QSC AG

ANNUAL REPORT 2014

# Key Data

| All amounts in € million | 2014 | 2013 | 2012 | 2011 | 2010 |
|---|---|---|---|---|---|
| Revenues | 431.4 | 455.7 | 481.5 | 478.1 | 422.1 |
| EBITDA | 35.0 | 77.8 | 77.9 | 79.9 | 78.1 |
| Depreciation / amortisation [1] | 69.0 | 51.3 | 53.4 | 53.7 | 57.2 |
| EBIT | (34.0) | 26.5 | 24.6 | 26.2 | 20.9 |
| Net profit | (33.9) | 23.6 | 19.0 | 28.0 | 24.2 |
| Earnings per share [2] (in €) | (0.27) | 0.19 | 0.14 | 0.20 | 0.18 |
| Shareholders' Equity [3] | 145.6 | 193.2 | 180.2 | 207.3 | 184.0 |
| Long-term liabilities [3] | 180.2 | 103.3 | 96.0 | 79.6 | 7.2 |
| Short-term liabilities [3] | 79.7 | 95.5 | 110.9 | 104.4 | 140.9 |
| Balance sheet total [3] | 405.5 | 392.0 | 387.1 | 391.3 | 332.2 |
| Equity ratio (in %) | 35.9 | 49.3 | 46.6 | 53.0 | 55.4 |
| Free cash flow | (24.9) | 25.6 | 23.6 | 41.0 | 27.7 |
| Liquidity [3] | 88.1 | 59.0 | 35.2 | 24.1 | 46.6 |
| Capital expenditure (capex) | 30.0 | 39.6 | 37.9 | 35.6 | 29.2 |
| Capex ratio [4] (in %) | 7.0 | 8.7 | 7.9 | 7.4 | 6.9 |
| Dividend per share (in €) | 0.10 [5] | 0.10 | 0.09 | 0.08 | - |
| Xetra closing price [3] (in €) | 1.74 | 4.30 | 2.11 | 2.09 | 3.30 |
| Number of shares [3] | 124,142,487 | 124,057,487 | 137,307,152 | 137,256,877 | 137,127,532 |
| Market capitalisation [3] | 216.0 | 533.4 | 289.7 | 286.7 | 452.5 |
| Employees [3] | 1,697 | 1,689 | 1,485 | 1,334 | 608 |

Consolidated Financial Statements 2010 to 2014 in accordance with IFRS

[1] Including non-cash share-based remuneration

[2] Basic

[3] As of 31 December

[4] Ratio of capital expenditure to revenues

[5] Proposed to the Annual Shareholders' Meeting

"2014 WAS NOT A GOOD YEAR FOR QSC. WE HAD THE RIGHT STRATEGY, BUT DID NOT IMPLEMENT IT WITH SUFFICIENT RIGOUR. WE HAVE CHANGED THAT. QSC IS NOW OPTIMALLY PLACED TO BECOME THE LEADING CLOUD SERVICE PROVIDER TO SME ENTERPRISES IN GERMANY."

JÜRGEN HERMANN, CHIEF EXECUTIVE OFFICER

MEASURES SINCE AUTUMN 2014

1. IMPLEMENTATION OF A PROGRAMME TO SUSTAINABLY CUT COSTS
2. REALIGNMENT OF DIRECT AND INDIRECT SALES
3. ENHANCED MARKETING OF CLOUD OFFERINGS
4. INITIATION OF STEPS NECESSARY TO INDUSTRIALISE INFORMATION TECHNOLOGY

Dear Shareholders,

2014 was not a good year for our Company. The operating business did not perform in line with expectations. As the year progressed, it became apparent that our strategy, which remains the right one, had not been implemented with sufficient rigour or the necessary focus. We have taken steps to change this. We have implemented a programme aimed at sustainably reducing our costs, realigned Direct and Indirect Sales, enhanced the marketing of cloud services and initiated the steps required to industrialise our IT. QSC is now optimally placed to become the leading cloud service provider to medium-sized enterprises in Germany.

The Cloud business is the way ahead

QSC's traditional segments of Telecommunications, Outsourcing and Consulting form the basis for its business operations, but the Cloud business nevertheless represents the way ahead. It was right to act early to launch our transformation from a pure network operator into an integrated ICT service provider. The next step now involves positioning QSC as a German cloud provider.

The telecommunications market has been characterised by tough price competition for years now, and this has been worsened by ever stricter regulation. In line with expectations, our telecommunications revenues thus declined by € 23.4 million in 2014. This downturn related in particular to the marketing of preliminary products to large resellers. Our business with sales partners who primarily address smaller business customers remained largely stable. Increasingly intense competition and the price war also reached the traditional outsourcing business in the past year. Customers increasingly expect individual, customised solutions, and that with lower

"OUR HYBRID SOLUTION ENABLES SME ENTERPRISES TO ENTER THE CLOUD AGE STEP BY STEP."

costs. This is particularly true for calls for tenders from larger companies. As a one-stop provider, QSC will therefore focus on its core target group of medium-sized enterprises, essentially companies with up to 5,000 employees. With a view to larger companies, QSC will limit itself to offering individual performance modules where it can score highly in terms of price and service.

At the beginning of the cloud age, the medium-sized companies QSC primarily targets face a special and seemingly contradictory set of challenges. They are obliged on the one hand to achieve savings and on the other to ensure greater flexibility in their business processes. Specifically, customers expect lower IT costs and shorter reaction times, while at the same time guaranteeing IT security and complying with data protection requirements. These objectives can only be met by combining innovative cloud services with existing IT environments. These so-called hybrid cloud solutions link companies' proprietary IT infrastructures with cloud services offered by various providers. As a general rule, however, medium-sized enterprises in particular do not have the resources and expertise to develop these hybrid clouds themselves. Furthermore, in-house development and operation of the necessary hardware and software is costly. This is precisely where QSC comes into play as a service provider. The QSC solution will link the various cloud services that customers need and thus offer them cost efficiency, the necessary degree of IT process flexibility and the greatest possible data security. This hybrid solution will thus enable the integration of existing IT structures and a gradual transition to the cloud age. As it includes customary programmes and applications, customers can continue to work as usual. One key advantage of QSC here is the location of its data centres: Its entire infrastructure for modern outsourcing is located within Germany, is certified here and is subject to strict German data protection requirements. It is precisely to this that more than 90 percent of medium-sized companies attach particular value.

QSC links up various cloud services


BENEFITS AT A GLANCE

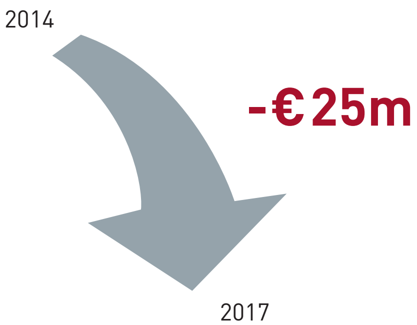
1. EASY AND SECURE E-MAIL COMMUNICATIONS
2. MAXIMUM SECURITY THANKS TO CONSISTENT END-TO-END ENCRYPTION
3. AUTOMATIC KEY EXCHANGE
4. CAN BE USED ON PC, TABLET AND SMARTPHONE
5. OPERATED AT QSC'S DATA CENTRES IN GERMANY

The hybrid cloud service forms a core component of our cloud strategy. It is flanked by projects related to the "Internet of Things" and the marketing of proprietary products via scalable distribution channels. Here too, developments in 2014 failed to live up to our expectations. Innovations focused too often on what is technically possible, rather than on customers' actual wishes. In 2015, we will be clearly shifting our focus towards the customer needs of cost optimisation, speed and convenience of use. The Security-as-a-Service solution offered by FTAPI already scores highly here and has thus gained customers such as Vodafone. At CeBIT 2015, this fixed network and mobile telephony provider presented its "Secure E-Mail" for business customers offering genuine end-to-end encryption, a feature that is still not widespread. FTAPI guarantees e-mail security with its easily handled technology for sending encrypted e-mails. Furthermore, FTAPI technology also enables file attachments of up to a terabyte in size to be simply and securely sent by web browser, mobile, as a desktop application or Outlook plugin. The cooperation between QSC and Vodafone shows how attractive our internally developed cloud services can be to resellers with strong market positions. Based on the solucon platform, our experts are working on further innovations that will be marketed together with partners with mass market experience in sectors such as telecommunications, energy and retail.

solucon platform as foundation for further innovations

All business units will contribute towards successfully implementing our cloud strategy. Our Consulting business benefits from its close proximity to customers and their internal processes and thus serves as a door-opener when it comes to combining these processes with cloud services. The Outsourcing business will gradually evolve into a cloud business, as ever more traditional IT services are being provided from within the cloud. Not only that, the Telecommunications business unit will contribute its experience in networking companies and securely linking them to the cloud.

"THE PROGRAMME WILL ALREADY LEAD TO SAVINGS OF MORE THAN €10M IN 2015. FROM 2017, ANNUAL SAVINGS WILL RISE TO AT LEAST €25M."




COST CUTTING AND FOCUSING WILL BE THE CORE POINTS OF THE NEW PROGRAMME OVER THE NEXT TWO YEARS.

Two sector experts / entrepreneurs augment Management Board

When it comes to developing further and implementing our cloud strategy, key momentum will also be provided by Felix Höger and Udo Faulhaber, who are due to reinforce QSC's Management Board from 1 January 2016 and 1 August 2015 respectively. We have thus attracted two proven sector experts and entrepreneurs who have already shown how cloud services can be successfully developed and marketed to German medium-sized enterprises.

Stefan A. Baustert, an experienced turnaround expert who joined QSC in January 2015, has already augmented the Management Board Team. From his very first day, he has played a leading role in helping to shape a cost-cutting and focusing programme. He will be pressing ahead with the continued implementation of it over the course of the year. This programme is one reaction to the unsatisfactory overall business performance in 2014, in which – put simply – QSC generated too little revenue with too many employees. This situation called for rigorous countermeasures, and that is precisely the objective of the programme now adopted. It will already lead to savings of more than € 10 million in 2015. From 2017, the annual savings are set to total at least € 25 million. One core component of this programme involves reducing staff totals by around 350 employees over the next two years. QSC is thus correcting the developments of 2012 and 2013, in which corresponding capacities were built up in anticipation of more rapid growth. The programme now initiated will make a key contribution towards QSC regaining its financial and earnings strength in the current year already. Based on a cautious forecast, with revenues of more than € 400 million we expect to generate EBITDA of more than € 40 million and positive free cash flow.

“SHAREHOLDERS LONG HAD TO WAIT FOR THE FIRST DIVIDEND. HENCE OUR CURRENT DECISION.”

**€ 0.10**

DIVIDEND: MANAGEMENT AND SUPERVISORY BOARDS PROPOSE DISTRIBUTING THE SAME AMOUNT FOR 2014 AS IN THE PREVIOUS YEAR.

The results of implementing this programme will already be apparent as the year progresses. This is also likely to give investors grounds to reconsider their reservations. There is no question that 2014 was not a good year for you either, fellow shareholders. Shares yielded the gains seen in the previous year. I would like to take this opportunity to thank you for your ongoing trust in this difficult phase. I know, like my Management Board colleagues, that you had to wait long for the first dividend after the IPO in 2000. We have therefore decided to propose a dividend of € 0.10 per share for the past financial year as well for approval by the Annual Shareholders' Meeting.

The renewed payment of a dividend makes two things clear. Firstly, QSC is firmly convinced that its turnaround will already be a success in 2015. Secondly, the Company continues to be solidly financed. This solidity also gives us the entrepreneurial freedom necessary to implement our strategy even more consistently than in the past, and that in 2015 and beyond. This will require the commitment of all employees. I also owe them my personal thanks for their dedication and their willingness to perform in a difficult year. I would also like to offer a special thank you to our customers and partners. Their trust forms the basis for QSC's future success, and I am sure that 2015 will be a good year for our Company once again.

QSC continues to be solidly financed

Cologne, 30 March 2015

Jürgen Hermann
Chief Executive Officer

"DEAR SHAREHOLDERS, I WOULD LIKE TO THANK YOU FOR YOUR ONGOING TRUST IN THIS DIFFICULT PHASE."

# Contents

# The Management Board

Jürgen Hermann

**Jürgen Hermann (*1964), Chief Executive Officer**

Jürgen Hermann has managed the Company since May 2013, having previously headed up the finance department for four years as CFO. In his capacity as CEO, he pays particular attention to strategy, innovation and communication. In the current year, he is giving top priority to QSC's strategy of focusing on the needs of medium-sized enterprises and the development of the "Pure Enterprise Cloud". A graduate in economics from the Universität der Bundeswehr in Hamburg, Jürgen Hermann subsequently served as an officer in the German army's telecommunications corps. He then moved to an executive position in the strategy department at Thyssen Telecom AG. In 1997, he joined the consultancy QS Communication Service GmbH. As head of finance, he played a key role in organising the IPO in April 2000 and in building QSC AG.


### Stefan A. Baustert (*1956)

Stefan A. Baustert has been Chief Financial Officer since 1 January 2015 and is also responsible for Human Resources, Corporate Purchasing, Investor Relations and internal IT operations. In this capacity, he will be overseeing the consistent implementation of the cost-cutting and focusing programme in the current financial year. Before joining QSC, he was Commercial Director at Rena GmbH, a mechanical engineering and plant construction company in southern Germany. Prior to this, he managed the publicly listed company Singulus Technologies AG for seven years, initially as CFO and later as CEO. Before that, he worked for five years as Commercial Director at E-Plus Mobilfunk GmbH until that company was sold to the KPN Group. A graduate in business administration, Baustert began his career in 1986 at the Thyssen Group, where he worked as CFO at Thyssen Telecom AG until moving to E-Plus.

### Henning Reinecke (*1966)

Henning Reinecke was appointed to QSC's Management Board as of 1 September 2013. As Chief Sales Officer, he has initiated the process of focusing even more closely on individual industries and reorganising the Outsourcing business. He was previously responsible for sales and marketing at INFO AG until its merger into QSC AG in 2013. He joined INFO AG as head of consulting sales on 1 October 2010. Prior to this, from 1994 onwards he gained more than 16 years of experience with national and international projects, sales and management at the IT service provider CSC. Reinecke studied business administration at the Wirtschaftsakademie in Hamburg and then worked for four years in group procurement at Beiersdorf AG in Hamburg.

# The Supervisory Board

Consistent with legal requirements, the six-member Supervisory Board comprises four shareholder and two employee representatives. In the regular election held at the Annual Shareholders' Meeting on 29 May 2013, shareholders elected four representatives, each to a five-year term in office. The employees had elected their two representatives in advance of the meeting.

**Dr. Bernd Schlobohm, Chairman**
Dr. Schlobohm, who holds a doctorate in engineering, founded QSC in 1997, oversaw the company as it went public in April 2000 and then managed it as CEO until May 2013. Together with QSC's co-founder, Gerd Eickers, he is the largest shareholder. At the end of 2014, these two shareholders held a combined stake of 25.1 percent in QSC.

**Dr. Frank Zurlino, Deputy Chairman**
Dr. Zurlino, holder of a doctorate in business engineering, was elected to the Supervisory Board in May 2013. Formerly head of strategy consulting and development at IBM Deutschland, he is now Managing Partner at the international management consultancy Horn & Company.

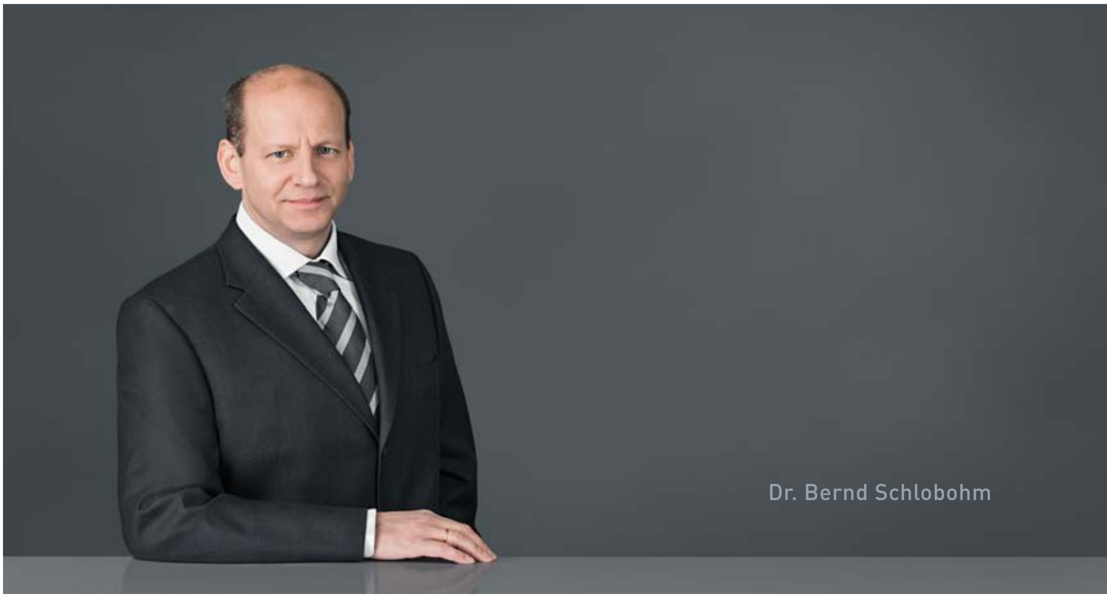
**Gerd Eickers**
A graduate in economics, Gerd Eickers founded QSC together with Dr. Bernd Schlobohm. After three years on the Management Board, he moved to the Supervisory Board in June 2004. In subsequent years, he played a major role in shaping the political framework for the TC market, particularly in his capacity as President of the Association of Telecommunications and Value-Added Service Providers (VATM).

**Ina Schlie**
Head of the global tax department at SAP AG, Ina Schlie was appointed to the Supervisory Board in September 2012 and then confirmed with a large majority at the Annual Shareholders' Meeting in May 2013. As a finance and tax expert, she also chairs the Audit Committee.

**Anne-Dore Ahlers**
QSC's workforce elected Anne-Dore Ahlers as one of the two employee representatives on the Supervisory Board in April 2013. She is currently the Chair of the Works Council and based in Hamburg.

**Cora Hödl**
QSC's workforce elected Cora Hödl, now head of the TC Voice Services department, as its second representative on the Supervisory Board in April 2013. A qualified communications electrician, Cora Hödl has worked at QSC since 2002 and is based in Cologne.

# Report of the Supervisory Board on the 2014 Financial Year Regarding the Company and the Consolidated Group




Dear Shareholders,

The following Supervisory Board Report informs you about the activities of the Supervisory Board in the 2014 financial year.

**Activities of the Supervisory Board •** In 2014, the Supervisory Board once again performed all of the duties incumbent on it by law and the Articles of Association. One particular focus related to the appointment of new Management Board members. The Supervisory Board advised and monitored the Management Board in its management of QSC. It was directly involved in all decisions and measures of material significance, particularly those impacting on the Company's financial position, financial performance and cash flows. After careful consideration, the Supervisory Board voted on all measures for which its consent is required by law, the Articles of Association and the Rules of Procedure of the Management Board.
The Management Board informed the Supervisory Board with regular, timely and detailed reports, both written and oral, about the Company's business performance, drawing in particular on monthly and quarterly financial statements and rolling budget/actual comparisons. The Management Board reports also included all relevant information concerning the Company's strategic development and planning, risk situation, risk management and compliance. All enquiries and requests for additional information by the Supervisory Board were promptly and thoroughly answered by the Management Board.

**Topics addressed by the Supervisory Board** • At joint meetings, the Supervisory and Management Boards discussed key aspects of the Company's business policies and strategy, as well as its performance and planning. Moreover, the Chairs of the two boards were in regular contact to discuss topics arising between Supervisory Board meetings.

The main focuses of Supervisory Board meetings and resolutions in 2014 were:

1. **Management Board** • By resolution dated 20 November 2014, the Supervisory Board extended Jürgen Hermann's appointment to the Management Board and as Chief Executive Officer subsequent to the expiry of his existing appointment on 31 March 2015 for a period running until 31 March 2018 and correspondingly extended his existing employment contract. On 15 December 2014, the Supervisory Board appointed Stefan A. Baustert as Chief Financial Officer for a period of three years as of 1 January 2015. At the same time, the Supervisory Board authorised its Chairman to conclude with Mr. Baustert the Management Board employment contract compiled by the Human Resources Committee and approved by the Supervisory Board. At the same meeting, the Supervisory Board approved the request submitted by Barbara Stolz, at that time the Company's CFO, to stand down from her position on the Management Board as of 31 December 2014. In March 2014, the Supervisory Board had already approved the request submitted by Stefan Freyer, at that time a member of the Management Board, to stand down from his position on the Management Board as of 31 March 2014 and passed resolution on the premature rescission of his Management Board employment contract. The Supervisory Board thanks Barbara Stolz and Stefan Freyer for their work.

2. **Acquisition of majority interest in FTAPI Software GmbH, Munich** • On 17 February 2014, the Supervisory Board approved the Management Board proposal to acquire 50.93 percent of the shares in FTAPI Software GmbH, a specialist in encrypted data exchange between corporate customers. The acquisition was executed on 24 February 2014.

3. **Promissory note loan of € 150 million** • At the Annual Shareholders' Meeting on 20 March 2014, the Management and Supervisory Boards deliberated the potential conclusion of contracts for promissory note loans totalling € 150 million, as well as the material contents of the respective contracts with Commerzbank AG as arranger. The Supervisory Board approved the conclusion of the contracts by written resolution on 7 May 2014.

4. **Full-year forecast 2014** • Comparisons of the Company's budgeted and actual business performance were on the agenda at each regular Supervisory Board meeting in 2014 as well. The Supervisory Board challenged the Management Board's assumptions and ensured that it was extensively informed about the reasons for the specification in greater detail of the full-year forecast in August 2014 and the reduction in the same in October 2014. At its meetings on 20 November 2014 and 30 January 2015, the Supervisory Board dealt in detail with the planned budget for the 2015 financial year.

Furthermore, in 2014 the Supervisory Board dealt with QSC's internal control mechanisms, and here in particular with the risk management system and with corporate governance and compliance consistent with statutory requirements. The Supervisory Board reviewed these areas on the basis of submissions and Management Board reports and discussed them with the Management Board. The Supervisory Board is of the opinion that the internal control and early warning risk identification systems operate reliably.

**Composition of the Supervisory Board** • The Supervisory Board witnessed no changes in its composition in 2014 and continued to comprise four shareholder representatives, namely Dr. Bernd Schlobohm (Supervisory Board Chairman), Dr.-Ing. Frank Zurlino (Deputy Chairman), Ina Schlie and Gerd Eickers, and two employee representatives, namely Anne-Dore Ahlers and Cora Hödl.

**Supervisory Board meetings and committees** • In addition to four regular meetings, the Supervisory Board held three further meetings by way of conference call in the 2014 financial year. Apart from Cora Hödl, who did not participate in one of these conference calls, all Supervisory Board members attended all meetings. Where necessary, the Supervisory Board also adopted resolutions on individual topics by circulating and approving the respective documents. Committee members attended all meetings of their respective committees in 2014.
The Supervisory Board has formed four committees to assist it in its work. These are the Human Resources Committee, the Audit Committee, the Nomination Committee and the Strategy Committee. The Chairs of the respective committees regularly report to the full Supervisory Board on the work of their committees.
The Human Resources Committee met three times in the year under report. The members of this committee are Dr. Bernd Schlobohm (Chair), Gerd Eickers and Cora Hödl. The Human Resources Committee prepared the Supervisory Board's decisions concerning Management Board members' target achievement in the 2013 financial year and Management Board target agreements for the 2014 financial year, relating in both cases to variable compensation. It also dealt in particular with the selection of a suitable candidate for the position of Chief Financial Officer and negotiating the corresponding Management Board employment contract.
The Audit Committee comprised Ina Schlie as its Chair and independent financial expert as defined in § 100 (5) and § 107 (4) of the German Stock Corporation Act (AktG), as well as Dr. Bernd Schlobohm and Dr.-Ing. Frank Zurlino. The Audit Committee monitors the financial reporting process, the effectiveness of the internal control, risk management and internal audit systems, the audit of the financial statements and compliance, as well as preparing any decisions required by the full Supervisory Board. The Audit Committee monitors the necessary independence and quality of the external auditor (the "auditor") and deals with any additional services performed by such. The committee issues the audit assignment to the auditor and determines the audit focuses, as well as negotiating and concluding the auditor's fee agreement.
The Audit Committee met five times in the past financial year. It conducted a review of the documents relating to the annual financial statements for the 2013 financial year, including the dependency report, held in-depth discussions of these documents and the accompanying audit reports

in the presence of the auditor and adopted recommendations for the full Supervisory Board resolution concerning the documents relating to the annual financial statements and their audit. The Audit Committee discussed the interim financial reports due for publication with the Management Board. It determined the audit focuses for the 2014 financial year and negotiated and concluded the auditor's fee agreement. The Audit Committee recommended to the Supervisory Board that KPMG AG Wirtschaftsprüfungsgesellschaft, headquartered in Berlin and with a branch office in Cologne, should once again be proposed to the Annual Shareholders' Meeting as auditor and group auditor for the 2015 financial year. Based on this recommendation, at its meeting on 19 March 2015 the Supervisory Board adopted a corresponding proposal to the Annual Shareholders' Meeting. Furthermore the Audit Committee reviewed the effectiveness of the internal control, risk management and internal audit systems at QSC AG.
The task of the Nomination Committee is to submit suitable candidates to the full Supervisory Board for its nomination of candidates at any forthcoming election of shareholder representatives to the Supervisory Board at the Annual Shareholders' Meeting. The members of the Nomination Committee are Gerd Eickers (Chairman) and Dr.-Ing. Frank Zurlino. As no elections of shareholder representatives to the Supervisory Board were due, the Nomination Committee did not meet in the year under report.
The members of the Strategy Committee are Dr. Bernd Schlobohm (Chairman) and Dr.-Ing. Frank Zurlino. The Strategy Committee has a purely advisory function and addresses QSC's strategic, and thus long-term development, and in particular with the development of ideas for forward-looking products and services. This committee met eight times in 2014.

Corporate governance • The Supervisory Board continuously monitors the further development in the German Corporate Governance Code and its implementation at QSC AG. Consistent with the Code, in the past financial year the Supervisory Board reviewed the efficiency of its own activities. No deficits were identified. At its meeting on 20 November 2014, the Supervisory Board reviewed and confirmed that QSC AG had complied with the recommendations made in the German Corporate Governance Code in the preceding year in accordance with the Declaration of Conformity adopted in the previous year. At the same time, the Management and Supervisory Boards jointly issued an updated Declaration of Conformity pursuant to § 161 of the German Stock Corporation Act (AktG) and made this permanently available on the Company's website.
The Management Board reports on corporate governance, also on behalf of the Supervisory Board, in the Corporate Governance Report within the Group Management Report.
Each member of the Supervisory Board discloses any conflicts of interest that may arise, taking due account of the recommendations made in the German Corporate Governance Code. Dr. Bernd Schlobohm, Chairman of the Human Resources Committee and of the Supervisory Board, did not participate in the discussions held in the Human Resources Committee and the Supervisory Board concerning target achievement for variable Management Board compensation in the 2013 financial year and also abstained upon adoption of the respective resolutions, as he was himself a member of the Company's Management Board until 29 May 2013. Other than this, no potential conflicts of interest arose in the year under report.

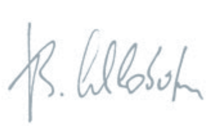
**Audit of financial statements** • KPMG AG Wirtschaftsprüfungsgesellschaft, headquartered in Berlin and with a branch office in Cologne, audited both the annual financial statements of QSC AG as of 31 December 2014 prepared by the Management Board in accordance with the requirements of the German Commercial Code (HGB) and the consolidated financial statements as of 31 December 2014 prepared in accordance with International Financial Reporting Standards (IFRS) and the supplementary provisions of German commercial law applicable pursuant to § 315a of the German Commercial Code (HGB), as well as the accompanying management and group management reports. The audit assignment had been awarded by the Audit Committee in accordance with the resolution adopted by the Annual General Meeting on 28 May 2014. Key focuses of the 2014 audit included: the audit of goodwill, and here in particular planning plausibility, costs of capital, reconciliation with market capitalisation and presentation in the consolidated financial statements, deferred taxes, the valuation of Plusnet GmbH & Co. KG, the accounting presentation of multi-component contracts, the completeness and measurement of provisions, the IT control environment, the presentation of the actual versus the forecast business performance, the outlook and opportunity and risk report in the management and group management reports, compliance with covenants for credit agreements, as well as Management Board compensation and travel expenses.
The auditor granted unqualified audit opinions to the Company's annual financial statements (HGB) and consolidated financial statements (IFRS) for the 2014 financial year, including the respective management reports.
The aforementioned documents, including the audit reports submitted by the external auditor, were provided to all Supervisory Board members in good time ahead of their review. At its meeting on 19 March 2015, the Supervisory Board discussed all of the aforementioned documents and the auditor's reports with the Management Board and the auditor, taking due account of the findings of the preliminary review conducted by the Audit Committee, and also reviewed and discussed the Management Board's proposal concerning the appropriation of profit. The auditor reported to the meeting on the key findings of its audit and in particular that no material weaknesses had been identified in the internal control and risk management system in respect of the financial reporting process. The auditor also informed the Supervisory Board of services it provided in addition to the audit of the financial statements and that there were no circumstances indicating that its impartiality was impaired.
Having conducted its own review, the Supervisory Board did not raise any objections to the annual financial statements (HGB) of QSC AG for the 2014 financial year, the consolidated financial statements (IFRS), the management report of QSC AG, or the group management report and concurs with the findings of the audit conducted by the auditor. Consistent with the recommendation made by the Audit Committee, the Supervisory Board therefore approved the consolidated financial statements (IFRS) and annual financial statements (HBG), with the latter thereby being formally adopted. With due consideration of the interests of shareholders and of QSC AG, the Supervisory Board endorses the appropriation of profit proposed by the Management Board. The Management and Supervisory Boards will propose the distribution of a dividend of € 0.10 per share with corresponding entitlement for approval by the Annual Shareholders' Meeting on 27 May 2015.

The Management Board compiled a report on relations with affiliated companies for the 2014 financial year. The auditor audited this report, reported in writing on its findings and granted the following unqualified opinion:

"Following our audit and assessment performed in accordance with professional standards, we confirm that:
1. The factual information in the report is correct.
2. The Company's compensation with respect to the legal
   transactions listed in the report was not inappropriately high."

The respective reports from the Management Board and the auditor were available to individual Supervisory Board members in good time ahead of their review. These reports were also discussed in detail at meetings of the Audit Committee and the full Supervisory Board. The representatives of the auditor participating in these meetings reported on the key findings of their audit. Following its own review, the Supervisory Board approved the Management Board's report on relationships with affiliated companies and also concurred with the findings of the audit of the report by the auditor. Based on its own review, the Supervisory Board established that no objections were to be raised against the declaration made by the Management Board at the end of the report on relationships with affiliated companies.
In conclusion, the Supervisory Board would like to extend its thanks to QSC's shareholders in particular for the trust they continue to place in the Company. It would also like to all employees for their work in the difficult past financial year. Furthermore, the Supervisory Board thanks the Management Board for its commitment.

Cologne, 19 March 2015
On behalf of the Supervisory Board of QSC AG



Dr. Bernd Schlobohm
Supervisory Board Chairman

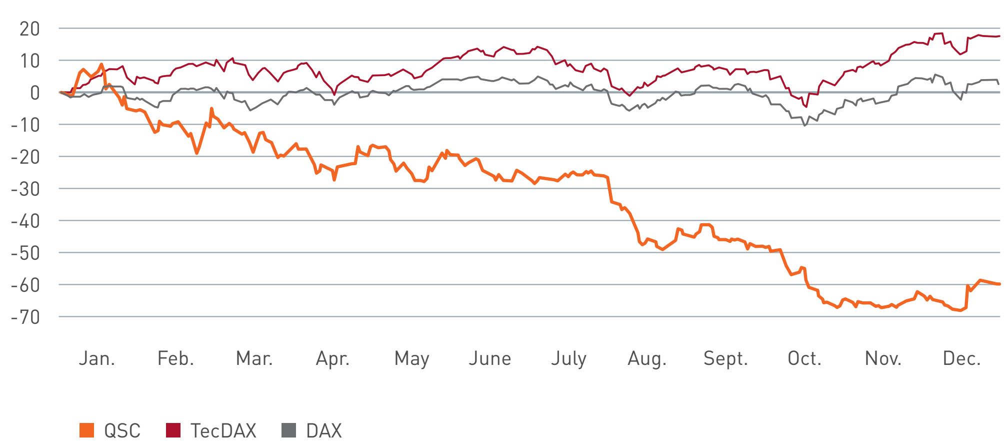
# QSC Share Performance

DAX sets new record at more than 10,000 points

**2014 – a turbulent year on the stock markets** • The Ukraine conflict, the collapse in the rouble, IS terror and widespread economic slowdowns – numerous external factors played a part in influencing global stock market prices in 2014. These factors led to sometimes severe fluctuations in share prices. Markets were repeatedly reassured by consistently low interest-rate policies and the glut in liquidity from central banks. All in all, having already exceeded the record mark of 10,000 points in June and then fallen to 8,600 points in October, the DAX rose by 3 percent in 2014 to close at 9,806 points on 30 December 2014.
The TecDAX, Germany's lead index for technology stocks, performed better, rising by 18 percent over the year to close at 1,371 points. Not all stocks contributed to this growth. Eleven of the 30 TecDAX companies in total saw their share prices fall, in some cases substantially. In a volatile overall market, investors parted company with shares that fell short of market expectations – and QSC shares were among these.

**Marked fall in QSC share price** • Having doubled in price in 2013, QSC shares had to yield these gains once again as 2014 progressed. The share price fell by 60 percent. In the first quarter of 2014, numerous investors cashed in on the gains generated in the preceding rally. This caused the share price to fall from its annual high of € 4.69 on 14 January to € 3.62 by March. QSC's share price then fluctuated between € 3.00 and € 3.60 until well into July. The capital market thus still valued QSC higher than in the corresponding period from the previous year.

SHARE PRICE PERFORMANCE IN 2014 (indexed)

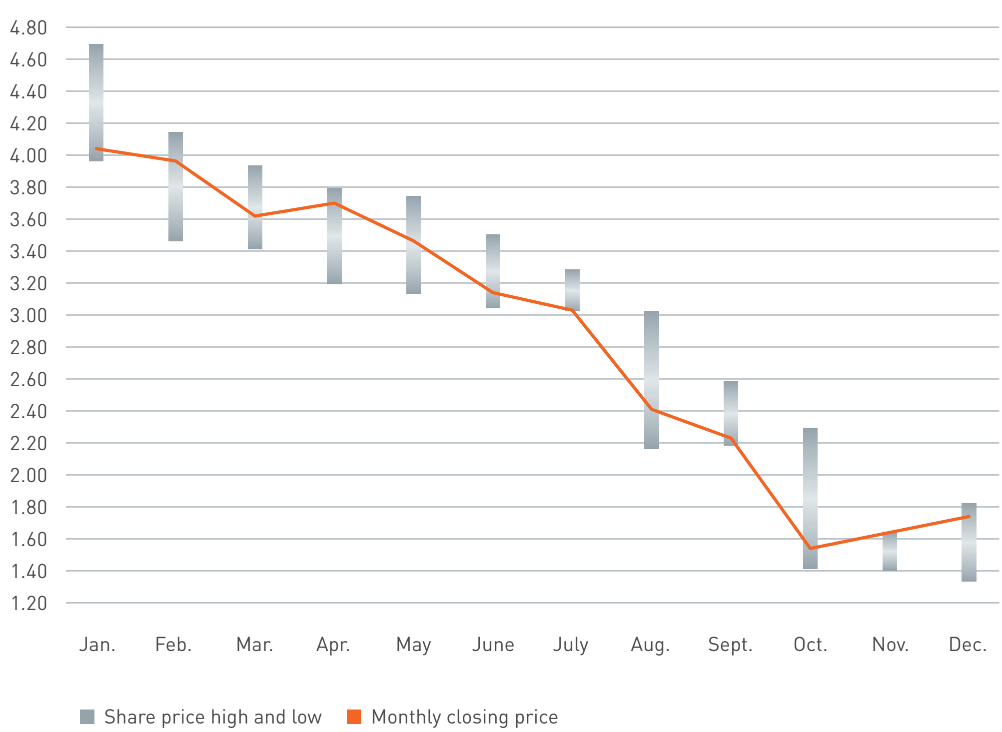


This situation only changed in August 2014. With the presentation of its half-year report on 11 August, QSC specified its full-year forecast in greater detail, referring among other factors to an unfavourable revenue mix in the second quarter of 2014 and to the weaker-than-expected performance of the IT Consulting business in particular. In a nervous market climate, this caused numerous investors to sell QSC shares. Not only that, numerous analysts adjusted their models and lowered their share price targets. The downturn in the share price accelerated following publication of the preliminary figures for the third quarter of 2014 on 16 October 2014. After two unexpectedly weak quarters in succession, QSC was then obliged to lower its full-year forecast for 2014. The share price fell in subsequent weeks to its annual low of € 1.33 on 16 December 2014. By the end of the year, QSC shares only managed to recover slightly to a year-end closing price of € 1.74.

**Lively trading in QSC shares** • While the share price fell, trading volumes with QSC shares rose further in the past year. According to Deutsche Börse statistics, an average of 914,000 shares changed hands each day on Xetra and on the trading floor in the past year, and thus more than 40 percent more than in the previous year. Overall, QSC's trading volumes on German stock exchanges totalled € 636.4 million in 2014, compared with € 574.3 million in the previous year.

Daily trading volumes with QSC shares up more than 40 percent

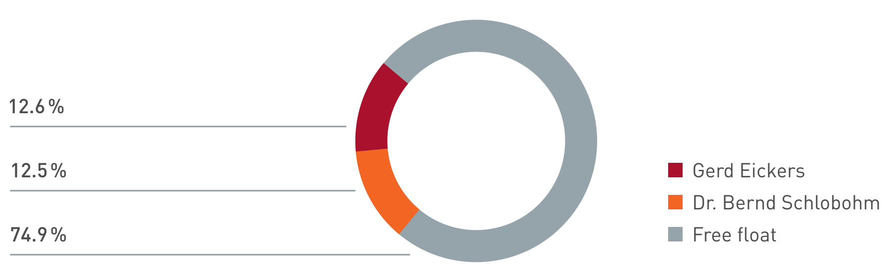
QSC SHARES: MONTHLY SHARE PRICE DEVELOPMENT IN FY 2014 (in €)



These figures reflect only a portion of the total trades with QSC shares. Institutional investors in particular are increasingly using off-market platforms to buy and sell securities. Based on brokers' estimates, these trades accounted for a further total of almost 25 percent of transactions with QSC shares.

