TELES AG Aktiengesellschaft Informationstechnologien
Berlin

Consolidated Financial Statements as of December 31, 2006
and Management Report for TELES Group 2006

Auditor's Report

This is a translation of the German Report.
The German version is authoritative

Table of Contents

Group Management Report for the Financial Year 2006

Consolidated Financial Statements for the Financial Year 2006

- Consolidated Balance Sheet
- Consolidated Statement of Income
- Statement of Changes in Shareholders' Equity
- Consolidated Statement of Cash Flows
- Notes to the Consolidated Financial Statements

Auditor's Report

Group Management Report of TELES AG Informationstechnologien for the Financial Year 2006

A. General Economic Situation/ Industry Development

Despite rising oil prices and higher interest rates, the general economy continued to grow in the period under review, achieving an expected 3.9% globally, 2.9% in Europe and 2.5% in Germany. The Western European and German information and telecommunications industry also maintained its expansion course.

Growth in the European and German information telecommunications industry as a whole can be expected to correspond more or less to general economic growth, with a decline expected in the current year, and particularly in Germany (cf. EITO and Bitkom forecasts). However, this is not due to a fall in demand, but is the result of the increase in pricing pressure experienced by the wireless and fixed network operators, which is passed in turn to the supplier.

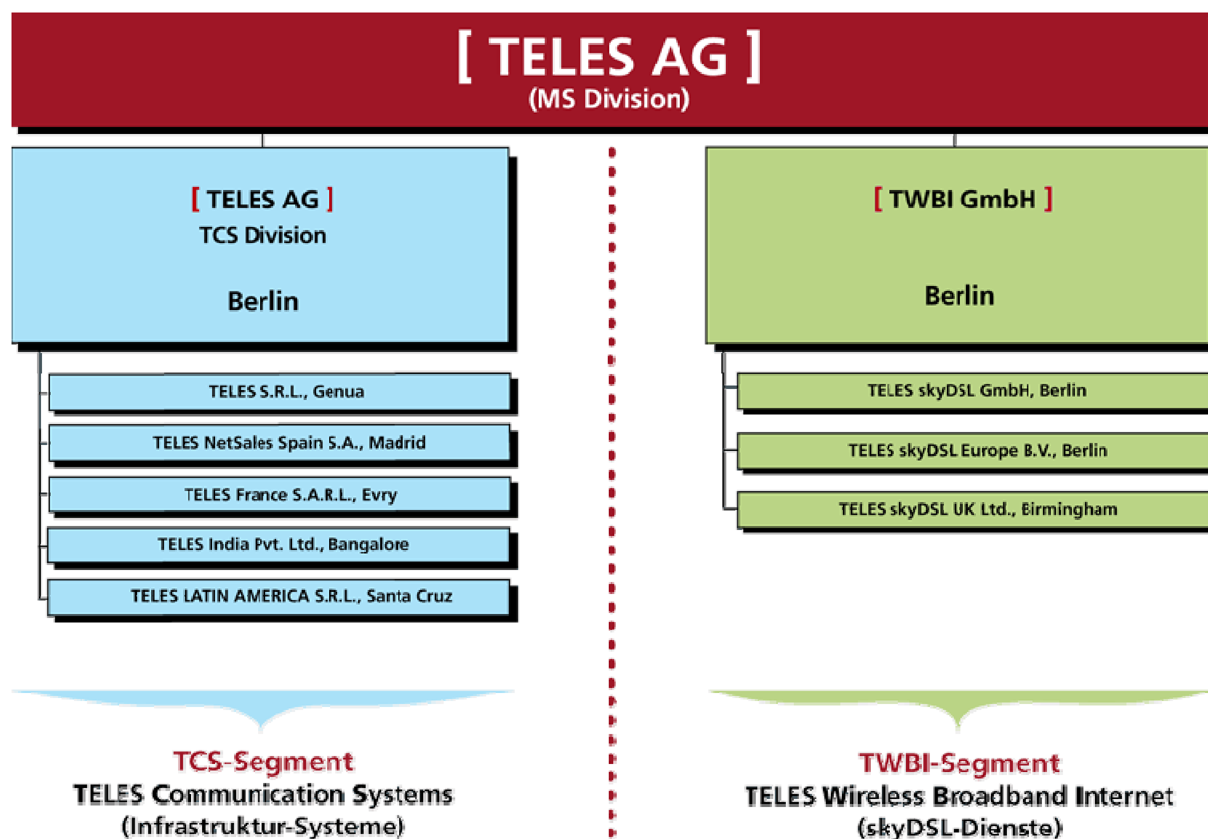
On the other hand, the market segment for telecommunications systems served by TELES continued to be influenced by two main factors in the period under review. Firstly, the market for the conventional TDM switching technology can be considered saturated. In addition, the telephone companies are focussing increasingly on the use of VoIP (Voice over Internet Protocol) technology for cheap telephony via the Internet. We expect this trend to continue and indeed to speed up throughout the world in the next few years.

In the market segment for broadband Internet services served by TELES the number of households with a high-speed Internet connection once again increased significantly throughout Europe in the period under review. In Germany alone more than a third of all households is connected to the Internet via broadband (prior year: 27%). To date, however, growth in this market segment has mainly been driven by the conventional broadband technologies. In contrast, wireless broadband Internet still plays a negligible role. It is expected that by the years 2010 and 2015 over 50% and 70% respectively of all households in Germany will have broadband Internet access, 1.2% and 1.7% of these via alternative access technologies such as satellite.

B. Group Economic Situation

As in the previous year, TELES is divided into two segments for IFRS purposes, as is illustrated in the diagram below:

- The **TCS Segment** (TELES Communication Systems, i.e. infrastructure systems)
- The **TWBI Segment** (TELES Wireless Broadband Internet, i.e. skyDSL services)



The Company's sound financial footing allowed it to pay out a total of 40 Mio€ or almost 2 € per share to its shareholders in connection with capital reductions both during 2005 and in the period under review. Above all, however, this strong financial background means that the company has more than sufficient reserves to bear the preproduction costs necessary to growth in continuing operations.

The following charts and explanations are based on the development of continuing operations at TELES in the reporting period of 2006. Future growth expectations for these business divisions are discussed in Section G.

Group Revenues and Earnings in 2006 (according to IFRS)

Group Operating Revenues and Earnings in Mio€	**2005**	**2006**	**Variation[1] 2006 vs. 2005**
Revenues	**25.4**	**28.2**	**11%**
Cost of Sales	15.7	17.4	11%
of which: Depreciation and Amortization	*0.2*	*0.3*	*53%*
Gross Profit	**9.6**	**10.8**	**12%**
Gross Profit Margin	38%	38%	0%
Sales and Marketing Expenses	11.9	11.2	-6%
Research and Development Expenses	5.2	6.1	17%
General and Administrative Expenses	4.8	9.9	106%
Stock Issued to Employees	0.3	0.3	4%
Other Income	0.2	0.1	-31%
Other Expenses	0.1	0.4	627%
EBITDA (Earnings before Interest, Tax, Depreciation and Amortization)	**-12.2**	**-16.6**	**-36%**
Operational Depreciation and Amortization	0.5	0.6	2%
EBIT	**-12.9**	**-17.5**	**-35%**
Financial Income and Expenses	2.0	2.9	43%
EBT	**-10.9**	**-14.5**	**-33%**

[1] Percentage variations are based on Euro amounts not subject to rounding.

Notes on the above Group figures:

- **Group Revenues** increased 11% from 2005 to 28.2 Mio€ in 2006, and are thus largely in line with the revenue expectations given in the last quarterly reports.

- At 12%, the increase in **Group Gross Profit** was slightly higher than for revenues in 2006, rising 1.2 Mio€ to 10.8 Mio€.

- The **Group Gross Profit Margin** remained unaltered compared to the prior year at 38%.

- **Group EBITDA** fell from -12.2 Mio€ in the prior year to -16.6 Mio€ in 2006. This is mainly due to the costs related to the legal enforcement of the Company's VoIP patents and new patent applications in the USA.

- The fall in **Group EBIT** to -17.5 Mio€ in 2006 is in line with EBITDA development.

- **Group EBT** amounted to -14.5 Mio€ in 2006 after -10.9 Mio€ in the prior year.

TELES recorded a net loss for the full year 2006 in the amount of 16.9 Mio€. The corresponding Earnings per Share (EPS) amounted to -0.80 (both undiluted and diluted).

The freenet shares transferred to TELES as part of the sale and purchase price for STRATO at the end of 2004/ beginning of 2005 were entered as assets available for sale, and share price increases since receipt of the shares in Q1/2005 have therefore not been included in the Income Statement; Capital Gains are recorded directly in Equity and amounted to 21 Mio€ (net of effects from deferred taxes) in the period from first-time recognition of the freenet shares until the end of 2006.

Revenues and Earnings by Segment in 2006 (according to IFRS)

The company is controlled by the Management Service Division (MSD), which was set up in addition to the two operating segments. The Company reports its MSD figures separately to enhance the transparency of its cost structure by showing that corporate services cause one-off impacts and recurring costs as well as showing the extent to which these costs can justifiably be allocated to the individual segments. In addition, a further division entitled TELES Intellectual Property Rights (TIPR) was introduced in 2006 because of the strategic importance of the TELES patents and related activities. The following charts show the allocation of revenues and earnings to the individual TCS (TELES Communication Systems) and TWBI (TELES Wireless Broadband Internet) Segments, with separate entries for MSD and TIPR.

Notes on the MS Division:

Revenues & Earnings by Segment in Mio€	**2005**	**2006**	**Variation[2] 2006 vs. 2005**
MS Division			
Revenues	**1.1**	**1.1**	**5%**
Gross Profit	**1.1**	**1.1**	**5%**
Gross Profit Margin	100%	100%	0%
General and Administrative Expenses	2.9	3.5	20%
Stock Issued to Employees	0.3	0.3	4%
Other Income	0.0	0.1	n.a.
Other Expenses	0.0	0.1	n.a.
EBITDA (Earnings before Interest, Tax, Depreciation and Amortization)	**-2.2**	**-2.7**	**-26%**
Operational Depreciation and Amortization	0.0	0.0	n.a.
EBIT	**-2.2**	**-2.7**	**-25%**
Financial Income and Expenses	2.0	3.1	55%
EBT	**-0.1**	**0.4**	**n.a.**

- **Revenues in the MS Division** represent cost allocations to the operating segments TCS and TWBI and do not include any amounts generated with third parties.

- **MSD General and Administrative Expenses** increased as against the prior year mainly due to one-off expenses. These include the cost of relocation which will take place in the second quarter 2007, the cost of satisfying the Financial Reporting Compliance Act (*Bilanzkontrollgesetz*) which came into force in 2004, and additional expenses related to safety measures. As in the past, they also include capital market costs (including annual audit, Investor Relations and the Annual General Meeting).

[2] Percentage variations are based on Euro amounts not subject to rounding.

In addition, there has been a charge of 0.3 Mio€ in MSD Operating Costs since 2005. This relates to expenses from the Employee Stock Option Programme (pursuant to IFRS 2) and does not affect liquidity.

- **MSD Financial Income and Expenses** amounted to 3.1 Mio€, a significant increase against the prior year (2.0 Mio€). The increase is due particularly to the revival of receivables from GRAVIS - in which the Company has an almost 20% holding - whose economic situation has improved considerably. The position also includes interest income from the Company's cash assets.

- **MSD EBT** is positive at 0.4 Mio€ as a result of the increase in financial income and expenses.

Notes on the TIPR Division:

Revenues & Earnings by Segment in Mio€	2005	2006	Variation[3] 2006 vs. 2005
TIPR Division			
Revenues	**0.0**	**0.0**	**n.a.**
Gross Profit	**0.0**	**0.0**	**n.a.**
General and Administrative Expenses	0.4	5.0	1,063%
EBITDA (Earnings before Interest, Tax, Depreciation and Amortization)	**-0.4**	**-5.0**	**-1,063%**
Operational Depreciation and Amortization	0.0	0.0	n.a.
EBIT	**-0.4**	**-5.0**	**-1,063%**
Financial Income and Expenses	0.0	0.0	n.a.
EBT	**-0.4**	**-5.0**	**-1,063%**

- **TIPR Expenses.** In view of the strategic importance of the TELES patents and related activities, the TIPR division (TELES Intellectual Property Rights) was introduced at the beginning of 2006 to increase transparency. TIPR Expenses (5.0 Mio€) increased against the prior year, particularly because of the legal enforcement of the Company's VoIP patents and new patent applications in the USA. A further 1.6 Mio€ of the expenses result solely from reserves created after the disallowance by the first-instance court of the Company's VoIP patents in Germany, in other words of the German VoIP patent and the German part of the European VoIP patent.

- **Outlook for 2007:** Although TIPR expenses can be expected to fall somewhat in 2007 compared to 2006, development will be dependent upon the progress of the legal enforcement of the VoIP patent in the USA over the next few quarters.

[3] Percentage variations are based on Euro amounts not subject to rounding.

Notes on the TCS Segment:

Revenues & Earnings by Segment in Mio€	2005	2006	Variation[4] 2006 vs. 2005
TCS Segment			
Revenues	**19.3**	**19.2**	**0%**
Cost of Sales	6.7	7.7	14%
of which: Depreciation and Amortization	*0.0*	*0.1*	*n.a.*
Gross Profit	**12.6**	**11.5**	**-8%**
Gross Profit Margin	65%	60%	-5%
Sales and Marketing Expenses	5.3	6.8	27%
Research and Development Expenses	4.3	4.9	16%
General and Administrative Expenses	1.9	1.8	0%
Other Income	0.2	0.1	-61%
Other Expenses	0.0	0.3	n.a.
EBITDA (Earnings before Interest, Tax, Depreciation and Amortization)	**1.3**	**-2.2**	**n.a.**
Operational Depreciation and Amortization	0.4	0.4	-2%
EBIT	**0.9**	**-2.7**	**n.a.**
Financial Income and Expenses	0.0	-0.2	n.a.
EBT	**0.9**	**-2.9**	**n.a.**

- **Strategic Overview:** The aim of the TCS (TELES Communication Systems) Segment is to use its position as a European NGN (Next Generation Network) market player to establish itself as a global NGN player. All of the Company's research and development (R&D) activities are aimed at creating innovative products and bringing these to global market maturity using a business portfolio which is constantly optimized. This enables the Company to reinforce its position in established markets and to enter new markets. In 2006 we began to create and optimize the sales structure necessary for this. This is supported by our strong, well-based financial standing.

- **TCS Revenues:** In 2006 we were happy to see revenues from NGN products more than doubled, contributing as much as 50% to total TCS revenues. This compensated largely for the expected but significant decline in business with mobile gateways. Further regional momentum was provided by expansion into other markets. Revenues in the TCS Segment were largely unaltered in 2006 compared to the prior year. Further details are given in Section G.

[4] Percentage variations are based on Euro amounts not subject to rounding.

- At 60%, the **TCS Gross Profit Margin** remained at a high level in 2006, but was 5 percentage points lower than in the prior year. This is partially the result of one-off expenses amounting to 0.4 Mio€ related to the new product orientation. In addition, it was not possible to compensate completely for existing pricing pressure with improved buying conditions. As revenues were more or less unchanged, the absolute gross profit fell correspondingly by 8%. TELES is confident that the gross profit margin can be maintained at about the same level in the medium term and that the absolute gross profit will therefore also develop in accordance with the expected significant revenue increase in the medium term.

- The absolute increase in **TCS Operating Expenses** in 2006 as against the prior year amounted to 17%. About one third of the higher costs are related to one-off expenses for the creation of the sales structure required for the product re-orientation discussed above and includes the setup or centralization of the necessary Sales and Marketing departments at the TELES headquarters. At the same time, higher costs resulted from an expansion of the product range in line with growth expectations for the next few years (see Section G).

- In 2006 **TCS EBITDA and EBIT** fell significantly, and were correspondingly negative at -2.2 Mio€ and -2.7 Mio€ respectively.

Notes on the TWBI Segment:

Revenues & Earnings by Segment in Mio€	**2005**	**2006**	**Variation[5] 2006 vs. 2005**
TWBI Segment			
Revenues	**6.1**	**9.1**	**48%**
Cost of Sales	9.0	9.8	8%
of which: Depreciation and Amortization	*0.2*	*0.2*	*13%*
Gross Profit	**-2.9**	**-0.7**	**75%**
Gross Profit Margin	-48%	-8%	40%
Sales and Marketing Expenses	6.6	4.4	-32%
Research and Development Expenses	0.9	1.1	21%
General and Administrative Expenses	0.7	0.7	-1%
EBITDA (Earnings before Interest, Tax, Depreciation and Amortization)	**-10.9**	**-6.8**	**38%**
Operational Depreciation and Amortization	0.1	0.1	24%
EBIT	**-11.2**	**-7.1**	**37%**
Financial Income and Expenses	0.0	0.0	n.a.
EBT	**-11.2**	**-7.1**	**37%**

[5] Percentage variations are based on Euro amounts not subject to rounding.

- **Strategic Overview:** The signs continue to point towards the achievement within a reasonable timeframe at least of a break-even in the activities of the TWBI (TELES Wireless Broadband Internet) Segment.

- **TWBI Revenues** increased 48% in 2006, and were thus significantly higher than in the prior year.

  However, the number of skyDSL customers had fallen slightly at the tail end of 2005 (a good 28,000 in the prior year). Movement in the customer base varied according to region. The customer base in the foreign markets served directly by TELES, for example (and particularly France, Italy and Spain), grew slightly and in those foreign markets served indirectly via master partners significantly. In Germany, the picture was very different: although TELES continues to be the market leader in broadband Internet access via satellite, there was a temporary decline in the customer base. The expectations for the years to come can be found in Section G.

- The additional transponder capacities rented at the end of 2004 and corresponding preproduction costs which were still being generated in 2006 resulted in a **TWBI Gross Profit** and **TWBI Gross Profit Margin** which was still negative in 2006, although significantly better than in 2005.

- **TWBI Operating Costs** were reduced by around 25% in 2006 as against 2005. Every possible effort is being made to reduce costs without endangering the possible achievement of a break-even result.

- **TWBI EBITDA** and **EBIT** decreased in 2006 to -6.8 Mio€ and -7.1 Mio€ respectively (prior year: -10.9 Mio€ and -11.2 Mio€) due to the significant increase in revenues and the drop in operating costs. Although losses are still being generated, these have been decreasing significantly since the fourth quarter 2005. The aim is to achieve at least break even within a reasonable timeframe.

