

Annual Report 2005



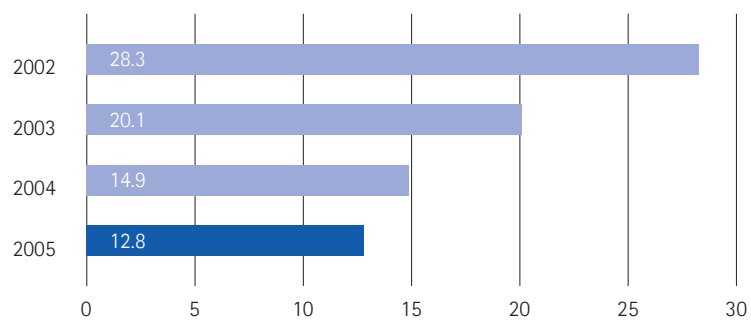
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At a Glance

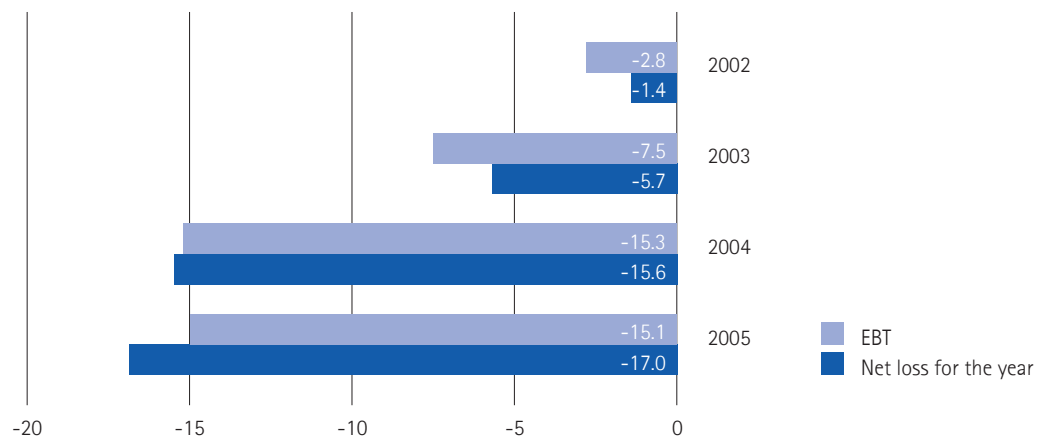
Pandatel Group	US GAAP	US GAAP	US GAAP	US GAAP	US GAAP	IFRS	IFRS
in €m	1999	2000	2001	2002	2003	2004	2005
Balance sheet							
Balance sheet total	47.7	58.3	57.4	50.5	45.1	34.0	18.6
Shareholders' equity	44.0	50.2	50.3	47.9	42.5	29.6	13.1
Cash and cash equivalents	32.7	25.5	18.1	24.8	22.4	9.9	5.1
Statement of income							
Revenues	23.5	36.5	30.6	28.3	20.1	14.9	12.8
Investments*	0.2	1.8	1.9	1.2	1.3	7.1	0.2
EBIT	7.6	10.4	3.0	-3.8	-8.2	-15.6	-15.3
Operating result	7.4	10.6	3.2	-2.4	-8.0	-15.3	-14.6
Earnings before taxes	7.7	11.6	4.4	-2.8	-7.5	-15.3	-15.1
Net income/loss for the year	3.5	5.6	2.3	-1.4	-5.7	-15.6	-17.0
Statement of cash flow							
Cash flow	4.0	7.1	3.3	0.1	-3.9	-12.4	-8.9
Other figures							
Earnings per share	0.59€	0.78€	0.32€	-0.19€	-0.78€	-2.06€	-2.15€
Payroll (average)	106	141	162	172	178	184	120
Equity ratio	92.2%	86.1%	87.7%	94.9%	94.3%	86.9%	70.3%
Closing price at year-end	65.50€	55.00€	7.95€	3.10€	4.70€	1.10€	0.83€

* without financial assets

Revenues in €m



Earnings in €m



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Preface by the Management Board

Ladies and Gentlemen,

Dear Shareholders,

In the summer of 2005 our Company, PANDATEL AG, found itself in a dramatic situation. With a steep drop in sales from a respectable €36.5 million in 2000 to only €14.9 million at the end of 2004 and a serious decline in the before-tax result (EBT) from plus €11.6 million in 2000 to minus €15.3 million in 2004, the Company seemed to be heading for disaster. Even the replacement of many of the Board members had done nothing to reverse this development. The main faults were an outdated product portfolio owing to the Company's failure in the past to develop new products, excessively high manufacturing costs at the Hamburg plant and insufficient adjustment of the Company's organizational structures which had been created originally to serve a much larger enterprise.

After drawing up an unvarnished report revealing the true state of the Company's finances and hence its position, the sole Director, Thomas Becker, was able in October 2005 to offer the Supervisory Board only two alternative scenarios: on the one hand, liquidation of the Company on the basis of a resolution to be passed by an extraordinary General Meeting of Shareholders at the end of 2005 to avoid the danger of insolvency at some time within the following twelve months or, on the other hand, rescue by a strategic investor with a convincing corporate strategy for PANDATEL AG. Only about five weeks remained to look for such an investor, said Becker, because if an extraordinary General Meeting of Shareholders was to be held by the end of the year 2005 it would have had to be convened by the second half of November at the latest.

After a negotiating marathon lasting from November 15 to 18, 2005, the Company's then main shareholder, AUGUSTA Technologie AG, and the Executive Board succeeded in reaching an agreement with Dr. Dan D. Yang, the chief partner of Dowslake Venture Ltd., which is PANDATEL AG's new major shareholder. On November 19, 2005 she took up the position of Chairman of the Company's Executive Board. She also acquired AUGUSTA AG's 49.98% share in two stages between then and the end of the year.

With the support of both the former and the newly elected Supervisory Boards, the Executive Board succeeded in a very short time in drawing up a strategy for the radical restructuring of PANDATEL AG and its merger with the US company Dowslake Microsystems Corp. and in putting it into effect without delay. The new concept is obviously so convincing that the German Federal Office for Financial Services Supervision (BaFin), in its notice of January 17, 2006 announcing its decision to waive the obligatory tender requirement, insisted on the immediate implementation of the restructuring program and the merger of Dowslake Microsystems Corp. into PANDATEL AG.

On March 27, 2006 we informed you, our Shareholders, of the decisions made by the newly elected Supervisory Board and the clear recommendations of the Executive Board and requested you to approve the urgently required restructuring measures at the forthcoming extraordinary General Meeting of Shareholders.

The conditions have thus now been laid down to ensure that the newly structured PANDATEL AG will develop profitably in the coming years.

In conclusion, here is some information on the development of the Company's sales and earnings in the business year 2005: Sales continued to decline, amounting to only €12.8 million and resulting in a loss of -€17.0 million. At December 31, 2005 PANDATEL AG had funds at its disposal amounting to €5.1 million. These figures again make it clear that, without the intervention of a strategic investor, the Company would have had no chance of survival.

Dear Shareholders, PANDATEL AG has asked a great deal of you in the past in the way of patience and understanding. Now, however, we are faced with the challenge of bringing the Company forward into a prosperous future. We wish to thank you all for the trust you have placed in us.

Dr. Dan D. Yang
CEO

Thomas Becker
CFO



Management Board



Dr. Dan D. Yang

Dr. Dan D. Yang graduated from University Paris-Orsay with a Doctorate degree in Optics and Photonics.

One of pioneers of intelligent optical networking, she was the founder of AFC Technologies in Ottawa Canada which was acquired by JDS Uniphase in 1999.

Holding nine United States patents on networking technology, she is also a renowned high tech entrepreneur in the Ottawa and Silicon Valley business communities.

In October 2000, she founded Dowlake Microsystems in the heart of Silicon Valley by putting in her own money.

Since then Dowlake Microsystems has emerged as a leading OEM partner to major communications system makers, thanks to her vision, dedication, strategic investment in China operations, seamless execution, and her total commitment to customer satisfaction. Dr Yang became CEO of PANDATEL AG on November 18, 2005.



Thomas Becker

Thomas Becker joined PANDATEL AG on August 25, 2005, initially as Chief Financial Officer. Between October 14, 2005, through November 18, 2005, he held the position of sole director of the company.

After studying business administration, he has served, for almost 30 years, as managing director and director in many well-known enterprises in the world of industry and economy as well as consultancy.

Based on his professional experience, he gained amongst others rich experience in the area of reorganization and restructuring.

Supervisory Board



Dr. Axel Pfeifer

Lawyer since 1991

Dr. Axel Pfeifer specializes in providing consultancy services to high-tech, venture capital and private equity companies. He also advises domestic and foreign companies and investors in the areas of mergers/acquisitions, changes in shareholder structure and the whole range of corporate and market law right up to the requirements for going public.

Another area of his expertise is the drawing up of contracts for international joint ventures and investment projects, including the financing of projects relating to industrial plant and infrastructure.

Besides passing both state qualifying examinations and gaining a doctorate in law on the subject of public corporations, Dr. Pfeifer also studied Anglo-American law and economics.

From 1991 to 1997 he was first a member and then the head of the legal departments of various international concerns operating in the areas of industrial plant construction, materials processing and trade. In 1992 he was a founding partner of a life sciences company financed by venture capital.



Steffen Leistner

Steffen Leistner is Vice President and Managing Director of Booz Allen Hamilton GmbH at their Berlin office. With offices in over 50 countries, Booz Allen Hamilton is one of the world's leading management and technology consultancies.

Dr. Leistner has been working for Booz Allen Hamilton since 1993. He is a member of the global Telecommunications and High-Tech Group and is mainly in charge of executing projects on behalf of leading European telecommunications firms and globally operating high-tech companies. His special area of expertise is in the areas of strategy and transformation.



Alex Fang

Since April 1994 Alex Fang has been Managing Director of CMT CHINA VALUE CAPITAL PARTNERS, a holding company concentrating on investment possibilities in China.

In 2001 he founded and took the position of Director of eGARDEN VENTURES LIMITED, a holding company concentrating on young start-ups in China and the USA.

From 1998 to 2000 he was head of the business development division of GET MANUFACTURING, INC., a global supplier of EMS (electronics management services) with offices in Hong Kong, China, Mexico and the United States.

From 1996 to 1997 he worked as Program Manager for the above corporation.

In 1996 he was Assistant to the CFO of GENERAL ELECTRONICS (HK) LTD., a versatile corporation listed on the Hong Kong stock exchange.

From 1994 to 1996 he worked as auditor for ERNST & YOUNG, Hong Kong.

He took an MBA degree in General Management at NORTHWESTERN UNIVERSITY, Kellogg School of Management, Evanston, Illinois, USA.

He also attended the UNIVERSITY OF SOUTHERN CALIFORNIA, Levanthal School of Accounting, Los Angeles, California, USA, taking a BSc degree in Auditing.

In June 1994 he completed his qualifications at the AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS.

The Year 2005 in Retrospect

January

Norbert Wienck, the former CEO, resigned from the Executive Board on January 19, 2006. The Board was therefore reduced to just two members, Dr.-Ing. Elke Jahn and Dr.-Ing. Niraj Agrawal.

The previous two establishments in Hamburg were merged into one at the Bargkoppelstieg address. By moving out of the Fasanenweg buildings, PANDATEL AG expected not only a saving in costs through a sub-let but also an increase in efficiency owing to the closer proximity of the staff to each other. The Company's operation in Israel was closed down.

February

A new product catalog was published with a considerably improved product portfolio.

March

Publication of the 2004 Annual Report at the end of March 2005 and holding of the balance sheet press conference and analysts' conference, both of which were poorly attended owing to a further decline in interest resulting from bad business results.

PANDATEL AG's participation in the CeBIT 2005 computer fair in Hanover provided plentiful evidence of the new direction embarked on by the Company. The sectors Connectivity Products, Access Multiplexers and WDM/Optical Systems were presented to the trade under the heading "Securing the Future" at stands covering an area of 60 sq.m. Selected products from the consolidated product portfolio and the primarily technical nature of the marketing approach clearly demonstrated PANDATEL AG's technical competence and the concentration of the Company's efforts, as a result of its consolidation, on the markets of the future IP/Ethernet, SDH/Sonet and Storage/Metro throughout all sectors of its business. The Company's presentation at the fair was designed both to provide a forum for new customer contacts and to pave the way for new projects, and this was understood and appreciated by the representatives of the trade who attended. PANDATEL AG managed to clarify its new strategy and to put its message over successfully. The Company's participation in the fair, which was planned entirely under the aspect of cost saving, confirmed the importance of the CeBIT as a platform for presenting PANDATEL AG and its products to potential new customers and interested parties, so that it can be assumed that the Company will be taking part again next year.

April

In connection with the takeover of Lightmaze Solutions AG, the Company's equity capital had been increased in the previous year to a total of €7,895,806 by the issue of 670,806 bearer shares at a nominal value of €1 per share. After the implementation of this capital increase had been recorded in the Commercial Register of the Hamburg Local Court in November 2004, the new shares were admitted for trading on the Frankfurt stock exchange (regular market Prime Standard) on April 8, 2005.

May

The Annual General Meeting on May 19, 2005, was attended by 76 shareholders wishing to learn on the spot about the many changes introduced in the 2004 financial year. The discussion of the individual agenda items among the shareholders took place in a frank and open atmosphere. The Executive and Supervisory Boards succeeded in explaining the measures taken for the restructuring of the Company. The shareholders approved all the agenda items with a majority of over 96% in each case. The full text of the speech given by the Executive Board representative and the list of agenda items discussed can be found on the Internet page www.pandatel.de.

Three-month report

Business in the first quarter of the financial year was restrained, as was only to be expected. Accordingly, both the turnover and the result for the quarter were slightly lower than in the previous year. In the first three months of 2005 PANDATEL AG's sales totalled €2.8 million as compared with €3.1 million in the same period of the previous year. This represents a drop of 7.3%. The restructuring measures had very little effect on the result. The EBIT was -€1.7 million as compared with -€2.7 million in the first quarter of 2004.

June

In June the Company came to an agreement with the former CEO Norbert Wienck concerning the terms of his departure from PANDATEL AG.

Half-year report

In the second quarter PANDATEL AG focussed its efforts to a greater extent on the introduction of its new products into the market. Turnover and result were still, however, below those of the previous year. Expressed in figures, the second quarter contributed a sum of €3.1 million to the total turnover of €5.9 million for the first half of 2005. In comparison with the same period of the previous year, this was a decrease of €1.5 million or 20%. At the cut-off date June 30, 2005, the EBIT was -€7.1 million (pr.y.: -€5.5 million), a decline of 29%.

On August 24, 2005, Thomas Becker was appointed by the Supervisory Board as CFO of the Company.

September

In the third quarter of 2005 PANDATEL AG successfully completed the due recertification of its quality management system in accordance with ISO 9001:2000. The Company is thus now in possession of a modern QM system that will serve it for some time into the future.

October

After the end of the quarter, with effect from October 14, 2005, Thomas Becker was appointed until further notice sole Director of PANDATEL AG with responsibility for the Company's operative management. Dr. Elke Jahn, formerly COO of PANDATEL AG, and Dr. Niraj Agrawal, formerly CTO of PANDATEL AG, resigned from the Executive Board with effect from October 13, 2005. Both had been members of the Company's Executive Board since July 2004.

Nine-month report

The weak business development of the previous half year continued in the third quarter of 2005, with further declining sales. The decrease in sales of existing products could be compensated for only in part by the marketing of new products. Turnover in the third quarter of the year was €2.9 million and in the first nine months, from January 1 to September 30, 2005, €8.9 million. Compared with the figure for the same period of the previous year (€11.1 million turnover) this represented a drop of €2.2 million. At September 30, 2005, the EBIT was -€10.6 million (pr.y.: -€8.2 million), corresponding to a decrease of 29%.

Dowlake Venture Ltd. joined PANDATEL AG as a major shareholder. The previous major shareholder, AUGUSTA Technologie AG, sold 29.0% of its shares in PANDATEL AG to Dowlake Venture Ltd. In view of PANDATEL AG's difficult financial situation, Dowlake Venture Ltd. intended to seek a release from the obligation to make a takeover bid if it acquired a total of 49.98% of the Company's equity capital. It submitted an application for such a release to the German Federal Office for Services Supervision, which was approved following the end of the year under review, on January 17, 2006.

The Supervisory Board also appointed Dr. Dan D. Yang as Chairman of the Executive Board and CEO of PANDATEL AG. She now manages the company together with Thomas Becker, CFO. Dr. Dan D. Yang is founder and CEO of the US networking specialists Dowlake Microsystems, Inc.

