Annual Report 2016

MOVING STEP BY STEP INTO THE DIGITAL WORLD.

SECURE.
INNOVATIVE.
AT YOUR SIDE.

QSC AG

MULTIYEAR OVERVIEW

All amounts in € million	2016	2015	2014	2013	2012
Revenues	386.0	402.4	431.4	455.7	481.5
EBITDA	37.1	42.2	35.0	77.8	77.9
Depreciation / amortisation [1]	50.2	53.3	69.0	51.3	53.4
EBIT	(13.1)	(11.1)	(34.0)	26.5	24.6
Net income (loss)	(25.1)	(13.2)	(33.9)	23.6	19.0
Earnings per share [2] (in €)	(0.20)	(0.11)	(0.27)	0.19	0.14
Shareholders' equity [3]	86.3	113.8	145.6	193.2	180.2
Long-term liabilities [3]	159.3	171.0	180.2	103.3	96.0
Short-term liabilities [3]	59.2	63.3	79.7	95.5	110.9
Balance sheet total [3]	306.0	348.1	405.5	392.0	387.1
Equity ratio (in %)	28.2	32.7	35.9	49.3	46.6
Free cash flow	8.4	7.1	(24.9)	25.6	23.6
Liquidity [3]	67.3	74.0	88.1	59.0	35.2
Capital expenditure (capex)	28.4	26.7	30.0	39.6	37.9
Capex ratio [4] (in %)	7.4	6.6	7.0	8.7	7.9
Dividend per share (in €)	0.03 [5]	0.03	0.10	0.10	0.09
Xetra closing price [3] (in €)	1.92	1.51	1.74	4.30	2.11
Number of shares [3]	124,172,487	124,162,487	124,142,487	124,057,487	137,307,152
Market capitalisation [3]	238.4	187.5	216.0	533.4	289.7
Number of employees [3]	1,360	1,454	1,697	1,689	1,485

Consolidated financial statements (IFRS) from 2012 to 2016.

[1] Including non-cash share-based compensation.

[2] Basic.

[3] As of 31 December.

[4] Ratio of capital expenditure to revenues.

[5] Proposal to the Annual General Meeting.

MOVING STEP BY STEP INTO THE DIGITAL WORLD. AND THAT WITH VISIBLE SUCCESS.

QSC AG is digitising the German SME sector. With decades of experience and expertise in its Cloud, Internet of Things (IoT), Consulting and Telecommunications businesses, we are accompanying our customers securely into the digital age. The digital expertise pooled in and around our Pure Enterprise Cloud and the Internet of Things has convinced more and more companies. Revenues in our Cloud segment rose almost 150% in 2016. And that was just the start – German SME players are only just beginning to go digital …

VISIBLE SUCCESS IN 2016. MILESTONES AT A GLANCE.

Launch of the Pure Enterprise Cloud
QSC presented its new Pure Enterprise Cloud to the public at the end of February. It is based on a modular system of proven cloud technologies, software solutions and service components together with high-performance network and infrastructure services. The Pure Enterprise Cloud enables users to link various cloud worlds while also making efficient use of traditional IT applications.

SME companies building on QSC's cloud competence
The Pure Enterprise Cloud convinced customers from the outset and quickly proved its worth in numerous projects. In August, for example, the metal processing company apt Hiller chose this innovative solution to standardise its heterogeneous ICT landscape. Within weeks, the first employees benefited from a uniform workplace environment created by the Pure Enterprise Cloud.

QSC is the "rising star" in the sector
Market researchers are also impressed with QSC's capacity for innovation. Experton, for example, labeled QSC in 2016 the "rising star" in the sector for its Pure Enterprise Cloud and its IoT portfolio. Analysts at Crisp Research see the internally developed IoT platform as the leading solution in the market and have singled out QSC as an innovator.

SAP assesses QSC as excellent
In the autumn, SAP awarded its highest possible assessment – "excellent" – to QSC's hosting services. At the same time, the software giant once again certified QSC's "SAP HANA Operations Services" and praised the Company's service management and service provision activities in particular.

Superb reception for All-IP
QSC became a pioneer in Germany by acting early to upgrade its network with IP technology. Now, it is benefiting to an above-average extent from great demand among SME players for sophisticated All-IP solutions. As a result, QSC defied the market trend in 2016 and increased its TC revenues with corporate customers.

Pooling IoT competence at Q-loud
To react even faster to new market requirements, in 2016 QSC pooled its IoT activities at Q-loud. This subsidiary's specialists in the Internet of Things demonstrated their flexibility and expertise in several projects and increased revenues several times over in a single year.

+148%

Growth in Cloud revenues in 2016

JÜRGEN HERMANN,
CHIEF EXECUTIVE OFFICER

“IN 2016, THE COMPANY GREW IN ALL BUSINESS FIELDS IN WHICH WE EXPECTED GROWTH – AND ABOVE ALL IN OUR CLOUD BUSINESS. THIS DEVELOPMENT WILL CONTINUE IN 2017.”

Dear Shareholders,

QSC's future is digital. In our mission to digitise the German SME sector, we made progress on numerous fronts in 2016. Expanding our Cloud business was the key priority. In the spring, we began marketing our Pure Enterprise Cloud, whose turnkey services enable customers to move easily from traditional IT landscapes into the cloud. Not only that, its modular structure means that SMEs enjoy maximum freedom when it comes to shaping their own digitisation strategies on a step-by-step basis. The first customers are already using our complete portfolio, while others are starting out by combining their own IT solutions with select cloud services from QSC. Different customers have different focuses: some attach priority to migrating workplace environments into the cloud, while others are at first more interested in optimising their operating processes. Both approaches are possible with the Pure Enterprise Cloud, in addition to being both efficient and secure. This outstanding flexibility is driving its success and the great appreciation shown by customers and industry observers alike. The numerous awards from prestigious IT analysts speak for themselves.

The IoT portfolio meets expectations of SME customers

The Cloud business has a second strong component: the IoT portfolio. This enables SMEs to network devices and structure their digital business models in the Internet of Things. In the past year, we pooled our IoT competencies at Q-loud. With its full-stack approach, this wholly owned subsidiary covers the entire IoT value chain – from transformation consulting to contract manufacturing for networked devices through to all aspects of operations. This approach meets the expectations of our SME customers, and in fact to an ever greater extent. Schüco, one of the world's leading manufacturers of high-quality window, door and façade systems, for example, has commissioned Q-loud to digitally network its existing and future product series. The aim of this cooperation is to achieve centralised management and monitoring for Schüco's products. More specifically, thanks to our technology, the doors and windows of entire buildings can now be centrally opened, closed and monitored.

Due in particular to numerous IoT projects and the marketing of the Pure Enterprise Cloud, revenues in the Cloud segment surged by 148% to € 18.1 million in 2016. Revenues also rose in the other two business fields where we expected growth, namely Consulting and our TC business with corporate customers. The success in our Consulting business was driven above all by the expertise shown by our team of more than 200 SAP-HANA specialists. This innovative IT platform is proving to be a core element of the digital transformation, as it facilitates smooth processing of large data volumes in real time. QSC has now implemented more than 40 HANA projects and also earned recognition from the software manufacturer itself – since 2016 QSC has been a "Partner of Excellence" to SAP.

“WE ARE ACQUIRING NEW CUSTOMERS FOR THE PURE ENTERPRISE CLOUD AND ARE PRESSING AHEAD WITH MIGRATING EXISTING OUTSOURCING CUSTOMERS.”

Excellent is also the word to describe our performance in the TC business with corporate customers. Here, we once again increased our revenues in 2016 in what is a toughly contested market affected by overall decline. The key to our success is our unique expertise in All-IP. QSC was the first TC provider to upgrade its network into a consistent IP-capable next generation network (NGN) and can now offer a broad range of services in this area – from basic Voice over IP connections through to complex telephony systems. More than 250,000 active latest-generation SIP-VoIP connections underline QSC’s pioneering role in this market. To focus on the three business fields of Cloud, Consulting and TC for corporate customers, we had to give our structures a thorough shake-up. We completed our two-year cost-cutting programme at the end of 2016. We have further automated our processes, especially in the traditional Outsourcing business, and significantly downsized our workforce. At the same time, we have attracted new experts, particularly for our Cloud and Consulting businesses and our sales activities. Overall, our structures are now leaner and our processes swifter.

As expected, revenues in our two traditional business fields of Outsourcing and TC for resellers declined. Both markets have witnessed extremely tough price competition, while the TC business has also been adversely affected by regulatory decisions. Overall, these factors will cost us revenues of up to € 20 million in our Outsourcing business and around € 25 million in our TC business with resellers in the current year. Given the market situation, since 2015 we have not participated in tenders requiring personnel to be taken over in our traditional Outsourcing business. Instead, we are relying on our Pure Enterprise Cloud when it comes to outsourcing and operating IT services. Not only that, this innovation is gradually benefiting our existing Outsourcing customers. In close liaison with these customers, we began the migration process in 2016 and will be continuing this in the years ahead as well. In view of this, we expect disparate developments in the current year – revenue growth above all in our Cloud business, as well as in Consulting and our TC business with corporate customers, and a further fall in revenues in Outsourcing and our TC business with resellers. On a group level, we have budgeted for a further reduction in our overall revenues for 2017. The focus on industrialised IT operations and our Cloud business expansion nevertheless guarantee that EBITDA will remain at least stable. The EBITDA margin is set to rise compared with 2016, as is the free cash flow.

The Cloud business will remain the key focus of our activities. We will acquire new customers for the Pure Enterprise Cloud and press ahead with migrating existing Outsourcing customers. We are also extending our range of services to provide a multi-cloud approach. This involves a networked, service-driven cloud that pools the benefits of various solutions. Today, many companies already draw on inexpensive offerings from global data centre operators such as Amazon or Microsoft for standard applications. QSC is integrating these kinds of cloud solutions into its own services. This way, based on its Pure Enterprise Cloud, it is offering customers what will be the dominant IT architecture for the decade ahead – a multi-cloud.

QSC extending its range of services to provide multi-cloud approach

The IoT portfolio will also make a major contribution to the dynamic growth in the Cloud business. Working with a full-stack approach, our IoT experts will attract new industrial customers while forging stronger business relationships with existing customers. We are still only at the beginning of the IoT age. Many companies are starting out with pilot projects and low unit quantities. Q-loud is already able to scale up these kinds of pilot projects, enabling SME companies to market networked devices in high unit numbers.

We have budgeted revenue growth in our Consulting business, with a key focus on consistently expanding our SAP-HANA competence. In our TC business with corporate customers we aim to outperform the market once again. In this traditional business field, our decades of experience, extensive portfolio and established relationships with customers and partners offer many opportunities for the future as well.

Turnaround already achieved for EBITDA and free cash flow

QSC is growing in precisely those areas that will shape the future. For its part, the capital market is not yet entirely convinced. In particular, many investors are sceptical about the development in our overall revenues. In terms of our EBITDA and free cash flow, however, we have already achieved a turnaround. We set ambitious, but achievable targets for the respective financial year and then we meet them. Given this reliability and the right strategy, we will regain the confidence of further investors and convince the capital market.

The growth achieved in our forward-looking business fields and turnaround in our EBITDA and free cash flow would not have been possible without the contribution of all our employees. I would like to take this opportunity to thank them for their commitment and for their willingness to continue playing an active role in reshaping our company. I would also like to extend my particular thanks to you, our shareholders. I know that the many positive aspects of our company's development are not always apparent at first sight and that the volatility in our share price calls for patience. I would therefore offer a special thank you for the trust you have placed in us. QSC – your company - will make further progress in numerous areas in 2017 and underline its pioneering role as the digitiser to the German SME sector.

Cologne, 29 March 2017

Jürgen Hermann
Chief Executive Officer

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THE MANAGEMENT BOARD

Jürgen Hermann (*1964), Chief Executive Officer
QSC's future is digital. Jürgen Hermann, a prime mover at QSC, has been pressing ahead with the right strategy to put this into practice since taking over as CEO in May 2013. Alongside strategy, this graduate in economics also bears management board responsibility for the key areas of innovation and communications. Having held senior positions for several years at Thyssen Telecom AG, he joined what was then QS Communication Service GmbH back in 1997 already. As Director of Finance, he played a key role in organising QSC's IPO in April 2000 and was the Company's Chief Financial Officer from 2009 to 2013.

Stefan A. Baustert (*1956), Chief Financial Officer
QSC needs lean structures to thrive in the digital age. Implementing these is the role of Stefan A. Baustert, who since becoming CFO at the beginning of 2015 has been adapting QSC's cost structures accordingly. In addition to finance, this graduate in business administration also holds board responsibility for procurement, human resources, and investor relations. His previous positions include working as CEO at the publicly listed company Singulus Technologies AG, as Commercial Director at E-Plus Mobilfunk GmbH, and, at the beginning of his career, holding various management positions at the ThyssenKrupp Group, where he was latterly CFO of Thyssen Telecom AG.

Udo Faulhaber (*1961), Chief Sales and Consulting Officer
QSC's strategy and its success are determined by its customers – and that is why Udo Faulhaber is in touch with them on a daily basis. This multifaceted entrepreneur came on board as Chief Sales and Consulting Officer on 1 August 2015 and has played a key role in shaping the success of the Pure Enterprise Cloud and its IoT portfolio. A graduate in production technology, he has long felt at home in the cloud. Together with Felix Höger, he turned Pironet NDH into a leading provider of cloud services in Germany. Further stations in his career were at Nixdorf, Bayer, Postbank and at arxes, an IT service provider he founded.

Felix Höger (*1973), Chief Technology and Operations Officer
QSC is entering new dimensions with its Pure Enterprise Cloud. The brain behind it belongs to Felix Höger, QSC's Chief Technology and Operations Officer since 1 January 2016. Until the end of 2014, he was CEO at Pironet NDH AG, whose predecessor NDH he already founded during his training. The merger with Pironet followed in 2000. As a pioneer and trailblazer for cloud computing among German SMEs, Felix Höger successfully turned his company from a network service and outsourcing provider into a successful and profitable cloud service provider.


JÜRGEN HERMANN


STEFAN A. BAUSTERT


UDO FAULHABER


FELIX HÖGER

THE SUPERVISORY BOARD

The six-member Supervisory Board comprises four shareholder and two employee representatives. In the regular election held at the Annual General Meeting on 29 May 2013, shareholders elected four representatives for a term in office of five years each. The employees selected their two representatives in advance of the meeting.

Dr. Bernd Schlobohm, Chairman
Dr. Schlobohm, who holds a doctorate in engineering, founded QSC in 1997, had the Company publicly listed 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 2016, these two shareholders held a combined stake of 25% 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.

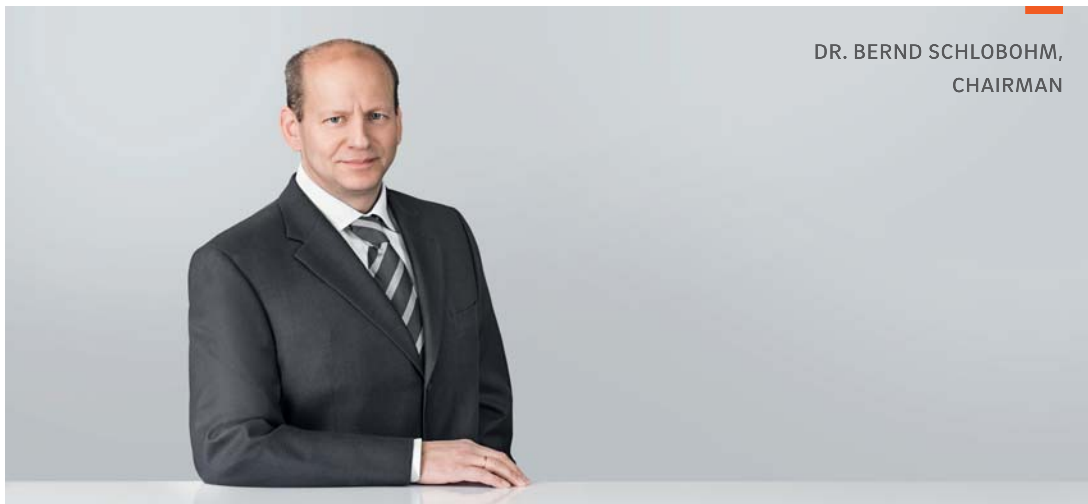
Gerd Eickers
QSC's second founder, Gerd Eickers, moved to the Supervisory Board in June 2004 after three years on the Management Board. In subsequent years, this graduate in economics played a major role in shaping the political framework for the TC market, particularly in his capacity as President of the Association of Telecommunications and Value-Added Service Providers (VATM).

Ina Schlie
Longstanding head of the global tax department at SAP SE, Ina Schlie was appointed to the Supervisory Board in September 2012 and then confirmed with a large majority at the Annual General 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, the Hamburg-based Chair of its Works Council, as one of the two representatives on the Supervisory Board in April 2013.

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

REPORT OF THE SUPERVISORY BOARD



Dear Shareholders,

The following Supervisory Board Report informs you about the activities of the Supervisory Board in the 2016 financial year.

Activities of the Supervisory Board. In 2016 as well, the Supervisory Board performed all of the duties incumbent on it by law and the Articles of Association. It continually monitored and advised the Management Board in its management of QSC AG. 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, it 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 members of the Management Board attended the meetings of the Supervisory Board unless stipulated otherwise by the Supervisory Board Chairman. At these 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 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 information about variances in the actual performance from targets previously reported and variances in the business performance from the planning. The reports also contained 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. The main focuses of Supervisory Board meetings and resolutions in the 2016 financial year were:

1. **Cloud business expansion.** QSC has two growth drivers in its Cloud business – the Pure Enterprise Cloud and its IoT portfolio. In 2016, the Supervisory Board repeatedly obtained detailed information about the progress made with sales and with expanding the respective range of services. It discussed the capital expenditure required for this purpose with the Management Board and monitored compliance with budget targets.

2. **Organisational restructuring.** During 2016 as well, the Supervisory Board ensured that it was continually informed about the progress made with implementing the cost-cutting programme initiated in the 2015 financial year and dealt in particular with the associated reorganisation of operations and sales structures.

3. **Attracting executives and specialists.** The organisational restructuring makes it necessary to recruit additional specialists and executives with experience in selling and operating cloud-based products and services in particular. The Management Board informed the Supervisory Board regularly about important personnel decisions for the first management tier and presented the measures it intended to take to counter the effects of the shortage of IT specialists.

Furthermore, in 2016 the Supervisory Board dealt with the internal control mechanisms at QSC AG, 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. The Supervisory Board also addressed the amendments resulting from the European market abuse regulation and audit reform in detail and, among other measures, made corresponding adjustments to the Rules of Procedure for both the Supervisory and Management Boards.

Composition of the Supervisory Board. The Supervisory Board witnessed no changes in its composition in 2016 and continued to comprise four shareholder representatives, namely Dr. Bernd Schlobohm (Supervisory Board Chairman), Dr.-Ing. Frank Zurlino (Deputy Chair), Ina Schlie and Gerd Eickers, and two employee representatives, namely Anne-Dore Ahlers und Cora Hödl.

Supervisory Board meetings and committees. The Supervisory Board held four scheduled meetings in person in the 2016 financial year, all of which were attended by all members. 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 2016.

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 twice in the year under report. The members of this committee are: Dr. Bernd Schlobohm (Chair), Gerd Eickers and Cora Hödl. As well as preparing the conclusion of a target agreement with Felix Höger, a member of the Management Board who commenced his board activity as of 1 January 2016, the committee also reviewed the target agreements concluded with the three other Management Board members in March 2015 in respect of the multiyear targets contained therein. The Human Resources Committee proposed to the Supervisory Board that it should adjust specific aspects of the individual parameters of these multiyear targets as external developments unforeseeable in March 2015 made it necessary to restore the incentive effect of the variable compensation on a uniform basis for the Management Board members in the interests of the Company and thus boost the overall responsibility of the Management Board. At the same time, the committee prepared the Supervisory Board decisions on the annual targets to be agreed with the members of the Management Board.

The committee also prepared the Supervisory Board resolution concerning Management Board members' target achievement in the 2015 financial year and the resultant variable Management Board compensation.

The Audit Committee comprises Ina Schlie as its Chair and independent financial expert, as well as Dr. Bernd Schlobohm and Dr.-Ing. Frank Zurlino. The Audit Committee monitors the financial reporting process and may submit recommendations to safeguard its integrity. It also monitors the effectiveness of the internal control, risk management and internal audit systems, as well as compliance, and prepares any decisions required by the full Supervisory Board in this respect. The Audit Committee also deals with the audit of the financial statements and is responsible for selecting and issuing the audit assignment to the auditor, as well as for monitoring the auditor's independence. It decides whether the Company may commission the auditor to provide non-audit services and, where appropriate, monitors the auditor's provision of such services. In this regard, on 16 November 2016 the Audit Committee adopted a catalogue of non-audit services agreed in advance that it will subsequently review annually. The services listed in this catalogue may be commissioned by the Management Board without consulting the committee provided that the overall budget for non-audit services approved by the Audit Committee for the respective financial year is not exceeded and the expected total fee for any individual non-audit service does not exceed € 50,000.00.

The Audit Committee met five times in the past financial year. It reviewed the documents relating to the annual and consolidated financial statements, including the dependent company report, for the 2015 financial year, held in-depth discussions about these documents and the accompanying audit reports in the presence of the auditor and adopted recommendations for the full Supervisory Board resolution concerning the annual and consolidated financial statements and their audit. The Audit Committee discussed the interim financial reports and statements due for publication with the Management Board. It determined the audit focuses for the

2016 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 General Meeting as auditor and group auditor for the 2017 financial year. Based on this recommendation, at its meeting on 16 March 2017 the Supervisory Board adopted a corresponding proposal to the Annual General Meeting. The Audit Committee dealt in detail with the requirements for QSC resulting from the audit reform, and in particular with the future tender process for appointing the auditor and the awarding of non-audit services to the auditor. The Audit Committee also for the first time issued Rules of Procedure governing its activities.
The Audit Committee ensured that it was kept permanently informed by the Management Board on the latest status of the sample audit of the consolidated financial statements and group management report for the 2014 financial year performed by the German Financial Reporting Enforcement Panel (DPR) and informed the full Supervisory Board as appropriate. By assessment dated 19 December 2016, the audit found that the 2014 consolidated financial statements contained errors in respect of the recognition of deferred tax assets on loss carryovers and goodwill at the fonial GmbH subsidiary. QSC acknowledged these errors and has corrected them in its current financial reporting. The identification of these errors was published in the Federal Gazette (Bundesanzeiger) and the Stock Exchange Gazette (Börsen-Zeitung) on 17 and 18 February 2017 respectively.
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 General Meeting. The members of the Nomination Committee are Gerd Eickers (Chair) and Dr.-Ing. Frank Zurlino. As no elections of shareholder representatives to the Supervisory Board were due in the 2016 financial year, the Nomination Committee did not meet in the year under report.
The members of the Strategy Committee are Dr. Bernd Schlobohm (Chair) and Dr.-Ing. Frank Zurlino. The Strategy Committee has a purely advisory function and addresses the strategic, and thus long-term, development of QSC AG, and in particular the development of ideas for forward-looking products and services. This committee met three times in 2016.

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. To account for the amendments made on 18 August 2016 to the multiyear targets agreed with three Management Board members, at the same meeting the Supervisory Board and Management Board together updated the Declaration of Conformity submitted pursuant to § 161 of the German Stock Corporation Act (AktG) on 19 November 2015 and made permanently available to the public on the Company's website. At its meeting on 17 November 2016, the Supervisory Board acting together with the Management Board submitted its updated annual Declaration of Conformity pursuant to § 161 AktG. This too is permanently available on the Company's website.

The Management Board reports in detail 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. 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 2016 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 2016 prepared in accordance with International Financial Reporting Standards (IFRS) as requiring application in the European Union 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 25 May 2016.
Key focuses of the 2016 audit included the audit of the goodwill impairment test, deferred taxes (particularly completeness and measurement), the measurement of the equity interest held in Ventelo GmbH / Plusnet GmbH & Co. KG, the provisions for dismantling central offices (particularly completeness and measurement), the measurement of unfinished services, the completeness and accuracy of the disclosures in the notes and management reports accompanying the consolidated and annual financial statements, segment reporting (particularly completeness and accuracy of disclosures), the audit of the completeness and accuracy of the implementation of amendments arising due to the German Accounting Directive Implementation Act (BilRUG) and Management Board travel expenses. The auditor granted unqualified audit opinions to the Company's annual financial statements (HGB) and consolidated financial statements (IFRS) for the 2016 financial year, including the respective management reports.

Furthermore, the Management Board compiled a report on relationships with affiliated companies for the 2016 financial year (dependent company report). The auditor audited this report, reported in writing on its findings and granted the following unqualified opinion:

"Based on 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 transactions listed in the report was not incommensurately high."

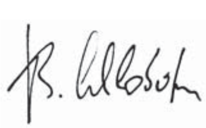
The aforementioned documents, including the audit reports submitted by the auditor, were provided to all Supervisory Board members in good time ahead of their review. At its meeting on 16 March 2017, the Supervisory Board discussed all of the aforementioned documents and the auditor's reports with the 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 that would have implications for the annual and consolidated financial statements. 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 2016 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 the annual financial statements (HGB). The annual financial statements are therefore 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 € 0.03 per share with corresponding entitlement for approval by the Annual General Meeting on 24 May 2017.

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 by the Management Board at the end of the report on relationships with affiliated companies.

The Supervisory Board would like to thank all shareholders for their trust. It also extends its particular thanks to all employees and the members of the Management Board for their dedication and work in the past financial year.

Cologne, 16 March 2017
On behalf of the Supervisory Board of QSC AG



Dr. Bernd Schlobohm
Supervisory Board Chairman

QSC SHARE PERFORMANCE

27%

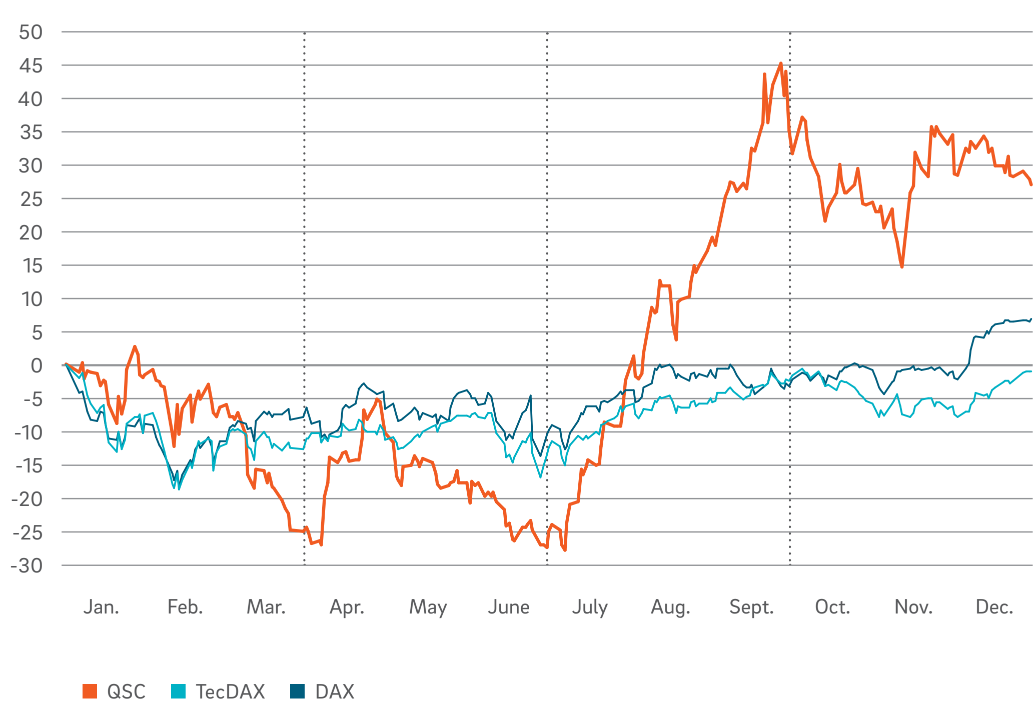
Increase in QSC's share price in 2016

QSC shares rise 27% against a turbulent backdrop on the stock markets. After a longer period of less favourable developments, QSC's shares outperformed the most important lead indices on the German stock exchanges once again in 2016. The shares stood at € 1.92 on 31 December 2016, 27% higher than the 2015 closing price. By contrast, the DAX rose by 7% over the same period while the TecDAX even fell by 1%. Overall, capital markets witnessed substantial volatility in the course of the year. At the beginning of the year, this was principally due to the concerns surrounding macroeconomic developments in China. The Brexit decision was then the main reason for the setback in the summer. The DAX only regained positive territory towards the end of the year.

Based on a closing price of € 1.51 at the end of 2015, QSC shares also came under further pressure in the first half of 2016. Alongside the overall trend on the capital market, a further factor related to the decision taken by the German Stock Exchange on 3 March 2016 to replace QSC's shares in the TecDAX due to the decline in the Company's market capitalisation. This obliged index-based funds, for example, to sell any shares held in QSC. The share price reached its annual low of € 1.05 directly after the Brexit decision on 24 June 2016. When publishing its half-year

QSC's share price performance

(indexed)



results on 8 August 2016, QSC was able to report positive consolidated net income once again for the first time in eight quarters. Not only that, its Cloud revenues showed that the strategic realignment was taking effect. Year-on-year, the Company managed to more than double its Cloud revenues. The following weeks witnessed a rally in the share price, which subsequently reached its annual high of € 2.24 on 21 September 2016. This meant that the share price more than doubled in just three months. After this, QSC's shares were affected by profit-taking, especially in October, before stabilising at a substantially higher level than at the beginning of the year.

Investors pay higher multiples. QSC's success in its Cloud business enabled it to allay investors' scepticism in 2016; over and above that, this development changed the way the Company was perceived on the capital market. Increasing numbers of investors invested in the digitiser of the German SME sector, and thus in a cloud stock, in the second half of 2016. Investors traditionally pay higher multiples for this kind of stock than for pure telecommunications stocks.

584,000 QSC shares traded per day. The scepticism shown by many investors also influenced trading volumes through to the summer. In the first half of 2016, a mere 472,000 shares changed hands on average each day. This figure rose to 710,000 in the second half of the year. Regardless of this development, QSC was among the 35 most-traded technology stocks on German stock exchanges for large periods of 2016 once again. Due not least to the sharp reduction in the share price, overall trading volumes totalled € 240.6 million in the first half of 2016, compared with € 489.2 million in 2015.

Shareholdings of institutional investors rise to 38%. Institutional investors played a key role in the rise in trading volumes in the second half of 2016. These investors had long indicated their interest in QSC, but had made their investments dependent on the Company achieving visible success in its Cloud business in particular. As the progress made in this respect became increasingly visible in the course of 2016, these investors became ever more willing to invest in the Company. According to the Company's share register, the percentage of free float shares held by institutional investors rose to 38% at the end of 2016, up from 33% one year earlier. At mid-year, this figure had even fallen to 30%. Accordingly, retail shareholders owned 62% of the free float at the end of 2016. Overall, free float shares make up 75% of QSC's total shares, while 25% of the shares are held by the two founders, Gerd Eickers and Dr. Bernd Schlobohm. Now members of QSC's Supervisory Board, these two individuals have not sold any of their shares in QSC since the Company's IPO in spring 2000. On the contrary, they have increased their shareholdings further in the intervening years.

25%

of QSC's shares owned by its two founders

The Dutch fund provider Kempen Capital Management was still QSC's third-largest shareholder in 2016 and continued to hold more than 5% of the shares. In September 2016, the US fund Dimensional Holdings informed QSC that it had exceeded the 3% disclosure threshold. This fund is under passive management and acts in accordance with quantitative models.

