DIRECTORS' REPORT
NETIA S.A. GROUP
for the year ended December 31, 2011

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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, 2011 include the financial statements of the Company and the following subsidiaries:

- Crowley Data Poland Sp. z o.o
- In2Loop Polska Sp. z o.o.in liquidation
- InterNetia Holdings Sp. z o.o. Group
- Net 2 Net Sp. z o.o. (previously operating under the name Netia Corpo Sp. z o.o.)
- Netia 2 Sp. z o.o.
- Netia Brand Management Sp. z o.o.
- Telefonia DIALOG S.A. 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 Saite Sp. z o.o, E-IMG Internet Intermedia Group Sp. z o.o., ZAX.EU Sp. z o.o., Silesia Multimedia Sp. z o.o., Netsystem Sp. z o.o., Sieci Multimedialne Intergeo Sp. z o.o., ComNet ITT Sp. z o.o.
- UNI-Net Poland Sp. z o.o.

The financial statements of the Telefonia DIALOG S.A. Group include the financial statements of Telefonia DIALOG S.A. and its subsidiaries:
- wholly-owned Avista Media Sp. z o.o. ,
- Petrotel Sp. z o.o. with 99,99% Telefonia DIALOG S.A. ownership

Changes within the Netia Group's structure

Mergers with subsidiaries

On January 31, 2011 Internetia Sp. z o.o. ("Internetia") merged with its wholly-owned subsidiary E-Tychy Sp. z o.o. ("E-Tychy"). 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 January 31, 2011 Global Connect Sp. z o.o. ("Global Connect") merged with its wholly-owned subsidiary SSI Net Sp. z o.o. ("SSI Net"). The merger was carried out through the transfer of the acquired company's assets to Global Connect (merger by acquisition) without any increase in Global Connect's share capital and without any share exchanges.

On May 31, 2011 Global Connect merged with its wholly-owned subsidiary Fornet Sp. z o.o. ("Fornet"). The merger was carried out through the transfer of the acquired company's assets to Global Connect (merger by acquisition) without any increase in Global Connect's share capital and without any share exchanges.

On November 30, 2011 Internetia Sp. z o.o. merged with its wholly-owned subsidiaries Global Connect Sp. z o.o., Multiplay Polska Sp. z o.o. ("Multiplay"), Igloonet Sp. z o.o. ("Igloonet"), Netpro Sp. z o.o. ("Netpro"), Pronet Sp. z o.o. ("Pronet").The merger was carried out through the transfer of the acquired companies assets to Internetia (merger by acquisition) without any increase in Internetia's share capital and without any share exchanges.

Acquisitions

Acquisition of Telefonia DIALOG S.A. from KGHM Miedź S.A.

On December 16, 2011 Netia acquired 19,598,000 shares (not in thousands) in Telefonia Dialog S.A., with its registered office in Wrocław ("Dialog"), with a nominal value of PLN 25 (not in thousand) each and the aggregate nominal value of PLN 489,950, which constitute 100% of the shares in the share capital of Dialog and represent 100% of the votes at the general meetings of Dialog. In consequence of the acquisition of the shares, Netia became an indirect owner of shares in two material subsidiaries of Dialog: Petrotel Sp. z o.o. ("Petrotel") and Avista Media Sp. z o.o. ("Avista").

The final price paid by the Company was PLN 968,927 and comprised Dialog's enterprise value of PLN 880,388 and cash and cash equivalents of PLN 88,539.

Dialog is a provider of fixed-line telephony and uses both its own and leased telecommunication networks, mainly in the region of the Lower Silesia voivodship, including fixed-line telephony, broadband internet access and television as well as mobile telephony and mobile internet access based on an MVNO agreement with a mobile network operator. Petrotel is a provider of fixed-line telephony mostly in the city of Płock and Avista is a customer service centre.

Acquisition of Crowley Data Poland Sp. z o.o. from Crowley Data, L.L.C. and Crowley Poland, L.L.C.

On December 14, 2011 Netia purchased from Crowley Data, LLC and Crowley Poland, LLC (the "Sellers") 197,862 shares (not in thousands) in Crowley Data Poland sp. z o.o., with its registered office in Warsaw ("Crowley"), constituting 100% of the shares in the share capital of Crowley and representing 100% of the votes at the meetings of the shareholders of Crowley (the "Shares").

The total purchase price for the enterprise was USD 30,797 and comprised the purchase of a shareholder loan advanced by the Sellers to Crowley with the balancing amount paid for 100 % of the shares. The purchase price for the Shares is subject to adjustment for the difference between the certain amounts stated in the balance sheet of Crowley as at 31 December 2010 and the respective amounts stated in the balance sheet of Crowley as at 30 November 2011.

On September 16, 2011, Netia executed a foreign exchange risk hedging transaction at the USD/PLN exchange rate of PLN 3.14 per USD 1.00 to mitigate the foreign currency risk associated with the acquisition.

A deposit in the amount of PLN 5,000 was paid directly after signing the share purchase agreement and this amount was treated as part of the purchase consideration. On December 14, 2011 the Company paid the outstanding (net of hedging gains) PLN 91,894 for all shares in Crowley (including purchase of the loan extended to the Crowley) and as of December 31, 2011 accrued for the purchase price adjustment of PLN 4,055. Consequently, Netia expects to close the transaction at a consideration of PLN 100,950 comprising the enterprise value of PLN 97,589 and net cash and cash equivalents of PLN 3,361.

Crowley renders such telecommunications services as data transmission, voice services and Internet access for business customers.

Acquisitions of Ethernet operators and other companies

On March 30, 2011, Internetia, the Company's subsidiary, concluded an agreement for the acquisition of 200 (not in thousands) shares in the share capital of Netpro Sp. z o.o. ("Netpro"), 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 Netpro shares has been set at PLN 600.

On June 28, 2011, Internetia concluded an agreement for the acquisition of 45,740 (not in thousands) shares in the share capital of Saite Sp. z o.o. ("Saite"), each with the nominal value of PLN 50 (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 Saite shares has been set at PLN 2,331.

On August 23, 2011, Internetia concluded an agreement for the acquisition of 1,000 (not in thousands) shares in the share capital of E-IMG Internet Intermedia Group Sp. z o.o. ("E-IMG Internet"), each with the nominal value of PLN 50 (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 E-IMG Internet shares has been set at PLN 2,764.

On September 30, 2011, Internetia concluded an agreement for the acquisition of 21,000 (not in thousands) shares in the share capital of ZAX.EU Sp. z o.o. ("ZAX.EU"), each with the nominal value of PLN 50 (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 ZAX.EU shares has been set at PLN 2,960.

On November 2, 2011, the Company purchased 100% of the share capital of Diecisiete Sp. z o.o. (currently Netia Brand Management Sp. z o.o.). The total price for all Diecisiete Sp. z o.o. shares has been set at PLN 8.

On November 18, 2011, Internetia concluded an agreement for the acquisition of 275 (not in thousands) shares in the share capital of Silesia Multimedia Sp. z o.o. ("Silesia"), 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 Silesia shares has been set at PLN 3,712.

On December 16, 2011, Internetia concluded an agreement for the acquisition of 100 (not in thousands) shares in the share capital of Netsystem Sp. z o.o. ("Netsystem"), 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 Netsystem shares has been set at PLN 2,890.

On December 21, 2011, Internetia concluded an agreement for the acquisition of 110 (not in thousands) shares in the share capital of Sieci Multimedialne Intergeo Sp. z o.o. ("Intergeo"), 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 Intergeo shares has been set at PLN 1,206.

On December 29, 2011, Internetia concluded an agreement for the acquisition of 433 (not in thousands) shares in the share capital of ComNet ITT Sp. z o.o. ("ComNet"), 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 ComNet shares has been set at PLN 6,707.

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 new opportunities arising from changes in the regulatory environment, the Company concluded a bitstream agreement with Telekomunikacja Polska S.A. ("TP SA") and commercially launched its broadband Internet access services over TP SA's network in January 2007. During the third quarter of 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 in turn has to pay 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 has begun to install its own equipment in the TP SA network nodes using a form of regulated access called Local Loop Unbundling (LLU) and has begun 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 34 such operators with a total of 124,887 (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 has been expanded to cover mobile broadband services as well as mobile handset based voice and data services.

In January 2011 the Company announced its strategy towards 2020 that includes, among other elements, plans to begin providing television and other content services over broadband connections and to invest in the upgrade of its existing copper and Ethernet networks to provide significantly higher broadband speeds. By the end of 2011 the Group had launched TV services and had upgraded 556,000 homes passed by its own telecommunication networks to New Generation standard (NGA) of broadband speeds.

In December 2011 Netia acquired Telefonia DIALOG S.A. with its subsidiaries Avista Media Sp. z o.o. and Petrotel Sp. z o.o. (the "Dialog Group") and Crowley Data Poland Sp. z o.o ("Crowley")., two other Polish alternative operators, which increased materially size of the Netia Group. Dialog and Petrotel provide a similar range of telecommunication services to Netia and serve business and residential customers. Crowley provides telecommunications services exclusively to business customers. Avista is a call center mainly providing outsourced customer services to the Dialog S.A.

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 (established in May 2009 through a corporate separation from UNI-Net).