The Chairman of the Supervisory Board, Axel Haas, and the Supervisory Board member Prof. Dr. Uwe Hannig resigned from their positions on November 21, 2005. Two new Supervisory Board members were appointed on January 24, 2006, by the Hamburg Local Court to serve for the period until the next Annual General Meeting.

December

At the end of December Dowlake Venture Ltd. purchased the remaining 20.98% of PANDATEL AG'S equity capital previously held by AUGUSTA Technologie AG. With this step, Dowlake Venture Ltd. completed its exercise of the option agreed upon on November 18, 2005, and AUGUSTA Technologie AG relinquished its participation in PANDATEL AG. This transaction has paved the way for the restructuring and reorientation of the Company already set in motion in November 2005.

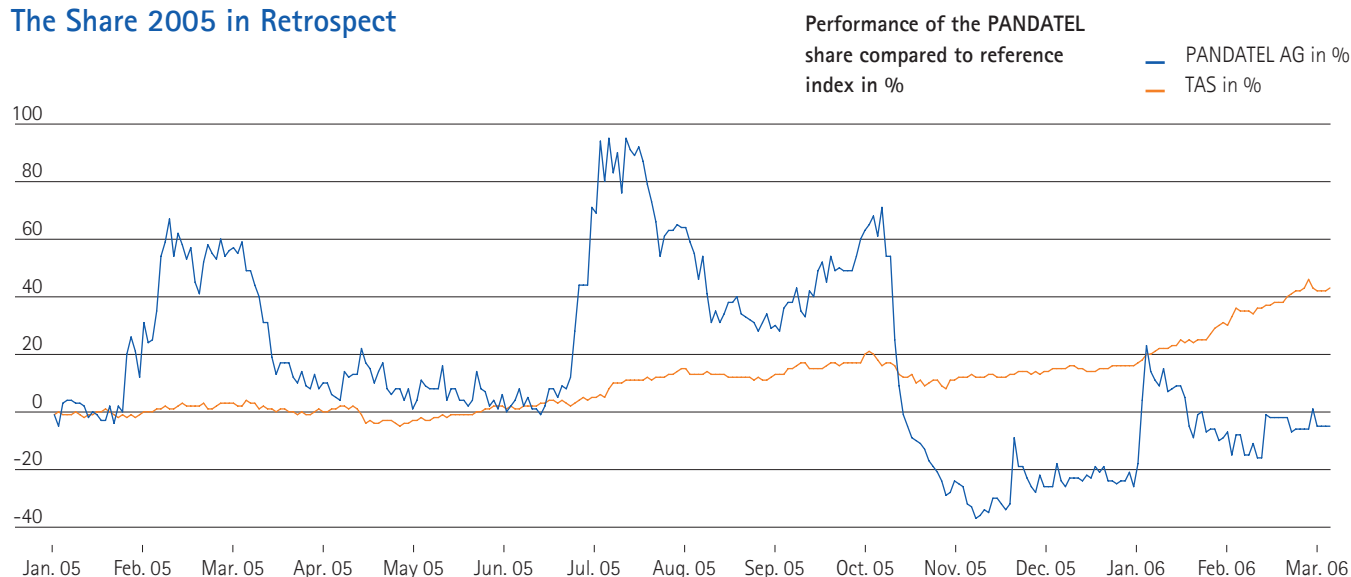
PANDATEL AG reached an agreement with its worker's council and announced a detailed plan for restructuring including a social plan.

As part of the restructuring plan, PANDATEL AG will consolidate its German operations from 3 locations to 1 in order to decrease operating cost. Upon shareholder approval, PANDATEL AG will move its headquarters from Hamburg to Hanover, in 2006, where PANDATEL AG has already its main team of engineers focused on Ethernet products. The current headquarters in Hamburg will be shutdown and key engineers will be offered to work in Hanover to be part of the R&D team. PANDATEL AG's current Lightmaze division in Eisingen (Würzburg) will also be shutdown and key engineers transferred to Hanover as well to continue the development and support of its YUMIX optical networking products.

Upon the completion of the restructuring, total number of PANDATEL AG employees in Germany will decrease from current 100 people to about 30. The layoff affects especially the production, as well as sales and administration. The new PANDATEL AG R&D team will focus its efforts on developing next generation of Ethernet and optical products while some development activities as well as manufacturing will be outsourced to Dowslake Microsystems. PANDATEL AG and Dowslake are currently working on a merger plan as they have announced on November 21, 2005.

Other details of restructuring plan include product consolidation and new management team. Currently, PANDATEL AG has more than thousands of product or variants to be produced, with a large number of them selling at extremely low volume. After restructuring, PANDATEL AG will consolidate to 3 product categories – Optical Networking, Ethernet & Multi-service Over SDH/SONET, and Last Mile/TDM Access. Products will be migrated to circuit platforms to decrease manufacturing burden and to improve cost as well as delivery. Total number of product platforms will be decreased to less than 40.

The Share 2005 in Retrospect



The stock markets

2005 was a very good year for stocks: above all the German and European indices made a strong comeback. The EuroStoxx rose by approx. 21% and the German stock index DAX by over 27%. The DAX received several boosts from political developments in Germany. Following the ousting of the SPD from the state parliament in North Rhine Westphalia, the announcement of a new general election was received very positively by the German financial market. The then unexpected result of this general election in the fall did the markets no harm – on the contrary, they reacted to the formation of a "grand coalition" with Angela Merkel at its head with further share-price increases. As a result, the DAX closed the year 2005 at 5,408.26. The TecDAX, too, developed very well in 2005, rising by just under 15% and closing on December 30, 2005 at 596.47.

The picture in the US markets was less rosy. The Dow Jones fell slightly, ending the year just below its starting level. This was certainly due in part to the Fed's repeated prime rate increases.

The PANDATEL share

In the 2005 financial year the PANDATEL AG share price was exceedingly volatile; over the year as a whole, thus, the share closed at €0.83 constituting a decline of 25%. Its high for the year was reached on July 8 at €2.16 and its low on November 8 at €0.70. In mid-November, following the announcement that Dowlake Venture Ltd. would be acquiring a major share in PANDATEL AG, the Company's share price recovered somewhat. It received another boost at the end of the year with the announcement of an agreement with the staff council and the publication of the restructuring plans. After the end of the period under review, the announcements that Dowlake had increased its shareholding to 49.98% and that Dr. Jozef Straus, the former CEO of JDS Uniphase, would be joining the Company's Supervisory Board, also gave rise to some price appreciation.

Analysts and investors

Only a few analysts showed any interest in 2005 in the development of the PANDATEL AG share. This was no doubt mainly attributable to the uncertainty of the Company's future.

The Share Key Data 2005

ISIN	DE 000 691 630 7
Number of shares	7,895,806
Closing price at year end 2004	€1.10
52-week high	€2.16
52-week low	€0.70
Closing price at year end 2005	€0.83
Market capitalization at year end	€6.6 m
Market capitalization of free float at year end	€2.9 m
Earnings per share	€-2.15
Shareholders' equity per share	€1.66

Corporate Governance

To ensure regular and open communication, PANDATEL AG is also implementing the recommendations and suggestions of the German Corporate Governance Codex. The code contains the regulations applicable in Germany for responsible leadership and for monitoring the company at the same time. The aim is to render these rules transparent for national and international investors and thereby strengthen confidence in the management of German companies. Most of the recommended rules have already been an integral part of corporate communications as practiced at PANDATEL AG for quite some time. Any deviations from these recommendations will most likely result from practical considerations based on circumstances within the Company, and will be explained in detail in the declaration of compliance. You can find a copy of the declaration published by the Executive and Supervisory Boards, including the exceptions, on the company's homepage www.pandatel.com and by clicking "Investor Relations".

The German Corporate Governance Codex recommends that the Executive and Supervisory Boards should include a report on corporate governance in the Company's Annual Report (3.10) and that this report should contain information on the emoluments paid to members of the Supervisory Board (5.4.7), on the purchase or sale of Company shares by members of the Boards or of the Company's management (6.6) and on share option programs or other incentive systems. PANDATEL AG has not so far produced such a corporate governance report, the information referred to above being included in the Notes to the Consolidated Financial Statements.

Declaration of compliance in accordance with Art. 161 of the Stock Corporation Act (AktG)

Declaration of conformity pursuant to Article 161 of the Stock Corporation Act (AktG) Declaration by the Executive Board and Supervisory Board of PANDATEL AG, Hamburg, on the recommendations of the "Government Commission on the German Corporate Governance Codex" in accordance with Art. 161 of the Stock Corporation Act (AktG)

According to the Executive Board and the Supervisory Board, PANDATEL AG complies with all recommendations of the "Government Commission on the German Corporate Government Codex" as amended on 21 July 2005 published by the Federal Ministry of Justice in the official part of the Federal Gazette ("Bundesanzeiger") on 2 June 2005 excluding the following:

Sub-paragraph 2.3.4

The German Corporate Government Codex recommends the company that it should make it possible for shareholders to follow the General Meeting using modern communication media (e.g. Internet).

At present, PANDATEL AG shareholders are not provided such media, for these measures are far too expensive given the company's present situation.

Sub-paragraph 3.8

The German Corporate Government Codex recommends to agree upon an appropriate deductible when taking out a Directors & Officers Insurance. The insurance policy taken out for the board members of PANDATEL AG does not provide for a deductible.

Sub-paragraph 4.2.3

The German Corporate Government Codex recommends that the overall compensation of the members of the Management Board shall comprise a fixed salary and variable components. Furthermore the German Corporate Government Codex recommends to include one-time and annually-payable components linked to the business performance as well as long-term incentives containing risk elements into the variable compensation.

Basically, the company complies with this recommendation. However, the salary of the present Management Board is an exception owing to the company's specific restructuring situation.

The German Corporate Government Codex recommends that, in particular, company stocks with a multi-year blocking period, stock options or comparable instruments (e.g. phantom stocks) serve as variable compensation components with long-term incentive effect and risk elements. Stock options and comparable instruments shall be related to demanding, relevant comparison parameters. Changing such performance targets or the comparison parameters retroactively shall be excluded. For extraordinary, unforeseen developments a possibility of limitation (Cap) shall be agreed for by the Supervisory Board.

Presently, the company does not have a stock option plan. However, it considers to again create a stock option plan in future.

The German Corporate Government Codex recommends to report the compensation of the members of the Management Board as well as details of a stock option program or comparable instruments containing long-term incentive components and components with risk character on the company's internet page in a suitable form and to specify them in the annual report.

PANDATEL AG discloses neither the compensation system of the members of the Management Board on its internet page nor in its annual report. The compensation system does not comprise a stock option program or comparable components.

Sub-paragraph 4.2.4

The German Corporate Government Codex recommends to report the compensation of the members of the Management Board in the Notes of the Consolidated Financial Statements. The figures should be individualized.

PANDATEL AG publishes the compensation of the members of the Management Board not individualized, but as total sum.

Sub-paragraph 5.1.2

The German Corporate Government Codex recommends that the Supervisory Board can delegate preparations for the appointment of members of the Management Board to a committee, which also determines the conditions of the employment contracts including compensation.

The Supervisory Board of PANDATEL AG comprises three members and does not set up committees because of its size.

Sub-paragraph 5.2

The German Corporate Government Codex recommends that the Chairman of the Supervisory Board shall also chair the committees that handle contracts with members of the Management Board and prepare the Supervisory Board meetings. He should not be Chairman of the Audit Committee.

The Supervisory Board of PANDATEL AG comprises three members and does not set up committees because of its size.

Sub-paragraph 5.3.1

The German Corporate Government Codex recommends the Supervisory Board to form committees with sufficient experience depending on the specifics of the enterprise and the number of its members.

The Supervisory Board of PANDATEL AG consists of three members and does not form any committees.

Sub-paragraph 5.3.2

The German Corporate Government Codex recommends that the Supervisory Board shall set up an Audit Committee.

The Supervisory Board of PANDATEL AG did not set up an Audit Committee.

Sub-paragraph 5.3.3

The German Corporate Government Codex recommends that the Supervisory Board can delegate other subjects to be handled by one or several committees. These subjects include the strategy of the enterprise, the compensation of the members of the Management Board, investments and financing.

The Supervisory Board of PANDATEL AG did not set up any committees for this is not necessary due to its size.

Sub-paragraph 5.4.3

The German Corporate Government Codex recommends to make elections to the Supervisory Board on an individual basis.

For no elections to the Supervisory Board have taken place since the publication of the current German Corporate Governance Codex no elections on an individual basis have taken place. The company intends to comply with this recommendation as soon as the next election to the Supervisory Board is to be made.

Sub-paragraph 5.4.7

The German Corporate Government Codex recommends that members of the Supervisory Board shall receive fixed as well as performance-related compensation. Performance-related compensation should also contain components based on the long-term performance of the enterprise.

Due to the company's economic situation and ongoing restructuring, the members of the Supervisory Board presently do not receive a performance-related compensation.

The German Corporate Government Codex recommends to report the compensation of the members of the Supervisory Board individually in the Corporate Governance Report, subdivided according to components.

The Corporate Governance Report does not report the compensation of the members of the Supervisory Board individually, subdivided according to components, because the Consolidated Financial Statements contained a compensation list for the members of the Supervisory Board in recent years. In the future, the company intends to comply with this recommendation.

Sub-paragraph 5.6

The German Corporate Government Codex recommends the Supervisory Board to examine the efficiency of its activities on a regular basis.

In the past years, the Supervisory Board examined its efficiency on a yearly basis. However, it did not carry out an examination, because the Supervisory Board Members changed near the examination.

Sub-paragraph 7.1.2

The German Corporate Government Codex recommends to make the Consolidated Financial Statements publicly accessible within 90 days of the end of the financial year; interim reports shall be publicly accessible within 45 days of the end of the reporting period.

Generally, PANDATEL AG complies with this recommendation. The only exception is its Nine Month Report 2005 owing to intra-corporate restructuring reasons.

PANDATEL AG
Executive Board

Hamburg, December 2005
Supervisory Board

Amendment to the declaration of compliance in accordance with Art. 161 of the Stock Corporation Act (AktG) during the fiscal year

Declaration of conformity pursuant to Article 161 of the Stock Corporation Act (AktG) Declaration by the Executive Board and Supervisory Board of PANDATEL AG, Hamburg, on the recommendations of the "Government Commission on the German Corporate Governance Codex" in accordance with Art. 161 of the Stock Corporation Act (AktG)

According to the Executive Board and the Supervisory Board, PANDATEL AG complies with all recommendations of the "Government Commission on the German Corporate Government Codex" as amended on 21 July 2005 published by the Federal Ministry of Justice in the official part of the Federal Gazette ("Bundesanzeiger") on 2 June 2005 supplemented by the below amendment, during the fiscal year, excluding the following:

Sub-paragraph 7.1.2

The German Corporate Government Codex recommends to make the Consolidated Financial Statements publicly accessible within 90 days of the end of the financial year; interim reports shall be publicly accessible within 45 days of the end of the reporting period.

Because PANDATEL AG changes its Frankfurt stock exchange listing to General Standard on April 13, 2006, it makes Financial Statements publicly accessible within 120 days of the end of the financial year and interim reports within 60 days of the end of the reporting period.

PANDATEL AG	Hamburg, April 2006
Executive Board	Supervisory Board

For further information please visit the following web site:
<http://www.corporate-governance-code.de/index-e.html>

Report of the Supervisory Board

In fiscal 2005, the Supervisory Board advised and regularly monitored the work of the Executive Board and was kept constantly informed by the Executive Board on the business situation at PANDATEL AG and its subsidiaries in the form of written and oral reports.

Matters which required the involvement of the Supervisory Board were notably and duly addressed in accordance with legislative regulations and the Articles of Association. The Supervisory Board comprehensively examined all the relevant business occurrences and, in the course of regular meetings with the Executive Board, discussed the business development, strategy and the main events of the company. In the twelve months under review, the Supervisory Board convened at four ordinary meetings and three extraordinary meetings. All but one meeting were attended by all Supervisory Board members. At these meetings, among other things the business situation at PANDATEL AG and its associated companies was discussed as well as the future corporate policy and questions relating to acquisitions and the strategic direction of the company. The Executive Board made detailed, up-to-date and in-depth reports on the development of business, the situation of the company as well as the strategy and future planning. In addition to the scheduled meetings, the members of the Supervisory Board and the Executive Board repeatedly met to exchange ideas and information. The Supervisory Board was therefore kept permanently informed on business developments.

In this way, the Supervisory Board was constantly supplied with detailed information on the current situation of the Company, so that it was able to recognize and react in a timely fashion to the risks that had arisen and were threatening PANDATEL AG's continued existence. In order to ensure that the necessary measures were taken, the Board involved itself at all stages and participated fully in the decision making process. Consequently the Executive and Supervisory Boards were in agreement, in October 2005, that there were only two possibilities with regard to the Company's future: on the one hand the liquidation of the Company and on the other the involvement of a new strategic investor. The arrival on the scene of Dowlake Microsystems/Venture at the end of 2005 offered a unique opportunity to ward off the danger of PANDATEL AG's liquidation and to open up new perspectives that would secure the Company's future. The Supervisory Board of PANDATEL AG participated decisively in the negotiations preparatory to the signing of the agreement with Dowlake.