The following **segmental reporting of TELES does not show separate figures for the MS and TIPR Divisions.** Instead, the corresponding expenses were allocated to the two core segments TCS and TWBI in accordance with IFRS:

Revenues & Earnings by Segment in Mio€	2005	2006	Variation[6] 2006 vs. 2005
TCS Segment			
Revenues	**19.3**	**19.2**	**0%**
Cost of Sales	6.7	7.7	14%
of which: Depreciation and Amortization	*0.0*	*0.1*	*n.a.*
Gross Profit	**12.6**	**11.5**	**-8%**
Gross Profit Margin	65%	60%	-5%
Sales and Marketing Expenses	5.3	6.8	27%
Research and Development Expenses	4.3	4.9	16%
General and Administrative Expenses	3.1	7.8	151%
Stock Issued to Employees	0.3	0.3	4%
Other Income	0.2	0.1	-33%
Other Expenses	0.1	0.4	619%
EBITDA (Earnings before Interest, Tax, Depreciation and Amortization)	**-0.3**	**-8.5**	**-3,321%**
Operational Depreciation and Amortization	0.4	0.4	-1%
EBIT	**-0.7**	**-9.0**	**-1,057%**
Financial Income and Expenses	2.0	2.9	43%
Earnings before Tax and Minority Interests	**1.3**	**-6.1**	**n.a.**
TWBI Segment			
Revenues	**6.1**	**9.1**	**48%**
Cost of Sales	9.0	9.8	8%
of which: Depreciation and Amortization	*0.2*	*0.2*	*13%*
Gross Profit	**-2.9**	**-0.7**	**75%**
Gross Profit Margin	-48%	-8%	40%
Sales and Marketing Expenses	6.6	4.4	-32%
Research and Development Expenses	0.9	1.1	21%
General and Administrative Expenses	1.7	2.1	22%
EBITDA (Earnings before Interest, Tax, Depreciation and Amortization)	**-11.9**	**-8.1**	**32%**
Operational Depreciation and Amortization	0.1	0.1	24%
EBIT	**-12.2**	**-8.4**	**31%**
Financial Income and Expenses	0.0	0.0	n.a.
Earnings before Tax and Minority Interests	**-12.2**	**-8.4**	**31%**

[6] Percentage variations are based on Euro amounts not subject to rounding.

B.1 Cash Flow

The following chart compares the 2005 and 2006 cash flows.

Cash Flow	**2005 Mio€**	**2006 Mio€**
Operating Activities	-15.5	-14.9
Investing Activities	62.2	0.1
Financing Activities	-22.4	-18.4
Net Increase/ Decrease in Cash and Cash Equivalents	24.3	-33.2
Cash and Cash Equivalents at end of year	74.3	41.1

The **cash outflow from operating activities** in 2006 amounted to -14.9 Mio€, mainly as a result of the negative EBITDA (-16.6 Mio€) and variations in working capital.

The **cash inflow from investing activities** in 2006 of 0.1 Mio€ relates mainly to the balance of cash inflows from rights from a debtor warrant bond (recovery rights) and outflows resulting from normal investment in the course business. This underlines how low the capital requirements for TELES activities are.

The **cash outflow from financing activities** in 2006 amounted to 18.4 Mio€ and resulted from the distribution made to the shareholders at the beginning of 2006 as a result of the capital reduction decided on by resolution of the Annual General Meeting on 3 June 2005.

Cash and Cash Equivalents at the end of 2006 fell by 33.2 Mio€ as a result of these inflows and outflows. In addition to its Cash and Cash Equivalents TELES also holds assets available for sale in the form of its 3.565 million shares in freenet ("freenet AG - new" resulting from the successful merger of 2 March 2007). TELES' cash position will therefore continue to be extremely comfortable in future.

B.2 Asset and Capital Structure

In a prior year comparison, the asset and capital structure was as follows:

Asset and Capital Structure	31.12.2005 Mio€	31.12.2006 Mio€
Cash and cash equivalents	74.3	41.1
Trade Receivables	4.5	3.8
Inventories	4.6	6.1
Fixed and Intangible Assets	1.6	1.4
Other Assets	76.2	85.0
Liabilities	27.2	9.3
Shareholders' Equity	134.0	128.1
In % of Balance Sheet Total	83%	93%
Balance Sheet Total	161.2	137.4
Investments in Fixed and Intangible Assets	1.6	0.8

Group **Trade Receivables** were reduced in 2006 by a total of 0.7 Mio€ as follows:

- A reduction in the TCS Segment by 1.1 Mio€ or almost 30%. Receivables are outstanding by an average of 50 days in this segment, a significant improvement as against the prior year (a good 70 days) thanks to optimized accounts receivable management and altered business processes and terms of payment. In addition, TELES employs where possible instruments securing payments such as letters of credit and payment guarantees.
- An increase of 0.3 Mio€ due to a significant upturn in the skyDSL business. In the TWBI Segment the theoretical time to payment is a good 30 days due to the use of direct debiting customary in the mass market industry.

Inventories had increased by 1.5 Mio€ in 2006 as against the prior year as a result of:

- An increase of 1.1 Mio€ in the TCS Segment, due in part to inventories already delivered in January 2007 under the scope of the business with freenet. The increase in TCS Inventories also results from measures to counteract the delivery bottlenecks which emerged in 2006 and from the development of the product portfolio.
- An increase as at the balance sheet date in respect of skyDSL - also resulting from the significant increase in revenues - which has in part already been reduced again.

Fixed and Intangible Assets fell by 0.2 Mio€ to 1.4 Mio€ in 2006. Very little capital expenditure continues to be required for TELES' business operations.

Other Assets are mainly related to the 3.565 million freenet shares received as part of the sale and purchase price for the WebHosting business ("freenet AG - new").

Liabilities had significantly decreased in 2006 as a result of the distribution of the second capital reduction in the amount of 18.4 Mio€ to the shareholders at the beginning of 2006.

Group Shareholders' Equity amounted to a remarkable 128.1 Mio€ at the end of 2006 as a result of extraordinary income from the sale of the WebHosting business in 2005, and despite the two capital reductions of a total of 41 Mio€ made in 2005 and 2006 and the operating losses in 2006. This corresponds to an **Equity Ratio** of **93%.**

The financial condition of TELES thus continues to be sound and more than sufficient for the future business development of the company.

The following chart shows the geographical segments in a prior year comparison:

in Mio€	Revenues		Segmental Assets		Investment in Tangible and Intangible Assets	
	2005	2006	31.12.2005	31.12.2006	2005	2006
Germany	6.8	10.8	81.6	52.0	1.3	0.6
Rest of Europe	16.1	14.2	5.4	2.7	0.1	0.0
Rest of World	2.5	3.2	0.4	0.5	0.2	0.2
Not Allocated			73.8	82.2		
Total	25.4	28.2	161.2	137.4	1.6	0.8

The value of the freenet shares as at 31 December 2005 and 31 December 2006 is mainly responsible for the value of non-allocated segmental assets in 2005/2006.

B.3 TELES Group Employees

The total number of employees at TELES was 261 on 31 December 2006. This represents a decrease of 20 compared to the end of 2005; the reduction mainly relates to the TCS Segment.

C. Risks with Material Influence on the Company's Financial and Profit Situation

In 2002 TELES initiated joint proceedings against Deutsche Telekom AG (DTAG) and SES ASTRAnet S.A. for the infringement of several patent rights with their "TDSL via Satellite" service. The company bases its case on the German and European patents protecting the skyDSL technology developed by TELES and on a corresponding German utility model. In two similar lawsuits regarding patent infringement the companies sued by TELES finally reached agreement with the Company – after a first-instance verdict – and withdrew from this field of business. In the patent infringement proceedings against DTAG and SES, which have been resumed after an interim postponement in respect of the German patent and utility model, a first-instance ruling was made on 27 January 2006. As forecast, the verdict was in favour of TELES. Only DTAG has appealed against the ruling, while the verdict against SES is effective and thus enforceable. In the same connection, the aforementioned intellectual property rights were challenged before the German and European Patent Offices in 2003. In 2005, following confirmation of the German core skyDSL patent by the Federal Patents Court at the end of 2004, the Patent Office also ruled similarly in favour of TELES in the first instance in a parallel case initiated by DTAG/SES to have the TELES utility model cancelled. In the appeal proceedings, however, the Federal Patents Court cancelled the utility model on formal legal grounds on 20 March 2007. The decision is not yet effective, and an appeal can be made. Ultimately, the result of this case affects neither TELES' skyDSL operations, nor does it have any particular influence on the outcome of the skyDSL patent infringement proceedings. The European skyDSL patent was already confirmed by the European Patent Office with only marginal qualifications on 26 January 2006. DTAG/SES have lodged an appeal against this ruling, too. TELES is confident that it will also win those cases which have not yet been finally decided. Both TELES and its legal advisors expect no risks to the Company to result from these facts and circumstances.

One of STRATO Medien AG's competitors took exception to advertisements for skyDSL in 2003 and applied for an injunction. On 17 February 2005 the Regional Court of Colgone ruled that STRATO must desist from advertising its satellite-based Internet access with what the court considered the misleading term "DSL", either on its own, or in the name "skyDSL". On 6 April 2005 STRATO Medien AG appealed the decision at the Higher Regional Court of Cologne, which dismissed the appeal on 15 February 2006. The right to further appeals was not granted. STRATO Medien AG did not appeal against this non-admission ruling, which has thus become effective since then. The risk of an identical follow-on case for TELES skyDSL GmbH, the sales company formed after STRATO Medien AG left the TELES Group, is deemed to be low by TELES and its legal advisors.

In June 2003 TELES acquired 33.3% of the shares in a start-up company which operates as telecommunications service provider. Business activities at this company, which is registered in England, have now been discontinued. It originally provided services to carriers in

Germany requiring low cost connections from fixed-line networks to mobile networks, until the mobile SIM cards were deactivated by the mobile network operator. The Company was unable to assert its temporary injunction for reactivation of the cards against the mobile network operators concerned, but is hoping for final clarification in the principal case after a mobile network operator initiated action for payment and damages at the end of 2004. TELES has also entered a claim for damages resulting from the deactivation of the mobile cards in the principal case. In its ruling of 31 May 2006, the Regional Court of Düsseldorf ruled at the first instance in favour of the claim brought by the wireless carrier and dismissed the counter-claim. The decision is not yet effective and has been appealed against. As there has been an about-turn in the jurisdiction regarding the legality of the deactivation of the SIM cards used in GSM gateways by the wireless carriers, it is uncertain whether the appeal will succeed before the Higher Regional Court of Düsseldorf. No high financial risks are involved, however.

In 2005, the same mobile network operator also applied for an injunction against the provision and sale of GSM gateways for carrier networks by TELES AG and TELES NetSales GmbH. In its ruling of 14 June 2006, the Regional Court of Düsseldorf dismissed the claim at the first instance. TELES AG's counterclaim against clauses in the wireless carrier's General Terms and Conditions which ban the use of its SIM cards in GSM gateways was, however, also without success. Both parties have lodged an appeal against the decision made at the first instance. In view of the aforementioned shift in jurisdiction regarding one aspect of the legal action (the legality of the use of GSM gateways in Germany), it is impossible here, too, to assess TELES' chances of success. It is also unclear what effect a ruling against TELES would have on international sales. As the ruling at the first instance was made in favour of TELES, both TELES and its legal advisors consider the risk of a general ban on exports and – in view of the minor significance of Germany as a market for GSM gateways – the economic risks for TELES to be low.

It was agreed under the sale of the WebHosting business that STRATO Medien AG would continue the lawsuit initiated by the bankruptcy administrator of KPNQwest Germany GmbH i.In., with any and all opportunities and threats related to this lawsuit remaining with TELES. As reported in prior years, STRATO withheld all payments to its technical supplier, KPNQwest, during 2001 and 2002, and claimed a reduction in payables for insufficient quality of services. After KPNQwest had filed for bankruptcy, the bankruptcy administrator instituted legal proceedings against STRATO in 2002 for payment of outstanding receivables. As of 31 December 2004 STRATO's trade accounts payable showed an amount of 5.4 Mio€, which includes a discount of 3.2 Mio€ for the reductions claimed, a claim the Company considers more than justified. In addition, STRATO is claiming around 8 Mio€ in damages. At the balance sheet date, the lawsuit was still underway. The Company has set up sufficient provisions for lawyers' fees and court costs. TELES and its legal advisors perceive no further threats to the Company from these facts and circumstances.

The appeal lodged by Quintum Inc. and its German distribution partners, who lost the case brought by TELES for infringement of its InstraStar patents (first-instance decision in favour of TELES by the Regional Court of Mannheim on 11 November 2005) has been suspended until the current nullity proceedings against the IntraStar patents have been finally decided.

In the meantime, TELES' appeal in respect of its initial claim against AVM GmbH and its distribution partners was dismissed by the Higher Regional Court of Karlsruhe on 28 June 2006. TELES has lodged a complaint against the non-allowance of its appeal in this last case. A decision is still outstanding.

A further case lodged by TELES against AVM GmbH as a result of the revision of the product which was originally criticized was also dismissed at the first instance by the Regional Court of Mannheim on 18 July 2006. The appeal against this decision lodged by TELES has since been suspended until a final decision is made in the current nullity proceedings against the patents in suit. The same applies to the appellate proceedings against the first-instance decision of the Regional Court of Mannheim of 9 June 2006 dismissing the patent infringement proceedings against CISCO Systems Inc.

The proceedings initiated on 15 February 2006 by TELES against Nokia for infringement of its patents have also since been suspended for the same reason.

In the cases brought by CISCO and Quintum for nullification of the German InstraStar patent and the German part of the European IntraStar patent, the 4th Senate of the Federal Patents Court in Munich declared both patent and partial patent void on 5 April 2006. The Federal Patents Court gave as its reason for this decision the lack of an inventive step in both patents. The rulings are not yet effective and TELES lodged an appeal against them with the Federal Court of Justice (BGH) on 21 June 2006. Further information can be found in TELES' press release dated 6 April 2006. TELES remains confident that these patents will eventually be confirmed. A double-digit number of patent infringement suits can be expected by TELES against primarily non-European companies in the future, as their hybrid Internet telephony products (or VoIP products) may currently infringe the IntraStar patents (see the German-language VoIP Patent Infringement Forum at www.teles.de for more information). TELES and its legal advisors perceive no threats to the company from these cases.

In October 2005 the IntraSTAR patent was granted to TELES for the United States of America. The Declaratory Judgement Action filed by CISCO for nullification of this US patent and to ensure its non-infringement by CISCO products is currently at the pre-trial discovery stage. A further VoIP patent granted to TELES in the USA on 5 December 2006 containing a whole series of further patent claims has been included by TELES in the case, thus increasing the Company's chances of success.

On 24 March 2006 TELES also filed a patent infringement action against Quintum in the USA based on the first US IntraStar patent. The second US IntraStar patent mentioned above was also incorporated into this case.

Generally speaking, no claims can be made under US law for reimbursement of legal fees, even where the opposing party has lost his case. As such, TELES and its legal advisers currently perceive no greater risks – apart from the cost of defence – from these proceedings.

D. Research and Development Activities

The TELES Group considers its highly qualified, experienced and very ambitious development team to be one of its most important assets, together with its highly competitive sales and marketing team. These will form the basis of growth at TELES in the years to come.

In the reporting period the TELES Group continued or initiated substantial development activities in both business segments.

TCS:

We would like to highlight the following activities in the TCS segment:

- The development of a high-performance soft switch solution (TELES MGC or TELES Media Gateway Controller) based on cluster technology, which makes it possible for the customer to invest in a powerful, redundantly configured system which can be scaled in accordance with growth at any time.

- ANSI (American National Standards Institute) and SS7 signalling protocols are currently being developed to enable the Company to serve the North American market, which is the world's largest supply market for NGN (Next Generation Network) technology today, and the fast-growing Asian market (e.g. China).

- In addition to the class 4 carrier NGN solutions (NGN solutions connecting the various carriers), class 5 applications are increasingly being developed and the markets examined for possible class 5 cooperation partners (solutions for direct access between the carrier and the end customer). We were already successful in finding partners whose product portfolio complements our own for close cooperation in 2006. These include the companies Audiocode Ltd. and Kapsch AG, and also the Fraunhofer Institute for Open Communication Systems (FOKUS).

TWBI:

- Integration of a mobile back channel (via the mobile telecommunications operator E-Plus) for a flat rate.
- Integration of a terrestrial ISDN back channel (via Arcor) for a flat rate (introduction in March 2007).
- Development of a “skyDSL Setup Box”, the market introduction of which is planned for 2007. With this the user would no longer have to install the skyDSL software on his PC or laptop, and an Ethernet interface would enable multiple use of the skyDSL service on the net.
- Continuation of the development of an alternative, simple and more versatile receiving aerial. The prototype is expected to be built in the first half of 2007.

E. Events after the Balance Sheet Date

The merger of mobilcom AG and freenet.de AG to telunico holding AG became effective on 2 March 2007, when it was entered into the Commercial Register. At the same time, telunico holding AG was renamed freenet AG. Once the merger and renaming had become effective TELES AG held 3,565 million shares (formerly 3,1 million) in the “new” freenet. This gives the Company voting rights amounting to 3.71%.

F. Threats to the Company’s Future Development

The development and utilization of economic opportunities and potential offered by the market entails inevitable risk. It is of critical importance for the success of a company that risks are recognized at an early stage and active efforts taken to counteract these.

In view of this, section 91 subsection 2 of German Stock Corporation Law (AktG) binds the management to “take suitable measures, and particularly to set up a monitoring system, to ensure that developments which endanger the future of the company are recognized at an early stage.” To this end the TELES Group applies a series of risk management and control systems which are coordinated with one another.

The TELES Group has therefore established a risk management system which is integrated into the operating processes of the Company, whereby the subsidiaries are responsible for the scope, form and content of their own risk management systems. Group management is responsible for monitoring and coordinating risk management for the Group. The risk reports from the subsidiaries to Group management include the regular and systematic identification, quantification and assessment of the relevant risks and back-up systems. Reporting is carried out on a monthly basis, with extraordinary reports as and when required according to certain indicators. The risk assessment is based on the cost of potential damage and the probability of such damage occurring.

The risks which could have a considerable negative impact on the financial and profit situation of the TELES Group are described below. These are not necessarily the only risks

which TELES faces. Risks which have not yet been recognized, or risks which are currently considered insignificant, could also impair business activities.