The Netia Group's revenues in 2011 and 2010 are presented below:

	Year ended December 31, 2011	**Share in total revenues**	**Year ended December 31, 2010**	**Share in total revenues**
	(PLN)	%	(PLN)	%
Direct voice, including:	737,373	46%	741,717	47%
Monthly fees	*516,707*	*32%*	*485,186*	*31%*
Calling charges	*220,051*	*14%*	*256,261*	*16%*
Indirect voice	22,469	1%	37,359	2%
Data	604,188	37%	562,470	36%
Interconnection revenue	77,602	5%	68,394	4%
Wholesale services	124,375	8%	115,561	7%
Other telecommunication revenue	48,014	3%	38,933	2%
	1,614,021	**100%**	**1,564,434**	**100%**
Radio communication services	4,352	0%	4,862	0%
Other services	430	0%	-	-
	1,618,803	**100 %**	**1,569,296**	**100%**

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 6,0 million services at 2010 year end to 6,3 million services at the end of 2011. The penetration of fixed broadband reached 45% of households in 2011 and is expected to continue to grow. Fixed line telephony services decreased from approximately 9,4 million lines at the end of 2010 to 8,8 million at the end of 2011 and is continuing to shrink. The penetration of fixed line telephony in Poland was approximately 63% of households at the end of 2011. The pay TV market in Poland increased from 11 million services in 2010 to reach more than 11,5 million services in total in 2011, mainly dominated by cable and DTH offerings.

The fixed broadband market has the highest growth of all fixed telecommunication segments and this trend is expected to continue over the next few years. 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 - increased to 911,570 at December 31, 2011 from 690,247 a year earlier. The Netia Group estimates that its share of total broadband market subscribers has increased from 11,5% to 14,4% during the past twelve months. Furthermore, at December 31, 2011 the Netia Group had 1,744,723 fixed line telephony subscribers of which 656,212 were connected over own proprietary networks, while 962,322 were served over WLR access and 126,189 were served over LLU voice over IP. The Netia Group estimates that its share of total fixed voice telephony market has increased from 13,2% to 19,9% during the past twelve months, including acquisitions.

The Netia Group has its own access networks built out in areas covering approximately 15% of households in Poland. At the end of 2011, Netia served 396,853 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, 2011 the Netia Group had approximately 786 thousand homes passed on NGA networks including Telefonia Dialog (PON, FTTB, VDSL). On top, the Netia Group had circa 476 thousand IPTV ready homes passed where it can render 3play services.

As of December 31, 2011, Ethernet networks acquired by the Netia Group since mid-2007 provided broadband access to a total of 132,532 mostly residential customers as compared to 115,194 customers at December 31, 2010, with approximately 603 thousand homes passed in total. During 2011 the Netia Group acquired the total of nine Ethernet networks (including both purchases of companies and asset transfers) with 22,823 active customers and around 104 thousand homes passed. The Netia Group remains fully dedicated to consolidation of the fragmented Polish Ethernet ISP market.

At the end of 2011 the Netia Group rendered telecommunications services based on WiMAX technology using 100 active base stations, which were available in 181 cities and towns. The number of WiMAX broadband Internet ports reached 19,130 at December 31, 2011 (up from 18,974 at the end of 2010). Using WiMAX radio base station infrastructure, the Group intends to spread its activities to additional cities and suburbs offering a full scope of telecommunications services (telephony services, Internet access and data transmission).

In 2011 Netia continued to extend the reach of its LLU-based services. Netia had over 700 unbundled nodes at December 31, 2011, reaching approximately 4,9 million active customer lines. Netia served 184,229 customers over LLU as at December 31, 2011 as compared to 126,895 at December 31, 2010. The total LLU subscriber base includes 106,968 gross customers migrated from lower margin bit-stream ("BSA") services. At the end of 2011, Netia served an average of 261 fixed broadband customers per LLU node as compared to 248 fixed broadband customers per LLU node at the end of 2010.

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 almost 40% in terms of pro-forma revenues and more than 50% in terms of total services. Moreover, with an ambitious amount of synergies to be extracted from integrating the operations, the Netia Group anticipates further growth in operational and net profitability together with capital expenditure optimization and thus a progressive free cash flow increase in upcoming years.

Operationally, our key objective remains to further strengthen our leadership position among alternative telecom operators in the Polish fixed line market. The Netia Group plans to continue strengthening market shares in fixed broadband and telephony market segments further until 2020. This will be driven predominantly by Local Loop Unbundling ("LLU"), wholesale Bit Stream Access ("BSA") and Netia's own access networks including NGA upgrades on own copper network (VDSL) and Ethernet networks. Thanks to the ongoing infrastructure upgrade the Netia Group already today offers to its customers a competitive Internet Protocol Television("IPTV") product together with Digital Terrestrial Television ("DTT") and Video on Demand ("VOD") to complement the offering grid. 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. Our priority in this area is to strongly increase our customer base penetration with multi-play services including IPTV 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.

Additionally, after having unbundled over 700 nodes country-wide the customer base in LLU coverage amounts to almost 5 million homes passed which can take 2play services and potentially 3play offer subject to LLU-based NGA upgrade, feasibility of which is being analysed. We will also continue to win new retail clients outside our own access and LLU networks based on wholesale access to the incumbent's network in Wholesale Line Rental ("WLR") and BSA regimes. 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.

Our aspiration is to comprehensively meet our customers' communications needs. To achieve that, we have been offering mobile voice services to our business segment customers, both as an extension to existing product bundles and as stand-alone mobile services. In 2009 we also launched mobile broadband services offered to both residential and business customers. Both of these mobile services have been provided in partnership with mobile network operator P4. Having acquired Telefonia Dialog and Crowley Data Poland, we complemented our options in the field of MVNO agreements for mobile voice with Polkomtel and Orange which could potentially serve to enrich our offer to business and residential clients in future.

The next element of our strategy is related to maintaining as well as building up whenever possible our position in the corporate and carrier 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 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 September 2008 we finalized the acquisition of Tele2 Polska, which significantly enhanced the scale of our operations and also increased the potential for up-selling of broadband, value-added services and content to Tele2 Polska customer base. We completed the integration activities in the third quarter of 2009, which allows us to capture 46 million PLN in annual synergies from 2010 onwards, far above our original expectations. In December 2011 we finalized the acquisitions of Telefonia Dialog and Crowley Data Poland, both of which should generate significant amount of contemplated synergies, estimated at PLN 106m of annual positive impact on our profitability. Going forward, we may consider further acquisitions. In particular we seek to continue the acquisitions of local Ethernet-based networks and to participate in further consolidation among altnets if opportunities arise. In 2009 we also completed a cost reduction and efficiency improvement program known as Project "Profit" which in 2010 delivered 140 million PLN of operational savings, which helped us to achieve the targeted Adjusted EBITDA margin of 23% by 2010. In 2011 we were able to boost our profitability to 25% EBITDA margin with a target for 2012 of 27.5% to be increased further into future thanks to aforementioned synergies.

A critical enabler for successful accomplishment of Netia's growth plans is an organizational culture characterized by focus on customer needs, entrepreneurship and efficiency. 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.

Network Infrastructure (not in thousands)

Deregulation of telecommunication market results in dynamic development of Netia network both in terms of backbone network capacity and coverage of access networks based on TP SA infrastructure. In parallel to geographical expansion of access networks, our backbone network is expanded in new areas based on leased fibre optic infrastructure from other vendors. Delivery of broadband access to the customers 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. In parallel to BSA extension, construction of LLU access nodes in the TP SA network has beenunder intensive development. At December 31, 2011, 707 LLU nodes had been deployed. This LLU network give us access to almost 5.0 million TP access lines Poland–wide. Implementation of modern ADSL 2+/VDSL technologies in LLU nodes may enable delivery of advanced services requiring broadband access (i.e IPTV, VoD, VoiP, MPLS). Netia intends to run tests of such services during the first part of 2012.

Development of Netia's own broadband access based on copper infrastructure is focused on implementation of Next Generation Access Network based on VDSL technologies increasing bandwidth delivered to the customer up to 80Mb/s. Acquisition of Ethernet networks is followed by the upgrade 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 build in fiber to the building technology will be able to deliver up to 100Mb/s capacity to each customer. Netia will continue plan of modernization of acquired Dialog Network to VDSL and FTTH standard. Based on modernized access Network Netia develops systems enabling delivery of IP based Multimedia services such as IPTV, VoD, CDN, etc. Essential part of our network development is concentrated on delivery of CPE dedicated to Netia customers.

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 50MB and higher (Next Generation Access "NGA"). Additionally, in December 2011 Netia acquired two sizeable telecom assets - Telefonia Dialog and Crowley Data Poland - both of which increased the scale of operations of the Netia Group significantly. Therefore Strategy 2020 may be subject to certain revisions or redirection by the Netia Group including the impact of these acquisitions. In particular, the newly announced financial guidance for 2012 and long term financial goals include the planned capital expenditures with respect to NGA project, envisaged mainly in the 2012 - 2013 period and a range of financial KPIs of the Company's future potential performance. No assurance can be given as to whether strategic initiatives included in Netia's strategy 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.

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 estimated potential annual synergies from these acquisitions at the level of PLN 106.000 and expects that all projects necessary to deliver such synergies can be completed within two years from the respective dates of acquisition. The synergy estimate is tentative and based on high level information provided by the sellers during due diligence and no assurance can be given that it is accurate in the amount or timing. Management is in the course of preparing its detailed integration planning and, based on the results of this work, may revise synergy estimates. 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 business of significant scale relative to the buyer, the acquisition of Dialog S.A. is associated with certain risk specific to this integration:

- Full integration will require migration of either Netia or Dialog billing and customer relationship management systems onto the other operator's platform. This process is likely to take at least one year 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 must be selected for implementation during 2013 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 PON networks over the last two 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, 2011 most reimbursements are still to be recovered and 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.

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 fixed-line telephony, wireless transmission and voice services based on Internet or cable television telephony. 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 third/fourth generation mobile cellular telephone systems equipped with IP. Due to the difficulties in predicting future technological developments, market potential and regulatory environment, Netia may sometimes invest in technologies that ultimately do not deliver the expected returns. When such a situation occurs, it can have a significant 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. That may result in Netia incurring significant costs to protect its rights or move its infrastructure. Similarly, the leases me 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.

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 or incurred 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. sustainable competition as well as the assurance of maximum benefits for end users. The fees shall be established in a separate decision.