Shareholder structure as of 31 December 2016

Seven analysts covering QSC. Many institutional investors base their decisions to buy or sell shares on sector and company studies. In the past year, seven financial services players regularly published reports on QSC. Metzler Equities and Landesbank Baden-Württemberg discontinued their coverage in the course of the year. All remaining analysts classified the QSC stock as worth holding at the end of 2016. Given the progress made by the Company in its operating business, the analysts raised their share price targets during the year, in some cases substantially so. In one case, the analysts revised their sell recommendation.

Financial institutes with studies on QSC

Bankhaus Lampe	Hauck & Aufhäuser	Oddo Seydler Bank
Commerzbank	Independent Research	Warburg Research
Deutsche Bank		

Road shows at leading financial centres throughout Europe

Intensive investor relations activities pay off. The return of institutional investors and the comparatively high number of analysts for what is a second-tier stock also reflect the success of the Company's ongoing investor relations activities. Despite the lows seen it its share price, QSC maintained its in-depth dialogue with investors, held numerous meetings to explain its strategy and thus prepared the ground for the rise in the share price seen in the second half of 2016. In the past year, the Company attended capital market conferences organized by Bankhaus Lampe, Berenberg Bank, Commerzbank, J.P. Morgan Cazenove and Oddo Seydler, among others, and also took part in road shows at leading European financial centres, such as Frankfurt, London and Zurich. These activities were supplemented by numerous one-to-one talks at the Company's locations in Cologne and Hamburg and in conference calls.

The conference calls held upon publication of the respective quarterly results attracted particular interest from institutional and retail investors alike. QSC made the relevant presentations and recordings of the comments made by members of the Management Board available without delay on its website and answered all enquiries received by phone or email. In general, the IR section of QSC's website acts as the central information platform. As well as financial reports and IR press releases, this section also includes the financial calendar, analysts' assessments and detailed documents relating to the Annual General Meeting. Not only that, QSC also works with a variety of social media. All of the Company's presentations are available on SlideShare, while shareholders can use Twitter to remain permanently up to date. An IR Newsletter serves the same purpose.

WWW.SLIDESHARE.NET/QSCAG
WWW.TWITTER.COM/QSCIREN
WWW.QSC.DE/EN/INVESTOR-RELATIONS

Annual General Meeting approves dividend proposal. Retail investors in particular take the Annual General Meeting as an opportunity to talk to the Company. The Annual General Meeting held in Cologne on 25 May 2016 was attended by around 220 shareholders. These voted with a large majority to approve, among other agenda items, the proposal submitted by the Management and Supervisory Boards to distribute a dividend of 3 cents per share for the 2015 financial year. The two bodies will be proposing a dividend in the same amount for the 2016 financial year for approval by this year's Annual General Meeting on 24 May 2017.

3 cents

Dividend proposal for 2016

Key facts about 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
Designated sponsorship	Oddo Seydler Bank AG
Shares outstanding as of 31 December 2016	124,172,487
Share class	No-par-value registered shares of common stock
Xetra closing price on 30 December 2015	€ 1.51
Xetra share price high in 2016	€ 2.24
Xetra share price low in 2016	€ 1.05
Xetra closing price on 30 December 2016	€ 1.92

GROUP MANAGEMENT REPORT

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GROUP FUNDAMENTALS

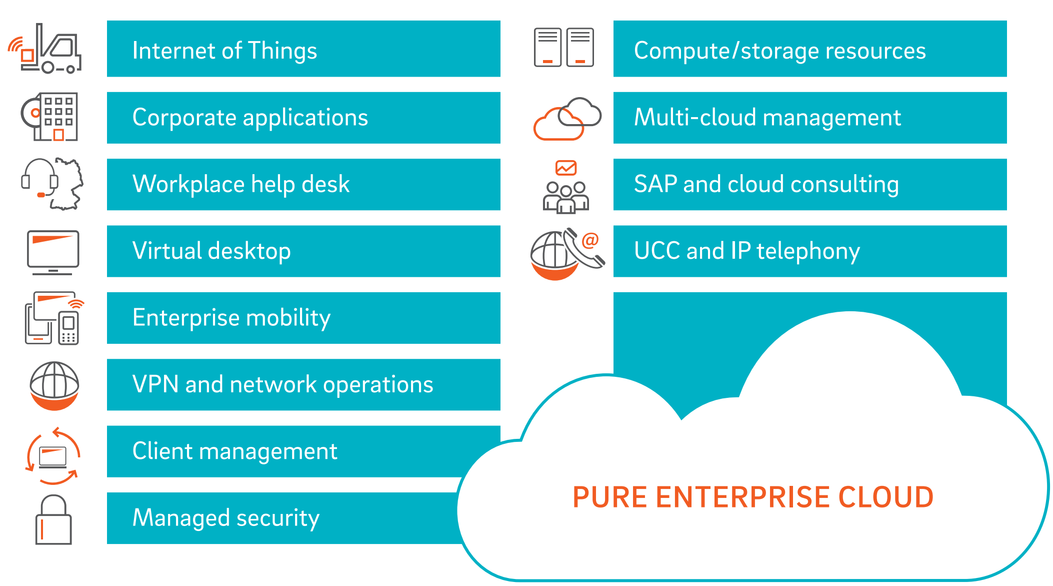
Business Activities

QSC is digitising the German SME sector. With decades of experience and expertise in its Cloud, Internet of Things, Consulting and Telecommunications businesses, QSC accompanies its customers securely into the digital age. Today already, cloud-based procurement models offer increased speed, flexibility and full service availability. The Company's TÜV and ISO-certified data centres in Germany and its nationwide All-IP network form the basis for maximum end-to-end quality and security in the transmission of all customer data. The Company markets its products and services both directly and via partners. QSC divides its operating business into the four segments described below.

Cloud – the centrepiece of digitisation. In this, its newest and fastest growing segment, QSC pools all activities relating to its Pure Enterprise Cloud and the Internet of Things (IoT). Developed since 2015, the Pure Enterprise Cloud is based on a modular system comprising proven cloud technologies, software solutions and service components. These are accompanied by high-performance network and infrastructure services. The Pure Enterprise Cloud acts as a link between different cloud worlds and also permits the effective use of traditional IT applications. It also already accounts for the growing interest shown by companies in multi-cloud solutions. The Pure Enterprise Cloud is thus developing into a central hub for bringing together and orchestrating very different cloud worlds.

Pure Enterprise Cloud also creates opportunities for multi-cloud solutions

Pure Enterprise Cloud: service portfolio



IoT portfolio mainly results from in-house development work

The IoT portfolio pooled at QSC's subsidiary Q-loud is also mainly the result of inhouse development work. Q-loud offers companies a full-stack service enabling them to network appliances and implement digital business models in the Internet of Things. This end-to-end service comprises transformation consulting, software and hardware competence, standard hardware, a proprietary IoT platform, security solutions and manufacturing of so-called "smart products".

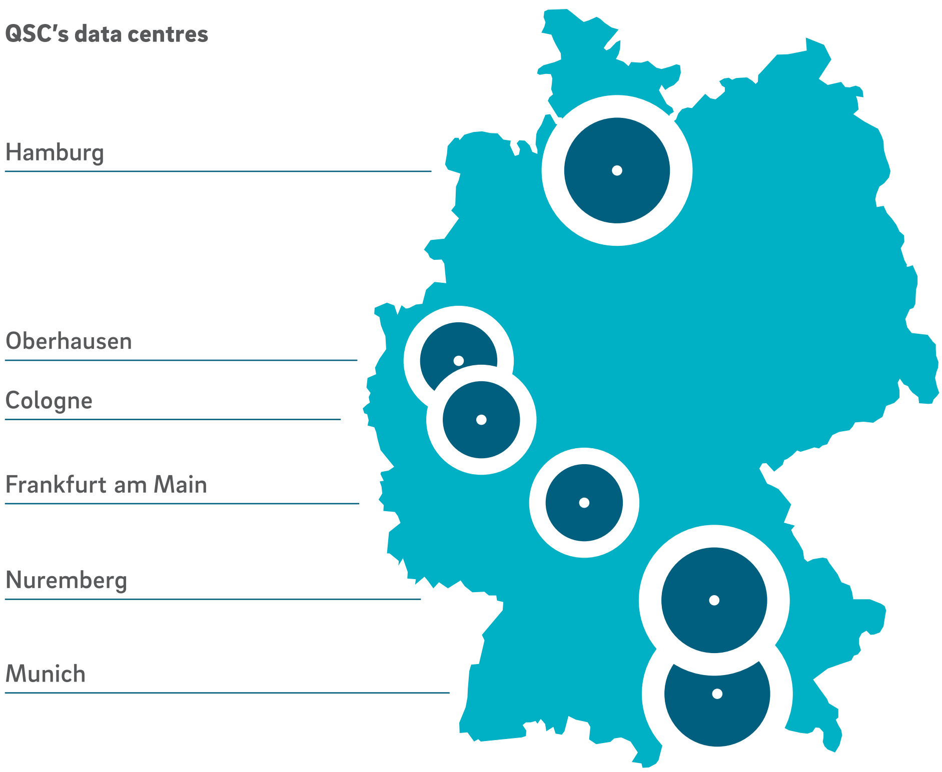
Outsourcing – migration to the Pure Enterprise Cloud underway. The Outsourcing segment comprises the traditional business in which companies outsource IT and data storage services to QSC. This is a highly individualised and thus personnel-intensive business field. With the launch and ongoing development of the Pure Enterprise Cloud, QSC already performs outsourcing services for numerous new customers in a highly efficient manner by drawing on standardised cloud-based services. The option of converting to cloud-based services is highly attractive for existing customers in the traditional Outsourcing business as well and is therefore already being drawn on.

Consulting – a guide to processes in the digital world. QSC advises companies on optimising their business processes with two key focuses on SAP and Microsoft. As a full-service SAP service provider and longstanding partner to SAP, QSC has extensive experience in the fields of basic operations, application management, implementation, user support and maintenance, as well as in managing the necessary software licenses. QSC acted early to focus on integrating cloud-based applications, and in particular on the new S/4HANA Business Suite. The use of cloud-based programmes is also playing an ever greater role in the Company's Microsoft-based consulting. Here, the services on offer range from needs analysis via consulting, design and implementation through to operations and ongoing optimisation.

Telecommunications (TC) – voice and data services from a single source. QSC started out as a TC provider and today still offers a broad range of voice and data transmission solutions. For their internet connections, customers can choose from asymmetric ADSL2+ lines, symmetric SDSL lines and premium internet access via wireless local loop (WLL) networks. Ever more customers are also using their internet connections for voice telephony. QSC has offered All-IP telephony connections (Voice over IP) and corresponding telephony systems since 2006 already. The range of services offered by the Company also includes further forms of voice telephony, including open call-by-call and preselect offerings and value added services.

Data centres and an All-IP network in Germany. All four segments work with QSC's proprietary ICT structure across the whole of Germany and are thus able to guarantee consistently high quality along the entire value chain. The centrepiece of this infrastructure consists of data centres certified by both TÜV and ISO. At the end of 2016, QSC operated data centres at six locations across Germany (Frankfurt am Main, Hamburg, Cologne, Munich, Nuremberg, Oberhausen) with total floor space of around 20,000 square metres. The Company is thus subject at all of its locations to German data protection requirements, which are very strict by international standards.

QSC's data centres



The data centres are linked with a cutting-edge infrastructure. In 2016, QSC significantly expanded its core backbone and now has what is one of Germany's most up-to-date and best-performing core networks. A redundant infrastructure with connection capacities of 100 GBit/s is also being put into place. Furthermore, the infrastructure is based on the next-generation network (NGN), which safeguards the convergence of various voice and data transmission technologies with the IP protocol. Moreover, QSC has traditionally operated a nationwide DSL network, one of Germany's largest wireless local loop (WLL) access networks and a nationwide All-IP voice network. Unlike many competitors, QSC fully upgraded its voice-data network to IP technology in 2006 already and has therefore been able to offer nationwide IP telephony and related services for 10 years.

100 GBit/s

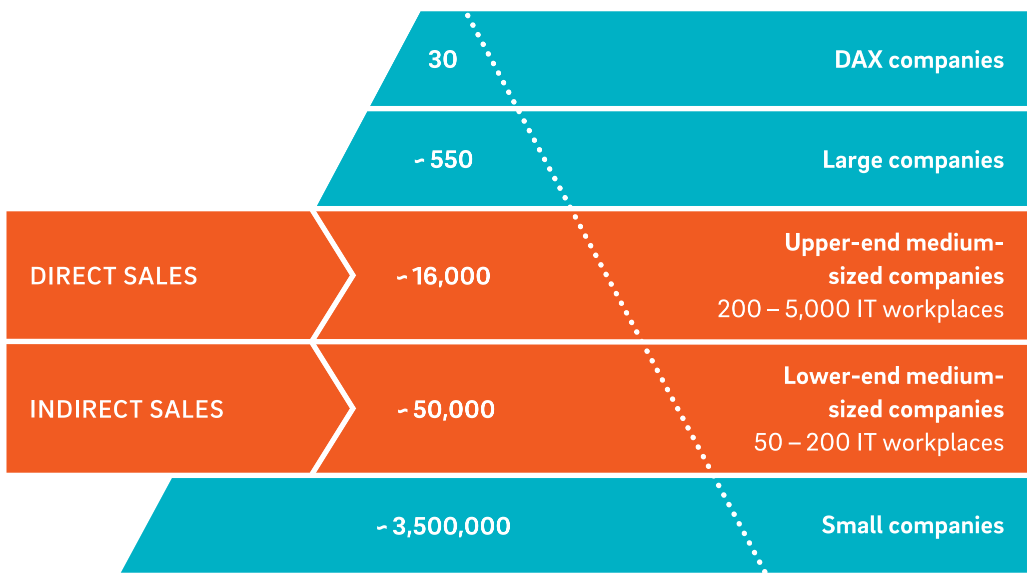
Connection capacities

Market and Competitive Position

Focus on German SME sector. Since its foundation, QSC has primarily focused on medium-sized companies headquartered in Germany. Thanks to its own structure and character as a medium-sized company, QSC enjoys particular credibility in this environment and has successfully built up a strong position over many years.

QSC works with two different distribution channels to optimally address the needs of its SME target groups. In Direct Sales, a key account team targets around 16,000 medium-sized companies in Germany with 200 to 5,000 IT workplaces. Indirect Sales focuses on around 50,000 companies with 50 to 200 workplaces. Here, QSC has worked together for many years now with more than 350 sales partners, more than 150 internet service providers (ISP) and national and international carriers.

QSC's sales activities



Comprehensive range of services as key competitive advantage. QSC covers the main requirements of SME companies in the digital age with a one-stop range of proprietary services. Its Pure Enterprise Cloud sees to the transformation in IT, its full-stack IoT portfolio deals with the networking of machines and appliances, its SAP competence (especially with SAP HANA) ensures smart processing of permanently growing data volumes while its All-IP expertise ensures smooth and secure voice and data transmission. The possibility of combining various modules has proven to be a key competitive advantage and is viewed by customers as QSC's particular strength.

Innovative portfolio makes QSC "Rising Star". The competitiveness of QSC's portfolio was underlined in 2016 by several accolades received from market researchers. Within its annual "Cloud Vendor Benchmark", IT analysts at Experton Group singled out the "Workplace Services" in the Pure Enterprise Cloud as a "Rising Star". Here, they particularly praised the scope and attractiveness, degree of innovation and future potential of the new Cloud portfolio. QSC also confirmed its existing placements as a "Cloud Leader" with three other Software-as-a-Service and Infrastructure-as-a-Service solutions. Experton Group also viewed QSC as a "Rising Star" in an analysis of 125 IoT providers within its "Industrie 4.0 / IoT Vendor Benchmarks".

Strategy

QSC accompanies SMEs step by step into the digital age. QSC's strategy consistently addresses the needs of small and medium-sized enterprises (SMEs). These companies face enormous challenges as the digitisation of the overall economy gains momentum. IT-based, digital business models are supplementing and replacing conventional models, and that ever more frequently. To seize the opportunities presented by the digital age and securely manage the forthcoming process of transformation, these companies need experienced service providers. Given enormous technical advances and the crucial role played by modern technologies in determining companies' long-term success, home-grown IT solutions are increasingly reaching their limits. QSC's strategy is tailored to meet precisely these needs.

The cloud is the IT architecture for the digital age

The process of turning away from proprietary IT solutions is occurring in parallel with the advance of the cloud, which is the IT architecture for the digital age. With its centralised approach, the cloud satisfies requirements in terms of agility, security and customer orientation. Customers wish to be able to interact with a company at all times, from all locations and from all conceivable end appliances. Only very large companies have the capacity to operate this kind of cloud solution on an in-house basis. German SME players will therefore place their trust in the performance capacity, technical competence and security offered by external providers. QSC is optimally positioned to satisfy these needs. The Company is one of only few one-stop providers in the German market. With its Pure Enterprise Cloud, it offers a service portfolio that combines all competencies and thus makes it far easier for customers to manage their transition into the new digital age.

Cloud, Consulting and TC promoting SME digitisation. The Pure Enterprise Cloud, which comprises all ICT services small and medium-sized companies need for their digitisation, is allocated to QSC's Cloud segment. Step by step, QSC will also provide its Outsourcing customers with the opportunity of significantly enhancing their IT efficiency by working with the Pure Enterprise Cloud. The Cloud segment also includes all of QSC's IoT activities. There are three key focuses in this area: firstly, so-called smartification, involving full-stack solutions for networking products;

secondly, solutions aimed at enhancing the energy efficiency of companies and private households; thirdly, IoT cloud enabling, in which QSC advises companies in developing and operating their IoT cloud solutions.

Consulting also plays a decisive role in digitising SME companies. After all, key focuses of activities at this segment include integrating cloud-based applications and transforming complete IT systems. Consulting acted early to prepare for SAP's technological advance to the S/4HANA Business Suite and now helps mainly larger SME players in smartly capturing and processing large volumes of data.

State-of-the-art end-to-end data transmission

With its TC services, QSC has laid the foundation for any successful digital transformation. After all, state-of-the-art voice and data transmission is a prerequisite for any digital business model. QSC is one of only few companies in Germany that is able to offer maximum end-to-end quality in the field of data transmission. Here too, QSC focuses on corporate customers. The traditional business with resellers that mainly target private customers is declining in significance. As a result of market and regulatory factors, the Company expects to see further reductions in its revenue and earnings contributions in this area.

Strategy as foundation for sustainable value growth. All aspects of QSC's strategy aim to assist SME companies in managing their transition to the digital age. Key contributions here are made by the Cloud and Consulting segments and the TC business with corporate customers, areas in which the Company expects to see rising revenue and earnings contributions. By contrast, revenues in the Outsourcing segment and the TC business with resellers are expected to decrease further. Looking forward, QSC will nevertheless strictly ensure adequate profitability in these areas as well. In particular, the growth expected in the Cloud business will create a strong foundation for sustainable value growth in the years ahead.

Organisational Structure

Nationwide presence in German market. QSC AG has its legal domicile in Cologne and has a second major location in Hamburg. These two sites are supplemented by ten sales offices across Germany. QSC has three material direct and indirect participating interests:

- Ventelo GmbH offers medium-sized and large companies services including direct landline connections, preselect and call-by-call, as well as value added services.
- Ventelo owns 100% of the shares in the network company Plusnet GmbH & Co. KG. Plusnet operates a nationwide DSL network.
- Q-loud GmbH: QSC has pooled all of its IoT activities here since November 2016 (www.q-loud.de).

SEE PAGE 138
NOTES

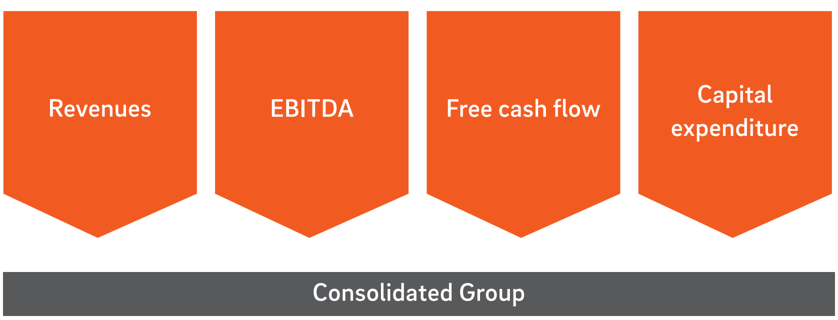
A complete overview of the scope of consolidation as of 31 December 2016 can be found in Note 39 of the Notes to the Consolidated Financial Statements.

Management

Management by key financial performance indicators. The Company is managed via its four segments: Cloud, Consulting, Outsourcing and Telecommunications. These are based on a system of profit, cost and service centres. The following key financial performance indicators are referred to on group level: revenues, EBITDA, free cash flow and capital expenditure. No reference is made to non-financial performance indicators for Company management purposes.

QSC works with a system of profit, cost and service centres

QSC's key financial performance indicators



EBITDA is defined as earnings before interest, taxes, amortisation of deferred non-cash share-based compensation and impairment losses on customer-related inventories, depreciation/amortisation of property, plant and equipment and intangible assets. The EBITDA margin presents EBITDA as a percentage of revenues. The free cash flow presents 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 and other investments, as well as investments in infrastructure.

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. 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 69 onwards. This ensures that any changes in opportunities and risks are directly factored into the management system.

SEE PAGES 69 FF.
RISK MANAGEMENT SYSTEM

CORPORATE GOVERNANCE REPORT

Key focus on creating long-term value. Since its foundation, QSC has accorded great priority to high-quality, transparent corporate governance, and thus to up-to-date management and supervision aimed at long-term value creation. Open communications with shareholders, employees, customers and suppliers naturally form part of corporate governance, as does cooperation on a basis of trust between the Company's boards.

The Company lives the Corporate Governance Code in its everyday work

Consistent with this commitment, the Company has implemented the requirements of the German Corporate Governance Code ("Code") in virtually all points and adheres to these in its day-to-day work. In a small number of cases, QSC nevertheless deliberately deviates from the recommendations made by the Government Commission. 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).

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 General Meeting.

Ongoing dialogue with capital market players. The Annual General Meeting is the most important event for the Company's dialogue with its shareholders. Just under 40% of the share capital was present at the Annual General Meeting for the 2015 financial year held in Cologne on 25 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. The Management and Supervisory Boards once again decided not to broadcast the event on the internet, as the associated costs and legal uncertainties outweigh 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 in one-to-one talks, some of which at capital market conferences organised by banks. Conference calls held on the days the quarterly

results are published also ensure that all target groups receive up-to-date information. QSC makes the respective presentations, as well as recordings 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 22 of this Annual Report.

SEE PAGES 19 FF.
QSC SHARE PERFORMANCE

CEO further increases his stake. Transparent communications clearly also involve promptly informing the public about purchases and sales of QSC shares by Management and Supervisory Board members and parties related to such. In the past financial year, the CEO Jürgen Hermann further increased his shareholding, acquiring 60,000 additional shares in QSC at the beginning of July 2016. He now owns a total of 400,000 shares.

CORPORATE GOVERNANCE DECLARATION

Management and Supervision

QSC has a dual management structure. QSC AG is a publicly listed stock corporation under German law and has a dual management structure. The Management Board manages the Company under its own responsibility while the Supervisory Board appoints, supervises and advises the Management Board. Members of both boards are bound solely by the Company's interests. No conflicts of interest requiring disclosure arose in the past financial year.

Management Board adopts resolutions by simple majority voting. 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 event of a parity. All resolutions relating to measures and transactions that are of major significance to the Company or that involve substantial financial 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 those areas under his or her own responsibility within the framework of Management Board resolutions. In the 2016 financial year, the Management Board consistently comprised four members, namely Jürgen Hermann (CEO), Stefan A. Baustert (Finance), Udo Faulhaber (Sales and Consulting) and Felix Höger (Technology and Operations).

50%

Share of women on Supervisory Board

Targets for share of women on Management and Supervisory Boards met in 2016. In line with statutory requirements, in 2015 QSC published its targets for the share of female members of its Supervisory Board, Management Board and top two management tiers. In the past financial year, the Company also complied with these targets. Based on a Supervisory Board resolution, the share of female members of this body should amount to at least 16.6%. In 2016, women accounted for 50% of its members. A target of 0% applied for the Management Board in 2016; this is because the terms in office of the Management Board members, all of whom are men, will only end after the target date set by lawmakers, namely 30 June 2017. For the two top management tiers, the Management Board aims to achieve a 5% share of women in the first management tier and 10% in the second management tier by 30 June 2017. These figures reflect the Company's core focus on IT and technology and the associated circumstance that in some cases all applicants for vacant positions are men. As of 31 December 2016, women made up 12% of the managers in the first tier and 16% in the second tier.

Gender parity on Supervisory Board. Pursuant to the Articles of Association, QSC's Supervisory Board comprises six members. Two thirds of Supervisory Board members are elected by shareholders and one third by employees. The Supervisory Board comprises three women, of which two employee representatives, and three men. The term in office of all members expires upon the conclusion of the Annual General Meeting for the 2017 financial year.
Unless otherwise stipulated by law or the Articles of Association, 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 draft versions of its resolutions where appropriate. 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 13 FF.
SUPERVISORY BOARD REPORT

Supervisory Board composition meets statutory and proprietary objectives. As recommended in Point 5.4.1 of the Code, the Supervisory Board members together possess the knowledge, ability, and expert experience required for the Board to properly perform its duties. 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 longstanding Director of the Group Tax Department at the globally active SAP Group, Ina Schlie satisfies all aspects of this requirement. Alongside Dr. Frank Zurlino, Managing Partner at the management consultancy Horn & Company, she is an independent member of the Supervisory Board.
The number of former Management Board members on the Supervisory Board is limited to a maximum of two. At present, these relate 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 hold directorships or perform advisory functions at significant competitors. With a 50% share of female members, the Supervisory Board significantly exceeds its own target of 16.6% in this respect. Upon the latest election, all candidates were aged below 75. Unlike recommended in the Code, the Supervisory Board has deliberately decided not to set a limit on the period of membership in the Supervisory Board. It does not believe that it would be in the Company's best interests to set an advance limit on the length of time individual members should sit on the board.

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, and to its risk situation, risk management and compliance. The Rules of Procedure for the Management Board require Supervisory Board approval to be obtained prior to the conclusion of any major business transactions, such as the adoption of annual planning and 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

Mandatory 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, QSC's corporate management is based on a system of shared values.

Internal guidelines consistent with Code requirements

The main contents of this system are summarized in QSC's Compliance Guidelines. These are binding for the Management Board and for all employees and are also expected to shape business dealings with third parties.
Integrity plays a key role within this system of values. The Company views integrity as the guiding principle 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 to behave impeccably in legal and ethical terms in their day-to-day work. This way, the Company aims to avoid adverse consequences for itself and for the public at large.
The key focus here is on prevention – inappropriate conduct should be avoided from the outset. Practice-oriented training events help raise all employees' awareness of the importance of topics such as legal compliance 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, travel expenses, procurement and all aspects of customer relationships, provide the clarity needed to ensure appropriate conduct in everyday operations. Despite these measures, the risk of individuals acting improperly cannot be precluded entirely. Any individual infringements occurring in spite of all preventive measures are clarified and penalised without regard to the individual and his or her position.

Guidelines provide clarity as to correct conduct in daily work

QSC views compliance as an important management task. Compliance requires the ongoing attention of the Company's directors and officers. The Management and Supervisory Boards therefore address this topic regularly, as does the Audit Committee. In doing so, they draw on information such as the quarterly risk reports, in-house controlling and internal audit reports. The associated discussions generate major impetus for enhancing the compliance management system on an ongoing basis.

Declaration of Conformity

Declaration made by the Management and Supervisory Boards of QSC AG pursuant to § 161 of the German Stock Corporation Act (AktG) regarding the Company's compliance with the German Corporate Governance Code (DCGK) in the version dated 5 May 2015

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 and adheres to them in its daily work. Since the submittal of its last Declaration of Conformity, the Company has complied and continues to comply with the recommendations of the Government Commission "German Corporate Governance Code" in the version dated 5 May 2015, with the following exceptions:

- **No agreement regarding a deductible in the D&O insurance for members of the Supervisory Board (§ 93 [2] of the German Stock Corporation Act [AktG]) (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 1 July 2010, included a deductible for Supervisory Board members of 10% of the respective damages per damage event. However, and contrary to the recommendation, the liability per year is capped at 100% 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 (Item 4.2.3, Paragraph 2, Sentence 6 and Item 4.2.5, Paragraph 3 [first bullet point], Paragraph 4 of the Code).** Only 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 fully comply with the recommendations when determining any future Management Board compensation.

- **No exclusion of retroactive changes to the performance targets or comparison parameters for the variable compensation of Management Board members (Item 4.2.3, Paragraph 2, Sentence 8 of the Code).** Management Board members receive variable compensation, the amount of which for the long-term incentive (LTI) component is based on the achievement of multiyear targets over a three-year performance period. Target agreements for multiyear targets were concluded with three Management Board members in March 2015. Upon concluding a further target agreement with a Management Board member who commenced his activity in 2016, on 18 August 2016 the Supervisory Board decided to adjust individual parameters of the target agreements concluded in March 2015. The Supervisory Board is of the opinion that external developments unforeseeable in March 2015 have made it necessary to restore the incentive effect of the variable compensation on a uniform basis for the Management Board members in the interests of the Company and thus boost the overall responsibility of the Management Board.

– **No regular limit set for length of Supervisory Board membership (Item 5.4.1, Paragraph 2, Sentence 1 of the Code).** The Supervisory Board of QSC has set specific targets for its composition that are consistent with the recommendations made in Item 5.4.1 with the exception of the requirements to set a regular limit for the length of Supervisory Board membership. The Supervisory Board believes that it would not be in the Company's best interests to set an advance limit on the length of individual board membership. It is basically desirable that the Supervisory Board should change its composition at certain intervals; on the other hand, the Company should also be able to draw on the expertise of experienced Supervisory Board members.

– **No disclosure of personal and business relations of each individual candidate with the Company, its executive bodies and with any shareholders holding material interests in the Company in election proposals to Annual General Meeting (Item 5.4.1, Paragraphs 5 to 7 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 § 125 (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, 17 November 2016

On behalf of the Management Board
Jürgen Hermann

On behalf of the Supervisory Board
Dr. Bernd Schlobohm

COMPENSATION REPORT

Performance-based compensation system. One major element of good corporate governance involves transparently presenting the total compensation paid to members of corporate bodies. The compensation system for members of the Management Board was adjusted, most recently as of 1 January 2015, to account for modified legal requirements, with these amendments being approved by the Annual General Meeting on 27 May 2015. The Supervisory Board continues to determine the total compensation payable to individual members of the Management Board. The criteria referred to when assessing the appropriateness of compensation on the one hand include the tasks of the individual Management Board member, his or her personal performance, and the Company's economic situation and its sustainable development. On the other hand, they take account of the appropriateness of compensation by reference to peer group companies and compensation structures otherwise applicable within the Company itself and at comparable companies. Furthermore, the compensation is structured to be competitive in the market for highly qualified executives.

Fixed compensation accounts for a maximum of 50% of annual target compensation for Management Board members. The compensation system for the Management Board of QSC AG consists of fixed and variable compensation components, pension benefits and other fringe benefits. The annual non-performance-related fixed compensation makes up a maximum of 50% of total annual target compensation (comprising fixed and variable compensation based on 100% target achievement). It accounts for the performance of the respective member of the Management Board and the function and responsibilities assigned to him or her. Fixed compensation is paid by transfer and in 12 equal monthly instalments at the end of each calendar month. Management Board members do not receive any separate compensation for assuming further group-internal positions.

Furthermore, Management Board members receive variable compensation (bonus), the amount of which is based on achievement of annual targets (short-term incentive) and multiyear targets (long-term incentive), with both sets of targets being agreed in a separate target agreement. These targets may be based on Company-related key figures and/or on individual considerations. For Company-related key figures, they may also include more ambitious minimum targets than those communicated in external outlooks.

