DIRECTORS' REPORT
NETIA S.A. GROUP
for the year ended December 31, 2006

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 condensed consolidated financial statements as at and for the year ended December 31, 2006 include the financial statements of the Company and the following subsidiaries:

UNI-Net Sp. z o.o.
Netia WiMax S.A. (previously operating under the name Netia WiMax II S.A. and Netia Globe S.A.)
Świat Internet S.A. Group
Netia Mobile Sp. z o.o.
InterNetia Sp. z o.o.
Pro Futuro S.A.

as well as the income and expenses of Netia Ventures Sp. z o.o. for the first quarter of 2006, i.e. until 100% of shares in Netia Ventures Sp. z o.o. were sold.

The Netia Group accounts for the investment in P4 Sp. z o.o. ("P4") using the equity method.

The Świat Internet S.A. Group's financial statements include the financial statements of Świat Internet S.A. and Premium Internet S.A.

3G Network Services Sp. z o.o.

On March 30, 2006 Netia transferred to P4 ownership of 100 (not in thousands) shares of Netia Ventures Sp. z o.o. (currently operating under the name "3G Network Services Sp. z o.o.", "3GNS"), with a total nominal value of PLN 50, representing 100% of its share capital, for a total price of PLN 75.

InterNetia Sp. z o.o.

On May 23, 2006 the Company's subsidiary, InterNetia Sp. z o.o., with its seat in Warsaw ("InterNetia"), was registered by the relevant Polish court. The shares in InterNetia were taken up solely by Netia.

Zachodni – Inwestycje Telekomunikacyjne Sp. z o.o.

On June 29, 2006 the Netia Group acquired 100% of the share capital of Zachodni – Inwestycje Telekomunikacyjne Sp. z o.o. ("ZIT"). ZIT has been rendering managerial services for Premium Internet S.A., the Company's subsidiary, since July 2005. As the purchase price of ZIT's shares will equal the amount due for those managerial services (and consequently the fair value of ZIT's net assets will equal the same amount), the Netia Group decided to reflect the economic substance of this transaction and not to account for it by applying the purchase method.

Pro Futuro S.A.

On July 4, 2006, the Company purchased from Jupiter Narodowy Fundusz Inwestycyjny S.A. ("Jupiter") 75.87% of the share capital of Pro Futuro S.A. ("Pro Futuro") for a total of PLN 28,751.

On July 4, 2006, the Company purchased from Polskie Towarzystwo Ubezpieczeń S.A. ("PTU") 8.13% of the share capital of Pro Futuro for a total of PLN 3,079.

On July 5, 2006, the Company purchased from dataCOM S.A. ("dataCOM") 16.00% of the share capital of Pro Futuro for a total of PLN 6,063.

On July 5, 2006, Pro Futuro sold 456,166 (not in thousands) shares of dataCOM with a total nominal value of PLN 3,193, representing 18.6% of its share capital for a total price of PLN 2,007. The disposal of dataCOM's shares was agreed in advance and was directly related to the above transactions.

Following the above purchases of Pro Futuro's shares from Jupiter, dataCOM and PTU, Netia holds 100% of Pro Futuro's share capital and the corresponding number of votes at its shareholders' meeting.

Pro Futuro was an independent telecommunications operator providing data transmission, internet access, hosting and VoIP transmission services. It provided these services using its own broadband telecommunications network (Infostrada Futuro), which was created on the basis of modern LMDS technologies. The company provided services based on the Infostrada network in Poland's largest cities: Warsaw, Łódź, Katowice, Kraków, Kielce, Gdańsk, Gdynia, Szczecin, Wrocław, Poznań, Bielsko-Biała and Lublin.

(All amounts in thousands, except as otherwise stated)

Mergers with subsidiaries

On July 31, 2006 the District Court for the Capital City of Warsaw entered in the register of entrepreneurs the merger between Netia and its three wholly-owned subsidiaries, which operated previously under the following names: Regionalne Sieci Telekomunikacyjne El-Net S.A. („El-Net"), Netia WiMax S.A. and Polbox Sp. z o.o. (the "Acquired Companies"). Except for El-Net, the Acquired Companies do not conduct telecommunications activities.

The merger was carried out pursuant to Article 492, §1, subsection 1 of the Polish Commercial Companies Code (the "CCC") in relation to Article 515, §1 of the CCC through the transfer of the Acquired Companies' assets to Netia (merger by acquisition) without any increase in Netia's share capital, without any share exchanges and without amending Netia's statute. According to Article 493, § 2 of the CCC, Netia's merger with the Acquired Companies occurred as of July 31, 2006. As of that date, pursuant to Article 494 of the CCC, Netia assumed all the rights and liabilities of the Acquired Companies that were dissolved. The merger completed the procedure of internal consolidation of the Acquired Companies within the Netia Group.

Furthermore, on August 31, 2006, Świat Internet S.A. merged with HFC Internet Sp. z o.o., its wholly-owned subsidiary and on November 30, 2006 Premium Internet S.A. merged with ZIT. These mergers were carried out in analogical way as the merger of Netia and the Acquired Companies, described above.

1.2 Information on basic products and services

The Netia Group offers advanced telecommunications services. These services include Telephony Services, as well as Data Transmission and Commercial Network Services.

Within the scope of Telephony Services, the Netia Group offers a range of services based on public wire line Telephony Services provided by means of Line Switching, as well as services in VoIP technology. The traditional voice services include: Analogue, ISDN, Centrex, "Komfort" voice mail and the "Komfort Plus" voice and fax mail, switched Internet Access and additional Telephony Services such as call forwarding, wake-up calls, automatic switching of local calls PABX, call barring, hotline, conference calls.

Traditional Voice Services are also offered indirectly via 1055 and 1077 prefixes to customers of other operators. Telephony Services based on VoIP technology have been rendered by the Netia Group since June 1, 2005. In 2006 the Netia Group commenced rendering services corresponding to PABX functionalities to business customers; these services are offered within the range of the Integralnet product.

The group of data transmission services includes fixed Internet access (for business and residential customers), secure Internet access, Frame Relay, IPVPN – MPLS and digital leased lines of various capacity, while services based upon intelligent networks include free phone, split charge and premium rate services.

The Netia Group offers commercial network services to other operators based on the use of network infrastructure, e.g. voice transit and transmission services, leased lines and access to the backbone network resources (e.g. fibre lease) or Hosting Services (e-mail, WebPages) or related to the use of telecommunications infrastructure owned by the Netia Group, e.g. Equipment Co-location Services.

Acting through its subsidiary Uni-Net, the Netia Group offers also Trunk Services within the entire territory of Poland and sells radio communication equipment.

The Netia Group's revenues in 2006 and 2006 are presented below:

	Year ended December 31, 2006	**Share in total revenues**	**Year ended December 31, 2005**	**Share in total revenues**
	(PLN)	%	(PLN)	%
Direct voice services	411,986	48 %	485,482	53 %
Monthly fees	*133,954*	*16 %*	*142,824*	*16 %*
Calling charges	*278,032*	*32 %*	*342,658*	*37 %*
Indirect voice	50,528	6 %	78,919	9 %
Data	171,486	20 %	128,258	14 %
Interconnection revenue	43,445	5 %	80,264	9 %
Wholesale services	150,327	17 %	97,867	11 %
Intelligent network services	15,349	2 %	19,960	2 %
Other telecommunication revenue	7,492	1 %	7,804	1 %
	850,613	**99 %**	**898,554**	**99 %**
Sales of goods	2,735	0 %	629	0 %
	853,348	**99 %**	**899,183**	**99 %**
Radio communication services	8,709	1 %	9,931	1 %
	862,057	**100 %**	**909,114**	**100 %**

1.3 Sales market (not in thousands)

The Netia Group operates on the telecommunications services market. The market, as far as fixed line telephony services are concerned, decreased from approximately 12.4 million lines at the end of 2004 to 11.8 at the end of 2005 and is believed to be continuing to fall. The penetration of fixed line telephony in Poland was 30.9 at the end of 2005.

The Netia Group currently offers direct access to the telecommunications services in an area inhabited by approximately 65% of Poland's population. Subscribers of the Group are located in 30 numbering zones in Poland. 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 2006 telecommunications services based on WiMAX technology were available in 32 cities and towns. Using WiMAX radio base station infrastructure, the Group intends to spread its activities to additional cities offering a full scope of telecommunications services (telephony services, Internet access and data transmission).

Following the full introduction of services based on bitstream access (BSA) expected by mid-2007, the Netia Group will be able to offer Internet access and voice services based on VoIP technology, nationwide, on the Telekomunikacja Polska S.A.'s ("TP SA") copper network subject to unbundling.

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 2006 none of the customers exceeded 10% share in the Netia Group's sales. Polkomtel S.A. was the largest supplier for the Netia Group (approx. 10% of the turnover). Polkomtel S.A. is not a related party to the Company.

1.4 Development perspectives for the Netia Group's operations

Strategy of the Netia Group

In May 2003, the Management Board adopted the main objectives of the Netia Group's five-year strategic plan, approved by the Supervisory Board, according to which the Netia Group's primary goal is to achieve the status of the most popular alternative telecom service provider for business customers in Poland.

The objectives of Netia's 2003 strategy included the following:

- to launch new products and services for business customers, according to their needs and technological trends;
- to reorganize the procedures for service provision to business customers, so as to ensure a higher level of services to key customers, i.e. the customers generating or expected to generate a considerable share of the total revenues of the Netia Group. In order to achieve this aim, relevant units within the Company had to be reorganized and expenditure on operating activity and investment had to be reallocated accordingly;
- to optimize the level of services and expenditure related to the mass market by using the available effectiveness of the new customer relationship management (CRM) system;
- to purchase other telecommunications companies, the takeover of which would support the strategic objectives of the Netia Group regarding the focus on the business customers segment; and
- to achieve at least a 10% average annual revenue growth and stable profitability ratios, guaranteeing an improvement of margins year on year, resulting in doubling the revenues and achieving an EBITDA margin of 35% by 2008.

During the course of 2006 Management reached the conclusion that Netia's strategy needs to be modified significantly in order to continue to deliver profitable growth. Pricing pressure on voice services, together with volume losses due to the twin impact of fixed-mobile substitution and the emergence of voice over IP telephony ("VOIP") services had already emerged as significant downward influences on revenues during 2005. Netia had responded by expanding its strategy to include exposure to mobile services through its investment in P4 and through the expansion of its market footprint by acquiring a national WiMax license:

Mobile telecommunications services

On May 9, 2005, P4, Netia's associate, was announced the winner of the UMTS tender, organized by the Polish regulator ("URTiP", currently "UKE"). The UMTS project creates new strategic opportunities to broaden Netia's product offer, including convergent services, and to increase the number of accessible customers. The ability to further strengthen Netia's product offering by including mobile and convergent products represents a significant opportunity to grow our customer base and expand geographically. P4 is targeting a 20% market share of the mobile telephony market over the long term and we expect mobile services to contribute significantly to Netia's future revenue growth.

