Annual Report . 2005 . Next Generation Connections

Key data

All amounts in € million

	2005	2004	2003	2002	2001
Revenues	194.4	145.9	115.6	47.1	29.4
EBITDA	+5.8	+3.2	(28.5)	(60.3)	(85.4)
EBIT	(18.7)	(22.7)	(61.9)	(101.1)	(113.0)
Net loss	(18.2)	(21.6)	(60.6)	(102.6)	(104.9)
Net loss per common share[1] (in €)	(0.17)	(0.21)	(0.58)	(1.01)	(1.04)
Equity[2]	85.0	70.2	89.5	145.3	240.0
Balance Sheet total[2]	151.3	116.0	132.7	194.6	298.0
Equity ratio (in %)	56.2	60.5	67.4	74.7	80.5
Capital Expenditures	20.1	15.9	8.5	11.8	41.7
Liquidity[2]	52.1	40.3	54.3	87.6	153.8
Share price[2] (in €)	3.86	3.66	3.03	0.38	1.25
Number of shares[2]	115,033,078	105,502,729	105,037,396	105,008,714	105,008,714
Market capitalization[2]	444.0	386.1	318.3	39.9	131.3
Employees[2]	450	367	373	433	263

Consolidated Financials Statements 2004 and 2005 under IFRS, 2001 to 2003 under US GAAP

[1] basic and diluted

[2] as of December, 31

At a glance

February 28, 2005
The starting point for upgrading the Company's nationwide infrastructure into a Next Generation Network for the convergent and IP-based transfer of data and voice. Together with Chinese-based Huawei Technologies, QSC then goes on to build one of Germany's largest Voice over IP networks within only a few months.

May 11, 2005
This marks the beginning of the partnership with debitel to market ADSL2+. By August, QSC has upgraded its network in the pilot region of Düsseldorf with super-fast ADSL2+ technology. In November, the companies broaden their collaboration to include four additional cities in the Ruhr region of Germany.

May 12, 2005
Bonn-based DSL service provider celox Telekommunikationsdienste GmbH is acquired for € 13.8 million. The entire purchase price is paid through a capital increase. With celox, QSC acquires a cutting-edge DSL network in more than 30 medium-sized German cities, which is swiftly integrated into the Company's own network in the following months.

August 2, 2005
The Company wins Commerzbank as a new large account. QSC networks 280 branch offices, representing 30 percent of Commerzbank's network infrastructure, in a nationwide Virtual Private Network (IP-VPN).

October 27, 2005
QSC wins an award as one of the three fastest-growing technology companies in Germany. Deloitte & Touche's annual Fast 50 rankings elects companies on the basis of their aggregate growth over the course of the past five years – between 2000 and 2004. Over that period, QSC grew its revenues by 2,835 percent to € 145.9 million.

November 21, 2005
The Company connects 1,200 Gothaer Insurance branch offices to an IP-VPN. Under this contract, QSC is responsible both for providing the connections as well as for the logistics and on-site installation.

November 30, 2005
QSC links some 400 service stations through an IP-VPN for TOTAL Deutschland GmbH (Total), one of Germany's largest integrated petrol distributors. Total then broadens the contract after the Company successfully builds and operates an IP-VPN for 200 petrol stations during the first half of the year.

December 1, 2005
Successful capital increase of 5.49 million newly issued shares. The resulting placement proceeds of € 20.15 million are employed for the demand-driven expansion of the Company's own infrastructure, in particular for upgrading the network with ADSL2+ technology. This makes QSC an attractive technology partner for Triple Play providers.

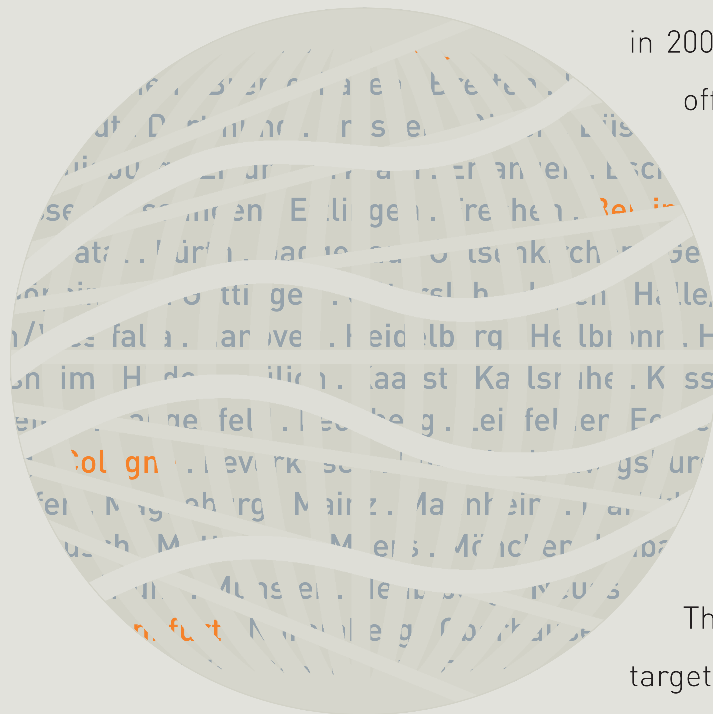
Next Generation Connections

Intelligent Networking

QSC is growing...

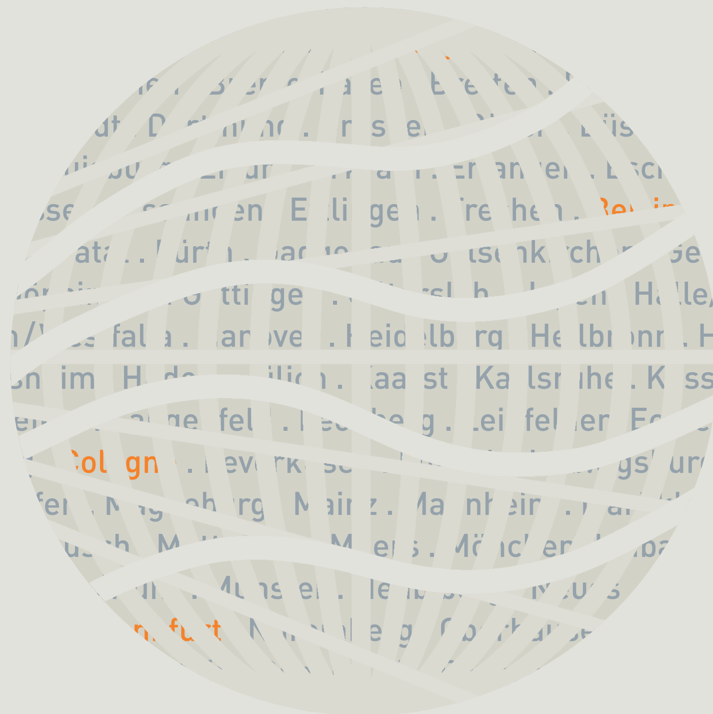
Next Generation Connections

The foundation for QSC's strong and profitable growth consists of its own broadband infrastructure. QSC upgraded its network into a **Next Generation Network** in 2005, enabling it to now offer **Voice over IP** on a nationwide scale. In 2005, the Company also expanded its **DSL network** into further cities and began upgrading this network with **ADSL2+** technology. The demand-driven and targeted expansion of its infrastructure is opening up new growth potential to QSC. It is only through its own infrastructure that makes QSC a pioneer when it comes to **Next Generation Connections**: **IP-VPN** solutions for large accounts, as well as innovations like the **VirtuOS** professional call manager.



expanding...

Next Generation Connections

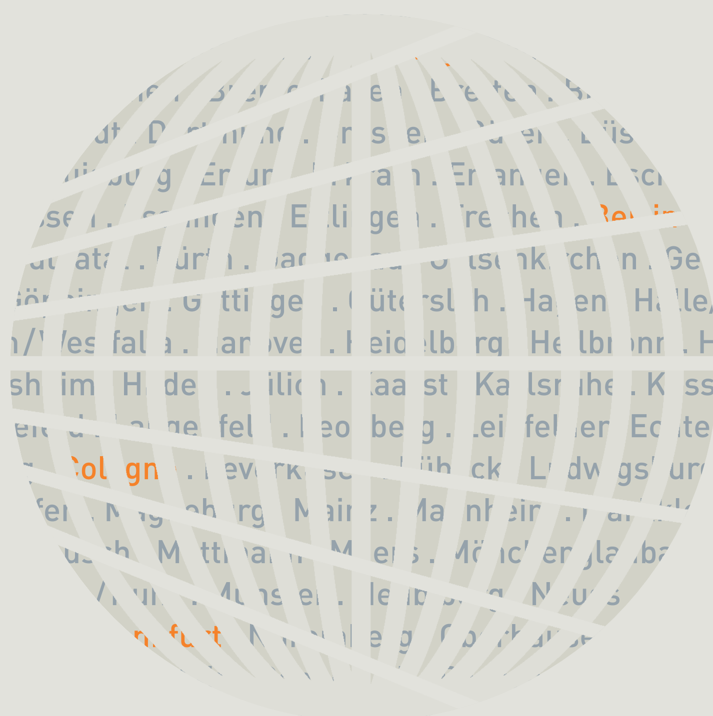


DSL network in more than 110 cities

Its own DSL network is the centerpiece of QSC's nationwide infrastructure. By year-end 2005, this network already included more than 110 cities – at year-end 2004, the total had only amounted to around 70. The **acquisition of Bonn-based DSL provider celox** on May 12, 2005, expanded the network by more than 30 new, typically medium-sized cities. Moreover, QSC also expanded its own DSL network on a demand-driven basis in 2005, investing wherever existing customers and customer inquiries would make swift amortization of the capital expenditures highly likely – a strategy that QSC will rigorously continue in 2006.

accelerating...

Next Generation Connections

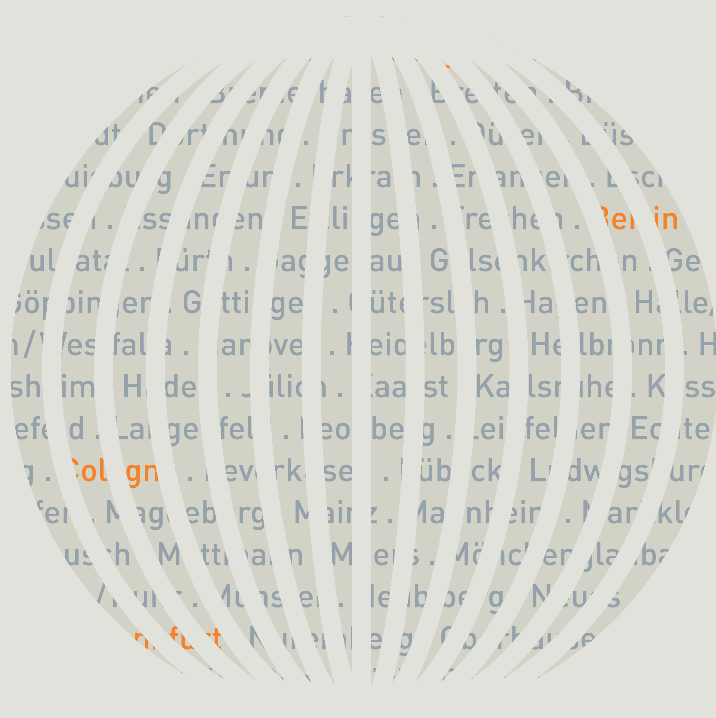


ADSL2+ technology for TV over the Internet

In 2005, QSC began upgrading its DSL network with super-fast ADSL2+ technology. ADSL2+ accelerates data transfer to speeds as high as **25 megabits per second**, even enabling multi-channel reception of high-definition television (HDTV). In rolling out ADSL2+, QSC is working together with seasoned wholesale partners, focusing its own activities on the demand-driven expansion and operation of the network, while strong partners like debitel and HanseNet with its "Alice" brand are marketing the ADSL2+ products.

connecting...

Next Generation Connections



NGN enables Voice over IP nationwide

In 2005, QSC upgraded its nationwide network for legacy voice telephony into a Voice over IP-capable Next Generation Network (NGN), while simultaneously equipping all **474 points of interconnection** with Deutsche Telekom's network. This upgrade will assure the most far-reaching and consistent transport of all telephone calls within QSC's own infrastructure, thus significantly improving its efficiency and cost structure in the voice telephony business. At the same time, the NGN underscores QSC's role as a technology leader for Voice over IP telephony in Germany.

nationwide!

Next Generation Connections

Aachen
Andernach Aalen
Aschaffenburg Augsburg
Baden-Baden . Bamberg . Baunatal
Bayreuth . Bendorf . Bielefeld . Böblingen
Bocholt . Bochum . Hamburg . Bonn . Braunschweig
Bremen . Bremerhaven . Bretten . Bruchsal . Darm-
stadt . Dortmund . Dresden . Düren . Düsseldorf
Duisburg . Erfurt . Erkrath . Erlangen . Eschborn
Essen . Esslingen . Ettlingen . Frechen . Berlin . Freiburg
Fuldatal . Fürth . Gaggenau . Gelsenkirchen . Gersthofen
Göppingen . Göttingen . Gütersloh . Hagen . Halle/Saale
Hamm/Westfalia . Hanover . Heidelberg . Heilbronn . Herten
Hildesheim . Hilden . Jülich . Kaarst . Karlsruhe . Kassel. Koblenz
Krefeld . Langenfeld . Leonberg . Leinfelden-Echterdingen
Leipzig . Cologne . Leverkusen . Lübeck . Ludwigsburg . Lud-
wigshafen . Magdeburg . Mainz . Mannheim . Markkleeberg
Meerbusch . Mettmann . Moers . Mönchengladbach
Mülheim/Ruhr . Münster . Neubiberg . Neuss
Neuwied . Frankfurt . Nuremberg . Oberhausen
Offenbach am Main . Osnabrück . Paderborn
Pforzheim . Plochingen . Potsdam . Ratingen
Recklinghausen . Regensburg . Remscheid
Reutlingen . Rheine . Rostock . Saarbrücken
Siegburg . Stuttgart . Siegen . Sindelfingen
Sinsheim . Trier . Troisdorf . Tübingen . Ulm
Unterföhring . Velbert . Vellmar . Wesseling
Wiesbaden . Wiesloch . Munich . Willich
Witten . Worms . Würselen . Würzburg
Wuppertal

Next Generation Connections

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Financial Report
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To the Shareholders

Dear Shareholders,
In 2005, QSC again accelerated its persistently strong growth,

with revenues rising by 33 percent to € 194.4 million, as opposed to growth of 26 percent the year before. A comparison of the absolute numbers highlights the magnitude of progress: In fiscal 2005, we increased revenues by nearly € 50 million, as opposed to "only" an additional € 30 million the year before.

Strong dynamic in the segment of Large Accounts

All segments contributed to this success. Once again, business in the segment of Large Accounts proved to offer especially high growth. In recent years, QSC has been systematically building and expanding its high-margin business of networking enterprise locations through virtual private networks (IP-VPN) and providing the corresponding managed services. Today, we are benefiting from our track record of competence, from our high level of quality and service, as well as from numerous reference projects. In 2005, QSC succeeded in winning, among others, Commerzbank, Gothaer Insurance and Total as new customers. In addition to new business, the Company's revenue growth of 55 percent to € 51.4 million from business in the Large Accounts segment during the past fiscal year was also based upon successes with existing customers, who are rewarding us with a rising share of their telecommunication budgets.

And QSC's acceptance among small and medium enterprises is also rising – more and more of them are telephoning and e-mailing with our products, and are using a direct, broadband connection to the QSC network to do that. Consequently, revenues in the Business Customers segment rose by more than 20 percent in 2005 to € 57.5 million.

In the Wholesale/Resellers segment, our collaboration with international carriers who do not possess a nationwide access network of their own is also paying off – revenues rose by 66 percent to € 30.4 million in 2005. The ADSL2+ upgrade of our network, which began last year, now also makes QSC an attractive technology partner for wholesale partners with mass-market experience, such as mobile service provider debitel and Telecom Italia subsidiary HanseNet with its successful "Alice" brand. These companies are positioning themselves early on with ADSL2+ offerings in the promising Triple Play market – the ability to offer Internet, telephony and TV over a single line.

Thanks to the ADSL2+ technology provided by QSC, these partners are able to offer even high definition television (HDTV) over DSL. QSC is utilizing this demand from wholesale partners to specifically expand and upgrade its own infrastructure. In doing so, we are adhering to our proven "network follows customer" approach. We are only upgrading our network and connecting new cities where local wholesale partners handle the marketing, thus rendering swift amortization and pay back of the required capital expenditures highly likely.

ADSL2+ upgrade strengthens business with enterprise customers

With this demand-driven network expansion and upgrade, we are also strengthening our business with enterprise customers, and especially our high-margin business with large accounts. Because the more cities we cover, the greater becomes the percentage of customer locations that we can reach with our own network within the framework of IP-VPN solutions. The higher this percentage, the more favorable becomes our cost structure and the more successful we will be in winning orders from large accounts – and we are doing it without cutting into our profitability. Consequently, we expanded our DSL network by some 40 new cities and more than 200 additional central offices in 2005, alone, in response to demand from enterprise customers as well as a result from the celox acquisition.

The upgrade of our network into a Next Generation Network (NGN), which has been concluded, also serves to strengthen our business with enterprise customers. This NGN enables voice and data to be transported over a consistent infrastructure and affords simple utilization of Voice over IP technology, even with conventional telephone systems if desired. This option allows a gentle migration to Voice over IP and is very well received by the market; our IPfonie product family has already made an encouraging contribution to our revenues and profitability in 2005.

Our own infrastructure serves as the foundation for our success with enterprise customers. We will therefore continue the demand-driven expansion and upgrade of our network in 2006. In response to strong demand from large accounts and wholesale partners, we will connect further locations to our DSL network – as we have already done in 13 cities by the end of March 2006. At the same time, responding to demand from our wholesale partners, we will drive the rapid upgrade of our network with ADSL2+ technology.

To finance this accelerated expansion and upgrade of our network, we raised some € 20 million in additional cash in the capital market in December 2005 through a capital increase. In both this transaction as well as the celox acquisition, we used the authorized capital that had been made available by you. In order to be able to quickly seize opportunities that present themselves to the benefit of QSC, it was necessary for us to exclude the preemptive subscription rights of all shareholders. However, following the capital increase in December, the share price increase led to significant value creation for all shareholders.

This share price rise also marked the end of QSC shares' sideways movement, which had characterized the share price performance in 2005. At the same time, our shares suffered from the general skepticism among institutional investors towards the telecommunications sector. Since the beginning of 2006, however, greater attention has been paid, in particular, to infrastructure providers who are well positioned in such promising markets as networking enterprise locations and Voice over IP – and this includes QSC. This is also being confirmed to us by the growing number of analysts who regularly follow our Company, the majority of them issuing buy recommendations.

These kinds of buy recommendations are an indication of the share price potential from which you, dear shareholders, are likely to benefit in the medium-term. At this point, we would like to express our sincere thanks for your continued trust. We view it as our mission to continue to live up to this trust, to sustainably increase the value of our Company and to thus also open up new prospects with respect to the valuation of QSC shares.

The strong growth dynamic and the demand-driven expansion and upgrade of our network during the past fiscal year have laid the foundation for this. The dedication of the entire QSC team made a crucial contribution in achieving this success. At this point, we would like to thank all of our people for their enthusiastic, committed and successful work during the past year. We were especially pleased to see the spirit of partnership with which our new colleagues from celox were welcomed to the team.

QSC plans to cross net income profitability threshold by year-end

We have our sights set on accomplishing a great deal together for 2006. We want to continue to significantly grow our revenues and profitability, and to cross the net income profitability threshold by year-end. We anticipate especially high revenue growth in the IP-VPN-/Managed Services business, in connecting enterprises directly to our network, as well as in the wholesale business. We are paying particular attention to these three strategic lines of business, because these three growth markets will be playing a crucial role in the growth of the value of your company in the years to come.

Cologne, March 23, 2006

Markus Metyas	Dr. Bernd Schlobohm Chief Executive Officer	Bernd Puschendorf

The Management Board

Dr. Bernd Schlobohm Markus Metyas Bernd Puschendorf

Dr. Bernd Schlobohm (*1960) // Chief Executive Officer
A post-graduate engineer who is responsible on the Management Board for Strategy and Technology as well as Quality and Product Management; in this position, he played a major role in driving the upgrade of QSC's infrastructure into a Next Generation Network, as well as in the development of new products like IPfonie. Prior to co-founding QSC together with Gerd Eickers in 1997, Dr. Schlobohm had been in charge of business at Thyssen equity investment Spaceline Communication Services as well as technology at Thyssen Telecom.

Markus Metyas (*1963)
An investment banker, his responsibility on the Management Board is for Finance, Procurement, Human Resources, Legal Affairs, Customer and Contract Management as well as Mergers & Acquisitions. His key projects in 2005 included the acquisition of Bonn-based DSL provider celox as well as the capital increase effected in December 2005. Prior to joining QSC in February 2000, this post-graduate businessman had supported numerous high-growth companies in connection with financing questions while at Morgan Stanley and Wasserstein Perella.

Bernd Puschendorf (*1950)
A businessman, he is in charge of Sales and Marketing and in 2005 played a leading role in winning new large accounts such as Commerzbank, Gothaer Insurance and Total. In addition, this seasoned sales and marketing manager specifically expanded business with network-related services as well as reseller business. Prior to his appointment to the QSC Management Board in March 2002, Bernd Puschendorf had held positions at IBM, Siemens and other companies; beginning in 1999, he held the post of speaker of the management in Germany of the Fujitsu Siemens joint venture.

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.

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 in charge of Thyssen Rheinstahl Technik for many years. At the same time, since 1983, he had been a member of the management team at Thyssen Handelsunion.

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.

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.

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.

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.

