

DEUTSCHE TELEKOM AG

Form 20-F/A

June 29, 2004

As filed with the Securities and Exchange Commission on June 29, 2004

SECURITIES AND EXCHANGE COMMISSION

Form 20-F/A

**REGISTRATION STATEMENT PURSUANT TO SECTION 12(b) OR (g) OF THE
SECURITIES EXCHANGE ACT OF 1934**

OR

**ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES
EXCHANGE ACT OF 1934
for the fiscal year ended December 31, 2003**

OR

**TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES
EXCHANGE ACT OF 1934**

Commission file number 1-14540

Deutsche Telekom AG

(Exact Name of Registrant as Specified in its Charter)

Germany

(Jurisdiction of Incorporation or Organization)

Friedrich-Ebert-Allee 140, 53113 Bonn, Germany

(Address of Registrant's Principal Executive Offices)

Securities registered or to be registered pursuant to Section 12(b) of the Act.

Title of each class
American Depositary Shares, each
representing one Ordinary Share

Name of each exchange on which registered
New York Stock Exchange

Ordinary Shares, no par value

New York Stock Exchange*

Securities registered or to be registered pursuant to Section 12(g) of the Act.

NONE

(Title of Class)

Securities for which there is a reporting obligation pursuant to Section 15(d) of the Act.

NONE

(Title of Class)

Indicate the number of outstanding shares of each of the issuer's classes of capital or common stock as of the close of the period covered by the annual report:

Ordinary Shares, no par value: 4,195,081,597 (as of December 31, 2003)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes No

Indicate by check mark which financial statement item the registrant has elected.

Item 17 Item 18

* Not for trading, but only in connection with the registration of American Depositary Shares.

This Amended Annual Report on Form 20-F/A dated June 29, 2004 is being filed to:

- (1) add financial information concerning certain affiliates and subsidiaries of Deutsche Telekom AG (found herein on pages A-1 to A-270) pursuant to the requirements of Item 3-09 of Regulation S-X;
- (2) amend "Item 3. Key Information — Exchange Rates" on page 8 of the Form 20-F filed on March 30, 2004 to change the reference in the table of the average noon buying rate for 2003 from "1.4111" to "1.1411", and to change the year reference in the first sentence below the table from "2003" to "2004";
- (3) amend "Item 5. Operating and Financial Review and Prospects — Consolidated Results of Operations — Segment Analysis — T-Com — Personnel Costs" on page 110 of the Form 20-F filed on March 30, 2004 to delete the words "during the year." in the second paragraph thereunder; and
- (4) amend "Item 5. Operating and Financial Review and Prospects — Consolidated Results of Operations — Segment Analysis — T-Systems — Total Revenue" on page 111 of Form 20-F filed on March 30, 2004 to insert the word "million" after "EUR 10,614" in the third paragraph thereunder.

Other than the foregoing items and conforming changes related thereto, and the correction of certain typographical errors, no part of the Annual Report on Form 20-F filed on March 30, 2004 is being amended, and the filing of this Amended Annual Report on Form 20-F/A should not be understood to mean that any other statements contained therein are true or complete as of any date subsequent to March 30, 2004. This Amended Annual Report on Form 20-F/A is incorporated by reference into the registration statements of Deutsche Telekom AG on Form F-3, File No.

333-13550, and on Form S-8, File No. 333-106591, and into each respective prospectus that forms a part of those registration statements.

PART III

ITEM 17. Financial Statements

Not applicable.

ITEM 18. Financial Statements

See pages F-1 through F-104.

Separate financial statements required by Rule 3-09 of Regulation S-X are included on pages A-1 through A-270 in this Annual Report.

ITEM 19. Exhibits

Documents filed as exhibits to this Annual Report.

- 1.1 Articles of Incorporation (Satzung) of Deutsche Telekom AG as amended to date (English translation included).
- 2.1 Indenture dated as of July 6, 2000, relating to debt securities of Deutsche Telekom International Finance B.V. (incorporated by reference to Deutsche Telekom's Registration Statement on Form F-3, File No. 333-12096).*
- 2.2 Except as noted above, the total amount of long-term debt securities of Deutsche Telekom AG authorized under any instrument does not exceed 10% of the total assets of the group on a consolidated basis. Deutsche Telekom AG hereby agrees to furnish to the Commission, upon its request, a copy of any instrument defining the rights of holders of long-term debt of Deutsche Telekom AG or of its subsidiaries for which consolidated or unconsolidated financial statements are required to be filed.
- 8.1 Significant subsidiaries as of the end of the year covered by this Annual Report.*
- 11.1 Deutsche Telekom AG's Code of Ethics.*
- 12.1 Certification of the Principal Executive Officer pursuant to Section 302 of of the Sarbanes-Oxley Act of 2002.
- 12.2 Certification of the Principal Financial Officer pursuant to Section 302 of of the Sarbanes-Oxley Act of 2002.
- 13.1 Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 14.1 Combined consent of Ernst & Young Deutsche Allgemeine Treuhand AG Wirtschaftspruefungsgesellschaft AG and PwC Deutsche Revision Aktiengesellschaft Wirtschaftspruefungsgesellschaft.*
- 14.2 Consent of PricewaterhouseCoopers Accountants N.V.
- 14.3 Consent of ZAO Deloitte & Touche CIS.
- 14.4 Statement Regarding Consent of Arthur Andersen and Arthur Andersen Sp. z o.o.

*Previously filed.

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SIGNATURES

The registrant hereby certifies that it meets all of the requirements for filing on Form 20-F and that it has duly caused and authorized the undersigned to sign this Annual Report on its behalf.

DEUTSCHE TELEKOM AG

Date: June 25, 2004

By: /s/ Kai-Uwe Ricke
Name: Kai-Uwe Ricke
Title: Chairman of the Management Board
By: /s/ Dr. Karl-Gerhard Eick
Name: Dr. Karl-Gerhard Eick
Title: Deputy Chairman of the Management Board
Finance and Controlling

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DEUTSCHE TELEKOM AG

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BEN NEDERLAND HOLDING B.V.

CONSOLIDATED FINANCIAL STATEMENTS

DECEMBER 31, 2001

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BEN NEDERLAND HOLDING B.V.

**CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2001**

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DIRECTORS

R.G.W. Holekamp (appointed July 4, 2001)

S.M. Fries (appointed July 4, 2001)

J.J.A. van Leeuwen (appointed July 4, 2001)

W.A.L. Schrijver (appointed July 4, 2001; resigned October 16, 2001)

P.E. de Weerd (June 18, 2001)

R.D. Whiteside (resigned December 7, 2001)

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**TO THE SHAREHOLDERS OF
BEN NEDERLAND HOLDING B.V.**

REPORT OF INDEPENDENT ACCOUNTANTS

We have examined the accompanying consolidated balance sheets of Ben Nederland Holding B.V., Amsterdam, and its subsidiaries as of December 31, 2001 and 2000 and the related consolidated profit and loss accounts and statements of cash flows, for each of the three years in the period ended December 31, 2001, all expressed in Euros. Our examinations of these statements were made in accordance with auditing standards generally accepted in the United States and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the consolidated financial statements referred to above present fairly the financial position of Ben Nederland Holding B.V., Amsterdam, and its subsidiaries at December 31, 2001 and 2000, and the consolidated results of their operations and their cash flows for each of the three years in the period ended December 31, 2001, in conformity with accounting principles generally accepted in the Netherlands.

As discussed in Note 2 to the financial statements, the Company changed its method of capitalizing asset construction costs in 2001 and ceased the capitalization of interest costs related to assets under construction in 2000.

Accounting principles generally accepted in the Netherlands vary in certain respects from accounting principles generally accepted in the United States. The application of the latter would have affected the determination of consolidated net loss expressed in Euros for each of the three years in the period ended December 31, 2001 and the determination of consolidated stockholders' equity and consolidated financial position also expressed in Euros at December 31, 2001 and 2000 to the extent summarized in Note 16 to the consolidated financial statements.

PricewaterhouseCoopers N.V.

Amsterdam, The Netherlands
April 24, 2002

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BEN NEDERLAND HOLDING B.V.**CONSOLIDATED BALANCE SHEETS****AT DECEMBER 31, 2001 AND 2000**

(After proposed appropriation of the result for the years)

(Amounts expressed in thousands of Euros)

| | 2001 | 2000 |
|--|------------------|------------------|
| | 000 | 000 |
| ASSETS | | |
| FIXED ASSETS | | |
| Intangible fixed assets | 548,075 | 549,369 |
| Tangible fixed assets | 460,752 | 335,538 |
| Financial fixed assets | | 23 |
| | <u>1,008,827</u> | <u>884,930</u> |
| CURRENT ASSETS | | |
| Short term loans | 2,680 | 6,421 |
| Receivables | 83,715 | 86,142 |
| Inventory | 13,064 | 14,228 |
| Cash and bank balances | 26,251 | 13,166 |
| | <u>125,710</u> | <u>119,957</u> |
| Total current assets | 125,710 | 119,957 |
| | <u>1,134,537</u> | <u>1,004,887</u> |
| TOTAL ASSETS | | |
| | <u>1,134,537</u> | <u>1,004,887</u> |
| SHAREHOLDERS EQUITY & LIABILITIES | | |
| TOTAL SHAREHOLDERS EQUITY | 608,549 | 807,415 |
| CURRENT LIABILITIES | 525,988 | 197,472 |
| | <u>1,134,537</u> | <u>1,004,887</u> |
| TOTAL SHAREHOLDERS EQUITY & LIABILITIES | 1,134,537 | 1,004,887 |
| | <u>1,134,537</u> | <u>1,004,887</u> |

The accompanying notes form an integral part of these financial statements.

BEN NEDERLAND HOLDING B.V.**CONSOLIDATED PROFIT AND LOSS ACCOUNTS
FOR THE THREE YEARS ENDED DECEMBER 31, 2001**

(Amounts expressed in thousands of Euros)

| | <u>2001</u> | <u>2000</u> | <u>1999</u> |
|------------------------------|-------------|-------------|-------------|
| | <u>000</u> | <u>000</u> | <u>000</u> |
| Net sales | 447,527 | 244,842 | 66,655 |
| Cost of sales ⁽¹⁾ | (226,546) | (156,633) | (69,757) |
| Gross profit | 220,981 | 88,209 | (3,102) |
| Operating expenses | (410,039) | (316,390) | (172,585) |
| Other operating income | 482 | 1,229 | 470 |
| Operating loss | (188,576) | (226,952) | (175,217) |
| Net financial expense | (10,290) | (12,427) | (3,716) |
| Extraordinary income | | | 16,504 |
| Net loss | (198,866) | (239,379) | (162,429) |

(1) Cost of sales excludes depreciation and amortization, which is included in operating expenses. The accompanying notes form an integral part of these financial statements.

BEN NEDERLAND HOLDING B.V.**CONSOLIDATED CASH FLOW STATEMENTS
FOR THE THREE YEARS ENDED DECEMBER 31, 2001**

(Amounts expressed in thousands of Euros)

| | 2001 | 2000 | 1999 |
|--|-------------------|-------------------|-------------------|
| | 000 | 000 | 000 |
| CASH FLOW FROM OPERATING ACTIVITIES | | | |
| Result after taxation for the period | (198,866) | (239,379) | (162,429) |
| Adjustments: | | | |
| Depreciation of tangible and intangible fixed assets | 75,032 | 54,785 | 29,166 |
| Loss on disposal of financial fixed assets | 23 | | |
| Changes in working capital: | | | |
| Decrease/(increase) inventory | 1,164 | (6,742) | (6,012) |
| Decrease/(increase) receivables | 2,427 | (52,982) | (27,495) |
| Decrease/(increase) short term loans | 3,741 | 557 | (3,802) |
| Decrease/(increase) current liabilities exclusive of shareholder loans | 11,947 | (46,309) | 146,309 |
| | <u>19,279</u> | <u>(105,476)</u> | <u>109,000</u> |
| Net cash used in operating activities | <u>(104,532)</u> | <u>(290,070)</u> | <u>(24,263)</u> |
| CASH FLOWS FROM INVESTING ACTIVITIES | | | |
| Investment in tangible fixed assets | (163,433) | (128,965) | (192,197) |
| Disposal of tangible fixed assets | 1,382 | 1,445 | 1,135 |
| Investment in intangible fixed assets | (36,901) | (432,018) | (21,464) |
| Investment in financial fixed assets | | (23) | |
| | <u>(198,952)</u> | <u>(559,561)</u> | <u>(212,526)</u> |
| CASH FLOWS FROM FINANCING ACTIVITIES | | | |
| Paid in capital | | 1,070,714 | |
| Loans from shareholders | 316,569 | (214,222) | 236,857 |
| | <u>316,569</u> | <u>856,492</u> | <u>236,857</u> |
| Net cash provided by financing activities | <u>316,569</u> | <u>856,492</u> | <u>236,857</u> |
| NET INCREASE IN CASH | 13,085 | 6,861 | 68 |
| Cash and cash equivalents beginning of year | 13,166 | 6,305 | 6,237 |
| Cash and cash equivalents end of year | 26,251 | 13,166 | 6,305 |

The accompanying notes form an integral part of these financial statements.

BEN NEDERLAND HOLDING B.V.**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
FOR THE THREE YEARS ENDED DECEMBER 31, 2001****1. ACTIVITIES**

In accordance with Article 2 of its Articles of Association the principal activities of the company are to participate in, to finance, to collaborate with, to conduct the management of companies and enterprises active in the area of telecommunications and to provide advice and all other services.

Furthermore, the company's objective is to exploit, to apply for and to hold all licenses required for establishing a full-scale mobile telecommunications business in the Netherlands and to maintain and operate a mobile telecommunications infrastructure in the Netherlands.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES*Basis of presentation*

The accompanying consolidated financial statements have been prepared in accordance with principles of accounting generally accepted in the Netherlands.

Changes in accounting policies

In 2001, the Company upgraded its accounting system to identify direct costs of Engineering & Operations employees working on assets under construction. These costs were not separately identifiable in prior years. As a result of the accounting system change, the Company began capitalizing these costs beginning January 1, 2001. Total costs capitalized for the year ended December 31, 2001 were EUR 4,595,000. No such costs were capitalized related to prior years.

Up to January 1, 2000 the Company capitalised interest on construction in progress. As of January 1, 2000 all interest is expensed. The balance of 1,795,000 at December 31, 1999 was charged to income in the year 2000.

Principles of consolidation

Group companies included in the consolidated accounts are those in which the company exercises significant influence. All intercompany balances and transactions are eliminated on consolidation.

Group companies included in the consolidated accounts are as follows:

| | Domicile | Proportion of voting rights held | |
|------------------------|-----------------|---|-------------|
| | | 2001 | 2000 |
| BEN Nederland B.V | The Hague | 100 % | 100 % |
| BEN Klantenservice B.V | The Hague | 100 % | 100 % |
| 3 G-Blue B.V | The Hague | | 100 % |

3 G-Blue B.V. merged into Ben Nederland B.V. in 2001.

Cash flow statement

The cash flow statements are prepared using the indirect method, in accordance with IAS 7.

Foreign currencies

In the profit and loss accounts, all transactions denominated in a currency other than the Euro are translated into Euros at the exchange rate prevailing at the time of the transaction. Assets and liabilities denominated in foreign currencies are translated into Euros at the exchange rates prevailing on the balance sheet dates with differences recorded through the profit and loss account.

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BEN NEDERLAND HOLDING B.V.

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)
FOR THE THREE YEARS ENDED DECEMBER 31, 2001**

Impairment of fixed assets

The carrying amounts of fixed assets are reviewed annually and written down where necessary for impairment.

Intangible fixed assets

Intangible fixed assets are stated at cost less amortisation calculated using the straight-line method over their estimated useful lives.

The DCS-1800 license, acquired in 1998, is carried at cost less amortisation on a straight-line basis from the launch of services to the end of the license period. (15 years).

The UMTS license is carried at cost. This license will be amortised on a straight-line basis, as from the launch of services to the end of the license period. The UMTS license runs through December 31, 2016.

Software licenses and capitalised software development costs are carried at cost less amortisation calculated using the straight-line method evenly over their useful lives of 3 years.

Tangible fixed assets

Tangible fixed assets are stated at cost less accumulated depreciation calculated over their estimated useful lives using the straight-line method.

The estimated useful life for certain network equipment was revised during 2000, and this change was applied prospectively. This had the impact of reducing the annual depreciation charge by approximately 9 million.

The annual depreciation rates are:

| | | |
|---------------------------------------|--------|---|
| Installation, machinery and equipment | 13%-33 | % |
| Furniture and fixtures | 20 | % |
| Leasehold improvements | 10 | % |

Financial fixed assets

Participations of less than 20% equity interest are carried at cost. If necessary, provisions are recorded when there are permanent impairments in value. As of 2001, there have been no impairments to date. Income derived from these participations is recognised only when dividends are declared.

Accounts receivable

Subscriber and other debtors are stated at nominal value less a provision for doubtful debts.

Inventory

Inventory, consisting of packaging, handsets, sim-cards and reload vouchers, is carried at cost. Appropriate allowance is made for obsolete and slow-moving goods.

Revenue recognition

Revenues are recorded at the time the service is rendered. Revenues from services rendered are recorded net of discounts and VAT.

Deferred income tax

Deferred income tax is provided, using the liability method, for all temporary differences arising between the tax bases of assets and liabilities and their carrying values for financial reporting purposes. Currently enacted tax rates are used to determine deferred income tax.