The Supervisory Board regards the German Corporate Governance Code as an important step towards the further development of the practice of company management and control. For this reason, the implementation of the Code was repeatedly an issue at the Board's meetings. In the 2005 financial year the Supervisory Board did not heed the recommendation to regularly examine the efficiency of its operations because two of its members resigned from the Board in November 2005 and their temporary replacements were not appointed by the Hamburg Local Court until January 2006. In December 2005 the Supervisory Board and Executive Board jointly submitted a Declaration of Compliance pursuant to § 161 of German Company Law (AktG). This Declaration has been published on the Company's Internet homepage.

The following changes took place in the organs of the Company in fiscal 2005 as compared with a year earlier: At January 19, 2005, the Chairman of the Executive Board, Norbert Wienck, left the Company. The Executive Board members Dr.-Ing. Elke Jahn and Dr.-Ing. Niraj Agrawal remained on the Board and took over Norbert Wienck's duties. On August 24, Thomas Becker was appointed to the Board as Chief Financial Officer (CFO). Just a few weeks later, on October 14, Thomas Becker assumed until further notice the function of sole Director responsible for management of PANDATEL AG's operations. Dr. Elke Jahn, formerly Chief Operations Officer (COO), and Niraj Agrawal, formerly Chief Technical Officer (CTO), resigned from the Executive Board of PANDATEL AG with effect from October 14, 2005 at their own request and by mutual agreement. One month later, on November 18, 2005, the Supervisory Board appointed Dr. Dan D. Yang, CEO of the US network specialist Dowlake Microsystems Inc., to the position of Chairman of the Executive Board of PANDATEL AG. Since then, she has been managing the Company together with Thomas Becker, who has reverted to his position as CFO. Immediately following this addition to the Executive Board, on November 21, 2005, PANDATEL AG announced that the Chairman of its Supervisory Board, Axel Haas, and the Supervisory Board member Prof. Dr. Uwe Hannig would be resigning from their positions with immediate effect. In January 2006 two new candidates were appointed by the Hamburg Local Court to serve on the Supervisory Board as long as the effect has not been cured, i.e. Supervisory Board election by the Extraordinary General Meeting.

The financial statements and consolidated financial statements at December 31, 2005, and the management reports of the company and the group for financial 2005, all of which were prepared by the Executive Board, have been examined by the auditors appointed at the Annual General Meeting, Dr. Ebner, Dr. Stolz und Partner GmbH Wirtschaftsprüfungsgesellschaft Steuerberatungsgesellschaft. The auditors found them to concur with the duly maintained accounts and statutory regulations. The auditors have issued an unqualified opinion on the financial statements and the consolidated financial statements. The auditors participated in the Supervisory Board meeting on April 24, 2006, at which the annual accounts were adopted, commented on the findings of the audit and answered questions. The Supervisory Board has examined the financial statements and the consolidated financial statements as well as the management reports of the company and the group on the basis of the auditors' report and has no cause for objection. The Supervisory Board has approved the financial statements and the consolidated financial statements drawn up by the Executive Board. The financial statements for the year have thus been adopted.

The auditors furnished the following opinion on the report of the Executive Board on the relations to the affiliated companies in accordance with section 312 German Stock Corporation Act:

"Having duly conducted our examination and assessment, we hereby confirm that

- the factual statements made in the report are correct,
- the company's performance in the legal transactions enumerated in the report was not inappropriately high."

The Supervisory Board concurs with the auditors' report. Following the final examination of the audit by the Supervisory Board, we raise no objections to the explanation by the Executive Board at the end of the report regarding the relations to the associated companies.

The Supervisory Board would like to thank the Executive Board for its activities and its commitment to the company. At the same time, the Supervisory Board would like to extend its thanks to all the staff members of PANDATEL AG for their dedication in 2005.

Supervisory Board

Dr. Axel Pfeifer, Chairman of the Supervisory Board
Dr. Jozef Straus
Alex Fang

Hamburg, April 24, 2006

Group Management Report PANDATEL AG

A new phase in PANDATEL AG's corporate history commenced in November 2005 with the arrival of Dowslake Venture Ltd., Santa Clara (USA), and the withdrawal of AUGUSTA Technologie AG, Frankfurt. The search for a strategic investor had already begun in the third quarter of the year, since neither orders nor sales had developed as hoped in the previous months despite efforts to slim down the Company and its structures, so that it had become doubtful whether the Company could continue to exist in the medium term.

During the previous four years PANDATEL AG had made several attempts to redefine its niche in the current market. Unfortunately none of these attempts was successful, with the result that sales in the last five years declined from €36.5 million in fiscal 2000 to €12.8 million in fiscal 2005. The EBIT (earnings before interest and taxes) declined comparably: while the year 2000 saw a historic high of plus €10.4 million, the loss in 2005 totalled -€15.3 million.

An analysis of the situation shows that there was a severe lack of corporate strategy seriously affecting product range, operations (purchasing and production), and sales.

Corporate Strategy

The founder of PANDATEL AG envisioned a company designing and manufacturing customer oriented products to service phone operators and other customers that require equipment for access to communications networks. Such innovative products were designed and tailored to customers' needs in the early stages of PANDATEL AG and, with the market ready to embrace such new concepts of communications equipment based especially on optical fiber technology, the company expanded very quickly achieving exceptional results in 2001.

Thereafter the communications market crashed and the technology became a commodity. Price erosion made it necessary to fight for every order. Gross profit dropped dramatically. German-made products became much less attractive due to their high cost. New players from Asia were able to sell at a fraction of the price. Without a strategy for positioning the company in the new market environment, in which cost was the most important decision-making parameter, the original tailor-made, high-priced, low-volume business model had no future.

Product Strategy

The first consequence of the lack of corporate strategy is the fragmented product line. Old products with many obsolete parts make it difficult for the operations division to fill orders properly. Each product type has many variants, causing a production burden because none of the products can really be produced in volume. New products are not ready for the market. Moreover, the addition of optical transport products to the range has created a diverse, yet unfocused product portfolio. There is no apparent core product and no discernable priority in development. A uniform product platform on which development resources can be utilized to the maximum does not exist at PANDATEL AG. Customers no longer know what PANDATEL AG is good at doing. Even looking at the 2005 catalog, it is difficult to identify where PANDATEL AG's strengths lie.

Operations Strategy

The fragmented product portfolio and the huge number of product variants create great difficulties for the operations division. In the manufacturing system, more than 30,000 different parts can be found. In 2005, 8,000 parts had to be purchased to produce more than 140 types of products, with mostly different sets of designs and materials. Operations was forbidden to purchase material in advance for fear of overstocking, although most electronic parts take 6 to 12 weeks for delivery. Operations is therefore in deep trouble and the Company is losing valuable customers. The company has not so far had any functioning supply chain management, so that engineers have not been aware of parts being obsolete. Materials have been bought at the quoted price without serious negotiation. PANDATEL AG has been buying many key optical and electronic components at generally 30% over market price.

Sales Strategy

In 2005, PANDATEL AG served close to 200 customers, which translates into average sales per customer of €60,000. Many hundreds of orders were processed, 80% of them worth less than €10,000. PANDATEL AG did not have a core customer base. Every customer was treated equally and key customers did not receive any more attention than others. This caused additional problems for operations because each order, no matter how large or small, had to be processed, billed and shipped in the same way. The margins made were not even enough to cover administration costs.

Conclusions

The fragmentation of the company is the result of a lack of corporate strategy. PANDATEL AG needs to refocus and to re-define its major markets, major products and major customers to determine where it should concentrate most of its resources. PANDATEL AG must find its niche with a redefined product portfolio in order to be more competitive technologically and cost-wise. PANDATEL AG must also streamline operations and cut operating costs.

For all these reasons the Company was compelled to look for a strategic investor to enable it finally to resolve its legacy of problems and to bring PANDATEL AG back to full economic strength. From this perspective, Dowlake Microsystems Corp. appears the ideal partner, since it will give PANDATEL AG access to the major market for communications equipment, namely the North American market, where the Company has never really operated successfully. Dowlake Microsystems has, moreover, a modern and cost-efficient plant in Shanghai with a considerably more favorable cost structure and an established supply chain management, so that production of the systems and modules manufactured there can be much more cost-competitive.

General market situation

The economic situation in Germany continues to be difficult. This is also reflected in the figures published by the telecommunications industry. The German National Association of Information, Telecommunications and New Media Industries (BITKOM) is expecting that growth in the entire area of information and telecommunications will have been about 2.6% in 2005 and will fall only slightly to about 2.4% in 2006. In telecommunications alone, it reckons that growth is even somewhat weaker, namely 2.0% in 2005 and an estimated 1.3% in 2006. In contrast, according to BITKOM, the areas of data communications and network infrastructure are likely to have seen a growth of 2.0% in 2005 and will grow by an estimated 1.7% in 2006.

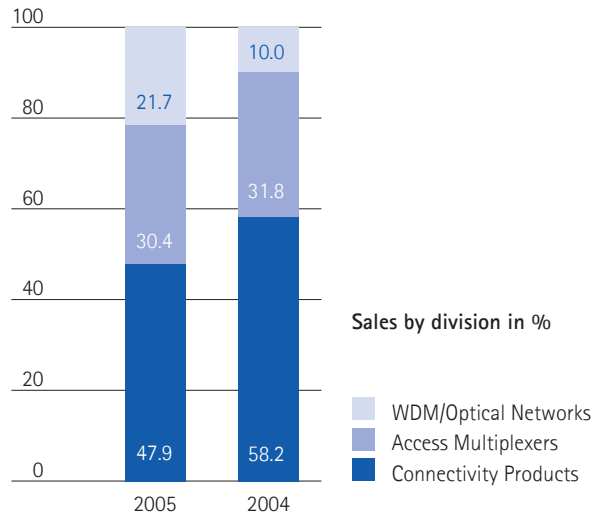
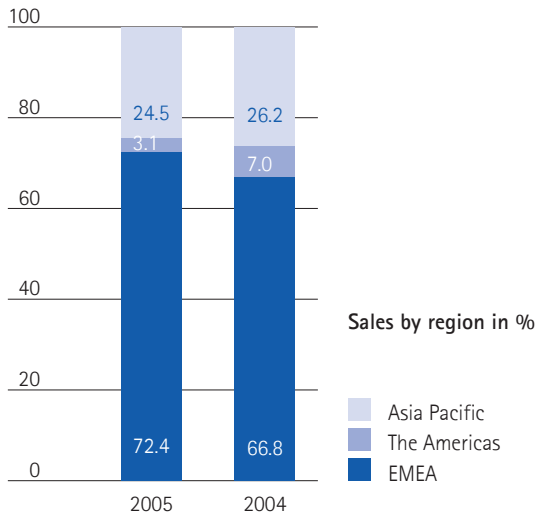
Sales trends 2005

In fiscal 2005, sales continued to decline, namely by -14% to €12.8 million. The comprehensive product range that had given PANDATEL AG the requisite competitive edge in past years, now began to develop increasingly into a competitive liability. One of the main reasons for this was that, while every customer request was met, no real further development took place. The new products introduced into the market in 2005 have not yet had the expected favorable impact on sales. In future PANDATEL AG will concentrate on a clearly defined product portfolio and will combine the individual strengths of PANDATEL AG, Lightmaze and Dowlake to make the Company competitive once more. The removal of production to Shanghai in the first or second quarter of 2006 is expected to bring considerable cost savings.

PANDATEL AG's total annual turnover fell from €14.9 million in 2004 to €12.8 million in 2005, since sales of its traditional products continued to decline. The Company also found itself under increasing competitive and pricing pressure from Far Eastern competitors which are able to manufacture and market their systems under much more favorable conditions.

In 2005 the proportion of foreign sales was 79.0% as compared with 82.9% in the previous year. The EMEA region (Europe, Middle East, Africa) remained the front-runner, experiencing a relatively moderate decline in comparison with the other regions, namely by 7.1% from €10.0 million in 2004 to €9.3 million in 2005. The largest contributions again came from the United Kingdom and France, with sales of €2.3 million and €2.1 million respectively. In contrast, Eastern Europe on the one hand, and Africa and the Near East on the other generated the lowest sales in the EMEA region. On the 2005 balance sheet date, these each recorded sales of only €0.4 million, representing a drop of 51% and 49% respectively. The American continent did relatively worst, whereas Latin and South America maintained previous year's level. In comparison with the previous year sales declined by 61.9%, amounting to €0.4 million in 2005 as against €1.0 million in 2004.

The shares of total sales accounted for by the different business divisions changed only very slightly. It was mainly in the area of Optical Systems that results failed to meet expectations, since the advanced but highly complex Yumix 4000 system produced by Lightmaze is employed chiefly in project business. The division responsible for the largest proportion of sales was again Connectivity Products, with 47.9% of total turnover. The contributions of Access Multiplexers and Optical Systems were 30.4% and 21.7% respectively.



Result

Declining sales, together with extraordinary depreciations and severance payments to laid-off workers, led again in 2005 to a negative result.

In fiscal 2005 PANDATEL AG recorded losses before interest and taxes (EBIT) amounting to -€15.3 million, as compared with -€15.6 million in the previous year. The net loss for the year was -€17.0 million (2004: -€15.6 million), which corresponds to a loss per share of -€2.15 (2004: -€2.06).

Orders received in fiscal 2005 fell by 16.2%, that is to €11.9 million as compared with €14.2 million in 2004. At December 31, 2005, PANDATEL AG's order books showed orders in hand amounting to €1.6 million as compared with €1.2 million on the same date in 2004.

Restructuring costs amounted in 2005 to the sum of €3.4 million (2004: €2.6 million). These consist mainly of costs for workforce reduction and payments to departing members of the Executive Board. They also include, however, €0.9 million in provisions for office rents and €1.6 million for the social compensation plan established in December 2005.

In fiscal 2005 a further provision of €50,000 was set aside to cover liquidation costs for the Competence Center in Israel. Moreover, the complete write-off of Lightmaze Solutions AG following an analysis of its remaining value placed an additional burden of €5.0 million on PANDATEL AG's balance sheet for the year. The closing of the Company's plant in Eisingen is expected to involve additional costs of €0.3 million.

Financial position

Sales and earnings in 2005 were well below what had been forecast even at the beginning of the year; accordingly PANDATEL AG's assets continued to shrink. At December 31, 2005, the Company had a capital-to-assets ratio of 70.3% and the balance sheet showed liquid assets of €5.1 million (without securities). On account of the decline in sales, the balance sheet total fell from €34.0 million in 2004 to €18.6 million in 2005. This is primarily due to the reduction in liquid funds from €9.9 million to €5.1 million.

In 2005 PANDATEL AG invested a total of €0.2 million in tangible and intangible assets, which corresponds to an investment ratio of 1.77% (2004: 47.7%).

Capital measures

A resolution passed by the 2004 Annual General Meeting authorized the Executive Board to increase the Company's equity capital, excluding existing shareholders from exercising pre-emption rights on issues of new shares. After the execution of the capital increase had been entered in the Commercial Register of the Hamburg Local Court in November 2004, 670,806 new shares were admitted on April 8, 2005, for trading on the Frankfurt Stock Exchange (regular market Prime Standard).

External development companies and main technological areas

The Company had started already to close down its Competence Center in Kfar Saba, Israel, in 2004, so that in the fiscal year just expired only smaller sums amounting to €50,000 had to be paid out to meet legal and consultancy costs.

The new majority shareholder, Dowlake Venture Ltd., is very strongly represented in the OEM sector, where its modules meet various customer requirements, mainly in the metro and access areas, and thus ideally supplement PANDATEL AG's more project-oriented systems.