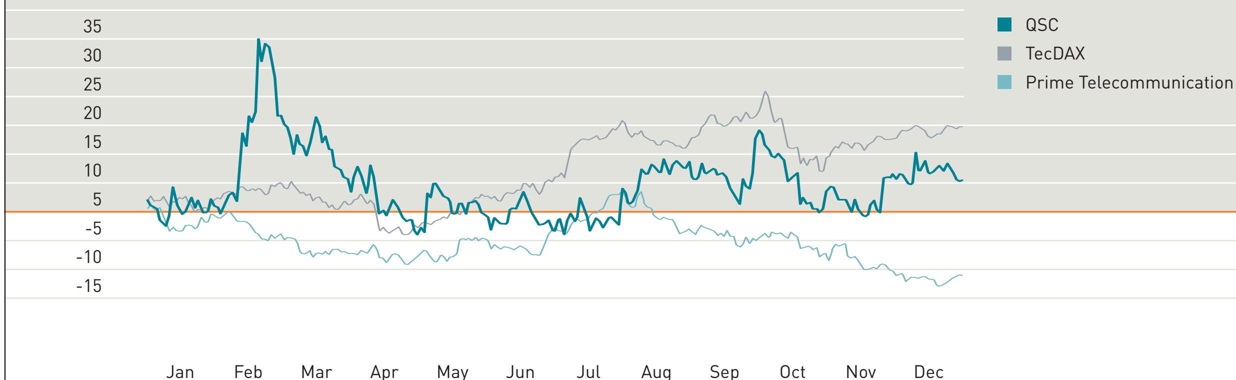
QSC's share price rises against industry trend

While the share prices of most telecommunication providers decreased in 2005, QSC shares rose by 5 percent. A growing number of equity research analyses published by European financial institutions are supporting additional share price growth potential.

Technology stocks take flight – Telecommunication under pressure // The trading prices of German technology stocks saw a broad-based recovery in 2005. They benefited from a low level of interest rates, a renewed interest in growth stocks, as well as from rising corporate earnings. Within the space of a year, the TecDAX, Germany's lead index for technology stocks, gained 15 percent.
By contrast, the discussion about legacy voice telephony potentially being replaced by Voice over IP technology, as well as the intensifying price war in the residential market, led to share price declines for telecommunication stocks in general – within the space of a year, the Prime Telecommunication Index, the lead index for German telecommunication stocks, lost 11 percent. Despite QSC's focus on the business customer market and an early focus on next generation voice products on IP basis, the Company's stock came under pressure in 2005 after recording a steep rise in its price in both 2004 and 2003. Following a significant upward trend during the first two months of the year, when QSC's share price reached as much as € 4.84, QSC was then caught up in the general investor scepticism towards the telecommunications industry. QSC shares reached their low for the year of € 3.39 on July 7, 2005, the day of the terrorist attacks in London. During the course of the following months, the trading prices of QSC shares recovered and, in contrast to most telecommunications stocks, went on to gain in value during the remaining course of the year; with a Xetra trading price of € 3.86 as per December 30, 2005, QSC shares closed up 5 percent.

QSC shares closing at € 3.86 at year-end 2005

QSC share price performance in 2005 (indexed)



Significantly rising analyst interest // Despite persistent skepticism towards telco stocks in general, 2005 saw a significant rise in interest in QSC on the part of European banks, stock brokers and research institutions. Both major financial institutions like Dresdner Kleinwort Wasserstein, HypoVereinsbank and UBS, as well as more specialized institutions like Kepler Equities and Landesbank Baden-Württemberg, published research on QSC for the first time. At the end of December 2005, a total of 13 financial institutions were regularly covering QSC, the vast majority of them issuing buy recommendations.

Trading volumes consistently high // Regular publication of new equity research analyst studies contributed to the strong demand for QSC shares in 2005. With an average trading volume of some 200,000 shares per day, QSC shares again numbered among the 30 most traded technology stocks in Germany in 2005, thus validating the inclusion of QSC in the TecDAX in 2004. On peak days, 700,000 and more shares changed hands in Xetra trading and on the trading floor in Frankfurt.

QSC now also included in the F.A.Z. Index

In addition to the TecDAX inclusion, in 2005 QSC shares were also added to the F.A.Z. Index, Germany's oldest stock market index. In existence since 1961, this index is made up of 100 German corporations with high levels of share capital and a sufficient number of freely tradable shares in circulation. This enabled QSC to further establish itself as one of Germany's most highly regarded and traded stocks.

Successful private placement with institutional investors // Aside from the growing number of equity analysts who follow the Company, two successful private placements during the past year document the strong interest in QSC among institutional investors. In May, for example, Sal. Oppenheim was successful in placing 80 percent of the 3.58 million new shares issued in connection with the acquisition of Bonn-based DSL provider celox; QSC had previously paid the purchase price for the Bonn-based DSL provider by issuing new shares, without having to deploy its cash reserves. The remaining 20 percent were held by the former owners of celox until the expiration of a lock-up period on December 31, 2005, and they, too, were successfully placed at the beginning of 2006.

Financial institutions that issue studies on QSC

Financial institutions that issue studies on QSC
Bankhaus Metzler
Berenberg Bank
Dresdner Kleinwort Wasserstein
DZ Bank
HSBC Trinkaus & Burkhardt
HypoVereinsbank
Kepler Equities
Landesbank Baden-Württemberg
Merck Finck & Co.
Sal. Oppenheim
SES Research
UBS
WestLB

In early December 2005, QSC increased its share capital by a further 5.49 million shares against contributions in cash and sold them institutionally through a private placement. The resulting € 20.15 million liquidity increase is being employed to fund the demand-driven, targeted expansion and upgrade of QSC's own infrastructure.

Successful private placement of QSC shares

In both cases, the Management Board utilized the authorized capital resolved by the Annual Shareholders Meeting, excluding the preemptive subscription rights of existing shareholders; this enabled the Company to seize the opportunities quickly as they presented themselves. The Management Board is convinced that both the celox acquisition as well as the accelerated expansion and upgrade of the network will lead to a sustained increase in the value of the Company over the medium term, from which all shareholders will benefit equally. Overall, the number of shares in circulation rose by 9,530,349 to 115,033,078 shares during the past fiscal year. In addition to the two increases of capital, this rise in the number of shares in circulation was also attributable to the conversion of a total of 456,110 stock options into an equal number of shares by QSC employees.

Basic data about QSC shares

Trading Symbol	QSC
ISIN	DE0005137004
Bloomberg Symbol	QSC GR
Reuters Symbol	QSCG.DE
Market Segment	Prime Standard
Stock Exchanges	Xetra and regional German stock exchanges
Index Membership	TecDAX, F.A.Z. Index, HDAX, CDAX,
	Midcap Market, Technology All Share,
	Prime All Share, Prime Telecommunication,
	Prime IG Fixed-Line Telecommunication
Designated Sponsors	HSBC Trinkaus & Burkhardt KGaA
	Landesbank Baden-Württemberg
	WestLB AG
Shares Outstanding per December 31, 2005	115,033,078
Share Class	No-Par-Value registered shares of common stock
Xetra price, closing at December 30, 2004	€ 3.66
Xetra price, maximum in 2005	€ 4.84
Xetra price, minimum in 2005	€ 3.39
Xetra price, closing at December 30, 2005	€ 3.86

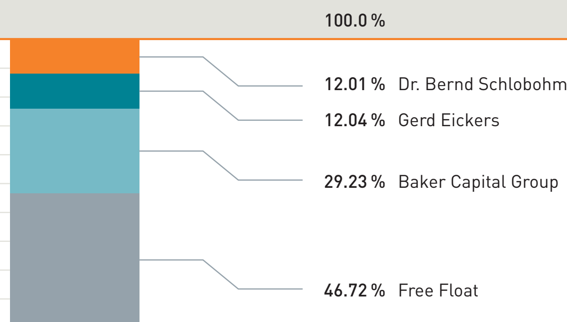
Successful placements lead to a rise in free-float // The issuance of a total of 9.5 million new shares of stock increased the proportion of the Company's shares that are widely held to 46.72 percent. With 29.23 percent, the US-based Baker Capital Group remained QSC's largest shareholder. The Company's two founders, Dr. Bernd Schlobohm and Gerd Eickers, now hold 12.01 and 12.04 percent of the shares, respectively. Neither QSC's two founders nor the Baker Capital Group have ever sold a share of QSC stock. This continuity of QSC's shareholder structure enhances the attractiveness of the Company's shares, especially in the eyes of institutional investors with a long-term view.

Intensive dialog with investors // In 2005, QSC continued its intensive dialog with investors and analysts. In 14 roadshows conducted in all key financial centers in Europe and the United States, the Management Board presented the QSC business model and the prospects it offers. In addition, the Management Board also presented the Company at investor conferences, including Frankfurt and London, as well as on the CeBIT fair in Hanover. Moreover, the Management Board conducted numerous one-on-one discussions with analysts and fund managers, as well as telephone conference calls following the announcement of the Company's quarterly and annual results.
QSC has traditionally attached high priority to the fair disclosure principle and consequently informs all investors comprehensively and promptly about both current corporate events as well as the Company's quarterly and annual results. QSC utilizes the website at www.qsc.de/en/investor_relations as its central information medium. The Annual Shareholders Meeting in Cologne on May 19, 2005, provided an additional communication platform for investors, who approved all items on the agenda by majorities of more than 99 percent each.

QSC awarded IR "Shooting Star of the Year"

In the summer of 2005, German business magazine Capital rewarded QSC's investor communication, naming the Company the "Shooting Star of the Year" within the framework of its annual Investor Relations Award. This distinction was based upon a survey of 550 analysts and fund managers. The clarity and transparency that QSC assigns to investor communications was also reflected by the survey of Annual Reports 2004 conducted by Manager Magazin. Amongst all 30 TecDAX companies, QSC's annual report scored second place in the "Design" category.

Shareholder Structure (in percent)



Corporate Governance & Compensation Report

Good corporate governance is a prerequisite for sustained strong and profitable growth. QSC has therefore traditionally attached great value to transparent communication, collaboration in a spirit of trust between all corporate bodies, as well as value-oriented corporate management.

High priority for corporate governance // QSC is largely in compliance with the recommendations contained in the German Corporate Governance Code (Code), which was initially adopted in the year 2002 and subsequently expanded in May 2003 as well as in June 2005. Since its initial public offering, in its day-to-day operations QSC has been living the kind of corporate governance called for by the Code. Because the Company views collaboration between all corporate bodies in a spirit of trust, transparent communication with all interested parties as well as value-focused corporate management as being the prerequisite for sustained strong and profitable growth. In a few points, however, QSC intentionally deviates from the recommendations contained in the Code. These points relate to recommendations that are geared all too strongly toward the management and monitoring of large corporations and do not sufficiently take into consideration the situation of lean companies with a strong entrepreneurial culture.

QSC committed to living good Corporate Governance

Annual Shareholders Meeting is the Company's central corporate body // The Management Board submits the Annual and Consolidated Financial Statements to the Annual Shareholders Meeting. The Annual Shareholders Meeting then decides on adoption of the financial statements, ratification of the actions of the Management and Supervisory Boards, election of members of the Supervisory Board and the independent auditor, amendments to the Articles of Association as well as on major entrepreneurial and financial directions. All documents and information relating to the Annual Shareholders Meeting are available on the QSC website.
Attendance rates of more than 60 percent of the voting capital at past Annual Shareholders Meetings document the keen interest on the part of our shareholders. Shareholders who do not attend in person have traditionally been able to have their voting rights exercised either by a proxyholder of their choice or by a Company-appointed proxyholder bound by the shareholder's instructions.

Efficient deliberation and monitoring by the Supervisory Board // QSC has a Supervisory Board made up of six board members. The composition includes both shareholder representatives as well as a sufficient number of independent members. They are convinced that the best approach is to jointly deliberate and monitor the work of the Management Board by bringing to bear their various qualifications and experience. With the exception of a three-member Compensation Committee, which deals in particular with questions relating to the employment contracts for and compensation paid to members of the Management Board, the Supervisory Board therefore does not form any committees. This also applies with respect to the audit committee urged in Item 5.3.2 of the Code. The Supervisory Board of QSC in its entirety possesses a sound understanding of questions relating to accounting and risk management; the exclusion of individual members of the Supervisory Board would mean having to forego valuable experience.

QSC predominantly focuses on the joint effort of all members of the Supervisory Board in connection with their compensation, as well. The Company foregoes the option contained in Item 5.4.7 of the Code relating to special compensation for memberships on Supervisory Board committees as well as success-based compensation. Every member of the Supervisory Board receives annual compensation of not more than € 25,000, with its Chairman John C. Baker and his Vice Chairman Herbert Brenke each receiving not more than € 30,000. Pursuant to § 10, Paragraph 5, of the Articles of Association, the variable element of the compensation paid to the members of the Supervisory Board is governed solely by their attendance at meetings during the course of a year. A Supervisory Board member's compensation is reduced by 50 percent should he or she attend fewer than 75 percent of the meetings of the Supervisory Board.

Transparent compensation structure for Supervisory Board members

The table below provides information about the compensation, number of shares and share options held by the members of the Supervisory Board. During the past fiscal year, the number of convertible bonds by long-term Supervisory Board members John C. Baker, Herbert Brenke, Gerd Eickers and David Ruberg declined as a result of the lapse of convertible bonds following the expiration of the 2000A SOP.

	Compensation 2004 and 2005 in €	Dec. 31, 2005		Dec. 31, 2004	
		Shares	Convertible Bonds	Shares	Convertible Bonds
John C. Baker	30,000	-	10,000	-	19,130
Herbert Brenke	30,000	187,820	10,000	187,820	19,130
Gerd Eickers	25,000	13,853,484	-	13,853,484	9,130
Ashley Leeds	25,000	9,130	10,000	9,130	10,000
Norbert Quinkert	25,000	3,846	-	3,846	-
David Ruberg	25,000	4,563	10,000	4,563	19,130

The other seats held by the members of the Supervisory Board are shown on page 103.

Close collaboration among the Management Board team // The QSC Management Board is made up of three members and manages the Company under its own responsibility and is committed to sustainably growing the value of the Company. The Management Board manages the Company as a team, and its members complement one another very well in terms of their qualifications and experience. QSC therefore views the compensation paid to the entire Management Board as being the decisive criterion in assessing the appropriateness of this compensation; the individualization of this compensation called for under Item 4.2.4, Sentence 2, of the Code would not provide any additional insight. The Management and Supervisory Boards of QSC therefore intend to propose a resolution to the 2006 Annual Shareholders Meeting pursuant to § 286, Paragraph 5, and § 314, Paragraph 2, Sentence 2, of the German Commercial Code (HGB). Under this

proposed resolution, the requirement of individualized disclosure of the compensation paid to the members of the Management Board called for pursuant to § 285, Sentence 1, Number 9, Letter a, and/or § 314, Paragraph 1, Number 6, Letter a, of the German Commercial Code would be able to be waived for the fiscal year starting on January 1, 2006, and for the four further subsequent fiscal years, i.e. through December 31, 2010.
Both in the Annual Report as well as on the Internet, QSC provides detailed information about the system of compensation for members of the Management Board. In fiscal 2005, the members of the QSC Management Board received aggregate compensation of € 1.68 million, as opposed to € 1.86 million the year before. 55 percent of this total consisted of fixed salary elements, 39 percent of variable salary elements and 6 percent of contributions to the Company's old-age pension plan. The variable salary elements are based upon the level of attainment of corporate and individual goals stipulated by the Supervisory Board Compensation Committee at the outset of the fiscal year and reviewed subsequent to the close of the fiscal year.

Performance-related compensation for Management Board members

Stock options serve as a further variable compensation element that has a long-term incentive effect. Like all employees, the members of the Management Board participate in the Company's stock option programs. QSC issues convertible bonds. Each bond entitles the holder to acquire one share of stock at the exercise price of the convertible bond; its value is based upon the trading price of the share at the time of exercise. In fiscal 2005, a total of 100,000 new convertible bonds were allocated to members of the Management Board. Pages 97 - 98 of the Notes to the Consolidated Financial Statements contain further details relating to the Company's stock option programs.
The table below provides information relating to the numbers of shares and stock options held by members of the QSC Management Board as of December 31, 2005, and December 31, 2004:

	Dec. 31, 2005		Dec. 31, 2004	
	Shares	Convertible Bonds	Shares	Convertible Bonds
Dr. Bernd Schlobohm	13,818,372	50,000	13,818,372	-
Markus Metyas	2,307	1,525,000	2,307	1,559,116
Bernd Puschendorf	3,000	1,025,000	-	1,000,000

It is QSC's conviction that multi-year vesting periods and exercise prices that are marked to market eliminate the need for a cumbersome valuation of stock options held by members of the Management Board (Item 4.2.3, Paragraph 3, Sentence 2), the definition of potential restrictions with respect to unanticipated developments (Item 4.2.3, Paragraph 2, Sentence 4), as well as the need for defining demanding, relevant comparison parameters (Item 4.2.3, Paragraph 2, Sentence 2). The existing structure of the stock option programs continues to be very suitable for a high-growth, founder-managed company.

Collaboration in a spirit of trust between the corporate bodies // The Management and Supervisory Boards of QSC collaborate closely to the benefit of the Company. The continuity of the membership of both corporate bodies plays a crucial role in this trust. The Management Board regularly, promptly and comprehensively informs the Supervisory Board about all questions relating to planning, business development, risk exposure and risk management that are of relevance to QSC, and discusses key issues with the Supervisory Board frankly and in a spirit of trust.

High quality of accounting // For the first time, QSC is preparing its Consolidated Financial Statements for the year ended December 31, 2005, under International Financial Reporting Standards (IFRS); accounting had previously been in accordance with US GAAP. The Company is thus complying with the requirements of the German Accounting Law Reform Act. The Company additionally prepares Annual Financial Statements under HGB accounting rules for the purpose of satisfying the requirements under German corporate law.
QSC views its Consolidated Financial Statements and interim reports as a key information medium for its shareholders and third parties, and takes pains to assure that they are compiled with the utmost care. The Company therefore deviates from Item 7.1.2 of the Code and submits its interim reports within 60 days following the close of the reporting period; QSC publishes its Consolidated Financial Statements within 90 days following the close of the fiscal year.

Transparent communication // Since its initial public offering, QSC has attached the highest priority to open and timely information for all shareholders, as well as to strict compliance with the fair disclosure principle. Consequently, the Company also instituted all necessary organizational measures early on for implementing in actual practice the German Investor Protection Improvement Act (AnSVG), which went into force in the autumn of 2004.

QSC website a key information medium for shareholders

QSC utilizes the Internet as a key information medium. The Company provides on its website financial reports, ad-hoc notices and press releases, financial calendar dates as well as detailed documents relating to all major events, such as the Annual Shareholders Meeting. In compliance with the Code, QSC prominently posts on its website the current Statement of Compliance as well as previous Statements of Compliance going back five years. All shareholders and interested parties can additionally subscribe to an electronic newsletter that provides information about current events at QSC.
www.qsc.de/en/investor_relations also contains information about the extent to which members of the Management or Supervisory Boards have acquired or sold QSC shares or derivatives based upon them. Pursuant to § 15a of the German Securities Trading Act (WpHG), each member of either of these corporate bodies, as well as persons close to them, are obligated to disclose such transactions, along with the value of any transactions equaling or exceeding € 5,000 within a calendar year.

The following transactions were reported to QSC during the past fiscal year:

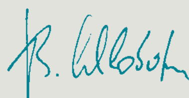
Trading Day / Stock Market	Names / Status	Financial Instrument	Type of Transaction	Par-Value in € / Quantity	Basic Price in € / Date of Maturity	Remarks
April 22, 2005	Dr. Bernd Schlobohm	Convertible bonds	Subscription	0.01	3.68	Within the 2002
Over the counter	CEO			50,000	April 22, 2010	SOP framework
April 25, 2005	Bernd Puschendorf	Convertible bonds	Subscription	0.01	3.70	Within the 2002
Over the counter	Management Board			25,000	April 25, 2010	SOP framework
April 26, 2005	Markus Metyas	Convertible bonds	Subscription	0.01	3.67	Within the 2002
Over the counter	Management Board			25,000	April 26, 2010	SOP framework
May 11, 2005	Gerd Eickers	QSC shares	Securities lending	3.84		Lending fee
Over the counter	Supervisory Board			2,815,824		0.5% p.a.
May 11, 2005	Dr. Bernd Schlobohm	QSC shares	Securities lending	3.84		Lending fee
Over the counter	CEO			38,786		0.5% p.a.
May 18, 2005	Gerd Eickers	QSC shares	Redemption of	3.72		Lending fee
Over the counter	Supervisory Board		Securities lending	2,815,824		0.5% p.a.
May 18, 2005	Dr. Bernd Schlobohm	QSC shares	Redemption of	3.72		Lending fee
Over the counter	CEO		Securities lending	38,786		0.5% p.a.
June 01, 2005	Bernd Puschendorf	QSC shares	Purchase	3.65		
Xetra	Management Board			820		
June 07, 2005	Bernd Puschendorf	QSC shares	Purchase	3.54		
Xetra	Management Board			2,180		
Dec. 05, 2005	Markus Metyas	QSC shares	Sale	3.842		Within the 2000A
Xetra	Management Board			39,682		SOP framework
Dec. 06, 2005	Markus Metyas	QSC shares	Sale	3.842		Within the 2000A
Xetra	Management Board			19,434		SOP framework

Declaration Pursuant to § 161 of the German Stock Corporation Act on Compliance with the German Corporate Governance Code, as Amended June 2, 2005, 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 June 2, 2005, 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 the 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)
   Management and Supervisory Board intend to propose to the Annual General Meeting a resolution pursuant to § 286 Paragraph 5 HGB (German Commercial Code), according to which the individualized particulars on management remuneration pursuant to § 285 Sentence 1 No. 9 lit. a) Sentence 5 to 9 HGB (German Commercial Code) may be omitted in the notes to the annual financial statements for the time being.
5. Formation of an audit committee (Item 5.3.2)
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)

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 17, 2005



For the Management Board
Dr. Bernd Schlobohm

For the Supervisory Board
John C. Baker

Report of the Supervisory Board

In 2005, the Supervisory Board advised the Management Board of QSC, monitored its management of the Company and performed the duties mandated by legal requirements and the Articles of Association. In its meeting on March 29, 2006, the Supervisory Board approved the Consolidated Financial Statements under IFRS for the 2005 fiscal year.

Report of the Supervisory Board for fiscal 2005 regarding the Company and the Corporate Group //
QSC AG continued its strong and profitable growth in 2005. As the Supervisory Board of QSC AG, we advised the Management Board, monitored its management of the Company and performed the duties mandated by legal requirements and the Articles of Association. The Supervisory Board was directly involved in all decisions or measures of fundamental importance, in particular those relating to the Company's assets, finances or earnings. The Supervisory Board approved all measures for which its consent is required by law, the Articles of Association or the Rules of Procedure of the Management Board.

Every month the Management Board submitted unaudited financial statements for the preceding month, including corresponding actual/target comparisons. Every quarter we received corresponding quarterly financial results. Variances from plans and targets were explained in detail. Further inquiries and requests by the Supervisory Board for additional information were always quickly and comprehensively answered. Furthermore, the Management Board informed us in detail in monthly written reports about the course of business and the Company's economic situation, in particular the structure of revenues, new orders, receivables (including age analysis) and the methods and results of its risk identification and monitoring, as well as all transactions of significance with respect to the profitability and liquidity of the Company. It is the opinion of the Supervisory Board that the Company's internal monitoring and risk early warning systems are becoming increasingly more effective. 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. The Management and Supervisory Boards carefully monitored the functionality and performance of the new billing system in actual practice, as well as the development of the market with regard to the planned network rollouts of our competitors.