**14 years after the IPO the founders have never sold a single share** • The lively trading in 2014 was accompanied by changes in the shareholder structure, with an increase in the retail investors' share of free float. QSC's two founders, Dr. Bernd Schlobohm and Gerd Eickers, are still the Company's largest shareholders. In March 2014, these individuals acquired a further 25,000 shares each via Xetra at a price of € 3.76. They thus now hold 15.5 million and 15.6 million shares respectively, corresponding to 12.5 percent and 12.6 percent stakes in QSC's share capital.
Since the Company went public in April 2000, neither Dr. Bernd Schlobohm nor Gerd Eickers have sold even a single QSC share. On the contrary, they have repeatedly increased their shareholdings, as most recently in 2014.

SHAREHOLDER STRUCTURE AS OF 31 DECEMBER 2014




**Large institutional players remain loyal to QSC** • At the end of 2014, 74.9 percent of QSC shares were in free float ownership with 28,757 shareholders. According to the share register, 52 percent of these, and thus 12 percentage points more than a year earlier, were attributable to retail investors, and 48 percent to institutional investors. QSC's two largest institutional investors remained loyal to QSC in 2014, as in the previous year. Based on available voting right notifications, the Dutch-based fund provider Kempen Capital Management owned more than 5 percent of the shares at the end of 2014. The British company J O Hambro Capital Management, which had previously held more than 3 percent in QSC, informed the Company in May 2014 that it had exceeded the 5 percent reporting threshold.

Two funds hold stakes of more than 5 percent

Credit Suisse Fund Management crossed the 3 percent threshold in both directions several times in the course of the year. Based on a notification dated December 2014, it once again held more than 3 percent of QSC's shares at the end of the year. By contrast, Allianz Global Investors, whose shareholding had temporarily exceeded 3 percent, reduced its holding once again in October 2014.

**11 financial institutions publish studies on QSC** • The decisions taken by institutional investors in particular are often influenced by analysts' opinions. In 2014, 11 financial institutions dealt regularly with QSC; Kepler Cheuvreux discontinued its coverage in the second quarter.
Numerous analysts adjusted their forecasts in the course of the year to reflect the Company's weaker operating performance and cut their target share prices, in some cases substantially. At the end of 2014, two buy recommendations were balanced out by two sell recommendations. Seven institutions saw no need to act and advised investors to hold QSC shares.

FINANCIAL INSTITUTIONS THAT PUBLISH STUDIES ON QSC

| | | |
|---|---|---|
| Bankhaus Lampe | Hauck & Aufhäuser | Metzler Equities |
| Berenberg Bank | Independent Research | Oddo Seydler Bank |
| Commerzbank | JPMorgan Cazenove | Warburg Research |
| Deutsche Bank | Landesbank Baden-Württemberg | |

**Ongoing dialogue with all interested parties** • QSC was again constantly in contact with analysts and with institutional and retail investors in 2014. The Management Board presented the Company at capital market conferences organised by leading financial institutions such as Berenberg Bank, Commerzbank, Deutsche Bank, DZ Bank and Kepler Cheuvreux, as well as at roadshows at all of Europe's leading financial centres. These activities were supplemented with a series of one-to-one meetings in Cologne and Hamburg and conference calls with numerous existing and potential investors.
One major instrument for capital market communication consists of the conference calls held on the day on which quarterly results are published and upon any ad-hoc announcements being released. QSC makes the presentations and recordings of the comments made by members of the Management Board promptly available on the Company's proprietary IR website. Moreover, the presentations are also available on SlideShare, the world's largest platform for documentation of this kind.
Alongside SlideShare, Twitter is a further social media tool used by QSC in its Investor Relations work to spread the latest news. Within QSC's website, the IR section serves as the key platform for all relevant information. As well as financial reports and IR press releases, investors and other interested parties can also find a financial calendar, analyst assessments and detailed documents relating to the Annual Shareholders' Meeting.

FOR FURTHER INFORMATION:
WWW.QSC.DE/EN/QSC-AG/INVESTOR-RELATIONS

FOR FURTHER INFORMATION:
WWW.SLIDESHARE.NET/QSCAG

**Dividend continuity – a key argument for QSC shares** • Given the fall in the share price, the dividend yield was an important factor in the Company's dialogue with existing and potential shareholders during 2014. The Company paid a dividend of 10 cents per share for the 2013 financial year. Based on the year-end price in 2014, this constituted a 5.7 percent return.
The Management and Supervisory Boards will once again propose the payment of a dividend of 10 cents per share for approval by the Annual Shareholders' Meeting in May 2015.

## BASIC INFORMATION ON QSC SHARES

| | |
|---|---|
| Securities control number | 513 700 |
| ISIN | DE0005137004 |
| Trading symbol | QSC |
| Bloomberg symbol | QSC GR |
| Reuters symbol | QSCG.DE |
| Market segment | Prime Standard |
| Stock exchanges | Xetra and regional German stock exchanges |
| Index membership | TecDAX |
| | CDAX |
| | HDAX |
| | Midcap Market |
| | Prime All Share |
| | Technology All Share |
| | DAX International Mid 100 |
| | DAXsector All Technology |
| | DAXsector Technology |
| | DAXsubsector All Communications Technology |
| | DAXsubsector Communications Technology |
| | DAXsupersector Information Technology |
| | DAXplus Family |
| | DAXplus Family 30 |
| | Tradegate Indicator TecDAX |
| Designated sponsorship | Oddo Seydler Bank AG |
| Shares outstanding as of 31 December 2014 | 124,142,487 |
| Share class | No-par-value registered shares of common stock |
| Xetra closing price on 30 December 2013 | € 4.30 |
| Xetra share price high in 2014 | € 4.69 |
| Xetra share price low in 2014 | € 1.33 |
| Xetra closing price on 30 December 2014 | € 1.74 |

# Group Management Report

# Group Fundamentals

## BUSINESS ACTIVITIES

**Full range of ICT services** • QSC AG ("QSC" or "the Company") offers business customers a full range of ICT services from a single source. ICT stands here for the convergence of Information Technology (IT) and Telecommunications (TC) into a single sector of the economy in the digital age. QSC's range of products and services comprises both custom-tailored solutions for individual ICT requirements and a modular product portfolio for smaller companies and sales partners and can be subdivided into four categories: Telecommunications, Outsourcing, Consulting, and Cloud. From 1 January 2015 onwards, internal reporting will also be based on this product structure. Accordingly, these four categories and the profit centres allocated to them will also form the basis for the new segment reporting (please see pages 70f.).

SEE PAGES 70f.
OUTLOOK

QSC AG'S SPECTRUM OF PRODUCTS, SERVICES AND SOLUTIONS


**Telecommunications – voice and data services from a single source** • At QSC, customers can find a whole range of voice and data communication products. For their internet connection, they can choose from asymmetric ADSL2+ lines, symmetric SDSL lines and premium internet access via wireless local loop (WLL) networks.

Many customers also use their internet connections for voice telephony. QSC offers IP telephony connections (Voice over IP) and the appropriate telephone systems. Furthermore, the range of services also includes further forms of voice telephony, including open call-by-call and preselect offerings and value-added services.

**Outsourcing – from operations to complete infrastructures** • QSC offers its customers a full range of outsourcing services and concentrates here on services surrounding its own data centres within Germany. The key focus is on outsourcing infrastructure. Here, QSC assumes all IT operations and ensures a smooth and trouble-free service. The range of services includes operation of servers, appropriate firewall and security services, as well as their integration within secure and fast network solutions. Moreover, QSC offers a broad portfolio of data centre services, from providing infrastructure in the form of housing and hosting through to building and operating proprietary data centres for customers. QSC's virtual private networks (VPNs) ensure that data can be securely exchanged among data centres, company outlets and branches, as well as with teleworkers, field staff, partners and suppliers.
In addition, the Company also maintains a service desk to support users, as well as an SAP and Microsoft application service. Here, QSC employees maintain customers' systems and work consistently on developing them further. If so desired, QSC can also assume IT operations management and thus responsibility for secure operations independently of infrastructure outsourcing. This may also involve operating the relevant SAP or Microsoft environment, database management systems, collaboration services and/or platforms for mobile devices.

**Consulting with key focus on SAP and Microsoft** • QSC has longstanding experience in advising companies on how to optimise their business processes with two key focuses on SAP and Microsoft. As well as applications development and SAP system customisation, the project work performed in the SAP environment also includes optimising key business processes and reporting.

Foundation of a Competence Centre for SAP HANA

Furthermore, in 2014 QSC founded its own SAP HANA Competence Centre and set up a test laboratory. Here, customers can rigorously test the efficiency and practicability of "in-memory" technology in line with their individual company requirements.
For Microsoft applications and technologies, the focus is on implementing cloud services with the assistance of Microsoft Private Cloud solutions and the use of communication and collaboration solutions. In general, Consulting is playing a key role in migrating customers' ICT into the cloud age.

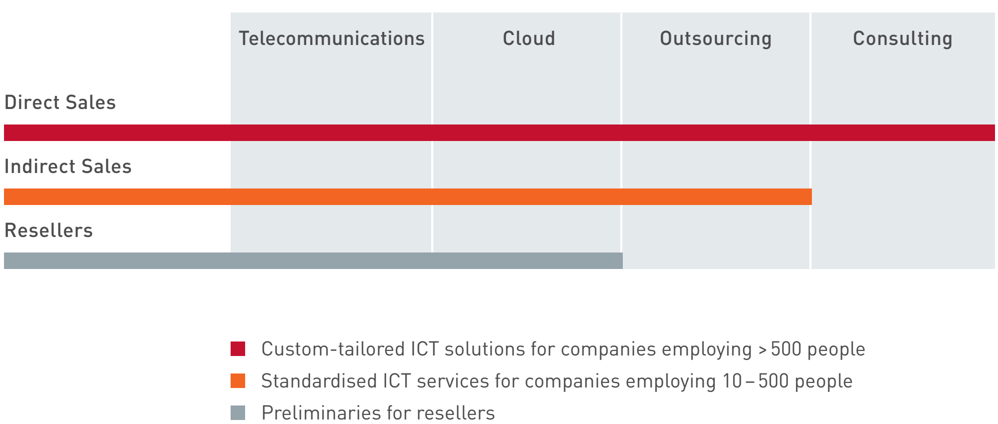
**Cloud – innovations for a new age** • QSC is pursuing the strategy of systematically extending its range of products and services to include internally developed products and accessing new business fields. The focus here is on software-as-a-service (SaaS) and platform-as-a-service (PaaS) solutions for the cloud age. The solucon platform serves as a basis for numerous innovations. Further information about this can be found in "Research and Development" from page 33 onwards.

SEE PAGES 33f.
RESEARCH AND DEVELOPMENT

QSC already offers mobile and scalable workplace components as SaaS services. These include unified communication (UC) and collaboration solutions, a cloud-based virtual workplace and the smart management of mobile devices. With its takeover of a majority interest in the encryption specialist FTAPI in February 2014, the Company has extended its portfolio to include products for the ultra-secure transmission and storage of critical company data.

**Tripartite sales structure targets different customer groups** • To address the needs of various customer groups with great precision, QSC has traditionally had three distribution channels – Direct Sales, Indirect Sales, and Reseller Sales ("Resellers"). Until 31 December 2014, these three business units also formed the basis for managing the Company and for its segment reporting.

QSC'S BUSINESS UNITS




- Direct Sales focuses on the solutions business and thus addresses more than 8,000 larger and medium-sized companies in Germany. Working directly with customers, it develops custom-tailored ICT solutions. To this end, it draws on the entire portfolio of products and services – from simple internet connections right through to outsourcing IT infrastructures. Alongside its regional organisational structure, Direct Sales also has three nationwide industry sales operations for energy, retail and insurance.
- Indirect Sales focuses on almost 900,000 smaller and medium-sized companies in Germany that generally do not have any in-house staff for information and communications technology and procure their ICT services from regional partners instead. QSC works together with more than 500 distributors and regional sales partners who primarily sell ICT products but are increasingly marketing cloud services as well.

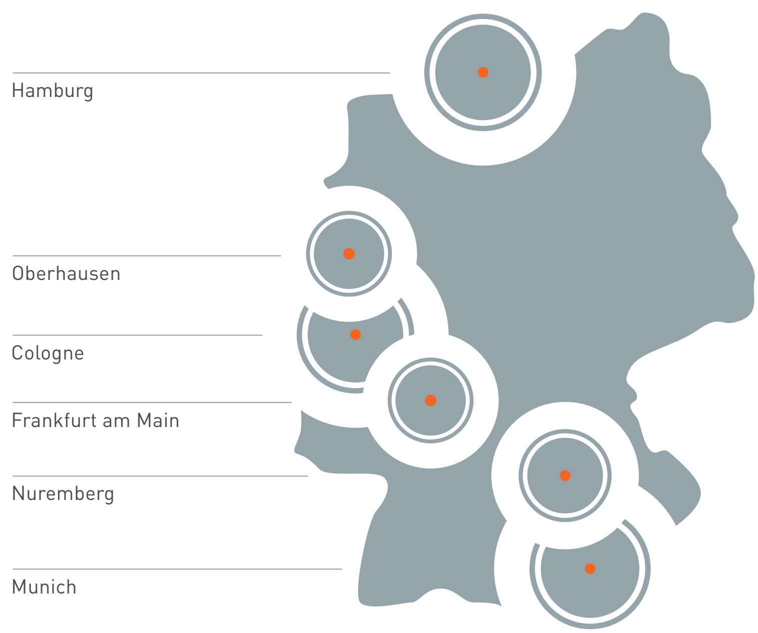
More than 500 distributors and sales partners

- At Reseller sales ("Resellers"), QSC pools its business with service providers who chiefly address private customers. Above all, these include telecommunications companies, cable network operators and internet providers.

Data centres are TÜV and ISO-certified

**Proprietary nationwide ICT infrastructure** • QSC has its own ICT infrastructure across the whole of Germany and can thus guarantee its customers consistently high quality along the entire value chain (end-to-end quality). The centrepiece of this ICT infrastructure consists of data centres certified by both TÜV and ISO. At the end of 2014, QSC operated data centres at six locations across Germany (Cologne, Frankfurt am Main, Hamburg, Munich, Nuremberg and Oberhausen) with total floor space of 15,000 square metres. The Company is thus subject at all of its locations to German data protection requirements, which are very strict by international standards. Together with this proximity to its SME customers, these proven high quality and security standards represent a key competitive advantage.

QSC'S DATA CENTRES




**Next Generation Network (NGN) ensures nationwide end-to-end quality** • The data centres are linked with a cutting-edge infrastructure. This is based on the Next Generation Network (NGN), which safeguards the convergence of various voice and data transmission technologies with the IP protocol. This involves a software-based solution that, irrespective of ownership of the physical infrastructure, allows QSC to offer its customers nationwide end-to-end quality and to manage and supervise its network services as appropriate.

Moreover, QSC has traditionally operated a nationwide DSL network, a nationwide IP-based voice network and one of Germany's largest wireless local loop (WLL) access networks.

## MARKET AND COMPETITIVE POSITION

**Focus on German market and medium-sized companies** • QSC is an ICT provider to companies of all sizes – from trade contractors up to large corporate groups – and focuses on serving the needs of the German market. Its key focus is on medium-sized companies. QSC – itself a medium-sized player – enjoys particular credibility here and has successfully built up a strong position over many years. For Consulting and Outsourcing projects, the Company also operates outside Germany in individual cases.

**Comprehensive range of ICT services as competitive advantage** • QSC has a strong market position in its traditional product areas. In its Telecommunications business, the Company competes on the one hand with conventional TC providers and on the other hand with IP-based services with IT systems houses and software makers. In this competitive environment, what sets QSC apart is its broad range of products and services and the quality of service it can offer as a medium-sized player. In its Outsourcing business, QSC is in competition with the subsidiaries of globally operating IT and TC companies and with large German systems houses. Here too, the ability to offer ICT solutions from a single source has proven to be an advantage. In Consulting, the Company has to compete with IT consultancies and IT systems houses and benefits in this environment as well from its broad-based ICT expertise. In its Cloud segment, QSC is gradually building up its market position. Here, it is in competition with IT and TC providers who are extending their service offerings, and with newly established technology providers. The latter group generally focuses on smaller market segments.

## STRATEGY

**ICT market offers substantial medium-term growth opportunities** • In recent years, QSC has evolved from a TC provider into an integrated ICT provider. The Company thus acted early to compensate for the decline foreseeable in the traditional TC business as a result of market and regulatory factors.

In the ICT market, QSC is pursuing a highly ambitious innovation and growth strategy. The Company sees the convergence of IT and TC into a single ICT market as a particular source of opportunities. Two key factors are driving this development: On the one hand, ever more companies are outsourcing their infrastructures, data and applications to central data centres and expect high bandwidths, quality and security – from the data centre via the connection network right through to individual workplaces. QSC is excellently positioned in this market and is already one of the few players to offer consistent end-to-end quality. On the other hand, mobile devices are displacing stationary workplaces. This is increasing the importance of integrated IT infrastructures and of applications that run centrally in the cloud. In its development work, QSC is therefore focusing above all on cloud-based products and services.

Focus on cloud-based products and services

**"Internet of Things" opens up new possibilities for ICT providers** • The spread of ICT into ever more areas of work and life, a process often referred to with the catchword "Internet of Things", is also creating additional growth potential. Here, communication no longer takes place between users and servers alone, but to an increasing extent directly between machines and sensors as well. ICT itself is also about to take a leap forward in terms of technology. The industrialisation of IT will break up traditional structures. To date, many IT processes are still performed manually and decentrally, which means that – just like in industry – automation promises great efficiency gains. The linchpin in this kind of industrialisation is cloud computing, with its extremely large benefits of size and scale compared with the client server technology that is still prevalent today. Against this backdrop, in-house IT departments, especially those at medium-sized companies, will in future increasingly focus on selecting and procuring suitable products and solutions. Internal proprietary systems will recede into the background. Associated with this is a new challenge – complexity management – and this is precisely where QSC comes into play. The Company is developing a "Pure Enterprise Cloud" that facilitates integration of traditional applications and new cloud services. This way, customers can manage their transition to the cloud-age step by step.

QSC is currently developing a "Pure Enterprise Cloud"

**QSC presses ahead with industrialisation of its existing portfolio** • The Pure Enterprise Cloud stands for the close dovetailing of the Company's strategy with the latest market developments. QSC is therefore promoting its ICT business and expanding its range of products and services, focusing in particular on the topics of cloud computing and the "Internet of Things". There are two key thrusts here. Firstly, in its existing portfolio QSC is driving the industrialisation of the the development, marketing and operation of existing products and solutions, as well as their networking. The Company's state-of-the-art portfolio enables it to increase its share of ICT budgets at its more than 30,000 existing business customers and also to attract further customers. At the same time, this industrialisation contributes crucially towards the Company achieving the medium-term increase it has planned in its financial and earnings strength.

The second focus involves innovations. These may involve new technologies for new markets, new technologies for existing markets, or existing technologies for new markets. Further information about the Company's innovation activities can be found in "Research and Development" from page 33 onwards. When it comes to innovations, QSC is not only relying on the expertise of its own developers. One component of the Company's strategy also involves acquiring smaller companies with great technological or market competence.

SEE PAGES 33f.
RESEARCH AND DEVELOPMENT

## ORGANISATIONAL STRUCTURE

**Nationwide presence in German home market** • QSC AG is the parent company and has its legal domicile in Cologne. In addition to the headquarters in Cologne, the Company has a second large location with numerous functionalities in Hamburg, from where the Consulting and Outsourcing businesses in particular are managed. In addition to these locations, QSC maintains ten sales offices across Germany. Specifically, these are located in Berlin, Bremen, Dresden, Frankfurt am Main, Hanover, Leipzig, Munich, Nuremberg, Oberhausen and Stuttgart. The Company currently has two major direct and indirect participating interests:

- Ventelo GmbH, which was fully taken over in 2002, offers medium-sized and larger companies services including direct landline connections, preselect and call-by-call, as well as value-added services.
- Ventelo owns 100 percent of the shares in the network company Plusnet GmbH & Co. KG, which was founded in 2006. Plusnet operates a nationwide DSL network.

A complete overview of the scope of consolidation as of 31 December 2014 can be found in Note 37 of the Notes to the Consolidated Financial Statements.

SEE PAGES 135ff.
NOTES

**Profit centre structure will enhance responsibility** • In the second half of 2013, QSC implemented a system of profit, cost and service centres. This has made individual operations more aware of their responsibility for revenues and earnings and has also fostered cross-location collaboration. The profit centre idea also allows competencies within a given line of business to be pooled at autonomous companies. FTAPI Software GmbH, in which a majority interest was acquired in February 2014, also constitutes an autonomous profit centre. Further information about this acquisition can be found on page 58 of this Group Management Report.

SEE PAGE 58
BUSINESS PERFORMANCE

## MANAGEMENT

**Management by key financial performance indicators** • In 2014, QSC managed the Company via three business units – Direct Sales, Indirect Sales and Resellers. With the introduction of the new profit centre structure, however, it has become apparent that managing the Company via these highly focused units offers significant benefits. As a result, QSC has correspondingly adjusted its management of the Company as of 1 January 2015. This profit centre structure is geared towards products.

Operating segments redefined from 1 January 2015

In both cases, QSC refers to the following financial performance indicators as key management figures: revenues, EBITDA, free cash flow and capital expenditure. No reference is made to non-financial performance indicators for management purposes.

EBITDA is defined as earnings before interest, taxes, amortisation of deferred non-cash share-based compensation, depreciation/amortisation and impairment losses on customer-related inventories and depreciation/amortisation of property, plant and equipment and intangible assets. The EBITDA margin presents EBITDA as a percentage of revenues. The free cash flow portrays the change in net liquidity/debt from operating activities. QSC accounts for its capital expenditure on a timing rather than flow-of-funds basis. This item includes customer-related, research-driven and other investments, as well as investments in infrastructure. These parameters ensure that well-balanced decisions can be made throughout the Company concerning liquidity, profitability and growth.

**Monthly reports as core management instrument** • The monthly reports contain all relevant key figures and budget/actual comparisons. They serve as a key basis for discussion at the fortnightly meetings of the Management Board, as well as for the monthly reports to the Supervisory Board. Moreover, the latest budget/actual comparisons are used as a basis for regularly updating the rolling planning for all Company divisions. This serves as an early warning system for potential variances, thus enabling corrective measures to be taken at an early stage. One integral component of reporting is the risk management system, which is described in this Group Management Report from page 74 onwards. This ensures that any changes in opportunities and risks are directly factored into the management system.

SEE PAGES 74f.
RISK MANAGEMENT

## RESEARCH AND DEVELOPMENT

**Sharp increase in R&D budget in 2014** • As planned, QSC stepped up its research and development activities in the past financial year. The budget showed a corresponding increase to € 8.9 million, up from € 5.9 million in 2013. Of this total, € 2.7 million was capitalised (2013: € 4.0 million) and € 6.2 million expensed (2013: € 1.9 million), mainly under cost of revenues. As of 31 December 2014, a total of 62 employees was predominantly working on development projects. In the previous year, this number had stood at 44.

RESEARCH AND DEVELOPMENT (in € million)


Key focuses of R&D activities in the 2014 financial year included the ongoing enhancement of the QSC-tengo and QSC-WiFi products, that have now already reached market maturity, and new developments based on the internally developed "solucon" cloud platform, as well as involvement in major research projects.

R&D activities characterised by customer proximity

In the case of the two products at the beginning of their lifecycle, namely QSC-tengo and QSC-WiFi, the developers focused their efforts in the past financial year on linking the products to established systems and on the configuration of appropriate interfaces, as well as on targeted expansion of their functionalities. Numerous innovations arose in dialogue with pilot customers. Large areas of the Company's R&D activities are characterised by this customer-based approach.

**Proprietary subsidiary pressing ahead with applications for "solucon" platform** • One centrepiece of QSC's innovation activity is "solucon – the enabling technology". This internally developed cloud platform enables software components to be rapidly provided and securely operated in modular units. In July 2013, QSC pooled all of its activities involving this platform at Q-loud. This profit centre is now developing solutions for segments such as energy, retail and industry and has a key focus on the "Internet of Things", i.e. the networking of various appliances, such as sensors, cameras, machines and mobile devices. One good example here is the development partnership agreed in November 2014 with URBANA, a long-established provider of energy-related services to the housing sector and industry. Here, a variety of appliances such as heat meters, gas and electricity meter readers, and temperature sensors are securely networked on the basis of the solucon platform. The partners are planning to deploy this solution at more than 1,000 properties in the current year. Furthermore, Q-loud is also responsible for developing next-generation telephony systems – so-called unified communication (UC) solutions.

MORE INFORMATION:
WWW.QSC.DE/Q-LOUD/EN

Networking of more than 1,000 properties planned

**Q-Smart focusing on long-term research projects** • In recent years, QSC has been involved in three long-term, publicly subsidised research projects for the cloud age and has pooled these activities at its Q-Smart profit centre. These projects are:

- O(SC)²ar, the "Open Service Cloud for the Smart Car" (http://osc4car.de/en)
- Sensorcloud, a highly scalable cloud platform for globally integrated sensors (www.sensorcloud.de)
- Finesce for "Future Internet Smart Utility Services". From Cologne, QSC is pressing ahead with a virtual power plant solution (www.finesce.eu/Trial_Site_Cologne.html).

All three projects involve networking various appliances and machines and their control structures via the cloud. Its involvement in these projects provided QSC with access to major topics when it comes to implementing the "Internet of Things" and enabled it to strengthen its cooperation with key market players. The resultant insights are now being factored into the Company's internal development projects.

## SOCIAL RESPONSIBILITY

**Focus on immediate environment** • QSC summarises three topics under the heading of corporate social responsibility (CSR): responsible corporate governance, social commitment and sustainable business activity. Further information about corporate governance can be found in this Annual Report from page 36 onwards. As a medium-sized company, QSC traditionally channels its social commitment into initiatives at the Company and in its immediate environment. These focus on in-company training, also over and above the Company's own needs, as well as on helping all QSC employees to better combine their family and work commitments. Further information can be found in "Human Resources" from page 50 onwards. Not only that, QSC has been a partner in the "Hamburg Way" for years now. This initiative assumes social responsibility towards people living in the city of Hamburg. QSC is involved here as a sponsor to various projects.

SEE PAGES 36ff.
CORPORATE GOVERNANCE

SEE PAGES 50ff.
HUMAN RESOURCES

**Efficient handling of scarce resources** • QSC traditionally operates in a sustainable manner and ensures that the environmental impact of its business operations, whether direct or indirect, is limited and sustainably reduced as far as possible. One particular focal point involves the data centres with their substantial energy requirements. These are permanently reviewed in terms of their savings potential. Savings have been achieved, for example by using energy-efficient hardware and air conditioning, as well as with the ongoing modernisation of building technology and supply infrastructure. Not only that, QSC has also relied on blade systems, whose architecture has the advantage that several servers access the same power supply units and thus reduce power loss.

**QSC operates particularly energy-efficient data centres** • The energy efficiency of the data centres in Munich and Nuremberg was most recently certified by TÜV in December 2013. Both locations were awarded Efficiency Class A. This certifies the sustainable operation of the data centres, as well as ongoing optimisation of consumption and air conditioning in line with cooling requirements and target temperatures.
One important key figure for assessing energy efficiency is power usage effectiveness (PUE), which reflects the effectiveness of energy use. QSC's data centres currently operate with an average PUE of less than 1.6, which places them among the most energy-efficient data centres in Germany.

**Sustainable business activity requires well-informed employees** • QSC works to raise awareness of environmental protection issues among its workforce. It is important, particularly when communicating with customers, to understand the extent to which ICT services can help reduce energy consumption and $CO_2$ emissions. The same also applies to avoided business travel and the use of home workplaces. QSC itself supports its employees with wide-ranging home office policies. QSC also promotes the training of its employees as internationally recognised energy managers (Chamber of Industry and Commerce – IHK). This involves extra-occupational practice-driven training in the field of energy-efficient technology.
QSC is also setting a good example when it comes to reducing business travel-related energy consumption. The Company supports two car-sharing models and offers its employees appropriate booking possibilities at their workplaces. The travel expense policies also explicitly provide for the use of car-sharing schemes. Equipping those departments that have contact to customers with Microsoft Lync solutions, which make it possible to hold video calls quickly and inexpensively, has also helped avoid business travel. Video conference rooms at the Company's locations enable larger-scale meetings to be held without any travel or associated environmental impact.

Video conferences often substituted for business travel

**Company car fleet with low $CO_2$ emissions** • With an average fleet value of just 116 grams of $CO_2$ per kilometre, QSC has one of Germany's most environmentally-friendly company car fleets. This was apparent in the results of a survey performed among 166 companies last year by the German environmental protection charity Deutsche Umwelthilfe e. V. This showed that only twelve company fleets were within the upper target of 130 grams of $CO_2$ per kilometre aimed at by the EU. Irrespective of this, when procuring company cars and all other products the Purchasing department makes efforts to permanently enhance the energy efficiency of the resources used. All of its decisions take account of the underlying principle of sustainable business activity. One core aspect here also involves ensuring that all materials are recycled where possible.

# Corporate Governance Report and Corporate Governance Declaration

**Good corporate governance traditionally a high priority** • Since its foundation, QSC has always accorded great priority to responsible and transparent management and supervision of the Company with the objective of sustained value creation. As a company based in Germany, QSC is essentially guided by German corporate law and the German Corporate Governance Code ("the Code"). The relevant government commission presented the most recent version of this Code on 24 June 2014. QSC largely complies with the Code's recommendations, but deviates from these in a few points that are outlined below. The current Declaration of Conformity dated 20 November 2014 forms a constituent component of this report and, like all previous such declarations, is permanently available on QSC's website.
In the following section, the Management Board reports, also on behalf of the Supervisory Board, on corporate governance pursuant to Point 3.10 of the Code. This report integrates the compensation report called for by Point 4.2.5 of the Code and also includes the corporate governance disclosures required by § 289a of the German Commercial Code (HGB).

## MANAGEMENT AND SUPERVISION

**Management Board manages the Company independently** • QSC AG is a publicly listed stock corporation under German law and has a dual management structure. The Management Board is responsible for independently managing the Company. The Supervisory Board appoints, supervises and advises the Management Board. Members of both boards are bound solely by the interests of the Company. There were no conflicts of interest requiring disclosure in the past financial year.

**Two changes in Management Board in 2014 financial year** • The Management Board comprised four members until 31 March 2014 and three thereafter. These were Jürgen Hermann (CEO), Barbara Stolz, Henning Reinecke, and Stefan Freyer (until 31 March 2014). Mr. Freyer left the Company at his own request. Furthermore, by amicable agreement CFO Barbara Stolz retired from the Board as of 31 December 2014 in order, like Stefan Freyer, to pursue new professional challenges. She was succeeded as of 1 January 2015 by Stefan A. Baustert, who most recently worked as Commercial Director at Rena GmbH, a mechanical engineering and plant construction company in southern Germany. He previously managed the publicly listed company Singulus Technologies AG for seven years, initially as CFO and subsequently as CEO. Prior to that, he was Commercial Director at E-Plus Mobilfunk GmbH for a five-year period until the company was sold to the KPN Group.

Stefan A. Baustert new CFO from 1 January 2015

**Management Board adopts resolutions by simple majority voting of all members** • The Rules of Procedure issued by the Supervisory Board stipulate that Management Board resolutions require a simple majority of the votes cast, with the CEO having the casting vote in the case of split resolutions. All resolutions relating to measures and transactions that are of major significance to the Company or that involve greater economic risk are adopted by the full Management Board. A business allocation plan governs the areas of responsibility of Management Board members. Each Management Board member manages these areas under his or her own responsibility within the framework of Management Board resolutions. The Supervisory Board generally appoints

Management Board members for three-year terms. In respect of the composition of the Management Board, the Supervisory Board is guided exclusively by the suitability of the candidate and, in reaching its decisions, does not accord primary relevance to the candidate's gender. When filling managerial positions at the Company, the Management Board is aware of its responsibility to take diversity into consideration. It aims to ensure an appropriate consideration of women in management positions.

**Gender parity on Supervisory Board** • Pursuant to the Articles of Association, the QSC Supervisory Board comprises six members. Since the Company has more than 500 employees, the German One-Third Participation Act ("Drittelbeteiligungsgesetz") is applicable. This means that two thirds of Supervisory Board members are elected by shareholders and one third by employees. Since the new elections in May 2013, the Supervisory Board has comprised three women and three men. The term in office of all members expires upon the conclusion of the Annual Shareholders' Meeting for the 2017 financial year.
Unless otherwise stipulated by law or its Rules of Procedure, the Supervisory Board and its committees adopt resolutions by a simple majority vote. Four committees – the Nomination, Human Resources, Audit and Strategy Committees – were in place throughout the past financial year. All committees regularly report to the full Supervisory Board and prepare its resolutions. Detailed information about the activities of the Supervisory Board and its committees can be found in the Supervisory Board Report on pages 13 to 18.

SEE PAGES 13ff.
SUPERVISORY BOARD REPORT

**Composition of Supervisory Board consistent with own objectives** • In the 2014 financial year as well, the Supervisory Board met all objectives relating to its composition that it had set itself on the basis of the German Stock Corporation Act (AktG) and the Code itself. Together, its members possess the knowledge, ability and expert experience required to properly complete its tasks. The Supervisory Board includes at least one member who is independent in the sense of § 100 (5) of the German Stock Corporation Act (AktG) and has expert knowledge in the fields of accounting or auditing. As Director of the Group Tax Department at the globally active SAP Group, Ina Schlie fully meets this requirement.
Assuming that employee representatives basically satisfy the independence criteria as defined in Point 5.4.2, Sentence 2 of the Code, alongside the two employee representatives the Supervisory Board should include at least two other members who are independent as defined in Point 5.4.2, Sentence 2 of the Code. Currently, these members are Ina Schlie and Dr. Frank Zurlino, Managing Partner at the management consultancy Horn & Company. The number of former Management Board members on the Supervisory Board is limited to a maximum of two. This presently relates to QSC's two founders and largest individual shareholders, Dr. Bernd Schlobohm and Gerd Eickers. Moreover, the Supervisory Board still does not include any members who exercise directorships or similar positions or advisory functions for important competitors. Upon the latest election, all candidates were aged below 75. With its composition of shareholder and employee representatives, the Supervisory Board also meets the objective of having at least one female member.

Supervisory Board is promptly and extensively informed

**Transactions of fundamental importance require Supervisory Board approval** • The Management Board informs the Supervisory Board without delay and comprehensively of issues important to the Company with regard to strategy, planning, business development, risk situation, risk management and compliance. The Rules of Procedure for the Management Board require that approval be obtained from the Supervisory Board prior to the conclusion of any major business transactions, such as the fixing of annual planning, major investments, acquisitions and financing measures. These Supervisory Board decisions are prepared in detail and discussed in the committees and by the full Supervisory Board.

## RELEVANT CORPORATE GOVERNANCE PRACTICES

**QSC plans to formulate compliance principles** • QSC views corporate governance as providing a framework for managing and supervising the entire Company. Its internal policies are therefore consistent with the Code. Moreover, the management of the Company is based upon a system of shared values. It is planned to summarise the main contents of this system of values in a set of QSC Compliance Guidelines in the current financial year. These principles will subsequently be binding for all employees.

Integrity plays a key role within this system of values. The Company views integrity as the guiding model and yardstick for proper corporate management and strictly observes compliance with laws and in-house regulations. In this, QSC sets great store by the sense of responsibility and personal integrity of all its employees. QSC expects its employees' day-to-day activities to be impeccable in legal and ethical terms so as to avert any harm to the Company and the general public.

The key focus here is on prevention – improper behaviour should be avoided from the outset. Practice-oriented internal training events help raise employees' awareness of the importance of topics such as law abidance and professionalism in their dealings with third parties. QSC strictly observes compliance with dual control principles and the segregation of responsibilities. Guidelines on critical points such as insider trading law, information security, data protection, approval and signature authorisations, risk management and procurement provide the necessary clarity for correct conduct in everyday operations. Despite these measures, the risk of individuals acting improperly cannot be precluded entirely. Any infringements occurring in spite of all preventive measures are clarified and punished without regard to the individual and his or her position.

Compliance is a key aspect of management

QSC views compliance as a key management task requiring the ongoing attention of its directors and officers. The Management Board, Supervisory Board and Audit Committee therefore regularly address this topic. In doing so, they draw among other sources on quarterly risk reports, in-house controlling and internal audit reports. These discussions produce major impetus for the ongoing enhancement of the compliance management system.

## DIALOGUE WITH SHAREHOLDERS

**Comprehensive and timely information** • QSC communicates transparently and extensively with the capital market. The Company uses its own website to report promptly on all relevant developments. Interested parties will find ad-hoc and press releases there, as well as the Company's quarterly and annual reports, latest presentations and a financial calendar. This website is also where QSC makes available all of the documents relevant to its Annual Shareholders' Meeting.

Shareholders' Meeting promotes dialogue with shareholders

**Open dialogue with shareholders and other interested parties** • The Annual Shareholders' Meeting is the most important event for the Company's dialogue with its shareholders. Some 51 percent of the share capital was present at the Annual Shareholders' Meeting for the 2013 financial year held in Cologne on 29 May last year. Shareholders not present were able to have their voting rights exercised either by a proxy holder of their choice or by a voting proxy bound to vote in line with their instructions. The shareholders approved all agenda items with large majorities. As in previous years, the Chair of the Meeting ensured that the meeting progressed efficiently, thus facilitating compliance with the timeframe of four to six hours stipulated in the Code. The Management and Supervisory Boards once again forewent broadcasting the event on the internet, as the associated costs and legal uncertainties outweighed the potential benefit for absent shareholders. In the course of the year, QSC upheld its dialogue with shareholders above all by way of meetings held with investors and analysts at road shows and one-to-one talks. Conference calls on the day the quarterly results are published also ensure that these target groups are provided with up-to-date information. QSC makes the respective presentations, as well as a recording of the comments made by members of the Management Board, available to all shareholders. Further information about the Company's investor relations activities can be found in "QSC Share Performance" on pages 19 to 23 of this Annual Report.

SEE PAGES 19ff.
QSC SHARE PERFORMANCE

**QSC founders increase shareholdings** • One self-evident component of transparent communications involves providing prompt information about purchases and sales of QSC shares by members of the Management and Supervisory Boards and their related parties as defined in § 15a of the German Securities Trading Act (WpHG). On 11 March 2014, the two founders Gerd Eickers and Dr. Bernd Schlobohm each acquired a further 25,000 QSC shares via Xetra at a price of € 3.76 per share. The two founders, who have concluded a pooling agreement, thus continue to hold 12.6 percent and 12.5 percent of QSC's shares respectively, while 74.9 percent of the shares are in free float ownership. The table below provides information about these share purchases and acquisitions of QSC shares by Management Board members.

| Trading date / stock exchange | Name / status | Type of transaction | Par value in € / no. of shares | Transaction volume in € |
|---|---|---|---|---|
| 11 March 2014 | Gerd Eickers | Purchase | 3.75875 | 93,968.75 |
| Xetra | Supervisory Board member | | 25,000 | |
| 11 March 2014 | Dr. Bernd Schlobohm | Purchase | 3.75875 | 93,968.75 |
| Xetra | Supervisory Board member | | 25,000 | |
| 13 August 2014 | Barbara Stolz | Purchase | 2.25533 | 22,553.31 |
| Xetra | Management Board member | | 10,000 | |
| 14 August 2014 | Jürgen Hermann | Purchase | 2.273 | 34,095.00 |
| Xetra | Management Board member | | 15,000 | |
| 20 August 2014 | Henning Reinecke | Purchase | 2.229 | 8,916.00 |
| Hamburg | Management Board member | | 4,000 | |

## 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") in the version dated May 13, 2013, as of its validity from June 24, 2014**

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 the version dated May 13, 2013, as of its validity from June 24, 2014, with the following exceptions:

- **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"]) (Item 3.8, Paragraphs 2 and 3 of the Code)** • QSC complies with the recommendation of the German Corporate Governance Code insofar as the D&O insurance policy has, since July 1, 2010, included a deductible for Supervisory Board members of 10 percent of the respective damages per damage event. However, and contrary to the recommendation, the liability per year is capped at 100 percent of the fixed annual compensation of the Supervisory Board members, since QSC does not deem it appropriate for the deductible to exceed their annual compensation.