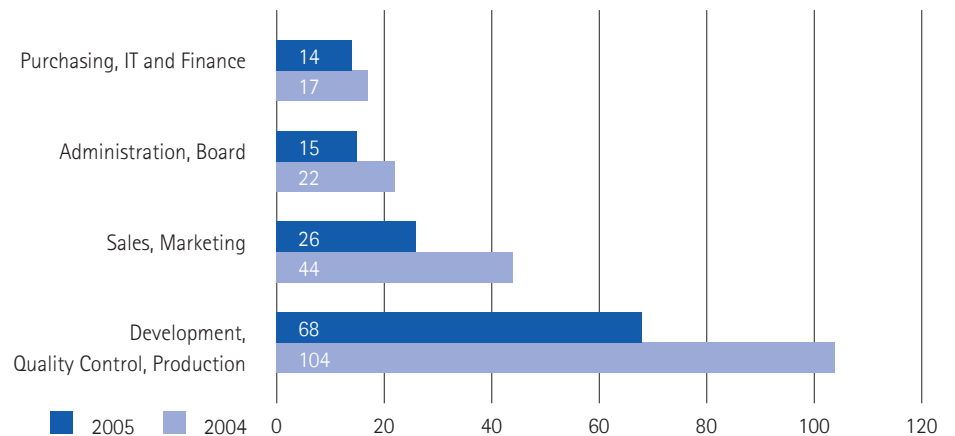
The staff of the Company's plants in Hamburg, Hanover and Eisingen continued to work in the year just expired at the development of new products and the improvement of existing ones. Special mention should be made of the following:

The release of the ET-CB wideband Ethernet converter. This piece of equipment is a centrally managed gigabit ethernet converter with integrated switching function capability.

The further development of the COP-FE. This has now been supplemented with a serial interface to the COP-RS but is not due for release until some time in 2006.

The implementation of full ADM function capability, including in-band management and ring management, in the C-MUX-155.

Staff by division



As regards the MACS4000, various developments are worth noting:

- CM-G – a G.SHDSL copper modem. This is a controllable frame card for the MACS4000, containing a multirate G.SHDSL copper modem, which can be employed in two-conductor or four-conductor mode.
- OM-F – a optical fractional E1 modem. This modem guarantees both structured (n x 64 kb/s) and unstructured (2.048 kb/s) E1 or transparent n x 64 kb/s data transmission.

In order to tighten up the product range and to concentrate more on the Company's core competences, management has identified three new product categories based on their differing areas of application:

Optical Networking

This category unites all the Yumix products developed at the Eisingen plant, supplemented by Dowlake's transport products, especially the small "pizza box" systems which complement major telco systems.

Ethernet and Multi-Service over PDH/SDH/Sonet

This category consists of the newer generation of Ethernet-over-Sonet/SDH products in the PANDATEL AG product family. They offer a very wide range of applications, especially linking data networking to public backbone networks. This product line will be complemented by Dowlake's high data-rate, small form-factor products.

Last mile/TDM access

This category includes various items of Ethernet equipment, modem/converters and multiplexers that round out or supplement the basic product range. This is the main area in which PANDATEL AG has developed since its inception.

Staff

In fiscal 2005 PANDATEL AG employed an average of 120 staff, not counting the Executive Board (2004: 184). This figure does not yet completely reflect the restructuring measures taken, including the dismissal of the entire staff of the Hamburg and Eisingen plants, since they only become legally effective at the end of the 2005 financial year or at the end of the second quarter 2006. There were 115 staff in full-time employment and 5 in part-time employment. In Paris and London, as well as in Madrid, the Company has 3 employees in all (2004: 4).

Changes in the Executive and Supervisory Boards

In January 2005 the former Chairman of the Executive Board, Norbert Wienck, resigned from the Board. His duties were taken over by the remaining Board members, Dr.-Ing. Elke Jahn and Dr.-Ing. Niraj Agrawal. In order to fill the vacant position of CFO, Thomas Becker was asked to join the Board in August 2005 with the mission to find a new direction for PANDATEL AG. In October 2005 both Dr. Elke Jahn and Dr. Niraj Agrawal left the Company. Thomas Becker assumed the function of CEO until Dr. Dan D. Yang joined the Company in November 2005; thereafter he returned to the position of CFO on the Executive Board of PANDATEL AG.

Also in November 2005, a major change took place in the membership of the Supervisory Board. With the sale of AUGUSTA Technologie AG's shareholding to Dowlake Venture Ltd., the Board members Axel Haas (Chairman) and Prof. Dr. Uwe Hannig withdrew from the Supervisory Board. After the close of the year under review, Alex Fang and Dr. Axel Pfeifer were appointed to the Board by the Hamburg Local Court in accordance with § 104 para. 1 of German Corporation Law (AktG).

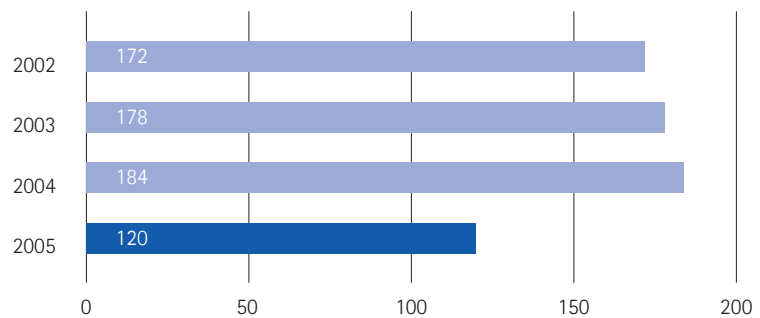
Major shareholdings

In November 2005 Dowlake Venture Ltd., took over 29.0% of PANDATEL AG's share capital from the Company's previous majority shareholder, AUGUSTA Technologie AG, Frankfurt. The remaining 20.98% of AUGUSTA Technologie AG's shareholding was purchased by Dowlake Venture Ltd. in December 2005, making the latter the Company's new majority shareholder. With the completion of this transaction, Dowlake Venture Ltd. fully exercised the option agreement concluded in November 18, 2005, and AUGUSTA Technologie AG terminated its participation in PANDATEL AG.

Corporate governance

With the aim of ensuring regular and open communication, PANDATEL AG also implements the recommendations and suggestions of the German Corporate Governance Codex. This codex summarizes the rules applicable in Germany for responsible management and simultaneous company monitoring. The objective is to make these rules transparent for national and international investors and to reinforce confidence in the management of German companies. We largely follow the latest versions of the recommendations and implement them within the PANDATEL AG Group accordingly. Deviations from the recommendations – most of which derive from circumstances particular to the Company – are described in detail in PANDATEL AG's Statement of Compliance.

Average number of employees by year



PANDATEL AG has published the Statement of Compliance by the Executive Board and the Supervisory Board, together with its exceptions, in its homepage at www.pandatel.de > Investor Relations. The German Corporate Governance Code recommends that the Executive and Supervisory Boards should include a report on corporate governance in the Company's Annual Report (3.10) and that this report should contain information on the emoluments paid to members of the Supervisory Board (5.4.7), on the purchase or sale of Company shares by members of the Boards or of the Company's management (6.6) and on share option programs or other incentive systems.

PANDATEL AG has not so far produced such a corporate governance report, the information referred to above being included in the Notes to the Consolidated Financial Statements.

Risk management

As a globally operating concern, PANDATEL AG is exposed to a number of risks within the framework of its worldwide business dealings that are inseparably connected with its entrepreneurial activities. The Company has installed a comprehensive risk management system for the early detection, reporting and control of risks. An essential component of PANDATEL AG's risk management system is early risk detection: with the help of a matrix, individual risk factors are systematically identified and assessed at specified intervals. Any risks detected are recorded and documented with respect to their possible effects and the likelihood of their materialization.

Besides market- and economy-related risks, company-related risks in all areas of the Company that may have an appreciable effect on business development, financial situation and net earnings are assessed. Incoming orders, economic data and the results of market studies by international research institutes contribute to the assessment of the forecasts and of the probability of their occurrence; wide-ranging projects, investments and restructuring measures are also taken into account in the assessment of risk.

The overall assessment of the risk potentials from the past financial year shows that even in 2006 the Company's continued existence is still considerably threatened as a result of

- the ongoing erosion of turnover owing to insufficiently competitive products and inadequate new development,
- excessively high production costs, resulting in unsatisfactory margins,

- cost structures that are not adjusted to the volume of the Company's business and

- continually shrinking cash reserves,

and that PANDATEL AG cannot remedy this situation on its own.

Risks arising from changes in the market environment

Despite some consolidation in the communications industry and a noticeable revival of parts of the telecommunications market (e.g. IP-Ethernet), the Company is continuing to lose sales and market share owing to its outdated product portfolio and insufficient product focus.

In the area of supply chain management, the Company has not succeeded in gaining the requisite competitive edge with regard to the procurement of components.

Products liability risks are estimated to be small. No products liability claims have been filed against PANDATEL AG at any time in the past and the Company is insured against such claims. All measures taken with regard to quality control and security are constantly examined and improved. The quality management system is certified in accordance with international standards.

Risks arising from loss of competitiveness

PANDATEL AG's traditional product portfolio is subject to increasing pricing pressure from low-wage Asian suppliers. From a technological point of view, PANDATEL AG has not succeeded in positioning itself in the market as a reasonably priced, innovative manufacturer through the modernization and reorientation of its range of products.

In view of the continuous shrinkage of its cash reserves, PANDATEL AG cannot effectively deal with the risks that have been recognized as threatening the continued existence of the Company without help from outside.

To this extent, the participation of the strategic investor Dowslake Venture Ltd., with the planned incorporation of Dowslake Microsystems Corp. into PANDATEL AG, is the only recognizable possibility that will allow the Company to be restructured and newly positioned in the market. This view was shared by the German Federal Office for Financial Services Supervision (BaFin) in its notice of January 17, 2005, releasing the Company from the obligation to offer shares to PANDATEL AG's existing shareholders.

The Executive Board is convinced that the measures introduced following the involvement of the strategic investor in mid-November 2005 represent the only possible alternative for the avoidance of the risks described.

Dependence report

Owing to the existence of a majority shareholding and a majority of represented voting rights by AUGUSTA Technologie AG and, following its withdrawal, by Dowslake Venture Ltd., PANDATEL AG is obliged in accordance with § 312 AktG to issue a dependence report. This report is drawn up by the Company's Executive Board and is examined and certified as part of the audit of the annual financial statements.

The concluding statement of the dependence report reads as follows:

"The Executive Board of PANDATEL AG declares herewith that in all the legal transactions listed in this dependence report, according to the circumstances of which we were aware at the time these legal transactions were conducted, our Company and our dependent subsidiaries received fair consideration and were in no way prejudiced and that no measures were taken to the disadvantage of the Company."

Particular events following the end of the financial year

Release of Dowslake Venture Ltd. from the obligation to publish a share offering:

In response to its application of November 30, 2005 and with effect from January 17, 2006, the BaFin released PANDATEL AG's new majority shareholder Dowslake Venture Ltd. (49.98%) and its owners Dr. Dan D. Yang and Zibin Lu, in accordance with § 37 of the German Securities Transfer Law (WpÜG) in conjunction with § 35 para. 1 no. 3 of the WpÜG's share offer regulations, from the obligations to publish its acquisition of the controlling share of PANDATEL AG in accordance with § 35 para. 1 sentence 1 WpÜG, to submit share offer documentation to the BaFin in accordance with § 35 para. 2 sentence 1 WpÜG and to publish an obligatory share offering in accordance with § 35 para. 2 sentence 1 WpÜG in conjunction with § 14 para. 2 sentence 1 WpÜG.

This release was granted under the following conditions:

- a) The BaFin must receive without delay an invitation to attend the General Meeting of Shareholders of PANDATEL AG that will be convened in connection with the planned restructuring measures and that will pass a resolution authorizing a non-cash capital contribution to the Company of at least 95% of the share capital of Dowslake Microsystems Corp.

- b) The BaFin must be officially informed without delay of the resolution passed by the General Meeting of Shareholders of PANDATEL AG as described under a).
- c) Evidence must be provided to the BaFin without delay of the entry in the Commercial Register of the capital contribution as described under a).

The two most important reasons, among others, for the BaFin's granting of this release are:

- 1) PANDATEL AG is subject to certain risks that threaten its continued existence. Since the Company has insufficient liquid funds for restructuring, the only alternative to a liquidation of the Company is the involvement of a strategic investor which will restore it to a sound economic condition.
- 2) The concept submitted to the BaFin involving the incorporation of Dowslake Microsystems Inc. into PANDATEL AG creates the necessary preconditions for a successful restoration of the Company.

Appointment of PANDATEL AG's Supervisory Board by the Hamburg Local Court

On January 24, 2006, the Company was informed of the decision of the Hamburg Local Court concerning appointments to its Supervisory Board. In response to the Executive Board's application of December 20, 2005, Axel Haas and Prof. Dr. Uwe Hannig, both of whom had resigned from the Board in November 2005, will be replaced as members of the Supervisory Board in accordance with § 104 para. 1 AktG by Alex Fang, an investment manager, and Dr. Axel Pfeifer, a lawyer.

Rental agreements

On March 13, 2005 a compromise was reached with the owners of the property at Fasanenweg 25 and Bargkoppelstieg 14 with regard to the rental agreements. Accordingly the Company will pay a lump sum of €545,000 plus an additional sum of €296,000 to cover the rents up to the termination of the agreements. The rental agreements expire on March 31 and June 30 respectively.

Executive Board members

Negotiations were conducted with the former members of the Executive Board, Drs. Jahn and Agrawal, in connection with the discontinuation of their contracts of service. A provision has been set up in the amount of the expected settlement.

Constituent meeting of the Supervisory Board of PANDATEL AG

On January 30, 2006, the Supervisory Board appointed by the Hamburg Local Court held its constituent meeting. The new Board elected from among its number Dr. Axel Pfeifer as Chairman, Dr. Steffen Leistner as Deputy Chairman and Alex Fang as ordinary Board member.

The regular election of the new Supervisory Board will take place at the next Annual General Meeting. On this occasion Steffen Leistner will resign from his position on the Supervisory Board. In his place, Dr. Jozef Straus has offered his services as a new member of the Supervisory Board.

Extraordinary General Meeting

In order to implement the restructuring concept initiated by Dowlake, the BaFin has expressly required the convocation of an extraordinary General Meeting of Shareholders of PANDATEL AG. This meeting is to pass the following resolutions:

- Share cut in a ratio of 2:1, i.e. reduction of equity capital by combining two old shares into one in accordance with the regulations on regular capital reduction as per §§ 222 et seq. AktG, the purpose of this being to restore the company to sound economic health and to compensate for losses and reductions of value; amendment of the Company's by-laws.
- Non-cash capital contribution to the Company of at least 95% of the shares of Dowlake Microsystems Corp.
- Closure of the present locations in Hamburg and Eisingen and concentration of their facilities at the Hanover site within the framework of the Company's restructuring and reorientation.

Other

Furthermore, the Executive Board has decided, with the approval of the Supervisory Board, to move the Company's manufacturing facilities to Shanghai. PANDATEL AG's comprehensive product portfolio will be pared down into just 25 product platforms and supplemented by Dowlake's product portfolio.

As a consequence of the removal of the manufacturing facilities to Shanghai and a massive layoff of personnel in Germany, costs will be adjusted to the considerably reduced volume of business.

The operative business of PANDATEL Inc., Sunrise/USA, has been terminated and the Company intends, after the incorporation of Dowlake Microsystems Corp., to merge the operations of these two companies.

Following restructuring, the subsidiary in Singapore will continue to function as a marketing and representation office.

As early as at the end of 2004 PANDATEL AG had closed down operations at its Competence Center in Israel. An application for its deletion from the Register of Companies has been submitted but not yet approved.

The change in stock exchange registration from Prime Standard to General Standard has already been approved by the German Stock Exchange. From mid-April onwards, PANDATEL AG shares will therefore be traded in the General Standard market, the aim being to save costs in this sector also.

Developments in 2006

With the assumption of 49.98% of its share capital by the new investors Dowlake Venture Ltd., new perspectives have opened up for PANDATEL AG which would otherwise have been closed to the Company. The incorporation of Dowlake Microsystems Inc. into PANDATEL AG and a radical course of restructuring for the Company's activities to date are essential for the realization of these perspectives. This is also the opinion of BaFin which, in waiving the obligation to offer new shares to the Company's existing shareholders, has obligated the Company to complete the merger with Dowlake Microsystem Corp. and to implement the restructuring plan.

The advantages of the merger and restructuring arise mainly from the search for a new direction to give the Company a clear position in the marketplace. This includes a refocusing of the Company on its core products, central customer base and most important markets. Old-generation products will have to be removed from the product range in order to streamline operations and hence the supply chain. Key customers must be identified and given greater support. Core technologies will be promoted and developed further, while commodity-type products will be outsourced.