Multiyear targets stretch over three financial years

The assessment period for multiyear targets covers three financial years. Multiyear targets are agreed at the beginning of the assessment period and must be met by the end of such period. When defining target achievement, the Supervisory Board may also agree further interim targets to be met over the individual financial years in the assessment period and/or further conditions. Variable compensation is payable in cash and accounts for at least 50% of the total annual target compensation (based on 100% target achievement). Target achievement is basically determined following the adoption of the consolidated financial statements relevant to the targets defined in the target agreement. Any resultant bonus is paid out at the end of the month in which the Annual General Meeting is held following expiry of the financial year, to the extent that it relates to annual targets, and at the end of the month in which the Annual General Meeting is held following expiry of the assessment period, to the extent that multiyear targets are involved.

Furthermore, the Company also grants pension benefits to its Management Board members.

These involve defined contribution commitments for benefits provided by insurance companies and pension funds and/or commitments to pay a fixed amount to enable the member to secure his or her own suitable provision for retirement and for surviving dependants.
The other fringe benefits granted to Management Board members mainly relate to the provision of a company car, payment of a car allowance and insurance provision customary to the market.

Variable compensation dependent on achievement of minimum targets. The Supervisory Board agrees lower and upper limits for the achievement of each individual annual and multiyear target. Failure to meet lower limits or any condition governing an annual target and/or multiyear target results in the complete loss of the variable compensation attributable to the respective target. In the case of the multiyear target, the variable compensation attributable to the respective target may be lost for the entire assessment period. Non-achievement of an interim target results in the partial or complete loss of the compensation dependent on achievement of such target. The upper limit serves to cap variable compensation in the event of exceptional developments at a maximum of 1.5 times the target compensation attributable to variable compensation and attainable upon 100% target achievement.

Long-term components of compensation granted high priority

In concluding target agreements, the Supervisory Board ensures that the share of variable target compensation due to achievement of the multiyear targets basically reaches the share attributable to achievement of the annual targets. The share of variable compensation due to annual targets may nevertheless be weighted more significantly to the extent that the compensation structure remains focused on the Company's sustainable development and on providing a long-term performance incentive by including other elements (such as additional bonuses by way of shares and stock options).
To recognise the achievement of multiyear targets and promote the Company's sustainable development, the Supervisory Board may commit to paying Management Board members an appropriate additional bonus in the form of shares or stock options in QSC and, if so, agree suitable waiting, holding and exercise periods. This may further increase the share of total variable compensation attributable to variable compensation of a long-term incentive nature, as well as the share of total target compensation attributable to variable compensation. Finally, to acknowledge exceptional performance, the Supervisory Board may – at its own discretion – grant Management Board members a suitable additional bonus in cash or in the form of shares or stock options in the Company. Holding and exercise periods may be agreed in this regard as well.

Management Board compensation for 2016. Total Management Board compensation for the 2016 financial year came to € 1,973k, as against € 1,182k in the previous year.
The year-on-year increase was due above all to the Group being managed by four Management Board members throughout the 2016 financial year, whereas for long periods of the previous 2015 financial year the Management Board had only three members. Due to the higher level of target achievement compared with the previous year, the variable share of compensation for the annual target also increased. Furthermore, total compensation for 2016 also includes share-based compensation of € 217k (2015: € 92k) granted to three Management Board members in connection with the subscription of a total of 400,000 convertible bonds within the 2015 stock option plan. Individualised Management Board compensation is presented in the table on Pages 44 and 45.

SEE PAGES 44 – 45
COMPENSATION OVERVIEW

In the target agreements entered into for the 2016 financial year, a congruent annual target and two separate, equally weighted multiyear targets were agreed for all Management Board members in office in the financial year under report. Furthermore, the Supervisory Board granted a special bonus to one Management Board member in recognition of exceptional performance. The 2016 annual target, which was linked to consolidated EBITDA for the 2016 financial year, was not fully reached. As a result, the Management Board members are only entitled to prorated shares of their bonuses. The assessment period for multi-year targets covers the financial years from 2015 to 2017. Target agreements for multiyear targets were entered into with three members of the Management Board in March 2015. When entering into a further target agreement with a Management Board member who commenced his activity in the 2016 financial year, the Supervisory Board resolved on 18 August 2016 to adjust individual parameters in the target agreements concluded in March 2015. The Supervisory Board believes that external developments unforeseeable in March 2015 necessitated these amendments in order to restore a uniform incentive effect for Management Board variable compensation in the interests of the Company and to boost collective Management Board responsibility.

Targets based on EBITDA and growth in Cloud segment

The adjusted multiyear targets continue to be linked to consolidated EBITDA for the 2017 financial year and to the revenues generated in the new high-growth Cloud segment in the 2017 financial year.

The share of multiyear variable compensation attributable to the 2016 financial year amounts to € 550k in total. This is only deemed to have been granted and is only disbursed when the targets set for the end of the assessment period have been fully met. There were no indications at the end of 2016 that the targets set for the 2017 financial year would not be met.

No loans were granted to Management Board members.

Benefits in the event of premature termination. All Management Board members have been promised settlements should their Management Board activities be prematurely terminated due to effective revocation of their appointment by the Company within the first two years covered by their employment contracts. These settlements amount to € 600k each in the case of Jürgen Hermann and Felix Höger and to € 500k each for the two other Management Board members Stefan A. Baustert and Udo Faulhaber. In the final year of their employment contracts, this settlement reduces by one twelfth per month in which the employment relationship still pertained in the final year of the contract. There is no entitlement to any settlement payment should the employment relationship being terminated without notice due to compelling reason (§ 626 BGB) or in the event of the employment relationship being terminated due to the respective Management Board legitimately resigning from his position. Should 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 should not exceed the amounts of € 600k or € 500k respectively.

Disclosures on retired Management Board members. Compensation of former Management Board members came to € 0k in the 2016 financial year (2015: € 421k).

Dr. Bernd Schlobohm, a former Management Board member, was granted a direct pension commitment for a retirement, occupational disability and widow's pension in 1997. At the balance sheet date, the obligation amounted to € 1,884k prior to the offsetting of reinsurance claims of € 1,282k. The actuarial present value of provisions for vested pension claims for other former Management Board members amounts to € 96k.

Shares and convertible bonds held by Management Board members. The following table presents individualised information about the number of shares and convertible bonds held by members of the Management Board:

	Shares		Convertible bonds	
	31 Dec. 2016	**31 Dec. 2015**	**31 Dec. 2016**	**31 Dec. 2015**
Jürgen Hermann	400,000	340,000	350,000	350,000
Stefan A. Baustert	40,000	40,000	200,000	100,000
Udo Faulhaber (since 1 August 2015)	-	-	150,000	-
Felix Höger (since 1 January 2016)	-	-	150,000	-
Henning Reinecke (until 30 April 2015)	-	5,000[1]	-	150,000[1]

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

CEO Jürgen Hermann buys further QSC shares in calendar year 2016

Jürgen Hermann purchased shares in the Company via the stock exchange in the 2016 calendar year and thus while he was an active member of the Management Board (please also see the corresponding directors' dealings notifications made pursuant to § 15a of the German Securities Trading Act [WpHG] on QSC's website).
Furthermore, the Management Board members Stefan A. Baustert, Udo Faulhaber and Felix Höger subscribed convertible bonds in QSC AG. These had been allocated to them by the Supervisory Board on 20 August 2015 within the 2015 Stock Option Plan.
The following table presents information about the convertible bonds granted to Management Board members in the 2016 financial year:

	Convertible bonds granted		
	Date	**Number**	**Conversion price**
Stefan A. Baustert	15 Jan. 2016	100,000	€ 1.42
Felix Höger	1 Apr. 2016	75,000	€ 1.10
Udo Faulhaber	5 Apr. 2016	150,000	€ 1.10
Felix Höger	6 Apr. 2016	75,000	€ 1.21

The convertible bonds may only be converted into shares in QSC AG after a four-year waiting period, i.e. options subscribed for 2016 may be converted at the earliest in the 2020 financial year.

Benefits granted
in € 000s

	Jürgen Hermann, Chief Executive Officer, since 30 May 2013				Stefan A. Baustert, Member of the Management Board, since 1 January 2015			
	2015	2016	2016 (min.)	2016 (max.)	2015	2016	2016 (min.)	2016 (max.)
Benefits granted								
Fixed compensation	300	300	300	300	250	250	250	250
Fringe benefits	29	31	31	31	36	35	35	35
Total	**329**	**331**	**331**	**331**	**286**	**285**	**285**	**285**
One-year variable compensation	150	150	0	225	125	175	0	237
Multiyear variable compensation								
Long-term incentive (2015 – 2017) [1]	150	150	0	225	125	125	0	187
2015 Stock Option Plan [2]	-	-	-	-	92	67	0	852
Total compensation pursuant to DCGK	**629**	**631**	**331**	**781**	**628**	**652**	**285**	**1,561**
Reconciliation with total compensation								
pursuant to § 314 (1) No. 6a HGB in conjunction with DRS 17								
Less annual variable target compensation granted	(150)	(150)			(125)	(175)		
Less Long-term incentive (2015 – 2017) [3]	(150)	(150)			(125)	(125)		
Plus annual variable actual compensation paid	107	128			89	156		
Total compensation	**436**	**459**			**467**	**508**		
Total expenses for share-based compensation								
recognised in reporting period	38	38			10	39		

Benefits paid
in € 000s

	Jürgen Hermann, Chief Executive Officer, since 30 May 2013		Stefan A. Baustert, Member of the Management Board, since 1 January 2015	
	2015	2016	2015	2016
Benefits paid				
Fixed compensation	300	300	250	250
Fringe benefits	29	31	36	35
Total	**329**	**331**	**286**	**285**
One-year variable compensation	107	128	89	106
Multiyear variable compensation				
Long-term incentive (2015 – 2017) [1]	0	0	0	0
2015 Stock Option Plan [2]	0	0	0	0
Sundry	-	-	-	-
Total compensation pursuant to DCGK	**436**	**459**	**375**	**391**

> Footnote numbers are explained on Page 46.

Udo Faulhaber Member of the Management Board since 1 August 2015				**Felix Höger** Member of the Management Board since 1 January 2016				**Henning Reinecke** Member of the Management Board until 30 April 2015			
2015	**2016**	**2016**	**2016**	**2015**	**2016**	**2016**	**2016**	**2015**	**2016**	**2016**	**2016**
		(min.)	**(max.)**			**(min.)**	**(max.)**			**(min.)**	**(max.)**
104	250	250	250	-	300	300	300	67	-	-	-
13	31	31	31	-	42	42	42	16	-	-	-
117	**281**	**281**	**281**	**-**	**342**	**342**	**342**	**83**	**-**	**-**	**-**
52	125	0	187	-	150	0	225	42	-	-	-
52	125	0	187	-	150	0	225	-	-	-	-
-	73	0	990	-	77	0	1,040	-	-	-	-
221	**604**	**281**	**1,645**	**-**	**719**	**342**	**1,832**	**125**	**-**	**-**	**-**
(52)	(125)			-	(150)			-	-		
(52)	(125)			-	(150)			-	-		
37	106			-	128			-	-		
154	**460**			**-**	**547**			**125**	**-**		
0	14			-	15			138	-		

Udo Faulhaber Member of the Management Board since 1 August 2015		**Felix Höger** Member of the Management Board since 1 January 2016		**Henning Reinecke** Member of the Management Board until 30 April 2015	
2015	**2016**	**2015**	**2016**	**2015**	**2016**
104	250	-	300	67	-
13	31	-	42	16	-
117	**281**	**-**	**342**	**83**	**-**
37	106	-	128	42	-
0	0	-	0	-	-
0	0	-	0	0	-
-	-	-	-	-	-
154	**387**	**-**	**470**	**125**	**-**

< Explanation of footnote numbers on Page 44:

1 The variable compensation for the long-term incentive is agreed on the basis of two separate and equally weighted multiyear targets. The assessment period for the multiyear targets comprises the financial years 2015 to 2017. The multiyear targets are based on consolidated EBITDA in the 2017 financial year and on the revenues generated in the new high-growth Cloud segment in the 2017 financial year. Should the figures fall short of the contractually agreed minimum limits, then the variable compensation attributable to the respective multiyear target is waived for the entire assessment period. Moreover, further interim targets and conditions have been agreed for the multiyear targets. Any failure to meet these also results in the loss of the variable compensation attributable to the multiyear target for the entire assessment period.

2 The Management Board members Stefan A. Baustert, Udo Faulhaber and Felix Höger subscribed convertible bonds in QSC AG in the 2016 financial year. These convertible bonds were allocated to them by the Supervisory Board within the 2015 Stock Option Plan on 20 August 2015. The table below provides information on the convertible bonds thereby subscribed.

	Subscription date	Number of convertible bonds	Conversion price in €	Present value of conversion right on subscription date in €	Maximum value of share-based compensation in € 000s
Stefan A. Baustert	15 Jan. 2016	100,000	1.42	0.67	852
Udo Faulhaber	5 Apr. 2016	150,000	1.10	0.49	990
Felix Höger	1 Apr. 2016	75,000	1.10	0.49	495
Felix Höger	6 Apr. 2016	75,000	1.21	0.55	545

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 determined upon subscription of the options in 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 2015 Stock Option Plan is reached when the weighted average price of QSC AG shares in Xetra trading on the Frankfurt Stock Exchange on the 20 trading days preceding the day on which the exercising of the conversion declaration becomes effective pursuant to the bond terms exceeds the conversion price by at least seven times.

3 This compensation does not require inclusion in total compensation pursuant to § 314 (1) No. 6a of the German Commercial Code (HGB), as non-share-based compensation is only deemed granted once any conditions precedent have been met.

Supervisory Board compensation. Consistent with the provisions in the Articles of Association of QSC AG, each member of the Supervisory Board receives fixed annual compensation of € 35k payable after the end 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.

As in the previous year, for its activity in the 2016 financial year the Supervisory Board received total compensation of € 315k. The table below presents individualised information about the compensation paid to Supervisory Board members, as well as about their respective holdings of shares and convertible bonds.

	Compensation as per § 15a of Articles of Association (€ 000s) [1]				Shares		Number of convertible bonds	
	2016		2015		31 Dec. 2016	31 Dec. 2015	31 Dec. 2016	31 Dec. 2015
Dr. Bernd Schlobohm, Chairman	95	(25)	95	(25)	15,519,910	15,518,372	132,000	200,000
Dr. Frank Zurlino, Deputy Chairman	60	(10)	60	(10)	10,000	10,000	-	-
Gerd Eickers	40	(5)	40	(5)	15,577,484	15,577,484	-	-
Ina Schlie	45	(10)	45	(10)	-	-	-	-
Anne-Dore Ahlers [2]	35	-	35	-	-	-	2,700	2,700
Cora Hödl [2]	40	(5)	40	(5)	-	-	4,100	4,100
Total	**315**	**(55)**	**315**	**(55)**				

[1] Numbers in parentheses refer to compensation for committee activity included in total amount.
[2] Employee representative.

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.

EMPLOYEES

Development in Workforce

Employee totals brought in line with revenue performance. QSC had a total of 1,360 employees as of 31 December 2016, equivalent to a further reduction of 94 employees on the previous year. At the end of 2014, QSC still had 1,697 employees. Within its cost-cutting programme, the Company has in two years managed to adjust the size of its workforce in line with its revenues. Revenues per head already rose again in 2016. Including customary personnel turnover, a total of 622 employees left the Company in the past two years. QSC thus parted company with more employees than necessary to ensure sufficient capacities to hire 285 specialist and management staff, mainly cloud experts, SAP consultants and sales employees. This way, QSC has made substantial progress with its organisational restructuring.

Number of employees

As of 31 December 2016, most employees worked at the two main locations in Cologne and Hamburg, with 411 employees at the Company's headquarters in Cologne and 657 in Hamburg. The other employees are mostly divided between subsidiaries, sales offices and branches in other German cities. Of the total workforce, 15% works partly or exclusively from home.

15%

Share of employees using home office

Personnel Strategy

Employees are our greatest source of added value. Notwithstanding unavoidable savings measures, QSC regards its employees as its most important source of added value. The Company's success is driven by their commitment and their will to perform. The increasing pace of social and technological change presents the Personnel Department with the challenge of continually and flexibly adapting to and helping to shape the dynamic environment in which the Company operates. QSC is therefore drawing on intensive training and development for its specialists and executives and on numerous measures aimed at promoting cooperation between the Company's locations and departments.

QSC trains young specialists. The Company granted high priority to vocational training once again in the past financial year and also took on 22 young colleagues upon the completion of their work-study or training programmes. At the same time, 20 young people began their training in

7%

Training ratio

Hamburg, Cologne, Munich and Nuremberg. QSC views this ongoing commitment as a crucial lever to secure the next generation of employees in times of demographic change and far-reaching shortages of specialists.
At the end of 2016, a total of 97 young adults were in training or work-study programmes. The training ratio thus amounted to 7%. 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 in business IT or business administration. Here, the Company collaborates with Nordakademie in Elmshorn, the University of Applied Sciences in Wedel and FOM University of Economics & Management, Cologne. Since the fourth quarter of 2016, QSC has also drawn on a work-study programme offered in cooperation with Wirtschaftsakademie Kiel. Like QSC, this business school focuses on small and medium-sized companies. QSC is also the major sponsor of the IT Management and Consulting master's degree course at Hamburg University.
QSC actively markets the opportunities offered by vocational training and to this end takes part in training fairs held in Cologne, Hamburg and other towns and cities. Further opportunities for making contact at an early stage include pupil internships, school partnerships and participation in Germany's nationwide "Girls' Days" and "Boys' Days".
As a further means of securing its next generation of employees, QSC also recruits university graduates in a targeted manner. The SAP junior programme was expanded in both qualitative and quantitative terms in 2016. At the end of the year, this programme had 24 participants and thus two more than one year earlier. At the same time, the programme was extended with an all-round training and coaching concept.

High priority accorded to further training. The further training and development offered to all employees is geared above all to the Company's strategic development and is a core task of all management staff. Managers hold regular meetings with employees to assess their individual competencies, evaluate their potential and identify their development needs. Suitable measures are then taken and employees' development situations are subsequently reassessed. The QSC Academy offers a broad range of seminars that are competence-based and career-oriented and cover both specialist and personal skills. One key focus in the past financial year involved expanding training in the field of IT service management in order to further optimise internal processes and interfaces. Most of our specialists and executives in technical departments successfully completed this training programme. Specialist training and qualifications are also granted particular priority, thus enabling the Company to react adequately to its rapidly changing market climate. To obtain support with personal, professional and health-related issues, employees also have the possibility of seeking free advice from the Fürstenberg Institut. This organisation also offers a separate section for managers, thus enabling them to receive one-to-one coaching at any time over and above their normal development activities. To promote its women employees in particular, QSC once again took part in PepperMINT, a cross-mentoring programme in the Rhineland metropolitan region.

Participation in state-sponsored research project. Digitisation, increasing flexibility and demographic change – all these factors present the ICT industry with numerous challenges. They require new concepts to help companies deal with existing know-how or new learning content, thus enabling them to remain innovative and competitive. QSC is not only promoting digitisation but, by participating in FLIP, a research project dealing with dynamic personnel and competency management, is also proactively facing the challenges ahead. This three-year programme is being supported by the Federal Ministry of Education and Research (BMBF). The objective is to develop and test new effective and efficient forms and methods of learnings for employees in order to facilitate dynamic competency management.

Corporate Culture

Culture of respect and mutual appreciation. QSC has had its own system of values for many years now. The key principles of this system embody a corporate culture characterised by respect and mutual appreciation and by a focus on performance and results in our daily work. The integrated management development programme available across all locations and all hierarchical levels makes an important contribution in this respect. Its objective is to detect and promote talent at an early stage and thus, despite great diversity, to create a uniform understanding of management.

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 employees to combine their family and work commitments. There are no core working hours and, in agreement with their supervisors, employees are free to perform part of their work from home.

Flexible working hours help to balance work and family commitments

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 with increasing responsibility.
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 40 onwards.

SEE PAGES 40 FF.
COMPENSATION REPORT

Social Responsibility

Commitment demonstrated in training and at the workplace. QSC believes that long-term business success is intrinsically linked to sustainability. In the interests of customers, investors, employees and society as a whole, it therefore attaches very great value to achieving economic and ecological sustainability, as well as to its social commitment. Activities here have traditionally focused on vocational training and on ensuring that employees can combine their family and professional obligations. As an employer, QSC also accords priority to equality of opportunity and diversity. The workplace is characterised by a corporate culture based on respect.

As an employer, QSC promotes diversity and equal opportunities

Sustainable business activity requires well-informed employees. QSC works to raise awareness of sustainability among all its employees. It is important for them, particularly when communicating with customers, to understand the extent to which ICT services can help reduce energy needs and CO_2 emissions. After all, these services enable employees at our own and other companies to avoid business travel and to work from home. QSC itself supports its employees with wide-ranging home office policies and 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. Employees can select from two car-sharing models when booking cars. The travel expense policies explicitly provide for the use of such 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 enable large-scale meetings to be held without any travel or associated environmental impact. Consistent with the EU-wide CSR Directive, from the 2017 financial year onwards QSC will be publishing disclosures on various sustainability aspects in a report on its non-financial performance indicators.

BUSINESS REPORT

Macroeconomic and Industry Framework

Solid growth in German economy. Like in previous years, the German market was the key focus of QSC's business activities. Gross domestic product here grew by 1.9% in 2016, and thus faster than in the previous year (1.7%). The ifo business confidence index, one of Germany's most important economic barometers, also pointed to a robust upturn. Between December 2015 and December 2016, this index rose by 2.6 percentage points to 111.0 points.

IT market among key growth drivers. According to estimates compiled by the Bitkom industry association, IT revenues in Germany rose by 3.6% to € 84.0 billion in 2016. The IT market thus grew at almost twice the rate of the overall economy, with a particularly marked increase in the software business. By contrast, TC revenues stagnated. Based on Bitkom estimates, overall revenues in the German ICT market had a total volume of € 160.5 billion in 2016 and were thus 1.6% ahead of the previous year's figure.

The German ICT market
(in € billion)

Three out of four companies expect data centres to be located in Germany. The digital transformation is rapidly changing the ICT market, with both IT and TC services increasingly being provided online from the cloud. According to Cloud-Monitor 2016 – a study carried out by KPMG on behalf of Bitkom – more than half of all companies in Germany already drew on cloud services in 2016, while almost a fifth are planning or discussing the deployment of such services. Three out of four companies expect their cloud service provider to operate data centres exclusively in Germany. This is one aspect where QSC scores highly, as all of its data centre infrastructure is located in Germany and is thus subject to that country's strict data protection regulations at all locations. The significance companies now accord to cloud-related topics is underlined by a forecast issued by the Experton Group, according to which cloud-revenues in the German corporate customer market will virtually treble from € 11.5 billion in 2016 to € 31.4 billion in 2020.
The IoT market harbours even greater revenue potential. According to a Deloitte study, revenues in Germany are set to nearly quadruple from € 13.7 billion in 2016 to € 50.1 billion in 2020. With its Pure Enterprise Cloud and its IoT full-stack portfolio, QSC is superbly positioned in both high-growth markets.

>50%

Share of companies using cloud services

More than 40% of companies plan to use SAP S/4HANA

German companies turning to SAP S/4HANA. QSC's strategy is also based on ongoing growth in its Consulting business. Here too, the Company has positioned itself favourably by focusing on the technological advance to SAP S/4HANA. A study compiled by Pierre Audoin Consultants shows that more than 40% of companies already have specific plans to introduce the new software generation, while 14% have already begun to do so. The study underlines that companies will invest heavily in external support for the new SAP software. QSC can expect to benefit from this development in its Consulting segment in particular.

Regulatory Framework

Core sections of TC market remain regulated. The German TC market relevant to QSC is in key aspects subject to regulation by the German Federal Network Agency. This is intended to ensure fair competition. Until 1998, Deutsche Telekom operated as a monopolist in the German market. Among other factors, it still possesses a nationwide, mostly copper-based 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. In the past financial year, the German Federal Network Agency took the following decisions relevant to QSC's business activities that will mainly lead to lower preliminaries costs.

Preliminary approval of fixed-network interconnection and termination fees. The German Federal Network Agency published a draft decision on 7 December 2016 concerning interconnection and termination fees at Telekom Deutschland for a two-year period from 1 January 2017. This draft decision cuts termination fees by more than 58%, while interconnection fees have only been marginally reduced. This is due to the first-time application of the EU Termination Rates Recommendation and the different cost standards set out therein for termination and interconnection fees. For interconnection fees, the tariff zones have also been abolished, as have the conversion fees for connections between NGN and conventional PSTN networks. This will make the migration from PSTN to NGN more efficient. The European consulting procedure is currently underway.

Preliminary approval of mobile telephony termination fees. On 30 November 2016, the German Federal Network Agency published a preliminary approval of mobile telephony termination fees for the period from 1 December 2016 to 30 November 2019. Due to the first-time application of the EU Termination Rates Recommendation, the approval provides for a graded reduction over three years: by around 34% to 1.1 cents/minute by 2017, to 1.07 cents/minute by 2018 and finally to 0.95 cents/minute. The European consulting procedure is complete and definitive approval is expected shortly.

Definitive approval of leased line fees. With its definitive resolution dated 15 December 2016, the German Federal Network Agency reapproved the license fees for leased lines for the period from 1 January 2017. As a pure Ethernet network has been used for the first time as the cost basis, the fees for Ethernet-based leased lines have been reduced by around 17% on average.

Market analysis and definition for Market 4. Consistent with the European relevant markets recommendation issued in 2014, in its market definition for Market 4 published in 2016 the German Federal Network Agency newly included high level bitstream access alongside conventional and Ethernet-based leased lines. It has thus subjected bitstream access to regulation for the first time. The obligations which the German Federal Network Agency will impose on Deutsche Telekom, the dominant market player in this area, and the way in which products will actually be structured in practice will be dealt with in the regulatory order due to be compiled in 2017 and the standard offering then based on such.

Market analysis and definition for Market 1. According to the relevant markets recommendation, Market 1 now only comprises fixed-network termination. The German Federal Network Agency has nevertheless taken account of specific national features and has also classified the connection setup to added value services and operator (pre-) selection as still requiring regulation. These areas have therefore been allocated to the new Market 1. Based on the corresponding regulatory order which came into force on 1 January 2017, Deutsche Telekom is now also obliged to continue providing the preliminary service important for call-by-call services.

Business Performance

Growth in forward-looking business fields. The operating business performed largely as planned in 2016. Revenues rose in those business fields in which QSC – as the digitiser to the German SME segment – expected growth. Alongside the Cloud business, these included Consulting and the TC business with corporate customers. Consistent with expectations, however, revenues decreased in the TC business with resellers and the traditional Outsourcing business. Overall, the Company generated revenues of € 386.0 million in 2016 as against € 402.4 million in the previous year.

€ 386m

Revenues in 2016

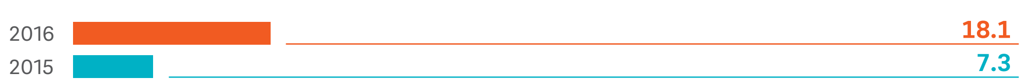
Cloud revenues rise by 148%. In Cloud, its newest segment, QSC generated revenues of € 18.1 million in 2016, compared with € 7.3 million in the previous year. This high growth was driven by the Company's success in marketing its Pure Enterprise Cloud and its IoT portfolio. QSC unveiled its innovative and new one-stop cloud-based offering – its Pure Enterprise Cloud – to the public in February 2016. The range of services was gradually extended in subsequent months and this process was accompanied by the migration of the first existing customers in the Outsourcing business to the new IT environment tailored to the requirements of the digital age. QSC also rapidly reported its first successes with new customers. In August 2016, for

example, the apt Hiller Group, a metal processing company, decided to use the Pure Enterprise Cloud at all five of its locations. The company is thus standardising its previously very heterogeneous ICT landscape. The first step involved providing all 400 workplaces with the one-stop cloud-based work environment “Enterprise Workplace Services”.
The potential harboured by this new solution portfolio also convinced market observers. Just a few months after the marketing launch, the IT analysts’ company Experton identified QSC as a “Rising Star” in its “Workplace Services” category, i.e. in the provision of cloud-based turnkey virtual workplaces. QSC’s IoT also met with great interest. In combination with other factors such as solution competence and customer satisfaction, it was the Company’s “highly attractive range of advisory and integration services” that led Experton in autumn 2016 to identify QSC as a “Rising Star” in its “Industry 4.0/IoT Vendor Benchmark 2017” study as well.

Sharp increase in IoT project revenues in 2016

QSC’s all-round IoT portfolio also convinced the first customers in 2016, with a marked rise in project revenues. Among other customers, the Company worked with energy-related service providers and heating manufacturers on securely networking appliances. At the same time, the Company laid a foundation to cooperate with Schüco, one of the world’s leading providers of high-quality window, door and façade systems. This cooperation is aimed at enabling these products to be centrally managed and monitored. QSC is developing and producing the new hardware, among other services, and is also operating a corresponding IoT platform.

Revenues, Cloud
(in € million)



Migration from traditional Outsourcing business to Pure Enterprise Cloud. Consistent with expectations, the revenues of € 117.4 million in the Outsourcing segment in 2016 fell short of the previous year’s figure of € 138.5 million. In terms of the outsourcing and assumption of ICT services, in the past year QSC built on the cloud-based provision of corresponding services. In the interests of its Cloud business, which has the potential to generate higher returns, the Company decided not to acquire new customers in its traditional Outsourcing business. QSC is also offering its existing customers the possibility of gradually migrating to industrialised and standardised outsourcing – and thus to the Pure Enterprise Cloud.

Revenues, Outsourcing
(in € million)

QSC continued to pay great attention to existing projects. Following a one-year transition phase, for example, since the end of May 2016 QSC has been operating all aspects of 23 SAP and other IT systems from its proprietary data centres on behalf of Gruner + Jahr, one of Europe's largest printing and publishing companies. This contract has a 60-month term.

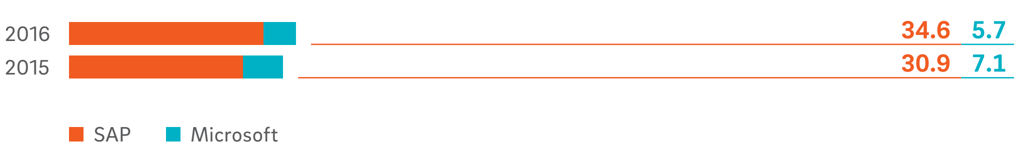
Consulting on growth course. Consulting revenues rose to € 40.3 million in the past financial year, up from € 38.0 million in the previous year. This growth was driven above all by the decision to focus from an early stage already on SAP's technological advance from the R/3 ERP product family to S/4HANA. In 2016, QSC generated 86% of its revenues with consulting services relating to SAP software and increased its sales in this area year-on-year by 12% to € 34.6 million. QSC's improved classification by SAP in a recertification in autumn 2016 underlines the Company's performance capacity in this core business field. In its operation of the SAP HANA platform and its activities as an SAP hosting partner, QSC is now classified as "excellent" rather than "advanced".

12%

Growth in revenues in SAP consulting business

Revenues, Consulting

(in € million)



TC business with corporate customers grows by 4%. QSC increased its TC revenues with corporate customers by 4% to € 91.8 million in 2016. Here, it benefited in particular from higher demand for All-IP services from small and medium companies. QSC upgraded its network with IP technology ten years ago already. By contrast, TC revenues with resellers fell as expected in a toughly contested market. Overall, revenues in the Telecommunications segment came to € 210.2 million, as against € 218.7 million in 2015. In terms of earnings, this segment benefited in 2016 from a settlement reached with Deutsche Telekom for interconnection fees for the years from 2012 to 2016. All mutual lawsuits have been withdrawn in return for the one-off payment by Deutsche Telekom of a low single-digit million euro amount.

Revenues, Telecommunications

(in € million)

Organisational restructuring proceeding apace. The process of focusing on forward-looking business fields, and on the Cloud business in particular, necessitates a far-reaching organisational structuring process. To this end, at the beginning of 2015 QSC initiated a cost-cutting programme with a two-year timeframe. By the end of 2016, the Company had generated savings of around € 24 million in total and thus significantly exceeded its self-imposed target of around € 20 million. These savings were substantially due to a scaling down in the workforce. At the end of 2016, QSC had 1,360 employees compared with 1,454 one year earlier.