New Access Infrastructure

On October 27, 2005 the Company's subsidiaries, Netia WiMax S.A. and Netia WiMax II S.A. (currently operating under the name "Netia WiMax S.A."), received the reservation of the 3.6-3.8 GHz frequencies, which were awarded to these companies in the tender proceeding completed by the URTiP on July 25, 2005. The Company plans to use the frequencies to provide telecommunication services based on WiMAX technology. The WiMAX based access network will be used to provide high quality data and voice transmission in areas with poor access infrastructure. Netia also expects to benefit from the WiMax and UMTS network build-out by taking advantage of such operational synergies as site sharing and common utilization of transmission equipment.

In 2006, rapid improvements in the regulatory environment have simultaneously led to the opening of new opportunities to gain access to customers for broadband and voice service over the TP network via bitstream, wholesale line rental (WLR) and eventually local loop unbundling (LLU). At the same time, these decisions and other regulatory decisions to further cut interconnection rates raise the prospect of further downward pressure on prices and on the future profitability of Netia's existing legacy infrastructure.

Against this background, Management has been working on a revised strategy to best exploit the new opportunities and deal best with the perceived threats in the new market environment. This strategy is expected to be finalized and announced during the second quarter of 2007 (see "Development program for the Netia Group's operations in 2007").

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

In May 2003, the Supervisory Board approved the basic aims of the Netia Group's development strategy. The business plan was approved by the Supervisory Board in October 2003 and then, based on our broadening strategic scope, updated in December 2005. Currently, the new long-term business plan is being prepared and it is probable that the detailed strategic initiatives will alter from those in the previously approved strategy. No assurance can be given as to whether new strategic initiatives, should they be undertaken as part of the new strategy, will be successful and if not they may adversely affect the operating activity of the Netia Group, its financial standing or its overall performance.

Funding Risk

Although Netia has maintained a significant cash surplus over the past few years and the Company's core activities remain cash generative, we can provide no assurance that the Company may not change its strategy to one which requires significant investments and start-up losses in order to develop new sources of revenue and to expand Netia's market share. Should such a change in strategy occur, then the Company would need to raise additional financing from financial institutions and or from its shareholders. We cannot guarantee that such funding would be available on acceptable market conditions or at all and, if this proved to be the case, Netia would have to significantly modify its plans.

Risk of changes in the shareholder structure, which may influence business activity (not in thousands)

Currently, Netia is not controlled by any strategic investors, and its Shares are held by a large number of shareholders. In December 2005 Novator Telecom Poland II S.a.r.l. („Novator"), with its seat in Luxembourg, purchased 40,088,862 shares in the Company, thus becoming the largest single shareholder of Netia. Moreover, in 2006, Novator increased its stake in the Company's share capital and according to the information passed to the Company, as of April 28, 2006 it held 98,243,602 shares which represented as at the date of filing of this report, 25.2% of the Company's share capital and 25.2% of the aggregate number of votes at the Company's General Meeting of Shareholders. During 2006, Third Avenue Management LLC increased its stake in the Company's share capital and holds 63,770,278 shares which represented 16.4% of the Company's share capital and 16.4% of the aggregate number of votes at the Company's General Meeting of Shareholders. Neither Netia's corporate documents nor the provisions of Polish law provide for any serious restrictions to changes in control over the Issuer in the event of third parties acquiring a considerable number of shares. Thus, such changes of control may materially affect the composition of the Supervisory Board and the Management Board and, in turn, the strategy and business activity of the Netia Group. Due to the above, the Issuer cannot guarantee that any adopted strategy of the Netia Group will be pursued in accordance with its initial objectives.

Conflict of interests between major and minority shareholders

Novator, as the owner of 25.2% of the Shares, is currently the Company's largest shareholder. Even though the equity stake held by Novator does not entitle it to exercise control over the Company, it nevertheless enables Novator to have a significant degree of influence on key decisions taken by the Company. In particular, Novator may exert a material degree of influence on the composition of the Company's Supervisory Board, especially given the fact that the remaining shareholders do not represent a single unified position. The Company's Statute provides that the consent of the majority of Supervisory Board members is required to adopt key resolutions affecting the Company's operations. Furthermore, Novator Telecom Poland S.a.r.l, Novator's related company, holds a controlling stake (currently amounting to 70%) in the share capital of P4, an affiliate of the Company. That stake will be reduced to 54.6% following the performance of an agreement between the shareholders and P4 concluded on January 31, 2007, which is described in "Subsequent events".

Any potential conflicts between Novator and the remaining shareholders may adversely affect the operations of the Netia Group.

Risk connected with the impact of potential future takeovers and acquisitions

Revenues and financial performance of the Netia Group may materially be affected by takeovers and mergers with other entities. Upon the Company's takeover of another entity, the process of fully integrating this entity may carry high risks, e.g. employment termination by key employees, the loss of a certain segment of its customers or high costs of the entire integration process.

The highly fragmented market of alternative operators rendering wireline telephone services may result in increasing consolidation within the Polish market. The Company shall 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 candidates for takeover, the negotiating of agreements and integration of the entities acquired. The Netia Group may request 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 the acceptance of existing liabilities and the risk of concealed 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. Failures to integrate the acquired entities into the structures of the Netia Group and / or the failure to generate expected operating and strategic synergies may adversely affect its activity and its financial standing.

Technological risk

The telecommunications sector is an area witnessing dynamic technological changes. In designing and expanding its networks, the Netia Group uses the newest technical solutions. However, what cannot be predicted is how the Netia Group's activity may be affected by technological advances in the field of fixed-line telephony, wireless transmission, voice transmission protocol via the Internet or cable television telephony. In particular, the activity of the Netia Group may be affected by the tendency to provide telecom services via wireless or portable platforms, with wireless broadband access and third generation mobile cellular telephone systems equipped with IP. Even if the Netia Group succeeds in adapting its activity to such technological advances, new market participants may emerge as a result of the new technology with competitive advantages to Netia or existing competitors may benefit relatively more than Netia from the new technologies..

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 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 Telecommunications Law transposed the so-called new set of directives and entered into force on September 3, 2004, with the exception of several provisions, which entered into force on January 1, 2005.

On the basis of the Telecommunications Law, the President of the UKE may impose regulatory obligations on operators. This is done after analyses of each of the 18 telecommunications markets (7 of which are retail markets, 11 are wholesale markets) and a determination that on a particular market a given entrepreneur holds a significant market power. Draft decisions on this matter are consulted (nationally) and consolidated (before the Commission).

As of now, none of the companies from the Netia Group has been found to hold a significant market power in any of the analyzed markets.

The Management may not, however, assure that Netia will not be considered by the President of UKE as a significant market power operator in the market for termination in its own network and that regulatory obligations will not be imposed on it with regard to grant reasonable requests for telecommunications access filed by another entrepreneurs, equal treatment obligations, and an obligation to publish information necessary to allow them to use services provided in this market. With this regard, the President of UKE has already consulted a draft decision. It was also subject to consolidation procedure and the Commission has not raised any substantial reservations or a veto.

Pursuant to the Telecommunications Law, each public telecommunications network operator is obliged to conduct negotiations concerning interconnection agreements upon another telecom operator's request. However, the President of the UKE shall be obliged to resolve any disputes between the parties to the negotiations by an administrative decision, which shall replace the relevant agreement only if one of the negotiating parties is a public telecommunications network operator obliged to provide the interconnection.

The Telecommunications Law states that the obligation to provide universal services shall rest with the operator selected pursuant to a decision of the President of the UKE issued after a tender procedure. On November 5, 2006 President of the UKE passed decisions assigning TP SA as an operator obliged to provide universal services commencing on May 8, 2011. Telecommunications providers whose revenues from telecom activity exceed PLN 4,000 will have to co-finance the performance of this obligation, by co-financing the funding of universal services, if the funding has been assigned to the telecommunications provider selected on the basis of the decision of the President of the UKE. The share in the funding that a telecommunications provider shall be obliged to provide shall also be established by a decision of the President of the UKE; however, it may not exceed 1% of the telecommunications provider's revenues in the given calendar year. The amount of the share in the funding of the universal service shall constitute a deductible cost, as defined by the Act on Corporate Income Tax.

The present stage of development of the telecommunications market in Poland does not guarantee that the Netia Group will not be obliged to co-finance the funding of universal services on the terms described above.

The Telecommunications Law obliges telecommunications providers to pay annual telecommunications fees of up to 0.05 % of the provider's annual revenues from telecommunications activity generated in the financial year 2 years prior to the year to which the annual fee pertains, if the annual revenues exceed PLN 4,000. The amount of the annual telecommunications fee shall constitute a deductible cost as defined by the Act on Corporate Income Tax.

Netia as from January 1, 2006 is obliged to provide subscribers' with a right to retain their numbers when changing operators. Despite the fact that Netia performs this obligation, the Management Board cannot guarantee that it will be possible to enter into an agreement with particular telecommunication operators to define the terms and conditions of cooperation between the parties to the extent required to execute the subscribers' rights to retain his/her number.

Ministry of Transport has prepared an amendment to the Telecommunications Law, which includes 123 changes in current law. Currently, there are intergovernmental consultations on the relevant draft. The Management Board would like to point out that the draft imposes on telecommunications operators (including Netia Group companies) many additional obligations. It is hard to determine when the draft becomes law at this stage.

Dependence of the Company on TP SA due to interconnections

The rendering of telecommunications services by the Netia Group is dependent on the possibility of access to the telephony network of TP SA. Except for some cases, calls initiated in Netia's network ending outside these networks, including the majority of international and domestic long distance calls by subscribers of Netia Group companies, are - due to technical reasons - executed via the network of TP SA. According to the provisions of the new Telecommunications Law TP SA is obligated to connect companies like Netia to its network. Netia Group companies running operations concluded interconnection agreements with TP SA covering each area in which the Company conducted its telecommunications activities.

The plans of the Netia Group allow for projected revenues arising from its activity on the International Calls market. Similar to other call types, the ability to provide such services is dependent on ensuring the necessary infrastructure and executing the terms of interconnection agreements with TP SA.

In the past Netia has had many disputes with TP SA over interconnection, in particular in relation to the interconnection agreements of its former subsidiary El-Net (now merged into Netia SA) and due to the continued existence of interconnection agreements between TP and Netia Group companies for local calls based on a bill & keep payment systems. In order to avoid further disputes and to prevent conflict escalation, in December 2006 Netia concluded an agreement with TP SA on closing all disputed issues. Currently, in particular, there are negotiations with TP SA on one complex contract for interconnection. It is expected that the new agreement, based on the reference interconnect offer (RIO), will be signed by June 30, 2007 and implemented by September 30, 2007.