Despite the fact that the amount of fees for telecommunications access to the network of TP SA that Netia currently pays with regard to use of different wholesale services was established between the Companies as binding until December 31, 2012, the 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 before the end of year 2012, 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, 2012 new regulations shall enter 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 new regulations 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 imposes 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.

The Minister of Administration and Digitalization, and previously Minister of Infrastructure has conducted consultations of draft law amending the Telecommunications Act and some other acts including the Act on Development (hereinafter referred to as "the Draft Law"), 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 in May 2011. The Draft Law, among other issues, forbids to enter into an agreement of providing telecommunications services longer than 24 months and obliges telecommunications entrepreneurs to extend their offer to include 12 month contracts (or shorter), broadens the obligatory content of contract for the provision of telecommunications services, and obligations with regard to network safety, including the prevention of unsolicited communications (spam). Moreover, the Draft Law provides for, *inter alia*, obligation of telecommunications undertakings providing services in fixed networks to determine in the contract with the subscriber values of mentioned in the Draft Law quality parameters of broadband Internet access service, introduction of rules of responsibility for number portability incompatibly with the will of the subscriber, extension of the obligation to provide facilities for disabled persons onto all of the telecommunications undertakings, increase of information obligations with regard to Subscribers as well as extension of obligation to transfer of data concerning telecommunications activity of a given telecommunications undertaking to the President of UKE. The National Chamber of Commerce for Electronics and Telecommunications (hereinafter referred to as "the KIGEiT") participated in consultations both of the guidelines for the Draft Law and its previous versions submitted its position against these and some other projected amendments. The KIGEiT participates in consultations of the Draft Law, as well. The Management Board, however, is unable to assure that the KIGEiT remarks will be accepted nor that the Draft Law will not impose other obligations on telecommunications undertakings, including Companies of the Netia Group. Member states, including Poland, were obliged to implement the new regulation by May 25, 2011. Until the date of approval of this consolidated report, the process of adjusting the Telecommunications Act to the Directives package remains in progress.

At this stage it cannot be determined in which reading and scope the provisions of the draft law will change the Telecommunications Act in forceand how material the impact of these new European obligations on the conditions for doing business by the Companies from the Group will be. Most of the changes described above may increase of their costs.

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 SA 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 SA 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 December 31, 2010. The deadline to file an application for awarding subsidy towards incurred costs of USO in respect to year 2011 has not yet lapsed.

The total amount claimed by TP SA on all applications for 2006-2009 was PLN 803,653.

In May 2011, the President of UKE issued decisions by virtue of which TP SA 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,

i.e. for the provision of universal service within the years 2006-2009 TP SA was awarded the total amount of PLN 66,994.

Both TP SA and KIGEiT filed for reconsideration by the President of UKE of the matters concluded by issuing of the above-mentioned decisions. By virtue of a decision issued on September 7, 2011, the President of UKE upheld the above decisions.
TP SA challenged the decisions of the President of UKE before the Voivodeship Administrative Court (further "WSA"). On February 3, 2012 WSA dismissed the complaints of TP SA against the decisions granting subsidy towards costs of provision of universal service in 2006 and 2007.

The Management Board is convinced of the validity of the issued judgements, but cannot assure that in cases of appeal by TP SA of decisions granting subsidy towards the costs of universal service for the following years of its providing, there will also be judgements issued dismissing the claims of TP SA and that in case of submitting by TP SA appeals against sentence, they will be dismissed by the Supreme Administrative Court, so that the amounts of the subsidies granted in the above-mentioned decisions cannot be increased.

Moreover, in June 2011 TP SA filed an application for subsidy towards costs of universal service provision in 2010 amounting to PLN 269,436. On January 10, 2012, the President of UKE issued the decision in which it admitted a subsidy towards the cost of universal service for the provision of facilities for disabled people and telephone services by means of public phones, for a total of 55 102 zł.

TPSA and KIGEiT filed for reconsideration by the President of UKE of the matter concluded by issuing the above-mentioned decisions.

Despite the fact that in the opinion of the Management Board the application of the TP SA for reconsideration should not be admitted, and that so far the applications of TP SA for subsidies towards costs of provision of universal service within 2006-2009 have been only partially admitted by the President of UKE, the Management Board is unable to assure that TP SA will not be finally awarded the subsidy for 2010 or 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.

(All amounts in thousands, except as otherwise stated)

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.

Based on Management's best estimates of Netia's revenue market share in the years 2006 - 2011 and the decisions of the President of UKE awarding TP SA 66,994 in USO subsidies for years 2006-2009 and 55,102 for year 2010, Netia has made a provision of PLN 5,104 for potential obligation under the subsidy for universal service provided in years 2006 - 2011. 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 SA prevail in any appeal, the USO liability in respect to 2006 – 2011 could still rise materially above the amount provided to date.

On the basis of the full amount of subsidies claimed by TP SA 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 SA from the Netia Group amounts to approximately PLN 56,838 for the period from 2006 until 2011 inclusive as follows:

	Maximum subsidies		**Provision**			
	Old Netia Group	**New Netia Group**	**Old Netia Group**	**Dialog Group**	**Crowley**	**New Netia Group**
	PLN	*PLN*	*PLN*	*PLN*	*PLN*	*PLN*
2006	4,854	6,293	27	6	1	34
2007	7,462	10,862	43	17	3	63
2008	6,389	9,202	55	21	4	80
2009	8,492	11,964	2,270	777	152	3,199
2010	9,934	13,888	2,032	673	135	2,840
2011	3,311	4,629	677	218	45	940
	40,442	**56,838**	**5,104**	**1,712**	**340**	**7,156**

Pursuant to the decision of the President of UKE designating TP SA to provide universal service the above obligation of TP SA expired as of May 8, 2011. No undertaking obliged to provide USO as of May 8, 2011 has been designated to date and, according to the published position of the President of UKE, will not be designated. No assurance can be given that Management best estimate of USO provision for 2006-2010 will be sufficient or that the President of UKE will not make full or partial awards to TP SA in respect to 2011 in the future or that TPSA will not be successful in its appeal to the court to increase the size of the USO awards above the amounts awarded.

Risks related to holding a position of SMP

The President of the UKE issued the decision, whereby it has designated Netia and Dialog 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),
- 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 S.A. and Dialog, 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 and Dialog in the above mentioned decisions of the President of the UKE, Netia and Dialog 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/informacje,dla_biznesu,42,921.html
and Dialog at:
http://dialog.pl/sites/default/files/files/download/Informacja_w_sprawie_dost%C4%99pu_telekomunikacyjnego_do_sieci_Telefonii_DIALOG.pdf.
The published documents, hereinafter the "Netia IC Offer" 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.

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 network, determination of Netia's market power in that market, and evaluation whether there are reasons to uphold, amend, or waive Netia's regulatory obligations.

No assurance can be given as to whether Netia or Dialog 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.

Asymmetry of interconnection rates depends on the policy of UKE

The President of UKE issued a decision amending the agreement between Netia and TP SA 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 SA'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 SA's network, will not be accelerated or otherwise changed by the President of UKE. Should such an adverse decision 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 SA. 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 SA filed an application to the President of UKE for amendment of rates for call termination in Netia's public fixed telephone network by differentiation of the amounts of rates for each tariff period. The President of UKE by virtue of Decision refused the change of the Contract pursuant to the application of TP.T Despite the fact, that the decision was issued in accordance with previous regulatory practice, the Management Board cannot assure that in case of its appeal by the TP SA, SOKIK will dismiss the appeal and the decision will remain in circulation.

TP SA also filed with the President of UKE for:
1) the issuance of decision replacing the change of the contract on interconnection between Netia and TP SA, 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 SA;
2) the issuance of decision replacing the change of the contract on interconnection between Dialog and TP SA, 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 SA;
3) the issuance of decision replacing the change of the contract on interconnection between Netia and TP SA 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 SA infrastructure.

The Management Boards 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 SA. One cannot assure, however, that the amount of these rates will not be changed, 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 and that rules of asymmetry of rates for termination of calls in the network Dialog in relation to rates for termination of calls in the network TP SA will be established on the same rules.

TP SA 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 SA through defining fees for number portability. The Management Boards believes that defining fees for number portability in accordance with TPSA's motion is not justified, however the Management Boards is not able to assure that TP SA'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.

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. No assurance can be given that the new President of UKE will follow policies and practices similar to those of the previous regulator, possibly leading to new risks and challenges for Netia's operations not foreseen elsewhere in these risk factors.

Risks relating to regulatory access rates

On October 22, 2009 the President of UKE and TP SA signed an agreement laying down rules for the performance by TP SA of obligations with regard to telecommunications access ("The Settlement Agreement between the President of UKE and TP SA"). 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 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.

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

Netia was surprised that TP SA'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 SA retail offers examined with the use of 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 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 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/PS 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 SA 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 SA 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 new 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 SA, 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 SA 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 SA 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.

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. According to them, Netia has notified to the President of UKE the will to provide data on costs for the year 2011 for the purposes of investigation with MS test of the new retail offers of TP SA. The transfer of these data shall happen before June 30, 2012.

The Management Board is unable to assure that the MS Test rules as applied by the Regulator will constitute a sufficient guarantee of TP SA price non-discrimination. The President of UKE's approval of the TP SA retail offers that have undergone the MS Test may result in Netia's and Dialog's loss of part of its share in net subscribers' connections and in decrease of its growth rate, and consequently lead to risk of failure to achieve our strategic and financial goals.

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 SA.

According to Telecommunications Law and the decisions of the President of UKE, TP SA 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 SA 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 SA network within launch of the Non-active Line - from 63.4 to 39.48 PLN (not in thousands);
- launch of service provided on the Active Line (switch-over of a pair of cables, servicing of orders for line) - from 55.51 to 46.98 PLN (not in thousands);
- service deactivation (switch-over of a pair of cables, servicing) - from 21.21 to 18.28 PLN (not in thousands);
- as well as due to number portability in such a way that its present amount does not exceed 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 40.98 to 38.68 PLN (not in thousands);
- change of Service Options - from 45.22 to 34.07 PLN (not in thousands);
- Service deactivation - from 40.98 to 38.68 PLN (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 SA introduced an appeal against the 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 Management Board cannot assure that the conditions established in the RO by the decision of the President of UKE issued after reconsideration of the case will not be in future amended or reversed.