- **No cap on individual variable compensation components or on the overall compensation of one Management Board member and consequently no presentation of the maximum achievable compensation in the compensation report (Items 4.2.3, Paragraph 2, Sentence 6 and 4.2.5, Paragraph 3 [first bullet point], Paragraph 4 of the Code)** • Just one Management Board member still holds convertible bonds issued within the 2006 Stock Option Plan as one variable component of his Management Board compensation. These were allocated before the recommendation took effect. The current Management Board contract provides for a cap in the event of unforeseen developments; it does not, however, set any maximum limit on gains from exercising conversion rights in connection with the 2006 Stock Option Plan and thus on the overall compensation of the Management Board member. In view of this, QSC will also not state any maximum amounts in the model tables in the compensation report. QSC otherwise fully complies with the recommendations in respect of existing Management Board compensation and will also comply with the recommendations when determining any future Management Board compensation.

- **Individual 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)** • QSC AG's Supervisory Board – in its earlier composition, and during whose period of office the employment contracts of two of the current members of the Management Board were signed (historic contracts) – was previously of the opinion that any advance agreement with respect to severance payment cap would be contrary to the spirit of a contract, which is usually concluded for a fixed term and does not, in principle, provide for the possibility of an ordinary termination by notice. Similarly, it was argued that it would be difficult in practice to enforce a contractual severance payment cap against a Management Board member in the circumstances where it would be relevant. Furthermore, it was considered unfeasible that any such advance stipulation would be reasonably able to take into account the particular facts and the surrounding circumstances that might later give rise to the premature ending of a Management Board member's contract. Accordingly, no cap was agreed with the Management Board members concerned. The Supervisory Board in its current composition since the Annual General Meeting on May 29, 2013, has relinquished this opinion and – for new Management Board members as from that date and upon the extension of one of the two historic contracts in November 2014 – has agreed a severance cap which complies with the Code. The Supervisory Board also intends to continue this policy in the future.

- **No aiming for an appropriate consideration of women when appointing the Management Board (Item 5.1.2, Paragraph 1, Sentence 2 of the Code)** • 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 disclosure of the private and business relationships of each individual candidate with the company, its representative bodies and any significant shareholder of the company in the event of proposals for election at the Annual General Meeting (Item 5.4.1, Paragraphs 4 to 6 of the Code)** • In QSC's opinion, the recommendation of the German Corporate Governance Code does not specify clearly enough which relationships of a candidate must be disclosed and the extent to which such disclosures are required to be made for proposed elections at the Annual General Meeting, in order to comply with the recommendation. In the interests of legal certainty with respect to future elections to the Supervisory Board, the Management Board and Supervisory Board have decided to declare a divergence from the recommendation. QSC is of the opinion that the existing disclosure requirements contained in § 124 paragraph 3 sentence 4 and in § 125 paragraph 1 sentence 5 of the German Stock Corporation Act ("AktG") are sufficient to meet the informational needs of the shareholders and will, at an appropriate date in the future, investigate and decide – voluntarily and without tying itself to the Code's recommendation – whether to disclose additional information about candidates proposed for election at the Annual General Meeting.

Cologne, November 20, 2014

On behalf of the Management Board
Jürgen Hermann

On behalf of the Supervisory Board
Dr. Bernd Schlobohm

## COMPENSATION REPORT

**Individualised presentation of Management Board compensation •** One major element of good corporate governance involves transparently presenting the total compensation paid to members of the corporate bodies. The underlying compensation system for members of the Management Board has been adapted in recent years to accommodate modified legal requirements (e.g. the German Appropriateness of Management Board Compensation Act [VorstAG]) and was most recently adopted by the Annual Shareholders' Meeting on 16 May 2012. Pursuant to § 315 (2) No. 4 of the German Commercial Code (HGB), QSC reports below on the basic principles of this compensation system, with individualised presentation of the compensation paid to Management Board members.

**Performance-based compensation system •** The Supervisory Board determines the total compensation payable to members of the Management Board, taking into consideration the tasks and individual performance of the respective Management Board member, the Company's economic and financial position and its sustainable development, the common level of compensation taking due account of peer group companies and the compensation structure otherwise in place at QSC. Variable compensation is designed to account for both positive and negative developments. Moreover, in determining compensation the Supervisory Board makes efforts to ensure that it is structured to be competitive in the marketplace and offer highly qualified executives an incentive to sustainably develop the Company and its value in a dynamically changing environment.

**Management Board compensation comprises fixed and variable components •** In principle, fixed salary components account for a maximum of 50 percent of the target annual compensation for each member of the Management Board. This fixed salary is paid in monthly cash instalments as basic compensation. Moreover, Management Board members additionally receive fringe benefits, specifically the use of a company car or the utilisation of a car allowance, as well as pension commitments. The latter involve defined contribution commitments for benefits provided by insurance companies and pension funds. Furthermore, QSC maintains liability indemnification insurance coverage for members of the Management Board. Since 1 July 2010, this policy has provided for a corresponding deductible for Management Board members in line with the requirements of the German Stock Corporation Act (AktG). Management Board members do not receive any separate compensation for assuming further offices within the consolidated group.

A maximum of 50% of p.a. target compensation for Management Board is fixed

Variable compensation is committed in the form of a fixed amount for each year in office in the event of 100-percent target achievement. It is based on single and multi-year targets for the consolidated group that are annually agreed in a target agreement process. These targets may refer to key corporate performance indicators, such as free cash flow and consolidated net income, as well as individual parameters resulting from non-quantifiable strategic targets. The target agreements are based on future financial years. In the case of Company-based key figures, they may contain minimum targets that are more ambitious than those stipulated in the externally communicated outlook.

**Management Board members must achieve minimum targets** • When entering into annual target agreements, the Supervisory Board ensures that the portion of the annual compensation attributable to achievement of the multi-year target is at least equivalent to that attributable to achievement of the annual target. The Supervisory Board defines lower and upper limits for each individual target, with the upper limit serving to cap variable compensation in the event of exceptional developments at no more than 1.5 times the target variable compensation component attainable upon 100 percent target achievement, and the lower limit stipulating the minimum target. If this minimum target is not met, the Management Board member receives no variable compensation for the respective target. Non-achievement of a multi-year target or failure to attain the respective lower limit established in a given financial year also results in the reduction or elimination of the variable compensation component attributable to the respective multi-year target in subsequent financial years in a multi-year period.
To recognise the achievement of multi-year targets, promote sustainable corporate development, or acknowledge exceptional performance, the Supervisory Board may commit to paying the Management Board as a whole, or individual Management Board members, an appropriate further bonus in cash or in the form of shares or stock options and agree suitable waiting, holding and exercise periods.
Variable compensation is payable at the end of the month in which the Company's Annual Shareholders' Meeting is held.

**Lower Management Board compensation for 2014** • Total Management Board compensation for the 2014 financial year amounted to € 1,337k, compared with € 1,726k in the previous year.

No entitlement to variable compensation for 2014

This reduction in total compensation is chiefly due to Management Board members not being entitled to any variable compensation for the 2014 financial year, as the minimum limits agreed with the Supervisory Board for the 2014 annual target and the multi-year target were not met. For the 2013 financial year, Management Board members had still received total variable compensation of € 790k. Moreover, the overall compensation for 2014 includes share-based payments totalling € 453k, which were granted to Management Board members in connection with the subscription of 150,000 convertible bonds each within the 2012 Stock Option Programme.
The following table shows the compensation of individual members of the Management Board:

| € 000s | Jürgen Hermann<br>CEO since 30 May 2013, previously Management Board member | | | | Dr. Bernd Schlobohm<br>CEO until 29 May 2013 | | | |
|---|---|---|---|---|---|---|---|---|
| | 2013 | 2014 | 2014 (min) | 2014 (max) | 2013 | 2014 | 2014 (min) | 2014 (max) |
| **Benefits granted** | | | | | | | | |
| Fixed compensation | 292 | 300 | 300 | 300 | 144 | - | - | - |
| Fringe benefits | 28 | 29 | 29 | 29 | 8 | - | - | - |
| **Total** | **320** | **329** | **329** | **329** | **152** | **-** | **-** | **-** |
| One-year variable compensation | - | - | - | 225 | 151 | - | - | - |
| Multi-year variable compensation | | | | | | | | |
| Sustainability targets (2011 – 2013) [1] | 269 | - | - | - | - | - | - | - |
| Sustainability targets (2012 – 2014) [1] | - | - | - | 225 | - | - | - | - |
| Stock Option Programme 2012 [2] | - | 151 | - | 2,070 | - | - | - | - |
| **Total** | **589** | **480** | **329** | **2,849** | **303** | **-** | **-** | **-** |
| Pension expenses | - | - | - | - | 130 | - | - | - |
| **Total compensation** | **589** | **480** | **329** | **2,849** | **433** | **-** | **-** | **-** |
| Total expenses for share-based compensation recognised in reporting period | - | 13 | | | - | - | | |

| € 000s | Jürgen Hermann<br>CEO since 30 May 2013, previously Management Board member | | Dr. Bernd Schlobohm<br>CEO until 29 May 2013 | |
|---|---|---|---|---|
| | 2013 | 2014 | 2013 | 2014 |
| **Benefits paid** | | | | |
| Fixed compensation | 292 | 300 | 144 | - |
| Fringe benefits | 28 | 29 | 8 | - |
| **Total** | **320** | **329** | **152** | **-** |
| One-year variable compensation | - | - | 151 | - |
| Multi-year variable compensation | | | | |
| Sustainability targets (2011 – 2013) [1] | 270 | - | - | - |
| Sustainability targets (2012 – 2014) [1] | - | - | - | - |
| Stock Option Programme 2012 [2] | - | - | - | - |
| Sundry | - | - | - | - |
| **Total** | **590** | **329** | **303** | **-** |
| Pension expenses | - | - | 130 | - |
| **Total compensation** | **590** | **329** | **433** | **-** |

[1] The multi-year variable compensation is geared towards maintaining, stabilising and increasing the Company's ability to sustainably distribute dividends from its income from ordinary business operations. The multi-year target is agreed in each case for the year under report and the two subsequent financial years. Non-achievement of the agreed minimum limit for the multi-year target in a given year within the multi-year target period results in the reduction or loss of the variable compensation attributable to the multi-year target for the following financial years in the multi-year target period.

| Barbara Stolz Management Board member from 1 June 2013 to 31 Dec. 2014 | | | | Henning Reinecke Management Board member since 1 September 2013 | | | | Arnold Stender Management Board member until 31 August 2013 | | | | Stefan Freyer Management Board member from 1 Sept. 2013 to 31 March 2014 | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **2013** | **2014** | **2014 (min)** | **2014 (max)** | **2013** | **2014** | **2014 (min)** | **2014 (max)** | **2013** | **2014** | **2014 (min)** | **2014 (max)** | **2013** | **2014** | **2014 (min)** | **2014 (max)** |
| | | | | | | | | | | | | | | | |
| 117 | 200 | 200 | 200 | 67 | 200 | 200 | 200 | 153 | - | - | - | 67 | 50 | 50 | 50 |
| 16 | 27 | 27 | 27 | 17 | 49 | 49 | 49 | 16 | - | - | - | 11 | 29 | 29 | 29 |
| **133** | **227** | **227** | **227** | **84** | **249** | **249** | **249** | **169** | **-** | **-** | **-** | **78** | **79** | **79** | **79** |
| - | - | - | 150 | - | - | - | 150 | - | - | - | - | - | - | - | - |
| | | | | | | | | | | | | | | | |
| 107 | - | - | - | 61 | - | - | - | 141 | - | - | - | 61 | - | - | - |
| - | - | - | 150 | - | - | - | 150 | - | - | - | - | - | - | - | - |
| - | 151 | - | 2,070 | - | 151 | - | 2,070 | - | - | - | - | - | - | - | - |
| **240** | **378** | **227** | **2,597** | **145** | **400** | **249** | **2,619** | **310** | **-** | **-** | **-** | **139** | **79** | **79** | **79** |
| - | - | - | - | - | - | - | - | - | - | - | - | 2 | 2 | - | - |
| **240** | **378** | **227** | **2,597** | **145** | **400** | **249** | **2,619** | **310** | **-** | **-** | **-** | **141** | **81** | **79** | **79** |
| | | | | | | | | | | | | | | | |
| | | | | | | | | | | | | | | | |
| - | 151 | | | - | 13 | | | - | - | | | - | - | | |

| Barbara Stolz Management Board member from 1 June 2013 to 31 Dec. 2014 | | Henning Reinecke Management Board member since 1 September 2013 | | Arnold Stender Management Board member until 31 August 2013 | | Stefan Freyer Management Board member from 1 Sept. 2013 to 31 March 2014 | |
|---|---|---|---|---|---|---|---|
| **2013** | **2014** | **2013** | **2014** | **2013** | **2014** | **2013** | **2014** |
| | | | | | | | |
| 117 | 200 | 67 | 200 | 153 | - | 67 | 50 |
| 16 | 27 | 17 | 49 | 16 | - | 11 | 29 |
| **133** | **227** | **84** | **249** | **169** | **-** | **78** | **79** |
| - | - | - | - | - | - | - | - |
| | | | | | | | |
| 107 | - | 61 | - | 141 | - | 61 | - |
| - | - | - | - | - | - | - | - |
| - | - | - | - | - | - | - | - |
| - | - | - | - | - | - | - | - |
| **240** | **227** | **145** | **249** | **310** | **-** | **139** | **79** |
| - | - | - | - | - | - | 2 | 2 |
| **240** | **227** | **145** | **249** | **310** | **-** | **141** | **81** |

[2] The Management Board members Jürgen Hermann, Barbara Stolz and Henning Reinecke each subscribed 150,000 convertible bonds in QSC AG on 25 August 2014. These convertible bonds had been allocated to them by the Supervisory Board within the 2012 Stock Option Programme on 29 August 2013. The fair value of a convertible bond on the subscription date amounts to € 1.004; conversion into shares in QSC AG is only possible after a holding period of 4 years, and at the latest 8 years after the subscription date. The minimum value of the convertible bonds granted amounts to € 0, as it would make no economic sense to exercise the conversion rights if the stock market price falls short of the conversion price of € 2.30 determined upon subscription of the options during the period in which the subscription rights apply or should the exercise hurdles and performance targets laid down in the bond terms not be achieved. The maximum value of share-based compensation in connection with the 2012 Stock Option Programme amounts to € 2,070k per active Management Board member. This is reached when the weighted average price of the QSC AG share in Xetra trading on the Frankfurt Stock Exchange on the last twenty trading days preceding the day on which the exercising of the conversion declaration becomes effective pursuant to the bond terms exceeds € 16.10 (seven times the conversion price of € 2.30).

Variable compensation is based on target agreements entered into at the beginning of the 2014 financial year. Here, congruent annual and multi-year targets were agreed for all Management Board members.

2014 annual targets linked to revenues and free cash flow

The 2014 annual target was linked to free cash flow and consolidated revenues, while the free cash flow and EBITDA were agreed as key references for the 2013 financial year. As usual, lower limits were agreed for both sub-targets. If not attained, these result in the elimination of the entire variable compensation for the 2014 financial year. The lower limits were not reached for either target in 2014.

The multi-year target is geared towards maintaining, stabilising and increasing the Company's ability to sustainably distribute dividends from its income from operating activities, a capability first achieved in the 2011 financial year. The multi-year target was also not met in the 2014 financial year.

**Benefits in the event of premature termination** • Management Board members Jürgen Hermann and Henning Reinecke have been promised settlements of € 600k and € 400k respectively should their Management Board activity be prematurely terminated due to effective revocation of their appointment by the Company within the first two years covered by their employment contracts. In the final year of their employment contracts, this settlement is reduced by 1/12 per month in which the employment relationship still existed in the final year of the contract. There is no entitlement to any settlement payment in the event of the employment relationship being terminated without notice due to compelling reason (§ 626 BGB). Should the Management Board activity be terminated by mutual agreement and without compelling reason, the total value of the benefits committed by the Company in any agreement of this nature may not exceed the amounts of € 600k or € 400k respectively.

**Information about retired Management Board members** • Management Board member Stefan Freyer stood down from his position upon the expiry of 31 March 2014. His employment relationship was rescinded at the same time by mutual agreement.

Upon the premature termination of his employment contract, Mr. Freyer received a one-off settlement of € 400k, thus simultaneously settling all claims to variable compensation for the 2014 calendar year.

Furthermore, the former Management Board member Stefan Freyer has a direct pension commitment granted to him by a predecessor company of INFO Gesellschaft für Informationssysteme Aktiengesellschaft in the 1997 financial year already. Under this pension commitment, upon reaching the age of 60 Mr. Freyer is entitled to a retirement, invalidity and surviving dependants pension. Prior to the offsetting of a corresponding reinsurance asset of € 18k, the actuarial present value of the respective pension obligation amounted to € 78k as of 31 December 2014. Expenses of € 2k were recognised for this item in the 2014 financial year.

Management Board member Barbara Stolz stood down from her position upon the expiry of 31 December 2014. The employment relationship will initially continue through to the end of its regular term as of 31 May 2016, but may be terminated at the request of Barbara Stolz at any time with a notice period of two weeks to the end of the respective month. From 2015 onwards, Ms. Stolz no longer has any entitlement to variable compensation. In return for waiving her variable compensation, Ms. Stolz was granted a settlement of € 142k due for payment in two portions. An amount of € 100k was already paid in January 2015. The remaining amount of € 42k will be payable upon termination of the employment relationship.

Should the employment relationship be prematurely terminated at the request of Ms. Stolz, the settlement will be increased by € 19k for each full calendar month between the termination date and 31 May 2016. This figure also includes the costs of her retirement and surviving dependants pension entitlement.

Furthermore, Ms. Stolz retains the rights to a total of 182,100 convertible bonds granted to her in connection with the 2006 and 2012 Stock Option Programmes. Of these, 152,100 convertible bonds from the 2012 Stock Option Programme are only convertible following expiry of the lock-up period in the 2018 calendar year. The expenses relating to this share-based payment were recognised in full in the 2014 financial year. The conversion price for the other 30,000 convertible bonds from the 2006 Stock Option Programme, which are convertible at any time, amounts to € 2.96 per convertible bond.

The compensation of those Management Board members retiring in the 2013 financial year is included with individualised disclosures in the table. These individuals did not receive any separate compensation for retiring from the Board.

**Shares and conversion rights held by Management Board members** • The following table presents individualised information about the number of shares and conversion rights held by members of the Management Board:

| | Shares | | Conversion rights | |
|---|---|---|---|---|
| | 31 Dec. 2014 | 31 Dec. 2013 | 31 Dec. 2014 | 31 Dec. 2013 |
| Jürgen Hermann | 240,000 | 225,000 | 350,000 | 200,000 |
| Dr. Bernd Schlobohm | | | | |
| (until 29 May 2013) | - | 15,493,372 [1] | - | 200,000 [1] |
| Barbara Stolz | | | | |
| (from 1 June 2013 to 31 Dec. 2014) | 10,000 [1] | - | 182,100 [1] | 30,000 [2] |
| Henning Reinecke (since 1 Sept. 2013) | 5,000 | 1,000 [2] | 150,000 | - |
| Arnold Stender (until 31 Aug. 2013) | - | - | - | 25,000 [1] |
| Stefan Freyer | | | | |
| (from 1 Sept. 2013 to 31 March 2014) | - | - | - | - |

[1] Holdings at the time of retirement from the Management Board
[2] Holdings at the time of joining the Management Board

Management Board members bought QSC shares in 2014

While they were still active Management Board members, Jürgen Hermann, Barbara Stolz and Henning Reinecke purchased shares in the Company via the stock exchange in the 2014 calendar year (please also see our directors' dealings notifications pursuant to § 15a of the German Securities Trading Act [WpHG]).
Furthermore, on 25 August 2014 the three aforementioned Management Board members each subscribed 150,000 convertible bonds in QSC AG. These convertible bonds had been allocated to them by the Supervisory Board on 29 August 2013 in the context of the 2012 Stock Option Programme. The conversion price was set at € 2.30 per convertible bond. Conversion into shares in QSC AG is only possible after a waiting period of 4 years, i.e. at the earliest on 26 August 2018.
Moreover, on 19 August 2014 Barbara Stolz also subscribed 2,100 convertible bonds that had been allocated to her by the Management Board of QSC AG on 12 March 2013 in the context of the 2012 Stock Option Programme. This allocation was made on account of the employee status of Ms. Stolz prior to her appointment to the Management Board of QSC AG. No loans were granted to members of the Management Board.

**Supervisory Board compensation** • Consistent with the relevant provision in the Articles of Association of QSC AG, each member of the Supervisory Board receives fixed annual compensation of € 35k payable following the expiry of the financial year. The Chairman and his or her Deputy receive € 70k and € 50k respectively. In addition to compensation for their duties on the Supervisory Board, each Supervisory Board member receives separate compensation of € 5k for their activities in any Supervisory Board committee (except the Nomination Committee). Committee Chairmen receive € 10k. Members sitting on several committees nevertheless receive a maximum total of € 25k for their committee activities. Supervisory Board members sitting on the Supervisory Board or a committee for only part of a given financial year receive prorated compensation.
For its activity in the 2014 financial year, the Supervisory Board as a whole received total compensation of € 315k (previous year: € 302k). The table below presents individualised information about the compensation paid to Supervisory Board members, as well as about their respective holdings of share and conversion rights.

| | Compensation * (€ 000s) [1] | | | | Shares | | Conversion Rights | |
|---|---|---|---|---|---|---|---|---|
| | 2014 | | 2013 | | 31 Dec. 2014 | 31 Dec. 2013 | 31 Dec. 2014 | 31 Dec. 2013 |
| Dr. Bernd Schlobohm, Chairman (since 29 May 2013) | 95 | (25) | 56 | (15) | 15,518,372 | 15,493,372 [4] | 200,000 | 200,000 [4] |
| Herbert Brenke (Chairman until 29 May 2013) | - | - | 35 | (6) | - | 187,820 [3] | - | - |
| Dr. Frank Zurlino, Deputy Chairman (since 29 May 2013) | 60 | (10) | 36 | (6) | 10,000 | 10,000 [4] | - | - |
| Gerd Eickers (Deputy Chairman until 29 May 2013) | 40 | (5) | 48 | (7) | 15,577,484 | 15,552,484 | - | - |
| Ina Schlie | 45 | (10) | 45 | (10) | - | - | - | - |
| Anne-Dore Ahlers [2] (since 29 May 2013) | 35 | - | 21 | - | - | - | 2,700 | 2,700 [4] |
| Cora Hödl [2] (since 29 May 2013) | 40 | (5) | 24 | (3) | - | - | 4,100 | 4,100 [4] |
| Klaus-Theo Ernst [2] (until 29 May 2013) | - | - | 14 | - | - | 500 [3] | - | - |
| Jörg Mügge [2] (until 29 May 2013) | - | - | 16 | (2) | - | 4,000 [3] | - | - |
| David Ruberg (until 29 May 2013) | - | - | 7 | - | - | 14,563 [3] | - | - |
| **Total** | **315** | **(55)** | **302** | **(49)** | | | | |

* Compensation as per § 15a of the Articles of Association
[1] Numbers in parentheses refer to compensation for committee activity, which is included in the overall compensation
[2] Employee representative
[3] Holdings at the time of leaving
[4] Holdings at the time of joining

2 Supervisory Board members increased shareholdings in 2014

In the 2014 calendar year, Supervisory Board members Dr. Bernd Schlobohm and Gerd Eickers increased their shareholdings by purchasing shares via the stock exchange (please also see our directors' dealings notifications pursuant to § 15a of the German Securities Trading Act [WpHG]). Dr. Bernd Schlobohm was granted a direct pension commitment for a retirement, occupational disability and widow's pension in 1997. As of the balance sheet date, the obligation amounted to € 1,616k prior to the offsetting of a reinsurance claim of € 902k. An amount of € 12k was added to the pension provision and correspondingly expensed in the 2014 financial year.
Apart from the reimbursement of travel and other out-of-pocket expenses, no member received any further compensation or other advantages for personal services rendered over and above the compensation presented here, neither were any loans granted to Supervisory Board members. QSC AG maintains liability indemnification insurance coverage for members of the Supervisory Board.

# Human Resources

## HUMAN RESOURCE MANAGEMENT

**Consolidation of workforce** • Having taken on substantial numbers of new employees in 2012 and 2013, in the past financial year QSC began to consolidate its workforce. The average number of employees nevertheless still showed a further increase of 72 to 1,692 employees. At the end of the year, the Company had 1,697 employees. The significant number of staff newly hired in 2013 led personnel expenses for the past financial year to increase by € 15.8 million to € 124.2 million. As part of its cost-cutting and focusing programme, QSC now plans to reduce its workforce by around 350 employees. To this end, it recognised provisions for redundancy payments and employee leave benefits in the fourth quarter of 2014 already.

Sharp rise in personnel expenses in 2014

AVERAGE NUMBER OF EMPLOYEES


**QSC's success driven by commitment of each and every employee** • Notwithstanding these unavoidable cost-cutting measures, QSC regards its employees as its most important source of added value. The Company's success is driven by the will to succeed and commitment shown by its employees. In view of this, QSC maintained its extensive training and development programme in 2014 as well and introduced numerous measures to promote cooperation between the Company's locations and departments.
As of 31 December 2014, most of the Company's employees worked at its two central locations in Cologne and Hamburg, with 442 people working in Headquarters in Cologne and 887 in Hamburg. The remaining employees were largely based at subsidiaries, sales and branch offices in other German cities. Five percent of employees work from home.

## TRAINING AND DEVELOPMENT

**Training ratio of 7 percent** • QSC has traditionally been highly committed to providing vocational training. After all, the Company sees this both as a crucial lever to secure the next generation of employees and as a way to make its contribution towards society. As of 31 December 2014, a total of 120 young adults were in training at QSC. The training ratio thus amounted to 7 percent. QSC offers various ways of entering the working world – vocational training as IT specialists with specialisms in system integration and application development or as commercial, IT and IT system assistants or via work-study programmes.

**Product training for all trainees** • QSC makes every effort to permanently enhance the quality of its training. A meeting of training staff led in September 2014 to a new approach towards networking employees with training responsibilities. They are now working together to promote training topics, such as product training, and are continually expanding the training portfolio. This way, all 35 new trainees were able to participate in various in-house training sessions in 2014 already.

The quality of training on offer has been underlined by the award of the Three-Star Seal to the Hamburg locations in "Hamburg's Best Apprentice Training Company". This competition aims on the one hand to reveal the strengths and weaknesses of training programmes to participant companies and on the other hand to make applicants aware of those companies offering the best vocational training in the Greater Hamburg area.

QSC also actively markets the opportunities offered by vocational training and takes part in numerous regional events and initiatives. In Cologne, there was also a "Speed Day", which offered interested young people information about training opportunities. Further opportunities for making contact at an early stage include pupil internships, school partnerships and participation in Germany's nationwide Girls' and Boys' Day.

QSC is a member of the Fair Company Initiative

QSC is also one of around 1,500 companies across Germany that have now joined the "Fair Company Initiative" and that comply with its rules. These include a commitment not to substitute internships for full-time positions and not to console university graduates applying for regular full-time employment with internships. On the contrary, internships serve to provide professional orientation and are adequately compensated.

**Targeted recruitment of university graduates** • As well as trainees, QSC also recruits university graduates. As of 31 December 2014, several graduate trainees were working in commercial departments. A further 10 graduate trainees were participants in an SAP junior programme. To spark an interest in this form of career entry at an early stage, QSC cooperates with several universities and also presents itself at fairs such as CeBIT. The Company is the major sponsor of the IT Management and Consulting master's degree course at Hamburg University. In the context of work-study programmes, the Company also collaborates with Nordakademie in Elmshorn, the University of Applied Sciences in Wedel, and FOM University of Economics & Management, Cologne. Having successful completed the approval process at Baden-Wuerttemberg Cooperative State University in Mannheim (DHBW) in 2014, a further work-study programme, namely Commercial Information Technology – Application Management, has been on offer since winter semester 2014.

**Launch of young talent promotion programme** • QSC continues to offer targeted support to its staff even after their initial vocational training. For the 2014 winter semester, the Company initiated a programme enabling employees to apply for assistance with extra-occupational study programmes (bachelor's and master's degrees). QSC is currently supporting ten employees, who were free to select their own universities.

**Broad range of training and development** • The rapid pace of technological advances in the ICT world makes it necessary to provide all employees with ongoing training and development. This training is particularly geared towards the Company's strategic development. QSC chiefly relies on in-house programmes and on the sharing of experience across departmental borders. The QSC Academy offers a broad range of seminars that are competence-based and career-oriented and cover both specialist and personal skills. Moreover, new employees are typically also trained in IT service management to enhance their understanding of internal processes and interfaces.

## COMPENSATION

**Market-based compensation system** • QSC pays all of its employees competitive compensation. The Company is not bound by any collective bargaining agreement, but gears its compensation and benefits towards individual and company-specific needs, as well as market standards. Alongside fixed salaries, all employees also receive variable compensation based on the achievement of corporate targets. The share of employees' total salaries attributable to variable compensation rises along with increasing responsibility.
In addition, the issuing of stock options and provision of an attractive company pension model serve to retain employees on a long-term basis. Depending on their activities, specialists and executives are also provided with company cars. Furthermore, longstanding company affiliation is rewarded with regulations governing sick pay and termination protection.
QSC reports separately on the compensation paid to its Management Board from page 42 onwards.

SEE PAGES 42ff.
COMPENSATION REPORT

## CORPORATE CULTURE

**Shared management culture** • QSC has traditionally had a system of values whose key principles embody a corporate culture characterised by respect and mutual appreciation and by a focus on performance and results in our daily work. With its "The future begins with me!" project, the Company launched a new initiative in the past financial year aimed at lending new momentum to QSC's shared corporate and management culture. The components of this initiative include an integrated management development programme across all locations and all hierarchical levels. The objective is to detect and promote talent at an early stage, and thus to build a homogenous management team.

New momentum
for corporate and
management culture

**Living a culture of trust** • QSC believes that an understanding of the personal situation of each and every employee and consideration of their wishes within the range of possibilities available to a medium-sized employer are natural components of any value-based corporate culture. The consistent availability of flexible working hours helps to make family and working life more compatible. There are no core working hours and, in agreement with their supervisors, employees are free to perform part of their work from home. Time accounts enable salary components to be saved up for sabbaticals of up to three months.
The QSC Group offers its employees professional assistance in combining their family and work commitments. Since 2011, the Fürstenberg Institute has been active at the Company, offering an extensive range of advisory services. The Company makes it easier for parents to return to work by offering part-time positions and home workplaces where possible.

# Business Report

## MACROECONOMIC AND INDUSTRY FRAMEWORK

**Macroeconomic slowdown in course of year •** QSC focuses on the German market. Gross domestic product in Germany grew by 1.5 percent in 2014, and thus significantly faster than in the two previous years. This growth was chiefly attributable to the strong start to the year. From the second quarter onwards, exports and business confidence were increasingly held back by conflicts such as those in Arabian countries and Ukraine, as well as by persistently weak growth in southern Europe. This was reflected, for example, in the development in the ifo business confidence index, one of Germany's key economic barometers. By October 2014, the ifo index had fallen to its lowest level since the end of 2012, before then recovering slightly once again towards the end of the year. Given the turbulences in export markets, private consumer spending became the key factor driving German economic growth in 2014. Following a two-year period of weakness, capital expenditure picked up once again, with the construction industry making the largest contribution in this respect.

2014 sees further rise in IT revenues and fall in TC revenues

**Subdued business with IT services •** The temporary economic weakness in the two summer quarters also left its mark on parts of the German ICT market. Overall, according to the industry association BITKOM, revenues grew by 1.6 percent to € 153.4 billion in the past financial year. Here, rising IT revenues were once again countered by falling TC revenues. IT revenues in Germany grew by 4.3 percent to € 77.8 billion in 2014. While business with hardware and software showed strong growth, IT services, which also include outsourcing and consulting, witnessed only subdued developments. According to BITKOM, this project-based business was particularly susceptible to the temporary economic slowdown.

GERMAN ICT MARKET (in € billion)


Due to market and regulatory factors, the German TC market posted a renewed drop in revenues, in this case by 0.9 percent to € 65.0 billion. Revenues with fixed network-based voice services, a market particularly relevant to QSC, even declined by 7.5 percent to € 9.7 billion. The declining significance of voice telephony was underlined in a market survey from autumn 2014, which showed that the number of voice minutes per day fell year-on-year by a further three million to 228 million in 2014. Five years ago, this figure had still stood at 258 million. Flat-rate connections cover an ever greater share of voice volumes. Call-by-Call and Preselect offerings only accounted for 9.6 percent in 2014, compared with 27.2 percent in 2009.

**Cloud market grows by 46 percent** • The changes in the fixed-network market are just one example of the rapid pace of transformation in the ICT market. Particularly interesting for QSC is the advance of cloud computing. Based on estimates compiled by BITKOM, revenues with cloud solutions for business customers in Germany surged by 46 percent to € 6.4 billion in 2014. The sector association had originally expected even higher growth, but the NSA debate in some cases led medium-sized companies in particular to postpone their decisions concerning the use of cloud solutions.

GERMAN CLOUD COMPUTING MARKET FOR BUSINESS CUSTOMERS (€ billion)


Surveys document the high degree of sensitiveness when it comes to matters of security. Here, around three quarters of companies cited concerns about unauthorised access to data as a reason for not initiating or extending their use of cloud computing. Moreover, 45 percent feared data loss. Consequently, business customers accord high priority to regional proximity for their IT service providers. Most IT managers expect their data to be stored only in German data centres. As QSC operates its data centres exclusively in Germany, with that country's especially strict data protection requirements, this is one area where the Company can successfully set itself apart from competitors. QSC already integrates cloud applications into numerous outsourcing projects and thus benefits from the fact that it acted early to position itself in this forward-looking market.

**"Internet of Things" creates new growth potential** • The cloud also serves as a key tool when it comes to the ongoing digitisation of all areas of business and associated networking of ever larger numbers of appliances. Based on estimates compiled by the Bosch Group, around two billion appliances were networked at the end of 2013 already, and this total is expected to rise by a factor of seven by 2022. The four largest markets here are evolving around the topics of home automation, mobility, healthcare and energy supply. QSC already addresses potential applications for three of these growth sectors. With solucon, it has a platform that enables large numbers of appliances to be easily, stably and securely networked.

Number of networked appliances to rise sevenfold by 2022

## REGULATORY FRAMEWORK

**Core sections of TC market remain regulated** • Even as an ICT provider, QSC continues to be active in the German TC market. Core sections of this market are subject to regulation by the German Federal Network Agency with the aim of continuing to ensure fair competition in this market. Until 1998, Deutsche Telekom had operated as a monopolist in the German market. Among other factors, it still possesses a nationwide infrastructure into all households that dates back to those days. Particularly for subscriber lines (local loops), i.e. the distance between the central office or cable branch and the respective customer connection, alternative providers continue to be dependent on this infrastructure built during Deutsche Telekom's time as a monopoly. The fibre optic networks that have recently been built in several cities and the products and services offered by TV cable network operators have also yet to bring about any fundamental change in this situation. In the past financial year, the German Federal Network Agency issued the following rulings of relevance to QSC's business operations.

Continuing decline in interconnection and termination fees

**Preliminary approval of fixed-network interconnection and termination fees** • On 11 July 2014, the German Federal Network Agency published a draft decision for interconnection and termination fees at Telekom Deutschland from 1 December 2014. This draft decision has cut fees by around 20 percent across all tariff levels. In parallel, the previous segregation into peak and non-peak times is to be lifted for the first time. An objection filed by the European Commission means that it has not yet been possible for the consultation and consolidation process to be completed. As a result, no final approval has yet been issued. As in previous proceedings already, the European Commission has objected here as well to the partial non-application of the termination recommendation. Termination fees should become valid at the same time, also for alternative subscriber network operators.

**Preliminary approval of mobile telephony termination fees** • On 3 September 2014, the German Federal Network Agency published a draft decision concerning mobile telephony termination fees for the period from 1 December 2014 to 30 November 2016. This draft only involved very minor reductions compared with the fees previously approved. Given the ongoing process of consolidation in mobile telephony across Europe, the approval issued was merely provisional. As in previous proceedings already, the European Commission has objected here as well to the partial non-application of the termination recommendation.

**Final approval of leased line fees** • In respect of leased line products that are subject to regulation, on 22 July 2014 the German Federal Network Agency definitively approved the fees for SDH and Ethernet leased lines with retrospective effect as of 1 November 2013. Despite criticism by the European Commission, no changes have been made. The fees are valid until 30 July 2015.

**Standard interconnection contract** • On 19 December 2014, the German Federal Network Agency published the main thrust of its first partial decision concerning the future standard interconnection contract. Due to the length of proceedings, negotiations have already resulted in some positive amendments. In its partial decision, the German Federal Network Agency has thus now particularly highlighted the need for fair cost allocation and the restriction of the offering and prices published therein to the services provided by Telekom Deutschland. The modifications to its standard offering made by Telekom Deutschland in response to this decision will then be reviewed in a second stage of proceedings.

**EU recommendation on markets susceptible to ex ante regulation** • Following in-depth discussions held both internally and externally, on 10 October 2014 the European Commission adopted its revised recommendation on markets susceptible to ex ante regulation ("market recommendation"). The markets included in this list are generally assumed to require regulatory intervention. Where national particularities mean that national regulatory authorities deem intervention necessary in further telecommunications markets, they must justify such moves to the European Commission in detail. As expected, the list of markets has been substantially reduced. In particular, voice telecommunication markets (except termination) have been removed from the current list given the competitive influences expected in future from internet-based services. One new addition to the list involves markets tailored exclusively to business customer preliminaries products (quality bit-stream and leased lines). This is in the interests of QSC's strategic alignment.

