DIRECTORS’ REPORT
NETIA S.A. GROUP
for the year ended December 31, 2010

Table of contents

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's structure

The consolidated financial statements as at and for the year ended December 31, 2010 include the financial statements of the Company and the following subsidiaries:

- In2Loop Polska Sp. z o.o.
- 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.

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 eTychy Sp. z o.o., Multiplay Polska Sp. z o.o., Pronet Sp. z o.o. and Global Connect Sp. z o.o. with its subsidiaries SSI Net Sp. z o.o. and Fornet Sp. z o.o.
- UNI-Net Poland Sp. z o.o.

Changes within the Netia Group's structure

Acquisitions

On June 15, 2010 Global Connect Sp. z o.o., the Company's subsidiary, concluded an agreement for the acquisition of 100 (not in thousands) shares in the share capital of SSI Net Sp. z o.o. 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 of these shares has been set at PLN 612.

On September 30, 2010, Internetia Sp. z o.o. ("Internetia"), the Company's subsidiary, concluded an agreement for the acquisition of 200,000 (not in thousands) shares in the share capital of Multiplay Polska Sp. z o.o. ("Multiplay"), 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 Multiplay shares has been set at PLN 7,998.

On October 6, 2010, Internetia Sp. z o.o. ("Internetia"), the Company's subsidiary, concluded an agreement for the acquisition of 18,410 (not in thousands) shares in the share capital of Igloonet Sp. z o.o. ("Igloonet"), each with the nominal value of PLN 100 (not in thousands), which represent 100% of the share capital and confer the right to 100% of the votes at the general meeting of shareholders. The total price for all Igloonet shares has been set at PLN 3,020.

On December 16, 2010, Global Connect Sp. z o.o. ("Global Connect"), the Company's subsidiary, concluded an agreement for the acquisition of 1,500 (not in thousands) shares in the share capital of Fornet Sp. z o.o. ("Fornet"), each with the nominal value of PLN 100 (not in thousands), which represent 100% of the share capital and confer the right to 100% of the votes at the general meeting of shareholders. The total price for all Fornet shares has been set at PLN 1,369.

On December 21, 2010, Internetia Sp. z o.o. ("Internetia"), the Company's subsidiary, concluded an agreement for the acquisition of 100 (not in thousands) shares in the share capital of Pronet Sp. z o.o. ("Pronet"), 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 Pronet shares has been set at PLN 1,800

***Registration of a new subsidiary (not in thousands*)**

On September 15, 2010, the Company's subsidiary, Netia 2 Sp. z o.o. ("Netia 2"), was registered in the National Court Register. Netia acquired 100 Netia 2's shares (with a par value of PLN 50 per share) constituting 100% of Netia 2's share capital and giving Netia 100% of the voting power at Netia 2's general meeting of shareholders.

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 26 such operators with a total of 105,030 (not in thousands) active customers. Additionally the Netia Group has acquired 7,810 (not in thousands) customers and local 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.

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 2009 and 2010 are presented below:

	Year ended December 31, 2009	Share in total revenues	Year ended December 31, 2010	Share in total revenues
	(PLN)	%	(PLN)	%
Direct voice, including:	743,395	50 %	741,717	47%
Monthly fees	*457,523*	*31%*	*485,186*	*31%*
Calling charges	*285,541*	*19 %*	*256,261*	*16%*
Indirect voice	65,654	4 %	37,359	2%
Data	520,460	35 %	579,850	37%
Interconnection revenue	66,917	4 %	68,394	4%
Wholesale services	81,592	5 %	115,561	7%
Other telecommunication revenue	22,489	2 %	21,553	1%
	1,500,507	**100 %**	**1,564,434**	**100%**
Radio communication services	5,364	0 %	4,862	0%
	1,505,871	**100 %**	**1,569,296**	**100%**

1.3 Sales market (not in thousands)

The Netia Group operates on the telecommunications services market. The market for fixed line telephony services decreased from approximately 10 million lines at the end of 2009 to 9,4 million at the end of 2010 and is continuing to fall. The penetration of fixed line telephony in Poland was 67% of households at the end of 2010.

Following the market liberalization and introduction of services based on bitstream 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 TP SA's copper network. The market for broadband services has increased significantly to an estimated 6 mln subscribers at the end of 2010 from 5,6 mln in December 2009. This market has the highest growth of all fixed telecommunication segments and this trend is expected to continue over the next few years. In 2010 household Internet penetration reached 43% and the Netia Group maintained its position as the leading alternative for broadband services to the national telecom operator (TP SA). Based on published market share estimates, Netia projects that it acquired over 30% of broadband net additions during 2010. The Netia Group's broadband subscribers base increased to 690,247 at December 31, 2010 from 559,413 a year earlier. The Netia Group estimates that its share of total broadband market subscribers has increased from 10.1% to 11.5% during the past twelve months.

The Netia Group has its own access networks built out in areas inhabited by approximately 65% of Poland's population. At the end of 2010, Netia served 223,169 broadband customers using the wholly owned copper 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.

The Netia Group started an important expansion of access and backbone networks in 2006 as a result of the implementation of its WiMAX project. At the end of 2010 telecommunications services based on WiMAX technology using 100 active base stations, were available in 181 cities and towns. The number of WiMAX broadband Internet ports reached 18,974 at December 31, 2010 (up from 17,079 at the end of 2009). 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).

As of December 31, 2010, Ethernet networks acquired by the Netia Group since mid-2007 provided broadband access to a total of 115,194 mostly residential customers as compared to 105,678 customers at December 31, 2009, with approximately 499,000 homes passed. During 2010 the Netia Group acquired a total of six Ethernet networks (including both purchases of companies and asset transfers) with 15,097 active customers and 83,800 homes passed. The acquisition program is part of Netia's strategic objective to acquire one million broadband customers. Following the acquisitions, Netia aims to up-sell voice services to the existing subscriber bases. The Netia Group remains fully dedicated to consolidation of the fragmented Polish Ethernet ISP market.

In 2010 Netia continued to extend the reach of its LLU-based services. Netia had 512 unbundled nodes at December 31, 2010, reaching approximately 4,3 million active customer lines. As of today, Netia has 520 nodes unbundled and expects to take the total of unbundled nodes to 700 by the end of 2011, reaching approximately 5.0 million customer lines.

Netia served 126,895 customers over LLU as at December 31, 2010 as compared to 98,555 at September 30, 2010 and 48,117 at December 31, 2009. The total LLU subscriber base includes 64,311 customers migrated from lower margin bitstream ("BSA") services.