Management can give no assurance that there will not be new disputes with TP SA over interconnection in the future and that such disputes may have a material impact on Netia's development and financial results.

Risk of increased competition

The Netia Group's main competitors in the field of telephone services are TP SA and cellular network operators, and in some geographic areas also other operators providing wireline telephone services including some cable television networks. Within the market for data transmission services, the main competitors are numerous providers of various sizes, the most significant of which is TP SA. Poland has witnessed a considerable increase in competition, which, as can be expected, will intensify even further, considering the lack of legal barriers in entering the market and increasing integration within the European Union. Netia is unable to evaluate the extent to which new market participants will use the availability of their rights, particularly with regard to the significantly lower costs of entering the market than those incurred by the Netia Group. The Warsaw market will probably continue to witness intense competition for customers. The Management Board is unable to evaluate the extent to which the intensification of competition will affect the Netia Group's activity.

Competition from TP SA

TP SA occupies a leading position among wireline telephone service operators in Poland. At the same time, it enjoys a stable position on the market for data transmission and indirectly, through its wholly owned subsidiary on the cellular telephone market. Within the scope of wireline telephone services, the Netia Group encounters competition from TP SA in all the geographic areas in which it operates. TP SA is a much larger entity than the Netia Group and possesses much wider backbone and access networks. It enjoys long-established relationships with many customers which the Netia Group considers its target customers, including many companies operating on the territory of the Netia Group's operation. The infrastructure used by TP SA in these territories is comparable to the infrastructure of the Netia Group in terms of the technologies employed.

Moreover, TP SA still maintains a leading position among operators of domestic long-distance calls, which enables it to offer more flexible tariffs. It is difficult to predict what policies TP SA will pursue with regard to tariffs, the selection of target markets and arrangements concerning access to its infrastructure and interconnections as a reaction to the extension of the network by the Netia Group and more intense competition from the Netia Group in various areas of the country. However, the Management Board expects that TP SA will compete with the Netia Group on prices and for the most attractive customers. In the past, the Netia Group was forced to lower its prices in order to attract new customers and retain the current ones, and such measures may also be necessary in the future. The Management Board expects that TP SA will maintain a strong competitive position against the Netia Group on the Warsaw market and in most geographic areas where the Netia Group provides telephone services, and will continue to compete with the Netia Group in other fields, including data transmission services and internet access. It is possible that aggressive competition from TP SA will materially and adversely affect the revenues of the Netia Group and the results of its operating activity.

TP SA owns most local loop access networks and has, in the past, offered other operators access to the network of these local loops on terms that, in many cases, render the addition of a customer to the network too expensive. However, during the course of 2006 a new telecommunications regulator has issued new decisions creating reference offers in the area of regulatory access to the TP SA network which Netia considers now to be commercially viable. As a result, during 2006 the Netia Group has signed a new cooperation agreement with TP SA that allows Netia to offer Internet access to TP SA's customers using a regulated TP SA wholesale service known as bitstream access. It is furthermore foreseen that additional cooperation agreements will be signed during 2007 that will enable Netia Group to offer voice services to TP SA customers using the regulated wholesale line rental (WLR) service and voice, data and differentiated value added services such as IPTV using the regulated wholesale service known as local loop unbundling (LLU). Whereas the key commercial terms of these services, as set by the regulatory decisions, are currently commercially attractive, operational cooperation with TP SA in order to provision and maintain such services to end customers needs to be much more coordinated than has historically been the case. Management can give no assurance that TP SA will provide the required level of cooperation or that the regulator will respond by effectively enforcing TP SA's cooperation. Furthermore, we can give no assurance that market developments or future regulatory decisions may not render the current opportunities to reach customers via TP SA access networks no longer commercially viable.

Competition from other independent operators

According to the regulations, which were in force before January 1, 2001, the Minister of Telecommunications granted licenses for the provision of local telecom services within a given geographic area (usually within a given numbering zone) to one private operator (apart from TP SA). Obtaining licenses usually entailed significant investments. Pursuant to the New Telecommunications Law, telecommunications activity may be pursued on the basis of an entry in the Register of Telecommunications Providers kept by the President of the UKE. Therefore, the Netia Group expects the number of operators active in the areas in which it conducts its activities to increase. In 2003 there was a swap of license fee liabilities of the then-operating subsidiaries of the Netia Group, and in the case of the fees which El-Net was obliged to pay, the swap for capital expenditures took place in 2006. However, license fees installments paid prior to the change in the telecommunications law have not been repaid to Netia. Operators who have not paid license fees and therefore do not need to recover the costs of such license fees therefore hold a competitive advantage.

In some areas in which the Netia Group operates, there are large institutions with their own internal telecommunications networks (where the users of the telecom services of such institutions include, additionally, the inhabitants of the given area), which reduces the potential revenues that the Netia Group could generate in these areas, and such operators may be a potential source of competition in the future.

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.

To help mitigate the losses to mobile operators, Netia has invested in Poland's newest mobile phone operator, P4. P4 intends to offer mobile telephony services beginning in 2007. Netia expects to benefit from an investment in P4's by being able to offer convergent products, by having an exclusive distribution arrangement for mobile sales to business customers, and by taking advantage of synergies arising from outsourcing services for P4.

Other sources of competition

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 head on with cable television operators. The importance of IPTV and related services (such as video on demand) is being analyzed in the context of Netia's strategy.

Market consolidation

Market consolidation through acquisitions remains an effective way for fixed line operators to increase their market position while improving scale. Netia has successfully acquired 4 telecommunications operators in as many years, making it the market leader for consolidation.

Acquisitions will no doubt remain a key activity of the Company's strategy as it seeks to increase its customer base and improve its scale. Past acquisitions have been important contributors to revenues.

Although the Company has been successful in its acquisition strategy to date, there is no assurance that it will be able to do so in the future or that it can achieve the scale of acquisitions necessary for the company to achieve synergies.

Investment in P4 and strategic importance of P4 to Netia's future development

There is considerable uncertainty as to the recoverable amount of the Netia Group's investment in P4 - the Netia Group's affiliated company which holds a UMTS license. P4 is a start-up phase enterprise and P4's business model is based on its planned limited coverage UMTS network with national GSM coverage provided to its customers via a national roaming agreement with an incumbent GSM operator. The overall level of competition in the market, including market prices for voice and data services, the future take-up of new mobile data services, access to sufficient distribution channels and the impact of possible mobile virtual network operators (MVNOs) that are entering the market, may all impact P4's ability to generate revenues and the future success of P4's business model. Observed delays in building and utilizing its own UMTS network and uncertainties over the market regulator's approach to new entrants relative to market incumbents, the rate of decrease in unit costs of UMTS handsets and market levels of handset subsidy generate uncertainties over achievable profit margins. Allocation of newly available frequencies and decisions about extension or reallocation of frequencies currently controlled by P4's competitors will have long term implications for P4's competitive position. Uncertainties as to the availability of additional sources of financingand the ability to attract the experienced employees necessary to implement P4's plans may also impact significantly on the success of P4's business. As a result of these and other uncertainties, including possible significant changes in mobile technology, the actual recoverable amount from Netia's investment in the equity of P4 may differ significantly in the future from Netia's current estimates.

(All amounts in thousands, except as otherwise stated)

Furthermore, on October 31, 2006 the Company concluded a number of agreements partially securing the repayment of the credit facility of EUR 150,000 granted to P4 by China Development Bank. The guarantee provided by the Company covers the repayment of 30% of the outstanding amounts under one of the tranches of the credit facility (limited to a total of EUR 75,000) increased by interest and costs (with a cap at EUR 90,000) (see "Loans, warranties and collaterals granted" for details). The Company's Management is not aware of any payment default by P4. Should P4 default on its payment obligations in the future, Netia may be required to pay up to EUR 27,000 in respect to guarantees and may lose its shares in P4.

The successful development of P4 into an important player on the Polish mobile market, having significant market share and being able to self-finance its continued development is in turn important for Netia to be able to realise its own development plans. The successful and profitable implementation of the Transmission Agreement with P4 (see "Agreements essential for the Netia Group's operations"), under which Netia is providing all the transmission services for P4's UMTS network depends on P4's long term ability to build out its network and meet its obligations to Netia. Furthermore, Netia's opportunities to cross sell its fixed line services to P4's mobile subscribers and for the joint development of fixed-mobile convergent services in the future depend upon P4 building a significant market share in order to be commercially viable.

Management can provide no assurance that P4 will develop in accordance with its current business plans and, should P4 underperform those plans, this would be likely to have a material financial impact upon the results and cash flows of Netia and also limit Netia's opportunities to grow its own fixed line business.

2.2 Factors and events having a significant influence on the operations of the Netia Group and the financial results achieved in 2006

Impairment of goodwill and other long-lived assets

Under IAS 36 "Impairment of Assets" the Netia Group is obliged to assess at each balance sheet date whether there is any indication that an asset may be impaired or there is any indication that an impairment loss recognized for an asset in prior years may no longer exist or may have decreased. The Netia Group also tests annually whether goodwill recorded in the balance sheet has suffered any impairment. The goodwill recognized on the acquisition of HFC Internet Group and Pro Futuro is allocated to the cash generating unit ("CGU") identified as the entire Netia Group. If any such indication exists, the Netia Group must estimate the recoverable amount from the CGU. The recoverable amount of the CGU is determined based on higher of fair value less cost to sell ("FVLCS") and value-in-use.

As at December 31, 2006, Management has determined that indications exist that the CGU of the Netia Group may be impaired. Financial performance during 2006 has been below previously planned levels and the Netia Group has been unable to consistently record an operating profit. Faster erosion of voice tariffs and average revenues per subscriber than was previously planned, together with prospects for further significant price declines resulting from the expected impact of regulatory decisions announced during 2006 are being reflected in the Netia Group's new business plan. In addition, the amount and timing of revenues and margins previously planned to be generated from WiMAX connected customers and from cooperation with P4 are being revised in the context of regulatory changes and delays in P4's UMTS network roll-out respectively. While assessing potential indications of impairment, Management has considered the assumptions used for the new Netia Group's long term business plan to cover the period 2007-2011, which is now being completed by Management but is not yet approved by the Supervisory Board at the date of the consolidated financial statements.

The Company performed the impairment test in relation to the assets allocated to the CGU identified as the entire Netia Group besides the investments in P4 Sp. z o.o. and non-current assets of UNI-Net Sp. z o.o. Management determined that fair value less cost to sell of the Netia Group was higher than value in use of the Netia's existing business.

