Warsaw, May 15, 2007

# COMMENT ON THE FINANCIAL REPORT FOR THE FIRST QUARTER OF 2007

This comment 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. The Netia Group's structure

The condensed consolidated financial statements as at and for the three-month period ended March 31, 2007 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.)
Świat Internet S.A. Group
Netia Mobile Sp. z o.o.
InterNetia Sp. z o.o.
Pro Futuro S.A.

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

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

## 2. Changes within the Netia Group's structure

***Increase of the Netia Group's share in UNI-Net Sp. z o.o.***

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 700,000. As a result of these transactions, the Netia Group holds 62.2% of UNI-Net's share capital and the corresponding number of votes at its General Shareholders' Meeting.

***Decrease of the Netia Group's share in Świat Internet S.A.***

On January 20, 2007, the Company sold to its subsidiary Pro Futuro S.A. 100 shares of Świat Internet S.A. („Świat Internet"), representing 0,057% of its share capital, for a total of PLN 100. As a result of this transaction, the Company holds 99.99% of Świat Internet's share capital and the corresponding number of votes at its General sSareholders' Meeting.

## 3. Shareholders holding at least 5% of the votes at the General Shareholders' Meeting of Netia as at the date of filing this report

Based on the information presented to the Company by the shareholders, as at the date filing of this report, significant blocks of the Company's shares were held by the following entities (the interest and the number of votes are calculated on the basis of the number of shares constituting the Company's share capital as at May 15, 2007):

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

Novator Telecom Poland II S.a.r.l. held 98,243,602 shares constituting 25.24% of the Company's share capital and representing 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. has not changed since March 1, 2007.

***Subsidiaries of SISU Capital Limited***

In the period from the submission of the previous quarterly report the subsidiaries of SISU Capital Limited increased their share in the Company's share capital and exceeded the threshold of 10% of the total number of votes at the General Shareholders' Meeting of the Company. The subsidiaries of SISU Capital Limited held a total of 39,043,006 of the Company's shares constituting 10.03% of its share capital and representing 10.03% of the total number of votes at the General Shareholders' Meeting of the Company.

***Third Avenue Management LLC***

In the period from the submission of the previous quarterly report Third Avenue Management LLC increased its share in the Company's share capital and exceeded the threshold of 18% of the total number of votes at the General Shareholders' Meeting of the Company. Third Avenue Management LLC held 71,660,517 shares constituting 18.41% of the Company's share capital and representing 18.41% 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***

Third Avenue International Value Fund held 19,594,034 of the Company's shares constituting 5.03% of the Company's share capital and representing 5.03% of the total number of votes at the General Shareholders' Meeting of the Company. The number of the Company's shares held by the subsidiaries of Third Avenue International Value Fund has not changed since March 1, 2007.

## 4. Changes in shares and share options held by members of the Company's Management Board and Supervisory Board

Since adopting the employee share option scheme (the "Plan") on April 10, 2003 to March 31, 2007, the Supervisory Board approved the issuing of a total number of 25,271,220 options to members of the Management Board and to Netia's key employees. Out of the total number of approved options 11,935,149 were outstanding as at March 31, 2007. The options are exercisable until December 20, 2007 or December 20, 2012 (due to an amendment of Netia's statute egardingthe extension of the period during which series K shares may be offered to members of the Management Board and key employees to execute their rights resulting from the Plan, the Supervisory Board extended the period of exercising newly issued options). The strike price of the approved outstanding options, depending on the agreement, ranges between PLN 3.12 and PLN 8.25 per share.

During the first quarter of 2007 the following changes took place in the number of options granted under the Plan:

*Three-month period ended March 31, 2007*

| | |
|---|---|
| At the beginning of the period | 1, 935,149 |
| Granted | 10,000,000 |
| At the end of the period | 11,935,149 |

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

| *Three-month period ended March 31, 2007* | Paul Kearney | Piotr Czapski | Paweł Karłowski | Jonathan Eastick | Mirosław Godlewski | Total |
|---|---|---|---|---|---|---|
| At the beginning of the period | 362,419 | 543,628 | 271,814 | 543,628 | - | 1, 721,489 |
| Granted | - | - | - | | 10,000,000 | 10,000,000 |
| Resignation from the Management Board | (362,419) | - | (271,814) | | | |
| At the end of the period | - | 543,628 | - | 543,628 | 10,000,000 | 1,721,489 |