At the end of 2010, Netia served an average of 248 customers per LLU node as compared to 162 customers per LLU node at the end of 2009.

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

The Netia Group renders its services both to business and residential customers. In 2010 none of the customers exceeded 10% share in the Netia Group's sales. 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)

Our key objective is to further strengthen our leadership position among alternative telecom operators in the Polish broadband market. We aim to reach one million broadband customers until the end of 2012 as well as continuing to strengthen our market share position in fixed broadband and telephony market segments further into 2020 to reach a combined share of 15% volumewise and 20% valuewise respectively. This will be driven predominantly by LLU, wholesale Bitsteam Access ("BSA") and Netia's own access networks including NGA upgrades. Our priority in this area is to strongly increase our customer base using LLU access, both by targeting new customers in our LLU coverage areas and by migrating customers from Wholesale Line Rental (WLR) and BSA onto LLU. Additionally, select access networks upgraded to NGA standard will facilitate new service portfolio development characterised in particular by a relatively higher profitability potential in future. We expect that these activities will enable us to enhance the profitability of voice and broadband services and will allow us to offer a broader range services to a greater number of customers. A key priority is to continue to boost the proportion of our customer base taking more than one service from Netia 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. In the fourth quarter of 2010 we launched a 'pilot' roll-out of IPTV commercial services in Wroclaw and Torun regions based on ETTH and copper access networks respectively. The success of the 'pilot' will be fundamental to Netia's product portfolio going forward, as our offer could in consequence include 3play services rendered to residential clients in a number of different locations countrywide. Making the mobile and in particular television services available to our customers will enable us to boost the value of our customer base, as well as will contribute to meeting a wider range of our customers' needs and strengthening our relationships with them.

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 utilisation of existing capacity and other assets by selectively pursuing projects that require limited investment and which are considered low risk for the returns available.

In September 2008 we finalised 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. 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 programme known as Project "Profit" which in 2010 delivered 140 million PLN of operational savings, which helped us to achieve the targeted EBITDA margin of 23% by 2010.

A critical enabler for successful accomplishment of Netia's growth plans is an organisational culture characterised 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 construction of new type 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 is under intensive development. At December 31, 2010, 512 LLU nodes had been deployed by Netia from a total plan of 700 expected to be fully deployed by the end of 2011. This LLU network is expected to give us access to 5.0 million of TP access lines Poland–wide. Implementation of modern ADSL 2+/VDSL technologies in LLU nodes will enable delivery of advanced services requiring broadband access (i.e IPTV, VoD, VoiP, MPLS).

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 50Mb/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.

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"). The newly announced financial guidance includes the planned capital expenditures with respect to NGA project, envisaged mainly in the 2011 - 2013 period as well as the Management's estimation of potentially achievable market shares in fixed broadband and fixed telephony in the Polish telecom market as well as 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. Current Netia's strategy and guidance until 2012, as announced on April 6, 2007 (including subsequent revisions) remains valid while 2011 and 2012 will become transition years for Netia in the pursue of the long term Strategy 2020.

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.

The fragmented market of alternative operators rendering wireline telephone services may result in increasing 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.

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 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 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, 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/forth 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 2011, Netia is piloting the introduction of upgraded broadband speeds to its copper and Ethernet ("ETTH") networks and adding television and content services to its offering. No assurance can be given that these pilot projects will be successful in proving the business case for such upgrades and new services. Moreover, even if the pilots are successful, 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 offer 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.

Foreign currency risk

Approximately 35% 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 April 24, 2009, the lower chamber of the Polish Parliament (Sejm) passed the act on the amendment of the Telecommunications Law and other acts. The purpose of the above-mentioned amendment was to further harmonize Polish provisions with the legal framework of the European Union and this amendment to the Telecommunications Law entered into force on July 6, 2009.

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, is obliged to adjust its standard client contracts to the new requirements within six months following the entry of the amendment into force.

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.

Another amendment of Telecommunications Law, concerning regulations laying down the rules of test for correctness of fees calculated by an operator holding a significant market power pursuant to the calculation method taking account of justified costs and incurred costs, is currently in the legislative process. At the current stage it is not possible to state if and when the new provisions will enter into force, foresee their exact wording, as well as assess their impact on the activity of the Companies from the Group.

The Ministry of Infrastructure has commenced consultations of guidelines for draft law amending the Telecommunications Act (hereinafter referred to as "the Guidelines"), aiming to implement the amendments of the 2002 Directives package, that entered into force in the EU in December 2009. The Directives amending the 2002 package, among other issues, forbid to enter into an agreement of providing telecommunications services longer than 24 months and oblige telecommunications entrepreneurs to extend their offer to include 12 month contracts (or shorter), broaden 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). National regulators are authorized to perform analyses of relevant product markets while taking into consideration the regional differences in development of competition throughout the country. The Guidelines provide for, *inter alia*, making telecommunications undertakings responsible for compliance with quality parameters of broadband Internet access, including minimum guaranteed speed of data transmission, extension of the obligation to provide facilities for disabled persons onto all of the telecommunications undertakings, 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") participates in consultations of the Guidelines and submitted its statement expressing its opinion against the said amendments, as well as concerning other draft amendments. The Management Board, however, is unable to assure that the KIGEiT remarks will be accepted. Member states, including Poland, are obliged to implement the new regulation by May 25, 2011 and this is the deadline for adjusting the Telecommunications Act.

At this stage it cannot be determined how material will be the impact of these new European obligations whilst most of the changes described above may increase the Company's costs or increase competition.

Risks resulting from the obligation to provide universal services

The telecommunications law stipulates that universal service obligation will be rested on telecommunications undertaking designated in the President of UKE decision issued upon carrying out of tender procedure. The President of UKE issued a decision designating TP SA to provide universal service until May 8, 2011. Telecommunications undertakings, whose revenue from telecommunications activity exceeded PLN 4,000, are obliged to participate in financing of this obligation. The exact participation amount of a telecommunications undertaking obliged to pay subsidy will be established by virtue of the President of UKE decision, as well, although the said amount cannot exceed 1% of revenues of a given telecommunications undertaking in a given calendar year. The amount of participation in subsidy towards the universal service will constitute cost of income acquisition under law on corporate income tax. At the present stage one cannot exclude that Netia Group will be obliged to co-finance subsidy towards universal services.

