



Annual Report . 2004 . Strong, Profitable Growth

## Strong, profitable growth

### Key data

	2004	2003	2002	2001	2000
All amounts in € million					
Revenues	145.9	115.6	47.1	29.4	5.0
EBITDA	+0.9	-28.5	-60.3	-85.4	-79.4
EBIT	-22.7	-61.9	-101.1	-113.0	-98.0
Net loss	-21.6	-60.6	-102.6	-104.9	-89.2
Net loss per common share <sup>1</sup> (in €)	-0.20	-0.58	-1.01	-1.04	-1.15
Equity <sup>2</sup>	70.5	89.5	145.3	240.0	339.1
Balance Sheet total <sup>2</sup>	114.8	132.7	194.6	298.0	419.7
Equity ratio (in %)	61.4	67.4	74.7	80.5	80.8
Capital Expenditure	12.4	8.5	11.8	41.7	85.8
Liquidity <sup>2</sup>	40.3	54.3	87.6	153.8	294.8
Share price <sup>2</sup> (in €)	3.66	3.03	0.38	1.25	3.98
Number of shares <sup>2</sup>	105,502,729	105,037,396	105,008,714	105,008,714	105,008,714
Market capitalization <sup>2</sup>	386.1	318.3	39.9	131.3	417.9
Employees <sup>2</sup>	367	373	433	263	194

<sup>1</sup> basic and diluted

<sup>2</sup> as of December, 31

# growing

on secure ground  
with substantial roots  
and strong limbs  
for new shoots  
with great prospects

## Strong, profitable growth

on secure  
ground

QSC is broadband:  
From a simple phone call  
to complex networking,  
we offer innovative and secure  
telecommunication with our  
DSL network.

We do business with customers  
in a spirit of partnership.  
Their trust enables QSC's strong  
and profitable growth.

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Strong, profitable growth

with substantial  
roots



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#### The QSC infrastructure

Aachen	Esslingen am Neckar	Krefeld	Offenbach am Main
Augsburg	Ettlingen	Langenfeld im Rheinland	Paderborn
Berlin	Frankfurt am Main	Leipzig	Pforzheim
Bielefeld	Freschen	Leverkusen	Potsdam
Bochum	Freiburg im Breisgau	Lübeck	Regensburg
Bonn	Fürth	Ludwigsburg	Raitlingen
Braunschweig	Gelsenkirchen	Ludwigshafen am Rhein	Rostock
Bremen	Göttingen	Magdeburg	Saarbrücken
Bremerhaven	Hagen	Mainz	Siegburg
Cologne	Halle an der Saale	Mannheim	Siegen
Darmstadt	Hamburg	Moers	Sindelfingen
Dartmund	Hannover	Mönchengladbach	Stuttgart
Dresden	Heidelberg	Mülheim an der Ruhr	Trier
Duisburg	Heilbronn	Munich	Ulm
Düsseldorf	Hilden	Münster	Wesseling
Erlangen	Karlsruhe	Neuss	Wiesbaden
Eschborn	Kassel	Nuremberg	Wiesloch
Essen	Koblenz	Oberhausen	Wuppertal

# and strong limbs

## Strong, profitable growth

### QSC-Solutions

QSC-Solutions	Customer Segment
<b>IP-VPN</b> Design, implementation and operation of broadband solutions on the basis of VPNs	Top 200 enterprises
<b>Managed Services</b> VoIP-Services, Managed Security, Managed LAN	Large enterprises Large and medium sized enterprises

Broadband-Aggregation Z-ISP	Carrier
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### QSC-Data QSC-Voice

Q-DSLmax Q-DSLpro	QSC-Select QSC-Direct	Large and medium sized enterprises
QSC-VPN	QSC-Direct basic IPfonie basic	
QSC-Speedw@y	IPfonie business IPfonie corporate	Small enterprises Small offices / Home offices

Q-DSL home Q-DSL tengo	Call-by-call IPfonie privat	Premium residential
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and strong limbs

for new shoots

with great prospects

## Strong, profitable growth

# for new shoots

**Strong revenue growth** // In 2004, QSC grew its revenues by 26 percent to € 145.9 million. From 2000 to 2004, revenues have risen by 2,800 percent. This makes QSC one of the most dynamic companies in Germany.

**Sustained positive EBITDA** // QSC dramatically improved its profitability last year. Its positive EBITDA totaled € 0.9 million, as opposed to € -28.5 million the year before. At the same time, the Company began generating a positive free cash flow in the second quarter of 2004, one quarter earlier than had been planned.

**Strong dynamics in IP-VPN business** // Revenues with major accounts, alone, rose by 69 percent to € 33.2 million in 2004. Building and operating virtual private networks, along with network-related services for companies with a large number of locations, is the segment with the highest growth.

**Prestigious customers** // AOL, Goodyear Dunlop and Tchibo numbered among that major corporates that opted for QSC in 2004. The number of customers is steadily rising – their satisfaction serves as the foundation for future growth.

**High-growth market** // QSC will be growing disproportionately in prosperous markets in the coming years, as well. Studies are predicting that DSL revenues with business customers in Germany will double in the coming years; the IP-VPN market, alone, is expected to reach a volume of € 1.7 billion by 2007.

**Positive share price performance** // QSC's growth is opening up new potential for the Company's shares. QSC shares have been included in the TecDAX since March 2004, and in fact even outperformed this lead index in 2004: While the TecDAX declined by four percent, the price of QSC shares advanced by 21 percent. At the same time, the number of studies on QSC has risen; at year-end 2004, nine financial institutions were already regularly publishing research on the Company.

with great  
prospects

### Strong, profitable growth

Partnership, security, innovation – These three characteristics typify QSC's positioning in the competitive arena and are convincing more and more customers.

For 2005, we anticipate profitable revenue growth of at least 20 percent to more than € 175 million.

Medium-term, QSC intends to number among the top three providers of enterprise networks in Germany.

## Strong, profitable growth

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## To the Shareholders

*Dear Shareholders,  
QSC continued its strong and  
profitable growth in 2004.*

QSC winning more than 20 percent of its proposals among enterprise customers

In a difficult economic environment, we succeeded in increasing our revenues by 26 percent to € 145.9 million, while simultaneously recording our first operating profit before depreciation in the amount of € 0.9 million – one year earlier, our EBITDA had stood at € -28.5 million. The solutions business with larger enterprises generated especially strong growth and profitability, with revenues in this segment, alone, advancing by 69 percent to € 33.2 million. In 2004, we thus made major progress toward establishing ourselves as one of the three leading providers of enterprise networks in Germany.

Focusing on enterprise customers is paying off for QSC. We are now being invited to participate in most requests for proposals from major accounts and are winning on more than 20 percent of our proposals thanks to our technical competence, service quality and customer focus. During the course of 2004, some of the customers that mandated QSC included Deutsche Bahn, the Tchibo retail chain and DEVK Insurance. For some time now, our solutions business has no longer been limited to merely building and operating enterprise networks. Tchibo, for example, also contracted with us to operate both local area networks as well as thousands of telecommunication end-user devices, such as telephones, facsimile machines and printers. Demand for these kinds of network-related services is likely to play a key role in continuing to drive our growth in the coming years.

High-quality network-related services can only be implemented on the basis of a provider's own broadband network. The QSC network, the third largest DSL network in Germany, is proving to be a crucial competitive advantage. Our infrastructure ranges all the way into the offices of our customers, thus enabling us to exercise quality control in terms of technology and processes. We are therefore steadily and specifically expanding this network, and thus our competitive edge. In 2004, alone, we connected over 20 new cities to our network; by mid 2005, we intend to add an additional 10 cities to the network, and will then be present in more than 80 cities.

QSC's own infrastructure consists of far more than just a DSL network. Today, QSC operates one of Germany's largest voice networks, and in the coming months we will be upgrading it into one of the largest Voice over IP networks in Germany. With this Next Generation Network (NGN), we are readying ourselves early on for the most far-reaching change in voice telephony since the introduction of mobile communication – the use of the Internet Protocol for telephone calls in addition to data transfer. In early March, we were one of the first telecommunication providers to introduce a corresponding product portfolio with IPfonie.

The NGN network and our new products show that QSC is innovative. And it is precisely this innovative strength that we view as being one of QSC's three key positioning factors in the competitive arena. In addition to our pioneering role in new developments, we are also characterized by our high network security, as well as by our business culture that is based on fair partnership principals. QSC is a reliable service provider to its customers and attaches the utmost priority to maximum security. Our partnership based approach towards customers, suppliers and employees additionally sets us apart from our globally aligned competitors.

QSC's clear positioning:  
partnership, security,  
innovation

Partnership, security, innovation: These characteristics make QSC the ideal telecommunication provider for German small and medium enterprises (SME). After successfully establishing ourselves in recent years as one of the leading solutions providers for larger enterprises, beginning in 2005 we aim to win more and more small and medium enterprises as solutions customers. Small and medium enterprises with branch networks are currently starting to recognize the advantages of an IP-VPN solution for their voice and data communication needs, and it is precisely these enterprises that we will specifically address with our new direct sales organization. We expect to benefit significantly among this customer group from the fact that QSC, itself, is a successful SME and operates accordingly.

In 2005, we will also increase the QSC team above and beyond the new key account management for SME customers; by the end of March, we had already recruited some 40 additional employees for the sales organization. The increasing demand for enterprise networks, as well as for broadband communication in general, offers us an outstanding environment to continue our strong and profitable growth – and we intend to vigorously utilize these opportunities. As in the past, in doing so we are focusing exclusively on profitable growth; we reject growth at any price. Every customer, every project and every product has to produce a significant contribution margin.

The capital market is rewarding this focus on high-margin growth. Against the trend of technology stocks, QSC's shares advanced by 21 percent in 2004. During the same period, the TecDAX lost four percent. Our positive share price performance has been sustained during the first quarter of 2005. Our intensive investor relations work, which is designed with a view to the long term, is paying off in this regard. This is demonstrated by the number of financial institutions that regularly publish research on our Company. At year-end 2004, this number had already stood at nine, and we expect even more research coverage in 2005.

In their forecasts, the research analysts are unanimous in referring to QSC's growth potential. Our NGN network, the expansion of our portfolio of products, services and solutions on the basis of Voice over IP and our direct sales entry into the small and medium enterprise market are major building blocks in enabling us to exploit this potential. However, the crucial factor for sustained profitable growth is the QSC team's customer focus. At this point, we would like to express our sincere thanks to all of our colleagues for their strong enthusiasm and commitment during the past year.



Our former colleague on the Management Board, Mark Goossens, made a major contribution to QSC's success. Following the successful conclusion of the Ventelo integration, he did not extend his Management Board contract in the late summer of 2004, and left the Company on friendly terms by mutual agreement effective December 31, 2004. Without Mark's enthusiasm and commitment, it would not have been possible to so swiftly and smoothly integrate Ventelo. We would like to take this opportunity to offer our thanks to him, as well.

QSC among the  
fastest growing  
technology companies  
in Europe

First and foremost, though, we would like to thank you, our shareholders. With your capital, you have made it possible to build QSC; and with your trust, you have laid the foundation for the successful development of our Company. And to no small degree, how successful QSC is was demonstrated by the distinction our Company received last autumn from Deloitte & Touche in connection with its Fast 50 rankings: QSC is Germany's fastest-growing telecommunication company and one of the fastest growing technology companies in Europe. This distinction serves as a further incentive to us. We intend to continue our strong and profitable growth in 2005 and beyond, and thus continue to increase the sustained value of our Company.

Cologne March 15, 2005

Markus Metyas

Dr. Bernd Schlobohm  
Chief Executive Officer

Bernd Puschendorf

## The Management Board



Dr. Bernd Schlobohm

Markus Metyas

Bernd Puschendorf

### Dr. Bernd Schlobohm // Chief Executive Officer

A post-graduate engineer, he co-founded QSC in 1997 together with Gerd Eickers. As the Company's Chief Executive Officer, Dr. Bernd Schlobohm is today responsible for Strategy and Technology as well as Quality and Product Management. At the same time, he is the first point of contact for regulatory questions and the media. In the 1990s, he was in charge of business at Thyssen equity investment Spaceline Communication Services as well as technology at Thyssen Telecom.

### Markus Metyas

A seasoned investment banker, he has been responsible for Finance, Sourcing, Human Resources and Legal Affairs since February 2000. Since January 2005, this Business and Finance graduate of the University of St. Gallen has additionally been in charge of Customer and Order Management. Moreover, Markus Metyas is also responsible for all activities in the field of Mergers & Acquisitions. In his previous posts at Morgan Stanley and Wasserstein Perella, he had been responsible for any number of M&A transactions, while simultaneously supporting numerous high-growth companies in connection with financing questions.

### Bernd Puschendorf

An experienced sales and marketing manager, he has been in charge of Sales and Marketing since March 2002, in which function he has also been driving the expansion of the network-related services business. A business professional, he has held executive positions in sales and marketing at major ITC companies for more than 30 years. At IBM, for example, he built the sales and marketing organization for UNIX servers in Germany. From 1997 to 2000, Bernd Puschendorf was in charge of sales and marketing at the computer arm of the Siemens Group and served as speaker of the management of the Fujitsu Siemens joint venture beginning in 1999.

## The Supervisory Board

### John C. Baker // Chairman

The founder and general partner of the Baker Capital Group, a US-based equity capital fund, represents QSC's largest shareholder. A Harvard graduate, he has been active in the private equity industry for more than 25 years and had invested in QSC before it went public.

### Gerd Eickers

After three years on the Management Board, the second QSC co-founder returned to the Supervisory Board in June 2004. Since February 2005, this post-graduate economist has additionally served as the president of the VATM, the premier telecommunication industry association in Germany.

### Norbert Quinkert

The chief executive officer of Motorola GmbH has been augmenting the QSC Supervisory Board since July 2003. In addition, he is also the vice president of the American Chamber of Commerce in Germany, as well as a member of the advisory council of Dresdner Bank.

### Herbert Brenke // Vice Chairman

An independent telecommunication consultant, he built mobile communication provider E-Plus in the 1990s, and was in charge of its business from 1993 to 1998. Prior to that, he had been a member of the management team at the Dusseldorf-based Thyssen Group.

### Ashley Leeds

The general manager of the Baker Capital Group had already been focusing on the telecommunication and media sector as an investment banker at Lehman Brothers. A Harvard graduate, she was one of the founding partners of Baker Capital.

### David Ruberg

A post-graduate information technology professional, he today represents the Baker Capital Group on the supervisory boards of various high-tech companies in the United States and Europe. Prior to that, he had managed the business of a US-based broadband provider as its chief executive officer.

## Report of the Supervisory Board

**Report of the Supervisory Board for the financial year 2004 regarding the Company and the group** // QSC sustained its growth in 2004. As the Supervisory Board of QSC AG, we advise the Management Board, monitor its management of the Company and perform the duties mandated by legal requirements and the Articles of Incorporation. The Supervisory Board was directly involved in all decisions or measures of fundamental importance, in particular those relating to the Company's financial, assets or earnings positions. The Supervisory Board approved all measures for which its consent is required by law, the Articles of Incorporation or the Rules of Procedure of the Management Board.

In written reports, the Management Board informed us monthly in detail about the course of business, the Company's economic situation, the methods and results of its risk management system. The Management Board also informed us about all transactions of significance with respect to the profitability and liquidity of the Company, and additionally submitted corresponding actual/target comparisons in this connection. In joint meetings and telephone conferences, the Supervisory and Management Boards discussed key aspects of the Company's business policies and strategies, as well as its corporate development and planning. Moreover, the Chairmen of both bodies conducted regular conversations to discuss current issues.

During the past fiscal year, the Supervisory Board considered the following issues in particular: Selling activities, optimizing QSC's success rate in connection with requests for proposals, the efficiency of the billing and accounts receivable collection systems, the budget, further network expansion, human resources development, as well as the identification and evaluation of potential acquisition opportunities and their structures. During the year covered by this Annual Report, the members of the Supervisory Board conducted four regular meetings as well as three telephone conferences. All members attended more than half of the Supervisory Board meetings during their term of office in the year 2004.

The Compensation Committee met after each of the meetings of the Supervisory Board. This Committee, which was established in May 2001, consists of John C. Baker, Herbert Brenke and David Ruberg. The Committee deliberated the employment contracts of the Management Board and the compensation paid to its members and regularly reported to the Supervisory Board on its activities.

The Supervisory Board also regularly deals with corporate governance issues. Following the suggestions contained in the German Corporate Government Code, the Supervisory Board also reviewed the efficiency of its own activities. In the meeting on November 18, 2004, the Management and Supervisory Boards jointly renewed the Statement of Conformity pursuant to § 161 of the German Stock Corporation Act ("AktG") and made this statement permanently available to the shareholders on the Company's website.

Ongoing dialog  
between Management  
and Supervisory Board

The Supervisory Board attaches high priority to monitoring the Company's accounting. The Supervisory Board reviewed the Annual Financial Statements of QSC AG, which are presented in accordance with the accounting principles set forth in the German Commercial Code ("HGB"), for the year ended December 31, 2004, and the Consolidated Financial Statements presented in accordance with US GAAP for the year ended December 31, 2004. The Supervisory Board also reviewed Management's Discussion and Analysis for the Company and the consolidated group. In its meeting on March 17, 2005, the Supervisory Board discussed all of the above-indicated financial statements and reports – including potential risks resulting from future developments – with the independent auditor commissioned by it, Ernst & Young AG Wirtschaftsprüfungsgesellschaft, of Eschborn/Frankfurt am Main. By electing to utilize the exempting provision of § 292a, HGB, the Company did not prepare consolidated financial statements presented in accordance with HGB accounting principles. Accordingly, additional disclosures pursuant to § 292a, HGB, were included in the Consolidated Financial Statements.

The independent auditor issued an unqualified opinion on the Company's Annual Financial Statements presented in accordance with HGB accounting principles, as well as the on the Consolidated Financial Statements presented in accordance with US GAAP, for the year 2004. Having conducted our own examination, the Supervisory Board has no objections to the Annual Financial Statements of QSC AG for the 2004 fiscal year presented in accordance with HGB accounting principles, the Consolidated Financial Statements presented in accordance with US GAAP or Management's Discussion and Analysis for the QSC AG and Management's Discussion and Analysis for the consolidated group, and we concur with the findings of the independent auditor. The Supervisory Board approves both the Consolidated Financial Statements presented in accordance with US GAAP as well as the Annual Financial Statements presented in accordance with HGB accounting principles, with the latter thereby being formally adopted.