Furthermore, as of April 1, 2007, Mr. Bertrand Le Guern was appointed as a member of Netia's Management Board and received 5 million options authorizing him to subscribe for the Company's shares. On April 13, 2007, Mr. Piotr Czapski, Mr. Jonathan Eastick and Mr. Tom Ruhan received respectively 5 million, 9 million and 4 million options authorizing them to subscribe for the Company's shares. There were no further changes in the number of Netia's options held by members of the Company's Management Board until the date of filing of this report.

The members of the Supervisory Board did not hold any options as at March 31, 2007.

The number of shares held by members of the Management Board has not changed during the first quarter of 2007 and as at the date of filing this report.

The number of shares held by members of the Supervisory Board has not changed during the first quarter of 2007. As a result of Mr. Andrzej Radzimiński's resignation from his position as of April 30, 2007, his shares are no longer treated as options held by the members of the Supervisory Board. There were no further changes in the number of options granted to members of the Supervisory Board as at the date of filing this report.

## 5. Legal proceedings

***Millennium***

In August and September 2000, the Company entered into certain agreements to acquire all of the outstanding equity of Millennium Communications S.A. ("Millennium"), a provider of telecommunications services in Warsaw. Certain advances were made to Millennium following the execution of the agreements, and currently a loan of EUR 2.9 million (PLN 11.2 million at the March 31, 2007 exchange rate of the National Bank of Poland) increased by the applicable interest is outstanding from Millennium. In December 2000, the Company brought a claim for the repayment of the loan against Millennium in the District Court in Warsaw. On October 16, 2006, the Regional Court granted the Company's claim and ordered Millennium to pay PLN 11.5 million with interest. The Court has also dismissed Millennium's counterclaim. Millennium filed an appeal. The matter is still pending.

In 2001, a valuation allowance of PLN 17.0 million was recorded as other operating expense against the outstanding amount receivable from Millennium as a result of the events described above.

On April 5, 2005, Millennium filed a claim against El-Net S.A. ("El-Net"), the subsidiary merged with Netia in July 2006, in connection with the alleged acts of unfair competition of El-Net against Millennium. El-Net filed an answer to the claim on June 6, 2005 in which it requested the District Court to dismiss the claim as wholly unsubstantiated. On December 23, 2006, the Court dismissed Millennium's claim in its entirety. Millennium filed an appeal. The matter is still pending.

In July 2005, Millennium filed a motion to secure the claim against El-Net for determination that an agreement between El-Net and Millennium concerning provisions of telephone services and the use of 30,000 telephone numbers by Millennium was not effectively terminated by El-Net. On August 21, 2005, Millennium filed a motion against El-Net in connection with the claim to which the injunction pertained to. El-Net filed an answer to the claim on October 19, 2005 in which it requested the District Court to dismiss the claim as wholly unsubstantiated. On October 11, 2006, the Court dismissed Millennium's claim in its entirety. Millennium filed an appeal. The matter is still pending.

The Management, having obtained legal advice, does not believe that the settlement of the matters described above will have a material adverse effect on the Netia Group's financial condition. Accordingly no liability has been recorded for the claims.

***Minority shareholders***

On August 1, 2002, the Company received a copy of a claim filed with the District Court in Warsaw by an individual shareholder demanding the cancellation of sections 10, 11 and 13 of Resolution No. 2 adopted by the Company's General Meeting on April 4, 2002. The individual shareholder claimed that the distribution of the Company's warrants under the financial restructuring was harmful to the minority shareholders and violated good custom. On August 14, 2002, the Company responded requesting the District Court to dismiss the claim as unsubstantiated. The matter is still pending.

In a second similar matter, a minority shareholder's claim was dismissed on merits by the District Court in Warsaw. On March 25, 2005, the minority shareholder filed an appeal. On December 8, 2005 the RegionalCourt examining the appeal overruled the judgment of the District Court and decided that the case has to be re-examined due to the fact that it should be the RegionalCourt not the District Court where the case should have been examined in the first resort. The matter is still pending.