(All amounts in thousands, except as otherwise stated)

TP SA filed with the President of UKE applications for awarding subsidy towards incurred costs of universal service provision. The applications regard subsidy towards costs incurred in period from May 8, 2006, until December 31, 2006. The President of UKE refused to award TP SA with a subsidy towards costs of services provided by TP SA in 2006, being a part of universal service. Upon filing a complaint by TP SA the Court repealed the President of UKE decisions. The President of UKE and KIGEiT filed cassation appeals against this judgement. The appeals were dismissed by the Supreme Administrative Court and the case was remanded to UKE for reconsideration. TP SA filed applications for subsidies towards universal service for years 2007-2009, as well.

In view of uncertainties over data included in the calculation, currently it is impossible to provide a reliable estimation of potential obligations arising from the subsidy towards universal service. On the basis of the 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 may be claimed by TP SA from Netia Group amounts to approximately PLN 27,000 for the period from 2006 until 2009 inclusive as follows:

2006	4,500
2007	7,000
2008	7,000
2009	8,500
	27,000

However, this amount may change substantially depending on (i) full or partial acceptance of TP SA applications by UKE and (ii) consistently of the Company's and UKE's estimations concerning revenues of telecommunications services providers. As Management is not aware of the size of any claim by TPSA in respect to 2010, it is still too early to estimate the related maximum amount.

The Management Board is unable to exclude the possibility of issuance of a decision, in result of which Netia will be designated to participate in universal service provision. However, in the opinion of the Management Board the list of investments claimed by TP SA does not currently justify such subsidies. Results of an independent audit of TP SA's claims conducted by UKE have not been published and no decisions of UKE in favor of TP SA have been made to date. As a consequence no reserve due to potential participation in universal service provision was established as for the balance sheet date.

Risks related to holding a position of SMP

The President of the UKE issued the decision, whereby it has designated Netia as a telecommunications operator 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., 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 in the above mentioned decision of the President of the UKE, the Company 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. The published document, hereinafter the "Netia IC Offer" contains 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 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 Netia in another wholesale market is determined, as well as that Netia 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.

Risk of changes of UKE decisions

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. Management Board is unable to exclude the risk that the decisions will not be reversed or amended by the court during the period during 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.

Dependence of the Company on TP SA due to telecommunication access services

<u>Risks relating to regulatory access rates</u>

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 freezes 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 within BSA Offer 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 upon implementation of new speeds to its BSA Offer in the future, are to be controlled by a new margin squeeze test established by virtue of the President of UKE decision ("MS test").

Under the above-mentioned principle, Netia and TP SA have specified conditions for settlements for broadband access to TP SA network. Payments for the use of subscribers' connections applied for to TP SA until October 10, 2009 were, from January 1, 2010, calculated at their nominal value, while taking into account retail prices of TP SA as of October 10, 2009. The parties have also adjusted the amount of wholesale rebate to the BSA reference offer, and introduced payments for settlements between operators according to the currently binding BSA Offer.

Payments for the use of subscribers' connections, for which the applications were filed to TP SA after October 10, 2009 were settled under previous rules specified in the BSA reference offer, until transition to settlement rules which takes the amount of fees, established with the use MS test, into account. The amount of these fees may not be higher than established according to the currently binding BSA reference offer, i.e. according to the "retail-minus" methodology for the day of October 10, 2009.

Currently installation and subscription fees due to realization of BSA Offer, as well as due to service provision on subscriber's connection are unified as regards all of the orders and consistent with the binding Reference Offer.

Alternative operators, including Netia, passed information on the costs to the President of UKE for the purpose of the MS model. According to the test results published by the President of UKE on July 23, 2010 the retail offers of TP SA (examined with the use of 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 also expressed in nominal values.

Netia was surprised that TP's new prices for the lowest transmission speeds somehow passed the tests. Netia has had its costs verified by an independent auditor, and after simulating the margin squeeze test against the TP's retail offer of October 1, 2010, using the audited costs, it still seems surprising that the above mentioned TP offer should have passed the margin squeeze test. During Q4 2010 Netia participated along with other operators associated at KIGEiT, a telecom chamber, and TP in consultations initiated by the Regulator, which were aimed at improving the test procedure to increase its transparency going forward. Currently, Netia awaits the results of the consultations by the Regulator.

The Management Board is unable to assure that the MS Test rules 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 offer that had undergone the MS Test may result in Netia'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.

<u>*Risks related to amendments to reference offers*</u>

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 regulates 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 introduces 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 introduces significant increases in the fees for fixed line number portability. Although these new rates have been appealed, the Management Board is unable to give any assurance that as a result of re-examination of the case the President of UKE will cancel the number portability fee which was introduced by RO or will decrease the amount of it.

KIGEiT and TP SA filed for re-consideration of the case concluded by issuance of RO. At the present stage of the procedure it is impossible to assert whether and which of the claims of both parties will be accepted and what the final content of RO approved by the final decision of the President of UKE will be.

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.

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 2009 the President of UKE issued temporary decisions amending agreements on the interconnection of networks between Netia and Polska Telefonia Cyfrowa Sp. z o.o., Netia and Polkomtel SA as well as Netia and PTK 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 between Netia and the above-mentioned operators, by setting the MTR at the level of PLN 0.1677 per minute.

PTK 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 Management Board cannot assure that the decisions will not be amended or reversed by the court, thereby materially increasing our interconnection costs and in such a case, that PTK Centertel Sp. z o.o., Polkomtel SA and Polska Telefonia Cyfrowa Sp. z o.o. will not raise the claims against Netia nor how the courts might treat such claims

Moreover, along with other market participants, Netia has 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, Netia 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 upheld by the courts.

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 fibres, 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 fibre 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.

In the Understanding of December 23, 2009, Netia and TP SA established that the amount of rates for access to network within LLU will not be changed until December 31, 2012, which is why until this time, the change of methodology of setting fees by its calculation taking account of incurred costs will have no impact on settlement rules between Netia and TP SA due to provision of access to local loop and local sub-loop built in copper technology. However, the Management Board is unable to assure that no circumstances will arise in the future that could lead to increase of the amount of costs of Netia's use of LLU service.