Business Risk

The business environment is basically affected by regional and economic conditions. Uncertainty regarding the economic and occasionally the political environment can interfere with the demand for products and services from TELES and make budgeting and forecasts difficult.

A customer's financial situation can also have a negative impact on revenues and performance in the individual business segments. It should therefore first be noted that none of the segments is dependent upon its customers. The largest single customer generated less than 10% of TELES' revenues in 2006 (in the TCS Segment). There are therefore no "cluster risks" in the receivables. The customary disclosure reports are always used to verify the creditworthiness of a new customer, and that of existing customers is also verified on a regular basis. In addition, advance payments are requested where possible and appropriate. In international sales – and particularly non-European transactions – letters of credit or payment guarantees are agreed, as is customary in the market. In its mass market business (the TWBI Segment) TELES primarily works with direct debiting processes.

The global markets for the TELES products are extremely competitive, particularly where the quality of products and services, time required for development and introduction and customer services are concerned.

In several of these markets it is necessary to develop and introduce new products very speedily if arising opportunities are to be exploited. The markets served by TELES (here: TCS Segment) are particularly characterized by the continuous introduction of innovative technologies. This requires high commitment where research and development is concerned. But quality problems can still arise. Profitability is very dependent upon the ability to adapt to market change, and to lower the cost of development and production of both new and existing high-quality products. In all, investment in new technologies can have a negative impact on revenues and results if it proves inoperable, does not enjoy the expected market acceptance or is not introduced to the market fast enough.

It should be mentioned here that TELES owns the rights to more than 40 patent families.

In addition to the challenge of providing a services portfolio suitable to the market, the emergence of substitution technologies and the continued development of the terrestrial networks, which currently provide the mostly popular type of broadband Internet access, is in principle conceivable in the market for broadband Internet services served by TELES. This could restrict the market potential for TELES' business activities.

TELES depends on third-party suppliers for the acquisition of tis components, primary products and services. Although TELES works closely with the suppliers, it is impossible to guarantee that no supply problems will occur in future. Bottlenecks or delays could have a significant effect on business development.

Finally, competition for highly-qualified personnel in the main areas serviced by TELES is extremely high. Future success is partially dependent upon how successful the Company is

in employing specialist personnel, integrating them into the company and binding them in the long term.

Regulatory Risk

In isolated cases, official regulations or amendments thereof can considerably increase operating costs. In addition, amendments to tax laws and regulations can result in higher taxes and/or have an influence on deferred taxes on both the assets and the liabilities side of the balance sheet.

TELES is open to a whole series of threats from legal proceedings in which it is involved or could be involved in future. In addition to the explanations given in Section C on current legal disputes, the Company could also become involved in court cases in the normal course of business, resulting for example from product liability, quality problems and protection faults. It is impossible to guarantee that the results of these or other proceedings would not cause considerable damage to business activities, the Company's reputation or its brands. Liability insurances have been taken out to cover certain legal risks where TELES management deems these to be suitable and customary in the industry. Reserves are created for legal disputes where there is a probability that such a commitment will arise and it is possible to make a reasonable estimation of the amount involved.

Other Operating Risks

TELES' products are also exposed to the risk of hostile attacks on its telecommunications networks and servers. To a certain extent, this is inevitable. We are counteracting such threats by continuous improvements to the security of our systems.

Foreign Currency Exposure

Fluctuations in exchange rates can cause undesired and unforeseeable volatility in the results and the cash flow. The risk can be reduced by settling business transactions as far as possible in the functional currency. Hedging instruments are employed - where suitable - if the functional currency cannot be applied. These include forward contracts, currency options and stop loss orders. Future alterations in the exchange rate can have an impact on prices for products and services and can alter the profit margin.

Interest Rate Risk

TELES' interest-rate risk results solely from interest-bearing deposits and investments. TELES' investment approach focuses on the one hand on the liquidity aspect, or the extent to which these investments can be repaid. At the same time, the Company attempts to achieve the best possible interest income with the lowest possible interest-rate risk.

Equity Price Risk

The only listed shares in TELES' investment portfolio are the 3.1 million shares in the former freenet.de AG acquired in the course of the sale of the WebHosting business in early 2005. Since the merger of freenet with Mobilcom, TELES now holds 3.565 million shares in the "new" freenet AG. The price risk inherent in shares which are traded on the stock exchange is offset by the chances of price improvement. The market value of this portfolio had increased from around 50 Mio€ at conclusion of the Sale and Purchase Contract for the WebHosting business to 65 Mio€ at the end of 2005 to around 75 Mio€ at the end of 2006. Further upside potential is also expected for the future, as underlined by analyst reports. Despite this, TELES also monitors share price movement on an ongoing basis to ensure that reaction is prompt should counteractive measures become necessary.

The Company also continues to hold almost 20% in GRAVIS Beteiligungs AG, which is not listed on the stock exchange.

G. Growth Expectations for TELES

We would like to draw attention once again to the fact that the very nature of growth forecasts means that we can make no representation or warranty in respect of their accuracy. Information on the risks pertaining to present and future developments can be found in Sections C and F. If any risk events should occur or the growth projections not be fulfilled, a corresponding impact on the share price of TELES AG cannot be ruled out.

This section draws on the group structure displayed in Section B.

Telecommunications Infrastructure and Systems Components (TCS Segment)

The telephone network is currently experiencing tumultuous development. Triggered by the booming Internet technologies, a transition is currently taking place from the conventional wired switching technology to packet switching (VoIP, or Voice over IP). At the same time, this heralds a further development towards the networks of the future (NGN, or Next Generation Networks, and IMS, or IP Multimedia Subsystems).

Under the sale of the Company's WebHosting business at the end of 2004, freenet.de AG agreed to purchase telecommunications infrastructure systems from TELES. The first partial deliveries were made in 2006, with the main rollout from this business set for 2007. The business centres on the implementation of a completely VoIP-capable softswitch solution (NGN). The Media Gateway Controller (MGC) from TELES lies at the heart of the softswitch solution.

This show-case project should also enable the Company to acquire further tier 2 carriers as customers. At the same time, TELES has installed around 150 IP/TDM networks for the tier 3 and tier 4 carriers to date, and as such is well positioned to sell softswitch solutions (NGN) in this segment, too. First MGC sales successes have been recorded and more are in the offing.

A variety of market surveys (e.g. DittBerner) would lead us to expect the following developments in the NGN sector:

- VoIP (Voice over Internet Protocol) established itself among the new networks invested in in 2005. More than 85% of all ports sold were VoIP ports.
- It is expected that the market for VoIP equipment for service providers will increase from 1.8 billion € in 2005 to 5.4 billion € in 2009. This is an average growth rate of 35% per annum.
- It is expected that in contrast to 2005 the Asian market (mainly China and India) for VoIP equipment for service providers will grow disproportionately and represent the largest part of the market in 2008/2009 (in 2005 the North American market was the largest).
- Class 4 applications currently make up a large proportion of VoIP investments made by service providers. It is expected that there will be a significant shift towards class 5 applications in this market over the next few years, with investment in class 5

applications growing by an average of 72% per annum by 2009, as compared to an average increase of 28% for class 4 applications.

It is TELES' objective to serve the class 5 applications market more strongly from 2008, building on its current business with class 4 applications. TELES is well equipped to enter these new growth markets.

NGN EXCELLENCE

NGN PRODUCTS AND SOLUTIONS

Access Gateways	Core Elements	Solutions & Applications
Business IADs	IP-TDM Platform	Wholesale / PrePaid
VoIP Gateways	Media Gateway Controller	NGN Backbone
Mobile Gateways	Media Gateways	IMS Break In/Out

The competitors in the promising NGN market include major players such as Siemens, Nortel, Alcatel, Ericson, Cisco and Huawei, who focus on tier 1 carriers, and medium-sized companies such as Sonus, who also serve tier 2 carriers, and also include other smaller players such as Veraz, MetaSwitch and Cirpack (Thomson Group), whose activities are mainly aimed at tier 2 and tier 3 carriers. Independently of this - and in addition to a number of market leaders in the EMEA (Europe, Middle East, Africa), NA (North America), CALA (Central and Latin America) und APAC (Asia Pacific) regions - the market is spread across a wide number of competitors. According to a number of research surveys even competitors with a global market share of only 2% have already made around 10 deals comparable in size to the freenet deal (as per 2006). To improve exploitation of the market potential TELES has increased its close cooperation with partners whose product portfolio complements its own. These include the companies Audiocode Ltd. and Kapsch AG, and also the Fraunhofer Institute for Open Communication Systems (FOKUS). This reinforces our expectations of success in breaking into this strongly growing market.

If we consider the expected dynamic market growth in the technologies and markets focused on by TELES and the fragmented competition in these areas, TELES should be able to stand firm against the regionally very diverse competition from small new or large established companies, thanks to its many years of experience and expertise in the field of telecommunications, its know-how and patents in the VoIP sector, its great flexibility and innovative capacity, which finds expression in over 40 patent families, and thanks to its three-figure customer base in over 25 countries. Management expects to see the measures introduced in 2006 mirrored in first revenue successes in 2007, although a noticeable effect on the profit situation is not expected until the following year.

Value-added Internet Services: Broadband Internet Services (TWBI Segment)

Success in this segment continues to be expected from the global trend towards high-speed Internet, as a result of which the demand for broadband Internet access is rising all over Europe. A recent survey (Deutschland online 4) expects over 50% and 70% of all households in Germany to have broadband Internet access by the years 2010 and 2015 respectively, 1.2% and 1.7% of these via alternative access technologies such as satellite, as terrestrial connection is not or will not be available. The picture is similar in the rest of Europe. It can generally be expected that narrow-band connections to the Internet will to a great extent have been replaced by broadband over the next 10 years. There are currently 180 million households in the 25 member states of the EU. The demand for broadband Internet is also increasing dramatically in the non-European markets. This is particularly true of the Middle Eastern, African and Asian markets.

Unlike conventional terrestrial broadband Internet access, the satellite-based skyDSL services provided by TELES are available almost everywhere in Europe in the footprint of the corresponding satellite. As a result, skyDSL services are the only way of profiting from broadband Internet anywhere where terrestrial broadband is not available.

This environment should enable TELES to achieve an initial breakeven within a reasonable period. For 2007, however, a cumulative loss is still expected on a month-by-month basis even if the break-even point is reached, and very little change is expected in 2007 where revenues are concerned.

TELES Intellectual Property Rights (TIPR Division)

In this very forward-looking business division for patents and patent rights, mainly in the field of VoIP and FMC (Fixed/ Mobile Convergence), negative results will be unavoidable for the time being. Costs result from the continued development and registration of new patents, but primarily from legal fees paid in advance for the enforcement of our patent and compensation claims, which are particularly highly in the USA. Management considers the probability of success to be high, however: The expected victory should result in compensation payments which are significantly higher than these up-front costs. The first small successes have already been made or are on the horizon. A more exact evaluation is not possible at this early stage of our patent disputes, however.

TELES Customer Premises Equipment (TCPE Division)

The preparations for this business division have only just got underway. This is an area in which TELES will be breaking new ground in two respects: On the one hand, this division will be pushing the preparation of the development of products protected by the aforementioned VoIP /FMC patents and patent registrations at the Berlin site, and on the other it is to help TELES to gain a foothold in China - building on the basis of these patent rights and new organisation - primarily in unlocking access both to the Chinese production sites of such VoIP/ FMC telephones and to the Chinese markets for all of TELES' telecommunications products. Here, too, preproduction costs can be expected. A more exact evaluation of these activities is also not possible at this early stage, however.

Summarizing this section of the Management Report 2006, the following can be concluded: The management of TELES is convinced that the technical and business orientation of the Group, together with its outstanding human and capital resources, provide an excellent foundation with which to translate the opportunities described in this report into business success in the years to come.

H. Basic Principles of the Compensation System for the Management and Supervisory Boards

The compensation package for members of the Management Board of TELES AG - with the exception of remuneration of the CEO - is composed of fixed, variable and long-term compensation (stock option plan). The annual variable compensation depends on the extent to which the targets agreed with the Supervisory Board at the beginning of each business year are achieved. Over the last few years it has averaged out at around one third of the annual compensation package. The number of stock options, which is listed in more detail in the Notes, is only vested on a pro rata basis according to eligibility. The options may not be exercised until the price of TELES shares exceeds the reference index (DAX or TecDAX, whichever is higher) by at least 10% per annum. The only remuneration received by the CEO until further notice is an employee benefit in the form of a company car.

The Supervisory Board receives a fixed allowance.

More information is given in the Notes.

I. Information according to Section 315 subsection 4 of the German Commercial Code

Composition of subscribed capital
The fully paid up share capital is made up of 23,304,676 no-par value shares with an arithmetic value of € 1.00 each. Each share has one voting right.

Limitations in respect of voting rights or the transfer of shares
The Management Board of the Company is not aware of any limitations in respect of voting rights or the transfer of shares.

Direct or indirect participation in the share capital which exceeds 10% of the voting rights
Sigram Schindler Beteiligungsgesellschaft mbH held 47.47% of the voting rights in TELES AG as at the balance sheet date. The Company is not aware of any further direct or indirect participation in the share capital which exceeds 10% of the voting rights.

Shares with special rights; controlling rights
Shares with special rights conferring controlling rights do not exist.

Control of voting rights
There is no control of voting rights as defined in Section 315 subsection 4 no. 5 HGB.

Regulations on the appointment and dismissal of members of the Management Board and amendments to the Articles of Association

Section 6 of the Articles of Association states that the Management Board must be composed of at least two members. The number of members set out in that section and the appointment of board members and revocation of such appointment is carried out by the Supervisory Board, as is the nomination of a member of the Management Board to CEO. Otherwise the appointment and dismissal of Management Board members is based on Sections 84 and 85 of German Stock Corporation Law (AktG).

Amendments to the Articles of Association are made in accordance with Sections 179 and 133 AktG, whereby Section 14 of the Articles empowers the Supervisory Board to make editorial amendments which do not affect the content.

Powers of the Management Board regarding the possibility of issuing or buying back shares

A resolution of the Annual General Meeting authorizes the Management Board to increase the share capital once or several times up to the value of T€ 19.000 (Authorized Capital I) against cash benefits or benefits in kind on or before 31 March 2009. Such increase is subject to the approval of the Supervisory Board.

The Restricted Capital I was created by resolution of the Annual General Meeting; it amounted to 1.932 Mio€ as at 31 December 2006 and served to fulfil options on a total of 1,931,964 individual shares. The Restricted Capital I only becomes effective when conversion rights from outstanding convertible bonds are exercised or when stock options from the employee stock option plans are exercised.

The Annual General Meeting also created the Restricted Capital III in an amount of up to T€ 1.300. This may only be utilized if stock options issued to members of the Management Board and employees of the Company are exercised by 30 August 2006. As at 31 December 2006 the Restricted Capital III amounted to T€ 384, divided into 383,876 individual shares.

A resolution of the Annual General Meeting empowered the Management Board to buy treasury stock amounting to up to ten percent of the share capital of TELES AG for other reasons than securities trading. The Management Board was also authorized to re-sell the purchased treasury stock subject to approval by the Supervisory Board. This authorization also extends to the offering of shares bought as a result of this authorization to third parties in the course of company mergers or the acquisition of companies or shareholdings therein. The price at which the shares in TELES AG may be sold to third parties according to these authorizations is linked to their market value at that time. The Company is also empowered to use the acquired shares to service conversion rights proffered by authorized persons from the employee stock option plans of TELES AG. The Management Board was also authorized to cancel treasury stock in TELES AG which was acquired on the basis of this authorization without such cancellation or implementation thereof requiring a further resolution of the Annual General Meeting. Such cancellation is, however, subject to the approval of the Supervisory Board. The cancellation authorization can be exercised in whole or in part.

Fundamental Company agreements which are subject to a change in the controlling interest due to a takeover bid
No such agreements exist.

Compensation agreements made between the Company and members of the Management Board or employees in case a takeover bid should be made
No such agreements exist.