In order to make PANDATEL AG more cost-competitive, production is in the course of being transferred to Shanghai, which offers lower personnel costs and a proven supply-chain management system, together with well established production processes involving advanced product test automation. This will mean considerable cost savings for the Company. In addition, advantages are expected to accrue from the consolidation of the three PANDATEL AG locations in Hamburg, Hanover and Eisingen and the establishment of a new head office in Hanover. This will not only have a favorable effect on internal information and decision-making but will also enable faster and more flexible communications with customers as well as simplifying the various administrative processes previously necessitated by the Company's operating at three different sites. The future head office and seat of the Company in Hanover will employ a staff of between 30 and 35. The eight employees already located in Hanover will be kept on and another seven employees from other locations will be offered a contract of employment in Hanover. Three of these have accepted this offer so far. The remaining vacant positions will be filled by new staff. Hanover was chosen as the new head office because of the strong research and development team already established there. The Hanover team are the brains behind PANDATEL AG's new generation of Ethernet products in which management sees a decisive advantage over products of low-cost manufacturers from Asia. Advantages will also accrue from the merging of the two product portfolios and a significant consolidation of PANDATEL AG's product range. The almost 7,000 different products formerly manufactured by PANDATEL AG will now be combined into three categories and fewer than 25 product platforms. Additional benefits will arise from the consolidation of the distribution and marketing, with PANDATEL AG's main strength being in Western Europe, and in the Asia-Pacific region from its base in Singapore, and Dowlake's being in the USA. Here, the functions and operations of PANDATEL Inc. will be taken over by Dowlake. The latter has a functioning sales network in North America. The most important markets, such as Germany, France, the United Kingdom, the USA and a few selected countries in the Asia/Pacific region where PANDATEL AG has a strong foothold and makes reasonable profits, will be the main focus of PANDATEL AG's own sales and marketing team.

The merger of the two companies will give rise to a new corporate culture within PANDATEL AG. The staff will focus on priorities, put customer requirements first and deliver top-quality products on an ongoing basis. To this end, modern systems of personnel management will be introduced, with the setting of goals, measurement of progress and incentives for particularly good work. Part of the restructuring plan consists in the introduction of a stock option plan for employees which is designed to ensure an identity of interests between staff and shareholders. Each employee of the Company must be aware at all times that satisfied customers are the first priority and that it is, in the last analysis, these customers who pay the staff's monthly wages. The Company has set itself the goal of identifying its most important products, customers and markets and of formulating a corporate strategy that will allow PANDATEL AG to move forward into the new era. In addition, it intends to reduce cash-burn as quickly as possible and to bring the Company towards profitability in the coming years.

From the financial point of view, management is expecting a continued drop in revenue associated with the existing problems as well as with restructuring. Some sales may be lost due to the refocusing of the Company and as a result of production delays caused by the relocation of manufacturing to Shanghai. While the restructuring process is under way it is therefore difficult to make reliable forecasts as to sales in fiscal 2006. We are confident, however, that this decline in turnover will pave the way eventually for the necessary step forward. On the basis of the reorientation of PANDATEL AG through the incorporation of Dowlake Microsystems Inc. and the implementation of its restructuring plan, the Company will be strengthened and will succeed in carving out a niche for itself within the telecommunications industry, as it would not have been able to do without the aid of its new strategic partner.

Hamburg, March 15, 2006

Dr. Dan D. Yang (CEO)

Thomas Becker (CFO)

Consolidated financial statements

Balance sheet of PANDATEL group as of December 31, 2005

ASSETS

€000	Notes	12/31/2005	12/31/2004
Non-current assets			
Intangible assets	(1)	1,030	1,648
Property, plant and equipment	(1)	1,361	2,352
Goodwill	(1)	0	4,349
Investments	(1)	0	25
Deferred taxes	(24)	300	2,938
Other non-current assets	(2)	0	459
Total non current assets		2,691	11,771
Current assets			
Inventories	(3)	3,644	4,604
Trade accounts receivable	(4)	3,422	3,640
Short-term investments	(5)	2,907	3,858
Taxes receivable	(6)	162	98
Prepaid expenses and other current assets	(7)	701	190
Cash and cash equivalents	(8)	5,093	9,878
Total current assets		15,929	22,268
Total assets		18,620	34,039

Liabilities and shareholders' equity

€000	Notes	12/31/2005	12/31/2004
Shareholders' equity			
Share capital	(9)	7,896	7,896
Additional paid in capital	(9)	4,652	21,579
Changes in shareholders' equity from exchange rate	(9)	544	87
Revaluation reserve	(9)	4	32
Retained earnings/Accumulated deficit	(9)	0	0
Total shareholders' equity		13,096	29,594
Non-current liabilities			
Deferred tax liabilities	(24)	541	1,208
Total non-current liabilities		541	1,208
Current liabilities			
Trade accounts payable	(10)	562	598
Liabilities against affiliated companies	(11)	0	15
Tax accruals	(12)	138	147
Accrued expenses	(13)	3,737	1,760
Other current liabilities	(14)	546	717
Total current liabilities		4,983	3,237
Total Liabilities and shareholders' equity		18,620	34,039

The attached notes form an integral part of these annual financial statements.

Statement of income of PANDATEL group

€000	Notes	2005	2004
Revenues			
Products		12,784	14,881
Services		0	26
	(15)	12,784	14,907
Cost of revenues			
Products		-8,246	-11,896
Services		-1	-26
	(16)	-8,247	-11,922
Gross profit/loss		4,537	2,985
Selling and marketing expenses	(17)	-3,938	-4,836
Research and development expenses	(18)	-4,454	-6,815
General administrative expenses	(19)	-2,961	-4,314
Amortization (and impairment) of goodwill	(1)	-4,349	0
Restructuring expenses	(20)	-3,449	-2,583
Other income/expenses	(21)	2	234
Operating income/loss		-14,612	-15,329
Interest income and expenses	(22)	229	288
Foreign currency exchange gains/losses	(23)	-709	-285
Financial result		-480	3
Result before income taxes		-15,092	-15,326
Income tax	(24)	-1,920	-260
Net income/loss		-17,012	-15,586
Withdrawal from capital reserve		17,012	13,572
Withdrawal from retained earnings		0	2,014
Net profit/loss		0	0
Earnings per share (diluted and undiluted) in €		-2.15	-2.06
Earnings per share before extraordinary expenditure (diluted and undiluted) in €		-2.15	-2.06

The attached notes form an integral part of these annual financial statements.

Cash flow statement for PANDATEL group

€000	2005	2004
Net loss for the year	-17,012	-15,586
Description on tangible and intangible assets	5,787	1,526
Extraordinary depreciation on inventory	103	1,213
Personal expenses for stock options	85	254
Profit/loss from sales of tangible assets	196	3
Other disbursements and income to be paid	1,971	152
Cash flow	-8,870	-12,438
Changes in		
trade accounts receivable	218	1,929
inventories	857	2,346
other assets, which cannot be classified as investing or financing activities	703	-490
Changes in		
trade accounts payable	-36	-388
other liabilities, which cannot be classified as investing or financing activities	1,782	915
Changes in cash and cash equivalents of limited availability	203	-393
Cash flow from operating activities	-5,143	-8,519

Cash flow statement for PANDATEL group

€000	2005	2004
Income from disposal of fixed assets	189	259
Income from disposal of intangible assets	0	261
Payments for investments in tangible assets	-165	-768
Payments for investments in intangible assets	-61	-444
Payments for investments in financial assets	0	-25
Acquisition of subsidiaries less cash acquired	0	-3,443
Cash flow from investing activities	-37	-4,160
Payments to company proprietors (dividends)	0	0
Cash flow from financing activities	0	0
Changes in cash balances impacting earnings	-5,180	-12,679
Changes in cash balances from exchange rates	395	132
Cash and cash equivalents at beginning of period	9,878	22,425
Cash and cash equivalents at end of period	5,093	9,878
Interest paid	2	4
Interest received	208	289
Tax paid (+)/received (-)	72	-56

Acquisition of subsidiaries

€000	2005	2004
Goodwill	0	4,349
Intangible assets	0	983
Tangible assets	0	697
Financial assets	0	0
Inventory	0	797
Trade accounts receivable	0	22
Other assets	0	0
Cash and cash equivalents	0	397
Deferred taxes	0	-1,084
Trade accounts payable	0	-17
Financial liabilities	0	0
Accruals	0	-93
Accruals and taxes payable	0	-20
Other liabilities	0	-31
Third party holdings	0	0
Purchase price paid	0	6,000
Contribution in kind	0	-2,160
Cash acquired	0	-397
Purchase price paid less cash acquired	0	3,443

Statement in changes of shareholders' equity for PANDATEL group

	Subscribed capital	
	Shares	Amount €000
At December 31, 2003	7,225,000	7,225
Capital increase by contribution in kind	670,806	671
Stock option plan1	-	-
Net loss for the year	-	-
Allocation of net loss for the year from retained earnings	-	-
Allocation of net loss for the year to capital reserve	-	-
Unrealized exchange and currency differences after deducting taxes T€0	-	-
At December 31, 2004	7,895,806	7,896
Stock option plan	-	-
Net loss for the year	-	-
Allocation of net loss for the year to retained earnings	-	-
Unrealized exchange and currency differences after deducting taxes T€3	-	-
At December 31, 2005	7,895,806	7,896

The attached notes form an integral part of these annual financial statements.

Capital reserve	Retained earnings	Net profit/loss	Changes in share- holders' equity from exchange rates	Revaluation reserve		Total shareholders' equity
				Currency	Financial instruments	
€000	€000	€000	€000	€000	€000	€000
33,408	3,023	(1,010)	26	4	(151)	42,525
1,489	-	-	-	-	-	2,160
254	-	-	-	-	-	254
-	-	(15,585)	-	-	-	(15,585)
-	(3,023)	3,023	-	-	-	0
(13,572)	-	13,572	-	-	-	0
-	-	-	61	70	109	240
21,579	-	-	87	74	(42)	29,594
85	-	-	-	-	-	85
-	-	(17,012)	-	-	-	(17,012)
(17,012)	-	17,012	-	-	-	-
-	-	-	457	-74	46	429
4,652	-	-	544	-	4	13,096
					4	

Consolidated statement of fixed assets for PANDATEL group

€000	Cost of acquisition and production						12/31/2005
	01/01/2005	Currency differences	Additions	Disposals	Reclassification		
I. Intangible assets							
1. Licenses and software	3,582	0	61	302	0	3,341	
2. Goodwill	4,349	0	0	0	0	4,349	
3. Self-provided intangible assets	180	0	0	0	0	180	
	8,111	0	61	302	0	7,870	
II. Tangible assets							
1. Land and buildings, incl. buildings on external premises	267	0	8	0	0	275	
2. Technical plant and machinery	594	0	0	0	0	594	
3. Other plant, factory and business equipment	5,312	-9	157	453	0	5,007	
	6,173	-9	165	453	0	5,876	
III. Financial assets							
Other long-term financial assets	25	0	0	25	0	0	
	25	0	0	25	0	0	
	14,309	-9	226	780	0	13,746	

The attached notes form an integral part of these annual financial statements.

01/01/2005	Currency differences	Additions	Disposals	Reclassification	Cummulative depreciation		Book value	
					12/31/2005	12/31/2005	12/31/2004	
2,115	9	453	146	0	2,431	910	1,467	
0	0	4,349	0	0	4,349	0	4,349	
0	0	60	0	0	60	120	180	
2,115	9	4,862	146	0	6,840	1,030	5,996	
105	0	170	0	0	275	0	162	
164	0	55	0	87	306	288	430	
3,552	-6	700	225	-87	3,934	1,073	1,760	
3,821	-6	925	225	0	4,515	1,361	2,352	
0	0	0	0	0	0	0	25	
0	0	0	0	0	0	0	25	
5,936	3	5,787	371	0	11,355	2,391	8,373	

Notes to the Consolidated Financial Statements

(A) The Company

PANDATEL AG, Hamburg, came into being from the transformation of Pan Dacom Telekommunikation GmbH, Hamburg, from a limited liability company into a joint stock corporation. The earlier company had commenced operations in 1987.

The transformation into PANDATEL AG, Hamburg, was resolved on March 3, 1999, and entered in the commercial register of the Hamburg District Court on May 14, 1999, under registration number HRB 71126.

The object of PANDATEL AG, Hamburg, is to develop, produce and trade in telecommunications systems and to engage in all activities directly or indirectly related to this.

PANDATEL AG develops, manufactures and distributes active components for network access and network transmission. Its products include multiplexers, modems and the software for managing these systems.

One operating facility is maintained in Hamburg; the Company also has representation offices in France and the United Kingdom, as well as subsidiaries in Singapore, the USA, Germany and Israel. The subsidiary in Israel ceased operations in the year 2004. It had served as one of the Company's competence centers for research and development.

The further development of the Company, its representation offices and subsidiaries are described in the Management Report in the section headed "Developments in 2006".

(B) Summary of the main accounting and valuation principles

Accounting principles

These consolidated financial statements have been prepared in line with the International Financial Reporting Standards (IFRS) and are denominated in euros (€). All the rules laid down in the International Financial Reporting Standards (IFRS) that are applicable and legally binding in the countries of the EU as at December 31, 2005, have been complied with.

The individual financial statements of PANDATEL AG drawn up in accordance with the HGB (German Commercial Code) and the consolidated financial statements of the PANDATEL Group drawn up in accordance with the IFRS are published in the German Federal Gazette.

With the passing of the German Balance Sheet Law Reform Act (BilReG) the transitional rules of § 292a HGB were superseded by those of § 315a HGB. Pursuant to § 315a HGB in combination with Art. 4 of the EU IAS regulations, capital-market oriented parent companies in Germany that are obliged to render annual accounts must draw up the consolidated financial statements that they have so far prepared in accordance with § 290 HGB henceforth in accordance with the rules of the IAS/IFRS. Compliance with the requirement to render consolidated accounts in accordance with the IFRS as specified in § 315a HGB is a condition for the admittance of shares of the parent company to the regular stock market. PANDATEL AG meets this requirement and draws up the consolidated financial statements for its Group with binding effect in accordance with IAS/IFRS.

Application of the IFRS rules and its effects

In accordance with IFRS 1, explanations must be provided of the effects that the change to IFRS has had on the previous years' financial statements so as to enable a transition to be made from the equity capital amounts and consolidated results (result for the period under review) shown in accordance with the previous US GAAP rules to those calculated under the new system. The change from US GAAP to IAS/IFRS necessitates adjustments mainly in the areas of development cost capitalization and deferred taxes.

PANDATEL AG has included in these Notes a transitional calculation for both the result of the period under review and the equity capital shown previously in accordance with US GAAP. Some individual account items have been broken down and reallocated as necessary. In addition, a transitional statement of cash flow is provided.

Equity capital (in €000) at	01/01/2004	12/31/2004
Equity capital in acc. with US GAAP	42,525	29,487
Capitalization of development costs (intangible assets)	0	181
Taxes on income (deferred taxes)	0	-74
Equity capital in acc. with IFRS	42,525	29,594

Result for the period at 12/31/2005	in €000
Result for the period in acc. with US GAAP	-15,693
Capitalization of development costs (research and development costs)	181
Taxes on income	-74
Result for the period in acc. with IFRS	-15,586

The following changes/reallocations were made in the cash flow statement:

Amounts in €000	US GAAP 12/31/2004	IFRS 12/31/2004	Difference
Cash flow from current business operations	-8,011	-8,519	-508
Cash flow from investment activities	-4,928	-4,160	768
Cash flow from financing activities	0	0	0

The changes in the cash flows from current business operations and investment activities result from the fact that development costs were capitalized for the first time under the IFRS (€181,000) as well as from the more appropriate representation of investment income and expenditure (€949,000). The above table shows in addition the change in cash and cash equivalents of limited availability (€392,000) and exchange-rate dependent changes in the financing fund (-€132,000) at the expense of the cash flow from current business operations.

Scope of consolidation

The consolidated financial statements include not only PANDATEL AG but also the following companies in which PANDATEL AG has a controlling financial interest (100% of the voting rights):

- PANDATEL Inc., USA
- PANDATEL Asia Pacific Pte Ltd., Singapore
- PANDATEL Ltd., Israel
- Lightmaze Solutions AG, Eisingen

PANDATEL Ltd., Israel, ceased operations in the year 2004 and is currently being wound down.

Consolidation principles

The statements of the individual companies have been drawn up in line with uniform accounting and valuation principles in order to facilitate their inclusion in the consolidated financial statements. All consolidated companies have the same balance sheet date.

The capital consolidation has been undertaken in accordance with the so-called revaluation method. The attributable values or current values of all the tangible assets and liabilities are first calculated and this portion of the equity capital is then set off against the acquisition costs. Any positive difference is declared as goodwill.

Loans and other accounts receivable or payable between the consolidated companies are offset against each other.

Income from intra-group sales as well as other intra-group income is offset against the corresponding expenses. Interim earnings or losses have been eliminated.

Translation of financial statements in foreign currency

Assets and liabilities carried by the foreign subsidiaries whose functional currency is the local currency of the country in which they are domiciled are translated into euros at the exchange rate ruling on the recording date. The equity capital is translated at the exchange rate ruling on the date of the transaction concerned. For the purposes of the consolidated financial statements, the income statement and cash flow statement of these foreign subsidiaries are translated into euros at the average exchange rate of the fiscal year.