In closing, we would like to provide information about major personnel issues during the past fiscal year. Mark Goossens did not renew his contract as a member of the Management Board, which terminated as set forth in the contract, and resigned by mutual agreement effective December 31, 2004. Mark Goossens had most recently served as the member of the Management Board of QSC AG responsible for Customer Service and Operations, as well as the General Manager of Ventelo GmbH. His responsibilities on the Management Board were assumed by the three remaining members of the Management Board, Dr. Bernd Schlobohm, Markus Metyas and Bernd Puschen-dorf. Ventelo's management was staffed from within QSC.

Mark Goossens played a key role in driving operative collaboration between the two companies and in integrating the former Ventelo employees into the QSC workforce. Without his constructive involvement, QSC would not have been able to so swiftly succeed in making the transition from a pure DSL provider to a full-line telecommunication provider. We wish to express our acknowledgement and our particular thanks for this accomplishment.

## Good performance in a weak market

We would also like to thank our colleague Claus Wecker, who so competently supported us on the Supervisory Board in past years. Although he resigned his office as a member of the Supervisory Board effective May 31, 2004, he will continue to be available to the Company as a legal advisor. In his place, the Annual Shareholders Meeting on May 27, 2004, elected Mr. Gerd Eickers to the Supervisory Board, effective June 1, 2004. We are pleased that this QSC co-founder will remain affiliated with the Company in this way following his resignation from the Management Board. In addition, the 2004 Annual Shareholders Meeting elected Mr. Norbert Quinkert, the Chief Executive Officer of Motorola GmbH, to the Supervisory Board, thus confirming him in office. Mr. Quinkert had already been appointed a member of the Supervisory Board in 2003 pursuant to § 104, Paragraph 2, Sentence 1, of the German Stock Corporation Act ("AktG").

QSC co-founder  
Gerd Eickers strengthens  
Supervisory Board

QSC's success during the past fiscal year was also the success of all of its employees. We therefore wish to express our thanks to both the Management Board as well as the entire QSC team for their tremendous personal commitment and enthusiasm. Their efforts and their will to achieve create the foundation for further increasing and sustaining the value of our Company.

Cologne, March 17, 2005  
On behalf of the Supervisory Board



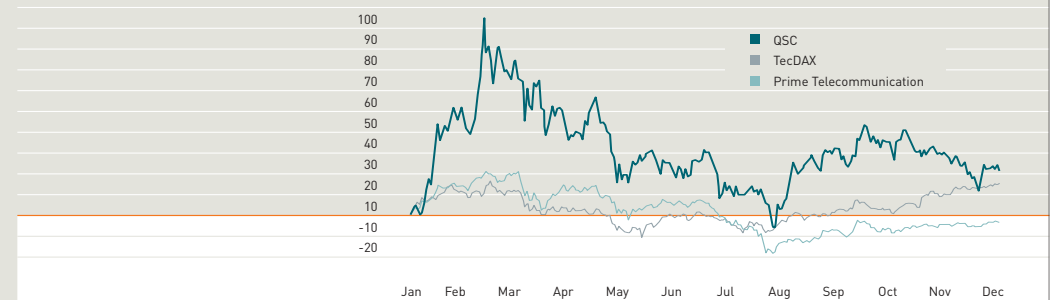
John C. Baker  
Chairman of the Supervisory Board

QSC shares post  
better performance  
than industry shares  
as a whole

QSC shares continued their advance in 2004: While the TecDAX lost 4 percent, the price of QSC shares rose by 21 percent with sustainably high trading volumes. At year-end 2004, nine financial institutions were already regularly publishing equity research on QSC – and this number is expected to rise in 2005.

**QSC share prices up sharply** // Following a broad-based advance in 2003, stagnating or even falling prices characterized German technology stocks in general in 2004. Over the course of the year, the TecDAX declined by 4 percent and did not recover from its summer lows until the end of the year. QSC shares were not able to entirely avoid this market trend. Here, too, a very good share price performance prior to their inclusion in the TecDAX in March was followed by a decline in prices that lasted into the summer months. Beginning in mid August, QSC shares went on to rise again by almost 40 percent to close the year at an Xetra trading price of € 3.66 on December 30, 2004. In a year-to-year comparison, QSC shares rose by 21 percent from their Xetra closing price of € 3.03 on December 30, 2003, thus significantly outperforming the TecDAX. QSC also posted above-average performance by comparison with the industry as a whole. The Prime Telecommunication Index, which includes all publicly traded telecommunication providers in the German Prime Standard, just rose by 15 percent over the course of the year 2004.

QSC share price performance in 2004 (indexed)



**High trading volumes for QSC shares** // In Xetra trading and on the trading floor in Frankfurt, alone, the trading volume of QSC shares increased by 230 percent in 2004 to € 287.5 million, as opposed to € 87.2 million the year before. An average of more than 260,000 shares change hands each day, with trading volumes often exceeding one million shares on peak days. In 2004, a total of 68.9 million shares were traded on the Xetra and on the trading floor in Frankfurt, alone.

An average of more than 260,000 shares change hands each day

**QSC establishes itself in the TecDAX** // Since March 22, 2004, QSC shares have been included in the TecDAX – the index of Germany’s 30 leading public technology stocks. With a trading volume of € 287.5 million in 2004 and a widely-held market capitalization of € 162.3 million as of December 31, 2004, the Company firmly established itself in this index during its first year of inclusion. QSC has continuously numbered among the 20 most-traded TecDAX equities. In addition, QSC shares have also been included in Deutsche Börse’s new German Entrepreneurial Index (GEX) since January 3, 2005. The GEX comprises 120 stock corporations whose owners manage their companies themselves and hold between 25 and 75 percent of their shares. With this new index, Deutsche Börse AG is acknowledging the fact that these owner-managed companies are often able to increase their market value more sustainably than widely held corporations. QSC numbers among the 20 strongest companies in the GEX in terms of market capitalization.

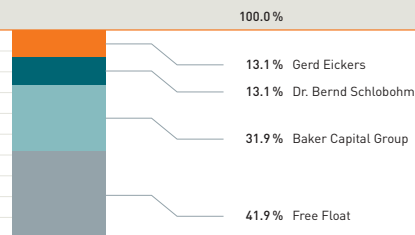
**Founders have never sold any shares** // QSC’s inclusion in the GEX stems from its stable shareholder structure since going public in April 2000: The Company’s two founders, Dr. Bernd Schlobohm and Gerd Eickers, hold a total of 26.2 percent of the shares and have never sold a single share since the Company was formed. The same is also true for the US-based Baker Capital Group, which holds 31.9 percent of the shares. 41.9 percent of the Company’s shares are widely held. Due to conversion of QSC convertible bonds to QSC shares under employee stock option programs, the number of shares in circulation rose slightly by 465,333 during the past fiscal year to 105,502,729.

Presence at more than 20 roadshows in Europe and the US in 2004

**TecDAX inclusion leads to stronger research interest** // Even before QSC’s inclusion in the TecDAX, there had been a noticeable increase in interest on the part of German and foreign institutional investors. This keen interest continued throughout the entire course of 2004. One visible manifestation of this was the quarter-to-quarter rise in the number of banks, brokerage houses and research institutes that publish their own equity research studies on QSC. Nine organizations are now regularly covering the Company: Bankhaus Metzler, Berenberg Bank, BW-Bank, DZ Bank, HSBC Trinkaus & Burkhardt, Merck Finck & Co., Sal. Oppenheim, SES Research and WestLB. We anticipate a further increase in coverage by stock analysts in 2005.

**Intensive communication with investors and analysts** // The greater interest on the part of analysts and institutional investors led to an intensification of investor relations activities in 2004. In more than 20 roadshows in all key financial centers in Europe and the United States, the Management Board presented the QSC business model and the potential it offers. In addition, the Management Board also presented the Company at major investor conferences, including Frankfurt, London and New York. The roadshow activities were complemented by one-on-one meetings with analysts and fund managers, as well as by regular telephone conferences following announcements of the Company’s quarterly and annual results.

Shareholder Structure (in percent)



**Basic data about QSC shares**

Trading Symbol	QSC
ISIN	DE0005137004
Bloomberg Symbol	QSC GR
Reuters Symbol	QSC6.DE
Market Segment	Prime Standard
Stock Exchanges	Xetra electronic trading system Regional German stock exchanges
Index Membership	TecDAX, GEX, HDAX, CDAX, Midcap Market, Technology All Share, Prime All Share, Prime Telecommunication, Prime IG Fixed-Line Telecommunication
Designated Sponsors	Baden-Württembergische Bank AG HSBC Trinkaus & Burkhardt KGaA WestLB AG
Shares Outstanding	105,502,729
Share Class	No-Par-Value registered shares of common stock
Xetra price, closing at December 30, 2003	€ 3.03
Xetra price, maximum in 2004	€ 6.28
Xetra price, minimum in 2004	€ 2.66
Xetra price, closing at December 30, 2004	€ 3.66

## Strong Growth – highly transparent

**More services for retail investors** // QSC has traditionally attached high priority to communication with retail investors. A Company newsletter regularly reports about significant developments. The investor relations team strives to respond by e-mail or telephone to inquiries from retail investors in a timely fashion.

Prompted by the greater need for information, the investor relations team revamped its Internet presence during the year covered by this report. At [www.qsc.de/en/investor\\_relations](http://www.qsc.de/en/investor_relations), investors can now obtain even more information that is of relevance to the capital market: From share price performance to corporate governance and documents relating to the Annual Shareholders Meeting right through to financial reports and a constantly updated financial calendar.

The attendance of 250 shareholders (attendance ratio: nearly 70 percent) at the Annual Shareholders Meeting on May 27, 2004, underscores the keen interest on the part of retail investors. The Annual Shareholders Meeting approved the individual items on the agenda by majorities of more than 99 percent each.

**QSC welcomes stricter disclosure requirements** // The German Investor Protection Enhancement Act went into force at the end of October 2004. It requires publicly traded corporations to apply greater strictness in observing the principle of fair disclosure – that information of relevance to stock prices be provided simultaneously to all capital market players – as well as to rigorous prevention of insider trading. QSC has been strictly complying with these principles since going public in April 2000, and thus views the new legislation as confirming its own fair and open information policy.

QSC regards long-term, value-driven corporate management as self-evident

For QSC, good corporate governance is self-evident. The strong dynamic of our markets, alone, requires open communication as well as collaboration between all of the bodies of the Company in a spirit of trust.

**Corporate governance enjoys high priority** // For QSC, open communication with its shareholders, employees, customers, suppliers and other interested parties is just as self-evident as long-term, value-driven corporate management and control. High priority here goes in particular to observing the interests of the shareholders in connection with our decisions, as well as to efficient collaboration between Management and Supervisory Boards in a spirit of trust. For QSC, good corporate governance serves as a key foundation for strong and profitable growth.

The Company therefore rigorously implements nearly all of the guidelines set forth in the German Corporate Governance Code. However, it is our conviction that some of the recommendations are too strongly tailored toward the management and control of large corporate groups and do not sufficiently take into consideration the situation of lean, entrepreneurial corporations.

**Supervisory Board views itself as a single entity** // QSC has a six-person Supervisory Board, whose members jointly contribute their various qualifications and experience to the benefit of the Company. The Company therefore predominantly focuses on their joint effort in connection with the compensation paid to the members of the Supervisory Board. Pursuant to § 10 of the Articles of Incorporation, the variable element of the compensation paid to the members of the Supervisory Board is governed solely by their attendance at Supervisory Board meetings during the course of a year. They do not receive any additional, success-based compensation (Code, Item 5.4.5). It is the conviction of both the Management and Supervisory Boards that these kinds of financial incentives would not be conducive to improving the work of this body.

As a committee of the Supervisory Board, the Compensation Committee deals with questions relating to the employment contracts for members of the Management Board and the compensation paid to them. The Company has not formed any further committees. This also applies with respect to the audit committee urged by the German Corporate Governance Code [Code, Item 5.3.2, Paragraph 1, Sentence 1]. The Supervisory Board in its entirety possesses a sound understanding of questions relating to accounting and risk management. It is the opinion of the Supervisory and Management Boards of QSC that the exclusion of individual members of the Supervisory Board through the formation of committees would mean having to forego valuable experience that has been demonstrated in actual practice. Given the manageable size of the Supervisory Board with its six members, efficient activities relating to these issues will continue to be assured in the future.

**Close collaboration among the Management Board team** // As in the case of the Supervisory Board, the members of the Management Board of QSC AG complement one another very well in terms of their qualifications and experience and manage the Company's business affairs as a team. We therefore view the level of compensation that is paid to the entire Management Board as the decisive criterion in assessing the appropriateness of this compensation; individualization would not produce any additional insight (Code, Item 4.2.4, Sentence 2).

Both in the Annual Report (pages 87/88) as well as on the Internet, QSC provides detailed information about the system of compensation for members of the Management Board, as well as their respective holdings of shares and conversion options. Like all employees, the members of the Management Board participate in existing stock option plans, under which the value of the options is based upon the trading price of the shares at the time of exercise. Given this background, we do not feel that quarterly notification of the values is necessary (Code, Item 4.2.3, Paragraph 3, Sentence 2). The existing plans thus far do not call for any restrictions with respect to extraordinary, unanticipated developments or for defining demanding, relevant comparison parameters (Code, Item 4.2.3, Paragraph 2). The existing structure of the stock option plans continues to be very suitable for a high-growth, founder-managed company like QSC.

**High quality of interim reporting** // The high priority that QSC attaches to corporate governance is underscored by the audit review of every quarterly report, which is performed by the independent auditing firm elected by the Annual Shareholders Meeting. However, the high quality of interim reporting that this assures necessitates up to 60 days of intensive work following the close of a reporting period. QSC therefore intentionally deviates from the 45-day term recommended in the Code (Code, Item 7.1.2).

Audit review of every quarterly report ensures high quality

Aside from these exceptions, QSC is in compliance with all items in the German Corporate Governance Code as amended May 21, 2003, as documented by the following Declaration of Conformity.

**Declaration Pursuant to § 161 of the German Stock Corporation Act on Compliance with the German Corporate Governance Code, as Amended May 21, 2003, at QSC AG** // Since its formation, QSC AG has been committed to good corporate governance and has viewed transparency and value-driven management as essential. Consequently, the company implements nearly all recommendations set forth in the German Corporate Governance Code and adheres them in its daily work. Since submittal of its last Declaration of Compliance, the company has complied and continues to comply with the recommendations of the Government Commission "German Corporate Governance Code", as amended May 21, 2003, with the following exceptions:

1. The recommendation that demanding, relevant comparison parameters be stipulated for stock options and comparable instruments for members of the Management Board (Item 4.2.3, Paragraph 2, Sentence 2, of the Code)
2. The recommendation that a possibility of limitation (cap) for extraordinary, unforeseen developments be agreed for stock options and comparable instruments for members of the Management Board (Item 4.2.3, Paragraph 2, Sentence 4, of the Code)
3. The recommendation that the company publish information relating to the value of stock options for members of the Management Board on its website and in its Annual Report (Item 4.2.3, Paragraph 3, Sentence 2, of the Code)
4. The recommendation that the compensation of the members of the Management Board be disclosed in individualized form in the notes to the consolidated financial statements (Item 4.2.4, Sentence 2, of the Code)
5. Formation of an audit committee (Item 5.3.2, Paragraph 1, Sentence 1, of the Code)
6. Taking into account the economic situation and performance of the company, as well as chair and membership positions on committees, in connection with compensation of the members of the Supervisory Board (Item 5.4.5 of the Code)
7. Publication of interim reports within 45 days (Item 7.1.2 of the Code)

At the end of 2004, the company had for the first time published the salient points of the compensation system for members of the Management Board and a description of QSC AG's stock option programs (from which members of the Management Board and all other employees have received allocations) on its website. QSC's corporate governance principles are regularly reviewed by the Management and Supervisory Boards. The company will promptly publish any future changes thereto with respect to conformity with the German Corporate Governance Code on its website.

Cologne, November 18, 2004




For the Management Board  
Dr. Bernd Schlobohm



For the Supervisory Board  
John C. Baker



## Growth



strong and  
profitable

# on a secure foundation

## The QSC business model is scalable

**Enterprises throughout Germany working and telephoning with QSC** // QSC offers large enterprises, business customers, value added resellers as well as premium residential customers comprehensive broadband communication – from simple telephone calls right through to complex enterprise networking. Business with telecommunication solutions for large enterprises is posting especially fast growth.

**QSC's own DSL infrastructure affords competitive edge at enterprises** // QSC implements telecommunication solutions over its own DSL network – the third largest DSL network in Germany. In more than 70 cities, we connect end-customers directly to our network; in the rest of Germany, we collaborate with strong partners. Enterprise customers, in particular, value the high level of network security that QSC offers with its non-Internet network structure. In addition, QSC operates one of Germany's largest traditional voice telephony networks, and in the future it will be operating one of the largest Voice over IP networks, as well. Thanks to its direct access to end-customers, QSC can offer product and service quality that clearly stands out against the competition.

**Infrastructure-based business model enables profitable growth** // The entire QSC infrastructure is designed for growth. Even dramatically rising voice and data volumes can be handled with existing resources. Consequently, higher revenues produce above-average growth in profitability – QSC earns high contribution margins through its low incremental costs. This scalability is what characterizes our infrastructure-based business model.

The security of this model is enhanced by a second factor: Larger enterprises typically tend to stay with telecommunication service providers that develop custom-tailored solutions for their voice and data communication needs. By doing business with them in a spirit of partnership right from the very first day, QSC lays the foundation for long-term customer relationships here – and considerably enhances its own planning predictability.

# with substantial growth

## VPN competence convinces major accounts

**One network for multiple locations** // Our strategic focus is on solutions business, i.e. custom-tailored solutions for voice and data communication at both large enterprises and small and medium enterprises. An Internet Protocol (IP)-based virtual private network (VPN) typically serves as the foundation for this kind of solution. An IP-VPN enables multiple enterprise locations to be securely linked. Only authorized individuals can communicate with one another or utilize data over this infrastructure. Building and operating a network of this kind necessitates experience, technology know-how and an understanding for the customer's needs – and this is precisely what characterizes QSC in the competitive environment.