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BEN NEDERLAND HOLDING B.V.**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)
FOR THE THREE YEARS ENDED DECEMBER 31, 2001**

Deferred tax assets relating to the carry forwards of unutilised tax losses are recognised to the extent that it is probable that future taxable income will be available against which the unused tax losses can be utilised.

At December 31, 2001, losses available for carry forward (all indefinite) of 620,988,000 were not recognised in determining the deferred tax asset.

Interest

It is the policy of the Company to expense interest as incurred.

3. FINANCIAL FIXED ASSETS

| | <u>2001</u> | <u>2000</u> |
|------------------------|-------------------|-------------------|
| | <u>000</u> | <u>000</u> |
| Balance at January 1 | 23 | |
| Additions/(Disposals) | (23) | 23 |
| | <u> </u> | <u> </u> |
| Balance at December 31 | | 23 |
| | <u> </u> | <u> </u> |

Ben Nederland B.V. acquired 50 shares (13%) with a nominal value of 454 in B-Genius, the E-Academy, N.V. on June 5, 2000. The participation has been disposed for NLG 1 in 2001.

4. INTANGIBLE FIXED ASSETS

| | <u>000</u> |
|-------------------------------------|-------------------|
| COST | |
| Balance at January 1, 2001 | 592,079 |
| Additions | 36,901 |
| Disposals | |
| | <u> </u> |
| Balance at December 31, 2001 | 628,980 |
| | <u> </u> |
| ACCUMULATED AMORTISATION | |
| Balance at January 1, 2001 | (42,710) |
| Amortisation for the year | (38,195) |
| | <u> </u> |
| Balance at December 31, 2001 | (80,905) |
| | <u> </u> |
| Net book value at December 31, 2001 | 548,075 |
| | <u> </u> |

5. TANGIBLE FIXED ASSETS**Total**

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| | Installations, machinery and equipment | Furniture and fixtures | Leasehold improvements | Assets under construction | |
|--|---|---------------------------------------|-----------------------------------|--|------------------|
| | 000 | 000 | 000 | 000 | 000 |
| AT COST | | | | | |
| Balance at January 1, 2001 | 169,436 | 4,729 | 92,143 | 110,791 | 377,099 |
| Additions | 57,693 | 1,823 | 24,602 | 85,951 | 170,069 |
| Disposals | (1,227) | | (132) | (266) | (1,625) |
| Transfers from assets under construction | 24,757 | | 10,545 | (41,938) | (6,636) |
| | <u>250,659</u> | <u>6,552</u> | <u>127,158</u> | <u>154,538</u> | <u>538,907</u> |
| ACCUMULATED DEPRECIATION | | | | | |
| Balance at January 1, 2001 | (30,554) | (1,266) | (9,741) | | (41,561) |
| Charge for the year | (24,560) | (1,216) | (11,061) | | (36,837) |
| Disposals | 235 | | 8 | | 243 |
| | <u>(54,879)</u> | <u>(2,482)</u> | <u>(20,794)</u> | | <u>(78,155)</u> |
| Net book value at December 31, 2001 | <u>195,780</u> | <u>4,070</u> | <u>106,364</u> | <u>154,538</u> | <u>460,752</u> |

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BEN NEDERLAND HOLDING B.V.**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)
FOR THE THREE YEARS ENDED DECEMBER 31, 2001**

Assets under construction mainly represent costs incurred in the design and construction of the company's network.

6. RECEIVABLES

| | <u>2001</u> | <u>2000</u> |
|-------------------------|---------------|---------------|
| | 000 | 000 |
| Third party receivables | 80,758 | 79,514 |
| Prepaid expenses | 1,034 | 564 |
| Taxation | 1,923 | 6,064 |
| | <u>83,715</u> | <u>86,142</u> |

7. ISSUED SHARE CAPITAL

The total authorised share capital consists of 500,000,000 shares each having a nominal value of 0.45 (NLG 1), of which 199,999,998 have been issued and fully paid at December 31, 2001 (2000: 90,756,042).

8. SHARE PREMIUM ACCOUNT

| | <u>2001</u> | <u>2000</u> |
|-------------------------------------|------------------|------------------|
| | 000 | 000 |
| Balance at January 1 | 1,138,781 | 113,445 |
| Share premium paid on shares issued | | 1,025,336 |
| | <u>1,138,781</u> | <u>1,138,781</u> |

9. ACCUMULATED DEFICIT

| | <u>2001</u> | <u>2000</u> |
|--------------------------------|-------------------|-------------------|
| | 000 | 000 |
| Balance at January 1 | (422,122) | (182,743) |
| Current year net result/(loss) | (198,866) | (239,379) |
| | <u>(620,988)</u> | <u>(422,122)</u> |

10. CURRENT LIABILITIES

| | <u>2001</u> | <u>2000</u> |
|-------------------------|-------------|-------------|
| | 000 | 000 |
| Loans from shareholders | 379,845 | 63,276 |

| | | |
|------------------------------|----------------|----------------|
| Trade creditors | 112,787 | 119,120 |
| Accruals and other creditors | 23,904 | 12,000 |
| Tax and social security | 9,452 | 3,076 |
| | <u>525,988</u> | <u>197,472</u> |

11. OPERATING EXPENSES

| | <u>2001</u> | <u>2000</u> |
|-------------------------------------|----------------|----------------|
| | 000 | 000 |
| Selling and marketing expenses | 150,390 | 128,310 |
| General and administrative expenses | 184,617 | 133,295 |
| Depreciation and amortisation | 75,032 | 54,785 |
| | <u>410,039</u> | <u>316,390</u> |

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BEN NEDERLAND HOLDING B.V.**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)
FOR THE THREE YEARS ENDED DECEMBER 31, 2001****12. REMUNERATION OF DIRECTORS**

The company's directors received remuneration of 874,105 during the year 2001.

13. EMPLOYEES

Total employee expenses amounted to 40,940,035 (2000: 30,166,093) including social security of 3,711,361 (2000: 2,645,145) and pension costs of 3,083,489 (2000: 1,883,913). Employee expenses are included in General and administrative expenses.

The group had an average of 1,142 employees during 2001 (2000: 691).

14. NET FINANCIAL INCOME/(EXPENSE)

| | <u>2001</u> | <u>2000</u> |
|-----------------------------------|------------------|------------------|
| | <u>000</u> | <u>000</u> |
| Interest and similar income | 985 | 890 |
| Interest and similar expense | (11,900) | (12,850) |
| Foreign exchange gain/(loss) | (158) | (493) |
| Other financial income/(expenses) | 783 | 26 |
| | <u>(10,290)</u> | <u>(12,427)</u> |

Interest expense primarily relates to that payable on shareholder financing.

15. COMMITMENTS

At December 31, 2001, the group had entered into various agreements, principally relating to the network, resulting in commitments of 393 million.

The company has issued guarantees under article 403 of the Dutch Civil Code to the group companies Ben Nederland B.V. en Ben Klantenservice B.V.

16. RECONCILIATION TO U.S. GAAP

The consolidated financial statements of Ben Nederland Holding B.V. have been prepared in accordance with Dutch GAAP, which differs in certain respects from generally accepted accounting principles in the United States (U.S. GAAP). Application of U.S. GAAP would have affected the balance sheet as of December 31, 2001 and 2000 and the net loss for each of the years in the three-year period ended December 31, 2001 to the extent described below.

(1) Capitalisation of interest on assets under construction and mobile communication licences

- a) Under Dutch GAAP capitalisation of interest accumulated from borrowings during the asset construction period is voluntary. Prior to January 1, 2000, the Company capitalised interest accumulated during the construction period and amortized these costs over the assets useful life. As of January 1, 2000 the company elected to cease capitalization of interest costs related to assets under construction. As part of this change in accounting policy the unamortised balance of 1,795,000 capitalized as of December 31, 1999 was reversed and charged to income in the year 2000. Under U.S. GAAP, interest accumulated on borrowings during the asset construction period are capitalised and are amortized once the respective assets are placed in operation resulting in an increase in the net loss of 692,000 in 2001 and a decrease in the net loss in 2000 of 4,375,000.
- b) Under Dutch GAAP, interest costs related to the financing of the mobile communications licences are expensed as incurred. Under US GAAP, the license is considered an inextricable part of the network used to provide the actual services and accordingly interest costs related to the financing of the licenses during the network construction period are capitalized as part

BEN NEDERLAND HOLDING B.V.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)
FOR THE THREE YEARS ENDED DECEMBER 31, 2001

of network cost. This results in a decrease in net loss of 11,653,000, 7,754,000 and 379,000 in 2001, 2000 and 1999, respectively.

(2) Technical equipment lease

During 1999, the Company entered into a sales lease back transaction relating to certain technical equipment in use by the Company. Under Dutch GAAP, the net cash received was recognized as other operating revenues. Under US GAAP, the gross cash received of 65.6 million and payment liabilities of 61.7 million are recognized on the balance sheet and the net cash gain on the transaction is recognized as other income over the lease term of 16 years.

(3) Vendor penalties

During 1998 and 1999 the Company received penalties from a vendor as the vendor failed to meet certain contractual requirements with respect to the roll out of the network. These payments relate to refunds on amounts paid for network assets purchased. Under Dutch GAAP these amounts were recorded as income. Under U.S. GAAP these payments are recorded as a deduction from the cost of the network assets resulting in a reduction of net income and the carrying value of network assets by 13.2 million in 1998 and 4.6 million in 1999. Additionally, depreciation expense related to these assets is reduced by 2.5 million, 2.5 million and 1.2 million for the years ended December 31, 2001, 2000 and 1999, respectively.

The effect of these items is set out in the following tables.

Reconciliation of net loss from Dutch GAAP to U.S. GAAP:

(Amounts in 000)

| | <u>2001</u> | <u>2000</u> | <u>1999</u> |
|---|-------------------|-------------------|-------------------|
| Net loss as reported in the consolidated financial statements under Dutch GAAP | (198,866) | (239,379) | (162,429) |
| Interest capitalisation ⁽¹⁾ | 10,961 | 12,129 | 379 |
| Technical equipment lease ⁽²⁾ | 250 | 250 | (3,875) |
| Vendor penalties ⁽³⁾ | 2,540 | 2,540 | (3,358) |
| Net loss in accordance with U.S. GAAP | <u>(185,115)</u> | <u>(224,460)</u> | <u>(169,283)</u> |

Reconciliation of shareholders equity from Dutch GAAP to U.S. GAAP

(Amounts in 000)

| | <u>Dec 31, 2001</u> | <u>Dec 31, 2000</u> |
|--|-------------------------|-------------------------|
| Shareholders equity in accordance with Dutch GAAP | 608,549 | 807,415 |
| Interest capitalisation ⁽¹⁾ | 26,181 | 15,220 |
| Technical equipment lease ⁽²⁾ | (3,375) | (3,625) |
| Vendor penalties ⁽³⁾ | (9,555) | (12,095) |
| Shareholders equity in accordance with U.S. GAAP | <u>621,800</u> | <u>806,915</u> |

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**OJSC MOBILE TELESYSTEMS
AND SUBSIDIARIES**

**Consolidated Financial Statements
December 31, 2003, 2002 and 2001
Unaudited**

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INDEX TO CONSOLIDATED FINANCIAL STATEMENTS

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Report of Independent Registered Public Accounting Firm

To the Shareholders of OJSC Mobile TeleSystems:

We have audited the accompanying consolidated balance sheets of Mobile TeleSystems, a Russian Open Joint-Stock Company, and subsidiaries (the "Group") as of December 31, 2003 and 2002, and the related consolidated statements of operations, changes in shareholders' equity and cash flows for each of the three years in the period ended December 31, 2003. These financial statements are the responsibility of the Group's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such consolidated financial statements present fairly, in all material respects, the financial position of the Group as of December 31, 2003 and 2002, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 2003, in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 3 to the consolidated financial statements, the Group changed its method of accounting for subscriber acquisition costs in 2001.

/s/ ZAO Deloitte & Touche CIS

March 26, 2004, except for Note 24,
as to which the date is June 15, 2004

Moscow, Russia

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OJSC MOBILE TELESYSTEMS AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

AT DECEMBER 31, 2003 and 2002

(Amounts in thousands of U.S. dollars, except share amounts)

| | December 31, | |
|---|---------------------|---------------------|
| | 2003 | 2002 |
| CURRENT ASSETS: | | |
| Cash and cash equivalents (Note 5) | \$ 90,376 | \$ 34,661 |
| Short-term investments (Note 6) | 245,000 | 30,000 |
| Trade receivables, net (Note 7) | 99,951 | 40,501 |
| Accounts receivable, related parties (Note 18) | 3,356 | 3,569 |
| Inventory (Note 8) | 67,291 | 41,386 |
| Prepaid expenses | 46,679 | 26,537 |
| Deferred tax asset, current portion (Note 15) | 44,423 | 12,223 |
| VAT receivable | 209,629 | 154,061 |
| Other current assets | 33,774 | 15,392 |
| Total current assets | 840,479 | 358,330 |
| PROPERTY, PLANT AND EQUIPMENT , net of accumulated depreciation of \$532,268 and \$299,216, respectively (Note 9) | 2,256,076 | 1,344,633 |
| LICENSES , net of accumulated amortization of \$257,024 and \$143,402, respectively (Notes 4 and 21) | 703,103 | 386,919 |
| OTHER INTANGIBLE ASSETS AND GOODWILL , net of accumulated amortization of \$148,052 and \$78,889, respectively (Note 10) | 312,677 | 138,090 |
| DEBT ISSUANCE COSTS , net of accumulated amortization of \$4,586 and \$2,898, respectively (Note 12) | 9,431 | 2,957 |
| INVESTMENTS IN AND ADVANCES TO ASSOCIATES (Note 20) | 103,585 | 34,034 |
| Total assets | \$ 4,225,351 | \$ 2,264,963 |

The accompanying notes to consolidated financial statements are an integral part of these statements.

OJSC MOBILE TELESYSTEMS AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

AT DECEMBER 31, 2003 and 2002

(Amounts in thousands of U.S. dollars, except share amounts)

| | December 31, | |
|--|---------------------|---------------------|
| | 2003 | 2002 |
| CURRENT LIABILITIES: | | |
| Accounts payable, related parties (Note 18) | \$ 31,904 | \$ 4,968 |
| Trade accounts payable | 168,039 | 117,623 |
| Deferred connection fees, current portion (Note 11) | 21,467 | 22,210 |
| Subscriber prepayments and deposits | 191,768 | 110,950 |
| Debt, current portion (Note 12) | 103,312 | 67,098 |
| Notes payable, current portion (Note 12) | 597,836 | |
| Capital lease obligation, current portion (Notes 13 and 18) | 9,122 | 21,232 |
| Income tax payable | 11,128 | 3,987 |
| Accrued liabilities (Note 14) | 143,789 | 73,919 |
| Other payables | 19,604 | 2,225 |
| Total current liabilities | 1,297,969 | 424,212 |
| LONG-TERM LIABILITIES: | | |
| Notes payable, net of current portion (Note 12) | 800,000 | 298,943 |
| Debt, net of current portion (Note 12) | 142,418 | 59,971 |
| Capital lease obligation, net of current portion (Notes 13 and 18) | 7,646 | 7,241 |
| Deferred connection fees, net of current portion (Note 11) | 25,177 | 19,694 |
| Deferred taxes (Note 15) | 180,628 | 87,485 |
| Total long-term liabilities | 1,155,869 | 473,334 |
| Total liabilities | 2,453,838 | 897,546 |
| COMMITMENTS AND CONTINGENCIES (Note 22) | | |
| MINORITY INTEREST | 47,603 | 65,373 |
| SHAREHOLDERS EQUITY: | | |
| Common stock: (2,096,975,792 shares with a par value of 0.1 rubles authorized and 1,993,326,138 shares issued as of December 31, 2003 and 2002, 345,244,080 of which are in the form of ADS (Note 1) | 50,558 | 50,558 |
| Treasury stock (9,929,074 as of December 31, 2003 and 9,966,631 as of December 31, 2002 common shares at cost) (Note 17) | (10,197) | (10,206) |
| Additional paid-in capital | 559,911 | 558,102 |
| Unearned compensation (Note 17) | (869) | (212) |
| Shareholder receivable (Note 12) | (27,610) | (34,412) |
| Accumulated other comprehensive income (Note 2) | 7,595 | |
| Retained earnings | 1,144,522 | 738,214 |
| Total shareholders equity | 1,723,910 | 1,302,044 |
| Total liabilities and shareholders equity | \$ 4,225,351 | \$ 2,264,963 |

The accompanying notes to consolidated financial statements are an integral part of these statements.