In the opinion of the Management, relevant markets are not developed sufficiently to allow for their geographical segmentation, but one cannot assure that in the next analysis of relevant markets the President of UKE will not differentiate on geographical grounds. Even in such a case, in the opinion of the Management, there would be no grounds to hold that TP SA has lost its significant market power on any market or that the regulatory obligations imposed on TP SA shall be repealed or limited. Despite this opinion, the Management Board cannot assure that as a result of relevant markets analysis, the President of UKE would not modify or waive some or all regulatory obligations imposed on TP SA with regard to the whole relevant market or to specific geographical areas of the country. If so, this could materially affect Netia's access to the TP SA network and our ability to offer services.

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.

In December 2008 the President of the Office for the Protection of Competition and Consumers ("UOKiK") issued a decision in which he stated that Tele2 Polska had breached the collective consumer interest by charging a fee of PLN 100 (not in thousands) to its clients for early termination of agreements concluded for a specified term. In the decision the President of UOKiK imposed on Tele2 Polska a fine of PLN 3,978. The decision of the President of UOKiK was not made immediately binding and enforceable. Tele2 Polska has appealed against the said decision. Due to the merger of Tele2 Polska and Netia, on February 27, 2009 Netia became a party to the above-mentioned proceedings conducted by SOKiK. In the decision dated on January 15, 2010 SOKiK has decreased the fine to PLN 1,989.

On November 19, 2010, the Appellate Court dismissed the appeal. The fine was paid.

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.

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.

Risk of collective suits

On July 17, 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. Netia intends 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 that 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 guarantee that change of market situation, future court judgements or regulatory body decisions will not cause that currently existing possibilities of services provision for clients with use of TP access networks will no longer remain 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 build 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 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, where 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 the Polish regulator issued a decision reducing the initial milestones. The amended milestones alloted for the years 2008 and 2009 regarding population coverage were exceeded whilst there was a marginal underperformance of the territorial coverage requirements. In the event that license obligations are not met by an operator, the UKE has the power to limit or confiscate the relevant license, if the issue is not rectified. 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 15.0 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 has received opinions from several independent tax and legal advisors, as well as tax law experts, which conclude that the claims of the Directors of the Tax Control Office and the Tax Chamber have no legal grounds. Accordingly, Management has not recognised the Tax Chamber's decision as a taxation expense and instead treats funds paid over to the tax authorities as an overpayment of tax.

Netia has filed an appeal to the Decision with the Voivodship Administrative Court and will undertake all possible legal steps to prove that the decision of the Tax Chamber Director was groundless. The next hearing in this matter at the Voivodship Administrative Court is scheduled for February 22, 2011.

Although there is a significant degree of instability in the interpretation of tax regulations by the Tax Authorities and the Courts, Management is highly confident that the merits of its arguments will prevail in the Courts and the funds will be returned by the tax office together with interest currently calculated at 12.5% per annum. However, should Netia lose this case and all subsequent appeals, the amount of PLN 58.3 million would have to be reclassified as a taxation expense relating to prior years.

2.2 Factors and events having a significant influence on the operations of the Netia Group and the financial results achieved in 2010

Cost saving initiatives (not in thousands)

Following the acquisition of Tele2 Polska in September 2008 which significantly augmented the scale of the business, Netia performed a comprehensive cost review across all functional areas of the Company. Areas for operating cost optimization were indentified, with a target to reduce full year operating expenses for year 2010 and onwards by PLN 100 million. The program included a reduction of Netia's headcount, review of control and reporting processes, increase in work effectiveness, span of control increase and contract renegotiations. By the end of 2010 nearly all initiatives were completed and annual savings in 2010 reached PLN 140 million surpassing the expected PLN 123 million announced at the end of the implementation phase.

Reversal of impairment losses

Upon an update of Netia's five-year business plan that takes into account new opportunities and potential threats resulting from changes in the telecommunications environment, Netia performed an impairment test in Q4 2010. 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, 2010 the Netia Group has recognized 221,184 PLN of reversal of impairment losses in profit and loss during the year ended December 31, 2010. 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, 2010 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 184,821, telecommunications licenses – PLN 25,447, investment property – PLN 9,501, computer software – PLN 1,407 and customer relationships – PLN 8. Following the reversal of 221,184 PLN of impairment losses a maximum additional amount of 261,438 of previously recognized impairment losses could be reversed as at December 31, 2010 should the results of future impairment test so require.

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 income tax asset

Following the Management's assessment of the recoverability of tax loss carry-forwards and timing differences against future taxable profits, in 2010 the Netia Group recognized PLN 52,762 of deferred income tax asset as compared to PLN 79,400 as of December 31, 2009. The decrease, offset partially by other changes, relates mainly to PLN 17,550 of impact from the reversal of the earlier impairment charges and PLN 10,525 of a decrease in deferred tax asset relating to tax losses, as significant part of tax losses were utilised in 2010. This assessment was based on the budget for 2011 and Netia's long term business plan for years 2011-2015. Rapid subscriber growth, costs savings, synergies from the Tele2 Polska acquisitions, successful migration of customers to LLU and the prospect of stable regulatory access rates 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 690,247 at December 31, 2010 from 559,317 a year earlier. By the end of 2011, Netia aims to reach between 780,000 and 800,000 broadband subscribers through further organic growth, with potential for a higher figure pending additional Ethernet networks acquisitions. Netia provides its broadband services using the following technologies:

(All amounts in thousands, except as otherwise stated)

Number of broadband ports	**2009**	**2010**
xDSL and FastEthernet over Netia's own fixed-line network	200,060	223,169
Bitstream access	293,782	321,075
WiMAX Internet	17,079	18,974
LLU	48,117	126,895
Others	279	134
Total	**559,317**	**690,247**

Broadband ARPU was PLN 53 in Q4 2010 as compared to PLN 60 in Q4 2009. The declining ARPUs reflect the impact of aggressive offers run during 2009 and early 2010 plus discounts given to focus sales on more profitable 2play voice and data bundles. Broadband ARPU is expected to settle between PLN 50 and PLN 60 per month in the medium term.

Broadband SAC was PLN 203 in Q4 2010 as compared to PLN 206 in Q4 2009 and PLN 202 in Q3 2010.

Local loop unbundling (LLU)

In 2010 Netia continued to extend the reach of its LLU-based services. As at December 31, 2010 Netia had 512 unbundled nodes, reaching approximately 4.3 million customer lines compared with 297 unbundled nodes as at December 31, 2009, and 2.5 million customer lines a year earlier.

Netia served 126,895 customers over LLU as at December 31, 2010 as compared 48,117 at December 31, 2009.

Acquisitions of local Ethernet network operators.