Detailed monthly reports assure information flow

Supervisory Board adopts revised five-year-plan

One main focus of the work of the Supervisory Board during the past fiscal year was the Company's strategic development, its concentration on the market segments of IP-VPN/Managed Services, Direct Access Business and Wholesale DSL, as well as the corresponding adoption of a revised five-year-plan. The Supervisory Board constantly monitored the development of sales activities, in particular important projects like our partnership with debitel. We also concentrated on the planning and implementation of individual strategic projects like the acquisition and subsequent operative integration of celox Telekommunikationsdienste GmbH, as well as preparation of the capital increase from authorized capital in December 2005. Among other things, during the course of the celox acquisition the Supervisory Board was provided with a summary of the due diligence results, and in preparing the capital increase considered alternative financing proposals from various banks.

Aside from the four regular meetings, the members of the Supervisory Board conducted one extraordinary meeting and five telephone conferences during the year covered by this report. All members attended more than 75 Percent of the Supervisory Board meetings during their term of office in the year 2005. Where necessary, we additionally adopted resolutions in writing on individual issues.

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. In particular, questions relating to variable compensation and targets for the members of the Management Board were dealt with by this committee.

The Supervisory Board also regularly deals with corporate governance issues. For example, a review of the rules of procedure for the Management Board was among the issues deliberated at the Supervisory Board Meetings in 2005. Following the requirements contained in the German Corporate Governance Code, the Supervisory Board also reviewed the efficiency of its own activities. In the meeting on November 17, 2005, the Supervisory Board satisfied itself that during the preceding year QSC AG was in compliance with the recommendations of the Corporate Governance Code pursuant to the Statement of Compliance adopted the preceding year and dealt with the revised version of the Code dated June 2, 2005. As a result, the Management and Supervisory Boards jointly renewed the Statement of Compliance pursuant to § 161 of the German Stock Corporation Act (AktG) and made this statement permanently available to the shareholders on the Company's website.

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, 2005, as well as the Consolidated Financial Statements, which were presented for the first time in accordance with International Financial Reporting Standards (IFRS) for the year ended December 31, 2005. The Supervisory Board also reviewed the Management Report for the Company and the consolidated group. In its meeting on March 29, 2006, the Supervisory Board discussed all of the above-indicated documents as well as the auditor's report – including the impact of the new accounting rules, the fitness of utilizing latitude in accounting and valuation for purpose as well as potential risks resulting from future developments – with the Management Board and the independent auditor commissioned by the Supervisory Board, Ernst & Young AG Wirtschaftsprüfungsgesellschaft, of Eschborn/Frankfurt am Main. The major focuses of the audit included an analysis of the processes involved in drawing up the annual financial statements and in payroll accounting, the value of the Company's receivables, controls in the revenue recognition process, in purchasing operations and in accounts payable, as well as completeness and accuracy of provisions.

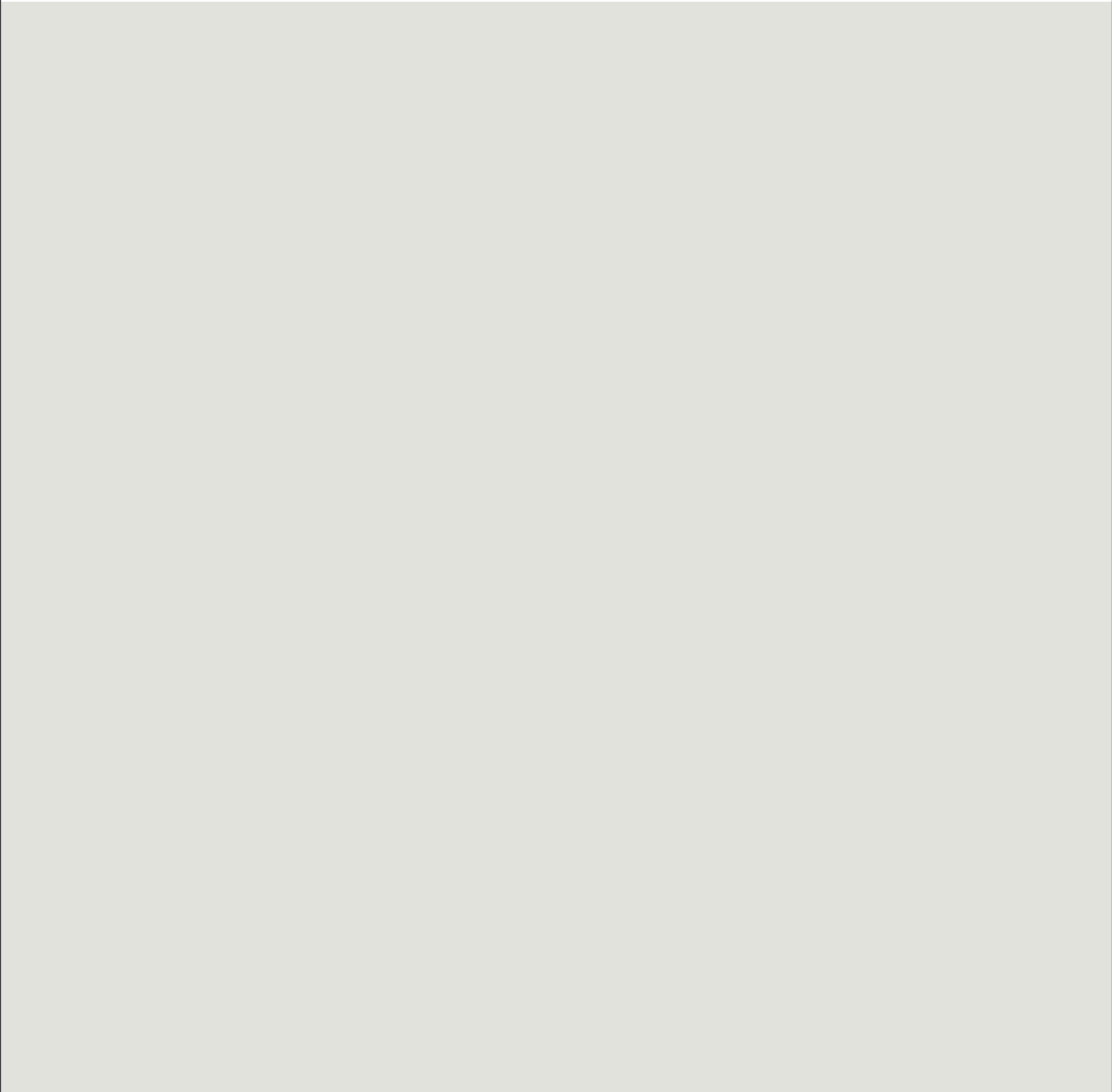
The independent auditor issued an unqualified opinion on the Company's Annual Financial Statements presented in accordance with HGB accounting principles, as well as on the Consolidated Financial Statements presented in accordance with IFRS, for the year 2005. Having conducted its own examination, the Supervisory Board has no objections to the Annual Financial Statements of QSC AG for the 2005 fiscal year presented in accordance with HGB accounting principles, the Consolidated Financial Statements presented in accordance with IFRS or the Management Report for QSC AG and the Management Report for the consolidated group, and concurs with the findings of the independent auditor. The Supervisory Board approves both the Consolidated Financial Statements presented in accordance with IFRS as well as the Annual Financial Statements presented in accordance with HGB accounting principles, with the latter thereby being formally adopted.

Supervisory Board approves the Consolidated Financial Statements

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, including the celox employees, for their tremendous personal commitment. Their efforts and their will to perform create the foundation for further increasing the value of our Company.

Cologne, March 29, 2006
On behalf of the Supervisory Board

John C. Baker
Chairman of the Supervisory Board



Next Generation Connections

Innovative Solutions

IP-VPN

The growth engine for large accounts

Virtual Private Networks (VPNs) create an enterprise's own, secure intranet on the basis of the worldwide Internet by transporting private data separately from the public Internet. As a general rule, VPNs use the Internet Protocol (IP) throughout for this transportation. This makes the enterprise's internal network accessible from any Internet access point, while simultaneously affording smooth integration of voice communication through Voice over IP. This rigorous and consequent utilization of the Internet as a platform for secure enterprise networks eliminates the need for dedicated leased line-based private enterprise networks, results in considerable cost savings and makes IP-VPN what is currently the Next Generation Connection of choice for enterprises.

QSC recognized this trend early on, and for years has been enjoying extremely strong growth in networking large accounts. In doing so, QSC offers corporate groups that maintain numerous branch locations, such as Tchibo and Commerzbank, as well as small and medium enterprises, far more than just a network in a network – QSC develops and operates custom-tailored communication solutions on a one-stop shopping basis. The spectrum of these managed services ranges from operating IP-VPNs and integrating Voice over IP into these networks to providing and maintaining the corresponding telephone systems and providing server services right through to individual security solutions, so-called managed security services.

These kinds of managed services can be implemented especially well on the basis of a provider's own infrastructure. Because this is the only way that QSC can assure its customers consistently high quality and maximum security at every workplace. In upgrading its infrastructure into a Next Generation Network, QSC created the prerequisites in 2005 for sustained strong growth in the IP-VPN business.

ADSL2+

Accelerator for the wholesale business

Data come from the Internet connection, voice comes over telephone lines, television over cable, satellite or antenna: ADSL2+ technology overcomes this established trichotomy. With transfer speeds of up to 25 megabits per second, it enables smooth reception of even multi-channel high-definition television (HDTV) in perfect quality over a conventional telephone line, in addition to fast data transfer and telephony. The introduction of ADSL2+ paves the way for "Triple Play", the ability to offer one-stop shopping for Internet, telephony and TV over one and the same line.

Providers with mass-market experience but without their own infrastructure are currently positioning themselves in the prospective Triple Play market – and with its DSL network in more than 110 cities, QSC numbers among their technology partners of choice. While QSC focuses on the demand-driven expansion, upgrade and operation of its infrastructure in these partnerships, seasoned wholesale partners like debitel and HanseNet are responsible for marketing ADSL2+ products to residential customers. Together with QSC, these partners are creating the foundation for Next Generation Connections in the living room: Telephone, Internet and crystal-clear TV images over one and the same DSL line.

VirtuOS

The office extension for business customers

"To reach customer service, please press 1. For queries to our Purchasing Department, please press 2..." – in the past, a great deal of time and money had to be invested up front in purchasing and adapting hardware and software in order to implement a professional presence to the outside world by means of an interactive voice response system. However, small and medium enterprises, in particular, tended to shy away from this kind of expense, often letting calls go unanswered or letting callers wait on hold.

The Virtual Office Suite – VirtuOS – from QSC that was introduced in late 2005 now offers a Web-based solution for small and medium enterprises, and shows what Next Generation Connections are all about: They are user-friendly, utilize the Internet and save money – in fact, it was possible to communicate the VirtuOS way for as little as five euros a month when this suite was launched in late 2005. With a few mouse-clicks and entries, VirtuOS can be configured via a Web-based customer portal. This assures that all telephone extensions in a department will ring until a specialist answers, for example, or that important customers will still be able to reach their account managers after hours, either via their mobile handsets or at home.

VirtuOS is just one example of the next generation of business customer products from QSC. They are all based upon the Next Generation Network, and unite the advantages of the Internet and IP technology with the high level of quality and service offered by QSC's own infrastructure.

VoIP

The innovative connection for everyone

Making phone calls over data lines. No other technology symbolizes the seminal change in telecommunications as well as Voice over IP, or VoIP for short. VoIP utilizes the Internet Protocol for packet-switched transmission of telephone calls – turning words into bits and bytes, sending them over a broadband connection until they are transformed back into words before reaching the person at the other end of the telephone. Only recently thought of as a technology only for computer freaks, IP telephony succeeded in making its breakthrough on the mass-market last year; today, millions of people in Germany are already VoIP-ing.

QSC recognized this paradigm shift early on, developing the corresponding solutions with its IPfonie product family. IPfonie affords enterprises, in particular, either an immediate switch to this new technology or a gentle migration, one extension at a time if desired. In the medium-term, though, the majority of enterprises are likely to move to the new technology – for one simple reason: Low monthly subscription and call rates, lower operating and maintenance costs, simple expansion options, as well as entirely new NGN services are generating cost savings of 30 to 50 percent.

The Company is outstandingly well equipped for the VoIP age: Its Next Generation Network is Voice over IP-capable throughout, which means that with QSC, it is already possible to utilize Voice over IP technology today – anywhere and from any broadband connection.

Group Management Report for Fiscal Year 2005

Network expansion fuels growth dynamic

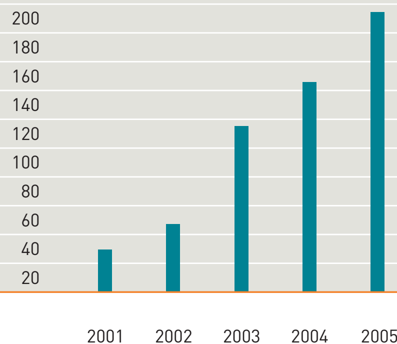
QSC sustained its strong and profitable growth in 2005, with revenues rising by 33 percent year-on-year to € 194.4 million while EBITDA rose by 81 percent to € 5.8 million. At the same time, through the targeted expansion and upgrade of its network, the Company laid the foundation for sustainable strong growth in the years to come.

Strong dynamic in business with large accounts

Growth in all segments // QSC grew its revenues by 33 percent during the past fiscal year to € 194.4 million, as opposed to € 145.9 million the year before. All four segments contributed to this strong development. Once again, business with large accounts proved to offer particularly high growth, with revenues in this segment increasing by 55 percent to € 51.4 million, as opposed to € 33.2 million one year earlier. The Wholesale/Resellers business grew even faster – revenues in this segment were up by 66 percent to € 30.4 million, as opposed to € 18.3 million the year before.

Switch to IFRS // In compliance with the requirements of the German Accounting Law Reform Act of 2004, QSC is presenting its consolidated financial statements under IFRS for the first time for the 2005 fiscal year. In this Annual Report, the Company is presenting all material changes stemming from the change in Accounting and Reporting standard.

Revenues (in € million)

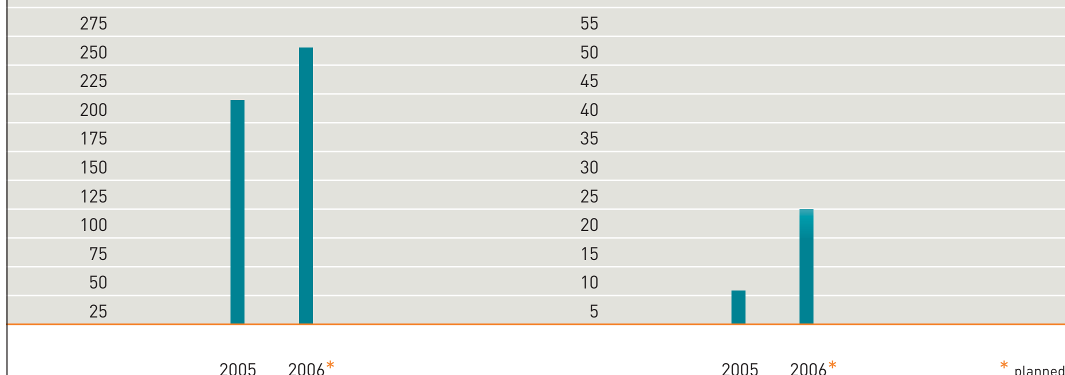


Profitability up sharply // With revenue growth of 33 percent, QSC increased its gross profit excluding depreciation and non-cash share-based payments – in spite of the demand-driven network expansion – by 55 percent to € 50.7 million, as opposed to € 32.8 million the year before, thus underscoring the scalability of its business model. The Company's EBITDA rose by 81 percent to € 5.8 million, as opposed to € 3.2 million in 2004.

Demand-driven network expansion // Through the targeted upgrade and expansion of its own infrastructure, QSC built the foundation in 2005 for sustaining its strong and profitable growth in the years to come. During the first half of the year, the Company upgraded its network into a Voice over IP-capable Next Generation Network, and, in coordination with wholesale partners, launched the upgrade of the network with ADSL2+ technology. The acquisition of Bonn-based DSL provider celox Telekommunikationsdienste GmbH (celox) in May 2005, along with the connection of new locations, expanded the Company's DSL network by some 40 cities to a total of more than 110 cities at year-end 2005 – this corresponds to an increase by more than 200 additional central offices to over 1,000 central offices as of today. QSC will continue the demand-driven network expansion and upgrade of its network during the current fiscal year. Overall, the Company is planning capital expenditures between € 20 and 25 million in 2006.

Network expansion opens up additional growth opportunities // QSC will stay on its growth course in 2006. The Company anticipates significant revenue growth to over € 240 million, as well as a significant rise in EBITDA to € 15 to 20 million. QSC also expects to cross the net income break-even threshold by year-end.

QSC anticipates EBITDA of between € 15 and 20 million



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Strong dynamics characterize QSC's markets

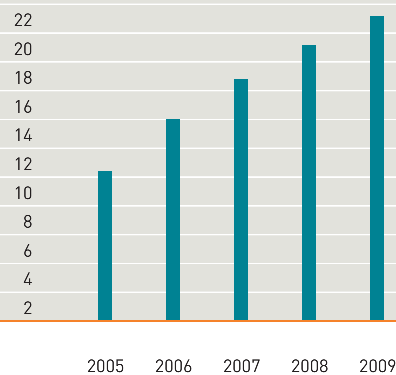
With its own nationwide infrastructure, QSC is outstandingly well positioned in the German DSL market, and in particular in the IP-VPN and Managed Services market for enterprise customers.

Number of DSL connections to double by 2009

Growth engine DSL // The economic environment remained difficult in Germany in 2005: Gross domestic product rose only by 0.9 percent, while the information and communication technology market (ITC) posted growth of 2.4 percent. The continuing migration of business processes to the Internet and the resulting growing demand for bandwidth on the part of enterprises, as well as the rising popularity of the Internet as an entertainment and communication medium for residential customers, produced a sustained strong growth in the market for DSL products and solutions. Consequently, the number of DSL connections in Germany rose by 3.6 million in 2005 to a total of 10.4 million; and at least 3 million additional connections are being forecast for 2006, as well. According to IDC and Deloitte & Touche, by 2009, the number of DSL connections will double to some 20 million lines.

Residential households account for more than 80 percent of these connections. QSC is benefiting from this market's strong demand in connection with its Wholesale/Resellers business. More and more providers with mass-market experience but without an infrastructure of their own – e.g. Internet and wireless providers, carriers, media enterprises and retailers – thus want to be able to offer DSL connections to residential customers and view QSC as a preferred network partner. These companies are thus positioning themselves for the emerging Triple Play market, i.e. the ability

Broadband Connections in Germany (in millions)



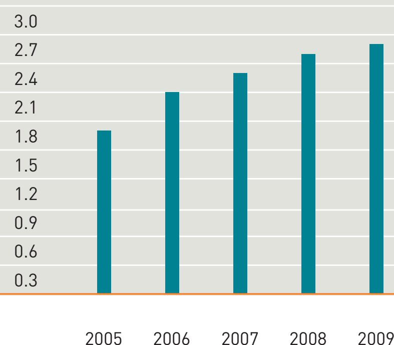
Source: IDC and Deloitte & Touche

to offer Internet, telephony and TV from a single source. As a prerequisite for DSL-based Triple Play offerings, it is necessary to upgrade existing networks with ADSL2+ technology, which affords transfer speeds of up to 25 megabits per second and thus enables reception of high-definition television (HDTV). QSC had already begun the demand-driven upgrade of its network with ADSL2+ technology during the past fiscal year.

ADSL2+ technology enables Triple Play offerings

DSL dominates broadband market // DSL technology is the dominant access technology for both residential as well as enterprise customers – more than 95 percent of all broadband Internet connections in Germany are DSL connections. There are three reasons why there will be only little opportunity for alternative technologies in the coming years: Firstly, DSL utilizes the existing telecommunication infrastructure over the last mile, and can thus reach virtually every household and every enterprise in Germany without the need for any major additional capital expenditures. Secondly, the ability to utilize conventional copper loops results in an attractive cost-benefit ratio and enables the corresponding pricing. And thirdly, DSL technology meets the market's requirements with respect to speed, security and quality that there is virtually no demand for alternative solutions. QSC therefore tends to view existing alternative access technologies, such as cable TV or wireless connections, more as being complementary technologies for DSL than as competition. QSC connects cable television customers to its DSL networks, for example, so that they can also utilize a coaxial cable for Internet and telecommunication services, in addition to television programming – this enables the cable network operators to avoid the high capital expenditures that would be required to build a backchannel in the cable TV network. And cable TV continues to be of no importance as an access technology for enterprise customers, since it is not possible to provide guaranteed bandwidths. In contrast to DSL, cable TV transfer speeds for each customer are a factor of network utilization level – the larger the number of users who are working online, the slower the data transfer speed for each user.

Broadband Connections at Enterprises in Germany (in millions)



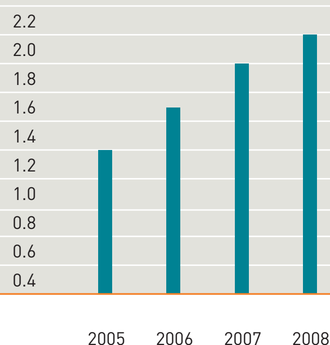
Source: IDC "Telekommunikationsmarkt in Deutschland", February 2006

Wireless broadband networks like WLAN, on the other hand, are taking on increasing significance among enterprise customers, too. QSC is benefiting from this trend, as the individual local area networks are typically connected via DSL lines. A similar development could be expected if WiMAX technology, with its greater ranges, makes the breakthrough in Germany.

Number of DSL connections at enterprises up 27 percent in 2005

Enterprises opt for DSL // The number of DSL connections in Germany that are used for business purposes again surged in 2005 – growing by 27 percent to 1.7 million according to information from market research institute IDC. During the same period, total nationwide revenues with enterprise customers rose by 31 percent to € 1.1 billion. By 2008, IDC is forecasting 2.6 million DSL connections at enterprises in Germany and revenues of some € 1.6 billion.
QSC is facing a limited number of competitors in this high-growth market. Both the high capital expenditures that are needed in order to build a DSL infrastructure as well as key account management structures and existing customer relations with long-term contracts serve as an effective barrier to market entry for new competitors. In contrast to the residential customer market, pure resellers play a negligible role in the business with enterprise customers – only a company's control over its own network infrastructure enables it to offer custom-tailored communication services with the kind of quality and security levels that this customer group expects. Both this factor as well as the higher quality and security requirements of enterprise customers largely mitigate the emergence of an intense price competition in the enterprise market.