The FVLCS of Netia Group's CGU was determined based on the market method which used the analysis of multiples of values of the sales/purchase transactions of telecommunication companies which were considered comparable to Netia Group and took place during the last fifteen months prior to the balance sheet date. The Management used the valuation based on enterprise value to normalized EBITDA multiple as normalized EBITDA is considered to be the most commonly used performance measure in the telecommunication industry. The multiple of an Enterprise Value / normalized EBITDA used in the fair value less cost to sell valuation amounted to 7.8.

The recoverable amount of the Netia Group's CGU was based on an estimation of the FVLCS. As a result, the impairment charge amounted to PLN 354,672 and was calculated as a difference between the FVLCS and the carrying value of net assets of Netia Group's CGU. The impairment charge has been recognized in the consolidated statement of operations for the twelve-month period ended December 31, 2006 and has been allocated to the carrying amount of goodwill and than to the non-current assets of Netia Group's CGU on a pro rata basis.

The impact of the above charge on the particular groups of assets is as follows:

Goodwill	14,799
Tangible fixed assets (excluding cars)	270,638
Fixed assets under construction	22,747
Capital work in progress for software	1,472
Computer software	10,746
Customer relationship	207
Telecommunication licenses	34,063
	354,672

(All amounts in thousands, except as otherwise stated)

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 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.

Cancellation of El-Net's license fee liabilities

Regionalne Sieci Telekomunikacyjne El-Net S.A. („El-Net"), the subsidiary acquired in 2004 and merged with Netia in July 2006, obtained licenses from the Ministry of Communications for the provision of local telephone services in areas including Warsaw, Bydgoszcz and smaller cities in the northern part of Poland. As of January 1, 2001, pursuant to the 2000 Act, all telephone licenses were converted by virtue of law into telecommunication permits. At that date the total nominal value of outstanding license fee obligations of El-Net was EUR 104,624 (PLN 400,835 at the exchange rate prevailing on December 31, 2006) increased by prolongation fees of PLN 37,733.

In accordance with the applicable law enacted in 2002, El-Net submitted applications for cancellation of outstanding local license fee obligations based on capital expenditure incurred by El-Net and which would be incurred within the Netia Group.

On March 22, 2006, El-Net received the decision of the Polish Minister of Transportation and Construction, dated March 21, 2006, canceling part of outstanding local license fee obligations and the prolongation fees, in exchange for El-Net's expenditure on the telecommunications infrastructure incurred in years 2001, 2002 and 2003. The total nominal value of the local license fees cancelled was EUR 20,940 (PLN 81,597 at the exchange rate prevailing on March 21, 2006) and the total nominal value of prolongation fees cancelled was PLN 8,566.

On June 27, 2006, El-Net received the decision of the Polish Minister of Transportation, dated June 26, 2006, canceling part of outstanding local license fee obligations along with the prolongation fees, in exchange for El-Net's expenditure on the telecommunications infrastructure incurred in years 2004 and 2005. The total nominal value of the local license fees cancelled was EUR 9,174 (PLN 37,675 at the exchange rate prevailing on June 26, 2006) and the total nominal value of prolongation fees cancelled was PLN 3,561.

On September 20, 2006 the Company received the decisions of the Minister of Transportation, dated September 14, 2006, enabling conducting the restructuring of license fee obligations based on the capital investments incurred by Netia from January 1, 2003 to July 31, 2006.

On December 18, 2006 the Company received the decisions of the Minister of Transport, dated December 14, 2006, with regard to the cancellation of all outstanding license fee obligations, as well as the prolongation fees, in exchange for investments in the telecommunications infrastructure made by the Company from January 1, 2003 to July 31, 2006. The nominal value of license fee obligations and prolongation fees cancelled based on the above decisions amounts to EUR 74,509 (PLN 283,239 at the exchange rate prevailing on December 14, 2006) and PLN 25,606, respectively.

The receipt of the above decisions completes the process of El-Net's license fee liabilities' restructuring. The total nominal value of license fee obligations and prolongation fees cancelled under this process amounted to EUR 104,624 and PLN 37,733, respectively.

At the acquisition of El-Net license fee liabilities were recorded at fair value based on the assessment performed in 2004 by the Management, which took into account the probability of future payments of license fee liabilities. Until the cancellation of all licence fee obligations the outstanding liabilities were recorded at amortized cost. During 2006 the Management, having analysed the progress of the cancellation process of the remaining liabilities, updated its assessment. Pursuant to the decisions obtained in March and June 2006, regarding cancellation of part of outstanding local license fee obligations and the prolongation fees in exchange for expenditure on the telecommunications infrastructure incurred in years 2001 – 2005 Management estimated that there was an 80% probability of cancellation in relation to the remaining licence fee liabilities and prolongation fees. In June 2006 the relevant adjustment was recorded as a gain in the income statement amounting to PLN 10,437. In addition, pursuant to the decisions obtained in September 2006, enabling conducting the restructuring of license fee obligations based on the capital investments incurred by Netia, the Management has changed its estimation and increased the probability of cancellation of the remaining licence fee liabilities and prolongation fees, up to 95%. This resulted in further reduction in license liabilities of PLN 40,713, and was accordingly recorded as a gain in the income statement. Upon receiving in December 2006 final decisions canceling all outstanding local license fee obligations along with the prolongation fees, the remaining liability of PLN 13,319 was reduced to nil and accordingly recorded as a gain in the income statement. Further changes in the value of licence fee liabilities as compared to December 31, 2005 relate to interest accrued and foreign exchange differences as presented below:

	(PLN)
Carrying value as at December 31, 2005	**57,413**
Interest accrued in the year 2006	5,247
Foreign exchange losses on the translation of EUR balances	1,809
Reassessment of the carrying value of license fee liabilities	(51,150)
Cancellation of the outstanding license fee liabilities	(13,319)
Carrying value as at December 31, 2006	**-**

Investments in associates

As of December 31, 2006, the Netia Group had a 30% interest in P4 (until August 23, 2005 the Company's subsidiary), which was announced as the winner of the mobile telephony UMTS frequency tender in May 2005 (see also "Subsequent events").

The following table summarizes financial information of the associate:

	Four-month period ended December 31, 2005	Year ended December 31, 2006
	(PLN)	(PLN)
At the beginning of the period	-	105,633
Investment in the associate	108,706	57,000
Unrealized profits on transaction with associate	-	(8)
Financial guarantee contract (see point 3.7)		9,493
Share of loss	(3,073)	(30,724)
At the end of the period	**105,633**	**141,394**

Following the provisions of the P4's Shareholders' Agreement, during the year ended December 31, 2006 the Company and Novator Telecom Poland S.a.r.l. ("Novator") contributed share capital of PLN 57,000 and PLN 133,000, respectively. As a result, the Company is the holder of 10,830 (not in thousands) P4 shares constituting 30% of the shares in P4's share capital. Novator is the holder of 25,270 (not in thousands) P4's shares constituting 70% of the shares in the P4's share capital.

Acquisition of Pro Futuro

The Netia Group accounted for the acquisition of Pro Futuro using the purchase method and started consolidating the financial statements of Pro Futuro as of July 1, 2006 adjusting the consolidated income statement and the consolidated balance sheet for material transactions, which took place between July 1, 2006 and July 4, 2006. The acquired business contributed revenue of PLN 22,433 and loss of PLN 11,243 in the six-month period ended December 31, 2006, after taking into account intercompany eliminations and impairment of goodwill.

During the year ended December 31, 2006 the Netia Group performed a valuation of Pro Futuro's assets, liabilities and contingent liabilities. In particular, the Netia Group assessed fair values of identifiable assets, liabilities and contingent liabilities according to IFRS 3, including fixed asset items which have been adjusted on the basis of an independent valuation, and recorded a deferred income tax liability. Additionally, in the purchase price allocation process the Netia Group identified customer relationships as an intangible asset. The fair value of customer relationships was estimated using the excess earnings method. Further changes to the valuation may be introduced in 2007 if additional information in respect of acquired assets, liabilities and contingent liabilities is obtained. Such additional information may include information related to pre-acquisition contingencies and calculation of the related deferred income taxes. The Netia Group will continue evaluating fair values of these assets, liabilities and contingent liabilities, which may result in further adjustments to the carrying amounts of identifiable net assets.

Details of provisional fair value of net assets acquired and goodwill as at the date of the acquisition are as follows:

	(PLN)
Purchase consideration, including transaction costs of PLN 933	70,933
Sale of Pro Futuro's investment	(2,007)
Provisional fair value of net assets acquired	(67,970)
Goodwill	**956**

The goodwill is based on provisional fair value of net assets acquired and is attributable to the significant synergies expected to arise after the Netia Group's acquisition of Pro Futuro.

The purchase consideration made by the Company in exchange for control over the net assets of Pro Futuro encompassed: the price for 100% shares of PLN 37,893 (including a retention of PLN 2,500 to be paid in 2007 subject to all conditions being met by the seller), the amounts paid for Pro Futuro's convertible bonds issued to its previous shareholder of PLN 32,107 and transaction costs of PLN 933. The purchase consideration was decreased by PLN 2,007 received due to the disposal of Pro Futuro's investment in dataCOM shares.

The assets, liabilities and contingent liabilities recognized in the consolidated balance sheet arising from the acquisition, as at the acquisition date, are as follows:

	Acquiree's carrying amount	Provisional fair value
	(PLN)	(PLN)
Property, plant and equipment	65,189	62,921
Computer software	2,681	2,645
Customer relationships	-	18,827
Investments	2,002	-
Receivables	3,341	2,712
Prepayments	325	325
Cash and cash equivalents	638	638
Short-term loans	(2,500)	(2,500)
Trade liabilities	(4,028)	(4,026)
Other liabilities and accruals	(7,843)	(10,181)
Deferred income tax liabilities	(770)	(3,391)
Provisional net assets acquired	**59,035**	**67,970**

(All amounts in thousands, except as otherwise stated)

Operational Data

The Netia Group achieved the following operational results in 2006:

- Subscriber lines in service were 398,276 at December 31, 2006 as compared to 413,011 at December 31, 2005. This included ISDN equivalent lines, which increased to 104,280 at December 31, 2006 from 96,949 at December 31, 2005.
- Business customer lines in service increased to 159,558 at December 31, 2006, i.e., by 5% from 151,787 at December 31, 2005.
- Business lines as a percentage of total subscriber lines at December 31, 2006 reached 40.0%, up from 36.8% at December 31, 2005.
- Residential lines in service were 238,718 at December 31, 2006 as compared to 261,224 at December 31, 2005.
- ADSL active ports increased to 55,871 at December 31, 2006 as compared to 38,822 at December 31, 2005.
- ADSL ports' penetration of Netia's total subscriber lines at December 31, 2006 reached 14%, up from 9% at December 31, 2005.
- WiMAX active customers were 836 at December 31, 2006.