Savings achieved significantly exceed target of € 20 million

QSC concludes savings programme with one-off write-downs. The cost-cutting programme supported the consistent realignment of the overall Company towards cloud-based services. With regard to the future revenue and earnings performance in the traditional Outsourcing business, in the course of preparing its 2016 consolidated financial statements in December 2016 the Company recognised a one-off write-down of € 13.9 million on the goodwill and intangible assets in this segment. At the same time, it announced a one-off write-down of € 1.3 million in connection with the separation from its FTAPI subsidiary. QSC concluded the respective management buyout in January 2017.

Research and Development

Development focuses on Cloud products. In view of the opportunities harboured by its Cloud business, QSC is primarily dealing with innovations for this segment in its research and development (R&D) activities as well. The corresponding budget amounted to € 5.1 million in 2016, as against € 7.6 million in the previous year. Of this total, € 5.1 million was recognised as cost of revenues. In the previous year, € 7.3 million was expensed, while an amount of € 0.3 million was capitalised.

In 2016, the largest share of R&D spending was channelled into innovations relating to the IoT business field, an area in which QSC is gradually building up a proprietary patent portfolio. QSC does not make a distinction between the work performed by developers and its ongoing operations either at the relevant subsidiary Q-loud or in other business fields. Unlike in previous years, the Company has therefore foregone any separate presentation of R&D employee totals.

Actual vs. Forecast Business Performance

QSC meets forecast. The Company's business performance in the 2016 financial year was consistent with its plans. As a result, QSC met or even exceeded all of the targets published at the beginning of the year. According to the forecast presented at the end of February 2016, QSC expected revenues of between € 380 million and € 390 million, EBITDA of between € 34 million and € 38 million and a positive free cash flow. The Company forecast capital expenditure of

€ 30 million. In view of the moderate volume of capital expenditure in the first three quarters, in November 2016 the Company raised its free cash flow forecast and subsequently expected its full-year free cash flow to exceed the previous year's figure of € 7.1 million. With a free cash flow of € 8.4 million, QSC slightly exceeded this expectation, while its full-year capital expenditure of € 28.4 million also remained moderate. With revenues of € 386.0 million and EBITDA of € 37.1 million, the Company's figures for these other two performance indicators were in the ranges forecast at the start of the year.

	Targets	Actual 2016 results	
Revenues	€ 380 – 390 million	€ 386.0 million	✓
EBITDA	€ 34 – 38 million	€ 37.1 million	✓
Free cash flow	> € 0 / > € 7.1 million	€ 8.4 million	✓
Capital expenditure	~ € 30 million	€ 28.4 million	✓

Performance Indicators

Revenues total € 386.0 million in 2016. QSC generated revenues of € 386.0 million in 2016, as against € 402.4 million in the previous year. Revenues grew in precisely those business fields in which the Company had expected growth – above all in the Cloud segment, but also in the Consulting and TC corporate customer businesses. By contrast, there was a marked reduction in revenues in the traditional Outsourcing business and in the TC business with resellers.

EBITDA amounts to € 37.1 million. QSC generated EBITDA of € 37.1 million in 2016, compared with € 42.2 million in the previous year. The Company already announced at the beginning of the year that further one-off expenses would be necessary, especially in the fourth quarter of 2016, in connection with the completion of the cost-cutting programme. Consequently, the EBITDA of € 7.3 million in the final quarter of 2016 was significantly lower than in the preceding quarters. Irrespective of this development, like in 2015 QSC generated a full-year EBITDA margin of 10%.

10%

EBITDA margin in 2016

Free cash flow rises to € 8.4 million. The Company's free cash flow improved to € 8.4 million in 2016, compared with € 7.1 million in the previous year. The table below shows the amounts of all parameters at the two balance sheet dates on 31 December 2015 and 31 December 2016.

€ million	31 Dec. 2016	31 Dec. 2015
Liquidity*	**67.3**	**74.0**
Liabilities under financing and finance lease arrangements	(1.7)	(4.5)
Liabilities due to banks	(149.4)	(158.0)
Interest-bearing financing liabilities	**(151.1)**	**(162.5)**
Net debt	**(83.8)**	**(88.5)**

* Cash and cash equivalents excluding liquidity of € 0.4 million included in disposal group.

It can be seen that net debt fell by € 4.7 million to € -83.8 million. QSC has long based it free cash flow reporting on the financial strength of its operating business and therefore corrects the change in net debt to exclude the impact of extraneous measures such as acquisitions and dividends. The distribution of a dividend of € 0.03 per share for the 2015 financial year led to an outflow of € 3.7 million in 2016. Correcting the net debt figure as reported to exclude this factor results in a free cash flow of € 8.4 million.

Capex mainly channelled into technology and infrastructure projects

Capital expenditure of € 28.4 million. QSC made capital expenditure (capex) of € 28.4 million in the past financial year, as against € 26.7 million in the previous year. The Company thus remained within the target of around € 30 million published at the beginning of the year. Of capex, 56% was channelled into technology and infrastructure. Upon the market launch of the Pure Enterprise Cloud, QSC standardised the structures at its data centres, among other measures. A further 36% of capex was customer-related, while the remaining 8% involved licenses and other property, plant and equipment.

Earnings Performance

Gross margin improves by 3 percentage points. The Company-wide savings programme made a major contribution in 2016 as well to reducing the cost of revenues and thus to increasing gross profit. Year-on-year, the cost of revenues decreased by € 25.0 million to € 312.6 million. Despite lower revenues, gross profit grew by € 8.6 million to € 73.4 million. The gross margin improved from 16% to 19% in the year under report.
The positive effects of the savings programme were also reflected in other cost items. Due above all to lower personnel expenses, sales and marketing expenses fell to € 34.7 million in 2016, down from € 37.1 million in the previous year. As a result of numerous savings within other administrative expenses, including among building and advisory expenses, overall general and administrative expenses only came to € 36.6 million, as against € 37.9 million in the previous year.

By contrast, other operating expenses rose significantly to € -17.8 million in 2016, compared with € -1.7 million in the previous year. This increase was due to one-off write-downs of goodwill and intangible assets amounting to € 15.2 million in total. These items are explained on Page 57 of this Group Management Report.

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BUSINESS REPORT

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

€ million	2016	2015
Revenues	**386.0**	**402.4**
Cost of revenues*	(282.9)	(292.3)
Gross profit	**103.1**	**110.1**
Sales and marketing expenses*	(33.0)	(34.9)
General and administrative expenses*	(31.8)	(32.2)
Other operating income	2.8	0.7
Other operating expenses*	(4.0)	(1.7)
EBITDA	**37.1**	**42.2**
Depreciation/amortisation		
(including non-cash share-based compensation)	(50.2)	(53.3)
Operating earnings (EBIT)	**(13.1)**	**(11.2)**

* Excluding depreciation/amortisation and non-cash share-based compensation.

It is apparent that, due to the development in revenues, EBITDA fell to € 37.1 million in the past financial year, as against € 42.2 million in the previous year. Depreciation and amortisation totalled € 50.2 million in 2016, compared with € 53.3 million one year earlier. This figure includes impairment losses totalling € 15.2 million recognised on goodwill and customer relationships in the Outsourcing segment and on intangible assets in the FTAPI disposal group. As a result of these impairment losses, the operating earnings (EBIT) reported for 2016 were once again negative at € -13.1 million (2015: € -11.2 million). Excluding these impairment losses, QSC would have reported positive operating earnings of € 2.1 million.
The financial result improved slightly from € -5.9 million in 2015 to € -5.8 million in 2016. Earnings before taxes came to € -18.9 million, as against € -17.1 million in 2015. Taxes on income amounted to € -6.1 million, compared with € 3.8 million in the previous year (adjusted value;

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please see Note 6 in the Notes to the Consolidated Financial Statements). This change was due to the reduction in deferred tax assets recognised on losses carried forward. As a result, consolidated net income for 2016 totalled € -25.1 million, compared with € -13.3 million in 2015 (adjusted figure; please see Note 6 in the Notes to the Consolidated Financial Statements).

Earnings Performance by Segment

High-growth Cloud business generates gross profit for first time. As previously announced, QSC recruited numerous cloud experts in 2016 and thus laid a foundation to generate ongoing dynamic growth in this forward-looking segment. This led the cost of revenues to rise by € 7.0 million to € 15.2 million. Revenues nevertheless grew faster, rising by € 10.8 million to € 18.1 million. As a result, gross profit improved by € 3.8 million to € 2.9 million in 2016, enabling QSC to report positive gross profit in its newest segment for the first time. Sales and marketing expenses also increased in 2016; at € -2.2 million the segment contribution was nevertheless significantly ahead of the previous year's figure of € -5.4 million.

Gross profit of € 2.9 million in Cloud segment

Personnel-intensive Consulting segment posts double-digit margin. QSC generated substantial growth in its Consulting business again in 2016, and especially in its business with SAP consulting services. In parallel, the Company further expanded its workforce and increasingly drew on external experts for individual projects. Due to this factor in particular, the cost of revenues rose by € 2.9 million to € 33.6 million in 2016. At € 6.7 million, gross profit therefore fell short of the previous year's figure of € 7.3 million. As sales and marketing expenses remained virtually unchanged, this resulted in a segment contribution of € 5.2 million, as against € 5.6 million in the previous year. The corresponding margin came to 13%, compared with 15% in the previous year.

Outsourcing maintains its high margin. The migration of the first Outsourcing customers to the Pure Enterprise Cloud began in the past financial year. This was accompanied by a shift in the first revenues to the Cloud segment. As a result, revenues and the associated cost of revenues both fell sharply in 2016. The gross margin amounted to € 31.6 million, down from € 41.0 million in the previous year. At € 24.3 million, the segment contribution also fell short of the previous year's figure of € 30.1 million. By contrast, the segment margin fell by just 1 percentage point to 21%, documenting the ongoing margin strength of the remaining Outsourcing business.

Attractive TC business with corporate customers. The Telecommunications segment comprises the high-margin business with corporate customers and the low-margin business with resellers. Thanks to its All-IP network, QSC generated growth with its corporate customers once again in 2016. As expected, however, its revenues in the toughly contested market with resellers declined. As the cost of revenues decreased overall at the same pace as revenues, the gross profit of € 61.9 million remained almost unchanged on the figure of € 62.7 million for 2015. As in the previous year, the gross margin came to 29%. Given the opportunities harboured by the business with corporate customers, QSC increased in sales and marketing expenses to € 19.2 million in 2016, up from € 17.7 million in the previous year. The segment contribution therefore amounted to € 42.7 million, as against € 45.0 million in 2015. At 20%, following on from 21% in 2015, the Company continued to generate an attractive margin.

20%

Attractive margin in TC business

Financial Position

Two 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 two core objectives – maintaining and optimising financing capacity and reducing financial risks. QSC invests its surplus liquidity exclusively in money market and low-risk investments. As a result, like in previous years there was once again no need for capital investment write-downs in 2016. QSC deployed derivative financial instruments in the form of interest swaps once again in 2016. These serve to hedge the interest rate risk on floating-rate tranches of the promissory note bond. As virtually all of QSC's operations are in the euro area, the Company is not exposed to any exchange rate risks. Further information about financial risk management can be found in Note 46 of the Notes to the Consolidated Financial Statements.
In its financing, the Company primarily depends on three sources. Firstly, it generates inflows of cash from its operating activities. Secondly, QSC draws on the funds received from a promissory note bond taken up in 2014 with an original volume of € 150 million. Thirdly, the Company had a current credit line of € 70 million as of 31 December 2016. Apart from for guarantee facilities, the Company made no use of this credit line as of 31 December 2016.

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High inflow of funds from operating business. At € 40.3 million, the cash flow from operating activities for 2016 was slightly higher than the previous year's figure of € 39.6 million. By contrast, the cash flow of € -26.0 million from investing activities fell slightly short of the previous year's figure of € -27.4 million. The cash flow from financing activities decreased to € -20.5 million, as against € -26.1 million in 2015. Overall, the resultant change in cash and cash equivalents came to € -6.2 million, compared with € -13.8 million in the previous year.

Net Asset Position

Congruent financing terms ensured. QSC has traditionally accorded priority to ensuring matching maturities for the financing of its assets and has a solid balance sheet structure. As of 31 December 2016, shareholders' equity and long-term liabilities covered 133% of the value of long-term assets. In the previous year, this key figure also amounted to 133% (adjusted value; please see Note 6 in the Notes to the Consolidated Financial Statements). Long-term assets accounted for 60% of total assets. Due in particular to depreciation and amortisation, their

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value fell by € 29.3 million to € 185.0 million as of 31 December 2016. As a result of investments in data centres, the value of property, plant and equipment rose by € 0.2 million to € 62.6 million at the end of 2016. By contrast, one-off write-downs led goodwill to decrease by € 10.6 million to € 55.6 million. The value of other intangible assets fell by the same amount to € 30.8 million. This was due to both depreciation and amortisation and to impairment losses (please see Note 19 in the Notes to the Consolidated Financial Statements).
Within short-term assets, there was a reduction in the value of the two main line items. At € 45.8 million, trade receivables fell short of the previous year's figure of € 48.7 million, as did cash and cash equivalents, which came to € 67.3 million as against € 74.0 million as of 31 December 2015.

€ 67.3m

Liquid funds in 2016

Shareholders' equity influenced by consolidated net income and dividend. Shareholders' equity totalled € 86.3 million as of 31 December 2016, compared with € 113.8 million at the end of 2015. As in the previous year, issued capital amounted to € 124.2 million, while the capital reserve rose by € 0.5 million to € 143.2 million. The accumulated deficit amounted to € -177.2 million as of 31 December 2016, compared with € -150.0 million at the previous year's balance sheet date. This increase was attributable to the negative consolidated net income of € -25.1 million for 2016 and to the dividend payment of € 3.7 million. QSC charges this distribution directly to equity.

Long-term financing provided by promissory note bond. Long-term liabilities decreased to € 159.3 million as of 31 December 2016, down from € 171.0 million at the previous year's balance sheet date. At € 145.4 million, the predominant share of this line item comprised liabilities due to banks. In 2014, QSC had taken up a promissory note bond with a term of 5 and 7 years. Short-term liabilities also declined, falling from € 63.3 million as of 31 December 2015 to € 59.2 million. This was primarily due to a reduction in trade payables to € 24.9 million, down from € 30.6 million at the previous year's balance sheet date.

Overall Summary

Scheduled course of business with high Cloud growth in 2016 financial year. The operating business performed in line with expectations in 2016. Revenues rose in those business fields in which QSC expected growth, and above all in its forward-looking Cloud segment. At the same time, the Company made substantial progress with its organisational restructuring and in this context achieved a further significant reduction in its employee totals. Despite the ongoing restructuring programme and associated one-off outlays, QSC increased its free cash flow for 2016 by € 1.3 million to € 8.4 million.

Significant progress with organisational restructuring in 2016

OUTLOOK

Overall Summary of Future Developments

Strong growth in Cloud business. QSC will be concentrating once again in 2017 on those business fields in which it expects to generate growth in the years ahead – and here above all on the Cloud segment, as well as on Consulting and the TC busi-ness with corporate customers. In the Cloud business, the Company will focus on expanding its two main activities – the Pure Enterprise Cloud and IoT.
Overall, in the current financial year QSC expects to generate revenues of between € 355 million and € 365 million and EBITDA of between € 36 million and € 40 million. Any stronger revenue performance will be prevented above all by the TC business with resellers. Due to market and regulatory factors, QSC expects revenues here to decline by around € 25 million. This factor will be accompanied by a planned reduction in revenues in the traditional Outsourcing business. Irrespective of these developments, the Company has budgeted a free cash flow figure slightly ahead of the previous year's figure of € 8.4million. The Opportunity and Risk Reports from Pages 67 and 69 respectively provide information about potential developments that from a current perspective could give rise to variances from the forecast provided here.

SEE PAGES 67FF.
OPPORTUNITY AND RISK REPORT

Future Macroeconomic and Industry Framework

IT market set to grow, TC market to remain under pressure. Within the German ICT market, the growth in IT revenues has been countered for years now by TC revenues that have at best stagnated. These disparate developments will also shape the current financial year. According to a forecast released by the Bitkom industry association, the overall ICT market in Germany is set to grow by a mere 1.2% to € 162.4 billion in 2017. The ICT market would thus show weaker growth than the overall economy, for which the Federal Government has forecast gross domestic product growth of 1.4% in 2017. Alongside a reduction in the IT hardware business, the factors referred to by Bitkom to explain this development relate above all to a decline in both fixed-network and mobile TC revenues due to price competition and regulatory factors. The termination fees set by the authorities alone are set to fall by up to 58% in 2017 (please see Page 53 in the Business Report).

SEE PAGE 53
BUSINESS REPORT

The German ICT market
(in € billion)

Cloud business driving IT market. The IT market will once again outperform the TC market. In a Bitkom survey performed at the beginning of 2017, for example, 85% of software companies and 83% of IT service providers stated that they expected revenue growth in the current year.

The cloud business continues to act as a key growth driver. A study carried out by the management consultancy Bain & Company concludes that around 60% of all revenue growth in the global IT market over the next four years will be attributable to cloud products. The relevant market is expected to double in size. Market watchers expect to see similarly dynamic developments in the IoT business. By 2020, IoT revenues in Germany alone could almost quadruple. With its Pure Enterprise Cloud and its IoT portfolio, QSC acted early to position itself in both forward-looking markets.

The German IoT market
(in € billion)

Expected Earnings Performance

EBITDA margin set to improve in 2017

EBITDA margin expected to remain in double-digit territory. For the current financial year, QSC has planned revenues of between € 355 million and € 365 million and EBITDA of between € 36 million and € 40 million. EBITDA should therefore remain at the previous year's level, while the EBITDA margin is set to improve compared with the previous financial year. This development is the result of the progress made in terms of cost structures and of the decline in the traditional TC business. Furthermore, around 50% of the expected reduction in revenues in the current year is due to stricter regulation of the TC market. QSC traditionally treats these kinds of regulated fees as transitory items which do not have any impact on earnings.
QSC will continue to implement its organisational restructuring process in the current financial year. In particular, the expansion in its Cloud business will make it necessary to hire further specialists. In other areas, by contrast, the Company will press ahead with standardising processes and reduce its personnel intensity.

Expected Earnings Performance by Segment

Further strong growth in Cloud segment. QSC expects its newest segment – Cloud – to generate the highest revenue growth once more in 2017. Key contributions here will come from the new and existing customer business with the Pure Enterprise Cloud and the IoT project business. QSC will be expanding its capacities in these forward-looking business fields and pooling its R&D resources and capital expenditure here as well. Thanks to the scalability of the business models, the Company expects the revenue growth to be accompanied by rising segment contributions.

Consistent revenue growth in Consulting. QSC expects the positive developments in its Consulting business to continue. This business is characterised by high personnel intensity, but the segment margin will remain in double-digit territory. In this segment, the Company benefits in particular from its all-round SAP competence and in particular from its extensive experience in deploying HANA technology.

Further decline in traditional Outsourcing. The traditional Outsourcing business is increasingly being replaced by cloud-based procurement models, as a result of which this business will play an ever less significant role in the Company's future development. Back in 2015, QSC already decided no longer to participate in tenders in the traditional Outsourcing business involving the takeover of staff. Furthermore, existing contracts will in future only be extended if an adequate margin can be ensured on an ongoing basis. A major Outsourcing contract is expected to be terminated in the course of 2017. This is because the customer, which has global operations, would prefer to work with a global IT service provider.

IP business boosts TC revenues with corporate customers. The disparate developments seen for years now will continue to shape the Telecommunications segment in 2017. Slight growth in the business with corporate customers will be offset by a declining business with resellers due to market and regulatory factors. Stricter regulation alone will lead to a loss of revenues of around € 15 million. This factor will be exacerbated by further expected reductions of around € 10 million due to ongoing price competition. Among corporate customers, QSC will benefit above all from increased demand from small and medium-sized companies for All-IP solutions. QSC has been operating an All-IP network for years already.

~ € 15m

Loss of revenues due to stricter regulation

Expected Financial and Net Asset Position

Capital expenditure of up to € 30 million planned. In the current financial year, QSC expects to generate free cash flow ahead of the previous year's figure of € 8.4 million. The largest contribution will comes from the cash flow from operating activities. This will be countered by capital expenditure on a scale of up to € 30 million. Given its cash flow from operating activities and its existing liquidity, QSC is solidly financed for the projects planned for the current financial year.

OPPORTUNITY REPORT

Opportunity management

Dynamic climate offers fresh opportunities

Opportunities thanks to dynamic digitisation. QSC is the digitiser to the German SME sector and one of only few providers in Germany able to offer companies all the services they need to enhance and prepare their IT for the digital age from a single source. As the market climate is highly dynamic, a continuous stream of new opportunities is expected. Responsibility for identifying and acting on such opportunities lies with the 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. These managers 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

Additional customers for the Pure Enterprise Cloud. QSC launched its cloud-based portfolio onto the market in 2016 and is continually expanding the services on offer. In 2017, the Company will be building on its initial success and addressing new and existing customers. Past experience shows that a substantial period of time generally passes between initial contacts with customers and revenue generation. To account for this, QSC has only budgeted a moderate volume of new customer revenues for the current year. However, demand could exceed our expectations as the IT in place at many small and medium-sized companies is increasingly reaching its limits given enormous technological advances and the requirements of digital business models.

More IoT projects in regular operation. QSC positioned itself at a very early stage with its full-stack approach in the forward-looking IoT market. Many SME players are still only beginning to address this topic and are initially implementing pilot projects. QSC has accounted for this in its planning for the current financial year. Should one or several of these projects be transferred to regular operation, then this might trigger an additional boost to revenues. Further opportunities could arise if SME companies draw on QSC's extensive IoT expertise with regard to the production of networked appliances. This way, the Company could benefit from growing turnover volumes with networked end appliances.

Technological advance to SAP S/4HANA. Advising customers on all aspects of SAP is traditionally one of the key focuses of the Consulting business. The software company is currently implementing the technological advance from its R/3 ERP product family to S/4HANA. As this new product family is a key to digitising business models, demand for corresponding advisory services may exceed expectations. As the digitiser for the SME sector, QSC has great credibility in this area and could simultaneously benefit from the interplay of advisory and implementation services based on its Pure Enterprise Cloud.

Competitive advantage: advice and implementation from a single source

Advance of All-IP connections. QSC has operated an end-to-end All-IP network in Germany for years now and is thus able to offer business customers uniform voice and data transmission based on the Internet Protocol (IP). Deutsche Telekom is now also upgrading its infrastructure and is simultaneously stopping the operation of its conventional voice network. For QSC, this results in two opportunities. Firstly, awareness of IP technology will increase noticeably among small and medium-sized companies. On the other hand, the switching off of conventional connections will oblige business customers to gain an overview of potential alternatives. QSC already benefited from this in 2016 and this factor could gain further momentum in 2017.

Replacement of ISDN technology in telephony systems. As a result of the upgrading in telecommunications technology to IP technology, conventional connections are now being switched off. It will then no longer be possible to simply continue operating ISDN telephony systems, which are still widely used. The more rigorously our competitors press their customers to convert to IP technology, the greater the opportunities available to QSC. After all, the Company on the one hand already offers a broad range of IP-based telephony systems for corporate customers of all sizes. On the other hand, QSC has extensive expertise in integrating conventional telephony systems into All-IP solutions. This makes it possible for SME customers to continue using their existing systems and thus avoid having to make investments.

Shortage of specialists in SME sector. Digitisation presents German SME companies with enormous challenges, and that not only in technological terms. They are also finding it increasingly difficult to press ahead with the necessary transformation with their own internal resources alone or to recruit additional specialists. This produces opportunities for broad-based service providers such as QSC.

RISK REPORT

Risk Management

QSC identifies risks at the earliest possible opportunity. Like all companies, QSC is permanently exposed to risks. Only by consciously addressing and assessing these risks can the Company maintain its competitiveness and achieve sustainable business success. Professional risk management therefore has to ensure that all events, actions or neglected actions that could potentially pose a threat to QSC's success, or even to its continued existence, are already identified, analysed, assessed, managed and monitored at the earliest possible stage of their development. Risk management comprises coordinated procedures, measures and the necessary rules for dealing with risks. Uniform risk management serves as the basis for decisions at QSC and all its subsidiaries.

Organisation and Procedures

Risk management is continually being optimised further

Company-wide uniform and integrated risk management system. To ensure the effectiveness of its risk management and facilitate the aggregation of risks and transparent reporting, QSC has implemented a Company-wide uniform integrated risk management system (RMS) and further optimised this system in the past financial year. The use of a risk management software that has proven its worth for years now enables 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 are taken at an early stage. Quarterly reports raise awareness of risk issues among all managers with responsibility for risk management. Guidelines, procedures and work instructions are in place to flank the RMS and ensure its implementation in day-to-day operations. The risk analyses, such as those required for management systems under ISO 27001 (Information Security) or ISO 9001 (Quality Management), ensure uniform, efficient reporting.
All Company departments are included in the RMS. 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. Heads of department report to Corporate Risk Management at least once a quarter. They also regularly check whether any risks with material implications and previously undetected have arisen in their areas of responsibility and whether there is any need to amend the assessment of risks already recognised. This process ensures that potential risks in the operating business can be detected at an early stage.

Corporate Risk Management is responsible for risk reporting to group management. It also serves as an interface to other audit and/or certification processes and ensures that, there too, the 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.

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 also acts as a permanent contact partner for all departments.
Corporate Risk Management is responsible for consolidating and documenting the risks assessed by the risk coordinators. Based on the risk reports submitted by departments, it compiles a compact report (using the "R2C" software) and forwards this to the Management Board on a quarterly basis. The Management Board is informed immediately of any high risks newly detected. The Management Board informs the Supervisory Board with an extensive risk report at least once a year. Furthermore, it also uses 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 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. 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 151 onwards.

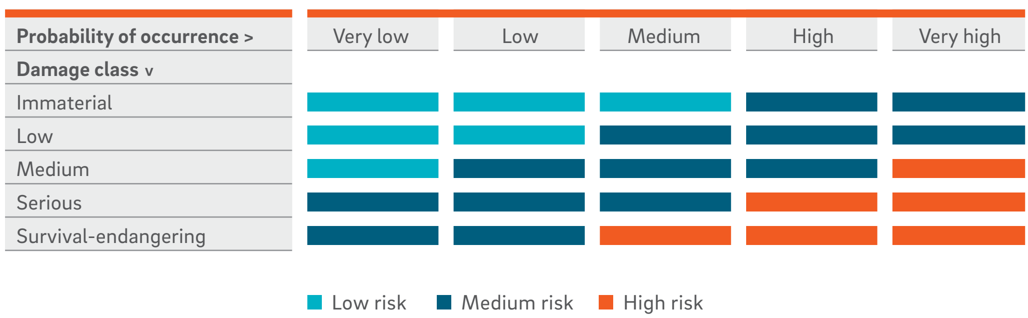
Management Board informed immediately about any high risks

SEE PAGES 151 FF.
NOTES

Assessment Methodology

Classification of risks by probability of occurrence and potential implications. The "Risk to Chance (R2C)" risk management software supports the overall risk management process throughout the Company. This tool initially uses a gross view to classify a risk in terms of its probability of occurrence and potential implications. This classification cumulatively results from allocation to the respective categories. For 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 following diagram provides an overview of the methodology used to classify risks.

Classification of risks



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

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.
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, to hedge risks with provisions and insurance coverage, where this is economically expedient, and to raise awareness of existing residual risks and/or risk acceptance. This way, the gross analysis of risks is refined into a net analysis. The external risk report only includes those risks that still have to be deemed material for QSC's future business performance even after all risk reduction and avoidance measures have been factored in. 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 are not viewed overall as direct threats to the Company's continued existence.
As a result of this risk analysis, in its external risk report QSC reports risks that are either individually material or aggregates individually immaterial risks in suitable risk categories (e.g. regulatory risks). The assessments and accompanying comments and requirements are only provided in quantitative terms in cases where it is possible to quantitatively assess the extent of damages. As this is generally not possible, however, the relevant risks are usually classified in terms of classes of damage.

Risks classified into relevant damages class

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. Within the audit of the annual financial statements, the external auditor also reviews the financial reporting process. Based on the auditor's findings, both the Supervisory Board Audit Committee and the full Supervisory Board deal with the internal control system in respect of the financial reporting process.

At QSC, the RMS is characterised by the following key features:

- 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 for document creation and posting and in its controlling department.
- QSC uniformly works with 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 and the Group Management Report.
- Group-wide monthly reporting ensures the early detection of potential risks during the financial year.

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

Individual Risks

Focus on actual risk situation. Risk monitoring focuses not so much on the risks identified by the gross evaluation as on the actual risk situation after taking relevant measures into consideration. Based on this net perspective, the following relevant risks were assessed as "high".

Decline in revenues in conventional TC business. The decline in German fixed-network voice call volumes is continuing. Not only that, the share of the open call-by-call and preselect businesses has also consistently reduced. Rather than for these offerings, consumers are increasingly opting for fixed-network flat-rate plans or using mobile communication instead of the fixed network. Price competition and regulation have led to further reductions in revenues. Information about the associated risks can be found in the separate "Regulatory risks" section. QSC is also exposed to price competition in the ADSL business with resellers targeting private customers. In this case, revenues are also falling due to growing demand for broadband and the resultant increase in the use of VDSL and cable connections.

QSC has long been reducing its dependency on the TC business

By expanding its IT and cloud business, QSC has been reducing its dependency on the conventional TC business for years now. Not only that, the Company has combated the risk of revenue losses in this 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 the decline in revenues in the conventional TC market for private customers to continue in the years ahead as well, and for this to be accompanied by a further rise in pressure on margins. This is especially true of business with resellers, but also of business with sales partners.

Lack of success in new business fields. QSC is pursuing a strategy of enabling small and medium-sized companies in particular to move forward to the digital age more easily and views the cloud as the IT architecture for the new age. The Company is therefore systematically extending its offering particularly with cloud-based products and services. Such innovations represent an opportunity, but also involve risks. Delays may arise in the development process, thus leading to belated market launches. Any lack of market acceptance for the innovations may mean that the revenue and earnings contributions are only realised at a later point in time than expected. Delays may also arise when the sales organisation does not have the necessary specialist qualifications.
Not only that, any delays in realising the revenue and earnings contributions expected in the high-growth Cloud segment would also reduce the Company's financial scope for strategic investments and increase its vulnerability in future periods of macroeconomic weakness.
QSC counters this risk by cooperating with potential partners and pilot customers at an early stage and before new products are launched onto the market. At the same time, with its Pure Enterprise Cloud it has created a modular service portfolio that integrates new cloud-based products and services, but also facilitates the extremely efficient operation of these applications.

QSC acts early to share experiences with partners and its pilot customers

Operations stability. The ICT industry is undergoing structural transformation. Particularly when it comes to outsourcing IT applications, customers expect ever higher technical and operating quality at ever lower cost and, despite this, expect services to be tailored to their individual needs. Service providers such as QSC have to meet these exacting standards by ensuring stable operations accompanied by inexpensive production, while at the same time satisfying customers' wishes swiftly and efficiently. Any lack of reliability in terms of operations stability may lead to a loss of both revenues and customers and thus impede the expansion in the business.
By permanently optimising its operating organisational structure and taking measures to stabilise operations, QSC has created a basis enabling it to fully meet customers' expectations. These measures also include extensive and effective emergency plans, which safeguard the permanent availability of all services or their immediate restoration without any disadvantages for customers following any criminal attack.

Security. Safeguarding IT security and complying with all relevant provisions of data protection law are two crucial success factors in QSC's business activity. Any failure to do so would harm the Company's reputation. Protecting company data and personal data relating to customers and employees with all suitable means available in technological and organisational terms is therefore an absolute focus of the QSC's IT security strategy.