Management, having obtained legal advice, does not believe that the settlement of the matters described above will have a material adverse effect on the Netia Group's financial condition. Accordingly no liability has been recorded for the claims.

## 6. Warranties and collateral 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 million (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 million. The guarantee covers the repayment of 30% of the outstanding amounts under one of the tranches of the Facility (not exceeding a total of EUR 75 million) to be applied towards the acquisition of transmitter and core network construction sites, and the costs of related construction works in connection with building P4's UMTS network, increased by interest and costs (capped at EUR 90 million). Furthermore, Netia is requiredto ensure that the P4 equity stake currently held by the Netia Group will 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 30 million. The total outstanding amount of committed contributions still to be made by Netia will not exceed EUR 42 million as at March 31, 2007.

**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 the Subordination Agreement as at March 31, 2007.

**The Agreement for Registered and Financial Pledges on Shares** and the Agreement on Change of Priority of the Pledges. Under the Agreement for 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.

## 7. Factors which may have an impact on the result of the Netia Group

***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 subsequently, based on boardening our strategic scope, updated in December 2005. On April 18, 2007 the Company announced the main assumptions of its operational strategy and no assurance can be given as to whether new strategic initiatives included in the new strategy, will be successful, and if not, whether they may adversely affect the operating activity of the Netia Group, its financial standing or its overall performance.

***Funding Risk***

Although Netia has maintained a significant cash surplus over the past few years and the Company's core activities remain cash generative, the Company has recently changed 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. As a result, the Company needs 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 development plans.

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

Currently, Netia is not controlled by any strategic investors, and its shares are held by a large number of shareholders. Novator Telecom Poland II S.a.r.l. („Novator"), is the largest single shareholder of Netia and according to the information furnished to the Company it holds 98,243,602 shares which, as at the date of filing this report, represented 25.2% of the Company's share capital and 25.2% of the aggregate number of votes at the Company's General Shareholders' Meeting. During 2007, Third Avenue Management LLC increased its stake in the Company's share capital and holds 71,660,517 shares representing 18.4% of the Company's share capital and 18.4% of the aggregate number of votes at the Company's General Meeting of Shareholders' Meeting. The subsidiaries of SISU Capital Limited also increased their stake in the Company's share capital in 2007, and hold 39,043,006 shares representing 10.0% of the Company's share capital and 10.0% of the aggregate number of votes at the Company's General Shareholders' Meeting. 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 materially influence 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 resolutions on key matters affecting the Company's operations. Furthermore, Novator Telecom Poland S.a.r.l, Novator's related entity, holds a controlling stake (currently 70%) in the share capital of P4, an affiliate of the Company. This 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 "Other information".

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 of 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 the candidates for takeover, the negotiating of agreements and integration of the entities acquired. The Netia Group may require additional funding in order to conduct such transactions.

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

***Technological risk***

The telecommunications sector is an area witnessing dynamic technological changes. In designing and expanding its networks, the Netia Group uses the latest technical solutions. However, it is not possible to predict how the Netia Group's operations may be affected by technological advances in the field of fixed-line telephony, wireless transmission, voice transmission protocol via the Internet or cable television telephony. In particular, the business activities 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 operations to such technological advances, new market participants may emerge as a result of the new technology with a competitive advantage over 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 the work of its staff and employees in executive positions. The Management Board cannot guarantee that the possible termination of employment by some of its key executives will not adversely affect the financial standing and performance of the Netia Group, which, should some of its executives terminate their employment, may then lack executives with sufficient knowledge and experience in the field of management and operating activity. Changes in composition at the Company's executive levels may result in disruptions in the Netia Group's business activity.

***Risk resulting from changes in the Telecommunications Law***

The 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.

The Management may not, however, assure that Netia will not be considered by the President of the 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 granting reasonable requests for telecommunications access filed by other entrepreneurs, equal treatment obligations, and an obligation to publish information necessary to allow them to use the services provided in this market. In this regard, the President of the UKE has already consulted a draft decision. It was also subject to consolidation procedure and the European Commission has not raised any substantial reservations or a veto.