## BUSINESS PERFORMANCE

**Challenging 2014 financial year** • By promoting its development into an ICT provider, QSC acted early to initiate a transformation process aimed at compensating for the expected reduction in conventional TC revenues and seizing new growth opportunities in promising future business fields, such as cloud computing. The course of business in 2014 underlined the scale of the challenges involved in such a far-reaching transformation. In the summer months, the Company therefore took initial measures to additionally boost sales and stabilise its cost base. In autumn 2014, it adjusted its full-year forecast for 2014. The cost-cutting and focusing programme will now ensure that QSC can master the existing challenges and return to its former financial and earnings strength. Revenues amounted to € 431.4 million in the past financial year, compared with € 455.7 million in the previous year. Sales in the Resellers segment alone, where most of the conventional TC business is pooled, fell by € 20.8 million to € 102.6 million. This was essentially due to three factors. On the one hand, in these business fields QSC is obliged to operate in saturated or in some cases even contracting markets characterised by highly intense competition. The intensity of competition in turn leads to falling prices. QSC does not participate in bidding contests, but rather focuses on market niches in which revenues can still be generated with adequate margins. Furthermore, the regulatory framework is also becoming more restrictive. In 2014, QSC lost revenues of € 8 million and EBITDA of € 3 million due to regulatory factors. The expectation that it would be possible to offset at least part of these losses with new cloud products for resellers proved to be incorrect.

TC revenues at QSC fall due to market and regulatory factors

**New orders of € 177.4 million** • The ICT business, by contrast, posted a comparatively better performance. New orders in Direct Sales, which essentially comprises the Consulting and Outsourcing businesses, came to € 177.4 million, as against € 153.9 million in 2013. The Company succeeded in particular in extending contracts with its existing customers – proof of the consistently high quality of its services. In November 2014, for example, FRESSNAPF Tiernahrungs GmbH, Europe's largest pet supply retailer, extended its comprehensive ICT service contract by five years through to 31 December 2019. The contract volume amounts to around € 13 million and, among other aspects, covers SAP operations, SAP application support and the link-up of around 800 stores in Germany to its headquarters.

NEW ORDERS, DIRECT SALES (in € million)


The Company also succeeded in acquiring new customers. In September 2014, for example, QSC acquired the Dussmann Group, one of the world's largest private multi-service providers, as a new customer in its Consulting business unit. QSC will take care of the group-wide launch of the HR solution SAP HCM, as well as performing all related consulting and integration tasks.
Overall, Direct Sales generated revenues of € 207.3 million in 2014, as opposed to € 209.2 million in the previous year. Unlike in previous years, it was not possible to achieve consistent revenue growth in the course of the year. This was attributable on the one hand to the lack of new large-scale Outsourcing orders and on the other to temporary weakness in the Consulting business. Direct Sales nevertheless introduced countermeasures in 2014 already and thus managed to increase its new orders once again in the second half of the year.

**Positive performance of established ICT products •** Given the underlying framework in the TC market, Indirect Sales, the third business unit, posted a satisfactory business performance in 2014. Revenues here came to € 121.6 million, as against € 123.2 million in the previous year. While TC revenues with business customers reduced due to market and regulatory factors, business with existing ICT products developed positively. QSC generated revenues above all with broadband, secure internet connections and networks, as well as with services based on these connections.
Revenues with new ICT products, on the other hand, did not yet live up to the original expectations. It took longer than expected to train and certify sales partners. Not only that, despite having shown interest many potential customers hesitated to actually make use of QSC's innovations in practice. In response to this, after the summer break QSC already introduced a whole package of measures to boost turnover with the new products. Special "on-boarding teams" now offer customers support in introducing cloud-based products. A special telesales team addresses customers just as directly as do proprietary sales employees for individual products. In parallel, QSC is stepping up online marketing for its innovative products.

**QSC awarded "Cloud Leader" status in two categories •** QSC is on the right course with its innovations. This was also underlined by the awarding to the Company of "Cloud Leader" status in two categories by market researchers at the Experton Group in June 2014. The experts single out companies with highly attractive ranges of products and services and strong market and competitive positions – in short, companies like QSC.

**Takeover of majority interest in encryption specialist FTAPI** • When innovating for the cloud age, QSC is relying not only on internal resources, but also on targeted acquisitions. In February 2014, QSC acquired 51 percent of the shares in the Munich-based company FTAPI Software GmbH. The remaining shares are held by the company's two founders, who are now pressing ahead with FTAPI's further development within QSC's network. The purchase price for the shares thereby acquired amounted to € 3.1 million. Further information about this can be found in Note 37 of the Notes to the Consolidated Financial Statements.

SEE PAGES 136f.
NOTES

Founded in 2010, this start-up company markets a number of products ensuring the highly secure transfer and storage of enterprise-critical data. FTAPI enables files to be transferred and stored in different security levels. Its functionalities can be smoothly integrated into existing CRM and ERP systems, as well as into e-mail solutions such as Outlook. The encryption is easy to handle, also works for large data quantities on a gigabyte scale and is available both as a local software solution and as a cloud service. Having taken over a majority interest, QSC integrated FTAPI's portfolio into its own range of services and products and presented it to the Company's sales partners. As FTAPI is managed as an independent profit centre, it retains the necessary latitude to continually extend its range of services and products.

**QSC places promissory note loan of € 150 million** • Other than the aforementioned developments, there were no events in themselves of material relevance for the course of business in the past financial year. As previously announced, the Company optimised its financing structure and to this end placed a debut promissory note loan of € 150 million with around 30 investors in Germany and abroad. QSC has drawn on a large share of this fresh capital to substitute for a syndicated loan still running until September 2016.

30 investors at home and abroad subscribe to promissory note loan

## ACTUAL VS. FORECAST BUSINESS PERFORMANCE

**2014 performance weaker than originally expected** • Depending on the progress made with launching new ICT and cloud products, QSC had originally planned revenues of € 450 million to € 470 million, EBITDA of € 60 million to € 70 million and free cash flow of € 26 million to € 32 million in 2014. This progress then required more time than envisaged at the beginning of the year. When presenting its Half-Year Financial Report in August 2014, QSC therefore specified its forecast in greater detail. It stated its intention of achieving the lower end of these forecast ranges on the condition that its new product business in particular would gain significant momentum in the second half of the year. This forecast proved to be overly ambitious. In mid-October, the Company therefore published a revised forecast, according to which QSC aimed to generate revenues of at least € 430 million, EBITDA of at least € 40 million and free cash flow of a maximum of € -12 million. The free cash flow forecast included an expected one-off negative working capital item of around € 18 million resulting from stricter payments management on the part of major suppliers.

On an operating level, QSC met these targets, with revenues of € 431.4 million, EBITDA before restructuring of € 42.2 million and free cash flow of € -24.9 million. In the fourth quarter of 2014, the Company began to compile a cost-cutting and focusing programme and to this end recognised provisions of € 7.2 million for its forthcoming restructuring. As a result, the EBITDA reported came to € 35.0 million.

## PERFORMANCE INDICATORS

**Revenues total € 431.4 million** • QSC generated revenues of € 431.4 million in the past financial year, as against € 455.7 million in the previous year. Due to market and regulatory factors, the predominantly conventional TC revenues in the Resellers business unit alone fell by € 20.8 million to € 102.6 million. Despite tougher market conditions in some areas, revenues in the other two business units declined only slightly.

REVENUES (in € million)


EBITDA adversely affected by higher personnel expenses

**EBITDA of € 35.0 million after restructuring expenses** • Alongside lower revenues, 2014 also witnessed a substantial increase in cost of revenues. These mainly result from higher personnel expenses. In anticipation of future growth, QSC had substantially expanded its capacities in some areas in previous years. With its cost-cutting and focusing programme, QSC plans to reverse this gap between revenues and costs. The Company posted provisions for redundancy payments and employee leave benefits in the fourth quarter of 2014 already. As a result of these factors, EBITDA amounted to € 35.0 million in the past financial year, as against € 77.8 million in the previous year.

EBITDA (in € million)


**Free cash flow includes one-off working capital item** • Free cash flow came to € -24.9 million in the past financial year, compared with € 25.6 million in the previous year. Alongside the Company's weaker operating performance, this reduction was also due to a one-off working capital item of € 18.1 million resulting from stricter payments management for large suppliers. The table below shows the amounts of all parameters at the two balance sheet dates on 31 December 2013 and 31 December 2014.

| € million | 31 Dec. 2014 | 31 Dec. 2013 |
|---|---|---|
| **Net debt** | | |
| Cash and cash equivalents | 87.8 | 58.7 |
| Available-for-sale financial assets | 0.3 | 0.3 |
| **Liquidity** | **88.1** | **59.0** |
| Liabilities under financing and finance lease arrangements | (8.9) | (14.4) |
| Liabilities due to banks | (161.1) | (85.6) |
| **Interest-bearing liabilities** | **(170.0)** | **(100.0)** |
| **Net debt** | **(81.9)** | **(41.0)** |

It can be seen that liquidity rose by € 29.1 million to € 88.1 million in 2014. Interest-bearing liabilities increased by € 70.0 million to € -170.0 million. As a result of these factors, net debt grew by € 40.9 million to € -81.9 million.
QSC bases its free cash flow reporting on the financial strength of its operating business and therefore corrects the resultant change in net debt to exclude the impact of extraneous measures such as acquisitions, dividends and associated outflows of cash. In February 2014, QSC paid € 3.6 million to acquire a majority interest in FTAPI. This figure includes the financial liabilities thereby taken over and subsequently redeemed, as well as liquid funds. The distribution of the dividend following the Annual Shareholders' Meeting on 28 May 2014 resulted in an outflow of € 12.4 million. Correcting the reported net debt figure to exclude these two factors results in a free cash flow of € -24.9 million.

**Further reduction in capital expenditure** • QSC made capital expenditure (capex) of € 30.0 million in the past financial year, as against € 39.6 million in the previous year. The capex ratio decreased from 9 percent to 7 percent of revenues and thus remained with the target range of between 6 percent and 10 percent.

CAPITAL EXPENDITURE (in € million)

Of capex, 43 percent was customer-related, with a key focus here on preliminaries for new customers in the Outsourcing and product businesses. Here, investments in long-term assets and interfaces were required prior to the transition to regular operations in order to ensure smooth operation of the customer's IT. 32 percent of capex was channelled into infrastructure, and here above all into permanently modernising and optimising the data centres and their day-to-day operations. The remaining capex related to software and licences (11 percent), research and development (6 percent) and sundry investments (8 percent). The latter item primarily involved plant and office equipment.

## EARNINGS PERFORMANCE

**Significant increase in cost of revenues** • The cost of revenues rose from € 345.4 million in the previous year to € 370.4 million in 2014. This increase, accompanied by a reduction in revenues, was chiefly driven by the rise in personnel expenses by € 22.8 million to € 88.2 million. In anticipation of future growth, QSC had significantly expanded its capacities, especially in Direct Sales, into 2014 and, in the case of some large-scale outsourcing projects, had also taken over employees from customers.
Moreover, the costs of building, operating and maintaining QSC's own infrastructure rose by € 11.7 million to € 49.5 million in 2014. This increase was chiefly due to the expiry of an item within deferred income and accrued expenses ("TELE2 item"). The reversal of this item in the financial years from 2011 to 2013 benefited QSC to the tune of € 20.9 million a year. This item had been recognised in connection with the exit of the former Plusnet co-shareholder TELE2. Due to continuing performance obligations, QSC had credited the payment made upon this exit to earnings over a period running to the end of 2013. The expiry of this item did not impact in its full amount on cost of revenues, as QSC simultaneously benefited from further savings resulting from a long-term contract with another network operator concerning the optimisation of TC infrastructure.

Savings thanks to long-term agreement with network operator

Within cost of revenues, the single largest line item in 2014 as well was cost of materials. These revenue-dependent costs reduced by € 10.9 million to € 189.4 million. Increased cost of revenues accompanied by lower revenues led gross profit to reduce by € 49.3 million to € 61.0 million in 2014.

**Success with sales and administrative expenses** • QSC achieved a further reduction in its sales and marketing expenses to € 39.5 million in the past financial year, down from € 47.7 million in 2013. This line item essentially comprises personnel expenses, commission payments, advertising expenses and depreciation. While advertising expenses increased slightly, the other components fell short of the previous year's figures. QSC paid less commission to resellers in particular and also managed to reduce its sales-related personnel expenses.
At € 38.3 million, general and administrative expenses also fell short of the previous year's figure of € 39.0 million. The significant reduction in personnel expenses in this area as well was countered by an increase in depreciation.

**One-off restructuring provisions of € 7.2 million** • In view of its unsatisfactory earnings performance, QSC began work in 2014 on compiling a cost-cutting and focusing programme. Further information about this can be found in the Outlook from page 68 onwards. QSC recognised provisions totalling € 7.2 million in its 2014 consolidated financial statements for the expenses expected in connection with the planned reduction in staff totals. A majority of these expenses relate to cost of revenues.

SEE PAGES 68f.
OUTLOOK

**Earnings strength of operating business** • QSC's operating earnings strength can be better understood if, by analogy with the quarterly reports, depreciation, amortisation and non-cash compensation components are reported separately in the income statement. Consistent with IAS 1, these figures are therefore a component of the individual cost items. The following abridged income statement presents depreciation and amortisation as a separate line item:

| € million | 2014 | 2013 |
|---|---|---|
| **Revenues** | **431.4** | **455.7** |
| Cost of revenues * | (327.1) | (303.5) |
| **Gross profit** | **104.4** | **152.3** |
| Sales and marketing expenses * | (37.8) | (41.8) |
| General and administrative expenses * | (32.3) | (35.6) |
| Other operating income | 1.1 | 3.4 |
| Other operating expenses | (0.3) | (0.5) |
| **EBITDA** | **35.0** | **77.8** |
| Depreciation/amortisation | | |
| (including non-cash share-based remuneration | | |
| and impairments of customer-related inventories) | (51.0) | (51.3) |
| Goodwill impairment | (18.0) | - |
| **Operating earnings (EBIT)** | **(34.0)** | **26.5** |

* Excluding depreciation/amortisation and non-cash share-based remuneration

**EBITDA margin of 10 percent before restructuring expenses** • In 2014, the Company's EBITDA was substantially affected by higher cost of revenues and restructuring provisions on the one hand and lower revenues on the other hand. EBITDA amounted to € 35.0 million, as against € 77.8 million in the previous year. Prior to restructuring provisions, this key figure amounted to € 42.2 million. The EBITDA margin came to 8 percent, or to 10 percent prior to restructuring.
Depreciation and amortisation decreased by € 0.3 million to € 51.0 million in the 2014 financial year. Furthermore, an impairment loss of € 18.0 million was recognised on goodwill in the Resellers segment. Further information about this can be found in Note 16 of the Notes to the Consolidated Financial Statements.

SEE PAGES 117ff.
NOTES

Net of depreciation, amortisation and impairment losses, operating earnings amounted to € -34.0 million in 2014, compared with € 26.5 million in the previous year. Due to the taking up of the promissory note loan, the financial result of € -6.2 million fell short of the previous year's figure of € -3.8 million. Earnings before taxes on income therefore came to € -40.1 million, as against € 22.7 million in 2013. Given tax income of € 6.2 million, consolidated net income therefore totalled € -33.9 million, compared with € 23.6 million in 2013. Basic earnings per share came to € -0.27, as opposed to € 0.19 in the previous year.
When comparing these earnings figures, four factors should chiefly be considered: Firstly, QSC no longer benefited from the positive TELE2 payment write-back of € 20.9 million a year. Secondly, increased personnel expenses within cost of revenues were not compensated for by corresponding revenues in 2014. Thirdly, the financial statements as of 31 December 2014 include restructuring provisions of € 7.2 million. Fourthly, in view of the downturn in its Resellers business unit QSC recognised goodwill impairment losses of € 18.0 million.

## EARNINGS PERFORMANCE BY SEGMENT

**QSC adjust segmentation in line with internal management** • As previously announced, QSC has amended its segment reporting as of 1 January 2015. The breakdown by sales unit has been replaced by a breakdown by product. This makes it possible to track the progress made in the Cloud business far more clearly than previously. In future, Cloud will be a standalone segment. The separation of Consulting and Outsourcing makes it possible to present the performance and profitability of these two very different business fields in greater detail. The fourth segment comprises the Telecommunications business. The 2014 financial year is therefore the final period for which QSC is basing its reporting on the three previous segments of Direct Sales, Indirect Sales and Resellers.

QSC initiates greater industrialisation of its processes

**Direct Sales maintains largely stable revenues** • The largest business unit, Direct Sales, generated revenues of € 207.3 million in 2014, compared with € 209.2 million in the previous year. Price competition, particularly for large-scale outsourcing projects, intensified as 2014 progressed. In this difficult market climate, QSC on the one hand began to focus more closely than previously on its collaboration with medium-sized companies and only to participate on a very selective basis in time-consuming and staff-intensive tender processes for major outsourcing projects. On the other hand, the Company initiated greater industrialisation of its processes. This realignment will continue to shape the Outsourcing business in the current year. By contrast, the Consulting business, also part of Direct Sales, achieved slight revenue growth and successfully acquired attractive new projects in the course of 2014 already.

REVENUES, DIRECT SALES (in € million)

In anticipation of the potential acquisition of major projects, Direct Sales continued to enlarge its cost base into 2014 and consistently enlarged its workforce in particular. Together with the takeover of employees from customers typical for large-scale projects, this approach was the key factors driving the increase in cost of revenues in this segment by € 20.1 million to € 159.8 million in 2014. The slight decrease in sales-related and administrative expenses was insufficient to offset this increase and the result was a sharp fall in profitability in Direct Sales in 2014. EBITDA halved to € 19.8 million, compared with € 41.6 million in 2013. EBIT only came to € -5.1 million, as against € 17.0 million in the previous year. One focus of the cost-cutting and focusing programme is therefore on streamlining the Outsourcing business.

**Indirect Sales defies downturn in conventional TC business** • At € 121.6 million, revenues in Indirect Sales fell only slightly short of the previous year's figure of € 123.2 million. Like the Resellers business unit, Indirect Sales had to absorb a downturn in sales due to stricter regulation of the TC market. However, it virtually managed to offset the effects with increased demand for ICT products.

Increased demand for ICT products in Indirect Sales

Largely due to the expiry of the TELE2 item, cost of revenues grew to € 72.5 million, up from € 65.3 million in the previous year. By contrast, other costs fell short of the respective previous year's figures.

REVENUES, INDIRECT SALES (in € million)


**Indirect Sales generates EBITDA of € 24.7 million** • Given the higher cost base, EBITDA for the past financial year reduced from € 31.1 million to € 24.7 million. With an EBITDA margin of 20 percent, Indirect Sales thus remained the segment with the highest margin. At € 12.3 million, as against € 20.1 million one year earlier, operating earnings were also significantly ahead of the figures for the other two segments.

**Price war and regulation massively impede Resellers** • Revenues in the third business unit showed a further significant reduction in 2014, reaching € 102.6 million, compared with € 123.4 million in the previous year. This development reflects tough price competition in the declining market for conventional TC services and stricter regulation. Cost of revenues, on the other hand, only showed a comparatively minor reduction, decreasing from € 98.5 million in 2013 to € 94.8 million in 2014. The expiry of the TELE2 item prevented any greater reduction in cost of revenues. Even though other cost items were lower, this led to a marked downturn in earnings. EBITDA amounted to € -9.4 million, as against € 5.0 million in 2013. In view of the weak performance of the TC business and delays with revenues for new cloud products for end consumers, QSC recognised goodwill impairment losses of € 18.0 million in 2014. As a result, EBIT in the Resellers segment came to € -41.2 million, compared with € -10.7 million in the previous year.

Impairment loss on goodwill at Resellers

REVENUES, RESELLERS (in € million)


## FINANCIAL POSITION

**Three core objectives of financial management** • QSC's financial management serves to ensure smooth financing of the operating business and upcoming capital expenditure. In this, it pursues three core objectives:

- Ensuring efficient liquidity management
- Maintaining and optimising financing capacity
- Reducing financial risks

QSC invests its surplus liquidity exclusively in money market and low-risk investments. As a result, there was once again no need for capital investment write-downs in 2014. QSC concluded derivative financial instruments in the form of interest swaps in 2014. These serve to hedge the interest rate risk on floating-rate tranches of the promissory note loan. As virtually all of QSC's operations are in the euro area, the Company is not exposed to any exchange rate risks. The Company had no off-balance sheet guarantee obligations. Further information about financial risk management can be found in Note 44 of the Notes to the Consolidated Financial Statements.

SEE PAGES 150ff.
NOTES

In its financing, the Company primarily depends on three sources: Firstly, it generates inflows of cash from its operating activities. Secondly, QSC took up a promissory note loan of € 150 million in 2014; further information about this can be found on page 58. Thirdly, the Company has a credit line running until September 2016, which totalled € 130 million as of 31 December 2014. Since taking up the promissory note loan, QSC only used this credit line for guarantees as of 31 December 2014.

SEE PAGE 58
BUSINESS PERFORMANCE

**One-off working capital item influences cash flow statement** • The cash flow from operating activities amounted to € 1.9 million in 2014, compared with € 64.2 million in the previous year. Alongside the weaker operating business performance, this reduction was also due to the one-off working capital factor and resultant substantial reduction of trade payables.
At € -30.3 million, the cash flow from investing activities fell slightly short of the previous year's figure of € -31.7 million. By contrast, the cash flow of € 57.4 million from financing activities was significantly ahead of the previous year's figure of € -8.6 million. This was due to the taking up of the promissory note loan in May 2014.

## NET ASSET POSITION

**Solid balance sheet** • QSC traditionally has a solid balance sheet structure, one that ensures matching maturities for the financing of assets. As of 31 December 2014, shareholders' equity and long-term liabilities covered 127 percent of the value of long-term assets. The equivalent figure at the end of 2013 was 109 percent. This increase was chiefly driven by the taking up of a long-term promissory note loan during 2014. The rise in long-term liabilities also changed the ratio of shareholders' equity and debt capital. The equity ratio came to 36 percent as of 31 December 2014, as against 49 percent in the previous year.

Equity ratio of 36 percent at end of December 2014

On the asset side of the balance sheet, long-term assets account for 63 percent of the balance sheet total. Depreciation, amortisation and impairment reduced their value by € 16.4 million to € 255.6 million as of 31 December 2014. Short-term assets, by contrast, rose by € 29.9 million to € 149.9 million as of the balance sheet date. This increase was chiefly driven by the inflow of liquidity from the promissory note loan.

**Reduction in long-term assets** • Long-term assets chiefly comprise four line items – property, plant and equipment, land and buildings, goodwill and other intangible assets. Due to depreciation, the value of property, plant and equipment declined to € 76.2 million as of 31 December 2014, compared with € 93.9 million one year earlier. For the same reason, the value of land and buildings decreased slightly from € 26.8 million to € 25.9 million. Goodwill reduced to € 67.1 million, down from € 76.3 million as of 31 December 2013. Impairment of € 18.0 million recognised on goodwill in the Resellers business unit was countered by newly created goodwill of € 8.8 million resulting from the first-time inclusion of FTAPI Software GmbH and fonial GmbH in the consolidated financial statements. Further details about the development in goodwill can be found in Notes 15 and 16 of the Consolidated Financial Statements. Due to capitalisation of in-house developments and the software taken over in the context of the FTAPI acquisition, the value of intangible assets increased to € 53.7 million, up from € 52.8 million as of 31 December 2013.

SEE PAGES 117ff. NOTES

**Substantial rise in liquidity** • At € 52.1 million, trade receivables remained virtually unchanged on the previous year. Further details about the recoverability of these receivables can be found in Note 18 of the Notes to the Consolidated Financial Statements. Cash and cash equivalents, the second large major line item within short-term assets, rose significantly to € 87.8 million as of 31 December 2014, up from € 58.7 million at the end of 2013.

SEE PAGES 121ff. NOTES

CASH AND CASH EQUIVALENTS (in € million)


**Shareholders' equity influenced by consolidated net income and dividend** • Shareholders' equity totalled € 145.6 million as of 31 December 2014, compared with € 193.2 million at the previous year's balance sheet date. Issued capital remained at the previous year's level of € 124.1 million.

The accumulated deficit increased to € -117.5 million, compared with € -71.0 million as of 31 December 2013. This was mainly the result of two factors. Firstly, consolidated net income for 2014 amounted to € -33.9 million and secondly the dividend payment of € 12.4 million was directly charged to this line item.

**Promissory note loan safeguards long-term financing •** Long-term liabilities grew to € 180.2 million as of 31 December 2014, up from € 103.3 million at the previous year's balance sheet date. This increase was principally due to the taking up of the promissory note loan in May 2014, which led long-term liabilities due to banks to rise by € 73.9 million to € 156.6 million as of 31 December 2014.
Short-term liabilities, by contrast, reduced to € 79.7 million, down from € 95.5 million as of 31 December 2013. Trade payables decreased substantially from € 58.7 million at the previous year's balance sheet date to € 44.8 million. This reduction also reflects the stricter payments management on the part of major suppliers discussed within the context of the Company's financial position.

## OVERALL SUMMARY

**More consistent implementation of the right strategy •** The Company's business performance in 2014 clearly shows that QSC continues to pursue the right strategy, but that it will also have to implement this more consistently than to date. After all, like in previous years the Company faced downturns, particularly in its conventional TC business, as a result of market and regulatory factors. The ICT business, by contrast, posted a largely stable performance. However, it became apparent that cutting costs and industrialising processes will be crucial, particularly in the Outsourcing business. Not least in response to this, QSC compiled a cost-cutting and focusing programme in the fourth quarter of 2014 and to this end recognised provisions of € 7.2 million.
The Company thus drew the consequences from its unsatisfactory overall business performance in 2014. The Outlook from page 68 onwards outlines how, by consistently implementing its strategy, QSC will expand its ICT and Cloud businesses in the current year and at the same time gradually regain its customary earnings strength.

SEE PAGES 68ff.
OUTLOOK

# Events After the Reporting Period

QSC is not aware of any events of material significance subsequent to the financial year that would require disclosure here.

# Outlook

## OVERALL SUMMARY OF FUTURE DEVELOPMENTS

**2015 dominated by cost-cutting and focusing process** • By pressing ahead with its development into an ICT and Cloud provider, QSC continues to pursue the right strategy. To offset the decline in the conventional TC business, however, this strategy will require more consistent implementation than previously. QSC is therefore introducing an extensive cost-cutting and focusing programme. This make a substantial contribution towards increasing the Company's earnings and financial strength once again in the current financial year already.
Against this backdrop, QSC expects to generate revenues in excess of € 400 million, EBITDA of more than € 40 million and positive free cash flow in the current year. The Opportunity and Risk Reports from pages 72 and 74 onwards respectively provide information about potential developments that could give rise to variances from the forecast provided here.

SEE PAGES 72ff.
OPPORTUNITY AND RISK REPORTS

## FUTURE MACROECONOMIC AND INDUSTRY FRAMEWORK

**Domestic demand boosts German economy** • In its Annual Economic Report, the German Federal Government has forecast GDP growth of 1.5 percent in the current year. According to the report, the domestic economy will be driven in particular by the sharp rise in incomes and ongoing increase in employment totals. As a result, private consumer spending and capital expenditure in the construction industry in particular will continue to contribute substantially to overall growth in 2015 as well. The risks facing the German economy relate above all to the ongoing euro area crisis, intensification in political conflicts, such as that in Ukraine, and weaker demand from emerging economies.

**Disparate developments in the ICT market** • The German ICT market will benefit only in part from the rise in domestic demand. Overall, the industry association BITKOM expects the ICT market to grow by 0.6 percent to € 154.3 billion in 2015. Here, the rise in IT revenues can be expected to be opposed once again by contracting TC revenues.

THE GERMAN ICT MARKET (in € billion)


Growth market for IT services

According to the BITKOM forecast, revenues in the German IT market are expected to grow by 2.4 percent to € 79.7 billion in the current year. Key momentum here would be provided by business with IT services, such as outsourcing and consulting, where revenues are forecast to grow by 3.2 percent to € 37.4 billion in 2015. The key growth drivers identified by BITKOM are big data and – more than anything – cloud computing.

**German TC market suffering from stricter regulation** • According to BITKOM's figures, revenues in the German TC market, by contrast, are set to reduce further, with a 0.9 percent contraction to € 64.4 billion forecast for 2015. Alongside persistent price competition, stricter regulation by the German Federal Network Agency is also holding back revenues at TC providers. Above all, the reduction in fixed-network interconnection and termination fees by around 20 percent across all tariff rates from 1 December 2014 will lead to substantial downturns.

**Cloud computing poised for a breakthrough – also among SMEs** • Based on forecasts issued by BITKOM, cloud computing revenues with business customers in Germany are set to show overall growth of 39 percent to € 8.8 billion in the current year. This already corresponds to just under 6 percent of the German ICT market. In its definition of cloud computing, BITKOM also includes related consulting and integration services, as well as the necessary hardware. Actual cloud services, namely Software-as-a-Service, Infrastructure-as-a-Service and Platform-as-a-Service, most recently accounted for less than half of revenues. Medium-sized companies in particular still have reservations about transferring programmes, platforms or their entire infrastructure to the cloud. Having said this, the benefits, especially in terms of efficiency, flexibility and security, outweigh the drawbacks and can be expected to generate high growth rates in 2015 and subsequent years.

GERMAN CLOUD COMPUTING MARKET FOR BUSINESS CUSTOMERS (in € billion)


## EXPECTED EARNINGS PERFORMANCE

QSC has planned revenues of more than € 400 million

**Consistent implementation of ICT and Cloud strategy** • QSC has planned revenues of more than € 400 million for the current financial year. At the same time, the Company will be implementing its ICT and Cloud strategy more consistently than to date. When developing new cloud products, it will also be addressing key customer needs, such as cost optimisation, speed and convenience of use, more closely than before. Furthermore, the Company is developing a "Pure Enterprise Cloud". This facilitates the integration of traditional applications and new cloud services and thus enables customers to move into the cloud age on a step-by-step basis.

**New programme leads to substantial savings** • Moreover, with its two-year cost-cutting and focusing programme the Company aims to generate substantial savings. One core component of the programme involves reducing staff totals by around 350 employees. These staff cuts, greater industrialisation of IT operations, optimisation of procurement and further measures will generate savings of more than € 10 million in 2015 already. Particular attention will be paid in the current year to restructuring the increasingly low-margin Outsourcing business, with key focuses here on industrialising processes, putting a new cloud platform in place and focusing on SME projects. In Outsourcing, like in other business units, QSC will be deliberately concentrating on the "right" revenues, i.e. on sustainable, high-margin revenues.

Savings of more than € 10 million in 2015 already

Furthermore, the new programme also entails a package of measures aimed at boosting sales activities. QSC will be making greater use of telesales, online sales and other ways of directly addressing customers. In parallel, the portfolio will be aligned even more consistently than before to the needs of the core target group of medium-sized companies. One particular focus will be on customers in the retail, energy, financial services, mechanical and plant engineering sectors.

## EXPECTED EARNINGS PERFORMANCE BY SEGMENT

**Amended segmentation** • Since 1 January 2015, the Company has based its segment reporting on its product structure. In the following section, QSC is therefore reporting for the first time on its expectations for the four segments of Outsourcing, Consulting, Telecommunications and Cloud.

**Focusing Outsourcing** • The Outsourcing business unit faces a far-reaching restructuring process in the current financial year. QSC will be focusing more closely than previously on business with medium-sized companies and will only be participating very selectively in time-consuming, staff-intensive tenders for large-scale projects. For the Company's business with medium-sized companies to succeed, greater industrialisation of processes and a platform strategy are absolutely crucial. The new "Pure Enterprise Cloud" will make the migration of medium-sized operations far easier in future. Following this far-reaching restructuring process, QSC expects revenues in the Outsourcing segment to stabilise. In the medium term, migrating medium-sized customers to cloud platforms can be expected to lead to a shift in revenues to the Cloud segment.

**Stable Consulting business** • Consulting managed to offset the temporary dip in demand in 2014 without delay by acquiring new projects. On this basis, its revenues for 2015 are expected to remain stable or increase slightly.

**Decreasing revenues in Telecommunications segment due to market and regulatory factors** • QSC's largest segment will be characterised by disparate developments in 2015. On the one hand, the conventional TC business will once again have to absorb the impact of stricter regulation. Not only that, due to market factors there will be a further decline in revenues in the Open-Call-by-Call and ADSL2+ Wholesale businesses in particular. On the other hand, business with IP-based products for business customers should develop stably overall.

**New business fields need time to develop** • In Cloud, its fourth segment, QSC does not yet expect to see any substantial revenues in the current year. The developments seen in 2014 show that the success of market launches for innovations cannot be easily predicted in advance. Irrespective of this, the Company will be maintaining its in-depth development work and acting early to obtain feedback from potential customers and partners.

## EXCPECTED FINANCIAL AND NET ASSET POSITION

**Positive free cash flow despite current cost-cutting programme** • The cost-cutting and focusing programme currently underway will involve substantial outlays, especially for redundancy payments and particularly in the first half of the year. For 2015 as a whole, QSC nevertheless expects to generate positive free cash flow.

Capex expected to total around € 25 million

The inflow of funds from the operating business will make a key contribution in this respect in 2015. This will be countered by moderate capital expenditure on three topics in particular – customer projects, ongoing optimisation of IT operations and development. Overall, the Company has planned capital expenditure on a scale of around € 25 million in the current year. In view of its operating cash flows and existing liquidity, QSC believes that it is solidly financed for its forthcoming projects in the current financial year.

# Opportunity Report

## OPPORTUNITY MANAGEMENT

**Highly dynamic market harbours new opportunities for QSC** • The ICT and Cloud markets are characterised by great momentum. This is repeatedly producing new opportunities for QSC. Responsibility for identifying and acting on such opportunities lies with the profit centres in the individual business fields. They are familiar with their specific market environments and alert to any resulting potential. In addition, the managers responsible draw on the expertise available in the Sales and Marketing department, as well as on market and competition analyses and internal studies. The managers responsible regularly report to the Management Board on existing opportunities and the measures necessary to seize them. The Supervisory Board Strategy Committee also regularly deals with this issue.

Specific opportunities are factored into the rolling planning, with a review being performed at an early stage to ascertain the risks involved in pursuing and implementing these opportunities. Here, the benefits of dovetailing risk and opportunity management are especially clear. QSC reports below on the future developments and events that could lead to a positive variance from the outlook provided in this Group Management Report. By analogy with risks, the Company classifies these as "large" opportunities with a comparatively high probability of occurrence and a substantially positive contribution to its financial position, financial performance and cash flows.

## INDIVIDUAL OPPORTUNITIES

**Acquisitions** • Takeovers have the potential both to boost QSC's core business and to accelerate the implementation of its innovation strategy. Building on a strong market position, acquisitions in the Telecommunications, Consulting and Outsourcing segments may serve to enhance margins or to reinforce or extend existing competencies. In the Cloud segment, the focus is on smaller companies with distinct technological or market expertise. Here, QSC gives the young companies the necessary latitude for their further development while also offering them a framework for sales, marketing and administration.

QSC's focus is on distinct technological or market expertise

In the past, QSC has repeatedly demonstrated its ability to master the risks involved in acquisitions and therefore sees itself as being well equipped for potential further takeovers. Such acquisitions may generate positive revenues and earnings contributions in the first year already. It should not be forgotten, however, that the costs of integrating these companies and providing them with sales and marketing support may be substantial, particularly for larger-scale takeovers. Moreover, start-ups often incur initial losses during the early years. In the medium term, however, young companies in particular harbour significant opportunities to generate disproportionate revenue and earnings growth.

**Consolidation of individual ICT markets** • Irrespective of acquisitions, in the current financial year QSC may stand to benefit from the consolidation of individual ICT markets. Competitors withdrawing from the market or focusing on existing customers offer QSC temporary or even permanent opportunities to improve its own market position. The Company succeeded here in the past, for example on repeated occasions in the highly contested TC market for business customers.
In this climate, QSC benefits from its extremely competitive infrastructure, whose continually falling incremental costs enable the Company to generate lucrative margins in the medium to long term as well, and that despite falling prices.

**Divestments** • QSC is also alert to opportunities arising from the consolidation of the ICT market. The possibility cannot be excluded that the Company will dispose of individual assets and /or associated business fields in the infrastructure field, for example, when the long-term advantages of such a move for QSC clearly predominate. Such disposal may lead to a short-term balance sheet contraction or to a loss of revenues and earnings contributions. Depending on the specific contractual arrangements, however, the benefits for QSC may predominate in the first year already. Such benefits result in particular from reduced running costs for infrastructure services and participation in synergy effects. Divestments thus offer the opportunity for the Company not only to improve its financial position, but also to enhance its earnings strength.

**Major projects** • QSC mainly focuses on medium-sized customers. Irrespective of this, the Company repeatedly receives invitations to bid for large outsourcing projects involving multi-year terms and contract volumes in a double-digit million range. In a highly competitive climate, QSC does not participate in bidding contests, but rather concentrates on projects offering an adequate margin and the possibility of generating positive free cash flow. Furthermore, in its project business QSC will be relying more closely in future on platform solutions. These make it possible to serve various customers via the same platform and thus to reduce the number of individual solutions. Thanks to the resultant efficiency gains, there is the chance that QSC could win one or two such tenders in the current year and, following the initial investment required for such projects, generate additional revenue and earnings contributions for several years.

The Company may win one or two orders put out to tender

**New products** • In the context of its growth and innovation strategy, QSC is pressing ahead with developing proprietary, cloud-based products. Experience shows that it can take some time for such innovations to become established in the market. The existing planning therefore includes only a comparatively low volume of revenue contributions.
There is the chance that individual innovations will make faster inroads into the market than expected. This way, small and medium-sized enterprises might overcome their ongoing reservations concerning cloud solutions and thus benefit from the efficiency and cost benefits offered by such solutions. The greater the desire on the part of end customers is, the greater the demand is on the part of QSC's sales partners to actively market new cloud products.
Opportunities also arise from QSC's potential collaboration with reseller partners with strong market presences. Together with such partners, the Company could bring cloud-based products to market maturity, also for the mass market, and subsequently participate in the potential revenues and earnings.

# Risk Report

## RISK MANAGEMENT

**Risks identified at the earliest opportunity** • Given constantly changing markets, there is a need for comprehensive risk and opportunity management. While the Opportunity Report from page 72 onwards focuses on the latter, the following section addresses all events, actions or neglected actions that could potentially pose a threat to QSC's success, or even to its continued existence. Risk management comprises coordinated procedures, measures and the necessary rules for dealing with risks. It thus ensures that any risks arising are identified at the earliest possible opportunity and subsequently analysed, assessed, managed and monitored. This way, it averts threats to the Company's success and secures this success on a long-term basis. Uniform risk management serves as the basis for decisions at QSC and all its subsidiaries.

SEE PAGES 72f.
OPPORTUNITY REPORT

## ORGANISATION UND PROCEDURES

**QSC has an integrated risk management system** • QSC has implemented a uniform integrated risk management system (RMS) to ensure the effectiveness of its risk management and facilitate the aggregation of risks and transparent reporting. This system was further optimised in the past financial year. The use of risk management software that has proven its worth for years now enabled the Company to classify risks precisely and, as a result, to clearly focus on material risks. The RMS is an integral component of decision-making processes at the Company. It ensures that risk assessments are considered in all decisions and that measures to reduce risks can be taken at an early stage. Quarterly reports raise awareness of risk issues among all managers with responsibility for risk. Guidelines, procedures and work instructions are in place to flank the RMS and ensure its implementation in day-to-day operations. Close dovetailing with the risk analyses performed for certification, such as the processes required for ISO 27001 for Information Security Management Systems, ensure uniform, efficient reporting.

