by the Company were fully paid and registered in the National Court Registry by the date of signing these consolidated financial statements.

Netia held 18,935,188 own treasury shares as at December 31, 2012.

The 5,115,579 series K shares issued prior to Netia's General Meeting of Shareholders held on May 26, 2010, were redesignated in accordance with a resolution adopted by Netia's General Meeting of Shareholders, as series B shares. Following this change of the Company's Statute in 2010 up to 13,258,206 series K shares could have been issued. The total number of series K shares issued through December 31, 2012 was 6,717,551 and their nominal value was PLN 6,717,551.

5.3 Agreements which could lead to changes in shareholding proportions in the future (not in thousands)

On the basis of the Plan 2011, the Company may issue up to 27,253,674 share options to the Management Board and employees of Netia. Each option enables the New Plan participant to receive, free of charge, up to ½ of a subscription warrant issued by the Company with the latest possible exercise date of May 26, 2020. Each warrant entitles its holder to subscribe for one series L share for the nominal value e. i PLN 1 zł, which shall be paid by the Company or its subsidiaries. In order to satisfy the claims arising from the exercise of the options under New Plan, the Shareholders Meeting resolved to authorize the issuance of up to 13,626,837 series L shares.

5.4 Holders of all securities which grant special control rights in relation to the Company

Mr. Andrzej Radzimiński holds 1,000 (not in thousands) series A1 shares which give him the right to appoint and dismiss a member of the Supervisory Board.

5.5 Limitations on the transfer of ownership rights to the Issuer's securities and limitations on exercising the voting rights carried by the Issuer's shares

Netia's corporate documents do not contain any limitations, which significantly limit changes in the control of the Issuer as a result of third parties' purchasing substantial amounts of shares.

Each Netia share carries one vote at the GSM. There are no limitations on exercising the voting rights from the Company's shares.

Mr. Andrzej Radzimiński holds 1,000 (not in thousands) series A1 shares which give him the right to appoint and dismiss a member of the Supervisory Board.

5.6 Dividends, share buybacks and distribution policy

Dividends

No dividends have been proposed or paid in respect to the financial year ended December 31, 2011 and no proposal has been made by the Management for the year ended December 31, 2012 as at the date of these financial statements.

Share buy-backs

In accordance with the approved distribution policy, the Management Board proposed and the shareholders granted (by approval of resolution 18 at the annual General Shareholders' Meeting held on June 2, 2011) an authorisation to the Company's Management Board to purchase its own shares for the purpose of their redemption pursuant to the procedure set forth in in Art. 362 § 1 point 5 of the Commercial Companies Code (the "General Program"). The Annual General Meeting of the Company assigned the total amount of up to PLN 350,000 for the execution of the General Program, out of which the amount of up to PLN 267,032 shall be utilized from the supplementary capital created out of profits for the year 2010 and the amount of up to PLN 82,968 shall be utilized from the supplementary capitals created out of profits in the previous years. Any specific buy-back proposal within the scope of the General Program must be accepted by the Supervisory Board prior to the implementation.

The first tranche of share buy-backs approved under the General Program began on August 17, 2011. The Company allocated an amount of up to PLN 60,000 for the tranche to repurchase a maximum of 2.5% of the Company's outstanding share capital. On November 9, 2011 the Company completed the repurchase of 9,775,000 (not in thousands) own shares constituting 2.5% of the Company share capital for a total of PLN 49,582 and the tranche was completed. The repurchased shares were redeemed on January 30, 2012.

Netia obtained the relevant consent from its Supervisory Board and on May 18, 2012 commenced a further tranche of buy-backs. The Company allocated an amount of up to PLN 75,000 for the tranche to repurchase a maximum of 3.5% of the Company's outstanding share capital. On October 11, 2012 the Company completed the repurchase of 12,700,477 (not in thousands) shares constituting 3.29% of Company share capital for a total of PLN 75,000 plus transaction costs of PLN 103.

Netia obtained a third relevant consent from its Supervisory Board on June 19, 2012 and the Company commenced a third tranche of buy-backs on October 12, 2012. The Company has allocated an amount of up to PLN 50,000 for the third tranche to repurchase a maximum of 2.5% of the Company's outstanding share capital. As of December 31, 2012 the Company had repurchased 6,234,711 (not in thousands) own shares constituting 1.61% of Company share capital for a total of PLN 31,698 plus transaction costs of PLN 13.

On January 23, 2013 the Company completed the third tranche of buy-bucks, under which the Company had repurchased 9,657,023 (not in thousands) shares constituting 2.5% of Company share capital for a total of PLN 47,579 plus transaction costs of PLN 20. As a result of these and earlier share buy-backs, Netia holds 22,357,500 (not in thousands) treasury shares from a total outstanding share capital of 386,280,904 (not in thousands) shares as at the date this report.