Estimates used in preparing the financial statements

In order to prepare the financial statements, the Executive Board must make estimates and assumptions on matters that affect the amounts of the assets and liabilities in the balance sheet and items in the income statement and cash flow statement, as well as on the statements in the explanatory notes. These estimates and assumptions can deviate from the actual circumstances.

Currency translation

Receivables, cash and cash equivalents and liabilities in foreign currencies are translated at the exchange rate ruling on the date of acquisition. Short-term receivables and liabilities are shown at the rate applicable on the balance sheet date.

Intangible assets

The intangible assets comprise software, licenses and similar rights. Intangible assets with a short useful life are written off by the straight-line method over their probable useful life (between 3 and 10 years). There are, however, also intangible assets whose useful life is unlimited. These include the goodwill of the firm of Lightmaze Solutions AG, Eisingen, which was acquired in 2004. This goodwill was written off completely in 2005 by way of extraordinary depreciation.

Tangible assets

The tangible assets are valued at their acquisition or production costs and are written off over their useful life by the straight-line method. The useful life of the various tangible assets is taken to be as follows:

	Years
External plant and leasehold fixtures	10
Technical plant and machinery	5 - 13
Operating and business equipment	3 - 14
Vehicle fleet	5 - 6
Office equipment	3 - 13
Tools	5
Low-value goods	1

In view of the amalgamation of the operating facilities in Germany, some tangible assets (e.g. leasehold fixtures) had to be written off in full.

Impairment of values of durable goods and intangible assets

Durable and intangible assets are examined for value impairment if events or changes have occurred that indicate that the net book value of the assets could no longer be obtained through their sale. Should facts or circumstances lead us to conclude that values have indeed been impaired, the net book value of the assets in question is compared with the future estimated income from their sale. If necessary, the resulting figure is written down to the lower value.

Financial assets

The financial assets are shown at cost of acquisition or current value, whichever is the lower.

Inventories

Raw materials and supplies as well as merchandise are shown at cost of acquisition or at market price, whichever is the lower. Finished goods are valued at cost of production. Cost of production encompasses the cost of materials and wages entailed in production, as well as the material and production overheads which have to be declared as assets according to tax law. Interest on borrowed capital is not shown as an asset. Where inventories are exposed to risks, such as that of reduced usability after lengthy warehousing, appropriate deductions for storage are made. Except in the case of customary retentions of title, inventories are unencumbered by third party rights.

Receivables

Receivables are shown at their nominal value, less value adjustments for expected defaults.

Securities

PANDATEL AG holds a portfolio of available-for-sale securities. These are available to the Company as required and are evaluated at their market value at the end of the financial year. Unrealized profits and losses, less any deferred taxes payable on them, are shown as components of the revaluation reserve forming part of the equity capital and have no effect on the operating result. They are removed from the reserve when the securities in question are sold, the profits or losses concerned then being shown in the income statement. Unrealized losses that are not only of a temporary nature necessitate a write-down on the securities that is also shown in the income statement. PANDATEL AG does not hold any securities for trading purposes.

Financial derivatives

PANDATEL AG applies IAS 39 in the version currently valid. This accounting standard requires that all financial derivatives are shown at market value, regardless of the purpose or intention underlying their purchase or sale. Changes in the market value of the financial derivatives are recorded on an accrual basis either in the operating result or in the equity capital (as part of the other changes in equity capital which do not affect the operating result), depending on whether the transaction concerned is a fair value hedge or a cash flow hedge. PANDATEL AG has so far used derivative financial instruments only to a minor extent.

Cash and cash equivalents

Cash and cash equivalents include cash balances, current balances with banks and time deposits with original terms of up to three months.

Cash and cash equivalents which serve as collateral and to which the Company has no access are not contained in the cash and cash equivalents. They are shown under other short-term assets (in the previous year under other long-term assets). For the purposes of the cash flow statement, cash and cash equivalents to which the Company has limited access are not included in the cash and cash equivalents.

Accruals and liabilities

Accruals are formed for uncertain liabilities and impending losses if there is a likelihood that an obligation exists and the amount of the claim or loss can be estimated with sufficient accuracy. Liabilities are shown at the amounts repayable. Short-term liabilities in foreign currency are valued at the exchange rate ruling at the close of the financial year.

Realization of sales

As a general principle, sales are realized with the rendering of services in accordance with the conditions agreed upon. Sales revenues take rebates, customer bonuses and cash discounts into account. Accruals are set aside for sale-or-return transactions in the appropriate amount. The basis for this is the ratio of the returns of the last two financial years to the corresponding sales.

Product-related expenses

Expenses relating to unit sales are entered in the income statement at the time they are incurred. Accruals for guarantee payments are formed at the time of the sale of the products.

Sales costs

Advertising costs and other sales expenses are entered immediately in the income statement.

Research and development expenses

Costs for the development of new products are shown as assets together with the production costs insofar as they can be allocated to a particular category and insofar as it is certain that the newly developed products are technically feasible and also marketable (IAS 38). The development activities must, moreover, be sufficiently likely to make money for the Company in the future. In this context the production costs comprise all the costs directly or indirectly attributable to the development process. Scheduled depreciation is based on the planned useful technical life of the products. Useful life is generally taken to be 3 years. According to IAS 38 research costs may not be declared as assets and are therefore entered immediately in the income statement as expenses. In PANDATEL AG's case no research costs have as yet been incurred.

For purposes of the annual financial statements, all assets are subjected to a value impairment test in which the variable gross margins, less unaccrued interest, are compared with the asset values and adjusted as necessary.

Remuneration in the form of stock options

The Company declares its stock options in accordance with the market value method. Accordingly, personnel expenditure is calculated on the basis of the market value of the options at their subscription date, taking the average option period in each case. The expenditure calculated in this way is therefore not necessarily indicative of the amounts actually debited in future reporting periods.

Income taxes

Taxes on income and earnings are calculated according to the so-called liability method. Deferred taxes are calculated for the expected future tax bill from differences in the valuation of assets and liabilities for tax purposes and the values shown in the financial statements. The valuation of these deferred taxes is based on the tax rates applicable at the time of reporting. The impact of changes in the tax rates is factored into the income statement in the year in which the changes take effect. The deferred tax values are adjusted, if necessary, depending on their realizability.

Earnings and diluted earnings per share

Earnings per share are calculated from the weighted number of outstanding ordinary shares, including equity-like securities. Equity-like securities for remuneration in the form of stock options are not included in the calculation if they have the effect of reducing the diluting effect on earnings.

(C) Explanatory notes

(1) Tangible and intangible assets, financial assets

The structure and development of the fixed assets are presented in the consolidated statement of fixed assets appended to this report.

The additions to the intangible assets result from the purchase of software.

It is expected that write-downs on intangible assets in the next few years will be as follows:

	€000
2006	318
2007	305
2008	245
2009	147
after 2009	15

The goodwill from the acquisition of Lightmaze Solutions AG in 2004 was written off completely in the course of the year 2005 owing to a continuously negative development of the business.

The additions to the tangible assets are mainly due to the purchase of other operating and business equipment, especially computer hardware.

The write-downs of the year under review can be broken down as follows:

€000	2005		2004	
	Scheduled	Unscheduled	Scheduled	Unscheduled
Intangible assets	513	0	437	211
Tangible assets	717	208	521	144
Goodwill	0	4,349	0	0
	1,230	4,557	958	355

Leasehold fixtures, office equipment and technical plant that were no longer used owing to the restructuring of the Company were written off by way of extraordinary depreciation.

In the year under review a profit of €27,000 (previous year: €11,000) and losses of €223,000 (previous year: €14,000) resulted from the disposal of fixed assets.

(2) Other non-current assets

€000	12/31/2005	12/31/2004
Rent deposits	0	4
Limited access cash	0	434
Other long-term assets	0	21
	0	459

(3) Inventories

The inventories are composed of the following:

€000	12/31/2005	12/31/2004
Raw materials and supplies	1,333	2,337
Unfinished goods and work in progress	464	524
Finished goods and services	1,028	1,417
Merchandise	331	133
Deposits paid	488	193
	3,644	4,604

Depreciations on inventory stocks amount to €4,979,000 (previous year: €5,164,000).

(4) Trade accounts receivable

€000	12/31/2005	12/31/2004
Gross receivables	4,205	4,245
Less value adjustments	783	605
	3,422	3,640

The value adjustments primarily concern customers from Europe.

(5) Short-term investments/marketable securities

The Company has no speculative intentions as regards the securities held at the balance sheet date, nor does it intend to retain these until maturity. These securities are therefore classified as available for sale and can be disposed of as required.

	Acquisition costs	Stock exchange or market value	Unrealized profits	Unrealized losses
Papers securitizing outside capital	2,900	2,907	7	0

The marketable securities available at the balance sheet date consist exclusively of euro-floaters (maturing 2009). The unrealized profits, less deferred taxes, are shown as part of the revaluation reserve.

(6) Taxes receivable

The taxes receivable amounting to €162,000 (previous year: €98,000) relate mainly to taxes on investment income.

(7) Prepaid expenses and other current assets

€000	12/31/2005	12/31/2004
Interest receivable	17	6
Prepaid expenses	38	38
VAT	338	133
Funds of limited availability	231	0
Other current assets	77	13
	701	190

The funds of limited availability have to do with rental agreements. Since these agreements will expire in 2006, the funds involved are shown as short-term assets.

(8) Cash and cash equivalents

€000	12/31/2005	12/31/2004
Current account	1,385	6,683
Overnight money euros	208	0
Time deposits	3,500	3,195
	5,093	9,878

No unrealized exchange-rate losses arose either at the balance sheet date or in the previous year.

Funds of limited availability in the amount of €231,000 (previous year: €434,000) are shown under other short-term assets (previous year: under other long-term assets).

(9) Share capital**Subscribed capital**

The subscribed capital amounts to €7,895,806.00 (previous year: €7,895,806.00), divided into 7,895,806 no-par value shares with an arithmetical share in the capital stock of €1.00 each. All the shares have been issued and are in circulation.

Authorized capital

The Executive Board is authorized, subject to the consent of the Supervisory Board, to increase the capital stock in one or several steps until May 26, 2009, by issuing new bearer shares against cash or non-cash contributions, by a maximum amount of €3,600,000.00. Advantage was taken of this authorization in connection with the acquisition of Lightmaze Solutions AG to the amount of €670,806.00 so that authorized capital in the amount of €2,929,194.00 remains. Subject to the consent of the Supervisory Board, the Executive Board is empowered to exclude the statutory subscription rights of the existing shareholders for newly issued bearer shares to a total of up to 720,000 new bearer shares, should the issue amount of the shares not be substantially lower than the share price on the stock market.

Contingent capital

The extraordinary General Meeting of September 22, 1999, resolved a conditional increase in the capital stock of up to €350,000.00 by issuing up to 350,000 new ordinary bearer shares in the form of unit shares. This capital increase is connected with the granting of option rights in several tranches to members of the Executive Board, segment heads and group leaders at PANDATEL AG. Each option entitles the holder to subscribe to one ordinary share in PANDATEL AG in accordance with the stock option plan resolved by the General Meeting.

Own shares

Pursuant to the resolution of the Annual General Meeting of May 30, 2002, the Company was authorized until November 2003 to acquire its own shares up to a maximum of 10% of the capital stock. This right was extended most recently at the General Meeting of May 19, 2005.

Allocation of retained earnings

The deficit for the year in the amount of €17,012,000 was offset against the capital reserves. The balance sheet profit/loss is €0.

Stock options

At December 31, 2003, stock options were granted in five tranches. The first tranche (from the year 1999) covered 54,163 stock options, of which 24,999 were held by members of the Executive Board. These options could not be exercised until December 1, 2001.

The second tranche (from the year 2000) covered 55,199 stock options, of which 24,999 were held by members of the Executive Board. The options of the second tranche were returned without exception and without claim to compensation on January 31, 2001. The third tranche (from the year 2001) covered 60,199 stock options, of which 24,999 were held by members of the Executive Board. The options of the third tranche could not be exercised until after the Annual General Meeting in May 2003.

The fourth tranche (from the year 2002) covered 56,999 stock options, of which 24,999 were again held by members of the Executive Board. The options of the fourth tranche could not be exercised until after the Annual General Meeting in May 2004. The fifth tranche (from the year 2003) covered 123,150 stock options, of which 75,000 were held by members of the Executive Board. The options of the fifth tranche could not be exercised until after the Annual General Meeting in May 2005.

The stock options from the first, third, fourth and fifth tranches can only be exercised if the price of the PANDATEL AG ordinary share exceeds either the issue price (€22.00 for the first tranche) by 20% or the reference price (€36.10 for the third tranche, €12.41 for the fourth tranche and €2.96 for the fifth tranche), and if the price of the PANDATEL AG ordinary share has at least kept pace during the period between issue and exercise of the option rights with the trend of a combination of the Neuer Markt index (All Share Index) with a one-third weighting, and the weighted sector index comprising Adva AG, AUGUSTA Technologie AG, BinTec AG, CeoTronics AG, euromicron AG, teles AG and transtec AG with a two-third weighting. The maximum maturity of the options from the three tranches is 7 years, the expected maturity 4.5 years. From the fourth tranche onwards, an annual fluctuation of 5% was taken into account, owing to the fact that some option holders left the Company before the stock option plan came to an end.

In the report prepared by the Institut für Wirtschaftsmathematik und betriebliche Altersversorgung GmbH, the fair value was calculated by way of simulation (the Monte-Carlo Method). The trends underlying both the prices of the PANDATEL AG shares and of the comparison portfolio, which were assumed to correlate positively, were calculated using the Black-Scholes Model.

The value of the options is spread across the conversion period as an expense and booked as a counter-position to the capital reserves. The second tranche was returned to the Company in 2001. The expenses incurred by the option holders who left the Company before the blocking period of the issued options had expired were reversed in the years of their departure.

	1st tranche	3rd tranche	4th tranche	5th tranche
Fair value in €	14.25	10.01	4.29	1.29
Based on the following assumptions:				
Mean maturity in years:	4.5	4.5	4.5	4.5
Fluctuation rate	0%	0%	5%	5%
Dividend	none	none	none	none
Risk-free interest	5.575%	4.76%	4.90%	5.4%
Volatility	37.79%	42.39%	46.45%	78.79%

	1st tranche	2nd tranche	3rd tranche	4th tranche	5th tranche	Total units
Outstanding options at January 1, 2005	41,247	0	37,826	43,666	67,650	190,389
Weighted average remaining maturity at January 1, 2005, in months	0	0	8	20	32	20
Weighted average exercise price at January 1, 2005, in €	22.00	0.00	36.10	12.41	2.96	18.37
Outstanding options at December 31, 2005	26,248	0	18,953	14,333	5,850	65,384
Exercisable options at December 31, 2005	26,248	0	18,953	14,333	5,850	65,384
Options issued in 2005	0	0	0	0	0	0
Options exercised in 2005	0	0	0	0	0	0
Lapsed/returned options in 2005	14,999	0	18,873	29,333	61,800	125,005
Expired options in 2005	0	0	0	0	0	0
Weighted average remaining maturity at December 31, 2005 in months	0	0	0	8	20	14
Weighted average exercise price at December 31, 2005, in months	22.00	0.00	29.50	22.90	14.04	18.37

In the years 1999 to 2005 a total of 284,326 stock options were returned. These were not awarded again. The expenses in connection with the stock option plan relate to the various functional areas as follows:

€000	2005	2004
Costs of goods sold	0	2
Sales costs	45	139
Research and development costs	7	29
General administrative costs	33	84
	85	254

(10) Trade accounts payable

€000	12/31/2005	12/31/2004
Trade accounts payable	498	598
Liabilities from deposits received	64	0
	562	598

(11) Liabilities against affiliated companies

In the previous year this item comprised the liabilities vis-à-vis AUGUSTA Technologie AG.

(12) Tax accruals

€000	Position at 01/01/2005	Used	Dissolved	Allocated	Position at 12/31/05
Accruals for pre-tax costs of flotation	138	0	0	0	138
Other tax accruals	9	9	0	0	0
	147	9	0	0	138

(13) Other accruals

€000	Position at 01/01/2005	Used	Dissolved	Allocated	Position at 12/31/05
Sales accruals	42	0	42	137	137
Outstanding staff remuneration	141	141	0	161	161
Miscellaneous accruals	264	247	12	373	378
Restructuring accrual	1,313	1,097	5	2,850	3,061
	1,760	1,485	59	3,521	3,737

The sales reserves comprise mainly commissions to sales agents.

The miscellaneous reserves include mainly provisions for outstanding bills (€264,000), for costs of drawing up the annual financial statements (€45,000) and for costs of publishing the Annual Report (€40,000).

The restructuring reserve includes severance payments in accordance with the social benefit plan (€1,600,000), additional costs involved in premature terminations of contracts (€850,000) and legal and consulting costs.

