Annual Report 2010

ITTC

QSC AG

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ITC

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Information technology [IT] and telecommunications [TC] are becoming one – and QSC is growing right along with this convergence.

The convergence of IT and TC is a reflection of the increasing networking of our society. We are making more and more use of software (IT) over the Internet (TC); the borders are beginning to blur. The Internet Protocol (IP) is serving as the central hub for transferring all information. QSC recognized early on that the IP would win out, and that is why our Next Generation Network is IP-based throughout. And because of this we are already able to develop and market IP-based ITC services. Since nowadays the more common term is ICT services, we will use the term ICT services throughout the rest of the report.

Originally a TC network operator, QSC is able to increasingly transform itself into provider of ICT services. The additional "I" here also stands for innovation – and new growth opportunities. Because we are convinced: The future lies in the ICT market.

Key Data

All amounts in € millions	2010	2009	2008	2007	2006
Revenues	422.1	420.5	413.3	335.2	262.5
EBITDA	78.1	76.9	67.3	34.9	21.2
Depreciation/amortization [1]	57.2	67.2	61.2	46.4	28.4
EBIT	20.9	9.7	6.1	(11.5)	(7.2)
Net profit (loss)	24.2	5.5	0.8	(11.7)	(5.3)
Earnings per share [2] (in €)	0.18	0.04	0.01	(0.09)	(0.04)
Return on revenue (in percent)	5.7	1.3	0.2	(3.5)	(2.0)
EBITDA margin (in percent)	18.5	18.3	16.3	10.4	8.1
EBIT margin (in percent)	5.0	2.3	1.5	(3.4)	(2.7)
Equity [3]	184.0	159.7	153.7	152.2	160.6
Long-term liabilities [3]	7.2	54.2	76.4	85.0	71.7
Short-term liabilities [3]	140.9	97.3	122.4	126.3	67.6
Balance sheet total [3]	332.2	311.3	352.5	363.5	299.9
Equity ratio (in percent)	55.4	51.3	43.6	41.9	53.6
Return on equity (in percent)	13.2	3.4	0.5	(7.7)	(3.3)
Free cash flow	27.7	12.9	(32.3)	(57.8)	(7.8)
Liquidity [3]	46.6	41.3	49.2	78.0	108.9
Capital expenditures	29.2	42.2	91.4	122.9	40.1
Capex ratio [4] (in percent)	6.9	10.0	22.1	36.7	15.3
Xetra closing price [3] (in €)	3.30	1.70	1.24	2.90	5.00
Number of shares [3]	137,127,532	136,998,137	136,998,137	136,358,315	133,897,686
Market capitalization [3]	452.5	232.9	169.9	395.4	669.5
Employees [3]	608	664	678	820	675
Revenue per employee (in K€)	694	633	610	409	389

Consolidated Financial Statements 2006 to 2010 in accordance with IFRS

[1] including non-cash share-based payments

[2] basic

[3] as of December 31

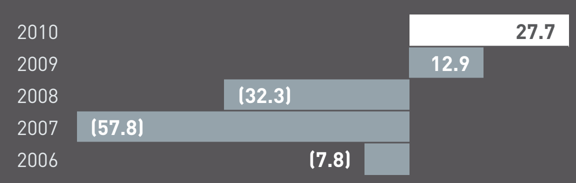
[4] ratio of capital expenditures to revenues

Objectives and Results

FREE CASH FLOW DOUBLES

QSC had initially predicted an increase in its free cash flow to more than € 22 million for fiscal 2010, but in August raised this forecast to more than € 25 million. In the end, QSC earned a free cash flow of € 27.7 million in 2010.

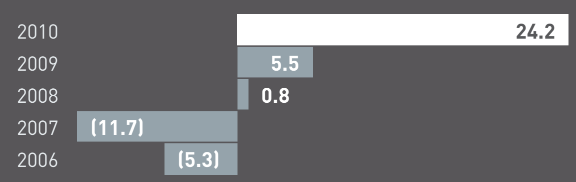
FREE CASH FLOW (in € millions)



CONSOLIDATED NET INCOME QUADRUPLES

QSC had expected to triple its consolidated net income to more than € 16 million in fiscal 2010 – but it more than quadrupled this profitability metric to € 24.2 million. This represents earnings per share of € 0.18, compared with € 0.04 the year before.

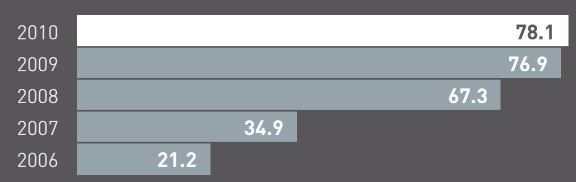
CONSOLIDATED NET INCOME (in € millions)



EBITDA CONTINUES TO RISE

QSC had forecast that its EBITDA would rise in fiscal 2010 – which it did. The transformation process boosted EBITDA to € 78.1 million; the EBITDA margin improved to 19 percent.

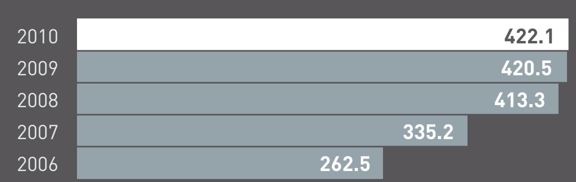
EBITDA (in € millions)



Double-digit growth in IP-based revenues

During the past fiscal year, QSC focused on IP-based revenues, increasing them by 11 percent within the space of a single year. And total revenues, too, were up to € 422.1 million.

REVENUES (in € millions)



Highlights 2010

Major progress in transformation process
As a provider of ICT services, QSC focuses on what are typically higher-margin, IP-based revenues. Their share of total revenues rose to 68 percent in fiscal 2010, compared with 62 percent the year before.

Hotel chains going with ICT solutions from QSC
In March and April, QSC won two customers with numerous locations in Germany, Mövenpick Hotels & Resorts and DERAG Hotel & Living. In both cases, QSC is networking all of the hotels' locations and ensuring smooth communications.

Long-term network partnership entered into with freenet
In June, QSC launched its Managed Outsourcing business with a 10-year contract with freenet Cityline. QSC integrated this new partner's existing narrowband network into its NGN, and is now operating its landline-based voice and Internet access services. QSC signed another contract with TELE2 in December.

Hyundai utilizing IPfonie centraflex
In June, Hyundai Corporation Europe opted to deploy the IPfonie centraflex virtual telephone system. In October, QSC then debuted the third generation of this forward-looking, award-winning ICT solution.

Launch of Germany's first nationwide Open Access platform
In August, QSC implemented the first network, process and services hub for providers and users of a new, typically fiber-based generation of broadband connections. The first partners are infrastructure provider HL komm and 1&1 Internet.

Acquisition strengthens IT competence
In December, QSC acquired IP Partner, a fast-growing provider of Housing and Hosting services. This new subsidiary operates two data centers and has more than 1,000 enterprise customers.

Contents

ICT

Individual
as in the employment of the IPfonie centraflex telephone system

Initiative
as in the first nationwide Open Access platform

Intelligent
as in the Housing and Hosting offerings from IP Partner

Ideal
as in Managed Outsourcing partnerships with network operators

Inspiring
as in the new service platform for Cloud Computing

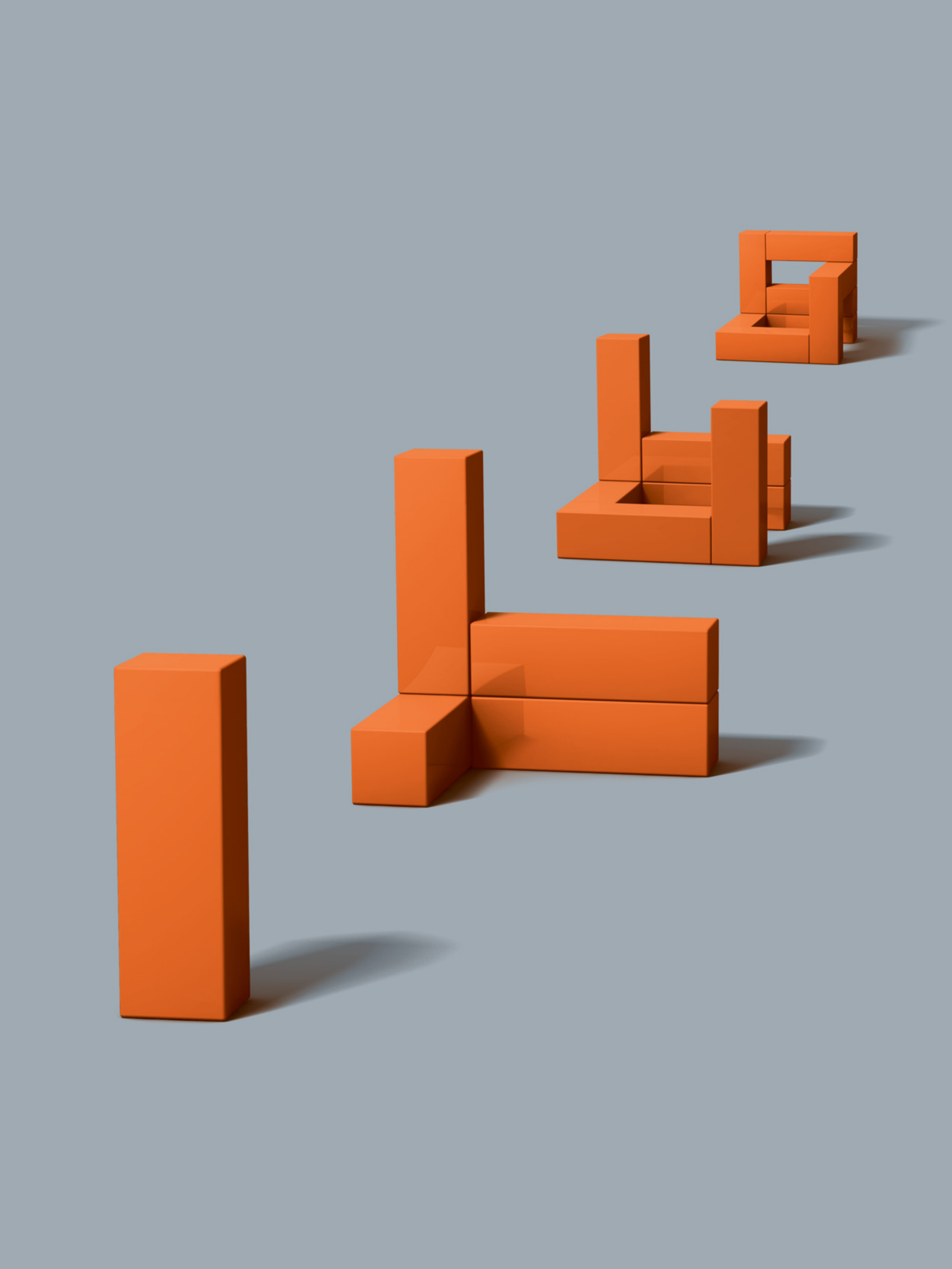
Impressive
as in the broader market that offers twice the volume

Individual

IPfonie centraflex: A custom telephone system in modular design

When IT and TC were still separate industries, the purchase of a TC system was one of a company's largest procurements. Moreover, costly specialists had to be called in to connect the system each time a new employee came on board or a department changed locations.

In the ICT age, on the other hand, the telephone system is essentially a software solution, and QSC is setting standards in this forward-looking market with IPfonie centraflex. All of the functionalities offered by this virtual telephone system, which was awarded the IT Innovation Prize, reside on a server at QSC. All that essentially needs to be done at the customer site is to connect the end-user devices, so that entire operations involving multiple locations can benefit from previously unknown flexibility and efficiency. Moreover, IPfonie centraflex adapts to the need of its customers: Additional workplaces or new offices can be configured centrally. This custom modular design system saves companies even more time and money, and thus is a further selling point.

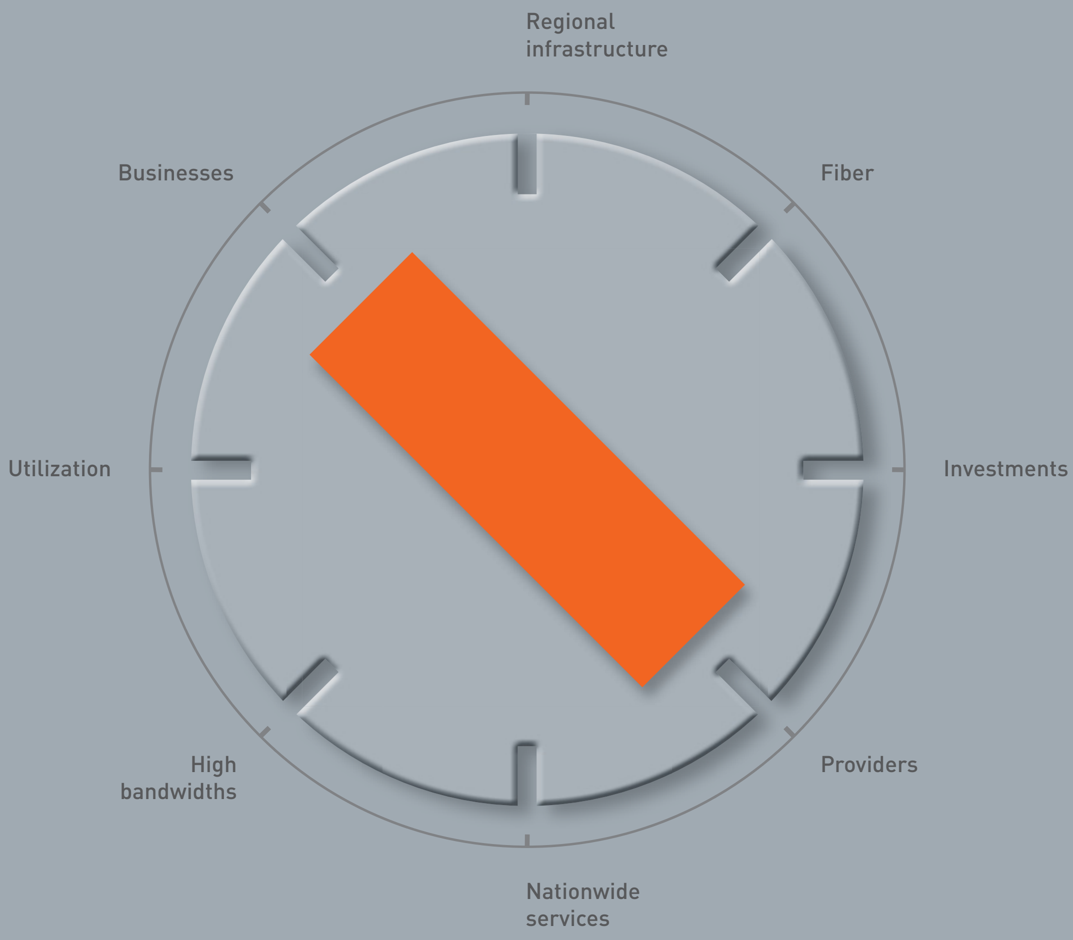


Initiative

Open Access: A hub for working at high speed

QSC was one of the first alternative providers to build a DSL network in Germany following the turn of the millennium, and in doing so it joined the lead in transforming the TC market. DSL enabled millions of Germans to benefit for the first time from all of the advantages of the Internet. A decade later, more and more municipal providers are building fiber optic networks in order to satisfy the unabated demand for broadband. However, they can only amortize their enormous capital investments in what is called Next Generation Access (NGA) if they are able to fully utilize their networks.

And this is precisely what QSC has been enabling since 2010, when the Company took the initiative and created the first Open Access platform, a nationwide network, process and services hub for providers and users of NGA. In doing so, QSC combines its innovative IT applications with its years of experience in marketing TC lines to resellers. This makes the Open Access platform a prime example of an ICT solution.


Regional infrastructure
Fiber
Investments
Providers
Nationwide services
High bandwidths
Utilization
Businesses

Intelligent

IP Partner: Turnkey solutions for secure IT operations

This new subsidiary, which was acquired in December 2010, had anticipated the convergence of IT and TC, as its name and business operations attest. Formed in the year 2000, IP Partner offers a broad spectrum of Housing and Hosting services that make extensive use of the Internet Protocol.

This Nuremberg-based company essentially handles the operation of its mainly small and mid-size customers' central IT infrastructures; applications from more than 1,000 customers run on the more than 10,000 servers in IP Partner's data centers. It takes powerful telecommunication links to ensure that these customers can access their data from anywhere and at any time. In other words, IP Partner operates its customers' central IT infrastructures and uses TC services to do this. In this way, IT and TC are converging into an intelligent ICT service that offers enormous growth potential.


1

Ideal

Managed Outsourcing: Partnerships with network operators

Numerous providers are still operating conventional TC networks in Germany, which serve solely to transfer telephone calls. This is an anachronism in the ICT age! With its Next Generation Network, QSC put in place early on the foundation for transferring these telephone calls much more cost-effectively in small data packets by using the Internet Protocol.

It was on this basis that the Company established a new ICT line of business last year: Managed Outsourcing. Under this concept, QSC integrates the existing narrowband networks of alternate providers into its NGN, and then operates their landline-based voice traffic, and in some cases also their Internet traffic. The end customer doesn't notice a thing while he continues to make phone calls and send and receive e-mails via his preferred provider. In 2010, freenet and TELE2 were the first telecommunications providers to be convinced of the efficiency advantages that are offered by this intelligent ICT solution – and further providers are expected to follow.

PERSONAL AD

Young NGN looking for old networks. Are you tired of operating a narrowband network with high fixed costs alone? Then QSC's NGN is the ideal partner for you.
For more information call 0800 7722375.

Inspiring

Q-loud: A service platform for new applications in the Cloud

No other development represents the convergence of IT and TC as well as the emergence of Cloud Computing, because under this concept, users employ IT in a TC environment. From their computers at home or at the office, users launch programs into the Cloud via a broadband line so that they can, for example, create documents, store them, share them with colleagues or jointly edit them in that common space. In Germany, alone, this market is expected to grow by more than 700 percent to € 8.2 billion by 2015.

QSC is benefiting in multiple ways from this explosive demand. The Company offers small and mid-size companies the option of relocating their hardware and software to its data centers; they then enjoy secure access to it over broadband lines from anywhere in the world. Moreover, the coming fiscal year is expected to see the launch of the Company's own service platform: Q-loud. Its streamlined functionality will make it possible for both the people of QSC as well as its partners to program inspired custom applications for companies – and thus make optimum use of Cloud Computing.

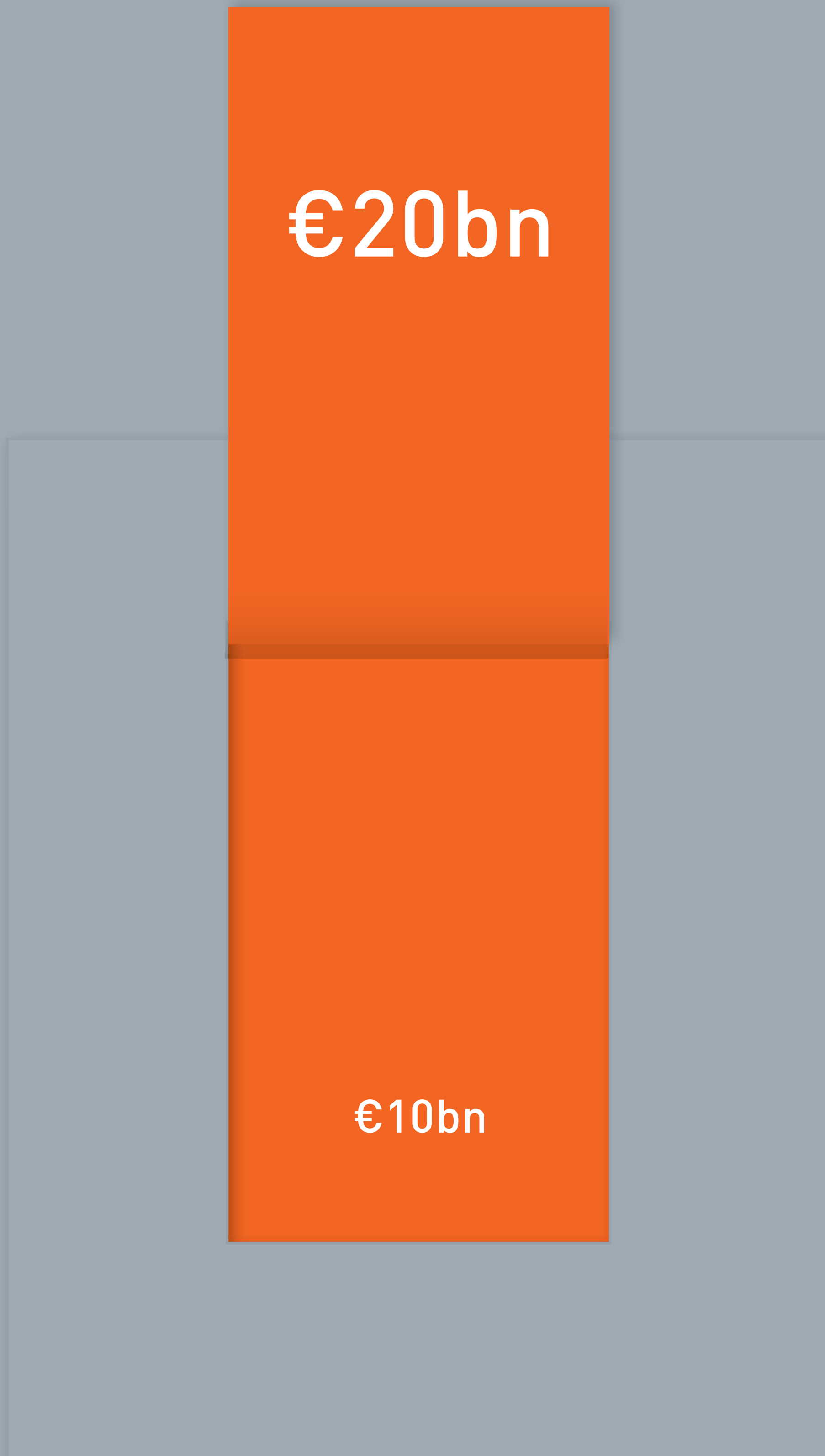

OPEN

Impressive

ICT: Transformation leads to a doubling of the market

As a TC provider, QSC was operating in a market in Germany that was estimated to be nearly € 10 billion in size. This is the amount of money that small and mid-size companies spend each year for landline-based voice and data services, in particular, as well as for inter-locational networking.

With its evolution into a provider of ICT services and its offerings of such innovative solutions as IPfonie centraflex, Open Access, Housing and Hosting, as well as Cloud Computing, QSC is in a position to double this addressable market in the coming years. Internal calculations show an impressive market volume totaling nearly € 20 billion; this represents some 20 percent of the total spending of SME companies on ICT products and services. This doubling of the potential market shows the kind of opportunities the convergence of IT and TC is opening up for QSC.


€20bn
€10bn

» 2010 was a successful year for QSC, as we made tremendous strides in our transformation process. The Company's evolution into a provider of ICT services, and thus its concentration on higher-margin, IP-based revenues, will again be the focus in 2011. Medium-term, we will be tapping into attractive growth and profitability potential with such new offerings as Housing and Hosting, as well as an innovative Cloud Computing platform.«

DR. BERND SCHLOBOHM // QSC Chief Executive Officer //

To Our Shareholders

« **Dr. Bernd Schlobohm** // CHIEF EXECUTIVE OFFICER

The Chief Executive Officer is responsible for QSC's strategy and is playing a major role in driving its evolution into a provider of ICT services. As a post-graduate engineer, he sees the convergence of IT and TC as offering enormous opportunities for his company, which he co-founded in 1997 together with Gerd Eickers. To date, neither of the two founders has ever sold a single share.

Dear Shareholders,

QSC's evolution from a TC network operator into a provider of ICT services dominated the Company's course of business during the past fiscal year. By the end of 2010, we were already generating 72 percent of our total revenues from IP-based products and services – ranging from simple Voice over IP transfer to complex voice-data solutions for chain-store customers; at the beginning of the past fiscal year, these products and services had accounted for only 65 percent of revenues. This rise is crucial to QSC's sustained success because IP-based revenues are the future of our industry. As our society grows increasingly interconnected, information technology (IT) and telecommunications (TC) are converging to form a single ICT industry – and the Internet Protocol, or IP for short, is central to the transfer of information in the ICT world. QSC enjoys a key advantage in this forward-looking market due to the fact that we built a consistent, IP-based Next Generation Network early on, and this now enables us to develop and market innovative ICT services today. This competitive edge combined with our growing share of IP-based revenues puts us in a very good position to sustainably grow the Company's financial strength and profitability.

In fiscal 2010, we made tremendous strides in our transformation process into a provider of ICT services. The results speak for themselves: QSC was able to more than double its free cash flow to € 27.7 million and more than quadruple consolidated net profit to € 24.2 million. In doing so, we not only significantly raised the share of IP-based revenues, which typically offer higher margins, but also built two promising IP-based lines of business, Managed Outsourcing and Open Access, while further accelerating the transformation process with the acquisition of IP Partner at year end.

« **Jürgen Hermann** // CHIEF FINANCIAL OFFICER

QSC's growing financial strength and profitability resulting from its transformation process is broadening the latitude available to the Chief Financial Officer. Hermann, an economist, is planning to distribute the Company's first dividend for 2011.

Joachim Trickl // CHIEF OPERATING OFFICER »

A trained physicist, he is responsible for the three business units. His ongoing dialogues with SMEs have made him intimately familiar with their ICT needs; and with this knowledge he structures QSC's product portfolio and sales organization.

freenet and TELE2, the first customers in new Managed Outsourcing business

In June, we won our first customer in the Managed Outsourcing business: freenet. In this new line of business, QSC is integrating its partners' TC networks into its own Next Generation Network and then operating their landline-based voice services, and in some cases also their data services. This enables us to better utilize our own network and to generate additional revenues that offer sufficient contribution margins. Our analysis indicates that six further players in Germany are still operating conventional TC networks – after having won freenet and TELE2, QSC sees these six as potential partners.

The number of potential customers is even higher in our second new line of business: Open Access. According to our observations, far in excess of 50 companies are already pushing the expansion of their infrastructures with fiber, thus exponentially broadening the bandwidth available to business and residential customers. All of these predominantly regionally operating providers of what is called Next Generation Access (NGA) are facing one major challenge: in order to rapidly amortize their capital expenses they need a correspondingly rapid rise in the number of customers, and those customers can best be won by trans-regionally operating marketers. With this Open Access platform, QSC has created an unrivaled solution to this problem: Germany's first nationwide network, process and services hub for NGA providers and marketers. Our first customers were Leipzig-based HL komm, Dortmund-based DOKOM, and 1&1 Internet.

In December, QSC then went on to acquire IP Partner, a fast-growing provider of Housing and Hosting services. With Hosting, IP Partner provides IT resources, such as servers and databases; with Housing, business customers install their own hardware in IP Partner's data centers, with their sophisticated security. There is growing demand for these ICT services, as they offer considerable efficiency advantages to enterprises while simultaneously helping these enterprises to ready themselves for a new ICT era: Cloud Computing. This way of using ICT, in which services are provided exclusively over the Internet, is taking on ever-increasing importance. With this concept, Housing and Hosting services replace stationary in-company solutions.

We look forward to collaborating with our new colleagues from IP Partner. With their proven IT expertise, they will be a valuable addition to our team. And we would like to take this opportunity to thank all of our people for their tremendous enthusiasm and commitment, as well as for their willingness to bring about the evolution of our Company into a provider of ICT services.

During the current fiscal year, QSC will be continuing this transformation process just as resolutely as in fiscal 2010. Our focus will be on further strengthening the Company's financial position and profitability, and again growing our IP-based revenues. At the same time, we will be further expanding our portfolio of solutions, products and services toward ICT services and pursuing two key innovations: Fixed/Mobile Integration and Cloud Computing. By interconnecting with a mobile carrier, QSC plans to also offer mobile voice and data services for the first time in 2011, which will enable the Company to provide one-stop sourcing for all the communication needs of business customers.

With its own Cloud Computing platform, QSC put in place early on a foundation for developing enterprise applications in the new ICT era. During the course of the year, we will be showcasing this unrivaled, user-friendly platform to the general public. Our know-how in this field has been recognized by the most recent award and financial support for our SensorCloud project from the German Federal Ministry of Economics and Technology (BMWi). SensorCloud is a central, highly scalable platform for networked sensors and control applications.

Award and support from BMWi for SensorCloud project

Early 2011 marks only the beginning of the Cloud Computing era. In the years to come, providers will still have to do a lot more development work and convincing in order to prompt business customers to make a broad-based shift of their ICT operations to specialized companies. However, QSC is already well prepared for the upcoming change: with Housing and Hosting, as well as the provision of secure broadband capacity, we offer the necessary infrastructure for using the Cloud. And with our Cloud Computing platform, we are laying the foundation for simple and efficient application development.

Plans call for the distribution of a dividend for the current fiscal year

All of these new lines of business show how dynamically QSC is developing into a provider of ICT services. For you, fellow shareholders, this transformation process offers a two-fold benefit: In 2010, capital markets already rewarded the consistent implementation of our strategy with a 94-percent rise in trading prices. At the same time, the growing percentage of IP-based revenues is strengthening our financial position and profitability, which in turn serves as the basis for the plans to distribute the first-ever dividend for the current fiscal year. In the coming years, as well, we want you to share in our Company's success in the form of a dividend, because this we know: QSC's success is based upon your ongoing enthusiasm and commitment. And for this we offer our sincere thanks.

Cologne, March 23, 2011

Dr. Bernd Schlobohm
Chief Executive Officer

Jürgen Hermann

Joachim Trickl

The Supervisory Board

In fiscal 2010, the Supervisory Board accompanied QSC's evolution into a provider of ICT services. This body is made up of both entrepreneurial individuals and large shareholders as well as two employee representatives. All shareholder representatives have been elected through the adjournment of the regular Annual Shareholders Meeting for the 2012 fiscal year.

Herbert Brenke • Chairman
An independent telecommunications consultant, he has been a member of the Supervisory Board since the Company's initial public offering. In the 1990s, he had built mobile communications provider E-Plus, and was in charge of its business from 1993 to 1998. Prior to that, he had been in charge of Thyssen Rheinstahl Technik and had been a member of the management board of Thyssen Handelsunion since 1983.

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 postgraduate economist has additionally been serving as the president of the VATM, the premier telecommunications industry association in Germany.

Klaus-Theo Ernst
In May 2008, the workforce elected the Head of Project Management at network operating company Plusnet as one of its two representatives on the newly formed QSC Supervisory Board. Klaus-Theo Ernst has worked at QSC since early 2001.

John C. Baker • Vice Chairman
Since 2000, the founder and general partner of the Baker Capital Group, a private equity firm based in the U.S., has represented QSC's largest shareholder on the Supervisory Board. A Harvard graduate, he has been active in the private equity industry for more than 25 years, and had already invested in QSC in 1999, prior to its initial public offering.

David Ruberg
Since November 2007, this postgraduate information technology professional has been the CEO of Netherlands-based Interxion, a leading European provider of data centers and managed services. A native of the United States, he has been a member of the QSC Supervisory Board since 2000.

Jörg Mügge
In May 2008, the QSC workforce elected the Head of Processes and Projects at Plusnet as its second representative on the QSC Supervisory Board. Jörg Mügge has been employed at QSC since April 2002.

Report of the Supervisory Board

for the 2010 fiscal year regarding the Company and the Consolidated Group

QSC's activities during the past fiscal year were characterized by its evolution into a provider of ICT services. In the ongoing transformation process, the Company succeeded in more than doubling its free cash flow year on year and even more than quadrupling net consolidated income during the same period. This success was based upon the achievements of all QSC employees, to whom, in addition to the Management Board, we would also like to express our thanks for their commitment and achievements during the past fiscal year.

Tasks of the Supervisory Board • During the past fiscal year, the Supervisory Board regularly provided advice on the management of QSC, monitored the work of the Management Board and performed all duties required by and in accordance with applicable laws and regulations and the Articles of Association. The Supervisory Board was directly involved in all decisions and measures of fundamental importance, in particular those relating to the Company's profitability, finances and net worth. After careful consideration, 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.

Issues of the Supervisory Board • The Management Board regularly and comprehensively informed the Supervisory Board in written and oral form on the development of business, utilizing monthly and quarterly financial reports as well as rolling actual vs. target comparisons in this connection. Inquiries and requests by the Supervisory Board for additional information were answered promptly and thoroughly by the Management Board. In joint meetings, 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 boards conducted regular conversations to discuss current issues arising between Supervisory Board meetings.

The main focuses of the Supervisory Board's activities in fiscal 2010 were:

1. The Company's strategy. The Supervisory Board discussed with the Management Board its decision to rigorously evolve QSC into a provider of ICT services, and kept itself constantly informed as to the progress being made in the transformation process.
2. The extension of Dr. Bernd Schlobohm's appointment. In a resolution adopted on March 16, 2010, the Supervisory Board extended Dr. Bernd Schlobohm's appointment as Chief Executive Officer of QSC AG by a further three years, through April 30, 2013, upon the expiration of his previous appointment effective April 30, 2010.
3. Modification of the contacts with members of the Management Board to reflect the requirements of the German Board Member Compensation Appropriateness Act ("VorstAG"). The extension of Chief Executive Officer Dr. Bernd Schlobohm's appointment prompted the Supervisory Board to review the compensation system for members of the Management Board against the background of the German Board Member Compensation Appropriateness Act of July 31, 2009, in its meeting on March 16, 2010, and to modify the contracts with members of the Management Board in order to strengthen the long-term alignment of the compensation paid to members of the Management Board. Further comments on the compensation system for members

Long-term alignment of Board Member compensation strengthened of the Management Board can be found in the Compensation Report. The Annual Shareholders Meeting on May 20, 2010, approved the compensation system for members of the Management Board that had been stipulated by the Supervisory Board.