Bitstream

In 2006 Netia and TP SA signed an agreement to obtain bitstream access, enabling Netia to provide broadband data transmission services, including Internet access, to TP SA's customers. The agreement was concluded based on the terms introduced by the regulator in its bitstream access reference offer and is binding from August 16, 2006. In January 2007 Netia, as the first alternative operator, launched commercially its broadband Internet access services to TP SA clients.

WiMAX

From July 2006, Netia ran large-scale commercial trials of its 3.6-3.8 GHz range WiMAX-based services, allowing cost efficient geographic expansion beyond Netia's existing fixed-line network. In November 2006, Netia switched the WiMAX project to a normal commercial mode and sales volumes are planned to accelerate significantly. As of December 31, 2006 836 customers were connected to WiMax and 30 base stations were in services. As of the date of this report there were over 1,700 connected customers and 52 base stations in service. Netia continues to refine its long-term plans for the use of WiMAX relative to regulatory access via bitstream, wholesale line rental and local loop unbundling as well as local market conditions. New guidance will be provided at the time of disclosure of Netia's revised medium-term strategy.

P4 - mobile project

P4 rescheduled the planned launch of its mobile services to Q1 2007 due to delays with obtaining the permits necessary to roll-out P4's UMTS network. The company selected Huawei as its 3G infrastructure supplier and Comverse as its supplier for rating, billing and customer care. In addition, P4 purchased a SAP application to support its business processes and signed a contract with Arvato to service the company's external call center in Poznan. In June 2006, the company signed a national roaming agreement with Polkomtel SA, one of the existing Polish mobile operators, which allows P4 to enter the market nationally with its service offering using the Polkomtel network while developing its own UMTS network. In October 2006, P4 signed a credit facility agreement with China Development Bank for EUR 150,000, providing ten year financing. The funds will be used by P4 for the purchase of equipment for its UMTS network from Huawei, including the acquisition of transmitter construction sites and related network construction costs. This financing, together with the equity already committed by P4's shareholders provides P4 with the financial resources to build its network in Poland's largest cities and to launch its mobile services as planned. This in turn allows Netia to achieve its key original investment objectives by gaining access to mobile products and services to market to its own customers (see "Subsequent events").

2.3 Agreements essential for the Netia Group's operations

Managed services contract with Ericsson

On April 28, 2006, the Company signed a five-year managed services contract with Ericsson Sp. z o.o. ("Ericsson "). The contract covers maintenance and management of the Netia Group's networks, as well as the support in the provision of standard services to Netia Group customers, inclusive of the installation of lines at customer's site. Approximately 300 (not in thousands) of the Netia Group's employees were transferred to Ericsson under the scope of this contract.

The transaction consists of two joint elements: (I) the contract covering services provision and (II) transfer contracts concerning employees, assets and agreements of the Netia Group. The infrastructure and telecommunications lines will remain the property of the Netia Group. Investment projects will also remain the Netia Group's responsibility. The Netia Group will be the owner of network and equipment installed in the future.

Framework agreement on delivering transmission solutions for P4's UMTS network

On July 3, 2006 the Company and P4 concluded a framework agreement on delivering by Netia to P4 the transmission solutions for P4's UMTS network ("Agreement"). The Agreement was concluded for the five-year term following which the Agreement shall be automatically extended for an unlimited period of time, unless the parties to the Agreement decide otherwise. The Agreement may be terminated prior to the term indicated above in case of violation of its provisions. The remuneration of Netia for providing services referred to in the Agreement shall be calculated based on the parameters and the number of circuits delivered to P4.

The liability of the parties with respect to the Agreement is limited to the actual damage amount, unless the damage is caused by the intentional fraud or gross negligence. Liability of Netia for the interruptions in signal transmission or for the deterioration of quality of services provided is limited to the level of the fee for the circuits leased, unless those irregularities are caused by the intentional fraud or gross negligence of Netia. In case the parameters of services are not met, the remuneration of Netia shall be reduced.

Agreement on bitstream access

Agreement on bitstream access has been described in detail under the point "Factors and events having a significant influence on the operations of the Netia Group […]".

Agreements partially securing the repayment of the vendor financing extended to P4

Agreements partially securing the repayment of the vendor financing extended to P4 has been described in detail under the point "Loans, warranties and collaterals granted".

2.4 Development program for the Netia Group's operations in 2007

Netia anticipates making an announcement about its new operating strategy by the end of the second quarter of 2007, once CEO, Mirosław Godlewski, has completed his initial review of Netia's operations and the draft strategy prepared by the management team. The draft strategy focuses on growth through expansion of Netia's market share in the residential fixed-line market. It anticipates building on the new opportunities presented by regulated access to the fixed-line customers of the incumbent operator and leveraging product, distribution and marketing synergies generated by the imminent launch of P4's mobile operations. These plans also anticipate the continued development of Netia's long-term commitment to the business segment. However, relative to the guidance provided a year ago, Netia expects a smaller role for WiMAX, faster revenue erosion from voice services delivered over Netia's own network and lower revenues and margins from the reselling of mobile services. As revenues and margins are integrally linked to the acceptance and implementation of the new strategy, management will provide 2007 guidance together with its announcement of the strategy.

In addition to organising the company in a way that Management considers will best support the new strategy for growing the fixed line business, once finalised, Netia will be focussed on making significant progress in a number of areas:

- doing everything possible to support its associate company, P4, in order to ensure that it makes a successful commercial debut on the Polish mobile market;
- expanding the reach of its sales channels for the residential market, in particular by beginning the indirect distribution of residential products such as internet access via high street retail outlets;
- implementation of the transmission agreement with P4, providing backhaul connectivity between P4's UMTS base stations and it's mobile switching centers (MSCs), using either existing or new transmission infrastructure, as P4 makes progress with its network rollout plans;
- improving the speed and economic performance of the WiMax roll-out through the introduction of new features and new types of multi-customer customer premises equipment;
- making further progress in the expansion of Netia's revenues from other telecommunications carriers, particularly in the areas of voice termination and leased line services;
- concluding WLR and LLU wholesale service agreements with TPSA and replacing bill and keep interconnection agreements with TPSA by new agreements based on the RIO interconnection reference offer, in accordance with the settlement concluded with TPSA in December 2006;
- work together with P4 to develop the capability for Netia to offer mobile services as both a distributor and as a reseller of P4's services;
- work together with P4 to develop mobile-fixed convergent service offerings for the customers of both companies;
- realisation of cost efficiencies necessary to ensure that Netia remains as cash generative and profitable as possible from those legacy revenue streams such as direct voice that are expected to continue to decline during the course of 2007.

3 Financial condition of the Netia Group

3.1 Consolidated balance sheet

As at December 31, 2006, non-current assets amounted to PLN 1,847,682 (86% of total assets) and decreased by 16% as compared to the end of 2005. This was mainly attributable to the impairment recorded for non-current assets and share of losses of the associate P4 Sp. z o.o. partially offset by contributions to its capital. ,

Current assets at December 31, 2006 in the amount of PLN 307,677 decreased by 28% as compared to PLN 426,910 at the end of 2005. The change was mainly attributable to the lower amount of cash and cash equivalents and cash in money market funds deposits, which decreased by PLN 96,003 throughout the year (see "Consolidated cash flow statement." below)

As at December 31, 2006, the equity amounted to PLN 1,951,900, comprising 91% of total equity and liabilities (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 11,068 and decreased by 31% as compared to the end of 2005, mainly due to the cancellation of El-Net's license fee liabilities (the process of restructuring of license fee obligations is described in point "Factors and events having a significant influence on the operations of the Netia Group […]"), partially offset by an increase of deferred revenue relating to dark fibre rental, which will be recognized beyond 2007.

As at December 31, 2006, current liabilities amounted to PLN 192,391 and decreased by 23% as compared to the end of 2005, mainly due to the cancellation of El-Net's license fee liabilities.

3.2 Consolidated income statement

Revenues from telecommunications services decreased by 5% to PLN 850,613 from PLN 898,554 in 2005. This was mainly attributable to the challenging market conditions in the direct voice segment. The revenues from direct voice services decreased by 15% to PLN 411,986 in 2006 from PLN 485,482 for 2005, mainly reflecting the overall tariff reduction trend in this product segment and lower number of residential segment subscriber lines. Total revenues from products other than direct voice (including indirect voice, data transmission, interconnection revenues, wholesale, intelligent network and other telecom services) increased by 6% to PLN 438,627 in 2006 from PLN 413,072 for 2005, and constituted 52% of total revenues from telecommunications services, as compared to 46% for 2005. Wholesale revenues, supported by the acquisition of Premium Internet SA in September 2005, were up by 54% to PLN 150,327, while data revenues rose 34% to PLN 171,486 due to increased Internet access sales to business and residential customers, and the contribution from the acquisition of Pro Futuro in July 2006.

Operating expenses (comprising services purchased, salaries and benefits, restructuring costs, impairment charges for specific individual assets and other expenses) represented 51% of total revenues for 2006 as compared to 43% for the previous year. The change was mainly attributable to lower revenues combined with increases in operating expenses necessary to support Netia's evolving product mix and strategic initiatives.

Depreciation of fixed assets increased by 10% to PLN 220,508 as compared to PLN 199,985 for the previous year, due to capital investments coming into operation and the reassessment of useful lives of narrowband radio equipment, which resulted in an additional charge of PLN 7,912.

Amortization of intangible assets increased by 7% to PLN 51,957 from PLN 48,472 for 2005 partially due to a PLN 1,900 charge following the recognition of customer relationships as an intangible asset.

Operating loss was PLN 341,384 as compared to operating profit of PLN 90,309 for 2005 and was affected mainly by an impairment charge on the Netia Group's non-current assets of PLN 354,672 and lower operating margins due to the changing revenue mix towards lower margin wholesale services.

Finance income, net was PLN 975 in 2006 as compared to PLN 8,248 for 2005. Finance income and costs were related mainly to the carrying value of El-Net's license fee liabilities and interest earned on cash and investments.

Share of losses of associates recorded in 2006 was PLN 30,724 and was related to Netia's 30% equity participation in the P4 mobile venture.

Income tax charge was PLN 7,222 as compared to an income tax charge of PLN 35,294 for 2005.

Loss was PLN 378,355 as compared to profit of PLN 60,190 for 2005. The change in the net result was mainly due to the impairment charge of PLN 354,672 upon the review of the Netia Group's telecommunications segment, lower Netia Group operating margins and start-up losses of P4. This was partially offset by a gain of PLN 64,469 related to the cancellation and reassessment of El-Net's license fee liabilities.