**More than just a network** // In addition to building and operating an IP-VPN, larger enterprises are increasingly asking telecommunication companies to provide further network-related services. These include network maintenance and networking decentral workstations, as well as assuming responsibility for network security. QSC recognized the trend toward these so-called managed services early on, and today offers large enterprises a broad portfolio of solutions for this.

**Strong dynamics in solution business** // QSC is generating its highest growth rates in high-margin solution business. In 2004, alone, revenues here rose by 69 percent to € 33.2 million. Corporates like Deutsche Bahn, DEVK Insurance or the Tchibo retail chain have contracted with QSC to build and operate IP-VPNs. These dynamics are likely to be sustained during the current fiscal year.

# and strong products

## Business customers place their trust in QSC

**One-stop shopping for modern voice and data communication** // Regardless of whether they want to surf, e-mail or make phone calls: At QSC, business customers will find just the right powerful products for all of their communication needs. Our QSC-Voice and QSC-Data products are perfect for covering the modern telecommunication needs of smaller businesses and freelance professionals – as demonstrated by rising demand in what is QSC's highest-revenue segment. Revenues here rose by 8 percent to € 47.2 million in 2004.

**Onto the Internet nationwide with Q-DSL** // With Q-DSLmax and Q-DSLpro, business customers throughout Germany can work the broadband way while enjoying the high quality and exceptional service offered by QSC. While Q-DSLmax assures direct access to the QSC network, Q-DSLpro is the specific alternative for small and medium enterprises located outside major population centers.

**Telephony at DSL speed** // The QSC-Direct basic voice product significantly expands the possibilities offered by a DSL line. This enables business customers to also use it to make secure and cost-effective telephone calls over their data line. This integration of voice and data on one and the same line is the future of telecommunications. We therefore also expect to see high demand for our new Voice over IP product portfolio, IPfonie.

**Classical telephony remains a growth market** // In spite of the gentle migration to Voice over IP, voice telephony business will continue to be a growth market in the coming years, as well. More and more business customers are utilizing QSC-Direct to conduct all of their incoming and outgoing calls over our network.

with new  
ideas

## Residential customers value innovation

**Strong growth thanks to high speed and attractive rates** // In addition to its core business with enterprises, QSC is also active in the residential customer segment. The focus here is on products for premium residential customers, residential subscribers who value high quality and good service. Consequently, more and more Internet-minded consumers who want to game, work and shop online are signing up for Q-DSL home. By concentrating on these kinds of premium customers, QSC is also generating attractive margins in this segment, where revenues rose by 44 percent to € 47.2 million in 2004.

**Residential customers boost network utilization during off-peak hours** // There are three factors that make the residential customer segment attractive for QSC: In addition to its positive contribution margins, this business also contributes to better network utilization factors, especially in the form of call-by-call business, as well as the opportunity to introduce innovations in a less complex environment. Since year-end 2003, for example, QSC has been able to gather experience with Voice over IP technology with QSC-IPfonie – in the spring of 2005, this was followed by products for business customers. Moreover, residential customers tend to make phone calls and surf at precisely those times when business customers make only limited use of our network.

**On-the-fly bandwidth – One of many innovations from QSC in 2005** // During the current fiscal year, QSC will be expanding its portfolio for residential customers. The focus will be on innovative data products. This means that in the future, every Internet user will be able to decide for themselves how much bandwidth they happen to need for downloading or uploading media files like music, films or photographs. In addition, QSC will continue to simplify telephony over data lines. In the future, QSC's Voice over IP users will be able to make and receive telephone calls in the accustomed manner: With the same telephone and the same functionalities – but at significantly more attractive prices.

and great  
teamwork

## QSC partners with value added resellers

**Value added resellers are important** // Today, QSC operates the third-largest DSL network in Germany. It directly reaches more than 20 million consumers and more than one million businesses – and it is precisely this high network coverage that makes QSC such an attractive partner for Internet service providers, value added resellers and carriers who do not have their own infrastructure. They market our DSL lines and value added services under their own name and for their own account. QSC partners only with value added resellers with whom it can generate sustained contribution margins. Consequently, the Company intentionally accepted a modest decline in revenues to € 18.3 million in this segment in 2004. New contracts with prestigious international market players are expected to produce rising revenues again beginning in 2005.

**QSC growing strongly and profitably in all segments in 2005** // Both value added resellers and residential customers as well as business customers and large enterprises are contributing to QSC's sustained positive operating results. In every proposal, we pay strict attention to achieving a sufficiently high contribution margin, and this determination is paying off: QSC posted strong and profitable growth in 2004, and will continue this sustained profitable growth in the years to come! Revenue growth of at least 20 percent to more than € 175 million is planned for 2005, alone.

## Group Management Report for Fiscal Year 2004

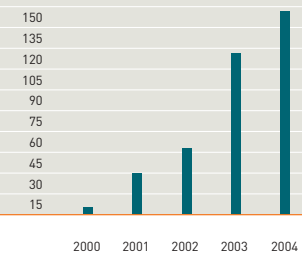
## QSC on growth course

With revenues up 26 percent year-on-year to € 145.9 million and a sustained positive EBITDA, QSC again continued its strong and profitable growth in 2004. The Company's focus on the high-growth, high-margin business customer telecommunications market early on is proving to be highly successful and will again drive QSC's development in 2005.

**69-percent growth with large enterprise customers** // QSC's total revenues grew by 26 percent in the past fiscal year to € 145.9 million, as opposed to € 115.6 million in 2003. Within the total group, the business with large enterprises, in particular, grew strongly. QSC builds and operates custom-tailored voice and data solutions for this customer group, and in addition offers network-related services. In 2004, revenues in this segment rose by 69 percent to € 33.2 million. The Company's segment result (revenues minus directly attributable expenses as well as depreciations in this segment) of € 18.5 million demonstrates the attractiveness of this high-margin line of business. Revenues with small and medium enterprises, in the business customer segment, as well as with residential customers also grew significantly in 2004.

Strong growth in all end-customer segments

Revenues (in € million)



## Strong growth in spite of a weak economy

**QSC generates a sustained positive EBITDA in all quarters** // Following a € -28.5 million EBITDA loss in 2003, QSC generated an operating profit before depreciation of € 0.9 million in 2004. In addition to strong revenue growth, strict cost management also contributed to this steep improvement. At € 135.7 million, network expenses remained nearly unchanged from the year before – yet revenues rose by € 30.3 million. This low level of correlation between revenue and expense growth is what characterizes QSC's infrastructure-based business model.

**Positive free cash flow since the second quarter** // After reaching EBITDA breakeven at the end of 2003, QSC had already recorded its first positive free cash flow in the second quarter of 2004 – and thus one quarter earlier than had been planned. The Company then went on to generate positive cash flows in each of the subsequent quarters, as well. As of December 31, 2004, QSC recorded liquid assets including marketable securities of € 40.3 million.

**Sustained growth to continue in 2005** // QSC plans to continue its strong and profitable growth in the current fiscal year. As in the year before, the Company anticipates an increase of revenues by at least 20 percent to more than € 175 million. At the same time, QSC is forecasting a positive EBITDA of between € 4 and 8 million, along with an operating cash flow of at least € 10 million. Given the strong growth opportunities that exist in connection with large enterprise and business customers, QSC will specifically expand its sales and marketing team, its portfolio of products, services and solutions, as well as its own network during the current fiscal year, thus creating the foundation for profitable growth beyond 2005.

QSC expects revenue growth of at least 20 percent also in 2005

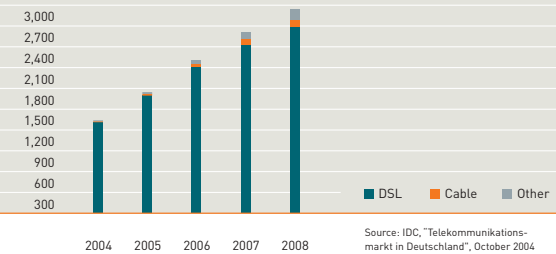
DSL – the growth driver of the German telecommunication market

Although German domestic demand in general stagnated and the ITC market saw only moderate growth, QSC sustained its growth course in 2004. In particular, the Company benefited from its focus on the promising IP-VPN market.

**ITC market poised for an upswing** // Germany is only very slowly recovering from the recession that set in at the outset of the new millennium. With gross domestic product expanding at a meager 1.6 percent, Germany continued to number among the industrialized countries with the lowest growth rates in 2004. The information and telecommunication (ITC) industry developed at only a slightly better pace. Following three years in the doldrums, industry association BITKOM reported growth of 2.5 percent in 2004, which was aided by a turnaround among telecommunication providers. A major share of their rising revenues is coming from the sustained high demand for DSL products and solutions. Overall, more than one million businesses and five million households already had a DSL connection in 2004.

**DSL dominates the German business customer market** // According to market researcher IDC, over 90 percent of all broadband connections in the German business market are DSL connections. This number impressively demonstrates the enormous head start that this broadband technology commands on the basis of the existing copper based telecommunication infrastructure on the last mile. Thanks to both the high quality and speed as well as the attractive cost-benefit ratio of data transfer over conventional copper based telephone lines, it is likely that there will be very little room for alternative technologies in the years to come either.

Broadband Connections of Business Customers in Germany (in thousands)





Broadband data transfer over wireless networks is increasingly proving to be a complementary technology to DSL. As more and more hotels, restaurants and transportation hubs are offering wireless Internet access via WLAN, QSC is benefiting from this trend. The Company is increasingly networking these so-called hotspots with DSL connections. QSC is of the opinion that a similar development can be expected if WiMAX technology were to take on greater significance in Germany. New sales opportunities are also being offered in the cable TV environment. Since November of last year, for example, QSC has been connecting households to the broadband network operated by a medium-size cable television provider. This enables these households to also utilize Internet and telecommunication services over the same coaxial cable that brings them television content. QSC's customer is thus able to avoid the high investments that would be involved in upgrading its TV cable to provide Internet access. It is precisely these up-front expenses that are preventing major cable TV network operators from migrating the broadcast connection to an interactive broadband portal. Consequently, it is QSC's opinion that cable TV will not pose an alternative to DSL in the coming years either.

**Business customer DSL revenues to double** // Logically enough, market researcher IDC predicts that DSL technology will continue to dominate the German business customer market. By 2008, the number of large enterprise and business customer connections is expected to double to 2.7 million. This correlates to revenues of € 2.0 billion – a 112-percent rise over total 2004 revenues. This dynamic is essentially attributable to the continuing shift of business processes to the Internet. Businesses require increasingly high transfer capacities in order to be able to utilize the advantages of Web-based processes.

QSC is facing a limited number of competitors in the large enterprise and business customer environment. In addition to the challenges of building a successful key account management team, the capital investments required for building their own nationwide DSL networks pose a high barrier to entry for further competitors. In contrast to the residential customer market, price is only one of many factors in the decision-making process of business customers – in addition to such qualitative factors as security, reliability and customer service. Consequently, the kind of aggressive price competition that exists in the residential customer market is not taking place in QSC's core business, nor does QSC expect to see this happen.

**Strong dynamics in IP-VPN business** // The virtual private network business – one of the most dynamic telecommunication submarkets – is of particular significance for QSC. According to IDC, the IP-VPN market alone is predicted to grow by nearly 20 percent annually by 2007 and reach a revenue volume of € 1.7 billion within the next three years. Yet enterprises have long been doing more than merely replacing their costly dedicated leased lines with flexible DSL links; instead, they are also outsourcing such services as network maintenance to providers of custom-tailored networks. In the future, these managed services are expected to play a major role in driving VPN.

IP-VPN market predicted to grow at least 20 percent annually

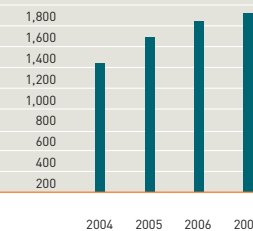
The integration of innovative network security solutions – managed security – into IP-VPNs is a particularly promising growth driver in this segment. Since only a very small minority of enterprises in Germany are thus far using virtual networks at all, new business, especially among small and medium enterprises, still offers strong growth potential.

With its own network and a prestigious list of reference customers, QSC sees itself very well positioned in the high-growth IP-VPN market. The Company is now being invited to participate in most requests for proposals for new IP-VPN solutions and is winning more and more large enterprise customers thanks to its technical competence, customer focus and flexibility.

**Voice over IP the market of the future** // There is an additional reason why enterprises of all sizes are increasingly looking at the issue of IP-VPN: The integration of voice communication into data networks with the aid of Voice over IP. The Voice over Internet Protocol (VoIP) transforms voice transmission into a simple data service, thus enabling voice communication over the Internet. According to a survey conducted by market researcher Gartner Group, two out of every three enterprises worldwide will be migrating to standardized IP networks over the course of the next five years, thus establishing the prerequisites for using Voice over IP. In the coming decade, Voice over IP will gradually come to dominate the voice communication market.

Not only did QSC bring its own Voice over IP product to market early on; the Company's powerful IP-VPN solutions also offer enterprises a good foundation for the enterprise-wide deployment of Voice over IP. The gradual voice communication migration is already running at the first customers.

IP-VPN Market in Germany (in € million)



Source: IDC, "Telekommunikationsmarkt in Deutschland", December 2003

## Strong dynamics with large enterprises

QSC grew its revenues by 26 percent to € 145.9 million in the past fiscal year. Business with large enterprises, in particular, grew strongly with revenues rising by 69 percent to € 33.2 million. The Company also posted strong and profitable growth with business and residential customers.

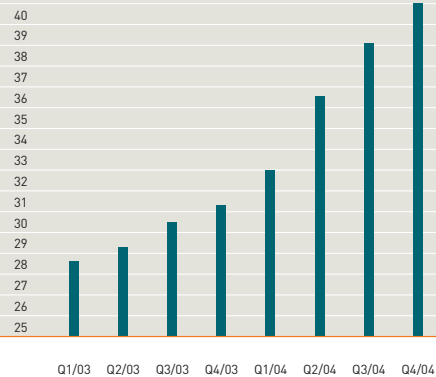
**Strong growth in all consumer business //** QSC's revenues advanced by 26 percent in 2004 to € 145.9 million, as opposed to € 115.6 million the year before. The dynamics of the Company's business development are underscored by a quarter-to-quarter comparison of revenues in 2004: They rose steadily from € 32.2 million in the first three months to € 40.0 million in the fourth quarter of 2004.

QSC recorded its highest growth rates in business with large enterprises, where revenues totaled € 33.2 million in 2004, as opposed to € 19.6 million in 2003 – an increase of 69 percent. This revenue growth stemmed both from the steadily rising number of customers in this segment as well as from greater demand for additional network-related services on the part of existing customers.

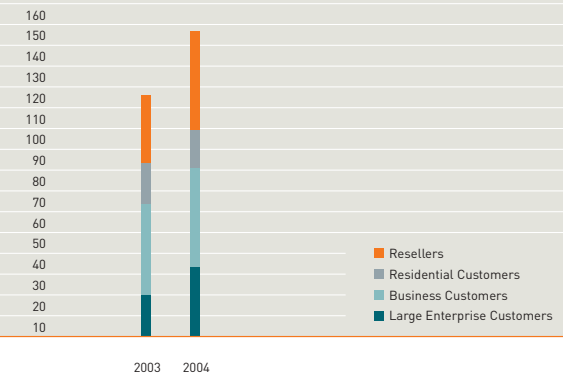
Increasing demand  
for network-  
related services

QSC's new large enterprise customer wins in 2004 included the Tchibo retail chain, automotive supplier Goodyear Dunlop, as well as the DEVK Insurance Group. The Tchibo contract documents the broad portfolio of products, services and solutions that QSC offers to major branch-based operations, in particular: QSC is operating both a nationwide IP-VPN network for this customer as well as existing telecommunication and LAN infrastructures. The Company's activities for Tchibo also include consolidation of its formerly separate voice and data services on one single centrally managed IP platform. These kinds of network-related services will further accelerate growth in large enterprise business in the years to come. Interesting development opportunities are also offered by business with carriers and Internet service providers without captive infrastructure. In the autumn of 2004, QSC won its first large enterprise customer in its new carrier-to-carrier services line of business: AOL in Germany. AOL is utilizing the QSC network to consolidate IP traffic for a considerable share of AOL broadband customers.

Revenues (in € million)



Revenue Mix (in € million)



## Rising revenues – Stable expenses

**Business customers using QSC solutions for data and voice communications** // The Company's business with small and medium enterprises developed well in 2004. QSC grew its revenues in the business customer segment by 8 percent from € 43.6 million in 2003 to € 47.2 million in 2004. One growth factor is the rising demand for Q-DSLmax, the high-performance DSL Internet connection for small and medium enterprises. A rising number of business customers are combining this DSL offering with QSC-Direct basic – an option that additionally affords high-quality, cost-effective telephony over a QSC broadband line. There was also a rise in the number of businesses that have a fixed line connection to the QSC network and use it to handle all of their voice telephony needs.

Business customers are increasingly using their DSL line for telephony

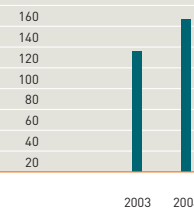
**Residential customers value innovative products** // During the past fiscal year, revenues in the residential customer segment rose by 44 percent to € 47.2 million, as opposed to € 32.7 million in 2003. On the one hand, residential customers are increasingly using the QSC network for their telephone calls, thus enabling the Company to optimize the capacity utilization of its own infrastructure, especially during the evening and nighttime hours. On the other hand, there was growing demand for the Company's premium DSL product, Q-DSL home, fuelled on by the introduction early on of QSC's Voice over IP product. IPfonie enables residential customers to make telephone calls at extremely low rates over their DSL line on the basis of the Internet Protocol (IP). With revenues of € 18.3 million, as opposed to € 19.6 million in 2003, business with resellers remained a major element of the Company's business model in 2004. Major telecommunication providers like BT Global Services and MCI market QSC's high-quality products under their own name.

QSC's business model is highly scalable

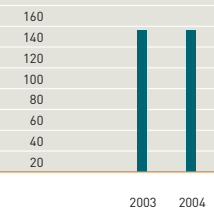
In spite of revenue growth of € 30.3 million, network expenses remained virtually constant in 2004. Consequently, there was a steep improvement in profitability. The low level of correlation between revenue growth and higher expenses numbers among the characteristics of QSC's infrastructure-based business model, and should accelerate profitability growth in the future, as well.