Berlin, 21 March 2007

The Management Board of TELES AG Informationstechnologien

Consolidated Financial Statements TELES AG Informationstechnologien for the Financial Year 2006

Consolidated Financial Statements TELES AG Informationstechnologien
for the Financial Year 2006
Translation – the German version is authoritative

CONSOLIDATED FINANCIAL STATEMENTS

PAGE

CONSOLIDATED BALANCE SHEET 2
CONSOLIDATED STATEMENT OF INCOME 3
STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY 4
CONSOLIDATED STATEMENT OF CASH FLOWS 5
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS 6
NOTE 1: GENERAL INFORMATION 6
NOTE 2: SUMMARY OF MAIN ACCOUNTING PRINCIPLES 6
NOTE 3: MAJOR ITEMS INCLUDED IN INCOME FROM OPERATIONS 18
NOTE 4: CHANGES IN THE COMPANIES INCLUDED IN CONSOLIDATION 19
NOTE 5: PROPERTY, PLANT AND EQUIPMENT 20
NOTE 6: INTANGIBLE ASSETS 21
NOTE 7: FINANCIAL ASSETS AVAILABLE-FOR-SALE 22
NOTE 8: OTHER FINANCIAL ASSETS 23
NOTE 9: INVENTORIES 24
NOTE 10: TRADE ACCOUNTS RECEIVABLE 24
NOTE 11: OTHER FINANCIAL ASSETS 24
NOTE 12: OTHER CURRENT ASSETS 25
NOTE 13: SHAREHOLDERS' EQUITY 25
NOTE 14: CONVERTIBLE DEBT 27
NOTE 15: OTHER NON-CURRENT LIABILITIES 28
NOTE 16: TRADE ACCOUNTS PAYABLE 28
NOTE 17: PROVISIONS 28
NOTE 18: DEFERRED REVENUES 28
NOTE 19: OTHER CURRENT LIABILITIES 29
NOTE 20: TAXATION ON INCOME 29
NOTE 21: OTHER INCOME AND EXPENSES 32
NOTE 22: FINANCIAL INCOME AND EXPENSES 32
NOTE 23: FINANCIAL RISKS 33
NOTE 24: DISCONTINUED OPERATIONS 33
NOTE 25: EMPLOYEE STOCK OPTION PLANS 35
NOTE 26: EARNINGS PER SHARE 41
NOTE 27: RESTRICTED CASH, OTHER FINANCIAL COMMITMENTS AND CONTINGENT LIABILITIES 41
NOTE 28: LITIGATION 42
NOTE 29: RELATED PARTY TRANSACTIONS 45
NOTE 30: COMPOSITION OF SALES REVENUES AND COST OF SALES 47
NOTE 31: SEGMENT REPORTING 47
NOTE 32: SUBSEQUENT EVENTS 50
NOTE 33: OTHER INFORMATION 50
LIST OF ABBREVIATIONS 54

CONSOLIDATED BALANCE SHEET

(in T€, except number of shares)	Note	31 December 2005	31 December 2006
ASSETS			
Non-current assets			
Property, plant and equipment	5	1,382	1,235
Intangible assets	6	181	126
Deferred tax assets	20	3,755	40
Financial assets available-for-sale	7	65,789	76,754
Other financial assets	8	686	1,632
		71,793	**79,787**
Current assets			
Inventories	9	4,564	6,079
Trade accounts receivable	10	4,504	3,763
Other financial assets	11	0	654
Income tax receivable		3,470	4,176
Other current assets	12, 29	2,528	1,798
Cash and cash equivalents	27	74,311	41,119
		89,377	**57,589**
Total assets		**161,170**	**137,376**
EQUITY AND LIABILITIES			
Equity			
Share capital: Issued: 23,304,676 and 23,304,676 respectively Outstanding: 21,130,183 and 21,130,183 respectively		23,305	23,305
Additional paid-in capital		6,151	6,444
Other comprehensive income		10,487	21,257
Unappropriated retained earnings		115,713	98,807
Treasury stock (2,174,493 and 2,174,493 respectively)		-21,702	-21,702
Other changes in equity		-3	4
Equity attributable to shareholders of the parent company		**133,951**	**128,115**
Minority interests		**7**	**16**
Total equity	13, 25	**133,958**	**128,131**
Non-current liabilities			
Convertible debt	14	892	888
Non-current accrued liabilities		0	1,615
Deferred tax liabilities	20	1,635	33
Other non-current liabilities	15, 29	318	316
		2,845	**2,852**
Current liabilities			
Trade accounts payable	16	1,890	1,666
Accrual for income taxes	17	1,160	313
Other accrued liabilities	17	454	1,308
Deferred revenues	18	54	410
Other current liabilities	19, 29	20,809	2,696
		24,367	**6,393**
Total liabilities		**27,212**	**9,245**
		161,170	**137,376**

Consolidated Financial Statements TELES AG Informationstechnologien for the Financial Year 2006
Translation – the German version is authoritative

CONSOLIDATED STATEMENT OF INCOME

(in T€, except per share information)	Note	01 January – 31 December 2005	2006
Sales revenues	30, 31, 33	**25,377**	**28,229**
Cost of Sales	30, 31, 33	**15,747**	**17,435**
Gross profit	31	**9,630**	**10,794**
Research and development expenses		5,460	6,339
Sales and marketing expenses	33	12,035	11,377
General and administrative expenses		4,947	10,016
Expenses related to employee stock option plans	25	281	293
Other income	21	202	140
Other expenses	21	50	368
Operating loss		**-12,941**	**-17,459**
Financial income	22	2,145	3,238
Financial expenses	22	93	299
Loss before taxes		**-10,889**	**-14,520**
Income tax expense	20	351	2,377
Loss from continuing operations		**-11,240**	**-16,897**
Income from discontinued operations, net of tax	24	121,688	0
Net income / loss		**110,448**	**-16,897**
of which:			
Shareholders of the parent company		110,441	-16,906
Minority interests		7	9
Earnings per share from continuing operations	26		
Undiluted		-0.54	-0.80
Diluted		-0.53	-0.80
Total earnings per share	26		
Undiluted		5.27	-0.80
Diluted		5.22	-0.80
Number of shares			
Undiluted		20,952,051	21,130,183
Diluted		21,153,579	21,130,183
Additional information (non-audited):			
EBIT[1]		-12,941	-17,459
EBITDA[2]		-12,166	-16,559
Income from reduction of share capital		18,343	0
Amounts payable to shareholders from reduction of share capital		18,343	0
Per share amounts including reduction of share capital			
Undiluted		6.15	---
Diluted		6.09	---

[1] Earnings before financial income/ expenses and taxes
[2] Earnings before depreciation and amortization, financial income/ expenses and taxes

STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY

(in T€, except number of shares)	**Number of shares**	**Par value**	**Add. paid-in capital**	**Other comprehensive income**	**Unappropriated retained earnings**	**Treasury stock**	**Other changes in equity**	**Minority interests**	**Total**
31 December 2004	**22,928,570**	**22,929**	**23,131**	**0**	**5,272**	**-21,702**	**3**	**0**	**29,633**
Net income attributable to shareholders of the parent company and minority interests					110,441			7	110,448
Currency translation							-6		-6
Employee stock options	376,106	376	558						934
Capital increase from the company's own resources		18,343	-18,343						0
Reduction of share capital		-18,343							-18,343
Stock issued to employees			805						805
Fair value measurement of assets available-for-sale, net of tax				10,487					10,487
31 December 2005	**23,304,676**	**23,305**	**6,151**	**10,487**	**115,713**	**-21,702**	**-3**	**7**	**133,958**
Net income attributable to shareholders of the parent company and minority interests					-16,906			9	-16,897
Currency translation							7		7
Stock issued to employees			293						293
Fair value measurement of assets available-for-sale, net of tax				10,770					10,770
31 December 2006	**23,304,676**	**23,305**	**6,444**	**21,257**	**98,807**	**-21,702**	**4**	**16**	**128,131**

CONSOLIDATED STATEMENT OF CASH FLOWS

(in T€)	Note	2005	2006
		01 January – 31 December	
Cash flow from operating activities:			
Net income		110,448	-16,897
Reconciliation of net income to cash flow from operations:			
Income/ loss from deconsolidation	4	-126,965	0
Income taxes	20	4,072	2,377
Financial income and expenses:			
Dividends received	22	-263	0
Net interest income		-2,045	-1,292
Other		0	-1,647
Stock issued to employees	25	805	293
Allowance for doubtful accounts		716	-110
Income from government grants		-31	-60
Amortization and depreciation of fixed assets	5	1,068	790
Amortization of intangible assets	6	539	106
Loss on disposal of non-current assets		93	11
Currency translation		-5	39
Change in other balance sheet items (net of effects from business combinations):			
Inventories		-342	-1,651
Trade accounts receivable		-1,766	832
Other current assets, accruals and deferrals		-1,817	117
Current liabilities		594	-75
Provisions and other liabilities		801	3,008
Incomes taxes received		0	1,175
Income taxes paid		-3,274	-3,188
Interest received		1,912	1,312
Interest paid		-62	-54
Cash outflow from operating activities		**-15,522**	**-14,914**
Cash flow from investing activities:			
Repayments on loans issued to employees	8	125	110
Proceeds from sale of fixed assets		58	11
Purchase of fixed assets	5	-1,846	-590
Purchase of intangible assets	6	-240	-52
Dividends received	22	263	0
Recovery rights		0	389
Disposal of subsidiaries, net of cash disposed	4	63,856	201
Cash inflow from investing activities		**62,216**	**69**
Cash flow from financing activities:			
Payment to shareholders from reduction of share capital	19	-22,468	-18,341
Withholding tax payment resulting from reduction of share capital		-826	0
Payments made on convertible debt issued to employees	13	-7	-4
Proceeds from issue of shares to employees	25	934	0
Other financing activities		29	-2
Cash outflow from financing activities		**-22,338**	**-18,347**
Change in cash and cash equivalents		24,356	-33,192
Cash and cash equivalents, beginning of the year	27	49,955	74,311
Cash and cash equivalents, end of year	27	**74,311**	**41,119**
Cash and cash equivalents include money market funds		0	4,998

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1: GENERAL INFORMATION

TELES Aktiengesellschaft Informationstechnologien ("TELES AG") and its subsidiaries ("TELES" or the "Company") are engaged in two areas of business: TELES develops, manufactures and sells innovative, integrated high-performance network and least cost routing systems for telecommunications and data networks. It also offers high-speed Internet access services via skyDSL.

TELES AG has its registered headquarters in Berlin, Germany. Its shares are listed in the Prime Standard and are traded on all German stock markets.

The average number of staff amounted to 285 as compared to 257 in the previous year.

NOTE 2: SUMMARY OF MAIN ACCOUNTING PRINCIPLES

Basis of Presentation

In compliance with section 315a HGB, TELES' consolidated financial statements as at 31 December 2006 were prepared in accordance with the accounting principles of the International Accounting Standards Board (IASB), London. All international accounting standards (IAS/IFRS) and related interpretations of the International Financial Reporting Interpretations Committee (IFRIC) binding in the EU as at 31 December 2006 have been applied.

The standards, interpretations and amendments which had to be implemented for the first time during the preceding business year are listed below:

- *IFRS 6 Exploration and Evaluation of Mineral Resources*

The regulations of IFRS 6 are not relevant for the Company.

The amendment of the basis for the reasoning behind IFRS 6*, Exploration and Evaluation of Mineral Resources,* has no relevance for the Company.

- *IFRIC 4 Determining Whether an Arrangement Contains a Lease*

IFRIC 4 requires that arrangements be examined for specific assets which belong legally to the contract party but are controlled physically and economically by the reporting entity, as a result of which, for example, third parties may not use the asset, or a third party may not take more than an insignificant portion of the output of that asset. The use of such assets requires that the classification of the implied lease be examined from the point of view of IAS 17, and accounted for accordingly.

The regulations of IFRIC 4 had no influence on the financial and profit situation of the Company in the preceding business year.

- *IFRIC 5 Rights to Interests Arising from Decommissioning, Restoration and Environmental Rehabilitation Funds*

The interpretations of IFRIC 5 are of no relevance to the Company.

- *IFRIC 6 Liabilities arising from Participating in a Specific Market - Waste Electrical and Electronic Equipment*

The interpretation was drawn up in connection with the EU Directive on Waste Electrical and Electronic Equipment (2002/96/EC, amended by Directive 2003/108/EC), which regulates the collection and disposal of electrical and electronic equipment. This Directive addresses the question of when the manufacturer of certain electronic goods should create a reserve for the environmentally sound disposal of corresponding waste equipment. IFRIC 6 concludes that market participation during the measurement period triggers liability recognition according to IAS 37.14(a). The measurement period is the period used to calculate the waste disposal obligation based on the market share.

The conclusions of IFRIC 6 had no influence on the financial and profit situation of the Company in the preceding business year, as TELES currently makes no provision for the future disposal of electronic waste due to materiality considerations. The cost of disposal to be expected in future is being examined on a regular basis, however.

- *Amendment to IAS 21, Effects of Changes in Foreign Exchange Rates*

The amendment to IAS 21 requires that exchange differences arising on monetary items that form part of the reporting entity's net investment in a foreign operation be recognized as a separate component of shareholders' equity in the financial statements in which the foreign operation is consolidated, proportionately consolidated, or is accounted for using the equity method in the consolidated financial statements. This regulation is not dependent on the currency in which the monetary item is carried in the accounts, and is not dependent on which entity within the group conducts a transaction with the foreign operation.

The amendment to IAS 21 had no influence on the financial and profit situation of the Company in the preceding business year.

- *Amendments to IAS 39, Financial Instruments: Recognition and Measurement*

The amendments to IAS 39 include certain limitations to the possibility of evaluating financial assets and liabilities at fair value. However, the securities held by the Company at the balance sheet date still fulfil the criteria for an evaluation at fair value.

Further amendments to IAS 39 concern accounting for hedging relationships ("*Cash-Flow Hedge Accounting of Forecast Intragroup Transactions"*) and clarification in respect of accounting for financial guarantees resulting from an amendment to IFRS 4 ("*Insurance Contracts", "Financial Guarantee Contracts"*).

These amendments to IAS 39 had no influence on the financial and profit situation of the Company in the preceding business year.

- *Further standards, interpretations and amendments*

The amendments to IFRS 1*, First-Time Adoption of IFRS,* IFRS 4 *Insurance Contracts* and IAS 19 *Employee Benefits* are of no relevance to the Company.

In addition, the following standards, interpretations and amendments must be applied in future reporting periods:

- *IFRS 7 Financial Instruments: Disclosures*

IFRS 7 amends the disclosure regulations for financial instruments and replaces the disclosure regulations of IAS 32.

The regulation is effective from 1 January 2007.

As IFRS 7 deals only with disclosure requirements, it will have no effect on the financial and profit situation of the Company.

- *IFRS 8 Operating Segments*

IFRS 8 amends the disclosure regulations for operating segments. In the future, selected information concerning the operating segments will be published based on the internal decision parameters of a company (management approach). The relevant information includes those regularly provided to the chief operating decision maker for decisional purposes. This should generate more relevant information compared to those previously provided by IAS 14.

The regulation is effective from 1 January 2009.

As IFRS 8 deals only with disclosure requirements, it will have no effect on the financial and profit situation of the Company.

IFRS 8 had not been officially adopted by the EU when these financial statements were drawn up.

- *Amendment to IAS 1 Presentation of Financial Statements*

The amendment to IAS 1 requires additional disclosures regarding a company's equity. Information must be provided on the composition and management of the economic equity. This includes for example external capital requirements and capital restrictions.

The regulation is effective from 1 January 2007.

The amendment to IAS 1 is not expected to have any relevance for the Company.

- *IFRIC 7 Applying the Restatement Approach under IAS 29 Financial Reporting in Hyperinflationary Economies*

IFRIC 7 contains guidance on how an entity should restate its financial statements in the first year it identifies the existence of hyperinflation in the economy of its functional currency: the corresponding regulations should be applied as though the economy had always been hyperinflationary.

The interpretation is effective for annual periods beginning on or after 1 March 2006.

The application of IFRIC 7 is expected to have no significant effect on the financial and profit situation of the Company.

- *IFRIC 8 Scope of IFRS 2*

IFRIC 8 clarifies that IFRS 2 *Share-based Payments* applies to arrangements where an entity makes share-based payments for apparently nil or inadequate consideration. IFRIC 8 explains that, if the identifiable consideration given appears to be less than the fair value of the equity instruments granted, this situation typically indicates that other consideration has been or will be received. IFRS 2 therefore applies.

The interpretation is effective for annual periods beginning on or after 1 May 2006.

IFRIC 8 is not expected to have any significant effect on the financial and profit situation of the Company.

- *IFRIC 9 Reassessment of Embedded Derivatives*

IFRIC 9 deals with the special situation of accounting for embedded derivatives according to IAS 39. IAS 39.11 requires an assessment of whether the embedded derivative should be separated from the host contract and accounted for according to the regulations for derivative financial instruments. IFRIC 9 concludes that the assessment should always be made at the time of contract conclusion. A reassessment should only be carried out during the contract period if the terms of the contract or corresponding cash flows change significantly.

This interpretation is effective for annual periods beginning on or after 1 June 2006.

The application of IFRIC 9 is not expected to have any significant effect on the financial and profit situation of the Company.

- *IFRIC 10 Interim Financial Reporting and Impairment*

IFRIC 10 addresses the inconsistency between the requirements of IAS 34 *Interim Financial Reporting* and those of other standards in respect of the recognition and reversal of impairment losses on goodwill and certain financial assets in the financial statements. IFRIC 10 concludes that an entity may not reverse an impairment loss recognized in an earlier interim period in respect of goodwill, an equity instrument or another financial asset carried at cost. IFRIC 10 also states that this decision may not be extended by analogy to other areas of potential conflict between IAS 34 and other standards.

The interpretation is applicable for accounting periods beginning on or after 1 November 2006.

The application of IFRIC 10 is not expected to have a significant effect on the financial and profit situation of the Company.

IFRIC 10 had not been formally adopted by the EU when the financial statements of the Company were drawn up.

- *IFRIC 11 IFRS 2 – Group and Treasury Share Transactions*

IFRIC 11 addresses the accounting of share-based payments within a group, the impact of transfers of employees within a group on the application of IFRS 2 and the question of how share-based payments should be accounted for where an entity issues treasury stock or is required to buy shares from another party. IFRIC 11 concludes that in the case of a share-based payment transaction in which the parent company grants its own equity instruments to the employees of a subsidiary these are to be accounted for as equity-settled transactions in accordance with IFRS 2.10 ff. If, however, the subsidiary grants shares in the parent company to its employees, these are to be accounted for as cash-settled payment transactions in accordance with IFRS 2.30 ff. The transfer of an employee from one subsidiary to another within the group has no effect on the recognition of the share-based payment. Share-based payments in which the entity chooses or is required to buy treasury stock to settle the share-based payment obligation should always be accounted for as equity-settled payment transactions.

The interpretation is applicable for accounting periods beginning on or after 1 March 2007.

The application of IFRIC 11 is not expected to have a significant effect on the financial and profit situation of the Company.

IFRIC 11 had not been formally adopted by the EU when the financial statements of the Company were drawn up.

- *IFRIC 12 Service Concession Arrangements*

Service concession arrangements are arrangements whereby a government or other public body (grantor) grants contracts for the supply of public services to private operators. IFRIC 12 rules the application by the operator of existing IFRSs on service concession arrangements to enable recognition of liabilities entered into and rights received under the scope of service concession arrangements.

The interpretation is applicable for accounting periods beginning on or after 1 January 2008.

IFRIC 12 is not expected to have any relevance for the Company.

IFRIC 12 had not been formally adopted by the EU when the financial statements of the Company were drawn up.

No IFRS standards and interpretations effective from 2007 were applied in an earlier reporting period.

Use of Estimates

The preparation of financial statements and related disclosures to conform with accounting principles requires management to make estimates and assumptions that affect the amounts

reported in the consolidated financial statements and accompanying notes. Estimates are used for, but not limited to, the accounting for inventory allowances, allowance for doubtful accounts, depreciation and amortization, the fair value measurement of unlisted shares, accruals, warranty costs, sales returns, impairment of assets, taxes and contingencies. Actual results may differ from these estimates. Estimation uncertainties resulting in a significant risk that the carrying amounts of assets and liabilities will require material adjustment within the next financial year affect taxation on income. Key assumptions must therefore be made to enable the calculation of national and international accrued taxes. For certain business transactions final taxation cannot be definitely determined during the ordinary course of business. The Company determines the amount of accruals for expected tax audits on the basis of estimates regarding the extent that additional taxes might become due. If final taxation of certain business transactions varies from initial expectations, this will have an effect on actual and deferred taxes in the period in which the taxes are finally determined. Furthermore, the recognition of deferred tax assets on tax losses carried forward depends on future expectations for the development of income. Reference is made to the balance sheet and Note 20 for detailed information on income taxes in the consolidated financial statements.