4. The acquisition by QSC of the shares in Plusnet GmbH & Co. KG. ("Plusnet") held by Communication Services TELE2 GmbH ("TELE2"). The Management Board kept the Supervisory Board regularly informed, in particular at the regular meetings of the Supervisory Board on August 17 and November 18, 2010, as well as in the special conference call on December 20, 2010, as to the status of the months-long negotiations on the acquisition of TELE2's 32.5-percent shareholdings in Plusnet, which it held jointly with QSC. The Supervisory Board deliberated the project's legal and economic data with the Management Board on multiple occasions. Both of these bodies thoroughly discussed what the advantages and disadvantages would be for QSC as a result of TELE2's withdrawal from Plusnet, which had up until then been jointly financed. Particular attention was paid to the appropriateness of the purchase price to be paid by QSC for TELE2's shareholdings in Plusnet and of the compensation to be paid by TELE2 for premature release from its contractual obligations toward Plusnet. On December 20, 2010, the Supervisory Board agreed to the acquisition of TELE2's shareholdings by QSC under certain conditions – which were then satisfied.

Acquisition of TELE2's shareholdings by QSC gets approval

5. The acquisition of IP Partner AG. The Management and Supervisory Boards discussed in detail the reasons for and objectives of this acquisition at the regular Supervisory Board meetings on August 17 and November 18, 2010, as well as in the special conference call on December 20, 2010. In this connection, the Supervisory Board dealt, in particular, with the target company's financial parameters and basic technical details. On December 20, 2010, the Supervisory Board agreed to the acquisition of IP Partner AG by QSC under certain conditions – which were then satisfied.

Moreover, in fiscal 2010 the Supervisory Board dealt with QSC's internal control mechanisms, and in this connection especially with its risk management system as well as its corporate management and compliance in accordance with statutory requirements. The Supervisory Board reviewed these factors on the basis of submitted documents and in a dialog with the Management Board. It is the opinion of the Supervisory Board that the internal control and early risk identification systems are operating dependably.

Composition of the Supervisory Board • In fiscal 2010, the Supervisory Board continued to comprise four shareholder representatives, Supervisory Board Chairman Herbert Brenke, Supervisory Board Vice Chairman John C. Baker, Gerd Eickers and David Ruberg, as well as two employee representatives, Klaus-Theo Ernst and Jörg Mügge.

Meetings of the Supervisory Board and its committees • The members of the Supervisory Board conducted four regular meetings and one conference call meeting during the year under review. With the exception of one Supervisory Board member who was not in attendance at one meeting, all members attended all meetings and participated in the conference call in 2010.
The Supervisory Board has established three committees to support it in its work: The Compensation Committee, the Audit Committee and the Nominating Committee.
The Compensation Committee met one time during the year under review. The members of this Committee are its Chairman, Herbert Brenke, as well as John C. Baker and Jörg Mügge. The

Compensation Committee deliberated on potential models for aligning the compensation model for members of the Management Board that is currently in force at QSC to reflect the requirements of the German Board Member Compensation Appropriateness Act. On the basis of the results of these deliberations, the Compensation Committee readied the full Supervisory Board resolutions for the new Management Board contract for Dr. Bernd Schlobohm as well as the modifications to the existing contracts for Jürgen Herrmann and Joachim Trickl. In addition, this Committee also established the basis for the Supervisory Board's decision on the target agreements with the members of the Management Board, which are to be based upon the new model.

The Audit Committee consists of its Chairman, John C. Baker, as well as Herbert Brenke and Gerd Eickers. The Audit Committee monitors the accounting process, deals with the effectiveness of the internal control system and risk management system, as well as with compliance issues, and readies decisions for the full Supervisory Board relating to accounting issues. It additionally oversees the requisite independence of the independent auditor. The Audit Committee met two times during the past fiscal year. It readied the review of the financial statements for the full Supervisory Board, discussed with the Management Board the interim reports to be published, stipulated the focuses of the audit and negotiated and agreed upon the audit fees with the independent auditor. The Audit Committee also recommended to the full Supervisory Board that KPMG AG Wirtschaftsprüfungsgesellschaft, domiciled in Berlin and with a branch office in Cologne, again be proposed to the Annual Shareholders Meeting as the independent auditor for QSC AG and the Corporate Group for the 2011 fiscal year. On the basis of this recommendation, at its meeting on March 23, 2011, the Supervisory Board resolved to make a corresponding proposal to the Annual Shareholders Meeting.

The task of the Nominating Committee is to submit to the full Supervisory Board suitable candidates to be nominated at the Annual Shareholders Meeting in connection with an upcoming election of shareholder-representative members of the Supervisory Board. The members of the Nominating Committee are its Chairman, John C. Baker, and Gerd Eickers. Since there were no upcoming elections of shareholder representatives to the Supervisory Board, this Committee did not meet during the year under review.

The Chairmen of the Compensation and Audit Committees regularly reported to the full Supervisory Board on the work of their committees.

Corporate Governance • The Supervisory Board continuously monitors the evolution of the German Corporate Governance Code and its implementation at QSC. Pursuant to the Code, during the past fiscal year the Supervisory Board also reviewed the efficiency of its own activities. At its meeting on November 18, 2010, the Supervisory Board reviewed and confirmed that QSC AG was in compliance with the recommendations of the German Corporate Governance Code during the preceding year pursuant to the Declaration of Compliance that had been adopted the year before. At the same time, the Management and Supervisory Boards jointly issued an updated Declaration of Compliance pursuant to § 161 of the German Stock Corporation Act ("AktG"), and made this statement permanently available on the Company's website.

Supervisory Board confirms compliance with Declaration of Conformity

The Management Board – also acting on behalf of the Supervisory Board – reports on corporate governance in the Declaration of Corporate Management/Corporate Governance Report. During the year under review, there were no conflicts of interest, which must be disclosed without delay to the Supervisory Board, with information thereon being provided to the Annual Shareholders Meeting.

Audit • KPMG AG Wirtschaftsprüfungsgesellschaft, domiciled in Berlin and with a branch office in Cologne, audited both the Annual Financial Statements of QSC AG for the year ended December 31, 2010, which were prepared by the Management Board in accordance with the accounting principles set forth in the German GAAP ("HGB"), along with the Consolidated Financial Statements for the year ended December 31, 2010, which were prepared in accordance with International Financial Reporting Standards (IFRS), as well as the Management Reports regarding the Company and the Consolidated Group. The audit commission had been awarded by the Supervisory Board in accordance with the resolution adopted by the Annual Shareholders Meeting on May 20, 2010. The major focus areas of the fiscal 2010 audit included goodwill accounting, revenue deferral and accrual, accounting in connection with the Managed Outsourcing contract with freenet, institution of the German Accounting Legislation Modernization Act ("BilMoG") with respect to new accounting rules, as well as a review of the viability of the IT-supported systems.
The independent auditor issued an unqualified opinion both 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 2010 fiscal year.
The above-mentioned documents, including the audit reports from the independent auditor, were available in a timely fashion to all members of the Supervisory Board for review. At its meeting on March 23, 2011, taking into consideration the results of the preliminary review conducted by the Audit Committee, the Supervisory Board discussed all of the above-mentioned documents as well as the auditor's reports – including the practicality of utilizing accounting and valuation latitude as well as the potential risks resulting from future developments – with the Management Board and the independent auditor. At this meeting, the auditor also informed the Supervisory Board about additionally provided services and that there were no circumstances that could give rise to concerns about any biases he might have.
Having conducted its own examination, the Supervisory Board has no objections to the Annual Financial Statements of QSC AG for the 2010 fiscal year presented in accordance with HGB accounting principles, the Consolidated Financial Statements presented in accordance with IFRS or the Management Report regarding QSC AG and the Management Report regarding the Consolidated Group, and concurs with the findings of the audit conducted by the independent auditor.
In accordance with the recommendations of the Audit Committee, 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.

Consolidated Financial Statements of QSC AG for fiscal 2010 approved

Cologne, March 23, 2011
On behalf of the Supervisory Board of QSC AG

Herbert Brenke
Chairman of the Supervisory Board

QSC Share Performance

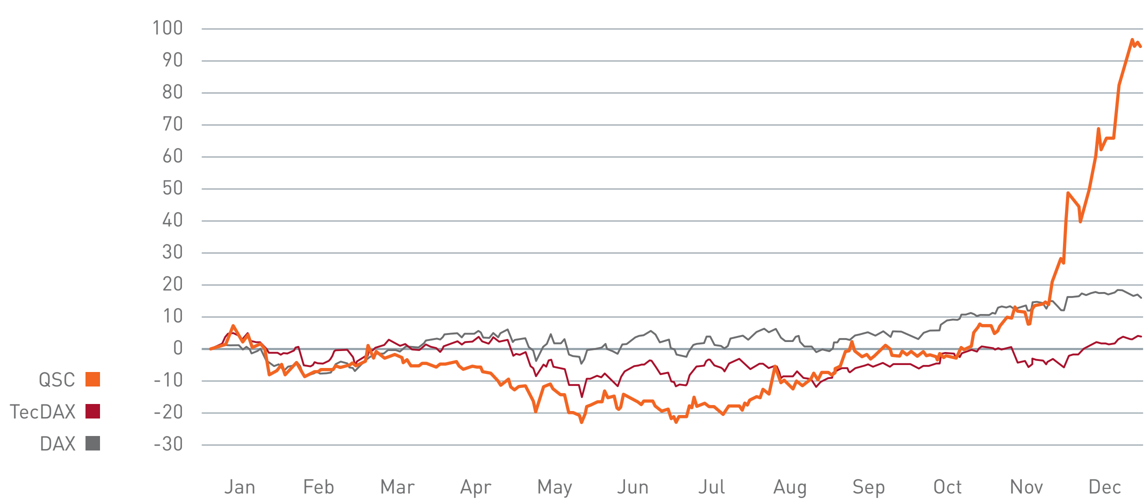
Broad-based upswing does not set in until fourth quarter of 2010 • After seeing an across-the-board recovery in Germany in 2009 as the world economy was gradually overcoming the global financial and economic crisis, share prices in Germany tended to develop on a cautious note in broad segments during the 2010 fiscal year. Discussions focusing on the stability of the euro, in particular, as well as the sustainability of the upswing, continued to concern numerous investors through autumn, which resulted in volatile or even declining trading prices. In the fourth quarter, the sharp economic upswing, especially in export-oriented economies like Germany, coupled with sustained positive corporate numbers, strengthened confidence, sparking a broad-based advance on German stock exchanges that lasted to the end of the year.

Broad-based advance on German stock exchanges in fourth quarter of 2010

This fourth-quarter rally played a major role in boosting the DAX by 16 percent over the full year of 2010, thus enabling this index to develop on a significantly better note than the TecDAX. Although by December 30, 2010, this lead index for technology shares had risen enough to offset the losses it had incurred during the course of the year, its total growth was only 4 percent. In contrast to various winners, such as QSC shares, weaker shares, especially from the solar industry, were burdened by various external factors over the course of 2010.

QSC trading price rises by 94 percent • By year-end 2010, QSC shares had proven extremely successful in freeing themselves from the poor example set by the TecDAX shares. Trading prices closed at € 3.30 on December 30, 2010; 12 months earlier, they had stood at € 1.70. This very positive development in the fourth quarter of 2010 nearly doubled trading prices within the space of a single year.

SHARE PRICE PERFORMANCE IN 2010 (indexed)



QSC shares had declined in value during the first two quarters of 2010, reaching their low for the year of € 1.29 on May 25. During the first half of the year, institutional investors, in particular, had taken a hesitant attitude toward buying. While they had been carefully following QSC's transformation processes into an ICT services provider, they admitted that they would postpone buying decisions until the QSC's successes manifest themselves more strongly in the quarterly results. And it was precisely these successes that were documented in the second quarter fiscal report announced on August 9, 2010, which showed that IP-based revenues had risen by 12 percent and free cash flow had nearly tripled within the space of a year. Prompted by this positive development, QSC at this point also raised its free cash flow forecast for the full fiscal year. The confidence shown by this move attracted the attention of numerous investors, which by the end of September 2010 caused trading prices to largely make up for the losses they had incurred up until that point. Announcement of the numbers for the third quarter of 2010 on November 8, 2010, prompted investors to finally overcome their skepticism. Both institutional and private investors realized just how rigorously QSC was pursuing its transformation process and the potential that this had for its trading prices. During the subsequent weeks, trading prices for QSC shares exploded, reaching their high for the year at € 3.48 on December 28, 2010. Its year-end trading price of € 3.30 on December 30, 2010, represented a market capitalization of € 452.5 million. This means that QSC's value on capital markets had risen by € 220 million within the space of twelve months.

QSC's market capitalization up by €220m in 2010

Trading volume of QSC shares up sharply at year-end 2010 • An analysis of trading volumes reveals the enormous dynamics of QSC shares in the fourth quarter of 2010. 55.0 million QSC shares were traded within three months, representing an average of 860,000 shares per day. A total of 123.1 million QSC shares changed hands in fiscal 2010, 16 million more than the year before. The increase in trading prices in the fourth quarter of 2010 and the high trading volumes this involved pushed stock exchange volumes upward by 51 percent to € 244.3 million in fiscal 2010. This strengthened QSC's position among the 30 most widely traded technology shares on German stock exchanges.

Analysts view QSC as a Buy in 2010 • At year-end 2010, 12 analysts were following QSC's transformation process into an ICT services provider. Their number had declined moderately by comparison with the year before. Three financial institutions, Merck Finck & Co, New Street Research and UniCredit, did not publish any new research in 2010. In addition, Sal. Oppenheim ended its coverage due to its acquisition by Deutsche Bank. However, there was an initial study from another institution, Close Brothers Seydler Research, which is especially active in the small- and mid-cap area.

Some analysts who have been following QSC for years recognized early on the successes in the transformation process – as well as their trading price potential – and had therefore already been issuing Buy recommendations for QSC shares during the first half of fiscal 2010. Further analysts followed suit after announcement of the numbers for the second quarter of 2010, causing the number of Buy recommendations to predominate at this point in time. However, the 94-percent rise in trading prices at year end then prompted several analysts to view QSC shares as being valued fairly in early 2011, and thus to classify these shares as a Hold.

FINANCIAL INSTITUTIONS THAT PUBLISH STUDIES ON QSC

Close Brothers Seydler Research	Exane BNP Paribas	Landesbank Baden-Württemberg
Commerzbank	HSBC Trinkaus & Burkhardt	Metzler Equities
Deutsche Bank	JPMorgan Cazenove	Silvia Quandt Research
DZ Bank	Kepler Capital Markets	Warburg Research

Intensive dialogue paying off • QSC's intensive dialogue with analysts was among the focal points of Investor Relations work during the past fiscal year. At the Analysts Conference in early March 2010 in Cologne, as well as in numerous personal and telephone conversations, the Management Board explained the background behind the transformation process along with QSC's opportunities as a mid-size provider of ICT services.

Growing investor interest in QSC during second half of year

During the course of fiscal 2010, the Management Board additionally presented its strategy and successes at roadshows in all major European financial hubs, as well as at capital market conferences conducted by such leading financial institutions as Berenberg Bank, Commerzbank, Deutsche Bank, Société Générale and WestLB. As a result of growing interest on the part of investors, there was a rise in both the number of visits to QSC by fund managers as well as the demand for conference calls with management, especially during the second half of the year.

In addition, the conference calls following announcement of the Company's quarterly numbers offered a further platform for dialogue. In fiscal 2010, QSC placed the presentations used in the calls, as well as the recordings of the comments made by the members of the Management Board, on a dedicated IR website, thus enabling a broad circle of interested parties to obtain first-hand information about these conference calls.

Numerous private investors made use of this new opportunity. The dialogue with this important category of shareholders formed a major part of the daily work of the IR Department again in fiscal 2010. Its objective is to ensure transparent financial communication with all market players and to provide comprehensive information to all interested parties.

BASIC INFORMATION ON 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, HDAX, CDAX,
	Midcap Market, Technology All Share,
	Prime All Share, DAX International Mid 100,
	DAXplus Family,
	DAXsector All Telecommunication,
	DAXsector Telecommunication,
	DAXsubsector All Fixed-Line Telecommunication,
	DAXsubsector Fixed-Line Telecommunication
Designated Sponsorship	Close Brothers Seydler Bank AG,
Shares outstanding as of December 31, 2010	137,127,532
Share class	No-par-value registered shares of common stock
Xetra closing price on December 30, 2009	€ 1.70
Xetra share price high in 2010	€ 3.48
Xetra share price low in 2010	€ 1.29
Xetra closing price on December 30, 2010	€ 3.30

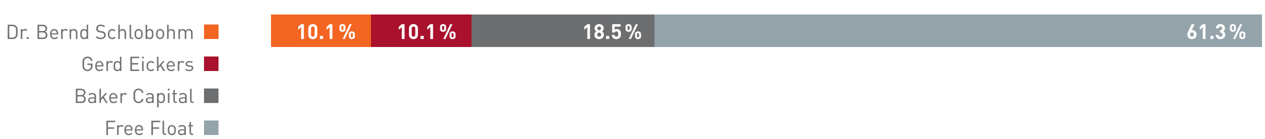
Extensive information offerings • Interested parties can find all relevant information relating to QSC and its shares at the Company's website: http://www.qsc.de/en/qsc-ag/investor-relations.html. This includes financial reports, IR press releases and documents relating to the Annual Shareholders Meeting, as well as analyst assessments, upcoming dates and comments on strategy. Moreover, the website also offers numerous opportunities to obtain timely information of relevance to capital markets. These offerings include an IR newsletter, an RSS feed and news disseminated by the social network Twitter. During the past fiscal year, the IR team expanded its communications via this new information channel in a targeted manner, and now offers interested parties the opportunity to receive the closing trading price at the end of each day, for example.

QSC's 2009 Annual Report earns overall grade of "good"

QSC views the Annual Report as its central information medium. As in previous years, the 2009 Annual Report, "An SME for SMEs", garnered a top-ten ranking among TecDAX issues in the widely followed "Manager Magazin" competition, earning an overall grade of "good." Since QSC is one of the smallest issues here, the IR team views this ranking as both a success and an incentive to continue informing our shareholders in the high-quality and comprehensive way that we always have.

Free-float rises in February 2011 • The website also offers current information about our shareholder structure. On December 31, 2010, the Company's three largest shareholders remained U.S.-based investment company Baker Capital, holding 24.5 percent of QSC shares, and QSC co-founders Dr. Bernd Schlobohm and Gerd Eickers, each holding 10.1 percent.
In February 2011, Baker Capital then notified QSC that its attributable shareholdings had been reduced to 18.5 percent in conjunction with a distribution of its closed-end funds, some of which have been in existence for more than ten years. These investors primarily consist of U.S.-based institutional addresses and family offices with a long-term focus. This transaction increases QSC's free-float to 61.3 percent.

SHAREHOLDER STRUCTURE AS OF MARCH 31, 2011



Percentage of institutional investors rises over the course of the year • On December 31, 2010, the free-float stood at 55.3 percent. 48.2 percent of these shares were attributable to private investors and 51.8 percent to institutional investors. There was a change in the composition of institutional investors during the course of fiscal 2010. On March 19, 2010, Deutsche Bank notified the Company that it now held less than the reportable thresholds of 5 and 3 percent; it had sold off all of its QSC holdings following its acquisition of Sal. Oppenheim. This share package was acquired by a handful of other institutional investors within the framework of a private placement. Overall, the Register of Shares showed that the number of QSC shareholders had declined moderately to 30,555 as of December 31, 2010, as opposed to 31,046 the year before.

» Revenues in information technology, telecommunications and digital entertainment electronics will rise by 2 percent to € 145.5 billion in fiscal 2011. The year after that, the total ICT market is expected to again grow by 2 percent to € 148.4 billion. The good economic situation and numerous innovations are giving rise to demand in the high-tech sector. One of the top trends is Cloud Computing.«

INDUSTRY ASSOCIATION BITKOM // CEBIT 2011

Group Management Report

The Company

BUSINESS OPERATIONS

QSC offers ICT solutions for small and mid-size companies • Established in 1997, QSC AG (QSC, or the Company) is a service provider for voice and data communications, as well as for the ICT services that build upon them. The increasing convergence of information technology (IT) and telecommunications (TC) is enabling QSC to broaden its portfolio of products, solutions and services to include innovative ICT services. Moreover, QSC additionally operates an Open Access platform, which unites a wide variety of broadband technologies, and uses this as the foundation for offering national and international locational networking, including Managed Services. Moreover, the Company makes available to its customers and marketing partners a comprehensive portfolio of telecommunications products that can be modularly adapted to every need and every access infrastructure.

Portfolio broadened to include innovative ICT services

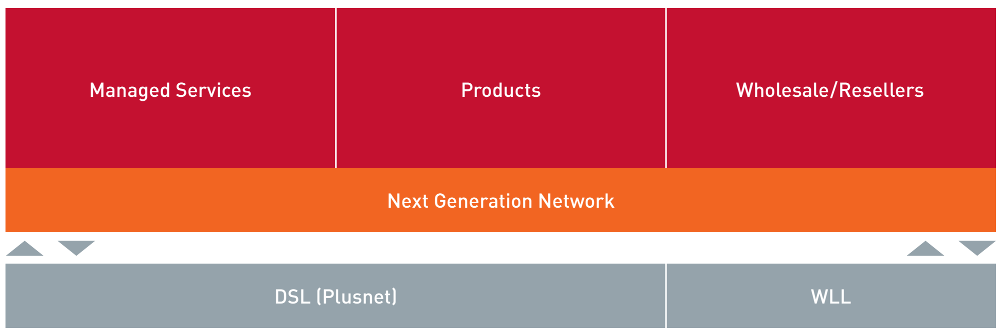
QSC, itself a mid-size company, has traditionally focused on small and mid-size business customers. The individual lines of business are divided into three business units (BU):

Managed Services • This business unit addresses some 8,300 larger and mid-size enterprises in Germany. QSC develops and operates custom-tailored ICT solutions and markets them through a nearly 30-person key account management organization. The foundation for these Managed Services typically consists of IP-based virtual private networks (IP-VPN), through which customers can securely operate all of their voice and data communications. Building upon these IP-VPNs, QSC offers numerous services, such as the operation of software-based telephone systems, as well as maintenance of local area networks and end-user devices. The acquisition of IT service provider IP Partner in December 2010 will enable QSC to offer more and more network-independent services, such as Housing and Hosting, in the future.

Products • With standardized products from QSC, small and mid-size companies can operate all of their voice and data communications over one and the same broadband line. The spectrum of offerings includes Internet connections, direct connections to the QSC voice network and Voice over IP products, as well as innovative solutions such as the IPfonie centraflex virtual telephone system. The target market for the Products BU consists of nearly 900,000 small- and mid-size companies in Germany, where as a general rule there is no employee who is responsible for information and communications technology. This means that they have to procure these services from regional partners. QSC is therefore focusing on partnering with some 100 regional distribution partners, distributors and systems houses.

Wholesale/Resellers • National and international carriers, Internet service providers, as well as telecommunications providers who do not possess infrastructures of their own, market DSL lines from QSC and the value-added services that build upon them under their own name and for their own account. QSC supplies unbundled DSL preliminaries and ensures smooth order management for the individual, directly-supported resellers via highly scalable IT interfaces. Moreover, this business unit also operates QSC's Wholesale voice business, under which QSC makes voice telephony services available to resellers who do not possess a corresponding nationwide infrastructure of their own. An outgrowth of this is Managed Outsourcing business, which was established in 2010 and in which QSC integrates the narrow-band voice networks of alternative providers into its Next Generation Network (NGN) and operates their entire landline business.

QSC'S BUSINESS OPERATIONS



QSC possesses a nationwide Next Generation Network • All of the business units use QSC's nationwide infrastructure. The Company operates a cutting-edge IP-based voice and data network, an IP-based Next Generation Network. Moreover, the Company also possesses one of the largest Wireless Local Loops (WLL) in Germany. This technology supplies bandwidths of up to 800 Mbit/s and is employed for Internet access and as a backup solution.

Network operating subsidiary Plusnet operates a DSL network over the last mile. It is based upon SHDSL.bis technology throughout, which means that it can ensure symmetrical speeds of up to 20 Mbit/s in sending and receiving data. Standardized technologies coupled with standard end-user devices enable partners and systems integrators to implement voice-data solutions in a relatively uncomplicated manner. QSC's own nationwide voice network, which alone has the maximum number of 474 so-called Points of Interconnection to Deutsche Telekom's voice network, rounds out the infrastructure and guarantees cost-effective provision of voice services.

KEY MARKETS AND COMPETITIVE POSITION

QSC collaborates with SME customers at eye level

Focusing on small and mid-size customers • QSC is an ICT provider for enterprises of every size – from trade contractors right through to large corporations. The focus is on serving small and mid-size customers, as QSC – itself a mid-size company – enjoys particular credibility here and can collaborate with customers at eye level. The Products and Wholesale/Resellers Business Units operate exclusively on the German market. In the Managed Services business, European sites are increasingly being integrated into national IP-VPN solutions

According to its own estimates, QSC's core TC market is nearly € 10 billion in size. Through its evolution into an ICT service provider, the Company is doubling the size of its addressable market to some € 20 billion. Further information relating to the size and development of QSC's relevant markets can be found under "General Industry Conditions" beginning on page 37.

QSC has established a good position in the marketplace in all three business units • In Managed Services, QSC is a mid-size player that numbers among the leading providers of networking solutions, in addition to internationally operating concerns Deutsche Telekom (DTAG), Telefónica and Vodafone. Ex-monopolist Deutsche Telekom is the Company's main competitor also in the Products segment, along with Versatel, Vodafone and city carriers like M-net and NetCologne. In this environment, QSC stands out in particular because it has the product and service quality of a mid-size provider. In the Wholesale/Resellers segment, QSC competes against the other alternative network operators in Germany, principally Telefónica and Vodafone. The NGN additionally affords the Company an excellent market position in voice business, as this enables QSC to offer voice services at extremely competitive terms and to smoothly integrate even entire networks.

NGN affords QSC with excellent position in voice business

LEGAL AND ECONOMIC FACTORS

Large areas of German TC market subject to regulation • QSC focuses on the German market for TC and IT services. Large portions of the German TC market are subject to regulation by the German Federal Network Agency. The purpose of this is to ensure fair competition in this market, where liberalization began in 1998. Up until then, Deutsche Telekom (DTAG) had operated as a monopolist on the German market; in fact, it still possesses from those days a nationwide infrastructure in all households. In connection with the subscriber line (local loop) – the distance between the central office or cable branch and the respective customer connection – alternative providers continue to be dependent upon this infrastructure, which was built during DTAG's time as a monopolist. During the past fiscal year, the following decisions relevant to QSC's business operations were issued by the German Federal Network Agency:

On April 21, 2010, the German Federal Network Agency issued a decision on the fees for access to DTAG's cable branches and conduit, thus making a follow-on decision to the one that it had issued on December 7, 2009, obliging DTAG to provide access to these facilities. This means that competitors possess fundamental opportunities to build VDSL-based broadband services on the basis of their own technical facilities. Especially during the current period of declining revenues for broadband connection services in the residential customer market, the amount of the fee leaves only little financial latitude. Consequently, no prominent DTAG competitor has thus far announced the establishment of its own VDSL infrastructure on the basis of this decision.

The German Federal Network Agency issued its decision relating to the provision and termination fees for unbundled access to subscriber lines on July 14, 2010. The newly stipulated fees will be valid through June 30, 2012. These fees constitute moderate reductions in comparison with the fees that had been applicable through June 30, 2010.

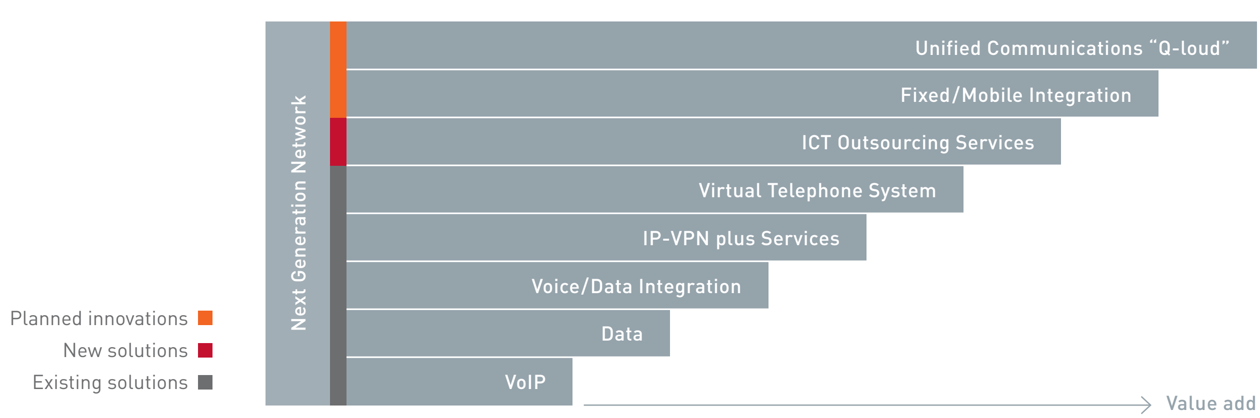
In the matter of mobile termination fees, the German Federal Network Agency issued an initial partial decision on December 8, 2010. Under this decision, it will be the first time that notification of the applicable fees will be made within the framework of a consultation and consolidation process pursuant to § 12 of the German Telecommunications Act; they will go into force retroactively effective December 1, 2010. The German Federal Network Agency's draft concept, dated

December 8, 2010, calls for reductions of between 49 percent and 53 percent relative to the previously applicable fees. However, the regulatory authority will not make a final decision until after the comments have been analyzed. It is not anticipated that the German Federal Network Agency will also use this procedure in connection with other fees for preliminaries in the future, such as for access to the subscriber line or the interconnection fees, although there is keen interest in this on the part of the European Commission.
On January 25, 2010, the German Federal Network Agency issued a regulation order concerning connection markets for voice communication. This ensures the continued existence of the regulatory obligation with respect to call mode selection (Call by Call and Preselect) for Deutsche Telekom connections. It not only covers existing voice connections (PSTN) but also includes the so-called All-IP connections of DTAG and its subsidiaries e.g., congstar). With this move, the German Federal Network Agency is guarding against strategic measures on the part of Deutsche Telekom aimed at avoiding this obligation. However, since the German Federal Network Agency did not order any implementation deadline, Deutsche Telekom succeeded in obtaining an administrative court injunction against this obligation for IP-based connections through December 31, 2010.

STRATEGY

Transformation into an ICT service provider • During the past fiscal year, QSC's strategy was based on its evolution from a network operator into an ICT service provider. Given the convergence of the IC and TC industries to form a consistent ICT market, QSC is using the opportunity to establish itself early on as the mid-size solutions provider for small and mid-size companies in this forward-looking market through expansion of its network-related services.

QSC'S TRANSFORMATION PROCESS



Concentrating on profitable growth • The Company's strategy has traditionally focused on profitable growth, and hence toward sustainably increasing the value of the Company. QSC strictly foregoes revenues that do not offer a sufficient contribution margin, preferring instead to concentrate on higher-margin IP-based lines of business; in fiscal 2010, the share of total revenues attributable to IP-based revenues rose to 68 percent, as opposed to 62 percent the year before.
Its evolution into an ICT service provider offers QSC a good foundation to continue increasing its profitability in the years to come. On the one hand, new high-margin revenue potential is opening up in such markets as Housing, Hosting and Cloud Computing; on the other, a service provider possesses a more flexible cost structure. This is because the landline network expenses and depreciation, in particular, are playing an increasingly less dominant role than in the case of a pure network operator. As part of this evolution, QSC is building on both internal resources as well as targeted acquisitions. A good example of this was the acquisition of Nuremberg-based Hosting and IT Outsourcing specialist IP Partner at the end of December 2010.
The strategy of concentrating on profitable growth is being augmented by far-reaching industrialization of all processes, as well as strict cost management. A strong balance sheet ensures financial independence.

Focusing on small and mid-size customers • QSC is positioning itself as a mid-size company for small and mid-size companies. Thanks to its size, QSC possesses a clear competitive advantage amongst small and mid-size companies, as it can more swiftly, flexibly and competently satisfy the needs of these customers. The Company's high service quality contributes substantially to its high level of customer satisfaction, which manifests itself, among other things, in the form of low termination rates and less customer complaints.

High quality of service contributes to high level of customer satisfaction

The Company intends to broaden its competitive advantage in the coming years, and thus win new customers. It plans to increase its percentage of the ICT budgets of its existing customers through cross- and up-selling of voice and data services, as well as through its offerings of additional network-related ICT services. By optimizing its service, QSC will at the same time further improve customer satisfaction and generate profitable growth

Central importance of the QSC workforce • It takes first-class people to provide first-class service. For this reason, the motivation and satisfaction of all employees is of crucial importance for QSC's corporate success. All employees are self-directed within their own areas of responsibility, which plays a significant role in employee satisfaction. The section entitled "Human Resources" that begins on page 32 contains detailed information relating to human resources development and leadership.
The high priority that QSC places on employee satisfaction ensures the loyalty of its professionals and executives and allows for the swift staffing of vacant positions. Moreover, the Company views itself as being well prepared for the forecast labor shortage, as it offers school graduates attractive training slots in conjunction with opportunities for advancement both within and outside the Company.

ORGANIZATIONAL STRUCTURE

The three BUs operate with a high degree of autonomy

QSC AG the hub of the organization • Cologne-based QSC AG is the parent corporation of the QSC Group and conducts its operating business in three business units. The Company has traditionally focused on its core competencies in technology and sales operations, and collaborates with service providers in the upstream and downstream value creation stages. Sales operations essentially occur within the three business units, to which the majority of the employees are organizationally allocated. Each of these business units has a clear customer focus and operates with a high degree of autonomy in its own markets; the respective business unit managers are responsible for their own revenues and profitability.

QSC AG's headquarters in Cologne are also the Company's largest location; a total of two thirds of the workforce are employed here. QSC's second largest location is Hamburg, where broadband provider Broadnet, which merged with QSC in October 2007, had previously been headquartered. In addition, the Company also maintains sales offices in Berlin, Bremen, Frankfurt, Hanover, Leipzig, Munich and Stuttgart. Since the acquisition of 100 percent of the shares of IP Partner AG, QSC has additionally been represented in Munich and Nuremberg with its own data centers and a powerful team for marketing ICT services.

Formed in the year 2000, IP Partner is a fast growing holding company that provides Housing and Hosting services for small- and mid-size companies through three operating subsidiaries, IP Colocation GmbH, IP Exchange GmbH and IPX-Server GmbH. With this acquisition at the end of the past fiscal year, QSC has accelerated its transformation process from a TC to an integrated ICT service provider.