**Constant level of network expenses** // During the past fiscal year, network expenses, which are recorded under cost of revenues, totaled € 135.7 million, up only € 0.5 million from the previous year's level of € 135.2 million. This stability is all the more remarkable in view of the fact that revenues rose by € 30.3 million to € 145.9 million during the same period. In addition to the successes of strict cost management, this development shows how highly scalable QSC's business model is, thus largely eliminating the correlation between revenues and their underlying expenses. This scalability is based first and foremost upon the fact that a significant portion of network expenses, far and away QSC's largest single expense item, consist of fixed expenses. The majority of network expenses consist of the network costs, themselves. This includes expenses for leased lines, for maintaining and expanding the Company's own network, as well as for utilizing the colocation rooms that are rented from Deutsche Telekom. These expenses are largely independent of the network's utilization factor as long as the network capacity is not fully used. Currently QSC estimates that, on average, less than 25 percent of the network's capacity is used.

Revenues (in € million)



Network Expenses\* (in € million)



\* including depreciation and non-cash compensation

A further fixed block of expenses consists of costs for technical personnel. Some 140 employees very efficiently operate the Company's entire nationwide telecommunication infrastructure. In contrast to its quarterly reports, in its annual financial statements, QSC also includes both depreciation on the network as well as non-cash compensation within network expenses. In 2004, these expenses totaled € 21.9 million, as opposed to € 27.9 million the year before. This decline is mainly attributable to the fact that five years after the capital investment phase began, more and more fixed assets have now been fully depreciated, which means that there will be no further depreciation expense for these assets. The variable element of network expenses consists predominantly of interconnection fees, as well as expenses for connecting subscribers to the QSC network. Interconnection fees are expenses for utilizing third-party lines, such as those incurred in connection with a telephone call made between a QSC subscriber and another network operator's customer. QSC additionally has to pay a one-time fee of up to € 104.08 to Deutsche Telekom to connect every new customer via an unbundled local loop, as well as any expenses incurred for on-site installation. Moreover, Deutsche Telekom additionally receives € 11.80 per month per subscriber for QSC's use of its infrastructure over the last mile. The more successfully QSC operates in the marketplace, the higher the sum of these expenses.

**Steep rise in gross profit** // Stable network expenses and high revenue growth led to a significant improvement in gross profit after depreciation and non-cash compensation in 2004. Gross profit totaled € 10.2 million, as opposed to a gross loss of € -19.6 million the year before. Exclusive of depreciation and non-cash compensation, QSC generated a gross profit of € 32.0 million for the past fiscal year, as opposed to € 8.4 million in 2003. This internationally customary, and thus comparable, presentation of gross profit correlates to a gross margin of 21.9 percent (2003: 7.3 percent). Tripling its gross margin within the space of only twelve months shows how quickly QSC can improve its profitability.

Gross margin already reached 21.9 percent in 2004

High synergies stemming from the successful integration of Ventelo

**Highly efficient selling and administrative operations** // Although revenues were up sharply in 2004, sales and marketing expenses declined moderately from € 23.2 million in 2003 to € 22.2 million. QSC was highly successful in focusing on directly addressing large enterprise customers, on close collaboration with strong distribution partners, as well as on marketing campaigns aimed at specific target groups.

Thanks to strict cost management and positive non-recurring effects in connection with the swift integration of Ventelo, QSC succeeded in reducing administrative expenses by a strong 41 percent. These expenses declined to € 10.2 million from € 17.2 million the year before. The swift and successful integration of the Ventelo organization produced considerable synergies during the past fiscal year, stemming in particular from the relocation of the Ventelo administration in Dusseldorf to QSC headquarters in Cologne in December 2003.

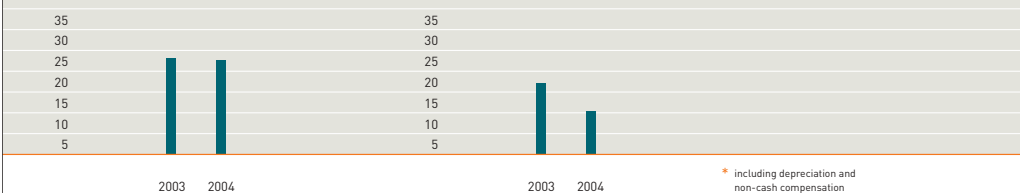
**Dramatic improvement in profitability in operating business** // In its quarterly reports, QSC follows the customary international practice of presenting depreciation and non-cash compensation as a separate line item in its statements of operations. This provides the reader with a faster overview of the development of QSC's operating performance at business. The following abridged version of the statements of operations for the full 2004 fiscal year therefore conforms to this method of presentation and records both depreciation as well as non-cash compensation as a separate line item.

All amounts in T €	2004	2003
Net revenues	145,874	115,625
Cost of revenues *	113,848	107,244
Gross profit	32,026	8,381
Selling and marketing expenses *	21,657	22,327
General and administrative expenses *	9,225	13,494
Research and development expenses *	287	1,103
EBITDA	857	(28,543)
Depreciation and non-cash compensation	23,530	33,311
Operating loss [EBIT]	(22,673)	(61,854)

\* excluding depreciation and non-cash compensation

Selling and Marketing Expenses \* (in € million)

Administrative Expenses \* (in € million)



## Highly efficient sales organization

QSC addresses its customers specifically and efficiently, and was thus able to achieve rising revenues with virtually constant sales and marketing expenses in 2004. Direct sales operations focus on large enterprises and resellers. Small and medium enterprises are addressed locally by strong regional partners, who receive comprehensive support from QSC.

**Targeted approach to each customer group** // During the past fiscal year, QSC spent only € 22.2 million, or 15 percent of its total revenues, on sales and marketing. In 2003, these activities had accounted for 20 percent of revenues, with € 23.2 million in corresponding expenses. This illustrates the extremely efficient use of the Company's sales and marketing organization. The separation between direct and indirect sales operations that was introduced in early 2003 has proven to be a complete success.

**Strong direct sales to large enterprise customers paying off** // Larger enterprises require custom-tailored telecommunication solutions and typically issue requests for proposals to select their service providers. In order to be able to optimally respond to the respective needs of these potential project customers, QSC has been utilizing a highly qualified direct sales organization for large enterprise customers right from the very beginning. A 60-person key account management team filters and handles requests for proposals, calculates prices, manages the design and implementation of custom-tailored integrated telecommunication solutions, and remains the point of contact for the project customer throughout the entire contract life. In doing so, the team can draw upon the full range of QSC's skills. The fact that QSC is now being invited to participate in the vast majority of requests for proposals and that it has strongly increased its revenues from large enterprises demonstrates the success of this direct sales operation.

In order to be able to continue to take optimum advantage of growth opportunities, the Company will be significantly growing its headcount in solution sales. Moreover, QSC is presently complementing these operations by adding special key account managers for small and medium enterprise customers with several branches in Germany. They are able to specifically cater to the needs of this customer group and will be focusing on building and operating IP-VPNs for this target group.

**Strong partners support business customers** // Smaller enterprises with fewer than 500 employees often rely on a local specialist or advisor in selecting their telecommunication service providers. Consequently, QSC maintains a network of strong authorized sales partners, who are able to draw upon comprehensive service and support. In addition, a dedicated QSC coordinator is available to these sales partners locally in each of QSC's six German sales offices. However, business customers are increasingly contacting QSC directly. The Company therefore complements its successful partner marketing operation with a small direct sales operation for voice and data products.

A 60-person key account management provides individual services for large enterprise customers

Marketing maintains ongoing contact with large enterprise and business customers

**Small teams responsible for large customer groups** // The reseller business is characterized by collaboration in a spirit of partnership with selected companies. Internet service providers and carriers with a strong market presence sell QSC's DSL lines under their own name and for their own account, and are professionally supported by a team of five QSC specialists. A team of only seven people at QSC's headquarters in Cologne is responsible for all of the Company's residential customer business. QSC addresses customers throughout this segment directly almost exclusively via advertising and its website. The sale of its Q-DSL home product benefits from the fact that over 90 percent of all lines are sold online. This allows a very high degree of efficiency in winning new customers.

**Target group-specific marketing supports selling operations** // QSC supports selling operations across all customer groups with pinpointed marketing campaigns. In addressing large enterprise customers, the "Business Lounge" concept has proven to be a successful way of winning and keeping customers. QSC regularly invites ITC decision-makers and opinion leaders to networking events in major cities. A variety of industry-specific events are also utilized to further dialog with ITC decision-makers. On the other hand, QSC intentionally foregoes participation at major trade-shows and congresses, as well as blanket coverage advertising campaigns, as they tend to be too unspecific in addressing QSC's fairly compact universe of potential customers. Overall, the Company spent € 1.0 million on advertising in 2004.

QSC assigns high priority to intensive public relations work. A 4-person team maintains an ongoing dialog with trade magazines and other decision-maker media. The Company's inclusion in the TecDAX in March 2004, in particular, sparked a significant rise in media attention. To no small degree, high profile coverage in the media is prompting entrepreneurs and decision-makers to perceive and value QSC as a quality provider of nationwide, integrated telecommunication services.

## Focus on Voice over IP

Development work at QSC is characterized by a partnership approach – most of the Company’s innovations stem from actual customer projects. In addition, QSC’s developers were working intensively on new Voice over IP solutions in 2004.

**Low expenses mask numerous innovations** // During the past fiscal year, QSC recorded only € 0.4 million in research and development (R&D) expenses in its statements of operations, as opposed to € 1.9 million in 2003. However, the Company repeatedly demonstrated its innovative strength, especially in connection with the large enterprise business. Networking a major retail chain nationwide, for example, as well as efficiently operating thousands of its end-user devices, necessitated a variety of process innovations in order to assure optimum performance. These kinds of innovations take shape in a dialog with the customer – and this is precisely one of the strengths of QSC’s developers.

Another innovation for a customer was the Z-ISP platform, which the Company has been using since October 2004 to provide AOL in Germany with a link between its broadband customers and QSC’s own network. QSC views this innovation as the core of its new carrier-to-carrier services line of business.

In 2004, R&D activities focused on evolving the Company’s Voice over IP competence. Together with Chinese partner Huawei Technologies, QSC developed an innovative, integrated approach to voice telephony over data lines on the basis of the Internet Protocol (IP). By mid 2005, QSC will be offering an IP-based Next Generation Network throughout Germany, which will afford high-quality, IP-based simultaneous transmission of voice and data. On the one hand, this will enable large enterprise and business customers to utilize Voice over IP on their conventional telephone systems with all of their familiar ISDN features. On the other hand, this network will serve as the foundation for a swift migration of large customers to Voice over IP.

QSC early on focusing on a Next Generation Network

## QSC generates positive EBITDA

As planned, QSC reached the operating profit zone before depreciation in 2004, recording a positive EBITDA in each quarter. Consequently, there was a steep improvement in the Company’s net results.

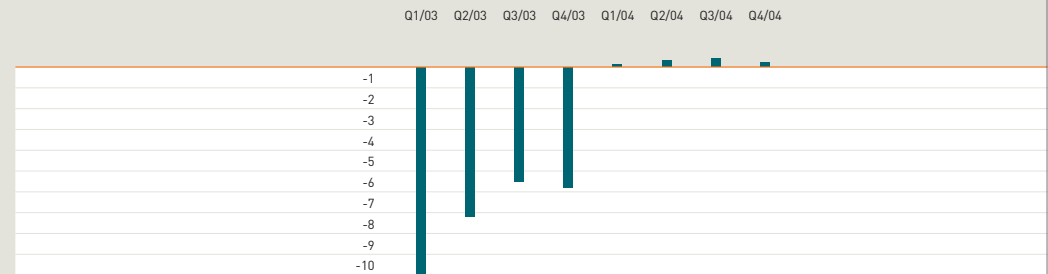
First positive EBITDA amounts to € 0.9 million

**EBITDA up sharply** // High revenue growth, especially in the high-margin large enterprise business, as well as stable expenses led to a significant improvement in the Company’s profitability in 2004. For the first time, QSC recorded a positive annual EBITDA, amounting to € 0.9 million; the year before, a loss of € -28.5 million had been incurred. QSC defines EBITDA as earnings before interest, taxes, the pro-rated results of equity investments accounted for under the equity method, amortization of deferred non-cash compensation, as well as depreciation on plant and equipment and amortization of goodwill.

Since more and more fixed assets have now been fully depreciated five years after the investment phase began, depreciation expense declined by nearly 20 percent to € 23.5 million in the past fiscal year, as opposed to € 28.5 million in 2003.

This significant improvement in the profitability of QSC’s operating performance, as well as declining depreciation expense, led to a significant reduction in EBIT to € -22.7 million, by almost two thirds, in 2004, as opposed to € -61.9 million the year before. The Company’s annual net loss declined by 64 percent from € -60.6 million in 2003 to € -21.6 million. The net loss per share thus amounted to € -0.20, as opposed to € -0.58 in 2003.

EBITDA (in € million)



## QSC records its first cash surpluses

A positive free cash flow since the end of the first quarter of 2004, a rapidly rising operating cash flow, as well as a high equity ratio characterize the Company's sound financing.

**Cash flow breakeven achieved in the second quarter** // QSC generated its first cash surplus of € 0.3 million in the second quarter of 2004, one quarter earlier than had been originally planned. The Company also continued to generate a positive free cash flow in each of the following quarters, as well. QSC calculates free cash flow on the basis of cash flow from operations less/plus cash flows from investment and financing activities. Annually recurring advance payments to Deutsche Telekom for the full 2004 year as well as specific network expansion measures had an additional negative effect on the full cash flow during the first quarter and as a consequence the Company's net liquid assets declined overall for the full year (Net liquid assets consists of cash and cash equivalents plus marketable securities). As of December 31, 2004, QSC recorded net liquid assets of € 40.3 million. These annually recurring advance payments to Deutsche Telekom will again have an impact on liquid assets in the first quarter of 2005, however to a significantly lesser degree. The final tranche of the purchase price for Ventelo in the amount of up to € 4.5 million is expected to come due in the third quarter of 2005.

The Company's operating cash flow has been steadily rising since the second quarter of 2004. The cash surplus from operations rose from € 1.3 million in the second quarter to € 3.6 million in the third quarter to € 5.0 million in the fourth quarter of 2004. Rising operating cash surpluses enabled QSC to optimize its financing during the course of 2004. As of December 31, 2004, the Company re-

Operating cash flow rising on a quarterly basis

QSC adds more than 20 new cities to its DSL network

corded € 6.8 million in obligations under capital leases for network technology and customer routers. The ability to utilize this relatively favorable form of financing for capital investments shows how significantly QSC's creditworthiness improved during the past fiscal year.

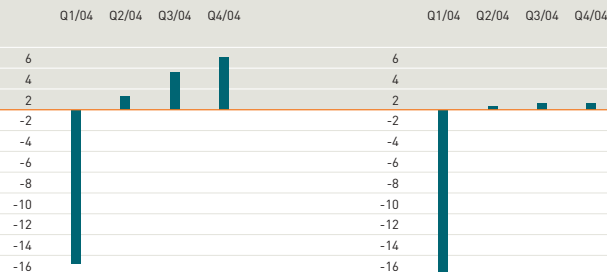
**High equity ratio underlines sound financing** // Aside from financial leasing, QSC again remained debt-free in 2004. At 61.4 percent, its equity ratio is unusually high for a German company. QSC's share capital rose moderately by € 465,333 to € 105.5 million in 2004. This increase was attributable to the holders of the Company's convertible bonds who in connection with the existing Share Option Plan (SOP) exercised their right to convert these bonds into new QSC shares.

**QSC expanding its network according to demand** // In 2004, the Company increased its capital investments by € 3.9 million to € 12.4 million. In this context, QSC invested in expanding its voice and data network, on the one hand, and added more than 20 new cities to its DSL network. In doing so, the Company usually served customer locations in these cities via third party leased lines, making it a viable proposition to expand its own network in those cities. On the other hand, QSC equips its large enterprise business customers with the required hardware at the inception of their contracts. The growing dimension of this business necessitates rising up-front capital expenditure and expenses.

In spite of higher capital investments, the value of the non-current assets recorded in the balance sheet declined by € 11.5 million to € 40.9 million in 2004, as more and more fixed assets are no longer being depreciated five years after the initial capital investment phase began. Moreover, the Company normally expenses the hardware for customers such as routers fully in the first year following acquisition.

Operating Cash Flow (in € million)

Free Cash Flow (in € million)



## Stable workforce generating strong growth

QSC's highly motivated workforce serve as the engine that drives QSC's success. A team of some 370 people is working in an extremely goal-oriented manner and in a spirit of partnership to make the Company one of the leading telecommunication providers for business customers. In order to make even faster progress toward this objective, QSC plans an increase of the workforce in 2005, particularly in the sales and marketing areas.

**Strong employee commitment** // In 2004, QSC generated its 26-percent growth in sales with a virtually constant head count. This illustrates, on the one hand, the high level of automation of business processes, and, on the other hand the efficiency and strong commitment of the 367-person team. 308 of them work at the headquarters in Cologne, 59 at sales offices and branches throughout Germany.

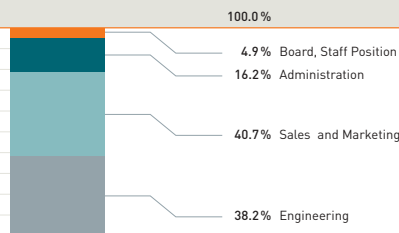
The moderate decline in the workforce from the year before, when QSC had employed 373 people as of December 31, 2003, primarily stemmed from outsourcing basic customer service functions to CRM specialist SNT Deutschland AG. This enabled QSC to focus even more strongly on its two core competencies: Supporting large enterprise and business customers, as well as solving complex technology problems. These two core competencies are what characterize the structure of the workforce as well. 41 percent of the employees work in sales and marketing activities, predominantly for large enterprise and business customers, 38 percent in technology-related activities. The fact that merely 16 percent of all employees work in administration underscores the efficiency of work flow at QSC. The visible manifestation of this efficiency can be seen in the development of annual revenue per employee. Amounting to € 108,000 in 2002 and nearly € 310,000 in 2003, annual revenue per employee in 2004 totaled nearly € 400,000.