Managed Services Market in Germany (in € billion)



Source: IDC "Telekommunikationsmarkt in Deutschland", November 2005

IP-VPN a growth market // In its business with enterprise customers, QSC focused right from the start on building and operating IP-based virtual private networks (IP-VPNs), as well as on managed services that build upon the connectivity service. This market continues to number among the fastest-growing sectors in the ITC industry. According to IDC, revenues in Germany rose by some 20 percent to € 1.2 billion in 2005, alone, with a growth forecast of € 2.0 billion by 2008. Managed services, i.e. services over and above the pure operation of virtual private networks, such as telephone system services, hosting services and Voice over IP solutions and customized managed security solutions, are proving to be growth engines. Thanks to its early focus on this market and its numerous reference projects, QSC is today being invited to participate in most requests for proposals for IP-VPNs and managed services, and is winning more and more customers as a result of its technology competence, customer focus and flexibility.

Voice over IP reaches the mass market // A further factor is increasing the attractiveness of IP-VPNs among enterprises: The option of integrating voice communication into data networks by means of Voice over IP, thus enabling voice and data communication to be handled over an integrated infrastructure i.e. broadband connection. According to a current study by Berlecon Research, one out of every three enterprises in Germany will already be using Voice over IP for telephony this year. IDC anticipates that, beginning in 2007, the Voice over IP market will be generating higher revenues with enterprises than with residential customers; in 2005, residential customers still accounted for around two thirds of total revenues. At the same time, integrated products consisting of DSL access/connection and Voice over IP are taking over pure software-based Voice over IP offerings. With its completely Voice over IP-capable Next Generation Network, DSL provider QSC is optimally positioned for this market of the future.

Businesses increasingly combine DSL connection with Voice over IP

Growth in all segments

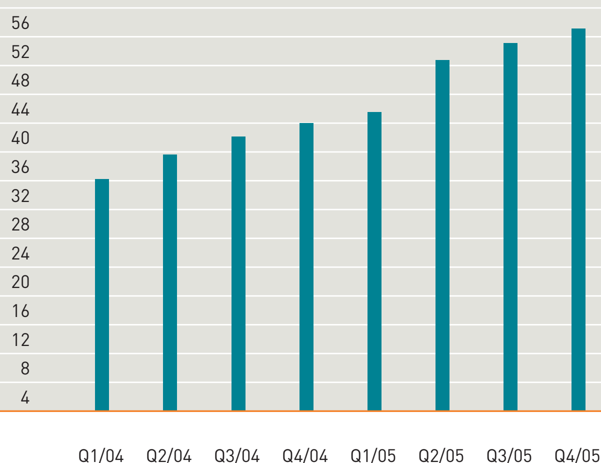
During fiscal 2005, QSC grew its revenues by 33 percent to € 194.4 million. In particular, business in both the segments Large Accounts as well as Wholesale/Resellers contributed to this strong growth.

QSC exceeds revenue forecast, which had been raised twice during 2005

Strong sequential growth // In 2005, QSC's revenues advanced by 33 percent to € 194.4 million, as opposed to € 145.9 million in the year 2004. The Company thus surpassed its most recent revenue forecast of at least € 193 million for the year, a prediction that it had already raised twice during the course of the year given the positive development of the underlying business throughout the year. This growth dynamic is also evident from a sequential comparison of quarterly revenues, which rose from € 41.5 million in the first quarter of 2005 to € 53.1 million in the fourth quarter.

Strong demand from large accounts // With revenue growth of 55 percent to € 51.4 million, as opposed to € 33.2 million the year before, the solutions business with large accounts again posted above-average growth rates. QSC succeeded in winning a significant number of new customers in this segment, including Commerzbank, Gothaer Versicherungen and Total. As for Commerzbank, the bank issued requests for proposals in connection with its "New Network Architecture" and subsequently, QSC won the contract to network 280 branch offices into the bank's corporate data network. Under this five-year contract, QSC is now equipping some 30 percent of Commerzbank's network infrastructure with IP-VPN technology. Thanks to the high level of quality and service it offers, QSC was additionally able to again rigorously and sustainably expand its share of the tele-communication budgets at many large accounts in 2005.

Revenues (in € million)

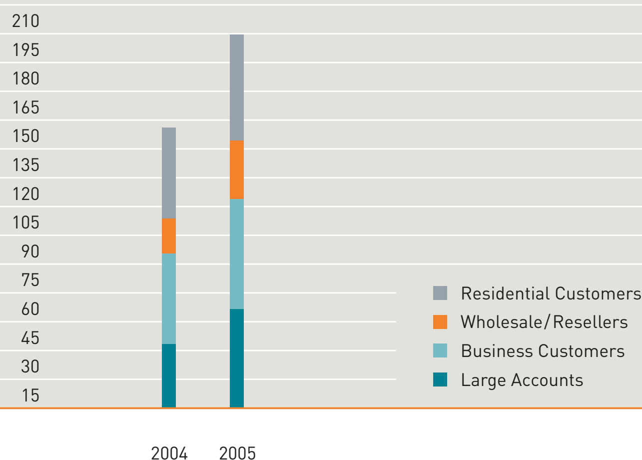


Among both new and existing customers, QSC is benefiting from the growing requirement on the part of customers to also outsource the operation of IP-VPNs as well as related but more far-reaching services to external service providers – as a result, the managed services business made good progress in 2005. Especially in the fourth quarter, QSC additionally posted non-recurring income, resulting for example from the planning and project design of nationwide network solutions as well as from business with major network partners.

Managed services business progressing in 2005

Business customers are increasingly utilizing Voice over IP // Revenues generated by the sale of standardized voice and data products in the Business Customers segment increased by 22 percent in 2005 to € 57.5 million, as opposed to € 47.2 million the year before. Contributing to this rise, first and foremost, was the successful launch of the IPfonie Voice over IP product family, along with sustained high demand for broadband connections to the QSC network, so-called direct access products. In the direct access business, sales of both the QSC-Direct voice product as well as the Q-DSLmax data product rose. The latter is additionally benefiting from the growing demand for Voice over IP, as an increasing number of enterprises are handling all of their communication needs over one and the same QSC broadband line, and in doing so are combining the Q-DSLmax data product with IPfonie.

Revenue Mix (in € million)



Strong growth in reseller business // With growth of 66 percent from € 18.3 million in 2004 to € 30.4 million, the Wholesale/Resellers segment was the segment that posted the highest growth in 2005. The difference between wholesale and reseller products lies in the greater independence and flexibility of the Company's wholesale partners in designing their product offerings.
QSC also benefited in this segment from the expansion of its infrastructure. This enabled the Company to strengthen its position as a partner to large carriers who do not have any or no sufficient local access infrastructure coverage of their own, such as BT Global Services, Colt and Equant. In globally networking major corporates, these carriers often utilize QSC's DSL lines in Germany. Equipping and connecting all 474 points of interconnection with Deutsche Telekom's network additionally produced a profitable rise in the Company's business with resellers of voice services.
The newly introduced ADSL2+ technology has been launched successfully in the German market by QSC. In May 2005, QSC signed an initial contract with debitel, one of Germany's largest wireless providers. While QSC is focusing on the technology rollout and operation of the ADSL2+ network under this partnership, debitel is responsible for marketing the products. After a successful start in the pilot region of Düsseldorf, in November 2005 the two companies broadened their collaboration to include four additional cities. Moreover, new growth opportunities are also being offered by QSC's partnership with HanseNet Telekommunikation GmbH that was entered into in January 2006; in April 2006, this new partner will begin marketing ADSL2+ connections from QSC under its "Alice" brand name.

debitel and HanseNet marketing QSC's ADSL2+ connections

High level of residential customer business // In 2005, revenues with residential customers advanced by 17 percent to € 55.1 million, as opposed to € 47.2 million the year before. Just as in the case of business customers, QSC benefited from the growing demand for Voice over IP in the residential environment – customers are increasingly using their QSC broadband data connections for telephony. In doing so, more and more customers are combining the IPfonie product with the Q-DSL home premium data product, thus eliminating the need for their legacy telephone connection. Yet QSC also continued to maintain an opportunistic presence in traditional voice telephony in 2005 – the Company is using offerings to optimize its network utilization factor through call-by-call services, especially during the evening and nighttime hours, when traffic from business customers is low.

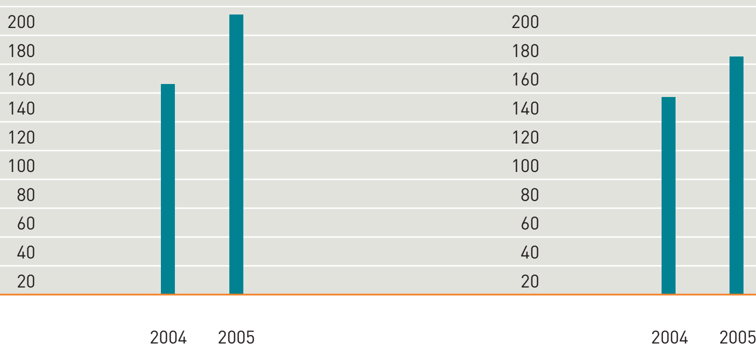
Gross margin improves significantly

With revenues advancing by € 48.5 million, network expenses rose by only € 28.5 million in 2005, despite the Company's strong growth and targeted network expansion. This enabled QSC to leverage its gross profit increase.

QSC's infrastructure-based business model is scalable // Network expenses, which are recorded under cost of revenues, totaled € 165.5 million for the past fiscal year, up € 28.5 million from the previous year's level – during the same period, revenues grew by € 48.5 million. At the same time, QSC upgraded its network into a Next Generation Network (NGN), equipped all 474 points of voice interconnection with Deutsche Telekom's network and expanded its DSL network by more than 200 central offices in some 40 further cities. The fact that the operation of a larger network coupled with rising revenues led to only a relatively lower rise in the costs of operating this network demonstrates the scalability of QSC's infrastructure-based business model – rising revenues do not correlate to correspondingly high expenses, thus enabling leveraged profitability growth.

QSC's business model enables leveraged profitability growth

There were three reasons why the development of network expenses during the past fiscal year was especially remarkable: Firstly, the strong dynamic in business with large accounts again necessitated corresponding up-front expenses for their connection to the QSC network. Secondly, the integration of the celox network into QSC's infrastructure involved non-recurring costs. And thirdly, the demand-driven expansion and upgrade of the Company's infrastructure into a NGN and the expansion of the DSL network in some 40 further cities necessitated corresponding expenses for start-up integration and operation of the existing network, over and above the capital expenditures.



* including depreciation and non-cash share-based payments

The fact that network expenses nevertheless rose at a relatively low rate in the year 2005 is attributable to their composition. Approximately 40 percent of QSC's network expenses are fixed, i.e. they do not grow in line with revenues as long as the network capacity is not fully used. The Company estimates that six years after the capital investment phase began less than 30 percent of the network's capacity is used on average. In 2005, QSC spent € 34.3 million, alone, in building, operating and maintaining its nationwide network. The € 4.4 million increase over the year before was primarily attributable to expansion and upgrade of the network, as well as to initial first time consolidation of the network expenses of celox.
The first-time consolidation of celox also resulted in a € 1.5 million rise in personnel expenses to € 9.8 million. At year-end 2005, 156 employees were operating QSC's entire network.
Another fixed element of network expenses consists of depreciation. In contrast to the interim financial statements, QSC includes depreciation in the line item for the respective expense class in its annual financial statements. During the past fiscal year, depreciation in connection with network expenses declined to € 21.9 million, as opposed to € 23.9 million the year before, even though for the first time this item, too, included depreciation on the celox network. The main reason for the decline is that six years after the beginning of the capital investment phase, more and more fixed assets have now been fully depreciated. New equipment has become significantly cheaper compared to the initial rollout in 2000, which also results in lower depreciation.
Around 60 percent of network expenses, on the other hand, were attributable to the variable goods sold, which rose by 33 percent to € 99.6 million in 2005 in connection with strongly rising revenues. Cost of good sold includes all customer-related expenses. In particular, this includes the ongoing fees that competitors have to pay to Deutsche Telekom for utilization of the unbundled last mile. The German Federal Network Agency reduced this latter fee moderately from € 11.80 monthly to € 10.65 effective April 1, 2005. With regard to dedicated customer leased lines, as well as the so-called interconnection fees that are incurred when QSC's subscribers utilize third-party networks, these expenses also rise with QSC's growing success in the market.

Gross margin more than tripled // In spite of the accelerated expansion and upgrade of its network, as well as up-front expenses in connection with business with large accounts and the celox integration, QSC succeeded in increasing its gross profit after depreciation and non-cash share-based payments in 2005 much faster than the related cost: The Company earned a gross profit of € 28.9 million, as opposed to € 8.9 million the year before. Exclusive of depreciation and non-cash share-based payments, the Company generated a gross profit of € 50.7 million, as opposed to € 32.8 million in 2004. This represents a rise in gross margin from 22 percent the year before to 26 percent in 2005.

Gross margin up 26 percent in 2005

QSC strengthens sales and marketing

QSC specifically expanded its sales and marketing team, thus laying the foundation for strong growth beyond 2005. And QSC also increased the headcount and office space required to accommodate the planned growth.

Clear focus on enterprise customers // During the past fiscal year, sales and marketing expenses rose by 41 percent to € 30.5 million, as opposed to € 21.7 million the year before. As early as the beginning of the year, QSC had already considerably expanded its sales team for large accounts in order to be able to take advantage of growth opportunities that present themselves in this market – in 2005, revenues in this segment rose by 55 percent to € 51.4 million. Overall, personnel expenses for sales and marketing increased by € 3.3 million to € 13.2 million during the past fiscal year.

In the case of business customers, the Company addresses larger SMEs directly, while also collaborating with strong marketing partners in the regions. The marketing successes of these partners led sales to an increase in commission payments to dealers and distributors in 2005. Overall, commission payments rose by € 3.0 million to € 7.8 million.

Growing success of marketing partners in the regions

In the Wholesale/Resellers business, just as well as in the segment of Large Accounts, QSC relies exclusively on addressing potential customers directly through its key account sales force. Through the acquisition of Bonn-based DSL provider celox, QSC strengthened its sales penetration in this segment considerably.

In its residential customers business, QSC focuses on selling over the Internet, and thus requires only an extremely lean organization: A team of merely five people is responsible for sales and marketing of Q-DSL home as well as the Company's voice offerings for residential customers.

This predominantly direct sales approach requires only relatively low advertising expenses, totaling € 1.6 million in 2005 as opposed to € 1.0 million the year before. QSC invests the bulk of these funds in networking events, one-on-one marketing, online advertising and public relations.

Lean administration in spite of celox acquisition // Administrative expenses rose to € 16.9 million in 2005, as opposed to € 13.3 million the year before. On the one hand, this was attributable to the acquisition of celox in May 2005; during the rest of the year, this DSL service provider continued to operate an independent organization from its Bonn location. On the other hand, at the beginning of 2005 QSC had decided to forego lease income as a result of the termination of the subleases at its Headquarters in Cologne in order to provide the office space needed for further growth. With general and administrative expenses accounting for merely 8 percent of total operating expenses, QSC thus continues to have a lean organization.

IP-VPN business necessitates high level of innovation

Stable level of research and development expenses // QSC has traditionally recorded relatively low research and development expenses (R&D expenses) in its financial statements: In 2005, R&D expenses amounted to € 0.4 million, as opposed to € 0.5 million the year before. These expenses essentially include the costs of developing new products, such as IPfonie and VirtuOS, as well as costs in connection with upgrading the QSC network into a Next Generation Network.
On the other hand, research and development expenses do not include the numerous process innovations that are constantly being developed, in particular in connection with building new IP-VPNs for large accounts. The seamless integration of managed services into these networks also necessitates a high level of innovation and adaptation. As such, the level of research and development expenses does not adequately reflect the time level of current process and service innovation that characterizes QSC, but are reported mainly under network expenses.

Significantly improved operating result in 2005 // In its quarterly reports, QSC conforms to the customary international practice of presenting depreciation, amortization and non-cash share-based payments as a separate line item in its income statements; in these consolidated financial statements, however, depreciation, amortization and non-cash share-based payments are contained in the line items for network, selling and marketing, general and administrative as well as research and development expenses. The following abbreviated income statement for the full 2005 fiscal year presents depreciation and amortization separately, thus affording a fast overview of the development of the Company's operating business.

	2005 in T €	2004 in T €
Net revenues	**194,387**	**145,874**
Cost of revenues *	(143,670)	(113,070)
Gross Profit	**50,717**	**32,804**
Selling and marketing expenses *	(29,397)	(20,906)
General and administrative expenses *	(15,544)	(12,361)
Research and development expenses *	(324)	(308)
Other operating income	586	4,506
Other operating expenses	(261)	(585)
EBITDA	**5,777**	**3,150**
Depreciation and non-cash share-based payments	24,443	25,804
Operating loss (EBIT)	**(18,666)**	**(22,654)**

* excluding depreciation and non-cash share-based payments

EBITDA rises sharply

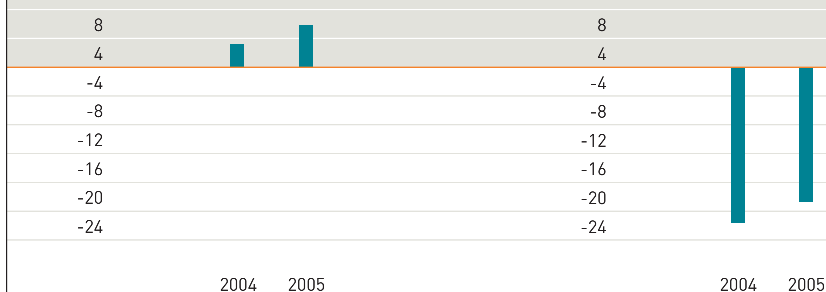
During the past fiscal year, QSC improved its EBITDA by 81 percent to € 5.8 million. As a result, the Company continued to improve its operating and net results.

Steadily rising profitability // In spite of the accelerated expansion and upgrade of its network, up-front expenses in connection with business with large accounts, as well as its expanded sales and marketing activities, QSC succeeded in significantly increasing its EBITDA in 2005. The latter improved by 81 percent to € 5.8 million, as opposed to € 3.2 million the year before. 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 share-based payments, as well as depreciation on property, plant and equipment and amortization of goodwill.

Depreciation expense declining six years after the capital investment phase began

Depreciation expense declined moderately by 5 percent to € 24.4 million in 2005, as opposed to € 25.8 million in the year 2004. On the one hand, six years after the capital investment phase began, more and more fixed assets have now been fully depreciated and prices for new equipment have been decreasing. On the other hand, the initial consolidation of celox as well as the demand-driven expansion and upgrade of the network resulted in an increase in the Company's assets and thus in higher depreciation expense. A non-recurring higher level of depreciation expense also resulted from the switch of the Company's accounting to IFRS; under these new rules, QSC capitalizes customer-related non-recurring installation costs of the type incurred in connection with new large accounts, in particular, and depreciates them over a period of 24 months.

The positive development of the Company's operating business as well as a moderate decline in depreciation expense again lead to an improvement in its operating loss (EBIT), its net loss, as well as its net loss per share. The Company's EBIT improved to € -18.7 million from € -22.7 million the year before. The net loss amounted to € -18.2 million in 2005, as opposed to € -21.6 million the year before. The net loss per share improved to € -0.17, as opposed to € -0.21 for the previous fiscal year.



High-margin business with large accounts

During the past fiscal year, QSC improved its profitability in all four segments. In particular, the Company sharply increased its EBITDA in the Large Accounts segment by 71 percent to € 33.0 million.

Segment EBITDA of 64 percent with large accounts // During the past fiscal year, QSC succeeded in growing its EBITDA, which is a key performance indicator in assessing the profitability of the segments, in all four segments – overall, EBITDA rose by 32 percent to € 87.0 million during the past fiscal year, as opposed to € 66.1 million the year before. Segment EBITDA is calculated as net revenues less all costs directly attributable to the segment in question. QSC records all non-attributable costs, in particular personnel expenses as well as the fixed costs of building, operating and maintaining the network, to a reconciliation account for the consolidated group EBITDA.

EBITDA in the Large Accounts segment rises to € 33 million

In 2005, QSC recorded the highest absolute EBITDA growth in the segment of Large Accounts: EBITDA here rose by 71 percent to € 33.0 million, representing an EBITDA margin of 64 percent, as opposed to 58 percent the year before. In this segment, in particular, QSC is benefiting from the demand-driven expansion of its infrastructure, as this enables an increasingly higher percentage of the Company's IP-VPN solutions to be covered through its own network.

The demand-driven expansion and upgrade of the network also led to increases in the respective EBITDA in the other segments. In the segment with the highest revenues, Business Customers, QSC generated an EBITDA of € 23.5 million in 2005, thus increasing this performance indicator by 20 percent within the space of twelve months. The corresponding margin was 41 percent.

In the Wholesale/Resellers segment, the Company achieved an EBITDA margin of 42 percent in 2005, representing a segment EBITDA of € 12.9 million, as opposed to € 10.6 million the year before. Following the connection of all 474 points of interconnection with Deutsche Telekom's network, the Company saw stronger demand on the part of resellers for relatively low-margin voice services, thus enabling it to better utilize its infrastructure.

In addition to data products like Q-DSL home, QSC also specifically offers voice telephony products to residential customers in order to better utilize its infrastructure during the evening and nighttime hours. As in all segments, however, the Company pays strict attention to generating a positive EBITDA and therefore contribution margin. Overall, QSC grew its segment EBITDA with residential customers by 5 percent to € 17.5 million, representing a corresponding margin of 32 percent.

	Large Accounts	Business Customers	Wholesale/ Resellers	Residential Customers
Revenues (in € million)	51.4	57.5	30.4	55.1
Segment EBITDA (in € million)	33.0	23.5	12.9	17.5
Segment EBITDA margin	64%	41%	42%	32%

Demand-driven network expansion

QSC specifically expanded and upgraded its infrastructure during the past fiscal year, thus laying the foundation for sustainably strong growth beyond 2005. Capital expenditures rose by € 4.2 million to € 20.1 million.