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OJSC MOBILE TELESYSTEMS AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS

FOR THE YEARS ENDED DECEMBER 31, 2003, 2002 and 2001

(Amounts in thousands of U.S. dollars, except share and per share amounts)

| | 2003 | 2002 | 2001 |
|--|------------------|------------------|----------------------|
| NET REVENUES: | | | |
| Service revenues | \$ 2,435,717 | \$ 1,274,287 | \$ 830,308 |
| Connection fees | 29,372 | 24,854 | 21,066 |
| Equipment sales | 81,109 | 62,615 | 41,873 |
| | <u>2,546,198</u> | <u>1,361,756</u> | <u>893,247</u> |
| COST OF SERVICES AND PRODUCTS, exclusive of depreciation and amortization shown separately below (including related party amounts of \$37,680, \$31,607 and \$30,537, respectively): | | | |
| Interconnection and line rental | 187,270 | 113,052 | 75,278 |
| Roaming expenses | 113,838 | 83,393 | 68,387 |
| Cost of equipment | 173,071 | 90,227 | 39,828 |
| | <u>474,179</u> | <u>286,672</u> | <u>183,493</u> |
| OPERATING EXPENSES (including related party amounts of \$11,002, \$9,602 and \$8,882, respectively) (Note 19): | 406,722 | 229,056 | 134,598 |
| SALES AND MARKETING EXPENSES (including related party amounts of \$23,668, \$12,140 and \$8,707, respectively): | 326,783 | 171,977 | 107,729 |
| DEPRECIATION AND AMORTIZATION | 415,916 | 209,680 | 133,318 |
| IMPAIRMENT OF INVESTMENT (Note 20) | | | 10,000 |
| Net operating income | 922,598 | 464,371 | 324,109 |
| CURRENCY EXCHANGE AND TRANSLATION (GAINS) LOSSES | (693) | 3,474 | 2,264 |
| OTHER EXPENSES/(INCOME) (including related party amounts of \$6,161, \$5,141 and \$2,978, respectively): | | | |
| Interest income (Note 6) | (18,076) | (8,289) | (11,829) |
| Interest expense | 106,551 | 44,389 | 6,944 |
| Other expenses (income), net | 3,420 | (2,454) | (2,672) |
| Total other expenses (income), net | 91,895 | 33,646 | (7,557) |
| Income before provision for income taxes and minority interest | 831,396 | 427,251 | 329,402 |
| PROVISION FOR INCOME TAXES (Note 15) | 242,480 | 110,417 | 98,128 |
| MINORITY INTEREST | 71,677 | 39,711 | 7,536 |
| NET INCOME before cumulative effect of a change in accounting principle | 517,239 | 277,123 | 223,738 (17,909) |

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Cumulative effect of a change in accounting principle, net of income taxes of \$9,644 (Note 3)

| | | | |
|---|---------------|---------------|---------------|
| NET INCOME | \$ 517,239 | \$ 277,123 | \$ 205,829 |
| Weighted average number of common shares outstanding | 1,983,374,949 | 1,983,359,507 | 1,983,359,507 |
| Earnings per share, basic and diluted: | | | |
| Net income before cumulative effect of a change in accounting principle | \$ 0.261 | \$ 0.140 | \$ 0.113 |
| Net income | \$ 0.261 | \$ 0.140 | \$ 0.104 |

The accompanying notes to consolidated financial statements are an integral part of these statements.

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OJSC MOBILE TELESYSTEMS AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS EQUITY

FOR THE YEARS ENDED DECEMBER 31, 2003, 2002 and 2001

(Amounts in thousands of U.S. dollars, except share amounts)

| | Common Stock | | Treasury Stock | | Accumulated | | Unearned Compen- sation | Share- holder Receivable | Retained Earnings | Total |
|---|---------------|-----------|----------------|--------------|---------------------------------------|----------------------------------|-------------------------------|--------------------------------|----------------------|--------------|
| | Shares | Amount | Shares | Amount | Other Comprehen- sive Income | Additional Paid-in Capital | | | | |
| BALANCES, December 31, 2000 | 1,993,326,138 | 50,558 | (9,966,631) | (10,206) | | 552,030 | | (49,519) | 258,221 | 801,084 |
| Receivable from Sistema (Note 12): Increases for interest | | | | | | 3,764 | | (3,764) | | |
| Payments from Sistema | | | | | | | | 14,325 | | 14,325 |
| Net income | | | | | | | | | 205,829 | 205,829 |
| Dividends declared | | | | | | | | | (2,959) | (2,959) |
| BALANCES, December 31, 2001 | 1,993,326,138 | 50,558 | (9,966,631) | (10,206) | | 555,794 | | (38,958) | 461,091 | 1,018,279 |
| Receivable from Sistema (Note 12): Increases for interest | | | | | | 2,073 | | (2,073) | | |
| Payments from Sistema | | | | | | | | 6,619 | | 6,619 |
| Issuance of stock options (Note 17) | | | | | | 235 | | (235) | | |
| Amortization of deferred compensation (Note 17) | | | | | | | | 23 | | 23 |
| Net income | | | | | | | | | 277,123 | 277,123 |
| BALANCES, December 31, 2002 | 1,993,326,138 | \$ 50,558 | (9,966,631) | \$ (10,206) | | \$ 558,102 | \$ (212) | \$ (34,412) | \$ 738,214 | \$ 1,302,044 |
| Receivable from Sistema (Note 12): Increases for interest | | | | | | 807 | | (807) | | |
| Payments from Sistema | | | | | | | | 7,609 | | 7,609 |
| Issuance of stock options (Note 17) | | | | | | 1,002 | | (1,002) | | |

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| | | | | | | | | | | | |
|---|----------------------|------------------|---------------------|---------------------|-----------------|-------------------|------------------|---------------------|---------------------|--|---------------------|
| Stock options exercised (Note 17) | | | 37,557 | | 9 | | | | | | 9 |
| Amortization of deferred compensation (Note 17) | | | | | | 345 | | | | | 345 |
| Dividends declared (Note 1) | | | | | | | | | (110,931) | | (110,931) |
| Cumulative translation adjustment net of income taxes | | | | | 7,595 | | | | | | 7,595 |
| Net income | | | | | | | | | 517,239 | | 517,239 |
| BALANCES, December 31, 2003 | 1,993,326,138 | \$ 50,558 | (9,929,074) | \$ (10,197) | \$ 7,595 | \$ 559,911 | \$ (869) | \$ (27,610) | \$ 1,144,522 | | \$ 1,723,910 |

The accompanying notes to consolidated financial statements are an integral part of these statements.

OJSC MOBILE TELESYSTEMS AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

FOR THE YEARS ENDED DECEMBER 31, 2003, 2002 and 2001

(Amounts in thousands of U.S. dollars)

| | 2003 | 2002 | 2001 |
|---|--------------|------------|------------|
| CASH FLOWS FROM OPERATING ACTIVITIES: | | | |
| Net income | \$ 517,239 | \$ 277,123 | \$ 205,829 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | | |
| Minority interest | 71,677 | 39,475 | 7,536 |
| Depreciation and amortization | 415,916 | 209,680 | 133,318 |
| Amortization of deferred connection fees | (29,372) | (24,854) | (20,027) |
| Equity in net loss of associates | (2,670) | | |
| Cumulative effect of a change in accounting principle | | | 17,909 |
| Gain on debt extinguishment | | | (2,780) |
| Inventory obsolescence expense | 3,307 | 5,614 | 2,543 |
| Provision for doubtful accounts | 32,633 | 7,047 | 3,219 |
| Deferred taxes | (43,001) | (18,989) | (39,964) |
| Non-cash expenses associated with stock bonus and stock option plans | 213 | 23 | |
| Impairment of investment | | | 10,000 |
| Changes in operating assets and liabilities: | | | |
| Increase in trade receivables | (64,597) | (18,945) | (7,181) |
| Decrease/(Increase) in accounts receivable, related parties | 213 | (1,360) | (3,091) |
| Increase in inventory | (14,737) | (18,186) | (4,129) |
| Increase in prepaid expenses | (11,029) | (2,634) | (8,552) |
| Increase in VAT receivable | (50,230) | (64,154) | (59,618) |
| (Increase)/Decrease in other current assets | (8,122) | (7,422) | 1,613 |
| (Decrease)/Increase in accounts payable, related parties | (1,417) | 81 | 1,049 |
| Increase/(Decrease) in trade accounts payable | 2,673 | (16,058) | 20,470 |
| Increase in subscriber prepayments and deposits | 76,861 | 46,064 | 49,980 |
| Increase/(Decrease) in income tax payable | 7,141 | (19,778) | 10,753 |
| Increase in accrued liabilities and other payables | 63,286 | 20,045 | 19,324 |
| | <hr/> | <hr/> | <hr/> |
| Net cash provided by operating activities | 965,984 | 412,772 | 338,201 |
| CASH FLOWS FROM INVESTING ACTIVITIES: | | | |
| Acquisitions of subsidiaries, net of cash acquired | (667,206) | (143,396) | (75,858) |
| Purchases of property, plant and equipment | (839,165) | (502,054) | (396,667) |
| Purchases of intangible assets | (119,606) | (72,218) | (44,533) |
| Purchases of short term investments | (215,000) | | (110,000) |
| Proceeds from sale of short term investments | | 55,304 | 195,602 |
| Investments in and advances to associates | (69,110) | (35,557) | (10,067) |
| | <hr/> | <hr/> | <hr/> |
| Net cash used in investing activities | (1,910,087) | (697,921) | (441,523) |
| CASH FLOWS FROM FINANCING ACTIVITIES: | | | |
| Proceeds from issuance of notes | 1,097,000 | 50,808 | 248,135 |
| Notes issuance cost | (9,556) | (649) | (3,856) |
| Capital lease obligation principal paid | (22,646) | (1,804) | (7,947) |
| Dividends paid | (110,864) | | (2,959) |
| Proceeds from loans | 712,716 | 52,851 | 13,577 |
| Loan principal paid | (677,374) | (7,008) | (13,683) |
| Payments from Sistema | 8,269 | 6,619 | 14,325 |
| | <hr/> | <hr/> | <hr/> |
| Net cash provided by financing activities | 997,545 | 100,817 | 247,592 |
| | <hr/> | <hr/> | <hr/> |
| Effect of exchange rate changes on cash and cash equivalents | 2,273 | (636) | (469) |
| | <hr/> | <hr/> | <hr/> |

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| | | | |
|---|------------|------------|------------|
| NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS: | 55,715 | (184,968) | 143,801 |
| | <hr/> | <hr/> | <hr/> |
| CASH AND CASH EQUIVALENTS, beginning of year | 34,661 | 219,629 | 75,828 |
| | <hr/> | <hr/> | <hr/> |
| CASH AND CASH EQUIVALENTS, end of year | \$ 90,376 | \$ 34,661 | \$ 219,629 |
| | <hr/> | <hr/> | <hr/> |
| SUPPLEMENTAL INFORMATION: | | | |
| Income taxes paid | \$ 286,016 | \$ 147,346 | \$ 129,418 |
| Interest paid | \$ 79,824 | \$ 43,438 | \$ 4,096 |
| Non-cash investing activities: | | | |
| Additions to network equipment and software under capital lease | \$ 10,928 | \$ 18,917 | \$ 34,072 |
| Payable related to business acquisition (Note 4) | \$ 27,500 | \$ | \$ |

The accompanying notes to consolidated financial statements are an integral part of these statements.

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OJSC MOBILE TELESYSTEMS AND SUBSIDIARIES**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

(Amounts in thousands of U.S. dollars,
except share and per share amounts or if otherwise stated)

1. DESCRIPTION OF BUSINESS*Business of the Group*

OJSC Mobile TeleSystems and its subsidiaries (MTS or the Group) is the leading provider of wireless telecommunication services in the Russian Federation (RF) and Ukraine in terms of the number of subscribers and revenues. The Group has operated primarily in the GSM standard since 1994.

Open Joint-Stock Company Mobile TeleSystems (MTS OJSC or the Company) was created on March 1, 2000, through the merger of Closed Joint-Stock Company Mobile TeleSystems (MTS CJSC) and RTC CJSC, its wholly-owned subsidiary. MTS CJSC was formed in 1993 to design, construct and operate a cellular telecommunications network in Moscow and the Moscow region. The development of the network was achieved through green-field build-out in the regions for which the Company was granted 900 or 1800 MHz (GSM-900 and GSM-1800) cellular licenses or through the acquisition of majority stakes in local GSM operators (see Note 21 Operating Licenses and Note 4 Businesses Acquired).

The Company's shares are traded in the form of American Depositary Shares (ADS). Each ADS represents 20 shares of common stock of the Company. In July 2000, the Company issued a total of 17,262,204 ADS, representing 345,244,080 common shares.

Ownership

As of December 31, 2003 and 2002, MTS's shareholders of record and their respective percentage direct interests were as follows:

| | <u>2003</u> | | <u>2002</u> | |
|---|--------------|---|--------------|---|
| Joint-Stock Financial Corporation Sistema (Sistema) | 41.0 | % | 35.0 | % |
| T-Mobile Worldwide Holding GmbH (T-Mobile) | 25.4 | % | 36.4 | % |
| VAST, Limited Liability Company (VAST) | 3.1 | % | 3.1 | % |
| Invest-Svyaz-Holding, Closed Joint-Stock Company | 8.0 | % | 8.0 | % |
| ADS Holders | 17.4 | % | 17.4 | % |
| GDR Holders | 5.0 | % | | |
| All executive officers and directors | 0.1 | % | 0.1 | % |
| | <u>100.0</u> | % | <u>100.0</u> | % |

Sistema owns 51.0% equity interest in VAST, a limited liability company incorporated under the laws of the Russian Federation; the remaining 49.0% interest is held by ASVT, a Russian open joint-stock company. Sistema's effective ownership in MTS was 50.6% and 44.6% at December 31, 2003 and 2002, respectively.

In March 2003, Sistema and T-Mobile (together, the Shareholders) entered into a call option agreement, pursuant to which T-Mobile granted Sistema the option to acquire from it 199,332,614 shares of MTS, representing 10.0% of outstanding common stock of MTS. On April 26, 2003, Sistema exercised its option with T-Mobile to purchase an additional 6.0% of the outstanding common stock of MTS and purchased T-Mobile's 49.0% interest in Invest-Svyaz-Holding, bringing its interest in Invest-Svyaz-Holding to 100.0%. Concurrently with this transaction, T-Mobile sold its holding of 5.0% in MTS.

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on the open market in the form of Global Depository Receipts (GDRs) listed on the London Stock Exchange.

In April 2003, Sistema issued \$350.0 million 10.25% notes, due in 2008. These notes are collateralized by 193,473,900 shares of common stock of MTS OJSC.

On June 30, 2003, the Group approved cash dividends of \$1.12 per ADS (\$0.056 per share) for a total of \$111.0 million. As of the date of these statements, dividends in the amount of \$96.7 million, net of tax in the amount of \$10.5 million, were paid.

On November 28, 2003, common shares of MTS OJSC were included by the Board of Moscow Interbank Currency Exchange (MICEX) into the MICEX B Quotation List.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES AND NEW ACCOUNTING PRONOUNCEMENTS

Accounting principles

MTS maintains its accounting books and records in Russian rubles for its subsidiaries located in the Russian Federation and Ukrainian hryvnas for Ukrainian Mobile Communications (UMC) based on local accounting and tax legislation. The accompanying consolidated financial statements have been prepared in order to present MTS financial position and its results of operations and cash flows in accordance with accounting principles generally accepted in the United States (U.S. GAAP) and expressed in terms of U.S. dollars.

The accompanying consolidated financial statements differ from the financial statements used for statutory purposes in that they reflect various adjustments, not recorded on the entities books, which are appropriate to present the financial position, results of operations and cash flows in accordance with U.S. GAAP. The principal adjustments are related to revenue recognition, foreign currency translation, deferred taxation, consolidation, and depreciation and valuation of property and equipment and intangible assets.

Basis of consolidation

Wholly owned subsidiaries and majority owned subsidiaries where the Company has operating and financial control are consolidated. Those ventures where the Company exercises significant influence, but does not exercise operating and financial control are accounted for by the equity method. All significant intercompany accounts and transactions are eliminated upon consolidation. The Company s share in net income of unconsolidated affiliates was insignificant for each of the three years in the period ended December 31, 2003, and is included in other income in the accompanying consolidated statements of operations. Results of operations of subsidiaries acquired are included in the consolidated statements of operations from the date of their acquisition.

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As of December 31, 2003 and 2002, MTS has investments in the following significant operating and holding entities:

| | Accounting Method | December 31, | |
|----------------------------|----------------------|--------------|---------|
| | | 2003 | 2002 |
| Rosico ⁽¹⁾ | Consolidated | | 100.0 % |
| ACC | Consolidated | 100.0 % | 100.0 % |
| Telecom XXI | Consolidated | 100.0 % | 100.0 % |
| Telecom-900 | Consolidated | 100.0 % | 100.0 % |
| SCS-900 | Consolidated | 88.5 % | 51.0 % |
| FECS-900 | Consolidated | 60.0 % | 60.0 % |
| Uraltel | Consolidated | 99.8 % | 53.2 % |
| MTS Finance ⁽²⁾ | Consolidated | 100.0 % | 100.0 % |
| BM Telecom | Consolidated | 100.0 % | 100.0 % |
| Kuban-GSM | Consolidated | 100.0 % | 52.7 % |
| Dontelecom | Consolidated | 100.0 % | 100.0 % |
| MTS-Barnaul | Consolidated | 100.0 % | 100.0 % |
| BIT | Consolidated | 100.0 % | 100.0 % |
| MTS-Capital | Consolidated | 100.0 % | |
| UMC | Consolidated | 100.0 % | |
| Sibchallenge | Consolidated | 100.0 % | |
| TSS | Consolidated | 100.0 % | |
| Volgograd Mobile | Equity | 50.0 % | |
| Astrakhan Mobile | Equity | 50.0 % | |
| Mar Mobile GSM | Consolidated | 100.0 % | |
| Primtelefon | Equity | 50.0 % | |
| MSS | Consolidated | 83.5 % | 83.5 % |
| ReCom | Consolidated | 53.9 % | 53.9 % |
| TAIF Telcom | Consolidated | 52.7 % | |
| UDN-900 | Consolidated | 51.0 % | 51.0 % |
| Novitel | Consolidated | 51.0 % | 51.0 % |
| MTS Belarus | Equity | 49.0 % | 49.0 % |

⁽¹⁾ On June 9, 2003, the Group's wholly owned subsidiary, Rosico, merged into MTS OJSC pursuant to a shareholders' resolution approving the transaction.