Specifically expanding the sales and marketing team for large enterprise customers

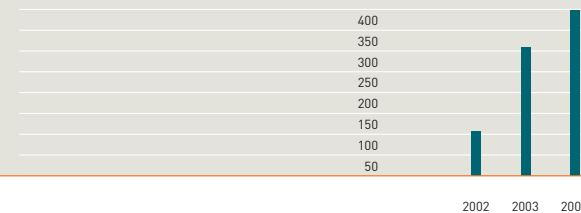
**Working together in a spirit of partnership** // Both in the sales and marketing organization as well as in the technical departments, particular attention is placed upon managing the rapidly growing business with large enterprises. During the course of 2004, QSC added people to the number of sales and marketing employees in this segment. It would be impossible to develop custom-tailored solutions and customer-specific developments of individual products and services without fast and unbureaucratic collaboration between the sales and marketing and technical departments. In customer satisfaction polls, major accounts value this flexibility as very positive. QSC attaches tremendous value to interpersonal and inter-departmental collaboration in a spirit of trust. The quality of this collaboration is reviewed annually on the basis of internal evaluations. The results show that this spirit of partnership in dealing with one another is steadily growing. Two years after the acquisition of voice provider Ventelo, this also applies with respect to the integration of the nearly 100 people whose workplaces were relocated from Dusseldorf to QSC headquarters in Cologne. Ventelo General Manager and QSC Management Board member Mark Goossens played a key role in this smooth integration. Following the successful conclusion of the integration, he did not extend his Management Board contract and left the Company by mutual agreement effective December, 31, 2004.

More than 80 percent of all employees work in sales and marketing as well as engineering

Workforce Structure (in percent)



Annual Revenue per Employee (in T €)





## Good risk management strenghtens QSC

**367 people – 1 team** // QSC fosters team-building at all levels. Regular personal development and training activities, along with an extensive intranet, assure a smooth flow of information across all locations and levels of the hierarchy. In addition, the new iPersis information system will lead to greater transparency, combined with higher efficiency in QSC's human resources management. Targeted training programs support collaboration among our people and sensitize managers to this issue. Moreover, the participation of all employees in QSC's stock option plans plays a key role in fostering a sense of joint ownership in the Company. A further key element in our education and training activities is customer focus: Every employee – from CEO to reception clerk – participates in seminars.

Continuing education offerings enjoy high priority

**QSC is committed to vocational education** // The high priority that the Company attaches to internal training and continuing education is underscored by QSC's commitment to professional and vocational education. As of December 31, 2004, the Company employed eleven trainees, with a further six trainees scheduled to be hired in 2005. QSC trains IT specialists and administrative clerks and integrates them very early in the regular workflow. For the Company, vocational education is a very good possibility to recruit young talents. At the same time, QSC wants to offer school graduates a chance to start to work in a promising and growing industry.

**Targeted increase of the workforce** // During the current fiscal year, QSC plans to hire new employees for its sales and marketing organization, in particular, in order to be able to take optimum advantage of growth opportunities. In its recruitment activities, the Company is benefiting from its higher brand awareness. In 2004, the number of job applicants rose by more than 130 percent to 4,400 with most applicants' qualifications being right in line with the Company's requirements. 40 percent of the workforce hold a university degree, while 60 percent have a technical or business non-university education. This high level of qualifications ensures QSC's technological competence and its ability to provide individual service – consequently, particular attention is paid to these aspects in recruiting new employees.

Risk management helps increase the value of the Company

In 2004, QSC continued to optimize its risk management system. The ability to identify, analyze and control potential opportunities and risks early on contributes to the sustainability of QSC's strong and profitable growth.

**Risk management is far more than a mandatory exercise** // The German Corporate Control and Transparency Act ("KonTraG") of May 1, 1998, states that the QSC Management Board implements appropriate risk management structures. Over and above these statutory requirements, however, QSC views efficient and forward-looking risk management as an important activity that creates additional shareholder value. The Company is aware of the fact that in spite of, as well as precisely because of, its dynamic and profitable growth and the significant rise in the number of new customers, it is subject to certain risks in connection with its business operations. Systematically dealing with these potential risks and fostering a culture of thinking and acting with a view toward risks is therefore an important element in securing and shaping the Company's future. Dealing with risks in a controlled manner helps enable QSC to rigorously utilize existing opportunities, accelerate growth and thus sustainably increase the value of the Company.

QSC's risk management system includes a cross-departmental system of procedures, as well as measures and methods for dealing with risks. This enables future developments that involve risks to be identified as early as possible, analyzed, assessed, controlled and monitored. In this connection, the corporate risk manager reports to the Management Board quarterly on all aspects of risk management. Weekly information from the controlling department assures a well-functioning early-warning system throughout the entire Company. The risk coordinators in the individual departments also play a key role in this connection. Within their areas of responsibility, these risk coordinators continuously monitor whether new risks have arisen, and initiate appropriate measures should this be the case.

The annual audit of the Company's financial statements includes the viability and effectiveness of QSC's risk management system. The findings thus obtained are taken into consideration in continuously evolving the risk management system. Some of those risks that QSC today views as being of major significance for its business operations are detailed below.

**The development of the economy** // Among the overall economic risks, QSC continues to monitor the persistently difficult economic environment, as this has a direct impact on the propensity of small, medium and large enterprises to invest in modern telecommunication infrastructures. However, QSC has already proven in past years that it can still grow strongly and profitably in a very weak overall market, because its products and services help to reduce costs and increase efficiency. The Company therefore views this risk as being manageable.

QSC growing despite weak economy

**The competitive behaviour of former monopolist Deutsche Telekom (DTAG)** // DTAG's aggressive pricing policy, in particular, has already had a negative impact on margins in the German telecommunication market in the past, and could continue to do so in the future. As an infrastructure provider, however, QSC AG is much less dependent upon DTAG's reselling prices than the majority of its competitors. Both in its end-customer business as well as in connection with required wholesale network services, such as interconnection fees and access to unbundled subscriber connection lines, QSC continues to count on viable supervision by both the German Regulatory Authority for Telecommunications and Posts ("RegTP") and the European Commission.

**The regulatory environment** // The decisions of the RegTP can have either an indirect or direct influence on QSC's competitive position and market. This also applies with respect to the bitstream access offerings from DTAG that were urged by the RegTP and that have been available since 2004. This enables companies to offer DSL products under their own names and for their own accounts with significantly lower capital investments – and could increase competitive pressure for QSC. On the other hand, though, bitstream access also generates opportunities, as it enables QSC to more efficiently complement its own network with bitstream access and thus offer nationwide data networks for business customers under its own name.

**QSC's own DSL infrastructure** // Operationally, an outage of QSC's own network is a risk. In addition to a potential loss of image as a result of extended, widespread outages, indemnification claims or high penalties, in particular, could result in corresponding expenses. Consequently, QSC increased redundancies within its network last year. Air conditioning prevents potential heat-related hardware defects, while strictly defined access authorizations to all QSC colocation rooms prevent misuse or sabotage. Through these and any number of further measures, the Company sees itself very well equipped for smooth DSL operations.

Operating cash flow surpluses for the first time

**Penalties in large enterprise contracts** // Within the framework of projects for major accounts, QSC enters into contracts that assure certain service levels, some of which involve potential penalties. This results in the risk of high warranty payment entitlements and damage compensation expenses stemming from interruptions that affect large enterprise customers. This risk is greatly reduced through intensive service level management, contractual structures and consistent monitoring of the entire network on a three-shift basis. QSC has thus far been able to assure all service level agreements.

**Solid financing structure** // In the second quarter of 2004, QSC generated its first positive free cash flow, and during the further course of the year steadily increased its liquid assets to € 40.3 million as of December 31, 2004. However, aggressive price competition or a sustained recession could result in the need for additional funding. Given this strong growth and the Company's rising operating cash flow surpluses, QSC today views this risk as being significantly lower than it was 12 or 24 months ago.

**The integration of future acquisitions** // QSC continues to be open to the possibility of also growing through acquisitions in the future. The risk in this connection is that an acquisition might not live up to expectations. The effect of this could include difficulties in consolidating network infrastructure products, employees and operational business. However, QSC's successful migration to become an integrated telecommunication provider through the acquisition of Ventelo documents the Company's ability to successfully manage these kinds of integration processes.

Given the assessment of the potential scope of damage and the likelihood that this could occur, there are currently no identifiable risks known to QSC's management board that would lead to a sustained material impairment of the financial or earnings positions of QSC AG. Organizationally, the prerequisites have been put in place to enable the Company to be informed as early as possible in the event of potential risk situations and take appropriate action. Nevertheless, as a result of these or other risks and incorrect assumptions, QSC's actual future results could vary materially from the Company's expectations. All statements contained in these consolidated financial statements that are not historical facts are forward-looking statements. They are based upon subjective judgments by the Company's board, current expectations and projections of future events, and can therefore be subject to regular change.

**Subsequent events** // No events or transactions have occurred since December 31, 2004, or are pending that would have a material effect on the consolidated financial statements at that date of for the period then ended.

## Sustained strong and profitable growth

The DSL market in Germany, especially the IP-VPN market, is characterized by strong growth dynamics. Given this background, QSC is determined to expand its market position in 2005 significantly; the Company plans to grow its revenues to more than € 175 million.

**Particularly strong growth with large enterprises and business customers** // With its innovative portfolio of products, services and solutions, QSC views itself as being well positioned in the telecommunication market for enterprise customers in Germany. In 2005, QSC intends to build upon this foundation to drive its growth, especially in the large enterprise and business customer segment, and thus continue to establish itself as one of the leading telecommunication providers in this market.

The Company anticipates particularly strong growth in high-margin business with IP-VPN solutions for large enterprises. On the one hand, QSC's high level of service quality, flexibility and technology competence is expected to lead to a further increase in its customer base. On the other hand, the demand for network-related services – managed services – is expected to further increase, thus raising revenue per customer. More and more enterprises are entrusting QSC not only with the building of IP-VPNs, but also with operating them, as well as with further network-related services, such as security solutions.

**Direct sales to small and medium enterprises offers new potential** // In 2005, QSC will broaden its IP-VPN services to small and medium enterprises, as well; in doing so, the Company is building upon direct selling efforts to this customer group. Small and medium enterprises are increasingly starting to recognize the advantages of an efficient and cost-effective network across multiple locations, and are beginning to look for appropriate solutions. As medium-sized enterprise itself, QSC is a natural partner to this customer group.

Its size makes QSC a natural partner for small and medium businesses

**Voice over IP a growth driver** // At both small and medium enterprises as well as major corporates, the process of gradual migration from conventional voice telephony to telephony over data lines, Voice over IP, will continue. Consequently, QSC will build a nationwide Voice over IP network by mid 2005. This Next Generation Network will assure high quality transmission of telephone calls over data lines. At the same time, QSC will broaden its portfolio to include the corresponding products. Products like QSC-IPfonie enable enterprise customers to utilize the full advantages of Voice over IP on the basis of their conventional telephone systems.

**Targeted expansion of infrastructure and team** // In 2005, QSC will invest in further expanding its DSL network on a demand-driven basis. As soon as enough customers in a given location are using or asking for QSC products, the Company will have a reliable basis to estimate the likely return on investment for expanding its own network infrastructure into those locations. At the same time, QSC is strengthening its sales and marketing team for enterprise customers in order to be able to derive even greater benefit from the growth dynamics of the market. QSC does not preclude the possibility of acquisitions in order to tap into further profitable growth opportunities. However, these acquisitions will have to be able to be integrated at predictable expense, enable synergies to be achieved and lead to a net result that creates additional value for the Company's shareholders.

**Organic revenue growth to more than € 175 million** // By expanding its portfolio of products, services and solutions, especially in the Voice over IP segment, expanding its sales and marketing team and further expanding its network on a selective basis, QSC will be creating the foundation for sustained profitable growth in the years to come. As in the year before, the Company is forecasting revenue growth of at least 20 percent to more than € 175 million in 2005. In addition, QSC forecasts a positive EBITDA of between € 4 and 8 million and an operating cash flow of at least € 10 million.

Cologne, March 3, 2005



Dr. Bernd Schlobohm  
Chief Executive Officer



Markus Metyas



Bernd Puschendorf

## Financial Report

## Audit Opinion

We have audited the consolidated financial statements, comprising the balance sheet, income statement, statement of changes in equity, cash flows as well as the notes to the consolidated financial statements, prepared by QSC AG, Cologne, for the fiscal year from January 1, 2004 to December 31, 2004. The preparation and content of the consolidated financial statements are the responsibility of the Company's management board. Our responsibility is to express an opinion whether the consolidated financial statements are in accordance with US generally accepted accounting principles (US GAAP) based on our audit.

We conducted our audit of the consolidated financial statements in accordance with German auditing regulations and generally accepted standards for the audit of financial statements promulgated by the Institut der Wirtschaftsprüfer (IDW). Those standards require that we plan and perform the audit such that it can be assessed with reasonable assurance whether the consolidated financial statements are free of material misstatements. Knowledge of the business activities and the economic and legal environment of the Group and evaluations of possible misstatements are taken into account in the determination of audit procedures. The evidence supporting the amounts and disclosures in the consolidated financial statements are examined on a test basis within the framework of the audit. The audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the consolidated financial statements give a true and fair view of the net assets, financial position, results of operations and cash flows of the Group for the fiscal year in accordance with US GAAP.

Our audit, which also extends to the group management report prepared by the management board for the fiscal year from January 1, 2004 to December 31, 2004, has not led to any reservations. In our opinion, on the whole the Group management report together with the other disclosures in the consolidated financial statements provides a suitable understanding of the Group's position and suitably presents the risks of future development. In addition, we confirm that the consolidated financial statements and the group management report for the fiscal year from January 1, 2004 to December 31, 2004 satisfy the conditions required for the Company's exemption from its obligation to prepare consolidated financial statements and the group management report in accordance with German law.

Eschborn/Frankfurt am Main, March 3, 2005  
Ernst & Young AG  
Wirtschaftsprüfungsgesellschaft

Fluck Janssen  
Wirtschaftsprüfer Wirtschaftsprüfer

## Statements of Operations

### Consolidated Statements of Operations

(EUR amounts in thousands (T €), except for per share amounts)

	2004	2003
<b>Net revenues</b>	<b>145,874</b>	<b>115,625</b>
Cost of revenues	135,723	135,175
(including T € 19 in non-cash compensation in 2004; 2003: T € 1,377)		
<b>Gross profit (loss)</b>	<b>10,151</b>	<b>(19,550)</b>
Selling and marketing expenses	22,218	23,172
(including T € (27) in non-cash compensation in 2004; 2003: T € 437)		
General and administrative expenses	10,167	17,185
(including T € 38 in non-cash compensation in 2004; 2003: T € 2,353)		
Research and development expenses	439	1,947
(including T € 0 in non-cash compensation in 2004; 2003: T € 668)		
<b>Operating loss</b>	<b>(22,673)</b>	<b>(61,854)</b>
<b>Other income (expenses)</b>		
Interest income	1,339	2,150
Interest expenses	(639)	(175)
Other non-operating income (loss)	414	(732)
<b>Net loss before income taxes</b>	<b>(21,559)</b>	<b>(60,611)</b>
Income taxes	-	-
<b>Net loss</b>	<b>(21,559)</b>	<b>(60,611)</b>
Net loss per common share (basic and diluted)	(0.20)	(0.58)
Weighted average shares outstanding (basic and diluted)	105,299,949	105,017,642

The accompanying notes to consolidated financial statements are an integral part of these statements.

## Balance Sheets

### Consolidated Balance Sheets (EUR amounts in thousands (T €))

		Notes	No.	Dec. 31, 2004	Dec. 31, 2003			Notes	No.	Dec. 31, 2004	Dec. 31, 2003
<b>ASSETS</b>						<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>					
<b>Current assets</b>						<b>Liabilities</b>					
<b>Current liabilities</b>						<b>Current liabilities</b>					
Cash and cash equivalents	5		22,536	34,964	Trade accounts payable				20,276	18,631	
Marketable securities	5		17,785	19,322	Trade accounts payable due to related parties	4			472	547	
Trade accounts receivable, net	6		25,616	18,559	Accrued liabilities	10			6,871	15,123	
Unbilled receivables			-	42	Deferred revenues	1			1,370	1,778	
Other receivables	6		3,207	3,263	Current portion of obligations under capital leases	11			2,647	-	
Prepayments and other current assets			4,801	4,140	Other current liabilities	10			8,239	6,571	
<b>Total current assets</b>			<b>73,945</b>	<b>80,290</b>	<b>Total current liabilities</b>				<b>39,875</b>	<b>42,650</b>	
<b>Non-current assets</b>						<b>Non-current liabilities</b>					
Other non-current assets			374	479	Convertible bonds	15			60	63	
<b>Plant and equipment, net</b>					Accrued pensions	12			316	510	
Networking equipment and plant	7		25,669	40,261	Non-current portion of obligations under capital leases	13			4,105	-	
Operational and office equipment	7		9,431	6,655	<b>Total non-current liabilities</b>				<b>4,481</b>	<b>573</b>	
<b>Total plant and equipment, net</b>			<b>35,100</b>	<b>46,916</b>	<b>Total liabilities</b>				<b>44,356</b>	<b>43,223</b>	
<b>Intangible assets, net</b>						<b>Shareholders' Equity</b>					
Licenses	8		694	850	Common stock, 190,999,789 and 190,024,179 shares authorized at	14			105,503	105,037	
Software	8		2,318	1,761	December 31, 2004 and 2003, respectively; 105,502,729 and 105,037,396						
Others	8		2	3	shares issued and outstanding at December 31, 2004 and 2003, respectively						
<b>Total intangible assets, net</b>			<b>3,014</b>	<b>2,614</b>	Treasury stock, 0 and 358,747 shares at December 31, 2004 and 2003	14			-	(266)	
Goodwill	9		2,393	2,393	Additional paid-in capital				474,750	473,302	
<b>Total non-current assets</b>			<b>40,881</b>	<b>52,402</b>	Deferred compensation				-	(75)	
<b>Total assets</b>			<b>114,826</b>	<b>132,692</b>	Other comprehensive income (loss)	1			259	(46)	
						Accumulated deficit					
						(510,042)					
						<b>Total Shareholders' Equity</b>					
						70,470					
						<b>Total liabilities and Shareholders' Equity</b>					
						114,826					
						132,692					

The accompanying notes to consolidated financial statements are an integral part of these statements.