Regulatory risks. 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 being able to intervene retrospectively on the basis of general fair competition law. There is a risk that the coming years will see a further reduction in the number of regulated markets. This could increase the scope of Deutsche Telekom AG (DTAG) to influence prices 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 ongoing public discussions and the investigation of relevant cases will promote conduct consistent with fair competition and that 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.
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.

Dependency on business partners. QSC generates its revenues with resellers in its Telecommunications segment with only a small number of large voice and DSL resellers. Losing one of these partners would noticeably reduce revenues at QSC. However, this would only impact to a lesser extent on its profitability, as these revenues mainly involve lower margins. QSC counters this risk by carefully maintaining the successful business relationships that have grown over the years.

Lack of specialists. In the course of the organisational restructuring programme implemented over the past two financial years, several important specialists left QSC at their own choice. Given the shortage of IT specialists on the German labour market, it was in some cases difficult to find adequate replacements within a short timeframe. This risk can be expected to continue to apply in 2017 and beyond. This may result in bottlenecks in operations and in the further development of existing and new IT applications. QSC is countering this risk above all by consistently training young specialists, cooperating with select universities and by offering a range of targeted retention measures for especially important specialists and executives.

Wide range of measures to secure next generation of QSC employees

Overall Summary

QSC is able to detect potential risks at an early stage and take appropriate action. 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 in the current financial year 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, QSC's future earnings may nevertheless materially deviate from the expectations of the Company and its management. All statements made in this Group Management Report 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 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 listed companies. The following disclosures reflect the circumstances at the balance sheet date.

Composition of issued capital. Issued capital amounted to € 124,172,487 as of 31 December 2016 and was divided into 124,172,487 no-par registered ordinary shares. According to the Share Register, these shares were distributed among 29,111 shareholders as of 31 December 2016.

Limitations on voting rights or transfer of shares. Each share grants one vote at the Annual General 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% of capital. There are the following direct and (pursuant to § 22 of the German Securities Trading Act [WpHG]) indirect holdings in the Company's capital that exceed 10% of voting rights:

- Dr. Bernd Schlobohm, Germany: 25.05% of voting rights (of which 12.50% directly and 12.55% indirectly
- Gerd Eickers, Germany: 25.05% of voting rights (indirectly)
- Gerd Eickers Vermögensverwaltungs GmbH & Co. KG, Cologne, Germany: 25.05% of voting rights (of which 12.55% directly and 12.50% indirectly).

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 30 January 2017. 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 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% 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 General 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% 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 General Meeting on 27 May 2015, 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 € 50,000,000 on one or several occasions up to 26 May 2020 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 flexibly 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 € 46,490,365 as of the balance sheet date. This was divided into Conditional Capital IV (€ 40,000,000), Conditional Capital VII (€ 750,365), Conditional Capital VIII (€ 5,000,000) and Conditional Capital IX (€ 750,000).
Conditional Capitals VII, VIII and IX 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 (Conditional Capital IX), Management Board members, managing directors of affiliated companies, employees of QSC and affiliated companies (Conditional Capitals VII and VIII) and other parties contributing to the Company's success (Conditional Capital VII). 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 General Meeting on 27 May 2015 to issue such instruments in order to access an additional,

low-interest financing option given favourable capital market conditions. The convertible bonds may be issued in return for both cash contributions and contributions in kind. 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 four cases: (1) to settle residual amounts resulting from the subscription ratio; (2) when the bonds are issued in return for contributions in kind, particularly in the context of company acquisitions; (3) if, in the case of bonds being issued in return for cash contributions pursuant to § 186 (3) Sentence 4 of the German Stock Corporation Act (AktG), the is-sue price does not fall materially short of the market value of the bonds; and (4) to the extent necessary to issue subscription rights to the bearers or creditors of warrant and/or convertible bonds previously issued in order to avoid dilution of their respective holdings. To date, the Management Board has not acted on the authorisation to issue tradable warrant and/or convertible bonds.

The exclusion of shareholders' subscription rights pursuant to § 186 (3) Sentence 4 of the German Stock Corporation Act (AktG) may only apply for the use of treasury stock, for the issue of new shares from authorised capital and for the issue of warrant and/or convertible bonds corresponding up to an aggregate total of no more than 10% of issued capital during the term of the respective authorisation. Apart from this, the exclusion of shareholders' subscription rights, irrespective of the legal grounds, for the use of treasury stock, for the issue of new shares from authorised capital and for the issue of warrant and/or convertible bonds (including those issued within QSC's stock option plans) may not exceed an aggregate total of 20% of issued capital during the term of the respective authorisation.

Further details apply in accordance with the underlying resolutions adopted by the Annual General Meeting for each of these measures.

Material agreements conditional on a change of control due to a takeover bid. In the 2014 financial year, QSC agreed five promissory note bonds with a financial institution with a total volume of € 150 million (balance sheet date: € 145 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% of the shares or voting rights in QSC. In the 2016 financial year, QSC agreed a syndicated loan agreement with 6 financial institutions which had a credit limit of € 70 million at the balance sheet date. This agreement allows the banks to terminate the loan prematurely should a natural person or legal entity, acting either alone or together with other persons or entities, gain control over QSC. In this context, control is defined as the de facto ability to exercise a controlling influence pursuant to § 17 of the German Stock Corporation Act (AktG) and "acting together" satisfies the definition of this concept provided in § 2 (5) of the German Securities Takeover Act (WpÜG).

The Company has no further material 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 FINANCIAL STATEMENTS

Consolidated Statement of Income

Euro amounts in thousands (€ 000s)

	Note	2016	2015* adjusted
Net revenues	7	**385,979**	**402,436**
Cost of revenues	8	(312,598)	(337,598)
Gross profit		**73,381**	**64,838**
Sales and marketing expenses	9	(34,683)	(37,096)
General and administrative expenses	10	(36,647)	(37,910)
Other operating income	12	2,698	682
Other operating expenses	12	(17,849)	(1,653)
Operating profit (loss)		**(13,100)**	**(11,139)**
Financial income	13	196	398
Financial expenses	13	(6,030)	(6,344)
Net income (loss) before income taxes		**(18,934)**	**(17,085)**
Income taxes	43	(6,120)	3,842
Net income (loss)		**(25,054)**	**(13,243)**
Attribution of net income (loss)			
Owners of the parent company		(24,839)	(13,121)
Non-controlling interests		(215)	(122)
Earnings per share (basic) in €	14	(0.20)	(0.11)
Earnings per share (diluted) in €	14	(0.20)	(0.11)

* Adjusted pursuant to IAS 8. See Note 6 for further details.

Consolidated Statement of Comprehensive Income

Euro amounts in thousands (€ 000s)

	2016	2015* adjusted
Net income (loss) for the period	**(25,054)**	**(13,243)**
Other comprehensive income		
Line items that are not reclassified in the income statement		
Actuarial gains (losses) from defined benefit pension plans	(744)	251
Tax effect	241	(81)
Line items that are not reclassified in the income statement	**(503)**	**170**
Line items that might subsequently be reclassified in the income statement		
Fair value measurement of cash flow hedge	8	(149)
Tax effect	(2)	48
Line items that might subsequently be reclassified in the income statement	**6**	**(101)**
Total fair value changes (net of tax) recognised directly	**(497)**	**69**
Total comprehensive income for the period	**(25,551)**	**(13,174)**
Attribution of total comprehensive income		
Owners of the parent company	(25,336)	(13,052)
Non-controlling interests	(215)	(122)

* Adjusted pursuant to IAS 8. See Note 6 for further details.

Consolidated Balance Sheet

Euro amounts in thousands (€ 000s)

	Note	31 Dec. 2016	31 Dec. 2015* adjusted	1 Jan. 2015* adjusted
ASSETS				
Long-term assets				
Property, plant and equipment	17	62,554	62,392	76,169
Land and buildings	17	24,359	25,152	25,915
Goodwill	18, 19	55,568	66,190	66,190
Other intangible assets	20	30,779	41,411	53,684
Trade receivables	21	2,435	4,583	7,761
Prepayments	22	3,161	3,608	2,641
Other long-term assets		190	292	2,948
Deferred tax assets	43	5,926	10,671	7,752
Long-term assets		**184,972**	**214,299**	**243,060**
Short-term assets				
Trade receivables	21	45,816	48,704	52,145
Prepayments	22	5,107	3,712	6,493
Inventories	23	73	884	1,278
Other short-term assets	24	1,533	6,521	1,855
Available-for-sale financial assets		-	-	343
Cash and cash equivalents	25	67,336	73,982	87,803
Subtotal for short-term assets		**119,865**	**133,803**	**149,917**
Assets held for sale	16	1,166	-	-
Short-term assets		**121,031**	**133,803**	**149,917**
TOTAL ASSETS		**306,003**	**348,102**	**392,977**

*Adjusted pursuant to IAS 8. See Note 6 for further details.

	Note	31 Dec. 2016	31 Dec. 2015* adjusted	1 Jan. 2015* adjusted
SHAREHOLDERS' EQUITY AND LIABILITIES				
Shareholders' equity				
Issued capital	26	124,172	124,162	124,142
Capital surplus	27	143,217	142,702	142,069
Other capital reserves	29	(3,493)	(2,996)	(3,066)
Accumulated deficit		(177,223)	(149,986)	(129,157)
Equity attributable to owners of the parent company		**86,673**	**113,882**	**133,988**
Non-controlling interests		(325)	(110)	12
Shareholders' equity		**86,348**	**113,772**	**134,000**
Liabilities				
Long-term liabilities				
Long-term liabilities under financing and finance lease arrangements	30	370	1,722	4,447
Liabilities due to banks	30	145,412	155,830	156,550
Convertible bonds	41	33	27	25
Accrued pensions	31	7,133	6,693	7,281
Other provisions	33	3,050	1,642	305
Other financial liabilities	35	2,525	3,879	8,331
Deferred tax liabilities	43	775	1,204	2,333
Long-term liabilities		**159,298**	**170,997**	**179,272**
Short-term liabilities				
Trade payables	32	24,890	30,596	44,820
Short-term liabilities under financing and finance lease arrangements	30	1,352	2,761	4,427
Liabilities due to banks	30	4,003	2,140	4,518
Other provisions	33	11,724	8,368	10,883
Accrued taxes	33	2,166	381	1,757
Deferred income	34	2,441	4,020	3,900
Other short-term liabilities	36	12,630	15,067	9,400
Subtotal for short-term liabilities		**59,206**	**63,333**	**79,705**
Liabilities associated with assets held for sale	16	1,151	-	-
Short-term liabilities		**60,357**	**63,333**	**79,705**
Liabilities		**219,655**	**234,330**	**258,977**
TOTAL SHAREHOLDERS' EQUITY AND LIABILITIES		**306,003**	**348,102**	**392,977**

Consolidated Statement of Changes in Equity

Euro amounts in thousands (€ 000s)

		Equity attributable to equity holders of QSC AG				
				Other capital reserves		
	Note	Issued capital	Capital surplus	Fair value of marketable securities	Actuarial gains (losses)	Cash flow hedge reserve
Balance as of 1 January 2015 – as originally reported –		**124,142**	**142,069**	**(1)**	**(1,590)**	**(1,475)**
Corrections pursuant to IAS 8.42	6	-	-	-	-	-
Balance as of 1 January 2015 – adjusted – *		**124,142**	**142,069**	**(1)**	**(1,590)**	**(1,475)**
Net income (loss) for the period *		-	-	1	-	-
Other comprehensive income						
for the period, net of tax	29	-	-	-	170	(101)
Total comprehensive income *		**-**	**-**	**1**	**170**	**(101)**
Revaluation of financial liabilities relating						
to business acquisition *		-	-	-	-	-
Conversion of convertible bonds	41	20	3	-	-	-
Dividends		-	-	-	-	-
Non-cash share-based compensation	41	-	630	-	-	-
Balance as of 31 December 2015 – adjusted – *		**124,162**	**142,702**	**-**	**(1,420)**	**(1,576)**
Balance as of 1 January 2016		**124,162**	**142,702**	**-**	**(1,420)**	**(1,576)**
Net income (loss) for the period		-	-	-	-	-
Other comprehensive income						
for the period, net of tax	29	-	-	-	(503)	6
Total comprehensive income		**-**	**-**	**-**	**(503)**	**6**
Revaluation of financial liabilities relating						
to business acquisition		-	-	-	-	-
Conversion of convertible bonds	41	10	7	-	-	-
Dividends		-	-	-	-	-
Non-cash share-based compensation	41	-	508	-	-	-
Balance as of 31 December 2016		**124,172**	**143,217**	**-**	**(1,923)**	**(1,570)**

* Adjusted pursuant to IAS 8. See Note 6 for further details.

Accumulated deficit	Total	Non-controlling interests	Total equity	
(117,511)	**145,634**	**-**	**145,634**	**Balance as of 1 January 2015 – as originally reported –**
(11,646)	(11,646)	12	(11,634)	Corrections persuant to IAS 8.42
(129,157)	**133,988**	**12**	**134,000**	**Balance as of 1 January 2015 – adjusted – ***
(13,121)	(13,120)	(122)	(13,242)	Net income (loss) for the period *
				Other comprehensive income
-	69	-	69	for the period, net of tax
(13,121)	**(13,051)**	**(122)**	**(13,173)**	**Total comprehensive income ***
				Revaluation of financial liabilities relating
4,708	4,708	-	4,708	to business acquisition *
-	23	-	23	Conversion of convertible bonds
(12,416)	(12,416)	-	(12,416)	Dividends
-	630	-	630	Non-cash share-based compensation
(149,986)	**113,882**	**(110)**	**113,772**	**Balance as of 31 December 2015 – adjusted – ***
(149,986)	**113,882**	**(110)**	**113,772**	**Balance as of 1 January 2016**
(24,839)	(24,839)	(215)	(25,054)	Net income (loss) for the period
				Other comprehensive income
-	(497)	-	(497)	for the period, net of tax
(24,839)	**(25,336)**	**(215)**	**(25,551)**	**Total comprehensive income**
				Revaluation of financial liabilities relating
1,327	1,327	-	1,327	to business acquisition
-	17	-	17	Conversion of convertible bonds
(3,725)	(3,725)	-	(3,725)	Dividends
-	508	-	508	Non-cash share-based compensation
(177,223)	**86,673**	**(325)**	**86,348**	**Balance as of 31 December 2016**

Consolidated Statement of Cash Flows

Euro amounts in thousands (€ 000s)

	Note	2016	2015* adjusted
Cash flow from operating activities	37		
Net income (loss) before income taxes		(18,934)	(17,085)
Depreciation, amortisation and impairment of long-term assets	11, 17, 20	39,027	52,688
Impairment of goodwill	18, 19	10,622	-
Other non-cash income and expenses		1,147	630
Loss from disposal of long-term assets		(8)	(1)
Income tax paid		(2,140)	(401)
Income tax received		390	2,792
Interest received		117	315
Changes in provisions	31, 33	3,212	(2,972)
Changes in trade receivables	21	4,256	6,619
Changes in trade payables	32	(6,487)	(12,868)
Changes in other assets and liabilities		9,089	9,923
Cash flow from operating activities	37	**40,291**	**39,640**
Cash flow from investing activities	38		
Purchase of intangible assets		(6,561)	(9,055)
Purchase of property, plant and equipment		(19,525)	(18,367)
Proceeds from sale of property, plant and equipment		52	27
Cash flow from investing activities	38	**(26,034)**	**(27,395)**
Cash flow from financing activities	38		
Dividends paid		(3,725)	(12,416)
Issuance of convertible bonds		6	2
Proceeds from issuance of common stock		17	23
Repayment of loans	30	(8,318)	(3,099)
Interest paid		(5,677)	(5,815)
Changes in advance payments relating to financing activities		-	(370)
Repayment of liabilities under financing			
and finance lease arrangements	30	(2,761)	(4,391)
Cash flow from financing activities	38	**(20,458)**	**(26,066)**
Change in cash and cash equivalents		**(6,201)**	**(13,821)**
Cash and cash equivalents as of 1 January		73,982	87,803
Cash and cash equivalents as of 31 December	25	**67,781**	**73,982**

* Adjusted pursuant to IAS 8. See Note 6 for further details.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE 2016 FINANCIAL YEAR

Company information

QSC AG is digitising the German SME sector. With decades of experience and expertise in its Cloud, Internet of Things, Consulting, and Telecommunications businesses, QSC accompanies its customers securely into the digital age. Today already, cloud-based procurement models offer increased speed, flexibility and full service availability. The Company's TÜV and ISO-certified data centres in Germany and its nationwide All-IP network form the basis for maximum end-to-end quality and security. QSC's customers benefit from one-stop innovative products and services that are marketed both directly and via 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, following the reorganisation of the stock market, in the Prime Standard since the beginning of 2003.

Accounting 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). Pursuant to § 315a (1) of the German Commercial Code (HGB), it is thus exempted from preparing consolidated financial statements in accordance with HGB.
QSC prepares its consolidated financial statements in accordance with the IFRSs issued by the International Accounting Standards Board (IASB) that require application in the EU as of 31 December 2016, as well as with the supplementary requirements of § 315a (1) HGB. The Company took due account of all IFRSs requiring mandatory application in the EU in the 2016 financial year, as well as of the interpretations of the International Financial Reporting Interpretations Committee (IFRIC) and the Standing Interpretations Committee (SIC).
In its consolidated financial statements, QSC generally makes application of the cost method. Material exceptions relate to financial instruments recognised at fair value. Liabilities for cash-settled, share-based payments in the form of equity instruments and the net liability for defined benefit pension plans are also recognised at fair value.
The financial year of QSC AG and its subsidiaries (hereinafter also referred to as "QSC") corresponds to the calendar year. The consolidated financial statements are presented in euros. All amounts, unless otherwise stated, are rounded up or down to the nearest thousand euro amount (€ 000s). The rounding up or down of figures may result in minor discrepancies on a scale of € 1k or 0.1 percent between numbers and percentages in this Annual Report.

Based on a transfer agreement dated 20 December 2016, all of the shares held in FTAPI Software GmbH, Munich, were sold on 9 January 2017. No other events or transactions which would have a material effect on the Group's net assets, financial position and earnings performance or cash flows occurred between the end of the reporting period and 16 March 2017 (the date on which the consolidated financial statements were approved by the Management Board for submission to the Supervisory Board).
The consolidated income statement has been prepared using the cost-of-sales method. In the interests of clarity and informational value, individual line items have been aggregated in the income statement and balance sheet. These line items are reported and commented on separately in the notes.

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 included in consolidation have been prepared on the basis of uniform accounting policies pursuant to IFRS 10 (Consolidated Financial Statements). All subsidiaries have the same balance sheet date as the parent company QSC AG.
All intragroup transactions and balances are eliminated in full. Subsidiaries are fully consolidated from the date of acquisition, i.e. the date on which QSC obtains control. Inclusion by way of full consolidation ends upon the parent company no longer exercising control. Information on the companies included in the consolidated financial statements is provided in Note 39.
Non-controlling interests are measured upon acquisition at their respective share of identifiable net assets at the company thereby acquired. Changes in the level of shareholding held by the Company in a subsidiary that do not lead to a loss of control are recognised as equity transactions.

3 SIGNIFICANT JUDGEMENTS AND ESTIMATES

The application of accounting policies requires the use of judgements as well as of forward-looking assumptions and estimates. Actual outcomes may differ from those assumptions and estimates. Significant adjustments to the carrying amounts of assets and liabilities may therefore be required within the coming financial year. The use of judgements, assumptions and estimates was required in particular for the accounting treatment of the following items:

Impairment of non-financial assets. At each reporting date, QSC assesses whether there are any indications of impairment for non-financial assets. It tests goodwill for impairment at least annually and whenever there are indications of such. Impairment is determined by calculating the recoverable amount for the group of cash-generating units (CGUs). This corresponds to the present value of the expected future cash flows at these units. The groups of CGUS correspond to the reporting segments. Should the recoverable amount of the group of CGUs fall short of the carrying amount of these units, then impairment losses are recognised. Goodwill of € 55,568k was recognised as of 31 December 2016 (2015: € 66,190k). Further details can be found in Notes 18 and 19.

Furthermore, customer bases acquired in return for payment are also tested for impairment upon any indication of such. Their value is determined using the multi-period excess earnings method. Customer bases of € 19,238k were recognised as of 31 December 2016 (2015: € 24,908k). Further details can be found in Note 20.

Deferred tax assets. QSC recognises deferred tax assets for all temporary differences and 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 2016, corporate income tax loss carryovers at QSC AG and all subsidiaries included in the consolidated financial statements totalled € 529 million (2015: € 533 million), while trade tax loss carryovers came to € 518 million (2015: € 523 million). Deferred tax assets of € 5,926k (2015: € 10,671k) and deferred tax liabilities of € 775k (2015: € 1,204k) were recognised as of 31 December 2016. Further details can be found Note 43.

Trade receivables. QSC recognises trade receivables in the balance sheet net of allowances. Allowances for doubtful debts are measured on the basis of regular reviews and assessments performed in conjunction with credit monitoring. The assumptions concerning future payment behaviour and customer creditworthiness are subject to significant uncertainties. As of 31 December 2016, trade receivables came to € 48,251k (2015: € 53,287k). Further details can be found in Note 21.

Provisions. A provision is recognised when QSC 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 material uncertainties in terms of the timing and level of the obligation. Given new information concerning the costs to be incurred, an amount of € 1,889k was added to provisions for dismantling obligations. As of 31 December 2016, provisions totalling € 16,940k (2015: € 10,391k) were recognised in the balance sheet. Further details can be found in Note 33.

With regard to company pensions, individual commitments have been made that constitute defined benefit obligations. Pension provisions are measured using the projected unit credit method prescribed by IAS 19 for defined benefit plans and determined on the basis of actuarial surveys. Actuarial gains or losses are directly charged or credited to equity and thus recognised in other comprehensive income. Further details, particularly concerning the parameters selected, can be found 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 2016, lease liabilities totalled € 1,722k (2015: € 4,483k).

Construction contracts. Receivables from 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 2016, receivables from construction contracts totalled € 163k (2015: € 975k).

Factoring. Within a factoring agreement with NORD/LB Luxembourg S.A. Covered Bond Bank, QSC regularly sells certain short-term trade receivables with a total volume of up to € 18.5 million to the bank. A discretionary decision has to be made concerning the scope of existing risk thereby transferred. Assuming continuing involvement, QSC has recognised receivables of € 198k (2015: € 370k).

4 SUMMARY OF 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 Company and when such revenue can be reliably measured. Revenue is measured at the fair value of the consideration received, less settlement discounts, rebates, VAT and other 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 not throughout the reporting period on a time-apportioned basis up to the end of the reporting period by reference to the percentage of completion.
- QSC defers income from the installation of customer lines on a time-apportioned basis over a contractual period of 24 months. Related expenses are capitalised and deferred accordingly.
- Government grants are recognised as other operating income over the periods in which QSC expenses those costs the grants are intended to compensate.
- Construction contracts are accounted for using the percentage of completion (PoC) method. Please also see the comments made in “construction contracts”.
- QSC recognises interest income using the effective interest method (i.e. the rate that discounts estimated future cash flows over the expected life of the financial instrument to its net carrying amount). Interest unwound on finance lease receivables from multiple element arrangements is also presented as interest income.

- Multiple element arrangements consist of a service portion and a hardware lease, where the fair values of the two components are separable and can be reliably determined. Application of IFRIC 4 requirements to hardware leases means that the Outsourcing segment functions as lessor in certain multiple element arrangements. 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. For the portion of the multiple element arrangement classified as a finance lease, the revenues are recognized upon inception of the arrangement and the interest portion is recognized over the term of such. In these cases, amounts owed by customers (lessees) under a finance lease are recognised as discounted receivables. When measuring hardware leases as operating leases, the revenues are recognized on a monthly basis in accordance with the contractual terms. The total contractual performance is apportioned to the respective components using the residual value method.
- Operating expenses are recognised when the performance has been utilised or at the time they are incurred.

Foreign currency translation. QSC presents its consolidated financial statements in euros. Transactions in currencies other than the euro are initially recognised using the spot exchange rate on the transaction date. Differences arising from changes in the exchange rate between the transaction date and the settlement or balance sheet date are recognised by QSC through profit or loss.

Property, plant and equipment. QSC recognises property, plant and equipment at cost less accumulated depreciation and impairment losses. Repair and maintenance expenses that do not constitute material replacement investments are directly expensed in the period in which they are incurred. The estimated useful lives of assets are taken as the basis for applying straight-line depreciation.
Property, plant and equipment are subject to straight-line depreciation over the following expected useful lives:

	Useful life in years
Property, plant and equipment	
Building	8–50
Networks and technical equipment	2–27
Installations on third-party land	2–25
Plant and operating equipment	2–30

Borrowing costs. Borrowing costs are recognised as an expense in the period in which they are incurred. There are no qualifying assets as defined in IAS 23.

Business combinations and goodwill. QSC accounts for business combinations using the acquisition method. This involves recognising all identifiable assets, liabilities and contingent liabilities of the acquired business at fair value. Goodwill arising in a business combination is initially measured at the amount by which the Company's interest in the fair value of the identifiable assets, liabilities and contingent liabilities exceeds the cost of the business combination.
QSC applies the anticipated acquisition method for business combinations in cases where obligations are entered into with non-controlling shareholders for the subsequent acquisition of those shareholders' remaining shares (contractual call and put options). In this method, it is assumed that the call or put options have been exercised by QSC as of 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.
The estimated fair value of the call or put options is rather accounted for upon first-time consolidation as additional acquisition cost and reported as a long-term financial liability in the balance sheet. Subsequent fair value changes are recognised directly in equity, as is the impact of any unwinding of the discount during the terms of the call and put options. Following initial recognition, QSC measures goodwill at cost, less any accumulated impairment losses.
QSC tests goodwill for impairment annually and upon any indication that the carrying amount is potentially impaired.

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 IAS 38 recognition criteria are met. The costs involved relate primarily to personnel and materials. Costs not eligible for capitalisation are recognised through 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 lives and tested for impairment whenever there is any indication of such. For assets with finite useful lives, the amortisation period and method are reviewed at least at the end of each financial year.
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 periods of 3 to 10 years and software over a period of 2 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. Acquired brands are written down over a period of 3 to 10 years.
The useful lives of intangible assets identified in the business combinations with IP Partner AG and INFO AG in 2011 are 10 to 20 years for customer bases and 3 to 4 years for software.

Financial assets. QSC classifies financial assets falling within the scope of IAS 39 either as financial assets at fair value through profit or loss, held-to-maturity investments, loans and receivables, or as available-for-sale financial assets.
QSC determines the classification of its financial assets upon initial recognition and tests this designation at the end of each reporting period. Items are reclassified where permitted and necessary.
Upon initial recognition, QSC measures financial assets at fair value. The Company accounts for all regular way purchases and sales of financial assets on the basis of the trade date, i.e. the date on which it committed 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 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 using the effective interest method and net of impairment losses. Gains and losses are recognised through profit or loss when the loans and 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 90 days, this is deemed to represent objective evidence that impairment testing is called for pursuant to IAS 39.58. Impairment losses are only recognised if other objective evidence of impairment in accordance with IAS 39.59 is identified which indicates that the receivables are uncollectible or that an impairment requirement has arisen.
Other assets in the form of reinsurance claims on life insurance policies, which are not classified as plan assets pursuant to IAS 19, are measured on the basis of the actuarial coverage reserves determined by the relevant insurance company. All other assets are recognised at their nominal values and, in line with their terms, are presented in the balance sheet as “Long-term assets” and “Short-term assets”.

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.

Prepayments. Transitory items involving outlays prior to the balance sheet date and relating to a specified period after the balance sheet date are recognised as prepayments.

Inventories. QSC initially measures inventories at cost. As of the balance sheet date, 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 original maturities of three months or less.

Provisions. A provision is recognised when QSC 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. The obligations for defined benefit plans are determined separately for each plan using the projected unit credit method and on the basis of actuarial surveys. Actuarial gains and losses are recognised under other reserves within other comprehensive income. The assumptions used by the Company to measure actuarial obligations are described in Note 31. Obligations for contributions to defined contribution plans are expensed as soon as the associated work has been performed.

Stock option plans. QSC's employees may receive share-based compensation 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 plans resolved or modified after 7 November 2002) and uses an appropriate option price model. Further details can be found in Note 41. The expense recognised for granting equity instruments and the corresponding increase in equity are spread over the vesting period of the options.
QSC does not recognise any expense for compensation entitlements which cannot be exercised. If the terms and conditions of a share-based compensation agreement are modified, QSC recognises as a minimum the level of expense that would have arisen in the absence of such modification. If a share-based compensation agreement is cancelled, QSC accounts for the 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 the inception date.

- **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 arrangement is recognised as a liability and reduced over the lease period by the capital portion of the lease payments. Contracts classified as finance leases primarily relate to arrangements for IT 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 finance lease arrangements, the payments are divided into their constituent elements of financing expense and capital repayment using the effective interest rate method and in such a way that the remaining carrying amount of the lease obligation is subject to a constant interest rate. Financing expenses are charged to income. QSC's finance leases predominantly have remaining terms of between 2 and 3 years.
  QSC classifies lease arrangements which do not transfer substantially all the risks and rewards incidental to ownership 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.

- **QSC as lessor.** Based on the requirements of IFRIC 4, QSC acts as the lessor in certain multiple element arrangements. The standard customer contract is then divided into a service contract for services to be rendered and a sale transaction for the leased hardware.
  For finance leases, the leasing component is recognised as a discounted receivable within "Trade receivables", while the revenues from the sales transaction are recognised in full in the year in which the contract is concluded. Customer payments on the leasing component are divided into principal and interest portions and recognised accordingly. Service revenues are recognised on a time-apportioned basis over the contractual term. Operating lease income is recognised as income through profit or 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. Subsequently, 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. The share tender options held by remaining shareholders are also recognised under financial liabilities with application of the anticipated acquisition method.

Derivative financial instruments. QSC has since 2014 been 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. Positive and negative fair values are reported as assets and other financial liabilities respectively. 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).

Where derivatives are used to hedge cash flow risks (cash flow hedges), the hedging relationship is documented and its 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 as a change in value charged or credited to equity. The ineffective portion of the hedging relationship is recognised through profit or loss. Amounts recognised in the cash flow hedge reserve are reclassified to the income statement in the period in which the underlying hedged transaction influences earnings.

Deferred income. QSC defers one-time income from the installation of customer lines on a time-apportioned basis over a contractual period of 24 months.

Taxes. QSC recognises current income tax assets and liabilities for current and prior periods at the amount expected to be reimbursed by or paid to the tax authorities. To calculate this, QSC uses the tax rates and tax laws expected to apply for the relevant assessment period. Current income taxes relating to items recognised directly in equity are 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 that 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 carryovers 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 that 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 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 expected to apply to the year when the asset is realised or the liability settled based on tax rates and tax laws that have been enacted as of the balance sheet date. Future changes in tax rates have to be accounted for if enacted or substantively enacted by the end of the reporting period.
Deferred taxes in connection with items recognised directly in equity in other comprehensive income are likewise recognised directly in equity (through OCI) and not through 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 tax authority.

5 CHANGES IN ACCOUNTING POLICIES

New standards in 2016. QSC AG has observed the following amendments in financial reporting pronouncements requiring mandatory application for the first time in the 2016 financial year. Changes materially relevant for QSC AG's consolidated financial statements are presented in the following section.