Pursuant to the Telecommunications Law, each public telecommunications network operator is required to conduct negotiations concerning interconnection agreements upon another telecom operator's request. However, the President of the UKE is required to resolve any disputes between the parties to the negotiations by way of an administrative decision, which shall replace the relevant agreement only if one of the negotiating parties is a public telecommunications network operator required 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 7, 2006 the President of the UKE issued a decision assigning TP SA as an operator required to provide universal services commencing on May 8, 2011. Telecommunications providers whose revenues from telecom activities 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 will be required 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 required to co-finance the funding of universal services on the terms described above.

The Telecommunications Law requires that telecommunications providers pay annual telecommunications fees of up to 0.05 % of the provider's annual revenues from telecommunications activities 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.

As from January 1, 2006, Netia is required 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.

The 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 the Netia Group companies) many additional obligations. It is difficult to determine when the draft will become law at this stage.

***Risks related to holding a position of SMP***

On April 26, 2007, UKE issued the decision no. DRTD-SMP-6043-10/06 (20), whereby it has appointed Netia as a telecommunications operator holding significant market power in the market for the call termination in its fixed public telephone network, in the area of the network where the termination is executed. At the same time, UKE imposed regulatory obligations that relate to:

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

The above described decision is immediately enforceable, with the exception that the obligation to publish the information has to be performed within 3 months from the receipt of the decision at the latest.

Currently, there are intense efforts undertaken to prepare an offer for the sale of call termination services in the network of Netia.

Nevertheless, Netia filed an appeal against the Decision to the District Court in Warsaw – The Court of Competition and Consumer Protection.

***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 accessing the telephony network of TP SA. Except for some cases, calls initiated in Netia's network ending outside this network, including the majority of international and domestic long distance calls by subscribers of the 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 required to connect companies such as Netia to its network. The Netia Group companies running operations have concluded interconnection agreements with TP SA covering of the areas where the companies conduct their 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 the 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 with Netia SA) and due to the continued existence of the interconnection agreements between TP SA and the 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, among others, there are negotiations with TP SA regarding 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.

The Management can give no assurance that no new disputes will arise in the future with TP SA over interconnection and will not materially impact Netia's development and financial results.

***Other regulatory risks***

UKE has recently carried out controls of Netia's compliance with legal requirements related to the provision of internet services to subscribers utilizing Bitstream Access over the TP SA network. To date, none of these controls have ended with a monetary penalty.

***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 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 a 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 in areas where the Netia Group conducts its business activities. The infrastructure used by TP SA in these areas 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 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 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 unified offers in the area of regulatory access to the TP SA network which Netia currently considers to be commercially viable. As a result, in 2006 the Netia Group 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 the 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 provide and maintain such services to end customers needs to be much more coordinated than has been the case in the past. The 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 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 required to pay, the swap for capital expenditures took place in 2006. However, the 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, 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 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 strengthentheir market position while by utilizing the effects of scale. Netia has successfully acquired four 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 consolidated revenues of the Netia Group.

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 subsidies 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 financing and 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.

Furthermore, on October 31, 2006 the Company concluded a number of agreements partially securing the repayment of the credit facility of EUR 150 million 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 (not exeeding a total of EUR 75 million) increased by interest and costs (capped at EUR 90 million) (see "Warranties and collateral 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 million 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 with respect to being able to achieve its own development plans. The successful and profitable implementation of the Transmission Agreement with P4, 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.

The 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.

## 8. Transactions with related parties

***Netia took up the shares in its subsidiary Świat Internet***

On January 22, 2007, Netia concluded an agreement with its subsidiary Świat Internet, whereupon Netia made an in-kind contribution of telecommunications network elements in exchange for new shares in its subsidiary.

The conclusion of the above mentioned agreement resulted from the execution of the resolution adopted by the General Shareholders' Meeting of the Company, regarding the increase of the Company's share capital by PLN 950.7 million, by way of issuing 95.1 million new, ordinary registered series M shares, PLN 10 par value per share, with a total nominal value of PLN 950.7 million. The increase of the Company's share capital was executed through the private subscription, that is the taking up by Netia of all new series M shares in exchange for the contribution, valued by a property appraisal expert at the amount of PLN 950.7 million.

***Guarantees granted***

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 (see also "Other information"). As at the date of filing of this report, there were no draw downs under these facilities. On February 14, 2007, due to the in-kind contribution of certain non-current assets, Świat Internet guaranteed the above loan facilities up to the amount of PLN 125 million.