As of December 31, 2010, Ethernet networks acquired by Netia since mid-2007 provided broadband access to a total of 115,194 mostly residential customers as compared to 105,678 customers at December 31, 2009, with approximately 499,000 homes passed. The acquisition program is part of Netia's strategic objective to acquire one million broadband customers and up-sell voice services to the existing subscriber base of the acquired Ethernet providers. Netia remains fully dedicated to consolidation of the fragmented Polish Ethernet ISP market.

During 2010 Netia acquired a total of 6 Ethernet networks (including purchases of companies and asset transfers) with 15,097 active customers and 83,800 homes passed.

Voice lines (own network and WLR)

Voice lines (own network and WLR (wholesale line rental)) totaled 1,230,965 at December 31, 2010 as compared to 1,158,448 at December 31, 2009. Netia aims to maintain its current voice subscriber base during 2011. The year-on-year increase in the number of voice lines resulted mainly from growth within VoIP and LLU-based voice services. During 2010, Netia grew its base of voice customers using relatively low cost VoIP technology from 43,867 to 125,366, principally over LLU to residential customers or in the business segment. Over time, the Company expects to gradually reduce its reliance on traditional switched telephony, thereby reducing its cost base.

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

Number of voice lines	**2009**	**2010**
Traditional direct voice	349,824	332,657
Voice over IP*(excl. LLU)*	19,734	42,987
WiMAX voice	21,526	20,043
WLR	743,231	752,899
LLU voice over IP	24,133	82,379
Total	**1,158,448**	**1,230,965**

Voice ARPU per WLR line amounted to PLN 48 in Q4 2010 as compared to PLN 51 in Q4 2009. The year-on-year decrease in ARPU is associated with offering more competitive tariffs under Netia's customer retention activities.

Voice ARPU per Netia network subscriber line amounted to PLN 54 in Q4 2010 as compared to PLN 62 in Q4 2009, with the annual decrease reflecting overall tariff reduction.

Blended voice ARPU was PLN 50 in Q4 2010 as compared to PLN 55 in Q4 2009. In the medium term, Netia expects blended voice ARPU to stabilize.

Indirect voice

CPS lines (carrier pre selection) totaled 82,983 at December 31, 2010 as compared to 116,628 at December 31, 2009. Netia is focused on the conversion of Tele2 Polska's CPS customers to WLR and is not actively acquiring new CPS customers.

Indirect voice ARPU per CPS line was PLN 28 in Q4 2010 as compared to PLN 36 in Q4 2009. 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

Annex to the UMTS Agreement

On July 24, 2009 Netia and P4 concluded an agreement for the sale of the transmission equipment used by Netia to provide transmission services to P4. The sale agreement was entered into on the following terms and conditions:

1. The transmission equipment was purchased by P4 in three batches.
2. The total price for the transmission equipment was PLN 65,418, of which:

a) PLN 22,832 was payable by P4 on the date of purchase of the first batch of the transmission equipment, i.e. August 1, 2009;
b) PLN 21,141 was payable by P4 on the date of purchase of the second batch of the transmission equipment, i.e. January 1, 2010; and
c) PLN 21,445 was payable by P4 on the date of purchase of the third batch of the transmission equipment, i.e. July 1, 2010.

3. The legal title to the given batches of the transmission equipment was transferred to P4 after P4 paid the price for a given batch.

In January 2010 and July 2010 the Company transferred to P4 the second and third batches of the transmission equipment and recognized gains on disposal of PLN 2,865 and PLN 4,433, respectively (a gain of PLN 5,298 was recognized on disposal of the first batch in the third quarter of 2009).

3 Financial condition of the Netia Group

3.1 Consolidated statement of financial position

As at December 31, 2010, non-current assets amounted to PLN 1,973,707 (77% of total assets) as compared to PLN 1,898,753 at the end of 2009. The main change within non-current assets relates to increase of property, plant and equipment by PLN 88,955. This is due to the reversal of impairment losses of PLN 184,819 (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, 2010) and additions of PLN 174,346, partially offset by depreciation charge of PLN 231,992 and net disposals of PLN 37,237 concerning mainly sale of transmission equipment (see point "Agreements essential for the Netia Group's operations"). The increase of property, plant and equipment was partially offset by decrease in deferred tax asset by PLN 26,638, primarily due to reversal of impairment losses and utilization of part of tax losses in 2010.

Current assets at December 31, 2010 in the amount of PLN 594,862 increased by 34% as compared to PLN 442,729 at the end of 2009. The change was mainly attributable to the Company's investments in treasury notes, which as at December 31, 2010 amounted to PLN 175,000 in nominal value and tax office receivable of PLN 58,325 (see point 2 "Major risks and threats related to the operational activities: *Tax regulations and their interpretation*).

As at December 31, 2010, the equity amounted to PLN 2,297,546, comprising 89% of total equity and liabilities and increased by 13% as compared to PLN 2,026,177 at the end of 2009 (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 27,421 and increased as compared to PLN 21,744 at the end of 2009, mainly due increase of long-term deferred income.

As at December 31, 2010, current liabilities amounted to PLN 243,602 and decreased by 17% as compared to PLN 293,648 at the end of 2009, mainly due to the advance payment of PLN 21,141 made by P4 and presented in liabilities at the end of 2009 and overall decrease in trade liabilities and accrued expenses due to significantly lower fixed costs in 2010 thanks to costs saving initiatives implemented in the prior year.

3.2 Consolidated income statement

Telecommunication revenue, excluding IVT, increased by 4% to PLN 1,564,434 from PLN 1,500,507 in 2009. Data revenue increased to PLN 579,850 up by 11% from PLN 520,460 in 2009, 14 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 4 percentage points. Revenue from direct voice services amounted to PLN 741,717 as compared to PLN 743,395 for 2009, supported by Netia's organic additions of VoIP and WLR voice customers.

The overall revenue level was supported by growth in wholesale services with an increase of 42% or PLN 33,969. The gradual run-down in indirect voice customers produced a revenue decrease of PLN 28,292 or 43%.

Cost of sales increased by 7% to PLN 1,075,979 from PLN 1,005,486 for 2009 and represented 69% of total revenue as compared to 67% for 2009. The increase in cost of sales in 2010 resulted mainly from higher level of network operations and maintenance costs and higher interconnection charges, driven by the growing regulated access customer base where WLR, LLU and BSA services combined increased by 11%. Whilst the increased share of LLU based customers is reducing costs, ancillary fees paid to TP for migration or changes of transmission speed are becoming significant. In addition, the network operation and maintenance cost for 2009 included a positive accounting impact from the settlement agreement with TP of PLN 3,745. Higher interconnection charges are mainly the result of increased voice termination and transit traffic services in the carrier segment.