Standard/interpretation	Title of standard/interpretation or amendment	Effective date[1]
Amendments to IFRS 10, IFRS 12 and IAS 28	Investment Entities: Applying the Consolidation Exception	1 Jan. 2016
Amendments to IFRS 11	Accounting for Acquisitions of Interests in Joint Operations	1 Jan. 2016
Amendments to IAS 1	Disclosure Initiative	1 Jan. 2016
Amendments to IAS 16 and IAS 38	Clarification of Acceptable Methods of Depreciation and Amortisation	1 Jan. 2016
Amendment to IAS 19	Defined Benefit Plans: Employee Contributions	1 Feb. 2015[2]
Improvements to IFRS 2010 – 2012	Amendments to IFRS 2, IFRS 3, IFRS 8, IFRS 13, IAS 16, IAS 24 and IAS 38	1 Feb. 2015[3,4]
Improvements to IFRS 2012 – 2014	Amendments to IFRS 5, IFRS 7, IAS 19, IAS 34	1 Jan. 2016

[1] Financial years beginning on or after the date stated.
[2] IASB effective date 1 July 2014.
[3] Although the provisions only require application in financial years beginning on or after 1 February 2015, the amendments to IFRS 2 and IFRS 3 require application to transactions executed on or after 1 July 2014.
[4] IASB effective date 1 July 2014.

Amendments to IFRS 10, IFRS 12 and IAS 28 – Applying the Consolidation Exception. The amendments clarify various issues relating to application of the consolidation exception provided for in 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.
With regard to the accounting treatment of the subsidiaries of an investment entity, the following distinction is now made: consistent with the "investment entity exception", subsidiaries that are themselves investment entities must be recognised at fair value. By contrast, subsidiaries that are not themselves investment entities, but that perform services supporting the parent company's activities and are thus to be viewed as an extension of the parent company's activities, must be consolidated.
Finally, the amendments clarify that an investor that does not satisfy the definition of an investment entity and that applies the equity method to its associates or joint ventures may retain the fair value measurement that the investment entity applies to its investments in subsidiaries. Moreover, the amendments require any investment entity measuring all of its subsidiaries at fair value to provide the disclosures on investment entities called for by IFRS 12.
These amendments have no implications for the consolidated financial statements of QSC AG.

Amendments to IFRS 11 – Accounting for Acquisitions of Interests in Joint Operations. IFRS 11 contains requirements governing the recognition of joint ventures and joint operations in the balance sheet and income statement. While joint ventures are recognised using the equity method, the presentation of joint operations provided for in IFRS 11 is comparable to proportionate consolidation.
With the amendment to IFRS 11, the IASB has stipulated how the acquisition of an interest in a joint operation that constitutes a business pursuant to IFRS 3 should be recognised. In such cases, the acquiring company should apply the principles governing the recognition of business combinations set out in IFRS 3. In this case, the disclosure obligations included in IFRS 3 also apply. The amendments have no implications for the consolidated financial statements of QSC AG.

Amendments to IAS 1 – Disclosure Initiative. The amendments refer to different reporting issues. They clarify that note disclosures are only required if their contents are not immaterial. This also explicitly applies when an IFRS requires a list of minimum disclosures. Furthermore, notes on the aggregation and disaggregation of items in the balance sheet and statement of comprehensive income have also been added as a requirements. The amendments further clarify how shares in other comprehensive income at companies recognised using the equity method should be presented in the statement of comprehensive income.
Finally, the model note structure has been deleted to enable companies to take more specific account of factors relevant to their individual situations.
The amendments have no material implications for the consolidated financial statements of QSC AG.

Amendments to IAS 16 and IAS 38 – Clarification of Acceptable Methods of Depreciation and Amortisation. With these amendments, the IASB has provided further guidelines for determining acceptable methods of depreciation and amortization. Accordingly, revenue-based methods of depreciation and amortisation are not permitted for property, plant and equipment and only in certain exceptional cases for intangible assets (rebuttable presumption of inappropriateness). These amendments have no implications for the consolidated financial statements of QSC AG.

Amendment to IAS 19 – Defined Benefit Plans: Employee Contributions. The amendments have clarified the requirements for dealing with the allocation of employee or third-party contributions to service periods in cases where the contributions are linked to service years. Furthermore, simplifications have been introduced for cases where the contributions are independent of the number of service years achieved.
These amendments have no material implications for the consolidated financial statements of QSC AG.

Improvements to IFRS 2010 – 2012. This Annual Improvement Project has introduced amendments to seven standards. By adjusting the wording of individual IFRSs, the IASB has thus clarified existing requirements. In addition, some amendments have implications for note disclosures. The amendments relate to IFRS 2, IFRS 3, IFRS 8, IFRS 13, IAS 16, IAS 24 and IAS 38.
Even though the respective provisions only require application in financial years beginning on or after 1 February 2015, the amendments to IFRS 2 and IFRS 3 require application for transactions occurring on or after 1 July 2014.
These amendments have no material implications for the consolidated financial statements of QSC AG.

Improvements to IFRS 2012 – 2014. This Annual Improvement Project has introduced amendments to four standards. By adjusting the wording of individual IFRSs/IASs, the IASB has thus clarified existing requirements. The amendments relate to IFRS 5, IFRS 7, IAS 19 and IAS 34.
These amendments have no material implications for the consolidated financial statements of QSC AG.
QSC does not plan to make premature application of the following new or amended standards and interpretations only requiring mandatory application in subsequent financial years. Unless otherwise stated, their implications for the consolidated financial statements are currently being reviewed.

Standard / Interpretation	Title of standard / interpretation or amendment	Effective date[5]
IFRS 9	Financial Instruments	1 Jan. 2018
IFRS 15	Revenue from Contracts with Customers	1 Jan. 2018
IFRS 16	Leases	1 Jan. 2019
Amendments to IFRS 2	Classification and Measurement of Share-based Payment Transactions	1 Jan. 2018
Amendments to IFRS 4	Applying IFRS 9 Financial Instruments with IFRS 4 Insurance Contracts	1 Jan. 2018
Amendments to IFRS 10 and IAS 28	Sale or Contribution of Assets between an Investor and its Associate or Joint Venture	–[6]
Amendment to IFRS 15	Clarifications to IFRS 15	1 Jan. 2018
Amendments to IAS 7	Disclosure Initiative	1 Jan. 2017
Amendments to IAS 12	Recognition of Deferred Tax Assets for Unrealised Losses	1 Jan. 2017
Amendment to IAS 40	Transfers of Investment Property	1 Jan. 2018
IFRIC 22	Foreign Currency Transactions and Advance Consideration	1 Jan. 2018
Improvements to IFRS 2014 – 2016	Amendments to IFRS 12	1 Jan. 2017
Improvements to IFRS 2014 – 2016	Amendments to IFRS 1 and IAS 28	1 Jan. 2018

[5] Financial years beginning on or after the date stated.
[6] The IASB decided on 17 December 2015 to postpone the effective date of this amendment standard indefinitely.

(A) EU ENDORSEMENT ALREADY PROVIDED

IFRS 9 Financial Instruments. The version of IFRS 9 issued in July 2014 replaces the current requirements contained in IAS 39 Financial Instruments: Recognition and Measurement. IFRS 9 sets out revised 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 new general requirements for hedge accounting. It also takes over the requirements for the recognition and derecognition of financial instruments contained in IAS 39. We do not expect the new model for recognising credit losses to lead to any significant increase in impairments, but are not yet able to quantify the effects.
IFRS 9 requires first-time application in financial years beginning on or after 1 January 2018. Earlier application is permitted.

IFRS 15 Revenue from Contracts with Customers. IFRS 15 sets out a comprehensive framework for the amount and timing of revenue recognition. It replaces the requirements currently governing revenue recognition, including those contained in IAS 18 Revenue, IAS 11 Construction Contracts and IFRIC 13 Customer Loyalty Programmes.
IFRS 15 requires mandatory application for the first time in financial years beginning on or after 1 January 2018. Premature application is permitted but currently not intended.
The new standard governing revenue recognition may have implications for the net assets and earnings performance of the QSC Group, especially in respect of the possibility of recognising revenues over time and of the recognition and measurement of contract acquisition costs. Pursuant to IFRS 15.35c, the prerequisite for recognising revenues over time is that such relate to the creation of customer-specific assets without any alternative use. Here, QSC must at all times have the right to invoice work already performed in the event of termination by the customer. QSC creates customer-specific assets without any alternative use. The review as to whether QSC's individual legal agreements will have implications for the future recognition of revenues has not yet been performed in detail. Alongside general provisions of the German Civil Code (BGB), this will depend on individual contractual arrangements.
Should the review performed for these project orders conclude that the requirements for recognising the respective revenues over time are not met, then revenues in this amount would only be recognised in later periods. As a result, the respective project-based margin would only be recognised in subsequent periods.
As of the balance sheet date on 31 December 2016, QSC AG has recognised as yet incomplete project orders pursuant to IAS 11 with an order volume of € 303k to which this new requirement would apply. QSC AG also acquires orders by way of public tenders.
Pursuant to IFRS 15.91, the contract costs incurred in the context of a public tender may partly require classification as assets. Pursuant to IFRS 15.93, the requirement for this classification is that such costs are only incurred for a contract thereby obtained and not regardless of such. This means that most of the internal costs thereby incurred may not be capitalised as assets. As a result, this requirement is not expected to have any material implications.
Further implications may arise with regard to the recognition of customer refunds and the delineation of individual elements in multiple element arrangements. The relevant review has not been completed.

(B) EU ENDORSEMENT STILL OUTSTANDING

IFRS 16 Leases. IFRS 16 introduces a uniform accounting model for recognising leases in the balance sheet at lessees. The lessee recognises a right-of-use asset that embodies its right to use the underlying asset and lease liability that embodies its obligation to make lease payments. Exceptions apply for short-term leases and low-value asset leases.
The accounting treatment at lessors is comparable with the current standard, i.e. lessors are still require to classify leases as finance or operating leases.

IFRS 16 replaces the existing standards and interpretations on leases, including IAS 17 Leases, IFRIC 4 Determining Whether an Arrangement Contains a Lease, SIC-15 Operating Leases – Incentives and SIC-27 Evaluating the Substance of Transactions Involving the Legal Form of a Lease. Subject to adoption into EU law, the standard will require first-time application in the first reporting period in financial years beginning on or after 1 January 2019. Earlier application is permitted for companies that also apply IFRS 15 Revenue from Contract with Customers upon initial adoption of IFRS 16 or earlier.
QSC has not yet initiated its assessment of the potential implications of applying IFRS 16 for its consolidated financial statements.

Amendments to IFRS 2 – Classification and Measurement of Share-based Payment Transactions. The amendments relate to the recognition of vesting conditions when measuring cash-settled share-based payments, the classification of share-based payments that include net settlement features for tax purposes and the recognition of any modification in the share-based payments from cash-settled to equity-settled.
Subject to adoption into EU law, the amendments will require application to compensation granted or amended in financial years beginning on or after 1 January 2018. Earlier application is permitted. Retrospective application is only permitted if it is possible to do so without using hindsight.

Amendments to IFRS 4 – Applying IFRS 9 Financial Instruments with IFRS 4 Insurance Contracts. The amendments relate to first-time application of IFRS 9 at insurers and therefore have no implications for QSC.

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 of IFRS 10 and those of IAS 28 (2011) in dealing with the sale or contribution of assets between an investor and its associate or joint venture.
Pursuant to IFRS 10, parent companies are required to recognise the full amount of any gain or loss generated from the sale of a subsidiary in their income statements upon the loss of control. By contrast, the currently applicable IAS 28.28 requires that a gain on sales transactions between an investor and an investment accounted for using the equity method – whether it be an associate or a joint venture – is recognised only to the extent of the investor's interest in the associate or joint venture.
In future, the entire gain or loss arising from a transaction should only be recognised when the assets sold or contributed constitute a business pursuant to IFRS 3. This applies regardless of whether the transaction is structured as a share or asset deal. If the assets do not constitute a business, however, the gain may only be recognised on a prorated basis.
The IASB has postponed the effective date of the amendments indefinitely.

Amendment to IFRS 15 – Clarifications to IFRS 15. The amendments on the one hand include clarifications to various requirements of IFRS 15 and on the other hand provide relief with regard to the transition to the new standard.
In addition to the clarifications, the amendments include two further transition relief provisions intended to reduce the complexity and costs of converting to the new standard. These involve options for the presentation of contracts either completed at the beginning of the earliest period presented or modified before the beginning of the earliest period presented.
Subject to adoption into EU law, the amendments require first-time application as of 1 January 2018.

Amendments to IAS 7 – Disclosure Initiative. The amendments are intended to improve the information provided on changes in a company's liabilities. According to the amendments, a company is required to provide disclosures on changes in those financial liabilities for which the cash flows will be presented in the cash flow statement as cash flows from financing activities. Related financial assets (e.g. assets arising due to hedge transactions) also have to be included in the disclosures.
Disclosures have to be made in the following cases: cash-effective changes, changes resulting from the acquisition or disposal of companies, changes due to the effects of changes in foreign exchange rates, changes in fair values and other changes.
The IASB suggests presenting the disclosures in the form of a reconciliation between the opening and closing balances in the balance sheet but also permits other forms of presentation.
Subject to adoption into EU law, the amendments require first-time application in the first reporting period in a financial year beginning on or after 1 January 2017. Premature application is permitted.
To satisfy the new disclosure obligations, QSC intends to present a reconciliation between the opening and closing balances for liabilities that shows the relevant changes in connection with its financing activities.

Amendments to IAS 12 – Recognition of Deferred Tax Assets for Unrealised Losses. The amendments clarify the recognition of deferred tax assets for unrealised losses in the context of debt instruments measured at fair value.
Subject to adoption into EU law, the amendments require first-time application in the first reporting period in a financial year beginning on or after 1 January 2017. Premature application is permitted.
QSC is currently assessing the potential implications of these amendments for its consolidated financial statements. To date, no material implications are expected.

Amendment to IAS 40 – Transfers of Investment Property. The amendments have no implications for the consolidated financial statements as QSC does not own any such property holdings.

IFRIC 22 Foreign Currency Transactions and Advance Consideration. IFRIC 22 addresses an application issue relating to IAS 21 Effects of Changes in Foreign Exchange Rates. It clarifies the date as of which the exchange rate used to translate transactions in foreign currencies should be determined in cases where such transactions include consideration received or paid. According to the interpretation, the underlying asset, income or expenses should be translated using the exchange rate effective at the time at which the asset or liability resulting from the advance consideration is first recognised.
Subject to adoption into EU law, this interpretation requires first-time application in the first reporting period in a financial year beginning on or after 1 January 2018. Earlier application is permitted.
QSC currently does not expect this interpretation to have any material implications for its consolidated financial statements.

Improvements to IFRS 2014 – 2016. The Annual Improvements to IFRSs (2014-2016) have amended three IFRSs. For IFRS 12, the amendments clarify that IFRS 12 disclosures basically also apply for investments in subsidiaries, joint ventures or associates classified as held for sale pursuant to IFRS 5. One exception in this respect relates to the disclosures called for in IFRS 12.B10-B16 (financial information). In IAS 28, the amendments clarify that the option of measuring an investment in an associate or a joint venture that is held by a venture capital organisation or other company qualifying as such can be exercised differently for each such investment. Furthermore, the limited relief provided for first-time IFRS adopters in IFRS 1.Appendix E (IFRS 1.E3-E7) has been deleted.
Subject to adoption into EU law, the amendments to IFRS 12 require first-time application in the first reporting period in a financial year beginning on or after 1 January 2017, while the amendments to IFRS 1 and IAS 28 require first-time application in the first reporting period in a financial year beginning on or after 1 January 2018. Earlier application is permitted.
QSC currently does not expect these amendments to have any material implications for its consolidated financial statements.

6 CORRECTION OF ERRORS

A sample audit performed by the German Financial Reporting Enforcement Panel (DPR) pursuant to § 342b (2) Sentence 3, No. 3 of the German Commercial Code (HGB) found that in the Company's consolidated financial statements as of 31 December 2014 the deferred tax assets recognised on loss carryovers and thus also consolidated net income were each € 11.6 million too high. Consistent application of the previous year's planning horizon would have resulted in annual net income that was € 11.6 million lower. The year-on-year extension in the planning horizon referred to when capitalising deferred tax assets on loss carryovers from three to four years by taking over the 2017 budget figures in the 2018 budget year was deemed inappropriate. In line with this assessment, the planning horizon referred to when calculating deferred tax assets was uniformly set at three years, also for the 2015 and 2016 financial years, and the resultant

deferred tax assets and income tax expenses as of 31 December 2015 were adjusted accordingly. For 2015, this circumstance and the resultant correction led to deferred tax income, as the reduction in deferred tax assets as of 31 December 2015 turned out lower than as of 1 January 2015. Furthermore, in the consolidated financial statements as of 31 December 2014 goodwill and the corresponding liability were each reported at amounts that were € 887k too high. The foundation of the fonial GmbH subsidiary on the basis of cash contributions did not constitute a business combination pursuant to IFRS 3, as no existing business operations were taken over. The financial liabilities reported in the consolidated financial statements as of 31 December 2014, of which € 900k were directly reclassified to equity in the 2015 financial year, had to be retired.
This is because, from an economic perspective, the additional amount expected from a contractual tender option represented a compensation component for the managing director and should have been distributed over the term of the respective employment contract. Due to updated expectations, the resultant earnings item of € 22k in the 2014 financial year was fully reversed in the 2015 financial year.
The Company concurs with the legal assessment by the German Financial Reporting Enforcement Panel (DPR), has corrected the figures as appropriate and, pursuant to IAS 8.41 et seq., has retrospectively implemented these corrections in these consolidated financial statements. The implications of these corrections for the previous year are presented in the following tables.

Correction in the consolidated opening balance sheet as of 1 January 2015

€ 000s	1 Jan. 2015 as originally reported	Correction pursuant to IAS 8 Deferred tax assets	Correction pursuant to IAS 8 Foundation of subsidiary on the basis of cash contributions	1 Jan. 2015 adjusted
ASSETS				
Long-term assets				
Property, plant and equipment	76,169			76,169
Land and buildings	25,915			25,915
Goodwill	67,077		(887)	66,190
Other intangible assets	53,684			53,684
Trade receivables	7,761			7,761
Prepayments	2,641			2,641
Other long-term assets	2,948			2,948
Deferred tax assets	19,377	(11,625)		7,752
Long-term assets	**255,572**	**(11,625)**	**(887)**	**243,060**
Short-term assets	**149,917**			**149,917**
TOTAL ASSETS	**405,489**	**(11,625)**	**(887)**	**392,977**

€ 000s	1 Jan. 2015 as originally reported	Correction pursuant to IAS 8: Deferred tax assets	Correction pursuant to IAS 8: Foundation of subsidiary on the basis of cash contributions	1 Jan. 2015 adjusted
SHAREHOLDERS' EQUITY AND LIABILITIES				
Shareholders' equity				
Issued capital	124,142			124,142
Capital surplus	142,069			142,069
Other capital reserves	(3,066)			(3,066)
Accumulated deficit	(117,511)	(11,625)	(21)	(129,157)
Equity attributable to owners of the parent company	**145,634**	**(11,625)**	**(21)**	**133,988**
Non-controlling interests	-		12	12
Shareholders' equity	**145,634**	**(11,625)**	**(9)**	**134,000**
Liabilities				
Long-term liabilities				
Long-term liabilities under financing and finance lease arrangements	4,447			4,447
Liabilities due to banks	156,550			156,550
Convertible bonds	25			25
Accrued pensions	7,281			7,281
Other provisions	305			305
Other financial liabilities	9,209		(878)	8,331
Deferred tax liabilities	2,333			2,333
Long-term liabilities	**180,150**		**(878)**	**179,272**
Short-term liabilities	**79,705**			**79,705**
Liabilities	**259,855**		**(878)**	**258,977**
TOTAL SHAREHOLDERS' EQUITY AND LIABILITIES	**405,489**	**(11,625)**	**(887)**	**392,977**

Correction in the balance sheet as of 31 December 2015

€ 000s	31 Dec. 2015 as originally reported	Correction pursuant to IAS 8 Deferred tax assets	Correction pursuant to IAS 8 Foundation of subsidiary on the basis of cash contributions	31 Dec. 2015 adjusted
ASSETS				
Long-term assets				
Property, plant and equipment	62,392			62,392
Land and buildings	25,152			25,152
Goodwill	67,077		(887)	66,190
Other intangible assets	41,411			41,411
Trade receivables	4,583			4,583
Prepayments	3,608			3,608
Other long-term assets	292			292
Deferred tax assets	20,207	(9,536)		10,671
Long-term assets	**224,722**	**(9,536)**	**(887)**	**214,299**
Short-term assets	**133,803**			**133,803**
TOTAL ASSETS	**358,525**	**(9,536)**	**(887)**	**348,102**
SHAREHOLDERS‘ EQUITY AND LIABILITIES				
Shareholders’ equity				
Issued capital	124,162			124,162
Capital surplus	142,702			142,702
Other capital reserves	(2,996)			(2,996)
Accumulated deficit	(139,673)	(9,536)	(777)	(149,986)
Equity attributable to owners of the parent company	**124,195**	**(9,536)**	**(777)**	**113,882**
Non-controlling interests	-		(110)	(110)
Shareholders’ equity	**124,195**	**(9,536)**	**(887)**	**113,772**
Liabilities				
Long-term liabilities	170,997			170,997
Short-term liabilities	63,333			63,333
Liabilities	**234,330**			**234,330**
TOTAL SHAREHOLDERS‘ EQUITY AND LIABILITIES	**358,525**	**(9,536)**	**(887)**	**348,102**

Correction in the consolidated income statement for the 2015 financial year

€ 000s	2015 as originally reported	Correction pursuant to IAS 8: Deferred tax assets	Correction pursuant to IAS 8: Foundation of subsidiary on the basis of cash con-tributions	2015 adjusted
Net revenues	**402,436**			**402,436**
Cost of revenues	(337,598)			(337,598)
Gross profit	**64,838**			**64,838**
Sales and marketing expenses	(37,096)			(37,096)
General and administrative expenses	(37,932)		22	(37,910)
Other operating income	682			682
Other operating expenses	(1,653)			(1,653)
Operating profit (loss)	**(11,161)**		**22**	**(11,139)**
Financial income	398			398
Financial expenses	(6,344)			(6,344)
Net income (loss) before income taxes	**(17,107)**		**22**	**(17,085)**
Income taxes	1,753	2,089		3,842
Net income (loss)	**(15,354)**	**2,089**	**22**	**(13,243)**
Attribution of net income (loss)				
Owners of the parent company	(15,354)			(13,121)
Non-controlling interests	-			(122)
Earnings per share (basic) in €	(0.12)			(0.11)
Earnings per share (diluted) in €	(0.12)			(0.11)

Notes to the Income Statement

7 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 this, they serve as the interface to the consumer, thus also assuming the associated default risk. Revenues from construction contracts came to € 535k in the year under report (2015: € 2,693k). These did not result in any material losses. Revenues from hardware leases in the context of new multiple element arrangements amounted to € 2,266k in 2016 (2015: € 1,849k). A breakdown of revenues can be found in the Segment Report (Note 40).

8 COST OF REVENUES

Cost of revenues include the cost of purchased services, the cost of building, operating and maintaining the network and data centres, and non-cash share-based compensation under stock option plans for employees working in technology operations. It also includes depreciation and amortisation on hardware and software used in technology operations. Moreover, this line item includes personnel expenses in the Outsourcing and Consulting lines of business. Furthermore, it also includes prorated personnel expenses for the business fields. Of total research and development expenses of € 5,144k (2015: € 7,593k), an amount of € 0k was capitalised as development expenses in the 2016 financial year (2015: € 333k).
A settlement was reached with Deutsche Telekom in Q4 2016 with regard to the appropriateness of interconnection and termination fees. This involved the payment of a low single-digit million euro amount, leading to a one-off reduction in cost of revenues.

€ 000s	2016	2015
Purchased services	161,648	170,652
Building, operation and maintenance of infrastructure	43,067	42,891
Depreciation and amortisation	29,432	44,985
Personnel expenses	78,196	78,748
Non-cash share-based compensation	255	322
Cost of revenues	**312,598**	**337,598**

9 SALES AND MARKETING EXPENSES

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

€ 000s	2016	2015
Personnel expenses	16,996	20,221
Commission payments	10,894	10,282
Other sales and marketing expenses	2,238	2,735
Allowances for bad debt and fair dealing payments	539	(125)
Advertising expenses	2,298	1,745
Depreciation and amortisation	1,614	2,141
Non-cash share-based compensation	104	97
Sales and marketing expenses	**34,683**	**37,096**

10 GENERAL AND ADMINISTRATIVE EXPENSES

In addition to personnel expenses and non-cash share-based compensation for Management Board members and head office departments, as well as for administration employees working in Finance, Human Resources, Legal Operations, and IT, general and administrative expenses also include costs for the administration buildings, legal and consulting costs, corporate communications costs (including investor relations) and depreciation and amortisation on hardware and software used in administrative operations.

€ 000s	2016	2015
Other general and administrative expenses	15,083	16,001
Personnel expenses	16,739	16,136
Depreciation and amortisation	4,676	5,562
Non-cash share-based compensation	149	211
General and administrative expenses	**36,647**	**37,910**

11 WRITE-DOWNS AND IMPAIRMENTS

€ 000s	2016	2015
Write-downs of cost of revenues	29,432	44,985
Write-downs of sales and marketing expenses	1,614	2,141
Write-downs of general and administrative expenses	4,676	5,562
Write-downs of other operating expenses	13,927	-
Write-downs and impairments	**49,649**	**52,688**

12 OTHER OPERATING INCOME AND EXPENSES

€ 000s	2016	2015
Other operating income	2,455	556
Income from subsidised projects	211	106
Income from disposal of long-term assets	32	20
Other operating income	**2,698**	**682**

€ 000s	2016	2015
Goodwill impairment	10,622	-
Write-downs of customer bases	3,305	-
Other operating expenses	3,882	1,640
Losses from disposal of long-term assets	40	13
Other operating expenses	**17,849**	**1,653**

Other operating income mainly includes income of € 1,614k from third parties in connection with value added services and damages claims of € 337k.
Other operating expenses mainly comprise a goodwill impairment of € 10,622k recognised in the Outsourcing segment (further details in Notes 18 and 19), write-downs of € 3,305k on capitalised customer bases and expenses of € 1,889k for the dismantling of decommissioned technical space.

13 FINANCIAL RESULT

€ 000s	2016	2015
Financial income (interest income)	196	398

€ 000s	2016	2015
Financial expenses (interest expenses)	6,030	6,344

Interest expenses include an amount of € 96k (2015: € 253k) for financing arrangements.
Borrowing costs attributable to qualifying assets were not incurred.
Net interest expenses for pension provisions amount to € 135k (2015: € 114k).

14 EARNINGS PER SHARE

When calculating diluted earnings per share, account only needs to be taken of convertible stock options resulting from the 2006 and 2012/2015 stock option plans. For these, it has been assumed that the options subscribed as of 31 December 2016 will also be converted if the respective conversion requirements are met.
Pursuant to the bond terms relevant to the 2006, 2012 and 2015 stock option plans, conversion is only possible when one of the following conditions is met:

- QSC's share price has outperformed the TecDAX comparative index in relative terms in the period between the convertible bond being subscribed and the conversion right being exercised.
- The stock market price for QSC shares has risen by at least 20 percent (2012/2015 stock option plans) or 10 percent (2006 stock option plan) between the convertible bond being subscribed and the conversion right being exercised.

QSC shares closed at € 1.92 in Xetra trading on 30 December 2016, while the TecDAX was listed at 1,811.72 points.
To calculate diluted earnings, it is initially assumed that the TecDAX outperformed QSC's share price. The second condition, i.e. whether the share price has increased by 10 percent or 20 percent, is therefore investigated.
For the 2006 stock option plan, account thus has to be taken of all options with conversion prices of € 1.74 (= € 1.92 : 1.1) or lower which have not yet been converted. As of 31 December 2016, the 2006 stock option plan comprised 26,800 options.

For the 2012 and 2015 stock option plans, account has to be taken of all options with conversion prices of € 1.60 (= € 1.92 : 1.2) or lower.
As of 31 December 2016, the 2012 stock option plan comprised 112,300 options, while the 2015 stock option plan included 400,000 options.
When calculating diluted earnings, account also has to be taken of the share-based payments still to be incurred through to conversion of the exercisable options. For the 2006 stock option plan, all share-based expenses have already been considered. For the 2012 and 2015 stock option plans, an average term of up to 4 years can still be expected.
The amount of share-based compensation to be considered through to the conversion of the 539,100 options is calculated as follows:

	Number of options	Correction value in €
SOP 2006	26,800	-
SOP 2012	112,300	43,309
SOP 2015	400,000	233,000
Total	**539,100**	**276,309**

To calculate diluted earnings per share, the numerator and the denominator therefore have to be adjusted by € 276,309 and 539,100 shares respectively.

2016 financial year	Basic earnings per share	Correction	Diluted earnings per share
Consolidated net income attributable to shareholders in the parent company (€ 000s)	(24,839)	(276)	(25,115)
Weighted average number of shares issued	124,164,987	539,100	124,704,087
Earnings per share (€)	**(0.20)**		**(0.20)**

2015 financial year	Basic earnings per share	Diluted earnings per share
Consolidated net income attributable to shareholders		
in the parent company (€ 000s)	(13,121)	(13,121)
Weighted average number of shares issued	124,155,820	124,155,820
Earnings per share (€)	**(0.11)**	**(0.11)**

15 PERSONNEL EXPENSES AND EMPLOYEES

€ 000s	2016	2015
Wages and salaries	98,150	99,400
Employer social security contributions (pension insurance)	6,872	7,540
Employer social security contributions (other)	6,527	7,652
Pension expenses	382	513
Non-cash share-based compensation	508	630
Personnel expenses	**112,439**	**115,735**

Wages and salaries include expenses for the termination of employment contracts totalling € 8,699k (2015: € 1,871k).

During the 2016 financial year, companies included in consolidation employed an average of 1,384 employees (2015: 1,553). The following table presents the employees' distribution by main corporate functions.

	2016	2015
Sales and marketing	198	247
Technology and consulting	1,055	1,152
Administration	121	141
Head office departments	10	13
Number of employees by corporate function (average)	**1,384**	**1,553**

Notes to the Balance Sheet

16 ASSETS AND LIABILITIES HELD FOR SALE

Based on a transfer agreement dated 20 December 2016, the Company sold all of its shares in FTAPI Software GmbH, Munich, on 9 January 2017.
The final measurement of the relevant CGU gave rise to impairment losses of € 2,276k. These have been recognised under cost of revenues (Note 8) and taxes on income (Note 43). Within the disposal group, the impairment losses reduced the carrying amounts of intangible assets and deferred tax assets by € 1,313k and € 963k respectively.
The recoverable amount of € 15k corresponds to the fair value (measured at Level 1 in the measurement hierarchy) less disposal costs.
Measurement of the disposal group at the lower of its carrying amount and its fair value less disposal costs as of the balance sheet date did not result in any further charge.
The assets and liabilities in the disposal group were structured as follows as of the balance sheet date and are recognised in the balance sheet as assets held for sale and as liabilities in connection with assets held for sale respectively:

€ 000s	31 Dec. 2016
Assets	
Property, plant and equipment	39
Other intangible assets	509
Trade receivables	141
Prepayments	4
Other short-term assets	28
Cash and cash equivalents	445
Assets held for sale	**1,166**
Liabilities	
Trade payables	32
Deferred income	861
Other short-term liabilities	258
Liabilities in connection with assets held for sale	**1,151**

No accumulated income and expenses relating to the disposal group have been recognised under other comprehensive income.