Next Generation Network enables Voice over IP nationwide // By the end of the first half of 2005, QSC had upgraded its network nationwide into a Next Generation Network (NGN) with the support of Chinese-based technology supplier Huawei Technologies. This NGN allows smooth utilization of Voice over IP technology also in conventional telecommunication systems, making QSC one of the leading providers in this promising market.

celox acquisition plays crucial role in expanding network coverage // In May 2005, QSC acquired Bonn-based DSL provider celox for € 13.8 million. Since celox possessed over 170 central offices in more than 30 medium-sized cities, QSC was able to significantly expand its network coverage in one step. At the same time, with its focus on enterprise customers and resellers, celox ideally complemented QSC's business operations and customer base.
By year-end 2005, QSC had already largely consolidated the two companies' networks, thus enabling considerable cost synergies to be achieved. During the course of the current fiscal year, QSC will be merging celox Telekommunikationsdienste GmbH with QSC AG, and will be able to achieve further synergies by moving the celox administration to QSC Headquarters in Cologne.

QSC to achieve further synergies from celox acquisition in 2006

Demand-driven expansion of locations // Over and above the celox acquisition, QSC additionally connected further cities to its DSL network on a demand-driven basis. QSC's network expansion approach adheres to the "network follows customer" approach, under which the Company connects only those locations in which existing customer relationships and/or documented customer inquiries make swift amortization and pay back of the required capital expenditures highly likely. A proprietary database that contains several hundreds of thousands of customer and location data enables ongoing access to the information required for these decisions.

Major importance of ADSL2+ // In connection with the demand-driven expansion of its network, QSC attaches particular significance to upgrading this network with ADSL2+ technology. In May 2005, an initial ADSL2+ pilot project was launched in Düsseldorf together with debitel. In connection with ADSL2+, QSC generally collaborates with partners who possess extensive mass-marketing experience, and upgrades the network on a demand-driven basis as coordinated with these partners.
Over and above the accelerated expansion and upgrade of its network, QSC invests in equipping new customers with the required hardware. Especially in connection with large accounts, significant capital expenditures are incurred at the outset of the contracts, which typically involve multi-year terms; these capital expenditures are then amortized over the term of the contracts. Given the strong growth in business with large accounts, these contract-related up-front capital expenditures rose sharply during the past fiscal year.

Capital market rewards quality growth

During the past fiscal year, QSC increased its shareholders' equity moderately in order to acquire celox and to fund the accelerated upgrade and expansion of its network. In both cases the new shares were successfully placed with institutional investors.

QSC uses stock to pay for celox acquisition // QSC financed the € 13.8 million purchase price for the acquisition of Bonn-based celox entirely through a capital increase against contributions in kind, without having to utilize liquid assets. This increased the number of QSC shares issued by 3,583,776; through the utilization of authorized capital, the Company's share capital rose correspondingly by nearly € 3.6 million. Around 80 percent of the Company's shares, representing 2,854,610 shares, were successfully placed with institutional investors on the day of the transaction. As agreed, the remaining 20 percent were held by the former celox shareholders until December 31, 2005, before also being successfully placed in early 2006 with only little impact on trading prices.

Successful capital increase against contributions in cash // In order to finance the accelerated expansion and upgrade of its network and to optimally take advantage of growth opportunities with large wholesale partners and resellers, QSC increased its share capital by an additional 5,490,463 new shares of no-par stock from authorized capital in December 2005 against contributions in cash at a price of € 3.67 per share; this increased QSC's share capital by nearly € 5.5 million. QSC raised proceeds of € 20.15 million from this successful placement.

QSC raises proceeds of € 20.15 million

Overall, the number of shares in circulation rose by 9.5 million during the past fiscal year to a total of 115.0 million. In addition to the two capital increases, the conversion of convertible bonds into 456,110 new shares of QSC stock under employee stock option programs also contributed to this rise.

Sound financial position and net worth

In 2005, QSC utilized its authorized capital as well as favorable finance lease terms to fund its strong growth and the demand-driven expansion and upgrade of its network. As a result, the Company's liquid assets rose significantly over the course of the fiscal year.

Annual results characterized by strong growth // Its balance sheet and cash flow statements also reflect QSC's strong growth and targeted network expansion over the past year. In addition, the switch to IFRS resulted in both reclassification of individual line items as well as reclassification of portions of the consolidated financial statements.

The value of the Company's long-term assets rose by € 12.2 million in 2005 to € 57.7 million. One major factor in this development was the Company's higher goodwill, which increased by € 6.9 million to € 9.3 million in connection with the initial consolidation of the celox acquisition and the corresponding capitalization of its goodwill. The value of property, plant and equipment, on the other hand, declined moderately by € 1.7 million to € 33.4 million, as more and more assets have now been fully depreciated six years after the beginning of the initial capital investment phase.

Among the Company's short-term assets, total recorded trade accounts receivables rose in line with revenues by 34 percent to € 34.2 million. Moreover, the successful capital increase in December 2005 produced a significant rise in liquid assets, i.e. available-for-sale financial assets, as well as cash and short-term deposits. On December 31, 2005, QSC thus possessed liquid assets totaling € 52.1 million; this amount no longer includes the escrow amount of € 4.3 million for payment of the final tranche of the purchase price for Ventelo, which was acquired in late 2002.

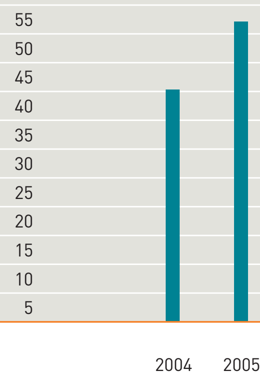
Liquid assets increase to € 52.1 million

Equity ratio of 56.2 percent underscores sound financing

Capital increases strengthen shareholders' equity // Both the capital increase in December 2005, which generated € 20.15 million in proceeds, as well as the celox acquisition led to an increase in shareholders' equity. The conversion of 456,110 convertible bonds into QSC shares within the framework of employee stock option programs additionally contributed to this increase. Overall, the Company's subscribed capital increased by € 9.5 million in 2005 to € 115.0 million, with the capital surplus rising by € 24.8 million to € 499.6 million. An equity ratio of 56.2 percent underscores QSC's sound financing structure.

Under long-term liabilities, QSC recorded only convertible bonds within the framework of its employee stock option programs, along with accrued pensions in the amount of € 0.8 million. Moreover, QSC utilized capital lease financings in order to fund its capital expenditures in 2005, a highly favorable option by comparison with other forms of financing. This increased long-term liabilities from finance lease obligations by € 6.6 million to € 10.7 million, while short-term liabilities from finance lease obligations reached € 8.4 million, as opposed to € 2.6 million the year before. QSC views the steadily growing supply of lease financing proposals at alternative terms as a proof of the quality of its business model and financial stability.

Liquid Assets (in € million)



A strong team

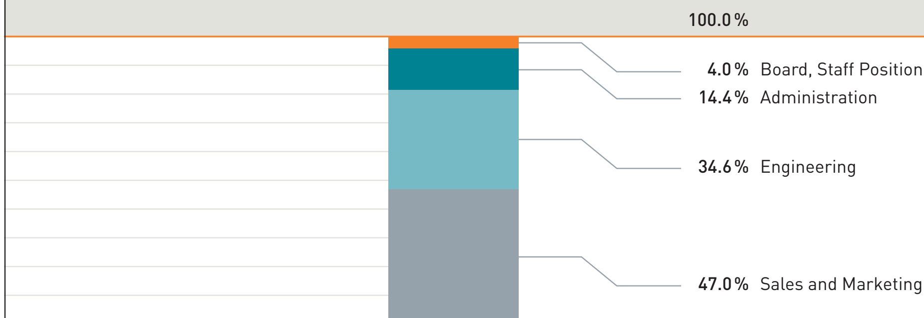
QSC's strong revenue growth and targeted network expansion are, first and foremost, the achievement of the Company's qualified, committed and enthusiastic workforce, which grew by 83 employees in 2005 to a total of 450.

Smooth celox integration // Both the targeted expansion of the sales and marketing team and the celox acquisition in particular resulted in an increase of QSC's workforce by 83 people in 2005 to a total of 450 people as of December 31, 2005. Consequently, personnel expense rose by 27 percent to € 30.4 million, as opposed to € 23.9 million the year before.
The celox acquisition strengthened the QSC team by 58 qualified employees. Their experience with enterprise customers and resellers complements the know-how of QSC's people very well; right from the very beginning, employees from both companies cooperated closely and constructively together. The two celox managing directors, Dr. Stefan Sattler and Dr. Thomas Zundl, played a major role in this swift and successful integration. Since the integration has been largely concluded in early 2006, the two former owners of celox will be moving on to new entrepreneurial challenges and leaving the Company effective March 31, 2006. However, they will still be supporting QSC on a consulting basis.

Employees from both QSC and celox collaborate in a spirit of trust

QSC strengthens sales and marketing organization // As announced in early 2005, QSC strengthened its sales and marketing organization for large accounts, in particular, during the past fiscal year. Overall, the number of employees working in sales and sales-related areas rose by 60 people in 2005 to a total of 211. This represents 47 percent of the total workforce. 35 percent of our people work in technology-related areas, where they assure smooth operation of the Company's nationwide infrastructure. Only 14 percent work in general and administrative functions – the decline from the previous year, when those functions had employed 16 percent of the workforce, demonstrates QSC's lean and efficient structure.

Workforce Structure (in percent)



Strong growth necessitates qualified people // Throughout all areas of the Company, QSC focuses on personal responsibility and collaboration with both internal and external counterparts in a spirit of fair partnership. This high level of independent and self responsible work is based on corresponding qualifications: Around one-third of QSC's people possess postgraduate degrees, while the other employees typically have gone through qualified professional or vocational training. Every QSC employee has the opportunity of broadening and updating his or her knowledge through internal and external training measures.

Training assures a flow of new talent // As of December 31, 2005, QSC employed 21 trainees: Administrative clerks, software specialists and IT system technicians. The Company views the employment and education of trainees both as a contribution toward securing future talent for itself as well as a way of offering school graduates vocational prospects in a forward-looking industry. Consequently, QSC has been increasing the number of trainees from year to year – at year-end 2004, only 11 trainees had been employed – and integrating them early on into the working world.

Performance-based compensation translates into loyal employees // Over and above vocational training, QSC views the ability to win and keep qualified people as being a major key to its future success. In doing so, the Company makes particular use of its employee stock ownership programs – which make all employees co-owners of QSC. Given the discussions about the mandatory public pension system, the option of dedicating a portion of an employee's gross pay to a direct combined private pension life insurance is becoming increasingly attractive.

Starting from a certain salary and performance level onward, QSC uses a performance-based compensation system for professionals and executives. This system provides for a corresponding variable income element that is based on the quarterly attainment of both personal and corporate goals. Beginning in 2006, customer satisfaction with QSC's products and services will also be a determining part of the variable compensation system.

Good work environment motivates employees

Yet monetary incentives alone cannot either motivate or assure the loyalty of highly qualified employees over the long term. It is QSC's conviction that what is even more important is a work environment that affords the individual employee a high degree of responsibility, assures appropriate latitude and offers professional and personal appreciation. Flat hierarchies, a corporate culture that embraces fairness, openness and respect as well as the continuing personal everyday influence of the Company's founder and CEO assure fast decision-making processes in an entrepreneurial environment. This makes QSC a preferred employer in the telecommunications industry – as is underscored by more than 3,000 applications that were received in the year 2005.

Risk Report

The ability to identify, analyze and control potential opportunities and risks early on strengthens QSC's dynamic pace of development. In 2005, the Company continued to refine its extensive risk management system.

Risk management creates value // The German Corporate Control and Transparency Act (KonTraG) of May 1, 1998, mandates that the Management Board of QSC AG maintain an appropriate system for monitoring existing risks. Over and above these statutory requirements, however, QSC AG views efficient and forward-looking risk management as an important, value-creating activity that serves as a foundation for decision-making throughout all areas of the Company. QSC 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. Risks are also posed by the telecommunications market being that it is characterized by regulatory decisions.

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. This way of 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.

Decentralized identification of risks as early as possible

QSC has institutionalized a system of risk management with the objective of identifying, analyzing, assessing, controlling and monitoring developments at as early a point in time as possible. This serves as the basis for the corporate risk manager to report to the Management Board quarterly on the structure, measurements and findings of the risk management system. In addition, the risk manager is also responsible for monitoring all existing risk reduction and avoidance measures. The performance indicator-based weekly reporting system at Finance does a very good of serving as an early warning system to supplement the risk management rules, measures and procedures. Detailed on the following pages are those risks that the Company today views as being of major significance for its business operations.

The development of the economy // Among the overall economic risks, QSC monitors the economic environment, in particular, because a weak economy has a direct impact on the willingness of business and project customers to invest in modern telecommunication infrastructure.
In past years, however, QSC has already been able to prove that it can still grow strongly and profitably in a weak overall market; in this connection, the Company benefits from the strong dynamics of its core markets.

The competition // The German market for DSL products and services is increasingly seeing market consolidation, as well as a concentration on only a few strong providers. QSC analyzes the changing competitive situation very precisely, yet views itself as being very well aligned in its core markets as an infrastructure provider. Moreover, the strong dynamics of the DSL and IP-VPN markets additionally make the possibility of a shakeout in the Large Accounts and Business Customers segments unlikely. In its Wholesale/Resellers business, QSC is benefiting from its focus on DSL technology and its business with enterprise customers since, in contrast to its competitors, no conflicts of interest result with respect to competing technologies or from addressing residential consumers.

Entry into wholesale business // Entering the wholesale market for ADSL2+ goes hand in hand with the risk of dependency upon marketing partners, because entering the wholesale market necessitates that QSC invest in new technology whose amortization is dependent upon the market success of the Company's respective partner. For this reason, QSC is upgrading to ADSL2+ on a demand-driven basis, with secure demand on the part of existing and potential wholesale partners affording swift amortization. Moreover, in its wholesale business the Company collaborates exclusively with partners who have an affinity for the mass market and possess extensive experience in consumer business.
The success of these partners in the mass market could result in an extremely high volume of new orders at QSC, necessitating both high-quality yet efficient handling of a large volume of customer data. As early as during the ramp-up to the launch of ADSL2+ in the pilot region of Düsseldorf, QSC had aligned itself appropriately, and therefore views rapidly rising demand on the part of its wholesale partners, and thus ADSL2+ users, as an enormous opportunity and thus as a growth engine for the Company.

ADSL2+ business
a growth engine for QSC

The competitive behavior of Deutsche Telekom (DTAG) // As an infrastructure provider, QSC is significantly less dependent upon former monopolist DTAG's reselling prices than the majority of the Company's competitors. Nevertheless, an aggressive pricing policy on the part of DTAG in connection with both the required preliminaries and end-customer market, in particular, could have a negative impact on the margin situation in the German telecommunications market. In this connection, QSC continues to count on viable supervision by both the German Federal Network Agency as well as the European Commission. The Company, itself, is playing an active role in this connection within the framework of intensive talks and by commenting on various methods.

QSC is also attentively monitoring DTAG's attempt to convince the German Federal Network Agency to increase interconnection fees. An increase of this type would delay amortization of the capital investment made by QSC in 2005 to tie in all 474 points of interconnection with DTAG's network and would increase QSC's procurement prices. In this case, too, QSC is counting on viable regulation that will foster both infrastructure expansion as well as competition in the voice market, while simultaneously safeguarding capital expenditures that have already been made. This risk is additionally reduced by the growing importance of Voice over IP in QSC's total revenues, along with the rising percentage of direct access customers.

QSC counts on viable regulation

One risk also consists of DTAG's planned VDSL network in 50 German cities. To offset its investments in this network, DTAG is asking the German Federal Network Agency to waive regulatory requirements and the resulting commitment to provide other market players with access to this network. If this endeavor were to succeed, DTAG, along with any selected competitors, would be given a virtual monopoly on broadband connection lines with speeds of more than 25 Mbit/s.

However, DTAG's VDSL offering primarily addresses residential customers, and thus essentially only indirectly impacts QSC's business operations in wholesale business. In this segment, QSC is addressing its ADSL2+ offering exclusively to wholesale partners with mass-market experience, who will market it to residential customers – QSC is expanding and upgrading its network solely on the basis of demand from these partners, thus significantly reducing the investment risk. The Company additionally anticipates that the European Commission will continue to not tolerate monopolies within the single European market and that access to the VDSL network, too, will therefore be available to competitors.

The regulatory environment // The decisions of the German Federal Network Agency can have either an indirect or direct influence on QSC's competitive position and market. This also applies with respect to the issue of bitstream access and thus to the ability of potential competitors to offer DSL products that feature specific quality parameters under their own names and for their own accounts with significantly lower investments in connection infrastructure. This could increase competitive pressure on QSC. While, at the request of the German Federal Network Agency, DTAG did submit an initial proposal in 2004, there continues to be a lack of a cost-based bitstream product to serve as a reasonable basis for costing on the part of competitors.

The German Federal Network Agency is likely to require a product of this kind during the course of 2006, which would again lend significance to the issue of bitstream access. However, the Company anticipates that in making its decision the German Federal Network Agency will give appropriate consideration to the high capital expenditures on the part of infrastructure providers like QSC. In addition, bitstream access also opens up opportunities for QSC, as the Company would then be able to efficiently complement its own network with bitstream access and thus offer nationwide data networks for business customers under its own name.

QSC's own infrastructure // A potential outage of QSC's own network is an operational risk that is constantly monitored. In addition to a potential loss of image, the risk of indemnification claims or high penalties, in particular, following extended, widespread outages could result in corresponding expenses. Consequently, maintaining and constantly improving security and reliability throughout the network enjoys the utmost priority within the framework of QSC's business operations. The Company continues to rely on redundancies within its network in this connection. Air conditioning equipment prevents potential heat-related hardware defects, while firmly defined access authorizations to all QSC colocation rooms prevent misuse or sabotage. Through these and any number of further measures, the Company sees itself as being very well equipped for smooth DSL operations.

Alternative technologies // Cable (TV) network operators are increasingly offering Internet access and voice telephony, as well. QSC is attentively monitoring these Triple Play offerings on the part of cable network operators, which address the residential customer market exclusively, as they pose potential competition to ADSL2+ technology. However, given the nationwide availability of DSL and the capital expenditures that would be required in the cable network, QSC views Internet access via cable TV as being a niche product. According to calculations by market research institute IDC, as well, DSL technology will continue to dominate the German broadband market in the years to come with a market share of more than 90 percent.

DSL will continue to dominate the broadband market

Penalties in project business // Within the framework of projects for large accounts, QSC enters into contracts that assure certain service levels, some of which involve potential penalties. This results in the risk of high recourse entitlements and expenses stemming from interruptions. This risk is minimized through intensive service level management, contractual agreements and consistent monitoring of the entire network on a three-shift basis. QSC has thus far been able to assure the satisfaction of nearly all service level agreements.

The way QSC is financed // At year-end 2005, QSC possessed liquid assets totaling € 52.1 million. However, aggressive price competition or a sustained recession could result in the need for additional funding. The successful capital increase against contributions in cash in the amount of € 20.15 million in December 2005 to finance accelerated network expansion and upgrade demonstrates the willingness on the part of the capital market to engage in this kind of financing. The Company's continued strong growth, as well as its steadily improving generation of internal cash flow, will lead to a further reduction in this risk.

Bad debts // An overall economic environment that continues to be tense results in financial risks, in particular from customer insolvency. However, QSC utilizes strict management of its accounts receivables and rigorous monitoring of customer payment patterns to minimize its credit risks and bad debts. In addition, the Company's only limited dependence upon individual customers also contributes toward minimizing this risk, as QSC does not generate more than 10 percent of its total revenues with one single end-customer.

The integration of future acquisitions // QSC is open to the possibility of also continuing to grow in the future through specific acquisitions. The risk in this connection is that an acquisition might not live up to expectations. The effect of this could include difficulties in consolidating networks, products, employees and operational processes. However, QSC's successful migration to become an integrated telecommunication provider through the acquisition of Ventelo in the year 2002, as well as the integration of Bonn-based DSL provider celox during the past fiscal year, document QSC's ability to successfully manage these kinds of integration processes.

QSC successfully managed the integration of both Ventelo and celox

Given the potential scope of damage and the likelihood that this and further potential risks could occur, it is currently reasonable to say that no risks are identifiable that could lead to a sustained, material impairment of the financial or earnings positions of QSC AG. Organizationally, all prerequisites have been put in place to enable the Company to be informed early on in the event of potential risk situations and take appropriate action.
Nevertheless, as a result of this or other risks and incorrect assumptions, QSC's actual future results could vary materially from the expectations of the Company and its management. All statements contained in these consolidated financial statements that are not historical facts are forward-looking statements. They are based upon current expectations and projections of future events, and are therefore subject to regular review within the context of the risk management system.

Subsequent events // No events or transactions have occurred since December 31, 2005, or are pending that would have a material effect on the consolidated financial statements for the period then ended.

Continued strong growth

QSC plans to continue its strong and profitable growth in 2006, in particular with enterprise customers, wholesale partners and resellers. At the same time, the Company will be accelerating the demand-driven expansion and upgrade of its network.

Strong underlying growth in QSC's markets // In spite of an economy that is only slowly recovering, QSC's core markets will again develop strongly in 2006 and beyond: According to forecasts by market researcher IDC, the number of DSL connections in Germany is expected to double to some 20 million by 2009, with the country's IP-VPN market crossing the two billion Euro a year revenue threshold by that time.

Accelerated network expansion // In order to take optimal advantage of its growth opportunities in these markets, QSC will be pushing the demand-driven expansion and upgrade of its nationwide infrastructure in 2006 – the Company had already connected 13 further cities to its DSL network during the first quarter of 2006 and now covers over 120 cities. Prompted by existing and potential customer demand, QSC will connect further cities to its DSL network during the course of the year, and together with its wholesale partners will accelerate the upgrade of this network with ADSL2+ technology. Since the Company additionally anticipates continued strong growth in business with large accounts and a corresponding rise in contract-related up-front expenses, QSC is planning on total capital expenditures of between € 20 and 25 million in 2006.

QSC planning capital expenditures of between € 20 and 25 million

The capital increase in December 2005, along with expected short amortization periods for the upgrade of each ADSL2+ location, will secure the solid financing of this capital investment program. Given the positive development of its operating business as well as the existing liquidity, QSC views itself overall as being sufficiently financed for the anticipated growth.

Large accounts - The growth engine // The accelerated expansion and upgrade of its network will improve QSC's competitive position in all segments. The Company expects high-margin solutions business with large accounts to record strong growth again in 2006. QSC is being invited to participate in most requests for proposals for networking major enterprises and providing the corresponding managed services, and is winning a growing percentage of these contracts as a result of its technological competence, flexibility and quality of service. At the same time, its owner- driven management structure and medium size has made QSC a partner of choice for medium-sized enterprises seeking to network their locations for the first time with an IP-VPN.