Companies included in Consolidation

The consolidated financial statements for the financial year 2006 include the parent company TELES AG as well as six German and eleven foreign subsidiaries. The number of subsidiaries decreased against the previous year as the result of one merger and one disposal respectively.

TELES holds a 19.9% investment in GRAVIS AG. Furthermore, TELES has been granted an option to acquire the majority of the shares in GRAVIS AG which becomes exercisable after 1 April 2007. As GRAVIS AG is not controlled by the Company, it was not included for consolidation purposes.

There are no investments in associated companies.

Please see Note 33 for a list of the companies included in consolidation.

Consolidation Methods

All companies in which TELES AG is directly or indirectly able to govern the financial and operating policies so as to benefit from their activities are included in these consolidated financial statements. Uniform accounting principles are applied. The first-time inclusion of these companies takes place when TELES AG gains control over the subsidiary. Amounts attributable to minority interests are shown separately.

Consolidation of shareholders' equity is based on the purchase method, unless the Company opted for the exemptions relating to business combinations as set forth in IFRS 1 at the time of adopting IFRS on 1 January 2002. Under the purchase method, the historical cost of the investment is offset against the group's share in the relevant shareholders' equity. Assets acquired and liabilities assumed, including those not accounted for in previous statutory

accounts, are stated at their fair values at the time of acquisition. Minority shares in the assets and liabilities are also stated at their fair values and included in minority interests at the time of acquisition. Any remaining positive balance was capitalized as goodwill and subjected to straight-line amortization until 31 December 2004. The residual book value was no longer recognized when companies were disposed of.

Intercompany transactions are eliminated. Intercompany receivables and liabilities are offset. Intercompany profits are eliminated and intercompany income and expenses are offset.

Minority interests in the net income of a consolidated subsidiary are shown separately in the income statement. Negative amounts reduce the balance sheet item “Minority Interests” until it is completely depleted.

Upon disposal of a subsidiary, the residual value of its assets and liabilities including goodwill are offset against the proceeds from the transaction.

Property, Plant and Equipment

Property, plant and equipment are stated at cost less accumulated depreciation and write-downs. No revaluations have been made. Depreciation is carried out using the straight-line method over the estimated useful lives of:

Computer hardware:	3 years
Office equipment:	5 years
Leasehold improvements:	10 years
Other:	10 years

Repair and maintenance expenses are shown as incurred.

Intangible Assets

Intangible assets acquired are capitalized if it is probable that their use will result in future economic benefits. They are carried at cost less amortization and write-downs, if applicable. Amortization is carried out using the straight-line method over the estimated useful lives of:

Software:	3-5 years
Customer relations:	7 years
Other:	3-5 years

Financial Assets

The shares in freenet.de AG owned by the Company are classified as assets available-for-sale. The shares are carried as “Financial Assets Available-for-Sale” and measured at their fair value. The fair value is determined by the stock price at the end of the period under review. Changes in value after first-time recognition are recognized directly within equity (“Other Comprehensive Income”).

The Company holds a minority interest in GRAVIS AG which is classified as an asset available-for-sale and recognized under the balance sheet item “Financial Assets Available-

for-Sale". The investment is measured at its fair value. As the securities of GRAVIS AG are not listed, the fair value had to be determined by using the discounted cash-flow method with a discount rate of 16%. Changes in value after first-time recognition are recognized directly within equity ("Other Comprehensive Income").

TELES has an option to acquire the majority of the shares in GRAVIS AG which becomes exercisable after 1 April 2007. The right is a derivative not held for hedging purposes and is classified as a trading asset. It is included in the balance sheet item "Other Financial Assets" (current) and measured at its fair value based on the measurement of the underlying securities. Changes in value after first-time recognition are recognized in income.

Furthermore, TELES holds a recovery right ("*Besserungsrecht*") from the remission of debt in respect of the above mentioned minority interest in GRAVIS AG. Under the terms of the recovery right, the Company participates in any increase in the fair value of GRAVIS AG in terms of profit sharing or in the event of resale of GRAVIS AG shares. Receivables resulting from the recovery right are initially stated at fair value and afterwards measured at amortized costs using the effective interest method. The receivables are included in the balance sheet item "Other Financial Assets" (non-current).

The Company also holds two recovery rights and call and put options on the shares of one subsidiary and a call option on the shares of another subsidiary. The recovery rights and options were not recognized, as the Company did not assign a value to them as at the balance sheet date.

The Company holds shares in investment funds which are classified as trading assets and measured at their fair values. Changes in value after first-time recognition are recognized in income. The fair value is determined by the repurchase price of the fund shares at the end of the period under review.

Trade accounts receivable and other receivables are initially stated at fair value and afterwards measured at amortized costs using the effective interest method. Credit risk is accounted for by grouping the receivables according to their due dates. Subsequent allowances for bad debt are made on the basis of age. Specific allowances are made where required.

Purchases and sales of financial assets are accounted for at the settlement date.

Inventories

Inventories are stated at average cost or net realizable value, whichever is lower. Allowances are made for existing slow-moving and obsolete inventory.

Cash and Cash Equivalents

The Company considers all highly liquid investments with a maturity of ninety days or less at the time of acquisition to be cash equivalents.

The cash equivalents include shares in money market funds.

Treasury Stock

Purchases by the Company of common stock are recorded as "Treasury Stock" and result in a reduction in shareholder's equity. When treasury shares are reissued, the Company uses a first-in, first-out (FIFO) method with the difference between cost and re-issue price treated as a reduction or increase in retained earnings.

Financial Liabilities

The Company has financial liabilities resulting from the issue of convertible debt as part of its ESOP. The liabilities issued bear a historic market interest rate of 6%. The Company holds loans receivable granted as part of the ESOP in an amount almost equal to the financial liabilities. Both items are considered as held to maturity and accounted at cost.

The convertible debt is classified as a liability since the conversion right depends on uncertain events which are beyond the control of the Company. Further, there was no equity attributable to the convertible debt as at the date when it was issued.

Provisions

Provisions are made for legal and constructive obligations resulting from past events if it seems probable that an outflow of resources embodying economic benefits will be required to settle the obligation and a reliable estimate of the amount required can be made.

The Company generally guarantees its telecommunication products over a period of 12 months. In some cases this period is extended by up to 24 months. Estimated guarantee costs are accrued when the related revenue is recognized. The amounts are based on historic experiences and the assessment of future circumstances.

Deferred Income Taxes

Accounting for deferred income taxes is based on the liability method. Deferred income taxes are recorded on all significant temporary differences between the tax base and the carrying value of assets and liabilities as well as on the tax loss carry forward. Deferred taxes are calculated using the tax rate applicable by law on the balance sheet date. Provisions are made if it seems probable that some or all of the deferred tax assets may not be used. Deferred income taxes are classified as non-current assets and liabilities in the balance sheet.

Impairment

Impairment tests are made if there is a triggering event indicating that the carried value of the asset may exceed its net realizable value.

Research and Development Expenses

Research expenses are shown as incurred. Costs incurred for the development of software for telecommunications devices or Internet services available for sale were not capitalized as the requirements of IAS 38, particularly with regard to cost identification, technological feasibility and the probability of related future economic benefits, were not met. Costs incurred for the development of internally used software were also not capitalized.

Leases
If the Company is not classified economic owner of the asset, the lease is accounted for as an operating lease. Lease payments are charged to income straight-line over the term of the lease.

If the Company is classified economic owner of the asset, the lease is accounted for as a financing lease. The leased asset is capitalized and depreciated over the useful life or the term of the lease, whichever is shorter. The liability assumed is accounted for at its present value and reduced by any principal payments made.

Foreign Currency Translation
The currency of the primary economic environment in which an entity operates has been designated as the functional currency. The functional currency of the subsidiaries of TELES AG corresponds to the local currency of the respective entity. Accordingly, all assets and liabilities have been calculated at the current exchange rate as at the balance sheet date. Income and expenses have been calculated at the average monthly exchange rates prevailing during the year. Gains and losses resulting from the calculation of the subsidiary's financial statements are included in "Other Changes in Equity". Gains and losses resulting from the calculation of foreign currency transactions are included in the net income for the period.

Employee Stock Option Plans
The employee stock option plans of the Company are recognized in accordance with IFRS 2 *Share-based Payments*. According to IFRS 2, the effects of share-based payments should be recognized in income and in the financial and assets position of the company; this includes expenses resulting from stock options granted to employees. Consequently, the fair value of the employees' services received in exchange for the stock options granted should be recognized as an expense and increase in equity. Since it is not possible to estimate reliably the fair value of the employees' services, the fair value must be measured by reference to the fair value of the stock options at the grant date.

The transition provisions state that IFRS 2 should be applied to all grants made after 7 November 2002 that were unvested as of 1 January 2005. The comparative figures have to be adjusted accordingly.

Payments received on the exercise of stock options are recorded as capital increase resulting in neither profit nor loss.

Revenue Recognition
Products
The Company generally recognizes product revenue when persuasive evidence of an arrangement exists, delivery has occurred, the fee is fixed or determinable, no significant customer obligations remain and collectibility is probable. The Company accrues all potential costs relating to product returns, warranty costs and other allowances based on its experience.

Services
The Company recognizes revenue from sales of services when these services are substantially complete and chargeable. The Company renders services which are completed within one reporting period as well as services which are completed over several periods. If contractual services are not completed at the balance sheet date, those invoiced but not yet rendered and those rendered but not yet invoiced are accrued.

In principle, revenues should only be recognized if it is probable that the economic benefits associated with the transaction will flow to the entity. In particular, service agreements with a service provision of several periods are in this regard subject to a continuous revaluation; revenues are not recognized if substantial uncertainty exists with respect to the receipt of payments.

Multiple-Element Sales Arrangements
The IFRSs effective at the balance sheet date do not govern the revenue recognition of multiple-element sales arrangements. The Company therefore applies the accounting principles of EITF 00-21 (US GAAP) in accordance with IAS 8.12. EITF 00-21 addresses ways of accounting for deliveries and services related to one another generally referred to as integrated or package solutions. The agreement regarding the integrated solution is usually concluded at the same time. If the components of a supply and service agreement could be considered as separate units of accounting, revenue recognition should be determined independently for each accounting unit. As a consequence, the cost of the whole multiple-element sales arrangement is split based on the fair values of the respective accounting units.

Reimbursement of Transportation and Shipping Costs
The Company records the reimbursement of shipping costs as revenue and the related costs as cost of sales.

Cost of Sales
Cost of sales relating to the sale of products comprise direct material and manufacturing costs and indirect costs including depreciation of fixed assets used in production and amortization of other intangibles as well as allowances for inventories.

Earnings per Common Share
Basic net income per common share is computed using the weighted-average number of common shares outstanding during the period. Treasury stock reduces the number of shares outstanding. Diluted net income per common share is computed using the weighted-average number of common and diluted common equivalent shares outstanding during the period. Diluted common equivalent shares consist of stock options only.

Segment Reporting
Segment reporting includes information on the revenue and risks associated with the various products and services as well as the various geographical markets in which the Company operates. Based on the origin of revenues and risks, the Company defines business segments as its primary segments and geographical regions as secondary segments.

Government Grants

Government grants received for investments in fixed assets are accounted for as "Other Non-current Liabilities" and released over the useful life of the related assets affecting net income. In so far as the related assets have been partially or fully depreciated at the time the government grants are received, the grants are immediately recorded as income.

Dividend Income

Dividend Income is recognized at the time the right to receive the payment is acquired.

Discontinued Operations

The Company generally presents continuing and discontinued operations separately in the income statement, disclosing a summary of income from discontinued operations. A breakdown of the income and the amounts attributable to discontinued operations in the statement of cash flows are shown in Note 24.

Subsequent minor contributions to profit by operations discontinued in previous financial periods are not disclosed separately in the financial year 2006, but are presented as part of Other Income and Expenses and of Financial Income.

NOTE 3: MAJOR ITEMS INCLUDED IN INCOME FROM OPERATIONS

	01 January – 31 December	
(in T€)	**2005**[3]	**2006**
Amortization and Depreciation (included in cost of sales and operating expenses)	775	900
of which: depreciation of fixed assets	667	794
of which: amortization of intangibles	108	106
Inventories		
Cost of inventories charged to expense	12,790	14,035
of which: write-downs of inventories (included in cost of sales)	278	464
Income relating to prior periods		
(included in operating expenses and other income)	332	0
Allowances for doubtful accounts (included in sales and marketing expenses)	842	943
of which: increase in allowances	1,169	1,074
of which: reversal of allowances	-327	-131
Staff costs (excluding expenses related to employee stock option plans)		
(included in cost of sales and operating expenses)	12,177	14,226
of which: employer's share to statutory pension scheme	748	846
of which: employer's share to defined contribution plans	34	53
Government grants ("*Investitionszulage*")		
relating to prior periods (included in other income)	24	77

[3] Continuing Operations

NOTE 4: CHANGES IN THE COMPANIES INCLUDED IN CONSOLIDATION

On 5 July 2006 TELES NetSales GmbH was retroactively merged with TELES AG as at 1 January 2006 by entry into the Commercial Register. As a consequence, TELES AG became sole proprietor of TELES S.R.L. and TELES France S.A.R.L. The shares in TELES Computer Systems India Private Ltd. previously held by TELES NetSales GmbH are now held by TELES skyDSL GmbH and the shares in TELES Latin America S.R.L. are now held by TELES NetService GmbH.

In addition, the business activities of TELES NetService GmbH are carried out by TELES AG itself as of the third quarter 2006 as a result of changes to the sales structure of the TCS Segment.

In June 2006 TELES Communication Systems Commerce and Industry Ltd. Sirketi, in which TELES held 100% of the shares, was sold. The sale was concluded by transfer of all of the shares held by TELES to the buyer. The purchase price amounted to T€ 25 and corresponded to the carrying value of the equity.

The following assets and liabilities were sold:

(in T€)

Cash and cash equivalents	3
Receivables	20
Fixed and intangible assets	30
Other assets	16
Current liabilities	44

The investing cash flow was affected by the disposal as follows:

(in T€)

Cash component of sale and purchase price	25
Less outflow of cash and cash equivalents	3
Inflow of cash and cash equivalents	**22**

NOTE 5: PROPERTY, PLANT AND EQUIPMENT

Property, plant and equipment developed as follows in the financial years 2005 and 2006:

	Asset costs				
(in T€)	**31 December 2004**	**Additions**	**Disposals**	**Sale of Companies**	**31 December 2005**
Computer hardware	20,847	842	395	15,723	5,571
Capital leases	2,342	0	0	925	1,417
Furniture and fixtures	1,070	100	89	320	761
Leasehold improvements	4,600	11	1	4,086	524
Assets leased to customers	323	0	323	0	0
Other	944	393	162	691	484
Total	**30,126**	**1,346**	**970**	**21,745**	**8,757**

	Accumulated depreciation				
(in T€)	**31 December 2004**	**Additions**	**Disposals**	**Sale of Companies**	**31 December 2005**
Computer hardware	11,542	851	388	7,334	4,671
Capital leases	1,448	0	0	31	1,417
Furniture and fixtures	945	39	41	286	657
Leasehold improvements	1,380	48	1	917	510
Assets leased to customers	323	0	323	0	0
Other	683	130	116	577	120
Total	**16,321**	**1,068**	**869**	**9,145**	**7,375**

	Net closing amounts	
(in T€)	**31 December 2004**	**31 December 2005**
Computer hardware	9,305	900
Capital leases	894	0
Furniture and fixtures	125	104
Leasehold improvements	3,220	14
Assets leased to customers	0	0
Other	261	364
Total	**13,805**	**1,382**

	Asset costs					
(in T€)	**31 December 2005**	**Additions**	**Disposals**	**Exchange Differences**	**Sale of Companies**	**31 December 2006**
Computer hardware	5,571	484	32	-23	24	5,976
Capital leases	1,417	0	0	0	0	1,417
Furniture and fixtures	761	20	10	-2	8	761
Leasehold improvements	524	54	0	0	0	578
Other	484	168	0	-7	3	642
Total	**8,757**	**726**	**42**	**-32**	**35**	**9,374**

	Accumulated depreciation				
(in T€)	**31 December 2005**	**Additions**	**Disposals**	**Sale of Companies**	**31 December 2006**
Computer hardware	4,671	580	12	3	5,236
Capital leases	1,417	0	0	0	1,417
Furniture and fixtures	657	32	9	1	679
Leasehold improvements	510	18	0	0	528
Other	120	160	1	0	279
Total	**7,375**	**790**	**22**	**4**	**8,139**

(in T€)	Net closing amounts 31 December 2005	31 December 2006
Computer hardware	900	740
Capital leases	0	0
Furniture and fixtures	104	82
Leasehold improvements	14	50
Other	364	363
Total	**1,382**	**1,235**

NOTE 6: INTANGIBLE ASSETS

Intangible assets developed as follows in the financial years 2005 and 2006:

			Asset costs		
(in T€)	31 December 2004	Additions	Disposals	Sale of Companies	31 December 2005
Software	7,937	240	1	3,857	4,319
Customer relations	6,916	0	0	409	6,507
Goodwill	4,806	0	0	4,806	0
Learning management system	1,560	0	0	1,560	0
Content for Internet courses	1,302	10	0	1,312	0
Other	322	10	0	213	119
Total	**22,843**	**260**	**1**	**12,157**	**10,945**

			Accumulated amortization		
(in T€)	31 December 2004	Additions	Disposals	Sale of Companies	31 December 2005
Software	7,406	178	0	3,436	4,148
Customer relations	6,788	5	0	286	6,507
Goodwill	4,385	0	0	4,385	0
Learning management system	1,332	130	0	1,462	0
Content for Internet courses	1,094	226	0	1,320	0
Other	320	0	0	211	109
Total	**21,325**	**539**	**0**	**11,100**	**10,764**

(in T€)	Net closing amounts 31 December 2004	31 December 2005
Software	531	171
Customer relations	128	0
Goodwill	421	0
Learning management system	228	0
Content for Internet courses	208	0
Other	2	10
Total	**1,518**	**181**

			Asset costs		
(in T€)	31 December 2005	Additions	Disposals	Sale of Companies	31 December 2006
Software	4,319	52	1	0	4,370
Customer relations	6,507	0	0	0	6,507
Other	119	0	1	0	118
Total	**10,945**	**52**	**2**	**0**	**10,995**

(in T€)	Accumulated amortization 31 December 2005	Additions	Disposals	Sale of Companies	31 December 2006
Software	4,148	104	0	0	4,252
Customer relations	6,507	0	0	0	6,507
Other	109	2	1	0	110
Total	**10,764**	**106**	**1**	**0**	**10,869**

(in T€)	Net closing amounts 31 December 2005	31 December 2006
Software	171	118
Customer relations	0	0
Other	10	8
Total	**181**	**126**

All intangible assets have a definite useful life.