One further major equity investment is in network operating company Plusnet GmbH & Co. KG, which was founded in July 2006. QSC has held 100 percent of its shares since October 31, 2010. Plusnet, which is located at QSC headquarters in Cologne, operates a nationwide DSL network. More in-depth information relating to the acquisition of the outstanding shares of Plusnet can be found in the section entitled "Events of major significance for the course of business" on page 43f.

In addition, Ventelo GmbH is another major equity investment. Acquired in late 2002, this company's offerings to small and mid-size customers include direct landline connections, preselect and call by call, as well as value-added services. Moreover, F&Q Netzbetriebs GmbH & Co. KG and T&Q Netzbetriebs GmbH & Co. KG, in which QSC bundles its Managed Outsourcing business with freenet and TELE2, respectively, have been in existence since 2010.

Furthermore, the Corporate Group includes numerous smaller companies which, in particular, market call-by-call offerings for residential customers. These companies, all headquartered in Cologne, are Broadnet Services GmbH, Broadnet Deutschland GmbH, tengo GmbH, 010090 GmbH, 010052 Telecom GmbH, 01012 Telecom GmbH, as well as 01098 Telecom GmbH.

Two further companies round out QSC's organizational structure. As a domain registrar, EPAG Domainservices GmbH specializes in registering and administering domain names, and stands among the leading domain name providers for resellers in Germany. Q-DSL home GmbH is where QSC has carved out its non-strategic DSL business with residential customers.

	Share in %
Major equity investments of QSC	
BroadNet Deutschland GmbH	100.0
Broadnet Services GmbH	100.0
EPAG Domainservices GmbH	100.0
F&Q Netzbetriebs GmbH & Co. KG	100.0
IP Partner AG	100.0
Plusnet GmbH & Co. KG	100.0
Q-DSL home GmbH	100.0
T&Q Netzbetriebs GmbH & Co. KG	100.0
tengo GmbH	100.0
Ventelo GmbH	100.0
010090 GmbH	100.0
010052 Telecom GmbH	100.0
01012 Telecom GmbH	100.0
01098 Telecom GmbH	100.0

HOW QSC IS STEERED

Consistent steering system throughout the entire organization • The Company is steered according to a consistent system involving three key metrics: cash flow per share, EBIT margin and revenue growth. The Company uses these steering parameters to ensure that well-balanced decisions concerning liquidity, profitability and growth are being made throughout the organization.

Three steering parameters: Cash flow per share, EBIT margin and revenue growth

QSC'S STEERING CONCEPT

Use of EBIT margin for steering ensures sustained profitability

The three business units, Managed Services, Products and Wholesale/Resellers, operate as independent profit centers, and are steered on the basis of the EBIT margin target parameter. This is the ratio between the costs attributable to the respective business units and their revenues as presented in the external segment reporting on page 113. This size ensures QSC the sustainable profitability of its operating business. Revenue growth, another key steering parameter, focuses on profitable and sustainable growth.
Cash flow per share is the ratio between free cash flow for the past period and the number of shares at the close of that period. As of December 31, 2010, QSC had earned a free cash flow of € 27.7 million; this is calculated from the change in liquid assets and interest-bearing liabilities. By focusing on free cash flow, QSC ensures the preservation of the Company's financial substance and independence. The key steering parameters developed as follows for the past two fiscal years:

	2010	2009
Cash flow per share (in €)	+0.20	+0.09
EBIT margin, Managed Services	+8.4%	(0.1%)
EBIT margin, Products	+9.0%	+5.0%
EBIT margin, Wholesale/Resellers	+2.7%	+2.0%
Revenue growth	+0.4%	+1.7%

In addition to these financial parameters, QSC also uses the following non-financial performance indicators to steer the Company internally: time-to-live for new customers, measurement of customer satisfaction through surveys, hotline availability and network uptime are employed to measure customer satisfaction as a strategic objective. Employee satisfaction as a strategic objective is currently being measured by personnel turnover as well as by a 360-degree survey that was introduced in the past fiscal year.

Monthly reports aid in steering • From an organizational standpoint, the following essential instruments are utilized to steer QSC:

- Bi-weekly meetings of the Management Board
- Monthly meetings of the Executive Board
- Monthly reports from the business units as well as the entire Group
- Monthly reports to the Supervisory Board
- Rolling planning for all operations throughout the Company

The management of opportunities and risks that is discussed in the Report on Risks ensures that any changes in exogenous factors will be directly incorporated into this steering system.

MANAGEMENT AND OVERSIGHT

Entrepreneurial spirit • Responsible for QSC's business is a three-member Management Board team that is headed up by co-founder Dr. Bernd Schlobohm, a man who embodies the highly entrepreneurial spirit that prevails throughout the entire organization. A six-member Supervisory Board, which is elected under German co-determination rules, oversees the activities of the Management Board and advises it. The Management Board is also a member of the ten-person Executive Board, which is in charge of daily operating business. At year-end 2010, this body was made up of the following members:

Executive Board is responsible for daily operating business

Members of the Executive Board	Function
Dr. Bernd Schlobohm	Chief Executive Officer (CEO)
Jürgen Hermann	Management Board member (CFO)
Joachim Trickl	Management Board member (COO)
Thomas Surwald	Head of Managed Services Business Unit
Arnold Stender	Head of Products Business Unit and
	Head of Wholesale/Resellers Business Unit
Ralph Vaupel	Head of Information Technology
Martin Rüther	Head of Human Resources and Purchasing
Tobias Gramm	Head of Legal Affairs
Dr. Jürgen Mattfeldt	Head of Strategy
Frank Thelen	Head of Telecommunications Technology

The Management Board is responsible for the business of the entire QSC Group. The heads of the business units and corporate staff departments report to it for all professional and disciplinary questions. The Rules of Procedure assign individual areas of activity to each of the members of the Management Board. The heads of the business units manage the professional and disciplinary issues arising within their respective activities and are responsible for their business units' revenues and profitability. In their operations they use the services of such corporate staff departments as Finance, Marketing and Human Resources. The Declaration of Corporate Management that begins on page 130 contains further information relating to the operations of the Management and Supervisory Boards.

EXPLANATORY REPORT ON THE STATEMENTS PURSUANT TO § 315, PARA. 4, GERMAN COMMERCIAL CODE (HGB)

Customary rules for a publicly traded corporation • The following overview presents the situation with respect to the mandatory statements pursuant to § 315, Para. 4, of the German Commercial Code (HGB): Overall, these are rules that are typical and customary at publicly traded corporations. The following information presents an overview of prevailing conditions on the balance sheet date.

Composition of capital stock • The capital stock of QSC as of December 31, 2010, amounted to € 137,127,532, and was classified into 137,127,532 no-par bearer shares of common stock. According to the Share Register, the capital stock was divided among 30,555 shareholders as of December 31, 2010.

Limitations of voting rights or transfers of shares • Each share possesses one vote. The Management Board is not aware of either limitations to voting rights or restrictions on the transfers of shares.

Each co-founder held 10.1 percent of QSC shares at year-end 2010

Direct or indirect holdings of more than 10 percent of capital • As of December 31, 2010, QSC's two founders, Dr. Bernd Schlobohm and Gerd Eickers, each held 10.1 percent of the total of 137,127,532 shares, with the U.S.-based Baker Capital equity investment company holding 24.5 percent.

Holders of shares with special rights granting controlling authority • There are no special rights that grant controlling authority.

Controlling authority over voting rights enabling employees to share in capital • There are no controlling authorities with respect to voting rights.

Appointment and dismissal of members of the Management Board • The appointment and dismissal of members of the Management Board is governed by §§ 84, 85, German Stock Corporation Act (AktG), as well as by § 7 of the Articles of Association and Bylaws, as amended February 1, 2011. Pursuant to § 7 of the Articles of Association and Bylaws, the Management Board can comprise one or more individuals. The Supervisory Board determines the number of members of the Management Board. Even though the capital stock of the Company amounts to more than three million euros, the Supervisory Board can stipulate that the Management Board can consist of only one individual. The appointment of deputy members of the Management Board is permissible.

Amendments to the Articles of Association and Bylaws • Pursuant to § 179, German Stock Corporation Act, in conjunction with § 20, Para. 1, of the Articles of Association and Bylaws, as amended February 1, 2011, amendments to the Articles of Association and Bylaws require a resolution adopted by a majority of at least 75 percent of the share capital represented at the Annual Shareholders Meeting. Pursuant to § 15 of the Articles of Association and Bylaws, the Supervisory Board is authorized to resolve amendments to the Articles of Association and Bylaws that relate only to matters of form and do not involve any changes to the actual content thereof.

Acquisition and buyback of QSC shares • The resolution of the Annual Shareholders Meeting on May 20, 2010, authorized the Management Board pursuant to § 71, Para. 1, No. 8, German Stock Corporation Act, to acquire QSC shares totaling up to 10 percent of the capital stock of the Company by May 19, 2015. The Management Board did not make use of this authorization.

Authorized capital • The Management Board is authorized, with the approval of the Supervisory Board, to increase the capital stock, on one or several occasions through May 19, 2015, to a total of € 65,000,000 (authorized capital) through the issuance of new no-par bearer shares against contributions in cash or in kind. In utilizing the authorized capital, the Management Board can, with the consent of the Supervisory Board, preempt the shareholders' right of subscription in the following four cases: (1) for rounding purposes resulting from the subscription ratios; (2) if the new shares are issued against contributions in kind, especially in conjunction with corporate acquisitions; (3) if, pursuant to § 186, Para. 3, Sent. 4, German Stock Corporation Act, the new shares are issued against contributions in cash, and if, at the time of final stipulation, their issue price is not materially lower than the trading price of shares already issued; (4) in order to ensure that shareholders and/or the creditors of option and/or convertible bond issues retain a right of subscription to new shares.

The purpose of authorized capital is to enable QSC to respond swiftly and flexibly to opportunities that present themselves on the capital market and to obtain equity capital at favorable terms if needed. It was not used during the past fiscal year.

QSC is able to respond swiftly to opportunities in the capital market

Conditional capital • The Company's conditional capital as of the balance sheet date amounted to a total of € 28,343,602, and was classified as follows: Conditional Capital III, amounting to € 482,237; Conditional Capital IV, amounting to € 25,000,000; Conditional Capital VI, amounting to € 1,490,760; as well as Conditional Capital VII, amounting to € 1,370,605.

With the exception of Conditional Capital IV, the conditional capital is employed to secure the conversion rights of holders of convertible bonds that QSC has issued or can issue within the framework of existing stock option plans to members of the Management Board, to the managing directors of affiliated companies, to employees, and to other individuals involved in the Company's success. The Management Board can utilize Conditional Capital IV to create publicly tradable option and/or convertible loans that will allow it to make available an additional, low-interest financing option for the Company, given favorable capital market conditions. Only in the following

three cases is the Management Board authorized, with the consent of the Supervisory Board, to preempt the shareholders' right of subscription to these option and/or convertible loans: (1) for rounding purposes resulting from the subscription ratios; (2) to ensure the right of subscription for the holders/creditors of previously issued conversion and option rights; (3) if, pursuant to § 186, Para. 3, Sent. 4, German Stock Corporation Act, their issue price is not materially lower than their trading price. The Management Board has thus far not utilized the authorization to issue publicly tradable option and/or convertible loans.
The preemption of the shareholders' right of subscription and acquisition, which pursuant to § 186, Para. 3, Sent. 4, German Stock Corporation Act, is justified only in the case of a price that is similar to the stock market trading price, may apply only to an aggregate total of not more than 10 percent of the capital stock for treasury shares, authorized capital, option and convertible loans during the term of the respective authorization.

Major agreements in conjunction with the condition of a change in control resulting from an acquisition offer • In fiscal 2008, QSC entered into a contract with three financial institutions for a line of credit in the amount of € 50 million; this contract provides the financial institutions with the option of special termination should a natural or legal person, acting either alone or together with others, gain control over QSC. No further agreements exist for condition in which a change of control results from an acquisition offer.

Indemnification agreements in the event of an acquisition offer • No indemnification agreements covering the event of an acquisition offer are in force with either the members of the Management Board or employees.

RESEARCH AND DEVELOPMENT

Establishment of a dedicated R&D Department • The Company has traditionally viewed Research & Development as being a cross-organizational task. Innovation is part of the daily work of our employees, who develop quality and process innovations in dialogue with the customer. These innovations, for example, ensure the smooth migration of the customer's complex IT and TC systems to QSC's portfolio of services and serve as a key prerequisite for long-term collaboration.
With its evolution into an ICT service provider, further opportunities are opening up for QSC; the Company can now increasingly win new customers with innovative, network-independent services and ensure even greater loyalty among the existing customer base. During the past fiscal year, this prompted QSC to create a dedicated department for business development, staffed with two permanent employees. The team is supported by employees from a variety of line departments, who pursue business development projects one or two days a week. All developers utilize internal know-how and external studies to identify trends and niches in the ICT market early on and to develop innovations accordingly.

Focus on Q-loud service platform • QSC is concentrating on the concept for and development of ICT applications that increase the profitability of companies. During the past fiscal year, the Company put in place the foundation enabling them to swiftly and easily provide these kinds of applications through the development of a network-independent platform that is based upon Open Source elements: Q-loud. This Cloud Computing platform will enable QSC itself, as well as its partners and customers, to develop custom applications. Conceivable applications would include the areas of Unified Communications, Business Process Outsourcing and Sensor Control. QSC plans to debut the first of its own applications during the course of fiscal 2011.
The platform idea is what also characterized the second innovation in fiscal 2010: In August, QSC introduced the first nationwide Open Access platform, a network, process and services hub for providers and users of so-called Next Generation Access (NGA) connections. These kinds of connections with bandwidths of 100 Mbit/s and more are currently being developed on a regional scale through the expansion of fiber optic infrastructures extending right into the building. The intelligent NGA platform also enables regional providers to market their broadband lines via inter-regional Internet service providers; the first customers are Leipzig-based fiber optic network operator HL komm, and marketer 1&1 Internet.

Close ties to operating business guarantee success • Work on these kinds of innovative services is conducted through a dialogue with both internal experts as well as potential customers; beyond that, QSC has fostered collaboration with universities in the region, such as the RWTH Aachen and the University of Applied Sciences in Cologne. Since QSC views development work as being closely linked with its operating business wnd as a cross-organizational task, the Company therefore does not record the costs incurred in this effort separately as a research and development line item. Instead, the costs of working on innovative products, services and processes are included in the major line items of cost of revenues, sales and marketing expenses, as well as general and administrative expenses.

In 2010, QSC drove collaboration with universities in the region

SOCIAL RESPONSIBILITY

Focusing on three major issues • QSC lives up to its social responsibility through three major categories within Corporate Social Responsibility (CSR): responsible corporate management, sustainable business practices and social commitment. Further information on corporate management can be found in the corresponding report that begins on page 130. In addition, CSR activities focus on social commitment, with information on this issue being included in the Human Resources section that begins on page 32. QSC firmly believes that by training young adults and supporting educational initiatives, for example, it can make a greater contribution to the evolution of our society than it could by emphasizing even greater resource conservation.

CORPORATE SOCIAL RESPONSIBILITY AT QSC

TC services help to conserve energy and reduce CO_2 emissions

Because telecommunications services are already making a major contribution to energy conservation and reduced CO_2 emissions today in many ways. Good examples are that telecommunications provides the option of transmitting large volumes of data over the Internet, instead of having to send them by courier, and that it makes possible the option of substituting videoconferencing for business travel. Moreover, broadband Internet connections are a key prerequisite for work-at-home plans, which also reduce CO_2 emissions – instead of commuting from home to work, work is brought home. Working in close coordination with customers, QSC is developing efficient telecommunications solutions in this area. In keeping with this idea, the Company also uses work-at-home plans and videoconferences for its own operations.

Resource conservation is a guiding principle for QSC in all areas, especially in connection with its purchasing policies. The Company is constantly optimizing its energy inputs, for example, by deactivating unused ports in central offices and swiftly replacing outmoded servers and energy-intensive computers. Since 2009, QSC has been procuring the lion's share of its electricity from renewable energies.

The Purchasing Department monitors the overall lifecycles of all resources that are used at QSC, and ensures that materials are largely reused within the framework of statutory regulations and beyond. This department additionally ensures that the fundamental ideas of sustainable economic growth and energy efficiency are given appropriate consideration when purchasing new hardware or company cars.

Human Resources

WORKFORCE

Rigorous process orientation boosts productivity • QSC had already industrialized many of its processes in previous years, enabling it to offer its products and services to its customers with a high degree of automation, and thus at highly competitive terms and conditions, in fiscal 2010. During the past fiscal year, this higher level of automation led to a declining head count, primarily due to the Company not re-staffing positions as they became vacant. Measured in terms of full-time equivalencies, QSC employed a workforce of 608 people on December 31 of the past fiscal year, compared with 664 people at year-end 2009. The productivity gains stemming from this automation are demonstrated by the increase in per-capita revenues, which rose by 10 percent to € 694,000 in fiscal 2010, compared with € 633,000 the year before.

At year-end 2010, QSC employed a workforce of 608

PRODUCTIVITY PER EMPLOYEE (in K€)

Increasing importance of home offices • QSC's largest location is Cologne, where all consolidated Group companies, with the exception of EPAG Domainservices, were registered legally at year-end 2010. Overall, a total of 398 people were employed here as of December 31, 2010. Its 70 jobs make Hamburg the second-largest location; until the merger in October 2007, broadband operating company Broadnet had been housed there. A further 100 people are distributed among the six sales offices and two branch offices throughout Germany and among EPAG's head office. In addition, home offices are taking on increasing significance. 40 employees are today working primarily from their home offices; this represents 7 percent of the workforce.
Legally speaking, the majority of the employees are employed at QSC AG, which had a workforce of 528 people on December 31 of the past fiscal year. Network operating company Plusnet GmbH & Co. KG had 68 employees, EPAG Domainservices GmbH 12.

Clear focus on sales and technology • QSC has traditionally focused on its core competencies in the fields of sales and technology. As of December 31, a total of 54 percent of our employees were working in distribution-related areas; these include the three business units, along with Marketing, and Quality and Complaint Management. 33 percent were working in technical operations to ensure smooth operation of the nationwide infrastructure, while simultaneously making major contributions toward evolving QSC into a provider of ICT services. Only 13 percent of all employees were working in administration.

WORKFORCE STRUCTURE

HUMAN RESOURCES MANAGEMENT

QSC introduces variable salary elements for all employees

QSC establishes uniform HR environments for all employees • QSC's success is based upon the achievements of all its people; their motivation, enthusiasm and commitment represent the Company's major asset. Increasing employee satisfaction therefore enjoys special attention and numbers among QSC's three strategic objectives. During the past fiscal year, the Company undertook extensive measures to further improve this core parameter. Among other things, a variable salary component was introduced for all employees, and clear career paths for professionals and executives were laid out. This will allow professionals with outstanding, specialized knowledge to advance independently within the company, as Human Resources has now been relieved of the responsibilities of promotion and transfer.
An internal roadshow in 2010 familiarized all employees with both the expanded options for their careers as well as the improved compensation system. Moreover, Human Resources management additionally informed about the opportunities for company old-age pensions and customized working hours. Because here, too, QSC has modernized conditions, enabling each and every employee to work flexibly either partially or entirely from home, as coordinated with his or her supervisor. All measures met with a positive response on the part of the workforce.

COMPENSATION

Variable compensation for all employees • With the introduction of a variable compensation component for all employees, QSC again improved its performance-based compensation system in the past fiscal year. The Company has traditionally not been subject to any collective-bargaining agreements, preferring instead to utilize a compensation system that is geared toward QSC's needs. A variable salary system that is based upon an over-arching Company agreement is in place for executives and professionals. Under this system, the degree to which variable compensation is tied to corporate objectives increases as executive responsibility rises; in fiscal 2010, free cash flow was the decisive parameter here.

100 percent of the variable compensation for members of the Executive Board depended on free cash flow in 2010 – subject to reaching the previous year's revenue level – and thus rewarded them for their commitment to the Company as a whole. Corporate objectives account for 70 percent in the case of second-tier management; 30 percent of the variable compensation here is measured on the basis of so-called performance targets, which can relate to either individual targets or to targets in that employee's own area. On the two next levels of the hierarchy, the share of compensation accounted for by these performance targets rises to 50 and 70 percent, respectively, thus intentionally providing a greater reward for accomplishments in the employee's own work environment.

Compensation report • Detailed information relating to the compensation paid to members of the Management Board is contained on pages 130 ff. of the Corporate Governance Report; the compensation report contained therein is an element of the Group Management Report.

INITIAL AND CONTINUING TRAINING AND EDUCATION

Trainee ratio rises to 7 percent • As of December 31, 2010, 43 young adults were being trained at QSC, eight more than the year before; this increased the trainee ratio to 7 percent. The Company views its commitment to in-company training not just as an essential element in securing new blood for the future, but also as an important contribution to its social responsibility. In fiscal 2010, QSC trained information technology specialists in systems integration and applications development, as well as administrative clerks and IT systems clerks.

TRAINEE RATIO

Moreover, administrative clerks had the opportunity to participate in a two-track course of study at the FOM University of Applied Sciences in Cologne; at year-end 2010, five employees were taking advantage of this integrated theoretical and practical training. In addition, QSC is also involved in training university graduates as part of an internship program. On December 31, 2010, the Company employed five interns for training in business operations areas.

Administrative clerks can complete a two-track course of study at FOM

In the future QSC will continue to win new talent for the Company by fostering trainees and students, and will encourage their loyalty to the Company through a targeted Human Resources policy. Planning calls for a further 15 trainees to be recruited for fiscal 2011.

Every employee can enjoy continuing training and education • 70 percent of the workforce has a qualified vocational or professional education, while 30 percent possess advanced degrees. They all have the opportunity to keep current their knowledge through continuing training and education. For this purpose QSC primarily employs internally developed measures and fosters a sharing of experiences across departmental borders. In this environment, key areas of training include broadening the employee's professional and methodological knowledge, coaching and accompanying new employees, and leadership and management.
In the training courses offered, the focus in fiscal 2010 was on using expert and leadership workshops, project management, presentation training, as well as time and stress management to broaden our employees' professional and leadership competencies. During the past fiscal year, QSC spent a total of € 0.3 million on external measures.

CORPORATE CULTURE

Four principles make up QSC's value system • All employees embrace a common value system. The following four principles provide navigational guidance in this area:

- **We serve the customer** • The sole measure of QSC's performance is how it is valued by its customers.
- **We are a strong team** • QSC embraces collaboration in a spirit of partnership through fair, open and trustworthy dealings with both internal and external counterparts.
- **We live communication** • QSC practices clear, purposeful and targeted communication that is characterized by mutual respect.
- **We create values** • QSC assigns a high level of responsibility to each and every employee, and trusts them to always make their decisions with the goal of increasing the value of the Company.

Interactive corporate culture helps to encourage employee loyalty

Building upon these principles, QSC has developed an interactive corporate culture that is helping to encourage the loyalty of its people to the Company; more than one half of the workforce has been employed at QSC for more than five years; 116 colleagues have worked for the Company for more than ten years, or since the year QSC went public. One example of its good work environment is the Company's absenteeism rate of 3.3 percent during the past fiscal year, low by comparison with the industry average.

QSC pays attention to compatibility between family and work • A major element of QSC's value-based corporate culture is an understanding for the personal situation of every employee; thus, a given employee's wishes are taken into consideration within the framework of the opportunities offered by a mid-size employer. This includes the creation of work-at-home positions as well as part-time work; in 2010, the part-time ratio stood at some 6 percent.

The use of flexible working hours throughout the organization facilitates compatibility between family and work; there are no core working hours, and all employees are free to handle a portion of their work from home, as coordinated with their supervisor. Moreover, 12 employees were regularly on parental leave during the past fiscal year, and QSC makes a very special effort to ease parents' re-entry into working life. This also includes offering both male and female employees options to further their careers as professionals or executives. During the past fiscal year, the share of female executives rose to 13 percent.

Flexible working hours facilitate compatibility between family and work

Social commitment to youth • In its social commitment as a mid-size company, QSC has begun initiatives within the Company or its direct environment that emphasize such issues as in-company training and compatibility between family and work. In addition, QSC has been a primary sponsor of the GOFUS initiative since the year 2002. GOFUS (www.gofus.de) is an association of active and former professional soccer players who use golf tournament proceeds to promote initiatives that provide assistance to economically disadvantaged children and young people. The spectrum of activities ranges from providing support for daycare facilities to running programs that ease young people's entry into working life.

Economic Conditions

GENERAL ECONOMIC CONDITIONS

World economy sailing on course of growth • In the wake of the most serious recession in post-war history, the global economic situation improved noticeably over the course of 2010. According to calculations by the International Monetary Fund, the high growth dynamic of the Asian economies, in particular, sparked a 4.8 percent rise in world gross domestic product, in comparison with a decline of -0.6 percent the year before. The industrialized countries saw a two-track development. While southern European economies, in particular, still battled to overcome the recession, export-oriented countries like Germany benefitted in the growing global demand. In this environment, German gross domestic product rose by 3.6 percent, after having suffered a -4.7 percent decline the year before; however, this did not help the German economy return to the level it had held prior to the outbreak of the global financial and economic crisis.

GDP DEVELOPMENT IN GERMANY

According to calculations by the German Federal Office of Statistics, exports were once again the country's most important growth driver in 2010: following a slump of -14.3 percent the year before, exports rose by 14.2 percent. Over the course of the year, however, the foundation for the upswing broadened, as both private and public sector consumption, as well as capital investments, picked up speed. The growth was especially noticeable with regard to investments in equipment: the volume of these investments rose by 9.4 percent after having slumped by -22.6 percent in the recession year 2009. And telecommunication providers, like QSC, who focus on business customers are benefiting from the growing willingness on the part of enterprises to invest in modern systems.

Prices for TC services in Germany were down -2.6 percent

As in years before, prices in the telecommunications industry continued to remain under pressure. While consumer prices in Germany in December 2010 were up 1.7 percent from their previous year's level, they declined by -2.6 percent in telecommunications; in no other category of goods did the German Federal Office of Statistics record such a strong decline in prices. While prices for voice telephony services for residential customers, in particular, continued to be under pressure, there was often considerable price competition in other market segments, as well. One good example of this is the DSL market for residential customers, in which QSC is represented through Wholesale partners: in fiscal 2010, numerous providers again lowered their flat rate offers to prices of below € 20 per month.

GENERAL INDUSTRY CONDITIONS

German ICT market overcomes recession • According to calculations by industry association BITKOM, revenues in the German ICT market rose moderately by € 2.7 billion to € 142.7 billion during the past fiscal year, following a decline in 2009. Within this market, QSC focuses on network-based and network-related ICT services for small- and mid-size business customers. According to the Company's own calculations, revenues in this market, which QSC is able to take part in thanks to its evolution into a provider of ICT services, rose to nearly € 20 billion. Its transformation process is enabling the Company to double its addressable market. Its previous core market, TC services for small- and mid-size business customers, had afforded a volume of nearly € 10 billion.

Addressable market affords volume of nearly € 20 billion

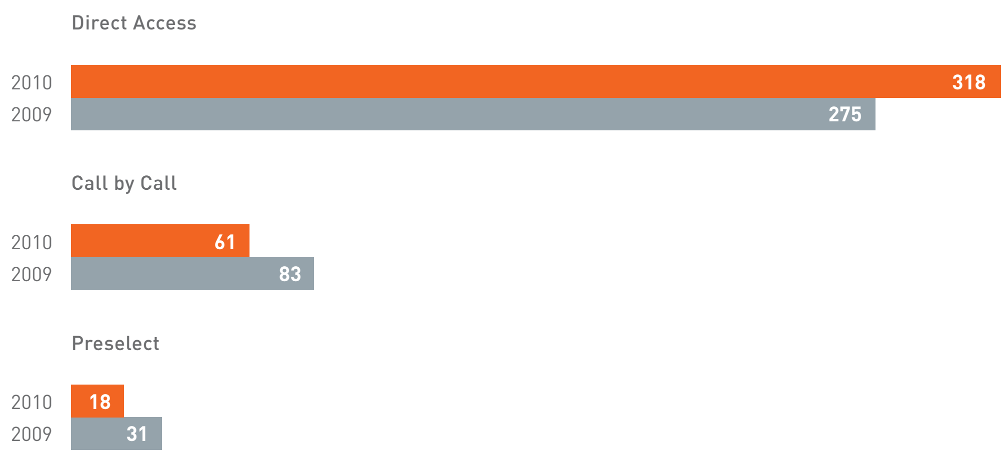
ICT MARKET IN GERMANY (in € billions)

The German ICT market developed along two tracks in 2010: while business with TC services stagnated, IT providers benefited from growing demand on the part of residential and commercial customers. And there was also a two-track development within the field of telecommunications: while business with data services improved significantly, revenues from voice services continued to decline as a result of price competition.

An analysis of the voice services business that was conducted by the VATM, an association of alternative TC providers, shows that the trend toward all-in-one connections was sustained in 2010. While, on the other hand, other voice offerings declined considerably in importance: the total number of Call-by-Call voice minutes per day declined by 27 percent during the past fiscal year and the number of Preselect voice minutes per day declined by a significant 42 percent. Thus, according to information from the VATM, all-in-one connections accounted for 80 percent of the total 397 million voice minutes per day; the year before, this parameter had stood at only 71 percent. And among these connections, a growing percentage are based upon Voice over IP technology – calculations by the VATM show that their number rose by 41 percent to 5.2 million in 2010.

In the data services business, the number of broadband connections rose by 1.8 million to a total of 26.9 million. Yet alternative types of connections, especially cable TV and in some cases fiber optic cable, were able to win a greater number of customers than Deutsche Telekom and its DSL competitors. At year-end 2010, 650,000 households in Germany were connected to a fiber optic network that reached right to the building – three years ago, this number had stood at only 110,000. And QSC was the first company to create a nationwide Open Access platform in order to make this new infrastructure available beyond a single region.

VOICE CALL MINUTES IN GERMANY (in million minutes per day)



DSL technology dominates among enterprises • Most enterprises in Germany continue to opt for DSL technology, with its share of the broadband connection market totaling 96 percent in 2010. Overall, IDC calculations show that the number of DSL connections at enterprises rose by 112,000 during the past fiscal year to total 2.9 million. However, the corresponding spending continued to remain constant at € 1.2 billion.

The German IP-VPN market grew by 6 percent to € 1.5 billion in 2010

Beyond pure data transfer, enterprises also utilize DSL connections for cross-locational IP-VPN solutions. According to IDC calculations, the German IP-VPN market grew by 6 percent during the past year to € 1.5 billion.

DSL CONNECTIONS AT ENTERPRISES (in millions)

VoIP market grows by 29 percent • Enterprises are also making increasingly greater use of their broadband connections for voice telephony – the Voice over IP market for business customers is growing by leaps and bounds. In 2010, according to information from IDC, revenues in this market rose by 29 percent to € 0.5 billion. What are rising in this connection are not only billable call volumes, but also the market for additional services.

VOIP BUSINESS CUSTOMER MARKET (in € billions)

Cloud Computing, the concept of shifting business processes to the Internet, is playing a key role in QSC's evolution into an ICT service provider, as Cloud Computing requires powerful telecommunications services in order to be implemented. In October 2010, umbrella organization BITKOM submitted a prediction regarding the future of Cloud Computing, calling for its revenues in Germany to grow from € 1.1 billion today to € 8.2 billion by the year 2015.

Cloud Computing revenues to grow to € 8.2 billion by 2015

IMPACT OF THE GENERAL ENVIRONMENT ON QSC

Transformation process opening up new market opportunities • Activities at QSC in 2010 focused on its evolution into an ICT services provider and on IP-based revenues. This will enable the Company to double its market potential while step-by-step reducing its dependence upon the classical German TC market with its often intense price competition. In this transformation process, QSC benefited from the economic growth during the past fiscal year and from the rising willingness on the part of small- and mid-size enterprises to invest in the innovative ICT services that this involved.

Profitability, Financial Position and Net Worth

COURSE OF BUSINESS

Double-digit growth in IP-based revenues • During the past fiscal year, QSC increased its revenues to € 422.1 million, compared to € 420.5 million in 2009, while successfully continuing its transformation from a network operator to a services provider. In fiscal 2010, revenues from its classic products as a network operator, such as Call by Call and ADSL2+, declined by € 26.1 million to € 133.2 million; revenues from IP-based products and services, on the other hand, advanced by € 27.7 million to € 288.9 million. This means that during the past fiscal year, QSC had already been generating 68 percent of its total revenues in forward-looking lines of business; the year before, this metric had stood at 62 percent.

REVENUE MIX (in € millions)

Progress in the transformation process is illustrated by the development that took place during the course of the year: in the first quarter of 2010, IP-based revenues had stood at € 69.2 million, accounting for 65 percent of total revenues. In the subsequent quarters, these revenues rose to € 70.8 million and 73.1 million, respectively, before reaching a total of € 75.7 million in the fourth quarter of 2010, constituting 72 percent of total revenues.

DEVELOPMENT OF IP-BASED REVENUES (in € millions)

This significant rise in revenues from forward-looking and higher-margin lines of business, with the exception of Managed Outsourcing, contributed to rising overall profitability in fiscal 2010: operating profit, EBIT, increased from € 3.9 million in the first quarter of 2010 to € 5.3 million in the fourth quarter; consolidated net income advanced from € 3.2 million during the first three months of 2010 to € 11.0 million in the final quarter of the year.

QSC winning new small- and mid-size customers • In the course of becoming a provider of ICT services, QSC concertedly broadened its portfolio of products and services during the past fiscal year, while simultaneously strengthening its position in its traditional markets. By winning over such mid-size customers as Mövenpick Hotels & Resorts, DERAG Hotel & Living and Papier Union, QSC reinforced its position of leadership as an SME for SMEs in IP-VPN business. With the inclusion of NTplus and ElectronicPartner's systems houses, the Company broadened its circle of specialty distributors of innovative voice and data services, such as the IPfonie centraflex virtual telephone system.

Following intensive preparatory work, in early October 2010 QSC debuted the newest generation of this solution: IPfonie centraflex 3.0. It features improved database interfaces, which enable customers to now easily link numerous business applications, such as call and contact center solutions. And since early 2011, the centraflex App has additionally been making access to major functions available via an iPhone.