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.

Due to the fact that the RO regulates the terms and rules of co-operation of TP SA 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 SA will not be changed or deteriorated in the future with the aim to ensure competitiveness comparing with other alternative operators.

TP SA 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 SA 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. Application for amendments of the RO in the scope of options of BSA services TP SA justified by the fact, that TP SA has been going to withdraw retail offers of services delivered in options: 1, 2 and 6 Mbit/s on April 1, 2012. However at this stage of proceedings one cannot predict the results of the proceeding, in the opinion of the Management Board the application of the TP SA should not be admitted. TP SA is obliged to ensure of not worse conditions of wholesale services for others operators, including Netia, than TP SA uses inside of its own undertaking in order to delivering services TP SA's subscribers. Taking under consideration, that TP SA still offers retail broadband services in options: 1, 2 and 6 Mbit/s for period: 12 and 24 months, on April 1, 2012 TPSA will be delivering services in such options. Therefore TP SA should be still obliged to ensure BSA services in the options: 1, 2 and 6 Mbit/s for others operators, including Netia .

TP SA applied also for approval of reference offer with regard to leased lines. At this stage of proceedings one cannot determine what new frame terms of using access to LLU and BSA and within what time frame will be approved by the President of UKE, as well as how the projected amendment of the RO as well as the reference offer stipulating terms of use of leased lines will affect the conditions of doing business by Netia.

In the Understanding as of December 23, 2009, Netia and TP SA agreed that the amount of service rates for access to TP SA 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 will not affect settlement rules between Netia and TP SA due to access to local loop and local sub-loop built according to copper technology. However, 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 SA's network on a mass scale.

Moreover, on January 31, 2012, the President of UKE obliged TP SA 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 SA's network by Companies of the Netia Group.
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.

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 Sp. z o.o., Netia and Polkomtel SA 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 SA and Polska Telefonia Cyfrowa Sp. z o.o. 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 Sp. z o.o. and Netia. The temporary decision changing MTR rates specified in the contract between Polkomtel SA and Dialog was also repealed. The Management Board cannot assure that the Appellate Court will reverse or amend the judgment of the lower court and that the decisions itself will not be reversed. Moreover, the Management Board cannot assure that the remaining decisions will not be amended or reversed by the court, thereby materially increasing our interconnection costs and in such a case, that Polska Telefonia Komórkowa Centertel Sp. z o.o., Polkomtel SA and Polska Telefonia Cyfrowa Sp. z o.o. will not raise the claims against Netia nor foresee how the courts might treat such claims.

Moreover, 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 SA and Polska Telefonia Cyfrowa Sp. z o.o.: as of July, 1, 2011 – at the level of 0.1520 PLN per minute and as of July 1, 2012 – at the level of 0.1223 PLN 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.

Due to issue of the decisions establishing the amount of MTRs at the level of 0.1520 PLN per minute and 0.1223 PLN per minute the President of UKE discontinued proceedings regarding issue of decisions obliging Polska Telefonia Komórkowa Centertel Sp. z o.o. and Polkomtel SA to apply MTRs amounting to 0.0966 PLN per minute.

Most of the Alternative Operators associated at the KIGEiT, including Netia and Dialog, concluded agreements with Polska Telefonia Komórkowa Centertel Sp. z o.o., Polkomtel SA and Polska Telefonia Cyfrowa Sp. z o.o., in which the said mobile networks operators confirmed rates paid for MTRs in line with the decision of the President of UKE and the mobile operators restricted their ability to make retrospective 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 SA 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 SA 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 SA as holding a significant market power on the relevant market, as well as imposed regulatory obligations on TP SA.

By virtue of the President of UKE decision TP SA 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 SA 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 SA 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.

On April 28, 2011 the President of UKE issued a decision holding TP SA 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 SA 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 SA has significant position on this market, and in this connection imposes regulatory obligations on TP SA. 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 SA the obligation to assure telecommunication access along with obligation to keep realized access and obligation of non-discrimination.

In the opinion of the Management, relevant markets, including broadband access markets within the area of the four municipalities comprised in the draft decision, are not developed sufficiently to allow for geographical differentiation of TP SA regulatory obligations, nor are there any grounds, to hold that on the area of these municipalities the regulatory obligations imposed on TP SA should be limited.

At this stage of the consultation proceedings concerning the draft decision one cannot predict, however, whether and when it will be issued nor whether it will be consistent with the draft decision published. Therefore it is impossible to determine what terms of wholesale broadband access will be binding within the borders of the above mentioned municipalities as well as when and how they will affect the existing ability of Companies of the Netia Group to provide services with use of such type of access to TP SA network within the mentioned area.

Despite the Management Board position that within the geographic area of the above mentioned municipalities all the obligations of TP SA as a designated telecommunications undertaking of significant market power should be maintained, the Management Board is unable to assure that the President of UKE will not issue a decision consistent with the draft decision, as a consequence will not withdraw regulatory obligations currently imposed on TP SA as regards broadband access within the above mentioned four municipalities, not foreseen in the consulted draft decision. The Management Board is unable to assure, as well, that in such a case the court will validly accept the allegations of the appeal against the decision of the President of UKE, if any will be lodged, and will restore obligations of TP SA in the scope necessary for preservation of effective competition within the areas of the above mentioned municipalities. In the Understanding of December 23, 2009, Netia and TP SA established that the amount of rates for access to TP SA 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 will have no impact on settlement rules between Netia and TP SA due to provision of access BSA lines unbundled according to the rules binding until the date of issue of the respective decision, if issued by the President of UKE. However, the Management Board is unable to assure that circumstances will not arise in future that could lead to increase of the amount of costs of provision of broadband access service by Companies of the Netia Group to subscribers to whom they will be provided with use of BSA service.

Netia possesses infrastructure and uses LLU services within the area of the four municipalities, in which according to the draft decision the regulatory obligations of TP SA shall be limited, which beyond the obligation, foreseen in the motioned draft decision, to assure by TPSA of continuity of broadband access on links, with use of which retail telecommunication services are provided, allows maintaining continuity of provision of broadband services by Companies of the Group to majority of end users to whom they are currently provided within these areas. The Management Board is unable to assure, however, that the change of technology from BSA to LLU will be possible in case of each subscriber's line within the area of these municipalities and that in this regard provision of broadband access services within these borders to all of the current users of Netia's and Dialog's services will be possible in future.

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 SA in breach of conditions of the so-called "flat interconnection rate". Tele2 Polska appealed against the above-mentioned decision, nevertheless the Management Board cannot assure that the appeal will be allowed and the decision will be reversed.

The Appellate Court rendered two judgments in which it held that the standard terms and conditions and price lists used by Tele2 Polska are abusive with respect to an obligation of a subscriber to reimburse the operator for the costs of requests for payment and debt collection proceedings. Both judgments of the appellate court are final and binding. Therefore Tele2 Polska is obliged to amend the standard contracts. The Management Board cannot assure that as a result of the aforementioned judgments, the Netia Group will not incur further costs regarding possible private claims for reimbursement.

Risks related to Dialog's business

TPSA has summoned Dialog to pay the amount of PLN 632 (including interests) for account of outstanding receivables arising from the use of telecommunication access to the TP SA's network by Dialog. Despite the fact that in the Management Board's opinion TP SA's claims are at least partly unjustified, it cannot be assure that in case of court proceedings they will not be taken into account or that Dialog's claims for payment against TP SA arising from the contracts and decisions on telecommunication access or using Dialog's infrastructure by TP SA will be paid in the amount of exceeding the amount TP SA's claims.

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 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 and Netia. 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 would be entitled to request abandonment of further TV channels' rebroadcasting by Netia or Dialog effectively and payment of the compensation in the amount of 300% of the gross revenue earned from rebroadcasting.

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. At this stage, the Management Board may not foresee the result of these KPA's proceedings, 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 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 OZZs .

According to the agreement currently in force, Dialog pays for the benefit of SFP the remuneration in the amount 1,6% of revenue earned by Dialog from rebroadcasting of the TV channels. The agreement between Dialog and Authors' Association "ZAIKS" is terminated, however Dialog pays 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 accepts these payments. 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% gross revenue earned by Netia from rebroadcasting of the TV channels during the period between 1st of August 2009 – 31st of December 2011 and proposed that the said rate shall apply for the future settlements between Netia and SFP.

Even though Netia doesn't provide activity in TVC technology and Management Board is convinced of that the amount of compensation demanded by SFP is unjustified, it couldn't be guaranteed that Netia shall not be obliged to pay to SFP such amount of compensation until KPA approves the lower rate of the remuneration.

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 and Dialog, 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.

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.

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 SA 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 SA and TP SA obedience to the UKE decisions

TP SA occupies a leading position in Poland among operators paying cable phone 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 SA in all the geographic areas it operates on. TP SA is a much larger entity than Netia Group and possesses far broader backbone and access network. TP SA is engaged in many years' relations with numerous clients that constitute a target client group of Netia Group. Infrastructure exploited by TP SA in the main cities of the country is comparable in terms of advancement of applied technologies to the infrastructure of Netia Group. However, TP SA 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 SA will have a significant adverse effect on Netia Group revenues and its operating activities outcomes.

TP SA 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 SA networks that currently is regarded by Netia to be commercially profitable. Due to the above in 2006 Netia signed a cooperation agreement with TP SA enabling Netia to offer Internet access to TP SA clients on the basis of regulatory TP SA wholesale offer called bit stream access. In June 2007 Netia and TP SA concluded networks interconnection agreements that complexly regulate terms of cooperation between operators. This agreement also applies to cooperation with TP SA 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 SA a binding statement on regarding the interconnection agreement between Netia and TP SA 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 SA 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 SA network enabling Netia Group to offer voice services to TP SA 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 SA 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 SA aiming at provision and maintenance of such services for end users will require closer cooperation than it used to be in the past.