## Statements of Cash Flows

### Consolidated Statements of Cash Flows (EUR amounts in thousands (T €))

	2004	2003				2004	2003
<b>Cash flow from operating activities</b>							
Net loss	(21,559)	(60,611)					
<b>Adjustments to reconcile net loss to cash used in operating activities</b>							
Non-cash compensation charge	30	4,835					
Depreciation and amortization	23,500	28,476					
Loss/(Gain) on sale of equipment	(47)	976					
Gain on sale of investment	(375)	(536)					
Bad debt expense	937	1,439					
<b>Change in operating activities</b>							
Increase in trade accounts receivable	(7,994)	(3,050)					
Decrease in unbilled receivables	42	197					
Decrease in other current receivables	56	6,213					
Decrease/(Increase) in prepayments and other current assets	(661)	270					
Decrease/(Increase) in other non-current assets	105	(19)					
Increase/(Decrease) in trade accounts payable	1,645	(7,243)					
Increase/(Decrease) in trade accounts receivable due to related parties	(75)	7					
Increase in obligations under capital leases	6,752	-					
Decrease in accrued liabilities	(8,252)	(2,748)					
Decrease in deferred revenues	(408)	(250)					
Increase in other current liabilities	1,668	4,022					
Increase/(Decrease) in accrued pensions	(194)	61					
<b>Net cash used in operating activities</b>	<b>(4,830)</b>	<b>(27,961)</b>					
<b>Cash flow from investing activities</b>							
Change in marketable securities	1,537	25,204					
Available-for-sale securities (unrealized gain)	305	82					
Acquisition of business, net of cash acquired	-	61					
Property acquired under capital leases	(7,574)	-					
Purchases of intangible assets	(1,573)	(907)					
Purchases of plant and equipment	(3,290)	(7,567)					
Proceeds from sale of equipment	401	2,169					
Proceeds from sale of investment	375	837					
<b>Net cash (used in) provided by investing activities</b>	<b>(9,819)</b>	<b>19,879</b>					
<b>Cash flow from financing activities</b>							
Payments of short-term debt and current portion of long-term debt	-	(90)					
Issuance/(Redemption) of convertible bonds	(3)	13					
Disposal of treasury stock	1,527	-					
Proceeds from issuance of common stock	697	28					
<b>Net cash (used in) provided by financing activities</b>	<b>2,221</b>	<b>(49)</b>					
<b>Net decrease in cash and cash equivalents</b>	<b>(12,428)</b>	<b>(8,131)</b>					
Cash and cash equivalents at beginning of the year	34,964	43,095					
<b>Cash and cash equivalents at end of the year</b>	<b>22,536</b>	<b>34,964</b>					
<b>Supplemental disclosures of cash flow information</b>							
Cash paid during the period for							
Interest expenses	272	175					

The accompanying notes to consolidated financial statements are an integral part of these statements.

## Statements of Equity

### Consolidated Statements of Shareholders' Equity from January 1, 2003 to December 31, 2004 (EUR amounts in thousands (T €), except for per share amounts)

	Ordinary Shares		Treasury Shares		Additional Paid-In Capital T €	Deferred Compensation Account T €	Comprehensive Income T €	Accumulated Other Compre- hensive Income T €	Receivables Due from Shareholders' T €	Accumulated Deficit T €	Total Shareholders' Equity T €
	Shares	T €	Shares	T €							
<b>Balance at January 1, 2003</b>	105,008,714	105,009	358,747	[266]	473,442	[5,058]	-	[1]	[427,872]	145,254	
Net loss											
Other comprehensive loss							[60,611]			[60,611]	
Comprehensive income							[46]	[46]		[46]	
Convertible bonds forfeited due to termination of employment (January 1, 2003)					[69]	69					
Convertible bonds forfeited due to termination of employment (April 1, 2003)					[11]	11					
Convertible bonds forfeited due to termination of employment (October 1, 2003)					[68]	68					
Issuance of common stock in connection with the conversion of convertible bonds (June 30, 2003)	3,300	3								3	
Issuance of common stock in connection with the conversion of convertible bonds (September 30, 2003)	9,360	9								9	
Issuance of common stock in connection with the conversion of convertible bonds (December 31, 2003)	16,022	16			8					24	
Redemption								1		1	
Amount amortized during the period						4,835				4,835	
<b>Balance at December 31, 2003</b>	105,037,396	105,037	358,747	[266]	473,302	[75]	[46]	-	[488,483]	89,469	
Net loss							[21,559]			[21,559]	
Other comprehensive income							305	305		305	
Comprehensive income							[21,254]				
Convertible bonds forfeited due to termination of employment (January 1, 2004)					[45]	45					
Issuance of common stock in connection with the conversion of convertible bonds (March 31, 2004)	219,298	219			174					393	
Issuance of common stock in connection with the conversion of convertible bonds (June 30, 2004)	51,969	52			12					64	
Issuance of common stock in connection with the conversion of convertible bonds (September 30, 2004)	85,600	86			4					90	
Issuance of common stock in connection with the conversion of convertible bonds (December 31, 2004)	108,466	109			41					150	
Disposal of treasury stock (March 31, 2004)			[122,865]	91	505					596	
Disposal of treasury stock (June 30, 2004)			[235,882]	175	757					932	
Amount amortized during the period						30				30	
<b>Balance at December 31, 2004</b>	105,502,729	105,503	-	-	474,750	-	259	-	[510,042]	70,470	

The accompanying notes to consolidated financial statements are an integral part of these statements.



## Notes to the Consolidated Financial Statements for Fiscal Year 2004

### 1. Basis of presentation

**General** // The consolidated financial statements of QSC AG ("QSC" or "the Company") and subsidiaries have been prepared in accordance with accounting principles generally accepted in the United States ("US GAAP"). All amounts, except per share amounts, are in thousands of Euro ("T €"). In order to comply with § 292a of the German Commercial Code ("HGB"), the consolidated financial statements were supplemented with Management's discussion and analysis on a consolidated basis and additional explanations. Therefore, the consolidated financial statements, which have to be filed with the Commercial Registry and published in the German Federal Gazette ("Bundesanzeiger"), comply with the Fourth and Seventh Directives of the European Community. For the interpretation of these directives, the Company relied on the German Accounting Standard No. 1 of the German Accounting Standards Committee.

**Principles of consolidation** // The consolidated financial statements include the accounts of QSC and its subsidiaries. All significant inter-company transactions have been eliminated in the consolidation. The equity method of accounting is used for companies and other investments in which QSC has significant influence. Generally, this represents ownership of at least 20% and not more than 50%. The consolidated financial statements of QSC include the following subsidiaries and investments:

	Share in %	Equity in T €	Net profit (loss) in T €
Ventelo GmbH, Germany	100	4,531	506
Netchemya S.p.A., Italy *	25	16,558	(3,471)

\* as of June 30, 2002 (Netchemya S.p.A. is currently in liquidation)

**Use of estimates** // The preparation of the financial statements in conformity with US GAAP requires management to make estimates and assumptions related to the reported amounts of assets and liabilities and the disclosures of assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses for the period. Although these estimates are based on our knowledge of current events and actions we expect to undertake in the future, actual results may ultimately differ from estimates.

**Foreign currencies** // QSC's financial statements are presented in Euro, its functional currency. Transactions in currencies other than the Euro are originally recorded at the exchange rate at the day the transaction is made between the Euro and the respective foreign currency. The difference between the exchange rate at the day the transaction was made and the exchange rate at the balance sheet date or at the day the transaction is finally closed, if sooner, are included in other non-operating income or other expense.

**Credit losses** // QSC determines its allowances for doubtful accounts based on an ongoing systematic review and evaluation performed as part of the credit-risk evaluation process. Specific allowances are calculated on an item-by-item basis. Trade accounts receivables are stated at their nominal value net of allowances for doubtful accounts.

**Cash and cash equivalents** // Cash and cash equivalents consist of highly liquid instruments with original maturities of three months or less from the date of purchase.

**Leasing** // The accrual of leased equipment is not related to the legal owner, but the economic owner. The economic owner is realizing the risks and opportunities arising from the use of the leased equipment. In a capital lease the lessee is the economic owner, capitalizing the leased equipment and depreciating it over the useful life. A relevant liability is recorded that will be reduced by the lease payments.

**Marketable securities** // Trading securities, representing securities bought and held principally for the purpose of near term sales, are accounted for at fair value as of the balance sheet date and unrealized gains and losses are included in earnings.

Held-to-maturity securities are accounted at amortized cost and unrealized gains and losses are included in earnings.

Available-for-sale securities are accounted for at fair value as of the balance sheet date and related unrealized gains and losses are included in other comprehensive income (loss), until realized.

A decline in value of any available-for-sale security below cost is deemed to be other than temporary resulting in a deduction in carrying amount to fair value. The impairment is charged to earnings and a new cost basis is established.

**Earnings per share //** Earnings per share is computed by dividing loss applicable to common stockholders by the weighted average number of shares of QSC's common stock outstanding. Diluted earnings per share are calculated in the same manner except that the number of shares is increased assuming exercise of dilutive stock options and convertible bonds where these are dilutive. For the years ended December 31, 2004 and 2003, the dilutive effect of options was not considered because QSC recorded net losses and the impact of an assumed option exercise would be anti-dilutive.

**Derivative instruments and hedging activities //** In accordance with Statements of Financial Accounting Standards ("SFAS") 133 "Accounting for Derivative Instruments and for Hedging Activities", as amended, derivative instruments, such as interest rate swap contracts and foreign-currency exchange contracts, are recognized in the financial statements and measured at fair value regardless of the purpose or intent for holding them. The Company does not use derivative financial instruments and based upon SFAS 133 no adjustments were made.

**Unbilled receivables //** Unbilled receivables represent amounts recognized as revenues related to services performed during the reporting period, but for which invoices have not been generated yet by the end of the accounting period. Invoices are generally issued within 30 days of the services being performed. At such time, amounts classified as unbilled receivables are reclassified to accounts receivables.

**Intangible assets //** Intangible assets consist of goodwill, software, licences and similar rights. SFAS 141 "Business Combinations" requires that the purchase method of accounting be used for all business combinations initiated after June 30, 2001. Goodwill represents the excess of the cost of an acquired entity over the fair values assigned to the assets acquired and the liabilities assumed. In accordance with SFAS 142, QSC amortizes software using the straight-line method over the useful life of 4 years and amortizes licenses on a straight-line basis over an estimated useful life of 10 years.

SFAS 142 prohibits the amortization of goodwill and indefinite life intangible assets. Instead, goodwill and indefinite life intangible assets are tested for impairment at least annually and on an interim basis when an event occurs or circumstances change between annual tests that would more-likely-than-not result in an impairment. Under SFAS 142, goodwill is assessed for impairment by using the fair value based method. The Company determines fair value by utilizing discounted cash flows. The fair value test required by SFAS 142 for goodwill and indefinite life intangible assets includes a two-step approach. Under the first step, companies must compare the fair value of a "reporting unit" to its carrying value. A reporting unit is the level at which goodwill impairment is measured, and it is defined as an operating segment or one level below it if certain conditions are

met. If the fair value of the reporting unit is less than its carrying value, goodwill is impaired and companies must proceed with step two. Under step two, the amount of goodwill impairment is measured by the amount that the reporting unit's goodwill carrying value exceeds the "implied" fair value of goodwill. The implied fair value of goodwill can only be determined by deducting the fair value of all tangible and intangible net assets (including unrecognized intangible assets) of the reporting unit from the fair value of the reporting unit (as determined in Step 1). In this step, companies must allocate the fair value of the reporting unit to all of the reporting unit's assets and liabilities (a hypothetical purchase price allocation).

The Company did not have any impairment loss as a result of adopting SFAS 142 and as a result of performing the required annual impairment test, which the Company has elected to perform on December 31, 2004.

**Plant and equipment //** Plant and equipment are recorded at historic cost less applicable depreciation and amortization. Maintenance and repairs, which do not improve or extend the useful lives of the respective assets, are expensed when incurred. Disposals are removed at amortized costs with the resulting gain or loss reflected in the statements of operations as other non-operating income (loss). QSC capitalizes costs associated with the deployment and expansion of its network when the risk of loss related to equipment and facilities is transferred to QSC.

Depreciation of assets is calculated using the straight-line method over the useful lives of the assets.

The following estimated useful lives have been used in calculating depreciation expenses:

	Useful live in years
Network equipment and plant	5 to 8
Leasehold improvements	8 to 10
Electronic communication equipment	up to 5
Office equipment and other assets	3 to 13
Buildings	20

**Pensions //** Provisions for pensions are determined using the projected unit credit method in accordance with SFAS 87, "Employers' Accounting for Pensions". All disclosures are in accordance with SFAS 132 "Employers' Disclosures about Pensions and Other Postretirement Benefits".

**Other reserves and accrued liabilities //** The accompanying financial statements include provisions for accrued expenses and contingent liabilities to the extent that the incurrence of such amounts is probable and can be reasonably estimated.

**Recognition of revenues //** QSC primarily derives its revenues through the sale of fixed-wire integrated telecommunication services in Germany. These sales are recognized when persuasive evidence of an arrangement exists, delivery has occurred or services have been rendered, the price of the transaction is fixed and determined, and collectibility is reasonably assured. Revenues are recognized net of discounts, cash sales incentives, customer bonuses and rebates granted.

Revenues are generated with sales partners and with end-user customers of QSC. The sales partner acts as reseller of QSC services and as such is the principal interface to its end-customer, and the sales partner assumes the credit risk associated with the payment of services by its end-customer. Revenues from non-recurring installation charges are capitalized and amortized over the estimated average customer subscription life of 24 months. Payments received in advance of providing services are recorded as deferred revenues until the period when such services are provided.

**Stock option programs //** In December 2002, the Financial Accounting Standards Board ("FASB") issued SFAS 148 "Accounting for Stock-Based Compensation - Transition and Disclosure". This Statement provides additional disclosure requirements for stock-based compensation plans and alternative methods of transition for companies that elect to change from Accounting Principles Board ("APB") 25 "Accounting for Stocks Issued to Employees" to SFAS 123 "Accounting for Stock-Based Compensation" for stock-based compensation.

On January 1, 2003, QSC adopted the fair value recognition provisions of SFAS 123 prospectively, as permitted by SFAS 148, to all stock option programs granted or modified after January 1, 2003. Compensation expense will be measured at the grant date based on the fair value of the equity award using a Black-Scholes option-pricing model. Compensation expense will be recognized over the expected life with an offsetting credit to additional paid in capital. There were no stock option programs granted or modified since January 1, 2003, and therefore QSC did not record any compensation expense on the basis of SFAS 123 in the financial years 2004 and 2003.

Existing stock option based compensation plans granted until December 31, 2002, will continue to be accounted for under the provisions of APB 25.

The following table illustrates the effect on net loss and earnings per share if the fair value based method had been applied to all outstanding and unvested awards in each period.

	2004 in T €*	2003 in T €*
Net loss as reported	(21,559)	(60,611)
Stock compensation expense recorded	30	4,835
SFAS 123 expense	(1,236)	(8,369)
<b>Net loss pro forma</b>	<b>(22,765)</b>	<b>(64,145)</b>
<b>Earnings per share (basic and diluted)</b>		
As reported	(0.20)	(0.58)
Pro forma	(0.22)	(0.61)

\* except for per share amounts

**Segment information //** QSC applies the "management approach" in accordance with SFAS 131, "Disclosures about Segments of an Enterprise and Related Information", for identifying reportable segments. The management approach designates the internal organization used by management for making operating decisions and assessing performance as the source of QSC's reportable segments. QSC is primarily operating in the customer segments large enterprises, business customers, resellers and residential customers.

The customer segment large enterprises embraces customized solutions of voice and data communication for large and medium enterprises. In addition to the configuration and operation of IP-VPN networks, QSC also provides a broad range of network-related services.

In the business customer segment QSC summarizes its product business. QSC covers most of the needs of small and medium enterprises concerning modern voice and data communication by basically determined products and processes.

The reseller segment includes the business with Internet service providers and telecommunication providers without proprietary infrastructure. They are marketing QSC's DSL lines as well as value-added services under their own name and for their own account.

In the residential customer segment the Company embraces the voice and data services for premium residential customers.

The positions that cannot directly be allocated to the segments are summarized in the reconciliation column. These costs are primarily personnel expenses, rental fees for leased lines, and expenses for repairs, maintenance and operation of our network and the rental fees for the colocation rooms.

The following table summarizes the segment reporting:

2004 in T €	Segment Large enterprises	Segment Business customers	Segment Resellers	Segment Residential customers	Recon- ciliation	Consoli- dated
Revenues	33,210	47,165	18,252	47,247	-	145,874
Directly allocated expenses	14,064	28,343	8,121	31,708	-	82,236
<b>Gross profit</b>	<b>19,146</b>	<b>18,822</b>	<b>10,131</b>	<b>15,539</b>	-	<b>63,638</b>
Not allocated expenses					62,781	62,781
<b>EBITDA</b>	<b>19,146</b>	<b>18,822</b>	<b>10,131</b>	<b>15,539</b>	<b>(62,781)</b>	<b>857</b>
Depreciation and deferred non-cash compensation expenses	663	956	1,330	3,058	17,523	23,530
Non-operating income					1,114	1,114
<b>Net profit/(loss)</b>	<b>18,483</b>	<b>17,866</b>	<b>8,801</b>	<b>12,481</b>	<b>(79,190)</b>	<b>(21,559)</b>
Assets as of December 31, 2004	919	1,326	1,845	4,242		

2003 in T €	Segment Large enterprises	Segment Business customers	Segment Resellers	Segment Residential customers	Recon- ciliation	Consoli- dated
Revenues	19,624	43,649	19,645	32,707	-	115,625
Directly allocated expenses	9,850	24,725	8,773	23,513	-	66,861
<b>Gross profit</b>	<b>9,774</b>	<b>18,924</b>	<b>10,872</b>	<b>9,194</b>	-	<b>48,764</b>
Not allocated expenses					77,307	77,307
<b>EBITDA</b>	<b>9,774</b>	<b>18,924</b>	<b>10,872</b>	<b>9,194</b>	<b>(77,307)</b>	<b>(28,543)</b>
Depreciation and deferred non-cash compensation expenses	206	929	2,056	3,917	26,204	33,311
Non-operating income					1,243	1,243
<b>Net profit/(loss)</b>	<b>9,568</b>	<b>17,995</b>	<b>8,816</b>	<b>5,277</b>	<b>(102,268)</b>	<b>(60,611)</b>
Assets as of December 31, 2003	221	997	2,206	4,202		

In 2003 and 2004, none of these segments generated revenues from a single customer that accounted for more than 10% of all revenues.