(14) Other current liabilities

€000	12/31/2005	12/31/2004
Social insurance contributions	142	176
VAT and other retained taxes	0	146
Other	404	395
	546	717

(15) Revenues

Sales declined by 14% from €14,907,000 in the previous year to €12,784,000 in the year under review, which was even less than expected.

In 2005 the proportion of foreign sales was 79.0% as compared with 82.9% in the previous year. The EMEA region (Europe, Middle East, Africa) remained the front-runner, experiencing a relatively moderate decline in comparison with the other regions, namely by 7.1% from €10.0 million in 2004 to €9.3 million in 2005. In contrast, Eastern Europe on the one hand, and Africa and the Near East on the other generated the lowest sales in the EMEA region. On the 2005 balance sheet date, these each recorded sales of only €0.4 million, representing a drop of 51% and 49% respectively. The American continent did relatively worst, whereas Latin and South America maintained previous year's level. In comparison with the previous year sales declined by 61.9%, amounting to €0.4 million in 2005 as against €1.0 million in 2004.

(16) Cost of revenues

€000	2005	2004
Expenditure for raw materials and supplies and for goods and services purchased	5,676	9,223
Personnel costs	1,145	1,345
Other attributable costs	1,426	1,354
	8,247	11,922

The expenditure for goods and services purchased decreased in the year under review in parallel with the decrease in sales. The personnel costs and the other attributable costs are much the same as in the previous year.

(17) Selling and marketing expenses

The selling and marketing expenses totalling €3,938,000 (previous year: €4,836,000) consist mainly of personnel costs in the amount of €1,320,000 (previous year: €2,230,000), losses on receivables and adjustments of value of €441,000 (previous year: €495,000) and advertising and marketing costs of €843,000 (previous year: €1,083,000).

(18) Research and development expenses

The research and development expenses include development costs for the new product YUMIX and costs for the further development of existing products.

Since the volume of sales realized through the newly developed products was far lower than expected, no additional development costs were shown in 2005 on the assets side of the balance sheet.

(19) General administrative expenses

The general administrative expenses contain costs in connection with the Company's stock exchange listing of €261,000 (previous year: €284,000). These relate to investor relations advice, remuneration for the designated sponsors, the admittance fees payable to Deutsche Börse AG, the costs for the Annual General Meeting and the costs for the quarterly reports and the consolidated financial statements.

(20) Restructuring expenses

€000	2005	2004
Personnel expenses	2,370	1,572
Provisions for rents	593	530
Write-offs of leasehold fixtures	208	355
Other	278	126
	3,449	2,583

(21) Other income/other expenses

€000	2005	2004
Accounting profits from disposals of fixed assets	27	11
Non-cash remunerations	36	73
Income from the release of reserves	59	91
Other income	119	77
	241	252
Less:		
Accounting losses from disposals of fixed assets	-223	-14
Other taxes	0	-4
Other operating expenses	-16	0
	-239	-18
	2	234

(22) Interest income/expenses

€000	2005	2004
Income from securities and lendings carried as financial assets	7	0
Other interest and similar income	24	15
Interest income from fixed-term deposits	202	277
Total interest income	233	292
Interest expenses from short-term liabilities	-1	-1
Guarantees	-3	-3
Total interest expenses	-4	-4
	229	288

(23) Foreign currency exchange gains/losses

€000	2005	2004
Currency gains from foreign investments, loans and deposits	117	282
Currency gains from open foreign-currency accounts receivable and payable	106	0
Currency losses from open foreign-currency accounts receivable and payable	0	-6
Currency losses from foreign investments, loans and deposits	-932	-561
	-709	-285

(24) Income taxes

The results before income tax of all the companies included in the consolidated financial statements for 2005 are -€15,093,000 (previous year: -€15,326,000). These results are subject to taxation in Germany, Singapore, the USA and Israel. PANDATEL AG and its subsidiaries in the USA and Singapore recorded a loss in 2005, while Lightmaze Solutions AG showed a small profit.

The income tax bill is made up of current and deferred taxes:

€000	2005	2004
Current taxes	-11	37
Deferred taxes	-1,909	223
	-1,920	260

In 2005 the Company was subject to corporation tax at a rate of 25% of taxable income plus the German solidarity surcharge of 5.5% of the tax bill. This results in a combined tax rate of 26.375% for 2005 (previous year: 26.375%).

Moreover, the Company is subject to trade tax which is deducted when calculating the profit for corporation tax purposes. Thus the effective trade tax for 2005 was 19.028% (previous year: 19.028%). The combined tax rates for 2005 were therefore 40.38% (previous year: 40.38%), taking into account the deductibility of the trade tax.

The following table explains the most important differences between the expected tax bill for corporation tax plus the German solidarity surcharge for the years 2005 and 2004, and the actual tax bill incurred:

€000	2005	2004
Expected tax yield/expenditure	-6,095	-6,188
Non-deductible expenses		
- Depreciation on intangible assets	2,005	185
- Stock option plan	34	103
- Other	13	18
Tax reduction owing to		
- Value adjustment for loan to subsidiary	-545	-208
- Value adjustment for deferred tax losses carried forward	6,326	6,241
Adjustments deferred taxes on the assets side on loss carried forward previous year	183	0
Deviating tax rate abroad	66	71
Other	-67	38
	1,920	260
Effective tax rate	-12.7 %	-1.7 %

At the balance sheet date PANDATEL AG had corporation tax loss carryovers of €32,456,000 (previous year: €23,361,000) and trade tax loss carryovers of €32,967,000 (previous year: €23,872,000). These can be carried forward in full. Owing to the change in shareholder structure (over 50%) and the planned non-cash contribution of Dowlake Microsystems Corp., PANDATEL AG's loss carryovers are at risk, to allow for which full value adjustments were made.

In addition, PANDATEL AG has corporation tax credits of €1,412,000 resulting from the change from the corporation tax credit method to the definitive taxation method. These credits can be used, up to a certain fixed amount, for dividend payments until the year 2019. However, since no dividend payments are planned at present and in view of the lengthy period over which the credits may be used, full value adjustments were made already in the previous year.

In the USA, loss carryovers exist of some €4,792,000 (previous year: €4,513,000). These have been fully value-adjusted in each case, since it appears uncertain whether the tax authorities will recognize them. These loss carryovers expire in the years 2011 to 2023.

The subsidiary in Singapore reported a loss for 2005 of €354,000 (previous year: a loss of €402,000). For 2005 a tax loss carryover of €972,000 (previous year: €618,000) remains, use of which is not subject to any limitation.

Deferred taxes carried as assets and liabilities result from the following items:

€000	12/31/2005	12/31/2004	€000	12/31/2005	12/31/2004
Deferred taxes carried as assets:			Deferred taxes carried as liabilities:		
Inventories	19	19	Inventories	0	282
Intangible assets	0	0	Accounts receivable	61	0
Provisions	279	191	Provisions	29	0
Loss carried forward AG	13,204	9,794	Trade accounts payable	0	2
Loss carried forward USA	1,917	1,805	Development costs declared as assets	49	74
Loss carried forward Singapore	214	136	Tangible fixed assets	140	363
Corporation tax credit balance pursuant to § 37 KStG	1,412	1,412	Intangible fixed assets	262	487
Accounts receivable	2	2		541	1,208
	17,047	13,359	Deferred taxes (net)	-241	1,730
Value adjustments	-16,747	-10,421		(liabilities)	(assets)
	300	2,938			

(25) Earnings per share

The following table shows the calculation of the undiluted and diluted earnings per no-par value share:

€000	2005	2004
Numerator		
Group net loss/profit for the year	-17,012	-15,586
	-17,012	-15,586
Denominator		
Weighted average of outstanding no-par value shares in units	7,895,806	7,560,403
Diluting shares in accordance with the stock option plan	0	0
	7,895,806	7,560,403
Loss/profit per no-par value share in €/unit	-2.15	-2.06
Diluted loss/profit per no-par value share in €/unit	-2.15	-2.06

Options are not included if their issue price is higher than their average stock market price.

A maximum of 65,384 options can have a diluting effect up to the year 2010.

(D) Other information**Cost of materials**

€000	2005	2004
Expenses for raw materials and supplies	5,372	7,576
Expenses for services rendered	256	972
	5,628	8,548

Personnel expenses

€000	2005	2004
Wages and salaries	5,376	8,519
Social insurance contributions	958	1,181
Pension payments	1	7
	6,335	9,707

Rents and other financial obligations

Other financial obligations arise from rental and leasing contracts in the following amounts:

	€000
2006	322
2007	163
2008	5
2009	0
2010	0
after 2010	0

Information on the business areas

The Company's reports are divided between primary and secondary segments. The primary segment reports break the Company's business down by geographical region, the secondary segment reports by product.

In the primary segment reports, that is broken down by region, PANDATEL AG differentiates between the following reporting areas to which our customers are allocated according to their place of domicile:

- EMEA (Europe, Middle East and Africa)
- The Americas
- Asia Pacific

The primary segment results for 2005 are as follows:

		EMEA	The Americas	Asia	Sum	Consolidation	Group result
Segment earnings	12/31/2005	9,250	397	3,137	12,784	0	12,784
(external)	12/31/2004	9,956	1,041	3,910	14,907	0	14,907
Segment earnings	12/31/2005	4,084	0	0	4,084	4,084	0
(internal)	12/31/2004	4,032	0	0	4,032	4,032	0
Segment depreciation	12/31/2005	1,158	5	67	1,230	0	1,230
(scheduled)	12/31/2004	808	39	111	1,333	0	958
Segment depreciation	12/31/2005	4,557	0	0	4,557	0	4,557
(unscheduled)	12/31/2004	355	0	0	0	0	355
Interest result	12/31/2005	504	-174	-101	229	0	229
	12/31/2004	502	-154	-60	288	0	288
Segment result	12/31/2005	-9,633	-104	-170	-9,907	-4,705	-14,612
	12/31/2004	-14,008	-432	-341	-14,781	-548	-15,329
Segment assets	12/31/2005	17,685	138	1,593	19,416	-796	18,620
	12/31/2004	33,622	156	1,702	35,480	-1,441	34,039
Segment liabilities	12/31/2005	5,487	3,856	2,507	11,850	-6,326	5,524
	12/31/2004	5,063	4,089	2,195	11,347	-6,902	4,445
Segment investments	12/31/2005	213	2	11	226	0	226
	12/31/2004	7,199	0	41	7,060	0	7,240
Important expenses without effect on payments	12/31/2005	2,355	0	0	2,355	0	2,355
	12/31/2004	1,622	0	0	1,622	0	1,622

In 2005 the proportion of foreign sales was 79.0% as compared with 82.9% in the previous year. The EMEA region (Europe, Middle East, Africa) remained the front-runner, experiencing a relatively moderate decline in comparison with the other regions, namely by 7.1% from €10.0 million in 2004 to €9.3 million in 2005. The largest contributions again came from the United Kingdom and France, with sales of €2.3 million and €2.1 million respectively. In contrast, Eastern Europe on the one hand, and Africa and the Near East on the other generated the lowest sales in the EMEA region. On the 2005 balance sheet date, these each recorded sales of only €0.4 million, representing a drop of 51% and 49% respectively. The American continent did relatively worst, whereas Latin and South America maintained previous year's level. In comparison with the previous year sales declined by 61.9%, amounting to €0.4 million in 2005 as against €1.0 million in 2004.

The intra-group invoicing prices bear comparison with external prices.

In addition, for the secondary classification PANDATEL AG breaks down its reporting into the following product segments:

- Connectivity
- Access Multiplexers
- Optical Systems.

The Connectivity Segment encompasses products for converting data or for linking companies. For example, it employs rack systems including management for modems and converters.

The Access Multiplexers segment makes products for data bundling and accessing metro networks, e.g. SDH over IP or IP over SDH multiplexers.

Complex wWDM systems for SAN applications belong in the Optical Systems segment. These include YUMIX, FOMUX, DWDM and CWDM systems as well as TDMs.

The following table shows the secondary segmentation by business areas:

		Access Multiplexers	Connectivity	Optical Systems	Sum	Consolidation	Group result
Segment earnings	12/31/2005 in %	3,889 30	6,122 48	2,773 22	12,784 100	0	12,784
	12/31/2004 in %	4,743 32	8,672 58	1,492 10	14,907 100	0	14,907
Segment assets	12/31/2005	5,883	9,412	4,314	19,609	-989	18,620
	12/31/2004	11,289	20,640	3,551	35,480	-1,441	34,039
Segment investments	12/31/2005	69	108	49	226	0	226
	12/31/2004	327	599	6,315	7,240		7,240

The segment assets are calculated on the basis of the percentage contributions of the different business segments to the segment earnings.

The shares of total sales accounted for by the different business segments changed only very slightly. It was mainly in the area of optical systems that results failed to meet expectations, since the advanced but highly complex Yumix 4000 system produced by Lightmaze is employed chiefly in project business. The segment responsible for the largest proportion of sales was again Connectivity Products, with 47.9% of total turnover. The contributions of Access Multiplexers and Optical Systems were 30.4% and 21.7% respectively.

Business relations with affiliated companies

Dowlake Venture Ltd. owns 49.98% of the Company's shares.

PANDATEL AG and its direct subsidiaries (PANDATEL Inc., PANDATEL Asia Pacific Pte Ltd., PANDATEL Ltd. and Lightmaze Solutions AG) are therefore controlled by Dowlake Venture Ltd. The PANDATEL Group did not do any business with Dowlake Venture Ltd. in the year under review.

In the period from January 1 to March 31, 2005, AUGUSTA Technologie AG held 51.43% of the shares of PANDATEL AG, Hamburg, and from March 31, 2005 onwards 49.98%.

With effect from November 19, 2005, AUGUSTA Technologie AG, Frankfurt, sold 29% of its PANDATEL AG shares to Dowlake Venture Ltd. Its remaining holding of 20.98% was sold to Dowlake Venture Ltd. on December 28, 2005.

For the major part of the year 2005, therefore, PANDATEL AG and its Group was controlled by AUGUSTA Technologie AG. Business dealings with AUGUSTA Technologie AG and its subsidiaries existed only to a limited extent and were conducted in accordance with usual market conditions.

Information on financial instruments

As part of its business operations, the Company is exposed, among other things, to risks from fluctuations of foreign currency exchange rates against the euro. Risks arising from financial transactions are subject to treasury management in collaboration with the banks with which PANDATEL AG deals.

In 2005 PANDATEL AG made use of currency futures as a hedge against losses on foreign currency receivables. During the period under review two US dollar put options were purchased. By paying an option premium, the Company purchased the right to convert an agreed sum in US dollars into euros on a fixed date and at a predetermined rate of exchange. The purpose of these options was to hedge the Company's US dollar positions. No option transactions were still pending at the balance sheet date.

The profits and losses from currency futures are shown under the heading "Currency profits/losses".

Key accounts

With the Company's three largest customers, sales were generated in the financial year of €2,024,000 (previous year: €2,423,000), €1,514,000 (previous year: €1,389,000) and €733,000 (previous year: €1,057,000).

The sales to these customers related to the segments Connectivity Products at €2,061,000 (previous year: €2,911,000), Optical Systems at €723,000 (previous year: €6,000) and Access Multiplexers at €1,487,000 (previous year: €1,952,000).

Payroll

The average number of persons employed by the Company in the year under review changed compared with the previous year as follows:

	2005	2004
Salaried staff	88	146
Wage earners	32	38
	120	184

Company Boards

The Executive Board is composed of the following:

Dr. Dan D. Yang, Chairman (since November 19, 2005)

Mr. Norbert Wienck, Hamburg (until January 19, 2005)

Dr. Elke Jahn, Hamburg (until October 14, 2005)

Dr. Niraj Agrawal, Hamburg (until October 14, 2005)

Mr. Thomas Becker, Calw (from August 24, 2005)

Dr. Dan D. Yang is also Chairman of the Board of Directors of Dowslake Microsystems Corp., Santa Clara.

In 2005 the emoluments of the Executive Board totalled €600,000 (previous year: €534,000). As in the previous year, no stock options were awarded. Compensation of €250,000

was paid to the former Board member Norbert Wienck. A reserve of €100,000 was set aside for payments to the resigning Board members Dr. Elke Jahn and Dr. Niraj Agrawal. The expenses for compensation payments are included in the total emoluments of the Executive Board for the year under review (€600,000).