17 PROPERTY, PLANT AND EQUIPMENT

€ 000s	Land and buildings	Network and technical equipment	Operational and office equipment	Total
Gross value at 1 Jan. 2015	**29,931**	**368,022**	**55,847**	**453,799**
Additions	82	16,158	1,413	17,653
Disposals	-	(3,840)	(254)	(4,094)
Reclassifications	-	(19)	19	-
Gross value at 31 Dec. 2015	**30,012**	**380,322**	**57,024**	**467,358**
Additions	37	20,504	584	21,125
Disposals	-	(745)	(368)	(1,113)
Reclassifications	-	107	(107)	-
Reclassifications to assets held for sale	-	-	(108)	(108)
Gross value at 31 Dec. 2016	**30,049**	**400,188**	**57,025**	**487,262**
Accumulated depreciation and impairments at 1 Jan. 2015	**4,015**	**303,689**	**44,011**	**351,715**
Additions	845	28,919	2,239	32,002
Disposals	-	(3,650)	(253)	(3,903)
Reclassifications	-	-	-	-
Accumulated depreciation and impairments at 31 Dec. 2015	**4,860**	**328,957**	**45,997**	**379,814**
Additions	830	18,700	2,134	21,664
Disposals	-	(790)	(270)	(1,060)
Reclassifications	-	3	(3)	-
Reclassifications to assets held for sale	-	-	(69)	(69)
Accumulated depreciation and impairments at 31 Dec. 2016	**5,690**	**346,870**	**47,789**	**400,349**
Carrying amounts at 31 Dec. 2015	**25,152**	**51,365**	**11,027**	**87,544**
Carrying amounts at 31 Dec. 2016	**24,359**	**53,318**	**9,236**	**86,913**

As of 31 December 2016, the carrying amount of technical equipment, plant and office equipment held under finance lease arrangements totalled € 842k (2015: € 3,042k).

Additions in the 2016 financial year totalled € 21,125k (2015: € 17,653k). As of 31 December 2016, the "Network and technical equipment" line item included assets under construction amounting to € 2,366k (2015: € 3,051k). These relate to the expansion in a core network and to data centres. In the income statement, QSC recognises depreciation and amortisation within the "Cost of revenues", "Sales and marketing expenses" and "General and administrative expenses" line items. Liens have been granted on real estate as security for liabilities under loan agreements (Note 30). Moreover, loans payable are secured by a mortgage lien provided to the lending bank for property, plant and equipment at a company property.

18 GOODWILL

Goodwill amounted to € 55,568k as of 31 December 2016 (2015: € 66,190k). Impairment testing led to the identification of an impairment requirement of € 10,622k in the Outsourcing segment. This has been recognised under other operating expenses in the consolidated income statement. Further details can be found in Note 19.

19 GOODWILL IMPAIRMENT

Consistent with IFRS 8 requirements, the Company's internal organisational structure used by the management for business decisions and performance assessments has been referred to as the basis for delineating segments. Accordingly, segment report is aligned to the Company's product structure. This has resulted in the segments of Telecommunications, Outsourcing, Consulting and Cloud.

The groups of cash-generating units (CGUs) to which goodwill has been allocated correspond to the operating segments determined for the companies included in consolidation pursuant to IFRS 8.5. The operating segments represent the lowest level of reporting at the companies included in consolidation for which goodwill is systematically monitored.

Including the impairment requirements at the Outsourcing segment, the carrying amount of goodwill is allocated to the segments as follows:

€ 000s	2016	2015
Telecommunications	20,844	20,844
Outsourcing	-	10,622
Consulting	10,409	10,409
Cloud	24,315	24,315
Carrying amount of goodwill	**55,568**	**66,190**

QSC determines the recoverable amount of the CGUs as their value in use and refers here to the cash flow forecasts based on the Management Board's planning for the Company for a three-year period. This planning accounts for management expectations with respect to the future performance of individual business units and considers both external market analyses and internal assumptions concerning the market opportunities for innovative applications in the ICT market.

The **Telecommunications segment** comprises the two areas of corporate customers and private customers. In the private customer business, regulation and the market-related decline in the low-margin Voice and ADSL2+ business have resulted in a further marked reduction in revenues. This contrasts with the stable level of revenues in the corporate customer business. The resultant decline in the margin in this segment can only be offset in part by lower structural expenses in the detailed planning period. This will lead to a marked decrease in EBIT and slight decline in the EBIT margin. The sustainable growth rate (in perpetuity) amounts to 0 percent (2015: 0 percent).

Alongside the reduction in market prices, the migration of customers to the new Cloud platform in particular means that the sharp fall in revenues in the **Outsourcing segment** is set to continue during the detailed planning period. The associated loss of margin in absolute terms will be more than offset by the cost-cutting programme launched in 2015, leading to a marked rise in EBIT and the EBIT margin. Overall, the budgeting assumptions for the Outsourcing segment had to be significantly scaled back compared with the previous year. This in turn resulted in an impairment requirement for all of the segment's goodwill. Consistent with the expected development in revenues, the sustainable growth rate here too will amount to 0 percent (2015: 0 percent).
A value in use of € 49,532k was determined for the Outsourcing segment. Due to the migration of existing customers to the new Cloud platform, the impairment requirement for this segment amounts to € 10,622k. The impairment requirement was allocated in full to goodwill and recognised under other operating expenses.

The positive trend seen in revenues in the **Consulting segment** in previous years will continue. The high volume of new orders expected for subsequent years as well will lead to strong revenue growth in the years from 2017 to 2019. This revenue performance and the increasing deployment of internal rather than external staff will result in a significant increase in EBIT and the EBIT margin. The sustainable growth rate has been accounted for at 0.5 percent in the corporate planning (2015: 0.5 percent).

The especially strong revenue growth in the **Cloud segment,** comparable with the development in revenues for innovative new product developments, is largely attributable to the new PEC platform. Alongside the acquisition of new customers, a further key growth driver results above all from migrating existing Outsourcing customers.

A further strong growth area involves activities at QSC's subsidiary Q-loud, which offers services within the M2M communication business field. Consistent with the revenue forecast, EBIT and the EBIT margin will also show correspondingly strong growth. As revenue growth is also expected beyond 2019, the sustainable growth rate has been stated at 1.0 percent (2015: 1.0 percent).

To discount the cash flows expected for the respective cash-generating units, the segment-specific weighted average costs of capital (WACC) were determined. Segment-specific beta factors were derived by reference peer group data.

The segment-specific pre-tax discount rates come to 9.07 percent for Telecommunications (2015: 9.58 percent), 7.92 percent for Outsourcing (2015: 9.14 percent), 9.22 percent for Consulting (2015: 9.56 percent) and 12.00 percent for Cloud (2015: 16.41 percent).

The value in use of the Telecommunications, Consulting and Cloud CGUS is ahead of the carrying amount of the respective assets. The estimated recoverable amounts of the Telecommunication and Consulting cash-generating units exceed their carrying amounts by € 64,532k and € 8,984k respectively (2015: € 34,213k and € 36,580k respectively). The value in use of the Cloud CGU is € 27,181k higher than its carrying amount. There are therefore no goodwill impairment requirements at any of the listed groups of CGUs.

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, gross profit, the capex ratio and the discount rate.

Various scenario analyses were performed for the impairment test. An impairment requirement would arise in the Telecommunications and Consulting CGU groups if, all other factors being equal, revenues in the final planning year, and thus in perpetuity, were to fall 8.6 percent and 2.4 percent respectively short of the revenues assumed in the planning (2015: 5.1 percent and 9.8 percent respectively). The Cloud CGU group would be subject to an impairment requirement if, all other factors being equal, revenues in the final planning year, and thus in perpetuity, were to fall 6.4 percent short of the planned revenues (2015: 11.3 percent).

20 OTHER INTANGIBLE ASSETS

€ 000s	Licenses	Acquired software	Internally generated software	Customer connections	Customer bases	Brands	Other	Total
Gross value								
at 1 Jan. 2015	**1,968**	**30,923**	**15,677**	**135,580**	**36,223**	**2,426**	**15,564**	**238,361**
Additions	91	1,081	343	6,595	-	-	307	8,417
Disposals	-	(6)	-	-	-	-	-	(6)
Gross value								
at 31 Dec. 2015	**2,059**	**31,999**	**16,019**	**142,175**	**36,223**	**2,426**	**15,871**	**246,772**
Additions	81	1,471	-	5,582	-	-	106	7,240
Disposals	-	(267)	(4,606)	-	-	-	-	(4,873)
Reclassifications to								
assets held for sale	-	-	(2,755)	-	-	-	(6)	(2,761)
Gross value								
at 31 Dec. 2016	**2,140**	**33,203**	**8,659**	**147,757**	**36,223**	**2,426**	**15,971**	**246,378**
Accumulated amortisa-								
tion and impairments								
at 1 Jan. 2015	**1,283**	**21,655**	**7,797**	**128,077**	**8,949**	**2,426**	**14,490**	**184,677**
Additions	107	2,900	7,659	7,132	2,366	-	524	20,686
Disposals	-	(3)	-	-	-	-	-	(3)
Accumulated amortisa-								
tion and impairments								
at 31 Dec. 2015	**1,390**	**24,552**	**15,456**	**135,209**	**11,315**	**2,426**	**15,013**	**205,361**
Additions	103	4,919	58	6,455	5,670	-	157	17,363
Disposals	-	(267)	(4,606)	-	-	-	-	(4,873)
Reclassifications to								
assets held for sale	-	-	(2,249)	-	-	-	(2)	(2,251)
Accumulated amortisa-								
tion and impairments								
at 31 Dec. 2016	**1,493**	**29,204**	**8,659**	**141,664**	**16,985**	**2,426**	**15,168**	**215,599**
Carrying amounts								
at 31 Dec. 2015	**669**	**7,447**	**564**	**6,966**	**24,908**	**-**	**858**	**41,411**
Carrying amounts								
at 31 Dec. 2016	**647**	**3,999**	**-**	**6,093**	**19,238**	**-**	**803**	**30,779**

Impairment losses of € 3,305k have been recognised on customer bases. These relate to customer relationships recognised at INFO AG in 2011 in the context of a purchase price allocation performed upon the business combination and involving the Outsourcing, Consulting and Cloud segments. The impairment requirement arose due to falling revenues with existing customers, especially in the Outsourcing business. The value was determined using the residual value method. The discount rate was derived from the parameters used for goodwill impairment tests. Prior to the impairment loss recognised on customer bases, the carrying amount came to € 11,075k as of 31 December 2016. The recoverable amount stood at € 7,770k. This gave rise to an impairment requirement of € 3,305k.
QSC has recognised the impairment loss under other operating expenses in its income statement. Scheduled amortisation is recognised within individual line items: € 7,987k under cost of revenues (2015: € 9,898k), € 1,567k under sales and marketing expenses (2015: € 2,054k) and € 3,191k under general and administrative expenses (2015: € 2,054k).
Information about the impairment losses recognised on software can be found in Note 16.

21 TRADE RECEIVABLES

€ 000s	2016	2015
Trade receivables		
Long-term trade receivables	2,435	4,583
Short-term trade receivables	45,816	48,704
Trade receivables	**48,251**	**53,287**

Long-term trade receivables are attributable to the recognition of leasing receivables in the context of multiple element arrangements. The receivables presented are not subject to any material restrictions on ownership or availability. The carrying amounts correspond to the fair values. QSC typically concludes full amortisation contacts with average rental terms of 36 to 48 months and without purchase options. Following the expiry of the basic rental period, it has the option of extending the contract or selling leased items for which no purchase options were granted. No residual values are guaranteed.
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 of € 107k for these contracts have been deducted (2015: € 102k). Write-downs of € 2k have been recognised due to the valuation of long-term construction contracts in the year under report (2015: € 0k). Receivables from construction contracts amounting to € 163k have been recognised under trade receivables (2015: € 975k).

Short-term trade receivables bear no interest and generally have maturities of 30 to 90 days. Allowances are recognised in the full amount of all receivables that are more than 90 days overdue, except for receivables from the project business. These are considered on an individual case basis, i.e. all receivables more than 180 days overdue are individually tested for impairment. As of 31 December 2016, trade receivables amounting to € 3,397k were impaired (2015: € 3,434k). The individual allowances schedule developed as follows:

€ 000s	2016	2015
Allowance at 1 January	**3,434**	**4,353**
Charged for the year	210	187
Utilised	(2)	(998)
Reversed	(245)	(108)
Allowance at 31 December	**3,397**	**3,434**

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

€ 000s	2016	2015
Gross total		
Impaired	4,041	4,085
Neither past due nor impaired	41,301	45,519
Past due but not impaired		
< 90 days	6,306	7,031
91 – 120 days	-	85
> 120 days	-	-
Gross total	**51,648**	**56,721**

Within a factoring agreement with NORD/LB Luxembourg S.A. Covered Bond Bank, QSC regularly sells certain short-term trade receivables with a total volume of up to € 18.5 million to the bank. As of the balance sheet date, trade receivables with a nominal amount of € 13.2 million had been transferred (2015: € 13.5 million).
The nominal amount corresponds to the fair value of the receivables assigned. Apart from retained default risk of € 198k (2015: € 370k), the receivables thereby assigned have been retired.

22 PREPAYMENTS

The long-term prepayments of € 3,161k (2015: € 3,608k) and short-term prepayments of € 5,107k (2015: € 3,712k) chiefly consist of prepayments for leased lines and technology premises, insurance and maintenance agreements.

23 INVENTORIES

Inventories totalled € 73k as of 31 December 2016 (2015: € 884k) and comprised merchandise held in stock amounting to € 48k (2015: € 860k) and consumables of € 25k (2015: € 24k).

24 OTHER SHORT-TERM ASSETS

Other short-term financial assets amount to € 1,533k (2015: € 6,521k) and mainly comprise VAT receivables of € 521k, creditors with debit accounts of € 377k (2015: € 255) and security of € 198k (2015: € 370k) that is subject to restrictions on disposability due to the sale of the respective receivables.

25 CASH AND CASH EQUIVALENTS

Cash and cash equivalents, including the liquidity at the disposal group, amount to € 67,781k (2015: € 73,982k) and consist of cash at banks and on hand.

26 ISSUED CAPITAL

Each share entitles its registered bearer to cast one vote at the Annual General Meeting and enjoys full dividend entitlement. Voting rights are not subject to any restrictions. All issued shares are fully paid-in.
Issued capital at the Company amounted to € 124,162,487 as of 1 January 2016 and comprised 124,162,487 no-par shares.
Conversion rights relating to stock option plans were exercised in the financial year under report, with 10,000 convertible bonds being converted into shares as a result.

The changes in ordinary shares and issued capital are as follows:

	Ordinary no-par shares	€
Balance at 1 January 2016	**124,162,487**	**124,162,487**
Addition due to issue of ordinary no-par shares	10,000	10,000
Balance at 31 December 2016	**124,172,487**	**124,172,487**

A dividend of € 0.03 per share with dividend entitlement was distributed in the year under report (€ 3,725k).

27 CAPITAL RESERVE

The capital reserve amounted to € 143,217k as of 31 December 2016 (2015: € 142,702k). This amount also includes the deferred share-based compensation for the stock option plan. The year-on-year change is due on the one hand to non-cash share-based compensation of € 508k and on the other to the exercising of convertible bonds of € 7k.

28 AUTHORISED AND CONDITIONAL CAPITAL

Authorised capital. The Management Board is authorised by resolution of the Annual General Meeting on 27 May 2015, subject to approval by the Supervisory Board, to increase the Company's issued capital by up to a total of € 50,000,000 on one or several occasions up to 26 May 2020 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 flexibly 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 € 46,490,365 as of the balance sheet date. This was divided into Conditional Capital IV (€ 40,000,000), Conditional Capital VII (€ 740,365), Conditional Capital VIII (€ 5,000,000) and Conditional Capital IX (€ 750,000).

Conditional Capitals VII, VIII and IX 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 (Conditional Capital IX), Management Board members, managing directors of affiliated companies, employees of QSC and affiliated companies (Conditional Capitals VII and VIII) and other parties contributing to the Company's success (Conditional Capital VII). 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 General Meeting on 27 May 2015 to issue such instruments in order to access an additional, low-interest financing option given favourable capital market conditions. The convertible bonds may be issued in return for both cash contributions and contributions in kind. 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 four cases: (1) to settle residual amounts resulting from the subscription ratio; (2) when the bonds are issued in return for contributions in kind, particularly in the context of company acquisitions; (3) if, in the case of bonds being issued in return for cash contributions 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; and (4) to the extent necessary to issue subscription rights to the bearers or creditors of warrant and/or convertible bonds previously issued in order to avoid dilution of their respective holdings. To date, the Management Board has not acted on the authorisation to issue tradable warrant and/or convertible bonds.

The exclusion of shareholders' subscription rights pursuant to § 186 (3) Sentence 4 of the German Stock Corporation Act (AktG) may only apply for the use of treasury stock, for the issue of new shares from authorised capital and for the issue of warrant and/or convertible bonds corresponding up to an aggregate total of no more than 10 percent of issued capital during the term of the respective authorisation. Apart from this, the exclusion of shareholders' subscription rights, irrespective of the legal grounds, for the use of treasury stock, for the issue of new shares from authorised capital and for the issue of warrant and/or convertible bonds (including those issued within QSC's stock option plans) may not exceed an aggregate total of 20 percent of issued capital during the term of the respective authorisation.

29 OTHER RESERVES

The development in this item in the 2016 and 2015 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	2016	2015
Other reserves		
Actuarial losses on pension plans	(1,923)	(1,420)
Change in fair value of cash flow hedge	(1,570)	(1,576)
Other reserves	**(3,493)**	**(2,996)**

The values are stated in each case after deferred taxes.

30 INTEREST-BEARING LIABILITIES

€ 000s	Average interest rate in % in 2016	Maturity	2016	2015
Short-term liabilities				
Under financing and finance lease arrangements	4.07	2017	1,352	2,761
Due to banks	4.55	2017	4,003	2,140
Short-term liabilities			**5,355**	**4,901**
Long-term liabilities				
From convertible bonds	3.50	from 2019	33	27
Due to banks	2.41	2018 – 2021	145,412	155,830
Fixed-rate € 57,912k	2.62			
Floating-rate € 87,500k	2.27			
Under financing and finance lease arrangements	4.62	2018 – 2021	370	1,722
Long-term liabilities			**145,815**	**157,579**
Interest-bearing liabilities			**151,170**	**162,480**

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 2017.

Long-term interest-bearing liabilities. As of 31 December 2016, 3,207,529 convertible bonds were outstanding in connection with the Stock Option Plans. The convertible bonds have a nominal value of € 0.01 each. Further details can be found in Note 41.
Of long-term liabilities due to banks as of the balance sheet date, an amount of € 145,000k involved liabilities from five tranches of a promissory note loan taken up in May 2014. An amount of € 5 million from Tranche 4 was prematurely repaid in October 2016.
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 € 412k due to banks.

	Nominal amount in € 000s	Term	Interest rate
Floating-interet 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%
Floating-interest tranches	**87,500**		
Fixed-interest tranches			
Tranche 4	33,500	5 years	2.29%
Tranche 5	24,000	7 years	3.05%
Fixed-interest tranches	**57,500**		

To hedge the cash flow risk involved in the floating-interest tranches of the promissory note loan, which amount to € 87,500k, QSC has concluded three interest swaps. Of these, an amount of € 76,500k has a term running until 20 May 2019 and an amount of € 11,000k has a term running until 20 May 2021. The interest swaps meet IAS 39 hedge accounting requirements (cash flow hedges). In respect of their terms and floating 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. The negative fair value of the interest swaps amounted to € 2,425k as of the balance sheet date (2015: € 2,414k) and has been recognised under other long-term financial liabilities (Note 35). 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. To account for the change in the value of the interest swap before deferred taxes an amount of € 8k (2015: € 149k) was recognised under OCI in the consolidated statement of comprehensive income in the 2016 financial year (2015: € 149k).
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 interest swap hedging classified as effective, the floating-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 2.27 percent. For the floating-rate tranches, this corresponds to an annual interest payment of € 1,986k through to initial maturity in 2019 and subsequently of € 250k through to maturity in 2021.
Furthermore, QSC had committed credit lines from a syndicated loan agreement newly concluded on 11 March 2016. The borrowers here are QSC, Ventelo and Plusnet. This revolving credit facility has an amount of € 70,000k and a term running until 11 March 2021. No amounts had been drawn down from this facility as of 31 December 2016. The current interest rate amounts to Euribor plus a margin. This margin may change depending on the Company's financial and earnings position.
The loan agreements serve to finance the Company's general working capital. 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 EBITDA and in the Company's debt servicing capacity. The agreed financial covenants were complied with in the 2016 financial year.
Loan liabilities are secured by a mortgage lien of € 23,000k on land in Hamburg. Additional security has also been provided to the lending bank in the form of a storage assignment of assets. Further loan liabilities on the level of QSC are secured by a mortgage lien of € 2,300k on a plant site. In addition, all entitlements to receive rent and lease income under the general subcontractor agreement with a customer have also been assigned as security.
Long-term liabilities under financing arrangements comprise an annuity loan used to finance buildings and data centres. Long-term liabilities under financing arrangements consist of fixed payment obligations for the period from 2017 to 2019.

31 PENSION PROVISIONS

QSC operates defined benefit pension plans, which are partially secured through reinsurance and classified as plan assets in accordance with IAS 19.
Pension provisions cover the obligations resulting from pension commitments made to one member of the Supervisory Board during his previous activity as a member of QSC's Management Board and to two former Management Board members at the former INFO AG, as well as obligations resulting from pension commitments made to parts of QSC's and Ventelo's workforces 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 pensionable salary. These defined benefit plans expose QSC 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. QSC recognises all actuarial gains and losses directly through OCI. In the 2016, the accumulated actuarial gains and losses of € 1,923k were recognised in OCI (2015:€ 1,420k). Total actuarial gains/losses after taxes came to € -503k in the 2016 financial year (2015: € 170k).

€ 000s	**2016**	**2015**
Present value of defined benefit obligation at 1 January	**8,044**	**8,439**
Service cost	-	6
Interest cost	165	140
Actuarial losses (gains)	722	(288)
Due to changes in demographic assumptions	-	-
Due to changes in financial assumptions	737	(310)
Due to experience adjustments	(15)	22
Benefits paid	(258)	(252)
Present value of defined benefit obligation at 31 December	**8,674**	**8,044**
Fair value of plan assets at 1 January	**(1,352)**	**(1,158)**
Interest income	(31)	(26)
Income from plan assets excluding amounts included		
in net interest income and expenses	23	37
Payment from fund assets	-	-
Transfers	20	-
Amounts paid out	1	-
Employer contribution to plan assets	(203)	(204)
Fair value of plan assets at 31 December	**(1,541)**	**(1,351)**
Accrued pensions at 31 December	**7,133**	**6,693**
Discount factor	1.51%	2.09%
Rate of compensation increase	2.00%	2.00%
Pension indexation	2.00%	2.00%

Actuarial gains and losses are recognised in OCI, as is income from plan assets (excluding amounts reported in net interest expenses). The income and expenses recognised in the income statement for defined benefit plans are structured as follows:

€ 000s	2016	2015
Pension costs		
Service costs	-	6
Interest costs	165	140
Expected return on plan assets	(31)	(26)
Pension costs	**136**	**120**

Pension payments of € 258k and funding contributions to plan assets of € 205k are expected in 2017. If the aforementioned assumptions used to measure pension obligations as of the balance sheet were to change by half a percent in each case, pension obligations would increase/decrease as follows:

€ 000s	Change in pension obligations	Pension obligations
Change in interest rate +0.5%	(652)	8,022
Change in interest rate -0.5%	736	9,410

As of 31 December 2016, the weighted average term of the defined benefit obligation came to 16.0 years (2015: 16.4 years).
Employer contributions to defined contribution plans amounted to € 6,872k in the 2016 financial year (2015: € 7,540k).

32 TRADE PAYABLES

All trade payables have terms of less than one year.

33 PROVISIONS

€ 000s	2016	2015
Long-term provisions at 1 January	**1,642**	**305**
Added	1,465	1,337
Utilised	(57)	-
Long-term provisions at 31 December	**3,050**	**1,642**

Long-term provisions comprise provisions of € 3,050k for dismantling obligations (2015: € 1,585k). The change is due to amended assessments concerning the volume of dismantling obligations. Dismantling obligations are typically incurred at the end of the rental period.

€ 000s	2016	2015
Other provisions at 1 January	**4,909**	**1,165**
Added	2,178	4,664
Utilised	(1,189)	(905)
Reversed	(1,745)	(15)
Other provisions at 31 December	**4,153**	**4,909**
Restructuring provisions at 1 January	**3,429**	**8,282**
Added	5,340	981
Utilised	(3,031)	(5,518)
Reversed	(322)	(316)
Restructuring provisions at 31 December	**5,416**	**3,429**
Provisions for onerous contracts at 1 January	**-**	**-**
Added	798	-
Utilised	-	-
Reversed	-	-
Provisions for onerous contracts at 31 December	**798**	**-**
Provisions for litigation risks at 1 January	**30**	**1,436**
Added	1,346	1
Utilised	(10)	(1,357)
Reversed	(9)	(50)
Provisions for litigation risks at 31 December	**1,357**	**30**

Other short-term provisions mainly involve dismantling obligations of € 3,192k added due to amended assessments (2015: € 1,303k) and customer refund claims of € 379k (2015: € 2,836k). The additions to restructuring provisions primarily relate to costs of € 4,008k for the termination of employment relationships.
The additions to provisions for onerous contracts relate to rented space for central offices that have been terminated and will no longer generate any revenues. The future payment obligations have been accounted for in the form of a provision.
The addition to litigation risks chiefly results from expected damages obligations.

€ 000s	2016	2015
Tax provisions at 1 January	**381**	**1,757**
Added	1,842	326
Utilised	(57)	(1,628)
Reversed	-	(74)
Tax provisions at 31 December	**2,166**	**381**

Tax provisions mainly include trade tax provisions of € 1,162k and corporate income tax provisions of € 464k.

34 DEFERRED INCOME

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

35 OTHER LONG-TERM FINANCIAL LIABILITIES

Other long-term financial liabilities amounted to € 2,525k as of 31 December 2016 (2015: € 3,879k). These chiefly relate to the negative fair value of derivative interest hedges (Note 30) at € 2,425k (2015: € 2,414k).

36 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 (€ 7,349k; 2015: € 5,448k), payroll and church tax liabilities (€ 1,553k; 2015: € 1,751k), land transfer tax liabilities (€ 1,032k; 2015: € 0k) and prepayments received (€ 800k; 2015: € 1,362k).

Notes to the Cash Flow Statement

The cash flow statement is divided into three sections: operating, investing and financing activities. The cash flow from operating activities has been calculated using the indirect method. The financial liabilities included in the cash flow from financing activities refer to all liabilities due to banks. Interest income is recognised in the cash flow from operating activities, while interest payments are accounted for in the cash flow from financing activities. Tax payments are reported in their full amount in the cash flow from operating activities, as it is not possible to allocate these items to individual segments.

37 CASH FLOW FROM OPERATING ACTIVITIES

The cash flow from operating activities came to € 40,291k in the 2016 financial year and thus showed a slight year-on-year increase of € 651k.
Provisions rose compared with the previous year, while trade payables decreased further. Together, these items more than offset the impact of lower trade receivables, income taxes paid and the reduction in earnings before taxes.

38 CASH FLOWS FROM INVESTING AND FINANCING ACTIVITIES

The cash flow from investing activities amounted to € -26,034k in the 2016 financial year (2015: € -27,395k). Of this sum € -19,525k related to the acquisition of property, plant and equipment (2015: € -18,367k) and € -6,561k to the acquisition of intangible assets (2015: € -9,055k).
The cash flow from financing activities totalled € -20,458k in the 2016 financial year (2015: € -26,066k). This outflow of funds mainly resulted from loan repayments of € -8,318k (2015: € 3,099k), interest paid of € -5,677k (2015: € -5,815k) and the dividend distribution of € -3,725k resolved by the Annual General Meeting (2015: € -12,416k).

Other Disclosures

39 SUBSIDIARIES

The consolidated financial statements include the following companies:

€ 000s	Shareholdings in %	Equity 31 Dec. 2016	Net income 2016
Subsidiaries			
(disclosures as per separate financial statements – HGB)			
Ventelo GmbH, Cologne, Germany	100.00	169,738	- [1]
Plusnet GmbH & Co. KG, Cologne, Germany	100.00	3,787	- [2,5]
Plusnet Verwaltungs GmbH, Cologne, Germany	100.00	26	1 [3]
BroadNet Deutschland GmbH, Cologne, Germany	100.00	3,681	88 [1,4]
IP Colocation GmbH, Cologne, Germany	100.00	2,304	249
Q-DSL home GmbH, Cologne, Germany	100.00	1,293	- [1]
010090 GmbH, Cologne, Germany	100.00	156	- [1]
T&Q Netzbetriebs GmbH & Co. KG, Cologne, Germany	100.00	25	105 [5]
T&Q Verwaltungs GmbH, Cologne, Germany	100.00	38	2 [6]
01012 Telecom GmbH, Cologne, Germany	100.00	27	- [1]
F&Q Netzbetriebs GmbH & Co. KG, Cologne, Germany	100.00	1	- [5]
Broadnet Services GmbH, Cologne, Germany	100.00	25	- [1]
01098 Telecom GmbH, Cologne, Germany	100.00	25	- [1]
010052 Telecom GmbH, Cologne, Germany	100.00	25	- [1]
010088 Telecom GmbH, Cologne, Germany	100.00	25	- [1]
01052 Communication GmbH, Cologne, Germany	100.00	25	- [1]
Q-loud GmbH, Cologne, Germany	100.00	1,245	(134)
tengo GmbH, Cologne, Germany	100.00	25	- [1]
tengo Vermögensverwaltungs GmbH, Cologne, Germany	100.00	25	- [1]
Broadnet NGN GmbH, Cologne, Germany	100.00	25	- [1]
F&Q Netzbetriebs Verwaltungs GmbH, Cologne, Germany	100.00	32	5 [7]
fonial GmbH, Cologne, Germany	74.90	(1,297)	(858)
FTAPI Software GmbH, Munich, Germany	50.93	(1,765)	1,049

[1] Profit transfer agreement with QSC AG – § 264 (3) HGB drawn on for this company.
[2] Shares held by Ventelo GmbH.
[3] Shares held by Plusnet GmbH & Co. KG.
[4] Profit transfer agreement not executed due to § 301 AktG.
[5] § 264b HGB drawn on for this company.
[6] Shares held by T&Q Netzbetriebs GmbH & Co. KG.
[7] Shares held by F&Q Netzbetriebs GmbH & Co. KG.

For all of its subsidiaries, the control exercised by QSC is attributable to its share of voting rights.

40 SEGMENT REPORTING

In accordance with the provisions of IFRS 8, the basis for identifying segments consists of the Company's internal organisational structure as used by corporate management for business administration decisions and performance assessments. This results in the following segments: Telecommunications, Outsourcing, Consulting and Cloud.

Cloud. QSC pools all activities relating to its Pure Enterprise Cloud and the Internet of Things (IoT) in its Cloud segment. The Pure Enterprise Cloud, which has been developed on an in-house basis since 2015, comprises a modular system of cloud technologies, software solutions and service components, as well as network and infrastructure services. Furthermore, the Cloud segment also includes the business activities pooled at QSC's Q-loud subsidiary. Q-loud offers companies a full-stack service enabling them to network appliances and implement digital business models in the Internet of Things. This end-to-end range of services includes transformation consulting, software and hardware competence, standard hardware, a proprietary IoT platform, security solutions and smart product manufacturing.

Outsourcing. This segment offers traditional outsourcing services to companies wishing to outsource their IT and data storage to QSC. As soon as cloud-based outsourcing services are provided, the respective revenues are allocated to the Cloud segment.

Consulting. QSC advises companies on how to optimise their business processes with two key focuses on SAP and Microsoft. As an SAP full-service provider, QSC performs services in the fields of basic operations, application management, implementation, user support and maintenance, as well as in managing the necessary software licenses. The Microsoft consulting services range from needs analysis to consulting, design and implementation services through to operations and ongoing optimisation measures.

Telecommunications (TK). Here, QSC offers a broad range of voice and data transmission solutions. These include asymmetric ADSL2+ lines, symmetric SDSL lines and premium internet access via wireless local loop. In this segment, QSC also offers All-IP telephony connections (Voice over IP) and corresponding telephony 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.

The segment contribution is the key segment performance indicator referred to by the management. This is defined as EBITDA before general administration expenses and other operating income and expenses. For income statement purposes, the cost of revenues is thus allocated in full to the respective segment, as are sales and marketing expenses. The direct and indirect allocation of costs to individual segments is consistent with internal reporting and management structures.

Indirect cost allocation is primarily based on resource utilisation by the respective segments.