⁽²⁾ Represents beneficial ownership.

Translation methodology

Effective January 1, 2003, the Russian economy ceased to be considered hyperinflationary. Management believes that the U.S. dollar is the appropriate functional currency because the majority of its revenues, costs, property and equipment purchased, and debt are either priced, incurred, payable or otherwise measured in U.S. dollars. Each of the legal entities domiciled in Russia, Ukraine and Belarus maintains its records and prepares its financial statements in the local currency, principally either Russian ruble, Ukrainian hryvna or Belarusian ruble, in accordance with the requirements of local statutory accounting and tax legislation.

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Translation (re-measurement) of financial statements denominated in local currencies into U.S. dollars has been performed in accordance with the provisions of Statement of Financial Accounting Standard (SFAS) No. 52 Foreign currency translation.

For subsidiaries of the Group where functional currency is the U.S. dollar, monetary assets and liabilities have been translated at the period end exchange rates. Non-monetary assets and liabilities have been translated at historical rates. Revenues, expenses and cash flows have been translated at historical rates. Translation differences resulting from the use of these rates have been accounted for as currency translation gains and losses in the accompanying consolidated statements of operations.

For UMC and Kuban-GSM where functional currency is the local currency, Ukrainian hryvna and Russian ruble, respectively, a new cost basis for all non-monetary assets has been established as of January 1, 2003. All year end balance sheet items have been translated into U.S. dollars at the period end exchange rate. Revenues and expenses have been translated at period average exchange rate. Cumulative translation adjustments in the amount of \$7,595, net of income taxes were recorded directly in the consolidated statement of shareholders equity.

Management estimates

The preparation of consolidated financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Examples of significant estimates include the allowance for doubtful accounts, the recoverability of intangible assets and other long-lived assets, and valuation allowances on deferred tax assets.

Cash and cash equivalents

Cash represents cash on hand and in MTS bank accounts and short-term investments having original maturities of less than three months.

Short-term investments

Short-term investments represent investments in time deposits, which have original maturities in excess of three months but less than twelve months. These investments are being accounted for at cost.

Allowance for doubtful accounts

MTS provides an allowance for doubtful accounts based on management s periodic review of accounts receivable from customers and other receivables.

Prepaid expenses

Prepaid expenses are primarily comprised of advance payments made for inventory and services to vendors.

Inventory

Inventory, accounted for at lower of cost, determined by the first-in, first-out, or FIFO method, or market, consists of telephones and accessories, held for sale and spare parts, to be used for equipment maintenance within next twelve months and other inventory items.

Telephones and accessories, held for sale, are written down to their market values based on specific monthly reviews of significant inventoried items and are expensed as cost of equipment.

Value-added taxes (VAT)

Value-added taxes related to sales are payable to the tax authorities on an accrual basis based upon invoices issued to the customer. VAT incurred for purchases may be reclaimed, subject to certain restrictions, against VAT related to sales.

Property, plant and equipment

Property, plant and equipment with a useful life of more than one year are capitalized at historical cost and depreciated on a straight-line basis over their expected useful lives as follows:

| | |
|------------------------------------|---|
| Network and base station equipment | 5 to 12 years shorter of 10 years or lease term |
| Leasehold improvements | lease term |
| Office equipment and computers | 5 years |
| Buildings | 50 years |
| Vehicles | 4 years |

Construction in progress and equipment held for installation are not depreciated until the constructed or installed asset is ready for its intended use.

Maintenance and repair costs are expensed as incurred, while upgrades and improvements that extend useful lives are capitalized.

License costs

License costs are capitalized as a result of (a) purchase price allocated to licenses acquired in business combinations (see Note 4 Businesses Acquired) and (b) licenses purchased directly from government organizations, which require license payments.

Our current operating licenses do not provide for automatic renewal upon expiration, and as the Group and the industry do not have sufficient experience with the renewal of licenses, license costs are being amortized, subject to periodic review for impairment, on a straight-line basis over three to ten years starting from the date such license area becomes commercially operational.

Upon adoption of SFAS No. 142, *Goodwill and Other Intangible Assets* on January 1, 2002, the Group reclassified \$22.0 million relating to the 1998 acquisition of Rosico from goodwill to licenses.

Other intangible assets and Goodwill

Intangible assets represent various purchased software costs, telephone numbering capacity, acquired customer base and rights to use premises. A significant portion of the rights to use premises was contributed by shareholders to the Group's charter capital. Telephone numbering capacity costs

with finite contractual life are being amortized over five to ten years and the rights to use premises are being amortized over ten years.

Software costs are amortized over four years. Acquired customer base is amortized over the estimated average subscriber life from 30 to 70 months. Other intangible assets are being amortized over three to four years. All finite-life intangible assets are being amortized using the straight-line method.

Telephone numbering capacity with unlimited contractual life is not amortized, but is reviewed, at least annually, for impairment in accordance with the provisions of SFAS No. 142. Amortization of deferred numbering capacity costs starts immediately upon the purchase of numbering capacity.

Goodwill represents the excess of the cost of business acquired over the fair market value of identifiable net assets at the date of acquisition, namely fair value of workforce-in-place acquired in the purchase of UMC (see Note 4 Business Acquired).

Goodwill is reviewed annually, as of the beginning of the fourth quarter, for impairment or whenever it is determined that impairment indicators exist. The Company determines whether an impairment has occurred by assigning goodwill to the reporting unit identified in accordance with SFAS No. 142, and comparing the carrying amount of the reporting unit to the fair value of the reporting unit. If a goodwill impairment has occurred, the Company recognizes a loss for the difference between the carrying amount and the implied fair value of goodwill. To date, no impairment of goodwill has occurred.

Leasing arrangements

The Group accounts for leases based on the requirements of SFAS No. 13, Accounting for Leases. Majority of the Group's operating leases are for the premises. Certain subsidiaries of the Group lease switches, base stations and other cellular network equipment as well as billing systems. For capital leases, the present value of future minimum lease payments at the inception of the lease is reflected as an asset and a liability in the balance sheet. Amounts due within one year are classified as short-term liabilities and the remaining balance as long-term liabilities.

Subscriber acquisition costs

Subscriber acquisition costs represent the direct costs paid for each new subscriber enrolled through MTS independent dealers. MTS expenses these costs as incurred. Prior to 2001, these costs were capitalized to the extent of any revenues that had been deferred from the acquisition of a subscriber, such as connection fees charged to a subscriber to initiate call service, and amortized as a component of sales and marketing expense on a straight-line basis over the estimated average subscriber life (see also Note 3 Change in Accounting Principle).

Investments impairment

Management periodically assesses the realizability of the carrying values of the investments and if necessary records impairment losses to write the investment down to fair value.

For the three years in the period ended December 31, 2003, no such impairments have occurred, except as discussed in Note 20 Investments In and Advances to Associates.

Debt issuance costs

Debt issuance costs are amortized using the effective interest method over the terms of the related debt.

Impairment of long-lived assets

MTS periodically evaluates the recoverability of the carrying amount of its long-lived assets in accordance with SFAS No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets. Whenever events or changes in circumstances indicate that the carrying amounts of those assets may not be recoverable, MTS compares undiscounted net cash flows estimated to be generated by those assets to the carrying amount of those assets. When these undiscounted cash flows are less than the carrying amounts of the assets, MTS records impairment losses to write the asset down to fair value, measured by the estimated discounted net future cash flows expected to be generated from the use of the assets. For the three years in the period ended December 31, 2003, no such impairments have occurred.

Subscriber prepayments

The Group requires the majority of its customers to pay in advance for telecommunication services. All amounts received in advance of service provided are recorded as a subscriber prepayment liability and are not recorded as revenues until the related services have been provided to the subscriber.

Revenue recognition

Revenues are recognized on an accrual basis, when services are actually provided or title to equipment passes to customer, regardless of when the resulting monetary or financial flow occurs.

MTS categorizes the revenue sources in the statements of operations as follows:

Service revenues: (a) subscription fees, (b) usage charge, (c) value-added service fees, (d) roaming fees charged to other operators for guest roamers utilizing MTS network and (e) prepaid phone cards;

Connection fees;

Equipment sales: (a) sales of handsets, and (b) sales of accessories.

Subscription fees

MTS recognizes revenues related to the monthly network fees in the month that the wireless service is provided to the subscriber.

Usage charges and Value-added services fees

Usage charges consist of fees based on airtime used by subscriber, the destination of the call and the service utilized.

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Value-added service fees are based on usage of airtime or volume of data transmitted for value added services, such as short message services, internet usage and data services. MTS recognizes revenues related to usage charges and value-added services in the period when services were rendered.

Roaming fees

MTS charges roaming per-minutes fees to other wireless operators for non-MTS subscribers utilizing MTS network. Guest roaming fees were \$153,271, \$83,393 and \$52,639 for the years ended December 31, 2003, 2002 and 2001, respectively.

Prepaid phone cards

MTS sells to subscribers prepaid phone cards, separately from the handset. These cards allow subscribers to make a predetermined allotment of wireless phone calls and/or take advantage of other services offered by the Group, such as short messages and sending or receiving faxes.

At the time that the prepaid phone card is purchased, MTS records the receipt of cash as a subscriber prepayment. The Group recognizes revenues from the phone cards in the period when subscriber uses time under the phone card. Unused time on sold phone cards is not recognized as revenues until the related services have been provided to the subscriber or the prepaid phone card has expired.

In 2002, MTS introduced a new line of prepaid service tariff plans, whereby a customer may purchase a package that allows a connection to the MTS network and a predetermined allotment of wireless phone calls and/or other services offered by the Group. Revenues under these plans are allocated between connection fees and service fees based on their relative fair values.

Connection fees

MTS defers initial connection fees from the moment of initial signing of the contract with subscribers over the estimated average subscriber life. The Group estimates that the average expected term of the subscriber relationship is 39 months in Russia and 47 months in Ukraine (see also Note 11 Deferred Connection Fees).

Equipment sales

MTS sells handsets and accessories to customers who are entering into contracts for service and as separate distinct transactions. The Group recognizes revenues from the handsets and accessories when title passes to the customer. MTS records estimated returns as a direct reduction of sales at the time the related sales are recorded.

In Ukraine, MTS also from time to time sells handsets at prices below cost. MTS recognizes these subsidies in cost of equipment when sale is recorded.

Expense recognition

Expenses incurred by MTS in relation to the provision of wireless communication services mainly relate to interconnection and line rental costs, roaming expenses, costs of handsets and other accessories sold, depreciation and amortization, and maintenance of the network.

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Calls made by subscribers from areas outside of territories covered by the Group licenses are subject to roaming fees charged by the wireless provider in those territories. These fees are recorded as roaming expenses, as MTS acts as the principal in the transaction with the subscriber and bears the risk of non-collection from the subscriber. Roaming fees are charged to MTS subscribers based on Group's existing tariffs and recorded as service revenues.

The costs of handsets and accessories, whether sold to subscribers through the distribution channel or as part of the service contract, are expensed when title passes to the customer. Any fees paid to dealers as commissions are recorded as a component of sales and marketing expenses.

Taxation

Deferred tax assets and liabilities are recognized for the expected future tax consequences of existing differences between financial reporting and tax reporting bases of assets and liabilities, and loss or tax credit carryforwards using enacted tax rates expected to be in effect at the time these differences are realized. Valuation allowances are recorded for deferred tax assets for which it is more likely that these assets will not be realized.

Advertising costs

Advertising costs are expensed as incurred. Advertising costs for the years ended December 31, 2003, 2002 and 2001 were \$102,018, \$48,624 and \$42,715, respectively, and are reflected as a component of sales and marketing expenses in the accompanying consolidated statements of operations.

Government pension fund

Subsidiaries of the Group contribute to the local state pension fund and social fund, on behalf of all its employees.

In Russia, starting from January 1, 2001 all social contributions, including contributions to the pension fund, were substituted with a unified social tax (UST) calculated by the application of a regressive rate from 35.6% to 2% of the annual gross remuneration of each employee. UST is allocated to three social funds, including the pension fund, where the rate of contributions to the pension fund vary from 28% to 2%, respectively, depending on the annual gross salary of each employee. The contributions are expensed as incurred.

In Ukraine the subsidiary of the Group is required to contribute a specified percentage of each employee payroll up to a fixed limit to Pension Fund, Unemployment Fund and Social Security Fund.

Earnings per share

Basic earnings per share (EPS) have been determined using the weighted average number of shares outstanding during the year. Diluted EPS reflect the potential dilution of stock options, granted to employees. There are 4,797,410 stock options outstanding as of December 31, 2003.

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The following is the reconciliation of the share component for basic and diluted EPS:

| | December 31, | | |
|---|---------------|---------------|---------------|
| | 2003 | 2002 | 2001 |
| Weighted average number of common share outstanding | 1,983,374,949 | 1,983,359,507 | 1,983,359,507 |
| Dilutive effect of stock options | 1,727,131 | 405,946 | 30,133 |
| | 1,985,102,080 | 1,983,765,453 | 1,983,389,640 |

Fair value of financial instruments

The fair market value of financial instruments, consisting of cash and cash equivalents, accounts receivable and accounts payable, which are included in current assets and liabilities, approximates the carrying value of these items due to the short term nature of these amounts. The fair value of our publicly traded long-term notes as of December 31, 2003 ranged from 103.6% to 110.2% of the principal amount. As of December 31, 2003, fair value of other fixed rate debt including capital lease obligation approximated its carrying value. The fair value of variable rate debt is equivalent to carrying value.

Comprehensive income

Comprehensive income is defined as net income plus all other changes in net assets from non-owner sources. The following is a reconciliation of comprehensive income, net of income taxes:

| | December 31, | | |
|-----------------------------------|--------------|------------|------------|
| | 2003 | 2002 | 2001 |
| Net income | \$ 517,239 | \$ 277,123 | \$ 205,829 |
| Cumulative translation adjustment | 7,595 | | |
| | \$ 524,834 | \$ 277,123 | \$ 205,829 |

Comparative information

Certain prior years amounts have been reclassified to conform to the current year presentation.

Stock-based compensation

MTS accounts for stock options issued to employees, non-employee directors and consultants following the requirements of SFAS No. 123, Accounting for Stock-Based Compensation and SFAS No. 148 Accounting for Stock Based Compensation Transition and Disclosure, an amendment to FASB Statement No. 123. Under the requirements of these statements compensation to employees and non-employee directors is measured based on the intrinsic value of options on the measurement date, calculated as a difference between the fair market value of stock and exercise price at that date. Compensation to consultants is measured based on the fair value of options on the measurement date as determined using a Black-Scholes option-pricing model.

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If the Group had elected to recognize compensation costs based on the fair values of options at the date of the grant, net income and earning per share amounts would have been as follows:

| | December 31, | | |
|--|---------------------|-------------|-------------|
| | 2003 | 2002 | 2001 |
| Net income as reported | \$ 517,239 | \$ 277,123 | \$ 205,829 |
| Pro-forma effect of the application of fair value method of accounting for stock options | (727) | (460) | (129) |
| Pro-forma net income | \$ 516,512 | \$ 276,663 | \$ 205,700 |
| Earnings per share basic and diluted | | | |
| As reported | \$ 0.261 | \$ 0.140 | \$ 0.104 |
| Pro-forma | \$ 0.260 | \$ 0.140 | \$ 0.104 |

Recently adopted accounting pronouncements

In June 2001, Financial Accounting Standard Board (FASB) issued SFAS No. 143, Accounting for Asset Retirement Obligations. SFAS No. 143 requires that the fair value of a liability for an asset retirement obligation is recorded in the period in which it is incurred if a reasonable estimate of fair value can be made. The associated asset retirement costs are capitalized as part of the carrying amount of the long-lived asset and depreciated over the asset's useful life. Changes in the liability resulting from the passage of time will be recognized as operating expense. The Group adopted SFAS No. 143 effective January 1, 2003. The adoption of SFAS No. 143 did not have a material impact on the Group's financial position or results of operations.

In April 2002, FASB issued SFAS No. 145, Rescission of FASB Statements Nos. 4, 44, and 64, Amendment of FASB Statement No. 13, and Technical Corrections. SFAS No. 4, Reporting Gains and Losses from Extinguishments of Debt, addressed statement of operations classification of gains and losses from extinguishment of debt. SFAS No. 64 amended SFAS No. 4 and is no longer necessary due to the rescission of SFAS No. 4. SFAS No. 145 also amended SFAS No. 13 Accounting for Leases, to eliminate an inconsistency between the required accounting for sale-leaseback transactions and the required sale-leaseback accounting for certain lease modifications that have economic effects that are similar to sale-leaseback transactions. Following the adoption of the requirements of SFAS No. 145 effective January 1, 2003, MTS reclassified a gain on the extinguishment of a credit facility with OJSC AB Inkombank of \$2.8 million and the related income tax expense of \$0.7 million from extraordinary gain on debt repayment to other income and income tax expense, respectively, in the consolidated statement of operations for the year ended December 31, 2001.