The remaining depreciable life of the major part of the software licenses is approx. two years.

NOTE 7: FINANCIAL ASSETS AVAILABLE-FOR-SALE

Financial assets available-for-sale include:

(in T€)	31 December 2005	31 December 2006
Listed securities: freenet AG[4]	65,720	75,764
Unlisted securities: GRAVIS AG	69	990
	65,789	**76,754**

Financial assets available-for-sale developed as follows:

(in T€)	2005	2006
1 January	69	65,789
Additions	55,025	0
Fair value measurement	10,695	10,965
31 December	**65,789**	**76,754**

Financial assets available-for-sale were measured at their fair value at the balance sheet date which is determined by a listed market price for the freenet AG shares and for the unlisted securities by using a valuation method (see also Note 2).

Please refer to Note 8 for Other Financial Assets (non-current) and to Note 11 for Other Financial Assets (current).

[4] In former times freenet.de AG; see Note 32

NOTE 8: OTHER FINANCIAL ASSETS

Other financial assets include:

(in T€)	**31 December 2005**	**31 December 2006**
Loans granted as part of the ESOP	686	577
Recovery right from the remission of debt	0	1,055
	686	**1,632**

The loans granted to employees as part of the ESOP bear an interest rate of 6% like the corresponding convertible debt. The fair value of these loans is equal to their net book value.

TELES holds a recovery right from the remission of debt in respect of the minority interest in GRAVIS AG. The recovery right was proportionately reinstated in the financial year 2006 (see also Note 2 and Note 22). The receivables of T€ 1,055 as at the balance sheet date resulting from the recovery right include an amount of T€ 268 which is due shortly.

In the course of the sale of TEIA AG and its subsidiary TEIA - SPC Lehrbuchverlag GmbH in 2005 a recovery right was granted under which TELES will receive additional contributions based on revenue and profit. In addition, in the event of a resale of these companies, TELES will receive 50% of profits as measured by the price at which the companies were sold less additional contributions already received. The recovery right is valid in the period 1 July 2005 to 30 June 2009.

Furthermore, TELES holds two call and one put option on all of the shares in call media services Ltd. The exercise price is £ 1.00 per share. The options have an unlimited term.

TELES also holds a put option on all of its shares in TELES Computer Systems India Private Limited. The option has an unlimited term.

As in the previous year these financial instruments were not recognized at the balance sheet date as the Company currently assigns no value to them.

NOTE 9: INVENTORIES

Inventories include:

(in T€)	31 December 2005	31 December 2006
Finished goods	471	444
Merchandise	566	571
Raw materials and supplies	3,527	5,064
	4,564	**6,079**
of which:		
Reported at net realizable values	213	171
Range > 12 months	519	310

NOTE 10: TRADE ACCOUNTS RECEIVABLE

Trade accounts receivable are made up as follows:

(in T€)	31 December 2005	31 December 2006
Trade accounts receivable	6,649	6,036
Other	441	203
	7,090	6,239
Less allowance for doubtful accounts	2,586	2,476
	4,504	**3,763**

Securities received amounted to T€ 143 as at 31 December 2006, which include T€ 23 bank guarantees and letters of credit and T€ 120 security deposits.

NOTE 11: OTHER FINANCIAL ASSETS

Other (current) financial assets include an option to acquire the majority of the shares in GRAVIS AG which becomes exercisable after 1 April 2007 (T€ 150, previous year: T€ 0) and shares in an investment fund (T€ 504, previous year: T€ 0).

The option right is measured at its fair value based on the measurement of the underlying securities.

The investment fund shares are measured at their fair value which is determined by the repurchase price of the fund shares at the end of the period under review.

NOTE 12: OTHER CURRENT ASSETS

Other current assets include:

(in T€)	31 December 2005	31 December 2006
Prepaid expenses	1,134	991
Receivables from government grants	224	60
Receivables from fiscal authorities	367	0
Other	803	747
	2,528	**1,798**

NOTE 13: SHAREHOLDERS' EQUITY

Common stock is made up of 23,304,676 non-par value shares. The imputed value per share amounts to € 1.00.

Following the resolution by the shareholders' meeting on 3 June 2005, the share capital was increased by € 18,342,856 out of capital reserves and subsequently reduced by the same amount for distribution to TELES' shareholders. The resolution was entered into the Commercial Register. The amount was paid to the shareholders on 2 January 2006 after the lock-up period designed to protect the creditors of companies in Germany.

The aforementioned reduction in share capital had no impact on the earnings of TELES as a corporate entity and was thus not taxable.

Authorized Capital

The authorized capital (Authorized Capital I) amounted to T€ 19,000 as at 31 December 2006.

The Authorized Capital I was issued on the basis of the resolution of the shareholders' meeting on 2 April 2004. The Authorized Capital I gives authorization to the Management Board to increase the Company's share capital in the period until 31 March 2009, subject to approval by the Supervisory Board. Contributions of up to T€ 19,000 may be made in cash or other assets as part of a single transaction or a series of transactions.

Restricted Capital

The restricted capital as at 31 December 2006 amounted to T€ 2,316 or 2,315,840 non-par value shares, and was made up as follows:

Restricted capital I: T€ 1,932 or 1,931,964 non-par value shares
Restricted capital III: T€ 384 or 383,876 non-par value shares

The Restricted Capital I, created for the first time at the shareholders' meeting in 1998, amounted to T€ 1,532 as at the last balance sheet date and was to be utilized for the

potential issuing of up to 1,531,964 non-par value shares as part of the Company's stock incentive plan. According to the resolution of the shareholders' meeting of 22 August 2006, the Restricted Capital I shall be used to issue potential shares to employees who have exercised conversion rights and stock options which had been granted on the grounds of previous shareholders' resolutions. It shall also be used to issue potential shares to employees as part of the ESOP approved under Item 7 of the agenda of the same shareholders' meeting. For that purpose, it was increased by T€ 400 or 400,000 non-par value shares. The Restricted Capital I will only be used if conversion rights or stock options are exercised under ESOP. In the reporting period, the Restricted Capital I was not utilized as no stock options were exercised.

At the shareholders' meeting of 11 July 2000, the Company's shareholders also approved the creation of the Restricted Capital III amounting to T€ 1,300. In accordance with the shareholders' resolution dated 31 August 2001, it will only be utilized when stock options granted to the Management Board and employees in the period until 30 August 2006 are exercised. The Restricted Capital III amounted to T€ 384 or 383,876 non-par value shares as at 31 December 2005. These values remained unchanged as at 31 December 2006 because no stock options were exercised in the reporting period.

Treasury Stock

On 25 May 1999, the Company's shareholders approved the Management Board's right to repurchase up to 10% of the Company's shares within the following 18 months for purposes other than trading. At the shareholders' meetings for the business years 2000 to 2005, the last being on 22 August 2006, prior authorizations were cancelled and new authorizations were granted to extend the right to repurchase shares for a period of up to 18 months.

Furthermore, the Management Board was authorized to resell the treasury stock subject to prior approval by the Supervisory Board. Treasury stock may also be transferred to third parties in a merger or in exchange for the acquisition of shares in companies which are to be wholly or partly owned. Shares may only be transferred at the prevailing market price. Treasury stock may also be re-issued when conversion rights are exercised by employees. The Management Board was also authorized to redeem treasury stock without authorization of the shareholders' meeting but subject to prior approval by the Supervisory Board. The authorization to redeem shares may be exercised in whole or in part. In financial 2006, no treasury shares were acquired on the basis of the authorization by the shareholders' meeting.

Treasury stock developed as follows:

(in T€)	**Number of shares**	**Cost**
31 December 2005	2,174,493	21,702
Additions	0	0
31 December 2006	2,174,493	21,702

Additional Paid-In Capital

Additional paid-in capital includes surpluses paid by shareholders. It was reduced by the effects of the pooling-of-interests accounting for business combinations under US GAAP.

The additional paid-in capital as at 31 December 2006 still includes T€ 1,424 due to the accounting for employee stock option plans in accordance with IFRS 2.

Other Comprehensive Income

Changes in value after first-time recognition of assets available-for-sale are recognized in other comprehensive income (T€ 21,257 as at 31 December 2006) and reduced by related deferred taxes.

Profit Transfer

TELES AG has concluded control and profit/loss transfer agreements with three of its subsidiaries. The agreements have a five-year term and create fiscal entities for trade and corporate tax purposes. The agreements with RVS GmbH and TECT AG were cancelled following the discontinuation of the activities of RVS and the sale of TECT AG to freenet.de AG. The profit transfer agreement with TELES NetSales GmbH was cancelled due to the merger of this subsidiary with TELES AG in the reporting period.

NOTE 14: CONVERTIBLE DEBT

Amounts recognized in the balance sheet:

(in T€)	**31 December 2005**	**31 December 2006**
6% convertible debt (maturity June 2008)	676	672
6% convertible debt (maturity August 2009)	216	216
	892	**888**

On 24 June 1998, the Supervisory Board of the Company authorized the grant of convertible bonds as part of the employee stock option plan. The Company received proceeds of T€ 1,569 from the issuing of 61,393 convertible bonds at a nominal value of € 25.56 each. The bonds mature on 24 June 2008, if not previously converted.

On 16 August 1999, the Supervisory Board of the Company authorized the grant of further convertible bonds as part of the employee stock option plan. The Company has a long-term loan receivable from employees who were granted a loan to pay for the convertible bonds. A total of 198,210 bonds were issued with a nominal value of € 2.00 each. The bonds mature on 16 August 2009, if not previously converted.

The bonds bear interest of 6% payable on 31 December of each year. The final interest payments are due on 24 June 2008 and 16 August 2009 respectively. The corresponding loans receivable from employees have the same terms. The fair value of the convertible bonds is equal to their carried amount. Please refer to Note 25 for the conversion terms.

NOTE 15: OTHER NON-CURRENT LIABILITIES

Other non-current liabilities include:

(in T€)	31 December 2005	31 December 2006
Payables to related parties	190	190
Other	128	126
	318	**316**

Information on related party transactions is given in Note 29.

NOTE 16: TRADE ACCOUNTS PAYABLE

Information is given in Note 28 on the contractual claim against a technical supplier reported in previous years.

NOTE 17: PROVISIONS

Provisions developed as follows:

			31 December			
(in T€)	**2005**	**Utilization**	**Release**	**Additions**	**Reclas-sification**	**2006**
Litigation	278	11	7	2,067	-90	2,237
of which: non-current				*1,615*		*1,615*
Other	176	158	3	671	0	686
Total	**454**	**169**	**10**	**2,738**	**-90**	**2,923**
Income taxes	**1,160**	**895**	**44**	**92**	**0**	**313**

The litigation risk assessment is based on estimates made by the Company's lawyers. No further details are disclosed so as not to weaken the Company's negotiating position, both in and out of court. Please refer to Note 28 for material litigation.

The outflow of resources is – except for the above mentioned non-current amount – primarily expected to occur within the next financial year.

NOTE 18: DEFERRED REVENUES

Deferred Revenues as at 31 December 2005 and 2006 include prepayments for accrued service revenues of the two business areas infrastructure systems and skyDSL services.

NOTE 19: OTHER CURRENT LIABILITIES

Other current liabilities include:

(in T€)	31 December 2005	31 December 2006
Amounts payable to shareholders from reduction of share capital	18,343	0
Payables to related parties	362	475
Other	2,104	2,221
	20,809	**2,696**

Information on related party transactions is given in Note 29.

NOTE 20: TAXATION ON INCOME

Earnings before tax were allocated as follows:

	Years ending 31 December	
(in T€)	**2005**	**2006**
Germany	**116,749**	**-12,371**
of which: continuing operations	-8,660	-12,371
of which: discontinued operations	125,409	0
Foreign countries	**-2,229**	**-2,149**
Income before taxes	**114,520**	**-14,520**

Income tax expense is made up as follows:

	Years ending 31 December	
(in T€)	**2005**	**2006**
Current taxes		
Germany	2,908	108
of which: continuing operations	190	108
of which: discontinued operations	2,718	0
Foreign countries	248	6
Total:	**3,156**	**114**
Deferred taxes		
Germany	666	1,470
of which: continuing operations	-337	1,470
of which: discontinued operations	1,003	0
Foreign countries	250	793
Total:	**916**	**2,263**
Tax expense:	**4,072**	**2,377**

The income of a corporation is at present subject to corporation tax of 25.0% plus a solidarity surcharge on that tax of 5.5%, resulting in an effective German corporation tax rate of approximately 26.4%. Taken with effective trade tax, the total tax due on taxable income amounts to approximately 38.9%.

The following table summarizes the significant differences between the Company's effective tax rate and the German rate of approximately 38.9%:

	Fiscal years ending 31 December	
(in T€)	**2005**	**2006**
Income/ loss before taxes	114,520	-14,520
Taxes at statutory rate	44,537	-5,647
Tax rate differentials	4	10
Non-taxable items	-47,292	-165
Non-deductible items	103	179
Change in valuation allowances	1,147	2,904
Non-recognition of deferred tax assets	4,378	5,210
Employee stock option plans	313	114
Other items, net	882	-228
Effective tax expense	**4,072**	**2,377**

Deferred taxes relating to assets available-for-sale were recognized directly in equity (T€ 403, previous year: T€ 208).

The approximate tax effects of temporary differences which give rise to deferred taxes are:

	Fiscal years ending 31 December	
(in T€)	**2005**	**2006**
Deferred tax assets:		
Intercompany transactions	79	40
Allowance for doubtful accounts	133	0
Operating tax loss carry forwards	6,727	12,400
Other	33	0
Valuation allowance	-603	-603
Total deferred tax assets	6,369	11,837
Offsetting against deferred tax liabilities	-2,614	-11,797
Net closing amount of deferred tax assets	3,755	40
Deferred tax liabilities:		
Costs of assets available-for-sale	850	811
Assets available-for-sale	208	403
Intercompany transactions	3,062	10,375
Depreciation of fixed assets	0	33
Other	129	208
Total deferred tax liabilities	4,249	11,830
Offsetting against deferred tax assets	-2,614	-11,797
Net closing amount of deferred tax liabilities	1,635	33
Deferred tax assets, net	**2,120**	**7**

Deferred tax liabilities from temporary differences of T€ 50 due to undistributed earnings of subsidiaries have not been recognized since distribution is not intended in the near future.

Unrecognized tax losses carried forward in companies with active businesses relate to German corporate tax (T€ 29,701) and trade tax (T€ 29,572), as well as foreign taxes on income (T€ 1,231), which cannot be utilized.

In addition, deferred tax assets on tax losses carried forward totalling approx. € 18 million in companies without active businesses were not recognized as they cannot be utilized by these companies. However, the major part of the losses was utilized by write-downs recorded in the tax accounts of the holding company.

When calculating a certain tax component of a company in a particular tax jurisdiction area, current deferred tax assets and liabilities were offset against one another. Deferred tax assets and liabilities can be summarized as follows:

(in T€)	**31 December 2005**		**31 December 2006**	
	To be settled in less than 12 months	To be settled in more than 12 months	To be settled in less than 12 months	To be settled in more than 12 months
Deferred tax assets	241	3,514	0	40
Deferred tax liabilities	0	1,635	0	33
Net deferred taxes	**241**	**1,879**	**0**	**7**

NOTE 21: OTHER INCOME AND EXPENSES

Other Income for the financial year 2006 mainly includes an amount of T€ 77 from government grants (2005: T€ 24) and T€ 63 in currency exchange gains (2005: T€ 21).

Other expenses for the financial year 2006 mainly include an amount of T€ 7 from the disposal of fixed assets (2005: T€ 8), T€ 10 in value-added tax adjustments (2005: T€ 6), T€ 19 in donations (2005: T€ 13), T€ 42 in write-down on granted loans (2005: T€ 0), T€ 150 for potential claims relating to the settlement of supply and service agreements and T€ 130 in currency exchange losses (2005: T€ 16).

NOTE 22: FINANCIAL INCOME AND EXPENSES

These items include:

	Financial years ending 31 December	
(in T€)	**2005**	**2006**
Financial income		
Interest	1,882	1,587
Dividends	263	0
Recovery right from the remission of debt	0	1,497
Other financial assets	0	154
Total	2,145	3,238
Financial expenses		
Convertible debt	55	55
Other	38	244
Total	93	299

NOTE 23: FINANCIAL RISKS

1. Foreign Currency Risks

Trade receivables are invoiced almost solely in Euro. In 2006, payments due to trade liabilities invoiced in US dollars amounted to approximately TUSD 3,561. The Company does not hedge against foreign currency risks at present. However, it closely monitors developments in the exchange rate.

2. Credit Risks

There are no credit risks arising from the sale of goods and services beyond the ordinary risks covered by valuation allowances against outstanding receivables.

Securities and cash are mainly placed with two major financial institutions. There is no credit risk.

3. Liquidity Risks

The Company has a substantial amount of free cash. Nonetheless, instruments are in place for the monitoring and disposal of cash in the group, the most important of which is the weekly cash report.

4. Interest Rate Risk

Financial assets in the form of cash are held as sight deposits at the prevailing short-term interest rate. There are no significant interest rate risks from financial liabilities. The development of interest rates was continuously monitored throughout the financial period so that interest rate risks could be hedged against, if necessary. However, at the balance sheet date no such financial instruments were held by the Company.

5. Price Risks

The Company holds shares classified as assets available-for-sale and is thus exposed to the price risk naturally inherent in shares traded on the stock market. This price risk is offset by the prospect of increasing share prices. Nevertheless, TELES monitors the development of the share price on a continuous basis to enable it to take timely countermeasures where necessary.

Furthermore, the Company holds shares in an investment fund. The aim of the fund concept is to utilize exchange rate fluctuations in the international currency markets in order to achieve returns at low risk which considerably exceed those of money market investments. In view of the high reputation and the successful fund management of the issuer, the Company expects the risk inherent in the fund to be very low.