3.3 Consolidated cash flow statement

Net cash generated from operating activities amounted to PLN 235,237 for 2006 and decreased by 30% as compared to 2005. The decrease was due to the lower operating margins and lower revenues recorded in 2006.

Net cash used for the purchase of fixed assets and computer software increased by 24% to PLN 180,574 for 2006 from PLN 146,102 in 2005, partly in connection with the execution of the new access technology projects. In addition, cash outflow related to the acquisition of Pro Futuro amounted to PLN 68,288 and PLN 57,000 was transferred during 2006 to P4 as part of Netia's equity contribution to the mobile venture. At the same time, Netia received PLN 49,834 and PLN 4,280 on the sale of certain financial and fixed assets, respectively. As a result, net cash used in investing activities amounted to PLN 252,839 for 2006 as compared to PLN 291,341 in 2005.

Net cash used in financing activities amounted to PLN 34,313 during 2006 and decreased by 60% as compared to the previous year mainly due to the share buy-back program completed in 2005 and lower proceeds from share issuance related to the expiration of three-year subscription warrants, partially offset by increasd dividend payment to Netia shareholders.

3.4 Financial resources management

As a result of the financial restructuring the Netia Group has no significant long-term debt in respect of any notes that had been issued. In 2003 local license fee obligations were cancelled. In 2006 local license fee obligations of El-Net in the nominal value of EUR 104,624, increased by the prolongation fees of PLN 37,733, assumed together with the acquisition of El-Net, were cancelled. Additionally, in 2006 the Netia Group generated positive cash flows from operating activities. Funds in the possession of the Netia Group enabled financing the acquisition of Pro Futuro, contributions to P4's capital, significantly increase investment expenditures and pay a dividend.

Back up credit facilities totaling PLN 200,000 were put in place during the course of 2006 with this amount being subsequently reduced to PLN 100,000 once the risk of El-Net liabilities had been fully removed.

The Netia Group's activities expose it to a variety of financial risks. The Netia Group's overall risk management program focuses on minimizing potential adverse effects of those risks on the financial performance of the Netia Group. The Netia Group uses derivative financial instruments to hedge certain risk exposure.

The Netia Group's revenues and costs are predominately denominated in Polish Zloty, other than some payments made under the equipment and construction contracts, which are linked to the U.S. Dollar and Euro. In order to mitigate the currency risk Netia Group holds deposits in Euro and U.S. Dollars for servicing those payments. Furthermore, the Netia Group has a commitment to make contributions to P4's capital, denominated in Euros. Therefore, to manage the currency risks, certain part of planned payments was hedged.

The Netia Group's income and operating cash flows are substantially independent of changes in market interest rates. The Netia Group does not participate in the market trading of securities. The investments held by the Netia Group and classified as short term deposits have an agreed redemption price and are regarded as having low market risk.

The Netia Group has no significant concentrations of credit risk. Cash transactions are limited to high credit quality financial institutions. The Netia Group has a large number of customers, nationally dispersed, and there are policies in place to ensure that sales of services to significant customers are preceded by appropriate verification of their credit history.

The Netia Group policy assumes maintaining sufficient cash and marketable securities to service the current payments. Surpluses are deposited in either bank deposits or treasury bills or low risk investment funds. Due to the dynamic nature of the underlying business, the Netia Group aims to maintain flexibility in funding by keeping borrowing facilities available.

3.5 Assessment of the possibility of executing the planned investments

In 2006 all the current financial needs relating to the operational and investment expenditure within the budget approved for a given year, as well as the dividend payment, were executed from the Company's own financial resources. As at December 31, 2006 the equity presented in the consolidated financial statements of the Netia Group amounted to PLN 1,951,900 and the working capital amounted to PLN 115,286, and cash and cash equivalents and cash deposited in money market funds amounted to PLN 158,343. Moreover, in 2006 local license fee obligations of El-Net in the nominal value of EUR 104,624, increased by the prolongation fees of PLN 37,733 were cancelled. Thus, in preparing its revised strategy during 2006 and at the beginning of 2007 Management is considering strategic options that include the acceleration of investment in order to expand Netia's market share by exploiting the opportunities provided by regulatory access, WiMax and possible acquisitions. Given existing commitments towards capital increases in P4 and in respect to investment obligations under the P4 transmission contract and to maintain the existing revenue streams, Netia will need to fund these new strategic investments through debt financing if such strategic initiatives are accepted by the Company's Supervisory Board. Management expect that such financing can be obtained from financial institutions on market conditions.

3.6 Loans Agreements

Loan Agreements with Bank Handlowy w Warszawie SA

On November 6, 2006, Netia entered into two one-year financing agreements with Bank Handlowy w Warszawie SA. Netia has secured an overdraft facility in the amount of PLN 40,000 and a term loan facility of PLN 160,000. On December 29, 2006 the PLN 160,000 loan facility was reduced to PLN 60,000. During the year ended December 31, 2006 there were no drawn downs of these facilities. These facilities are intended to be maintained as back-up credit lines.

3.7 Loans, warranties and collaterals granted

Agreements partially securing the repayment of the vendor financing extended to P4

On October 31, 2006 the Company concluded a number of agreements partially securing the repayment of the credit facility of EUR 150,000 (the "Facility") granted to P4 by China Development Bank, acting as the Mandated Lead Arranger, and BPH SA, as the Facility Agent and Security Agent, under the Facility Agreement dated October 31, 2006. The Facility agreement provides for a ten year amortising term Facility with a three year availability period. The funds will be used by P4 for the purchase of core equipment for its UMTS network from Huawei Polska Sp. z o.o., including the acquisition of transmitter construction sites and related network construction costs. In order to facilitate the conclusion of part of the vendor financing package assumed in P4's original business plans, the Netia Group and Novator provided certain undertakings and separate guarantees in direct proportion to their shareholdings in P4. Accordingly, Netia concluded the following agreements:

Share Retention Agreement. Under the Share Retention Agreement, Netia provided a guarantee to a maximum amount of EUR 27,000. The guarantee covers the repayment of 30% of the outstanding amounts under one of the tranches of the Facility (limited to a total of EUR 75,000) to be applied towards the acquisition of transmitter and core network construction sites, and the costs of related civil works investments in P4's UMTS network, increased by interest and costs (with a cap at EUR 90,000). Furthermore, Netia is obliged to ensure that the P4 equity stake currently held by the Netia Group shall not be disposed of before August 23, 2008. Thereafter, the current shareholders of P4 may not reduce their combined holdings below 50% of P4's share capital without the prior consent of China Development Bank.

Equity Contribution Agreement. Under the Equity Contribution Agreement, Netia and Novator One L.P. agreed to ensure that during the scheduled Facility repayment period, P4's share capital will be increased or the shareholders will grant subordinated loans to P4 pro rata to their respective shareholdings in P4 to ensure that P4 can meet its obligations up to a maximum committed amount of EUR 300,000. The total outstanding amount of committed contributions still to be made by Netia will not exceed EUR 49,000 as at December 31, 2006.

The Subordination Agreement. Under the Subordination Agreement, Netia agreed to subordinate all of its, and the Netia Group's, financial receivables due from P4, including any subordinated shareholders loans, by giving priority to the receivables due under the Facility granted to P4. The subordination does not affect commercial agreements concluded with P4 and other agreements, once accepted by the creditors on a case-by-case basis. Netia had no such receivables subject to subordination as at December 31, 2006.

The Agreement for the Registered and Financial Pledges on Shares and the Agreement on Change of Priority of the Pledges. Under the Agreement for the Registered and Financial Pledges on Shares, Netia Mobile (P4's shareholder), established a registered and a financial pledge in favour of the Security Agent on its entire equity stake in P4 to secure P4's obligations under the Facility. At the same time, under a separate Agreement on Change of Priority of the Pledges, Netia Mobile agreed that the registered pledge established in its favour by Telecom Poland S.a.r.l. on P4's shares in connection with the conclusion of P4's Shareholders' Agreement be subordinated to the registered and financial pledges established by Telecom Poland S.a.r.l. on the same date in favour of the Security Agent to secure P4's obligations under the Facility.

Loans granted

The following loans were paid out by the Company in 2006:

- to Netia Mobile Sp. z o.o., the Company's subsidiary, with a total value of PLN 54,150. The loans are not due as at the balance sheet date;
- to Netia WiMax II S.A., the Company's subsidiary, with a total value of PLN 1,100. The loans are not due as at the balance sheet date;
- to Pro Futuro, the Company's subsidiary, with a total value of PLN 6,500. The loans are not due as at the balance sheet date;
- to Netia WiMax S.A., the subsidiary merged with the Company in July 2006, with a total value of PLN 1,290;
- to Neotel Communiacations Polska Sp. z o.o. with a value of PLN 833. The loan is not due as at the balance sheet date;
- to Telepuls Sp. z o.o. with a value of PLN 700. The loan was compensated with Netia's liabilities to Telepuls Sp. z o.o.

The following loans granted by the Company were repaid in 2006:

- by Premium Internet S.A. in the amount of PLN 8,100,
- by Neotel Communiacations Polska Sp. z o.o. in the amount of PLN 93,
- by Share Incentive Plan Trust in the amount of USD 81.

In 2006 El-Net, the subsidiary merged with the Company in July 2006, repaid a loan with a nominal value of PLN 1,342 and a purchase price of PLN 51.

In addition, on December 22, 2006, the Company entered into loan agreements with its subsidiaries: Netia WiMax II, Netia Mobile, Premium Internet and Pro Futuro, for the amounts of PLN 180,000, PLN 180,000, PLN 20,000 and PLN 6,000, respectively. The subsidiaries may draw down the loans in full or in installments, within 7 days after Netia's receiving a related notice. In 2006, there were no drawn downs relating to the above loan agreements.

4 The Company's supervisory or governing authority

4.1 Rights of the Supervisory and Management Board's members

According to the Company's Statute valid in 2006, the bodies of the Company are the General Assembly of Shareholders, the Supervisory Board and the Management Board.