QSC debuted IPfonie centraflex 3.0 in October

Long-term network partnerships with freenet and TELE2 • IP-based products like IPfonie centraflex build upon the Company's NGN. In fiscal 2010, QSC utilized the efficiency and performance of this network to build two additional lines of business: Managed Outsourcing and Open Access. In Managed Outsourcing, QSC integrates existing customer narrowband networks into its NGN, and then runs their entire traffic volume over the fixed network by means of its own infrastructure. In June 2010, QSC won its first customer, freenet Cityline GmbH, a member of the freenet group, which entered into a long-term network partnership that will initially run for ten years. Communication Services TELE2 GmbH, the German subsidiary of the TELE2 group, signed another long-term Managed Outsourcing contract in December 2010.

Open Access a new line of business • In late August 2010, QSC showcased to the broad public its Open Access platform, the first network, process and services hub for so-called Next Generation Access. In particular, this platform unites regional providers who are presently hard at work expanding their local fiber optic networks with strong distribution partners who also want to offer their customers broadband connections with speeds of 100 megabits per second or more. QSC's first partners are 1&1 Internet and Leipzig-based HL komm.

Declining revenues in ADSL2+ business • The growing importance of fiber-based broadband connections, especially in urban settings, is taking place within the context of increasing market saturation and stiffer price competition for DSL-based broadband connections. Since QSC takes an intentionally cautious attitude towards these markets, preferring instead to focus on IP-based revenues, the number of connected lines decreased to 512,400 in fiscal 2010, compared with 588,800 on December 31, 2009. This reduced the share of total revenues accounted for by ADSL2+ business to 23 percent in 2010, compared with 28 percent the year before; during the course of the year, it decreased from 26 percent in the first quarter to 19 percent in the fourth quarter of 2010.

IT competence strengthened through the acquisition of IP Partner • Declining ADSL2+ revenues, on the one hand, and rising IP-based revenues, on the other, demonstrate the progress that QSC has made in its transformation process. In December 2010, the Company accelerated this process with the complete acquisition of Nuremberg-based IP Partner AG. However, the economic transfer was not effected until January 3, 2011, which is why this company was not included in the consolidation for fiscal 2010.

IP Partner operates two data centers with >10,000 servers

Formed in the year 2000, this provider of IT services is a fast-growing supplier of Hosting and IT Outsourcing services for small- and mid-size companies. This company already operates two data centers in Munich and Nuremberg with more than 10,000 servers for over 1,000 business customers, and is expanding its capacities even further. The purchase price comprises two components. As of January 3, 2011, QSC paid € 15 million in cash to the company's former shareholders. A further € 10 million is due no later than the end of April 2012, subject to various prerequisites, which include a sustained high level of corporate growth, in particular.

EVENTS OF MAJOR SIGNIFICANCE FOR THE COURSE OF BUSINESS

Complete acquisition of Plusnet • On December 22, 2010, QSC retroactively acquired 32.5-percent shareholdings in Cologne-based DSL network operating company Plusnet GmbH & Co. KG, effective October 31, 2010, from Communication Services TELE2 GmbH, of Dusseldorf, the German subsidiary of the TELE2 group, for € 36.7 million. TELE2 paid € 66.2 million for premature termination of the contract, which had originally been scheduled to run until at least December 31, 2013. In return, QSC agreed to bear the full costs of Plusnet in the future. At the same time, QSC and TELE2 entered into two contracts for DSL Wholesale and Managed Outsourcing, each having a term of ten years. With these agreements, QSC has streamlined the shareholder structure and is now in a position to be even more flexible in shaping its Managed Outsourcing business.

This transaction had the following major effects on QSC's financial position and net worth as of December 31, 2010:

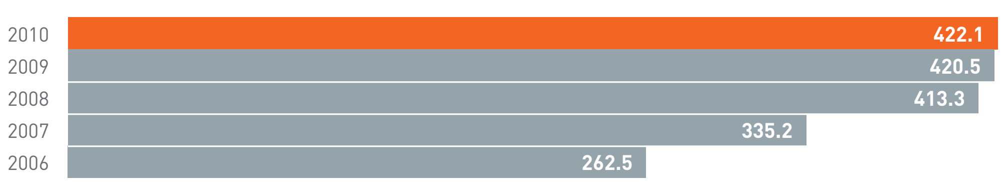
1. Since in December 2010 the agreement was still subject to the consent of the German Federal Network Agency, which has since been granted, the financial settlement did not occur until January 2011. As of December 31, 2010, QSC therefore recorded a receivable against former shareholder TELE2.
2. Retroactively to October 31, 2010, the long-term liabilities of other shareholders – the capital account of Plusnet co-shareholder TELE 2 – were eliminated after acquisition of its shareholdings by QSC at book value.
3. Since TELE2 provided compensation for premature termination of the contract, which had a minimum term that was to run until December 31, 2013, QSC defers this payment through its term, returning it step by step in the Income Statement.

Further comments on the effects of these transactions on the Company's financial position and net worth can be found in the Group Management Report on individual line items of the Balance Sheet and Statements of Cash Flows.
Aside from this, there were no singular events either within the Company or within the marketplace during the course of the past fiscal year that would have had a significant influence on the development of QSC's business.

PROFITABILITY

Revenues rise to € 422.1 million • In fiscal 2010, QSC grew its revenues to € 422.1 million, compared with € 420.5 million the year before. Operating business is characterized by multiple-year contracts with enterprise customers and long-term supply relationships with resellers of voice and data services, which is why the Company does not record orders on hand separately.

REVENUES (in € millions)



Declining network costs • As a result of the transformation process, QSC is increasingly selling network-independent ICT services, and can therefore reduce network expenses, which are recorded under cost of revenues and include depreciation and non-cash, share-based payments. Because the Company maintained its strict cost management system while further optimizing its nationwide network, this largest cost line item decreased by € 9.9 million to € 315.2 million in fiscal 2010.

NETWORK EXPENSES (in € millions)

As well, the costs for building, operating and maintaining the network, itself, declined to € 54.4 million, compared with € 58.2 million the year before. Personnel expense within the network expenses line item declined to € 12.4 million, compared with € 14.8 million in 2009. Taking into consideration depreciation, which, in contrast to its quarterly reports and pursuant to IFRS, QSC includes in the individual expense line items, QSC thus reduced the structural components of network expenses to a total of € 108.5 million, compared with € 120.2 million the year before; their share of total revenues amounted to 34 percent in fiscal 2010, compared with 37 percent in 2009. 66 percent of network expenses were accounted for by cost of materials, which rose moderately by € 1.9 million year on year to € 206.7 million, first and foremost as a result of QSC's successes in IP-based voice business.

Gross margin rises to 25 percent • Higher revenues and lower network expenses produced a significant rise in gross profit in fiscal 2010, which improved to € 106.9 million, compared with € 95.5 million the year before. Gross margin increased by two percentage points to 25 percent.

GROSS PROFIT (in € millions)

Strict cost discipline • Sales and marketing expenses increased moderately by € 2.0 million to € 56.0 million in fiscal 2010. In addition to depreciation expense, this line item essentially records three blocks of costs: personnel expenses, commission payments and advertising expenses. Due to the success of QSC's marketing partners during the past fiscal year commissions payments rose; while, on the other hand, personnel and advertising expenses declined moderately.

General and administrative expenses down to € 29.6 million in 2010

General and administrative expenses decreased to € 29.6 million during the past fiscal year, compared with € 32.3 million the year before, even though non-recurring expenses in conjunction with the realignment of the shareholder structure at Plusnet as well as the acquisition of IP Partner were incurred in the fourth quarter of 2010. The high efficiency of administrative operations is underscored by the fact that the share of total revenues accounted for by these costs in fiscal 2010 again declined by one percentage point to 7 percent.

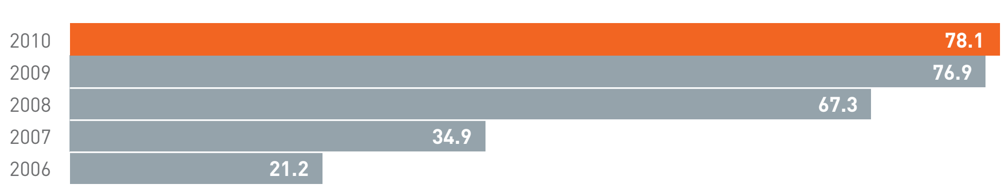
High-margin revenues improve profitability • In its quarterly reports, QSC conforms to the customary international practice of presenting depreciation, amortization and non-cash share-based payments as separate line items in its income statements. In these Consolidated Financial Statements, however, these metrics are included in the line items for cost of revenues, sales and marketing, as well as general and administrative expenses. The following abbreviated income statement presents depreciation/amortization and non-cash share-based payments separately, thus providing a quick overview of the development of the Company's operating business:

in K€	2010	2009
Net revenues	**422,106**	**420,546**
Cost of revenues *	(273,584)	(277,817)
Gross profit	**148,522**	**142,729**
Sales and marketing expenses *	(43,505)	(39,849)
General and administrative expenses *	(26,461)	(26,459)
Other operating income	684	1,849
Other operating expenses	(1,168)	(1,380)
EBITDA	**78,072**	**76,890**
Depreciation/amortization	(57,139)	(66,728)
Non-cash share-based payments	(55)	(490)
Operating profit (EBIT)	**20,878**	**9,672**

* Excluding depreciation/amortization and non-cash share-based payments

EBITDA margin rises to 19 percent • The sharp rise in IP-based revenues, as well as sustained cost discipline throughout all areas of the organization, enabled QSC to grow its EBITDA even further to € 78.1 million, compared with € 76.9 million in 2009, in spite of the ongoing transformation process. QSC defines EBITDA as earnings before interest, taxes, amortization of deferred non-cash, share-based compensation, as well as depreciation and amortization of property, plant and equipment, intangible assets and goodwill. The EBITDA margin thus rose to 19 percent, compared with 18 percent in 2009.

EBITDA (in € millions)



Depreciation expense declined to € 57.1 million in fiscal 2010, compared with € 66.7 million the year before when it had reached its peak. Through its evolution from a network operator into a services provider, QSC is planning on significantly lower capital expenditures in the coming years, and thus further declines in depreciation expense, in comparison with the times in which the network was being built and expanded.

DEPRECIATION EXPENSE (in € millions)

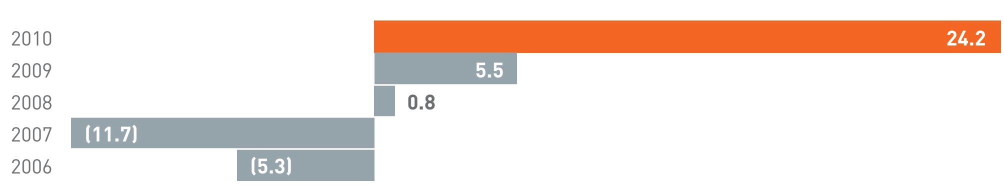
EBIT more than doubles • Declining depreciation expense and the greater profitability of its operating business enabled QSC to more than double its earnings before interest and taxes (EBIT) to € 20.9 million in fiscal 2010; the year before it had stood at 9.7 million. During this same period, the EBIT margin rose from 2 to 5 percent.
As a result of declining interest-bearing liabilities, QSC's financial loss was cut to € -2.0 million, compared with € -2.5 million in 2009. Earnings before income taxes thus rose to € 18.8 million, compared with € 7.2 million the year before.

EBIT (in € millions)

Consolidated net income more than quadrupled • Given the Company's sustained and growing profitability in fiscal 2010, in accordance with IFRS rules it applied deferred tax assets against loss carryforwards, thus realizing a positive effect from taxes in the amount of € 5.3 million. Net consolidated income after taxes rose to € 24.2 million, compared with € 5.5 million the year before; earnings per share increased to € 0.18, compared with € 0.04 in fiscal 2009.

Earnings per share improve to € 0.18

NET PROFIT (LOSS) (in € millions)



PROFITABILITY BY SEGMENT

Stable development in the Managed Services segment • During the past fiscal year, QSC generated revenues of € 74.0 million in the Managed Services segment, compared with € 74.3 million the year before. Two contrasting developments characterized the fiscal year: with its clear focus on small- and mid-size companies, QSC was able to win new customers in fiscal 2010, while simultaneously expanding its share of the ICT budgets of its existing customers; 70 percent of new business came from existing customers. On the other hand, especially in conjunction with contract extensions for large corporates, QSC sensed greater price sensitivity in the market for networking solutions, which has thus far been only partially offset by offering additional ICT services. Nevertheless, the majority of the follow-on price negotiations had been concluded by year-end 2010. Moreover, as a result of the acquisition of IP Partner in December 2010, innovative ICT services performed during the current fiscal year will account for an increasing share of total revenues.

70 percent of new business comes from existing customers

MANAGED SERVICES REVENUES (in € millions)

Focus on SME customers and ICT services strengthening profitability • In the Managed Services segment, the cost of revenues line item, representing costs incurred, in particular, through utilization of QSC's nationwide infrastructure, totaled € 35.1 million in fiscal 2010, compared with € 41.4 million the year before, as QSC is increasingly integrating network-independent ICT services into its portfolio of products and services. Since there was hardly any change in the other costs, segment EBITDA rose to € 16.9 million, compared with € 12.1 million one year earlier. The increase in the corresponding EBITDA margin to 23 percent, compared with 16 percent in 2009, was also a result of the Company's focus on business with small- and mid-size customers, which tends to offer higher margins. Since the depreciation expense of € 10.7 million remained lower than the previous year's level of € 12.1 million, the rise in operating profit in the Managed Services segment was even sharper, with EBIT standing at € 6.2 million, compared with € -0.1 million the year before. The Company's EBIT margin of 8 percent underscores its successes resulting from its evolution into a provider of ICT services.

MANAGED SERVICES EBIT (in € millions)

Concentrating on IP-based revenues in the Products segment • Amounting to € 85.7 million in fiscal 2010, revenues in the Products segment again saw a decline from the previous year, when QSC had generated € 92.1 million in this segment. However, over the course of the year revenues stabilized at between € 21 and € 22 million per quarter. The year-on-year decline was essentially attributable to conventional voice telephony. The share of total revenues accounted for by Preselect and Call-by-Call offerings amounted to 43 percent.

PRODUCTS REVENUES (in € millions)

Higher segment EBIT in spite of lower revenues • Focusing on higher-margin IP-based revenues improved profitability in the Products segment. Since network expenses consequently declined sharply during the past fiscal year, segment EBITDA of € 19.0 million remained at the previous year's level of € 19.4 million, in spite of lower revenues. The EBITDA margin improved to 22 percent, compared with 21 percent in 2009. Thanks to declining depreciation expense, QSC was able, in fact, to significantly increase its operating profit in this segment: at € 7.7 million, it was up 67 percent from the previous year's level of € 4.6 million. The EBIT margin improved to 9 percent, compared with 5 percent in 2009.

PRODUCTS EBIT (in € millions)

Voice business the revenue driver in the Wholesale/Resellers segment • In fiscal 2010, QSC grew its revenues in its largest segment, Wholesale/Resellers, to € 262.3 million, compared with € 254.2 million the year before. Sustained successes in Wholesale voice business, where QSC offers resellers IP-based voice services over its own, highly efficient NGN, played a key role in this growth. On the other hand, the importance of Wholesale ADSL2+ business continued to decline: in 2010, this segment accounted for only 37 percent of total revenues, compared with 46 percent the year before; in the fourth quarter of 2010, the share of revenues accounted for by this line of business amounted to only 31 percent. However, the decline in Wholesale ADSL2+ business also led to a further reduction in especially high-margin, non-recurring revenues for connecting new customers.

Share of revenues accounted for by ADSL2+ declined to only 31 percent in Q4 2010

WHOLESALE / RESELLERS REVENUES (in € millions)

Segment earns attractive EBIT • Wholesale business plays a major role in ensuring the best possible utilization of QSC's nationwide network infrastructure; this is why the Wholesale/Resellers segment had to bear the lion's share of network expenses, which amounted to € 193.2 million, compared with € 187.4 million the year before. This rise also related to the shift in revenues within the segment, as voice business tends to produce somewhat higher variable network costs, e.g., for interconnection fees, than ADSL2+ business. The change in revenue contribution can also be seen in sales and marketing expenses: their rise to € 19.0 million, compared with € 13.2 million in 2009, was attributable to commission payments to resellers of voice services. As a result of these higher costs, QSC was only able to earn an EBITDA of € 42.3 million in this segment in fiscal 2010, compared with € 45.4 million the year before; the EBITDA margin declined to 16 percent from 18 percent the year before. As a result of decreasing depreciation expense, QSC was able to increase its bottom-line profitability in this segment, as well, in 2010. Segment EBIT improved by 35 percent to € 7.0 million, compared with € 5.2 million the year before.

QSC grew EBIT in all three segments in 2010

WHOLESALE / RESELLERS EBIT (in € millions)

FINANCIAL POSITION

QSC pursuing conservative investment policy • QSC steers its entire financing and capital position centrally from its headquarters in Cologne. It pursues three major objectives:

- Efficient management of available liquidity
- Maintaining and optimizing financeability
- Reducing financial risks

For these purposes, QSC pools the cash proceeds of all its subsidiaries. The Company invests its surplus liquidity exclusively in money market accounts and low-risk bond issues, as part of its continued conservative investment policy; consequently, the Company did not have to make any write-downs on investments of capital in fiscal 2010, either. Generally speaking, QSC does not make use of derivative financial instruments. This also helps to minimize financial risks, as does the fact that QSC operates virtually exclusively in the euro zone and is thus not subject to any foreign-currency exchange rate risks.

Free cash flow more than doubles during past fiscal year

Rising financial strength • QSC continued to strengthen its financial position during the past fiscal year. The Company utilizes the parameter of free cash flow as the key metric for this purpose. QSC defines free cash flow as the change in the difference between its holdings of liquid assets and interest-bearing liabilities. In fiscal 2010, QSC earned a free cash flow in the amount of € 27.7 million, compared with € 12.9 million the year before, which means the Company has been able to more than double this key performance indicator within the space of a year.
Liquid assets, which in addition to cash and cash equivalents also include available-for-sale assets, rose by € 5.3 million to € 46.6 million as of December 31, 2010, compared with € 41.3 million at the close of the year before. During this period, QSC reduced its interest-bearing liabilities by € 22.4 million to € 18.1 million. This produced a positive free cash flow in the amount of € 27.7 million. And QSC increased its net liquidity by the same amount in fiscal 2010: it totaled € 28.4 million, compared with € 0.7 million one year earlier.

in K€	Dec. 31, 2010	Dec. 31, 2009
Capital management		
Liabilities under financing arrangements	(7,537)	(22,775)
Other short-term liabilities	(576)	(2,774)
Liabilities due to banks	(10,000)	(15,000)
Interest-bearing liabilities	**(18,113)**	**(40,549)**
Plus cash and short-term deposits	46,233	40,952
Plus available-for-sale financial assets	332	330
Net liquidity	**28,452**	**733**

Three main factors impacting operating cash flow • The decline in cash flow from operating activities to € 56.6 million in fiscal 2010, compared to € 65.5 million the year before, is primarily due to three main factors: One, the Company's successful transformation process and its focus on IP-based, higher-margin revenues more than doubled its income before taxes. Two, there were lower depreciation expenses due to QSC's status as an ICT services provider. Three, as of balance sheet date December 31, 2010, there was a temporary increase in the value of the recorded trade receivables.

CASH FLOW FROM OPERATING ACTIVITIES (in € millions)

Net cash used in investing activities declined significantly to € -25.1 million in fiscal 2010, compared with € -40.3 million the year before. This metric, too, reflects the Company's successful evolution into a provider of ICT services, as this line of business involves lower capital expenditures than those of a network operator.
The decline in cash flow used in financing activities to € -26.2 million in fiscal 2010, compared with € -33.0 million the year before, was due to the accelerated reduction of interest-bearing debt during the past fiscal year. In fiscal 2010, QSC redeemed a further € 17.6 million in debt under financing arrangements, reduced its liabilities to banks by € 5.0 million, and lowered its other short- and long-term liabilities by € 2.2 million.

Capital expenditures account for only 7 percent of revenues • As a provider of ICT services, QSC was able to continue its significant reduction of its capital expenditures in fiscal 2010: amounting to € 29.2 million, they were down some 30 percent from the previous year's level of € 42.2 million. Their share of total revenues declined from 10 percent to 7 percent.
70 percent of these capital expenses were customer-related, consisting predominantly of capitalized provisioning costs for customer connections, as well as technical end-user devices, such as routers. Only € 6.5 million, or 22 percent, was attributable to ongoing modernization and replacement investments in QSC's nationwide network and the evolution of the NGN. Eight percent of capital expenses went for miscellaneous purposes.

70 percent of QSC's capital expenditures are customer-related

CAPITAL EXPENDITURES (in € millions)

QSC continues to draw down debt in 2010 • Thanks to cash provided by operating activities and declining capital expenditures, QSC was able to further strengthen its financial position during the past fiscal year and again significantly reduce its interest-bearing liabilities. In particular, the Company redeemed debt under financing arrangements. Long-term liabilities under financing arrangements amounted to only € 2.0 million as of December 31, 2010, compared with € 7.3 million at the close of the 2009 fiscal year; short-term liabilities declined to € 5.5 million, compared with € 15.5 million as of December 31, 2009.
Moreover, QSC also used its agreed line of credit during the past fiscal year; as of December 31, 2010, QSC recorded only € 10.0 million in liabilities due to banks, compared with € 15.0 million

on December 31, 2009. Since the existing agreement will terminate at year-end 2011, in the first quarter of 2011 QSC has already begun talks with several financial institutions in order to establish a credit line which it can draw upon in the coming years. Given the keen interest displayed by several financial institutions, QSC expects to quickly conclude contract negotiations.

Impact of the Plusnet realignment on debt • Due to the realignment of the shareholder structure at Plusnet, long-term liabilities to minority shareholders, in this case to TELE2, in the amount of € 42.6 million as of December 31, 2009, were eliminated. At the same time, deferred income rose to € 69.8 million, compared with € 13.8 million on December 31, 2009. This line item reflects the deferment of TELE2's payment for premature termination of the Plusnet contract, which would otherwise have run until year-end 2013, over this residual term.

NET WORTH

New partnership with TELE2 changes balance sheet structure • The balance sheet total rose moderately to € 332.2 million as of December 31, 2010, compared with € 311.3 million at year-end 2009. The Company's new partnership with TELE2 altered the balance sheet ratios: current assets rose to account for 43 percent, compared with 33 the year before, as this is where QSC had recorded its outstanding receivable from TELE2 in the amount of € 28.4 million. This, as well as scheduled depreciation, reduced the share of long-term assets to 57 percent, by comparison with 67 percent the year before.

Shareholders' equity finances 97 percent of long-term assets

On the liabilities side, 55 percent of these assets are financed through equity capital and 45 percent through outside capital; the year before, this ratio had stood at 51:49 percent. QSC's extremely sound balance sheet structure can be seen, in particular, in the current/non-current congruency: equity capital finances 97 percent of long-term assets.

Scheduled depreciation reduces long-term assets • Scheduled depreciation and a focus on replacement and modernization investments led to a significant decline in the value of property, plant and equipment to € 108.1 million in fiscal 2010, compared with € 126.2 million the year before. The value of other intangible assets decreased to € 23.0 million, compared with € 33.7 million at year-end 2009, as QSC's Wholesale partners had won significantly fewer new ADSL2+ customers during the past fiscal year than in the year before. QSC writes off the capital expenditures for connecting these customers within a period of two years.

Systematic management of accounts receivable • Trade accounts receivable rose to € 61.3 million as of December 31, 2010, compared with € 53.6 million at the close of the previous fiscal year. QSC continues to pursue a policy of strict management of accounts receivable, enabling allowances for bad debts and customer goodwill on accounts receivable to again remain at a low level of € 0.4 million in 2010, accounting for merely 0.1 percent of revenues. At year-end 2010, all accounts receivable which were older than 90 days had been written off in full.

QSC additionally records its accounts receivable from former shareholder TELE2 in the amount of € 28.4 million under accounts receivable. This amount was paid in the first quarter of 2011, which significantly increased the Company's liquidity.

Equity ratio rises to 55 percent • Primarily as a result of consolidated net income, shareholders' equity rose to € 184.0 million, compared with € 159.7 million as of December 31, 2009. This increased the equity ratio to 55 percent, compared with 51 percent at year-end 2009.

EQUITY RATIO

There was a reclassification within the shareholders' equity line item. In readying itself to distribute its first dividend, QSC reduced the loss carried forward under commercial accounting law to € 91.4 million, while reducing the capital surplus to € 139.6 million. This reclassification did not affect the loss carried forward under tax law, which means that in the coming years, as well, QSC will be able to benefit from the startup losses it had incurred during the years it was building its own nationwide infrastructure. With this reclassification in the financial statements of QSC AG – the relevant individual corporation for dividend payments – the Company put in place the decisive prerequisite for making its planned first dividend distribution for the 2011 fiscal year; pursuant to § 71 of the German Stock Corporation Act (Aktiengesetz), a dividend may be paid only from current earnings, surpluses and other reserves to the extent that they exceed the loss carried forward.

COMPARISON BETWEEN ACTUAL AND FORECAST COURSE OF BUSINESS

Successes in transformation process strengthen financial position and profitability • In early 2010, QSC's markets were still in weak condition following the serious recession. In spite of this, in early March 2010 the Company announced its initial outlook for the current fiscal year with a clear focus on further strengthening its financial position and profitability: at that time, QSC had planned to increase free cash flow from € 12.9 million in 2009 to more than € 22 million, as well as to further increase revenues, EBITDA and consolidated net income.

Successes made in its transformation process prompt QSC to raise forecast

During the following quarters, the successes made in the transformation process became ever more apparent: IP-based revenues rose at double-digit rates, and were able to compensate for the anticipated declines in the conventional, network operator lines of business. Against this backdrop, on August 9, 2010, QSC raised its forecast for the full fiscal year: the Company now anticipated that it would double free cash flow to more than € 25 million, triple consolidated net income to more than € 16 million, compared with € 5.5 million the year before, and continue to increase revenues and EBITDA.

In 2010, QSC proved its forecast true in full

QSC proved this forecast true in full: the Company was able to more than double free cash flow to € 27.7 million and to more than quadruple its consolidated net income to € 24.2 million. Revenues rose by € 1.6 million to € 422.1 million and EBITDA by € 1.2 million to € 78.1 million.

FREE CASH FLOW (in € millions)

CONSOLIDATED NET INCOME (in € millions)

EBITDA (in € millions)

REVENUES (in € millions)

* Forecast

GENERAL REMARKS REGARDING THE COURSE OF BUSINESS IN 2010

In fiscal 2010, QSC successfully sustained its transformation process from a network operator to a provider of ICT services. The share of total revenues accounted for by IP-based business rose sharply over the course of the year, as the Company was focusing on these higher-margin revenues while simultaneously building further ICT lines of business, such as Managed Outsourcing. The net result was that QSC was able to significantly improve its financial position and profitability.

Report on Risks

RISK STRATEGY

Optimum balance between shielding against risks and taking advantage of opportunities • QSC's strategy is geared toward both profitable growth as well as maximum customer and employee satisfaction. Since the Company's markets are subject to ongoing change, what is required is a predictive system for managing opportunities and risks that serves as the basis for decisions throughout all areas of the organization.
The purpose of the risk strategy is to use ongoing risk management in order to achieve an optimum balance between avoiding and/or minimizing existing and potential risks and swiftly using opportunities. Systematically dealing with potential opportunities and risks while fostering a culture where risk is kept in mind therefore represent a key element in securing and shaping the future.

MANAGEMENT OF OPPORTUNITIES

Managing opportunities and risks closely related • The exploitation of opportunities and the mitigation of risks are closely linked at QSC. Opportunities arise from internal and external developments that have a potentially positive impact on business operations. The responsibility for identifying these kinds of opportunities early on and swiftly taking advantage of them rests with the coordinators in the business units or corporate staff departments. To do this, they rely primarily on market and competition analyses, internal studies, and market research results. The forecast report on page 65 contains an overview of the opportunities that will be of particular relevance for QSC in the coming two fiscal years.

Decentral responsibility for identifying and utilizing opportunities

MANAGEMENT OF RISKS

Consistent risk management system throughout • The risk management system comprises inter-coordinated rules, measures and procedures for dealing with risks that arise from internal and external events, acts or failures to act that could pose a potential threat to QSC's success or even its survival. The purpose of the risk management system is to identify, analyze, assess, control and monitor future risk-laden developments as early on as possible in order to ensure the Company's success over the long term. The risk management system focuses on

- Avoiding risks through prevention
- Employing suitable measures to reduce existing risks
- Compensating for and securing against existing risks through the formation of accruals/provisions and by taking out insurance coverage
- Accepting residual risks in close coordination with corporate management.

The risk management system (RMS) covers all business units, corporate staff departments and subsidiaries. QSC considers risk assessments in all its decision-making, and from the outset employs appropriate measures wherever possible to reduce those risks that do arise. Regular reporting helps the coordinators to identify risks early on and ensures that they are taken into consideration appropriately in the decision-making process. The RMS is accompanied by guidelines, process instructions and standard operating procedures, which ensure its implementation in everyday operations.

Finance uses operational and financial performance indicators to monitor risks

Risk Management and Finance play a key role in the RMS. Corporate risk management, which reports to the Chief Executive Officer, is responsible for both the annual risk inventory as well as for the quarterly risk reports and is in constant contact with all areas throughout the organization. Finance is responsible for monitoring risks on the basis of operational and financial performance indicators.

Ongoing monitoring and assessment of risks that arise is handled decentrally by risk coordinators; as of December 31, 2010, the Company had entrusted 12 executives with this task. With this decentralized organizational structure, QSC ensures that it will be able to identify potential risks in its operating business as early as possible throughout all areas of the organization. The risk coordinators regularly review their areas of responsibility to determine whether previously unidentified risks have arisen and whether there has been a change in existing risks. They regularly report to the Management Board on the risks and challenges in their areas.

Quarterly risk reports • Corporate Risk Management oversees the introduction of and compliance with all risk-avoidance and risk-reduction measures. It additionally handles consolidation and documentation of the decentrally assessed risks, and produces a detailed quarterly risk report for the Management Board. At least once a year, the Management Board informs the Supervisory Board in the form of a detailed risk report, while additionally using the RMS as the basis for also informing the Supervisory Board about all major risks and opportunities during the course of the year. In addition, the entire early-detection system for risks is reviewed within the framework of the audit of the Company's Annual Financial Statements.

Pages 120 through 123 of the Notes to the Consolidated Financial Statements contain further information on the risk management system as it relates to financial instruments in accordance with IFRS 7.

SUPPLEMENTARY INFORMATION PURSUANT TO § 289, Para. 5, German Commercial Code ("HGB")

Accounting process an integral element of the RMS • Accounting-related risk management is an integral element of the RMS. The billing and accounting risks are constantly monitored, with the results included in the Group-wide reporting. Within the framework of the audit of the annual financial statements, the auditor also reviews the accounting process and the IT systems that are employed for this purpose. On the basis of his observations, both the Supervisory Board's Audit Committee as well as the full Supervisory Board deal with the issue of accounting-related risk management.

Major characteristics of the accounting-related RMS • QSC details the major characteristics of this RMS below:

- QSC possesses a clear management and corporate structure. The accounting for all subsidiaries is handled by QSC AG on the basis of contracts for services or work. Those responsible for the individual processes are clearly named at the subsidiaries.
- Among other things, QSC uses the following to ensure strict compliance with both statutory requirements as well as International Financial Reporting Standards (IFRS):
  - Employment of qualified professionals
  - Specific and ongoing further education for these professionals
  - Strict observance of the four-eyes principle through the organizational separation of execution, accounting and approval functions
  - Clear separation of roles in creating and posting documents, as well as in Controlling
- QSC uses a consistent suite of standard software from SAP at both the parent corporation as well as at all subsidiaries. The software is comprehensively safeguarded against unauthorized access. This standardization ensures that all major business transactions at all companies are recorded consistently, properly and in a timely manner.
- A set of Accounting Principles serves as the basis for accounting and consolidation at all companies. After being drawn up, the individual financial statements are transferred to a consistent consolidation system that ensures elimination of intercompany transactions. At the same time, an extensive plausibility check is performed on the entered data. All work required for completion of the consolidation is then performed within this system, which provides the basis for the Consolidated Financial Statements as well as the major information in the Notes to the Consolidated Financial Statements.
- Monthly Group-wide reporting ensures early identification of potential risks during the course of the year. It includes all accounting processes that are of relevance for the Corporate Group, such as consolidation of capital, debt, expense and earnings.

Monthly Group-wide reporting ensures that risks are identified early on

With these measures, QSC provides the required transparency in its accounting and prevents to the greatest possible extent the occurrence of potential risks in this process, in spite of the enormous complexity of IFRS.

INDIVIDUAL RISKS

Detailed on the following pages are those industry, regulatory, strategic, performance, financial, information technology and other risks that QSC today views as being of major significance with respect to its business operations.

INDUSTRY RISKS

Alternative technologies – Cable TV • Cable TV operators are marketing broadband connections with growing success and are thus competing against the DSL offerings from QSC's Wholesale partners, especially in urban regions. In view of the price competition that this causes and the increasing market saturation of broadband connections in Germany that is occurring at the same time, QSC is no longer pursuing this line of business, but rather focusing on increasing IP-based revenues. Given this background and in view of the fact that 95 percent of business customers continue to prefer DSL connections, the Company views competition from cable TV as a moderate risk.

Major cable network operators are customers in Wholesale voice business

At the same time, the growing significance of cable connections offers an opportunity for QSC, as the cable TV network operators must by necessity collaborate with TC providers in connection with voice telephony; QSC counts major cable network operators among its customers in Wholesale voice business.

Alternative technologies – FTTX • All major Internet applications can be easily implemented with ADSL2+ technology. Nevertheless, regional providers, in particular, as well as Deutsche Telekom, are beginning to invest in successor technologies under the buzzwords Fiber to the Home (FTTH), Fiber to the Basement (FTTB) and Fiber to the Curb (FTTC). These terms refer to the concept of running fiber optic cables right to the individual household or to the basement of a given building, or to a nearby street branch. Long-term, the nationwide rollout of a fiber optic network could make infrastructure investments by network operators like QSC obsolete.