Gross profit for 2010 was PLN 493,317 as compared to PLN 500,385 for 2009. Gross profit margin was 31.4% for 2010 and 33.2% for 2009. Lower customer ARPUs and higher volumes of lower margin wholesale regulated access customers in the subscriber mix plus higher costs associated with activation of a higher volume of new broadband customers, migrations to LLU and customer retention were partially offset by cost savings and the increased share of LLU based customers.

Selling and distribution costs decreased by 8% to PLN 312,865 from PLN 338,446 for last year and represented 20% of total revenue as compared to 22% in 2009. This improvement reflects the positive impact of Tele2 Polska related synergies and the impact of "Profit" Project on the structure of selling and distribution costs, supported mainly by lower billing, mailing and logistics costs as well as lower advertising spending and commissions paid to third parties.

General and administration costs decreased by 18% to PLN 142,249 from PLN 173,458 for 2009 and represented 9% of total revenue as compared to 12% in 2009, reflecting expenditure reductions following the Project "Profit" and the positive impact of Tele2 Polska related synergies.

Other income was PLN 18,881 as compared to PLN 17,890 in 2009, and included PLN 7,086 of reminder fees and penalties and PLN 5,511 of forgiven liabilities.

Other gains, net were PLN 8,709 as compared to PLN 9,965 in 2009. This included a gain of PLN 7,298 on disposal of the second and third tranche of radio transmission equipment to P4 and a gain of PLN 952 on sales of fixed assets while in the prior year period the Netia Group recorded a gain of PLN 5,298 on disposal of the first tranche of radio transmission equipment to P4 and PLN 2,537 on sales of property and other fixed assets

Unusual items in 2010 included the 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. In the prior year, EBITDA included a positive accounting impact of PLN 15,326 from the settlement agreement with TP, PLN 5,298 gain on sale of the first tranche of transmission equipment to P4 and "Profit" Project related expenses of PLN 11,742 PLN for a net total of PLN 8,882 of gains.

EBITDA inclusive of the unusual items was PLN 586,439 for 2010 as compared to PLN 312,834 for 2009. EBITDA margin increased to 37.4% for 2010 as compared to 20.8% for 2009.

Operating profit (EBIT) was PLN 285,775 as compared to an operating profit of PLN 14,268 for 2009. Excluding net unusual items described above of PLN 226,945 in 2010 and PLN 8,882 in 2009, EBIT increased to PLN 58,830 in 2010 from PLN 5,386 for 2009.

Net finance income was PLN 3,014 as compared to net finance costs of PLN 13,143 in 2009 and was related mainly to interests earned on cash and treasury bills deposits.

Income tax charge of PLN 24,874 was recorded in 2010 as compared to income tax benefit of PLN 87,572 for 2009 and included a PLN 17,550 impact from the reversal of the earlier impairment charges and a PLN 1,094 impact from other one-offs. Excluding these unusual items, income tax charge, relating mainly to deferred tax, would have been PLN 6,230. The PLN 58,325 net paid to the tax office in relation to a tax dispute was not expensed as Management expects, based on advice received, to recover this amount, with interest, through the courts.

Net profit was PLN 263,895 for 2010 versus net profit of PLN 88,697 for 2009. Excluding unusual items and related tax charges, net profit would have been PLN 55,594 versus net loss of PLN 7,248 for 2009.

3.3 Consolidated statement of cash flows

Net cash generated from operating activities amounted to PLN 289,483 for 2010 as compared to PLN 300,119 in 2009. When excluding the overpaid tax of PLN 58,325, net operating cash generated from operating activities would be PLN 347,808. The increase was due to higher revenues and lower fixed costs, due to costs savings initiatives, in 2010.

Net cash used for the purchase of fixed assets and computer software decreased by 19% to PLN 193,234 for 2010 from PLN 237,774 for 2009 reflecting a reduction in capital investment.

Other significant cash outflow / inflow items during 2010 included PLN 168,482 related to the purchases of the short-dated treasury bonds, PLN 60,000 relating to repurchase of the short-dated treasury bonds, PLN 14,141 of purchase consideration for the Ethernet companies acquired in 2010. As a result, net cash used in investing activities during 2010 amounted to PLN 289,059 as compared to PLN 303,317 of cash from investing activities in 2010.

Net cash used in financing activities in 2010 amounted to PLN 7,932 and net cash used in financing activities during 2009 amounted to PLN 7,037. These outflows were related mainly to finance lease payments and payment of fees relating to bank loans.

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 2010 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". Moreover, as at December 31, 2010 the Netia Group had net cash available of PLN 173,600, PLN 175,000 in nominal value of treasury notes and was debt free with external financing available under mandate letter of PLN 700,000 to finance any future investment requirements (please refer to Note 3.5 Loans Agreement for details). Accordingly, Management sees no immediate threats to financing of its currently planned organic investments.

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

Undrawn Borrowing facilities

Effective from August 5, 2010 Netia terminated its existing loan facilities totalling PLN 295,000 available under the Facility concluded on May 15, 2007 with Rabobank Polska S.A. as the arranger, Bank Millennium S.A., Bank Gospodarki Żywnościowej S.A. and Raiffeisen Bank Polska S.A.

The cumulative draw downs under the Facility made in previous years amounted to PLN 205,000 and were repaid in full in 2008. In the year ended December 31, 2010 PLN 5,998 of accumulated deferred transaction costs related to the Facility was recognized in the income statement as finance cost.

In parallel, on July 29, 2010 Netia signed a mandate letter with Rabobank, Raiffeisen Bank Polska S.A. and BRE Bank S.A. for arrangement of new financing for a potential market consolidating acquisition within the telecommunications sector in Poland.

On October 4, 2010 bank BNP Paribas, Polish branch, (BNP Paribas SA Oddział w Polsce) joined the mandate letter signed by the Company on July 29, 2010 with Rabobank Polska S.A., Raiffeisen Bank Polska S.A. and BRE Bank S.A. (the "Mandate") for arrangement of new financing fund potential acquisitions by Netia.

The total amount of external financing which may be obtained under the Mandate is PLN 700 million.