Distribution policy

Whilst the Netia Group is cash generative, high depreciation charges in the near term and the on-going possibility of impairment charges from annual impairment tests make net earnings of the Company relatively volatile. In these circumstances, the Management Board's intention is to make distributions to the shareholders as regularly as legally possible.

For 2013 Management Board intends to propose to the Supervisory Board that approximately PLN 128,000 (approximately PLN 0.35 per share equivalent, not in thousand) be returned to the shareholders through the buy-back of the remaining 4.2% of the Company's share capital authorized under a shareholders' buyback resolution taken in 2011. Subject to the approval of the Supervisory Board, the buy-back would be conducted through an offer for the purchase by Netia of its shares directed to all the shareholders of the Company at a significant premium to the current market price.

Depending on the evolution of distributable reserves in Netia, which stand at PLN 481,636 and represent the key constraint on future distributions, Management may use dividends or offers to purchase shares directed to all shareholders or capital redemptions to facilitate payments these funds to shareholders. Based on its free cash flow projections, Management estimates that the Company may distribute up to PLN 145,000, approximately PLN 0.40 per share (not in thousands), from 2014 onwards with some scope to moderately increase payments over time.

With due regard to continuing acquisition opportunities and given the ambitious targets to stabilise the Residential segment during 2013, Management intends to keep leverage below 1,0x Adjusted EBITDA in the medium term to maintain flexibility.

The form of the distribution to be made in 2013 is under consultation. Management's recommendation of this distribution policy is subject to Supervisory Board's approval and shareholders voting where applicable.

6 Other information

6.1 Transactions with related parties

Intercompany purchase of fixed assets

In second quarter of 2012 the Company acquired passive telecommunications network elements from its Dialog subsidiary as part of the on-going integration of Dialog into the Netia Group. Proceeds from CC series bonds issuance were used to pay for telecommunications networks elements acquired from Dialog. These network elements will be managed jointly with Netia's existing network to reduce operating costs in the future. Dialog will continue to utilise the telecommunications network elements to service its clients via a long-term agreement put in place between Netia and Dialog.

Bonds issued

On June 1, 2012 Dialog purchased 6 CC series registered bonds issued by Netia, each of a nominal value of PLN 50.000 and of a total nominal value of PLN 300.000 and with maturity date falling on May 31, 2017.

On September 14, 2012 Netia Brand Management Sp. z o.o. purchased 3 DD series registered bonds issued by Netia, each of a nominal value of PLN 5.000 and of a total nominal value of PLN 15.000 and with maturity date falling on August 31, 2017.

On February 15, 2013 Netia Brand Management Sp. z o.o. purchased 3 EE series registered bonds issued by Netia, each of a nominal value of PLN 5.000 and of a total nominal value of PLN 15.000 and with maturity date falling on January 31, 2018.

Other transactions with related parties

The following transactions were concluded between the Company and its subsidiaries during 2012:

- sale and purchase of telecommunications services;
- sale and purchase of other services (rental and book-keeping services) to subsidiaries;
- sale and purchase of fixed and intangible assets.

A detailed list of transactions with subsidiaries has been presented in the Company's financial statements (Note 36).

Other transactions with subsidiaries have been described in points 3.6 "Loans, warranties and collaterals granted" and 6.1 "Remuneration paid and payable to the members of the Management Board and the Supervisory Board in 2012".

6.2 Guidance, medium term an long term outlook (not in thousands)

On December 20, 2012 the Company published guidance for FY 2013 and updated the long-term strategic financial goals.

Netia maintains its FY 2013 guidance and long-term strategic financial goals as published originally on December 20, 2012.

(All amounts in thousands, except as otherwise stated)

Guidance for 2013:

Guidance 2013	
Number of services (RGUs) ('000)	2,650
Revenue (PLN m)	1,925
Adjusted EBITDA (PLN m)	525
Adjusted EBITDA margin (%)	27.3%
Adjusted EBIT (PLN m)	65
Capital investment (excl. M&A and integration capex) (PLN m)	225
Capital investment (excl. M&A and integration capex) to sales (%)	11.7%
Adjusted operating free cash flow (Adj. OpFCF) (PLN m)*	300

**Adjusted EBITDA less capital investments*

The above guidance excludes the impact of one-off integration costs and one-off integration capex, estimated at up to PLN 10.0m and up to PLN 35.0m, respectively.