QSC optimises its risk management in course of 2014

The Risk Management and Finance departments play a key role in RMS. Corporate Risk Management is responsible for the quarterly risk reports, conducts quarterly audits in person and on location, and acts as a permanent contact partner for all divisions. Furthermore, it serves as an interface to other audit and/or certification processes and ensures that, there too, the operating risks relevant to the Company are uniformly recorded. The Finance department is responsible for monitoring risks on the basis of key operating and financial performance figures.

Managers reporting directly to the Management Board ("direct reports") continually monitor and assess the risks arising. Within the RMS framework, they are responsible as risk coordinators for making sure that the risks identified are always up-to-date. The "direct reports" report to Cor-

QSC's focus is on distinct technological or market expertise

porate Risk Management on an ad-hoc basis or within the quarterly audit framework. This process ensures that potential risks in the operating business can be detected at an early stage. The risk coordinators also regularly check whether any risks as yet undetected have arisen and whether there have been any changes in existing risks in their respective areas.

**Quarterly risk reporting to the Management Board** • Corporate Risk Management continuously monitors the introduction of and compliance with measures to avoid and reduce risks. It is also responsible for consolidating and documenting the risks assessed by the risk coordinators. Corporate Risk Management takes the risk reports as a basis for compiling a compact report using the "R2C" software described in greater detail under "Assessment methodology" and forwards this report to the Management Board on a quarterly basis. For high risks, the Management Board is informed on an ad-hoc basis. The Management Board informs the Supervisory Board with an extensive risk report at least once a year, while also using the RMS as a means of keeping the Supervisory Board informed of all material risks newly arising.
Risk management guidelines issued by the Management Board govern the approach to handling risks described here and define risk management processes and organisational structures. These guidelines are reviewed and modified as necessary on a regular basis, and at least once a year. In the context of their audit of the financial statements, the external auditors each year review whether the RMS is suitable for the early detection of any risks to the Company's continued existence. Furthermore, checks are also performed by the internal auditors.

SEE PAGES 150ff. NOTES

Further information about the RMS in respect of IFRS 7 disclosure obligations for financial instruments can be found in the Notes to the Consolidated Financial Statements from page 150 onwards.

## ASSESSMENT METHODOLOGY

**Classification of risks by probability of occurrence and potential implications** • The overall risk management process is supported throughout the Company by the "Risk to Chance (R2C)" risk management software. This tool initially uses a gross view to classify a given risk as "high", "medium" or "low" depending on its estimated probability of occurrence and potential implications. The classification cumulatively results from allocation to the respective categories. For the probability of occurrence, these are "very low", "low", "medium", "high" and "very high". For implications, the categories are "immaterial", "low", "medium", "serious" and "threat to continued existence". In the case of the highest implication category ("threat to continued existence"), severe financial damages have to be exacerbated by an actual or legal circumstance that would endanger QSC's continued existence. The assessments and accompanying comments and requirements are generally qualitative in nature and quantitative only in exceptional cases.

## CLASSIFICATION OF RISKS

| **Probability of Occurrence >** **Damage Class v** | Very low | Low | Medium | High | Very High |
|---|---|---|---|---|---|
| Immaterial | Low Risk | Low Risk | Low Risk | Medium Risk | Medium Risk |
| Low | Low Risk | Low Risk | Medium Risk | Medium Risk | Medium Risk |
| Medium | Low Risk | Medium Risk | Medium Risk | Medium Risk | High Risk |
| Serious | Medium Risk | Medium Risk | Medium Risk | High Risk | High Risk |
| Survival-endangering | Medium Risk | Medium Risk | High Risk | High Risk | High Risk |

Low Risk Medium Risk High Risk

**Assessment of probability of occurrence**

| | |
|---|---|
| Very low: | Less than once in 5 years (approx. 0 %) |
| Low: | Not more than once in 5 years (approx. 25 %) |
| Medium: | Approx. once a year (approx. 50 %) |
| High: | More than once a year (approx. 75 %) |
| Very high: | Once a quarter or more (almost 100 %) |

**Damage class (Estimated damage in the event of occurrence)**

| | |
|---|---|
| Immaterial: | Under € 50,000 |
| Low: | € 50,000 to € 250,000 |
| Medium: | € 250,000 to € 1,000,000 |
| Serious: | Over € 1,000,000 |
| Survival-endangering: | As a result of legal or actual circumstances occurring |

This risk analysis and classification is followed by measures aimed at dealing with and monitoring risks. These serve to

- Reduce existing risks by way of suitable measures
- Hedge risks with provisions and insurance coverage where economically expedient
- Raise awareness of existing residual risks and / or risk acceptance.

All risks are initially recorded in a gross view without consideration of their implications or the introduction of suitable measures. In this status, classification as “risk to continued existence” only leads to an overall assessment of “high” if there is at least a “medium” probability of occurrence. Risks to the Company’s continued existence that are assessed as having only a very low or low probability of occurrence – and that are not included in any greater detail in the net view – are therefore not classified as “high” for ongoing observation purposes and are thus not viewed as direct threats to the Company’s continued existence.

General risks are analysed to assess whether and how these could specifically harm QSC. If this analysis concludes that relevant damages from such risks really are conceivable, then these risks are included as specific risks. General risks without any specific reference to the Company are otherwise not recorded in the RMS. General risks include developments such as global catastrophes, financial system collapse, war and terrorist attacks.

Net view of risks is decisive

The net view of risks is the decisive factor in the assessment. The aforementioned gross view is assessed by the managers with responsibility for risk, who subsequently determine the approach for handling these risks. As explained above, this may involve reducing the risk exposure by way of suitable measures, hedging such risks with provisions and insurance coverage or raising awareness for and/or accepting existing residual risks. The subsequent net view, which is typically determined on a qualitative basis, then serves as the basis for compiling a ranking and the resultant risk report.

## SUPPLEMENTARY DISCLOSURES PURSUANT TO § 315 (2) NO. 5 HGB

**Accounting risks permanently monitored** • Risk management in respect of financial reporting forms an integral component of the RMS. The risks involved in accounting and financial reporting are constantly monitored, with the results being factored into Group-wide reporting. In the context of the audit of the annual financial statements, the auditor also reviews the financial reporting process and the IT systems thereby used. Based on the auditor's findings, the Supervisory Board Audit Committee and the full Supervisory Board deal with the internal control system in respect of the financial reporting process.

QSC lists the main features of this RMS below:

- QSC has a clear management and corporate structure. Accounting activities for subsidiaries are performed either by QSC AG itself on the basis of agency agreements or handled in close liaison with the subsidiaries. Individual process responsibility is clearly allocated at all subsidiaries.
- QSC ensures strict compliance with legal requirements and International Financial Reporting Standards (IFRS) by means of a range of measures including employing qualified specialists, providing targeted and ongoing training and development for these specialists, strictly observing the dual control principle by separating execution, billing and approval functions in organisational terms and clearly segregating duties in terms of document creation and posting and in its controlling department.
- QSC works with uniform standard software from SAP throughout the Company.
- The accounting software is comprehensively protected from unauthorised access. It ensures that all major transactions at all companies are consistently, correctly and promptly recorded.
- Once prepared, separate financial statements are transferred to a uniform consolidation system in which intercompany transactions are eliminated. This system then provides the basis for the consolidated financial statements and for major disclosures in the Notes to the Consolidated Financial Statements.

– Group-wide monthly reporting ensures the early detection of potential risks during the financial year. This reporting includes all accounting processes relevant to the Group, such as consolidation of capital, debt, income and expenses.

With these measures, QSC creates the necessary transparency for its financial reporting and – to the greatest possible extent and despite the enormous complexity of IFRS – prevents any potential risks arising in this process.

## INDIVIDUAL RISKS

**Focus on actual risk situation taking due account of measures** • In its risk monitoring, the Company focuses on its actual risk situation after taking measures into consideration rather than on the risks identified by the gross evaluation. Based on this net perspective, the following relevant risks were assessed as "high".

**Decline in conventional voice telephony** • German fixed-network voice call volumes continue to decline. Not only that, the share of this declining market attributable to the open Call-by-Call and Preselect businesses is consistently falling. Germans are increasingly opting for fixed-network flat-rate plans or using mobile communication instead of the fixed network. This contracting market is also characterised by tough price competition. Moreover, the stricter regulatory framework has also led to reduced revenues. Information about the associated risks can be found in the separate "Regulatory risks" section below.

Dependence on TC business now been falling for years

Due to its development into an ICT provider, QSC has been reducing its dependence on the TC business for years now. Not only that, the Company has combated the risk of revenue losses in this traditional line of business by acting early to build up a fully IP-based NGN. At the same time, QSC has been reviewing whether and to what extent it can maintain its voice offerings on competitive terms following the potential expiry of further regulatory requirements. Irrespective of this, the Company expects to see an ongoing decline in revenues in the conventional TC market in the coming years and increased pressure on margins. This is especially true of business with resellers, but also of business with sales partners. To counter this, the Company will further grow its revenues in the ICT market.

**Operations stability** • The ICT sector is undergoing structural transformation. In the Outsourcing business in particular, customers expect ever higher technical and operating quality at ever lower costs and, despite this, expect services to be tailored to their individual needs. These exacting standards have to be met by means of stable operations accompanied by inexpensive production, while at the same time by satisfying customers' wishes swiftly and efficiently. By permanently optimising its operating organisational structure and by taking measures to stabilise operations, QSC has created a basis enabling it to fully meet customers' expectations.

**Cross-border projects** • QSC focuses on the German market. In its Direct Sales business, however, there is increasing demand for cross-border services from medium-sized companies as well. International topics also play a role in many calls for tenders; this may involve data centre locations outside Germany, international links or international 24/7 services.
QSC is countering this risk in its Direct Sales business by boosting and expanding its international activities. For larger-scale networking projects, the Company has offered cross-border solutions for years now and, as a result, has gained extensive experience in this field. Furthermore, the Company has developed an international networking concept. Not only that, partners in other key markets are also playing a major role. QSC is extending its network of partners and intensifying existing partnerships in order to be able to offer its customers the international solutions they desire, especially in Direct Sales. In return, these partners also collaborate with QSC in implementing ICT solutions in Germany. Even though QSC's business activities remain focused on the German market, the Company is thus gradually extending its international competence in cross-border projects.

**Licence management** • In Direct Sales, QSC uses licences from other providers in the context of outsourcing and consulting projects and, with increased development activity, is at the same time steadily expanding its proprietary licence portfolio. This is placing greater demands on both internal and customer-related licence management, particularly given the ongoing evolution in licencing models. There is the risk of substantial damages and recourse claims as a result of a licencing excess or shortfall. QSC is continuing to counter this risk by permanently expanding its licence management operations, consistently monitoring all licences used and systematically expanding its administration and marketing of proprietary licences.

Licence management is continuously expanded

**Regulatory risks** • Even as an ICT provider, QSC continues to operate in the regulated German TC market. Here, there is still a tendency in the political arena, and thus indirectly on the part of the German Federal Network Agency and the European Commission, to limit or abolish access regulation in various markets and to restrict themselves from now on to monitoring these markets and, where appropriate, to intervene retrospectively on the basis of general fair competition law. The implications of the amended recommendations concerning those markets to be subject to preliminary regulation will make themselves felt in the coming years. There is a risk that the coming years will see a further reduction in the number of regulated markets. This could increase the pricing latitude of Deutsche Telekom AG (DTAG) in markets already removed from regulation. Furthermore, there is the risk that specific regulated preliminary markets, especially bit-stream and subscriber lines (local loops), will be regionalised in such a way that specific preliminaries are no longer available in more competitive geographical sub-markets (e.g. metropolitan areas).
The experience gained to date with the end of regulation in various markets shows that public monitoring of DTAG's competitive behaviour is insufficient to keep this company from exploiting its newly gained room for manoeuvre. QSC nevertheless expects that sustainable public discussion and the investigation of relevant cases will promote conduct consistent with fair competition and the German Federal Network Agency or the German Cartel Office will otherwise draw on their legal options.

Moreover, given its proprietary infrastructure QSC is significantly less dependent than most other ICT providers on DTAG's resale prices for voice and data services. Nevertheless, margins in the German TC market could be adversely affected in particular by aggressive pricing policies on the part of DTAG in the preliminaries and end-customer markets outside cartel and regulatory limits or in markets no longer regulated. This was also seen to be case in several areas in 2014. This being so, QSC relies on well-functioning supervision by the German Federal Network Agency and the European Commission. The Company limits potential risks by closely monitoring the regulatory landscape and by participating on an ongoing basis in the relevant discussions and commenting on various proceedings.

**New products** • The development of proprietary cloud-based products represents not only an opportunity, but also a risk. Delays may arise in the development process and subsequently lead to market launches being postponed. A potential lack of initial market acceptance for innovations may mean that the Company can only generate revenue and earnings contributions later than expected. Delays may also arise should the sales organisation not have the necessary specialist qualifications.
To account for this risk, the planning for the current financial year includes only a comparatively low volume of revenue contributions from new cloud-based products. Furthermore, QSC is countering this risk by aligning its development work even more closely to current customer needs, thus minimising the risk of a lack of market acceptance for innovations. Not only that, the Company is developing direct distribution channels for innovative products and training its existing sales organisation on cloud-related topics.

## OVERALL SUMMARY

**No material risks discernible** • Taking due account of the potential scope of damages and probabilities of occurrence of these and further potential risks, no risks that could result in any permanent and significant impairment of the Company's financial position, financial performance or cash flows are currently discernible. In organisational terms, all meaningful and reasonable prerequisites have been put in place to enable the Company to detect potential risks at an early stage and take appropriate action.
Due to these or other risks or to erroneous assumptions, the future earnings of QSC may nevertheless materially deviate from the expectations of the Company and its management. All statements made in the Consolidated Financial Statements that are not historical facts constitute forward-looking statements. They are based on current expectations and forecasts of future events and are regularly reviewed in a risk management context.

# Takeover-Related Disclosures

**Customary regulations for a publicly listed company** • The following overview outlines the disclosures mandatory under § 315 (4) of the German Commercial Code (HGB). Overall, these involve regulations that are typical at publicly listed companies. The following disclosures reflect the circumstances at the balance sheet date.

**Composition of issued capital** • Issued capital amounted to € 124,142,487 as of 31 December 2014 and was divided into 124,142,487 no-par registered ordinary shares. According to the Share Register, these shares were divided among 28,757 shareholders as of 31 December 2014.

**Limitations on voting rights or transfer of shares** • Each share grants one vote at the Annual Shareholders' Meeting. A voting and pooling agreement is in place between the following shareholders with direct and indirect holdings in QSC: Dr. Bernd Schlobohm, Gerd Eickers and Gerd Eickers Vermögensverwaltungs GmbH & Co. KG. This agreement provides for the uniform exercising of voting rights and restrictions relating to the disposability of the pool-bound shares. The Management Board is otherwise not aware of any further limitations on voting rights or restrictions on the transfer of shares.

**Direct or indirect holdings of more than 10 percent of capital** • Gerd Eickers and Dr. Bernd Schlobohm each notified us pursuant to § 21 of the German Securities Trading Act (WpHG) that, by virtue of attribution pursuant to § 22 (2) Sentence 1 WpHG, their direct and indirect share of the voting rights in QSC AG on 4 March 2013 amounted to 25.09 percent (31,045,856 voting rights). Of this total, 12.52 percent (15,493,372 voting rights) was attributable to Mr. Eickers from Dr. Schlobohm and 12.57 percent (15,552,484 voting rights) was attributable to Dr. Schlobohm from Mr. Eickers. Gerd Eickers Vermögensverwaltungs GmbH & Co. KG, Cologne, most recently notified us pursuant to § 21 WpHG that, by virtue of attribution pursuant to § 22 (2) Sentence 1 WpHG, its indirect share of the voting rights QSC AG on 10 June 2013 amounted to 25.09 percent (31,045,856 voting rights). These voting rights were attributable to Gerd Eickers Vermögensverwaltungs GmbH & Co. KG from Mr. Eickers and Dr. Schlobohm.

**Bearers of shares with special rights conferring powers of control** • There are no special rights conferring powers of control.

**Voting right controls for employee holdings in capital** • There are no voting right controls.

**Appointment and dismissal of Management Board members** • The appointment and dismissal of members of the Management Board is governed by § 84 and § 85 of the German Stock Corporation Act (AktG) and by § 7 of the Articles of Association in their version dated 21 January 2015. Pursuant to § 7 of the Articles of Association, the Management Board comprises one or more individuals. The Supervisory Board determines the number of Management Board members. Even though issued capital exceeds € 3 million, the Supervisory Board may stipulate that the Management Board should consist of only one individual. The appointment of deputy members of the Management Board is permitted.

**Amendments to the Articles of Association** • Pursuant to § 179 of the German Stock Corporation Act (AktG), amendments to the Articles of Association require a resolution adopted by a majority of at least 75 percent of issued capital represented at a Shareholders' Meeting. Pursuant to § 15 of the Articles of Association, the Supervisory Board is authorised to adopt amendments and additions to the Articles of the Association that are of a purely formal nature and in themselves do not involve any changes to actual content.

**Acquisition and buyback of treasury stock** • By resolution of the Annual Shareholders' Meeting on 29 May 2013, the Management Board is authorised pursuant to § 71 (1) No. 8 of the German Stock Corporation Act (AktG) until 28 May 2018 to acquire QSC shares on a scale of up to 10 percent of issued capital upon the adoption of the said resolution. To date, the Management Board has not acted on this authorisation.

**Authorised capital** • By resolution of the Annual Shareholders' Meeting on 20 May 2010, the Management Board is authorised, subject to approval by the Supervisory Board, to increase the Company's issued capital by up to a total of € 65,000,000 on one or several occasions up to 19 May 2015 by issuing new no-par registered shares in return for contributions in cash and/or kind (authorised capital). When drawing on authorised capital, the Management Board may, subject to approval by the Supervisory Board, exclude shareholders' subscription rights in four cases: (1) to exclude residual amounts from shareholders' subscription rights; (2) when the new shares are issued in return for contributions in kind, particularly in the context of company acquisitions; (3) if, pursuant to § 186 (3) Sentence 4 of the German Stock Corporation Act (AktG), the new shares are issued in return for cash contributions and if, at the time of final stipulation, the issue price does not fall materially short of the stock market price of the shares already listed; and (4) to the extent necessary to issue subscription rights for new shares to the bearers or creditors of warrant and/or convertible bonds in order to avoid dilution of their respective holdings.
This authorised capital is intended to enable QSC to react swiftly and flexible to opportunities arising on the capital market and where necessary to obtain equity capital on favourable terms. No use was made of authorised capital in the past financial year.

**Conditional capital** • The Company had conditional capital totalling € 30,770,365 as of the balance sheet date. This was divided into Conditional Capital IV (€ 25,000,000), Conditional Capital VII (€ 770,365) and Conditional Capital VIII (€ 5,000,000).
Conditional Capitals VII and VIII serve to secure the conversion rights of bearers of convertible bonds that QSC has issued or may issue within the framework of existing stock option plans to Management Board members, managing directors of affiliated companies, employees of QSC and affiliated companies and other parties contributing to the Company's success. Conditional Capital IV may be used by the Management Board to create tradable warrant and/or convertible bonds.

The Management Board is authorised by resolution of the Annual Shareholders' Meeting on 20 May 2010 to issue such instruments in order to access an additional, low-interest financing option given favourable capital market conditions. The Management Board is authorised, subject to approval by the Supervisory Board, to exclude shareholders' subscription rights to these warrant and/or convertible bonds in only three cases: (1) to settle residual amounts resulting from the subscription ratio; (2) to grant subscription rights to the bearers/creditors of conversion or warrant rights already issued to avoid any dilution of their respective holdings; and (3) if, pursuant to § 186 (3) Sentence 4 of the German Stock Corporation Act (AktG), the issue price does not fall materially short of the market value of the bonds. To date, the Management Board has not acted on the authorisation to issue tradable warrant and/or convertible bonds.

The exclusion of shareholders' subscription and purchase rights, which pursuant to § 186 (3) Sentence 4 of the German Stock Corporation Act (AktG) is justified only when the respective issue price is close to the stock market price, may apply only to an aggregate total of no more than 10 percent of issued capital for treasury stock, authorised capital and warrant and convertible bonds during the term of the respective authorisation.

**Material agreements conditional on a change of control due to a takeover bid** • In the 2011 financial year, QSC entered into a syndicated loan agreement with seven financial institutions with an agreed credit facility of € 130 million as of the balance sheet date. This agreement provides the financial institutions with the option of terminating the credit line prematurely should a natural person or legal entity, acting either alone or together with other persons or entities, gain control over QSC. In the 2014 financial year, QSC agreed five promissory note loans with a financial institution with a total volume of € 150 million. These allow the lender to terminate the agreements prematurely should a natural person or legal entity or a group of persons and entities acting together directly or indirectly acquire more than 50 percent of the shares or voting rights in QSC. The Company has no further agreements conditional on a change of control due to a takeover bid.

**Compensation agreements in the event of a takeover bid** • No compensation agreements in the event of a takeover bid have been concluded either with the Management Board or with employees.

# Financial Report

## CONSOLIDATED STATEMENT OF INCOME

Euro amounts in thousands (€ 000s)

| | Note | 2014 | 2013 |
|---|---|---|---|
| **Net revenues** | 6 | **431,444** | **455,724** |
| Cost of revenues | 7 | (370,443) | (345,449) |
| **Gross profit** | | **61,001** | **110,275** |
| Sales and marketing expenses | 8 | (39,479) | (47,735) |
| General and administrative expenses | 9 | (38,256) | (38,987) |
| Other operating income | 10 | 1,104 | 3,422 |
| Other operating expenses | 10 | (18,320) | (474) |
| **Operating profit** | | **(33,950)** | **26,501** |
| Financial income | 11 | 358 | 363 |
| Financial expenses | 11 | (6,554) | (4,192) |
| **Net profit before income taxes** | | **(40,146)** | **22,672** |
| Income taxes | 41 | 6,231 | 940 |
| **Net profit (thereof attributable to equity holders of QSC AG)** | | **(33,915)** | **23,612** |
| **Earnings per share (basic) in €** | 12 | **(0.27)** | **0.19** |
| **Earnings per share (diluted) in €** | 12 | **(0.27)** | **0.19** |

## CONSOLIDATED STATEMENT OF CASH FLOWS

**Euro amounts in thousands (€ 000s)**

| | Note | 2014 | 2013 |
|---|---|---|---|
| **Cash flow from operating activities** | 35 | | |
| Net profit before income taxes | | (40,146) | 22,672 |
| Depreciation and amortisation of fixed assets | 14, 17 | 49,724 | 50,830 |
| Goodwill impairment | 15, 16 | 18,005 | - |
| Non-cash share-based remuneration | | 637 | 465 |
| Loss from disposal of long-term assets | | 75 | 13 |
| Changes in provisions | 29, 31 | 6,801 | (9,336) |
| Changes in trade receivables | 18 | (2,074) | 10,576 |
| Changes in trade payables | 30 | (17,283) | 5,230 |
| Changes in other assets and liabilities | | (13,816) | (16,288) |
| **Cash flow from operating activities** | 35 | **1,923** | **64,162** |
| **Cash flow from investing activities** | 36 | | |
| Disbursements for purchase of subsidiary, | | | |
| net of liquid funds acquired | | (3,616) | - |
| Purchase of intangible assets | | (15,529) | (14,665) |
| Purchase of property, plant and equipment | | (11,165) | (17,014) |
| **Cash flow from investing activities** | 36 | **(30,310)** | **(31,679)** |
| **Cash flow from financing activities** | 36 | | |
| Dividends paid | | (12,414) | (11,138) |
| Issuance of convertible bonds | | 6 | 6 |
| Proceeds from issuance of common stock | | 179 | 690 |
| Proceeds of loans granted | 28 | 150,000 | 11,000 |
| Repayment of loans | | (74,497) | (4,602) |
| Change in prepayments relating to financing activities | | (310) | - |
| Repayment of liabilities under financing | | | |
| and finance lease arrangements | | (5,490) | (4,543) |
| **Cash flow from financing activities** | 36 | **57,474** | **(8,587)** |
| **Change in cash and cash equivalents** | | **29,087** | **23,896** |
| Change in cash and cash equivalents as of 1 January | | 58,716 | 34,820 |
| **Cash and cash equivalents as of 31 December** | 23 | **87,803** | **58,716** |
| Interest paid | | 2,951 | 3,080 |
| Interest received | | 248 | 336 |
| Income tax paid | | 3,674 | 4,242 |

# CONSOLIDATED BALANCE SHEET

Euro amounts in thousands (€ 000s)

| | Note | 31 Dec. 2014 | 31 Dec. 2013 |
|---|---|---|---|
| ASSETS | | | |
| **Long-term assets** | | | |
| Property, plant and equipment | 14 | 76,169 | 93,869 |
| Land and buildings | 14 | 25,915 | 26,766 |
| Goodwill | 15, 16 | 67,077 | 76,265 |
| Other intangible assets | 17 | 53,684 | 52,809 |
| Trade receivables | 18 | 7,761 | 5,223 |
| Prepayments | 19 | 2,641 | 2,226 |
| Other long-term assets | | 2,948 | 349 |
| Deferred tax assets | 41 | 19,377 | 14,541 |
| **Long-term assets** | | **255,572** | **272,048** |
| **Short-term assets** | | | |
| Trade receivables | 18 | 52,145 | 52,539 |
| Prepayments | 19 | 6,493 | 5,070 |
| Inventories | 20 | 1,278 | 1,746 |
| Other short-term assets | 21 | 1,855 | 1,565 |
| Available-for-sale financial assets | 22 | 343 | 343 |
| Cash and cash equivalents | 23 | 87,803 | 58,716 |
| **Short-term assets** | | **149,917** | **119,979** |
| BALANCE SHEET TOTAL | | **405,489** | **392,027** |

| | Note | 31 Dec. 2014 | 31 Dec. 2013 |
|---|---|---|---|
| SHAREHOLDERS' EQUITY AND LIABILITIES | | | |
| **Shareholders' equity** | | | |
| Capital stock | 24 | 124,142 | 124,057 |
| Capital surplus | 25 | 142,069 | 141,286 |
| Other capital reserves | 27 | (3,066) | (1,176) |
| Accumulated deficit | | (117,511) | (70,996) |
| **Shareholders' equity** | | **145,634** | **193,171** |
| **Liabilities** | | | |
| **Long-term liabilities** | | | |
| Long-term liabilities under financing and finance lease arrangements | 28 | 4,447 | 8,835 |
| Liabilities due to banks | 28 | 156,550 | 82,697 |
| Convertible bonds | 39 | 25 | 19 |
| Accrued pensions | 29 | 7,281 | 6,765 |
| Other provisions | 31 | 305 | 370 |
| Deferred income | 32 | - | 712 |
| Other financial liabilities | 33 | 9,209 | - |
| Deferred tax liabilities | 41 | 2,333 | 3,912 |
| **Long-term liabilities** | | **180,150** | **103,310** |
| **Short-term liabilities** | | | |
| Trade payables | 30 | 44,820 | 58,696 |
| Short-term liabilities under financing and finance lease arrangements | 28 | 4,427 | 5,530 |
| Liabilities due to banks | 28 | 4,518 | 2,868 |
| Other provisions | 31 | 10,883 | 2,655 |
| Accrued taxes | 31 | 1,757 | 3,068 |
| Deferred income | 32 | 3,900 | 4,238 |
| Other short-term liabilities | 34 | 9,400 | 18,491 |
| **Short-term liabilities** | | **79,705** | **95,546** |
| **Liabilities** | | **259,855** | **198,856** |
| **TOTAL SHAREHOLDERS' EQUITY AND LIABILITIES** | | **405,489** | **392,027** |

# CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

Euro amounts in thousands (€ 000s)

| | Note | Equity attributable to equity holders of QSC AG | | | | |
|---|---|---|---|---|---|---|
| | | | | Other capital reserves | | |
| | | Capital stock | Capital surplus | Fair value of marketable securities | Actuarial gains/(losses) | Cash flow hedge reserve |
| **Balance as of 1 January 2014** | | 124,057 | 141,286 | (1) | (1,175) | - |
| Net profit for the period | | - | - | - | - | - |
| Other comprehensive income | | | | | | |
| for the period, net of tax | 27 | - | - | - | (415) | (1,475) |
| **Total comprehensive income** | | - | - | - | (415) | (1,475) |
| Revaluation of financial liabilities relating | | | | | | |
| to business acquisition | 37 | - | - | - | - | - |
| Conversion of convertible bonds | 39 | 85 | 94 | - | - | - |
| Dividends | | - | - | - | - | - |
| Non-cash share-based remuneration | 39 | - | 689 | - | - | - |
| **Balance as of 31 December 2014** | | 124,142 | 142,069 | (1) | (1,590) | (1,475) |
| **Balance as of 1 January 2013** | | 123,677 | 140,542 | (1) | (1,206) | - |
| Restatement in accordance with IAS 8 | 5 | - | - | - | - | - |
| **Restated balance as of 1 January 2013** | | 123,677 | 140,542 | (1) | (1,206) | - |
| Net profit for the period | | - | - | - | - | - |
| Other comprehensive income | | | | | | |
| for the period, net of tax | 27 | - | - | - | 31 | - |
| **Total comprehensive income** | | - | - | - | 31 | - |
| Conversion of convertible bonds | 39 | 380 | 310 | - | - | - |
| Dividends | | - | - | - | - | - |
| Non-cash share-based remuneration | 39 | - | 434 | - | - | - |
| **Balance as of 31 December 2013** | | 124,057 | 141,286 | (1) | (1,175) | - |

| Accumulated deficit | Total share-holders' equity | |
|---|---|---|
| (70,996) | 193,171 | **Balance as of 1 January 2014** |
| (33,915) | (33,915) | Net profit for the period |
| | | Other comprehensive income |
| - | (1,890) | for the period, net of tax |
| (33,915) | (35,805) | **Total comprehensive income** |
| | | Revaluation of financial liabilities relating |
| (186) | (186) | to business acquisition |
| - | 179 | Conversion of convertible bond |
| (12,414) | (12,414) | Dividends |
| - | 689 | Non-cash share-based remuneration |
| (117,511) | 145,634 | **Balance as of 31 December 2014** |
| (82,776) | 180,236 | **Balance as of 1 January 2013** |
| (694) | (694) | Restatement in accordance with IAS 8 |
| (83,470) | 179,542 | **Restated balance as of 1 January 1 2013** |
| 23,612 | 23,612 | Net profit for the period |
| | | Other comprehensive income |
| - | 31 | for the period, net of tax |
| 23,612 | 23,643 | **Total comprehensive income** |
| - | 690 | Conversion of convertible bond |
| (11,138) | (11,138) | Dividends |
| - | 434 | Non-cash share-based remuneration |
| (70,996) | 193,171 | **Balance as of 31 December 2013** |

# CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

Euro amounts in thousands (€ 000s)

| | 2014 | 2013 |
|---|---|---|
| Other comprehensive income | | |
| Line items that are not reclassified in the income statement | | |
| Actuarial losses from defined benefit pension plans | (613) | 51 |
| Tax effect | 198 | (20) |
| Line items that are not reclassified in the income statement | (415) | 31 |
| Line items that might subsequently be reclassified in the income statement | | |
| Fair value measurement of cash flow hedge | (2,180) | - |
| Tax effect | 705 | - |
| Line items that might subsequently be reclassified in the income statement | (1,475) | - |
| Total fair value changes (net of tax) recognised directly in equity (attributable to shareholders of QSC AG) | (1,890) | 31 |
| Net profit for the period | (33,915) | 23,612 |
| Total comprehensive income for the period | (35,805) | 23,643 |

# Notes to the Consolidated Financial Statements for the 2014 Financial Year

## CORPORATE INFORMATION

QSC AG (hereinafter also called "QSC" or "the Company") offers small and mid-size organisations comprehensive information and telecommunications services ("ICT services") – ranging from telephony, data transfer, Housing and Hosting through to IT Outsourcing and IT Consulting. In its capacity as an SAP and Microsoft Partner, QSC AG is also a specialist in the areas of SAP and Microsoft implementations. The portfolio of products is rounded off by the provision of in-house developed cloud services for a wide range of applications. Supported by a state-of-the-art network infrastructure and with its own IT centres in Germany certified to TÜV and ISO standards, QSC is one of the leading SME providers of ICT services in Germany. The Company offers customised solutions for individual ICT requirements as well as a modular-based product portfolio for smaller business customers and sales partners.
QSC is a stock corporation registered in the Federal Republic of Germany. Its legal domicile is Mathias-Brüggen-Straße 55, 50829 Cologne, Germany. The Company is registered in the Commercial Register of the Cologne District Court under number HRB 28281. QSC has been listed on the Deutsche Börse Stock Exchange since 19 April 2000, and on the Prime Standard since the beginning of 2003, following the reorganisation of the equity market. On 22 March 2004, QSC was added to the TecDAX, which includes the 30 largest and most liquid technology issues in the Prime Standard.

## ACCOUNTING PRINCIPLES AND POLICIES

### 1 Basis of preparation

Pursuant to Article 4 of Regulation (EC) No. 1606/2002 of the European Parliament and the Council dated 19 July 2002, the Company is required to prepare consolidated financial statements in accordance with International Financial Reporting Standards (IFRS) and – in accordance with § 315a (1) of the German Commercial Code (HGB) – is thus exempt from preparing consolidated financial statements in accordance with HGB. QSC prepares the consolidated financial statements on a historical cost basis, except in the case of available-for-sale financial assets and financial liabilities resulting from company acquisitions, which have been measured at fair value.
QSC prepares the consolidated financial statements in accordance with the IFRSs issued by the International Accounting Standards Board (IASB), applicable as of 31 December 2014, as required to be applied in the EU. The supplementary requirements of § 315a (1), HGB, are also complied with. All IFRSs and Interpretations issued by the International Financial Reporting Interpretations Committee (IFRIC) and the Standing Interpretations Committee (SIC) which are mandatory for the 2014 financial year have been applied by the Company.

The financial year of QSC and its subsidiaries (hereinafter also referred to as the "consolidated group") corresponds to the calendar year. The consolidated financial statements are presented in euros and all amounts, except when otherwise stated, are rounded to the nearest thousand. No events or transactions which would have a material effect on the consolidated group's net assets, financial position and earnings performance or cash flows occurred after the end of the reporting period and prior to 16 March 2015 (the date on which the consolidated financial statements were presented to the Supervisory Board for approval).

## 2 Consolidation

The consolidated financial statements comprise the financial statements of QSC AG and its subsidiaries as of 31 December of each financial year. The financial statements of subsidiaries are drawn up to the same balance sheet date and use the same accounting policies as applied by the parent company. All intra-group transactions and balances are eliminated in full. Subsidiaries are fully consolidated from the date of acquisition, being the date on which the Company obtains control, and continue to be consolidated on this basis until the date that such control ceases. Information on the entities included in the consolidated financial statements is provided in Note 37.

## 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 outcomes may differ from those assumptions and estimates, with the consequence that there is a risk that a significant adjustment to the carrying amounts of assets and liabilities could become necessary within the coming financial 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 consolidated group assesses whether there are any indications of impairment for 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 indications exist. Impairment is determined 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 CGU. The CGUs correspond to the reportable segments. An impairment loss is recognised if the recoverable amount of the CGU is less than its carrying amount. As of 31 December 2014 goodwill totalling € 67,077k (2013: € 76,265k) were recognised. Further details are provided in Note 15 and 16.

**Deferred tax assets** • QSC recognises 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 tax loss carryovers can be utilised.
Estimates by management are required to determine the amount of deferred tax assets that can be recognised, based upon the likely timing and level of future taxable profits together with underlying tax planning strategies. As of 31 December 2014, corporate income tax loss carryovers amounted to € 379 million (2013: € 374 million), and trade tax loss carryovers amounted to € 370 million (2013: € 368 million). As of 31 December 2014, deferred tax assets totalling € 19,377k (2013: € 14,541k) and deferred tax liabilities totalling € 2,333 (2013: € 3,912k) were recognised. Further details are provided in Note 41.

**Pension and other post-employment benefits** • The expense for defined benefit pension plans and other post-employment medical benefits is determined on the basis of actuarial valuations, which require the use of assumptions for discount rates, 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. Actuarial gains and losses are recognised directly in equity (through OCI) and reported in other provisions. As of 31 December 2014, provisions for pensions and similar obligations amounted to € 7,281k (2013: € 6,765k). Further details are provided in Note 29.

**Share-based remuneration** • QSC measures the expense recognised for share-based remuneration in cases where equity instruments are used to remunerate work performed using an appropriate option price model. The amount of the expense is calculated using assumptions relating to the risk-free interest rate relevant for the duration of the share options, the expected dividend to be paid and the shares' expected market price volatility. Due to the long-term nature of these remuneration agreements, such estimates are subject to significant uncertainty. Further details are provided in Note 39.

**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 behaviour and customer creditworthiness are subject to significant uncertainties. As of 31 December 2014, trade receivables totalled € 59,906k (2013: € 57,762k). Further details are provided in Note 18.

**Provisions** • A provision is recognised when the consolidated 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 amount of the obligation can be reliably estimated. Such estimates are subject to significant uncertainties. As of 31 December 2014, provisions totalling € 12,945k (2013: € 6,093k) were recognised in the balance sheet. Further details are provided in Note 31.

**Leases** • QSC determines whether an agreement represents a lease or lease arrangement on the basis of the economic content of the agreement at the inception of the lease. Discretion is used in determining whether an agreement grants rights to usage of an asset and the extent to which fulfilment of the contractual agreement depends on usage of one or more specific assets. As of 31 December 2014, lease liabilities totalled € 8,874k (2013: € 14,365k).

**Construction contracts** • Receivables arising on construction contracts are accounted for using the percentage of completion (PoC) method in accordance with IAS 11 if there is a customer-specific order. Revenue and expenses are recognised by reference to the stage of completion of contract activity, which, in turn, is based upon estimated total cost. As of 31 December 2014, accounts receivable under construction contracts totalled € 875k (2013: € 509k).

## 4 Significant accounting policies

**Revenue and expense recognition** • QSC recognises revenue to the extent that it is probable that the economic benefits will flow to the consolidated group, and when revenue can be reliably measured. Revenue is measured at the fair value of the consideration received, less settlement discount, rebates, and other sales taxes or duties. The following specific recognition criteria must also be met before revenue is recognised:

- Revenue from services is recognised when the services have been provided. QSC recognises revenue for services that have not been provided completely or throughout the entire reporting period on a time-apportioned basis up to the end of the reporting period by reference to the stage of completion.
- QSC defers non-recurring income from the installation of customer lines on a time-apportioned basis over an average contractual period of 24 months.
- Government grants are recognised as other operating income over the periods in which QSC recognises as expenses the related costs for which the grants are intended to compensate.
- Construction contracts are accounted for under the percentage of completion (PoC) method. Reference is made to the comments contained under “Construction contracts”.
- QSC recognises interest income using the effective interest method (i.e. using 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). Interest unwound on finance lease receivables from multi-component contracts is also presented as interest income.
- Multi-component contracts consist of a service portion and a hardware lease, for which the fair values of the two components are separable and can be determined reliably. Applying the requirements of IFRIC 4 to hardware leases means that the consolidated group’s IT Outsour-

cing unit functions as lessor in certain multi-component contracts. The lease agreements relate to identifiable assets usable exclusively by the customer. Revenue for services performed under the service contract is distributed pro rata over the contractual period. Revenue from contracts classified as finance leases is recognised at the start of the contract, and the interest portion is recognised on a monthly basis. In these cases, amounts owed by customers (lessees) under a finance lease are recorded as discounted receivables. Revenue from contracts classified as operating leases is recognised on a monthly basis over the contractual period. Total contract income is attributed to the respective components, applying the relative fair value method.
- Operating expenses are recognised when the performance has been utilised or at the time they are incurred.