Outstanding Bank Loans

As at December 31, 2010, the Netia Group had outstanding bank loans of total PLN 31 from Polbank EFG. The loan was drawn by the Company's subsidiary Pronet Sp. z o.o. and is repayable till August 22, 2011. Interests charged on the loan by the bank are 12.75% p.a.

3.6 Loans, warranties and collaterals granted

Loans granted

The following loans were paid out by the Company in 2010:

- to InterNetia Holdings Sp. z o.o., the Company's subsidiary, with a total value of PLN 14,070 (out of which PLN 1,000 were repaid in 2010). The outstanding loans are not due as at the balance sheet date.

The following loans granted by the Company were repaid in 2010:

- by InterNetia Holdings Sp. z o.o.in the amount of PLN 15,827 (from which PLN 14,827 was compensated based on the compensation agreement dated September 30, 2010 as Netia Holdings was entitled to the claim for the amount of PLN 17,300 for contributions to the increased share capital of Internetia Holdings; remaining claim of PLN 2,472 was compensated with interests payable),
- by Net2Net Sp. z o.o. in the amount of PLN 70.

Netia Group did not grant any warranties or collaterals in 2010.

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 2010

Management Board

As at December 31, 2010 and December 31, 2009 the Company's Management Board consisted of the following members:

- Mirosław Godlewski – President,
- Jonathan Eastick – Chief Financial Officer,
- Grzegorz Esz,
- Piotr Nesterowicz,
- Tom Ruhan.

Supervisory Board

Effective May 25, 2010 Mr. Piotr Żochowski resigned from his position as Member of the Company's Supervisory Board.

Due to the above changes as at 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 2010 the membership of the committees was as follows:

Audit Committee:
- Raimondo Eggink, the Chairperson of this Committee,
- Tadeusz Radzimiński,
- Ewa Pawluczuk – since May 26, 2010
- Piotr Żochowski - until May 25, 2010

Nomination and Remuneration Committee:
- Jerome de Vitry, the Chairperson of this Committee,
- Raimondo Eggink
- Ewa Pawluczuk
- Piotr Żochowski - until May 25, 2010

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 e. i 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 Supervisory Board has not granted any share options under the New Plan as at February 21, 2011.

4.5 Remuneration paid and payable to the members of the Management Board and the Supervisory Board in 2010

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 current members of the Management Board	
Mirosław Godlewski	1,491
Jonathan Eastick	1,430
Grzegorz Esz	1,046
Piotr Nesterowicz	1,030
Tom Ruhan	1,107
	6,104
Remuneration of current members of the Supervisory Board	
Benjamin Duster	96
George Karaplis	96
Stan Abbeloos	96
Raimondo Eggink	120
Nicolas Maguin	96
Ewa Pawluczuk	110
Tadeusz Radzimiński	96
Jerome de Vitry	120
	830
Remuneration of members of management boards of subsidiaries	1,231
Total	**8,165**

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.

Between the adoption of the employee share option scheme (the "2003 Plan") on April 10, 2003 and December 31, 2010, the Supervisory Board approved and issued a total number of 87,877,470 options to members of the Management Board and to Netia's key employees. From the total number of approved options, 53,245,436 were outstanding as at December 31, 2010 including 40,771,814 options held by members of the Management Board. No members of the Supervisory Board hold options in the Company. The options are exercisable until December 20, 2012. The strike price of the approved outstanding options, depending on the terms of the grant, ranges between PLN 3.50 and PLN 8.25 per share.

There were no changes in the number of options held by members of the Company's Management Board in the year ended December 31, 2010.

Options held by members of the Company's Management Board are presented below:

- Mr Mirosław Godlewski held 13,334,000 options,
- Mr Jonathan Eastick held 10,938,314 options,
- Mr Grzegorz Esz held 4,166,500 options,
- Mr Piotr Nesterowicz held 6,666,500 options,
- Mr Tom Ruhan held 5,666,500 options.

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, 2009	RSUs granted	December 31, 2010
Stan Abbeloos	50,000	15,000	65,000
Benjamin Duster	50,000	15,000	65,000
Raimondo Eggink	50,000	15,000	65,000
George Karaplis	50,000	15,000	65,000
Nicolas Maguin	50,000	15,000	65,000
Ewa Pawluczuk	50,000	15,000	65,000
Jerome de Vitry	50,000	15,000	65,000
Tadeusz Radzimiński	-	65,000	65,000
Total RSU	**350,000**	**170,000**	**520,000**

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, 20, is as follows:

	Cost of options
	PLN
Mirosław Godlewski	1,198
Jonathan Eastick	781
Grzegorz Esz	1,791
Piotr Nesterowicz	447
Tom Ruhan	482
	4,699

The cost of RSU recorded in year ended December 31, 2010 amounted to PLN 682:

	Costs of RSU
Stan Abbeloos	91
Benjamin Duster	91
Raimondo Eggink	91
George Karaplis	91
Nicolas Maguin	91
Ewa Pawluczuk	91
Jerome de Vitry	91
Tadeusz Radzimiński	45
Total RSU	**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, 2010 and December 31, 2009 Mr. Mirosław Godlewski – the Company's President of the Management Board – held 10,000 shares of the Company.

As at December 31, 2010 and December 31, 2009 Mr. Tom Ruhan – a member of the Company's Management Board – held 253,593 shares of the Company.

As at December 31, 2010 and December 31, 2009, Mr. Jonathan Eastick – a member of the Company's Management Board – held 50,000 and 35,500 shares of the Company, respectively.

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

As at December 31, 2010 and December 31, 2009, Mr. Raimondo Eggink – a member of the Company's Supervisory Board – held 40,000 and 20,000 shares of the Company, respectively.

As at December 31, 2010 and December 31, 2009, Mr. Tadeusz Radzimiński – a member of the Company's Supervisory Board – held 6,000 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, 2010.

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, 2010.

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, 2010 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 February 21, 2011; for details on the ownership interest and the number of votes as at December 31, 2010 please refer to note 18 in the consolidated financial statements of Netia Group as of December 31, 2010):

Third Avenue Management LLC

On January 14, 2011, Third Avenue Management LLC informed the Company that it had reduced its holdings of the Company's shares from 93,720,763 constituting 24.06% of the Company's share capital and carrying 24.06% of the total number of votes at the General Shareholders' Meeting of the Company to 85,578,145 constituting 21.97% of the Company's share capital and carrying 21.97% of the total number of votes at the General Shareholders' Meeting of the Company.