Other comprehensive income // Other comprehensive income costs as of December 31, 2004, consist of the following:

	2004 in T €	2003 in T €
<b>Other comprehensive income (loss)</b>		
Additional minimum pension liability	128	(128)
Unrealized gain on available for sale securities	177	82
<b>Other comprehensive income (loss)</b>	<b>305</b>	<b>(46)</b>

New accounting standards // Effective January 1, 2002, the Company adopted SFAS 144, "Accounting for the Impairment or Disposal of Long-Lived Assets", which addresses financial accounting and reporting for the impairment and disposal of long-lived assets. These statements supersede SFAS 121, "Accounting for the Impairment of Long-Lived Assets to be Disposed Of". The Company reviews the carrying value of its long-lived assets, including fixed assets, investments, (this is tested for impairment in accordance with SFAS 142 as disclosed above), and intangible assets, for impairment whenever events or changes in circumstances indicate that the carrying amount of such assets may not be fully recoverable. Recoverability of long-lived assets, excluding goodwill (see discussion above), is assessed by a comparison of the carrying amount of the asset or the group of assets to the total estimated undiscounted cash flows expected to be generated by the asset or group. If the estimated future net undiscounted cash flows are less than the carrying amount of the asset or group, the asset or group is considered impaired, and an expense is recognized equal to the amount required to reduce the carrying amount of the asset to its then fair value. No adjustments were required to the carrying value of long-lived assets in 2004 or 2003.

In June 2001, the FASB issued SFAS 143, "Accounting for Asset Retirement Obligations". SFAS 143 requires that the fair value of a liability for an asset retirement obligation be recognized in the period in which it is incurred if a reasonable estimate of fair value can be made. The associated asset retirement costs are capitalized as part of the carrying amount of the long-lived asset. SFAS 143 is effective for fiscal years beginning after June 15, 2002. The adoption of SFAS 143 did not have a material impact on the results of operation or the financial position of QSC.

In June 2002, the FASB issued SFAS 146 "Accounting for Costs Associated with Disposal or Exit Activities". This Statement addresses financial accounting and reporting for costs associated with exit or disposal activities and nullifies Emerging Issues Task Force (EITF) Issue No. 94-3 "Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (including Certain Costs Incurred in a Restructuring)". This Statement requires that a liability for a cost

associated with an exit or disposal activity be recognized when the liability is incurred. Under Issue 94-3, a liability for an exit cost as defined in Issue 94-3 was recognized at the date of an entity's commitment to an exit plan. However, this standard does not apply to costs associated with exit activities involving entities acquired under business combinations or disposal activities covered under SFAS 144. The adoption of SFAS 146 did not have a material impact on the results of operations or the financial position of QSC.

In November 2003 and March 2004, the EITF reached partial consensus on EITF 03-1, "The Meaning of Other-Than-Temporary Impairment and Its Application of Certain Investments". EITF 03-1 addresses the meaning of other-than-temporary impairment and its application to investments classified as either available-for-sale or held-to-maturity under SFAS 115, "Accounting for Certain Investments in Debt and Equity Securities", and investments accounted for under the cost method. The EITF agreed on certain quantitative and qualitative disclosures about unrealized losses pertaining to securities classified as available-for-sale or held-to-maturity. In addition, EITF 03-1 requires certain disclosures about cost method investments. The recognition and measurement provisions of EITF 03-1 have been deferred until additional guidance is issued.

In December 2003, the FASB issued FIN 46R (a revision of FIN 46 as issued in January 2003) "Consolidation of Variable Interest Entities", which addresses how a business enterprise should evaluate whether it has a controlling financial interest in an entity through means other than voting rights and accordingly should consolidate the entity. FIN 46R is effective for all interests in structures commonly referred to as special-purpose entities for periods ending after December 15, 2003, and for all other types of variable interests for periods ending after March 15, 2004. The Company does not have any variable interests in special-purpose entities, and therefore the adoption of FIN 46R did not have a significant impact on the financial position of the Company. In addition, the Company does not have any interests in any other variable interest entities, and therefore the Company does not anticipate that the adoption of FIN 46R will have a material impact on its results of operations or its financial position.

In December 2004, the FASB issued SFAS 123 (revised 2004), "Share-Based Payment" ("SFAS 123R"). SFAS 123R establishes accounting guidance for transactions in which an entity exchanges its equity instruments for goods or services. It also addresses transactions in which an entity incurs liabilities in exchange for goods or services that are based on the fair value of the entity's equity instruments or that may be settled by the issuance of those equity instruments. Equity-classified awards are measured at grant date fair value and are not subsequently remeasured. Liability-classified awards are remeasured to fair value at each balance sheet date until the award is settled. SFAS 123R applies to all awards granted after July 1, 2005, and to awards modified, repurchased or cancelled after that date using a modified version of prospective application. QSC does not anticipate that the adoption of SFAS 123R will have a material impact on its results of operations or its financial position.

## 2. Cost of revenues and other cost

Cost of revenues // Cost of revenues are our network expenses totalling T € 135,723 and T € 135,175 for 2004 and 2003, respectively. Cost of revenues consists of cost of services, personnel expenses and depreciation and deferred compensation. Cost of services are T € 99,809 for 2004 (2003: T € 93,272).

The Company capitalizes customer installation costs and amortizes these costs over the estimated average customer subscription life of 24 months.

Personnel cost // Personnel expenses of fiscal year 2004 totalled T € 27,207 (2003: T € 30,374) and are comprised of:

	2004 in T €	2003 in T €
<b>Personnel cost</b>		
Wages and salaries	23,543	26,260
Social security contribution	3,470	3,966
Net pension cost	194	148
<b>Personnel cost</b>	<b>27,207</b>	<b>30,374</b>

Additionally, the Company recorded deferred compensation expense for stock option programs of T € 30 (2003: T € 4,835).

QSC employed an average of 356 persons in fiscal year 2004 (2003: 386).

Advertising cost // Sales and marketing cost in fiscal year 2004 include advertising cost of T € 978 in comparison to T € 1,192 in 2003. Advertising costs are expensed as incurred.

### 3. Acquisitions and investments

**Acquisitions //** On December 13, 2002, QSC acquired 100% of Ventelo GmbH, Dusseldorf ("Ventelo"). Ventelo is a nationwide voice telephony carrier providing business customers with voice telephony services. Ventelo's market position in voice communications for business customers complements QSC's broadband data communications service to the same customer segment. Ventelo will further enhance QSC's ability to offer integrated telecommunication solutions for all business customer segments. Total acquisition costs for Ventelo were T € 11,454, including direct acquisition costs of T € 90. As of December 31, 2004, a second and final tranche of T € 4,450 was outstanding that will presumably be paid in the second half of financial year 2005. On April 1, 2002, Ventelo was outsourced from its former parent company Ventelo Deutschland GmbH due to §§ 159 et seqq. "Umwandlungsgesetz". Ventelo is responsible for potential liabilities of the former parent company for a period of five years. The estimated fair value of the identifiable net assets exceeded the purchase price resulting in a negative goodwill of T € 193, and the Company reduced the acquired assets, on a pro rata basis, by this amount.

**Investments //** Netchemya S.p.A., Italy, one of QSC's investments made in 2000, is currently in liquidation because follow-on funding and the implementation of the business plan were not secured. QSC therefore wrote-off its remaining investment in Netchemya of T € 4,136 in 2002. In December 2004, QSC received a settlement payment of T € 375 that is included in non-operating income.

### 4. Related party transactions

During 2004, QSC participated in transactions with companies affiliated with members of the management. All contracts with these companies require approval of the Supervisory Board. The business relationships and transactions with related parties during 2004 were all performed at arms-length and were as follows:

**IN-telegence GmbH & Co. KG ("IN-telegence") //** IN-telegence provides value-added telecommunication services. All contracts with IN-telegence have been terminated on May 31 and June 30, 2002. The transactions in 2004 were based on the settlement of these contracts. As of December 31, 2004, T € 465 (2003: T € 533) were recognized as accounts payable to IN-telegence and as in the previous year there were no accounts receivable from IN-telegence.

**Teleport Köln GmbH ("Teleport") //** Teleport operates and maintains QSC's private broadcast exchange and in-house telephone systems. As of December 31, 2004, payables to Teleport amounted to T € 7 (2003: T € 10).

**microShare AG ("microShare") //** microShare provides consulting services on the conception, documentation and implementation of internal IT-based processes. As of December 31, 2004, there were no payables to microShare (2003: T € 4).

The following table sets forth the development of related party transactions from 2003 to 2004:

	Revenues in T €	Expenses in T €	Cash Received in T €	Cash Paid in T €
<b>Fiscal Year 2003</b>				
IN-telegence	25	25	563	445
Teleport	2	54	2	56
microShare	-	87	-	142
<b>Fiscal Year 2004</b>				
IN-telegence	-	1	-	534
Teleport	2	68	3	116
microShare	-	2	-	6

## 5. Cash and cash equivalents and marketable securities

Cash and cash equivalents and marketable securities as of December 31, 2004, and 2003, are comprised of:

	Dec. 31, 2004 in T €	Dec. 31, 2003 in T €
Cash and cash equivalents	22,536	34,964
Trading Securities	5,138	10,046
Held-to-maturity securities	-	4,138
Available-for-sale securities	12,647	5,138
	<b>40,321</b>	<b>54,286</b>

The fair market value of the held-to-maturity securities approximates the carrying value as of December 31, 2003.

## 6. Trade accounts receivable, net and other receivables

Trade accounts receivable, net and other receivables as of December 31, 2004 and 2003, are comprised of:

	Dec. 31, 2004 in T €	Dec. 31, 2003 in T €
<b>Trade accounts receivable, net</b>		
Trade accounts receivable	29,265	21,271
Allowance for doubtful accounts	(3,649)	(2,712)
<b>Trade accounts receivable, net</b>	<b>25,616</b>	<b>18,559</b>
<b>Other receivables</b>		
Tax claims	2,720	2,199
Others	487	1,064
<b>Other receivables</b>	<b>3,207</b>	<b>3,263</b>

Trade account receivables, net have a term of less than one year. Other receivables include T € 9 (2003: T € 0) that have a term of more than one year.

## 7. Plant and equipment, net

After having largely completed the network rollout, capital expenditures consist primarily of success based capital expenditures for customer premises equipment and select, demand-driven network extension. The changes in plant and equipment, net in 2004, were as follows:

	Network equipment and plant in T €	Operational and office equipment in T €
Cost as of January 1, 2004	102,970	14,227
Additions	4,161	6,703
Disposals	(2,385)	(679)
<b>Cost as of December 31, 2004</b>	<b>104,746</b>	<b>20,251</b>
Accumulated depreciation as of January 1, 2004	62,709	7,572
Additions	18,753	3,597
Disposals	(2,385)	(349)
<b>Accumulated depreciation as of December 31, 2004</b>	<b>79,077</b>	<b>10,820</b>
<b>Plant and Equipment, net as of December 31, 2004</b>	<b>25,669</b>	<b>9,431</b>
<b>Plant and Equipment, net as of December 31, 2003</b>	<b>40,261</b>	<b>6,655</b>

## 8. Intangible assets, net

QSC requires a class 3 license to operate transmission lines in Germany as well as a class 4 license for the provision of voice telephony services. These licenses are awarded by the German regulatory authority and are subject to an initial, one-time fee. QSC, together with other German license holders, took legal action appealing the authority's license fee directive. On April 23, 2003, QSC received a revised license fee directive concerning its class 3 licence that led to a reassessment of intangible assets.

A reassessment of the license fee of class 4 license is expected, but it has yet to take place.

Intangible assets, net changed in 2004 as follows:

	Licenses in T €	Software in T €	Other in T €
Cost as of January 1, 2004	1,516	4,514	13
Additions	-	1,573	-
Disposals	-	(130)	-
<b>Cost as of December 31, 2004</b>	<b>1,516</b>	<b>5,957</b>	<b>13</b>
Accumulated depreciation as of January 1, 2004	666	2,753	10
Additions	156	993	1
Disposals	-	(107)	-
<b>Accumulated depreciation as of December 31, 2004</b>	<b>822</b>	<b>3,639</b>	<b>11</b>
<b>Intangible assets, net as of December 31, 2004</b>	<b>694</b>	<b>2,318</b>	<b>2</b>
<b>Intangible assets, net as of December 31, 2003</b>	<b>850</b>	<b>1,761</b>	<b>3</b>

The annual amortization expense is estimated to be T € 1,230 for 2005, T € 979 for 2006, T € 713 for 2007, T € 481 for 2008 and T € 148 for 2009.

## 9. Goodwill

Upon acquisition of the shares in COMpoint Networking Consulting GmbH and GINKO AG, both companies were merged into QSC in 2002, QSC recorded as goodwill the excess purchase price over the fair value of the identifiable net assets acquired. As QSC adopted SFAS 142 on January 1, 2002, goodwill has not changed since then. Goodwill amounted T € 2,393 as of December 31, 2004, and as of December 31, 2003.

## 10. Other current and accrued liabilities

All liabilities shown in the table below have a term of less than one year.

	Dec. 31, 2004 in T €	Dec. 31, 2003 in T €
<b>Other current liabilities</b>		
Social security	996	454
Taxes	2,793	1,098
Other	4,450	5,019
<b>Other current liabilities</b>	<b>8,239</b>	<b>6,571</b>
<b>Other accrued liabilities</b>		
Outstanding invoices	4,566	9,838
Employee bonus and remuneration	1,553	3,955
Vacation outstanding	122	674
Workmen's compensation	150	182
Tax consulting and legal fees	480	474
<b>Other accrued liabilities</b>	<b>6,871</b>	<b>15,123</b>
	<b>15,110</b>	<b>21,694</b>

As in the previous year, other current liabilities include the final tranche for the acquisition of Vento of T € 4,450.

## 11. Current portion of obligations under capital leases

In the financial year 2004, the Company recorded for the first time obligations under capital leases of T € 2,647. In addition, we are referring to our remarks under 13. "Non-current portion of obligations under capital leases".



## 12. Employee benefit plan

As of December 31, 2004, there was an employee benefit plan for one of QSC's executive managers. Pension benefits are fixed at a monthly amount after legal retirement age.

The components of net periodic benefit costs were:

	Dec. 31, 2004 in T €	Dec. 31, 2003 in T €
<b>Net periodic benefit costs</b>		
Service cost	97	65
Interest cost	18	32
<b>Net periodic benefit costs</b>	<b>115</b>	<b>97</b>

The following table sets forth the funded status of QSC's pension plan, amounts recognized in QSC's balance sheets, and the principal weighted average assumptions inherent in their computation:

	Dec. 31, 2004 in T €	Dec. 31, 2003 in T €
<b>Change in benefit obligation</b>		
Benefit obligation at beginning of year	651	289
Service cost	134	28
Interest cost	32	10
Settlement	-	24
Actuarial gain (loss)	(208)	313
Transfer to external company	(194)	-
<b>Benefit obligation at end of year</b>	<b>415</b>	<b>664</b>
Unfunded status	415	664
Unrecognized net actuarial loss	(142)	(282)
Minimum Liability	43	128
<b>Accrued benefit cost</b>	<b>316</b>	<b>510</b>
<b>Weighted-average assumptions</b>		
Discount rate	6%	6%
Expected return on plan assets	3%	3%
Rate of compensation increase	3%	3%

## 13. Non-current portion of obligations under capital leases

As of December 31, 2004, the Company recorded T € 4,105 as non-current portion of obligations under capital leases.

Total additions to plant and equipment in financial year 2004 on the basis of capital leases were T € 7,574. The corresponding depreciation of T € 965 is included in the depreciation of equipment and plant. The fair value of the leased equipment as of acquisition date is equivalent to the acquisition cost. The internal rate of return of the capital lease contracts averages 6%. The financial obligations out of the contracts are T € 2,647 for 2005, T € 2,864 for 2006 and T € 1,241 for 2007.

## 14. Share capital

**Nominal share capital** // The nominal share capital of QSC consists of ordinary share capital of T € 105,503 (2003: T € 105,037) and is divided into 105,502,729 (2003: 105,037,396) ordinary shares having a notional value of one Euro each. Each share gives the registered holder one vote at the General Meeting of shareholders and the right to fully share in dividends. There are no restrictions on voting rights. During 2004, nominal share capital increased by T € 466 due to the conversion of 465,333 convertible bonds. Employees used their right to convert their convertible bonds to registered ordinary shares of QSC.

**Treasury shares** // As of December 31, 2004, QSC held no treasury shares (2003: 358,747). Treasury shares were sold in the period from March 10, 2004, to May 4, 2004, with an average price of € 3.51 per share. The gain of T € 1,262 has been recorded against additional paid in capital not affecting net income.

**Conditional capital as per commercial register** // As of December 31, 2004, QSC had conditional capital of T € 35,032. T € 10,032 relates to stock option plans for QSC's employees as well as Advisory and Supervisory Board members and T € 25,000 for bonds, which are to be underwritten by a banking syndicate with the obligation to offer the bonds for subscription to the shareholders.

**Approved capital** // The Management Board was authorized by resolution of the Annual General Meeting on May 27, 2004, to increase capital stock, with approval of the Supervisory Board, on one or several occasions by up to T € 50,000 by issuing new common registered shares in return for cash or non-cash contributions, though use has not yet been made of this authorization.

Authorization to issue treasury shares // The authorization of the Annual General Meeting of QSC on May 15, 2003, to acquire its own shares up to an imputed share in the capital stock in the total amount of T € 10,000 through the stock exchange or based on a public tender offer, was time-limited by law until October 31, 2004. Therefore, this authorization was revoked at the Annual General Meeting on May 27, 2004, and replaced by a new identical authorization being in effect until October 31, 2005.