QSC's acceptance as a telecommunication service provider in general is also growing among small and medium businesses; in both data and voice business, more and more small and medium enterprises are utilizing direct connections to the QSC network. The growth of the Business Customer segment is additionally being fuelled by strong demand for both IPfonie products as well as further innovations like the VirtuOS virtual office application.

One particular focus area in 2006 will be to expand the Wholesale/Resellers business. Following contracts with ADSL2+ marketing partners debitel and HanseNet, QSC anticipates further collaboration with wholesale partners during the current fiscal year. And the Company's growing network coverage and nationwide VoIP offering are simultaneously leading to stronger demand from major carriers who do not possess sufficient infrastructure of their own in Germany.

Voice over IP gaining greater significance across all segments

Voice over IP technology is gaining greater significance across all segments. With the upgrade of its network to a Next Generation Network in 2005 and the launch of its IPfonie product family, QSC numbers among the pioneers in this high-growth market, and is likely to benefit from this among enterprise customers, residential customers and resellers.

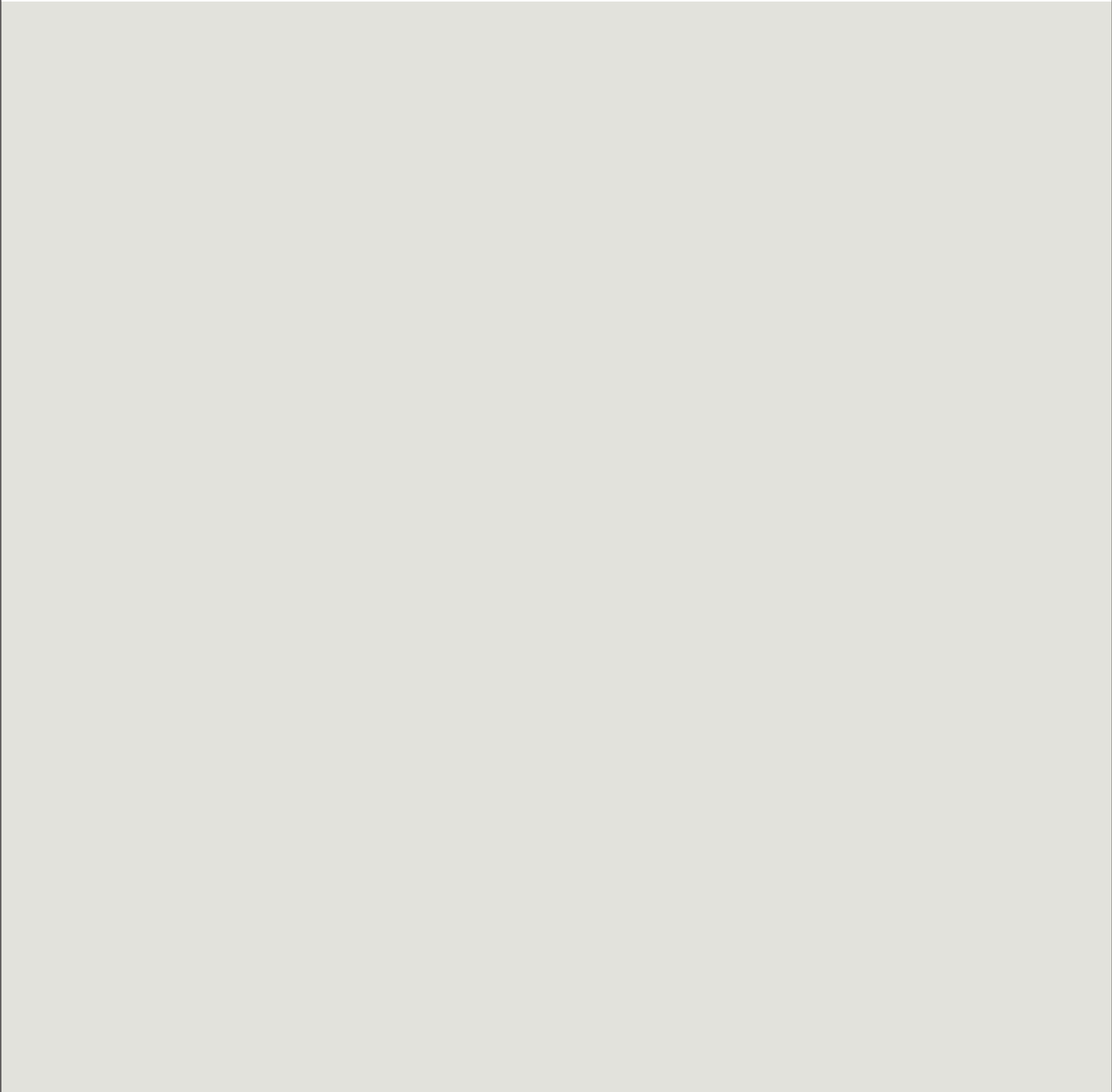
Crossing the net income breakeven threshold // The accelerated expansion and upgrade of its network, its attractive market positioning in its core businesses as well as its pioneering role in Voice over IP will make a major contribution to QSC's sustained strong and profitable growth in the years to come. For 2006, the Company anticipates revenue growth to over € 240 million, as well as an EBITDA of between € 15 and 20 million. QSC also expects to cross the net income breakeven threshold by year-end.

Cologne, March 17, 2006

Dr. Bernd Schlobohm
Chief Executive Officer

Markus Metyas

Bernd Puschendorf



Financial Report

Consolidated Financial Statements

Consolidated Statements of Income

Euro amounts in thousands (T €)

Notes	No.	2005	2004
Net revenues	6	**194,387**	**145,874**
Cost of revenues	7	(165,532)	(136,961)
Gross profit		**28,855**	**8,913**
Selling and marketing expenses	8	(30,493)	(21,725)
General and administrative expenses	9	(16,916)	(13,303)
Research and development expenses	10	(437)	(460)
Other operating income	11	586	4,506
Other operating expenses	11	(261)	(585)
Operating loss		**(18,666)**	**(22,654)**
Financial income	12	1,015	1,339
Financial expenses	12	(815)	(667)
Income from associated companies	12	280	375
Net loss before income taxes		**(18,186)**	**(21,607)**
Income taxes		-	-
Net loss		**(18,186)**	**(21,607)**
Net loss per common share (basic and diluted) in €	13	(0.17)	(0.21)

Consolidated Balance Sheets

Euro amounts in thousands (T €)

Notes	No.	Dec. 31, 2005	Dec. 31, 2004
ASSETS			
Long-term assets			
Goodwill	15	9,265	2,393
Intangible assets	16	8,804	6,518
Property, plant and equipment	17	33,371	35,100
Other long-term financial assets		293	389
Deferred taxes	41	5,969	1,124
Long-term assets		**57,702**	**45,524**
Short-term assets			
Prepayments	18	2,096	1,297
Trade accounts receivables	19	34,177	25,616
Other receivables and short-term financial assets	20	914	3,207
Available-for-sale financial assets	21	26,065	17,785
Cash and short-term deposits	21	30,313	22,536
Short-term assets		**93,565**	**70,441**
TOTAL ASSETS		151,267	115,965
SHAREHOLDERS' EQUITY AND LIABILITIES			
Shareholders' equity			
Capital stock	22	115,033	105,503
Capital surplus	23	499,643	474,750
Other reserves	24	(1,357)	16
Accumulated deficit		(528,281)	(510,095)
Shareholders' equity		**85,038**	**70,174**
Long-term liabilities			
Convertible bonds	26	60	60
Accrued pensions	27	796	585
Long-term portion of finance lease obligations	28	10,687	4,105
Deferred taxes	41	3,847	1,166
Long-term liabilities		**15,390**	**5,916**
Short-term liabilities			
Short-term portion of finance lease obligations	28	8,437	2,647
Provisions	29	930	1,101
Trade accounts payable	30	31,596	26,518
Deferred revenues	31	3,441	1,370
Other short-term liabilities	32	6,435	8,239
Short-term liabilities		**50,839**	**39,875**
TOTAL SHAREHOLDERS' EQUITY AND LIABILITIES		151,267	115,965

Consolidated Statements of Cash Flows

Euro amounts in thousands (T €)

Notes	No.	2005	2004
Cash flow from operating activities	33		
Net loss		(18,186)	(21,607)
Depreciation and amortization		24,408	25,774
Non-cash share-based payments		152	(31)
Gains from disposal of long-term assets		(156)	(93)
Gains from disposal of long-term financial assets		(280)	(375)
Changes in provisions		(764)	(503)
Changes in trade accounts receivables		(8,163)	(7,057)
Changes in trade accounts payable		4,783	(6,067)
Changes in other financial assets and liabilities		906	1,971
Cash flow from operating activities		**2,700**	**(7,988)**
Cash flow from investing activities	34		
Purchase of available-for-sale financial assets		(19,970)	(14,915)
Disposal of available-for-sale financial assets		10,129	16,618
Payments related to acquisitions		1,539	-
Purchases of intangible assets		(5,812)	(5,073)
Purchases of property, plant and equipment		(4,153)	(4,590)
Proceeds from disposal of assets		176	446
Proceeds from disposal of financial assets		280	375
Cash flow from investing activities		**(17,811)**	**(7,139)**
Cash flow from financing activities	35		
Changes in convertible bonds		-	(3)
Proceeds from issuance of common stock		20,626	697
Proceeds from finance lease		6,752	1,300
Repayments of finance lease		(4,490)	(822)
Disposal of treasury stock		-	1,527
Cash flow from financing activities		**22,888**	**2,699**
Change in cash and short-term deposits		**7,777**	**(12,428)**
Cash and short-term deposits at January 1		22,536	34,964
Cash and short-term deposits at December 31		**30,313**	**22,536**
Interest paid		765	257
Interest received		620	905

Consolidated Statements of Shareholders' Equity

Euro amounts in thousands (T €)

Notes	No.	Capital Stock T €	Capital Surplus T €	Treasury Stock T €	Other Reserves T €	Accumulated Deficit T €	Total Shareholders' Equity T €
Balance at January 1, 2004		**105,037**	**473,227**	**(266)**	**(46)**	**(488,488)**	**89,464**
Net loss						(21,607)	(21,607)
Changes in fair value of available-for-sale financial assets					177		177
Deferred taxes on available-for-sale financial assets					(71)		(71)
Changes in accrued pensions					(73)		(73)
Deferred taxes on accrued pensions					29		29
Conversion of convertible bonds		466	231				697
Disposal of treasury stock			1,262	266			1,528
Non-cash share-based payments			30				30
Balance at December 31, 2004		**105,503**	**474,750**	**-**	**16**	**(510,095)**	**70,174**
Net loss						(18,186)	(18,186)
Changes in fair value of available-for-sale financial assets	24				(1,444)		(1,444)
Deferred taxes on available-for-sale financial assets	41				71		71
Issuance of common stock by assets in kind	23	3,584	10,178				13,762
Issuance of common stock authorized by shareholders' meeting	23	5,490	14,361				19,851
Conversion of convertible bonds	39	456	319				775
Non-cash share-based payments	39		35				35
Balance at December 31, 2005		**115,033**	**499,643**	**-**	**(1,357)**	**(528,281)**	**85,038**

Consolidated Statements of Recognized Income and Expense

Euro amounts in thousands (T €)

Notes	No.	2005	2004
Directly recognized in equity	25		
Changes in accrued pensions		-	(73)
Available-for-sale financial assets			
change in fair value		(1,253)	259
realized losses		(191)	(82)
Apportionable to tax effect		71	(42)
Directly recognized in equity		**(1,373)**	**62**
Net loss		(18,186)	(21,607)
Net loss and recognized income and expense		**(19,559)**	**(21,545)**

Audit Opinion

We have audited the consolidated financial statements prepared by QSC AG, Cologne, Germany, comprising the balance sheet, the income statement, statement of changes in equity, statement of recognized income and expenses, cash flow statement and the notes to the consolidated financial statements for the fiscal year from January 1 to December 31, 2005. The preparation of the consolidated financial statements and group management report in accordance with IFRSs as adopted by the EU and the additional requirements of German commercial law pursuant to Sec. 315a (1) HGB are the responsibility of the Company's management. Our responsibility is to express an opinion on the consolidated financial statements and the group management report based on our audit.
We conducted our audit of the consolidated financial statements in accordance with Sec. 317 HGB ("Handelsgesetzbuch": German Commercial Code) and German generally accepted standards for the audit of financial statements promulgated by the Institut der Wirtschaftsprüfer (Institute of Public Auditors in Germany) (IDW). Those standards require that we plan and perform the audit such that misstatements materially affecting the presentation of the net assets, financial position and results of operations in the consolidated financial statements in accordance with the applicable financial reporting framework and in the group management report are detected with reasonable assurance. Knowledge of the business activities and the economic and legal environment of the Group and expectations as to possible misstatements are taken into account in the determination of audit procedures. The effectiveness of the accounting-related internal control system and the evidence supporting the disclosures in the consolidated financial statements and the group management report are examined primarily on a test basis within the framework of the audit. The audit includes assessing the annual financial statements of the entities to be included in consolidation, the determination of the entities to be included in consolidation, the accounting principles and consolidation standards used and significant estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements and the group management report. We believe that our audit provides a reasonable basis for our opinion.

Our audit has not led to any reservations.
In our opinion, based on the findings of our audit, the consolidated financial statements comply with IFRSs as adopted by the EU and the additional requirements of German commercial law pursuant to Sec. 315a (1) HGB and give a true and fair view of the net assets, financial position and results of operations of the Group in accordance with these requirements. The group management report is consistent with the consolidated financial statements, and as a whole provides a suitable view of the Group's position and suitably presents the opportunities and risks of future development.

Eschborn/Frankfurt am Main, Germany, March 17, 2006
Ernst & Young AG
Wirtschaftsprüfungsgesellschaft

Bösser	Janssen
Wirtschaftsprüfer	Wirtschaftsprüfer

Notes to the Consolidated Financial Statements for Fiscal Year 2005

BASIS OF PRESENTATION AND METHODS

1 Corporate information

QSC AG (QSC, the Company or the Group) is a nationwide telecommunication provider with its own DSL network that offers comprehensive broadband communication to business customers and residential customers: From leased lines in a variety of bandwidths to voice and data services to networking of enterprise locations (IP-VPN).
QSC is a stock corporation registered in the Federal Republic of Germany whose legal domicile is Mathias-Brüggen-Strasse 55, 50829 Cologne, Germany. The Company is carried on the Register of Companies of the Local Court of Cologne under Number HRB 28281. QSC has been listed on the Deutsche Börse Stock Exchange since April 19, 2000, and on the Prime Standard since the beginning of 2003 following the reorganization of the equity market. On March 22, 2004, QSC was added to the TecDAX index, which includes the 30 largest and most liquid technology issues in the Prime Standard.

2 General principles

The consolidated financial statements for the year ended December 31, 2005, have been prepared for the first time in accordance with the International Financial Reporting Standards (IFRS). The consolidated financial statements have been prepared in accordance with the IFRS and International Accounting Standards (IAS) issued by the International Accounting Standards Board (IASB) as well as their interpretation by the International Financial Reporting Interpretations Committee (IFRIC – originated from the former Standing Interpretations Committee, SIC) that had to be applied in the EU and at the time of reporting. In order to comply with article 4 of the regulation (EG) number 1606/2002 of the European Parliament and the council dated July 19, 2002, the Company prepared the consolidated financial statements as required in the European Union (EU) and in accordance with the additional rules of § 315a paragraph 1 of the German Commercial Code (HGB).
The consolidated financial statements comprise the financial statements of QSC and its subsidiaries as of December 31, each year. The consolidated financial statements are presented in euros and all amounts, except when otherwise indicated, are rounded to the nearest thousand (T €).

3 Adoption of IFRS 1

The reconciliation from Generally Accepted Accounting Principles in the United States of America (US GAAP) to IFRS is in accordance with IFRS 1. For the year ended December 31, 2004, the consolidated financial statements have been presented the last time in accordance with US GAAP. Consequently, the transition from US GAAP to IFRS occurs retroactive at January 1, 2004. The required reconciliations and the impact of the transition from US GAAP to IFRS on consolidated shareholders' equity and the consolidated income statement are presented in note 36.

4 Consolidation

Companies included in the consolidated financial statements // The consolidated financial statements include the accounts of QSC, its subsidiaries and the associated companies. All inter-company transactions have been eliminated in the consolidation. Subsidiaries are fully consolidated from the date of acquisition, being the date on which the Group obtains control. The equity method of accounting is used for companies and other investments in which QSC has significant influence. The subsidiaries and associated companies that are included in the consolidated financial statements are listed in note 37.

Principles of consolidation // Subsidiaries are consolidated by eliminating the acquisition costs against the fair value of the assets and liabilities acquired. Any access of acquisition costs over the fair value is recognized as goodwill.
Net revenues and other income, expenses as well as receivables and liabilities between the included companies have been eliminated.

5 Basis of preparation

Net 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.

Foreign currency translation // 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 expenses.

Plant and equipment // Plant and equipment is stated at cost, excluding the cost of day-to-day servicing, less accumulated depreciation and accumulated impairment in value. The cost of day-to-day servicing includes the cost of replacing part of such plant and equipment when that cost is incurred if the recognition criteria are met. Depreciation is calculated using the straight-line method over the useful lives of the assets.

Plant and equipment that consists of different components which can be separated clearly and that have different useful lives, are split up for the purpose of depreciation. For the calculation of depreciation the different useful lives are used. The carrying values of plant and equipment are reviewed for impairment when events or changes in circumstances indicate that the carrying value may not be recoverable. An item of property, plant and equipment is derecognized upon disposal or when no future economic benefits are expected from its use or disposal. Any gain or loss arising on derecognition of the asset (calculated as the difference between net disposal proceeds and the carrying amount of the asset) is included in the income statement in the year the asset is derecognized. The asset's residual values, useful lives and methods are reviewed, and adjusted if appropriate, at each financial year end.
When each major inspection is performed, its cost is recognized in the carrying amount of the plant and equipment as a replacement if the recognition criteria are satisfied.

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

	Useful life in years
Asset	
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

Borrowing costs // Borrowing costs are recognized as an expense when incurred.

Goodwill // Goodwill acquired in a business merger is initially measured at cost being the excess of the cost of the acquisition over the net fair values of the identifiable assets, liabilities and contingent liabilities. Following initial recognition, goodwill is measured at cost less any accumulated impairment losses. Goodwill is reviewed for impairment, annually or more frequently if events or changes in circumstances indicate the carrying value may be impaired. For the purpose of impairment testing, goodwill acquired in a business merger is, from the acquisition date, allocated to each of the Group's cash-generating units that are expected to benefit from the synergies of the merger, irrespective of whether other assets or liabilities are assigned to those units. The units to which the goodwill is allocated correspond to the primary segments of the Company. Impairment is determined by assessing the recoverable amount of the cash-generating unit to which the goodwill relates. The recoverable amount is the fair value of the discounted cash flows out of the segments. Where the recoverable amount of the cash-generating unit is less than the carrying amount, an impairment loss is recognized.

Other intangible assets // Intangible assets, acquired separately, are measured on initial recognition at cost. The cost of intangible assets acquired in a business merger is the fair value at the date of the acquisition. Internally generated intangible assets will be capitalized when the capitalization criteria in accordance with IAS 38 are met and related expenses are recognized in the income statement in the year in which the expenditure is incurred.
The useful lives of intangible assets are assessed to be either finite or indefinite.
Intangible assets with finite lives are amortized over the useful economic life and assessed for impairment whenever there is an indication that the intangible assets may be impaired. The amortization period and the amortization method for an intangible asset with a finite useful life is reviewed at least at each financial year-end. Intangible assets with indefinite useful lives are tested for impairment annually. Such intangibles are not amortized. The useful life of an intangible asset with an indefinite life is reviewed annually to determine whether indefinite life assessment continues to be supportable. If not, the change in the useful life assessment from indefinite to finite is made on a prospective basis.
Intangible assets consist of goodwill, software, licences and similar rights as well as provisioning costs for customer connections. 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. The non-recurring costs of provisioning customer connections are capitalized and amortized over the average contract term of 24 months.

Trade accounts receivables // Trade accounts receivables are stated at their nominal value net of allowances for bad debts. QSC determines its allowances for bad debts 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. Recognized allowances for bad debts are finally written-off when the trade accounts receivables are finally classified as uncollectible.

Financial assets // Financial assets are classified as either receivables, held-for-trading, held-to-maturity investments or available-for-sale financial assets. When financial assets are recognized initially, they are measured at fair value, plus, in the case of investments not at fair value through profit or loss, directly attributable transaction costs. QSC determines the classification of its financial assets after initial recognition and, where allowed and appropriate, re-evaluates this designation at each financial year-end.

Receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in active market. Such assets are carried at amortized cost using the effective interest method. Gains and losses are recognized in income when the receivables are derecognized or impaired, as well as through the amortization process.
Financial assets are classified as held-to-maturity when the Company has the positive intention and ability to hold to maturity. Held-to-maturity securities are accounted at amortized cost and gains and losses are recognized in income over the remaining life.
Financial assets are classified as held-for-trading if they are acquired for the purpose of selling in the near term. Gains or losses on investments held-for-trading are recognized in income.
Financial assets that are not classified in any of the three proceeding categories are available-for-sale financial assets. After initial recognition available-for-sale financial assets are measured at fair value with gains or losses being recognized as a separate component of equity until the investment is derecognized or until the investment is determined to be impaired at which time the cumulative gain or loss previously reported in equity is included in the income statement.

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.

Provisions // Provisions are recognized when the Company has a present obligation (legal or constructive), the incurrence is probable and a reliable estimate can be made of the amount of the obligation. Where the Company expects some or all of a provision to be reimbursed, the reimbursement is recognized as a separate asset but only when the reimbursement is virtually certain. The expense relating to any provision is presented in the income statement net of any reimbursement. If the effect of the time value of money is material, provisions are discounted using a current pre-tax rate that reflects, where appropriate, the risks specific to the liability. Where discounting is used, the increase in the provision due to the passage of time is recognized as interest expense.

Trade accounts payable // Trade accounts payable are recognized at the amount to be paid. A liability is derecognized when the obligation under the liability is discharged or cancelled or expired.

Accrued pensions// QSC operates two defined-benefit pension plans at December 31, 2005 and 2004, respectively. The cost of providing benefits under the defined-benefit plans is determined separately for each plan using the projected unit credit actuarial valuation method. Actuarial gains and losses are recognized directly in equity in other reserves. The assumptions that were made by the Company to evaluate the actuarial obligations are specified in note 27.