***Other transactions***

A detailed list of transactions with related parties has been presented in the interim condensed consolidated financial statements of the Netia Group (Note 12) and interim condensed financial statements of Netia (Note 11).

## 9. Other information

***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 the 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 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 million granted to P4 (see "Warranties and collateral granted") 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 million, pro rata to their respective changed shareholdings in P4's share capital, whereby Tollerton has agreed to make contributions of EUR 35 million and the investment commitment of Netia Mobile will be reduced to EUR 79 million from EUR 90 million.

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 a 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 a 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.

***Main assumptions of Netia's strategy and guidance for 2007***

On April 18, 2007 the Company announced the main assumptions of its operational strategy and guidance for 2007:

<u>Mission</u>
To be the preferred choice for broadband services.

<u>Vision</u>
To be the fastest-growing communication service provider in Poland by:
- satisfying our customers' needs for fully featured, high quality broadband services;
- creating value through dynamic growth of our customer base;
- providing an inspiring, performance-driven and entrepreneurial work environment.

Main strategic objectives

1. Gain broadband services leadership:
   - reach 1 million broadband customers (*).
2. Leverage PLAY investments by:
   - introducing fixed-mobile convergent services in 2008;
   - achieving cost and infrastructure synergies at the group level.
3. Optimize Netia's strong position in the business market segment by:
   - increasing significantly the number of SOHO & SME clients;
   - increasing profitability of large corporate clients while minimizing capital expenditures.
4. Introduce changes to the organizational culture to support a strategy focused on value growth by:
   - strengthening employees' values such as focusing on clients' needs, reaching objectives, entrepreneurial drive and trust.
5. Invest for profitable growth:
   - achieving an industry-leading revenue compound average growth rate during 2007-2009;
   - maximizing utilization of existing assets;
   - achieving strong EBITDA growth by 2009 and positive free cash flow by 2010 as a result of three years of investment in broadband services of up to PLN 700 million.

Guidance for 2007

1. Number of broadband clients. Netia intends to have more than 200,000 broadband clients by the end of 2007, in comparison to 57,000 clients as at the end of 2006.
2. 2007 revenues are forecasted to reach a level of PLN 830-865 million.
3. Adjusted 2007 EBITDA is forecasted to reach PLN 130 million. The forecast of adjusted 2007 EBITDA allows for start-up losses of up to PLN 80 million connected with the investments in new client access methods made available under the applicable regulatory decisions, i.e., bitstream access, wholesale line rental and local loop unbundling.
4. 2007 investment outlays are expected to reach up to PLN 300 million.

*(*) The total number of clients using broadband services through the use of various access methods, e.g. xDSL within Netia's own copper network, WiMax, bitstream (BSA) and through local loop unbundling via TP SA's network.*

***Credit facility agreement***

On May 15, 2007 the Company entered into a PLN 300 million credit facility agreement with Rabobank Polska SA (the "Bank") as arranger, credit facility agent, security agent and lender (the "Agreement", the "Facility"). The above Facility will be extended to Netia in the form of a term loan and a revolving loan of up to PLN 250 million and PLN 50 million, respectively. The Facility is to be repaid by November 15, 2011. The Facility bears interest at a variable interest rate of WIBOR plus a margin dependant on financial ratios. The proceeds from the Facility will be used to finance Netia's capital expenditures and current operations.

The repayment of the Facility is secured by the following: two capped mortgages on the right of perpetual usufruct of the Company's real estate at ul. Poleczki 13 in Warsaw, a registered pledge on a set of movables and rights constituting an organised part of the enterprise of Świat Internet, registered pledges and financial pledges on the shares of Świat Internet, UNI-Net, InterNetia Sp. z o.o, Netia WiMax S.A., Premium Internet S.A, and assignment as collateral security of Netia's receivables under certain agreements. The financial pledges on shares will remain in place until registration of the registered pledges is completed.

***Termination of Loan Agreements with Bank Handlowy w Warszawie SA***

On May 15, 2007 the Company gave Bank Handlowy w Warszawie SA. a notification, that available facilities totalling PLN 100,000, will be terminated according to the relevant provisions of the agreements. There will be no draw downs under these facilities until their termination.