**Foreign currency translation** • QSC presents the consolidated financial statements in euros. Transactions in currencies other than the euro are initially recorded using the spot exchange rate prevailing on the transaction date. Differences arising from changes in the exchange rate between the transaction date, on the one hand, and the settlement date or balance sheet date, on the other, are recognised by QSC in profit or loss. The functional currency for all consolidated group companies is the euro.

**Property, plant and equipment** • QSC reports property, plant and equipment in the balance sheet at acquisition or construction cost less accumulated depreciation and impairment losses. Replacement part costs for property, plant and equipment are added to the carrying amount of the asset in question at the time of replacement. Costs incurred after the commissioning of plants or first use of equipment are also capitalised if their incurrence enhances or significantly expands the asset in question; otherwise, the expense is recognised in profit and loss. The estimated useful lives of the assets are used as a basis for the application of straight-line depreciation. Property, plant and equipment are depreciated straight-line over the estimated useful lives shown in the table below:

| | Useful life in years |
|---|---|
| **Property, plant and equipment** | |
| Buildings | 20 to 50 |
| Networks and technical equipment | 2 to 25 |
| Leasehold improvements on third party land | 4 to 20 |
| Network components | 2 to 10 |
| Operational and office equipment | 3 to 13 |

**Borrowing costs** • Borrowing costs are recognised as an expense in the period in which they are incurred.

**Business combinations and goodwill** • QSC accounts for business combinations using the acquisition method, in accordance with which all identifiable assets and liabilities, as well as contingent liabilities of the acquired business, are recognised at their fair value. Goodwill arising in a business combination is initially measured at cost, being the excess of the cost of the business combination over the Company's interest in the net fair value of identifiable assets, liabilities and contingent liabilities.
QSC applies the anticipated acquisition method for business combinations, when obligations are entered into with non-controlling shareholders for the subsequent acquisition of those shareholders' remaining shares (contractual call and put options). Under this method, it is assumed that the call or put options have been exercised at the acquisition date. Based on this assumption that 100 percent of the shares have been acquired, there is no disclosure of non-controlling interests in the consolidated financial statements. Instead, the estimated fair value of the call or put options are taken into account at the date of first-time consolidation as additional acquisition cost and reported as a non-current financial liability in the balance sheet. Subsequent fair value changes as well as the impact of any unwinding of discount during the terms of the call and put options are recognised directly in equity.
Subsequent to initial recognition, QSC measures goodwill at cost, less any accumulated impairment losses. QSC tests goodwill for impairment annually, and at other times when there are indications 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 corresponds to their fair value as of the date of acquisition. Internally generated intangible assets are capitalised if the recognition criteria contained in IAS 38 are met. The costs involved relate primarily to personnel and materials. Costs not required to be recognised as assets are recognised in profit or loss in the period in which they arise. An assessment is made initially as to whether the useful lives of intangible assets are finite or indefinite. Intangible assets with finite lives are amortised over their useful economic life and tested for impairment whenever there is an indication that the intangible asset may be impaired. A review of the amortisation period and the amortisation method for such assets with a finite useful life is performed, at a minimum, at the end of each financial year.
Intangible assets with indefinite useful lives are not amortised, but are tested for impairment at least once a year.
QSC's other intangible assets primarily include software, licences and similar rights as well as non-recurring provisioning costs for activating customer connections. Moreover, brands and customer bases have been recognised as assets in conjunction with initial consolidations.
Licences are amortised over a period of 5 to 10 years and software over a period of 3 to 5 years.

Non-recurring provisioning costs for activating customer connections are amortised over an average contractual period of 24 months. Internally generated intangible assets (development costs) are amortised after completion of the development phase over a period of 3 to 5 years. Brands acquired in earlier accounting periods have been written down in full.
The useful lives of the intangible assets identified in conjunction with business combinations with IP Partner AG and INFO AG in financial year 2011 are 10 to 20 years for customer bases, 1.5 to 3 years for electricity contracts and 3 to 4 years for software.

Investments and financial assets • QCS classifies financial assets falling 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 on initial recognition and tests this designation at the end of each reporting period. Items are reclassified where allowed and appropriate.
On initial recognition, QSC measures financial assets at fair value. QSC accounts for all regular way purchases and sales of financial assets on the basis of the trade date, which is the date that the consolidated group committed itself to purchasing or selling 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 an active market. Subsequent to initial recognition, loans and receivables are measured at amortised cost, where applicable using the effective interest method and after deduction of impairment losses. Gains and losses are recognised in profit or loss when the receivables are derecognised or impaired, as well as through the amortisation process.
Payment due notices are sent out immediately when receivables become overdue. Uncollected receivables outstanding for more than six months are reviewed for default risk. When receivables are overdue by 60 – 90 days, this is deemed to represent objective evidence that impairment testing is called for in accordance with IAS 39.58. Impairments are only made if other objective evidence of impairment in accordance with IAS 39.59 is identified which indicates that receivables are uncollectible or that an impairment loss has been incurred.
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. Subsequent to initial recognition, QSC measures these at fair value, with unrealised gains and losses recognised in OCI, and therefore directly through equity in other reserves. When the investment is derecognised, the cumulative gain or loss previously recorded in equity is reclassified to profit or loss.
Other assets in the form of reinsurance claims on life insurance policies, which are not classified as plan assets within the meaning of IAS 19, are measured on the basis of the actuarial coverage reserves determined by the relevant insurance company. All other assets are stated at their nominal value and are presented in the balance sheet as “Long-term assets” and “Short-term assets”, based on their due dates.

**Construction contracts** • Receivables arising on construction contracts are accounted for using the percentage of completion (PoC) method in accordance with IAS 11 if there is a customer-specific order. Profit is recognised by reference to the stage of completion of the contract when total contract costs and contract revenue of the relevant contract can be measured reliably in accordance with the requirements of IAS 11. The stage of completion of a contract is determined using the cost-to-cost method (IAS 11.30a). When the above requirements are met, total contract revenue is recognised by reference to the stage of completion of the contract. Contract costs comprise costs relating directly to the contract as well as indirectly attributable production overheads. When it is probable that total contract costs will exceed total contract revenue, the expected loss is recognised immediately as an expense. Advance payments from customers are offset against construction contract trade receivables.

**Inventories** • QSC values inventories initially at their average acquisition cost. At the end of the reporting period, goods for resale are stated at the lower of cost and net realisable value.

**Cash and cash equivalents** • Cash and cash equivalents reported in the balance sheet and statement of cash flows comprise cash at banks, cash on hand and short-term deposits with an original maturity of three months or less.

**Provisions** • A provision is recognised when the consolidated 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. Where QSC expects some or all of a recognised provision to be reimbursed, the reimbursement is recognised as a separate asset if the reimbursement is virtually certain. The expense for allocations to the provision is recognised in the income statement net of any reimbursement.

**Pensions** • As stipulated in IAS 19, the valuation of provisions for pensions is based on the benefit entitlement procedure for defined benefit pension plans and is determined on the basis of an actuarial expertise. The obligation for defined benefit plans is determined separately for each plan using the projected unit credit method. Actuarial gains and losses are recognised directly in equity (through OCI) and reported in other provisions. The assumptions used by the Company to measure actuarial obligations are described in Note 29.

**Stock option programs** • QSC's employees may 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 7 November 2002), respectively, using an appropriate option price model. Further details are provided in Note 39. The expense recognised for granting equity instruments (as well as the corresponding increase in equity) is spread over the vesting period of the options.

QSC does not recognise any expense for remuneration entitlements which cannot be exercised. If the terms and conditions of a share-based remuneration agreement are modified, QSC recognises 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 and recognises the previously unrecognised expense immediately.

**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 fulfilment of the arrangement is dependent on the use of a specific asset, or assets, or the arrangement conveys a right to use the asset.

- **Finance leases – QSC as lessee** • In accordance with IAS 17, items attributable to QSC as their economic owner are recognised as assets and depreciated over their useful lives, or over the lease term if shorter. The obligation arising from the leasing arrangements is recognised as a liability and reduced over the lease period by the capital portion of the lease payments. Contracts classified as finance leases relate primarily to arrangements for computing hardware and data centre technology. Leased assets are measured at their fair value or, if lower, at the present value of the minimum lease payments during the non-cancellable period of the lease. In the case of rent-to-own and financing arrangements, the payments are divided into their constituent elements of financing expense and capital repayment using the effective interest rate method, such that the remaining carrying amount of the lease obligation is subject to a constant interest rate. Financing expenses are recognised immediately as a charge against income. QSC's financing arrangements predominantly consist of rent-to-own arrangements with terms of between 2 to 3 years.

- **Operating leases – QSC as lessee** • QSC classifies lease arrangements which do not transfer substantially all the risks and rewards incidental to ownership from QSC to the lessee as operating leases. Operating lease payments are recognised as an expense in the income statement on a straight line basis over the lease term.

- **The consolidated group as lessor** • Based on the requirements of IFRIC 4, the consolidated group is the lessor in certain multi-component contracts. In such cases, amounts owed by the lessee under finance leases are recognised as discounted receivables in the amount of the net investment value from consolidated group leases and reported under "Trade receivables". For multi-component contracts, the overall contract with the customer is divided into a service contract for services to be rendered and a sale transaction for the leased hardware. Service revenue is recognised pro rata over the contractual period. In the case of finance leases, revenue from the sale transaction is recognised in full in the year in which the contract is concluded. Operating lease income is recognised as income through profit and loss on a straight line basis over the lease term.

**Financial liabilities** • QSC measures all interest-bearing loans on initial recognition at fair value, less directly attributable transaction costs. Subsequent to initial recognition, interest-bearing loans and borrowings are measured at amortised cost using the effective interest method. Gains and losses are recognised in the income statement when the liabilities are derecognised as well as through the amortisation process.

**Derivative financial instruments** • In the second quarter 2014 QSC became party to derivative financial instruments in the form of interest rate swaps which are used to hedge the risk of fluctuations in interest payments.
Derivative financial instruments are recognised initially at the contract date and measured both then and at the end of subsequent reporting periods at their fair value. A positive fair value is reported as an asset and a negative fair value as other financial liabilities. The fair value of interest-rate derivatives is determined on the basis of present value models, taking account of relevant market information (interest rate curves).
In the event that derivatives are used to hedge a cash flow risk (so-called "cash flow hedges"), the hedging relationship is documented and the hedging relationship's effectiveness measured at each reporting date. The change in the fair value of the hedging instrument attributable to its effective portion is recognised in the statement of comprehensive income and reported directly in equity. The ineffective portion of the hedging relationship is recognised in profit or loss. Amounts recognised in the cash flow hedge reserve are reclassified to the statement of income in the period, in which the underlying hedged transaction impacts earnings.

**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.

**Taxes** • QSC recognises current income tax assets and liabilities for the current and for 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 expected to apply for the relevant corresponding assessment period. Current income tax relating to items recognised directly in equity is also recognised in equity.
Deferred taxes are recognised 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 recognises deferred income tax liabilities for all taxable temporary differences, except

- where the deferred tax liability arises from the initial recognition of goodwill;
- where the deferred tax liability 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
- where the deferred tax liability arises from 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 recognises deferred tax assets for all deductible temporary differences, unused tax loss carry-overs and unused tax credits to the extent that it is probable that taxable profit will be available against which the deductible temporary differences, tax losses and tax credits can be utilised except

– where the deferred 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 reported result for the period nor taxable profit or loss; and
– in respect of deductible temporary differences associated with investments in subsidiaries, associates and interests in joint ventures, if it is probable that the temporary differences will not reverse in the foreseeable future and insufficient taxable profit will be available against which the temporary differences can be utilised.

The carrying amount of deferred 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 utilised. Previously unrecognised deferred tax assets are also reassessed at each balance sheet date and are recognised to the extent that it has become probable that future taxable income will allow the deferred tax asset to be recovered.
QSC measures deferred tax assets and liabilities at the tax rates that are expected to apply to the year when the asset is realised or the liability is settled, based on tax rates and tax laws that have been enacted or substantively enacted as of the balance sheet date. Future changes in tax rates are required to be taken into account if enacted or substantively enacted by the end of the reporting period. Deferred taxes in connection with items recorded directly in equity as other income are likewise recorded directly in equity (through OCI) and not in profit or loss.
Deferred tax assets and deferred tax liabilities are offset if a legally enforceable right exists to set off current tax assets against current tax liabilities and the deferred tax assets and deferred tax liabilities relate to the same taxable entity and the same taxation authority.
Revenue, expenses and assets are recognised 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 sales tax is recognised as part of the cost of acquisition of the asset or as part of the expense item as applicable; and
– receivables and payables (with the exception of provisions) 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 assets” or “Other short-term liabilities”, respectively.

## 5 Corrections and changes in accounting policies

**Correction in accordance with IAS 8** • When drawing up the consolidated financial statements for the year ended 31 December 2014, it was identified that a difference (€ 694k) arising on the elimination of intragroup receivables and payables between QSC AG and Plusnet GmbH & Co. KG relating to the provision of services prior to 2013 had been offset against trade payables without impact on profit or loss, rather than being recognised in the Consolidated Statement of Income. In accordance with IAS 8, trade payables and shareholders' equity were both restated as at 1 January 2013 by € 694k.

| € 000s | 1 Jan. 2013 adjusted 2014 | 1 Jan. 2013 |
|---|---|---|
| Trade payables | 53,146 | 52,452 |

| € 000s | 31 Dec. 2013 adjusted 2014 | 31 Dec. 2013 |
|---|---|---|
| Trade payables | 58,696 | 58,002 |

| € 000s | 1 Jan. 2013 adjusted 2014 | 1 Jan. 2013 |
|---|---|---|
| Issued capital | 123,677 | 123,677 |
| Capital surplus | 140,542 | 140,542 |
| Other capital reserves | (1,207) | (1,207) |
| Accumulated deficit | (83,470) | (82,776) |
| **Shareholders' equity** | **179,542** | **180,236** |

| € 000s | 31 Dec. 2013 adjusted 2014 | 31 Dec. 2013 |
|---|---|---|
| Issued capital | 124,057 | 124,057 |
| Capital surplus | 141,286 | 141,286 |
| Other capital reserves | (1,176) | (1,176) |
| Accumulated deficit | (70,996) | (70,302) |
| **Shareholders' equity** | **193,171** | **193.865** |

The restatement had no impact on the Consolidated Statement of Income or on the Consolidated Statement of Cash Flows for the financial years 2013 and 2014.

**New Standards in 2014** • QSC AG has observed the following amendments in financial reporting pronouncements, application of which was mandatory for the first time in financial year 2014. Changes which are materially relevant for QSC AG's consolidated financial statements are presented in the following section.

**IFRS 10 – Consolidated Financial Statements** • This Standard sets out a new and comprehensive definition of control. If one entity controls another entity, the parent company must consolidate the subsidiary company. Under the new concept, an entity controls another entity if it has the ability to direct its activities on the basis of voting or other rights, if it participates in positive and negative variable returns from the controlled entity and if it has ability to influence the amount of returns.
In accordance with the transition requirements contained in IFRS 10, the Group has re-assessed its control over investees as at 1 January 2014. No changes arose in determining the scope of the group reporting entity.

**IFRS 11 – Joint Arrangements** • IFRS 11 specifies new accounting requirements for joint arrangements. Under the new concept, it must be decided whether the joint arrangement is a joint operation or a joint venture. Joint operations exist when the parties that have joint control of the arrangement have direct rights to the assets, and obligations for the liabilities, relating to the arrangement. Each entity accounts for its own share of the individual assets and liabilities. In the case of a joint venture, the parties have rights to the net assets of the arrangement. These rights are accounted for in the consolidated financial statements using the equity method; it is no longer permissible to account for such an arrangement proportionately.
The amendments to IFRS 11 did not have any impact on QSC during the period under report.

**IFRS 12 – Disclosure of Interests in Other Entities** • This Standard sets out disclosure requirements for interests in other entities. The necessary disclosures are considerably more extensive than those required by IAS 27, IAS 28 and IAS 31.
The expanded disclosure requirements were complied with in 2014.

**Amendments to IFRS 10, IFRS 11 and IFRS 12 – Transition rules** • The amendments contain a clarification and additional exemptions relevant for the transition to IFRS 10, IFRS 11 and IFRS 12. Adjusted comparative information, for instance, is only required to be presented for the preceding comparative period. In addition, there is no longer a requirement to disclose comparative information for periods prior to initial application of IFRS 12 for non-consolidated structured entities. This has not had any implications for QSC AG.

**Amendments to IFRS 10, IFRS 12 and IAS 27 – Investment Entities** • These amendments contain a definition of an "investment entity" and exclude such entities from the scope of application of IFRS 10. They have no impact on consolidated financial statements, which contain investment entities, unless the parent itself is an investment entity. Accordingly, the amendments had no impact on QSC AG's consolidated financial statements.

**Amendments to IAS 27 – Separate Financial Statements** • In conjunction with the approval of IFRS 10 Consolidated Financial Statements, the rules relating to the control principle and the requirements for drawing up consolidated financial statements have been taken out of IAS 27 and are now dealt with in IFRS 10 (see comments on IFRS 10). The overall effect is that IAS 27 now only contains requirements for accounting for subsidiaries, joint ventures and associated companies in separate IFRS financial statements.
The amendment had no impact on QSC AG's consolidated financial statements.

**Amendments to IAS 28 – Investments in Associates and Joint Ventures** • At the same time that IFRS 11 Joint Arrangements was approved, amendments were also made to IAS 28. IAS 28 continues to deal with the application of the equity method. As a result of IFRS 11, however, the scope of application was expanded significantly inasmuch that the equity method now not only applies to investments in associates, but also to joint ventures accounted for using the equity method (see IFRS 11). The option to use the proportionate method to consolidate joint ventures has been removed.
One further amendment relates to the accounting treatment applied in accordance with IFRS 5, when only part of an investment in an associate or joint venture is held for sale. IFRS 5 is required to be applied to the shares being sold, whereas the remaining shares (i.e. those being retained) continue to be accounted using the equity method up to the sale of the shares initially stipulated for sale.
The amendments did not have any impact during the period under report.

**Amendments to IAS 32 – Offsetting of Financial Assets and Financial Liabilities** • The amendments to IAS 32 clarify the criteria for offsetting financial instruments. Under the new rules, the significance of enforceable rights of offset is explained and the situations in which items should be reported on a gross or net basis are clarified.
The amendment had no impact on QSC AG's consolidated financial statements.

**Amendment to IAS 36 – Recoverable Amount Disclosures for Non-Financial Assets** • In conjunction with an amendment to IFRS 13, a new mandatory disclosure requirement for the goodwill impairment test pursuant to IAS 36 was introduced for 2013, requiring disclosure of the recoverable amount of cash-generating units, irrespective of whether an impairment loss was recognised or not. Since this disclosure requirement was added unintentionally, it was removed for 2014 by the May 2013 amendment. At the same time, the new amendment gives rise to additional disclosures if an impairment loss was actually recognised and the recoverable amount was determined on the basis of a fair value.
The change in disclosure requirements did not have any impact on QSC AG's consolidated financial statements.

**Amendment to IAS 39 – Novation of Derivatives and Continuation of Hedge Accounting •** As a result of this amendment, hedge accounting is not required to be discontinued for existing hedging relationships in circumstances when a hedging instrument is required to be novated to a central counterparty as a result of laws or regulations.
The amendment does not have any significant impact on QSC AG's consolidated financial statements.

QSC AG does not plan to apply early any of the following Standards and Interpretations described below which do not become mandatory until subsequent financial years. Unless stated otherwise, the impact on the consolidated financial statements of QSC AG is still being investigated.

The amendments described below have already been endorsed by the European Union:

**IFRIC 21 – Levies •** IFRIC 21 is an Interpretation of IAS 37. The principal issue covered is when a present obligation arises for levies imposed by governments and when a provision / payable should be recognised. A number of items are excluded from the scope of the Interpretation, in particular fines and other penalties, levies relating to government contracts or outflows of resources that are within the scope of other IFRSs, such as IAS 12. IFRIC 21 requires that a liability be recognised if the so-called "obligating event" – based on the wording of the underlying legislation – has occurred. The specific wording used can therefore be highly relevant for the accounting treatment.
The Amendments are mandatory for the first time for annual periods beginning on or after 17 June 2014.

**Improvements to IFRS 2011 – 2013 – Amendments to IFRS 1, IFRS 3, IFRS 13 and IAS 40 •** Four Standards were amended in conjunction with the IFRS Annual Improvement Project. The amendments relate, in part, to the clarification of existing rules through the improved wording of individual IFRSs.
The amendments are mandatory for annual periods beginning on or after 1 January 2015.

The amendments described below have not yet been endorsed by the European Union:

**IFRS 9 - Financial Instruments •** The new version of IFRS issued in July 2014 replaces the current requirements contained in IAS 39 Financial Instruments: Recognition and Measurement. IFRS 9 sets out the requirements for the classification and measurement of financial instruments, including a new model for expected credit losses for the purposes of determining the impairment of financial assets, as well as the new general requirements for hedge accounting. It also replaces the requirements for the recognition and derecognition of financial instruments contained in IAS 39. IFRS 9 – subject to EU endorsement – is mandatory for the first time for annual periods beginning on or after 1 January 2018.

**IFRS 14 – Regulatory Deferral Accounts** • This Standard, which has been issued as part of a more comprehensive IASB project on rate regulation, is an interim solution, aimed at facilitating the adoption of IFRS by rate-regulated entities until such time that requirements are stipulated for all IFRS users.
Prices are regulated in particular in sectors with entities which have considerable market power, such as transport or utilities (electricity, water, gas). Rate regulations may, for example, result in a requirement to reduce prices or a right to increase prices in the following year, depending on an increase or decrease in volumes in the current year. In the absence of any specific requirements in current IFRS, a debate has arisen as to whether these rights and obligations meet the definition of an asset or liability in accordance with IFRS. The general tendency is to conclude that they do not. In order to close this gap, the IASB has initiated a comprehensive project, the outcome of which is not expected to be known for a number of years.
The interim Standard allows IFRS first-time adopters to recognise regulatory deferral accounts in their IFRS financial statements, provided that they were already recognised in accordance with their previous national GAAP requirements.
The new Standard – subject to EU endorsement – is mandatory for the first time for annual periods beginning on or after 1 January 2016.

**IFRS 15 – Revenue from Contracts with Customers** • IFRS 15 sets out a comprehensive framework for the measurement and timing of recognition of revenue. It replaces the current requirements for revenue recognition, including those contained in IAS 18 Revenue, IAS 11 Construction Contracts and IFRIC 13 Customer Loyalty Programmes.
IFRS 15 – subject to EU endorsement – is mandatory for the first time for annual periods beginning on or after 1 January 2017. Earlier application is permitted.

**Amendments to IFRS 10 and IAS 28 – Sale or Contribution of Assets between an Investor and its Associate or Joint Venture** • The amendments address an acknowledged inconsistency between the requirements in IFRS 10 and those in IAS 28 (2011), in dealing with the sale or contribution of assets between an investor and its associate or joint venture.
The amendments – subject to EU endorsement – are mandatory for the first time for annual periods beginning on or after 1 January 2016.

**Amendments to IFRS 10, IFRS 12 and IAS 28 – Investment Entities: Applying the Consolidation Exception** • The amendments clarify various issues relating to applying the consolidation exception pursuant to IFRS 10, if the parent meets the definition of an "investment entity". Accordingly, parent entities are also exempt from preparing consolidated financial statements if the higher-level parent entity accounts for its subsidiaries at fair value in accordance with IFRS 10 rather than consolidating them.
The amendments – subject to EU endorsement – are mandatory for the first time for annual periods beginning on or after 1 January 2016.

**Amendments to IFRS 11 – Acquisition of an Interest in a Joint Operation** • The amendments to IFRS 11 address the accounting treatment of an acquisition of an interest in a joint operation, which constitutes an operation as defined by IFRS 3 Business Combinations. In such cases, the acquirer is required to apply the requirements of IFRS 3 to account for the business combination. The disclosure requirements contained in IFRS 3 must also be complied with.
The amendments – subject to EU endorsement – are mandatory for the first time for annual periods beginning on or after 1 January 2016.

**Amendments to IAS 1 – Notes Disclosures** • The amendments address various disclosure issues, including clarification that information does not require to be disclosed if it is not material. This also applies explicitly, if an IFRS requires a list of minimum disclosures. In addition, explanatory rules for aggregating and disaggregating items in the balance sheet and statement of comprehensive income are provided. The presentation of an entity's share of other comprehensive income of equity-accounted entities is also clarified. Finally, it is stressed that there is no standard template for the notes and that the emphasis should be on structuring the notes based on the relevance for the specific reporting entity.
The amendments – subject to EU endorsement – are mandatory for the first time for annual periods beginning on or after 1 January 2016.

**Amendments to IAS 16 and IAS 38 – Clarification of Acceptable Methods of Depreciation and Amortisation** • The IASB provides further guidance in these amendments on determining acceptable methods of depreciation and amortisation.
The amendments – subject to EU endorsement – are mandatory for the first time for annual periods beginning on or after 1 January 2016.

**Amendments to IAS 16 and IAS 41 – Agriculture: Bearer Plants** • These amendments stipulate that bearer plants should, in future, be accounted for in the same way as property, plant and equipment pursuant to IAS 16, since their utilisation is similar. By contrast, the produce growing on bearer plants will remain within the scope of IAS 41.
The amendments – subject to EU endorsement – are mandatory for the first time for annual periods beginning on or after 1 January 2016.

**Amendments to IAS 19 – Employee Benefits: Employee Contributions** • The amendments clarify the requirements relating to the allocation of contributions from employees or third parties to defined benefit plans to periods of employee service, if the contributions are linked to the number of years of employee service.
The amendments – subject to EU endorsement – are mandatory for the first time for annual periods beginning on or after 1 July 2014.

**Amendments to IAS 27 – Equity Method in Separate Financial Statements** • These amendments reinstate the equity method as an accounting option for investments in subsidiaries, joint ventures and associates in their separate financial statements. The existing options to account for such entities at cost or in accordance with IAS 39/IFRS 9 remain unchanged.
The amendments – subject to EU endorsement – are mandatory for the first time for annual periods beginning on or after 1 January 2016.

**Improvements to IFRS 2010 – 2012 – Amendments to IFRS 2, IFRS 3, IFRS 8, IFRS 13, IAS 16, IAS 24 and IAS 38** • Seven Standards were amended in conjunction with the IFRS Annual Improvement Project. The amendments relate, in part, to the clarification of existing rules through the improved wording of individual IFRSs. Some amendments also had the effect of changing disclosure requirements.
The amendments – subject to EU endorsement – are mandatory for the first time for annual periods beginning on or after 1 July 2014 or, in the case of the amendment to IFRS 2 and to IFRS 3, to transactions executed on or after 1 July 2014.

**Improvements to IFRS 2012 – 2014 – Amendments to IFRS 5, IFRS 7, IAS 19, IAS 34** • Four Standards were amended in conjunction with the IFRS Annual Improvement Project. The amendments relate, in part, to the clarification of existing rules through the improved wording of individual IFRSs/IASs.
The amendments – subject to EU endorsement – are mandatory for the first time for annual periods beginning on or after 1 January 2016.

## INCOME STATEMENT DISCLOSURES

### 6 Net revenues

Revenues are generated with resellers as well as with end-user customers. The resellers offer QSC's products and services to consumers under their own name and on their own account; in doing so, they serve as the interface to the consumer, thus also assuming the risk of bad debts. QSC defers non-recurring income from the installation of customer lines on a time-apportioned basis over an average contractual period of 24 months.
Revenues from construction contracts totalled € 2,960k for the year under review (2013: € 5,599k), and losses on construction contracts amounted to € 0k (2013: € 116k). Hardware leasing revenues from new multi-component contracts totalled € 4,925k in 2014 (2013: € 2,929k).

### 7 Cost of revenues

Cost of revenues include the cost of materials, the cost of building, operating and maintaining the network and the data centres, personnel expenses and non-cash share-based remuneration under stock option programs for employees working in technology operations. It also includes depreciation and amortisation on hardware and software utilised in technology operations. Moreover, this item includes personnel expenses from the Outsourcing and Consulting lines of business. Non-recurring provisioning costs for activating customer connections are capitalised and depreciated over the average contractual period of 24 months. In the 2014 financial year, research expenses totalling € 6,243k were incurred (2013: € 1,879k); development expenses totalling € 1,767k (2013: € 4,635k) were capitalised as intangible assets.

| € 000s | 2014 | 2013 |
|---|---|---|
| Cost of materials | 189,389 | 200,324 |
| Building, operation and maintenance of the network | 49,455 | 37,774 |
| Depreciation and amortisation | 43,080 | 41,954 |
| Personnel expenses | 88,225 | 65,366 |
| Non-cash share-based remuneration | 294 | 31 |
| **Cost of revenues** | **370,443** | **345,449** |

## 8 Sales and marketing expenses

Sales and marketing expenses include, in particular, advertising expenses and regular commission payments to dealers and distributors, allowances for bad debt, personnel expenses and non-cash share-based remuneration related to SOPs for employees in sales and marketing, as well as depreciation and amortisation on hardware and software utilised in sales and marketing operations. Similarly to the installation costs, the upfront commission payments to dealers and distributors for each new customer line are capitalised and amortised over the average contractual period of 24 months.

| € 000s | 2014 | 2013 |
|---|---|---|
| Personnel expenses | 19,586 | 22,723 |
| Commission payments | 11,340 | 13,322 |
| Other sales and marketing expenses | 3,814 | 3,891 |
| Allowance for bad debt and fair dealing payments | 398 | (174) |
| Advertising expenses | 2,642 | 2,056 |
| Depreciation and amortisation | 1,635 | 5,867 |
| Non-cash share-based remuneration | 64 | 50 |
| **Sales and Marketing expenses** | **39,479** | **47,735** |

## 9 General and administrative expenses

In addition to the personnel expenses and the non-cash share-based remuneration 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 also include costs for the administration buildings, legal and consulting costs, corporate communications costs (including investor relations), as well as depreciation and amortisation on hardware and software utilised in administrative operations.

| € 000s | 2014 | 2013 |
|---|---|---|
| Other general and administrative expenses | 16,602 | 15,710 |
| Personnel expenses | 15,745 | 19,914 |
| Depreciation and amortisation | 5,578 | 3,010 |
| Non-cash share-based remuneration | 331 | 353 |
| **General and administrative expenses** | **38,256** | **38,987** |

## 10 Other operating income and expenses

| € 000s | 2014 | 2013 |
|---|---|---|
| Other operating income | 482 | 831 |
| Gains from the reversal of provisions for legal disputes | - | 1,981 |
| Income from subsidised projects | 619 | 593 |
| Gains from disposal of fixed assets | 3 | 17 |
| **Other operating income** | **1,104** | **3,422** |

| € 000s | 2014 | 2013 |
|---|---|---|
| Other operating expenses | 237 | 471 |
| Losses from disposal of fixed assets | 78 | 3 |
| Goodwill impairment | 18,005 | - |
| **Other operating expenses** | **18,320** | **474** |

Other operating income chiefly comprises income of € 619k from subsidised projects (2013: € 593k). This involves grants provided by the German Federal Ministry of Economics and Technology and the EU. Other operating expenses include the impairment loss of € 18,005k recognised on goodwill at the Resellers CGU. Further details can be found in Notes 15 and 16.

## 11 Financial result

| € 000s | 2014 | 2013 |
|---|---|---|
| Interest income | 358 | 363 |
| **Financial income** | **358** | **363** |

| € 000s | 2014 | 2013 |
|---|---|---|
| Interest expense | 6,554 | 4,192 |
| **Financial expenses** | **6,554** | **4,192** |

Interest expense includes expenses of € 358k (2013: € 363k) relating to financing arrangements. Borrowing costs, which would have had to be attributed to qualifying assets, were not incurred. Net interest expense from pension provisions amounts to € 223k (2013: € 232k).

## 12 Earnings per share

For the purpose 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 of common stock approximately as a mean value from the respective number of common shares at the end of each quarter.
For the purpose 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 31 December 2014, the number of potential shares of common stock with a dilutive effect was 141,543. During the period between the balance sheet date and the date on which the consolidated financial statements were issued, 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 31 December 2014.

| | 2014 | 2013 |
|---|---|---|
| Net profit attributable to ordinary equity holders of the parent in € 000s | (33,915) | 23,612 |
| Weighted average number of issued shares | 124,125,487 | 123,833,301 |
| **Earnings per share (basic) in €** | **(0.27)** | **0.19** |

| | 2014 | 2013 |
|---|---|---|
| Net profit attributable to ordinary equity holders of the parent in € 000s | (33,943) | 23,612 |
| Weighted average number of issued and convertible shares | 124,267,030 | 125,783,722 |
| **Earnings per share (diluted) in €** | **(0.27)** | **0.19** |

## 13 Personnel expenses and employees

| € 000s | 2014 | 2013 |
|---|---|---|
| Wages and salaries | 108,041 | 92,527 |
| Employer's social security contributions (pension fund) | 8,408 | 7,615 |
| Employer's social security contributions (other) | 7,000 | 7,058 |
| Net pension costs | 107 | 803 |
| Non-cash share-based remuneration | 689 | 434 |
| **Personnel expenses** | **124,245** | **108,437** |

Wages and salaries include expenses for the termination of employment contracts totalling € 9,287k (2013: € 1,492k).
During the 2014 financial year, the consolidated group employed an average of 1,692 employees (2013: 1,620). The following table presents the employees' distribution by main corporate functions:

| | 2014 | 2013 |
|---|---|---|
| Sales and marketing | 166 | 135 |
| Technology Operations, Outsourcing, Consulting | 1,233 | 1,188 |
| Administration | 265 | 269 |
| Board and staff positions | 28 | 28 |
| **Number of employees by corporate function (average)** | **1,692** | **1,620** |

# BALANCE SHEET DISCLOSURES

## 14 Property, plant and equipment

| € 000s | Land and buildings | Network and technical equipment | Operational and office equipment | Total |
|---|---|---|---|---|
| Gross value at 1 January 2013 | 29,607 | 344,000 | 53,795 | 427,402 |
| Additions | 945 | 18,951 | 2,361 | 22,257 |
| Disposals | - | 948 | (87) | 861 |
| Reclassifications | (594) | 1,719 | (1,213) | (88) |
| Gross value at 31 December 2013 | 29,958 | 365,618 | 54,856 | 450,432 |
| Additions | 38 | 14,719 | 2,405 | 17,161 |
| Disposals | - | (12,316) | (1,498) | (13,814) |
| Reclassifications | (65) | 1 | 65 | - |
| Changes in scope of consolidation | - | - | 20 | 20 |
| Gross value at 31 December 2014 | 29,931 | 368,022 | 55,847 | 453,799 |
| Accumulated depreciation and amortisation at 1 January 2013 | 2,348 | 248,069 | 42,112 | 292,529 |
| Additions | 843 | 32,828 | 2,248 | 35,918 |
| Disposals | - | 1,632 | (87) | 1,545 |
| Reclassifications | - | 963 | (1,159) | (195) |
| Accumulated depreciation and amortisation at 31 December 2013 | 3,192 | 283,492 | 43,113 | 329,797 |
| Additions | 841 | 32,101 | 2,369 | 35,312 |
| Disposals | - | (11,905) | (1,498) | (13,403) |
| Reclassifications | (18) | - | 18 | - |
| Changes in scope of consolidation | - | - | 9 | 9 |
| Accumulated depreciation and amortisation at 31 December 2014 | 4,015 | 303,689 | 44,011 | 351,715 |
| Carrying amounts at 31 December 2013 | 26,766 | 82,126 | 11,743 | 120,635 |
| Carrying amounts at 31 December 2014 | 25,915 | 64,333 | 11,836 | 102,084 |

As of 31 December 2014, the carrying amount of plant and equipment, as well as of operational and office equipment held under financing arrangements and rent-to-own contracts totalled € 6,519k (2013: € 8,606k). The carrying amount is made up of € 6,011k for technical equipment and of € 508k for operational and office equipment.
Additions during the 2014 financial year amounted to € 17,161k (2013: € 22,257k). As of 31 December 2014, the "Network and technical equipment" line item included assets under construction amounting to € 784k (2013: € 449k), which stem primarily from expanding the data centres. QSC presents depreciation and amortisation in the income statement under "Cost of revenues", "Sales and marketing expenses" and "General and administrative expenses", respectively. There were no unplanned impairments recorded in the 2014 financial year.
Liens have been granted on real estate as collateral for liabilities under loan agreements (compare Note 28). Moreover, loans payable are secured by a mortgage lien provided to the lending bank for property, plant and equipment – furnishings and equipment – at the company's property situated at Grasweg 62-66 in Hamburg.

## 15 Goodwill

Goodwill amounted to € 67,077k as of 31 December 2014 (2013: € 76,265k). Goodwill was increased by the acquisitions of the encryption specialist FTAPI (€ 7,930k) and of fonial GmbH (€ 887k). This goodwill was allocated to the Indirect Sales segment. These additions were countered by an impairment requirement of € 18,005k identified upon the impairment test at the Resellers cash-generating unit (CGU). This has been recognised under other operating expenses in the consolidated income statement. Further details can be found in Note 16.

## 16 Impairment of goodwill

For the purpose of impairment testing, goodwill acquired in conjunction with business combinations was allocated to the following cash-generating units (CGUs), which were also reportable segments. Within the framework of the initial consolidation, the allocation was made to the cash generating units to which the acquired enterprises were associated.

| € 000s | 2014 | 2013 |
|---|---|---|
| Direct Sales | 32,706 | 32,706 |
| Indirect Sales | 31,232 | 22,415 |
| Resellers | 3,139 | 21,144 |
| **Carrying amount of goodwill** | **67,077** | **76,265** |

QSC initially determines the recoverable amount of the cash generating units (CGUs) on the basis of a calculated value in use employing three-year cash flow forecasts for this purpose. This planning is based upon the Management Board's planning for the Company. The planning is based upon the Management Board's expectations with respect to the future development of the individual business units and takes into consideration both external market analyses as well as internal assumptions relating to the marketing opportunities for innovative applications in the ICT market. QSC expects the Direct Sales CGU to generate solid growth in future. The Indirect Sales and Resellers GCUs are expected to be characterised by a continued market- and regulatory-induced contracting development in conventional TC business, on the one hand, and by a positive development in the ICT sector with innovative applications, on the other. The development in these GCUs will depend, in particular, upon the marketing of the Company's own high-margin innovative products and services, for which Management expects strong growth potential from 2016 onwards. As in the past fiscal year, a sustainable growth rate of 1.0 percent was assumed for all three GCUs. The segment-specific weighted average costs of capital (WACC) were determined in discounting the anticipated future cash flows of the respective cash generating units. The after-tax capitalisation interest rate is 9.51 percent (2013: 11.61 percent) for the Direct Sales GCU, 9.86 percent (2013: 12.53 percent) for Indirect Sales and 10.91 percent (2013: 14.36 percent) for the Resellers segment. These discount rates reflect Management's estimates with respect to Company-specific risks. In addition to a base rate and a market risk premium, they also include further risk-uplift factors that reflect the risk structure of the respective segment as well as that of the IT and Telecommunications industries. The base rate that represents a risk-free and periodically adequate alternative investment was determined on the basis of the interest rate structure curve for public-sector bond issues as of 31 December 2014. The increase in the capital interest rates for the Indirect Sales and Resellers CGUs reflect the degree of uncertainty inherent in the revenue and earnings growth planned in connection with marketing new products and services. The corresponding segment-specific capital interest rates before taxes amount to 13.52 percent for Direct Sales (2013: 16.98 percent), 14.55 percent for Indirect Sales (2013: 18.51 percent) and 13.46 percent for Resellers (2013: 18.83 percent).