From today's vantage point, QSC views this as a manageable risk and simultaneously sees an opportunity, as nationwide expansion of the fiber optic network would involve capital investments ranging at least into double-digit billions, and from today's vantage point there is no way to see how a capital investment of this magnitude could be financed. Independently of this, in August 2010 QSC debuted the first nationwide Open Access platform with 1&1 Internet AG and Leipzig-based HL komm as customers. This Open Access platform is serves as a network, process and services hub for providers and users of these FTTX connections, thus enabling them to more quickly amortize their investments.

Replacement of legacy voice telephony • Fiscal 2010 saw a continuation of stiff price competition within the legacy voice telephony market. But by expanding its IP-capable Next Generation Network early on, QSC had prepared for this change, although it is still being forced to incur losses in conventional voice telephony with Call-by-Call and Preselect rates. At the same time, however, the Company is bringing in rising revenues with VoIP telephony and other IP-based services, and therefore does not anticipate that this risk will have any major impact on its business operations.

REGULATORY RISKS

An end to regulation • There is a trend on the part of the political community and the German Federal Network Agency to end regulation of various markets and to restrict itself in the future to monitoring these markets so as to intervene retroactively under general fair competition legislation, if necessary. There is a risk that the coming years will see a further decline in the number of regulated markets, which would mean that Deutsche Telekom's pricing latitude could rise in markets that have already been removed from regulation.
Experiences with the end of regulation in various markets show that public monitoring of DTAG's competitive behavior will not be sufficient to keep it from exploiting its newly won freedom. However, QSC anticipates that a sustained public discussion in combination with public disclosure of pertinent cases will foster behavior that is in conformity with the rules of fair competition, and that the German Federal Network Agency or the German Cartel Office will otherwise make use of their authority. QSC is keenly monitoring this risk, as its ramifications for the Company could be considerable should regulation fail.

Competitive behavior of Deutsche Telekom • Thanks to its own infrastructure, QSC is significantly less dependent upon former monopolist DTAG's resale prices than the majority of its competitors. Nevertheless, an aggressive pricing policy on the part of DTAG vis-à-vis both the required preliminaries and the consumer market, in particular, could have a negative impact on the margin situation in the areas of the German telecommunications market that lie outside those areas governed by cartel law and regulations or in markets that are no longer being regulated.
This being so, QSC continues to count on viable oversight by the German Federal Network Agency and the European Commission. The Company is limiting the potential risks by intensively monitoring the regulatory landscape through its ongoing participation in the discussion and by commenting on various proceedings. Taking these factors into consideration and assuming viable regulation in conformity with the rules of fair competition, QSC views these risks as being moderate.

QSC puts its faith in regulation in a spirit of fair competition

Expansion of the VDSL network • Another risk is posed by DTAG's improved DSL network. In 2009, the German Federal Network Agency clarified that other market players must receive access both to the VDSL network (bitstream) as well as to passive network elements. The purpose of the latter is to allow the market players to offer their own VDSL products using their own VDSL technology as well as unbundled access to the subscriber line. However, the decision on fees that was issued in fiscal 2010 has thus far not led to increased capital investments on the part of competitors.
Bitstream-based VDSL access will be subject to retroactive regulation of fees in the future. The retroactive regulation of fees will not significantly change the risk that DTAG could reduce QSC's customer base in the Wholesale segment through aggressive pricing in the preliminaries and consumer-market areas. Besides the decision by the German Federal Network Agency, however, the European Commission has already fundamentally clarified that it will maintain its ban on monopolies within the single European market, and will therefore insist on competitor access to all levels of DTAG's entire DSL network. QSC therefore views the potential impact of this risk as being moderate.

FTTX Regulation • A further risk stems from the regulated access to the regionally limited fiber optic connection network (FTTH) that DTAG plans to put in place beginning in 2012. However, the German Federal Network Agency has already included fiber optic in the access obligation that was made known to the European Commission in the draft of a regulation order governing access to unbundled subscriber lines. According to this, access to fiber shall be subject only to retroactive fee regulation. QSC views the resulting risk as being manageable, as significant expansion of Deutsche Telekom's FTTH infrastructure has not yet begun, on the one hand, and the German Federal Network Agency can modify regulatory orders in the case of appropriate findings, on the other.

CORPORATE STRATEGY RISKS

Integration of acquisitions • As QSC evolves into an ICT services provider, the Company does not preclude the possibility of broadening its own spectrum of products and services through targeted acquisitions in the future, even following the acquisition of IP Partner. The risk involved in these acquisitions is that an acquired company might not live up to the expectations that have been set for it. In the past, however, the swift and successful mergers of Broadnet and celox with QSC and the full integration of Ventelo have demonstrated QSC's ability to successfully manage these kinds of integration processes. The Company therefore views this risk as being manageable in the event of a further potential acquisition.

Swift mergers of Broadnet and celox demonstrate integration capabilities

PERFORMANCE RISKS

Revenues as a subscriber network operator • In recent years, QSC has built a nationwide infrastructure, within which it generates a considerable portion of its revenues from voice and data services. The emergence of new technologies or heightened competitive pressure from other network operators could severely restrict this QSC business. Thanks to its NGN, though, the Company is already able today to offer favorable prices that are geared toward this market, without endangering its margin position. From today's vantage point, QSC therefore views this risk as being moderate.

Loss of licenses for telephone numbers • QSC operates numerous telephone numbers in its voice business. There is a risk that the Company's licenses for these numbers will be revoked as a result of breaches of statutory or regulatory provisions and/or failure to comply with regulations, in which case the Company would have to pay significant amounts of money to deactivate them. QSC therefore uses numerous measures to ensure that it is in compliance with all regulations. Given this security system in voice business, which has thus far functioned very well, the Company views this risk as being under control.

Potential penalties • Within the framework of its Managed Services projects and business with Wholesale/Reseller partners, QSC enters into contracts that ensure certain service levels, some of them involving 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. In the past, QSC has been able to honor nearly all service level agreements, and therefore views the potential impact of this risk as being moderate.

Dependence upon individual customers • QSC generates high revenues with relatively few partners in its Wholesale/Reseller business. This entails the risks associated with being dependent upon one or only very few major accounts. The Company constantly monitors this risk, especially in light of the continuing consolidation of the market. However, since network operator QSC and the respective Wholesale/Reseller partners are mutually dependent upon one another, the Company views this risk as being manageable. Moreover, past experience has shown that Wholesale/Reseller partners will only gradually migrate their existing customers to other networks, if at all, in the event of a takeover, as this involves costs that are often considerable.

Outage of the QSC infrastructure • The risk of a network outage is constantly monitored. In addition to a loss of image, 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 is given the utmost priority within the framework of business operations. For this purpose, QSC employs redundancies within its network. Air conditioning equipment prevents potential heat-induced hardware failures, while strictly defined access authorizations to all colocation rooms prevent misuse or sabotage. Because of these and a number of further measures, the Company sees itself as being very well equipped to continue smooth operations.

Numerous measures assure smooth network operation

Customer communication in the event of maintenance work or outages • Voice and data services, and the ICT services that build upon them, are indispensable for smooth everyday operations at modern companies. QSC uses numerous measures to ensure trouble-free network operation. Nevertheless, the possibility of temporary outages cannot be excluded. Thus, there is a risk that customer relationships could be burdened by these kinds of interruptions or by the need for essential maintenance work.

QSC therefore takes pains to ensure transparent communication and also employs redundancies in its maintenance work. A professionally staffed hotline that allows customers to identify potential sources of trouble is available around the clock for any inquiries that might nevertheless arise. QSC therefore views this risk as being under control.

FINANCIAL RISKS

Financing • An extended recession, aggressive price competition in major markets or potential acquisitions could necessitate additional funding be; QSC therefore very precisely monitors financing and liquidity risks. As of December 31, 2010, the Company was in a comfortable position: net liquidity totaled € 28.4 million and an unused line of credit in the amount of € 16 million was available within the framework of an agreement that runs through December 31, 2011.
The Company's high equity ratio and rising positive free cash flow put QSC in a good position to obtain additional borrowed capital at attractive terms and conditions. Since QSC additionally aims to earn a rising free cash flow in 2011, as well, and operates a strict system of accounts receivable management, the Company views the risk of a financing bottleneck as being minor and views the financing risk overall as being under control.

No foreign exchange risks • QSC focuses on small- and mid-size business customers in the German market. It is therefore able to invoice all major business transactions in euros and is not subject to any significant foreign exchange risk.

INFORMATION TECHNOLOGY RISKS

Criminal intrusions into QSC systems • Unauthorized intrusions into QSC's IT network could result in considerable damage. The same also applies with respect to insufficient data protection and uncontrolled access to QSC data centers. In the event of an outage of the operating IT systems, it would not be possible to handle new orders or resolve system interruptions; the resulting monetary damages and loss of reputation could be significant.

QSC possesses a sophisticated IT security system

To mitigate these kinds of risks, QSC has appointed special security coordinators in its IT operations, whose leader reports directly to the Chief Executive Officer. This head of security bears the primary responsibility for a sophisticated security system, which includes the latest firewalls and a multi-tier virus protection system that virtually eliminates the above-described risks. In addition, the Company-wide IT security policy provides all employees with concrete guidance on avoiding IT security risks. As a result of all of these measures and according to reasonable standards, QSC views these IT security risks as being manageable.

Loss of data • Operating errors, hardware defects or the destruction of the data center through attack or natural disaster can result in a loss of business-critical data. Growing volumes of data accumulated as a result of the Company's fast-paced growth could additionally push the capacities of the Company's data storage and backup systems to their limits. In any event, a loss of operating data would make it impossible for the Company to operate.
QSC addresses these risks through extensive data backup measures. The Company archives its complete backups for multiple years, and stores the monthly backups in separate physical locations. Central data inventories are automatically backed up daily; in addition, QSC maintains a backup data center in Düsseldorf. Thanks to these extensive measures, as well as the Company's disaster recovery plan, QSC views the risk of data loss as being under control.

OTHER RISKS

Availability of personnel • QSC's success is based upon the achievements of its qualified people. One risk in this area is that achievers could leave the Company at short notice, and another is that it might not be possible to recruit new talent from the market according to the planned terms and conditions. QSC combats this risk through extensive personnel loyalty measures. In-house training and education, university partnerships and a number of networking activities additionally ensure that QSC possesses a sufficient number of new staff. The Company therefore views this risk as being under control.

University partnerships and in-house training secure new staff for the future

GENERAL REMARKS

No major identifiable risks • Given the potential scope of damage and the likelihood that these and further potential risks could occur, it is currently reasonable to say that no risks that could lead to a sustained material impairment of QSC's financial or earnings positions are identifiable. Organizationally, all meaningful and reasonable prerequisites have been put in place so that the Company may be informed early on in the event of potential risk situations and thereby take appropriate action.

Nevertheless, due to these 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

Aside from the acquisition of IP Partner, which from an economic point of view was effected January 3, 2011, and which is described in the Group Management Report on pages 43, QSC is not aware of any events or transactions that have occurred since the close of the past fiscal year on December 31, 2010 that would have a material effect on the development of QSC's business.

Report on Opportunities and Outlook

GENERAL REMARKS ON FURTHER DEVELOPMENT

Forecast calls for free cash flow of € 35 to € 45 million • During the current fiscal year, QSC will continue its transformation process into an ICT services provider, and anticipates that this will further strengthen its profitability and financial position. The Company specifically plans to increase free cash flow to € 35 to € 45 million. This planned strengthened profitability and financial position will serve as the foundation for the Company's plans to distribute its first ever dividend for the current fiscal year.

FREE CASH FLOW (in € millions)

* planned

QSC plans to have its shareholders share in the Company's success in the coming years, as well, and the transformation process, which will be continued in fiscal 2012, and the resulting share of higher-margin, IP-based revenues will make this all possible.

FUTURE GENERAL ECONOMIC CONDITIONS

Stable upswing in Germany • Following the sharp economic recovery during the past fiscal year, sustained, though somewhat weaker, growth is expected in Germany in fiscal 2011. In its 2011 Annual Economic Report, the German government predicts gross domestic product to rise by 2.3 percent. And the German economy is entering the new year with a similar level of confidence: the ifo business climate index reached new record levels in January 2011; and, in particular, the highly positive expectations of the some 7,000 companies involved in the survey give reason for optimism. The sustained upswing is gradually prompting more and more companies to end their reluctance to invest: The Annual Economic Report is predicting that capital expenditures on equipment will rise by 8.0 percent during the current fiscal year.

Forecast calls for capital expenditures to rise by 8 percent in 2011

FUTURE GENERAL INDUSTRY CONDITIONS

Growth in the ICT market • Optimism is also spreading in the ICT market. In the fourth quarter of 2010, the BITKOM index, the industry's key confidence indicator, rose to its highest level ever since its inception in 2001. Overall, though, this industry association expects to see only a moderate rise to € 145.5 billion in revenues in the ICT market during the current fiscal year, compared with € 142.7 million in 2010. For 2012, BITKOM anticipates a further rise to € 148.4 million. This is because rising revenues in the IT market will be offset by stagnating and in some submarkets even declining revenues in the TC market.

ICT MARKET IN GERMANY (in € billions)

According to BITKOM, total revenues in the German TC market in fiscal 2011 are expected to remain at € 64.3 billion, the previous year's level. As in previous years, there are two contrasting developments taking place in this market: revenues from data services are rising, while revenues from conventional voice services, in particular, are declining. This is because, on the one hand, there is intense price competition in the latter sector, while on the other, fewer and fewer customers are utilizing such traditional offerings as Call by Call and Preselect, instead preferring to go with all-in-one connections as well as Voice over IP technology.

Rising revenues from data services, but declining voice revenues

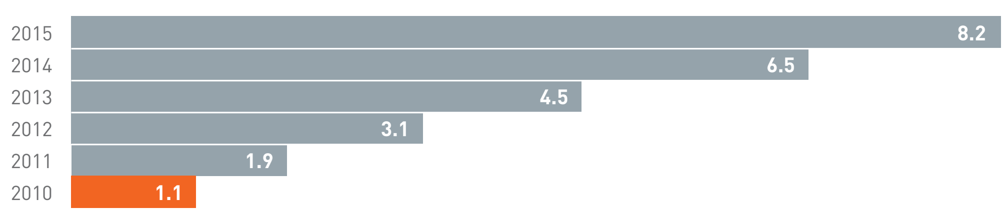
Strongly rising revenues with Voice over IP • Numbers from market researcher IDC clearly illustrate the potential that is offered by VoIP technology. They show that corporate expenditures for VoIP connections will continue to rise at annual rates of 20 percent and more for the coming years. IDC is already forecasting revenues of € 650 million in the German market for fiscal 2011, and a further rise to € 830 million for 2012.

VOIP BUSINESS CUSTOMER MARKET IN GERMANY (in € millions)

In business with data services, ICT providers are benefiting from the growing networking of the economy, which continues unabated. As a result, IDC anticipates rising revenues in the IP-VPN market for 2011 and 2012. Compared with € 1.6 billion during the current fiscal year, these revenues are expected to grow to € 1.7 billion in 2012.

Cloud Computing market to grow by a factor of 7 through 2015 • In addition to IP-VPNs, enterprises are increasingly making use of Cloud Computing solutions for their networks. BITKOM anticipates average annual growth rates of nearly 50 percent in this market in the coming years. And market volume in Germany is already expected to nearly double to € 1.9 billion in 2011, and to further rise to € 3.1 billion in 2012. In fact, on the basis of a study by the Experton Group, BITKOM is predicting revenues of € 8.2 billion by the year 2015.

CLOUD COMPUTING MARKET IN GERMANY (in € billions)



ANTICIPATED PROFITABILITY

Transformation process to characterize operating development • QSC anticipates – in line with market development – that its revenues will continue to develop on a two-track basis in fiscal 2011: declining revenues in the traditional lines of business of a network operator, such as Call by Call and ADSL2+, will be contrasted with the rising IP-based revenues from providing ICT services. In view of the existing pricing pressure along with the increasing market saturation, QSC is planning on a further reduction in the number of connected lines, and thus revenues, especially in ADSL2+ business. On the other hand, the Company's evolution into a provider of ICT services will open up new opportunities in such attractive growth markets as Housing and Hosting. Since IP Partner is strengthening its Managed Services business, in particular, QSC expects to see business develop positively in this segment in fiscal 2011. Following declines in previous years, the Products segment is expected to stabilize – quarterly revenues had remained largely constant the year before. The development of business in the Wholesale/Resellers segment, on the other hand, is likely to be impaired by the anticipated decline in the ADSL2+ market. On the other hand, this segment tapped into a new and interesting line of business in fiscal 2010: Managed Outsourcing. The rise in percentage of IP-based revenues that is expected in all three segments underscores the Company's successes in the transformation process.

As an ICT services provider, QSC has new opportunities in growth markets

First ever distribution of a dividend planned • A further rise in higher-margin, IP-based revenues combined with strict cost discipline and declining depreciation expense are together expected to strengthen QSC's profitability during the current fiscal year. Along with this, the realignment of the shareholdings at Plusnet is increasing the opportunities to further optimize the nationwide infrastructure and the costs this entails.
With this rising profitability, QSC views itself as being well positioned to have its shareholders share in the Company's success in the coming years by paying out a dividend.

ANTICIPATED FINANCIAL POSITION

Free cash flow again expected to rise • In the coming two years, QSC expects to see high levels of cash coming from operating activities. The cash burn for investment activities, on the other hand, will be moderate, as QSC is not planning to make any major capital investments in its infrastructure, with exception of replacement and modernization investments, as well as expansion of the data centers of its new subsidiary IP Partner. The majority of capital expenditures will continue to be for customer-related purchases.
High levels of net cash from operating activities and a moderate level of capital expenditures will allow free cash flow to rise significantly to € 35 to € 45 million in fiscal 2011. As in previous years, this key performance indicator includes all current financial incomes and outflows, and does not take into consideration the non-recurring payment of the first tranche of the purchase price for IP Partner in the amount of € 15.0 million. For subsequent years, the fact should be taken into consideration that former Plusnet co-shareholder TELE2 will be making all payments in fiscal 2011 that would otherwise have been due and payable by year-end 2013.

For 2011, QSC plans free cash flow of between € 35 to € 45 million

The Company will use its rising free cash flow during the current fiscal year to strengthen its financial position. Moreover, QSC does not rule out the possibility of further acquisitions during the current fiscal year that might again accelerate its ongoing transformation process.

ANTICIPATED NET WORTH

Strengthening QSC's financial position • The financial settlement from the realignment of the shareholder composition at Plusnet that was agreed in December 2010 was effected in January 2011. As a result, there was a rise in liquid assets and, at the same time, the existing receivable from former co-shareholder TELE2 was charged off. The payment of the first tranche of the purchase price for IP Partner in the amount of € 15.0 million was also made in January 2011.
Independently of this, the anticipated rise in free cash flow and consolidated net income is expected to improve the Company's balance sheet ratios and financial position during the current fiscal year, which will manifest itself, in particular, in a rising equity ratio and a declining level of interest-bearing liabilities.

OPPORTUNITIES FOR QSC

Transformation process opening up new opportunities • In fiscal 2011, QSC will continue its transformation process and broaden its business activities within the forward-looking ICT markets. The Company's evolution into a provider of ICT services will produce the following opportunities, in particular:

- **Winning further small and mid-size customers** • As an SME for SMEs, QSC is uniquely positioned in the German ICT market and can operate at eye level with its customers. The Company will use this competitive advantage, along with a focused sales strategy, to further increase its SME market share.

- **Increasing revenues from existing customers** • Up until now, many customers have been using only portions of QSC's ICT offerings. The Company will therefore target its expanded portfolio of products and services to small- and mid-size companies in order to tap into additional revenue potential from its existing customers.

- **Integration of IP Partner** • QSC anticipates significantly rising demand at IP Partner during the current fiscal year, and is therefore doubling the data center capacities of this new subsidiary; three new data centers will be going into operation by mid-year.

- **Acquisition of ICT specialists** • Even after the complete acquisition of IP Partner, QSC does not rule out acquisitions in the ICT market that might again accelerate its transformation process. Both the existing net liquidity as well as the rising free cash flow will be providing the Company with the requisite financial latitude.

- **Growing revenues with Managed Outsourcing** • With freenet and TELE2, QSC had already won two major customers for its Managed Outsourcing business in fiscal 2010. In fiscal 2011 and beyond, the high efficiency of its Next Generation Network is expected to make this new line of business interesting for other operators of narrowband networks in Germany.

- **Stronger customer loyalty through Fixed/Mobile Integration** • During the course of fiscal 2011, QSC plans to interconnect with a mobile telephony provider in order to add mobile voice and data services to its existing portfolio of products and services offered to business customers. Organizations of every size will thus be able to cover all of their telecommunications needs with services from QSC.

- **Expansion of the Open Access platform** • QSC anticipates that further regional network operators and nationwide marketers will be using this first nationwide network, process and services hub for NGA connections during the course of fiscal 2011. This will enable the Company to especially benefit from the fiber optic infrastructures that are being built in many municipalities.

- **Presentation of the Q-loud software platform** • During the course of fiscal 2011, QSC will present its Q-loud Cloud Computing platform, along with initial applications. QSC will thus be building a foundation early on that will support the development of applications for companies, which will enable it to benefit even more from the anticipated growth in the Cloud Computing market.

Cologne, March 23, 2011

QSC AG
The Management Board

Dr. Bernd Schlobohm
Chief Executive Officer

Jürgen Hermann

Joachim Trickl

» Network-based provision of telephony and communication applications (Communication as a Service) is especially suitable for small and mid-size companies. ICT solutions like IPfonie centraflex offer maximum efficiency and flexibility. That's why SMEs, in particular, should challenge their preconceptions and seriously consider appropriate offers. «

STUDY: TELEPHONY FROM THE CLOUD // Berlecon Research //

Financial Report

CONSOLIDATED STATEMENTS OF INCOME

Euro amounts in thousands (K€)

	Notes No.	2010	2009
Net revenues	6	422,106	420,546
Cost of revenues	7	(315,206)	(325,056)
Gross profit		106,900	95,490
Sales and marketing expenses	8	(55,982)	(54,000)
General and administrative expenses	9	(29,556)	(32,287)
Other operating income	10	684	1,849
Other operating expenses	10	(1,168)	(1,380)
Operating profit		20,878	9,672
Financial income	11	261	779
Financial expenses	11	(2,294)	(3,256)
Net profit before income taxes		18,845	7,195
Income taxes	43	5,323	(1,681)
Net profit		24,168	5,514
Earnings per share (basic) in €	12	0.18	0.04
Earnings per share (diluted) in €	12	0.17	0.04

CONSOLIDATED STATEMENTS OF CASH FLOWS

Euro amounts in thousands (K€)

	Notes No.	2010	2009
Cash flow from operating activities	36		
Net profit before income taxes		18,845	7,195
Depreciation and amortization	14, 17	49,825	58,468
Non-cash share-based payments		(188)	213
Loss from disposal of long-term assets		844	1,679
Changes in provisions	30, 33	559	175
Changes in trade receivables	18	(7,689)	4,284
Changes in trade payables	32	(3,857)	(1,605)
Changes in other financial assets and liabilities		(1,744)	(4,915)
Cash flow from operating activities	36	**56,595**	**65,494**
Cash flow from investing activities	37		
Purchase of intangible assets		(18,632)	(28,303)
Purchase of property, plant and equipment		(6,502)	(12,028)
Cash flow from investing activities	37	**(25,134)**	**(40,331)**
Cash flow from financing activities	38		
Changes in convertible bonds		(4)	2
Repayment of liabilities to minority interest shareholders	31	(1,690)	(3,536)
Proceeds from issuance of common stock	25	274	-
Repayment of other short- and long-term liabilities		(2,198)	(6,004)
Repayment of loans granted	29	(5,000)	-
Repayment of finance lease	29	(17,562)	(23,496)
Cash flow from financing activities	38	**(26,180)**	**(33,034)**
Change in cash and short-term deposits		**5,281**	**(7,871)**
Change in cash and short-term deposits at January 1		40,952	48,823
Cash and short-term deposits at December 31	24	**46,233**	**40,952**
Interest paid		1,356	2,863
Interest received		237	828
Income tax paid		536	271

CONSOLIDATED BALANCE SHEETS

Euro amounts in thousands (K€)

	Notes No.	Dec. 31, 2010	Dec. 31, 2009
ASSETS			
Long-term assets			
Property, plant and equipment	14	108,087	126,187
Goodwill	15	49,279	49,279
Other intangible assets	17	22,959	33,658
Other long-term financial assets		498	769
Deferred tax assets	43	8,484	-
Long-term assets		**189,307**	**209,893**
Short-term assets			
Trade receivables	18	61,284	53,595
Receivables from former shareholders	19	28,358	-
Prepayments	20	2,883	2,497
Inventories	21	1,045	2,372
Other short-term financial assets	22	2,774	1,671
Available-for-sale financial assets	23	332	330
Cash and short-term deposits	24	46,233	40,952
Short-term assets		**142,909**	**101,417**
TOTAL ASSETS		332,216	311,310

	Notes No.	Dec. 31, 2010	Dec. 31, 2009
SHAREHOLDERS' EQUITY AND LIABILITIES			
Shareholders' equity			
Capital stock	25	137,128	136,998
Capital surplus	26	139,593	563,687
Other capital reserves	28	(1,291)	(1,129)
Consolidated balance sheet loss		(91,382)	(539,844)
Shareholders' equity		184,048	159,712
Liabilities			
Long-term liabilities			
Long-term liabilities to minority shareholders	31	-	42,580
Long-term financing obligations	29	2,044	7,272
Convertible bonds	41	20	24
Accrued pensions	30	1,067	741
Other long-term liabilities		-	576
Deferred tax liabilities	43	4,108	3,056
Long-term liabilities		7,239	54,249
Short-term liabilities			
Trade payables	32	38,043	40,982
Short-term financing obligations	29	5,493	15,503
Liabilities due to banks	29	10,000	15,000
Other provisions	33	2,085	1,266
Accrued taxes	33	2,215	771
Deferred revenues	34	69,842	13,785
Other short-term liabilities	35	13,251	10,042
Short-term liabilities		140,929	97,349
LIABILITIES		148,168	151,598
TOTAL SHAREHOLDERS' EQUITY AND LIABILITIES		332,216	311,310

CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY

Euro amounts in thousands (K€)

	Notes No.	Equity attributable to equity holders of the parent				Total Shareholders' equity
		Capital stock	Capital surplus	Other capital reserves	Consolidated balance sheet loss	
Balance at January 1, 2010		136,998	563,687	(1,129)	(539,844)	159,712
Net profit					24,168	24,168
Income and expenses directly recognized in equity	28			(162)		(162)
Net profit and recognized income and expenses				(162)	24,168	24,006
Conversion of convertible bonds	41	130	145			275
Non-cash share-based payments	41		55			55
Reclassification of capital reserves			(424,294)		424,294	-
Balance at December 31, 2010		137,128	139,593	(1,291)	(91,382)	184,048
Balance at January 1, 2009		136,998	563,197	(1,141)	(545,358)	153,696
Net profit					5,514	5,514
Income and expense directly recognized in equity	28			12		12
Net profit and recognized income and expenses				12	5,514	5,526
Non-cash share-based payments	41		490			490
Balance at December 31, 2009		136,998	563,687	(1,129)	(539,844)	159,712

CONSOLIDATED STATEMENTS OF DIRECTLY RECOGNIZED INCOME AND EXPENSES

Euro amounts in thousands (K€)

	2010	2009
Directly recognized in equity		
Changes in accrued pension	(237)	18
Changes in unrealized fair values		
of available-for-sale financial assets	2	-
Apportionable to tax effect	73	(6)
Directly recognized in equity	(162)	12
Net profit	24,168	5,514
Net profit and recognized income and expenses	**24,006**	5,526

Auditor's report

We have audited the consolidated financial statements prepared by QSC AG, Cologne, comprising the consolidated balance sheets, the consolidated statements of income, the consolidated statements of periods to the whole result, consolidated statements shareholder's equity, consolidated statements of cash flows and the notes to the consolidated financial statements, together with the group management report for the financial year from 1 January to 31 December 2010. The preparation of the consolidated financial statements and the group management report in accordance with IFRS as applicable in the EU and in compliance with the supplementary requirements as set out in § 315a, para. 1 HGB is the responsibility of the Company's management. Our responsibility is to express an opinion on the consolidated financial statements and on the group management report, based on our audit.

We conducted our audit of the consolidated financial statements in accordance with § 317 HGB and German generally accepted standards for the audit of financial statements promulgated by the Institut der Wirtschaftsprüfer (IDW). Those standards require that we plan and perform the audit such that misstatements materially affecting the presentation of the net assets, financial position and results of operations in the consolidated financial statements in accordance with principles of proper accounting 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 those entities included in consolidation, the determination of entities to be included in consolidation, the accounting and consolidation principles 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 the IFRS as applicable in the EU and the supplementary requirements as set out in § 315a, para. 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.

Cologne, 23 March, 2011

KPMG AG
Wirtschaftsprüfungsgesellschaft

Kraus	Gall
Wirtschaftsprüfer	Wirtschaftsprüfer

Notes to the Consolidated Financial Statements for Fiscal Year 2010

CORPORATE INFORMATION

QSC AG (QSC or the Company) is one of the leading service providers for voice and data communication, as well as the ICT services that build upon them. Established in 1997, the Company has been focusing on small and mid-size business customers. QSC is the first provider to operate an Open Access platform, which unites a wide range of broadband technologies to offer national and international site networking, including Managed Services. QSC additionally supplies its customers and distribution partners with a comprehensive product portfolio that can be modularly adapted to every need. QSC was the first provider in Germany to build its own Next Generation Network (NGN), and therefore enjoys long years of experience in IP-based telephony solutions, in particular. QSC employs a workforce of some 700 people and has been listed on the TecDAX index since 2004. 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.

GENERAL PRINCIPLES

1 Basis of preparation

According to the article 4 of the regulation (EG) number 1606/2002 of the European Parliament and the council dated July 19, 2002, the Company is required to prepare the consolidated financial statements in accordance with the International Financial Reporting Standards (IFRS), and according to the rules of § 315a (1) of the German Commercial Code (HGB) is thus exempt from preparing the consolidated financial statements in accordance with the German Commercial Code. QSC prepares the consolidated financial statements on a historical cost basis, except for available-for-sale financial assets, which have been measured at fair value. QSC prepares the consolidated financial statements in accordance with the International Financial Reporting Standards (IFRS) issued by the International Accounting Standards Board (IASB), which became mandatory at December 31, 2010, and which are required to be applied in the EU. The Company also prepares the consolidated financial statements in accordance with the supplementary rules of § 315a (1) HGB. The Company took into consideration all IFRS and International Accounting Standards (IAS) as well as their interpretation by the International Financial Reporting Interpretations Committee (IFRIC) and the Standing Interpretations Committee (SIC) that became mandatory for the 2010 fiscal year.

The financial year of QSC and its subsidiaries (the Group) corresponds to the calendar year. The consolidated financial statements are presented in euros, and all amounts, except when otherwise indicated, are rounded to the nearest thousand (K€).
No events or transactions which would have a material effect on the Group's profitability, financial position and net worth as well cash flows for the period then ended occurred prior to March 23, 2011 (which is the date of the consolidated financial statements' approval by the Management Board for handover to the Supervisory Board).

2 Basis of consolidation

The consolidated financial statements comprise the financial statements of QSC AG and its subsidiaries as of December 31 each year. QSC prepares the subsidiaries' financial statements for the same reporting year as the parent company, using consistent accounting policies. All intra-group balances, transactions, income and expenses, and profits and losses resulting from intra-group transactions that are recognized in assets, are eliminated by the Company in full. Subsidiaries are fully consolidated from the date of acquisition, being the date on which the Group obtains control, and continue to be consolidated until the date that such control ceases. The subsidiaries and associated companies that are included in the consolidated financial statements are listed in Note 39.

3 Significant judgments and estimates

The application of accounting policies requires the use of judgments as well as of forward-looking assumptions and estimates. Actual results may differ from those assumptions and estimates, with the result that there is a risk that a significant adjustment to the carrying amounts of assets and liabilities could become necessary within the coming fiscal year. The use of judgments, assumptions and estimates was necessary in particular for the accounting treatment of the following items:

Impairment of non-financial assets • At each reporting date, the Group assesses whether there are any indicators of an impairment in all non-financial assets. Goodwill and other intangible assets with indefinite useful lives are tested for impairment at least once a year and at other times when such indicators exist. Impairment is determined for goodwill by assessing the recoverable amount of the cash-generating unit (CGU), which is measured as the present value of the expected future cash flows from the cash-generating unit. The CGUs correspond to the reportable segments. QSC regards as CGUs its business segments. Where the recoverable amount of the CGU is less than their carrying amount, an impairment loss is recognized. Further details are given in Note 16.

Deferred tax assets • QSC recognizes deferred tax assets for all temporary differences, as well as for unused tax losses to the extent that it is probable that taxable income will be available against which the loss carry forwards can be utilized.
Significant judgment by management is required to determine the amount of deferred tax assets that can be recognized, based upon the likely timing and level of future taxable profits together with underlying future tax planning strategies. As of December 31, 2010, the carrying value of recognized corporation tax losses was € 443 million (2009: € 457 million), and the carrying value of recognized municipal trade tax losses was € 439 million (2009: € 453 million). Further details are contained in Note 43.

Pension and other post-employment benefits • The cost of defined benefit pension plans and other post-employment medical benefits is determined using actuarial valuations. The actuarial valuation involves making assumptions about discount rates, expected rates of return on assets, future salary increases, mortality rates and future pension increases. Due to the long-term nature of these plans, such estimates are subject to significant uncertainty. Management has exercised the option stipulated in IAS 19 that actuarial gains and losses are recognized directly in equity in other reserves. As of December 31, 2010, provisions for pensions and similar commitments amounted to K€ 1,067 (2009: K€ 741). Further details are given in Note 30.

Share-based payments • QSC measures the expense recognized for share-based remuneration in cases where equity instruments are used to remunerate work performed, using an appropriate option price model. The computation is done using assumptions relating to the risk-free interest rate relevant for the duration of the option, the expected dividend to be paid and the share's expected market price volatility. Due to the long-term nature of these remuneration agreements, the estimates used are subject to significant uncertainties.

Trade receivables • QSC presents trade receivables in the balance sheet net of allowances. Allowances for doubtful debts are measured on the basis of regular reviews and assessments which are performed in conjunction with credit monitoring. The assumptions applied to reflect future payment behavior and customer creditworthiness are subject to significant uncertainties. As of December 31, 2010, allowances totaling K€ 3,913 (2009: K€ 7,561) were recognized on trade receivables.