Share-based payments // In accordance with IFRS 2, the services rendered by employees that are remunerated in the form of share-based payments are recognized as cost. IFRS 2 is effective for reporting periods that began at or after January 1, 2005. QSC has adopted IFRS 2 since January 1, 2005, and considered all stock option programs that were granted or modified after November 7, 2002.
The stock option programs of the Company are based on convertible bonds and therefore equity-settled share-based payments. The personnel expense will be measured at the grant date based on the fair value of the equity award using a Black-Scholes option-pricing model. The share-based payments will be recognized over the expected life with an offsetting credit to capital surplus. The outstanding convertible bonds are listed in note 39.

Judgements and estimates // In the process of applying the Group's accounting policies in accordance with IFRS, the management has made judgements and estimates. Actual results may ultimately differ from these judgements and estimates mainly with regard to the following items:
- Actuarial gains and losses based on the defined-benefit pension plans are recognized directly in equity in other reserves in the year in which the gains and losses are incurred.
- Financial assets were mostly classified as available-for-sale financial assets and consequently changes in fair value are directly recognized in equity.
- In line with impairment test of goodwill, future projections are based on market analysis and management experience.
- The evaluation of provisions is based on management experience.
- The amount of allowances for bad debts is funded by the analysis of the individual customer.
- The probability to realize deferred taxes is based on future projections.
- The useful lives of property, plant and equipment and intangible assets are based on management experience

Leases // The determination of whether an arrangement is or contains a lease is based on the substance of the arrangement and requires an assessment of whether the fulfilment of the arrangement is dependent on the use of a specific asset or assets and whether the arrangement conveys a right to use the asset.
Finance leases, which transfer to the Company substantially all the risks and benefits incidental to ownership of the leased item, are capitalized at the inception of the lease at the fair value of the leased property or, if lower, at the present value of the minimum lease payments. Lease payments are apportioned between the finance charges and reduction of the lease liability so as to achieve a constant rate of interest on the remaining balance of the liability. Finance charges are charged directly against income.

Deferred taxes // Deferred income tax is provided using the liability method on temporary differences at the balance sheet date between the taxes bases of assets and liabilities and their carrying amounts for financial reporting purposes. Deferred income tax assets are recognized for all deductible temporary differences, carry-forward of unused tax credits and unused tax losses, to the extent that it is probable that taxable profit will be available against which the deductible temporary differences, and the carry-forward of unused tax credits and unused tax losses can be utilized. The carrying amount of deferred income tax assets is reviewed at each balance sheet date and reduced to the extent that it is no longer probable that sufficient taxable profit will be available to allow all or part of the deferred income tax to be utilized. Unrecognized deferred income tax assets are reassessed at each balance sheet date, and are recognized to the extent that is has become probable that future taxable profit will allow the deferred tax assets to be recovered.
Deferred income tax assets and liabilities are measured at the tax rates that are expected to apply to the year when the asset is realized or the liability is settled, based on tax rates (and tax laws) that have been enacted or substantively enacted at the balance sheet date. The basis of the recognized deferred taxes is included in note 41.

Voluntary adoption of new accounting standards // Apart from the IFRS, whose application is mandatory for fiscal year 2005, the IASB has also published other IFRS and IFRICs, which have already received EU endorsement but which will only become mandatory at a later date. Below, only those standards and interpretations which could be relevant for QSC are described. Voluntary early application of these standards is explicitly permitted or encouraged.
On December 16, 2004, the IASB published amendments to IAS 19 "Employee Benefits – Actuarial Gains and Losses, Group Plans and Disclosures". This amendment introduces the recognition of actuarial gains and losses in equity as an alternative to the existing methods. QSC is accounting for pensions obligations for the first time in its financial statements for 2005, applying the newly implemented alternative treatment of recognition of actuarial gains and losses. The comparison figures have been correspondingly adjusted. Further details are included in note 27.
On August 18, 2005, the IASB published the standard IFRS 7 "Financial Instruments: Disclosures". This standard supersedes the existing IAS 30 and adopts all provisions regarding disclosures in the notes contained in IAS 32. The disclosures of IFRS 7 shall apply to periods beginning on or after January 1, 2007; earlier application is encouraged. In the opinion of QSC the new provisions will have no impact on the Company.
The adoption of IFRIC 4 and IFRIC 5, which have already received EU endorsement but which will only become mandatory at a later date, will not have a material impact on the results of operation or the financial position of QSC.

INCOME STATEMENT DISCLOSURES

6 Net revenues

Revenues are generated with wholesale partners and resellers and with direct customers. The resellers offer QSC's products and services to consumers under their own name and for their own account; in doing so, they serve as the interface to the consumer, thus also assuming the risk of bad debts. The structure of the Company's revenues by segment is shown in note 38.

7 Cost of revenues

	2005 in T €	2004 in T €
Cost of revenues		
Cost of materials	99,577	74,902
Building, operation and maintenance of the network	34,319	29,892
Depreciation and amortization	21,858	23,872
Personnel expenses	9,774	8,276
Non-cash share-based payments	4	19
Cost of revenues	**165,532**	**136,961**

The costs of revenues include the costs of materials, the costs of building, operating and maintaining the network, personnel expenses for employees whose jobs relate to technology, non-cash share-based payments under stock option programs, as well as depreciation and amortization on the hardware and software employed in connection with technology operations. Non-recurring costs of provisioning customer connections are capitalized and depreciated over the average contract term of 24 months.

8 Selling and marketing expenses

	2005 in T €	2004 in T €
Selling and marketing expenses		
Personnel expenses	13,181	9,887
Commissions	7,848	4,832
Other selling and marketing expenses	3,845	2,629
Allowance and depreciation of bad debts	2,940	2,574
Advertising expenses and allowances	1,583	984
Depreciation and amortization	1,077	846
Non-cash share-based payments	19	(27)
Selling and marketing expenses	**30,493**	**21,725**

Selling and marketing expenses include, in particular, advertising expenses and advertising expense allowances, regular commission payments to dealers and distributors, allowances for bad debts, personnel expenses for sales and marketing employees, as well as depreciation and amortization on the hardware and software employed in connection with selling and marketing operations. Analogously to the provisioning costs, the non-recurring commission payments to dealers and distributors for each new customer line are capitalized and amortized over the average contract term of 24 months.

9 General and administrative expenses

	2005 in T €	2004 in T €
General and administrative expenses		
Other general and administrative expenses	8,441	6,981
Personnel expenses	7,103	5,380
Depreciation and amortization	1,360	904
Non-cash share-based payments	12	38
General and administrative expenses	**16,916**	**13,303**

In addition to the personnel expenses for the members of the Management Board and for staff position, as well as for employees from finance, central purchasing, human resources and legal operations who work in administration, the general and administrative expenses item also includes costs for the administration buildings, legal and consulting costs, corporate communication costs, including investor relations, as well as depreciation and amortization on the hardware and software employed in connection with administrative operations.

10 Research and development expenses

	2005 in T €	2004 in T €
Research and development expenses		
Personnel expenses	324	308
Depreciation and amortization	113	152
Research and development expenses	**437**	**460**

Research and development expenses essentially consist of the personnel expenses for the employees who work in these operations and expenses stemming from the depreciation and amortization of the hardware and software employed in connection with development operations.

11 Other operating expenses and income

	2005 in T €	2004 in T €
Other operating expenses		
Miscellaneous operating expenses	240	531
Losses from disposal of long-term assets	21	54
Other operating expenses	**261**	**585**

	2005 in T €	2004 in T €
Other operating income		
Miscellaneous operating income	251	1,043
Reversals of unutilized provisions and write-off of liabilities	179	3,370
Gains from disposal of long-term assets	156	93
Other operating income	**586**	**4,506**

Reversals of unutilized provisions and the write-off of liabilities essentially relates to items formed for litigation risks and in connection with the integration of Ventelo GmbH (Ventelo).

12 Financial result and income from associated companies

	2005 in T €	2004 in T €
Financial expenses		
Interest expenses	797	300
Losses from exchange rate differences	18	367
Financial expenses	**815**	**667**

	2005 in T €	2004 in T €
Financial income		
Interest income	974	1,212
Gains from exchange rate differences	41	127
Financial income	**1,015**	**1,339**

The Company's income from associated companies in the amount of T € 280 (2004: T € 375) represents payments from the liquidation assets of Netchemya S.p.A., of Italy (Netchemya), a QSC equity investment from fiscal 2000. The liquidation proceedings were concluded on October 31, 2005.

13 Earnings per share

	2005	2004
Earnings per share (basic and diluted) in €		
Net loss in T €	(18,186)	(21,607)
Weighted average number of common shares	108,967,370	105,299,949
Earnings per share (basic and diluted) in €	**(0.17)**	**(0.21)**

Earnings per share (basic) are computed by dividing net loss by the weighted, average number of common shares outstanding during the fiscal year. To compute earnings per share (basic), the earnings per share (basic) are adjusted by the number of all potentially dilutive shares. This dilutive effect was not taken into consideration for the 2005 and 2004 fiscal years, as QSC had incurred losses during these reporting periods and the adjustment would have resulted in a decrease in losses per share.

14 Personnel expenses and employees

	2005 in T €	2004 in T €
Personnel expenses		
Wages and salaries	25,747	20,197
Social security contribution	4,133	3,473
Net pension costs	502	180
Non-cash share-based payments	35	30
Personnel expenses	**30,417**	**23,880**

	2005	2004
Number of employees according to functions (in average)		
Selling and marketing	188	149
Engineering	147	150
General and admistration	63	48
Board and staff positions	21	15
Number of employees according to functions (in average)	**419**	**362**

BALANCE SHEET DISCLOSURES

15 Goodwill

	Goodwill in T €
Cost	
Cost at January 1, 2004	2,393
Additions	-
Disposals	-
Cost at December 31, 2004	**2,393**
Additions	6,872
Disposals	-
Cost at December 31, 2005	**9,265**
Accumulated amortization	
Accumulated amortization at January 1, 2004	-
Additions	-
Disposals	-
Accumulated amortization at December 31, 2004	**-**
Additions	-
Disposals	-
Accumulated amortization at December 31, 2005	**-**
Carrying amount at December 31, 2005	**9,265**
Carrying amount at December 31, 2004	**2,393**

In connection with the acquisition of the shares of COMpoint Networking Consulting GmbH and GINKO AG, which were both merged with QSC in fiscal 2002, the difference between the costs of acquisition and the pro-rata shareholders' equity attributable to QSC at the time of acquisition was capitalized as goodwill. In conformity with IFRS 3, goodwill has no longer been regularly amortized since January 1, 2002; instead, it is reviewed annually for any reduction in value. The basis for the reduction-in-value review consists of the Business Customers segment to which the goodwill relates. The achievable amount corresponds to the cash value of anticipated future payment streams generated in this segment. The assumptions relating to future revenues and cost planning that are employed in performing the computation are based upon current business planning with a planning horizon of five years. It was assumed that no further investments were made in the segment. The discount rate employed was 10%, the assumed terminal growth rate 3%. The assumed terminal growth rate corresponds to the values that are customarily employed in the telecommunications industry.
The capitalized celox goodwill in the amount of T € 6,872 is allocated to the Wholesale/Resellers segment. Further explanations are contained in note 37.

16 Other Intangible assets

	Licenses in T €	Software in T €	Other in T €	Total in T €
Cost				
Cost at January 1, 2004	1,516	4,514	2,291	8,321
Additions	-	1,573	3,500	5,073
Disposals	-	(130)	-	(130)
Cost at December 31, 2004	**1,516**	**5,957**	**5,791**	**13,264**
Additions	-	1,632	4,404	6,036
Additions by consolidation	49	472	1,180	1,701
Disposals	-	-	-	-
Cost at December 31, 2005	**1,565**	**8,061**	**11,375**	**21,001**
Accumulated amortization				
Accumulated amortization at December 31, 2004	666	2,753	10	3,429
Additions	156	993	2,275	3,424
Disposals	-	(107)	-	(107)
Accumulated amortization at December 31, 2004	**822**	**3,639**	**2,285**	**6,746**
Additions	161	1,226	3,555	4,942
Additions by consolidation	38	424	47	509
Disposals	-	-	-	-
Accumulated amortization at December, 2005	**1,021**	**5,289**	**5,887**	**12,197**
Carrying amount at December 31, 2005	**544**	**2,772**	**5,488**	**8,804**
Carrying amount at December 31, 2004	**694**	**2,318**	**3,506**	**6,518**

Other intangible assets include installation costs for customer connections in the amount of their net book values of T € 4,256, which are depreciated over the average contract term of 24 months. Depreciation of these capitalized customer connections totaled T € 3,602 in fiscal 2005. Moreover, this item also includes capitalized celox customer relationships in the amount of T € 558 as well as the celox brand in the amount of T € 622. The comparison figures for 2004 have been correspondingly adjusted. Please refer to note 37 for further explanations.

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 Bundesnetzagentur, the former 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.

17 Property, plant and equipment

	Network equipment and plant in T €	Operational and office equipment in T €	Total in T €
Cost			
Cost at January 1, 2004	102,970	14,227	117,197
Additions	4,161	6,703	10,864
Disposals	(2,385)	(679)	(3,064)
Cost at December 31, 2004	**104,746**	**20,251**	**124,997**
Additions	16,616	4,232	20,848
Additions by consolidation	8,353	925	9,278
Disposals	(14,804)	(325)	(15,129)
Cost at December 31, 2005	**114,911**	**25,083**	**139,994**
Accumulated depreciation			
Accumulated depreciation at December 31, 2004	62,709	7,572	70,281
Additions	18,753	3,597	22,350
Disposals	(2,385)	(349)	(2,734)
Accumulated depreciation at December 31, 2004	**79,077**	**10,820**	**89,897**
Additions	14,753	4,713	19,466
Additions by consolidation	6,281	658	6,939
Disposals	(9,478)	(201)	(9,679)
Accumulated depreciation at December 31, 2005	**90,633**	**15,990**	**106,623**
Carrying amount at December 31, 2005	**24,278**	**9,093**	**33,371**
Carrying amount at December 31, 2004	**25,669**	**9,431**	**35,100**

18 Prepayments

Prepayments total T € 2,096 (2004: T € 1,297) and essentially consist of prepaid expenses for leased lines and technology premises, as well as insurance.

19 Trade accounts receivables

	2005 in T €	2004 in T €
Trade accounts receivables		
Trade accounts receivables, gross	35,999	29,265
Allowance for bad debts	(1,822)	(3,649)
Trade accounts receivables, net	**34,177**	**25,616**

All trade accounts receivables have terms of less than one year.

20 Other receivables and short-term financial assets

Other receivables and short-term financial assets amount to T € 914 at the close of the 2005 fiscal year (2004: T € 3,207) and essentially consist of tax refund entitlements.

21 Cash and short-term deposits as well as available-for-sale financial assets

	2005 in T €	2004 in T €
Cash and short-term deposits and available-for-sale financial assets		
Cash and short-term deposits	30,313	22,536
Available-for-sale financial assets	26,065	17,785
Cash and short-term deposits and available-for-sale financial assets	**56,378**	**40,321**
Restricted cash	(4,300)	-
Available liquidity	**52,078**	**40,321**

Cash and short-term deposits include restricted cash in the amount of T € 4,300. This consists of the remaining portion of the second tranche of the acquisition price for the acquisition of Ventelo, whose final amount was stipulated in December 2005 and which is currently being held in an escrow account.

22 Capital stock

	2005	2004
Capital stock		
Capital stock in T €	115,033	105,503
Number of no-par common stock	115,033,078	105,502,729

Each share of stock entitles the registered owner to cast one vote at the Annual Shareholders Meeting and enjoys full dividend entitlement. The voting right is not subject to any restrictions. The capital stock rose by T € 456 as a result of the issuance of common shares within the framework of the stock option programs, by T € 3,584 as a result of the increase of capital against contributions in kind in conjunction with the celox acquisition, as well as by T € 5,490 as a result of the increase of capital on the basis of the resolution of the Annual Shareholders Meeting on May 27, 2004.

23 Capital surplus

The capital surplus amounts to T € 499,643 as of December 31, 2005 (2004: T € 474,750). This amount includes the cost of issue of the increase of capital in the amount of T € 299, as well as the deferred share-based payments under the stock option program in the amount of T € 98, which will be recognized in the income statement over the expected life of the options. Further details are explained in note 39.

24 Other reserves

Other reserves include gains and losses on available-for-sale financial assets, as well as actuarial gains and losses on defined-benefit pension plans. The values for the 2005 and 2004 fiscal years are shown in the Consolidated Statement of Changes in Shareholders' Equity.

25 Statement of recognized income and expenses

	2005 in T €	2004 in T €
Directly recognized in equity		
Changes in accrued pensions	-	(73)
Available-for-sale financial assets		
change in fair value	(1,253)	259
realized losses	(191)	(82)
Apportionable to tax effect	71	(42)
Directly recognized in equity	**(1,373)**	**62**
Net loss	(18,186)	(21,607)
Net loss and recognized income and expense	**(19,559)**	**(21,545)**

26 Convertible bonds

	2005	2004
Convertible bonds		
Amount of loan in T €	60	60
Number of convertible bonds	5,968,676	6,032,443

The convertible bonds issued in conjunction with stock option programs have a nominal value of € 0.01 each. The convertible bond item includes all convertible bonds subscribed by employees that have not yet been converted although they are still eligible for conversion.

27 Accrued pensions

	2005 in T €	2004 in T €
Pensions		
Present value of defined benefit obligation at January 1	636	387
Service costs	65	38
Interest costs	25	23
Losses from retroactive plan adjustments	145	-
Actuarial gains and losses	(5)	197
Benefits paid	(9)	(9)
Present value of defined benefit obligation at December 31	**857**	**636**
Fair value of plan assets at January 1	(51)	(42)
Expected return on plan assets	(2)	(1)
Actuarial gains and losses	5	4
Employer contributions for plan assets	(13)	(12)
Fair value of plan assets at December 31	**(61)**	**(51)**
Accrued pensions at December 31	**796**	**585**
Discount rate	4.00%	4.00%
Expected return on plan assets	3.50%	3.50%
Rate of compensation increase	3.00%	3.00%
Rate of pension indexation	3.00%	3.00%

The accrued pensions as of December 31, 2003, and 2004, were adjusted in conjunction with the changeover to IFRS. The composition of the pension expense under defined-benefit plans is as follows:

	2005 in T €	2004 in T €
Net pension costs		
Service costs	65	38
Interest costs	25	23
Expected return on plan assets	(2)	(1)
Losses from retroactive plan adjustments	145	-
Net pension costs	**233**	**60**

One defined-benefit plan is secured through reinsurance that is classified as plan asset in accordance with IAS 19.

28 Portion of finance lease obligations

	2005 in T €	2004 in T €
Portion of finance lease obligations		
Long-term portion	10,687	4,105
Short-term portion	8,437	2,647
Portion of finance lease obligations	**19,124**	**6,752**

The allocation of liabilities under finance lease obligations as either long-term or short-term items has been effected in conformity with IAS 1. Consequently, a leasing liability is classified as being short-term in nature if, in particular, redemption is to be made to the lessor within 12 months following the close of the fiscal year. The portion of finance lease obligations does not contain any obligations having a term of more than 5 years. A total of T € 16,705 was added to property, plant and equipment within the framework of finance lease agreements during the past fiscal year, of which T € 1,476 had already been depreciated. The depreciation is contained in depreciation on property, plant and equipment. A total of T € 6,706 relates to financing liabilities stemming from "sale and lease back" transactions. The market value of the leased items at the time of acquisition was essentially equal to the costs of acquisition. The internal rate of return in the finance lease agreements averages around 6%. Future obligations, including financing costs totaling T € 1,721 under these agreements, amount to T € 9,330 for the year 2006, T € 7,122 for the year 2007 and T € 4,393 for the year 2008.

29 Provisions

	2005 in T €
Provisions	
Other provisions at January 1	746
Additions	880
Use	(583)
Reversals	(162)
Other provisions at December 31	**881**
Litigation risks at January 1	355
Additions	49
Use	(208)
Reversals	(147)
Litigation risks at December 31	**49**
Provisions	**930**

Other provisions essentially include obligations to third parties relating to as-yet unbilled electricity deliveries as well as commission payments of unknown amount, which were estimated. The valuation was performed on the basis of prior-period experience.

30 Trade accounts payable

	2005 in T €	2004 in T €
Trade accounts payable		
to third parties	31,559	26,046
to related parties	37	472
Trade accounts payable	**31,596**	**26,518**

All trade accounts payable have a term of less than one year.

31 Deferred revenues

Revenues from non-recurring installation charges are capitalized and amortized over the estimated average customer subscription life of 24 months. Advance payments from customers are also deferred until such time as the corresponding performance has been provided.

32 Other short-term liabilities

	2005 in T €	2004 in T €
Other short-term liabilities		
Miscellaneous	5,138	4,450
Taxes	638	2,793
Social security	659	996
Other short-term liabilities	**6,435**	**8,239**

All other short-term liabilities have a term of less than one year. The item Miscellaneous essentially consists of the second tranche of the purchase price for Ventelo in the amount of T € 4,450.

CASH FLOW STATEMENT DISCLOSURES

33 Cash flow from operating activities

Cash flow from operating activities amounted to T € 2,700 in fiscal 2005, as opposed to T € -7,988 the year before. The net gains on disposal of long-term securities in both years correspond to the payments received from the Netchemya liquidation proceeds.

34 Cash flow from investing activities

Cash flow from investing activities amounted to T € -17,811, as opposed to T € -7,139 the year before. This reduction essentially resulted from the change in available-for-sale financial assets in the amount of T € -9,841, as opposed to T € 1,703 the year before. The cash used in connection with the acquisition of tangible and intangible assets rose by T € 302 from the year before. In the case of payments for acquisitions after deduction of acquired liquid assets, the addition of the celox shares was netted with the increase of capital. The remaining amount of T € 1,539 results from the difference between the acquired cash from celox and the costs of acquisition. Further details are contained in note 37.

35 Cash flow from financing activities

Cash flow from financing activities amounted to T € 22,888 in fiscal 2005 and T € 2,699 in fiscal 2004. The increase resulted essentially from payments in connection with the issuance of shares within the framework of the increase of capital in December 2005.