The Management Board does not receive any regular information about segment-specific capital expenditure, assets and liabilities, general administration expenses, depreciation and amortisation and other operating income and expenses as components of the respective segment earnings figures.

€ 000s	Telecom-munications	Outsourcing	Consulting	Cloud	Group
2016 financial year					
Net revenues	**210,194**	**117,439**	**40,252**	**18,094**	**385,979**
Cost of revenues	(148,272)	(85,878)	(33,565)	(15,194)	(282,909)
Gross profit	**61,922**	**31,561**	**6,687**	**2,900**	**103,070**
Sales and marketing expenses	(19,202)	(7,222)	(1,474)	(5,068)	(32,966)
Segment contribution	**42,720**	**24,339**	**5,213**	**(2,168)**	**70,104**
General and administrative expenses					(31,823)
Depreciation and amortisation (including non-cash share-based compensation)					(50,157)
Other operating income and expenses					(1,224)
Operating earnings (EBIT)					**(13,100)**
Financial income					196
Financial expenses					(6,030)
Earnings before taxes					**(18,934)**
Taxes on income					(6,120)
Net income					**(25,054)**

€ 000s	Telecom-munications	Outsourcing	Consulting	Cloud	Group
2015 financial year					
Net revenues	**218,670**	**138,455**	**37,983**	**7,328**	**402,436**
Cost of revenues	(155,922)	(97,451)	(30,714)	(8,205)	(292,292)
Gross profit	**62,748**	**41,004**	**7,269**	**(877)**	**110,144**
Sales and marketing expenses	(17,727)	(10,907)	(1,657)	(4,568)	(34,859)
Segment contribution	**45,021**	**30,097**	**5,612**	**(5,445)**	**75,285**
General and administrative expenses					(32,136)
Depreciation and amortisation (including non-cash share-based compensation)					(53,317)
Other operating income and expenses					(971)
Operating earnings (EBIT)					**(11,139)**
Financial income					398
Financial expenses					(6,344)
Earnings before taxes					**(17,085)**
Taxes on income					3,842
Net income					**(13,243)**

Revenues include € 5,993k generated with non-German EU customers and € 1,243k with non-EU customers. All other revenues were generated in Germany.

41 STOCK OPTION PLANS

Since 1999, QSC has incepted a total of eight stock option plans providing for the issue of convertible bonds with a nominal amount of € 0.01 each to employees, Management Board members, advisors and suppliers. Convertible bonds are allocated by the Management Board, which requires the consent of the Supervisory Board for allocations to advisors and suppliers. The Supervisory Board alone decides on allocations to members of the Management Board of QSC AG.
Participants in these plans are entitled to subscribe convertible bonds in return for payment of the nominal amount of € 0.01 and to convert each convertible bond into a no-par registered share in return for payment of the exercise price.
The exercise price for the convertible bond corresponds to the stock market price of the share on the issue date. The convertible bonds have an eight-year term and are subject to a four-year lockup period following subscription.
As of the balance sheet date on 31 December 2016, the SOP 2006, SOP 2012 and SOP 2015 plans were active.
Convertible bonds outstanding within the SOP 2006 plan may only be converted until May 2019 at the latest. The conversion right provided for by the SOP 2006 plan may only be exercised if at least one of the following conditions is met: the stock market price of the share has outperformed the comparative TecDAX index in relative terms between subscription of the convertible bond and exercising of the conversion right or the stock market price of the share has risen by at least 10 percent between subscription of the convertible bond and exercising of the conversion right.
Convertible bonds allocated within the SOP 2012 and SOP 2015 plans may only be subscribed until 15 May 2017 and 26 May 2020 respectively at the latest. The convertible bonds have a maximum term of eight years from subscription. The conversion right provided for by these SOP plans may only be exercised at the earliest after the expiry of a 4-year waiting period and only if at least one of the following two conditions is met: the share price is at least 20 percent higher than the conversion price or the share has outperformed the TecDAX in relative terms since the subscription date.
No personnel expenses have been recognised pursuant to IFRS 2 for the convertible bonds resulting from the 2000, 2000A, 2001 and 2002 SOP plans, none of which is now utilisable.
No option values had to be calculated in the 2015 financial year for the SOP 2006 plan.
The option values for the convertible bonds issued in the SOP 2012 and SOP 2015 plans were determined using the Black-Scholes option pricing model.

The following assumptions were referred to for the SOP 2012:

	2016	2015
SOP 2012		
Expected average term of the SOP 2012	8 years	8 years
Average risk-free interest rate	-0.25%	0.28%
Volatility (1 year)	41.43%	50.06%
Average fair value of options in €	0.81	0.95
Fair value of convertible bonds granted for the year in €	264,579	265,050

The average expected term for the SOP 2015 plan also amounts to 8 years. The risk-free interest rate for the measurements performed in the 2016 financial year ranged from 0.24 percent to -0.16 percent (2015: 0.30 percent), while volatility amounted to between 41.71 percent and 44.08 percent (2015: 51.40 percent). The average option value came to € 0.54 (2015: € 0.92) while the convertible bonds granted in the SOP 2015 plan were valued at a total amount of € 217,238 (2015: € 92,041).
Volatility was determined on the basis of daily closing prices over a historical period of twelve months. The distribution of the convertible bonds outstanding under all plans as of 31 December 2015 and 31 December 2016 is as follows:

	Number of convertible bonds	Weighted average exercise price in €
Outstanding at 31 December 2014	**2,514,712**	**2.72**
Granted in 2015	379,000	1.80
Lapsed in 2015	(214,000)	3.34
Exercised in 2015	-	-
Outstanding at 31 December 2015	**2,679,712**	**2.54**
Granted in 2016	727,000	1.49
Lapsed in 2016	(189,183)	2.60
Exercised in 2016	(10,000)	1.98
Outstanding at 31 December 2016	**3,207,529**	**2.30**

In the 2016 financial year, convertible bonds were only subscribed from the 2012 and 2015 stock option plans.

The exercise prices of the remaining 3,207,529 convertible bonds outstanding range from € 1.10 to € 4.59, while the remaining term for exercising them ranges from directly exercisable through to 25 August 2023 at the latest. The exercise price is set upon subscription and cannot be changed subsequently.
Depending on the development in its share price, the Company expects the outstanding convertible bonds to be converted at the latest by 2023.
As of the balance sheet date, 492,029 of the outstanding convertible bonds were directly exercisable (2015: 636,812). The remaining convertible bonds were subject to the agreed lockup periods.
In the financial year under report, expenses of € 508k were incurred for non-cash share-based compensation (2015: € 630k).

42 RELATED PARTY TRANSACTIONS

Compensation of members of the management in key positions. Compensation of members of the management in key positions includes salaries, expense reimbursements, settlements, benefits in kind and expenses incurred for pension commitments and stock option plans.

€ 000s	2016	2015
Compensation of management members		
Short-term benefits	2,022	1,410
Post-employment benefits	-	-
Other long-term benefits	550	327
Termination benefits	-	421
Share-based compensation	106	186
Compensation of management members	**2,678**	**2,344**

Transactions with members of the management in key positions. Members of the Company's Management Board hold voting rights for 440,000 shares. Supervisory Board members have a total of 31,107,394 shares, corresponding to around 25.05 percent of voting rights.
As the top-most group company, QSC AG prepares the consolidated financial statements of the eponymous consolidated group. Due to a voting right pooling agreement and accounting for the average majorities present at annual general meetings, QSC AG is dependent pursuant to § 17 of the German Stock Corporation Act (AktG) on Dr. Schlobohm and Gerd Eickers and on Gerd Eickers Vermögensverwaltungs GmbH & Co. KG.

In 2016, QSC maintained business relations with companies in which members of its own Management and Supervisory Boards act as shareholders. IAS 24 states that individuals or companies constitute related parties when one of the parties has the possibility of controlling or exercising significant influence over the other party. All contracts with these companies require Supervisory Board approval and are concluded on customary market terms.

€ 000s	Net revenues	Expenses	Payments received	Payments made
2016 financial year				
IN-telegence GmbH	422	170	498	203
Teleport Köln GmbH	25	1	32	1
QS Communication Verwaltungs Service GmbH	-	170	-	169
2015 financial year				
IN-telegence GmbH	551	159	659	204
Teleport Köln GmbH	33	3	41	4
QS Communication Verwaltungs Service GmbH	-	153	-	182

€ 000s	Receivables	Payables
31 December 2016		
IN-telegence GmbH	73	-
Teleport Köln GmbH	4	-
QS Communication Verwaltungs Service GmbH	-	31
31 December 2015		
IN-telegence GmbH	69	-
Teleport Köln GmbH	6	-
QS Communication Verwaltungs Service GmbH	-	-

IN-telegence GmbH is a provider of value added services in the telecommunications industry. QSC draws on carrier services from the company and itself provides the company with network services.

The business activities at Teleport Köln GmbH involve managing telecommunications services, managed services and outsourcing services. This company draws on QSC's telecommunications services and itself provides QSC with a low volume of telecommunications services.
QS Communication Verwaltungs Service GmbH advises QSC in the development of concepts and software for cloud-based services. The expenses incurred relate to advisory services.

43 DEFERRED AND CURRENT TAXES

QSC used an aggregate tax rate of 32.32 percent (2015: 32.30 percent) to calculate deferred taxes. The deferred tax expenses and income for the period and the allocation of temporary differences are presented below:

€ 000s	Assets	Liabilities	Assets	Liabilities	Consolidated income statement	
	2016	2016	2015	2015	2016	2015
Deferred tax assets and liabilities						
Intangible assets	859	7,996	123	10,285	3,024	4,961
Property, plant and equipment	2,119	1,920	3,378	2,866	(313)	1,342
Other assets	448	-	382	-	66	72
Other receivables	2,896	494	2,372	1,480	1,510	6,247
Inventories	74	-	272	-	(198)	(455)
Deferred income	6	358	171	170	(354)	(543)
Accrued pensions and other provisions						
Change in market price of derivatives	1,162	-	944	34	11	(1,695)
Other liabilities	784	-	780	-	6	1
Total deferred taxes on	205	4,201	451	4,244	(203)	(4,853)
temporary differences	**8,553**	**14,970**	**8,872**	**19,079**	**3,550**	**5,076**
Total deferred taxes						
on loss carryovers	**11,568**	**-**	**19,673**	**-**	**(8,105)**	**(995)**
Total deferred taxes						
before netting	**20,121**	**14,970**	**28,546**	**19,079**		
Netting	14,195	14,195	17,875	17,875		
Total deferred taxes	**5,926**	**775**	**10,671**	**1,204**		

The temporary differences in conjunction with interests in subsidiaries for which no deferred tax liabilities are recognised amounted to € 5,926k in the 2016 financial year (2015: € 22,230k). The following table presents the reconciliation of the expected income tax expenses to the actual income tax expenses. The expected income tax expenses are calculated by multiplying earnings before taxes with the assumed tax rate.

€ 000s	**2016**	**2015**
Reconciliation		
Earnings before taxes	**(18,934)**	**(17,085)***
Tax rate	32.32%	32.30%
Expected tax expenses	(6,119)	(5,518)
Tax effects of		
Changes in allowances on deferred taxes recognised for loss carryovers	6,739	1,034
Changes in permanent differences	3,433	-
Non-deductible operating expenses in connection		
with investments in corporations	1,202	-
Non-deductible operating expenses	713	768
Tax-exempt income	(196)	-
Non-period income (expenses)	322	(292)
Changes in tax rates	(21)	8
Other items	47	158
Reconciled tax expenses	**6,120**	**(3,842)**

* Adjusted.

Reconciled tax expenses consist of € 1,565k for current income tax expenses (of which: € 322k for current expenses relating to previous years) and € 4,555k for deferred tax expenses (2015: deferred tax income of € 4,081k). Tax income of € 239k was recognised directly in equity in the 2016 financial year in connection with actuarial gains and losses and the fair value measurement of cash flow hedges (2015: tax expenses of € 33k).
As of 31 December 2016, corporate income tax loss carryovers at QSC AG came to € 374 million (2015: € 378 million), while trade tax loss carryovers totalled € 362 million (2015: € 368 million).
As of 31 December 2016, corporate income tax loss carryovers at FTAPI Software GmbH totalled € 3.8 million (2015: € 4.8 million), while trade tax loss carryovers also came to € 3.8 million (2015: € 4.8 million).

These tax losses can basically be offset to an unlimited extent against future taxable income at the companies at which deferred tax assets totalling € 11.6 million (QSC AG: € 11.5 million; FTAPI Software GmbH: € 0.1 million) have been recognised on loss carryovers (2015: QSC AG: € 18.1 million; FTAPI Software GmbH: € 1.6 million). In recognising and measuring deferred tax assets on loss carryovers, it is assumed that tax loss carryovers totalling € 33.8 million (QSC AG: € 33.6 million; FTAPI Software GmbH: € 0.2 million) can be used in the medium term (2015: QSC AG: € 53.3 million; FTAPI Software GmbH: € 4.8 million).
For trade tax purposes, it is assumed that trade tax loss carryovers totalling € 37.6 million (QSC AG: € 37.4 million; FTAPI Software GmbH: € 0.2 million) can be used in the medium term (2015: QSC AG: € 58.7 million; FTAPI Software GmbH: € 4.8 million).
The Company's long-term planning provides for the sustainable generation of taxable income. Given historical developments and the planning uncertainties resulting from the transformation process at the group of companies, however, only that portion of taxable income expected in a foreseeable period of three years has been accounted for (2015: three years). No deferred tax assets have been recognised in the balance sheet for remaining corporate income tax and trade tax loss carryovers not yet used.

44 LEGAL DISPUTES

Neither QSC AG nor its group companies are involved in any court or arbitration proceedings that could materially impact on their economic position.

45 LEASES, ORDER OBLIGATIONS AND OTHER FINANCIAL OBLIGATIONS

Obligations under operating leases. The companies included in consolidation are 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	2016	2015
Operating lease arrangements		
Up to 1 year	30,071	26,298
1 to 5 years	28,359	43,730
Over 5 years	-	130
Operating lease arrangements	**58,430**	**70,159**

In the 2016 financial year, QSC recognised expenses of € 26,588k for operating leases (2015: € 26,587k). These have been reported under cost of revenues.

Obligations under financing and hire purchase arrangements. QSC has entered into financing and hire purchase arrangements and finance leases as lessor for various items of technical equipment and plant and operating equipment. Future payment obligations under these arrangements can be reconciled to their present values as follows:

€ 000s	2016	2015
Financing and hire-purchase arrangements		
Up to 1 year	1,377	2,821
1 to 5 years	382	1,758
Over 5 years	-	-
Total payment obligations	**1,759**	**4,579**
Less interest component	(37)	(132)
Present value of payment obligations	**1,722**	**4,447**

These obligations are presented in line with their maturities as short or long-term liabilities.

Rights under operating lease arrangements – QSC 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 Company will receive the following future minimum lease payments under non-cancellable operating lease arrangements:

€ 000s	2016	2015
Operating lease arrangements		
Up to 1 year	24,071	24,143
1 to 5 years	32,858	34,429
Over 5 years	5,978	8,358
Operating lease arrangements	**62,907**	**66,930**

To measure future minimum lease payments, all major customers were taken into account to whom services were already provided at the reporting date and from whom payments were contractually agreed at the balance sheet date. In 2016, € 29,176k (2015: € 27,543k) were recognised under revenues as rental payments.

Rights under finance lease arrangements – QSC as lessor. Pursuant to IFRIC 4 requirements, QSC is also deemed to be the lessor in specific multiple element arrangements. Future minimum lease payments from customers under finance lease arrangements can be reconciled to their net present value as follows:

€ 000s	2017	2018 – 2021	from 2022	Total
Future minimum lease payments				
Lease payments	3,948	2,451	-	6,399
Discounted amounts	(34)	(16)	-	(50)
Present values	**3,914**	**2,435**	**-**	**6,349**

Lease payments received in 2016 totalled € 5,129k (2015: € 5,956k).

Other financial obligations. Other financial obligations amount to € 14,729k (2015: € 17,090k). This total comprises obligations of € 11,626k due in 2017 and obligations of € 3,103k due in the years 2018 to 2020. Purchase commitments for future investments amounted to € 2,070k in the past financial year (2015: € 739k) and mainly involved purchase orders for property, plant and equipment.

46 OBJECTIVES AND METHODS USED IN FINANCIAL RISK MANAGEMENT AND CAPITAL 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 with a comprehensive risk management system, which is an integral component 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 lays down the principles of the Company's financial policies annually and monitors the risk management system. Further information about risk management can be found in the Group Management Report.

Financial liabilities mainly comprise financing and finance lease arrangements, trade payables and liabilities due to banks.

The main purpose of these financial liabilities is to finance the Company's operating activities. Financial assets directly resulting from business activities relate in particular to trade receivables and cash and cash equivalents. No derivatives were traded in the 2016 financial year.

The main risks to which QSC is exposed due to its use of financial instruments include interest rate risk, credit risk and liquidity risks. Since no material transactions are executed in foreign currencies, there are no material foreign currency risks. There were no material risk clusters in the past financial year. The strategies and procedures used to manage these risks are presented below.

Market interest risk. QSC is exposed to the risk of changes in market interest rates. This risk primarily results from the Company's floating-interest short-term liabilities due to banks, as well as from floating-interest liquidity. Short and long-term liabilities under financing arrangements and finance leases, on the other hand, have fixed interest rates. As of 31 December 2016, floating-rate financial liabilities accounted for 57.9 percent of total financial liabilities.

The promissory note loan taken up in the second quarter of 2014 with a total volume now amounting to € 145,000k (an amount of € 5,000k was repaid in 2016) comprises five tranches with terms of 5 and 7 years and is subject to floating (€ 87,500k in three tranches) and fixed (€ 57,500k in two 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 floating interest rates to be fully hedged throughout the respective term with regard to interest rate risk. Accounting for the hedge, QSC thus de facto pays fixed interest of 2.27 percent on those tranches of the promissory note loan with floating 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 base points would change the fair value of the hedging instruments by € 403k and € -4,533k respectively. In the statement of comprehensive income, this would impact on the volume of income offset against equity and thus on shareholders' equity.

The following table presents the sensitivity of consolidated earnings before taxes to any reasonably possible change in interest rates in respect of floating-rate liquidity as of 31 December 2016:

	Increase/decrease in base points	Impact on earnings before taxes € 000s
2016	+ 100	542
2016	- 100	(10)
2015	+ 100	200
2015	- 100	(154)

Credit risk. QSC is exposed to the risk of payment defaults on the part of customers and issuers. The Company makes efforts to ensure that it only enters into business dealings with creditworthy customers and thus attempts to exclude this risk from the outset. To this end, creditworthiness checks are performed before the respective contract is concluded. Once business relations have been initiated, receivable balances are monitored to reduce potential default risks. Maximum default risks are limited to the carrying amounts of the receivables disclosed in Note 21. QSC expects non-impaired receivables to be collectible.

Liquidity risk. QSC monitors its risk of a liquidity shortfall with monthly liquidity planning. This accounts for the remaining terms of available financial assets and the expected future cash flows from operating activities. The Company aims to maintain a balance between ensuring permanent availability of liquidity and safeguarding its flexibility by drawing on short and long-term liabilities and 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; Note 30), QSC has to pay de facto fixed interest of € 3,477k per annum for the periods through to 2019 and € 981k per annum 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 2016, short-term and long-term financial liabilities had the following maturities. These disclosures are based on the expected undiscounted payments.

€ 000s	Carrying amount	Due by end of 2017	Due by end of 2018	Due by end of 2019	Due by end of 2020	Due by end of 2021	Due after 2021	Total
Liabilities under financing arrangements	1,722	1,377	306	76	-	-	-	1,758
Trade payables	24,890	24,890	-	-	-	-	-	24,890
Liabilities due to banks	149,415	6,393	3,770	112,052	982	35,367	-	158,564
Interest swaps*	2,425	-	-	-	-	-	-	-
Other short-term and long-term liabilities	1,994	1,867	100	10	8	-	9	1,994
At 31 December 2016	**180,446**	**34,527**	**4,175**	**112,138**	**990**	**35,367**	**9**	**187,206**

€ 000s	Carrying amount	Due by end of 2016	Due by end of 2017	Due by end of 2018	Due by end of 2019	Due by end of 2020	Due after 2020	Total
Liabilities under financing arrangements	4,483	2,821	1,377	306	76	76	-	4,655
Trade payables	30,596	30,596	-	-	-	-	-	30,596
Liabilities due to banks	157,970	5,980	7,699	3,884	117,125	981	35,381	171,051
Interest swaps*	2,414	-	-	-	-	-	-	-
Liabilities for phantom stock, put option	1,095	-	-	-	1,283	-	-	1,283
Other short-term and long-term liabilities	2,147	1,756	377	-	10	8	3	2,154
At 31 December 2015	**198,705**	**41,154**	**9,453**	**4,190**	**118,494**	**1,065**	**35,384**	**209,740**

* As well as the corresponding balance sheet line items, "Liabilities due to banks" also includes 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 by reference to the following key figures: equity ratio and net liquidity. The equity ratio is calculated by dividing equity by total assets. Net liquidity corresponds to interest-bearing liabilities less cash and cash equivalents (excluding cash and cash equivalents at the disposal group).

€ 000s	2016	2015
Capital management		
Liabilities under financing and finance lease arrangements	(1,722)	(4,483)
Liabilities due to banks	(149,415)	(157,970)
Interest-bearing liabilities	**(151,137)**	**(162,453)**
Plus cash and cash equivalents	67,336	73,982
Net liquidity	**(83,801)**	**(88,471)**
Shareholders' equity	86,348	113,772
Total assets	306,003	348,102
Equity ratio	**28%**	**33%**

47 FINANCIAL INSTRUMENTS

Disclosures on the balance sheet. Given that the carrying amounts largely correspond to fair values, no separate disclosures have been made on the respective fair values.

€ 000s	Carrying amount	IFRS 7.8 category		
31 December 2016		Loans and receivables	Fair value – hedging instruments	Other financial liabilities
Assets not measured at fair value				
Cash and cash equivalents	67,336	x		
Long-term trade receivables	2,435	x		
Short-term trade receivables	45,816	x		
Liabilities measured at fair value				
Interest swaps – hedge accounting	2,425		x	
Liabilities not measured at fair value				
Trade payables	24,890			x
Liabilities due to banks	149,415			x
Liabilities for financing and finance lease arrangements	1,722			x
Other short-term and long-term liabilities	1,994			x

€ 000s	Carrying amount	IFRS 7.8 category			
31 December 2015		Loans and receivables	Fair value – hedging instruments	Other financial liabilities	Designated at Fair Value
Assets not measured at fair value					
Cash and cash equivalents	73,982	x			
Long-term trade receivables	4,583	x			
Short-term trade receivables	48,704	x			
Liabilities measured at fair value					
Interest swaps – hedge accounting	2,414		x		
Minority shareholder put options	1,095				x
Liabilities not measured at fair value					
Trade payables	30,596			x	
Liabilities due to banks	157,970			x	
Liabilities for financing and finance lease arrangements	4,483			x	
Other short-term and long-term liabilities	2,147			x	

Fair value disclosures for instruments with recurring measurement. At the end of each reporting period, QSC AG ascertains whether any reclassifications are required between the levels of the measurement hierarchy. No reclassifications were made in the reporting period from 1 January 2016 to 31 December 2016.

Class	Measurement hierarchy level	Fair value in € 000s at 31 Dec. 2016	Description of measurement method
Interest swaps – hedge accounting	2	2,425	The fair value of interest derivatives is determined on the basis of present value models including market information (interest structure curves). The fair value measurement of interest swaps was performed by the intermediary bank; the fair value is derived either from the mid-market price or, if expressed as a bid and ask price, from the indicative price at which the bank would have bought back and sold the financial instrument at the close of business on the relevant marketplace on the respective measurement date.

Disclosures on the consolidated income statement. The following interest income and expenses and the following net gains and losses on financial instruments are included in the consolidated income statement.

€ 000s	Interest incom/interest expenses	Impairments	Payments received on retired receivables	Net result 2016
Loans and Receivables (LaR)	147	37	30	67
Financial Liabilities measured at Amortised Cost (FLAC)	(4,234)	-	-	-

€ 000s	Interest incom/interest expenses	Impairments	Payments received on retired receivables	Net result 2015
Loans and Receivables (LaR)	362	919	204	1,123
Financial Liabilities measured at Amortised Cost (FLAC)	(5,197)	-	-	-

48 DECLARATION PURSUANT TO § 161 AKTG REGARDING CONFORMITY WITH THE GERMAN CORPORATE GOVERNANCE CODE

The declaration pursuant to § 161 of the German Stock Corporation Act (AktG) regarding QSC's conformity with the German Corporate Governance Code in the version dated 5 May 2015 has been issued by the Management and Supervisory Boards and is permanently and publicly available to the shareholders on the Company's website. Future amendments to the rules relevant for conformity with the German Corporate Governance Code will be posted on the QSC website without delay. Further information is provided in the separate Corporate Governance and Compensation Report.

49 AUDITOR'S FEES

At the Annual General Meeting on 25 May 2016, the shareholders of QSC AG appointed KPMG AG Wirtschaftsprüfungsgesellschaft, headquartered in Berlin and with a branch in Cologne, as auditor and group auditor of QSC AG for the 2016 financial year.
The following fees have been recognised as expenses for services provided by the auditor for the 2016 financial year.

€ 000s	2016	2015
Auditor's fees		
Audit of financial statements (of which for previous years)	494 (150)	473 (96)
Other certification services	10	34
Tax advisory services	45	-
Other services	24	20
Auditor's fees	**573**	**527**

Audit fees comprise the fees charged by KPMG for auditing the consolidated financial statements and the annual financial statements of QSC AG and its subsidiaries and for its activities in connection with an audit by the German Financial Reporting Enforcement Panel (DPR). Other certification services mainly involve a business management certification. Other services relate to audit-related advisory services.

50 COMPENSATION OF THE MANAGEMENT AND SUPERVISORY BOARDS

Total Management Board compensation for the 2016 financial year came to € 1,973k, as against € 1,182k in the previous year. This comprises fixed compensation of € 1,100k (2015: € 721k), ancillary benefits of € 138k (2015: € 93k), variable compensation of € 518k (2015: € 276k) and share-based compensation of € 217k (2015: € 92k).
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 and about payments committed to active Management Board members in the event of the premature termination of their activities.
Compensation of former Management Board members came to € 0k in the 2016 financial year (2015: € 421k).
The following table presents individualised information about the number of shares and convertible bonds held by members of the Management Board:

	Shares		Convertible bonds	
	31 Dec. 2016	31 Dec. 2015	31 Dec. 2016	31 Dec. 2015
Jürgen Hermann	400,000	340,000	350,000	350,000
Stefan A. Baustert	40,000	40,000	200,000	100,000
Udo Faulhaber (since 1 August 2015)	-	-	150,000	-
Felix Höger (since 1 January 2016)	-	-	150,000	-
Henning Reinecke (until 30 April 2015)	-	5,000[1]	-	150,000[1]

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

Jürgen Hermann purchased shares in the Company via the stock exchange in the 2016 calendar year and thus while he was an active member of the Management Board (please also see the corresponding directors' dealings notifications made pursuant to § 15a of the German Securities Trading Act [WpHG]).
Furthermore, the Management Board members Stefan A. Baustert, Udo Faulhaber and Felix Höger subscribed convertible bonds in QSC AG. These had been allocated to them by the Supervisory Board on 20 August 2015 within the 2015 Stock Option Plan.

The following table summarises the convertible bonds granted to Management Board members in the 2016 financial year:

	Convertible bonds			
	Date	Number	Conversion price	Fair value per bond on grant date
Stefan A. Baustert	15 Jan. 2016	100,000	1.42	0.67
Felix Höger	1 Apr. 2016	75,000	1.10	0.49
Udo Faulhaber	5 Apr. 2016	150,000	1.10	0.49
Felix Höger	6 Apr. 2016	75,000	1.21	0.55

The convertible bonds may only be converted into shares in QSC AG after a four-year waiting period, i.e. options subscribed for the 2016 financial year may be converted at the earliest in the 2020 financial year.
As in the previous year, the Supervisory Board received compensation totalling € 315k for its activity in the 2016 financial year. 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 and an overview of the shares and convertible bonds held by Supervisory Board members.
The actuarial present value of provisions for vested claims to pensions for former Management Board members amounts to € 1,980k prior to the offsetting of an asset value of € 1,282k for a reinsurance policy.

51 RISKS

Risks are presented in detail in the Risk Report within the Group Management Report.

52 PROPOSED APPROPRIATION OF PROFIT

The Management and Supervisory Boards have decided to propose to the Annual General Meeting that a dividend of € 0.03 per share be paid to shareholders.

53 DIRECTORS AND OFFICERS

Management Board. The members of the Management Board in the 2016 financial year were as follows:

Management Board member	
Jürgen Hermann	Chief Executive Officer
Stefan A. Baustert	Chief Financial Officer
Udo Faulhaber	Chief Sales and Consulting Officer
Felix Höger	Chief Technology and Operations Officer

Supervisory Board. The members of the Supervisory Board in the 2016 financial year were as follows:

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

The term in office of the Supervisory Board ends upon the conclusion of the Annual General Meeting approving the actions of the Company's directors and officers for the 2017 financial year.

Cologne, 15 March 2017

QSC AG
The Management Board

Jürgen Hermann
Chief Executive Officer

Stefan A. Baustert

Udo Faulhaber

Felix Höger

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, 15 March 2017

QSC AG
The Management Board

Jürgen Hermann
Chief Executive Officer

Stefan A. Baustert

Udo Faulhaber

Felix Höger

AUDITOR'S REPORT

We have audited the consolidated financial statements prepared by QSC AG, Cologne, comprising the consolidated statement of profit and loss, consolidated statement of comprehensive income, consolidated balance sheet, consolidated statement of changes in equity, consolidated statement of cash flows and the notes to the consolidated financial statements together with the group management report for the business year from 1 January 2016 to 31 December 2016. The preparation of the consolidated financial statements and the group management report in accordance with IFRSs, as adopted by the EU, and the additional requirements of German commercial law pursuant to § 315a Abs. 1 HGB [Handelsgesetzbuch „German Commercial Code"] (and supplementary provisions of the shareholder agreement/articles of incorporation) are the responsibility of the parent 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 [Handelsgesetzbuch „German Commercial Code"] and German generally accepted standards for the audit of financial statements promulgated by the Institut der Wirtschaftsprüfer [Institute of Public Auditors in Germany] (IDW). Those standards require that we plan and perform the audit such that misstatements materially affecting the presentation of the net assets, financial position and results of operations in the consolidated financial statements in accordance with the applicable financial reporting framework and in the group management report are detected with reasonable assurance. Knowledge of the business activities and the economic and legal environment of the Group and expectations as to possible misstatements are taken into account in the determination of audit procedures. The effectiveness of the accounting-related internal control system and the evidence supporting the disclosures in the consolidated financial statements and the group management report are examined primarily on a test basis within the framework of the audit. The audit includes assessing the annual financial statements of 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 group management report. We believe that our audit provides a reasonable basis for our opinion.
Our audit has not led to any reservations.
In our opinion, based on the findings of our audit, the consolidated financial statements comply with IFRSs, as adopted by the EU, the additional requirements of German commercial law pursuant to § 315a Abs. 1 HGB (and supplementary provisions of the shareholder agreement/articles of incorporation) 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, complies with the German statutory requirements, and as a whole provides a suitable view of the Group's position and suitably presents the opportunities and risks of future development.

Cologne, 15 March 2017

KPMG AG
Wirtschaftsprüfungsgesellschaft

Pütz	Klaaßen
Wirtschaftsprüfer	Wirtschaftsprüfer

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Our blog offers an informative overview of the latest topics and events in our sector. QSC's experts allow you to peek behind the scenes.
blog.qsc.de

Digitales Wirtschaftswunder
The German blog about digital transformation in the SME segment – with specialist contributions and expert opinions:
digitales-wirtschaftswunder.de

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