In June 2002, FASB issued SFAS No. 146, Accounting for Costs Associated with Exit or Disposal Activities, which requires the recognition of a liability when incurred for costs associated with an exit or disposal activity. The fundamental conclusion reached by the FASB in this Statement is that an entity's commitment to a plan, by itself, does not create a present obligation to others that meets the definition of a liability. SFAS No. 146 also establishes that the liability should initially be measured and recorded at fair value. The Group adopted the provisions of SFAS No. 146 effective January 1, 2003. The adoption of SFAS No. 146 did not have a material impact on the Group's financial position or results of operations.

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In November 2002, FASB issued FASB Interpretation No. 45, *Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others* (FIN 45). FIN 45 requires that the guarantor recognizes, at the inception of certain guarantees, a liability for the fair value of the obligation undertaken in issuing such guarantee. FIN 45 also requires additional disclosures about the guarantor's obligations under certain guarantees that it has issued. The Group adopted the initial recognition and measurement provisions of this interpretation on a prospective basis to guarantees issued or modified after December 31, 2002. The adoption of FIN 45 did not have a material impact on the Group's financial position or results of operations.

In November 2002, the Emerging Issues Task Force (EITF) issued a final consensus on EITF Issue No. 00-21, *Accounting for Revenue Arrangements with Multiple Deliverables*. EITF Issue No. 00-21 provides guidance on when and how an arrangement involving multiple deliverables should be divided in separate units of accounting. The Group adopted the requirements of EITF Issue No. 00-21 prospectively for arrangements entered into after June 15, 2003. The adoption of EITF Issue No. 00-21 did not have a material impact on the Group's financial position or results of operations.

In April 2003, FASB issued SFAS No. 149, *Amendments of FASB Statements No. 133 on Derivative Instruments and Hedging Activities*. SFAS No. 149 clarifies under what circumstances a contract with an initial investment meets the characteristic of a derivative, clarifies when a derivative contains a financing component, amends the definition of an underlying and certain other existing pronouncements. The Group adopted the requirements of SFAS No. 149 for contracts entered into or modified and for hedging relationships designated after June 30, 2003. The adoption of SFAS No. 149 did not have a material impact on the Group's financial position or results of operations.

In May 2003, FASB issued SFAS No. 150, *Accounting for Certain Financial Instruments with Characteristics of Both Liabilities and Equity*. SFAS No. 150 requires issuers to classify as liabilities (or assets in some circumstances) certain classes of freestanding financial instruments that embody obligations for the issuer, including mandatory redeemable financial instruments, obligations to repurchase the issuer's equity shares by transferring assets and certain obligations to issue a variable number of shares. The Group adopted the requirements of SFAS No. 150 effective July 1, 2003. The adoption of SFAS No. 150 did not have a material impact on the Group's financial position or results of operations.

New accounting pronouncements

In December 2003, FASB issued a revision to Interpretation No. 46, *Consolidation of Variable Interest Entities*, an Interpretation of ARB No. 51 (FIN 46R or the Interpretation). FIN 46R clarifies the application of ARB No. 51, *Consolidated Financial Statements*, to certain entities in which equity investors do not have the characteristics of a controlling financial interest or do not have sufficient equity at risk for the entity to finance its activities without additional subordinated financial support. FIN 46R requires the consolidation of these entities, known as variable interest entities (VIEs), by the primary beneficiary of the entity. The primary beneficiary is the entity, if any, that will absorb a majority of the entity's expected losses, receive a majority of the entity's expected residual returns, or both.

Among other changes, the revisions of FIN 46R (a) clarified some requirements of the original FIN 46, which had been issued in January 2003, (b) eased some implementation problems, and (c) added new scope exceptions. FIN 46R deferred the effective date of the Interpretation for public

companies, to the end of the first reporting period ending after March 15, 2004, except that all public companies must at a minimum apply the provisions of the Interpretation to entities that were previously considered special-purpose entities under the FASB literature prior to the issuance of FIN 46R by the end of the first reporting period ending after December 15, 2003.

The Group is evaluating whether the adoption of FIN 46 will have a material impact on its financial position, cash flows and results of operations. The Group did not enter into any transactions under the scope of FIN 46R after February 1, 2003.

In December 2003, the Securities Exchange Commission (SEC) issued Staff Accounting Bulletin (SAB) No. 104, Revenue Recognition. SAB 104 updates portions of the interpretive guidance included in Topic 13 of the codification of Staff Accounting Bulletins in order to make this interpretive guidance consistent with current authoritative accounting and auditing guidance and SEC rules and regulations. The Group believes it is following the guidance of SAB 104.

3. CHANGE IN ACCOUNTING PRINCIPLE

Effective January 1, 2001, the Group changed its accounting principle regarding recognition of subscriber acquisition costs. Subscriber acquisition costs represent the direct costs paid for each new subscriber enrolled through MTS independent dealers. Prior to the 2001, these costs were capitalized to the extent of any revenues that had been deferred from the acquisition of a subscriber, such as connection fees charged to a subscriber to initiate call service, and amortized as a component of sales and marketing expense on a straight-line basis over the estimated average subscriber life. MTS now expenses subscriber acquisition costs as incurred. This change of accounting principle was made to facilitate the comparison of MTS results with other telecommunication companies.

As a cumulative effect of this change, the remaining balance of capitalized subscriber acquisition cost as of January 1, 2001 in the amount of \$17,909 (\$0.009 per basic and diluted share), net of \$9,644 in taxes was expensed and included in income during the year ended December 31, 2001.

4. BUSINESSES ACQUIRED

Telecom XXI acquisition

In May 2001, MTS acquired 100% of the outstanding common stock of Telecom XXI, a Russian closed joint-stock company, for cash consideration of \$49.7 million. Telecom XXI has GSM-900 and GSM-1800 licenses, covering northwest of Russia, including St. Petersburg and Leningrad region as well as Kaliningrad. Telecom XXI did not have any subscribers at the date of the acquisition. The Telecom XXI acquisition was accounted for using the purchase method of accounting. The purchase price was allocated as follows:

| | |
|---------------------|-----------|
| Current assets | \$ 849 |
| Non-current asset | 1,322 |
| License costs | 74,639 |
| Current liabilities | (944) |
| Deferred taxes | (26,124) |
| | <hr/> |
| Purchase price | \$ 49,742 |
| | <hr/> |

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License costs are amortized over the remaining term of the license of approximately 7 years at the date of the acquisition.

Telecom-900 acquisition

In August 2001, MTS acquired 81% of the outstanding common stock of Telecom-900, a Russian closed joint-stock company, for a cash consideration of \$26.8 million from Sistema. Telecom-900 is the holding company for three regional mobile phone operators, Siberia Cellular System 900 CJSC (SCS-900), Uraltel CJSC (Uraltel), and Far East Cellular Systems 900 CJSC (FECS-900). At the date of acquisition, these companies had approximately 96,000 subscribers and licenses to provide GSM-900/1800 mobile services in the Novosibirsk region, Altai Republic, Sverdlovsk region and Khabarovsk region.

Telecom-900 acquisition was accounted for using the purchase method of accounting. The purchase price was allocated as follows:

| | |
|-------------------------|-----------|
| Current assets | \$ 12,136 |
| Non-current assets | 29,297 |
| License costs | 31,542 |
| Current liabilities | (21,883) |
| Non-current liabilities | (10,626) |
| Deferred taxes | (7,754) |
| Minority interest | (5,900) |
| | <hr/> |
| Purchase price | \$ 26,812 |
| | <hr/> |

In November 2002, MTS acquired the remaining 19% of Telecom-900 from Invest-Svyaz-Holding, a shareholder of the Group and a wholly owned subsidiary of Sistema, for a cash consideration of \$6.9 million. The acquisition was accounted for using the purchase method of accounting. The allocation of the purchase price increased recorded license costs by \$2.7 million.

On August 13, 2003, Telecom-900 completed the purchase of the 43.7% and 2.95% stakes in Uraltel for a cash consideration of \$35.7 million. The transaction increased Telecom-900's ownership in Uraltel to 99.85%. The acquisition was accounted using purchase method of accounting. The allocation of purchase price increased recorded license cost by \$24.5 million.

In November 2003, the Group completed the purchase of the 30% stake in SCS-900 from Sibirtelecom for cash consideration of \$28.6 million. The Group's acquisition of this stake increased its ownership in SCS-900 to 81.0%. On December 29, 2003, the Group acquired for cash consideration of \$9.3 million a 100% stake in ILIT LLC, a company which owns a 7.5% stake in SCS-900, increasing its ownership in SCS-900 to 88.5%. The acquisition was accounted using purchase method of accounting. The allocation of purchase price increased recorded license cost by \$25.7 million.

License costs are amortized over the remaining contractual terms of the respective license, ranging from 6 to 10 years at the date of the first acquisition.

Kuban-GSM acquisition

In March 2002, MTS acquired 51% of Kuban-GSM, a Russian closed joint-stock company, for cash consideration of \$71.4 million. At the date of acquisition, Kuban-GSM had approximately 500,000 subscribers. It operates in thirteen major cities throughout the south of the European part of the Russian Federation, including Sochi, Krasnodar and Novorossiisk. The Kuban-GSM acquisition was accounted for using the purchase method of accounting. The purchase price was allocated as follows:

| | |
|-------------------------|-----------|
| Current assets | \$ 11,751 |
| Non-current assets | 80,848 |
| License costs | 62,549 |
| Acquired customer base | 3,561 |
| Current liabilities | (31,289) |
| Non-current liabilities | (19,827) |
| Deferred taxes | (15,866) |
| Minority interest | (20,327) |
| | <hr/> |
| Purchase price | \$ 71,400 |
| | <hr/> |

In October 2002, MTS exercised its option to buy additional 353 shares for \$5.0 million payable in cash, increasing its ownership in Kuban-GSM to 52.7%. The acquisition of the additional interest was accounted for using the purchase method of accounting. The allocation of the purchase price increased recorded license costs by \$4.4 million, increased acquired customer base by \$0.2 million, and decreased minority interest by \$0.5 million.

In September 2003, the Group acquired 100.0% of Kubtelesot for cash consideration of \$107.0 million. Kubtelesot owned 47.3% of Kuban-GSM, and the Group's purchase of this stake increased its ownership in Kuban-GSM to 100.0%. The acquisition was accounted for using the purchase method of accounting. The allocation of purchase price increased recorded license cost by \$57.5 million, increased acquired customer base by \$8.4 million, and decreased minority interest by \$59.0 million.

License costs are amortized over the remaining contractual term of the license of approximately 5 years at the date of the first acquisition. Acquired customer base is amortized over the average remaining subscribers life of approximately 70 months.

BM Telecom acquisition

In May 2002, MTS completed its acquisition of 100% of the outstanding common stock of Ufa-based BM Telecom, a closed joint-stock company, for \$41.0 million in cash. At the date of acquisition BM Telecom had approximately 100,000 subscribers and it holds a GSM-900/1800 license to

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operate in Bashkortostan Republic of Russia. This acquisition was accounted for by the purchase method. The purchase price was allocated as follows:

| | |
|-------------------------|-----------|
| Current assets | \$ 3,312 |
| Non-current assets | 14,736 |
| License costs | 48,932 |
| Current liabilities | (3,603) |
| Non-current liabilities | (10,227) |
| Deferred taxes | (12,150) |
| | \$ 41,000 |
| Purchase price | \$ 41,000 |

License costs associated with the acquisition of BM Telecom are amortized over the remaining term of the license of approximately 5 years.

Dontelecom acquisition

On September 26, 2002, MTS completed its acquisition of 66.66% of the outstanding common stock of Dontelecom, a closed joint-stock company, for cash consideration of \$15.0 million (including 33.33% acquired from Sistema for \$7.5 million). At the date of acquisition Dontelecom had approximately 39,000 subscribers. Dontelecom holds a GSM-900/1800 license to operate in the Rostov region. This acquisition was accounted for using the purchase method. The purchase price was allocated as follows:

| | |
|-------------------------|-----------|
| Current assets | \$ 3,422 |
| Non-current assets | 8,401 |
| License costs | 14,739 |
| Current liabilities | (5,849) |
| Non-current liabilities | (357) |
| Deferred taxes | (3,675) |
| Minority interest | (1,681) |
| | \$ 15,000 |
| Purchase price | \$ 15,000 |

In October 2002, the Group completed the acquisition of the remaining 33.33% of the outstanding common stock of Dontelecom for \$7.5 million. The acquisition was accounted for using the purchase method of accounting. The purchase increased the recorded license costs by \$7.3 million.

License costs are amortized over the remaining contractual term of the license of approximately 3 years at the date of the acquisition.

UMC acquisition

On March 4, 2003, MTS acquired 57.7% of the outstanding voting interest of UMC, a provider of mobile services in Ukraine, for cash consideration of \$199.0 million, including the acquisition of 16.3% of the outstanding voting interest from Deutsche Telekom AG, a related party, for \$55.0 million. Acquisition costs relating to the transaction of \$1.4 million were capitalized. In connection with the acquisition, MTS also assumed debt of UMC with face value of approximately \$65.0 million, with the

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fair value of approximately \$62.0 million. At the date of acquisition, UMC had approximately 1.8 million subscribers.

The acquisition was accounted for using the purchase method. For convenience, MTS consolidated UMC from March 1, 2003. Purchase price allocation is as follows:

| | |
|-------------------------|------------|
| Current assets | \$ 82,293 |
| Non-current assets | 272,721 |
| License costs | 82,200 |
| Acquired customer base | 30,927 |
| Current liabilities | (63,551) |
| Non-current liabilities | (78,580) |
| Deferred taxes | (27,425) |
| Minority interest | (99,581) |
| | \$ 199,004 |
| Purchase price | \$ 199,004 |

MTS paid \$171.5 million of the purchase price in cash and agreed to pay the balance of the purchase price of \$27.5 million to Cetel B.V., a wholly owned subsidiary of Deutsche Telekom AG, within one year. The amount payable accrues interest of 9% per annum.

MTS also had an option agreement with Ukrtelecom to purchase its remaining 26.0% stake in UMC, exercisable from February 5, 2003 to November 5, 2005, with an exercise price of \$87.6 million. On June 4, 2003, MTS exercised its call option. As a result of the transaction, MTS ownership in UMC increased from 57.7% to 83.7%. The acquisition was accounted for using purchase method of accounting. The allocation of purchase price increased recorded license cost by \$10.2 million, increased acquired customer base by \$13.9 million, and decreased minority interest by \$66.4 million.

In addition, MTS entered into a put and call option agreement with TDC Mobile International A/S (TDC) for the purchase of its 16.3% stake in UMC. The exercise period of the call option was from May 5, 2003 to November 5, 2004, and the put option was exercisable from August 5, 2003 to November 5, 2004. The call option price was \$85.0 million plus interest accrued from November 5, 2002 to the date of the exercise at 11% per annum; the price of the put option was calculated based on reported earnings of UMC prior to the exercise and was subject to a minimum amount of \$55.0 million. On June 25, 2003, MTS notified TDC of its intent to exercise its rights under the put and call option agreement. The purchase was completed during July 2003. MTS paid cash consideration of approximately \$91.7 million to purchase the remaining 16.3% stake in UMC. The acquisition was accounted for using purchase method of accounting. The allocation of purchase price increased recorded license cost by \$52.7 million, increased acquired customer base by \$8.7 million, and decreased minority interest by \$43.8 million.

The UMC license costs are amortized over the remaining contractual terms of the licenses of approximately 9 to 13 years at the date of the acquisition, acquired customer base is amortized over the average remaining subscribers life of approximately 47 months. Other acquired intangible assets, represented mostly by software, are amortized over their respective useful lives of 3 to 10 years.

In accordance with SFAS No. 141 Business Combinations, the Group recognized \$8.0 million of goodwill relating to workforce-in-place.

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UMC is one of the two leading mobile operators in Ukraine, operating under nationwide GSM 900/1800 and NMT 450 licenses. As at the date of purchase of the controlling stake, it was providing services to approximately 1.8 million subscribers.

TAIF Telcom acquisition

In April 2003, MTS acquired 51.0% of the common shares of TAIF Telcom, a Russian open joint-stock company, for cash consideration of \$51.0 million and 50.0% of the preferred shares of TAIF Telcom for cash consideration of \$10.0 million. In May 2003, MTS acquired an additional 1.7% of the common shares of TAIF Telcom for cash consideration of \$2.3 million. In connection with the acquisitions, MTS also assumed indebtedness of approximately \$16.6 million that is collateralized by telecom equipment.

MTS also entered into call and put option agreements with the existing shareholders of TAIF Telcom to acquire the remaining 49.0% of common shares and 50.0% of preferred shares of TAIF Telcom. The exercise period for the call option on common shares is 48 months from the acquisition date and for the put option on common shares is 36 months following an 18 month period after the acquisition date. The call and put option agreements for the common shares stipulate a minimum purchase price of \$49.0 million plus 8% per annum commencing from the acquisition date. The exercise period for the call option on preferred shares is 48 months following a 24 month period after the acquisition date and for the put option on preferred shares it is a 24 month period after the acquisition date. The call and put option agreements for the preferred shares stipulate a minimum purchase price of \$10.0 million plus 8% per annum commencing from the acquisition date.

If all of the options are exercised, MTS' share in TAIF Telcom will increase to 100.0%.