NOTE 24: DISCONTINUED OPERATIONS

In the financial year 2005, the WebHosting business was sold under the terms of a contract dated 12 December 2004. Furthermore, in the interests of a further concentration of its business activities, the Company sold its debt-ridden WebLearning business on 1 July 2005.

The table below shows income from discontinued operations for the financial year 2005:

(in T€, except per share information)	
Operating result from discontinued operations	
Sales revenues	5,042
Operating expenses	5,156
Other income	9
Other expenses	33
Financial income	135
Earnings before taxes	**-3**
Income tax expenses	381
Operating result	**-384**
Income from discontinued operations	
Income from discontinued operations before taxes	**125,412**
Income tax expenses	3,340
Income from discontinued operations, net of tax	**122,072**
Total income / loss from discontinued operations, net of tax	**121,688**
Weighted average number of common shares used to compute earnings (loss) per share	
Undiluted	20,952,051
Diluted	21,153,579
Earnings per share from discontinued operations	
Undiluted	5.81
Diluted	5.75

Subsequent minor profit contributions from operations discontinued in previous financial periods are not disclosed separately in the financial year 2006, but presented as part of Other Income and Expenses and Financial Income.

The following Cash Flow was generated by the discontinued operations in the financial year 2005:

(in T€)	
Cash flow from operating activities	-1,125
Cash flow from investing activities	-1,122
Cash flow from financing activities	-6,414
Net changes in cash	-8,661

NOTE 25: EMPLOYEE STOCK OPTION PLANS

In 1998 and 1999, and also in 2001, 2002, 2004 and 2005, TELES AG adopted employee stock option plans in which the Company granted equity instruments to staff; the consideration for those exercised comprises likewise equity instruments. Any equity instruments granted as part of these plans may only be exercised if a defined performance hurdle is taken: The average performance of the TELES stock during the reference period must outperform the benchmark by at least ten percentage points.

Under the terms of the stock options plans for 1998, 1999, 2001 and 2002, 70% of the options granted to each employee are exercisable without any further conditions once the performance hurdle is taken. The remaining 30% only become exercisable if the employee has not sold any of the shares received under the plan by the end of the term ("bonus amount"). The 2004 and 2005 stock incentive plans do not include bonus amounts.

The option rights expire 8 to 10 years after their issue date.

Following the reduction of share capital which was approved by the extraordinary shareholders' meeting in 2004, the imputed value of the share options granted before the end of 2004 was reduced from € 2.00 to € 1.00.

A description of the individual terms of the plans is set out below:

The 1998 and 1999 Stock Option Plans

In 1998 and 1999 the Company issued convertible bonds to employees and members of the Management Board. The bonds have a 10-year term. The conditions of the original plans were modified in 2001. For more details please see the following explanations.

The 2001 and 2002 Stock Option Plans

a) The 2001 Plan

On 31 August 2001, the Management Board and the Supervisory Board of TELES AG were authorized to grant up to 650,000 further stock options with a total nominal value of € 1,300,000 to employees and members of the Management Board on or before 30 August 2006 based on a stock option plan approved by the Management Board and the Supervisory Board.

On 31 August 2001, the Management Board and the Supervisory Board of TELES AG were also authorized to grant up to 1,593,581 stock options to the participants of the 1998 and 1999 stock option plans on or before 31 December 2001. Under the terms of release agreements issued ("*Erlassverträge*"), the employees and the Management Board of the Company were granted the right to waive their exchange rights on shares from stock option plans adopted in previous years. In return they would be granted stock options under the new plan. The release agreements are valid for a period of two years after conclusion under the following conditions: If the average price of the TELES stock exceeds a value of € 20.00 during any period of ten days and all of the remaining conditions originally agreed are fulfilled, then those entitled may exchange convertible bonds in accordance with the

conditions detailed in the 1998 and 1999 stock option plans within a specified period of time. A total of 709,079 stock options were exchanged.

Each option grants the right to acquire one share with an imputed value of € 1.00 per share at an exercise price of € 2.00 per share. The option rights can be exercised in installments. At the earliest, the exercise of options rights can be started two years after the issuance and can be completed after six years.

The option rights expire on 9 October 2009 and 2011 respectively.

Although conversion rights were exchanged for stock options, the corresponding convertible debts were not settled. Instead, they have been retained until the end of the term or the exit of the employee, whichever occurs first.

b) The 2002 Plan

On 17 December 2002, a total of 417,640 stock options were issued by the Company to employees based on the authorization of the shareholders' meeting of 31 August 2001.

Each option grants the right to buy one share with an imputed value of € 1.00 per share at an exercise price of € 3.40 per share. The stock options may not be exercised earlier than two years after their date of issue.

The option rights expire on 16 December 2012.

The stock options granted as part of the 2001 and 2002 stock option plans may only be exercised if a defined performance hurdle is taken: The average performance of the TELES stock during the reference period must outperform the benchmark by at least ten percentage points. The benchmark period starts on the day following the grant date and ends whenever the employee decides to exercise his options. The average performance of the stock is based on the average closing prices as determined by the XETRA trading system during a period of ten days before the stock options are granted and a period of ten days before the option is exercised. The average performance of the benchmark is calculated accordingly. The relevant benchmark will either be the TecDAX (or NEMAX 50) or the DAX, whichever performs better. If an option right only becomes exercisable once a defined performance hurdle has been taken, the performance hurdle must only be taken once during the term of the options.

The 2004 Plan

Based on the authorization by the annual shareholders' meetings dated 31 August 2001 and 22 August 2003, a total of 581,572 employee stock options were granted on 17 August 2004. According to the resolutions of the shareholders' meeting in 2004, the Restricted Capital I and the amount of the Restricted Capital III remaining after deduction of previous ESOP expenses shall be used if new shares are issued on the basis of stock options. Some of the stock options were granted to employees who had once left the Company and later returned. These employees first had to waive any conversion rights granted historically.

Each option grants the right to acquire one share with an imputed value of € 1.00 per share at an exercise price of € 6.19 per share. The option rights can be exercised in installments. At the earliest, the exercise of options rights can be started two years after the issue date and can be completed after six years.

The option rights related to converted options expire on 16 August 2010. The remaining rights expire on 16 August 2014.

The performance hurdle and the related conditions correspond to those of the 2001 and 2002 stock option plans.

If extraordinary or unforeseeable events occur, the right to exercise options may be further restricted.

The 2005 Plan

Based on the authorization by the annual shareholders' meeting of 2 April 2004, a total of 295,290 employee stock options were granted on 22 November 2005. The resolutions of the aforementioned shareholders' meeting state that the Restricted Capital I shall be used if new shares are issued on the basis of stock options.

Each option grants the right to acquire one share with an imputed value of € 1.00 per share at an exercise price of € 6.98 per share. The option rights can be exercised in installments. At the earliest, the exercise of options rights can be started two years after the issue date and can be completed after six years.

The option rights expire on 21 November 2015.

The performance hurdle and the related conditions correspond to those of the 2001 and 2002 stock option plans.

If extraordinary or unforeseeable events occur, the right to exercise options may be further restricted.

Development of the Number of Stock Options granted

Taking the exchange of conversion rights for stock options into account, the total number of stock options and conversion rights granted developed as follows:

	Employee stock option plan					
	1998 & 1999 Conversion rights	2001 Stock options	2002 Stock options	2004 Stock options	2005 Stock options	Total
Outstanding on 31 December 2004	**399,084**	**477,137**	**375,204**	**581,572**	**0**	**1,832,997**
Granted	0	0	0	0	295,290	295,290
Exercised	0	-246,236	-129,870	0	0	-376,106
Forfeited	0	-33,752	-11,768	-28,450	0	-73,970
Outstanding on 31 December 2005	**399,084**	**197,149**	**233,566**	**553,122**	**295,290**	**1,678,211**
Granted	0	0	0	0	0	0
Exercised	0	0	0	0	0	0
Forfeited	0	-744	-3,060	-6,154	-69,614	-79,572
Outstanding on 31 December 2006	**399,084**	**196,405**	**230,506**	**546,968**	**225,676**	**1,598,639**
Number of vested options on 31 December 2006	**399,084**	**193,137**	**143,322**	**281,339**	**59,904**	**1,076,786**

The options outstanding on 31 December 2006 had a weighted average remaining contractual life of 5.3 years.

Expenses from Equity Instruments granted to Employees

Expenses have been calculated for the 2002, 2004 and 2005 employee stock option plans.

Since it is not possible to estimate reliably the fair value of services rendered by the employee in exchange for the equity instruments granted, the fair value must be measured indirectly by reference to the fair value of the equity instruments at the grant date.

The value of the subscription rights was determined using a Monte Carlo Simulation, taking the performance hurdle into account, and is costed proportionately over the vesting period. Non-market vesting conditions are included in assumptions regarding the number of options that are expected to become exercisable. The estimates regarding non-market vesting conditions are revised on each balance sheet date and resultant changes are recognized in the income statement with a corresponding adjustment to equity.

The following parameters were used to determine the value of the subscription rights:

	Employee stock option plan		
	2002	**2004**	**2005**
Valuation date	17 December 2002	17 August 2004	22 November 2005
Exercise price TELES	3.40 €	6.19 €	6.98 €
Basis DAX	3,185.74	3,735.19	5,080.48
Basis TecDAX	421.47	462.39	580.17
Valuation rate TELES	3.10 €	6.31 €	6.90 €
Valuation rate DAX	3,139.97	3,705.73	5,174.72
Valuation rate TecDAX	395.10	465.24	587.44
Interest rate	4.39%	4.10%	3.49%
Volatility TELES	91.70%	65.60%	57.68%
Volatility DAX	31.65%	33.24%	27.46%
Volatility TecDAX	51.79%	37.43%	29.32%
Correlation TELES / DAX	0.21	0.27	0.24
Correlation TELES / TecDAX	0.27	0.29	0.27
Correlation DAX / TecDAX	0.72	0.78	0.77
Fair value of the option	**2.57 €**	**2.42 €**	**2.12 €**

A stock price threshold of 200% of the exercise price was determined for the early exercise of options using corresponding studies.

For the purpose of an objective approach, volatilities and correlations are determined historically and calculated on the basis of the daily XETRA closing prices of the TELES stock and the DAX and TecDAX (or NEMAX 50) indices.

The development of TELES' stock price in the period from its first listing in 1998 to 2000 was mainly influenced by the New Economy Boom on Germany's Neuer Markt (New Market). The period from July 1998 to December 1999 saw the strongest fluctuations in the price of the TELES stock. During this phase, the stock price increased from approx. €23.18 at the time of TELES' first listing to more than €90 and subsequently fell to about €27 in December 1999. Due to the one-off character of these developments and the related extreme daily stock price fluctuations, the time slot for determining the historical volatilities and correlations has been limited to a period of three years prior to the grant date of stock options for the 2002 and 2004 plans and to a period of four years for the 2005 plan.

The following expenses from equity instruments granted to employees have been recognized in income for the financial years 2005 and 2006:

(in T€)	Employee stock option plan			
	2002	**2004**	**2005**	**Total**
Financial year ending 31 December				
2005	**293**	**423**	**89**	**805**
of which: continuing operations	47	145	89	281
of which: discontinued operations	246	278	0	524

(in T€)	Employee stock option plan			
	2002	**2004**	**2005**	**Total**
Financial year ending 31 December				
2006	**47**	**145**	**101**	**293**
of which: continuing operations	47	145	101	293
of which: discontinued operations	0	0	0	0

NOTE 26: EARNINGS PER SHARE

The following table illustrates the computation of diluted and undiluted earnings per common share attributable to shareholders of the parent company:

	Financial years ending 31 December	
(in T€, except per share information)	**2005**	**2006**
Net income for the year attributable to shareholders of the parent company	110,441	-16,906
Weighted average number of common shares used to compute earnings per share		
Undiluted	20,952,051	21,130,183
Diluted	21,153,579	21,130,183
Earnings per share		
Undiluted	5.27	-0.80
Diluted	5.22	-0.80
Net income for the year attributable to shareholders of the parent company including amounts resulting from the reduction of share capital	128,784	---
Weighted average number of common shares used to compute earnings per share		
Undiluted	20,952,051	---
Diluted	21,153,579	---
Amount per share after capital reduction		
Undiluted	6.15	---
Diluted	6.09	---

Financial Year ending 31 December 2005:
Stock options granted to employees are the only category of potential dilutive shares.

The outstanding convertible bonds (see Note 25) could be potentially dilutive in the future, but were not included in the calculation of diluted earnings per share because they are anti-dilutive for the periods presented.

Financial Year ending 31 December 2006:
Potential shares from employee stock option plans and outstanding convertible bonds were not considered to be dilutive as an assumed conversion would result in a reduction of the loss per share for the period.

NOTE 27: RESTRICTED CASH, OTHER FINANCIAL COMMITMENTS AND CONTINGENT LIABILITIES

Restricted Cash

Cash in the amount of T€ 102 (prior year: T€ 118) was restricted as at the balance sheet date.

Operating Leases

The Company has rented satellite capacities, buildings, vehicles, warehouses and certain office equipment under non-cancellable lease contracts without purchase options. Office buildings leases have a maximum term until 30 April 2012 – due to a new leasing contract concluded in the financial year 2006 – and some include prolongation rights for the Company. Operating lease expenses amounted to T€ 7,374 and T€ 6,507 for the financial years ending 31 December 2006 and 31 December 2005 respectively.

Future minimum lease payments under non-cancellable lease contracts with a term of one year or longer were approximately as follows:

(in T€)	**31 December 2006**
Less than one year	6,298
Between one and five years	2,383
More than five years	173
Total	**8,854**

Other Financial Commitments

Future minimum payments under legally binding agreements are as follows:

	31 December	
(in T€)	**2005**	**2006**
Purchase commitments		
Software	3	0
Fixed assets	73	0
Other services	275	33
Maintenance	32	31
Total	**383**	**64**

Direct debiting related to the TWBI business activities (see also Note 31) is carried out by a renowned financial service provider. It was agreed that an amount of T€ 9 (previous year: T€ 31) be deposited for contingent direct debit liabilities in this respect.

NOTE 28: LITIGATION

The Company is involved in legal proceedings and litigation arising in the ordinary course of business. It is the Company's policy to accrue for amounts related to these matters if it is probable that a liability has been incurred and an amount can be reasonably estimated.

In 2002 TELES initiated joint proceedings against Deutsche Telekom AG (DTAG) and SES ASTRAnet S.A. for the infringement of several patent rights with their "TDSL via Satellite" service. The company bases its case on the German and European patents protecting the skyDSL technology developed by TELES and on a corresponding German utility model. In two similar lawsuits regarding patent infringement the companies sued by TELES finally reached agreement with the Company – after a first-instance verdict – and withdrew from this

field of business. In the patent infringement proceedings against DTAG and SES, which have been resumed after an interim postponement in respect of the German patent and utility model, a first-instance ruling was made on 27 January 2006. As forecast, the verdict was in favour of TELES. Only DTAG has appealed against the ruling, while the verdict against SES is effective and thus enforceable. In the same connection, the aforementioned intellectual property rights were challenged before the German and European Patent Offices in 2003. In 2005, following confirmation of the German core skyDSL patent by the Federal Patents Court at the end of 2004, the Patent Office also ruled similarly in favour of TELES in the first instance in a parallel case initiated by DTAG/SES to have the TELES utility model cancelled. In the appeal proceedings, however, the Federal Patents Court cancelled the utility model on formal legal grounds on 20 March 2007. The decision is not yet effective, and an appeal can be made. Ultimately, the result of this case affects neither TELES' skyDSL operations, nor does it have any particular influence on the outcome of the skyDSL patent infringement proceedings. The European skyDSL patent was already confirmed by the European Patent Office with only marginal qualifications on 26 January 2006. DTAG/SES have lodged an appeal against this ruling, too. TELES is confident that it will also win those cases which have not yet been finally decided. Both TELES and its legal advisors expect no risks to the Company to result from these facts and circumstances.

One of STRATO Medien AG's competitors took exception to advertisements for skyDSL in 2003 and applied for an injunction. On 17 February 2005 the Regional Court of Colgone ruled that STRATO must desist from advertising its satellite-based Internet access with what the court considered the misleading term "DSL", either on its own, or in the name "skyDSL". On 6 April 2005 STRATO Medien AG appealed the decision at the Higher Regional Court of Cologne, which dismissed the appeal on 15 February 2006. The right to further appeals was not granted. STRATO Medien AG did not appeal against this non-admission ruling, which has thus become effective since then. The risk of an identical follow-on case for TELES skyDSL GmbH, the sales company formed after STRATO Medien AG left the TELES Group, is deemed to be low by TELES and its legal advisors.

In June 2003 TELES acquired 33.3% of the shares in a start-up company which operates as telecommunications service provider. Business activities at this company, which is registered in England, have now been discontinued. It originally provided services to carriers in Germany requiring low cost connections from fixed-line networks to mobile networks, until the mobile SIM cards were deactivated by the mobile network operator. The Company was unable to assert its temporary injunction for reactivation of the cards against the mobile network operators concerned, but is hoping for final clarification in the principal case after a mobile network operator initiated action for payment and damages at the end of 2004. TELES has also entered a claim for damages resulting from the deactivation of the mobile cards in the principal case. In its ruling of 31 May 2006, the Regional Court of Düsseldorf ruled at the first instance in favour of the claim brought by the wireless carrier and dismissed the counter-claim. The decision is not yet effective and has been appealed against. As there has been an about-turn in the jurisdiction regarding the legality of the deactivation of the SIM cards used in GSM gateways by the wireless carriers, it is uncertain whether the appeal will succeed before the Higher Regional Court of Düsseldorf. No high financial risks are involved, however.

In 2005, the same mobile network operator also applied for an injunction against the provision and sale of GSM gateways for carrier networks by TELES AG and TELES NetSales GmbH. In its ruling of 14 June 2006, the Regional Court of Düsseldorf dismissed the claim at the first instance. TELES AG's counterclaim against clauses in the wireless carrier's General Terms and Conditions which ban the use of its SIM cards in GSM gateways was, however, also without success. Both parties have lodged an appeal against the decision made at the first instance. In view of the aforementioned shift in jurisdiction regarding one aspect of the legal action (the legality of the use of GSM gateways in Germany), it is impossible here, too, to assess TELES' chances of success. It is also unclear what effect a ruling against TELES would have on international sales. As the ruling at the first instance was made in favour of TELES, both TELES and its legal advisors consider the risk of a general ban on exports and – in view of the minor significance of Germany as a market for GSM gateways – the economic risks for TELES to be low.