Notwithstanding the Settlement Agreement between the President of UKE and TP SA, the Management Board is not able to guarantee that TP SA will cooperate on an adequate level of engagement, nor that the regulatory body will react forcing TP SA 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 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 SA, 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. Management 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 2011 regarding population coverage and area of the country were achieved. In the event that reservation obligations are not being met by an operator, the President of UKE has the power to limit or confiscate the reservation, if the undertaking is not able to assure effective use of possessed right. However, historically such measures have rarely been used.

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 2011

Reversal of 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 2011. 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, 2011 the Netia Group has recognized 220,677 PLN of reversal of impairment losses in profit and loss during the year ended December 31, 2011. 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.This reversal of impairment increases profits and distributable reserves at December 31, 2011 but will also have the effect of increasing future depreciation and amortization charges

The reversal of the impairment loss for the CGU was allocated to the assets of the unit that had previously been impaired, except for goodwill, pro rata with the carrying amounts of these assets. In case the carrying amount of an individual asset would be increased above the lower of its recoverable amount and the carrying amount that would have been determined (net of amortization or depreciation) had no impairment loss been recognized for the asset in prior periods, the amount of the reversal of the impairment loss that would otherwise have been allocated to the asset, was allocated pro rata to the other assets of the CGU, except for goodwill.
The test resulted in the partial reversal of previous impairment charges recorded in 2003 and 2006 allocated to the existing non-current assets as follows: tangible fixed assets – PLN 183,330, telecommunications licenses – PLN 36,506, investment property – PLN 838 and computer software – PLN 3. Following the reversal of 220,677 PLN of impairment losses, all previously recognized impairment losses, which could have been reversed as at December 31, 2011, have been reversed.

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, 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, in 2011 the Netia Group recognized PLN 110,012 of deferred income tax asset as compared to PLN 52,762 as of December 31, 2010. The increase concerns mainly net deferred tax asset from acquired subsidiaries of PLN 74,058 ,deferred tax asset of PLN 36,831 recognised on deductible temporary differences relating to the trademark Netia contributed in kind with an organised part of the business to the Company's subsidiary Netia Brand Management in December 2011 and PLN 20,837 of impact from the reversal of the earlier impairment charges. The increase was offset partially by other changes, which relate mainly to a PLN 52,848 decrease in deferred tax asset relating to tax losses, as significant part of tax losses were utilised in 2011 and additionally deferred tax asset of PLN 19,670 was derecognised due to insufficient expected taxable profits to utilise all tax losses in 2012. This assessment was based on the budget for 2012 and Netia's long term business plan until 2016. Rapid subscriber growth, costs savings, synergies from the Tele2 Polska acquisitions, and successful migration of customers to LLU and the recent launch of TV services over NGA upgraded networks provide management with sufficient visibility of future profits to justify recognition of the deferred tax assets.

Operational data (not in thousands)

Broadband

Broadband subscribers increased to 750,156 at December 31, 2011 in Old Netia from 690,247 a year earlier. In addition, broadband subscribers in Dialog Group and Crowley as at December 31, 2011 were 158,950 and 2,464, respectively, giving New Netia a total of 911, 570 broadband lines. During 2012 Netia aims to continue to increase broadband subscribers through further organic growth, with potential for further increases from additional Ethernet networks acquisitions. Netia provides its broadband services using the following technologies:

Number of broadband ports	**New Netia 2011**	**Old Netia 2011**	**2010**
xDSL and FastEthernet over Netia's own fixed-line network	396,853	246,295	223,169
Bitstream access	311,358	302,632	321,075
WiMAX Internet	19,130	16,785	18,974
LLU	184,229	184,229	126,895
Others	-	-	134
Total	**911,570**	**750,156**	**690,247**

Broadband ARPU for old Netia was PLN 52 in Q4 2011 as compared to PLN 53 in Q4 2010. The declining ARPUs reflect increased focus on 2plays and pre-emptive price reductions made in mid-2010. Brodband Arpus for Dialog and Crowley in Q4 2011 were PLN 56 and PLN 1,047 respectively.

Broadband SAC for old Netia was PLN 178 in Q4 2011 as compared to PLN 203 in Q4 2010. The year-on-year decrease in Broadband SAC was associated with the introduction of Netia Spot routers and Netia Player set-top boxes, which are being leased to customers, using the same business model as satellite TV, and capitalized.

Local loop unbundling (LLU)

In 2011 Netia continued to extend the reach of its LLU-based services. As at December 31, 2011 Netia had 706 unbundled nodes, reaching approximately 4.9 million customer lines compared with 512 unbundled nodes as at December 31, 2010, and 4.3 million customer lines a year earlier. At this stage, Netia has nearly completed its LLU roll-out program, with the last LLU nodes, taking their total number to 713, to be unbundled in Q1 2012, and intends to focus now on increasing the penetration of active customers per LLU node by both organic growth and migrations of the remaining existing BSA/WLR served clients within the reach of LLU onto higher margin LLU services.

Netia served 184,229 customers over LLU as at December 31, 2011 as compared to 126,895 at December 31, 2010. During Q4 2011 Netia migrated 3,248 1play and 3,402 2play clients onto LLU, increasing the cumulative gross number of 1play and 2play migrations to 106,968. Of the new LLU sales for Q4 2011, a sizable portion (56%) came from re-activation of previously dormant TP lines or activation of new fixed lines.

At the end of Q4 2011, Netia served an average of 261 customers per LLU node as compared to 248 customers per LLU node in Q4 2010.

Acquisitions of local Ethernet network operators

As of December 31, 2011, Ethernet networks acquired by Netia since mid-2007 provided broadband access to a total of 132,532 mostly residential customers as compared to 115,194 customers at December 31, 2010, with approximately 603,000 homes passed.

During Q4 2011 Netia acquired four further Ethernet networks with 11,046 active customers and 45,866 homes passed. In total, during 2011 Netia acquired nine Ethernet networks (including both purchases of companies and asset transfers) with 22,823 active customers and 103,832 homes passed.
Netia remains fully dedicated to consolidation of the fragmented Polish Ethernet ISP market and is making good progress on its pipeline of acquisitions for 2012.

Multiplay services

Netia continues to increase the share of services sold in voice and data bundles. As at December 31, 2011, bundled services were delivered on 31% and 47% of lines in the Residential and SOHO/SME segments of Old Netia, respectively. This represents increases by 3 and 4 percentage points in the respective segments from December 31, 2010.

NGA network development

In 2011, Old Netia completed the first phase of upgrading the existing copper and Ethernet networks to NGA (Next Generation Access) standard. Approximately 556,000 homes passed (HPs) had been upgraded by the year-end versus the original target of 500,000 HPs. This included approximately 434,000 VDSL HPs and approximately 122,000 Ethernet HPs (FTTB). Capital expenditures related to this first phase of the upgrade amounted to PLN 11.9m as Netia has first upgraded the least expensive homes passed.

Through the acquisition of the Telefonia Dialog group, New Netia's NGA network was further extended by approximately 230,000 NGA HPs, including 112,000 passive optical networks (PON) HPs, 94,000 VDSL HPs and 24,000 Ethernet (FTTB) HPs.
Currently, New Netia covers in total 786,000 households with its NGA networks, including 112,000 PON HPs, 528,000 VDSL HPs and 146,000 Ethernet FTTB HPs. Moreover, New Netia today covers a further 450,000 IPTV ready HPs within its network coverage (including Dialog) based on ADSL2+ technology, which combined with NGA ready HPs, all of which can deliver 3play services, New Netia today has around 1,236,000 IPTV ready HPs in its proprietary network coverage.

During 2012 New Netia intends to further expand its NGA coverage by another 450,000 HPs to reach approximately 1,200,000 NGA ready HPs by 2012 year end. Thus, the New Netia should cover in total approximately 1,650,00O IPTV ready HPs by 2012 year end which can be reached with 3play service bundles (IPTV + fixed broadband + fixed voice). In addition, Netia currently conducts tests of IPTV over its LLU network and may decide to extend further the network coverage of its TV services if these tests prove successful. Initial estimates indicate up to 650,000 HPs could be served with IPTV on ADSL2+ technology over LLU.

(All amounts in thousands, except as otherwise stated)

IPTV and content services

On November 8, 2011 Netia introduced a new TV offering 'Telewizja Osobista' (Personal Television). The offering includes a new proprietary set-top box – the 'Netia Player', which provides access to digital TV, both paid IPTV and free DTT (digital terrestrial TV / DVB-T), quick and easy access to popular internet services or own multimedia over a TV screen, and video-on-demand content libraries such as Ipla, Kinoplex and HBO GO. The rich HBO GO's content, with Netia being its first provider in Poland, constitutes one of the key elements of this new product and is provided in a bundle with Netia's Internet access services.

The number of active IPTV customers in Old Netia grew to 6,261 as at December 31, 2011 from 1,929 as at September 30, 2011. This included 1,092 customers of the bundled HBO GO services, offered from November 2011. Sales forces are being prepared to focus on the 3play opportunity across the entire covered area and sales rates are expected to accelerate significantly in 2012. The number of active IPTV customers in Telefonia Dialog group grew to 43,379 as at December 31, 2011 from 42,952 as at September 30, 2011.

Mobile customers

Netia continues to develop its base of cross-sold mobile broadband customers, which have economics similar to BSA services. Old Netia's mobile broadband customer base totalled 28,096 at December 31, 2011 as compared to 7,959 at December 31, 2010. *Mobile broadband ARPU* for Old Netia was PLN 29 in Q4 2011 as compared to PLN 28 in Q3 2011 and PLN 27 in Q1 2011. Old Netia's mobile broadband services are provided via an MVNO agreement with the mobile operator P4 (Play).
New Netia includes Dialog group's base of 46,563 MVNO voice subscribers and 2,171 MVNO data subscribers as at December 31, 2011.