The purchase price allocation was as follows:

| | |
|-------------------------|-----------|
| Current assets | \$ 3,870 |
| Non-current assets | 48,391 |
| License costs | 68,407 |
| Current liabilities | (26,099) |
| Non-current liabilities | (5,550) |
| Deferred taxes | (16,814) |
| Minority interest | (8,965) |
| | <hr/> |
| Purchase price | \$ 63,240 |
| | <hr/> |

License costs acquired are amortized over the remaining contractual terms of the licenses of approximately 4 years.

TAIF Telcom provides mobile services in the GSM-900/1800 standard in the Republic of Tatarstan and in the Volga region of Russia. At the date of acquisition, TAIF Telcom had approximately 240,000 subscribers.

Sibachallenge acquisition

On August 22, 2003, MTS completed the purchase of 100.0% of Sibachallenge, a cellular operator in the Krasnoyarsk region, for cash consideration of \$45.5 million, paid a finder's fee of \$2.0 million

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and assumed net debt of approximately \$6.6 million. Sibachallenge holds licenses to provide GSM-900/1800 and DAMPS mobile services in the Krasnoyarsk region of Siberia, the Republic of Khakasiya, and in the Taimyr Autonomous region, all of which are located in the Siberian part of Russia. At the date of acquisition, Sibachallenge had approximately 132,000 subscribers.

The purchase price allocation was as follows:

| | |
|-------------------------|-----------|
| Current assets | \$ 4,078 |
| Non-current assets | 16,678 |
| License costs | 52,625 |
| Current liabilities | (6,405) |
| Non-current liabilities | (6,628) |
| Deferred taxes | (12,894) |
| | \$ 47,454 |
| Purchase price | \$ 47,454 |

License costs acquired are amortized over the remaining contractual terms of the licenses of approximately 8 years.

Tomsk Cellular Communications acquisition

In September 2003, MTS purchased 100.0% of Siberian operator Tomsk Cellular Communications (TSS) for cash consideration of \$47.0 million. TSS holds licenses to provide GSM-900/1800 mobile cellular communications in the Tomsk region. At the date of acquisition, TSS had approximately 183,000 subscribers.

The acquisition was accounted for using the purchase method. The purchase price allocation was as follows:

| | |
|-------------------------|-----------|
| Current assets | \$ 3,299 |
| Non-current assets | 11,412 |
| License costs | 49,282 |
| Current liabilities | (4,543) |
| Non-current liabilities | (105) |
| Deferred taxes | (12,345) |
| | \$ 47,000 |
| Purchase price | \$ 47,000 |

License costs acquired are amortized over the remaining contractual terms of the licenses of approximately 8 years.

Acquisitions of various regional companies

In August 2003, the Group reached an agreement to acquire, in a series of related transactions, equity interests in five Russian regional mobile phone operators from MCT Corporation for a total of \$71.0 million. The Group agreed to purchase a 43.7% stake in Uraltel (described above) and 100.0% of Vostok Mobile BV, which holds a 50.0% stake in Primtelefon.

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The Group also agreed to purchase Vostok Mobile South, which holds 50.0% stakes in Astrakhan Mobile and Volgograd Mobile, as well as an 80.0% stake in Mar Mobile GSM. The Group also entered into agreements to acquire the remaining 20.0% of Mar Mobile GSM and another 2.95% stake in Uraltel from existing shareholders unrelated to MCT Corporation for approximately \$1.0 million.

On August 26, 2003, the Group completed the acquisition of Vostok Mobile BV and recorded a 50.0% stake investment in Primtelefon using equity method of accounting.

On October 14, 2003, the Group completed the purchase of Vostok Mobile South and thus acquired a 50.0% stake in Volgograd Mobile and Astrakhan Mobile and an 80.0% stake in Mar Mobile GSM. Also, in a separate transaction the Group completed the acquisition of the remaining 20.0% stake in Mar Mobile GSM from existing shareholders unrelated to MCT corporation, thus consolidating a 100.0% ownership in the company.

Pro-forma results of operations (unaudited)

The following unaudited pro forma financial data for the years ended December 31, 2003 and 2002, give effect to the acquisitions of UMC, TAIF Telcom, Sibchallenge, TSS, Kuban-GSM and other various regional companies as if they had occurred at the beginning of the respective years.

| | December 31, | |
|---------------------------------------|---------------------|--------------|
| | 2003 | 2002 |
| Pro-forma: | | |
| Net revenues | \$ 2,640,856 | \$ 1,714,532 |
| Net operating income | 925,149 | 544,917 |
| Net income | 583,222 | 342,595 |
| Earnings per share, basic and diluted | \$ 0.294 | \$ 0.173 |

The pro-forma information is based on various assumptions and estimates. The pro-forma information is not necessarily indicative of the operating results that would have occurred if the Group acquisitions had been consummated as of January 1, 2003 and 2002, nor is it necessarily indicative of future operating results. The pro-forma information does not give effect to any potential revenue enhancements or cost synergies or other operating efficiencies that could result from the acquisitions. The actual results of operations of these companies are included in the consolidated financial statements of the Group only from the respective dates of acquisition.

5. CASH AND CASH EQUIVALENTS

Cash and cash equivalents as of December 31, 2003 and 2002 comprised of the following:

| | December 31, | |
|---------------------------------|---------------------|-------------|
| | 2003 | 2002 |
| Ruble current accounts | \$ 40,597 | \$ 19,860 |
| Ruble deposits | 20,201 | |
| U.S. dollar deposits | 886 | 7,999 |
| U.S. dollar current accounts | 20,130 | 6,404 |
| Other | 8,562 | 398 |
| | <hr/> | <hr/> |
| Total cash and cash equivalents | \$ 90,376 | \$ 34,661 |
| | <hr/> | <hr/> |

6. SHORT-TERM INVESTMENTS

Short-term investments, denominated in U.S. dollars, as of December 31, 2003 comprised of the following:

| | Annual interest rate | Maturity date | December 31, 2003 |
|--|-------------------------------------|------------------------|------------------------------|
| | <hr/> | <hr/> | <hr/> |
| OJSC Moscow Bank of Reconstruction and Development | 4.8 | February 2, % 2004 | \$ 200,000 |
| OJSC Moscow Bank of Reconstruction and Development | 8.0 | October 4, % 2004 | 10,000 |
| OJSC Moscow Bank of Reconstruction and Development | 8.4 | October 21, % 2004 | 19,100 |
| OJSC Moscow Bank of Reconstruction and Development | 8.4 | November 23, % 2004 | 5,000 |
| OJSC Moscow Bank of Reconstruction and Development | 8.4 | December 5, % 2004 | 5,900 |
| OJSC Moscow Bank of Reconstruction and Development | 8.4 | December 20, % 2004 | 5,000 |
| | | | <hr/> |
| Total short-term investments | | | \$ 245,000 |
| | | | <hr/> |

Short-term investments, denominated in U.S. dollars, as of December 31, 2002 comprised of the following

| | Annual interest rate | Maturity date | December 31, 2002 |
|--|-------------------------------------|----------------------|------------------------------|
| | <hr/> | <hr/> | <hr/> |

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| | | | |
|--|-----|------------------------|-----------|
| OJSC Moscow Bank of Reconstruction and Development | 9.0 | October 22, % 2003 | \$ 19,100 |
| OJSC Moscow Bank of Reconstruction and Development | 9.0 | November 21, % 2003 | 5,000 |
| OJSC Moscow Bank of Reconstruction and Development | 9.0 | December 5, % 2003 | 5,900 |
| | | | <hr/> |
| Total short-term investments | | | \$ 30,000 |
| | | | <hr/> |

OJSC Moscow Bank of Reconstruction and Development is a related party (see also Note 18 Related Party).

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7. TRADE RECEIVABLES

Trade receivables as of December 31, 2003 and 2002 were as follows:

| | December 31, | |
|----------------------------------|---------------------|------------------|
| | 2003 | 2002 |
| Accounts receivable, subscribers | \$ 87,149 | \$ 29,505 |
| Accounts receivable, roaming | 26,500 | 17,266 |
| Allowance for doubtful accounts | (13,698) | (6,270) |
| Trade receivables, net | <u>\$ 99,951</u> | <u>\$ 40,501</u> |

The following table summarizes the changes in the allowance for doubtful accounts for the years ended December 31, 2003, 2002 and 2001:

| | December 31, | | |
|---------------------------------|---------------------|-----------------|-----------------|
| | 2003 | 2002 | 2001 |
| Balance, beginning of year | \$ 6,270 | \$ 5,178 | \$ 1,959 |
| Provision for doubtful accounts | 32,633 | 7,047 | 3,219 |
| Accounts receivable written off | (25,205) | (5,955) | |
| Balance, end of year | <u>\$ 13,698</u> | <u>\$ 6,270</u> | <u>\$ 5,178</u> |

8. INVENTORY

Inventory as of December 31, 2003 and 2002 comprised of the following:

| | December 31, | |
|-------------------------------|---------------------|------------------|
| | 2003 | 2002 |
| Spare parts for base stations | \$ 26,635 | \$ 15,519 |
| Handsets and accessories | 23,499 | 18,056 |
| Other inventory | 17,157 | 7,811 |
| Inventory | <u>\$ 67,291</u> | <u>\$ 41,386</u> |

Obsolescence expense for the years ended December 31, 2003, 2002 and 2001 amounted to \$3,307, \$5,614 and \$2,543, respectively, and was included in operating expenses in the accompanying consolidated statements of operations.

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9. PROPERTY, PLANT AND EQUIPMENT

The net book value of property, plant and equipment as of December 31, 2003 and 2002 was as follows:

| | December 31, | |
|--|---------------------|---------------------|
| | 2003 | 2002 |
| Network and base station equipment (including leased network and base station equipment of \$66,311 and \$55,383 respectively) | \$ 1,775,180 | \$ 959,465 |
| Leasehold improvements | 6,582 | 4,299 |
| Office equipment, computers, software and other (including leased office equipment, computers and software of \$1,923 and \$1,739, respectively) | 147,395 | 68,271 |
| Buildings | 144,680 | 96,420 |
| Vehicles | 11,611 | 7,607 |
| Property, plant and equipment, at cost | 2,085,448 | 1,136,062 |
| Accumulated depreciation (including accumulated depreciation on leased equipment of \$23,343 and \$13,420, respectively) | (532,268) | (299,216) |
| Equipment for installation | 334,264 | 313,222 |
| Construction in-progress | 368,632 | 194,565 |
| Property, plant and equipment, net | \$ 2,256,076 | \$ 1,344,633 |

Depreciation expenses during the years ended December 31, 2003, 2002 and 2001 amounted to \$233.1 million, \$116.0 million and \$73.7 million, respectively, including depreciation expenses for leased property, plant and equipment in the amount of \$7.6 million, \$3.4 million and \$1.6 million, respectively.

10. OTHER INTANGIBLE ASSETS

Intangible assets at December 31, 2003 and 2002 comprised of the following:

| | Useful lives | December 31, 2003 | | | December 31, 2002 | | |
|---|-----------------|-----------------------------|---------------------------------|---------------------------|-----------------------------|---------------------------------|---------------------------|
| | | Gross carrying value | Accumulated amortization | Net carrying value | Gross carrying value | Accumulated amortization | Net carrying value |
| Amortized intangible assets: | | | | | | | |
| Acquired customer base | 30 to 70 months | \$ 81,289 | \$ (18,307) | \$ 62,982 | \$ 7,410 | \$ (955) | \$ 6,455 |
| Rights to use premises | 10 years | 19,638 | (10,476) | 9,162 | 11,752 | (8,352) | 3,400 |
| Numbering capacity with finite contractual life, software and other | 3 to 10 years | 338,222 | (119,269) | 218,953 | 184,237 | (69,582) | 114,655 |

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| | | | | | | |
|--|-------------------|----------------------|-------------------|-------------------|---------------------|-------------------|
| | 439,149 | (148,052) | 291,097 | 203,399 | (78,889) | 124,510 |
| | <u>439,149</u> | <u>(148,052)</u> | <u>291,097</u> | <u>203,399</u> | <u>(78,889)</u> | <u>124,510</u> |
| Unamortized intangible assets: | | | | | | |
| Numbering capacity with indefinite contractual life | 13,047 | | 13,047 | 13,047 | | 13,047 |
| Goodwill | 8,533 | | 8,533 | 533 | | 533 |
| | <u>13,047</u> | | <u>13,047</u> | <u>13,047</u> | | <u>13,047</u> |
| | <u>8,533</u> | | <u>8,533</u> | <u>533</u> | | <u>533</u> |
| Total other intangible assets | \$ 460,729 | \$ (148,052) | \$ 312,677 | \$ 216,979 | \$ (78,889) | \$ 138,090 |
| | <u>\$ 460,729</u> | <u>\$ (148,052)</u> | <u>\$ 312,677</u> | <u>\$ 216,979</u> | <u>\$ (78,889)</u> | <u>\$ 138,090</u> |

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As a result of a limited availability of local telephone numbering capacity in Moscow and the Moscow region, MTS has been required to enter into agreements for the use of telephone numbering capacity with several telecommunication operators in Moscow. Costs of acquiring numbering capacity with finite contractual life are amortized over period of five to ten years in accordance with the terms of the contract entered into to acquire such capacity. Numbering capacity with indefinite contractual life is not amortized.

The principal component of MTS' right to use premises was obtained in the form of contributions to its charter capital in 1993. These premises included MTS' administrative offices and facilities utilized for mobile switching centers.

Amortization expense for the years ended December 31, 2003, 2002 and 2001 amounted to \$69.2 million, \$30.0 million and \$17.5 million, respectively. Based on the amortizable intangible assets existing at December 31, 2003, the estimated amortization expense is \$122.7 million during 2004, \$90.0 million during 2005, \$51.3 million during 2006, \$15.9 million during 2007, \$3.1 million during 2008 and \$8.1 million thereafter. Actual amortization expense to be reported in future periods could differ from these estimates as a result of new intangible assets acquisitions, changes in useful lives and other relevant factors.

11. DEFERRED CONNECTION FEES

Deferred connection fees for the years ended December 31, 2003 and 2002 were as follows:

| | December 31, | |
|---|--------------|-----------|
| | 2003 | 2002 |
| Balance at beginning of the year | \$ 41,904 | \$ 47,412 |
| Payments received and deferred during the year | 34,112 | 19,346 |
| Amounts amortized and recognized as revenue during the year | (29,372) | (24,854) |
| | 46,644 | 41,904 |
| Less current portion | 21,467 | 22,210 |
| Non-current portion | \$ 25,177 | \$ 19,694 |

MTS defers initial connection fees from the moment of initial signing of the contract with subscribers and recognizes the revenue over the estimated average subscriber life (see Note 2 Summary of Significant Accounting Policies and New Accounting Pronouncements).

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12. DEBT

At December 31, 2003 and 2002, debt comprised of the following:

| | Currency | Annual interest rate (Actual rate at December 31, 2003) | December 31, 2003 | December 31, 2002 | Available credit facilities as of December 31, 2003 |
|------------------------------|----------|--|----------------------|----------------------|--|
| 9.75% Notes due 2008 | USD | 9.75% | \$ 400,000 | \$ | \$ |
| 8.38% Notes due 2010 | USD | 8.375% | 400,000 | | |
| 10.95% Notes due 2004 | USD | 10.95% | 299,640 | 298,943 | |
| Floating Rate Notes due 2004 | USD | LIBOR+4% (5.15%) | 298,196 | | |
| Total notes | | | \$ 1,397,836 | \$ 298,943 | \$ |
| Less current portion | | | 597,836 | | n. a. |
| Total long-term notes | | | \$ 800,000 | \$ 298,943 | n. a. |
| ING Bank (Eurasia) | USD | LIBOR+4.15% (5.30%) | \$ 60,000 | \$ | \$ |
| Dresdner Bank | USD | LIBOR+3.20%-3.35% (4.35%-4.50%) | 15,400 | 39,280 | 600 |
| Ericsson | USD | LIBOR+4% (5.15%) | 23,400 | 30,150 | |
| Deutsche Telekom AG | USD | LIBOR+5%-7% (6.22%-8.22%) | 7,981 | | |
| TDC Mobile International A/S | USD | LIBOR+5%-7% (6.22%-8.22%) | 6,838 | | |
| Citibank | USD | LIBOR+3.5% (4.65%) | 10,000 | 9,000 | |
| West LB | EUR | EURIBOR+2% (4.17%) | 5,092 | 4,000 | |
| KFW | EUR | LIBOR+0.95%-4% (2.41%-5.46%) | 4,313 | | |
| HSBC | USD | LIBOR+2.75% (3.88%) | 25,000 | | |
| Hermes Credit Facility | EUR | EURIBOR + 0.65% (2.82%) | 55,550 | | 3,700 |
| AVAL bank | UAH | 10-16% | 10,890 | | 9,110 |
| Motorola | USD | LIBOR + 1.5% (2.72%) | 1,361 | 6,181 | |
| Guta Bank | USD | 7%-15% | 1,511 | | |
| International Moscow Bank | RUR | 13.4% | 10,864 | | 1,019 |
| International Moscow Bank | USD | LIBOR+3.45% (4.60%) | | 5,000 | |
| MBRD | RUR | 18.5% | 1,220 | | 448 |
| Ruble denominated debt | RUR | 13.4%-20% | 5,860 | 30,334 | 7,500 |
| Other debt | USD | 7%-15% | 450 | 3,124 | |
| Total debt | | | \$ 245,730 | \$ 127,069 | \$ 22,377 |
| Less current portion | | | 103,312 | 67,098 | n. a. |
| Total long-term debt | | | \$ 142,418 | \$ 59,971 | n. a. |

The Notes

On December 21, 2001, MTS Finance S.A. (MTS Finance), a 100% beneficially owned subsidiary of MTS, registered under the laws of Luxembourg, issued \$250.0 million 10.95% (effective interest rate of 11.25%) notes at the price of 99.254%. Proceeds received from the notes, net of underwriting discount, were \$248.1 million. Related debt issuance costs in the amount of \$3.9 million were capitalized. On March 20, 2002, MTS Finance issued additional \$50.0 million 10.95% (effective interest rate of 10.25%) notes at a price of 101.616%. Proceeds received from these notes, including the offering premium, were \$50.8 million. Related debt issuance costs in the amount of \$0.6 million were capitalized. All the notes are fully and unconditionally guaranteed by MTS OJSC and mature on December 21, 2004. MTS Finance makes interest payments on the notes semi-annually in arrears on June 21 and December 21 of each year, commencing on June 21, 2002. The notes are listed on the Luxembourg Stock Exchange. In May 2002 these notes were registered with the SEC under the Securities Act of 1933.