Provisions • A provision is recognized when the Group has a legal or constructive obligation as a result of a past event, when it is likely that an outflow of resources embodying economic benefits will be required to settle such an obligation, and when the obligation's amount can be reliably estimated. Such estimates are subject to significant uncertainties. As of December 31, 2010, provisions totaling K€ 4,300 (2009: K€ 2,037) were recognized in the balance sheet.

4 Summary of significant accounting policies

Revenue recognition • QSC recognizes revenue to the extent that it is probable that the economic benefits will flow to the Group, and when revenue can be reliably measured. Revenue is measured at the fair value of the consideration received, excluding discounts, rebates, and other sales taxes or duty. The following specific recognition criteria must also be met before revenue is recognized:

- Revenue from services is recognized when the services have been provided. QSC recognizes services that have not been provided completely or throughout the entire reporting period, respectively, at balance sheet date on a time-apportioned basis with regard to the stage of completion.
- QSC defers revenue from the installation of customer lines on a time-apportioned basis over an average contractual term of 24 months.
- QSC recognizes revenue as interest accrues (using the effective interest method that is the rate that exactly discounts estimated future cash receipts through the expected life of the financial instrument to the net carrying amount of the financial asset).

Foreign currency translation • QSC presents the consolidated financial statements in euros. 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 differences between the exchange rate at the day the transaction was closed and the exchange rate at balance sheet date, or at the day the transaction is finally closed, if sooner, are included in the income statement.

Property, plant and equipment • QSC states property, plant and equipment at cost of acquisition or construction 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 costs result in an addition or significant improvement to the relevant asset; otherwise it is immediately recognized in profit or loss. Depreciation is calculated using the straight-line method over the estimated useful lives of the assets. The following estimated useful lives have been used in calculating depreciation:

	Useful life in years
Assets	
Network equipment and plant	3 to 8
Building improvements	5 to 10
Network components	2 to 10
Operational and office equipment	3 to 13

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

Business combinations and goodwill • QSC accounts business combinations using the acquisition accounting method. It involves recognizing identifiable assets and liabilities, as well as contingent liabilities of the acquired business at fair value. Goodwill acquired in a business combination is initially measured at cost, being the excess of the cost of the business combination over the Group's interest in the net fair value of the acquiree's identifiable assets, liabilities and contingent liabilities.
Following initial recognition, QSC measures goodwill at cost, less any accumulated impairment losses. QSC tests goodwill and other indefinite life intangibles for impairment annually, and at other times when there are indicators of a potential impairment in the carrying amount.

Other intangible assets • Intangible assets are measured on initial recognition at cost. The cost of intangible assets acquired in a business combination correspond to the fair value as of the date of acquisition. Internally generated intangible assets are capitalized if capitalization conditions according to IAS 38 are met. Expenses that are not intended to be recognized are recorded under profit or loss in the period in which they are 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 additionally assessed for impairment whenever there is an indication that the intangible asset may be impaired. Such a review of the amortization period and the amortization method for such an intangible asset with a finite useful life is done at least at each financial year end.
Intangible assets with indefinite useful lives are not amortized, but are tested for impairment at least annually.
QSC's intangible assets include primarily software, licenses and similar rights as well as non-recurring provisioning costs for activating customer connections. The Company amortizes licenses over a period of five to ten years and software over a period of four years. Non-recurring provisioning costs for activating customer connections are amortized over an average contractual period of 24 months.

Investments and financial assets • QSC classifies financial assets within the scope of IAS 39 as either financial assets at fair value through profit or loss, held-to-maturity investments, loans and receivables, or available-for-sale financial assets, as appropriate. 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. A reclassification is done if permitted and necessary.

Upon initial recognition, QSC designates financial assets at fair value. QSC recognizes directly in equity all regular way purchases and sales of financial assets on the trade date, which is the date that the Group committed itself to purchasing the asset. Regular way purchases or sales are purchases or sales of financial assets that require delivery of assets within the period generally established by regulation or convention in the marketplace.

- Loans and 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.
- Available-for-sale financial assets are those non-derivative financial assets that are designated as available-for-sale or are not classified in any of the three preceding categories. After initial measurement, available-for-sale financial assets are measured at fair value with unrealized gains or losses being recognized directly in equity in the net unrealized gains reserve. When the investment is disposed of, the cumulative gain or loss previously recorded in equity is recognized in the income statement.

Inventories • Inventories are valued at average amortized cost. As at balance sheet date, goods are stated at the lower of cost and net realizable value.

Cash and short-term deposits • Cash and short-term deposits in the balance sheet and statements of cash flow comprise cash at banks and at hand and short-term deposits with an original maturity of three months or less.

Provisions • Provisions are recognized when the Group has a present obligation (legal or constructive) as a result of a past event, it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation and a reliable estimate can be made of the amount of the obligation. Where the Group expects some or all of a provision to be reimbursed, for example under an insurance contract, 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.

Pensions • QSC operates two defined benefit pension plans. 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 30.

Stock option programs • QSC's employees, but also suppliers and consultants, may also receive share-based remuneration in the form of equity instruments in return for work performed. QSC measures the expense of issuing such equity instruments on the basis of the fair value of the equity instrument at the grant or provision date (based on the stock option programs resolved or modified after November 7, 2002), respectively, using an appropriate option price model. Further details are provided in Note 41. The expense recognized for granting equity instruments (as well as the corresponding increase in equity) is spread over the vesting period of the options. QSC recognizes no expense for remuneration entitlements which cannot be exercised. If the terms and conditions of a share-based remuneration agreement are modified, QSC recognizes as a minimum the level of expense that would have arisen if the terms and conditions had not been modified. If a share-based remuneration agreement is cancelled, QSC accounts for the remuneration agreement as if it had been exercised on the cancellation date. Any previously deferred expense is recognized immediately as an expense in the income statement.

Leases • QSC determines whether an arrangement is or contains a lease on the basis of the substance of the arrangement at inception date. This requires judgment as to whether the fulfillment of the arrangement is dependent on the use of a specific asset, or assets, or the arrangement conveys a right to use the asset. QSC operates exclusively as lessee.
In the case of rent-to-own and financing arrangements, the payments are divided into their constituent elements of financing expense and redemption in accordance with the effective interest rate method, which means that the residual book value of the leasing obligation is discounted at a constant interest rate. Financing expenses are recorded immediately as a charge against income. QSC classifies lease arrangements which do not transfer substantially all the risks and rewards incidental to ownership from the Group to the lessee as operating leases. Operating lease payments are recognized as an expense in the income statement on a straight line basis over the lease term.
QSC's financing arrangement essentially consist of rent-to-own contracts with terms of between two to three years.

Long-term liabilities to minority shareholders • As of December 31, 2009, the long-term liabilities to minority shareholders correspond to Communication Services TELE2 GmbH's ("TELE2") minority interest in Plusnet GmbH & Co. KG (Plusnet), a subsidiary which was co-founded with QSC in July 2006. Following the inclusion in QSC's consolidated financial statements, this item has correlated with the consolidated capital account of TELE2, which represents a part of Plusnet's equity in Plusnet's Annual Financial Statement. In accordance with existing agreements, QSC measures the long-term liabilities to minority shareholders at amortized cost. Consequently, on the one hand, the long-term liabilities of other shareholders increase, as agreed upon, with each and every investment in Plusnet that is backed by TELE2; and on the other, they are reduced by the portion of depreciation and amortization which can be attributed to TELE2 within Plusnet. The long-term liabilities to minority shareholders do not bear interest. The earning portion of Plusnet, which is attributable to minorities, is presented analogously to the recognition as borrowing debt under financial expenses. On December 22, 2010, QSC acquired TELE2's minority share for € 36.7 million effective retroactively to October 31, 2010.

Deferred income • QSC defers one-time income from the installation of customer lines on a time-apportioned basis over an average contractual period of 24 months.
In conjunction with the early termination of QSC's contract with TELE2, originally intended to run until the end of 2013, TELE2 paid an amount of € 66.2 million in January 2011. This amount was recorded as deferred income and is being recognized as income on a time-apportioned basis over the period from November 1, 2010, to December 31, 2013.

Financial liabilities • QSC measures all interest-bearing loans on initial recognition at fair value, less directly attributable transaction costs. After initial recognition, interest-bearing loans and borrowings are subsequently measured at amortized cost using the effective interest method. Gains and losses are recognized in the income statement when the liabilities are derecognized as well as through the amortization process.

Taxes • QSC recognizes current income tax assets and liabilities for the current and prior periods at the amount expected to be recovered from or paid to the taxation authorities. To compute the amount, QSC uses the tax rates and tax laws that are enacted or substantively enacted by the corresponding assessment period. Actual income tax relating to items recognized directly in equity is recognized in equity.
Deferred income tax is provided using the liability method on temporary differences at the balance sheet date between the tax bases of assets and liabilities and their carrying amounts for financial reporting purposes.
QSC recognizes deferred income tax liabilities for all taxable temporary differences, except

- where the deferred income tax liability arises from the initial recognition of goodwill or of an asset or liability in a transaction that is not a business combination and, at the time of the transaction, affects neither the accounting profit nor taxable profit or loss; and
- in respect of taxable temporary differences associated with investments in subsidiaries, associates and interests in joint ventures, where the timing of the reversal of the temporary differences can be controlled and it is probable that the temporary differences will not reverse in the foreseeable future.

QSC recognizes deferred tax assets 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 except

- where the deferred income tax asset relating to the deductible temporary difference arises from the initial recognition of an asset or liability in a transaction that is not a business combination and, at the time of the transaction, affects neither the accounting profit nor taxable profit or loss; and
- in respect of deductible temporary differences associated with investments in subsidiaries, associates and interests in joint ventures, deferred income tax assets are recognized only to the extent that it is probable that the temporary differences will reverse in the foreseeable future and taxable profit will be available for which the temporary differences 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 asset to be utilized. Unrecognized deferred income tax assets are also reassessed at each balance sheet date and are recognized to the extent that it has become probable that future taxable income will allow the deferred tax asset to be recovered. QSC measures deferred income tax assets and liabilities 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.
Deferred income tax relating to items recognized directly in equity is recognized in equity and not in the income statement.
Deferred income tax assets and deferred income tax liabilities are offset, if a legally enforceable right exists to set off current tax assets against current income tax liabilities and the deferred tax assets and deferred income tax liabilities relate to the same taxable entity and the same taxation authority.

Revenues, expenses and assets are recognized net of the amount of sales tax except

- where QSC is unable to recover the sales tax incurred on a purchase of assets or services from the taxation authority, in which case the Company recognizes the sales tax as part of the cost of acquisition of the asset or as part of the expense item as applicable; and
- receivables and payables that are stated with the amount of sales tax included.

QSC includes the net amount of sales tax recoverable from or payable to the taxation authority in the balance sheet under "Other short-term financial assets" or "Other short-term liabilities", respectively.

5 Changes in accounting policies

The following amendments in financial reporting pronouncements, mandatory for the first time in the financial year 2010, complied with by QSC AG.

IFRS 2 – Share-based Payment • the IASB published amendments to IFRS 2 clarifying the accounting treatment of share-based cash-settled remuneration within a group. An entity that receives goods or services in conjunction with a share-based payment arrangement is required the account for these goods or services regardless of which entity in the group settles the related obligation or whether the obligation is to be equity-settled or cash-settled. If the reporting entity receives goods or services without any obligation on its own part to settle the share-based payment transaction, the goods or services received must be accounted for in accordance with the requirements for equity-settled share-based payments, even if the entity which is required to settle the transaction does so in cash. The amendment did not have any impact on the consolidated financial statements.

IFRS 3 – Business Combinations (revised 2008) • The revised Standard sets out new rules for the application of the purchase method for business combinations. The principal changes relate to the measurement of non-controlling interests (minority interests), the recognition of business acquisitions made in stages and the treatment of conditional consideration and acquisition-related costs. The definition of a business has been widened under the new rule: the capability to use an integrated set of activities and assets as a business is sufficient to constitute a business. Conditional purchase price payments must be recognized at acquisition date at their fair value as part of the purchase consideration. An accounting option was introduced for the purposes of measuring non-controlling interests (minority interests). Accordingly, they can either be measured at the acquiring entity's share of the fair value of the identifiable assets and liabilities of the acquired entity or at their fair value (the full-goodwill method). In the case of business acquisitions made in stages, the fair value of the investment held at the date on which control passes must be re-measured through profit or loss. Acquisition-related costs must be recognized as expense when incurred.

IAS 27 – Consolidated and Separate Financial Statements in IAS 27 (2008) • The principal amendments to this Standard deal with the accounting treatment of transactions which result in an entity either retaining or losing control over another entity. Transactions which result in a change in shareholding without control being lost must be accounted for as equity transactions. Any investment remaining at the date of loss of control must be measured at its fair value. It is also permitted to report negative balances for minority interests. In other words, in future, losses will be allocated without restriction on the basis of the proportionate share of the investment held. The amendment did not have any impact on the consolidated financial statements.

Improvements to IFRS 2008 and 2009 • When a plan to sell an investment in a subsidiary is made known and that sale will involve the loss of control, all assets and liabilities must be classified as held for sale if the criteria set out in IFRS 5 are fulfilled. Assets and liabilities must all be reclassified, regardless of whether a minority interest remains after the sale. Also in conjunction with the IASB's annual improvement projects, a number of amendments were made with the objective of clarifying existing IFRSs through improved wording, while other amendments also have an impact on the presentation, recognition and measurement of items in financial statements.
The IASB published various other pronouncements which were required to be applied in the calendar year 2010. These amendments did not have any impact on the consolidated financial statements of QSC AG.

Recently published financial reporting pronouncements – not yet applied • The following new financial reporting pronouncements had been published by December 31, 2010, but were not mandatory at that date. QSC will apply the amendments when they become mandatory.

Standard	Endorsement by December 31, 2010
IAS 24 – Related Party Disclosures (revised 2009)	Yes
Amendments to IFRS 7 – Disclosures – Transfers of Financial Assets	No
Amendments to IAS 32 – Classification of Rights Issues	Yes
IFRIC 19 – Extinguishing Financial Liabilities with Equity Instruments	Yes
Amendments to IFRIC 14 – Prepayments of a Minimum Funding Requirement	Yes
IFRS 9 – Financial Instruments	No

IAS 24 – Related Party Disclosures (revised 2009) • Entities were previously required to disclose information on all transactions with entities controlled, jointly controlled or significantly influenced by a government. As a result of the amendment to IAS 24, detailed disclosures will now only be required for significant transactions. Quantitative or qualitative disclosures must be made to indicate the impact of transactions which are not individually significant, but which are collectively significant. As a result of the amendment to IAS 24, the definition of a related party (individual or entity) and the reporting requirements of entities which are controlled, jointly controlled or significantly influenced by a government, have been clarified with respect to the detailed disclosures required for individually significant transactions with these entities. The amendments are mandatory for the first time for annual periods beginning on or after January 1, 2011.

Amendments to IFRS 7 – Disclosures - Transfers of Financial Assets • The amendments to IFRS 7 relate to additional disclosures in the event of the transfer of financial assets. The disclosures are intended to show the relationships between the transfer of financial assets and corresponding financial liabilities. In addition, the disclosures should enable a better assessment of the nature and risks of continuing involvement in the derecognized financial assets. Additional disclosures are also required if there is a disproportionately large number of transfers with continuing involvement, for example at and around the end of the reporting period.
The amended IFRS 7 is mandatory for the first time – subject to a different mandatory date in conjunction with EU endorsement – for annual periods beginning on or after July 1, 2011. In the year of first-time application, there is no requirement to make comparative prior year disclosures.

Amendments to IAS 32 – Classification of Rights Issues • The amendment to IAS 32 clarifies the accounting treatment for rights issues, option and option warrants that are issued pro rata to an entity's existing shareholders in the same class of non-derivative equity instruments and which entitle a fixed number of equity instruments to be acquired or retained in return for a fixed amount of cash in any currency. Under the new rules contained in IAS 32.11(b)(ii) and IAS 32.16(b)(ii), it will no longer be necessary to make a distinction under the certain circumstances whether the rights are to be exercised in a currency other than the functional currency or not.

Prior to this amendment, rights to be exercised in another currency were required to be presented and measured as financial liabilities.
The amendments are mandatory for the first time for annual periods beginning on or after February 1, 2010.

IFRIC 19 – Extinguishing Financial Liabilities with Equity Instruments • IFRIC 19 sets out the requirements if an entity, either partially or in full, settles a financial liability by issuing shares or other equity instruments. The Interpretation specifies that

- the equity instruments issued to a creditor extinguish a financial liability are a component of the "consideration paid" in accordance with IAS 39.41;
- the corresponding equity instruments must be measured at their fair value. If the fair value cannot be measured reliably, the equity instruments must be measured at the fair value of the extinguished liability.
- the difference between the carrying amount of the financial liability to be derecognized and the first-time carrying amount of the issued equity instruments must be recognized in the income statement.

IFRS 19 is mandatory for annual periods beginning on or after July 1, 2010. Based on our current understanding, it is unlikely that the amendments to the pronouncements stated above will have a significant impact on the future consolidated financial statements of QSC.

IFRS 9 – Financial Instruments • This Standard, published in November 2009, covers the first of the three phases of the IASB project aimed at replacing the existing IAS 39, Financial Instruments: Recognition and Measurement. IFRS 9 amends the recognition and measurement requirements for financial assets (including hybrid contracts). It applies a uniform approach to accounting for a financial asset either at amortized cost or fair value and replaces the various rules contained in IAS 39. The approach taken in IFRS 9 is based on how the entity manages its financial instruments (business model) and on the nature of the contractually agreed cash flows from the financial assets. The Standard also sets out a uniform method to determine impairment losses. The Standard is mandatory for annual periods beginning on or after January 1, 2013; early adoption is permitted. QSC is currently reviewing the impact on its consolidated financial statements.

INCOME STATEMENT DISCLOSURES

6 Net revenues

Revenues are generated with wholesale partners and resellers, as well as 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. In addition, QSC generates revenues from the installation of customer lines. In fiscal 2010 they amounted to K€ 10,836 (2009: K€ 18,060). The structure of the Company's revenues by segment is shown in Note 40. QSC defers non-recurring revenue from the installation of customer lines on a time-apportioned basis over an average contractual term of 24 months.

7 Cost of revenues

Cost of revenues include the cost of material, the cost 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 provisioning costs for activating customer connections are capitalized and depreciated over the average contract term of 24 months.

in K€	2010	2009
Cost of materials	206,720	204,825
Building, operation and maintenance of the network	54,420	58,190
Depreciation and amortization	41,657	47,209
Personnel expenses	12,444	14,802
Non-cash share-based payments	(35)	30
Cost of revenues	**315,206**	**325,056**

8 Sales and marketing expenses

Sales 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 and the non-cash share-based payment in connection with SOPs, as well as depreciation and amortization on the hardware and software employed in connection with sales and marketing operations. Analogously to the installation 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.

in K€	2010	2009
Personnel expenses	16,453	17,459
Commissions	20,079	14,668
Other sales and marketing expenses	4,713	4,481
Allowance for bad debts and fair dealing payments	430	1,343
Advertising expenses	1,830	1,898
Depreciation and amortization	12,462	14,061
Non-cash share-based payments	15	90
Sales and marketing expenses	**55,982**	**54,000**

9 General and administrative expenses

In addition to the personnel expenses and the non-cash share-based payments for the members of the Management Board and for staff positions, as well as for employees from Finance, Human Resources, Legal Operations, and IT who work in administration, the general and administrative expenses item also includes costs for the administration buildings, legal and consulting costs, corporate communications costs, including investor relations, as well as depreciation and amortization on the hardware and software employed in connection with administrative operations.

in K€	2010	2009
Other general and administrative expenses	11,234	10,996
Personnel expenses	15,227	15,463
Depreciation and amortization	3,020	5,457
Non-cash share-based payments	75	371
General and administrative expenses	**29,556**	**32,287**

10 Other operating income and expenses

in K€	2010	2009
Miscellaneous operating income	655	1,548
Reversals of unutilized provisions and write-off of liabilities	29	1
Gains from disposal of property, plant and equipment	-	300
Other operating income	**684**	**1,849**

in K€	2010	2009
Miscellaneous operating expenses	1,168	1,339
Losses from disposal of property, plant and equipment	-	41
Other operating expenses	**1,168**	**1,380**

11 Financial result

in K€	2010	2009
Interest income	261	779
Financial income	**261**	**779**

in K€	2010	2009
Interest expense	1,892	3,183
TELE2's minority interest in Plusnet GmbH & Co. KG	402	73
Financial expenses	**2,294**	**3,256**

Interest expense includes expenses under financing arrangements in the amount of K€ 1,068 (2009: K€ 1,958). The K€ 402 amount was attributable to the additional expense in connection with the return of liabilities toward minority shareholders that had been carried forward.

12 Earnings per share

For the purposes of calculating undiluted earnings per share, QSC divides profit attributable to the holders of the Company's common stock by the weighted average number of shares of common stock in circulation during the year. The Company computes the weighted average number of issued shares approximately as mean from the respective number of common stock to quarterly closing dates.
For the purposes of calculating diluted earnings per share, QSC divides profit attributable to the holders of the Company's common stock by the sum of the weighted average number of shares of common stock plus the weighted average number of shares of common stock that would arise if all potential shares of common stock with dilutive effect were converted into shares. As of December 31, 2010, the number of potential shares of common stock with a dilutive effect was 1,961,941. Of these, a further 584,082 convertible bonds from the existing conditional capital are still convertible. During the period between the balance date and the date on which the consolidated financial statements were authorized for issue, no transactions involving existing or potential shares of common stock have occurred which would have significantly changed the weighted average number of issued shares as of December 31, 2010.

	2010	2009
Net income attributable to ordinary equity holders of the parent company in K€	24,168	5,514
Weighted average number of common shares	137,024,016	136,998,137
Earnings per share (basic) in €	**0.18**	**0.04**

	2010	2009
Net income attributable to ordinary equity holders of the parent company in K€	24,168	5,514
Weighted average number of common shares	138,985,957	139,404,400
Earnings per share (diluted) in €	**0.17**	**0.04**

13 Personnel expenses and employees

in K€	2010	2009
Wages and salaries	38,236	41,583
Employer's social security contributions (pension fund)	3,013	3,138
Employer's social security contributions (other)	2,600	2,697
Net pension costs	275	305
Non-cash share-based payments	55	490
Personnel expenses	**44,179**	**48,213**

Wages and salaries include expenses for the termination of employment contracts in the amount of K€ 660.

During fiscal 2010, the Company employed on average 658 employees (2009: 722). The following table presents the distribution according to the employees' primary function:

	2010	2009
Sales and marketing	100	106
Engineering	355	369
General and administration	181	219
Board and staff positions	22	28
Number of employees by function (on average)	**658**	**722**

BALANCE SHEET DISCLOSURES

14 Property, plant and equipment

in K€	Network equipment and plant	Operational and office equipment	Total
Gross value at January 1, 2009	289,238	34,887	324,125
Additions	17,554	451	18,005
Disposals	(3,019)	(577)	(3,596)
Gross value at December 31, 2009	303,773	34,761	338,534
Additions	11,345	514	11,859
Disposals	(3,040)	-	(3,040)
Reclassification	(6,289)	6,289	-
Gross value at December 31, 2010	305,789	41,564	347,353
Accumulated depreciation and amortization at January 1, 2009	152,132	30,965	183,097
Additions	27,794	2,757	30,551
Disposals	(1,171)	(130)	(1,301)
Accumulated depreciation and amortization at December 31, 2009	178,755	33,592	212,347
Additions	27,308	1,690	28,998
Disposals	(2,079)	-	(2,079)
Reclassification	(3,996)	3,996	-
Accumulated depreciation and amortization at December 31, 2010	199,988	39,278	239,266
Carrying amount at December 31, 2009	125,018	1,169	126,187
Carrying amount at December 31, 2010	105,801	2,286	108,087

At December 31, 2010, the carrying amount of plant and equipment, as well as operational and office equipment held under financing arrangements and rent-to-own contracts totaled K€ 15,657 (2009: K€ 23,826).
Additions during the year amounted to K€ 11,859 (2009: K€ 18,005). As of December 31, 2010, the line item 'Network and equipment' included assets under construction amounting to K€ 94 (2009: K€ 77).
QSC presents depreciation and amortization in the income statement under 'Cost of revenues', 'Sales and marketing expenses' and 'General and administrative expenses', respectively. The classification of assets within property, plant and equipment has been modified as a result of greater insight.

15 Goodwill

As in the past fiscal year, goodwill amounts to K€ 49,279.

16 Impairment of goodwill

Goodwill acquired in conjunction with business combinations was allocated to the following CGUs, which were also reportable segments, for the purpose of impairment testing:

in K€	2010
Managed Services	5,720
Products	15,543
Wholesale/Resellers	28,016
Carrying amount of goodwill	**49,279**

QSC initially determines the recoverable amount of the Group's CGUs on the basis of a value in use, which, in turn, is measured using three-year cash flow forecasts. The latter constitutes the corporate plan which is devised by the Management Board. The growth rate according to the detailed planning period was derived on the basis of projected industry growth rates and the overall development of the economy. For all CGUs, a long-term growth rate of 1.0 percent was assumed.
The capitalization interest rate utilized for discounting the expected future cash flows is 8.25 percent. In the past fiscal year, a capitalization interest rate of 9.25 percent was utilized. This discount rate reflects management's assessment of company-specific risks and includes a base rate (risk-free and appropriate for an alternative investment according to the interest rate structure curve at December 31, 2010) and a risk-uplift factor (reflecting the risk structure of the Group and of the telecommunications industry in general).
The calculation of the CGUs' value in use requires management to make estimates about gross profit, discount rate, and the development of prices and market share, which are subject to uncertainties. QSC believes that no reasonably possible change in any of the above key assumptions would cause the CGUs' carrying value to materially exceed its recoverable amount.

17 Other intangible assets

in K€	Licences	Software	Customer connections	Other	Total
Cost at January 1, 2009	1,164	14,219	68,678	13,751	97,812
Additions	-	2,911	21,067	233	24,211
Disposals	-	(311)	-	-	(311)
Cost at December 31, 2009	1,164	16,819	89,745	13,984	121,712
Additions	113	1,533	15,552	125	17,323
Disposals	-	-	-	-	-
Cost at December 31, 2010	1,277	18,352	105,297	14,109	139,035
Accumulated amortization at January 1, 2009	412	10,103	33,621	8,668	52,804
Additions	294	2,704	31,472	1,091	35,561
Disposals	-	(311)	-	-	(311)
Accumulated amortization at December 31, 2009	706	12,496	65,093	9,759	88,054
Additions	175	2,324	24,225	1,298	28,022
Disposals	-	-	-	-	-
Accumulated amortization at December 31, 2010	881	14,820	89,318	11,057	116,076
Carrying amount at December 31, 2009	458	4,323	24,652	4,225	33,658
Carrying amount at December 31, 2010	396	3,532	15,979	3,052	22,959

Additions to the line item “Other intangible assets” include internally generated intangible assets in the amount of K€ 69.
QSC presents depreciation and amortization in the income statement under ‘Cost of revenues’, ‘Sales and marketing expenses’ and ‘General and administrative expenses’, respectively.

18 Trade receivables

in K€	2010	2009
Trade receivables	61,284	53,595

Trade receivables are not interest-bearing and generally have an original maturity of between 30 and 90 days. As of December 31, 2010, trade receivables amounting to K€ 3,913 (2009: K€ 7,561) were impaired. Allowances developed as follows:

in K€	2010	2009
Allowance at January 1	**7,561**	**7,135**
Charge for the year	742	1,503
Amounts written off	(4,078)	(790)
Unused amounts reversed	(312)	(287)
Allowance at December 31	**3,913**	**7,561**

The analysis of trade receivables as of December 31 was as follows:

in K€	2010	2009
Impaired	4,656	8,147
Neither past due nor impaired	57,510	50,581
Past due but not impaired		
< 90 days	3,031	2,428
91 – 120 days	-	-
> 120 days	-	-
Trade receivables not impaired	**65,197**	**61,156**

Trade receivables of the Group and Ventelo GmbH (Ventelo) have been utilized as security for the K€ 50,000 syndicate loan contract dated June 13, 2008.

19 Receivables from former shareholders

The receivable against former shareholders in the amount of K€ 28,358 was essentially attributable to TELE2's obligation for premature withdrawal from contracts relating to jointly held network operating company Plusnet in the amount of K€ 66,226, on the one hand, as well as for the acquisition of the minority interest in Plusnet by QSC for K€ 36,725, on the other. The liability of K€ 28,358 was paid by TELE2 in January 2011.

20 Prepayments

Prepayments total K€ 2,883 (2009: K€ 2,497) and essentially consist of prepaid expenses for leased lines and technology premises, as well as insurance.

21 Inventories

Inventories amount to K€ 1,045 (2009: K€ 2,372) and essentially contain supply of technical devices for end customers. At the end of the reporting period, an exceptional write-down of K€ 118 (2009: K€ 615) was made. End customer devices are presented in the working capital at the date of acquisition and transferred to property, plant and equipment at the date of dispatch to end customers.

22 Other short-term financial assets

Other short-term financial assets total K€ 2,774 (2009: K€ 1,671) and relate primarily to tax receivables.

23 Available-for-sale financial assets

in K€	2010	2009
Available-for-sale financial assets	**332**	**330**

Available-for-sale financial assets consist of shares in a money market fund.

24 Cash and short-term deposits

in K€	2010	2009
Cash on hand	46,233	37,945
Short-term deposits (2 months)	-	3,007
Cash and short-term deposits	**46,233**	**40,952**

As of December 31, 2010, cash included restricted cash in the amount of K€ 699. This essentially included cash that was provided to banks as security for guarantees.

25 Capital stock

	2010	2009
Issued capital		
Capital stock in K€	137,128	136,998
No-par common stock	137,127,532	136,998,137

Each share of stock entitles the registered owner to cast one vote at the Annual Shareholders Meeting and enjoy full dividend entitlement. The voting right is not subject to any restrictions. The capital stock rose by K€ 130 in fiscal 2010, exclusively as a result of the issuance of common shares within the context of stock option programs. Each share has a par value of € 0.01. All issued shares have been fully paid-in.

26 Capital surplus

As of December 31, 2010, capital surplus amounts to K€ 139,593 (2009: K€ 563,687). This amount includes deferred share-based compensation which relates to the Company's stock option program. As of December 31, 2010, K€ 424,294 were removed from the capital surplus and utilized to cover the loss carried forward.
Capital surplus may only be utilized according to the rules of the Stock Corporation Act (AktG).

27 Authorized and conditional capital

For the fiscal year ended 2010, the Company's authorized capital amounted to K€ 65,000. As of December 31, 2010, the Company's conditional capital amounted to K€ 28,344.

28 Other capital reserves

Other capital 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 2010 and 2009 fiscal years are shown in the consolidated statements of changes in shareholders' equity and in the consolidated statements of recognized income and expenses.

29 Interest-bearing liabilities

in K€	Effective interest rate in % in 2010	Due date	2010	2009
Short-term liabilities				
Financing arrangements	7.19	2011	5,493	15,503
Due to banks	EURIBOR + 1.00	2011	10,000	15,000
Other short-term liabilities	7.24	2011	576	2,198
Short-term liabilities			16,069	32,701
Long-term liabilities				
Convertible bonds	3.50	2011 – 2019	20	24
Financing arrangements	7.19	2011 – 2013	2,044	7,271
Other long-term liabilities	7.24	2011 – 2012	-	576
Long-term liabilities			2,064	7,871
Interest-bearing liabilities			18,133	40,572

In fiscal 2010, short-term liabilities due to banks consisted of liabilities arising from the syndicate loan arrangement dated June 2008. This arrangement provides a revolving line of credit in the amount of K€ 50,000 and will run through year-end 2011. Security is provided through a transfer of all of the trade receivables of the Group and Ventelo. The loan values utilized serve the common financing of working capital and utilization is subject to specific conditions, especially meeting certain financial performance indicators. In 2010, the respective interest rate was reduced due to the 2008 consolidated financial statements to the respective EURIBOR plus an additional 1.00 percent.
As of December 31, 2010, there were 1,961,941 convertible bonds (issued in conjunction with stock option programs) outstanding (see also Note 41). The convertible bonds have a nominal value of € 0.01 each.

30 Accrued pensions

QSC operates two defined benefit pension plans, whereby one defined benefit pension plan is secured through reinsurance that is classified as plan asset in accordance with IAS 19.
QSC has opted to recognize all actuarial gains and losses directly in equity. In fiscal 2010, the accumulated amount of all actuarial gains and losses as presented in the consolidated statements of directly recognized income and expenses was K€ 62 (2009: K€ -193).

in K€	2010	2009
Present value of defined benefit obligation at January 1	**849**	**773**
Service costs	58	57
Interest costs	45	46
Actuarial losses (gains)	246	(18)
Benefits paid	(9)	(9)
Present value of defined benefit obligation at December 31	**1,189**	**849**
Fair value of plan assets at January 1	**(108)**	(95)
Expected return on plan assets	(4)	(4)
Actuarial losses	6	6
Employer's contributions for plan assets	(16)	(15)
Fair value of plan assets at December 31	**(122)**	**(108)**
Accrued pensions at December 31	**1,067**	**741**
Discount rate	4.56%	5.41%
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%

Total actuarial losses after taxes amount to K€ -162. In the past fiscal year, a gain of K€ 12 was recorded.

The composition of the pension costs under defined benefit plans is as follows:

in K€	2010	2009
Service costs	58	57
Interest costs	45	46
Expected return on plan assets	(4)	(4)
Net pension costs	**99**	**99**

Actual losses on the plan assets amounted to K€ 73.

Amounts of the current and the four previous reporting periods are as follows:

in K€	2010	2009	2008	2007	2006
Present value of defined benefit obligation	(1,189)	(849)	(773)	(843)	(791)
Fair value of plan assets	122	108	95	83	70
Deficit	**(1,067)**	**(741)**	**(678)**	**(760)**	**(721)**

In 2010, QSC did not make any adjustments based on past experience with regard to the present value of defined benefit obligations and plan assets.