It was agreed under the sale of the WebHosting business that STRATO Medien AG would continue the lawsuit initiated by the bankruptcy administrator of KPNQwest Germany GmbH i.In., with any and all opportunities and threats related to this lawsuit remaining with TELES. As reported in prior years, STRATO withheld all payments to its technical supplier, KPNQwest, during 2001 and 2002, and claimed a reduction in payables for insufficient quality of services. After KPNQwest had filed for bankruptcy, the bankruptcy administrator instituted legal proceedings against STRATO in 2002 for payment of outstanding receivables. As of 31 December 2004 STRATO's trade accounts payable showed an amount of €5.4 million, which includes a discount of €3.2 million for the reductions claimed, a claim the Company considers more than justified. In addition, STRATO is claiming around €8 million in damages. At the balance sheet date, the lawsuit was still underway. The Company has set up sufficient provisions for lawyers' fees and court costs. TELES and its legal advisors perceive no further threats to the Company from these facts and circumstances.

The appeal lodged by Quintum Inc. and its German distribution partners, who lost the case brought by TELES for infringement of its InstraStar patents (first-instance decision in favour of TELES by the Regional Court of Mannheim on 11 November 2005) has been suspended until the current nullity proceedings against the IntraStar patents have been finally decided.

In the meantime, TELES' appeal in respect of its initial claim against AVM GmbH and its distribution partners was dismissed by the Higher Regional Court of Karlsruhe on 28 June 2006. TELES has lodged a complaint against the non-allowance of its appeal in this last case. A decision is still outstanding.

A further case lodged by TELES against AVM GmbH as a result of the revision of the product which was originally criticized was also dismissed at the first instance by the Regional Court of Mannheim on 18 July 2006. The appeal against this decision lodged by TELES has since been suspended until a final decision is made in the current nullity proceedings against the patents suit. The same applies to the appellate proceedings against the first-instance decision of the Regional Court of Mannheim of 9 June 2006 dismissing the patent infringement proceedings against CISCO Systems Inc.

The proceedings initiated on 15 February 2006 by TELES against Nokia for infringement of its patents have also since been suspended for the same reason.

In the cases brought by CISCO and Quintum for nullification of the German InstraStar patent and the German part of the European IntraStar patent, the 4th Senate of the Federal Patents Court in Munich declared both patent and partial patent void on 5 April 2006. The Federal Patents Court gave as its reason for this decision the lack of an inventive step in both patents. The rulings are not yet effective and TELES lodged an appeal against them with the Federal Court of Justice (BGH) on 21 June 2006. Further information can be found in TELES' press release dated 6 April 2006. TELES remains confident that these patents will eventually be confirmed. A double-digit number of patent infringement suits can be expected by TELES against primarily non-European companies in the future, as their hybrid Internet telephony products (or VoIP products) may currently infringe the IntraStar patents (see the German-language VoIP Patent Infringement Forum at www.teles.de for more information). TELES and its legal advisors perceive no threats to the company from these cases.

In October 2005 the IntraSTAR patent was granted to TELES for the United States of America. The Declaratory Judgement Action filed by CISCO for nullification of this US patent and to ensure its non-infringement by CISCO products is currently at the pre-trial discovery stage. A further VoIP patent granted to TELES in the USA on 5 December 2006 containing a whole series of further patent claims has been included by TELES in the case, thus increasing the Company's chances of success.

On 24 March 2006 TELES also filed a patent infringement action against Quintum in the USA based on the first US IntraStar patent. The second US IntraStar patent mentioned above was also incorporated into this case.

Generally speaking, no claims can be made under US law for reimbursement of legal fees, even where the opposing party has lost his case. As such, TELES and its legal advisers currently perceive no greater risks – apart from the cost of defence – from these proceedings.

NOTE 29: RELATED PARTY TRANSACTIONS

The following transactions between the Company and related parties occurred in the reporting period:

Purchase of Services:

	Financial years ending 31 December	
(in T€)	**2005**	**2006**
Mock-Rechtsanwälte	83	40
Rechtsanwälte Feser & Spliedt	92	30
Total	**175**	**70**

The aforementioned services were received from professional associations in which members of the TELES Supervisory Board have a financial interest.

Receivables from Related Parties:
Receivables from related parties amounted to T€ 3 as at the balance sheet date.

Payables to Related Parties:

(in T€)	Financial years ending 31 December 2005	2006
Convertible debt held by Management Board members	190	190
Bonuses payable to Management Board members	177	252
Payables to members of the Supervisory Board	185	223
Total	**552**	**665**

Remuneration of the Members of the Management Board:

(in T€)	Financial years ending 31 December 2005		2006	
	Fixed	Variable	Fixed	Variable
Jan Bastian	149	100	148	84
Andreas Krüger	150	100	151	84
Olaf Schulz	159	100	161	84
Joachim Schwarzer	14	0	0	0
Rochus Wegener	12	0	0	0
	484	**300**	**460**	**252**

The amounts stated for variable remuneration were accrued based on original targets. The ultimate determination for financial 2006 is still pending.

In 2006, no further stock options were granted to members of the Management Board.

Prof. Dr.-Ing. Schindler received the equivalent of T€ 24 (previous year: T€ 24) in benefits from the use of a company car.

	Stock options	Shares
Prof. Dr.-Ing. Sigram Schindler	39,600	11,403,055
Jan Bastian	83,310	4,484
Andreas Krüger	60,000	73,164
Olaf Schulz	66,648	0
	249,558	**11,480,703**

On 31 December 2006, Prof. Dr.-Ing. Sigram Schindler held directly as well as indirectly 48.93% of the shares in TELES AG: 47.47% of the TELES AG shares previously held directly were transferred to “Sigram Schindler Beteiligungsgesellschaft mbH” in the financial

year 2006 and were in its possession at the balance sheet date; 1.46% of the shares are still held directly by Prof. Dr.-Ing. Sigram Schindler.

Remuneration of the Members of the Supervisory Board:

Total remuneration of the members of the Supervisory Board amounted to T€ 45 in each of the financial years reported.

	Financial years ending 31 December	
(in T€)	**2005**	**2006**
Dr. Walter Rust	20	20
Dr. Jürgen D. Spliedt	15	15
Prof. Dr. Dr. Thomas Schildhauer	10	7
Prof. Dr. h.c. Radu Popescu-Zeletin	0	3
	45	**45**

NOTE 30: COMPOSITION OF SALES REVENUES AND COST OF SALES

(in T€)	**2005**	**2006**
Sales revenues	**25,377**	**28,229**
Products	18,880	19,166
Services	6,497	9,063
Cost of Sales	**15,747**	**17,435**
Products	7,359	7,801
Services	8,388	9,634

NOTE 31: SEGMENT REPORTING

Description of the reported Segments

TELES is divided into the two main segments telecommunications systems (TCS) and broadband Internet services (TWBI). The segment for telecommunications systems includes the development, manufacture and sale of telecommunications equipment to carriers. Activities of the TWBI segment are focused on wireless broadband Internet services which are internationally available. The Company evaluates segment performance mainly on operating income.

Measurement of Segment Income/Loss

The underlying accounting principles are basically the same as the ones set forth in the section “Summary of Main Accounting Principles”.

The operating income of the segments includes allocations of corporate overheads as well as expenses due to the legal enforcement of the company’s patents (TCS T€ 1,641 / T€ 4,712, previous year: T€ 1,399 / T€ 250, TWBI T€ 1,063 / T€ 248, previous year: T€ 756 /

T€ 176). The sections “MS Division” and “TIPR Division” in the Management Report explain the nature of these expenses.

The Gross Profit in the TWBI Segment includes expenses for transponder capacities of T€ 5,779 (previous year: T€ 5,511).

Intersegmental transactions were immaterial.

(in T€)	**Financial year ending 31 December**			
	2005			
	TCS	**TWBI**	**Other**	**TELES**
Sales revenues	19,262	6,115		25,377
Gross profit	12,538	-2,908		9,630
Gross profit margin %	65.1	-47.6		37.9
Operating income	**-779**	**-12,162**		**-12,941**
Financial income and expenses				2,052
Income before taxes				-10,889
Income tax expense				351
Income/ loss from continuing operations				-11,240
Income/ loss from discontinued operations, net of tax (see also Note 24)				121,688
Net income				**110,448**
Segment assets	85,151	2,042	193	87,386
Non-allocated assets				73,784
Consolidated assets				161,170
Segment liabilities	21,127	1,896	312	23,335
Non-allocated liabilities				3,877
Consolidated liabilities				27,212
Investments	882	304	420	1,606
Depreciation and amortization	534	241		775

(in T€)	Financial year ending 31 December			
	2006			
	TCS	**TWBI**	**Other**	**TELES**
Sales revenues	19,173	9,056		28,229
Gross profit	11,510	-716		10,794
Gross profit margin %	60.0	-7.9		38.2
Operating income	**-9,012**	**-8,440**	**-7**	**-17,459**
Financial income and expenses				2,939
Income before taxes				-14,520
Income tax expense				2,377
Income/ loss from continuing operations				-16,897
Income/ loss from discontinued operations, net of tax (see also Note 24)				0
Net income				**-16,897**
Segment assets	52,152	2,792	190	55,134
Non-allocated assets				82,242
Consolidated assets				137,376
Segment liabilities	4,814	1,077	315	6,206
Non-allocated liabilities				3,039
Consolidated liabilities				9,245
Investments	650	128		778
Depreciation and amortization	620	280		900

Geographical Information

Sales revenues per regions were as follows:

(in T€)	Financial years ending 31 December 2005	2006
Sales revenues:		
Germany	6,782	10,771
Rest of Europe	16,123	14,204
Other	2,472	3,254
Total	25,377	28,229

Both reported segments generate sales revenues in Germany, the rest of Europe and other parts of the world.

Segmental assets per region were as follows:

(in T€)	31 December 2005	31 December 2006
Segmental assets:		
Germany	81,613	51,965
Rest of Europe	5,359	2,709
Other	414	460
Non-allocatable	73,784	82,242
Total	161,170	137,376

Additions to fixed and intangible assets were as follows:

(in T€)	31 December 2005	31 December 2006
Germany	1,253	572
Rest of Europe	130	31
Other	223	175
Total	1,606	778

NOTE 32: SUBSEQUENT EVENTS

The merger of mobilcom AG and freenet.de AG to telunico holding AG became effective on 2 March 2007, when it was entered into the Commercial Register. At the same time, telunico holding AG was renamed freenet AG. Once the merger and renaming had become effective TELES AG held 3,565,002 of the voting rights (formerly 3,100,002) in the "new" freenet. This gives the Company voting rights amounting to 3.71%.

NOTE 33: OTHER INFORMATION

Changes in Accounting Policies for improved Presentation

From the beginning of 2006 the Company applies the accounting principles of EITF 00-21 (US GAAP) for the recognition of revenues from multiple-element sales arrangements. This should mainly provide more transparent information for the future. The change in accounting policy had an effect of T€ 57 in the business area skyDSL services (increase in sales revenues and other current assets) and thus on the financial and profit situation of the Company in the preceding business year. The change was not applied retrospectively due to the marginal impact.

Changes as against the Previous Year

Certain expenses in the TWBI Segment were reallocated to the functional areas as of the third quarter 2005. The figures reported in the Annual Report 2005 were therefore adjusted to improve comparability. The outcome of this is an increase in Cost of Sales of T€ 151 and a corresponding decrease in Sales and Marketing Expenses for the financial year 2005.

Services from the Auditing Company

In 2006, PricewaterhouseCoopers AG Wirtschaftsprüfungsgesellschaft rendered the following services to the Company: annual audit (T€ 125), tax consultancy (T€ 101) and other consultancy services (T€ 94).

Companies included in Consolidation

The consolidated financial statements include the accounts of TELES AG and the following companies, all of which are wholly-owned subsidiaries of TELES AG unless otherwise stated:

Subsidiary	Registered headquarters
TELES skyDSL Europe B.V.	Roelofarendsveen, Holland
TELES Communications Corp.	San Francisco, USA
TELES Computer Systems India Private Ltd. [1]	Bangalore, India
TELES France S.A.R.L.	Evry, France
TELES S.R.L.	Genoa, Italy
RVS Datentechnik GmbH	Munich, Germany
TELES Wireless Broadband Internet GmbH	Berlin, Germany
TELES skyDSL GmbH	Berlin, Germany
TELES Latin America S.R.L. [2]	Santa Cruz, Bolivia
TELES skyDSL UK Ltd. [3]	Birmingham, Great Britain
TELES Ireland Ltd.	Shannon, Republic of Ireland
TELES EuroService Ltd.	Shannon, Republic of Ireland
TELES NetSales Spain S.A.	Madrid, Spain
TELES NetService GmbH	Berlin, Germany
DirectSat AG	Berlin, Germany
call media services Ltd.	London, Great Britain
more! Computer AG	Berlin, Germany

[1] --- 84.999% held by TELES skyDSL GmbH / 0.001% held by TELES NetService GmbH
[2] --- 1% held by TELES NetService GmbH / 99% held by TELES AG
[3] --- 100% held by TELES Wireless Broadband Internet GmbH

Information on Companies not included in Consolidation

(Reference is made to Note 2)

Name of company	Registered headquarters	Shares held by TELES AG (%)	Currency	Equity [1] (in T€)	Net income 2006 [1] (in T€)
GRAVIS Beteiligungs AG	Berlin, Germany	19.99	EUR	7,205	655

[1] --- Figures for GRAVIS Group, based on national accounting regulations

Corporate Governance Code

The Management Board and Supervisory Board of TELES AG have submitted a declaration of compliance with the German Corporate Governance Code pursuant to Section 161 AktG. This declaration can be viewed on the TELES AG website.

Management Board

The following individuals were members of the Management Board of TELES AG during the reporting period:

Prof. Dr.-Ing. Sigram Schindler, Berlin, Chief Executive Officer
Dipl.-Inf. Jan Bastian, Berlin, Telecommunications Systems
Dipl.-Ing. Andreas Krüger, Berlin, Broadband Internet Services
Dipl.-Betriebswirt Olaf Schulz, Berlin, Chief Financial Officer

The following intra-group Supervisory Board seats were held by members of the Management Board:

Prof. Dr.-Ing. Sigram Schindler:	TELES Wireless Broadband Internet GmbH TELES skyDSL GmbH TELES NetService GmbH DirectSat AG more! Computer AG
Dipl.-Inf. Jan Bastian:	TELES Wireless Broadband Internet GmbH TELES skyDSL GmbH TELES Computer Systems India Private Ltd. DirectSat AG
Dipl.-Ing. Andreas Krüger:	TELES NetService GmbH
Dipl.-Betriebswirt Olaf Schulz:	TELES Wireless Broadband Internet GmbH TELES skyDSL GmbH TELES Computer Systems India Private Ltd. TELES NetService GmbH

Supervisory Board

The following individuals were members of the Supervisory Board of TELES AG during the reporting period:

Dr. Walter Rust, Berlin, lawyer and notary (Chairman)
Dr. Jürgen D. Spliedt, Berlin, lawyer and certified accountant (Deputy Chairman)
Prof. Dr. Dr. Thomas Schildhauer, Berlin, University Professor;
ordinary member until 22 August 2006
Prof. Dr. h.c. Radu Popescu-Zeletin, Berlin, University Professor;
ordinary member since 22 August 2006

The following individuals held seats on the supervisory board and comparable supervisory committees of other companies:

Dr. Walter Rust,
SHF Communication Technologies AG, Berlin (Chairman of the Supervisory Board)

Prof. Dr. Dr. Thomas Schildhauer,
WG-DATA AG, Berlin (ordinary member of the Supervisory Board)
rbb Media GmbH, Berlin (ordinary member of the Supervisory Board)

Prof. Dr. h.c. Radu Popescu-Zeletin,
IVISTAR Kommunikationssysteme AG, Berlin
(ordinary member of the Supervisory Board)
Detecon International GmbH, Bonn (Chairman of the Advisory Board)
Motorola Corporation, Schaumburg, USA (ordinary member of the Visionary Board)
Microsoft Corporation, Redmond, USA (ordinary member of the Interoperability Board)

Berlin, 21 March 2007

The Management Board

List of Abbreviations

AG	Aktiengesellschaft (Stock Corporation)
AktG	Aktiengesetz (German Stock Corporation Act)
DRS	Deutscher Rechnungslegungsstandard (German Accounting Standard)
DRSC	Deutsches Rechnungslegungsstandards Committee (German Accounting Standards Committee)
EITF	Emerging Issues Task Force
ESOP	Employee Stock Option Plan
EStG	Einkommensteuergesetz (German Income Tax Act)
FIFO	First-in, First-out
GmbH	Gesellschaft mit beschränkter Haftung (Limited company)
HGB	Handelsgesetzbuch (German Commercial Code)
IAS	International Accounting Standards
IASB	International Accounting Standards Board
IFRS	International Financial Reporting Standard
KapErh	Kapitalerhöhung (Capital increase)
Ltd	Limited
Mio€	Euro millions
SIC	Standing Interpretations Committee
T€	Euro thousands
TUSD	US dollars thousands
US GAAP	United States Generally Accepted Accounting Principles

Auditor’s Report *

We have audited the consolidated financial statements prepared by TELES Aktiengesellschaft Informationstechnologien, 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 1st of January to 31st of December 2006. The preparation of the consolidated financial statements and the group management report in accordance with the IFRSs, as adopted by the EU, and the additional requirements of German commercial law pursuant to § (Article) 315a Abs. (paragraph) 1 HGB ("Handelsgesetzbuch": German Commercial Code) are the responsibility of the parent Company's Board of Managing Directors. 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 the entities to be included in consolidation, the accounting and consolidation principles used and significant estimates made by the Company´s Board of Managing Directors, as well as evaluating the overall presentation of the consolidated financial statements and the group management report. We believe that our audit provides a reasonable basis for our opinion.

Our audit has not led to any reservations.

In our opinion based on the findings of our audit the consolidated financial statements comply with the 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 and as a whole provides a suitable view of the Group's position and suitably presents the opportunities and risks of future development.

Berlin, March 30th, 2007

PricewaterhouseCoopers
Aktiengesellschaft
Wirtschaftsprüfungsgesellschaft

(Hartman)	(ppa. Voß)
Wirtschaftsprüfer	Wirtschaftsprüfer
(German Public Auditor)	(German Public Auditor)

* Translation - the German version is authoritative