On January 30, 2003, MTS Finance issued \$400.0 million 9.75% notes at par. These notes are fully and unconditionally guaranteed by MTS OJSC and mature on January 30, 2008. MTS Finance is required to make interest payments on the notes semi-annually in arrears on January 30 and July 30, commencing on July 30, 2003. The notes are listed on the Luxembourg Stock Exchange. Proceeds received from the notes were \$400.0 million and related debt issuance costs of \$3.9 million were capitalized.

On August 5, 2003, MTS Finance issued \$300.0 million notes bearing interest at floating rate 3 months LIBOR + 4% (5.15% at December 31, 2003) at the price of 99% (effective interest rate of 6.19% at December 31, 2003). These notes are fully and unconditionally guaranteed by MTS OJSC and mature on August 7, 2004. MTS Finance is required to make interest payments on the notes quarterly, commencing on November 5, 2003. The notes are listed on the Luxembourg Stock Exchange. Proceeds received from the notes, net of underwriting discount, were \$297.0 million and related debt issuance costs of \$1.8 million were capitalized.

On October 14, 2003, MTS Finance issued \$400.0 million notes bearing interest at 8.375% at par. The cash proceeds, net of issuance costs of approximately \$4.6 million, amounted to \$395.4 million. These notes are fully and unconditionally guaranteed by MTS OJSC and will mature on October 14, 2010. MTS Finance is required to make interest payments on the notes semi-annually in arrears on April 14 and October 14 of each year, commencing on April 14, 2004. The notes are listed on the Luxembourg Stock Exchange.

These notes are subject to certain restrictive covenants including, but not limited to, limitations on the incurrence of additional indebtedness, limitations on the Group's ability to enter into sales leaseback transactions, restriction on any merger, consolidation or disposition of assets, restrictions on the sales of any licenses. In addition, these notes provide the holders a right to require MTS Finance to redeem all of the notes outstanding at 101% of the principal amount of the notes plus accrued interest upon any change in control, as defined.

Ericsson debt restructuring

In December 1996, Rosico entered into a credit agreement with Ericsson Project Finance AB (Ericsson) that provided for a credit facility with an aggregate principal amount of \$60,000 and had a

maximum term of five years (the Ericsson Loan). The loan was repayable in ten equal consecutive quarterly payments of \$6.0 million commencing in 1999. On July 24, 2001 MTS, Rosico and Ericsson signed an amendment to the credit agreement rescheduling Rosico principal payments in nineteen consecutive quarterly installments. The amounts advanced under the agreement bear interest of LIBOR + 4% (5.15% at December 31, 2003). If Rosico fails to pay any amount under this facility, the overdue interest would bear interest at a rate of additional 6% per annum. The credit agreement contains covenants restricting Rosico's ability to encumber its present and future assets and revenues without lender's express consent.

Concurrent with the Group's acquisition of Rosico, Sistema agreed to fund the full and timely repayment of the Ericsson Loan and to indemnify Rosico and MTS for any costs incurred by either Rosico or MTS in connection with the repayment of the Ericsson Loan. During 2000, Sistema and MTS agreed on a method that would allow Sistema to fund its obligation in a manner that minimizes the total costs of meeting this obligation (including related tax costs). Under this method, MTS enters into a long-term, ruble-denominated promissory notes with nil% interest and maturities from 2049 to 2052 to repay a portion of the funding from Sistema. The carrying value of these notes is insignificant at December 31, 2003 and 2002. The Group records interest expense on these notes over the term such that the full amount of the obligation will be reflected as a liability at the date of repayment. Through December 31, 2003, Sistema has made payments under this obligation in the amount of \$55.6 million, 36.5 million of which are repayable in the form of long-term, ruble denominated promissory notes with nil% interest. Amounts receivable from Sistema under this indemnification are recorded as shareholder receivable in the accompanying consolidated balance sheets.

At December 31, 2003 and 2002, \$23.4 million and \$30.2 million were outstanding, respectively, under the Ericsson Loan.

On February 25, 2003 Ericsson assigned all of its rights and obligations under the Ericsson Loan to Salomon Brothers Holding Company, Inc.

Dresdner Bank credit facilities

In November 2001, Telecom XXI entered into a credit facility with Dresdner Bank CJSC (Dresdner Bank) to borrow up to \$20.0 million. Amounts borrowed by Telecom XXI under this credit facility are repayable within one to six months from the disbursement date and the credit facility has a final repayment date of November 2003. The borrowings bear interest of LIBOR + 3.2% (4.35% at December 31, 2003) per annum. Default interest is 12% per annum. The loan was fully repaid in November 2003.

In December 2001 and April 2002, UDN-900 entered into credit agreements with Dresdner Bank, expiring on

April 2004. As of December 31, 2003 and 2002, the amounts outstanding under these agreements were \$5.4 and \$4.3 million, respectively. These borrowings bear interest at LIBOR + 3.2% (4.35% December 31, 2003) per annum and are guaranteed by MTS OJSC.

In July 2002, MTS OJSC entered into a credit facility with Dresdner Bank. The credit facility allows borrowings up to \$12.0 million with the final repayment date no later than June 1, 2004. The amount advanced under the facility bears interest of LIBOR + 1.95% (3.10% at December 31, 2003) per annum. Default interest is 12% per annum. As of December 31, 2003 and 2002, nil and \$5.0 million was outstanding under this credit facility, respectively.

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In October 2002, MSS entered into a credit agreement with Dresdner Bank to borrow up to \$10.0 million. As of December 31, 2003 and 2002 \$10.0 million was outstanding under this agreement. Borrowings under this agreement bear interest of LIBOR + 3.35% (4.50% at December 31, 2003) per annum and mature in October 2004. The loan is guaranteed by MTS OJSC.

ING bank (Eurasia)

In September 2003, UMC entered into a \$60.0 million syndicated credit facility with ING Bank (Eurasia) ZAO, ZAO Standard Bank and Commerzbank Aktiengesellschaft with an interest rate of LIBOR + 4.15% (5.30% at December 31, 2003). The loan is guaranteed by MTS OJSC. The proceeds were used by UMC to refinance its existing indebtedness. The loan is payable in 8 equal quarterly installments starting from September 2004. As of December 31, 2003 the principal outstanding under this credit facility is \$60.0 million.

Deutsche Telekom AG and TDC Mobile International A/C

The credit facilities with Deutsche Telekom AG and TDC bear interest at LIBOR + 5% (6.22% at December 31, 2003) and LIBOR + 7% (8.22% at December 31, 2003) and are redeemable in five equal quarterly installments commencing April 2003. During the year UMC paid \$2.1 million of interest on Deutsche Telekom loan. At December 31, 2003 the unpaid balance on these loans was \$14.8 million. The amounts outstanding under these facilities were guaranteed by MTS OJSC. The debt was fully repaid in April 2004.

KFW

On December 21, 1998, UMC entered into two loan agreements with KFW, a German bank, for EUR 1.9 million (approximately \$2.4 million as of December 31, 2003) and EUR 10.9 million (approximately \$13.6 million as of December 31, 2003). These loans bear interest at LIBOR + 4% (5.46% at December 31, 2003) and LIBOR + 0.95% (2.41% at December 31, 2003) per annum, respectively, and mature on March 31, 2004 and February 28, 2005, respectively. At December 31, 2003 the unpaid balance on these loans was \$4.3 million.

HSBC Bank LLC

In October 2003, TAIF Telcom entered into a \$25.0 million credit facility with HSBC Bank LLC which is guaranteed by MTS OJSC. The facility bears interest at LIBOR + 2.75% (3.88% at December 31, 2003) and is redeemable in ten equal quarterly installments commencing on June 2004. The loan is subject to certain restrictive covenants including, but not limited to, restriction on the amount of dividends paid by TAIF Telcom until MTS owns 100% of TAIF Telcom's outstanding common stock. At December 31, 2003 the outstanding balance is \$25.0 million.

Hermes Credit Facility (HECF)

On December 30, 2003, UMC entered into Hermes Credit Facility with ING BHF Bank and Commerzbank to finance the acquisition of GSM equipment from Siemens Aktiengesellschaft. The aggregate amount available under this credit facility is EUR 47.4 million (\$59.3 million at December 31, 2003). The loan is guaranteed by MTS OJSC and bears interest at EURIBOR + 0.65% (2.82% at December 31, 2003). The amount outstanding will be redeemable in 10 equal semi-annual

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installments, starting on July 31, 2004 or earlier, depending on the fulfillment on the credit agreement terms by the borrower. The balance outstanding at December 31, 2003 is EUR 44.5 million (\$55.6 million).

AVAL Bank

On December 31, 2003, UMC had the balance of \$10.9 million of overdraft with AVAL bank. The short-term overdraft facility is limited to 110.0 million hryvnas (\$20.0 million at December 31, 2003), bears interest at 10 16% per annum and matures on June 30, 2004.

Citibank credit facility

In November 2002, Telecom XXI entered into a credit facility with Citibank. Amounts borrowed under the credit facility and outstanding at December 31, 2003 must be repaid in June 2004 and bear interest of LIBOR + 3.5% (4.65% at December 31, 2003) per annum. Overdue amounts bear an additional 3% per annum. At December 31, 2003, \$10.0 million is outstanding under this facility. The amount is guaranteed by MTS OJSC.

Guta Bank

In January 2003, TAIF Telcom entered into a credit facility agreement with Guta Bank to finance the purchase of telecommunications equipment. The maximum amount allowed to be borrowed under the facility is approximately \$2.2 million. The loan bears interest at 7% to 15% per annum and matures in February 2007. The amount outstanding under this facility was \$1.5 million as of December 31, 2003. The loan is collateralized by equipment with a net book value of \$2.9 million as of December 31, 2003.

International Moscow Bank

In February 2002, SCS-900 entered into a credit facility agreement with the International Moscow Bank to borrow up to \$5.0 million for the purpose of current operations and financing of investment outlay, including payments for contract with Ericsson Radio Systems AB. The amount bears interest at LIBOR + 3.45% (4.60% at December 31, 2003). The default interest rate is 7.5% per annum. The debt was redeemed in May 2003.

On June 9, 2003, Kuban-GSM entered into a 350.0 million ruble (approximately \$11.9 million at December 31, 2003) credit facility with International Moscow Bank. Amounts borrowed under this facility mature in June 2005 and have an interest rate of 13.4% until June 2004.

As of December 31, 2003, approximately \$10.9 million was outstanding under this facility. The loan is collateralized by equipment with book value of approximately \$15.5 million at December 31, 2003.

Moscow Bank of Reconstruction and Development (MBRD)

In 2003, Dontelecom entered into a ruble denominated loan agreement with MBRD, a related party. The amounts borrowed under this loan bear interest at rate of 18.5% and payable in June 2004. During the year 2003, Dontelecom paid interest of \$0.1 million. As of December 31, 2003, the total amount payable under this loan agreement amounted to \$1.2 million.

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During the year 2003, MTS OJSC signed several short-term loan agreements with MBRD. Amounts borrowed were payable during the period of one to two months. During the year interest expense on these loans was approximately \$0.3 million.

Rosbank loan

In February and March 2003, Kuban-GSM entered into ruble-denominated credit facilities with Rosbank permitting borrowings of up to approximately 245.0 million rubles (approximately \$8.3 million at December 31, 2003). Borrowings under this agreement bear interest at rates varying from 18% to 20% per annum and are secured by a pledge of equipment. The facilities mature in February 2005 and March 2005. As of December 31, 2003 the amount outstanding under this agreement was \$0.8 million.

WestLB International loan

In July 2002, MTS-P, a wholly owned subsidiary of the Company, entered into a credit facility agreement with WestLB International S.A. As of December 31, 2003 and 2002, the amount of borrowings under this agreement was \$5.0 and \$4.0 million, respectively. Amounts outstanding under this agreement bear interest of EURIBOR + 2% (4.17% at December 31, 2003) per annum for the first two years for each advance and 4% per annum for the remaining interest periods for each advance until maturity. Final maturity of this agreement is December 28, 2006. The loan is guaranteed by MTS OJSC.

Motorola loan

In October 1997, MSS issued promissory notes to Motorola Inc. for delivery and installation of GSM 900 cellular equipment in the Omsk region in the amount of \$5.4 million. These promissory notes were due to be repaid on various dates through September 2001. On November 27, 2001, MSS entered into an agreement to restructure this liability. This restructuring established a new repayment schedule under which the notes and the accrued interest as of November 27, 2001 are being repaid in regular installments from February 2002 to May 2004, imputing an interest rate of approximately 2.7%. MSS total payments under this agreement have not changed by greater than 10% due to this restructuring. As of December 31, 2003, the amount payable under these promissory notes was \$1.4 million.

Dontelecom has a loan agreement with Motorola for GSM cellular equipment, principal and interest which are payable semiannually. The amounts outstanding bear interest of at 8.23% per annum. The loan was fully repaid in January 2003.

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The following table presents aggregate scheduled maturities of debt principal outstanding as of December 31, 2003:

| | |
|---|--------------|
| Payments due in the year ended December 31, | |
| 2004 | \$ 701,148 |
| 2005 | 69,974 |
| 2006 | 48,014 |
| 2007 | 16,128 |
| 2008 | 408,302 |
| Thereafter | 400,000 |
| | <hr/> |
| | \$ 1,643,566 |
| | <hr/> |

13. CAPITAL LEASE OBLIGATIONS

The following table presents future minimum lease payments under capital leases together with the present value of the net minimum lease payments as of December 31, 2003:

| | |
|---|-----------|
| Payments due in the year ended December 31, | |
| 2004 | \$ 12,741 |
| 2005 | 7,217 |
| 2006 | 1,779 |
| 2007 | 32 |
| 2008 | 33 |
| Thereafter | 277 |
| | <hr/> |
| Total minimum lease payments (undiscounted) | 22,079 |
| Less amount representing interest | (5,311) |
| | <hr/> |
| Present value of net minimum lease payments | 16,768 |
| Less current portion of lease payable | (9,122) |
| | <hr/> |
| Non-current portion of lease payable | \$ 7,646 |
| | <hr/> |

For a schedule by years of future minimum lease payments under capital leases to Invest-Svyaz-Holding, a shareholder of the Group and a wholly owned subsidiary of Sistema, together with the present value of the net minimum lease payments as of December 31, 2003, see Note 18 Related Parties.

14. ACCRUED LIABILITIES

Accrued liabilities at December 31, 2003 and 2002 were comprised of the following:

| | December 31, | |
|----------------------------------|---------------------|------------------|
| | 2003 | 2002 |
| VAT | \$ 33,545 | \$ 29,393 |
| Interest payable | 32,911 | 1,500 |
| Taxes other than income | 31,139 | 31,810 |
| Other accruals | 46,194 | 11,216 |
| Total accrued liabilities | \$ 143,789 | \$ 73,919 |

15. INCOME TAX

MTS provision for income taxes was as follows for the respective periods ended:

| | December 31, | | |
|---|---------------------|-------------------|------------------|
| | 2003 | 2002 | 2001 |
| Current provision for income taxes | \$ 285,481 | \$ 129,406 | \$ 138,092 |
| Deferred income tax benefit | (43,001) | (18,989) | (39,964) |
| Total provision for income taxes | \$ 242,480 | \$ 110,417 | \$ 98,128 |

From January 1, 2001, MTS statutory income tax rate was 35%. In August 2001, a new law regarding taxation of income became effective. Under that law, effective from January 1, 2002, the statutory income tax rate was reduced to 24%. This reduction in the statutory income tax rate resulted in the recognition of a net deferred tax benefit of approximately \$22 million in 2001.

From January 1, 2004, UMC statutory income tax rate changes from 30% to 25% as a result of changes in Ukrainian legislation.