31 Long-term liabilities to other shareholders

As of December 31, 2009, the long-term liabilities to minority shareholders correspond to the consolidated capital account of Communication Services TELE2 GmbH (TELE2) accounted for in the balance sheet of Plusnet GmbH & Co. KG (Plusnet). They do not bear interest. At the date of foundation of Plusnet, this item corresponded to TELE2's cash capital contribution to Plusnet (see explanations contained in the 'Summary of significant accounting policies').
On December 22, 2010, QSC acquired TELE2's minority share for € 36.7 million effective retroactively to October 31, 2010. Accordingly, as of December 31, 2010, this line item ceased to be applied.

32 Trade payables

in K€	2010	2009
to third parties	38,039	40,956
to related parties	4	26
Trade payables	**38,043**	**40,982**

All trade payables have a term of less than one year.

33 Provisions

Other provisions primarily comprise liabilities of uncertain amount against third parties due to receivables, risk of lawsuits, and provision for credit balances granted. These items were measured on the basis of past experience. Deferred taxes consisted of municipal trade tax of K€ 1,197 for fiscal 2010, corporation tax of K€ 851 for fiscal 2010, and payroll tax of K€ 167 for previous years.

in K€	2010
Other provisions at January 1	**907**
Arising during the year	457
Utilized	(254)
Unused amounts reversed	(403)
Other provisions at December 31	**707**
Provisions due to receivables at January 1	**116**
Arising during the year	161
Utilized	(51)
Unused amounts reversed	(51)
Provisions due to receivables at December 31	**175**
Litigation risks at January 1	**243**
Arising during the year	960
Utilized	-
Unused amounts reversed	-
Litigation risks at December 31	**1,203**
Other provisions at December 31	**2,085**

in K€	2010
Tax provisions at January 1	**771**
Arising during the year	1,844
Utilized	(400)
Unused amounts reversed	-
Tax provisions at December 31	**2,215**

34 Deferred income

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.

QSC also recognized deferred income in 2010 in connection with a payment of K€ 66,226 received from TELE2 relating to the early termination of the contract with that entity, originally intended to run until at least December 31, 2013, and covering cooperation activities with the broadband network company Plusnet; this amount is being recognized as income over the period from November 1, 2010, to December 31, 2013.

35 Other short-term liabilities

All other short-term liabilities have a term of less than one year and consist essentially of revenue tax liabilities.

CASH FLOW STATEMENT DISCLOSURES

36 Cash flow from operating activities

Cash flow from operating activities amounted to K€ 56,595 in fiscal 2010 (2009: K€ 65,494). In comparison to the past fiscal year, the EBIT, adjusted by depreciation and amortization, contributed to a K€ 3,007-improvement in cash flow. This was contrasted with a K€ -11,906-reduction resulting from other changes, particularly from changes in trade payables. Income tax paid in the amount of K€ 536 (2009: K€ 271) is to be subsumed under cash flow from operating activities.

37 Cash flow from investing activities

In fiscal 2010, cash flow from investing activities totaled K€ -25,134 (2009: K€ -40,331). K€ 2,324 of the total investments made in 2010 (K€ -29,182) were financed through finance lease, and are thus not included here. Also not included are investments in the amount of K€ 1,481, which were made by TELE2. Moreover, investments in the amount of a further K€ 242 were not presented, since they will not lead to an outflow of cash until 2011, or had already originated in 2009 and led to an outflow in 2010.

38 Cash flow from financing activities

In fiscal year 2010, cash flow from financing activities amounted to K€ -26,180 (2009: K€ -33,034). This decline resulted primarily from the K€ 24,760-reduction in interest-bearing-liabilities. Moreover, K€ 1,690 were paid to TELE2. Interest paid in the amount of K€ 1,356 and interest received in the amount of K€ 237 are to be subsumed under cash flow from financing activities.

OTHER DISCLOSURES

39 Subsidiaries

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

in K€	Share in % at Dec. 31, 2010	Shareholders' equity at Dec. 31, 2010	Net profi t (loss) 2010
Subsidiaries			
(disclosures according to German Comm. Code)			
Plusnet GmbH & Co. KG ("Plusnet"), Cologne	100	49,938	750
Ventelo GmbH ("Ventelo"), Cologne	100	8,134	670
Q-DSL home GmbH ("DSL home"), Cologne	100	1,293	21*
010090 GmbH ("010090"), Cologne	100	156	21*
EPAG Domainservices GmbH ("EPAG"), Bonn	100	25	195*
Broadnet Services GmbH			
("Broadnet Services"), Cologne	100	19	(8)*
BroadNet Deutschland GmbH			
("BroadNet Deutschland"), Cologne	100	2,898	28*
01098 Telecom GmbH ("01098"), Cologne	100	25	21*
01012 Telecom GmbH ("01012"), Cologne	100	27	21*
010052 Telecom GmbH ("010052")			
(formerly Q-DSL privat GmbH), Cologne	100	25	7*
tengo GmbH ("tengo"), Cologne	100	23	(2)*
F&Q Netzbetriebs GmbH & Co. KG			
("F&Q Netzbetriebs"), Cologne	100	26	-
F&Q Netzbetriebs Verwaltungs GmbH			
("F&Q Netzbetriebs Vewaltung"), Cologne	100	25	-
Intellinet Call by Call Communication			
Services GmbH & Co. KG ("Intellinet")			
(formerly T&Q Netzbetriebs GmbH & Co. KG), Cologne	100	25	-
T&Q Verwaltungs GmbH ("T&Q"), Cologne	100	25	-

* Net profit (loss) before consolidation

The following subsidiaries have exercised their option for exemption pursuant to § 264 (3) of the German Commercial Code (HGB): DSL home, 010090, EPAG, BroadNet Deutschland, Broadnet Services, 01098, 01012, 010052, and tengo GmbH.

Plusnet • On July 10, 2006, QSC and TELE2 founded Plusnet. Following the acquisition of TELE2's 32.5-percent minority stake on December 22, 2010, QSC now owns 100 percent of the shares. Plusnet's purpose is to continue to operate the Germany-wide DSL network.

Ventelo • On December 13, 2002, QSC acquired 100 percent of Ventelo, a nationwide voice telephony carrier providing enterprise customers with voice telephony services. Ventelo's market position in voice communications for enterprise customers ideally complemented QSC's broadband data communications service to the same customer segment. The acquisition of Ventelo enabled QSC to also offer integrated telecommunications solutions for all enterprise customer segments. Total acquisition costs for Ventelo were K€ 11,454, including direct acquisition costs of K€ 90.

DSL home • On March 31, 2006, QSC acquired 100 percent of the shares of DSL home. The purchase price paid for the formerly non-operative Kristall 40. GmbH totaled K€ 27. In accordance with § 123 (3) no. 1 of the German Company Transformation Law (UmwG), all retail customer contracts relating to DSL residential customer business were transferred to DSL home by way of spin-off. At the Annual General Meeting held on May 23, 2006, the shareholders gave their approval to the spin-off with retrospective effect from January 1, 2006. The Spin-Off and Transfer Agreement was signed on August 9, 2006.

010090 • On April 12, 2006, QSC acquired 100 percent of the shares of 010090. The purchase price paid for the formerly non-operative Kristall 39. GmbH totaled K€ 27. The company 010090 markets voice telephony products for residential customers, in particular call-by-call products.

EPAG • EPAG is a former 100-percent-subsidiary of celox Telekommunikationsdienste GmbH. The latter was merged into QSC with effect from January 1, 2006. This merger made EPAG a direct QSC investment. EPAG specializes in the registration and administration of international domains, and numbers among the leading domain providers for resellers in Germany.

Broadnet Services • Broadnet Services is a former 100-percent-subsidiary of Broadnet, and has been a direct investment of QSC since the date of the Broadnet merger. Broadnet Service markets voice telephony products for residential and business customers.

BroadNet Deutschland • BroadNet Deutschland is a former 100-percent-subsidiary of Broadnet, and has been a direct investment of QSC since the date of the Broadnet merger. BroadNet Deutschland markets voice telephony products for residential customers, especially call-by-call products.

01012 • On July 17, 2008, QSC acquired 100 percent of 01012. Total acquisition costs for 01012 amounted to K€ 28. 01012 markets voice telephony products for residential customers, especially call-by-call products.

01098 • On July 2, 2008, QSC acquired 100 percent of the shares of 01098. Total acquisition costs for formerly non-operative Kolibri 113 GmbH amount to K€ 25. 01098 markets voice telephony products for residential customers, especially call-by-call products.

010052 • 010052 emerged on October 30, 2009, from a name change of Q-DSL privat GmbH. The latter was formed on December 17, 2009, and is a wholly-owned QSC company. 010052 markets voice telephony products for residential customers, especially call-by-call products.

tengo • On January 15, 2010, QSC formed tengo GmbH with share capital of K€ 25. tengo markets voice products for residential customers, in particular call-by-call offerings.

F&Q Netzbetriebs GmbH & Co. KG • Under a purchase agreement dated September 6, 2010, QSC acquired 100 percent of F&Q Netzbetriebs GmbH & Co. KG having a limited partner's share of K€ 1 as well as a general partner, F&Q Netzbetriebs Verwaltungs GmbH. The general partner's share capital amounts to K€ 25 and comprises one share having a par value of K€ 25, which is held by F&Q Netzbetriebs GmbH & Co. KG, itself. F&Q provides voice and Internet services for customers of Freenet Cityline GmbH. A network partnership had been in place here between QSC and Freenet. The purchase price totaled K€ 26. What were acquired were essentially liquid assets.

T&Q Netzbetriebs GmbH & Co. KG • Under a purchase agreement dated December 29, 2010, QSC acquired 100 percent of T&Q Netzbetriebs GmbH & Co. KG having a limited partner's share of K€ 25 as well as a general partner, T&Q Verwaltungs GmbH. The general partner's share capital amounts to K€ 25 and comprises one share having a par value of K€ 25, which is held by T&Q Netzbetriebs GmbH & Co. KG, itself. T&Q serves to provide voice services for TELE2. A network partnership had been in place here between QSC and TELE2. The purchase price totaled K€ 50. What were acquired were essentially liquid assets.

40 Segment reporting

In accordance with IFRS 8, the foundation of QSC's reportable segments is the internal organization used by management for making operating decisions and assessing performance.

The Managed Services segment addresses some 8,300 larger and mid-size enterprises in Germany. QSC develops and operates custom-tailored ICT solutions and markets them through a nearly 30-person key account management organization. The foundation for these Managed Services typically consists of IP-based virtual private networks (IP-VPN). Building upon these IP-VPNs, QSC offers numerous services, such as the operation of software-based telephone systems, as well as maintenance of local area networks and end-user devices.

The Products segment encompasses standardized products from QSC, that enable small and mid-size companies to operate all of their voice and data communications over one and the same broadband line. The spectrum of offerings includes Internet connections, Voice over IP products, as well as innovative solutions such as the IPfonie centraflex virtual telephone system. The target market for the Products BU consists of nearly 900,000 small- and mid-size companies in Germany, who as a general rule procure ICT services from regional partners. QSC is therefore focusing on partnering with some 100 regional distribution partners and distributors.

The Wholesale/Resellers segment encompasses QSC's business with Internet service providers, as well as telecommunications providers who do not possess infrastructures of their own. The latter market DSL lines from QSC and the voice and value-added services that build upon them under their own name and for their own account. QSC supplies unbundled DSL preliminaries and ensures smooth order management for the individual, directly-supported resellers via highly scalable IT interfaces. Moreover, this business unit also operates QSC's wholesale voice business, under which QSC makes voice telephony services available to resellers who do not possess a corresponding nationwide infrastructure of their own.

Management has stipulated EBIT (in accordance with IFRS) as the key steering parameter for the segments. Thus operating costs are fully attributed to their respective business units; plus a complete calculation of profit or loss up to the operating results is made. Both the direct and indirect attribution of costs to the individual segments corresponds to the Company's internal reporting system and steering logic. With regard to assets and liabilities, there were also directly and indirectly attributable items. Assets and liabilities that are indirectly attributable are allocated according to financial viability based on contribution margins, except for deferred tax assets and liabilities.

in K€	Managed Services	Products	Wholesale/ Resellers	Reconciliation	Consolidated
For the year ended December 31, 2010					
Net revenues	**74,044**	**85,718**	**262,344**	**-**	**422,106**
Cost of revenues	(35,121)	(45,282)	(193,181)		(273,584)
Gross profit	**38,923**	**40,436**	**69,163**	**-**	**148,522**
Sales and marketing expenses	(12,456)	(12,026)	(19,023)		(43,505)
General and administrative expenses	(9,314)	(9,162)	(7,985)		(26,461)
Depreciation and amortization	(10,663)	(11,218)	(35,258)		(57,139)
Non-cash share-based payments	(18)	(19)	(18)		(55)
Other operating income	(293)	(297)	106		(484)
Operating profit	**6,179**	**7,714**	**6,985**	**-**	**20,878**
Assets	69,714	81,472	172,546	8,484	332,216
Liabilities	14,788	18,111	111,161	4,108	148,168
Capital expenditures	6,528	7,609	15,045	-	29,182

in K€	Managed Services	Products	Wholesale/ Resellers	Reconciliation	Consolidated
For the year ended December 31, 2009					
Net revenues	**74,261**	**92,066**	**254,219**	**-**	**420,546**
Cost of revenues	(41,429)	(49,025)	(187,363)		(277,817)
Gross profit	**32,832**	**43,041**	**66,856**	**-**	**142,729**
Sales and marketing expenses	(11,727)	(14,890)	(13,232)		(39,849)
General and administrative expenses	(9,098)	(8,845)	(8,516)		(26,459)
Depreciation and amortization	(12,125)	(14,641)	(39,962)		(66,728)
Non-cash share-based payments	(116)	(132)	(242)		(490)
Other operating income	89	76	304		469
Operating profit (loss)	**(145)**	**4,609**	**5,208**	**-**	**9,672**
Assets	66,386	82,980	161,944	-	311,310
Liabilities	23,750	24,106	100,686	3,056	151,598
Capital expenditures	9,929	8,736	23,551	-	42,216

In the 2009 and 2010 fiscal years, no material revenues were generated from doing business with companies from foreign countries, and neither were intersegment revenues generated. Long-term financial assets are exclusively of a domestic nature. In fiscal year 2010, the Wholesale/Resellers segment included two customers whose share in total revenues exceeded 10 percent, namely 20 percent and 12 percent, respectively.

41 Stock option programs

QSC has established a total of six 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 date of issuance. The convertible bonds have a term of five or eight years and are subject to a vesting period of up to three years.
On the basis of IFRS 2, no personnel expenses were recorded for the convertible bonds issued under the 2000, 2000A, 2001 and 2002 SOPs. The option values for the convertible bonds under the 2006 SOP were computed at the grant date with the aid of the Black-Scholes option-pricing model, with the following assumptions being employed. In 2009 and 2010, no convertible bonds were issued under the 2004 SOP.

	2010	2009
2006 SOP		
Expected average life of options 2006 SOP	8 years	8 years
Dividend yield	0.00%	0.00%
Average risk-free interest rate	2.73%	3.17%
Expected volatility (3 years)	57.52%	57.68%
Average fair value of convertible bonds in €	0.97	0.75
Fair value of options granted for the year in €	82,694	189,457

The convertible bonds outstanding under all programs as of December 31, 2009 and 2010, are presented below:

	Number of convertible bonds	Weighted average exercise price in €
Outstanding at December 31, 2008	**2,240,040**	**3,62**
Granted in 2009	253,000	1,18
Forfeited in 2009	(86,777)	4,46
Exercised in 2009	-	-
Outstanding at December 31, 2009	**2,406,263**	**3,33**
Granted in 2010	85,000	1,55
Forfeited in 2010	(399,927)	3,63
Exercised in 2010	(129,395)	2,11
Outstanding at December 31, 2010	**1,961,941**	**3,27**

The exercise prices of the remaining 1,961,941 convertible bonds range from € 1.00 to € 5.68, and the remaining term for exercise varies from "immediately exercisable" to August 23, 2018. The exercise price is set at the date of issuance and cannot be changed after that date. The Company expects conversion of the remaining bonds (depending on the market price development) to be completed by 2018 at the latest.
At balance sheet date 1,614,504 of the remaining convertible bonds were exercisable, with the remaining convertible bonds being subject to the agreed retention period.

42 Related party transactions

In 2010, QSC participated in transactions with companies affiliated with members of the Management and Supervisory Boards. 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 the approval of the Supervisory Board and are closed on the basis of normal market conditions.

in K€	Net revenues	Expenses	Cash received	Cash paid
For the year ended December 31, 2010				
IN-telegence GmbH & Co. KG	711	50	929	57
Teleport Köln GmbH	15	5	16	8
QS Communication Verwaltungs Service GmbH	-	178	-	233
Dr. Bernd Schlobohm	-	98	-	-
For the year ended December 31, 2009				
IN-telegence GmbH & Co. KG	751	137	817	160
Teleport Köln GmbH	12	104	14	128
QS Communication Verwaltungs Service GmbH	-	167	-	187
Dr. Bernd Schlobohm	-	96	-	-

in K€	Trade receivables	Trade payables
At December 31, 2010		
IN-telegence GmbH & Co. KG	70	(4)
Teleport Köln GmbH	3	-
QS Communication Verwaltungs Service GmbH	-	-
At December 31, 2009		
IN-telegence GmbH & Co. KG	153	(2)
Teleport Köln GmbH	1	(3)
QS Communication Verwaltungs Service GmbH	-	(21)

IN-telegence GmbH & Co. KG is a provider of value-added telecommunications services in the telecommunications industry. Teleport Köln GmbH provides support to QSC in the installation process of end-customer connections. QS Communication Verwaltungs Service GmbH provides consultancy on the product management of voice products. Expenses incurred for the Company's Chief Executive Officer, Dr. Bernd Schlobohm, relate to the transfer to pension provisions. The granting of a pension commitment, as presented in the Consolidated Financial Statements, amounts to K€ 954 (2009: K€ 741), after having been offset against fund assets of K€ 122 (2009: K€ 108).

43 Deferred taxes

As in the previous year and due to the 2008 corporate tax reform, QSC utilized an income tax rate of 31.58 percent for calculating deferred taxes. Deferred taxes for the corresponding periods are:

in K€	Asset	Liability	Asset	Liability	Consolidated Statements of Income	
	2010		2009		2010	2009
Deferred taxes						
Intangible assets	-	6,007	-	9,064	(3,057)	(3,610)
Property, plant and equipment	-	8,405	-	6,326	2,079	2,594
Working capital shares and other financial assets	-	10	-	9	1	-
Trade receivables	-	-	-	-	-	51
Trade receivables related parties	-	39	-	39	-	-
Prepayments	36	301	-	85	180	(90)
Other receivables	13	36	13	72	(36)	(61)
Deferred income	1,849	-	4,080	-	2,231	2,633
Accrued pensions and provisions	22	1,109	-	234	931	183
Other liabilities	-	-	-	-	-	(51)
Total deferred taxes on temporary differences	**1,920**	**15,907**	**4,093**	**15,829**	**2,329**	**1,649**
Total deferred taxes on losses carry forward	**18,363**	**-**	**8,680**	**-**	**9,683**	**-**
Total deferred taxes before netting out	**20,283**	**15,907**	**12,773**	**15,829**		
Netting out	(11,799)	(11,799)	(12,773)	(12,773)		
Total deferred taxes	**8,484**	**4,108**	**-**	**3,056**		

The temporary differences in connection with interests in subsidiaries for which no deferred tax liabilities are recorded amounted to K€ 22,917 in fiscal year 2010 (2009: K€ 17,364).

The following table reflects the reconcilement of the expected income tax to the actual income tax expense. The expected tax income is calculated by multiplying net loss before taxes with the assumed income tax rate:

in K€	2010	2009
Reconciliation		
Net profit	**18,845**	**7,195**
Tax rate	31.58%	31.58%
Expected tax expense	5,951	2,272
Tax effect of		
adjustments made to allowances for deferred taxes		
relating to carry forward of losses	(9,683)	(339)
non-deductible expenses	1,170	400
neglected capitalization of deferred taxes relating		
to carry forward of losses	(2,687)	(693)
permanent differences	(94)	155
income (expenses) unrelated to accounting period	(100)	(26)
Miscellaneous	120	(88)
Reconciled tax expense	**(5,323)**	**1,681**

Reconciled income tax expense consists of municipal trade expense in the amount of K€ 1,179, corporation tax expense in the amount of K€ 851, and deferred income tax income totaling K€ 7,353. In fiscal 2010, tax expense of K€ 73 related to recognized actuarial gains and losses was directly recognized in equity.

As of December 31, 2010, QSC's corporation tax and trade tax losses available for carry forward amounted to € 443 million (2009: € 457 million) and € 439 million (2009: € 453 million), respectively. These tax losses can be carried forward without restriction for future offset against the taxable profits of entities in which the tax losses arose. In 2010, deferred taxes were applied to loss carry forwards in the amount of € 18.4 million, as it is anticipated that after its positive results in fiscal 2010, QSC AG will also have taxable income in fiscal 2011 through 2013. There were no deferred tax assets recorded in the balance sheet for still unutilized corporation tax losses available for carry forward in the amount of € 385 million, and for still unutilized trade tax losses in the amount of € 380 million.

44 Litigation

In a judicial review proceeding (Spruchverfahren) at the regional court in Hamburg, 30 former minority shareholders of Broadnet AG have filed an application for an additional contribution in cash in addition to the shares of QSC AG, which they received in exchange for their Broadnet AG shares. All minority interest shareholders of Broadnet AG had received 12 QSC shares in exchange for 11 Broadnet shares in connection with the merger. This corresponds to an exchange ratio of 1 Broadnet share for 1.0908 QSC shares. Should the regional court in Hamburg effectively rule an additional contribution in cash, it would have to be granted to all former minority shareholders of Broadnet AG who held shares of Broadnet AG at the time the merger came into effect. As a consequence, a possible ruling for an additional payment per share would have to be made for 999,359 former Broadnet shares. A first hearing was held on November 26, 2009, at the regional court in Hamburg. On the basis of a proposal made by the court, QSC made a proposal for a scheme of arrangement to the applicant under which QSC (without changing its interpretation of the law with respect to matters of law) obliges itself to make an additional payment in cash in the amount of 73 cents per Broadnet share and to bear certain expenses incurred on the part of the applicant. The settlement negotiations have failed since the settlement offer was not accepted by all applicants. A new appointment for an oral hearing has not yet been made. A provision was formed for this.

In the litigation between Deutsche Telekom AG and Ventelo GmbH over excessive amounts paid, an out-of-court settlement was entered into between the two parties in May 2010. This did not have any major influence on net worth or profitability for fiscal 2010 within the Corporate Group.

45 Contingencies and other financial obligations

Operating lease obligations • The Group has entered into commercial leases on various motor vehicles. These leases have an average life of between three and five years. Future minimum rentals payable under non-cancelable operating leases as of December 31 are as follows:

in K€	2010	2009
up to 1 year	637	633
1 to 5 years	601	541
Operating lease obligations	**1,238**	**1,174**

In fiscal year 2010, QSC recognized expenses incurred in connection with operating lease arrangements in the amount of K€ 886 (2009: K€ 1,009).

Obligations under financing and rent-to-own arrangements • QSC has entered into financing arrangements and rent-to-own contracts for various items of technical equipment as well as for fixtures and furnishings. The future payment obligations under these arrangements can be reconciled to their cash values as follows.

in K€	2010	2009
Financing and rent-to-own arrangements		
up to 1 year	6,335	18,645
1 to 5 years	2,096	8,035
Total liabilities	**8,431**	**26,680**
less interest share	(318)	(1,131)
Value in use of liabilities	**8,113**	**25,549**

Other financial obligations • Other financial obligations in the coming fiscal years arising from long-term contracts for fiber optic lines, technical premises, and office premises, in particular, amounted to K€ 52,803 (2009: K€ 53,046). Purchase commitments to future investments amounted to K€ 5,932 (2009: K€ 5,514) in the past fiscal year.

Guarantees • There were no guarantee obligations as of December 31, 2010.

46 Objectives and methods used in financial risk management

The Group's principal financial liabilities comprise essentially financing and rent-to-own arrangements, trade payables and liabilities due to banks. The main purpose of these financial liabilities is to raise finances for the Group's operating activities. Financial assets which arise directly from the Group's operating activities are, in particular, trade receivables, cash and short-term deposits, and available-for-sale financial assets. In 2010 and 2009 no trading in derivatives was concluded. The Group's major risks arising from the use of financial instruments include interest rate risk, credit risk and liquidity risk. Since no material transactions in foreign currencies are carried out, there are no material foreign currency risks. The following summarizes the strategies and procedures for managing each of the aforementioned risks.

Interest rate risk • QSC is exposed to the risk of changing market interest rates. This risk results primarily from the Group's variable interest-bearing short-term liabilities due to banks, as well as from variable interest-bearing liquidity. Short- and long-term liabilities under financing arrangements, on the other hand, are outside capital having a fixed interest rate As of December 31, 2010, the share of variable rate debts in total rate debts amounted to 55 percent. The following table reflects the sensitivity of the Group's earnings before taxes to a reasonably possible change in interest rates in relation to variable rate debts as of December 31 and liquidity (including available-for-sale financial assets).

	Increase/ decrease in basis points	Effect on profit before taxes in K€
2010	+100	362
2010	(100)	(362)
2009	+100	260
2009	(100)	(260)

Credit risk • QSC is exposed to the risk of bad debt on the part of customers and issuers. The Company strives to trade with creditworthy third parties only, thereby trying to rule out this risk from the very beginning. For this reason, it is the Group's policy that all customers who wish to trade on credit terms are subject to credit verification procedures. After establishing business relations, receivable balances are monitored on an ongoing basis in order to reduce the Group's possible risk of bad debts. The maximum risk of bad debts is limited to the carrying value of the trade payable as disclosed in Note 18. In the past fiscal year, there were no significant concentrations of credit risk within the Group. As far as trade receivables not yet written down are concerned, QSC expects them to be collectible.

With regard to the Group's other financial assets, QSC is also subject to a credit risk arising from default on the part of the counterparty. The maximum credit risk arising from such a default corresponds to the carrying value of these instruments. QSC is therefore pursuing a highly conservative investment policy, and in the past fiscal year only invested in securities with first-class credit rating.

Liquidity risk • The Group monitors its risk to a shortage of funds by using a monthly recurring liquidity planning tool, which takes into account the remaining term of available financial assets as well as the expected future cash flows from operating activities. The Group strives to achieve an equilibrium between continuity of funding and flexibility through the use of short- and long-term liabilities and liabilities under financing arrangements. The following table summarizes the Group's maturity profile of short- and long-term liabilities as of December 31, based on contractual undiscounted payments.

in K€	Carrying amount	On demand	Due end of 2011	Due end of 2012	Due end of 2013	Total
Liabilities under financing arrangements	7,537	-	5,752	1,891	205	7,848
Trade payables	38,043	-	38,043	-	-	38,043
Liabilities due to banks	10,000	-	10,050	-	-	10,050
Other obligations under financing arrangements	576	-	583	-	-	583
Other short- and long-term liabilities	12,675	-	12,675	-	-	12,675
At December 31, 2010	**68,831**	**-**	**67,103**	**1,891**	**205**	**69,199**

in K€	Carrying amount	On demand	Due end of 2011	Due end of 2012	Due end of 2013	Total
Liabilities under financing arrangements	22,775	-	16,315	4,761	2,690	23,766
Trade payables	40,982	-	40,982	-	-	40,982
Liabilities due to banks	15,000	-	15,064	-	-	15,064
Other obligations under financing arrangements	2,774	-	2,331	583	-	2,914
Other short- and long-term liabilities	7,844	-	7,844	-	-	7,844
At December 31, 2009	**89,375**	**-**	**82,536**	**5,344**	**2,690**	**90,570**

Capital management • The primary objective of QSC's capital management is to ensure sufficient equity, a strong credit rating and the ability to maintain its business operations in an independent and flexible manner. The Group monitors capital using the following parameters: equity ratio and net liquidity. Equity ratio is computed by dividing equity by the balance sheet total. Net liquidity is fixed rate debts less cash and short-term deposits as well as available-for-sale financial assets.

in K€	2010	2009
Capital management		
Liabilities under financing arrangements	(7,537)	(22,775)
Short- and long-term liabilities	(576)	(2,774)
Liabilities due to banks	(10,000)	(15,000)
Fixed rate debts	**(18,113)**	**(40,549)**
plus cash and short-term deposits	46,233	40,952
plus available-for-sale financial assets	332	330
Net liquidity	**28,452**	**733**
Equity	184,048	159,712
Balance sheet total	332,216	311,310
Equity ratio	**55%**	**51%**

At balance sheet date, all performance indicators stipulated by the syndicate loan's had been met. The latter includes financial ratios with regard to equity, earnings before interest, taxes and amortization, as well as liabilities under financing arrangements.

47 Financial instruments

The following table presents carrying values and fair values of all financial instruments included in the consolidated financial statements except for convertible bonds issued in conjunction with the stock option programs (see Note 41).

in K€	Classification according to IAS 39	Carrying value		Fair value	
		2010	2009	2010	2009
Financial instruments					
Cash and Short-term Deposits	ACAC	46,233	40,952	46,233	40,952
Available-for-sale Financial Assets	AFS	332	330	332	330
Trade Receivables	ACAC	61,284	53,595	61,284	53,595
Receivables from Former Shareholders	ACAC	28,358	-	28,358	-
Trade Payables	FLAC	38,043	40,982	38,043	40,982
Liabilities due to Banks	FLAC	10,000	15,000	10,000	15,000
Liabilities under Financing Arrangements	FLAC	7,537	22,775	7,848	23,766
Other Short- and Long-Term Liabilities	FLAC	13,251	10,618	13,258	10,758
Aggregated according to classification in line with IAS 39					
Assets Carried at Amortised Cost	ACAC	135,875	94,547	135,875	94,547
Available-for-sale Financial Assets	AFS	332	330	332	330
Financial Liabilities measured at Amortised Cost	FLAC	68,831	89,375	69,142	90,506

Cash and short-term deposits, available-for-sale financial assets as well as trade receivables predominantly have short remaining terms. Their carrying value thus approximately corresponds to their fair value at the balance sheet date. The same applies to trade payables and liabilities due to banks. The fair value of liabilities under financing arrangements and other short- and long-term liabilities was calculated on the basis of regular interest rates. The fair value of financial assets held for trading was determined on the basis of market prices.

in K€	From interests, dividends	Subsequent to initial recognition		Net gain (loss)	
		Allowance	At fair value	2010	2009
Assets Carried at Amortised Cost (ACAC)	259	(742)	-	(483)	(727)
Available-for-sale Financial Assets (AFS)	-	-	2	-	3
Financial Liabilities measured at Amortised Cost (FLAC)	(1,892)	-	-	(1,892)	(3,183)
Net gain (loss) according to classification	(1,633)	(742)	2	(2,375)	(3,907)

Expenses arising from the valuation adjustment on trade receivables are presented in the income statement under 'Sales and Marketing expenses'.

48 Declaration pursuant to § 161 AktG regarding compliance with the German Corporate Governance Code

The declaration pursuant to § 161 of the Stock Corporation Act (AktG) regarding compliance with the German Corporate Governance Code in the version dated June 18, 2009, and, since its enforcement, in the version dated May 26, 2010, respectively has been issued by the Management Board and the Supervisory Board and is permanently and publicly available to the shareholders on the Company's website. Future amendments to the rules relevant for compliance with the Corporate Governance Code will be posted on the QSC website without delay. Further information is provided in the separate Corporate Governance and Compensation Report.

49 Auditors' fees

In fiscal year 2010, QSC recognized the following services provided by the auditing firm appointed to audit the Group's annual financial statements as expense: K€ 203 for the consolidated financial statements audit and K€ 67 for other services.

50 Compensation of the Management Board

The aggregate compensation paid to members of the QSC Management Board in fiscal 2010 totaled € 1.70 million, as opposed to € 2.34 million the year before, when two additional members of the Management Board, Bernd Puschendorf (through January 31, 2009) and Markus Metyas (through April 15, 2009) were still in office. Fixed salary elements accounted for 50.8 percent of this total compensation, variable salary elements for 46.5 percent and fringe benefits for 2.7 percent. No loans were granted to members of the Management Board. In addition to the temporarily higher number of Management Board members, the decline by comparison with 2009 was also the result of the non-recurring grant of 250,000 stock options to new Management Board member Joachim Trickl in fiscal 2009. Moreover, given the difficult economic situation in early 2010, the Management Board had voluntarily waived a portion of its variable compensation element for 2009. The provisions that had been formed for this purpose in the amount of € 0.12 million were returned in fiscal 2010 and charged against income, thus reducing the amount of the total compensation. Without these special effects, the Management Board compensation paid to the three members holding office would have stood at the previous year's level.
QSC continues to consider that this description of the Management Board's compensation provides an important basis for assessing its appropriateness. QSC is exempt from the legal requirement of disclosing compensation on an individual basis as a result of the resolution taken at the Annual General Meeting on May 23, 2006. The exemption applies to the annual and consolidated financial statements for fiscal years 2006 to 2010. Further information is provided in the separate Corporate Governance/Compensation Report.

51 Risks

A detailed analysis and discussion of risks can be found in the Report on Risks, which is contained in the Management Report.

52 Subsequent events

On December 21, 2010, QSC announced the acquisition of all shares of IP Partner AG, of Nuremberg. The shares were transferred effective January 3, 2011 (date of acquisition). Formed in the year 2000, this IT services provider is a fast-growing provider of Hosting and IT Outsourcing services for small and mid-size enterprises. According to provisional information, IP Partner AG and its workforce of nearly 60 people generated revenues in fiscal 2010 that are expected to total € 14 million, earning a positive result. IP Partner operates two data centers in Munich and Nuremberg with more than 10,000 servers for more than 1,000 business customers. Further data centers having total floor space of 3,000 square meters are under construction. With this acquisition, QSC has accelerated its transformation process from a TC into an integrated provider of ICT services, and will thus be able to offer its predominantly small and mid-size customers a far broader spectrum of products and services in the future.
The purchase price is made up of two components: QSC paid € 15 million in cash to the former shareholders as of January 3, 2011; a further € 10 million will be due and payable by no later than the end of April 2012, subject to various prerequisites, which include, in particular, a sustained high rate of corporate growth.
The initial accounting of this corporate merger had not yet been completed at the time the Consolidated Financial Statements were approved by the Management Board for transmittal to the Supervisory Board. In particular, usable information relating to the acquired assets and liabilities and their attributable present values is not yet available. The initial consolidation will be taken into consideration in the interim financial statements for the first quarter of 2011.