Voice lines (own network and WLR)

Voice lines (own network and WLR (wholesale line rental)) in Old Netia totaled 1,177,408 at December 31, 2011 as compared to 1,218,567 at December 31, 2010. In addition, voice lines in Dialog's and Crowley's networks totalled 539,908 and 27,407, respectively, at December 31, 2011. Dialog reported voice services totalling 810 thousand in its last business update published prior to Netia signing a conditional purchase agreement on September 29, 2011. This number has since been revised down and the 539,908 reported for December 31, 2011 is broadly consistent with Netia's definitions. The change is related to conversion of data connections into voice line equivalents and has no impact on financial results.

Accordingly, New Netia had a total of 1,744,723 voice services as at December 31, 2011.

Aggressive price competition from TP and smaller players, often targeting low ARPU customers with low monthly fees, together with substitution from mobile and cable TV, is putting pressure on the subscriber base whilst Netia is targeting higher ARPU customers and upselling unlimited fixed-line national call bundles in order to attract higher value customers.

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 is switching 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	**New Netia 2011**	**Old Netia 2011**	**2010**
Traditional direct voice	596,330	318,742	332,657
Voice over IP*(excl. LLU)*	42,279	36,992	30,589
WiMAX voice	17,603	16,447	20,043
WLR	962,322	680,054	752,899
LLU voice over IP	126,189	125,173	82,379
Total	**1,744,723**	**1,177,408**	**1,218,567**

Voice ARPU per WLR line amounted in Old Netia to PLN 48 in Q4 2011 as compared to PLN 48 in Q4 2010. ARPU stabilisation reflects the success of upselling all-inclusive fixed voice offers for higher monthly fees and the loss of some low ARPU customers to competition.

Voice ARPU per Netia network subscriber line amounted to PLN 52 in Q4 2011 as compared to PLN 54 in Q4 2010, , with the year-on-year decrease reflecting overall tariff reduction trends and pressure on prices in the business segment in particular.

Blended voice ARPU in Old Netia was PLN 50 in Q4 2011 as compared to PLN 51 in Q4 2010. In Q4 2011 blended voice ARPU in Dialog and Crowley was PLN 42 and PLN 63, respectively.

Indirect voice

CPS lines (carrier pre selection) in Old Netia totaled 66,781 at December 31, 2011 as compared to 82,983 at December 31, 2010. In addition, CPS lines in Dialog and Crowley totalled 3,382 and 3,533, respectively, at December 31, 2011. 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 1,744,732 clients as at December 31, 2011.

Indirect voice ARPU per CPS line was PLN 23 in Q4 2011 as compared to PLN 28 in Q4 2010. Tariff reductions, reduced call volumes and conversion of higher ARPU customers to Netia's WLR or LLU offers is responsible for the year-on-year ARPU decline.

2.3 Agreements essential for the Netia Group's operations

Share purchase agreements

On December 14, 2011 Netia purchased 197,862 shares (not in thousands) in Crowley Data Poland sp. z o.o. Details of this agreement are described in Note 1.1The Netia Group structure.

On December 16, 2011 Netia acquired 19,598,000 shares (not in thousands) in Telefonia Dialog S.A. Details of this agreement are described in Note 1.1The Netia Group structure.

Loans agreements

On 29 September 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. Details of the loan agreement are described in Note 3.5 Loans Agreements

3 Financial condition of the Netia Group

3.1 Consolidated statement of financial position

As at December 31, 2011, non-current assets amounted to PLN 3,102,520 (87% of total assets) as compared to PLN 1,973,707 at the end of 2010. The main change within non-current assets relates to increase of property, plant and equipment by PLN 708,469. This is mainly due to acquisition of Dialog Group and Crowley (property, plant and equipment of PLN 532,722 as at the acquisition date) and the reversal of impairment losses of PLN 220,677 (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, 2011) and additions of PLN 216,542. Increase of intangible assets by PLN 380,349 concerns mainly acquisition of Dialog Group and Crowley on which goodwill of PLN 182,028, customer relationships of PLN 132,106 and trademarks of PLN 13,942 were recognized. Increase in deferred tax asset by PLN 57,250 was attributable mainly to net deferred tax asset recognized on acquisitions of subsidiaries.

Current assets at December 31, 2011 in the amount of PLN 446,664 decreased by 25% as compared to PLN 594,862 at the end of 2010. The change was mainly attributable to the decrease in the Company's investments in treasury notes and cash balance of PLN 188,707 which were used for acquisitions in Q4 2011. This was partially offset by higher balance of receivables as at December 31, 2011 as compared to the end of 2010 as a direct result of consolidation of Dialog Group and Crowley as at December 31, 2011.

As at December 31, 2011, the equity amounted to PLN 2,500,373, comprising 70% of total equity and liabilities and increased by 9% as compared to PLN 2,297,546 at the end of 2010. The main changes are the net result for 2011 of PLN 248,786 and repurchase of own shares of PLN 49,582 (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 549,185 and increased as compared to PLN 31,871 at the end of 2010, mainly due to the bank loans of PLN 700,000 drawn in December 2011 (see Note 3.5 Loans Agreements), which non-current part as of December 31, 2011 at amortised cost amounted to PLN 514,416.

As at December 31, 2011, current liabilities amounted to PLN 499,626 and increased by PLN 260,474 as compared to PLN 239,152 at the end of 2010, mainly due to the current part of the bank loans drawn by Netia of PLN 178,823 as of December 31, 2011 and higher balances of trade and other payables and deferred income due to acquisition of Dialog Group and Crowley.

3.2 Consolidated income statement

Telecommunication revenue of New Netia amounted to PLN 1,614,021. Telecommunication revenue of Old Netia amounted to PLN 1,588,870 and increased by 2 % from PLN 1,564,434 in 2010. Data revenue of New Netia amounted to PLN 604.188.Data revenue of Old Netia increased to PLN 596,937 up by 6% from PLN 562,470 in 2010, 7 percentage points being attributable to broadband-related organic growth and 1 percentage point to acquisitions of Ethernet operators while data transmission connections for P4 accounted for a decrease of 2 percentage points. Revenue from direct voice services decreased by 2% to PLN 724,593 in Old Netia as compared to PLN 741,717 for 2010, as a result of decreasing customer numbers and traffic volumes.

The overall revenue level in Old Netia was supported by growth in the carrier segment driven by increases in wholesale services by 7% or PLN 8,287 and interconnection revenue by 10% or PLN 7,045. Other telecommunications revenue increased by PLN 7,768 or 20% driven by growing number of mobile data and value-added services. The gradual run-down in indirect voice customers produced a revenue decrease of PLN 16,007 or 43% to PLN 21,352.

Costs of sales of New Netia amounted to PLN 1,103,029. Cost of sales of Old Netia increased by 1% to PLN 1,085,841 from PLN 1,075,979 for 2010 and represented 68% of total revenue as compared to 69% for 2010. The increase in cost of sales in 2011 resulted mainly from higher level of interconnection charges and depreciation and amortization costs.

Gross profit of New Netia for 2011 was PLN 515,774. Gross profit of Old Netia was PLN 507,381 as compared to PLN 493,317 for 2010. Gross profit margin of Old Netia was 31.8% for 2011 and 31.4% for 2010.

Selling and distribution costs of New Netia amounted to PLN 297,253. Selling and distribution costs of Old Netia decreased by 7% to PLN 289,860 from PLN 312,865 for last year and represented 18% of total revenue as compared to 20% in 2010. This improvement reflects lower selling and distribution costs, supported mainly by lower billing, mailing and logistics costs, mainly as a result of more customers accepting electronic invoices as well as lower advertising spending and commissions paid to third parties. This was partially offset by higher other expenses related to selling and distribution cost driven by higher retention costs related to fees payable to TP upon increasing broadband transmission speeds to Netia's bitstream access customers and higher cost of licenses for providing Internet access security in line with increased sales volumes of value added broadband services, which form part of Other Telecommunications Revenues.

General and administration costs of New Netia amounted to PLN 152,473. General and administration costs of Old Netia increased by 5% to PLN 150,109 from PLN 142,249 for 2010 and represented 9% of total revenue in both periods. This was mainly due to PLN 5,104 provided in relation to Netia's estimated universal service obligation, PLN 10,434 of M&A costs, of which PLN 6,370 are included into 'Other expenses' related to the general and administrative category and PLN 1,097 of New Netia integration costs. The above cost increases were partially offset by decrease in salaries' and benefits' cost related to the general and administrative category, associated with lower net costs of share based awards recognized over the vesting period.

Other income of Old Netia was PLN 15,534 as compared to PLN 18,881 in 2010, and included PLN 7,397 of reminder fees and penalties and PLN 2,700 of income from settlements.

Other gains, net of Old Netia were PLN 4,219 as compared to PLN 8,709 in 2010. This included a gain of PLN 3,052 on disposal of fixed assets and a gain on sale of impaired receivables of PLN 1,151.

Unusual items in 2011 in Old Netia included the non-cash gain on reversal of earlier impairment charges of PLN 220,677, expenses related to M&A activities of PLN 10,434, universal services costs of PLN 5,104, New Netia Integration costs of PLN 1,097 and restructuring costs of PLN 426 and for a net total of PLN 203,616 of gains. In the prior year, EBITDA included a non-cash gain on reversal of earlier impairment charges of PLN 221,184, the gain on disposal of the second and the third tranches of transmission equipment to P4 of PLN 7,298, restructuring expenses related to the "Profit" Project executed during 2009 of PLN 790 and expenses related to M&A activities of PLN 747 for a net total of PLN 226,945 of gains.