Management no longer considers it financially attractive to pursue growth in overall service (RGU) numbers due to pricing pressure and lower margin in off-network RGUs and the continuing weakness in the fixed voice segment. Accordingly, Management is targeting 2013 as a year of transitioning to greater on-network sales focus and increased sales of on-net broadband and TV services. As a result, the goal of "Continued growth in the number of services (RGUs)" had been withdrawn from the long-term strategic financial goals.

Successful implementation of this revised commercial approach should stabilize financial performance of the Residential segment in 2014 and beyond. Given the on-going strong performance of the Business segments, long-term financial goals for Adjusted EBITDA, capex to sales ratio and Adjusted operating free cash flow (Adjusted OpFCF) remain viable and remained unchanged from the previously published goals.

The long-term strategic financial goals are as follows:

Long-term strategic financial goals (until 2020)
Services (RGUs) per subscriber to reach 2.0x
Continuously increasing value share
EBITDA margins in 27%-29% range throughout
Capex to sales ratio to stay below 15% during network upgrade (2012-2013) and falling to 10%-12% thereafter
OpFCF margin to sales continuously above 12%

6.3 Information on the registered audit company

The financial statements of Netia and the consolidated financial statements of the Netia Group for 2012 and 2011 were audited by Ernst & Young Audit Sp. z o.o. on the basis of a contract concluded on December 4, 2009.

The total fees specified in contracts with the registered audit company, payable or paid for the audit and review of the financial statements and for other services are presented below:

Item	**2012**	**2011**
Audit of stand-alone and consolidated financial statements	265	293
Review of stand-alone and consolidated financial statements	230	252
Audit of subsidiaries' financial statements	304	131
Other attest services	-	292
Total	**799**	**968**

6.4 Compliance with corporate governance rules

The Management Board of the Company represents that in 2012 the Company in principle complied with the corporate governance rules stated in the document entitled "Code of Best Practice for WSE Listed Companies". As per the Company's declaration published in the current report dated February 28, 2008 since the "Code of Best Practice for WSE Listed Companies" became effective on January 1, 2008, the Management Board of the Company declares that it appreciates the importance of corporate governance rules provides in that document and the role played by those rules in enhancing the transparency of stock exchange listed companies, and it has exercised duly diligent efforts for those rules to be observed in Netia to the greatest extent possible. With reservation of the explanation presented in the annual report on compliance with corporate governance rules, according to the Management Board's best knowledge in 2012 none of the rules stated in the "Code of Best Practice for WSE Listed Companies" was breached by the Company. All rules were applied by the Company according to the wording presented in the above mentioned document.

The Management Board of the Company is responsible for the internal control system at the Company and for the effectiveness thereof in the process of preparing financial statements and interim reports which are made and published by the Company. Therefore the Netia Group has implemented controls to ensure that financial reporting is reliable. Those controls are tested and assessed on effectiveness by internal audit, finance department managers and external auditors.

The financial department headed by the Chief Financial Officer – Management Board member, is responsible for the preparation of the financial statements and interim reports of the Company.

The financial data which is the basis for the financial statements and interim reports are taken from the Company's monthly financial and management reporting. Once the accounts for each calendar month are closed the mid level and senior management at the financial department headed by the Chief Financial Officer – Management Board member jointly analyse the financial results of the Company as compared to the assumptions made in the budget. All identified errors are corrected in the Company's books without delay in accordance with the accounting policy adopted by the Company. The Company applies the rule of independent review of the published financial reports whether or not such review or audit is required by law.

The quarterly reports, interim statements and financial data which is the basis of the reports are reviewed by the Company auditor. The review applies in particular to the adequacy of financial data and the scope of the required disclosures. The results of the quarterly review or audit are presented by the auditor to the management of the Company financial department at summary meetings and to the Audit Committee. After the review or audit is completed, the financial statements and interim reports are delivered to the members of the Company's Audit Committee. Moreover, prior to the Management Board's approval of the interim financial statements for publication, the Chief Financial Officer – Management Board member presents the Audit Committee with important aspects of a quarterly/annual financial statement, particularly with changes in the accounting principles, if any, important revaluations or accounting opinions, material disclosures and business transactions. The interim financial statements are approved for publication after acceptance by the Audit Committee. Moreover, the auditors present the Audit Committee with information on any shortcomings of the control mechanisms which they established in the course of auditing the financial statements. Any recommendations made after a review of risk management procedures and internal control mechanisms are gradually implemented.

6.5 Subsequent events *(not in thousands)*

Release of a mortgage

In January 2013, one of the two capped mortgages relating to the Loan (see Note 3.5 Loans Agreements) was released by the Court. Moreover, due to the division of the other real estate into two plots and subsequent release of the mortgage on one of them, as at the date of these financial statements the loan is secured by one capped mortgage on the right of perpetual usufruct of part of the Company's real estate at ul. Poleczki 13.