## 15. Employee equity incentive program

The following table summarizes activity under QSC's stock option plans for the years ended December 31, 2004 and 2003:

	Number of stock options	Weighted average exercise price in €
Issued and subscribed, below market	4,157,623	2.11
Issued and subscribed, at market	6,941,093	1.92
Exercised	(3,902,749)	1.95
Forfeited	(814,292)	3.53
<b>Outstanding at December 31, 2003</b>	<b>6,381,675</b>	<b>1.82</b>
Issued and subscribed, below market	-	-
Issued and subscribed, at market	163,663	4.33
Exercised	(465,333)	1.39
Forfeited	(47,562)	2.06
<b>Outstanding at December 31, 2004</b>	<b>6,032,443</b>	<b>1.92</b>

QSC accounts for its stock option plans under provisions of APB 25. Under APB 25, compensation expense is recognized based on the amount by which the fair value of the underlying common stock exceeds the exercise price of the stock options at the measurement date. Compensation expenses were recognized for convertible bonds exercised under SOP 2000 and for convertible bonds, which were exercised under SOP 2000A before the initial public offering.

In the case of SOP 2001 and 2002 and convertible bonds of SOP 2000A exercised after the initial public offering, the fair value of the underlying common stock and the exercise price of the stock options are the same. Therefore, no compensation expense is recorded due to APB 25. In 2004, QSC amortized T € 30 (2003: T € 4,835).

Had compensation expense for share options granted under the plans been determined in accordance with SFAS 123, deferred compensation expense would have been T € 1,236 (2003: T € 8,369), consisting of T € 0 for SOP 2000 (2003: T € 5,595), T € 245 for SOP 2000A (2003: T € 1,737), T € 614 for SOP 2001 (2003: T € 650) and T € 377 for SOP 2002 (2003: T € 387).

The average fair value of options granted as of December 31, 2004, was estimated at € 10.06 (SOP 2000), € 7.46 (SOP 2000A), € 0.49 (SOP 2001) and € 0.62 (SOP 2002). The following weighted average assumptions were used: dividend yield of 0% (2003: 0%), expected life of 3 years (2003: 4 years) and a risk free interest rate of 2.47% for government bonds with a two year maturity and 2.73% for government bonds with a three year maturity depending on the remaining term of the convertible bond. A volatility of 61.35% (2003: 79.44%) was used in valuing options.

## 16. Income taxes and deferred taxes

The German corporate income tax law applicable for financial year 2004 sets a statutory income tax rate of 25% (2003: 25%) plus a solidarity surcharge of 5.5% (2003: 5.5%). QSC is subject to a trade tax rate of 18.37% (2003: 18.37%). As of December 31, 2004, as well as in the previous year, deferred taxes were calculated with a combined income tax rate of 39.9%.

The following table reconciles the statutory income tax expense to the actual income tax expense:

	Dec. 31, 2004 in T €	Dec. 31, 2003 in T €
<b>Net loss before taxes</b>	<b>(21,559)</b>	<b>(60,611)</b>
Expected income tax	(8,602)	(24,186)
Tax effect of		
non-deductible expenses	18	4,340
valuation allowance for deferred tax	(1,304)	(1,830)
tax rate differential	-	(970)
valuation allowance loss carryforward	9,881	22,646
Other	7	-
<b>Expected income tax</b>	<b>-</b>	<b>-</b>

As of December 31, 2004, corporate income tax loss carryforward was T € 380,361 and trade tax loss carryforward was T € 380,396. According to tax legislation as of December 31, 2004, the tax losses may be carried forward indefinitely and in unlimited amounts. Beginning with financial year 2004, German tax law restricts offset of taxable income against existing tax loss carryforwards to an amount of T € 1,000 plus 60% of taxable income above T € 1,000. As required by SFAS 109, deferred tax assets will not be recognized to the extent it is considered more likely than not that such benefits will be realized in future years. For deferred tax assets relating to the tax loss carryforwards (T € 24,785 for corporate income tax and T € 24,726 for trade tax), a valuation allowance of T € 9,881 is reported.

The reconciliation of the valuation allowance is as follows:

	Dec. 31, 2004 Tax asset in T €	Dec. 31, 2003 Tax asset in T €
<b>Deferred tax asset</b>		
Deferred revenues	197	(709)
Deferred cost	328	1,061
Pension reserve	(38)	(21)
Other reserve	484	-
Discounted acquisition cost Ventelo	(21)	-
Reversal of valuation allowance of tax loss carryforward	202	-
Additions intangible assets	153	-
Other	-	(335)
Tax loss carryforward	(9,881)	(141,464)*
	<b>(8,576)</b>	<b>(141,468)</b>
Less valuation allowance	8,576	141,468
	-	-

\* in 2003 accumulated

## 17. Litigations

QSC currently has no significant litigations.

## 18. Lease commitments and contingent liabilities

Contingent liabilities are primarily based on long-term leasing agreements for dark-fibre lines, technical centers, office space and company vehicles. As of December 31, 2004, QSC's commitments from operating leases with a non-cancellable lease term in excess of one year were as follows:

Year ending December 31,	in T €
2005	25,685
2006	12,745
2007	4,598
2008	3,352
2009	2,682
after 2009	997
<b>Total</b>	<b>50,059</b>

These expenses were T € 23,631 and T € 23,713 for the years ended December 31, 2004 and 2003, respectively.

As of December 31, 2004, QSC had contingent liabilities of T € 3,002 (2003: T € 5,535). Contingent liabilities are primarily for guarantees granted mainly to suppliers for lease and other contractual obligations.

## 19. Management Board and Supervisory Board

Management Board // The members of the Management Board are:

Dr. Bernd Schlobohm	Engineer	Chief Executive Officer
Markus Metyas	Businessman	
Bernd Puschendorf	Businessman	
Mark Goossens *	Engineer	

until December 31, 2004 \*

The remuneration of the members of the Management Board conforms to the requirements of the German Corporation Act as well as to the principal suggestions and recommendations set out in the German Corporate Governance Code. The remuneration of the members of the Management Board for financial year 2004 totalled T € 1,861 (2003: T € 2,520).

Total remuneration comprises fixed and variable components. The fixed components of the package ensure a basic level of remuneration enabling the members of the Management Board to perform their duties in the interests of the Company without needing to focus on merely short-term performance targets. The amount of fixed remuneration paid to the members of the Management Board in the financial year 2004 were 54% of total remuneration (T € 1,001).

The variable components are depending on the realization of targets and company objectives, defined by the Compensation Committee at the beginning of the year. At the end of the fiscal year, the realization of targets and company objectives is checked and the variable remuneration is fixed. The Compensation Committee informs the Supervisory Board about the decision. In 2004 the variable components were 44% of the total remuneration (T € 812).

The total remuneration for company pension plans was 2% of the total remuneration (T € 48).

Stock options serve as variable components of remuneration providing long-term incentives. This element of the total remuneration package is oriented to an increase in stock price. In this way, it aims to enhance the value of the Company. In the financial year 2004, stock options were not awarded to the members of the Management Board.

Shares and conversion rights of members of the Management Board:

	Dec. 31, 2004		Dec. 31, 2003	
	Shares	Conversion rights	Shares	Conversion rights
Dr. Bernd Schlobohm	13,818,372	-	13,818,372	-
Markus Metyas	2,307	1,559,116	2,307	1,559,116
Bernd Puschendorf	-	1,000,000	-	1,000,000
Mark Goossens	384	400,000	384	400,000

Supervisory Board // The members of the Supervisory Board are:

John C. Baker	Private Equity Investor	Chairman
Herbert Brenke	Businessman	Vice Chairman
Gerd Eickers *	Businessman	
Ashley Leeds	Private Equity Investor	
Norbert Quinkert	Businessman	
David Ruberg	Private Equity Investor	
Claus Wecker **	Lawyer	

\* since June 1, 2004  
\*\* until May 31, 2004

John C. Baker is member of the Board of Directors of Cherry Road Technologies Inc., Parsippany, USA. Herbert Brenke is Chairman of the Supervisory Boards of Telegate AG, Martinsried, and ASKK Holding AG, Hamburg, as well as member of the Supervisory Boards of ASR Auto-Stern von Russland AG, Moscow, Russia, and SHS Informationssysteme AG, Munich. Herbert Brenke is also member of the Advisory Board of Küttner GmbH & Co. KG, Essen.

Ashley Leeds is member of the Board of Directors of Voltaire Ltd., Herzlia, Israel, and Canal + Television AB, Stockholm, Sweden.

Norbert Quinkert is member of the Supervisory Board of ALD Vacuum Technologies AG, Hanau, Pfalz Flugzeugwerke AG, Speyer, and IHP (Institut für Halbleiterphysik), Frankfurt/Oder. Norbert Quinkert is also Executive Vice President of the American Chamber of Commerce in Germany, Frankfurt/Main, and member of the Advisory Board of Dresdner Bank AG, Frankfurt/Main.

David Ruberg is Chairman of the Supervisory Board of InterXion Inc., Amsterdam, Netherlands, and member of the Board of Directors of Broadview Networks Inc., New York, NY, USA, and Adaptix, Inc., Seattle, WA, USA.

Claus Wecker is member of the Supervisory Board of ASKK Holding AG, Hamburg.

Gerd Eickers is member of the Supervisory Board of MVC AG, Frankfurt/Main, and member of the Advisory Board of GTT GmbH, Göttingen.

The total remuneration of the Supervisory Board for financial year 2004 was T € 160, in comparison to T € 148 for financial year 2003. In 2004, no convertible bonds were allocated to the members of the Supervisory Board. As resolved in the Annual General Meeting on May 17, 2001, the compensation for the Chairman and the Vice Chairman of the Supervisory Board is T € 30 per year. The compensation for all other members of the Supervisory Board is T € 25 per year. A member of the Supervisory Board will receive only 50% of these amounts if the participation at regular called meetings is below 75% per fiscal year.

Claus Wecker is partner of a law firm that provides legal consultancy services to QSC. In 2004, total cost for these services was T € 140, and T € 31 were recognized as accounts payable (2003: T € 12).

Shares and conversion rights of members of the Supervisory Board:

	Dec. 31, 2004		Dec. 31, 2003	
	Shares	Conversion rights	Shares	Conversion rights
John C. Baker	-	19,130	-	19,130
Herbert Brenke	187,820	19,130	187,820	19,130
Gerd Eickers	13,853,484	9,130	13,841,100	9,130
Ashley Leeds	9,130	10,000	9,130	10,000
Norbert Quinkert	3,846	-	3,846	-
David Ruberg	4,563	19,130	4,563	19,130
Claus Wecker	83,025	-	83,025	-

## 20. Declaration pursuant to § 161 of the corporation act on compliance with the German Corporate Governance Code

The Management Board and the Supervisory Board executed the declaration due to § 161 Stock Corporation Act and published it on the website of the Company.

## 21. Major differences between German and US accounting principles

§ 292a of the accounting regulations set out in the German Commercial Code ("HGB") offers an exemption to prepare consolidated financial statements in accordance with the accounting regulations set out in HGB if consolidated financial statements are prepared and published in accordance with internationally accepted accounting principles (US GAAP or IFRS). To make use of this exemption, the Company is required to describe the major differences between the accounting methods applied and German accounting methods.

Providing all relevant information to investors in order to facilitate future investment decision-making is generally a primary emphasis of US GAAP, while German HGB accounting rules emphasizes the principle of prudence and creditor protection.

Under German HGB, type of revenue generally has no impact on revenue recognition. Under Staff Accounting Bulletin ("SAB") 101 "Revenue Recognition in Financial Statements", revenues received at the beginning of a contract are capitalized and amortized over the estimated average customer subscription life of 24 months. Installation costs are capitalized as well and amortized as costs over the estimated average customer subscription life of 24 months.

In accordance with US GAAP, deferred compensation resulting from the issuance of convertible bonds based on stock option programs is recorded as personnel expenses. In consolidated financial statements prepared according to German accounting principles, this approach need not be taken.

Under German HGB, deferred tax assets are not recorded for net operating losses. Under US GAAP, deferred tax assets are recorded for net operating losses, and a valuation allowance is established when it is not secured that deferred tax assets will be realized.

According to German HGB, goodwill and intangible assets acquired in business combinations are capitalized and subject to amortization and impairment testing. According to SFAS 142, goodwill and intangible assets with an indefinite life acquired in business combinations are only subject to impairment testing but not to amortization. Goodwill and intangible assets are tested for impairment at least annually.

According to German HGB, treasury shares are considered as marketable securities and are valued at the lower of cost or market at the balance sheet date. Unrealized and realized losses and realized gains are included in earnings. Under US GAAP, treasury shares are recorded at cost within shareholders' equity. Changes in value, whether realized or unrealized, are not recognized.

Under German HGB, marketable securities are valued at the lower of acquisition cost or market value at the balance sheet date. In accordance with SFAS 115, securities are considered to be either held-to-maturity, trading or available-for-sale securities. Under US GAAP, held-to-maturity securities are accounted at amortized cost, trading and available-for-sale securities are valued at fair value as of the balance sheet date. Unrealized gains and losses from trading and held-to-maturity securities are included in earnings. Unrealized gains and losses from available-for-sale securities are reported net of tax in accumulated other comprehensive income. A decline in value below cost is deemed to be other than temporary resulting in a deduction in carrying amount to fair value, and the impairment is charged to earnings.

For some employees there were employee benefit plans in place, which led to accrued benefit cost in the balance sheet. Based on an actuarial opinion, the provisions for pensions are determined using the projected unit credit method in accordance with SFAS 87, "Employers' Accounting for Pensions". The determination under German HGB is different.

## 22. Subsequent events

No events or transactions have occurred since December 31, 2004, or are pending that would have a material effect on the consolidated financial statements at that date of for the period then ended.

Cologne, March 3, 2005



Dr. Bernd Schlobohm  
Chief Executive Officer



Markus Metyas



Bernd Puschendorf

## Glossary

**ADSL** // Asymmetrical Digital Subscriber Line: asymmetric data transmission technology with downstream rates between 1.5 Mbit/s and 8 Mbit/s and upstream rates between 16 kbit/s and 640 kbit/s.

**ATM** // Asynchronous Transfer Mode: universal transfer method for broadband applications, with speeds ranging from 2 Mbit/s to 622 Mbit/s.

**Backbone** // High-speed network that interconnects networks with lower speeds/capacities.

**Bandwidth** // Line transmission capacity: the greater the bandwidth, the more units of information (voice, images and other data) can be transported within a given time interval.

**Bitstream Access** // Ramp-up product for broadband services that provides a network operator with broadband transfer capacity (e.g. on a DSL platform) between the end customer and a defined point of interconnection (POI) in the network of a further provider, thereby enabling him to acquire the bitstream and offer it on the basis of his own end-customer rate plans.

**Call-by-Call** // Call-by-call telephone calls or Internet accesses enable a customer to dial the network prefix of his or her telephone provider of choice prior to each telephone call or Internet access.

**Colocation Room** // Central Office or colocation room: the 'colocation room' at Deutsche Telekom; this is where the 'last mile' to an end-user begins. The Central Office houses the DSL infrastructure of alternative network operators such as QSC. Here, the

twisted copper wire pair is handed over by Deutsche Telekom to the alternative network operator.

**DSL** // Digital Subscriber Line: a data transmission method that enables digital data to be transferred via the normal copper-wire telephone line at high transmission rates.

**IP** // Internet Protocol: the Internet is based upon the IP data transfer standard. The IP enables a data packet to be routed via multiple different computer platforms until it reaches its destination.

**ISP** // Internet Service Provider: they facilitate customer data communication by providing Internet access and related services, e.g. e-mail management.

**ITC** // Information Technology and Communications: The ITC industry is made up of all vendors and providers of hardware and software, voice and data communication infrastructures and telecommunication devices, as well as information technology services and telecommunication services.

**LAN** // Local Area Network: a network confined to a particular geographical area or building (e.g. within a company).

**Last Mile** // The distance from the telephone outlet to the nearest local switching center (central office).

**Leased Line** // A permanent connection line.

**Mbits/s / kbit/s** // Megabit per second/Kilobit per second; measuring units of data transmission speed.

**MSC** // Metropolitan Service Center: QSC's local access network mode where local broadband traffic is bundled and connected with Internet and/or the PoTS (Plain old Telephony System) world. The MSC's also house broadband application servers.

**RegTP** // German Regulatory Authority for Telecommunications and Posts. Following the liberalization of the telecommunications market, the RegTP was formed from the German Federal Ministry of Posts and Telecommunications (BMPT) and the German Federal Office of Posts and Telecommunications (BAPT). The mission of this authority is to monitor the market power of the dominant player and assure the required equal opportunity for its competitors.

**SDSL** // Symmetric Digital Subscriber Line: symmetric transmission technology, allows for data transfer into both directions at equal speeds of up to 2.3 Megabit per second.

**SMEs** // Small and medium enterprises with up to 500 employees.

**SoHos** // Small offices, Home offices: the term used to denote mini-companies (with up to nine employees) as well as free-lance professionals.

**TAL** // "Teilnehmeranschlussleitung" (subscriber line or local loop): line between a central office and the subscriber's physical connection to the respective network.

**TKG** // German acronym for the German Telecommunications Act. It serves as the basis for liberalization of the telecommunication sector in Germany.

**UMTS** // Universal Mobile Telecommunications System. The Third Generation mobile communication standard, which enables data transfer rates of up to two megabits per second. Transfer can be via either wireless or wireline networks.

**Voice over DSL** // The possibility to transmit voice and data simultaneously within the frame work of DSL technology.

**Voice over IP** // Voice over Internet Protocol: the technique of using the Internet Protocol (IP) to transfer voice communication over packet-switched data networks.

**VPN** // Virtual Private Network: in a VPN, several corporate sites are connected through a public network to form a secure network impervious to outsiders. Only persons or sites with due authorization are able to communicate with each other, access data or exchange data via such a network.

**WiMAX** // Worldwide Interoperability for Microwave Access. WiMAX is a new standard for wireless local area networks that is theoretically capable of offering ranges of up to 50 kilometers and data transfer rates of up to 70 Mbit/s.

**WLAN** // Wireless Local Area Network. A WLAN is based upon the IEEE 802.11 standard. A network of this kind typically possesses a range of only a few hundred meters and can transfer data at speeds of up to 75 Mbit/s, depending upon the standard being used.

## Calendar

Annual Shareholders Meeting  
May 19, 2005

Quarterly Reports  
May 31, 2005  
August 30, 2005  
November 29, 2005

Conferences/ Events  
June 28, 2005  
Baden-Wuerttembergische Bank AG  
Capital Market Conference 2005,  
Frankfurt

November 21-23, 2005  
German Equity Forum  
Autumn 2005, Frankfurt

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