General Shareholders' Meeting ("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 Supervisory Board shall consist of up to 7 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 balance sheet and the profit and loss statement;

b) presentation to the Company's GSM of a written report on the results of the Supervisory Board's examination of the report of the Management Board and the recommendations of the Management Board with respect to the distribution of profits or coverage of losses;

c) the appointment and removal of the members of the Management Board, and the issuance of by-laws for the Management Board;

d) setting or changing the compensation for the members of the Management Board and defining other terms and conditions of their employment, and the setting and changing of any incentive plan for the Management Board and other key employees;

e) approval of business plans and budgets for the Company;

f) unless provided in the most recent business plan or budget of the Company approved by the Supervisory Board, consent to incurring or making loans or other indebtedness in excess of USD 100 on a single or a series of related transactions or the equivalent amount in Polish zlotys or any other currencies;

g) unless provided in the most recent business plan or budget of the Company approved by the Supervisory Board, the authorization of capital expenditures, assumption of obligations or commitments in excess of USD 100 in a single or a series of related transactions or the equivalent amount in Polish zlotys or any other currencies;

h) unless provided in the most recent business plan or budget of the Company approved by the Supervisory Board, the giving of any guarantee or indemnity with respect to the obligations of liability of any other entity, which guarantee or indemnity shall be in excess of USD 100 in a single or a series of related transactions or the equivalent amount in Polish zlotys or any other currencies;

i) unless provided in the most recent business plan or budget of the Company approved by the Supervisory Board, the sale or acquisition of real estate for a purchase price exceeding USD 100 in a single or series of related transactions or the equivalent amount in Polish zlotys or any other currencies;

j) unless provided in the most recent business plan or budget of the Company approved by the Supervisory Board, consent to the sale, lease, pledge, hypothecation encumbering or transferring any of the Company's assets having a value in excess of USD 100 in a single or series of related transactions or the equivalent amount in Polish zlotys or any other currencies, provided, however, that sales of products and obsolete equipment in the ordinary course of business will be subject to no restrictions;

k) unless provided in the most recent business plan or budget of the Company approved by the Supervisory Board, the making of any investment or funding of any amounts in or with respect to any non telecommunications related business or operations of the Company (including, for this purpose, Uni-Net Sp. z o.o. with registered seat in Warsaw), whether under contractual arrangements existing at the time of such investment or funding or otherwise;

l) consent to the commencement, settlement, assignment, compromise or release of any claim of or against the Company in excess of USD 100 in a single or series of related transactions or the equivalent amount in Polish zlotys or other currencies;

m) bidding for any license or concession or agreeing to the material modification of any existing license of the Company or any subsidiary;

n) consent to acquiring shares of or investing in other entities other than in existing subsidiaries of the Company;

o) consent to the adoption of a performance stock option plan in accordance with § 5B of this Statute;

p) appointment of the expert auditor to audit the Company's financial statements;

r) the conclusion by the Company of any contracts with an related party. For the purposes of this point, "Affiliate" shall mean (i) a member of the Management Board or Supervisory Board or a second degree relative of such member, (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 aforementioned persons and "control" shall mean the possibility of even indirect influence over the management or business policy of the controlled entity through holding shares with the right to vote in such entity, under a shareholders agreement, an agreement for official receivership of votes or in any other similar manner, even if not connected with a written agreement.

The Management Board of the Company shall consist 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 Changes in the Management Board and Supervisory Board in 2006

Changes in the Management Board

Effective March 1, 2006 Mr. Paweł Karłowski was appointed as Member of the Management Board and Chief Commercial Officer.

Effective April 5, 2006 Mr. Jonathan Eastick was appointed as Member of the Management Board and Chief Financial Officer. Since March 1, 2006 until October 23, 2006 Mr. Jonathan Eastick was also a Member of the Management Board and Chief Financial Officer of P4, the Netia's associate. Based on the Resolution of the Supervisory Board of Netia S.A. dated April 5, 2006 concerning issues connected with the appointment of a member of the Company's Management Board, in all business relations between the Company and P4, Mr. Jonathan Eastick; (i) did not act on behalf of the Company and (ii) abstained from conducting in any way, directly or indirectly, any businesses between the Company and P4, which could possibly lead to a conflict of interest.

Effective April 5, 2006 Mr. Tom Ruhan was appointed as Member of the Management Board and Chief Legal Officer.

Effective September 13, 2006 Mr. Wojciech Mądalski, President of the Company, resigned from his position.

Effective September 13, 2006 Mr. Paweł Karłowski was appointed as Acting President of the Management Board.

Changes in the Supervisory Board

Effective January 5, 2006 Mr. Nicholas Cournoyer, Chairman of the Company's Supervisory Board, resigned from the position of Member and Chairman of the Company's Supervisory Board.

On January 9, 2006 the Supervisory Board appointed Mr. Hubert Janiszewski, Netia's Supervisory Board member, for the position of Chairman of the Company's Supervisory Board. On March 29, 2006, the Company's Shareholders' Meeting dismissed Mr. Hubert Janiszewski as Chairman and member of Netia's Supervisory Board.

Effective January 15, 2006 Mr. Richard Moon, a Member of Netia's Supervisory Board, resigned from his position.

Effective March 29, 2006 Mr. Mark Holdsworth, a Member of Netia's Supervisory Board, resigned from his position.

On March 29, 2006, the Company's Shareholder's Meeting appointed Mr. Raimondo Eggink, Mr. Bruce McInroy, Mr. Constantine Gonticas and Mr. Pantelis Tzortzakis to Netia's Supervisory Board.

On April 5, 2006 the Company's Supervisory Board unanimously appointed Ms. Alicja Kornasiewicz, Netia's Supervisory Board member, for the position of Chairperson of the Company's Supervisory Board, with immediate effect.

4.3 System for controlling employee share option schemes

At present, there is one incentive scheme in force in the Netia Group (an employee share option scheme) approved by the Supervisory Board in 2002 ("the Scheme"). The Scheme 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 Scheme 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 Scheme may not exceed 18,373,785.

The execution of the Scheme has been entrusted to the Company's Supervisory Board. To the extent provided for in the Scheme, the Supervisory Board, at its exclusive discretion, shall make decisions relating to, among other things, participation in the Scheme, 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 Scheme.

4.4 Remuneration paid and payable to the members of the Management Board and the Supervisory Board in 2006

The compensation and related cost of remuneration (including bonus paid and accrued and nominal value of shares issued resulting from exercise of options) of members of the Company's Management and Supervisory Board are presented below:

	PLN
Remuneration of current members of the Management Board	
Jonathan Eastick	721
Paweł Karłowski	1,056
Piotr Czapski	1,063
Paul Kearney	1,039
Tom Ruhan	889
	4,768
Remuneration and termination benefits for the former members of the Management Board	3,643
Remuneration of current members of the Supervisory Board	
Alicja Kornasiewicz	87
Andrzej Radzimiński	70
Bogusław Kasprzyk	70
Constantine Gonticas	53
Pantelis Tzortzakis	53
Bruce McInroy	54
Raimondo Eggink	53
	440
Remuneration and termination benefits for the former members of the Supervisory Board	44
Remuneration of current members of management boards of subsidiaries	635
Remuneration and termination benefits for the former members of management boards of subsidiaries	547
Total	**10,077**

The members of the Company's Management Board and Supervisory Board do not collect any additional remuneration for being members of the authorities of the subsidiaries. In respect to the period from March 1, 2006 to October 23, 2006 when Mr. Jonathan Eastick served as a Board Member of associate company P4, Mr. Eastick received PLN 380 directly from P4.

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

The movements in the number of options held by members of the Company's Management Board are presented below (number of options not in thousands):

Options	Paul Kearney	Piotr Czapski	Paweł Karłowski	Jonathan Eastick	Former members of the Management Board	Total
At the beginning of year	362,419	543,628	-	-	906,047	1,812,094
Granted	-	-	271,814	543,628	-	815,442
Exercised	-	-	-	-	(906,047)	(906,047)
At the end of year	362,419	543,628	271,814	543,628	-	1,721,489

The members of the Supervisory Board did not have any share options as at December 31, 2006.

The Company recognizes the cost of share-based awards to employees (including share options) 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, 2006, is as follows:

	Cost of options
	PLN
Jonathan Eastick	85
Paweł Karłowski	116
Piotr Czapski	259
Paul Kearney	178
	638

4.5 Shares held by the 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, 2006 Mr. Tom Ruhan – a member of the Company's Management Board – held 253,593 series K shares of the Company.

As at December 31, 2005 Mr. Wojciech Mądalski – the Company's former President – held 2,043,292 series K shares of the Company. As at June 30, 2006 his holdings increased to 2,576,607 shares. Due to Mr. Wojciech Mądalski's resignation from the Company's President, in September 2006, his shares are no longer recognized as shares held by members of the Company's Management Board.

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

As at December 31, 2006, Mr. Andrzej Radzimiński – a member of the Company's Supervisory Board – held 10,000 ordinary shares and 1,000 series A1 shares. The number of the Company's shares has not changed since December 31, 2005.

As at December 31, 2006, Mr. Raimondo Eggink – a member of the Company's Supervisory Board – held 20,000 shares of the Company.

As at December 31, 2006, Mr. Constantine Gonticas – a member of the Company's Supervisory Board – held 43,000 shares of the Company.

As at December 31, 2006, Ms. Alicja Kornasiewicz – the Chairperson of the Company's Supervisory Board – does not hold any shares in the Company. However, Ms. Kornasiewicz is also a member of the Management Board of a financial institution which trades in shares, including the shares of Netia S.A. The Company has disclosed the details of all trades made by this financial institution of which the Company was notified. The number of shares held by this financial institution at 31 December 2006 has not been disclosed to the Company.

As at December 31, 2005, Mr. Nicholas Cournoyer – the-then Chairman of the Supervisory Board – held 3,000 series A shares of the Company and 6,000 series J shares of the Company. Due to his resignation from the position of the member of the Supervisory Board his shares are no longer recognized as shares held by members of the Company's Supervisory Board.

4.6 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 an agreement the Supervisory Board of Netia granted one member of the Management Board compensation should that person be dismissed from his position between September 14, 2006 and a day within 12 months after the President of the company is appointed. 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 six times the monthlysalary in the amount of PLN 210. Should the member of the Management Board resign from their position within 12 months after the President of the company is appointed, Netia will be required to pay a one-off severance payment being the equivalent of three times the monthly salary in the amount of PLN 105.

4.7 Changes in the basic management principles of the Netia Group

Advisory bodies of the Supervisory Board

On April 5, 2006 the Company's Supervisory Board of Netia S.A. established the Audit Committee and appointed Messrs. Raimondo Eggink, Bruce McInroy and Andrzej Radzimiński as members of this Committee. At the same date the Supervisory Board established the Remuneration Committee and appointed Messrs. Constantine Gonticas and Bogusław Kasprzyk as members of this Committee.

Legal and organizational changes

Due to the ongoing process of internal consolidation of Netia's subsidiaries, in 2006 Netia merged with its three wholly-owned subsidiaries (the mergers were described in point "The Netia Group's structure"). The purpose of the internal consolidation is to simplify and make the Netia Group's capital structure more transparent. The Management Board believes that this will positively impact the Netia Group's operations through reduction of administrative costs, including a decrease in the scale of intercompany transactions in its daily operations.