Third Avenue International Value Fund

Third Avenue International Value Fund held 19,594,034 of the Company's shares constituting 5.03% of the Company's share capital and representing 5.03% of the total number of votes at the General Shareholders' Meeting of the Company. The Company has received no information concerning changes in the number of shares held by Third Avenue International Value Fund since 31 December, 2009.

ING Otwarty Fundusz Emerytalny

ING Otwarty Fundusz Emerytalny held a total of 48,010,027 of the Company's shares constituting 12.33% of the Company's share capital and representing 12.33% 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 31 December, 2009.

Subsidiaries of SISU Capital Limited

The subsidiaries of SISU Capital Limited held a total of 39,043,006 of the Company's shares constituting 10.02% of its share capital and carrying 10.02% of the total number of votes at the General Shareholders' Meeting of the Company. The Company has received no information concerning changes in the number of shares held by SISU Capital Limited since 31 December, 2009.

Based on the information presented to the Company as of December 31, 2009 the clients of Pioneer Pekao Investment Management SA held a total of 38,891,802 of the Company's shares constituting 9.99 % of its share capital and representing 9.99 % of the total number of votes at the General Shareholders' Meeting of the Company. During third quarter of 2010 Pioneer Pekao Investment Management SA ownership of Netia's shares decreased to the level of 3.80% of the total number of votes at Netia's general shareholders' meeting.

5.2 Share capital (not in thousands)

At December 31, 2009, the Company's share capital consisted of 389,276,294 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 2010 the Company issued 181,935 ordinary series K shares due to the exercise by certain persons (who were not Management Board members) of 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 the change of the Company's Statute in 2010 up to 13,258,206 series K shares may be issued. The total number of series K shares issued through December 31, 2010 was 120,876 and their nominal value was PLN 121 thousands.

As a result 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 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.

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 120,876 and their nominal value was PLN 121 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. The Supervisory Board has not granted any share options under the New Plan as at February 21, 2011.

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 buyback

The Company did not conduct a share buy-back in 2010.

6 Other information

6.1 Transactions with related parties

The following transactions were concluded between the Company and its subsidiaries during 2010:
- 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 39).

(All amounts in thousands, except as otherwise stated)

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 2010".

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

In February 2010 Netia announced its guidance for 2010 and in May 2010 increased its broadband service clients guidance by 3% from 680,000 to 700,000, reflecting the progress made in net subscriber additions during Q1 2010. Full guidance for 2010 is set out below:

	Guidance 2010
Number of broadband service clients *(excl. Ethernet acquisitions)*	700,000
Number of voice service clients (own network, WLR and LLU)	1,225,000
Unbundled local loop (LLU) nodes	500+
Revenue (PLN m)	1,550.0+
Adjusted EBITDA (PLN m)	355.0+
Adjusted EBITDA margin (PLN m)	23%
EBITDA (PLN m)	360.0+
EBIT (PLN m)	60.0+
Capital investment (excl. M&A) (PLN m)	220.0
Capital investment to sales (%)	14%

Subscriber guidance excluded potential for further Ethernet network acquisitions which remain important to Netia's strategy but are difficult to forecast in time and amount. In addition, Netia forecastsed to be net profitable for the full year 2010.

Guidance for 2011 and medium term outlook

Netia guidance for 2011 is as follows:

	Guidance 2011
Revenue (PLN m)	> 1,610.0
Adjusted EBITDA (PLN m)	> 405.0
Adjusted EBITDA margin (%)	25%
EBITDA (PLN m)	> 400.0
Adjusted EBIT (excl. impairment reversal) (PLN m)	> 70.0
EBIT (PLN m)	> 70.0
Capital investment (excl. M&A) (PLN m)	230.0
Capital investment to sales (%)	14%
Operating free cash flow (OpFCF)	170.0
Number of broadband service clients (Growth excludes Ethernet acquisitions)	780,000 - 800,000
Unbundled local loop (LLU) nodes	700

Subscriber guidance excludes potential for further Ethernet network acquisitions which remain important to Netia's strategy but are difficult to forecast in time and amount. During 2011 Netia intends to at least maintain its voice subscriber base.

In addition, Netia forecasts to be net profitable for each quarter of 2011.

The mid-term guidance, first published in 2009 and confirmed on January 13, 2011 remains unchanged:

Mid-term guidance (2010-2012)	
Revenue growth (CAGR) total	3% - 5%
Revenue growth (CAGR) in retail market segments	5% - 10%
EBITDA margin in 2010 (%)	23%
EBITDA margin in 2012 (%)	28%
Net profit by	2010
Capex to sales down to 15% by	2010
1 million broadband subscribers	2012

(All amounts in thousands, except as otherwise stated)

(All amounts in thousands, except as otherwise stated)

The long-term outlook beyond 2012 published on January 13, 2011 together with Netia's Strategy 2020 is as follows:

Long-term outlook (beyond 2012)*
Blended** fixed line market share to grow from 11.5% to at least 15%
Expected revenue growth above 2% per annum delivers increasing value share
EBITDA margins in 26% - 28% range throughout
Capex to sales ratio to stay below 15% during network upgrade (2011 – 2013) and falling to 10% - 12% thereafter (2014 – 2020)
OpFCF margin to sales continuously above 10%

* *The above guidance excludes impact of potential transformational M&A activities*

** *Average of the fixed voice and fixed broadband market shares in the Polish fixed telecom market.*

6.3 Information on the registered audit company

The financial statements of Netia and the consolidated financial statements of the Netia Group for 2010 and 2009 were audited by Ernst & Young Audit Sp. z o.o. on the basis of a contract concluded on December 4, 2009 and March 30, 2007, respectively.

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	**2009**	**2010**
Audit of stand-alone and consolidated financial statements	471	358
Review of stand-alone and consolidated financial statements	423	272
Audit of subsidiaries' financial statements	137	148
Other attest services	-	350
Other services	57	-
Total	**1,088**	**1,128**

6.4 Compliance with corporate governance rules

The Management Board of the Company represents that in 2010 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 2010 non 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

(All amounts in thousands, except as otherwise stated)

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

On January 14, 2011, Third Avenue Management LLC informed the Company that it had reduced its holdings of the Company's shares to 85,578,145 constituting 21.97% of the Company's share capital and carrying 21.97% of the total number of votes at the General Shareholders' Meeting of the Company.

Warsaw, February 21, 2011