The Supervisory Board consists of the following persons:

Mr. Axel Haas, Chairman (until November 18, 2005), Chairman of the Executive Board of AUGUSTA Technologie AG, Frankfurt

Dr. Ing. Steffen Leistner, Deputy Chairman, Managing Director at Booz Allen & Hamilton, Munich

Prof. Dr. Uwe Hannig (until November 18, 2005), Managing Director of Auto-Center Zwickau GmbH, Autopark Zwickau GmbH, AVM Aktiv Verwaltungs- und Managementgesellschaft mbH, Clever CarDiscount GmbH (since January 1, 2004), Megatrend Gesellschaft für Marktforschung und Unternehmenskommunikation GmbH and PreVis Premium Immobilien und Service GmbH. All the afore-mentioned companies are domiciled in Zwickau.

Mr. Haas is also Chairman of the Supervisory Board of ND SatCom AG, Immenstaad.

Prof. Dr. Hannig is Chairman of the Supervisory Board of Terra Limes NRW AG, Willich.

By decision of the Hamburg District Court on January 19, 2006, Dr. Axel Pfeifer, a lawyer, and Mr. Alex Fang, an investment banker, were appointed to the Supervisory Board. At the Supervisory Board meeting on January 30, 2006 Dr. Axel Pfeifer was elected Chairman of the Supervisory Board.

Dr. Axel Pfeifer is also Chairman of the Supervisory Board of PROUT Aktiengesellschaft, Darmstadt.

Mr. Fang is also a member of the Board of the companies Osram Lighting Center Systems Ltd., Hongkong, China, and Diyixian.com Ltd., Hongkong, China.

The emoluments of the Supervisory Board amounted to €30,000 (previous year: €36,000). Of this, €12,000 was paid to Mr. Haas, €12,000 to Dr. Leistner and €6,000 to Prof. Dr. Hannig.

The members of the Supervisory Board are elected until the close of the Annual General meeting that approves its actions for the fourth year following the commencement of its term of office.

	Number of shares = Amount of nominal capital			Number of share options	
	12/31/2005	12/31/2004	Percentage of nominal capital	12/31/2005	12/31/2004
Executive Board					
Norbert Wienck* ¹	-	0	-	0	49,999
Dr. Elke Jahn* ²	-	335,403	-	0	0
Dr. Niraj Agrawal* ²	-	335,403	-	0	0
Thomas Becker	0	0	0.00	0	0
Dr. Dan D. Yang * ⁴	0	0	0.00	0	0
Supervisory Board					
Axel Haas* ³	-	50,000	-	0	0
Dr. Steffen Leistner	-	1,145	-	0	0
Prof. Dr. Uwe Hannig* ³	-	1,000	-	0	0
Total	0	722,951	0.00	0	49,999

*¹ left the Board on January 19, 2005

*² left the Board on October 14, 2005

*³ left the Board on November 21, 2005

*⁴ Dr. Dan D. Yang owns 50% of Dowlake Venture Ltd.

Particular events following the end of the financial year

Detailed information on the events following the end of the financial year is contained in the Management Report.

Disclosure in accordance with § 25 para. 1 WpHG (German Securities Trading Act)

The following reports have been submitted concerning ownership of more than 5% of the shares of PANDATEL AG:

Shareholder	Shares at 12/31/2005	
	in %	
Dr. Elke Jahn, Dr. Niraj Agrawal*	5.66	
Dowlake Venture Ltd.	49.98	

* The shares each contain 223,634 voting rights (2.83%) of the other Board member, attributed to the member concerned in accordance with § 22 para. 2 WpHG.

The following notifications were received by the Company:

April 2005

AUGUSTA Technologie AG, Wilhelm-Leuschner-Str. 9-11, Frankfurt am Main, informed the Executive Board in accordance with § 21 para. 1 WpHG that its share of the voting rights in PANDATEL AG, Hamburg, had fallen below the statutory notification level of 50% with effect from March 30, 2005, and was now 49.98% (3,946,516 shares).

November 2005

AUGUSTA Technologie AG, Wilhelm-Leuschner-Str. 9-11, Frankfurt am Main, informed the Executive Board in accordance with § 21 para. 1 WpHG that its share of the voting rights in PANDATEL AG, Hamburg, had fallen below the statutory notification level of 25% with effect from November 25, 2005, and was now 20.98% (1,656,620 shares).

Dowlake Venture Ltd., a company registered in the British Virgin Islands (Reg. Office Offshore Incorporation Ltd., PO Box 957, Roadtown, Tortola, BVI, with the postal address 3206 Scott Boulevard, Santa Clara, CA 95054, United States of America), informed the Executive Board in accordance with § 21 para. 1 WpHG that its share of the voting rights in PANDATEL AG, Hamburg, had risen

above the statutory notification levels of 5%, 10% and 25% with effect from November 25, 2005, and was now 29% (2,289,896 shares).

In addition, Dr. Dan D. Yang and Mr. Zibin Lu, both resident at 2388 Hong Qiao Road, C-37 Dynasty Villa, Shanghai 100335, People's Republic of China, informed the Executive Board in accordance with § 21 para. 1 WpHG that their joint share of the voting rights in PANDATEL AG, Hamburg, had risen above the statutory notification levels of 5%, 10% and 25% also with effect from November 25, 2005, and was now 29% (2,289,896 shares).

Ownership by the two above-named persons of 2,289,896 no-par value shares of PANDATEL AG via their jointly owned company Dowlake Venture Ltd. is confirmed in accordance with § 22 para. 1 no. 1 WpHG and, in view of their mutual agreement to act in unison, also in accordance with § 22 para. 2 WpHG.

January 2006

AUGUSTA Technologie AG, Wilhelm-Leuschner-Str. 9-11, Frankfurt am Main, informed the Executive Board in accordance with § 21 para. 1 WpHG that its share of the voting rights in PANDATEL AG, Hamburg, had fallen below the statutory notification levels of 10% and 5% with effect from December 30, 2005, and was now 0.00% (0 shares).

Information on the auditing company

The auditing company Ebner, Stolz und Partner GmbH, Hanover, was entrusted with the task of auditing the Group's annual financial statements.

Its total fees for 2005 were as follows:

Audit of financial statements	€	76,681.15
Other certifications and evaluations	€	31,161.78
Tax advice	€	11,142.59
Other services	€	2,799.49
Total	€	121,785.01

The other certifications and evaluations consisted mainly of examining the interim reports, checking the changeover to IFRS and assessing the restructuring concept to be submitted to the German Supervisory Authority (BaFin).

Declaration regarding the Corporate Governance Code

In December 2005 the Executive and Supervisory Boards submitted the Declaration of Compliance as required by § 161 AktG and made it available to shareholders on the PANDATEL AG Internet homepage under www.pandatel.de.

Group membership

Until March 2005 PANDATEL AG was a 51.43% subsidiary of AUGUSTA Technologie AG. This company prepares consolidated financial statements and a group management report in which PANDATEL AG's figures are included up to March 2005. The consolidated financial statements of AUGUSTA Technologie AG are published at the Frankfurt/Main District Court under registration number HRB 41371.

Hamburg, March 15, 2006

Dr. Dan D. Yang	Thomas Becker
Chairman of the Executive Board	Member of the Executive Board

Auditor's Report

We have audited the consolidated financial statements prepared by PANDATEL AG, Hamburg, comprising the balance sheet, the income statement, statement of changes in equity, cash flow statement and the notes to the consolidated financial statements, together with the group management report for the business year from January 1 to December 31. 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. [paragraph] 1 HGB 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 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 the group management report. We believe that our audit provides a reasonable basis for our opinion.

Our audit has not led to any reservations.

In our opinion, based on the findings of our audit, the consolidated financial statements comply with IFRSs as adopted by the EU and the additional requirements of German commercial law pursuant to § 315a Abs. 1 HGB and give a true and fair view of the net assets, financial position and results of operations of the Group in accordance with these requirements. The group management report is consistent with the consolidated financial statements and as a whole provides a suitable view of the Group's position and suitably presents the opportunities and risks of future development.

Hanover, March 27, 2006

Dr. Ebner, Dr. Stolz und Partner GmbH
Wirtschaftsprüfungsgesellschaft Steuerberatungsgesellschaft

Wilfried Steinke
Wirtschaftsprüfer
[German Public Auditor]

Hans-Peter Möller
Wirtschaftsprüfer
[German Public Auditor]

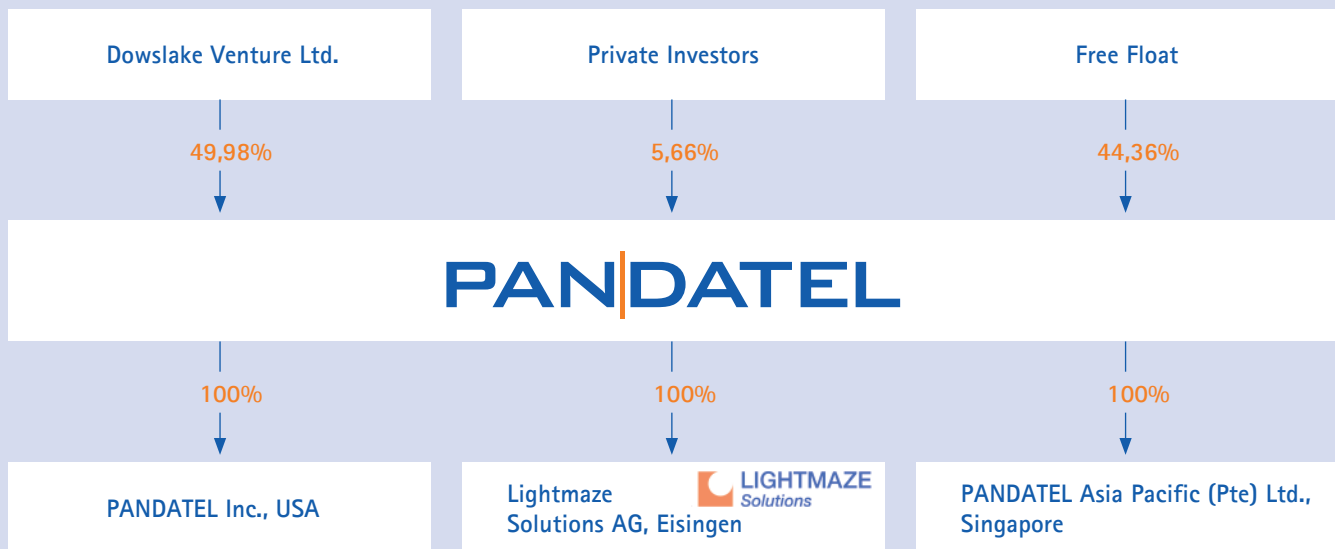
Glossary

Backbone	Powerful supra-regional main data line that links up many sub-networks
Bandwidth	Transmission capacity of communication systems, measured in data per second
Broadband technology	Transmission method in which the bandwidth of the transmission medium is broken down into several frequency bands that specific tasks (sending/receiving) or types of communication are allocated to
Carrier	Network operator that provides transport services to other companies for a fee
CESoP	Circuit Emulation Services over Package – technology for transporting TDM data streams via packet-based networks
C-MUX-155	Optical multiplexer which transmits voice and data information via SDH/SONET networks in very fine speed gradations with the help of >Virtual Concatenation Technology
Connectivity Converter	Ability of systems to communicate with each other via a network System that converts data set in a particular format into another format
COP-FE	TDM multiplexer for the >CESoP standard, which transmits voice and data information via IP/Ethernet networks
Cross-connect	Optoelectronic component which switches between two optical channels depending on individually definable parameters
CWDM	Coarse WDM – Method that uses broader channels and is therefore more cost-efficient than >WDM or >DWDM
DSL	Digital Subscriber Line – Transmission technology for broadband Internet access via the telephone network
DWDM	Dense Wavelength Division Multiplexing – Special form of >>WDM where the individual wavelengths are positioned very close to one another and thus ensure even more efficient use of the fiber optic cable
Ethernet	Transmission protocol for local area networks (>LANs)
First mile access	>Last mile access
G.SHDSL	>SHDSL; the "G " stands for a standardization series of the International Telecommunication Union
Gigabit Ethernet	Ethernet variant with a maximum transmission rate of 1000 Mbit/s, corresponding to 1 Gbit/s
GSM	Global System for Mobile Communications – European mobile radio telephone standard
Integrated Access Device Interface converter	Integrated device for network access – multifunctional device >Converter for the copper area; converts electronic signals from one interface to another
Internet Protocol (IP)	Non-manufacturer-specific >transmission protocol for cross-network communication
Internet Service Provider	>Service provider for Internet access, abbreviated ISP

Inverse multiplexer	>Multiplexer that splits a high-speed channel into several independent channels with low transmission speed or combines several independent data streams to form one broadband channel
LAN	Local Area Network – Computer network that is installed at the user 's end and is geographically limited
Last-mile access	The last mile is the connection range between the network exchange and the home exchange; frequently what is meant is the copper line between telephone company and end customer
MACS4000	Management system for PANDATEL products with which all local and remote components in a network can be centrally operated, monitored and configured
Mbit/s	Megabit per second – Data transmission speed in million bits per second
Meshed network	Meshed networks – In a meshed network, the nodes of a network can be linked to each other at random; the data can reach their destination using any routes, and these routes can be individually defined
Metro Ethernet	Metro networks equipped with >Ethernet-based services; virtual >LANs, for example, can be established by means of Ethernet connections, allowing several company locations to be integrated into a homogeneous network
Metro network	Metropolitan Area Network – Telecommunication network that covers a city or region
Modem	Modulator/Demodulator – Device that converts digital data into suitable signals for transmission over analog lines and at the other end converts the signals back into digital data
Multiplexer	System that enables the simultaneous transmission of several mutually-independent data streams down one and the same physical channel (copper cable, fiber optic line)
Multi-services Network management	Merging of different solutions in convergent networks System for managing a network as well as its resources and components
Network nodes	Connecting point between more than two transmission routes in a computer network, for example a >multiplexer or >router
Network operator	Organization or company which operates and maintains a network and which places it at the disposal of third parties for use – usually for a charge
OEM	Original Equipment Manufacturer – Manufacturer that buys products from other manufacturers and integrates them into its own products; sometimes the original manufacturer is termed OEM
OEM product	Product from an external manufacturer that a company includes into its own product portfolio and sells under its own label

Optical systems	Instruments and systems that enable the >optical transmission of data
Optical transmission	Data transmission via fiber optic line or synthetic fiber with light as the signal carrier
Packet-based networks	Networks for the fast and reasonably priced transport of large quantities of data. In packet-based networks, >Ethernet technologies and the >IP protocol are mainly used today
PSN	The abbreviation for "Packet Switched Network"
QoS	Quality of Service in communication networks
Redundancy	This designates the additional presence of the functionally identical or comparable resources of a technical system which are not required in normal operation and are only used in the event of a fault
Routing	In telecommunications: a method of conveying news between networks; routers convey data packages in the best possible way from one network to another
SAN	Storage Area Network – Centrally-managed high-speed storage network which provides several servers with simultaneous storage access and increases error tolerance thanks to its structure
SDH	Synchronous Digital Hierarchy – Standard for the high-speed transmission of data via fiber optic networks
SDSL	Symmetric Digital Subscriber Line – >>DSL with symmetric transmission speed, i.e. upload and download speed are identical
Service provider	Company that provides communication or storage services with network access, e.g. Internet service provider
SHDSL	Single Pair High Bit Rate Digital Subscriber Line – Symmetric >>DSL method for copper double cores
SONET	Synchronous Optical Network – international standard for single-level multiplexing of high-speed networks with transmission rates of 44 Mbit/s and higher; basis of the SDH standard
Storage Area Network Switching	>SAN Means by which a transmission path is switched between sender and receiver
TDM	Time Division Multiplexing – Technology in which signals for different messages are transmitted in a time–interleaved pattern down a single channel
Topology	In a computer network, the topology represents the structure of the connections between the individual >network nodes
Transceiver	Acronym derived from Transmitter/Receiver – a combined transmitter and receiver
Transmission protocol	Definition of the way in which information is to be exchanged between two systems
Value added reseller	Reseller with additional service

Virtual concatenation	Technology that allows the efficient transport of large data bandwidths via >SDH
VoIP	Voice over IP – Abbreviation for IP telephony; designation for telephony using a computer network on the basis of the >Internet Protocol (IP)
WDM	Wavelength Division Multiplexing – Technology which uses laser light of different wavelengths ((colors) to simultaneously transmit several communication channels down a single fiber optic line
xWDM	Collective term for the multiplexing technologies >WDM, >CWDM and >DWDM
YUMIX	Product platform for intelligent optical networks, by the PANDATEL subsidiary Lightmaze Solutions



Financial Calendar 2006

Extraordinary Shareholders' Meeting	March 27, 2006, Hamburg
Annual report 2005 published	April 30, 2006
Press conference	prob. May 2006, Hanover
Analyst meeting	prob. May 2006, Hanover
Three-Month Report	May 30, 2006
Annual general meeting	prob. July/August 2006, Hanover
Semi-annual Report	August 30, 2006

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