36 Reconciliation in accordance with IFRS 1

The point of departure for the reconciliation of shareholders' equity as well as the Company's net worth, financial and earnings positions from US GAAP to IFRS was the consolidated balance sheet in accordance with US GAAP as of January 1, 2004. The reconciliation of the US GAAP consolidated balance sheet to the consolidated balance sheet in accordance with IFRS as of January 1, 2004, and December 31, 2004, as well as from the US GAAP to the IFRS income statement for the 2004 fiscal year can be seen from the following tables:

	in T €
Reconciliation of consolidated shareholders' equity statement	
at December 31, 2003	
Shareholders' equity US GAAP	89,469
Accrued pensions	(5)
Shareholders' equity IFRS	**89,464**

	in T €
Reconciliation of consolidated shareholders' equity statement	
at December 31, 2004	
Shareholders' equity US GAAP	70,470
Deferred taxes	(42)
Accrued pensions	(254)
Shareholders' equity IFRS	**70,174**

The adjustment of shareholders' equity as of January 1, 2005, results from an increase in accumulated deficit in the amount of T € -254, with the majority of this amount, T € -201, resulting from actuarial losses, as well as from an adjustment of deferred income taxes in the amount of T € -42.

	in T €
Reconciliation of consolidated income statement for the fiscal year 2004	
Net loss US GAAP	(21,559)
Net pension costs	(48)
Net loss IFRS	**(21,607)**

The net loss in the amount of T € -21,607 improved by a total of T € 6,567 in fiscal year 2004 through income resulting from the return of provisions as well as from write-offs of liabilities.
Cash flow from operating activities for 2004 in the amount of T € -4,830 in accordance with US GAAP was adjusted by depreciation of T € 2,274 and prepayments in the amount of T € 1,226 as a result of capitalized provisioning costs. In addition, an adjustment was made within the framework of finance lease (T € 6,752) by netting investments and through the remaining presentation of repayments within the framework of financing activities, respectively.
Cash flow from investing activities for 2004 in the amount of T € -9,819 in accordance with US GAAP was adjusted as a result of additions in the amount of T € -3,500 under other intangible assets and as a result of provisioning costs and adjustment of accrued pensions in the amount of T € -198. In addition, an adjustment of T € 6,274 was made for 2004 by netting investments under finance lease agreements.
Cash flow from financing activities for 2004 in the amount of T € 2,221 in accordance with US GAAP was adjusted through the change in recorded finance lease agreements in the amount of T € 478.

37 Subsidiaries and associated companies

QSC's consolidated financial statements include the following equity investments:

	Share as of Dec. 31, 2005 in %	Shareholders' equity Dec. 31, 2005 in T €	Net profit/ (loss) 2005 in T €
Subsidiaries and associated companies			
Ventelo GmbH	100	5,062	530
celox Telekommunikationsdienste GmbH	100	328	(726)
Netchemya S.p.A., Italy *	25	-	-

* in liquidation

celox // On May 12, 2005, QSC acquired 100% of celox, a nationwide provider of professional solutions in the field of data communication for small and medium enterprises and major corporates. celox operates its own DSL network with over 170 colocation rooms in more than 30 medium-size German cities. Through this acquisition, QSC achieved both an especially swift and cost-effective further geographical expansion of the network, while simultaneously significantly broadening its customer base. One major element of the acquisition method employed in conformity with IFRS 3 in connection with initial consolidation is the allocation of the expended purchase price among the acquired assets, liabilities and contingent liabilities, as well as the computation of any remaining goodwill following treatment of deferred taxes. Within the framework of the purchase price allocation, all identifiable assets and liabilities were valued relative to their attributable market values and were as follows at the time of acquisition:

	Recognized on acquisition in T €	Carrying amount in T €
Assets		
Long-term assets	2,442	2,442
Deferred taxes	2,564	-
Trademark celox	622	-
Customer base celox	558	-
Trade accounts reveivables	398	398
Other financial assets and prepayments	1,754	1,754
Cash and short-term deposits	1,731	1,731
Assets	**10,069**	**6,325**
Liabilities		
Deferred taxes	(471)	-
Tarde accounts payable	(295)	(295)
Provisions	(803)	(803)
Other short-term liabilities	(1,418)	(5,125)
Liabilities	**(2,987)**	**(6,223)**
Fair value of net assets	7,082	102
Goodwill arising on acquisition	6,872	
Total	**13,954**	

The purchase price for celox amounted to T € 13,954, including acquisition costs in the amount of T € 192. T € 13,762 of the purchase price was paid in the form of 3,583,776 new shares of stock, which were created from authorized capital against the contribution of all celox shares as well as a loan redemption entitlement against celox on the part of the legacy celox shareholders in the amount of T € 3,707. The cash flow resulting from the acquisition was as follows:

	in T €
Cash inflow on acquisition	
Total acquisition costs inclusive direct costs of acquisition	(13,954)
Issuance of common stock	13,762
Cash and short-term deposits acquired	1,731
Cash inflow on acquisition	**1,539**

QSC's consolidated financial statements have included celox' financial statements since May 12, 2005. celox's contribution to the consolidated net loss for the period from May 12 through December 31, 2005, amounted to T € -306. In consolidating celox as of January 1, 2005, the pro-forma contribution had amounted to T € -789.

Ventelo // On December 13, 2002, QSC acquired 100% of Ventelo GmbH, Düsseldorf ("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, 2005, a second and final tranche of T € 4,300 was outstanding, but is currently being held as restricted cash in an escrow account. On April 1, 2002, Ventelo was outsourced from its former parent company Ventelo Deutschland GmbH due §§ 159 et seqq. "Umwandlungsgesetz". Ventelo is responsible for potential liabilities of the former parent company for a period of five years.

Netchemya // For Netchemya S.p.A., Italy, one of QSC's investments made in 2000, the liquidation proceedings were concluded on October 31, 2005. 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 and in 2005 of T € 280 that are included in income from associated companies.

38 Segment reporting

The source of QSC's reportable segments is the internal organization used by management for making operating decisions and assessing performance as. QSC is primarily operating in the customer segments Large Accounts, Business Customers, Wholesale/Resellers and Residential Customers. The customer segment Large Accounts 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 Wholesale/Resellers 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 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 collocation rooms.

2005 in T €	Segment Large accounts	Segment Business customers	Segment Wholesale/ Resellers	Segment Residential customers	Recon- ciliation	Consoli- dated
Net revenues	**51,393**	**57,530**	**30,388**	**55,076**	**-**	**194,387**
Directly allocated costs	(18,372)	(33,988)	(17,516)	(37,549)	-	(107,425)
Contribution margin	**33,021**	**23,542**	**12,872**	**17,527**	**-**	**86,962**
Not allocated costs	-	-	-	-	(81,185)	(81,185)
EBITDA	**33,021**	**23,542**	**12,872**	**17,527**	**(81,185)**	**5,777**
Depreciation and amortization	(1,995)	(2,296)	(1,619)	(2,913)	(15,585)	(24,408)
Non-cash share-based payments	-	-	-	-	(35)	(35)
Financial result	-	-	-	-	200	200
Income from associated companies	-	-	-	-	280	280
Net profit/(loss)	**31,026**	**21,246**	**11,253**	**14,614**	**(96,325)**	**(18,186)**
Long-term assets	7,969	13,381	10,881	15,897	103,139	151,267
Liabilities	3,917	4,510	3,179	5,722	48,901	66,229
Capital expenditures	2,372	2,730	1,924	3,464	9,641	20,131

2004 in T €	Segment Large accounts	Segment Business customers	Segment Wholesale/ Resellers	Segment Residential customers	Recon- ciliation	Consoli- dated
Net revenues	**33,210**	**47,165**	**18,252**	**47,247**	**-**	**145,874**
Directly allocated costs	(13,876)	(27,557)	(7,645)	(30,656)	-	(79,734)
Contribution margin	**19,334**	**19,608**	**10,607**	**16,591**	**-**	**66,140**
Not allocated costs	-	-	-	-	(62,990)	(62,990)
EBITDA	**19,334**	**19,608**	**10,607**	**16,591**	**(62,990)**	**3,150**
Depreciation and amortization	(663)	(1,360)	(1,893)	(4,351)	(17,507)	(25,774)
Non-cash share-based payments	-	-	-	-	(30)	(30)
Financial result	-	-	-	-	672	672
Income from associated companies	-	-	-	-	375	375
Net profit/(loss)	**18,671**	**18,248**	**8,714**	**12,240**	**(79,480)**	**(21,607)**
Long-term assets	3,894	10,458	8,881	14,220	78,512	115,965
Liabilities	990	2,033	2,828	6,502	33,438	45,791
Capital expenditures	794	1,630	2,268	5,214	6,031	15,937

Directly attributable costs consist of those segment expenses that can be directly allocated to the respective segment on the basis of revenues. Non-attributable costs are not apportioned among the segments, because they are structural costs for which it is not possible to make a causal allocation. In particular, the vast majority of these costs consists of the costs of building, operating and maintaining the network; these costs do not rise steadily on the basis of the number of customers and the volumes of traffic transported. In addition, these unallocated costs also include personnel expenses, administrative expenses, as well as segment-independent general advertising expenses. No further subclassification of the primary segments into secondary segments (geographical segments) was made, as QSC's telecommunication services are predominantly offered on a national scale.

39 Stock option programs

QSC has established a total of five stock option programs since 1999, which call for the issuance of convertible bonds having a nominal value of € 0.01 each to employees and, with the consent of the Supervisory Board, to members of the Management Board as well as to consultants and suppliers. The participants in these programs are granted the right to convert each convertible bond into one share of registered, no-par stock against payment of the exercise price. The exercise price of the convertible bonds represents the market price of the share on the valuation date. The convertible bonds have a term of five years and are subject to a vesting period of up to three years. On the basis of IFRS 3, no personnel expenses were recorded for the convertible bonds issued under the 2000, 2000A, 2001 and 2002 SOPs, as they were resolved by Annual Shareholders Meetings prior to November 7, 2002. The option values for the convertible bonds under the 2004 SOP were computed at the grant date with the aid of the Black-Scholes option-pricing model, with the following assumptions being employed:

SOP 2004	
Expected life of options	5 years
Dividend yield	0.00%
Risk-free interest rate	2.68%
Expected volatility	29.90%
Average fair value of convertible bonds in €	1.15
Fair value of options granted for the year ended Dec. 31, 2005 in €	133,383

The deferred option values in the amount of T € 133 were reduced to T € 98 in fiscal 2005 through non-cash share-based payments in the amount of T € 35.

The convertible bonds outstanding as of December 31, 2005, and 2004, under all programs are shown below:

	Number of convertible bonds	Weighted average exercise price in €
Outstanding at December 31, 2003	6,381,675	1.82
Granted during the year	163,663	4.33
Forfeited during the year	(47,562)	2.06
Exercised during the year	(465,333)	1.39
Outstanding at December 31, 2004	**6,032,443**	**1.92**
Granted during the year	429,684	3.69
Forfeited during the year	(21,449)	2.23
Exercised during the year	(456,110)	1.70
Outstanding at December 31, 2005	**5,984,568**	**2.06**

40 Related party transactions

During 2005, QSC participated in transactions with companies affiliated with members of the management. According to IAS 24 related parties are individuals or companies with the possibility to influence or even control the other party. All contracts with these companies require approval of the Supervisory Board. The business relationships and transactions with related parties during 2005 and 2004 were all performed at arms-length and were as follows:

	Net revenues in T €	Expenses in T €	Cash received in T €	Cash paid in T €
For the year ended Dec. 31, 2005				
IN-telegence GmbH & Co. KG	26	(67)	25	(73)
Teleport Köln GmbH	8	91	4	100
microShare AG	1	-	1	-
QS Communication				
Verwaltungs Service GmbH	-	192	-	220
For the year ended Dec. 31, 2004				
IN-telegence GmbH & Co. KG	-	1	-	534
Teleport Köln GmbH	2	68	3	116
microShare AG	-	2	-	6
QS Communication				
Verwaltungs Service GmbH	-	-	-	-

	Trade accounts receivables in T €	Trade accounts payable in T €
At December 31, 2005		
IN-telegence GmbH & Co. KG	5	20
Teleport Köln GmbH	4	14
microShare AG	-	-
QS Communication Verwaltungs Service GmbH	-	3
At December 31, 2004		
IN-telegence GmbH & Co. KG	-	465
Teleport Köln GmbH	-	7
microShare AG	-	-
QS Communication Verwaltungs Service GmbH	-	-

IN-telegence GmbH & Co. KG provides value-added telecommunication services. All contracts with IN-telegence have been terminated on May 31 and June 30, 2002. Teleport Köln GmbH operates and maintains QSC's private broadcast exchange and in-house telephone systems. microShare AG provides consulting services on the conception, documentation and implementation of internal IT-based processes. QS Communication Verwaltungs Service GmbH provides consultancy on the integration of celox.

41 Deferred taxes

For the calculation of deferred taxes compared to the previous year an unchanged income tax rate of 39.9% was used. This includes a trade tax rate of 18.37%, a statutory income tax rate of 25% plus a solidarity surcharge of 5.5% on the statutory income tax rate.

Deferred taxes for the fiscal years 2005 and 2004 are:

	2005 in T €		2004 in T €	
	Asset	Liability	Asset	Liability
Deferred taxes				
Intangible assets	-	2,948	-	1,546
Property, plant and equipment	-	513	68	-
Financial assets	839	-	-	81
Trade accounts receivables	-	285	-	-
Prepayments	-	607	-	218
Deferred revenues	1,302	-	548	-
Accrued pensions and provisions	163	35	198	-
Other short-term liabilities	-	564	203	-
Total deferred taxes referred to temporary differences	**2,304**	**4,952**	**1,017**	**1,845**
Netting out	(1,106)	(1,106)	(679)	(679)
Total deferred taxes referred to temporary differences after netting out	**1,198**	**3,846**	**338**	**1,166**
Loss carryforward previous year	2,207	-	786	-
Loss carryforward celox	2,564	-	-	-
Total deferred taxes referred to losses carryforward	**4,771**	**-**	**786**	**-**
Total deferred taxes	**5,969**	**3,846**	**1,124**	**1,166**

The following table reconciles the expected income tax to the actual income tax expense. The expected tax income was calculated by multiplying net loss with the income tax rate of 39.9%:

	2005 in T €	2004 in T €
Reconciliation		
Net loss	**(18,186)**	**(21,607)**
Expected tax income	7,256	8,621
Tax effect of		
non-deductible expenses	(53)	(18)
neglected capitalization of deferred taxes referred to losses carryforward	(7,012)	(8,596)
Miscellaneous	(191)	(7)
Income taxes	**-**	**-**

As of December 31, 2005, corporate income tax loss carry-forward was T € 415,939 and trade tax loss carry-forward was T € 415,518. 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. According to tax legislation, the tax losses may be carry forward indefinitely and in unlimited amounts.

42 Litigations

QSC does not presently have any major litigations.

43 Commitments and contingent liabilities

Commitments and contingent liabilities in the coming fiscal years for long-term contracts, in particular for fiber optic lines, technical premises, office premises and corporate vehicles, amount to T € 71,907.

	Dec. 31, 2005 in T €	Dec. 31, 2004 in T €
Commitments and contingent liabilities		
up to 1 year	35,078	25,685
1 to 5 years	36,829	24,374
more than 5 years	-	-
Commitments and contingent liabilities	**71,907**	**50,059**

As of December 31, 2005, QSC had guarantees in the amount of T € 3,386 (2004: T € 3,002) outstanding, primarily to suppliers for rental and other contractual obligations.

44 Management Board

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

The remuneration of the members of the Management Board conforms 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 2005 totalled T € 1,681 (2004: T € 1,861). 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 2005 were 55% of total remuneration (T € 922).
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 2005 the variable components were 39% of the total remuneration (T € 652).
The total remuneration for company pension plans was 6% of the total remuneration (T € 107). 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 2005, in total 100,000 stock options were awarded to the members of the Management Board.

	Shares		Convertible bonds	
	Dec. 31, 2005	Dec. 31, 2004	Dec. 31, 2005	Dec. 31, 2004
Dr. Bernd Schlobohm	13,818,372	13,818,372	50,000	-
Markus Metyas	2,307	2,307	1,525,000	1,559,116
Bernd Puschendorf	3,000	-	1,025,000	1,000,000

45 Supervisory Board

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	

The members of the Supervisory Board represents functions in the following companies:

	Function	Company
Herbert Brenke	Chairman of the Supervisory Board	ASKK Holding AG, Hamburg, Germany
	Chairman of the Supervisory Board	Telegate AG, Martinsried, Germany
	Member of the Supervisory Board	ASR Auto-Stern von Russland AG, Moscow, Russia
	Member of the Supervisory Board	SHS Informationssysteme AG, Munich, Germany
	Member of the Advisory Board	Küttner GmbH & Co. KG, Essen, Germany
Gerd Eickers	Chairman of the Supervisory Board	MVC AG, Frankfurt/Main, Germany
	Member of the Advisory Board	GTT GmbH, Göttingen, Germany
Ashley Leeds	Member of the Board of Directors	Canal + Television AB, Stockholm, Sweden
	Member of the Board of Directors	Voltaire Ltd., Herzlia, Israel
Norbert Quinkert	Member of the Supervisory Board	ALD Vacuum Technologies AG, Hanau, Germany
	Member of the Supervisory Board	IHP (Institut für Halbleiterphysik), Frankfurt/Oder, Germany
	Member of the Supervisory Board	Pfalz Flugzeugwerke AG, Speyer, Germany
	Member of the Advisory Board	Dresdner Bank AG, Frankfurt/Main, Germany
	Executive Vice President	American Chamber of Commerce, Frankfurt/Main, Germany
David Ruberg	Chairman of the Supervisory Board	InterXion Inc., Amsterdam, Netherlands
	Member of the Board of Directors	Adaptix Inc., Seattle, USA
	Member of the Board of Directors	Broadview Networks Inc., New York, USA

The total remuneration of the Supervisory Board for financial year 2005 was T € 160, in comparison to T € 160 for financial year 2004. In 2005, 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.

	Shares		Convertible bonds	
	Dec. 31, 2005	Dec. 31, 2004	Dec. 31, 2005	Dec. 31, 2004
John C. Baker	-	-	10,000	19,130
Herbert Brenke	187,820	187,820	10,000	19,130
Gerd Eickers	13,853,484	13,853,484	-	9,130
Ashley Leeds	9,130	9,130	10,000	10,000
Norbert Quinkert	3,846	3,846	-	-
David Ruberg	4,563	4,563	10,000	19,130

46 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.

47 Auditors' fees

In fiscal 2005, the certified public accounting firm that was appointed to audit the Company's annual financial statements received T € 150 for the audit, T € 76 for tax consulting and T € 40 for other services rendered.

48 Risks

Development of the economy // Among the overall economic risks, QSC monitors the economic environment, in particular, because a weak economy has a direct impact on the willingness of large accounts and business customers to invest in modern telecommunication infrastructure.

Competition // The German market for DSL products and services is increasingly seeing massive consolidation, as well as a concentration on only a few strong providers. The strong dynamics of the DSL and IP-VPN markets continue to make the possibility of a shakeout in the major account and business customer segments unlikely.

Entry into wholesale business // Entering the wholesale market for ADSL2+ involves the risk of dependency upon marketing partners, because entering the wholesale market necessitates that QSC invest in new technology, whose amortization is dependent upon the market success of the respective partner.

Competitive behavior of Deutsche Telekom (DTAG) // As an infrastructure provider, QSC is significantly less dependent upon former monopolist DTAG's reselling prices than the majority of the Company's competitors. Nevertheless, an aggressive pricing policy on the part of DTAG in connection with both the preliminaries and end-customer markets, in particular, could have a negative impact on the margin situation in the German telecommunications market.

Regulatory environment // The decisions of the German Federal Network Agency can have either a direct or indirect influence on QSC's competitive position and market. This also applies with respect to the issue of bitstream access and thus to the ability of potential competitors to offer DSL products that feature specific quality parameters under their own name and for their own account with significantly lower investments in connection with infrastructure. This could increase competitive pressure on QSC.

QSC's own infrastructure // A potential outage of QSC's own network is an operational risk that is constantly monitored. In addition to a potential loss of image, the risk of indemnification claims or high penalties, in particular, following extended, widespread outages could result in corresponding expenses.

Alternative technologies // Cable (TV) operators are increasingly offering Internet access and voice telephony, as well. QSC is attentively monitoring these Triple Play offerings on the part of cable network operators, which address the residential customer market exclusively, as they pose potential competition to ADSL2+ technology.

Penalties in project business // Within the framework of projects for large accounts, QSC enters into contracts that assure certain service levels, some of which involve potential penalties. This results in the risk of high recourse entitlements and expenses stemming from interruptions.

The way QSC is financed // At year-end 2005, QSC possessed liquid assets totaling € 52.1 million. However aggressive price competition or a sustained recession could result in the need for additional funding.

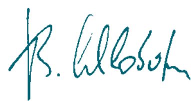
Bad debts // An overall economic environment that continues to be tense results in financial risks, in particular from customer insolvency.

Integration of future acquisitions // QSC is open to the possibility of also continuing to grow in the future through specific acquisitions. The risk in this connection is that an acquisition might not live up to expectations. The effect of this could include difficulties in consolidating networks, products, employees and operational processes.

49 Subsequent events

No events or transactions have occurred since December 31, 2005, 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 17, 2006



Dr. Bernd Schlobohm
Chief Executive Officer

Markus Metyas

Bernd Puschendorf

Glossary

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

ADSL 2+ // An evolution of ADSL technology that affords transfer speeds of up to 25 Mbit/s downstream and 1 Mbit/s upstream.

Backbone // High-speed network that interconnects networks with lower speeds and/ or 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.

IFRS // International Financial Reporting Standards, formerly called International Accounting Standards (IAS); international accounting rules to which corporations in Europe with a capital market focus have been subject since their 2005 fiscal year.

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.

SDSL // Symmetric Digital Subscriber Line: symmetric transmission technology, allows for data transfer into both directions at equal speeds of up to 6.0 Megabit per second.

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.

Triple Play // The ability to simultaneously provide Internet, telephony and entertainment offerings such as television or video on demand over one and the same line, usually broadband.

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.

US GAAP // United States Generally Accepted Accounting Principles; the generally used term for US accounting rules that govern both a company's financial accounting as well as its annual financial statements.

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 // Acronym for 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 which standard is being used.

Calendar

Annual Shareholders Meeting
May 23, 2006

Quarterly Reports
May 30, 2006
August 29, 2006
November 28, 2006

Conferences / Events
June 1, 2006
9th German Corporate Conference
Deutsche Bank AG, Frankfurt

November 27-29, 2006
German Equity Forum Autumn 2006
Deutsche Börse AG, Frankfurt

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Fries Printmedien GmbH & Co. KG, Cologne

Further information under www.qsc.de