Cologne, March 23, 2011

QSC AG
The Board of Management

Dr. Bernd Schlobohm Chief Executive Officer	Jürgen Hermann	Joachim Trickl

Statement of Responsibility

To the best of our knowledge, and in accordance with the applicable reporting principles, the Consolidated Financial Statements give a true and fair view of the assets, liabilities, financial position and profit or loss of the Group, and the Group Management Report includes a fair review of the development and performance of the business and the position of the Group, together with a description of the principal opportunities and risks associated with the expected development of the Group.

Cologne, March 23, 2011

QSC AG
The Board of Management

Dr. Bernd Schlobohm
Chief Executive Officer

Jürgen Hermann

Joachim Trickl

» Working in a consortium, QSC is developing a SensorCloud for networked sensors, control data, and applications. This innovation offers an entirely new way of capturing, storing and processing measurement data from a broad spectrum of industries and applications – ranging from the environment to mobility to production machinery. The German Federal Ministry of Economics (BMWi) is promoting this ICT project and awarded it an innovation prize in March 2011.«

CONSORTIUM: QSC // RWTH Aachen // FH Cologne // Dillenburger // symmedia

Corporate Governance

Declaration of Corporate Management/ Corporate Governance Report

QSC is committed to good corporate governance • Corporate governance means management and oversight of companies to ensure responsible and sustainable value creation. QSC's Management and Supervisory Boards are committed to the Company and aim to ensure its continued existence along with a sustainable increase in its value through responsible corporate leadership that focuses on the long term. QSC therefore complies with the vast majority of the recommendations set forth in the German Corporate Governance Code ("Code"). However, the Company intentionally deviates from the Code regarding a few points. These are primarily recommendations that do not sufficiently take into consideration the situation of mid-size companies with a strong entrepreneurial culture. The Management and Supervisory Boards regularly subject the exceptions noted in the Declaration of Compliance to critical review and deal intensively with corporate governance, most recently in the Supervisory Board meeting on November 18, 2010.

Focus on responsible and long-term corporate leadership

Speaking on both its own behalf and on behalf of the Supervisory Board, the Management Board of QSC reports below on corporate governance pursuant to Item 3.10 of the Code, as most recently amended in May 2010. The following report also integrates the Compensation Report called for by Item 4.2.5 of the Code, and additionally contains information pursuant to § 289a of the German Commercial Code ("HGB").

SHAREHOLDERS AND ANNUAL SHAREHOLDERS MEETING

Annual Shareholders Meeting makes key decisions • The regular Annual Shareholders Meeting is typically conducted during the first five months of the subsequent fiscal year; each share possesses one vote. The Annual Shareholders Meeting decides on ratification of the acts of the Management and Supervisory Boards, amendments to the Articles of Association and Bylaws, as well as on major entrepreneurial issues, and elects the shareholder representatives to the Supervisory Board, as well as the independent auditor. In addition, the Management Board submits the Annual and Consolidated Financial Statements to the Annual Shareholders Meeting.

QSC invites its shareholders to the Annual Shareholders Meeting by mail, as the Company is already in possession of a comprehensive list of the postal addresses of its shareholders thanks to its bearer shares. Shareholders can comprehensively inform themselves about impending decisions sufficiently in advance of the Annual Shareholders Meeting through the Annual Report, the Consolidated Financial Statements and the agenda of the Annual Shareholders Meeting. All relevant documents and information are available on the Company's website.

The Company simplifies the ability of shareholders to exercise their rights at the Annual Shareholders Meeting: shareholders who do not attend in person can have their voting rights exercised either by a proxyholder of their choice or by a Company-appointed proxyholder bound by the shareholder's instructions.

COLLABORATION BETWEEN MANAGEMENT AND SUPERVISORY BOARDS

Close collaboration in a spirit of trust • As a stock corporation organized under German law, QSC is subject to German stock corporation law and possesses a two-body management and oversight structure comprising a Management Board and a Supervisory Board. Both of these corporate bodies collaborate with one another closely for the benefit of the Company. The Management and Supervisory Boards are committed to sustainably increasing shareholder value through profitable growth and consider good corporate governance to be an indispensable element in achieving this goal.

The Management Board promptly and comprehensively reports to the Supervisory Board on all relevant questions relating to planning, business development, risk position and risk management, as well as compliance. At regular meetings and in telephone conference calls, the Supervisory Board advises and monitors the activities of the Management Board, and discusses key issues frankly and in a spirit of trust. The Supervisory Board receives the necessary documents, in particular, the Annual Financial Statements, the Consolidated Financial Statements and the audit report, sufficiently in advance of the respective meetings.

MANAGEMENT BOARD

QSC managed by three-member Management Board • A three-member Management Board manages the Company under its own direction and in the interest of the Company, taking into consideration the needs of the shareholders, employees and other groups associated with QSC (stakeholders). It develops the Company's strategic alignment, coordinates it with the Supervisory Board and ensures its implementation. It additionally ensures compliance through statutory requirements for all members of the corporate Group (Compliance) and ensures that an appropriate system of risk management and controlling is in place.

The Management Board meets at least twice a month as a corporate body in addition to its regular meetings within the framework of the meetings of the Executive Board, whose responsibilities are detailed in the Management Report in the section entitled "Management and Oversight." Besides the issues stipulated by legislation or the Articles of Association and Bylaws, the Management Board decides, in particular, on measures and transactions that are of major significance for QSC or that involve a greater economic risk.

Management Board decides on all major transactions

The Rules of Procedure for the Management Board stipulate that resolutions be adopted by a simple majority of the votes cast. Moreover, a division-of-tasks plan governs the responsibilities for specific areas. The individual Management Board member in question manages these areas as his own responsibility within the framework of Management Board resolutions. The following table offers an overview of the division of tasks at year-end 2010:

	Areas of Responsibility
Dr. Bernd Schlobohm (Chairman)	Strategy, Corporate Communications, Human Resources and Purchasing, Quality and Complaint Management, Telecommunications Technology, Information Technology, Networks
Jürgen Hermann	Finance, Investor Relations, Legal Affairs
Joachim Trickl	Managed Services, Products and Wholesale/Resellers Business Units, Marketing

Decisions reached by full three-member Management Board • QSC's Management Board collaborates closely and in a spirit of trust. Given the size of the Company and its corporate body, it refrains from forming committees to address specific issues. Rather, the full Management Board, in addition to its regular duties, discusses and decides on such issues as drawing up the annual financial statements and staffing executive positions.

The Supervisory Board appoints all members of QSC's Management Board for a term of from three to a maximum of five years. In staffing the Management Board, it is guided exclusively by the qualifications of the individual in question and does not give any decision-making relevance to gender in this regard.

Management Board members are appointed for between 3 to 5 years

SUPERVISORY BOARD

Qualifications the key factor in staffing the Supervisory Board • Under the terms of the Articles of Association and Bylaws, the Supervisory Board of QSC comprises six members. Since the Company typically employs more than 500 people, the German One-Third Participation Act is in effect, which means that two thirds of the members of the Supervisory Board are elected by the shareholders and one third by the employees. The term of office of the employee representatives will end upon the adjournment of the regular Annual Shareholders Meeting in 2012; the term of office of the shareholder representatives will end upon the adjournment of the regular Annual Shareholders Meeting in 2012.

A sufficient number of independent members hold seats on Supervisory Board

Concerning the nominations of potential Supervisory Board members, care is taken to ensure that, overall, its members possess the requisite knowledge, skills, abilities and professional experience to properly execute their duties and that a sufficient number of independent members belong to it. Only one member of the Supervisory Board, QSC co-founder Gerd Eickers, had previously been a member of the Management Board, through December 31, 2003. With the exception of an age limit, the Supervisory Board has thus far not defined any more stipulations relating to its composition.

Supervisory Board involved in all fundamental decisions • The Supervisory Board advises and oversees the Management Board regarding management of the Company, and is involved in all decisions of fundamental significance. The Management Board's Rules of Procedure require the consent of the Supervisory Board prior to any major business transactions, such as stipulation of the annual planning, major capital investments, acquisitions and financial measures. The Report of the Supervisory Board on pages 7 ff. provides detailed information about the activities of this corporate body and its committees.

Supervisory Board maintains three committees • In fiscal 2010, there were three committees of the Supervisory Board: The Compensation, Audit and Nominating Committees. Pursuant to the Supervisory Board's Rules of Procedure, the Nominating Committee comprises two members, as it is merely a preparatory committee, while the other committees, which actually adopt resolutions, consist of three members. Under the Rules of Procedure, the decisive criterion in selecting the committee members is their qualifications for the task in question. Unless otherwise prescribed by legislation or by the Articles of Association and Bylaws, the committees adopt their resolutions by a simple majority. All three committees regularly report on their work to the full Supervisory Board and prepare its resolutions. Nevertheless, the Compensation Committee regularly reviews the compensation system for the members of the Management Board, as their competencies make its members best suited for dealing with the issue of Management Board compensation. The following table offers an overview of the members and chairmen of the respective committees:

	Chairmen and members of the committees of the Supervisory Board
Nominating Committee	John C. Baker (Chairman), Gerd Eickers
Audit Committee	John C. Baker (Chairman), Herbert Brenke, Gerd Eickers
Compensation Committee	Herbert Brenke (Chairman), John C. Baker, Jörg Mügge

TRANSPARENCY AND ACCOUNTING

Comprehensive and timely information • On its website, QSC provides timely and comprehensive information in German and English about all relevant developments within the Company, thus ensuring that all shareholders are treated equally. Interested parties will find ad-hoc and press releases, financial dates, extensive documents on major events, as well as quarterly and annual reports at http://www.qsc.de/en/investor-relations.html. QSC prepares its Consolidated Financial Statements under IFRS rules within 90 days of the close of the respective fiscal year; for purposes of German corporate law, the Company additionally prepares Annual Financial Statements under German Commercial Code ("HGB") rules. Both sets of financial statements are drawn up by the Management Board and then reviewed by the auditor and the Supervisory Board. The Company submits its quarterly reports within 45 days of the close of each reporting period.

The Internet site additionally contains information relating to the acquisition or sale of QSC shares, or derivatives based upon them, by members of QSC's Management and Supervisory Boards, as well as persons close to them, if the value of the executed transactions equals or exceeds the sum of € 5,000 within a calendar year. There were no reportable transactions pursuant to § 15a, German Securities Trading Act ("WpHG"), in fiscal 2010.

No reportable transactions at QSC in 2010

COMPLIANCE

Minimizing the risk of improper behavior • QSC's value system is based upon collaboration in a spirit of partnership and mutual respect, and gives every employee a high degree of responsibility. However, even in this kind of corporate culture, the risk of improper behavior on the part of some individuals cannot be completely eliminated. QSC has therefore taken a number of measures in order to minimize this risk, seeking to prevent damage to the Company and to society as a whole. Dealing with internal and external counterparts fairly, openly and in a spirit of trust ranks among QSC's guiding principles, which are detailed on page 35 of the Management Report and are rigorously upheld in everyday Company life. Seminars and training sessions additionally serve to sensitize all employees to the central importance of such issues as obeying the law and professionalism in their dealings with third parties.

QSC strictly observes compliance with the four-eyes principle and the division of responsibilities; every transaction affecting liquidity is reviewed by multiple people. Guidelines governing such critical points as travel expenses and purchasing provide the required clarity for correct behavior in everyday operations.

Compliance is also a major leadership task at QSC. The Executive Board, the Management Board, the Supervisory Board and its Audit Committee regularly deal with these issues. To do this, they draw upon risk reports and internal controlling, and critically examine the processes that exist within the Company.

Compensation Report

Evolution of the compensation paid to members of the Management Board • One major element of good corporate governance is a transparent portrayal of the total compensation paid to members of the corporate bodies. The compensation system for members of the Management Board was evolved during the past fiscal year in line with the German Appropriateness of Management Board Compensation Act ("VorstAG"), and was adopted by the Annual Shareholders Meeting on May 20, 2010. Pursuant to § 315, Para. 2, No. 4, of the German Commercial Code ("HGB"), QSC reports below on the principles of this compensation system; this Report is a constituent element of the Group Management Report. Pursuant to the resolution adopted by the Annual Shareholders Meeting on May 23, 2006, no individualized presentation of this compensation is made in this connection; this waiver will apply for the last time to the Annual and Consolidated Financial Statements for the 2010 fiscal year.

Compensation system traditionally highly success-based and long-term in nature • The system of compensation paid to members of the Management Board had already been aligned to sustainable development even prior to the coming into force of the German Appropriateness of Management Board Compensation Act, when the target agreements entered into with the members of the Management Board for fiscal 2009 contained Company-related targets that were embedded within a three-year plan covering 2009 to 2011. At the same time, it was highly performance- and success-based, and had therefore satisfied large portions of the German Appropriateness of Management Board Compensation Act, even before this new legislation went into force. Nevertheless, during the past fiscal year the Supervisory Board reviewed the entire compensation system, and once again strengthened its long-term alignment.

Long-term alignment of compensation strengthened again

The total compensation paid to members of the Management Board is stipulated by the Supervisory Board. In doing so, the Supervisory Board takes into consideration the tasks and personal achievements of each respective Management Board member, the achievements of the full Management Board, the Company's economic and financial position and sustainable development, as well as the usual and customary nature of the compensation, taking into consideration the environment at comparable companies as well as the compensation structure that otherwise applies at the Company. Both positive and negative developments are taken into consideration in designing the variable compensation element.

At QSC, the compensation paid to members of the Management Board comprises fixed and variable salary elements. The fixed elements account for a maximum of 50 percent of the target compensation paid to each member of the Management Board. The fixed element is paid in monthly installments as base compensation. Moreover, the members of the Management Board additionally receive fringe benefits, in particular in the form of old-age pension commitments (in part, defined benefit plans for old-age, survivors and disability benefits secured by reinsurance coverage, and in part, defined contribution commitments for benefits provided by insurance companies and welfare relief funds), as well as the use of a company car or the utilization of a car allowance. Moreover, the Company maintains liability indemnification insurance coverage that includes the members of the Management Board. Effective July 1, 2010, the policy provides for a corresponding deductible for the members of the Management Board, in accordance with the requirements of the German Stock Corporation Act.

The variable compensation element is committed in the form of a fixed amount for each year in office in the event that 100 percent of the targets are achieved and is based upon the attainment of agreed annual and multiple-year targets. These targets can include such key corporate performance indicators as free cash flow and consolidated net income, as well as individual parameters that result from non-quantifiable strategic targets or hybrid forms. In entering into the annual target agreements, the Supervisory Board takes pains to assure that the variable target compensation as a result of the attainment of multiple-year targets is greater than the compensation for the attainment of single-year targets. The Supervisory Board defines upper and lower limits for each individual target, with the upper limit serving to cap the variable compensation element in the event of out-of-the-ordinary developments and the lower limit stipulating the minimum target. If this metric is not attained, the Management Board member will not receive any variable compensation element for the corresponding target.

The Supervisory Board can commit an appropriate further bonus in the form of shares or stock options, with waiting, holding and exercise terms being agreed upon, in recognition of the attainment of multiple-year targets and to foster sustained corporate development. Moreover, the Supervisory Board can offer members of the Management Board additional bonuses in recognition of extraordinary achievements.

Fixed salary elements accounted for less than 50 percent of total compensation in 2010 • The aggregate compensation paid to members of the QSC Management Board in fiscal 2010 totaled € 1.70 million, as opposed to € 2.34 million the year before, when two additional members of the Management Board, Bernd Puschendorf (through January 31, 2009) and Markus Metyas (through April 15, 2009), were still in office. Fixed salary elements accounted for 50.8 percent of this total compensation, variable salary elements for 46.5 percent, and fringe benefits for 2.7 percent. In addition to the temporarily higher number of Management Board members, the decline by comparison with 2009 was also the result of the non-recurring grant of 250,000 stock options to new Management Board member Joachim Trickl in fiscal 2009. Moreover, given the difficult overall economic situation in early 2010, the Management Board had voluntarily waived a portion of its variable compensation element for 2009. The provisions that had been formed for this purpose in the amount of € 0.12 million were returned in fiscal 2010, as reflected in the income statement, thus reducing the amount of the total compensation. Without these special deeds, the Management Board compensation paid to the three members holding office would have stood at the previous year's level.

Management Board voluntarily waived a portion of its bonuses for 2009

The variable compensation element was based upon the target agreements entered into fiscal 2010, with the same annual and multiple-year targets being agreed for all members of the Management Board. In connection with this, the 2010 annual target, upon which the variable compensation element paid to Management Board members in 2010 was dependent, was cumulatively linked to free cash flow and revenue targets. The multiple-year target relating to the 2009-2011 three-year plan, in which the target agreements for fiscal 2009 were already embedded, was geared toward the attainment of a sustainable dividend position which came from income from ordinary business activities in the financial statements for the 2011 fiscal year. Certain intermediate annual targets for which no separate compensation is made must be achieved in a sustainable manner in order to reach this multiple-year target, in particular, positive earnings from ordinary business

activities in 2010 and 2011. In the target agreements entered into in fiscal 2010, the Supervisory Board additionally utilized the opportunity to commit additional compensation in shares of the Company in recognition for the attainment of the multiple-year target, whereby it is possible to demand that these shares not be transferred until after a period of two years subsequent to the determination that the target has been achieved. In doing so, QSC is taking into particular consideration the requirements set forth in the German Appropriateness of Management Board Compensation Act and the German Corporate Governance Code, under which the Management Board compensation must be aligned toward sustainable corporate development.
The upper target attainment level was at 180 percent in fiscal 2010, and is scheduled to be reduced to 150 percent medium term. In the case of the multiple-year target that was agreed in the target agreements for 2010, missing either one or more intermediate targets or the multiple-year target will result in the complete elimination of the variable compensation element relating to the multiple-year target.
In the past, the members of the Management Board additionally participated in stock option programs. In connection with this, QSC issued convertible bonds that entitle their holders to acquire one share of stock against payment of the exercise price upon the expiration of fixed terms, sometimes comprising multiple years. This exercise price corresponds to the trading price of the shares on the day the convertible bonds were issued. Further information about these programs is contained in Note 41 to the Consolidated Financial Statements. 50,000 conversion rights for Dr. Bernd Schlobohm expired during the past fiscal year. The following table presents individualized information relating to the shares and stock options held by members of the Management Board.

	Shares		Stock Options	
	Dec. 31, 2010	Dec. 31, 2009	Dec. 31, 2010	Dec. 31, 2009
Dr. Bernd Schlobohm	13,818,372	13,818,372	300,000	350,000
Jürgen Hermann	145,000	145,000	47,000	47,000
Joachim Trickl	5,000	5,000	250,000	250,000

Appropriate compensation paid to members of the Supervisory Board • In the 2010 fiscal year, the members of the Supervisory Board again received aggregate compensation in the amount of € 160,000. Pursuant to the Articles of Association and Bylaws, both the Chairman of the Supervisory Board, Herbert Brenke, as well as his Vice Chairman, John C. Baker, each received € 30,000 and the other members € 25,000 each, as all of them had attended at least 75 percent of the meetings. With the exception of the travel and other out-of-pocket expenses reimbursed to the members, no member received any further compensation or other advantages for personal services rendered over and above the remuneration set forth herein. Nor were any loans granted to members of the Supervisory Board. QSC maintains liability indemnification insurance coverage, in which the members of the Supervisory Board are included.
This compensation paid to members of the Supervisory Board is neither linked to the success of the Company nor does it provide a separate reward for the chairmanship of, or membership in. committees, as the Supervisory Board does not view this as being appropriate.
The table below presents individualized information relating to the compensation paid to, and the number of shares and stock options held by, members of the Supervisory Board. In the past, Supervisory Board members, like the Management Board members, had participated in stock option programs, under which QSC issued convertible bonds that entitle their holders to acquire one share of stock against payment of the exercise price upon the expiration of fixed terms, sometimes comprising multiple years. This exercise price corresponds to the trading price of the shares on the day the convertible bonds were issued. Note 41 to the Consolidated Financial Statements contains detailed information about these programs.

	Compensation*	Shares		Convertible Bonds	
	(in €)	Dec. 31, 2010	Dec. 31, 2009	Dec. 31, 2010	Dec. 31, 2009
Herbert Brenke	30,000.00	187,820	187,820	-	-
John C. Baker	30,000.00	10,000	10,000	-	-
Gerd Eickers	25,000.00	13,877,484	13,877,484	-	-
David Ruberg	25,000.00	14,563	14,563	-	-
Klaus-Theo Ernst	25,000.00	500	500	-	3,258
Jörg Mügge	25,000.00	4,000	-	6,000	6,000

* pursuant to § 10, Para. 5, of the Articles of Association and Bylaws

Declaration of Compliance

Declaration Pursuant to Section 161 of the German Stock Corporation Act (Aktiengesetz) regarding QSC AG's Compliance with the German Corporate Governance Code (Deutscher Corporate Governance Kodex) as amended June 18, 2009, respectively as of its validity as amended May 26, 2010.

Since its formation, QSC AG ("QSC") 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 (Deutscher Corporate Governance Kodex) and adheres to them in its daily work. Since the 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" in its version dated June 18, 2009, respectively as of its validity in its version dated May 26, 2010, with the following exceptions:

- **No sending of the notification of the convening of the General Meeting together with the convention documents to all domestic and foreign financial services providers, shareholders and shareholders' associations by electronic means (Item 2.3.2 of the Code)** • There are two reasons why QSC sends the convention documents only by mail: Firstly, experience has shown that an invitation provided by mail leads to a higher attendance of the shareholders at the General Meeting. Secondly, as QSC is in possession of all postal addresses of its shareholders due to the fact that QSC has issued registered shares, QSC refrains from collecting e-mail addresses of its shareholders for reasons of efficiency.

- **No agreement regarding a deductible in the D&O insurance for members of the Supervisory Board (Section 93, Paragraph 2 of the German Stock Corporation Act (Aktiengesetz) mutatis mutandis) (Item 3.8, Paragraph 2 of the Code)** • QSC accepts the recommendation of the German Corporate Governance Code insofar as the D&O insurance policy will include a deductible for Supervisory Board members of 10 percent of the respective damages per damage event as of July 1, 2010. However, and contrary to the recommendation, the deductible will be limited to 100 percent of the fixed annual remuneration of the Supervisory Board members. In particular, against the backdrop of the comparatively low remuneration of the Supervisory Board Members, QSC deems inappropriate a deductible which exceeds the annual remuneration.

- **No periodic review of the Management Board members' compensation system including the material elements of the contracts by the Supervisory Board's plenum (Item 4.2.2, Paragraph 1 of the Code)** • The periodic review of the compensation system is carried out by the Compensation Committee of the Supervisory Board. It is QSC's opinion that the Compensation Committee is, because of its competencies, best prepared to deal with the Management Board's remuneration. The company thus continues to adhere to this proven principle.

- **No stipulation of demanding, relevant comparison parameters for stock options and comparable instruments regarding the members of the Management Board (Item 4.2.3, Paragraph 3, Sentence 2 of the Code)** • Due to the fact that the QSC stock option plans are linked to the QSC share price and their long term design, QSC believes that there is no need to stipulate demanding, relevant comparison parameters. However, the current stock option plan 2006 (SOP 2006) contains exercise barriers and, therefore, strengthens the link between the stock option plan and the development of the QSC share price respectively to its development compared to the development of the TecDAX.

- **The contracts of the Management Board members do not contain a cap on severance payments in case of premature termination (Item 4.2.3, Paragraph 4 of the Code)** • To postulate a cap regarding severance payments would be contrary to the spirit of the Management Board contract, which is usually concluded for a fixed term and does, in principle, not provide for the possibility of an ordinary termination by notice. Moreover, a contractual severance payment cap would be difficult to practically enforce against a Management Board member in the circumstances where it would be relevant. Furthermore, such advance stipulation would be unfeasible to reasonably take into account the particular facts and the surrounding circumstances that later actually give rise to the premature ending of a Management Board member's contract.

- **No aiming for an appropriate consideration of women when appointing the Management Board (Item 5.1.2, Paragraph 1, Sentence 2 of the Code as amended May 26, 2010)** • The Supervisory Board does not follow this recommendation insofar as its decisions when filling Supervisory Board positions are guided solely by the qualifications of the persons available – as it has been in the past. In this respect the Supervisory Board does not give decision priority to gender.

- **No stipulation of concrete objectives regarding the composition of the Supervisory Board that, whilst considering the specifics of the enterprise, take into account the international activities of the enterprise, potential conflicts, and diversity, as well as an appropriate degree of female representation, in particular. No consideration of such objectives by the Supervisory Board with regards to proposals for election and no publishing of such objectives in the Corporate Governance Report (Item 5.4.1, Paragraphs 2 and 3 of the Code as amended May 26, 2010)** • The Supervisory Board has already specified an age limit for its members in the past. As of the publication date of this declaration of compliance, the Supervisory Board has continued to examine and work out which of the concrete objectives stated in Item 5.4.1, Paragraph 2 of the Code are, in addition, appropriate for the composition of the Supervisory Board, whilst taking the specifics of the enterprise into consideration. After this reviewing process the Supervisory Board will stipulate further concrete objectives regarding composition if necessary. Consequently, as of now, no further objectives in addition to the stipulated age limit may be taken into consideration with regards to any proposals for election. Consequently, there can be no corresponding publication in the Corporate Governance Report until further objectives have been specified.

- **No consideration of the performance of the company or chair and membership positions in commit-tees regarding the compensation of the members of the Supervisory Board (Item 5.4.6, Paragraphs 1 and 2 of the Code)** • QSC does not believe that the Supervisory Board members' motivation and responsibility with regards to their duties will be improved by considering the performance of the company or any chair or membership position in committees regarding the compensation of the members of the Supervisory Board.

Cologne, November 18, 2010

For the Management Board
Dr. Bernd Schlobohm

For the Supervisory Board
Herbert Brenke

Functions of the Supervisory Board

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

Member of Supervisory Board	Function	Company
John C. Baker	Chairman of Supervisory Board	InterXion Inc., Schiphol-Rijk, Netherlands
	Member of Supervisory Board	Verified Identity Pass Inc., New York, USA, until April 2010
	Member of Supervisory Board	Voltaire Ltd., Ra'anana, Israel, until February 2011
Herbert Brenke	Chairman of Supervisory Board	ASKK Holding AG, Hamburg, Germany
	Member of Supervisory Board	SHS VIVEON AG, Munich, Germany
Gerd Eickers	Chairman of Supervisory Board	Contentteam AG, Cologne, Germany
	Member of Supervisory Board	Amisco NV, Brüssel, Belgium
David Ruberg	Vice Chairman of Supervisory Board	InterXion Inc., Schiphol-Rijk, Netherlands, since January 2011
	Member of Board of Directors	Adaptix Inc., Dallas, USA, until October 2010
	Member of Board of Directors	Broadview Networks Inc., New York, USA, until January 2011

Glossary

ADSL • The Asymmetric Digital Subscriber Line. Transfer of digital data over a twisted copper pair telephone line with an "asymmetric" transfer capacity of up to 8 Mbit/s for downloads and up to 800 Kbit/s for uploads.

ADSL2+ • An evolution of ADSL technology that primarily improves the transfer rates and ranges of an ADSL connection. Optimally, ADSL2+ affords transfer speeds of up to 25 Mbit/s downstream and up to 3.5 Mbit/s upstream.

Backbone • An interconnected high-speed network to which networks with lower speeds/capacities are linked. At QSC, the backbone resembles a ring through Germany. Berlin, Düsseldorf, Frankfurt, Hamburg and Munich are interconnected in ring form by a 10-gigabit Ethernet line, thus forming the QSC backbone.

Bitstream Access • A 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.

Broadband • A data transmission capacity of at least 1 Mbit/s.

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

Cloud Computing • The provision of IT infrastructures (e.g. data storage, computing capacity) and programs over networks, typically powerful Internet links. The customer pays only for services actually used, instead of having to invest in hardware and software.

CO • Central Office. The Central Office is where the subscriber lines, or local loops, from the individual households are connected. The equipment that enables the provider to offer the various data transmission technologies (e.g. ADSL, ADSL2+, SDSL, SHDSL) is installed at the central office.

DSL • Digital Subscriber Line. A data transmission method that enables digital data to be transferred at high transmission rates over a normal copper-wire telephone line.

Hosting • The provision of IT capacities, such as servers, storage, databases and further products, in a service provider's data center.

Housing • In the case of Housing, in contrast to Hosting, enterprises use only a service provider's building infrastructure for the data center and install their own hardware in racks or cages that have been provided.

ICT • Information and Communication Technology. Industry which offers enterprises and residential customers information technology (hardware, software and IT services) and telecommunication technology (voice and data services, devices, infrastructure). The ubiquitous use of the Internet protocol leads to a convergence of information and telecommunication technology.

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.

IP-Centrex • Centrex (CENnTRal Office EXchange) describes the outsourcing of a telephone system to a telecommunications provider. This is a concept that was introduced in fixed networks in the United States in the late 1950s. The Internet Protocol is now affording Centrex a renaissance in the form of "IP-Centrex." The end-user devices are linked directly to the data connection and communicate via the provider's server, which assumes the functionality of the system.

ISP • Internet Service Provider. An ISP enables customer data communication by providing Internet access and related services, e.g. the management of e-mail.

Last Mile • The "Last mile" is the name given to the path of the line from the central office to the end-customer's telephone connection. The Last Mile is owned by Deutsche Telekom and is leased by alternative providers like QSC at a price that is stipulated by the German Federal Network Agency.

Leased Line • A permanent connection line that is always on.

Managed Services • QSC defines Managed Services as a wall-to-wall service (LAN, WAN, telco management) that includes all customer-specific interfaces: from connection of individual enterprise locations within a Virtual Private Network (VPN) for voice and data transmission to internal cabling and equipping of the local area network right through to the installation of telephone systems, including the end-user devices.

Mbit/s/Kbit/s • Megabits per second/kilobits per second. Measure unit for data transmission speed.

NGA • Next Generation Access. Next Generation Access means Internet connections that cater to the growing demand for broadband. In particular, they include direct connections to the type of fiber optic networks that are being implemented by a growing number of municipalities.

NGN • Next Generation Network. An NGN consolidates the wide range of transmission methods and network structures into a convergent network architecture. This integrates telecommunications, data and TV networks within an IP-based network, for example.

Open Access • In telecommunications, Open Access refers to distinction between those who operate a network infrastructure and those who use it. Under Open Access, network operators open their infrastructures for use by third parties. With Germany's first nationwide Open Access platform in 2010, QSC established a network, process and services hub for providers and users in the forward-looking Next Generation Access market.

Outsourcing • Outsourcing means contracting out corporate tasks and structures to third parties. The duration and scope are defined in the respective contracts. Although this concept had initially been applied to IT infrastructure and IT-intensive processes, it is now being used across all industries.

POI • The Point of Interconnection refers to the transfer point from one provider's voice network to another's. QSC possesses the maximum number of 474 POIs in Germany.

Port • A port is the connection between the last mile from the end-customer to the provider's DSLAM at the central office. A DSLAM comprises multiple linecards, i.e. plug-in cards containing 32 to 64 physical ports. A connector is attached to each of these ports, which consists of two metallic pins, thus linking the final mile from the end-customer with the provider's network.

Preselect • Preselection is automatic dialing of a prefix for a communication operator to handle calls. Every network operator has its own carrier selection code. In the case of preselection, this code is preselected in the subscriber's exchange and is automatically utilized.

Protocol • A protocol contains standards for controlled data transfer. Protocols, for example, stipulate the data structure, the structure of the data packets as well as their encoding. There are various protocols, such as http or IP, depending upon the application in question.

Router • A device with network connections and configurable software that interconnects multiple networks and organizes the path the messages take between networks. First and foremost, routers are employed in order to link local area networks (LANs) with wide area networks (WANs).

SaaS • Software as a Service. This is a distribution or business model under which software is supplied, supported and operated as a service on the basis of Internet technologies.

SHDSL • Symmetric High Bit Rate Digital Subscriber Line. Actually "G.SHDSL." A symmetrical, DSL-based data transmission technology over copper twisted pairs. QSC utilizes SHDSL technology in connection with most of its business customer products, and additionally offers both high downlink and uplink bandwidths. Even higher bandwidths can be achieved by coupling multiple copper twisted pairs. Three twisted pairs offering a total of up to 6.0 Mbit/s are currently possible at QSC.

SHDSL.bis • An extension of the SHDSL standard affords data transfer rates of up to 5.7 megabits per second. Moreover, the expanded standard defines bundling up to 4 twisted copper pairs.

TAL • The German acronym for a subscriber line or local loop. The line between a central office and the subscriber's physical connection to the respective network.

TKG • The German acronym for the German Telecommunications Act. The TKG serves as the basis for liberalization of the telecommunications sector.

Unbundled access • The customer's connection is physically connected directly to the alternative carrier's network. In order to assure competition in the local service area, as well, the German regulatory authority wants alternative telco providers to have a right to unbundled access to Deutsche Telekom's subscriber line.

VDSL • Very High Data Rate Digital Subscriber Line. VDSL stands for an asymmetric data transmission technology that utilizes copper cables. Theoretical VDSL capacities range up to 100 Mbit/s. With consideration to other frequency bands, though, slower speeds of up to 50 Mbit/s are utilized in actual practice.

Voice over IP • Voice over Internet Protocol. The technique of using the Internet Protocol to transfer voice over packet-switched data networks.

VPN • Virtual Private Network. In a VPN, several enterprise sites are connected through a public network to form a secure network that cannot be accessed by outsiders. Only authorized persons or sites are able to communicate with one another, access data or exchange data over this network.

WLAN • Wireless Local Area Network. A wireless network confined to a particular geographical area.

WLL • Wireless Local Loop. Technology allowing to wirelessly linking subscriber lines to the network.

Index

Calendar

Annual Shareholders Meeting
May 19, 2011

Quarterly Reports
May 9, 2011
August 8, 2011
November 7, 2011

Contact

QSC AG
Investor Relations
Mathias-Brüggen-Straße 55
50829 Cologne
Phone +49-221-6698-724
Fax +49-221-6698-009
E-mail invest@qsc.de
Internet www.qsc.de

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Overall Responsibility
QSC AG, Cologne

Art Direction
sitzgruppe, Düsseldorf

Photography
Nils Hendrik Müller, Peine

Printing
das druckhaus, Korschenbroich

Further information at www.qsc.de