EBITDA of Old Netia inclusive of the unusual items was PLN 606,834 for 2010 as compared to PLN 586,439 for 2010. EBITDA margin increased to 38.09% for 2011 as compared to 37.4% for 2010.

Operating profit (EBIT) of Old Netia was PLN 303,669 as compared to an operating profit of PLN 285,755 for 2010. Excluding net unusual items described above of PLN 203,616 in 2011 and PLN 226,945 in 2010, EBIT increased to PLN 100,053 in 2011 from PLN 58,810for 2010.

Net finance income of Old Netia was PLN 17,028 as compared to net finance costs of PLN 3,014 in 2010. The improvement was related mainly to interest earned on larger cash and treasury bills deposits, the cancellation of the Company's old bank facility which was generating amortized costs during 2010 and gains on cash flow hedges made to offset currency exposure in certain operating expenses. Financial cost for 2011 included PLN 2,491 of interests accrued on bank loans to finance Dialog Group acquisitions in December 2011.

Income tax charge of Old Netia of PLN 68,580 was recorded by Old Netia in 2011 as compared to PLN 24,874 for 2010 and included a PLN 51,863 concerning the taxes and related penalty interest already paid in 2010.

Net profit of New Netia was PLN 248,786. Net profit of Old Netia was PLN 252,117 for 2011 versus net profit of PLN 263,895 for 2010.

3.3 Consolidated statement of cash flows

Net cash generated from operating activities by New Netia amounted to PLN 418,827. Net cash generated from operating activities by Old Netia amounted to PLN 407,371 for 2011 as compared to PLN 289,483 in 2010. The increase was principally due to higher adjusted EBITDA and the one-off payment of PLN 58.325 in corporation taxes from previous years during 2010.

Net cash used for the purchase of fixed assets and computer software increased by 32% to PLN 254,620 for 2011 from PLN 193,234 for 2010 reflecting an increase in capital investment. Net cash used for the purchase of fixed assets and computer software by New Netia amounted to PLN 262,659.

In 2011 Old Netia spent PLN 1,045,268 on acquisition of Dialog Group and Crowley. The cash outflow from New Netia perspective on these acquisitions was PLN 972,287, net of cash in acquired in the new subsidiaries.

Other significant cash outflow / inflow items during 2011 in New Netia included PLN 700,000 proceeds from borrowings, PLN 204,029 related to the purchases of the short-dated treasury bonds, PLN 383,134 relating to repurchase of the short-dated treasury bonds, PLN 49,582 of repurchase of own shares, PLN 22,698 of purchase consideration for the Ethernet companies acquired in 2011. As a result, net cash used in investing activities during 2011 amounted to PLN 1,072,710 as compared to PLN 289,056 of cash used on investing activities in 2010.

Net cash provided by financing activities in 2011 amounted to PLN 635,822 and net cash used in financing activities during 2010 amounted to PLN 7,932. The inflows in 2011 concerned mainly proceedings from Netia's borrowings. The outflows in 2010 were related mainly to finance lease payments.

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 in 2011 and is expected to continue 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, 2011, the Group's equity amounted to PLN 2,500,373 and the Netia Group had negative working capital of PLN 52,962 inclusive of cash available of PLN 156,509 and short-term bank loans of PLN 180,593. Netia's operations were free cash flow generative in 2011 as were those of the Dialog Group and Crowley, and Management expects this to continue over the medium term. Accordingly, Management sees no immediate threats to financing of its currently planned organic investments, which are projected at PLN 290 ,000 plus up to PLN 35,000 for integrating Dialog and Crowley.

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 29 September 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, 201 and the revolving loan was drawn on December 15, 2011. As at December 31, 2011 the value of these loans at amortised costs was PLN 693,239.

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 conditional generally applied to such types of agreements. The borrowing is measured at amortized cost using an effective interest rate of 8.0%. Total transaction costs included in the calculation of the effective interest rate amounted to PLN 9,252. 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, 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.

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. Petrotel repaid its outstanding loans in January 2012 and ComNet and Intergeo in February 2012.

3.6 Loans, warranties and collaterals granted

Loans granted

The following loans were paid out by the Company in 2011:

- to Netia Brand Management z o.o., the Company's subsidiary, with a total value of PLN 10.
- to Crowley Data Poland Sp. z o.o., the Company's subsidiary, with a total value of PLN 27,099 (loan purchased by the Company from the sellers of Crowley Data Poland Sp. z o.o., see Note 1.1 *The Netia Group's structure)*

The following loans granted by the Company were repaid in 2011:

- by Net 2 Net Sp. z o.o., the Company's subsidiary, with a total value of PLN 80.
- by Internetia Sp. z o.o., the Company's subsidiary, with a total value of PLN 4,400.
- by Internetia Holdings Sp. z o.o., the Company's subsidiary, with a total value of PLN 24,022 (was compensated based on the compensation agreement dated March 31, 2011)

Netia Group did not grant any warranties or collaterals in 2011, 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 2011

Management Board

As at December 31, 2011 and December 31, 2010 the Company's Management Board consisted of the following members:
- Mirosław Godlewski – President,
- Jonathan Eastick – Chief Financial Officer,
- Grzegorz Esz,
- Piotr Nesterowicz,
- Tom Ruhan.

On November 23, 2011 Mr. Piotr Nesterowicz resigned from the position of member of the Company's Management Board effective from January 1, 2012.

Supervisory Board

As at December 31, 2011 and December 31, 2010 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 2011 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
- Ewa Pawluczuk

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

2003 Plan

The 2003 Plan is 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. As soon as the options granted to the participants in the 2003 Plan are exercised, the Company will issue shares in the Company, constituting an equivalent of the profit on the options exercised. The participants are not obliged to pay for the nominal value of the shares. The number of series K shares which can be issued for the purposes of the 2003 Plan may not exceed 13,258,206.

The execution of the Scheme has been entrusted to the Company's Supervisory Board. To the extent provided for in the 2003 Plan, the Supervisory Board, at its exclusive discretion, shall make decisions relating to, among other things, participation in the 2003 Plan, the allotment of options, and the terms & conditions of their being exercised. The Company's Management Board may present the Supervisory Board with recommendations related to other employees' participating in the 2003 Plan.

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 (not in thousands), 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 2011 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 fulfillment of the business criteria set by the supervisory board for each year of the 2011 Plan. 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.

4.5 Remuneration paid and payable to the members of the Management Board and the Supervisory Board in 2011

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	1,492
Jonathan Eastick	1,334
Grzegorz Esz	1,040
Piotr Nesterowicz	962
Tom Ruhan	1,004
	5,832

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	383,716	206
Jonathan Eastick	432,376	232
Piotr Nesterowicz	281,612	151
Tom Ruhan	338,786	182
	1,436,490	770

Remuneration of current members of the Supervisory Board

	PLN
Benjamin Duster	96
George Karaplis	96
Stan Abbeloos	96
Raimondo Eggink	120
Nicolas Maguin	96
Ewa Pawluczuk	120
Tadeusz Radzimiński	96
Jerome de Vitry	120
	840
Remuneration of members of management boards of subsidiaries	721
Remuneration of members of supervisory boards of subsidiaries	13
Total	**7,406**

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 and Supervisory Boards 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 December 31, 2011, 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. The options are exercisable until December 20, 2012. The strike price of the approved outstanding options, depending on the agreement, ranges between PLN 3.50 and PLN 8.25 per share.

During the year ended December 31, 2011 the following changes took place in the number of options granted under the 2003 Plan:

Options	**Year ended December 31, 2011**	**Year ended December 31, 2010**
At the beginning of the period	40,771,814	40,771,814
Exercised	(4,282,750)	-
At the end of the period	**36,489,064**	**40,771,814**

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.

In the year ended December 31, 2011 the Supervisory Board granted 1,725,000 options to members of the Management Board under 2011 Plan. As at December 31, 2011, the weighted average remaining contractual life of the outstanding options was 8.5 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 of PLN 5.23.

Year ended December 31, 2011

At the beginning of the period	-
Granted	1,725,000
At the end of the period	**1,725,000**

(All amounts in thousands, except as otherwise stated)

For 2011 the Supervisory Board set performance goals based on the following key performance indicators:
- Revenue
- Adjusted EBITDA
- Operating Free Cash Flow
- Broadband subscriber base

As at the date of this Directors' Report the supervisory Board was yet to meet to decide on the proportion of 2011 granted options to be retained until vesting by the Management Board members.

The following changes in the number of options granted to members of the Management Board occurred during the year ended December 31, 2011:

	At the beginning of the period	Granted	Exercised	At the end of the period
Mirosław Godlewski	13,334,000	575,000	(1,134,000)	12,775,000
Jonathan Eastick	10,938,314	287,500	(1,366,500)	9,859,314
Grzegorz Esz	4,166,500	287,500	-	4,454,000
Piotr Nesterowicz	6,666,500	287,500	(832,250)	6,121,750
Tom Ruhan	5,666,500	287,500	(950,000)	5,004,000
Total number of options	**40,771,814**	**1,725,000**	**(4,282,750)**	**38,214,064**

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 members of the Supervisory Board did not hold any options as at December 31, 2011 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, 2010	RSUs granted	December 31, 2011
Stan Abbeloos	65,000	15,000	80,000
Benjamin Duster	65,000	15,000	80,000
Raimondo Eggink	65,000	15,000	80,000
George Karaplis	65,000	15,000	80,000
Nicolas Maguin	65,000	15,000	80,000
Ewa Pawluczuk	65,000	15,000	80,000
Jerome de Vitry	65,000	15,000	80,000
Tadeusz Radzimiński	65,000	15,000	80,000
Total RSU	**520,000**	**120,000**	**640,000**

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, 2011 and 2010, is as follows:

	Year ended December 31, 2011	**Year ended December 31, 2010**
	PLN	PLN
Mirosław Godlewski	151	1,199
Jonathan Eastick	75	782
Grzegorz Esz	880	1,792
Piotr Nesterowicz	134	447
Tom Ruhan	75	482
	1,315	**4,702**

The cost of RSU recorded in year ended December 31, 2011 amounted to PLN 1,217 as compared to PLN 682 in 2010:

	Year ended December 31, 2011	Year ended December 31, 2010
Stan Abbeloos	153	91
Benjamin Duster	153	91
Raimondo Eggink	153	91
George Karaplis	153	91
Nicolas Maguin	153	91
Ewa Pawluczuk	153	91
Jerome de Vitry	153	91
Tadeusz Radzimiński	146	45
Total cost of RSU	**1,217**	**682**

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, 2011 and December 31, 2010 Mr. Mirosław Godlewski – the Company's President of the Management Board – held 393,716 and 10,000 shares of the Company, respectively.