Furthermore, in 2006 the Network Department operating activities and a part of its employees were transferred to Ericsson, based on a negotiated, five-year contract (see point "Agreements essential for the Netia Group's operations"). Thanks to the cooperation with Ericsson the Netia Group will gain more flexibility in extending its telecommunications network and will expand its geographical coverage without the increase of employment in departments dealing with network maintenance and customer installations. This will directly influence the reduction of employment costs.

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 the shareholders, as at December 31, 2006 significant blocks of the Company's shares were held by the following entities (the interest and the number of votes calculated on the basis of the number of shares constituting the Company's share capital as at the balance sheet date):

Novator Telecom Poland II S.a.r.l.

Since December 31, 2005, Novator Telecom Poland II S.a.r.l. increased its share in the Company's capital and held 98,243,602 shares constituting 25.24% of the Company's share capital and carrying 25.24% of the total number of votes at the General Shareholders' Meeting of the Company. The number of the Company's shares held by Novator Telecom Poland II S.a.r.l.

Subsidiaries of SISU Capital Limited

The subsidiaries of SISU Capital Limited held a total of 23,743,225 of the Company's shares constituting 6.10% of its share capital and carrying 6.10% of the total number of votes at the General Shareholders' Meeting of the Company. The number of the Company's shares held by the subsidiaries of SISU Capital Limited has not changed since December 31, 2005.

Third Avenue Management LLC

In 2006, Third Avenue Management LLC increased its share in the Company's capital and exceed the threshold of 16% of the total number of votes at the general Shareholders' Meeting of the Company. Third Avenue Management LLC held 63,770,278 shares constituting 16.39% of the Company's share capital and carrying 16.39% of the total number of votes at the General Shareholders' Meeting of the Company, inclusive of the shareholding of Third Avenue International Value Fund described below.

Third Avenue International Value Fund

In 2006, Third Avenue International Value Fund increased its share in the Company's capital and exceed the threshold of 5% of the total number of votes at the general Shareholders' Meeting of the Company. Third Avenue Management LLC held 19,594,034 shares constituting 5.03% of the Company's share capital and carrying 5.03% of the total number of votes at the General Shareholders' Meeting of the Company.

In the financial year 2006, the subsidiaries of Griffin Capital Management Ltd reduced their interests in the Company's share capital and, as at December 31, 2006, did not exceed the threshold of 5% of the total number of votes at the general Shareholders' Meeting of the Company.

5.2 Agreements which could lead to changes in shareholding proportions in the future

On the basis of an incentive scheme, the Company may also issue a maximum of 18,373,785 series K shares no later than by December 31, 20012. In connection with certain authorised people having exercised the rights arising from that scheme, the Company has issued 4,945,065 series K shares as at December 31, 2006.

5.3 Holders of all securities which grant special control rights in relation to the Issuer

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.

5.4 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.

5.5 Description of the proceeds from the issue used by the Company in the reporting period (not in thousands)

On April 29, 2003 based on the Prospectus published on December 2, 2002 the Company conducted a subscription for series I, II, III Notes with a nominal value of PLN 0.01 conferring the right to subscribe series J shares (for series I and II Notes) and series K shares (for series III Notes) ("Notes"). 50,798,111 Notes were offered within the subscription offer.

Series I and II Notes were to enable the detaching of subscription warrants and the series III notes were issued to launch the Netia incentive stock option plan (see point "System for controlling employee share option schemes") adopted by Netia's Supervisory Board on June 28, 2002, as subsequently amended.

On April 29, 2005, 1,361,947 two-year subscription warrants expired and on April 29, 2006, 1,022,433 three-year subscription warrants expired. In the year ended December 31, 2006 7,662,385 of the warrants were exercised and the Company's share capital was accordingly increased by 7,662,385 series J shares. The issue price for each series J share amounted to PLN 2.53. The proceeds from the series J share issue has been dedicated to the current activities of the Company. From the issuance date of warrants until their expiration dates, the total number of series J shares issued at the exercise of warrants was 62,464,062.

In the year ended December 31, 2006 the Company issued 1,052,691 bearer series K shares, due to the exercise by certain persons authorised thereto of their rights under the employee share option scheme. The total number of series K shares issued until December 31, 2006 amounted to 4,945,065 shares. Participants in the scheme are not obligated to pay up for shares received.

5.6 Information presented on the basis of Art. 363 of the Commercial Companies' Code

In accordance with resolutions of the Company's General Shareholders' meeting (the "Shareholders Meeting") held on March 29, 2006 the Netia Group has resolved to distribute the net profit of Netia S.A. for the year ended December 31, 2005 and the amount of PLN 2,812 was transferred to the Company's special reserve capital (in connection with the purchase of own shares series C and E). Additionally, in relation to the Shareholders Meeting's resolution regarding the decrease of share capital, the Company deducted from other supplementary capital the amount of PLN 120,463, representing the consideration paid for shares redeemed within the buy-back program and nominal value of redeemed shares, which were issued by the Company for the purpose of the previous stock option plan.

6 Other information

6.1 Transactions with related parties

The following transactions were concluded between the Issuer and its subsidiaries and associate during 2006:
- 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.

The income and costs from these transactions and income from interest on loans, the total value of which in relation to each subsidiary and associate exceeded 500 EUR, amounted respectively to:

	Income (PLN)	Costs (PLN)	Interest (PLN)
RST El-Net S.A. (until it was merged with Netia)......	17,155	309	3,269
Świat Internet S.A.	3,292	1,392	1,061
Premium Internet S.A.	17,889	4,224	1,115
Netia WiMax II S.A.	3,733	747	935
Pro Futuro S.A.	1,235	502	1.163
P4..	3,746	-	-

A detailed list of transactions with subsidiaries and associates has been presented in the Issuer's Financial Statements (Note 39).

Futhermore, former members of the Supervisory Board and Management Board of one of the Company's subsidiaries were related parties to ZIT, a company, which rendered managerial services for Premium Internet S.A. and was aquired by the Netia Group in June 2006 (see "The Netia Group's structure"). Due to that transaction, they received an advance payment of PLN 5,324 and as at December 31, 2006 the related outstanding liability amounted to PLN 10,217.

Other transactions with associates 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 2006".

6.2 Explanation for the differences between the financial results of the annual report and forecasts that had been published

No financial forecasts referring to the Company's and Netia Group's results were published in 2006 by the Company.

(All amounts in thousands, except as otherwise stated)

6.3 Information on the registered audit company

The financial statements of Netia and the consolidated financial statements of the Netia Group for 2005 were audited by PricewaterhouseCoopers Sp. z o.o. on the basis of a contract concluded on December 11, 2006.

The total fees specified in the contract 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	2006	2005
Audit of stand-alone and consolidated financial statements	545	583
Review of stand-alone and consolidated financial statements	404	379
Other services	127	257
Total	**1,076**	**1,219**

6.4 Subsequent events

Increase of the Netia Group's share in UNI-Net

On January 9, 2007, the Company purchased from the minority shareholders 4% of the share capital of the Company's subsidiary UNI-Net Sp. z o.o. ("UNI-Net"), for a total of PLN 700. Following these transactions, the Netia Group holds 62,2% of UNI-Net's share capital and the corresponding number of votes at its shareholders' meeting.

Netia took up the shares in its subsidiary Świat Internet

On January 22, 2007, Netia concluded an agreement with its wholly owned subsidiary Świat Internet, with regard to the taking up of the shares in the increased share capital of Świat Internet. The agreement will effect in the in-kind contribution of the telecommunications network elements owned by Netia to the Świat Internet's capital. The increase of Świat Internet's share capital will be executed through the private subscription, that is the taking up by Netia of all new issued shares in exchange for the contribution, valuated by a property appraisal expert at the amount of PLN 950,703.

The transfer of the ownership of the assets contributed to Świat Internet will occur within one month as of the registration in the registry of entrepreneurs of the above mentioned share capital increase.

Appointment of new President of the Management Board and CEO

On January 23, 2007, the Company's Supervisory Board appointed Mr. Mirosław Godlewski as Netia's President of the Management Board and Chief Executive Officer, effective February 15, 2007. Mr. Paweł Karłowski, the Acting President of the Company, continues to serve as Netia's Management Board member and Chief Commercial Officer.

Amendment of the P4 shareholders agreement

On January 31, 2007 the Company concluded an investment agreement (the "Investment Agreement"), which provides for the accession of a new shareholder, Tollerton Investments Limited ("Tollerton") to P4 and for the subscription by Tollerton for a 22% equity stake in the increased share capital of P4 in return for 100% of shares in Germanos Polska Sp. z o.o. together with its two subsidiaries Telecommunication Center Mobile Sp z o.o. and Mobile Phone Telecom Sp. z o.o. (the "Distribution Companies"), which will be contributed to P4 to pay for the new shares subscribed for by Tollerton. The Investment Agreement further provides for an amendment of the Shareholders Agreement of P4 dated August 23, 2005 after the transactions contemplated in the Investment Agreement have been completed.

Following the increase of P4's share capital, Netia Mobile will hold 23.4% of P4's share capital while Novator will hold a 54.6% of P4's share capital. The above is conditional on obtaining the consent of the Chairman of the Polish Office for the Protection of Competition and Consumers and the consent of China Development Bank, as required under the terms of the facility of EUR 150,000 granted to P4 to the transactions contemplated in the Investment Agreement, and on the Distribution Companies terminating certain existing exclusive distribution agreements to which they are the parties.

In the amended Shareholders Agreement, which will be concluded upon Tollerton subscribing for P4's shares, the Shareholders reiterate their earlier commitments to make contributions to P4 up to EUR 300.000, pro rata to their respective changed shareholdings in P4's share capital, whereby Tollerton has agreed to make contributions of EUR 35,000 and the investment commitment of Netia Mobile will be reduced to EUR 79,500 from EUR 90,000.

The Investment Agreement and the amended Shareholders Agreement specify the key principles of commercial cooperation of Netia and the Distribution Companies based on which the Company and P4 will conclude commercial contract providing for Netia's access to the Distribution Companies' sales network.

Key implications for the Company relating to the above agreements are as follows:
- the Company will have guaranteed long-term access to the distribution network for products from the fixed-line segment offered by the Company,
- Netia's associate company, P4, gains access to leading national distribution network of over 225 stores together with the continuing use of the Germanos brand name,
- the P4 joint venture is strengthened by the addition of a second strategic investor with proven know-how in mobile phone retailing, distribution, logistics and procurement.

Share options granted under the Plan (not in thousands)

On February 15, 2007 the President of the Company's Management Board was granted 10,000,000 options to subscribe for series K shares in accordance with the Plan. The grant is divided into three tranches: 4 million, 3 million and 3 million. The strike prices of the options for each tranche are: PLN 5.50, PLN 7.00 and PLN 8.25, respectively. The granted options shall expire on December 20, 2012.

Warsaw, March 1, 2007