The calculation of the CGUs' value in use is subject to forecasting uncertainties, particularly in respect of the development in prices and market shares, with these uncertainties requiring consideration when planning revenues and gross profit, as well as the capex ratio and discount rate. As far as market segments with cloud-based products are concerned, QSC continues to expect a higher rate of growth in the relevant market potential. Compared with the previous year, however, more conservative assumptions have been made concerning the volume of revenues actually achievable by QSC in these markets. QSC believes that the basic assumptions used to determine the CGUs' value in use, particularly regarding the capital interest rates, adequately reflect the risk position. The planning also assumes that no capital expenditure over and above the current level will be necessary as a prerequisite for improving or increasing the CGUs' earnings strength. Taking account of these more conservative planning assumptions, the value in use determined for the Resellers CGU amounts to € 22,213k, resulting in a corresponding impairment requirement of € 18,005k.

Various scenario analyses were performed for the impairment tests. The estimated recoverable amounts of the Direct Sales and Indirect Sales CGUs exceed their carrying amounts by € 28,900k and € 83,744k respectively. QSC has established that a potential, but unlikely, change in a major assumption could lead to the carrying amount exceeding the recoverable amount. The free cash flow scenario calculations relate to expected revenues and earnings contributions. An impairment requirement would arise if, all other factors being equal, revenues at the Direct Sales and Indirect Sales CGUs in the final planning year, and thus in perpetuity, were to fall around 3.0 percent and around 21.0 percent respectively short of the revenues assumed in the planning. Goodwill at the Resellers CGU would have to be written down in full if revenues in the final planning year, and thus in perpetuity, were to fall around 2.0 percent short of the respective budget values.

## 17 Other intangible assets

| € 000s | Licenses | Software | Customer connections | Customer bases | Brands | Other | Total |
|---|---|---|---|---|---|---|---|
| Gross value at 1 January 2013 | 1,663 | 28,062 | 121,975 | 36,223 | 2,426 | 15,364 | 205,713 |
| Additions | 208 | 10,860 | 6,136 | - | - | 100 | 17,304 |
| Disposals | - | - | - | - | - | - | - |
| Reclassifications | - | 88 | - | - | - | - | 88 |
| Gross value at 31 December 2013 | 1,870 | 39,010 | 128,112 | 36,223 | 2,426 | 15,464 | 223,105 |
| Additions | 98 | 5,213 | 7,468 | - | - | 100 | 12,879 |
| Disposals | - | (33) | - | - | - | - | (33) |
| Reclassifications | - | - | - | - | - | - | - |
| Changes in scope of consolidation | - | 2,410 | - | - | - | - | 2,410 |
| Gross value at 31 December 2014 | 1,968 | 46,600 | 135,580 | 36,223 | 2,426 | 15,564 | 238,361 |
| Accumulated amortisation and depreciation at 1 January 2013 | 1,082 | 20,836 | 114,386 | 4,216 | 834 | 13,834 | 155,188 |
| Additions | 94 | 3,578 | 6,859 | 2,366 | 1,592 | 424 | 14,913 |
| Disposals | - | - | - | - | - | - | - |
| Reclassifications | - | 195 | - | - | - | - | 195 |
| Accumulated amortisation and depreciation at 31 December 2013 | 1,176 | 24,609 | 121,246 | 6,581 | 2,426 | 14,258 | 170,295 |
| Additions | 107 | 4,875 | 6,832 | 2,368 | - | 232 | 14,413 |
| Disposals | - | (32) | - | - | - | - | (32) |
| Reclassifications | - | - | - | - | - | - | - |
| Changes in scope of consolidation | - | 1 | - | - | - | - | 1 |
| Accumulated amortisation and depreciation at 31 December 2014 | 1,283 | 29,452 | 128,077 | 8,949 | 2,426 | 14,490 | 184,677 |
| Carrying amounts at 31 December 2013 | 694 | 14,401 | 6,866 | 29,642 | - | 1,206 | 52,809 |
| Carrying amounts at 31 December 2014 | 686 | 17,148 | 7,503 | 27,274 | - | 1,074 | 53,684 |

Additions to the intangible assets include internally generated intangible assets (capitalised development cost) in the amount of € 1,767k (2013: € 4,635k).
The carrying amount of capitalised development cost amounted to € 7,933k (2013: € 7,132k). This amount is made up of € 3,587k for developments which have already been completed, and of € 4,346k for developments which have not yet been completed.
Capitalised development cost (internally generated software) has a useful life of four years and is depreciated on a straight-line basis over this period. Cumulative depreciation total € 1,273k for the past financial year (2013: € 54k).
The change in the scope of consolidation involves the encryption software contributed and included at an amount of € 2,410k upon the acquisition of FTAPI Software GmbH, Munich. Further details can be found in Note 37.
QSC presents depreciation and amortisation in the income statement under "Cost of revenues", "Sales and marketing expenses" and "General and administrative expenses", respectively. There were no unplanned impairments recorded in the 2014 financial year.

## 18 Trade receivables

| € 000s | 2014 | 2013 |
|---|---|---|
| Long-term trade receivables | 7,761 | 5,223 |
| Short-term trade receivables | 52,145 | 52,539 |
| **Trade receivables** | **59,906** | **57,762** |

The long-term trade receivables are essentially attributable to the accounting treatment of leasing receivables within the context of multi-component contracts. The receivables presented are not subject to any major restrictions on ownership or availability. The carrying amounts correspond to the fair values.
Full amortisation contacts without a purchase option having an average rental term of from 36 to 48 months are typically entered into. Following the expiration of the base rental period, the consolidated group has the option of extending the contract or selling the leased items, for which no purchase option was granted, within the framework of exploitation of the residual value. No residual values are guaranteed.

Within the framework of a factoring agreement with Norddeutsche Landesbank Luxembourg S.A., which had originally been concluded by INFO AG, QSC regularly sells certain short-term trade receivables having a total volume of up to € 18.5 million to the bank. As of the balance sheet date, accounts receivable having a nominal total value of € 18.5 million (2013: € 18.4 million) were transferred. The nominal value corresponds to the attributable fair market value of the transferred receivables. The transferred receivables have been taken off the books. QSC bears a maximum default risk of € 370k (2013: € 370k) with respect to those transferred receivables. As in the previous year, this amount, which is kept on deposit as collateral, was not utilised during the year under review. Receivables already sold may be bought back by QSC at any purchase date.
Short-term trade receivables are non-interest-bearing and generally have an original maturity of between 30 and 90 days. Short-term trade receivables do not bear interest and generally have maturities of 30 to 90 days. Allowances are recognised in the full amount of all receivables more than 90 days overdue. Receivables from the project business are considered on an individual case basis, i.e. all receivables more than 180 days overdue are individually tested for impairment. Furthermore, based on experience values a general allowance of 1 percent is recognised on those receivables not individually impaired.
As of 31 December 2014, trade receivables amounting to € 4,353k (2013: € 5,342k) were impaired. Allowances developed as follows:

| € 000s | 2014 | 2013 |
|---|---|---|
| Allowance at 1 January | 5,342 | 5,622 |
| Charge for the year | 1,388 | 1,071 |
| Utilised | (241) | (343) |
| Unused amounts reversed | (2,136) | (1,008) |
| Allowance at 31 December | 4,353 | 5,342 |

Trade receivables include receivables relating to uncompleted contracts for which the percentage-of-completion (PoC) method pursuant to IAS 11 is applied. The amount reported comprises cumulative contract costs incurred up to the balance sheet date plus a proportion of profit earned on the relevant contracts based on the cost-to-cost method. Advance payments received for these contracts are offset against the relevant PoC receivables. Contract revenue recognised in 2014 amounted to € 2,638k (2013: € 1,353k). During the year under review (as in the previous year), no write-downs were recognised with regard to the valuation of long-term construction contracts.
PoC receivables totalling € 875k (2013: € 509k) are reported as trade receivables. The income statement impact of PoC accounting is explained in Note 6.

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

| € 000s | 2014 | 2013 |
|---|---|---|
| Gross total | | |
| Impaired | 5,180 | 4,950 |
| Neither past due nor impaired | 50,028 | 42,934 |
| Past due but not impaired | | |
| < 90 days | 9,079 | 13,134 |
| 91 – 120 days | 38 | 176 |
| > 120 days | 760 | 1,910 |
| **Gross total** | **65,085** | **63,104** |

## 19 Prepayments

The long-term prepayments of € 2,641k (2013: € 2,226k) and short-term prepayments of € 6,493k (2013: € 5,070k) chiefly consist of prepayments for leased lines and technology premises, insurance and maintenance agreements.

## 20 Inventories

Inventories amounted to € 1,278k as of 31 December 2014 (2013: € 1,746k) and primarily include merchandise held in stock. End-user equipment is recognised in short-term assets upon acquisition and reclassified to long-term assets upon shipment to end customers. Impairment losses of € 584k were recognised in 2014 (2013: € 0k). Furthermore, consumables of € 27k have also been recognised under inventories (2013: € 34k).

## 21 Other short-term financial assets

Other short-term assets amount to € 1,855k (2013: € 1,565k) and mainly involve claims due from upstream suppliers. Moreover, this item also includes collateral of € 370k (2013: € 370k) subject to restrictions on disposability due to the sold receivables.

## 22 Available-for-sale financial assets

Available-for-sale financial assets, which amount to € 343k (2013: € 343k), consist of shares in a money market fund. These shares have been deposited with a bank as collateral for guarantees.

## 23 Cash and cash equivalents

Cash and cash equivalents amount to € 87,803k (2013: € 58,716k) and consist of cash at banks and on hand.

## 24 Issued capital

| | 2014 | 2013 |
|---|---|---|
| **Issued capital** | | |
| Capital stock in € 000s | 124,142 | 124,057 |
| No-par registered shares of common stock | 124,142,487 | 124,057,487 |

Each share of stock entitles the registered owner to cast one vote at the Annual Shareholders Meeting and enjoys full dividend entitlement. The voting right is not subject to any restrictions. The capital stock rose by € 85k in the 2014 financial year, solely as a result of the issuance of common shares in connection with stock option programs. Each share has a par value of € 1.00. All issued shares have been fully paid-in.

## 25 Capital surplus

Capital surplus amounted to € 142,069k as of 31 December 2014 (2013: € 141,286k). This amount also includes the deferred share-based compensation for the Stock Option Programme. The year-on-year change is due on the one hand to non-cash share-based remuneration of € 689k and on the other to the exercising of convertible bonds of € 94k. The capital surplus may only be used in accordance with the requirements of the German Stock Corporation Act (AktG).

## 26 Authorised and conditional capital

**Authorised capital** • The Management Board is authorised, with the approval of the Supervisory Board, to increase the capital stock on one or several occasions through 19 May 2015 to a total of € 65,000,000 through the issuance of new no-par registered shares against contributions in cash and/or in kind. As a general rule, subscription rights are also required to be given to existing shareholders.

**Conditional capital** • As of 31 December 2014, conditional capital amounted to € 30,770k, of which € 5,770k relate to conditional increases in share capital which will only be executed to the extent that holders of convertible bonds issued in connection with QSC stock option plans exercise their conversion rights.
Conditional capital in the amount of € 25,000k relates to a conditional increase in share capital issued in accordance with the authorisation by shareholders given at the Annual General Meeting on 20 May 2010, and valid through 19 May 2015. The conditional capital will be executed only to the extent that holders of options bonds and/or convertible bonds issued or guaranteed by QSC or by a consolidated group entity – as defined by § 18 AktG and in which QSC directly or directly has a majority participation – exercise their option/conversion rights under the bond or fulfil their option/conversion obligation and, secondly, only to the extent that no cash settlement is given and no treasury shares of the Company or the shares of an another publicly traded company are used to service the options/conversion. New shares will be issued at the option/conversion price determined on the basis of the authorisation resolution referred to above.

## 27 Other reserves

Other reserves include gains and losses on available-for-sale financial assets, actuarial gains and losses on defined benefit pension plans and losses resulting from changes in the fair values of long-term financial liabilities. The development in this item in the 2014 and 2013 financial years is presented in the consolidated statement of changes in equity and under OCI in the consolidated statement of comprehensive income.
Other reserves were structured as follows as of 31 December:

| € 000s | 2014 | 2013 |
|---|---|---|
| Other reserves | | |
| Change in fair value of available-for-sale assets | (1) | (1) |
| Actuarial gains and losses on pension plans | (1,590) | (1,175) |
| Change in fair value of cash flow hedge | (1,475) | - |
| Other reserves | (3,066) | (1,176) |

The values are stated in each case after deferred taxes.

## 28 Interest-bearing liabilities

| € 000s | Effective interest rate in % in 2014 | Due date | 2014 | 2013 |
|---|---|---|---|---|
| **Short-term liabilities** | | | | |
| Under financing and finance | | | | |
| lease arrangements | 3.67 | 2015 | 4,427 | 5,530 |
| Due to banks | 5.30 | 2015 | 4,518 | 2,868 |
| **Short-term liabilities** | | | **8,945** | **8,398** |
| **Long-term liabilities** | | | | |
| From convertible bonds | 3.50 | 2015 – 2019 | 25 | 19 |
| Due to banks | 2.49 | 2016 – 2021 | 156,550 | 82,697 |
| Fixed rate (€ 69,050k) | 2.79 | | | |
| Floating rate (€ 87,500k) | 2.25 | | | |
| Under financing and finance | | | | |
| lease arrangements | 3.67 | 2016 – 2019 | 4,447 | 8,835 |
| **Long-term liabilities** | | | **161,022** | **91,551** |
| **Interest-bearing liabilities** | | | **169,967** | **99,949** |

**Short-term interest-bearing liabilities** • Short-term liabilities under financing and finance lease arrangements and to banks consist of fixed repayment obligations through to the end of 2015.

**Long-term interest-bearing liabilities** • As of 31 December 2014, 2,514,712 convertible bonds were outstanding in connection with the Stock Option Programmes. The convertible bonds have a nominal value of € 0.01 each. Further details can be found in Note 39.
Of long-term liabilities due to banks as of the balance sheet date, an amount of € 150,000k involves liabilities from five tranches of a promissory note loan taken up in May 2014. The terms of the individual tranches have been presented in the table below. Alongside the promissory note loan, QSC has further long-term loans of € 6,550k due to banks.
To hedge the cash flow risk involved in the variable-interest tranches of the promissory note loan, which amount to € 87,500k, QSC has concluded three interest swaps. Of these, € 76,500k has a term running until 20 May 2019 and € 11,000k have a term running until 20 May 2021. The interest swaps meet IAS39 hedge accounting requirements (cash flow hedges). In respect of their terms and variable interest rates, the interest swaps are congruent with the tranches of the promissory note loan thereby hedged. The underlying effectiveness assessment is performed as of each balance sheet date using the hypothetical derivative method.

| | Nominal amount € 000s | Term | Interest rate |
|---|---|---|---|
| **Variable-interest tranches** | | | |
| Tranche 1 | 56,500 | 5 years | 6-month Euribor + 1.4 % |
| Tranche 2 | 20,000 | 5 years | 3-month Euribor + 1.2 % |
| Tranche 3 | 11,000 | 7 years | 6-month Euribor + 1.8 % |
| **Variable-interest tranches** | **87,500** | | |
| **Fixed-interest tranches** | | | |
| Tranche 4 | 38,500 | 5 years | 2.29 % |
| Tranche 5 | 24,000 | 7 years | 3.05 % |
| **Fixed-interest tranches** | **62,500** | | |

The negative fair value of the interest swaps amounted to € 2,262k as of the balance sheet date (2013: € 0k) and has been recognised under other long-term financial liabilities (Note 33). The fair value measurement of the interest swaps was performed by the intermediary bank. This is derived either from the mid-market price or, when expressed as a bid and asked price, from the indicative price at which the bank would have terminated and concluded or bought back and sold the financial instrument on the relevant marketplace at the close of business on the respective measurement date.

An amount of € 2,180k (2013: € 0k) has been recognised under OCI in the consolidated statement of comprehensive income for the change in the value of the interest swap before deferred taxes. The residual amount of € 82k involves accumulated interest that has been recognised under financial expenses.

No amounts were recognised for hedge ineffectiveness in the income statement in the period under report. The payments expected for the hedge include interest payments for the hedged item and the hedging relationship. These are incurred on an ongoing basis over the term and recognised under interest expenses.

Including the interest swap hedging, which is to be classified as effective, the variable-rate tranches of the promissory note loan have an effective interest rate corresponding to that of a fixed-interest instrument with an interest rate of 2.25 percent. For the variable-rate tranches, this corresponds to an annual interest payment of € 1,967k through to initial maturity in 2019 and subsequently of € 248k through to maturity in 2021.

Furthermore, QSC had committed credit lines from the syndicated loan agreement concluded in September 2011. The borrowers here are QSC, Ventelo and Plusnet. This revolving credit facility has an amount of € 130,000k and a term running until 16 September 2016. As of 31 December 2014, no loan amounts had been drawn down (2013: € 73,000k). The current interest rate amounts to Euribor plus an average of 2.5 percentage points. The margin may change depending on the Company's financial and earnings position.

The loan amounts drawn down are used for general working capital financing. Drawdowns of loan amounts are dependent on QSC complying with specified key financial ratios ("financial covenants") during the term of the credit facility. The financial covenants refer to the development in shareholders' equity and to the Company's debt servicing capacity. The agreed financial covenants were complied with in the 2014 financial year.

Loans payable are secured by a mortgage lien of € 23,000k on land at Grasweg 62-66. Additional collateral has also been provided to the lending bank in the form of a storage assignment of assets. Further loans payable at the level of QSC are secured by a mortgage lien of € 2,300k on the plant site of a subsidiary. In addition, all entitlements to receive rent and lease income under the general subcontract agreement between the subsidiary and a customer have also been assigned as collateral.

Long-term liabilities under financing arrangements comprise an annuity loan, in particular, that is utilised to finance buildings and data centres. Long-term liabilities under financing arrangements consist of fixed payment obligations for the period 2016 through 2019.

## 29 Accrued pensions

QSC operates defined benefit pension plans, which are partially secured through reinsurance and classified as plan assets in accordance with IAS 19.

The pension provision covers benefit entitlements of one former member of the QSC Management Board and two former members of the INFO AG management board as well as benefit entitlement granted to parts of the QSC and Ventelo GmbH workforce in previous years.

The pension entitlements relate to defined benefits which depend primarily of the period of service with the company and the relevant level of salary. These defined benefit plans expose the consolidated group to various actuarial risks, including longevity and interest rate risks.

The pension provision for defined benefit plans is measured using the projected unit credit method in accordance with the requirements of IAS 19 and takes future developments into account. Assumptions are based on the 2005 G biometric tables issued by Prof. Dr. Klaus Heubeck.

As in the previous fiscal year, QSC recognises all actuarial gains and losses directly through OCI. In the 2014 financial year, the cumulative amount of all actuarial gains and losses as presented in the consolidated statement of directly recognised income and expenses was € 2,343k (2013: € 1,730k).

| € 000s | 2014 | 2013 |
|---|---|---|
| **Present value of defined benefit obligation at 1 January** | **7,874** | **7,449** |
| Service costs | 24 | 132 |
| Interest costs | 223 | 232 |
| Actuarial losses (gains) | 561 | (113) |
| Due to changes in the demographic assumptions | - | 39 |
| Due to changes in financial assumptions | 713 | (152) |
| Due to experience adjustments | (152) | - |
| Benefits paid | (243) | (132) |
| Transfer of obligations | - | 306 |
| **Present value of defined benefit obligation at 31 December** | **8,439** | **7,874** |
| **Fair value of plan assets at 1 January** | **(1,109)** | **(545)** |
| Interest income | (40) | (23) |
| Income from plan assets, exclusive of amounts contained | | |
| in net interest expense and income | 52 | 24 |
| Payment from fund assets | 151 | - |
| Transfer | (5) | (359) |
| Employer contributions to plan assets | (207) | (207) |
| **Fair value of plan assets at 31 December** | **(1,158)** | **(1,109)** |
| **Accrued pensions at 31 December** | **7,281** | **6,765** |
| Discount rate | 1.53 % – 2.05 % | 2.70 % – 3.30 % |
| Rate of compensation increase | 2.28 % | 3.30 % |
| Rate of pension indexation | 1.78 % – 2.00 % | 2.00 % – 2.70 % |

Total actuarial losses after taxes amounted to € 415k (2013: € -31k).
Actuarial gains and losses as well as income from plan assets (excluding amounts reported in net interest income/expense) are recognised through OCI.
Expenses and income recognised in the income statement relating to defined benefit plans comprise the following:

| € 000s | 2014 | 2013 |
|---|---|---|
| Service costs | 24 | 132 |
| Interest costs | 223 | 232 |
| Expected return on plan assets | (40) | (23) |
| **Pension costs** | **207** | **341** |

Pension payments amounting to € 255k and funding contributions to plan assets amounting to € 206k are expected in 2015.
If the assumptions used to measure pension obligations at the end of the reporting period (as described above) were changed individually by a half percent, pension obligations would increase/decrease as follows:

| € 000s | Change in pension obligations | Pension obligations |
|---|---|---|
| Change in interest rate + 0.5 % | (651) | 7,788 |
| Change in interest rate - 0.5 % | 738 | 9,177 |

In 2014, QSC made experience adjustments to the present values of the DBO and the fund assets. These resulted in actuarial gains of € 152k (2013: € 0k).

## 30 Trade payables

All trade payables have terms of less than one year.

## 31 Provisions

| € 000s | 2014 | 2013 |
|---|---|---|
| **Long-term provisions at 1 January** | **370** | **856** |
| Reclassification to short-term provisions | (40) | (226) |
| Additions | 20 | 17 |
| Utilised | (45) | - |
| Unused amounts reversed | - | (277) |
| **Other long term provisions at 31 December** | **305** | **370** |

The long-term provisions relate to leasehold improvement obligations amounting to € 250k (2013: € 234k) and other personnel provisions amounting to € 54k (2013: € 51k). The leasehold improvement obligations are typically incurred at the end of the rental period. The rental agreements have differing termination dates, ranging from 2019 to 2028, and the due dates of the leasehold improvement obligations are distributed accordingly.

| € 000s | 2014 | 2013 |
|---|---|---|
| Other provisions at 1 January | 1,169 | 2,265 |
| Reclassification from long-term provisions | (40) | 226 |
| Addition from change in scope of consolidation | 174 | - |
| Additions | 9,149 | 1,062 |
| Utilised | (1,005) | (2,199) |
| Unused amounts reversed | - | (185) |
| Other provisions at 31 December | 9,447 | 1,169 |
| Provisions for risks of legal disputes at 1 January | 1,486 | 4,176 |
| Addition from change in scope of consolidation | 13 | - |
| Additions | 57 | 156 |
| Utilised | (90) | (865) |
| Unused amounts reversed | (30) | (1,981) |
| Provisions for risks of legal disputes at 31 December | 1,436 | 1,486 |
| Other short-term provisions at 31 December | 10,883 | 2,655 |

Other short-term provisions essentially relate to risks of legal disputes and human resources provisions. Measurement has been based on empirical values from previous periods. Short-term provisions include expenses of € 8,287k for the termination of employment relationships. Of this amount, € 7,189k relates to redundancy payments and employee leave benefit for the planned reduction in staff totals within the cost-cutting programme. The remaining € 1,098k involves redundancy payments and employee leave benefits for employees who left the company in 2014 already.

| € 000s | 2014 | 2013 |
|---|---|---|
| Tax provisions at 1 January | 3,068 | 3,505 |
| Additions | - | 2,123 |
| Utilised | (1,074) | (2,479) |
| Unused amounts reversed | (237) | (81) |
| Tax provisions at 31 December | 1,757 | 3,068 |

Tax provisions include trade tax provisions amounting to € 1,156k and corporate income tax provisions amounting to € 601k.

## 32 Deferred income

QSC defers non-recurring income from the installation of customer lines on a periodic and pro rata basis over an average contract term of 24 months. Advance payments from customers are also deferred up to the date the service is provided.

## 33 Other long-term financial liabilities

Long-term other financial liabilities amounted to € 9,209k as of 31 December 2014 (2013: € 0k). Of these, an amount of € 5,802k relates to the fair value of the put options granted in connection with the acquisition of shares in FTAPI Software GmbH (hereinafter also called "FTAPI"), € 900k to the fair value of the put options granted in connection with the establishment of fonial GmbH, € 2,262k to the negative fair value of derivative interest hedges and € 245k to the obligation in connection with an employee participation programme at FTAPI.

Upon the acquisition of a majority interest in FTAPI, agreements were reached with the minority shareholders under which QSC is entitled to acquire the remaining shares in FTAPI under a defined price formula during defined exercise periods in the years 2017 to 2019 (purchase option). Conversely, the remaining shareholders are entitled to offer their shares in FTAPI to QSC for purchase under a defined price formula during the same exercise periods (sell option). Consistent with the requirements of IAS 32.23, a financial liability of € 5,616k was stated upon initial recognition to account for QSC's obligation in connection with the sell option held by the remaining shareholders (please also see disclosures in Note 37). The fair value of the expected exercise price for the sell option was used as the basis for calculating the financial liability (Level 3 as per IFRS 13.81), with application upon acquisition of a risk and maturity-congruent interest rate of 4.28 percent. The purchase price for the remaining shares is dependent on FTAPI's economic performance during the option exercise period. In its planning, QSC assumes that the put options will be drawn on in 2017. Measurement of the put options has been based on FTAPI's expected EBITDA for 2016, multiplied by a contractually agreed factor and reduced by net debt.

As of the balance sheet date on 31 December 2014, the purchase options were revalued using an interest rate of 5 percent. The € 186k increase in fair value resulting from this revaluation has been recognised directly in consolidated equity.

A similar arrangement was also agreed with the minority shareholder in fonial GmbH (please also see disclosures in Note 37). These options may be exercised in 2018 and 2019. Measurement of the options is based on enterprise value, consisting of two components, namely EBIT for 2017 and 2018 and achievement of operating performance parameters for the two years. In its planning, QSC assumes that the options will be exercised in 2018. Based on an interest rate of 5 percent, the fair value of the options (Level 3 as per IFRS 13.81) amounted to € 900k as of the acquisition date and as of 31 December 2014.

This balance sheet line item includes an amount of € 2,262k for the negative fair value of the interest swaps acquired to hedge cash flow risks from variable-interest tranches of the promissory note loan (please see Note 28).
Furthermore, variable compensation commitments were made to senior employees at FTAPI. These mature upon the remaining shares in FTAPI being offered to and acquired by QSC. The amount of cash compensation is dependent on QSC's purchase price payment to acquire the remaining shares in FTAPI. The value of this compensation as of the balance sheet date was determined at € 245k and recognised through profit or loss.

## 34 Other short-term liabilities

All other short-term liabilities have terms of less than one year and mainly relate to obligations in connection with employment contracts, including claims to variable compensation, vacation entitlement and payroll and church tax liabilities.

## CASH FLOW STATEMENT DISCLOSURES

### 35 Cash flow from operating activities

The cash flow from operating activities amounted to € 1,923k in the 2014 financial year and thus fell € 62,239k short of the previous year's figure of € 64,162k. This development was chiefly due to the reduction in consolidated net income by € 62,818k and to a substantial downturn in liabilities, with a year-on-year impact of € 22,513k. These items were opposed by the non-cash increase in amortisation by € 18,005k as a result of the impairment loss recognised for goodwill.

### 36 Cash flows from investing and financing activities

The cash flow from investing activities amounted to € -30,310k in 2014 (2013: € -31,679k). Of the capital expenditure of € 30,040k in 2014, an amount of € 3,339k is recognised under liabilities due to its maturity in 2015. The cash flow from the acquisition of shares in FTAPI, less the liquid funds thereby acquired, amounts to € 3,629k.
The cash flow from financing activities amounted to € 57,474k in 2014 (2013: € -8,587k). This development was primarily attributable to the taking up of loans of € 150,000k (2013: € 11,000k) and the repayment of loans of € 74,497k (2013: € 4,602k). Interest paid of € 2,951k (2013: € 3,080k) and interest received of € 248k (2013: € 336k) have also been allocated to the cash flow from financing activities.

# OTHER DISCLOSURES

## 37 Subsidiaries

The consolidated financial statements of QSC include the following equity investments:

| € 000s | Shareholdings in % 31 Dec. 2014 | Shareholders' equity at 31 Dec. 2014 | Result for the year 2014 |
|---|---|---|---|
| **Subsidiaries (disclosures pursuant to the German Commercial Code [HGB])** | | | |
| Ventelo GmbH ("Ventelo"), Cologne | 100.00 | 169,738 | (1,095)* |
| Plusnet GmbH & Co. KG ("Plusnet"), Cologne ** | 100.00 | 6,924 | - |
| BroadNet Deutschland GmbH ("BroadNet Deutschland"), Cologne | 100.00 | 3,502 | 99**** |
| IP Colocation GmbH ("IP Colocation"), Nuremberg | 100.00 | 1,986 | 359 |
| Q-DSL home GmbH ("DSL home"), Cologne | 100.00 | 1,293 | (34)* |
| 010090 GmbH ("010090"), Cologne | 100.00 | 156 | 447* |
| T&Q Netzbetriebs GmbH & Co. KG ("T&Q"), Cologne | 100.00 | 190 | (153) |
| T&Q Verwaltungs GmbH ("T&Q Verwaltung"), Cologne | 100.00 | 34 | 2 |
| 01012 Telecom GmbH ("01012"), Cologne | 100.00 | 27 | 29* |
| F&Q Netzbetriebs GmbH & Co. KG ("F&Q"), Cologne | 100.00 | 356 | - |
| Broadnet Services GmbH ("Broadnet Services"), Cologne | 100.00 | 25 | 2,412* |
| 01098 Telecom GmbH ("01098"), Cologne | 100.00 | 25 | 29* |
| 010052 Telecom GmbH ("010052"), Cologne | 100.00 | 25 | 29* |
| 010088 Telecom GmbH ("010088"), Cologne – formerly tengo GmbH, Cologne | 100.00 | 25 | 29* |
| 01052 Communication GmbH ("01052"), Cologne | 100.00 | 25 | 29* |
| Q-loud GmbH ("Q-loud"), Cologne | 100.00 | 25 | (50)* |
| tengo GmbH ("tengo"), Cologne | 100.00 | 25 | (467)* |
| Broadnet NGN GmbH ("Broadnet NGN"), Cologne | 100.00 | 25 | (31)* |
| F&Q Netzbetriebs Verwaltungs GmbH ("F&Q Verwaltung"), Cologne | 100.00 | 27 | 1 |
| Plusnet Verwaltungs GmbH ("Plusnet Verwaltung"), Cologne *** | 100.00 | 19 | 5 |
| fonial GmbH, Cologne | 74.90 | 50 | (3) |
| FTAPI Software GmbH, Munich | 50.93 | (792) | (1,549) |

* Annual result before profit and loss takeover agreement
** The shares are held by Ventelo GmbH
*** The shares are held by Plusnet GmbH & Co. KG
**** The profit transfer agreement is not executed due to § 301 AktG

Through a contract dated 17 December 2013, Collutio Holding GmbH, of Vienna, which was already a wholly owned subsidiary of QSC, was merged with QSC. The merger went into force upon being entered in the Commercial Register on 24 March 2014.

On 24 February 2014, QSC acquired a nominal 50.93 percent of the shares of Munich-based FTAPI Software GmbH (hereinafter also called "FTAPI"), which specialises in encrypted data exchange between business customers. Taking into consideration its own shares of the company, this calculates to an investment ratio of 57.23 percent on the part of QSC.

A cash purchase price of € 3,056k was paid to the former shareholders for shares amounting to a nominal 50.93 percent. Moreover, agreements are in place with the minority shareholders under which QSC is entitled to acquire the remaining shares of FTAPI under a defined price formula during defined exercise periods in the years 2017 through 2019 (purchase option). Conversely, the remaining shareholders are entitled to offer their shares of FTAPI to QSC for purchase under a defined price formula during the same exercise periods (sell option). Pursuant to the conditions contained in IAS 32.23, a financial liability in the amount of € 5,616k was taken into consideration for QSC's obligation stemming from the sell option held by the remaining shareholders. The cash value of the anticipated exercise price for the sell option was used as the basis for calculating the financial liability (fair value pursuant to Level 3 under IFRS 13.81), with an interest rate of 4.28 percent, which is adequate in terms of risk and term, being applied. In this connection, the purchase price for the remaining shares is contingent upon the economic development of FTAPI during the option exercise period.

Moreover, incidental costs of acquisition in the amount of € 93k were incurred in conjunction with the acquisition, which were recorded in the Statement of Income.

The determination of the cost of acquisition and the fair values of the assets and liabilities thereby acquired resulted in goodwill of € 7,930k. This goodwill essentially reflects the synergies anticipated from the joint activities of FTAPI and QSC, as well as the future success potential of innovative products in the field of encryption technology.

In the initial consolidation of FTAPI, it was assumed that this sell option had already been exercised in determining a provisional difference with respect to the above-indicated sell option held by the remaining shareholders (so-called anticipated acquisition method). On the basis of the anticipated acquisition of 100 percent of the shares of FTAPI, no no-controlling shares were presented for the minority shareholders of FTAPI in these Interim Consolidated Financial Statements. As a result, the estimated fair value of the financial liability at the time of acquisition, resulting from the sell option rights, was presented as additional costs of this corporate acquisition.

Goodwill from the initial consolidation of FTAPI has been calculated as follows:

| € 000s | |
|---|---|
| **Total assets** | |
| Intangible assets | 2,409 |
| Property, plant and equipment | 11 |
| Receivables and other assets | 87 |
| Cash holdings and bank balances | 62 |
| **Total assets** | **2,569** |
| **Total liabilities** | |
| Provisions | 250 |
| Trade payables | 67 |
| Other liabilities | 716 |
| Deferred taxes | 794 |
| **Total liabilities** | **1,827** |
| **Fair value of net assets** | **742** |
| Cost of acquisition (of which fair value of financial liability for the sell options: € 5,616k) | 8,672 |
| **Goodwill** | **7,930** |

The financial liability for the sell option was valued at € 5,802k as of the balance sheet date. The change of € 186k in the fair value between the acquisition date and the balance sheet date was chiefly due to the compounding of the liability and has been recognised directly in equity. This liability has been recognised under other long-term liabilities.

In the period from 24 February to 31 December 2014, FTAPI contributed € 269k to consolidated revenues and € -1,368k to consolidated net income. If the acquisition had already taken place as of 1 January 2014, then the resultant difference in revenue and net income contributions would have been immaterial.

Together with a business partner QSC AG founded fonial GmbH, domiciled in Cologne (hereinafter also "fonial"), on 3 December 2014. QSC AG holds a 74.9 percent share of this company's capital and voting rights. fonial GmbH has as its object the further development and marketing of a cloud-based telephony system.

QSC paid up its portion of share capital in fonial GmbH, amounting to € 37k, in cash. Furthermore, arrangements under which QSC is entitled to acquire the remaining shares in fonial GmbH under a defined price formula and in defined exercise periods in 2018 and 2019 have been agreed with the minority shareholder (purchase option). Conversely, the non-controlling shareholder is entitled to offer its share of capital to QSC for purchase under a defined price formula during the same exercise periods (sell option). Consistent with the requirements of IAS 32.23, a financial liability of € 900k has been recognised for QSC's obligation in connection with the sell option held by the remaining shareholders. The fair value of the expected exercise price for the sell option was used as the basis for calculating the financial liability (Level 3 as per IFRS 13.81), with application of a risk and maturity-congruent interest rate of 5 percent (please see Note 33). The purchase price for the remaining shares is dependent on fonial's economic performance during the option exercise period.

The determination of the cost of acquisition and the fair values of the assets and liabilities thereby acquired resulted in goodwill of € 887k. This essentially reflects the synergies expected from the joint activities of fonial and QSC and the future potential for success with cloud-based products. Upon the initial consolidation of fonial, it was assumed when determining the cost of the company acquisition that the sell options held by the non-controlling shareholders had already been exercised as of the acquisition date ("anticipated acquisition method"). As a result of the acquisition of 100 percent of the shares in fonial thereby assumed, no non-controlling interests have been recognised for the minority shareholders in QSC's consolidated financial statements. This means that the estimated fair value of the financial liability resulting from the sell option, amounting to € 900k, has been recognised as an additional cost of the company acquisition as of the acquisition date.

Goodwill from the initial consolidation of fonial has been calculated as follows:

| € 000s | |
|---|---|
| Fair value of net assets (excluding cash at banks) | 50 |
| Cost of acquisition (of which fair value of financial liability for sell option: € 900k) | 937 |
| **Goodwill** | **887** |

The financial liability for the purchase options towards the non-controlling shareholders in FTAPI, amounting to € 900k as of 31 December 2014, has been recognised under other long-term liabilities.

fonial is currently in the start-up phase. Its contribution to consolidated revenues and consolidated net income in 2014 was therefore immaterial. Even if the business combination had already taken place as of 1 January 2014, the management assesses the share of revenues and net income attributable to fonial as immaterial compared with consolidated revenues and consolidated net income.

The following subsidiaries have exercised their option for exemption pursuant to § 264 (3) and § 264b of the German Commercial Code (HGB), respectively: Q-DSL home GmbH, 010090 GmbH, BroadNet Deutschland GmbH, Broadnet Services GmbH, 01098 Telecom GmbH, 01012 Telecom GmbH, 010052 Telecom GmbH, 010088 Telecom GmbH, 01052 Communication GmbH, F&Q Netzbetriebs GmbH & Co. KG, T&Q Netzbetriebs GmbH & Co. KG, Plusnet GmbH & Co. KG, Ventelo GmbH, Broadnet NGN GmbH, Q-loud GmbH and tengo GmbH.