As at December 31, 2011 and December 31, 2010 Mr. Tom Ruhan – a member of the Company's Management Board – held 592,379 and 253,593 shares of the Company, respectively.

As at December 31, 2011 and December 31, 2010, Mr. Jonathan Eastick – a member of the Company's Management Board – held 499,175 and 50,000 shares of the Company, respectively.

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

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

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

As at December 31, 2011 and December 31, 2010, Mr. Raimondo Eggink – a member of the Company's Supervisory Board – held 40,000 shares of the Company.

As at 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, 2011 and December 31, 2010, Mr. Tadeusz Radzimiński – a member of the Company's Supervisory Board – held 20.001 and 6,000 shares of the Company, respectively.

As at December 31, 2011 Mr. Jerome de Vitry – a member of the Company's Supervisory Board – held 20,000 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 255, as at December 31, 2011.

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, 2011.

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.

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

During the year ended December 31, 2011 there were no significant legal or organizational changes.

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 information presented to the Company by its shareholders, as at the date filing of 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 March 14, 2012; for details on the ownership interest and the number of votes as at December 31, 2011 please refer to note 16 in the consolidated financial statements of Netia Group as of December 31, 2011):

Third Avenue Management LLC

Third Avenue Management LLC informed the Company that on December 9, 2011 it had reduced its holdings of the Company's shares from 77,812,602 held as at May 4, 2011 constituting 20.38% of the Company's share capital and carrying 20.38% of the total number of votes at the General Shareholders' Meeting of the Company, to 69.988,577 constituting 18.33% of the Company's share capital and carrying 18.33% of the total number of votes at the General Shareholders' Meeting of the Company.

ING Otwarty Fundusz Emerytalny

ING Otwarty Fundusz Emerytalny held a total of 48,010,027 of the Company's shares constituting 12.57% of the Company's share capital and representing 12.57% 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 ING Otwarty Fundusz Emerytalny since December 31, 2010.

Subsidiaries of SISU Capital Fund Limited

On February 25, 2011 SISU Capital Fund Limited informed the Company that subsidiaries of SISU Capital Fund Limited had increased their holdings of the Company's shares from 39,043,006 held as at December 31, 2010 constituting 10.22% of the Company's share capital and carrying 10.22% of the total number of votes at the General Shareholders' Meeting of the Company to 44,336,534 constituting 11.61 % of the Company's share capital and carrying 11.61% of the total number of votes at the General Shareholders' Meeting of the Company.

5.2 Share capital (not in thousands)

At December 31, 2010, the Company's share capital consisted of 389,458,229 ordinary shares and 1,000 series A1 shares with a par value of PLN 1 per share. Each ordinary share had one vote at the shareholders' meetings. 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 2011 the Company issued 2,142,835 ordinary series K shares due to four Management Board members and certain persons who were not 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").

The 5,115,579 series K shares issued prior to Netia's General Meeting of Shareholders held on May 26, 2010, including 61,059 shares issued in 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 may be issued. The total number of such redefined series K shares issued through December 31, 2011 was 2,263,711 and their nominal value was PLN 2,263,711.

As a result 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 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 9,775,000 own treasury shares as at December 31, 2011. 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 39,807,145.

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

The series K shares issued prior to Netia's General Meeting of Shareholders held on May 26, 2010, including 61,059 shares issued in 2010, were designated, in accordance with the resolution adopted by Netia's General Meeting of Shareholders, as series B shares. Since the change of the Company's Statute in 2010 up to 13,258,206 series K shares may be issued based on the basis of 2003 Plan. The total number of series K shares issued through December 31, 2010 was 2,263,711 and their nominal value was PLN 2,234 thousands.

On the basis of the New Plan, 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 Share buybacks

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 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 shares buy-back program approved under the General Program began on August 17, 2011. The Company allocated an amount of up to PLN 60,000 for the Program 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 own shares constituting 2.5% of the Company share capital for a total of PLN 49,582 and the Program was completed.

Netia may commence a further buyback program, subject to obtaining a relevant consent from its Supervisory Board. Management has allocated PLN 75,000 from 2012 expected free cash flows to be utilized in further share buy-backs subject to supervisory Board approval in accordance with the General Program.

6 Other information

6.1 Transactions with related parties

The following transactions were concluded between the Company and its subsidiaries during 2011:
- sale and purchase of telecommunications services;
- sale 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 "Loans, warranties and collaterals granted" and "Remuneration paid and payable to the members of the Management Board and the Supervisory Board in 2011".

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

Netia today sets out its guidance for FY2012. The guidance below will be reconfirmed following the completion of the ongoing Dialog and Crowley integration planning process, which is expected to be completed by the end of April 2012.

(All amounts in thousands, except as otherwise stated)

The existing mid-term guidance for 2010 – 2012, originally issued in 2009, is being withdrawn and replaced with the below FY2012 guidance as a result of both the recent acquisitions, which significantly increase Netia's scale of operations, and due to reaching the last year of its time horizon.

Guidance for 2012 is set out below:

	Guidance 2012
Number of services (RGUs) ('000)	2,900
Revenue (PLN m)	2,185
Adjusted EBITDA (PLN m)	600.0
Adjusted EBITDA margin (%)	27.5%
Adjusted EBIT (PLN m)	125.0
Capital investment (excl. M&A and integration capex) (PLN m)*	300.0
Capital investment (excl. M&A and integration capex) to sales (%)	14%
Adjusted operating free cash flow (Adj. OpFCF) (PLN m)**	300

** Capital investments excluding New Netia's integration related capital investments*
***Adjusted EBITDA less capital investments*

The above guidance excludes the impact of one-off integration costs and one-off integration capex, estimated currently at up to PLN 50.0m and up to PLN 35.0m, respectively.

New Netia now focuses on the total number of services (RGUs) target based on its subscriber base, reflecting a multiplay approach and stressing the importance of ARPU increase per active subscriber.

The long-term strategic financial goals issued together with the Strategy 2020 are being updated to reflect the expanded New Netia Group as follows:

Long-term strategic financial goals (until 2020)
Continued growth in the number of services(RGUs)
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 2011 and 2010 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	**2011**	**2010**
Audit of stand-alone and consolidated financial statements	293	358
Review of stand-alone and consolidated financial statements	252	272
Audit of subsidiaries' financial statements	131	148
Other attest services	292	350
Total	**968**	**1,128**

6.4 Compliance with corporate governance rules

The Management Board of the Company represents that in 2011 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 2011 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)*

Interest rate risk hedging

On January 5, 2012 and January 10, 2012 the Company entered into IRS contracts hedging interest rate risk associated with interest payments in the amount of fifty per cent of all amounts projected to be outstanding under the Term Loan (See Note 3.5 Loans Agreements).

Establishment of the registered pledges

On the basis of the loan agreement (see Note 3.5 Loans Agreements), a registered pledge over 19,598,000 shares in Dialog with the nominal value of PLN 25 each and the total nominal value of PLN 489,950,000 constituting 100% of the share capital of Dialog and entitling to exercise 100% of the votes at the general meeting of Dialog was registered on January 26, 2012.

Moreover, a registered pledge over 6,220,980 shares in Netia Brand Management with the nominal value of PLN 50 each and the total nominal value of PLN 311,049,000 constituting 100% of the share capital of Netia Brand Management and entitling to exercise 100% of the votes at the shareholders' meeting of Netia Brand Management was registered on February 7, 2012.

The opening of the liquidation of the subsidiary

On February 27, 2012 the Company was informed that the District Court for the capital city of Warsaw, XIII Commercial Division of the National Court Register has registered the opening of the liquidation of Netia's subsidiary In2Loop Polska sp. z o.o. with the registered seat in Warsaw ("Netia's Subsidiary"). The resolution regarding the dissolving of Netia's Subsidiary was adopted on October 27, 2011. The entry of the liquidation opening in the register of entrepreneurs was done on December 30, 2011. Netia owns a 100% of shares in In2Loop Polska sp. z o.o.. In2 Loop Polska sp .z o.o. was acquired as the wholly owned subsidiary of Tele2 Polska sp. z o.o. in September 2008 and from that time has not been performing the economic activity.

Changes in the share capital

On January 30, 2012 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, a decrease in other supplementary capital by PLN 39,807,145.

Following the exercise of stock options in February 2012, on March 8, 2012 36,039 shares were issued increasing the share capital of the Company to PLN 381.863.103.

Acquisitions

On February 14, 2012 Internetia purchased 100% of the share capital of Elpro-Elektronika Profesjonalna Waldemar Nitka Sp. z o.o.

(All amounts in thousands, except as otherwise stated)

("Elpro"), an internet service provider offering broadband Internet access to residential clients.

On March 7, 2012 Internetia purchased 100% of the share capital of STI Sp. z o.o. ("STI"), an internet service provider offering broadband Internet access to residential clients.

Overdraft facility agreement

On March 8, 2012 Netia entered into an overdraft credit facility agreement with BRE Bank S.A. of PLN 50.000.000. 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. The terms and conditions of the agreement comply with market practice and are not different from the terms and conditional generally applied to such types of agreements.

Warsaw, March 14, 2012