## 38 Segment reporting

In accordance with the provisions of IFRS 8, the basis for identification of the segments consists of the Company's internal organisational structure, which is used by corporate management as the basis for business administration decisions and performance assessments. At QSC, segmentation is aligned to the customer structure, as presented below.
The Direct Sales Business Unit focuses on more than 8,000 larger and medium-sized enterprises in Germany. Its portfolio comprises national and international site networking, outsourcing solutions, data centre services, such as Housing and Hosting. IT Consulting is a further important element of this business unit's portfolio; QSC is a consulting partner for SAP and Microsoft solutions.
The Indirect Sales Business unit addresses nearly 900,000 smaller and medium-sized companies in Germany that typically do not have employees of their own on staff for information and communications technology, obtaining their ICT services from regional partners instead. QSC is therefore collaborating with regional service providers, sales partners and distributors, offering them Internet connections, direct connections to the QSC voice network, Voice over IP products, as well as standardised cloud services, such as a virtual telephone system and a flexible modular design system for utilising QSC data centres.
The Resellers Business Unit is where QSC bundles its business with ICT services providers that predominantly address residential customers; they include telecommunications carriers, cable network operators and Internet service providers. QSC makes a variety of preliminaries available for its customers, along with such conventional voice services as call-by-call offerings and unbundled DSL lines. Moreover, this business unit also includes Managed Outsourcing, under which QSC integrates the narrowband voice networks of alternative providers into its Next Generation Network (NGN) and provides full operation of their fixed network business.
Management has stipulated operating profit, i.e. earnings before interest and taxes (EBIT) in accordance with IFRS, as the key steering parameter for the segments. Thus, costs are fully attributed to their respective business units; also performed is a complete calculation of profit or loss with the exception of interest and taxes. Both the direct and indirect attribution of costs to the individual segments corresponds to the Company's internal reporting system and steering logic. There were also directly and indirectly attributable items of assets and liabilities. With the exception of deferred tax assets and liabilities, assets and liabilities that are indirectly attributable are allocated according to financial viability on the basis of contribution margins.

| € 000s | Direct Sales | Indirect Sales | Resellers | Reconciliation | Consolidated Group |
|---|---|---|---|---|---|
| **2014 financial year** | | | | | |
| **Net revenues** | **207,271** | **121,590** | **102,583** | **-** | **431,444** |
| Cost of revenues | (159,780) | (72,463) | (94,826) | | (327,069) |
| **Gross Profit** | **47,491** | **49,127** | **7,757** | **-** | **104,375** |
| Sales and marketing expenses | (15,884) | (14,307) | (7,589) | | (37,780) |
| General and administrative expenses | (11,892) | (10,265) | (10,191) | | (32,348) |
| Depreciation and amortisation | (24,482) | (12,196) | (31,619) | | (68,297) |
| Non-cash share-based remuneration | (365) | (176) | (148) | | (689) |
| Other operating income | 38 | 139 | 612 | | 789 |
| **Operating profit (loss)** | **(5,094)** | **12,322** | **(41,178)** | **-** | **(33,950)** |
| Assets | 220,725 | 127,407 | 37,980 | 19,377 | 405,489 |
| Liabilities | 132,366 | 51,773 | 73,383 | 2,333 | 259,855 |
| Capital expenditure | 17,992 | 5,798 | 6,250 | - | 30,040 |

| € 000s | Direct Sales | Indirect Sales | Resellers | Reconciliation | Consolidated Group |
|---|---|---|---|---|---|
| **2013 financial year** | | | | | |
| **Net revenues** | **209,176** | **123,159** | **123,389** | **-** | **455,724** |
| Cost of revenues | (139,677) | (65,279) | (98,508) | | (303,464) |
| **Gross Profit** | **69,499** | **57,880** | **24,881** | **-** | **152,260** |
| Sales and marketing expenses | (16,912) | (15,190) | (9,716) | | (41,818) |
| General and administrative expenses | (12,015) | (12,639) | (10,971) | | (35,625) |
| Depreciation and amortisation | (24,431) | (10,869) | (15,530) | | (50,830) |
| Non-cash share-based remuneration | (149) | (144) | (141) | | (434) |
| Other operating income | 1,033 | 1,097 | 818 | | 2,948 |
| **Operating profit (loss)** | **17,025** | **20,135** | **(10,659)** | **-** | **26,501** |
| Assets | 205,516 | 107,822 | 64,148 | 14,541 | 392,027 |
| Liabilities | 78,279 | 46,559 | 70,106 | 3,912 | 198,856 |
| Capital expenditure | 26,177 | 7,542 | 5,842 | - | 39,561 |

Deferred tax assets and liabilities have been presented as reconciliation items.

The recognition of more conservative planning assumptions for growth in cloud-based products in the Resellers segment resulted in an impairment requirement of € 18,005k. This has been recognised under amortisation. Further details can be found in Notes 15 and 16.
FTAPI Software GmbH, acquired in 2014, has been allocated in full to the Indirect Sales segment. No material revenues were generated from business with companies outside Germany in the 2013 and 2014 financial years, nor were intersegment revenues generated. Long-term financial assets are exclusively of a domestic nature. In 2014, there were no customers whose share of total revenues exceeded 10 percent (2013: one customer in the Resellers segment with 10.1 percent).

**Information relating to products and services** • Revenues with external customers for categories of comparable products and services developed as follows:

| € 000s | 2014 | 2013 |
|---|---|---|
| Telecommunications | 235,789 | 259,147 |
| Outsourcing | 156,541 | 159,933 |
| Consulting | 35,178 | 34,452 |
| Cloud | 3,937 | 2,192 |
| **Revenues** | **431,444** | **455,724** |

As product-based segmentation has been introduced for the 2015 financial year, the presentation of consolidated revenues by product and service has already been based on the new allocation.

## 39 Stock option programs

Since 1999, QSC has established a total of seven stock option programs (SOPs), 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 four to eight years and are subject to a vesting period of up to four years. In connection with the 2006 SOP, the conversion right cannot be exercised until at least one of the following conditions is met: Either the trading price of the shares has developed better on a relative basis between the day of issue and the time of exercise of the conversion right than the comparison index (TecDAX), or the trading price has risen by at least 10 percent between the day of issue and the time of exercise of the conversion right.

On 16 May 2013, the QSC Annual Shareholders' Meeting agreed to the 2012 stock option program (2012 SOP), calling for the issuance of up to 5,000,000 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. All employees of QSC whose employment had not been terminated as of 1 December 2012 are eligible to subscribe. The subscription period began in March 2013 and will end no later than 15 May 2017. The convertible bonds have a term of between four and eight years. The conversion right may – no earlier than at the end of a waiting period of 4 years – only be exercised if at least one of the following two conditions have been met: Either the trading price of QSC shares is at least 20 percent higher than the conversion price or the development of the shares has exceeded that of the TecDAX index.
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 and 2012 SOPs were computed at grant date using the Black-Scholes option-pricing model with the following assumptions.

| | 2014 | 2013 |
|---|---|---|
| **2006 SOP** | | |
| Expected average term of the 2006 SOP | 8 years | 8 years |
| Dividend yield | 5.75 % | 2.09 % |
| Average risk-free interest rate | 0.27 % | 1.60 % |
| Volatility (3 years) | 46.62 % | 40.22 % |
| Average fair value of options in € | - | - |
| Fair value of convertible bonds granted for the year in € | - | - |

| | 2014 | 2013 |
|---|---|---|
| **2012 SOP** | | |
| Expected average term of the 2012 SOP | 8 years | 8 years |
| Dividend yield | 5.75 % | 2.09 % |
| Average risk-free interest rate | 0.27 % | 1.60 % |
| Volatility (3 years) | 46.62 % | 40.22 % |
| Average fair value of options in € | 1.19 | 1.52 |
| Fair value of convertible bonds granted for the year in € | 960,374 | 1,549,283 |

In the 2014 financial year, only convertible bonds under the 2012 SOP were subscribed. Volatility was determined on the basis of daily closing prices over a historical period of three years.
The distribution of the convertible bonds outstanding under all programs as of 31 December 2013 and 2014, is as follows:

| | Number of convertible bonds | Weighted average exercise price in € |
|---|---|---|
| **Outstanding at 31 December 2012** | **1,275,219** | **2.58** |
| Granted in 2013 | 1,019,000 | 2.85 |
| Forfeited in 2013 | (17,168) | 2.70 |
| Exercised in 2013 | (380,248) | 1.82 |
| **Outstanding at 31 December 2013** | **1,896,803** | **2.88** |
| Granted in 2014 | 766,800 | 2.40 |
| Forfeited in 2014 | (63,891) | 4.44 |
| Exercised in 2014 | (85,000) | 2.10 |
| **Outstanding at 31 December 2014** | **2,514,712** | **2.72** |

The exercise prices of the remaining 2,514,712 convertible bonds range from € 1.07 to € 5.00, and the remaining term for exercise varies from "immediately exercisable" to 19 May 2019. 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 2022 at the latest.
As of the balance sheet date, 736,912 of the remaining convertible bonds were exercisable, with the remaining convertible bonds being subject to the agreed retention period.
During the year under review, expense incurred in conjunction with non-cash share-based remuneration amounted to € 689k (2013: € 434k).

## 40 Related party transactions

In 2014, QSC participated in transactions with companies affiliated with members of the Management and Supervisory Boards. IAS 24 states that related parties are individuals or companies with the possibility of influencing or even controlling the other party. All contracts with those companies require the approval of the Supervisory Board and are concluded on the basis of prevailing market conditions.

| € 000s | Net revenues | Expenses | Cash received | Cash paid |
|---|---|---|---|---|
| **2014 financial year** | | | | |
| IN-telegence GmbH | 840 | 115 | 33 | 127 |
| Teleport Köln GmbH | 32 | 4 | 37 | 5 |
| QS Communication Verwaltungs Service GmbH | - | 155 | - | 202 |
| **2013 financial year** | | | | |
| IN-telegence GmbH | 947 | 39 | 1,137 | 35 |
| Teleport Köln GmbH | 31 | 4 | 34 | 5 |
| QS Communication Verwaltungs Service GmbH | - | 208 | - | 231 |

| € 000s | Trade receivables | Trade payables |
|---|---|---|
| **At 31 December 2014** | | |
| IN-telegence GmbH | 73 | - |
| Teleport Köln GmbH | 21 | - |
| QS Communication Verwaltungs Service GmbH | - | - |
| **At 31 December 2013** | | |
| IN-telegence GmbH | 83 | 4 |
| Teleport Köln GmbH | 6 | - |
| QS Communication Verwaltungs Service GmbH | - | 17 |

IN-telegence GmbH is a provider of value added services in the telecommunications industry and essentially utilises network services from QSC. To a limited extent, subsidiaries of QSC AG also utilise these value added services from IN-telegence, Teleport Köln GmbH provides support to QSC in the installation of end-customer connections and utilises telecommunication services from QSC. QS Communication Verwaltungs Service GmbH provides consulting services to QSC in connection with the product management of voice products.
Further information relating to the members of the Management and Supervisory Boards is contained in Notes 48 and 51, as well as in the Compensation Report.

## 41 Deferred and current taxes

QSC used an aggregate tax rate of 32.32 percent (2013: 32.21 percent) to calculate deferred taxes. The deferred tax expense and income for the period and the allocation of temporary variances are presented below:

| € 000s | Asset | Liability | Asset | Liability | Consolidated Statement of Income | |
|---|---|---|---|---|---|---|
| | 2014 | | 2013 | | 2014 | 2013 |
| **Deferred tax assets and liabilities** | | | | | | |
| Intangible assets | - | 15,123 | 130 | 14,733 | (520) | 153 |
| Property, plant and equipment | 4,407 | 5,236 | 2,633 | 9,510 | 6,842 | 3,167 |
| Other financial assets | 321 | 12 | 100 | 12 | 221 | 14 |
| Other trade receivables | - | 5,356 | - | 3,135 | (2,221) | 442 |
| Inventories | 727 | - | 1,506 | - | (779) | 582 |
| Deferred revenues | 753 | 208 | 850 | 699 | 394 | 67 |
| Accrued pensions and other provisions | 2,799 | 113 | 1,334 | 92 | 1,246 | 17 |
| Change in market price of derivatives | 731 | - | - | - | 27 | - |
| Other liabilities | 1,077 | 17 | 1,833 | 107 | (666) | (1,013) |
| **Total deferred taxes on temporary differences** | **10,815** | **26,065** | **8,386** | **28,288** | **4,544** | **3,429** |
| **Total deferred taxes on loss carryovers** | **32,293** | **-** | **30,532** | **-** | **1,761** | **1,966** |
| **Total deferred taxes before being netted out** | **43,108** | **26,065** | **38,918** | **28,288** | | |
| Netting out | (23,731) | (23,731) | (24,376) | (24,376) | | |
| **Total deferred taxes** | **19,377** | **2,333** | **14,542** | **3,912** | | |

The temporary differences in conjunction with interests in subsidiaries for which no deferred tax liabilities are recorded amount to € 22,411k in the 2014 financial year (2013: € 19,473k).
The following table presents 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:

| € 000s | 2014 | 2013 |
|---|---|---|
| **Reconciliation** | | |
| **Net profit (loss) before taxes** | **(40,146)** | **22,672** |
| Tax rate | 32.32 % | 32.21 % |
| | | |
| Expected tax expense | (12,976) | 7,302 |
| Tax effect of | | |
| Adjustments made to allowances on deferred taxes | | |
| relating to loss carryovers | (44) | (8,766) |
| Change in permanent differences | 5,819 | - |
| Non-deductible operating expenses | 903 | 557 |
| Non taxable income | - | - |
| Non-period expense | (223) | (132) |
| Change in taxation rate | (351) | - |
| Other | 641 | 99 |
| | | |
| **Reconciled tax expense** | **(6,231)** | **(940)** |

Reconciled tax income consists of € 75k for current income tax expenses (of which € -223k for prior years) and € 6,305k for deferred tax income (2013: deferred tax income of € 5,415k). Tax income of € 903k was recognised directly in equity in the 2014 financial year in connection with the recognition of actuarial gains and losses (2013: tax expenses of € 20k).

As of 31 December 2014, corporate income tax loss carryovers totalled € 379 million (2013: € 374 million) and trade tax loss carryovers totalled € 370 million (2013: € 368 million). As of 31 December 2014, corporate income tax loss carryovers at FTAPI Software GmbH amounted to € 3 million, while trade tax loss carryovers also amounted to € 3 million.

These tax losses can basically be offset to an unlimited extent against future taxable income at the companies at which deferred tax assets have been recognised on loss carryovers of € 32.3 million (QSC AG: € 31.3 million; FTAPI Software GmbH: € 1.0 million), (2013: € 30.5 million at QSC AG). In recognising and measuring deferred tax assets on loss carryovers, it is assumed that tax loss carryovers of € 97 million (QSC AG: € 94 million; FTAPI Software GmbH: € 3 million) can be used in the medium term (2013: € 95 million at QSC AG).

For trade tax purposes, it is assumed that tax loss carryovers totalling € 103 million (QSC AG: € 100 million; FTAPI Software GmbH: € 3 million) can be used in the medium term (2013: € 95 million at QSC AG).

The Company's long-term planning provides for the sustainable generation of taxable income. Given the history of losses and the planning uncertainties resulting from the transformation process at the group of companies, however, only that taxable income expected in a foreseeable period of 4 years (2013: 3 years) has been accounted for. The adjustment in this figure to four years takes due account of the fact that, due to the restructuring measures in 2014, consistent budgeting can only be assumed for the three subsequent years. Furthermore, more conservative planning assumptions result in greater forecasting precision for the fourth plan year. No deferred tax assets have been recognised in the balance sheet for the remaining corporate income tax and trade tax loss carryovers as yet unused.

## 42 Legal disputes

In the judicial review proceeding ("Spruchverfahren") brought before the Hamburg Regional Court ("Landgericht") by 31 former minority shareholders of Broadnet AG, it was ruled on 20 September 2013 that QSC must pay an additional contribution in cash of € 0.96 per share to all former minority shareholders of Broadnet AG (in total 999,359 shares). The additional contribution in cash is subject to interest at 2 percentage points above the base rate with effect from 31 December 2007, and at 5 percentage points above the base rate with effect from 1 September 2009. The costs of the proceedings are to be borne by QSC. The total amount of the additional contribution in cash amounting to € 959k plus interest corresponds to the provision recognised by QSC. Three applicants immediately lodged appeals against this ruling with the Hamburg Higher Regional Court ("Oberlandesgericht"). The appeals lodged were rejected by the Hamburg Higher Regional Court with rulings dated 15 May 2014 and 21 May 2014, as a result of which the ruling passed by Hamburg Regional Court on 20 September 2013 remains in effect.
However, the ruling passed by the Hamburg Regional Court was still not legally binding, as it could not be served to one of the petitioners. Upon application by QSC, the original ruling was publicly served on 27 November 2014. The appeal period ended on 12 January 2015 without any further appeal being lodged, as a result of which the proceedings have been concluded. The principal claim, which including interest amounted to € 1,299k, was paid in February 2015.

In a judicial review proceeding ("Spruchverfahren") at the Hamburg Regional Court following the squeeze-out of the minority shareholders of what was originally INFO Gesellschaft für Informationssysteme Aktiengesellschaft (Hamburg District Court, HRB 36067, hereinafter called "Old INFO AG") within the framework of the merger of Old INFO AG with today's INFO Gesellschaft für Informationssysteme Aktiengesellschaft ("INFO AG", formerly IP Partner AG, following the merger renamed INFO Gesellschaft für Informationssysteme Aktiengesellschaft, since merged with QSC AG), the petitioners (a total of 45) were seeking an increase in the cash settlement paid to them by INFO AG (€ 18.86 per no-par share of Old INFO AG) in mostly unspecified amounts. With its ruling on 3 February 2014, the Hamburg Regional Court refused to hear the petitioners' case. Two petitioners lodged an appeal against this ruling within the respective deadline. The ruling is therefore not yet legally binding. In a ruling dated 19 June 2014, Hamburg Regional Court decided not to remedy the appeals and referred the matter for decision by the Hamburg Higher Regional Court. This court rejected the appeals in a ruling dated 22 December 2014. The proceedings have thus been concluded. According to the court ruling, QSC is required to pay the court costs and the costs of the joint agent. Provisions have been recognised for this purpose.

## 43 Contingencies and other financial obligations

**Obligations from operating leases** • The consolidated group is party to various long-term operating lease arrangements as lessee, mostly for technical rooms and offices, fibre optic connections, PC and vehicles. The Company concludes partial amortisation agreements without purchase options or price indexing clauses but with extension options in some cases and an average lease term of two to five years. The items concerned are not subleased to customers. As of 31 December future minimum lease payments under non-cancellable operating leases were as follows.

| € 000s | 2014 | 2013 |
|---|---|---|
| Up to 1 year | 18,983 | 22,420 |
| 1 to 5 years | 44,575 | 49,095 |
| Over 5 years | 18,625 | 13,645 |
| **Operating lease arrangements** | **82,183** | **85,160** |

In the 2014 financial year, QSC recognised expenses totalling € 22,228k (2013: € 28,629k), which are presented under "Cost of revenues".

**Obligations under financing and rent-to-own arrangements** • QSC has entered into financing arrangements and rent-to-own contracts, as well as finance lease arrangements 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.

| € 000s | 2014 | 2013 |
|---|---|---|
| Financing and rent-to-own arrangements | | |
| Up to 1 year | 4,610 | 5,836 |
| 1 to 5 years | 4,578 | 9,127 |
| Over 5 years | - | 76 |
| **Total payment obligations** | **9,188** | **15,039** |
| less interest component | (314) | (674) |
| **Present value of payment obligations** | **8,874** | **14,365** |

These obligations are presented by their respective maturity dates under short- and long-term liabilities.

**Rights under operating lease arrangements – QSC Group as lessor** • Arrangements similar to operating leases are in place with customers, mainly for the rental of computer centre space, disk storage devices and shared hardware resources. The Company concludes partial amortisation agreements without purchase options or price indexing clauses but with extension options in some cases and an average lease term of three to five years. The consolidated group will receive the following future minimum lease payments under non-cancellable arrangements similar to operating leases:

| € 000s | 2014 | 2013 |
|---|---|---|
| Up to 1 year | 15,954 | 15,746 |
| 1 to 5 years | 18,528 | 22,928 |
| Over 5 years | 903 | 234 |
| **Operating lease arrangements** | **35,385** | **38,908** |

For the purpose of measuring future minimum lease payments the major customers were taken into account for whom services were already provided at the reporting date and payments from whom were contractually stipulated at the balance sheet date. In 2014, € 20,154k (2013: € 21,552k) were recorded under revenues as rental payments.

**Rights under finance lease arrangements – QSC Group as lessor** • Under the rules contained in IFRIC 4, the consolidated group also is deemed to be the lessor in specific multi-component arrangements. Future minimum lease payments from customers under finance lease arrangements can be reconciled to their net present value as follows:

| € 000s | 2015 | 2016 – 2019 | From 2020 | Total |
|---|---|---|---|---|
| **Future minimum lease payments** | | | | |
| Lease payments | 5,664 | 7,836 | - | 13,500 |
| Discounting fees | (113) | (76) | - | (189) |
| **Present values** | **5,551** | **7,760** | **-** | **13,311** |

Lease payments received in 2014 totalled € 4,981k (2013: € 3,044k).

**Other financial obligations** • Other financial obligations amount to € 16,646k (2013: € 12,051k). This total consists of obligations of € 7,784k due in 2015 and € 5,939k due in the years 2016 to 2018. An amount of € 975k is due after the 2018 financial year. Purchase commitments to future investments amounted to € 498k (2013: € 2,647k) in the past financial year and relate essentially to purchase orders for property, plant and equipment.

**Guarantees** • There were no guarantee obligations as of 31 December 2014.

## 44 Objectives and methods used in financial risk management

In connection with its business activities, QSC is subject to a number of financial risks that are inseparably linked with its entrepreneurial actions. QSC combats these risks through a comprehensive risk management system, which is an integral element of its business processes and corporate decisions. The key elements of this system are a Group-wide planning and controlling process, Group-wide policies and reporting systems, as well as Group-wide risk reporting. The Management Board stipulates the principles of the Company's financial policies annually and monitors the risk management system. Further information on risk management can be found in the Group Management Report.

The 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 consolidated group's operating activities. Financial assets which arise directly from the consolidated group's operating activities are, in particular, trade receivables, cash and cash equivalents, and available-for-sale financial assets. In the 2014 financial year, no trading in derivatives was concluded.

The consolidated group's major risks that arise 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 is a summary of the strategies and procedures used for managing each of the aforementioned risks.

**Interest rate risk** • QSC is exposed to the risk of changes in market interest rates. This risk results primarily from the consolidated 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 31 December 2014, the share of variable-rate debts in total rate debts amounted to 51.5 percent. The promissory note loan taken up in the second quarter of 2014 with a total volume of € 150,000k comprises five tranches with terms of 5 and 7 years and is subject to variable (€ 87,500k in 3 tranches) and fixed (€ 67,500k in 2 tranches) interest rates. To hedge the interest rate risk, in parallel with the placement of the promissory note loan QSC also concluded three interest swaps with nominal volumes totalling € 87,500k and identical terms running until 20 May 2019 (nominal: € 76,500k) and 20 May 2021 (nominal: € 11,000k). The interest swaps enable the cash flows

from those tranches of the hedged item with variable interest rates to be fully hedged throughout the respective term with regard to interest rate risk. Accounting for the hedge, QSC thus pays de facto fixed interest of 2.25 percent on those tranches of the promissory note loan with variable interest rates, as a result of which any changes in market interest rates will not have any net impact on the Company's interest expenses. However, any change in the level of interest rates by +/-100 basis points would change the fair value of the hedging instruments by € 1,429k and € -6,184k respectively. In the statement of comprehensive income, this would thus impact on the volume of income offset against equity and thus on shareholders' equity.
The following table reflects the sensitivity of the consolidated group's earnings before taxes to a reasonably possible change in interest rates in relation to variable rate debts as of 31 December and liquidity (including available-for-sale financial assets). The interest rate risks relating to the variable-rate tranches of the promissory note loan are covered by interest swaps with congruent terms.

| | Increase / decrease in basis points | Impact on net profit before income taxes in € 000s |
|---|---|---|
| 2014 | + 100 | 881 |
| 2014 | - 100 | (88) |
| 2013 | + 100 | (143) |
| 2013 | - 100 | 143 |

**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 consolidated 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 consolidated group's possible risk of bad debts. The maximum risk of bad debts is limited to the carrying amount of the trade payable as disclosed in Note 18. In the past financial year, there were no significant concentrations of credit risk within the consolidated group. As far as trade receivables not yet written down are concerned, QSC expects them to be collectible.
In investing financial assets, QSC is also subject to a credit risk in the event of the elimination of a contracting party. The maximum this risk represents is the book value of these instruments. QSC is therefore pursuing a highly conservative investment policy, and in the past financial year solely invested in securities with a first-class credit rating.

**Liquidity risk** • The consolidated group monitors its risk of a liquidity shortfall through monthly recurring liquidity planning, which takes into account the remaining term of available financial assets as well as the expected future cash flows from operating activities. The consolidated group strives to maintain an equilibrium between continuity of funding and flexibility through the use of short- and long-term liabilities and liabilities under financing arrangements.

With regard to the promissory note loan, due to the full hedging of interest rate risks with opposing interest swaps (cash flow hedge; please see Note 28), QSC has to pay de facto fixed interest of € 3,581k for the periods through to 2019 and of € 1,055k thereafter. QSC intends to uphold the hedge relationship through to the maturity of the respective hedged items and hedging instruments. The expected cash flows for the hedged promissory note loan therefore involve ongoing interest payments and repayment of the liabilities for the underlying instruments upon their respective maturities. The cash flows for the underlying and hedge transactions have therefore been presented jointly in the chart below.

As of 31 December 2014, the short-term and long-term liabilities of the consolidated Group had the following maturities. These disclosures are based on the expected undiscounted payments.

| € 000s | Carrying amount | Due by end of 2015 | Due by end of 2016 | Due by end of 2017 | Due by end of 2018 | Due by end of 2019 | Due after 2020 | Total |
|---|---|---|---|---|---|---|---|---|
| Liabilities under financing | | | | | | | | |
| and finance lease arrangements | 8,874 | 4,617 | 2,835 | 1,389 | 306 | 76 | - | 9,223 |
| Trade payables | 44,820 | 44,820 | - | - | - | - | - | 44,820 |
| Liabilities due to banks | 161,068 | 8,476 | 5,972 | 7,691 | 3,876 | 117,197 | 36,491 | 179,703 |
| Interest swaps* | 2,262 | | | | | | | |
| Liabilities | | | | | | | | |
| Phantom stock, put option | 6,947 | - | - | 6,751 | 1,054 | - | - | 7,805 |
| Other short and long-term liabilities | 35,884 | 26,190 | 2,881 | 253 | 251 | 243 | 6,066 | 35,884 |
| **As of 31 December 2014** | **259,855** | **84,103** | **11,688** | **16,084** | **5,487** | **117,516** | **42,557** | **277,435** |

* As well as the corresponding balance sheet line items, the "Liabilities due to banks" payment series also includes the interest swaps.

**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. Capital is monitored 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 cash equivalents as well as available-for-sale financial assets.

| € 000s | 2014 | 2013 |
|---|---|---|
| **Capital management** | | |
| Liabilities under financing and finance lease arrangements | (8,874) | (14,365) |
| Liabilities due to banks | (161,068) | (85,565) |
| **Interest-bearing liabilities** | **(169,942)** | **(99,930)** |
| plus cash and cash equivalents | 87,803 | 58,716 |
| plus available-for-sale financial assets | 343 | 343 |
| **Net debt** | **(81,796)** | **(40,871)** |
| Shareholders' equity | 145,634 | 193,171 |
| Balance sheet total | 405,489 | 392,027 |
| **Equity ratio** | **36 %** | **49 %** |

As of the balance sheet date, all performance indicators stipulated by the loan agreements had been complied with. The indicators include financial ratios related to equity and earnings before interest, taxes and amortisation.

## 45 Financial instruments

The following table presents the carrying amounts 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.

| € 000s | Classification category pursuant to IAS 39 | Carrying amounts | | Fair value | |
|---|---|---|---|---|---|
| | | 2014 | 2013 | 2014 | 2013 |
| **Financial instruments** | | | | | |
| Cash and Cash Equivalents | LaR | 87,803 | 58,716 | 87,803 | 58,716 |
| Available-for-sale Financial Assets | AFS | 343 | 343 | 343 | 343 |
| Long-Term Receivables | | | | | |
| from Multi-Component Contracts | LaR | 7,761 | 5,066 | 7,761 | 5,066 |
| Long-Term Trade Receivables | LaR | - | 157 | - | 157 |
| Short-Term Receivables | | | | | |
| from Construction Contracts | LaR | 875 | 509 | 875 | 509 |
| Short-Term Trade Receivables | LaR | 51,270 | 52,030 | 51,270 | 52,030 |
| Trade Payables | FLAC | 44,820 | 58,696 | 44,820 | 58,696 |
| Liabilities due To Banks | FLAC | 161,068 | 85,565 | 161,068 | 85,565 |
| Liabilities under Financing | | | | | |
| and Finance Lease Arrangements | FLAC | 8,874 | 14,365 | 9,039 | 14,556 |
| Interest Swaps – Hedge Accounting | FV | 2,262 | - | 2,262 | - |
| Put Option, Minority Shareholders | FV | 6,947 | - | 6,947 | - |
| Other Short and Long-Term Liabilities | FLAC | 9,400 | 18,491 | 9,400 | 18,491 |
| Aggregated according to classification categories | | | | | |
| pursuant to IAS 39: | | | | | |
| Financial Assets Carried at Amortised Cost | LaR | 147,709 | 116,478 | 147,709 | 116,478 |
| Available-for-sale Financial Assets | AFS | 343 | 343 | 343 | 343 |
| Financial Liabilities Measured at Amortised Cost | FLAC | 224,162 | 177,117 | 224,327 | 177,308 |
| Interest Swaps – Hedge Accounting | FV | 2,262 | - | 2,262 | - |
| Financial liabilities measured at Fair Value | FV | 6,947 | - | 6,947 | - |

Abbreviations: LaR – Loans and Receivables / AFS – Available For Sale / FLAC – Financial Liabilities at Amortised Cost / FV – Fair Value

Cash and cash equivalents, available-for-sale financial assets as well as trade receivables largely have short remaining terms. Their carrying amount thus roughly corresponds to their fair value at the balance sheet date. The fair value of liabilities under financing arrangements and of other short- and long-term liabilities was calculated on the basis of regular interest rates. The fair value of available-for-sale financial assets was determined on the basis of market prices (Level 1 pursuant to IFRS 13.76). The carrying amount of receivables from multi-component arrangements already includes the discounted cash flows and thus corresponds to fair value.
The fair values of the interest swaps have been calculated by the intermediary bank on the basis of market data (Level 2 as per IFRS 13.81).

To calculate the fair values of the purchase options granted in connection with the acquisition of shares in FTAPI Software GmbH and fonial GmbH, the performance indicators expected on the basis of the respective company budgets have been measured using a risk and term-adequate interest rate (fair value: Level 3 as per IFRS 13.81). The difference in fair value between the acquisition date and the balance sheet date, amounting to a total of € 186k (before deferred taxes) was recognised directly in other comprehensive income.

| € 000s | From interests, dividends | Subsequent to initial recognition | | Net gain (loss) | |
|---|---|---|---|---|---|
| | | Allowance | At fair value | 2014 | 2013 |
| Loans and Receivables (LaR) | 321 | 50 | - | 371 | 698 |
| Available-for-sale Financial Assets (AFS) | - | - | - | - | - |
| Financial Liabilities measured at Amortised Cost (FLAC) | (5,880) | - | - | (5,880) | (3,978) |
| Financial Instruments measured at Fair Value | (282) | - | - | (282) | - |
| **Net results by classification category** | **(5,841)** | **50** | **-** | **(5,791)** | **(3,280)** |

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

## 46 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, as amended 13 May 2013, and, since its enforcement, as amended 24 June 2014, 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.

## 47 Auditors' fees

In conjunction with services provided by the auditors of the consolidated financial statements, the following amounts were charged during the 2014 financial year: € 332k (2013: € 341k) for audit services, € 100k (2013: € 95k) for other services, and € 56k (2013: € 34k) for other audit services.

## 48 Compensation of the Management and Supervisory Boards

Total compensation of the Management Board for the 2014 financial year amounted to € 1,337k, as against € 1,726k in the previous year. This comprises fixed compensation of € 750k (2013: € 887k), fringe benefits of € 134k (2013: € 49k), variable compensation of € 0k (2013: € 790k) and share-based compensation of € 453k (2013: € 0k).
The breakdown of total compensation by individual Management Board member can be found in the compensation tables included in the Compensation Report within the Group Management Report. This report also includes extensive information about the compensation system, about payments committed to active Management Board members in the event of the premature termination of their activities and disclosures concerning former Management Board members.
The following table provides individualised disclosures concerning the number of shares and conversion rights held by Management Board members:

| | Shares | | Conversion rights | |
|---|---|---|---|---|
| | 31 Dec. 2014 | 31 Dec. 2013 | 31 Dec. 2014 | 31 Dec. 2013 |
| Jürgen Hermann | 240,000 | 225,000 | 350,000 | 200,000 |
| Dr. Bernd Schlobohm | | | | |
| (until 29 May 2013) | - | 15,493,372 [1] | - | 200,000 [1] |
| Barbara Stolz | | | | |
| (from 1 June 2013 to 31 Dec. 2014) | 10,000 [1] | - | 182,100 [1] | 30,000 [2] |
| Henning Reinecke (since 1 Sept. 2013) | 5,000 | 1,000 [2] | 150,000 | - |
| Arnold Stender (until 31 Aug. 2013) | - | - | - | 25,000 [1] |
| Stefan Freyer | | | | |
| (from 1 Sept. 2013 to 31 March 2014) | - | - | - | - |

[1] Holdings at the time of retirement from the Management Board

[2] Holdings at the time of joining the Management Board

Jürgen Hermann, Barbara Stolz and Henning Reinecke purchased shares via the stock exchange during their period of Management Board activity in the 2014 calendar year (please also see our disclosures of directors' dealings pursuant to § 15a WpHG).
No loans were granted to Management Board members.
Management Board members Jürgen Hermann, Barbara Stolz and Henning Reinecke each subscribed to 150,000 convertible bonds in QSC AG on 25 August 2014. These convertible bonds had been granted to them by the Supervisory Board on 29 August 2013 within the framework of the 2012 Stock Option Programme. The fair value of each convertible bond on the subscription date amounted to € 1,004. Conversion into shares in QSC AG is only possible after a holding period of 4 years, and at the latest 8 years after the subscription date. The minimum value of the convertible bonds granted amounts to € 0, as it would make no economic sense to exercise the conversion rights if the stock market price falls short of the conversion price of € 2.30 determined upon

subscription of the options during the period in which the conversion rights apply or should the exercise hurdles and performance targets laid down in the bond terms not be achieved. The maximum value of the share-based compensation in connection with the 2012 Stock Option Programme amounts to € 2,070k per Management Board member. This is reached when the weighted average price of the QSC AG share in XETRA trading on the Frankfurt Stock Exchange on the last twenty trading days preceding the day on which the exercising of the conversion declaration becomes effective pursuant to the bond terms exceeds € 16.10 (seven times the conversion price of € 2.30). Furthermore, on 19 August 2014 Barbara Stolz subscribed to 2,100 convertible bonds which had been granted to her by the Management Board of QSC AG on 12 March 2013 within the framework of the 2012 Stock Option Programme. This allocation was based on the employee status of Ms. Stolz prior to her appointment to the Management Board of QSC AG.
For its activity in the 2014 financial year, the Supervisory Board received compensation totalling € 315k (2013: € 302k). The breakdown of overall compensation by individual Supervisory Board member and further details can be found in the Compensation Report within the Group Management Report. This report also includes information about the compensation system.
The following table provides individualised disclosures concerning the number of shares and conversion rights held by Supervisory Board members:

| | Shares | | Conversion rights | |
|---|---|---|---|---|
| | 31 Dec. 2014 | 31 Dec. 2013 | 31 Dec. 2014 | 31 Dec. 2013 |
| Dr. Bernd Schlobohm, Chairman (since 29 May 2013) | 15,518,372 | 15,493,372 [3] | 200,000 | 200,000 [3] |
| Herbert Brenke (Chairman until 29 May 2013) | - | 187,820 [2] | - | - |
| Dr. Frank Zurlino, Deputy Chairman (since 29 May 2013) | 10,000 | 10,000 [3] | - | - |
| Gerd Eickers (Deputy Chairman until 29 May 2013) | 15,577,484 | 15,552,484 | - | - |
| Ina Schlie | - | - | - | - |
| Anne-Dore Ahlers [1] (since 29 May 2013) | - | - | 2,700 | 2,700 [3] |
| Cora Hödl [1] (since 29 May 2013) | - | - | 4,100 | 4,100 [3] |
| Klaus-Theo Ernst [1] (until 29 May 2013) | - | 500 [2] | - | - |
| Jörg Mügge [1] (until 29 May 2013) | - | 4,000 [2] | - | - |
| David Ruberg (until 29 May 2013) | - | 14,563 [2] | - | - |

[1] Employee representative
[2] Holdings at the time of leaving
[3] Holdings at the time of joining

Supervisory Board members Dr. Bernd Schlobohm and Gerd Eickers increased their shareholdings by purchasing shares via the stock exchange in the 2014 calendar year (please also see our disclosures of directors' dealings pursuant to § 15a WpHG).

## 49 Risks

Risks are detailed in the Report on Risks contained in the Consolidated Management Report.

## 50 Proposed profit appropriation

The Management and Supervisory Boards will propose to the Annual General Meeting that a dividend of € 0.10 per share be paid to shareholders.

## 51 Directors and officers

**Management Board** • The members of the Management Board in the 2014 financial year were as follows:

| Management Board member | |
|---|---|
| Jürgen Hermann | Chief Executive Officer |
| Barbara Stolz | Chief Financial Officer, stood down as of 31 December 2014 |
| Stefan Freyer | Management Board member, stood down as of 31 March 2014 |
| Henning Reinecke | Chief Sales Officer and responsible for market-based |
| | development of entire ICT range |
| Stefan A. Baustert | Chief Financial Officer since 1 January 2015 |

**Supervisory Board** • The members of the Supervisory Board in the 2014 financial year were as follows:

| Supervisory Board member | |
|---|---|
| Dr. Bernd Schlobohm | Entrepreneur, Chairman |
| Dr. Frank Zurlino | Managing Partner at Horn & Company, Deputy Chairman |
| Ina Schlie | Head of Group Tax Department at SAP AG |
| Gerd Eickers | Businessman |
| Anne-Dore Ahlers | Chairman of Works Council, Employee Representative |
| Cora Hödl | Head of TC Voice Services, Employee Representative |

The term of office of the Supervisory Board ends upon adjournment of the Annual Shareholders' Meeting that ratifies the acts of the members of the Management Board for the 2017 financial year.

Cologne, 16 March 2015

QSC AG
The Management Board

| | | |
|---|---|---|
| Jürgen Hermann<br>Chief Executive Officer | Stefan A. Baustert | Henning Reinecke |

# 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, 16 March 2015

QSC AG
The Board of Management

Jürgen Hermann
Chief Executive Officer

Stefan A. Baustert

Henning Reinecke

# 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 2014. 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, 19 March 2015

KPMG AG
Wirtschaftsprüfungsgesellschaft

| | |
|---|---|
| Pütz | Gall |
| Wirtschaftsprüfer | Wirtschaftsprüfer |

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