The statutory income tax rate reconciled to MTS effective income tax rate is as follows for the respective periods ended:

| | December 31, | | |
|---|---------------------|-------------|-------------|
| | 2003 | 2002 | 2001 |
| Statutory income tax rate for year | 24.0 % | 24.0 % | 35.0 % |
| Adjustments: | | | |
| Expenses not deductible for tax purposes | 2.3 | 2.1 | 13.6 |
| Tax allowance generated from investment in infrastructure | | | (8.3) |
| Effect of decrease in income tax rate | | | (6.6) |

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| | | | |
|---|-----------------|-----------------|-----------------|
| Effect of higher tax rate of subsidiary | 0.9 | | |
| Currency exchange and translation | 1.6 | | |
| Other | 0.4 | (0.3) | (3.9) |
| | <u> </u> | <u> </u> | <u> </u> |
| Effective income tax rate | 29.2 % | 25.8 % | 29.8 % |
| | <u> </u> | <u> </u> | <u> </u> |

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Temporary differences between the tax and accounting bases of assets and liabilities give rise to the following deferred tax assets and liabilities at December 31, 2003 and 2002:

| | December 31, | |
|---|---------------------|--------------|
| | 2003 | 2002 |
| Assets (liabilities) arising from tax effect of: | | |
| Deferred tax assets | | |
| Depreciation of property, plant and equipment | \$ 19,171 | \$ 13,606 |
| Deferred connection fees | 8,805 | 10,057 |
| Allowance for doubtful accounts | 14,157 | 1,505 |
| Loss carryforward (Rosico and MSS) | 7,113 | 10,033 |
| Other | 25,158 | 8,050 |
| | 74,404 | 43,251 |
| Valuation allowance | (7,113) | (12,695) |
| | 67,291 | 30,556 |
| Deferred tax liabilities | | |
| Licenses acquired | \$ (170,162) | \$ (91,606) |
| Other | (33,334) | (14,212) |
| | (203,496) | (105,818) |
| Net deferred tax liability | \$ (136,205) | \$ (75,262) |
| Net deferred tax assets, current | \$ 44,423 | \$ 12,223 |
| Net deferred tax liability, long term | \$ (180,628) | \$ (87,485) |

Net change in valuation allowance for the years ended December 31, 2003 and 2002 were \$5.6 million and \$13.2 million, respectively.

As of December 31, 2003 and 2002, Rosico and MSS were entitled to loss carryforwards in the amounts of \$29,638 and \$41,803, respectively. These loss carryforwards resulted in deferred tax assets at December 31, 2003 and 2002 in the amounts of \$7,113 and \$10,033, respectively. As Russian companies are required to file tax declarations on a standalone basis, MTS is not able to utilize these losses to offset its taxable income. While Rosico was merged into MTS OJSC in June 2003, the Group has still recorded a valuation allowance for the entire amount of the available tax loss carryforward related to Rosico as MTS has not yet performed all procedures necessary to determine what amounts will be available for deductions in the future. In addition in 2002 the Group recorded a valuation allowance for the lower of cost or market provision in the amount of \$2,662 since it was more likely than not that the tax asset will not be realized.

The Group does not record a deferred tax liability related to undistributed earnings of UMC, as it intends to permanently reinvest these earnings. The undistributed earnings of UMC as of December 31, 2003 were \$327.8 million.

16. SHAREHOLDERS EQUITY

In accordance with Russian laws, earnings available for dividends are limited to profits determined in accordance with Russian statutory accounting regulations, denominated in rubles, after certain

deductions. Net income of MTS OJSC for the year ended December 31, 2003 and 2002 which is distributable under Russian legislation totaled 13,423.0 million rubles (\$437.4 millions), 10,759.0 million rubles (\$343.3 million) and 8,587.0 million rubles (\$294.4 million), respectively.

17. STOCK BONUS AND STOCK OPTION PLANS

On April 27, 2000, MTS established a stock bonus plan and stock option plan for selected officers, key employees and key advisors. Under this plan, directors, key employees and key advisors received the right to participate in a stock option plan under which they may receive options to purchase up to 9,966,631 of MTS common shares.

During 2003, 2002 and 2001, MTS made several grants pursuant to its stock option plan to employees and directors of the Group. These options are generally vested over a two year period from the date of the grant, contingent on continuous employment with the Company. A summary of the status of the Group's stock option plan is presented below:

| | Shares | Weighted average exercise price, U.S. dollar |
|----------------------------------|--------------|--|
| | <hr/> | <hr/> |
| Outstanding at January 1, 2001 | | |
| Granted during 2001 | 1,829,221 | 1.31 |
| | <hr/> | <hr/> |
| Outstanding at December 31, 2001 | 1,829,221 | 1.31 |
| | <hr/> | <hr/> |
| Granted | 2,846,681 | 1.49 |
| Forfeited | (27,481) | 1.31 |
| | <hr/> | <hr/> |
| Outstanding at December 31, 2002 | 4,648,421 | 1.42 |
| | <hr/> | <hr/> |
| Granted | 1,952,632 | 2.43 |
| Exercised | (37,557) | 1.31 |
| Exchanged for cash award | (1,746,310) | 1.31 |
| Forfeited | (19,776) | 1.31 |
| | <hr/> | <hr/> |
| Outstanding at December 31, 2003 | 4,797,410 | 1.87 |
| | <hr/> | <hr/> |

None of the options outstanding at December 31, 2003 and 2002 were exercisable. Options outstanding at December 31, 2003, have exercise price ranging from \$1.49 to \$2.43 per share and their weighted average remaining contractual life was approximately one year at December 31, 2003.

During 2003 19,776 stock options were forfeited, and 1,746,310 options were exchanged for cash consideration of \$2.9 million that was included in operating expenses in the consolidated statements of operations. Since the date of the grant total options amounted to 1,913, nil and 45,344 related to 2003, 2002 and 2001 grants, respectively have been forfeited.

Fair values of options granted in 2003, 2002 and 2001 were 1.02 U.S. dollars, \$0.50 and \$0.36 per share, respectively, and were estimated using the Black-Scholes option pricing model. The risk free rates applied for 2003, 2002 and 2001 were 5.2%, 6.1% and, 15.5%, respectively. The following assumptions were applied to options granted in 2003, 2002 and 2001, respectively: (i) expected dividend yields of approximately 3.0%; (ii) expected volatility rates of 40.0%, 50.0% and 45.0%, and (iii) expected lives of 2 years.

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In accordance with the Russian legislation, MTS Board members and key employees may be considered insiders with respect to the Group and thus may be restricted from selling their shares.

18. RELATED PARTIES

Related party balances as of December 31, 2003 and 2002 comprised of the following:

| | December 31, | |
|-------------------------------------|--------------|----------|
| | 2003 | 2002 |
| Accounts receivable: | | |
| T-Mobile for roaming | \$ 853 | \$ 1,374 |
| Strom Telecom for software | 1,074 | |
| Receivables from investee companies | 1,429 | 2,195 |
| | \$ 3,356 | \$ 3,569 |
| Accounts payable: | | |
| Cetel B.V. for UMC shares | \$ 27,500 | \$ |
| MGTS for interconnection | 704 | 630 |
| Telmos for interconnection | | 184 |
| MTU-Inform for interconnection | 2,398 | 4,154 |
| Sundry payables | 1,302 | |
| | \$ 31,904 | \$ 4,968 |

Transactions with major related parties are described below.

OJSC Moscow Bank of Reconstruction and Development (MBRD)

Starting August 2000, MTS has been keeping certain bank and deposit accounts with MBRD, whose major shareholder is Sistema. As of December 31, 2003, MTS cash position at MBRD amounted to \$279.7 million including \$265.2 million in time deposits and \$14.5 million in current accounts. As of December 31, 2002, MTS cash position at MBRD amounted to \$38.7 million including \$34.0 million in time deposits and \$4.7 million in current accounts. The related interest accrued and collected on the deposits for the years ended December 31, 2003, 2002 and 2001 amounted to \$9.9 million, \$5.1 million and \$3.0 million, respectively, and was included as a component of interest income in the accompanying consolidated statements of operations.

Loans transactions with MBRD are described in Note 12 Debt.

Rosno OJSC

MTS arranged medical insurance for its employees and insured its property in the amounts of approximately \$874.0 million, \$781.0 million and \$612.0 million in 2003, 2002 and 2001, respectively, with Rosno OJSC, whose significant shareholder is Sistema. Insurance premiums paid to Rosno OJSC for the years ended December 31, 2003, 2002 and 2001, amounted to \$16.9 million, \$4.9 million and \$8.0 million, respectively, including premiums paid for medical insurance amounting to \$5.0 million, \$3.6 million and \$2.5 million, respectively. Management believes that all of the insurance contracts with Rosno OJSC have been entered at market terms.

Maxima Advertising Agency (Maxima)

In 2001, 2002 and 2003, MTS had agreements for advertising services with Maxima. Advertising fees paid to Maxima for the years ended December 31, 2003, 2002 and 2001, were \$24.7 million, \$13.1 million and \$8.7 million, respectively. Maxima is related to MTS through MTS directors who are also members of Maxima's board of directors.

Telmos

In 2003, 2002 and 2001, MTS had interconnection arrangements with, and received domestic and international long-distance services from Telmos, a subsidiary of Sistema. Interconnection and line rental fees paid to Telmos for the years ended December 31, 2003, 2002 and 2001, were approximately \$1.6 million, \$1.3 million and \$4.0 million, respectively. Management believes that these arrangements are at market terms.

Moscow City Telephone Network (MGTS)

In 2003, 2002 and 2001, MTS had line rental agreements with MGTS and rented cable plant from MGTS for installation of optic-fiber cable. MTS also rented buildings for administrative office, sales and marketing offices as well as premises for switching and base station equipment. Amounts paid under these agreements for the years ended December 31, 2003, 2002 and 2001, were approximately \$5.0 million, \$4.4 million and \$1.5 million, respectively. In 2002 and 2001, MTS also purchased buildings from MGTS and paid \$2.0 million and \$2.6 million, respectively. Management believes that all these transactions were made at market terms. Sistema is the majority shareholder of MGTS.

MTU-Inform

In 2003, 2002 and 2001, MTS had interconnection and line rental agreements with MTU-Inform, a subsidiary at Sistema. Amounts paid under these agreements for the years ended December 31, 2003, 2002, and 2001, amounted to approximately \$26.6 million, \$24.1 million and \$29.0 million, respectively. In 2003, 2002 and 2001 MTS also purchased telephone numbering capacity from MTU-Inform. Payments under these agreements for the years ended December 31, 2003, 2002 and 2001, amounted to \$0.5 million, \$1.6 million and \$4.7 million, respectively. Management believes that these agreements are at market terms.

Comstar

In 2003 and 2002, MTS had interconnection and line rental agreements with Comstar, a subsidiary of Sistema. Amounts paid under these agreements for the years ended December 31, 2003, and 2002, amounted to approximately \$4.0 million, and \$3.2 million, respectively. Management believes that these agreements are at market terms.

T-Mobile

In 2003, 2002 and 2001, the Group had non-exclusive roaming agreements with T-Mobile, a shareholder of the Group. Payments made by MTS under these roaming agreements were approximately \$1.1 million, \$1.0 million and \$0.7 million for the years ended December 31, 2003, 2002 and 2001, respectively.

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As discussed in Note 12, UMC had \$8.0 million payable to Deutsche Telecom AG, parent company of T-Mobile. As discussed in Note 4, at December 31, 2003 MTS had a payable related to the purchase of UMC for \$27.5 million to Cetel B.V., a wholly owned subsidiary of Deutsche Telecom AG.

Invest-Svyaz-Holding

In 2003, 2002 and 2001, MTS entered into agreements with Invest-Svyaz-Holding, a shareholder of MTS and a wholly owned subsidiary of Sistema, for leasing of network equipment and billing system. These leases were recorded as capital leases based on the requirements of SFAS No. 13, Accounting for Leases. The present value of future lease payments is reflected as a liability in the balance sheet. Amounts due within one year are classified as current liabilities, and the remaining balance as long-term liabilities. The interest rate implicit in these leases varies from 11% to 44%, which management believes are market terms.

The following table summarizes the future minimum lease payments under capital leases to Invest-Svyaz-Holding together with the present value of the net minimum lease payments as of December 31, 2003:

| | |
|---|----------|
| Payments due in the year ended December 31, | |
| 2004 | \$ 9,518 |
| 2005 | 6,786 |
| 2006 | 1,732 |
| | 18,036 |
| Total minimum lease payments (undiscounted) | 18,036 |
| Less amount representing interest | (4,892) |
| | 13,144 |
| Present value of net minimum lease payments | 13,144 |
| Less current portion of lease obligations | (6,223) |
| | 6,921 |
| Non-current portion of lease obligations | \$ 6,921 |

In addition to the above lease transactions, the Group guarantees debt of Invest-Svyaz-Holding in the amount of \$21.6 million to a third party, which is used by Invest-Svyaz-Holding primarily to finance its leases to the Group. For the year ended December 31, 2003 leases to the Group amounted to approximately 99% of revenues of Invest-Svyaz-Holding.

For the year ended December 31, 2003, principal and interest paid to Invest-Svyaz-Holding were \$5.4 million and \$3.3 million, respectively. Principal and interest paid to Invest-Svyaz-Holding for the year ended December 31, 2002 were \$2.9 million and \$1.4 million. Principal and interest paid to Invest-Svyaz-Holding for the period from the date of acquisition of Telecom-900 on August 10, 2001 through December 31, 2001, were \$0.5 million and \$0.1 million, respectively. Management believes that these agreements are at market terms.

Strom Telecom

During 2003 the Group entered into three agreements, for a total amount up to \$32.3 million with Strom Telecom, an associate of Sistema. Pursuant to these contracts, the Group purchased a billing system, a communication software support system and equipment for approximately \$23.7 million.

See Note 4 Businesses Acquired for other related parties transactions.

19. OPERATING EXPENSES

Operating expenses for 2003, 2002 and 2001, consisted of the following:

| | December 31, | | |
|-----------------------------------|---------------------|-------------------|-------------------|
| | 2003 | 2002 | 2001 |
| Salaries and social contributions | \$ 156,808 | \$ 84,706 | \$ 44,425 |
| General and administrative | 42,530 | 26,549 | 21,569 |
| Taxes other than income taxes | 40,432 | 39,119 | 25,312 |
| Repair and maintenance | 39,406 | 20,361 | 10,578 |
| Provision for doubtful accounts | 32,633 | 7,047 | 3,219 |
| Rent | 31,968 | 15,578 | 9,479 |
| Billing and data processing | 22,067 | 9,549 | 2,981 |
| Consulting expenses | 11,361 | 7,692 | 2,093 |
| Insurance | 7,351 | 6,774 | 5,258 |
| Other operating expenses | 22,166 | 11,681 | 9,684 |
| Total operating expenses | <u>\$ 406,722</u> | <u>\$ 229,056</u> | <u>\$ 134,598</u> |

20. INVESTMENTS IN AND ADVANCES TO ASSOCIATES

At December 31, 2003 and 2002, the Group's investments in and advances to associates included, respectively, the following:

| | December 31, | |
|---|---------------------|------------------|
| | 2003 | 2002 |
| MTS Belarus loans receivable | \$ 51,481 | \$ 30,089 |
| MTS Belarus equity investment | 5,884 | 2,455 |
| Primtelefon equity investment | 31,174 | |
| Astrakhan Mobile and Volgograd Mobile equity investment | 5,806 | |
| Astrakhan Mobile and Volgograd Mobile loans receivable | 6,850 | |
| Volgograd Mobile loans receivable | 204 | |
| MSS note receivable | 827 | |
| Receivables from other investee companies | 1,359 | 1,490 |
| Total investments in and advances to associates | <u>\$ 103,585</u> | <u>\$ 34,034</u> |

MTS Belarus

In September 2001, MTS won a tender initiated by the Telecommunications Ministry of the Republic of Belarus to form a joint venture, which will have a GSM-900/1800 license to operate in Belarus. In accordance with the tender, in November 2001 the Group made an initial \$10.0 million payment to the government of Belarus.

From December 2001, soon after the date the Group was awarded the tender, it became increasingly apparent based upon various communications and correspondence that the Group would not be able to commence operations in Belarus as expected. The Company halted additional payments

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under the original agreement and expensed its initial \$10.0 million investment, as it appeared probable that the investment would not be recoverable. This charge is reflected as an impairment of investment in the accompanying consolidated statements of operations for the year ended December 31, 2001.

As a result of additional negotiations, and a change in the Belarus government's position, effective June 26, 2002, the joint venture received all of the governmental approvals and licenses required to commence operations in Belarus. Subsequently, the Group continued investing in MTS Belarus.

As of December 31, 2003 and 2002, the Group provided MTS Belarus with a total of \$51.5 million and \$30.1 million in loans, respectively. These loans bear interest at 3% to 11% per annum. All loans outstanding as of December 31, 2002 have been repaid according to the original terms.

Based on projected future cash flows as well as other factors, management believes that no impairment of the Group's investments in Belarus is required as of December 31, 2003.

Primtelefon, Astrakhan Mobile and Volgograd Mobile

As described in Note 4 Businesses Acquired, in August 2003 the Group purchased equity interests in various Russian regional mobile operators, including stakes in Primtelefon, Astrakhan Mobile and Volgograd Mobile, as a part of its strategic business plans.

21. OPERATING LICENSES

In connection with providing telecommunication services, the Group has been issued various operating licenses by the Ministry of Information Technologies and Communications. In addition to the licenses received directly from the Ministry of Information Technologies and Communications, the Group was granted access to various telecommunication licenses through acquisitions. At December 31, 2003 and 2002, recorded values of the Group's telecommunication licenses were as follows:

| | December 31, 2003 | December 31, 2002 |
|---|------------------------------|------------------------------|
| | <u> </u> | <u> </u> |
| Moscow license area (MTS OJSC) | \$ 255,812 | \$ 255,812 |
| North-Western region (Telecom XXI) | 74,639 | 74,639 |
| Krasnodar and Adigea regions (Kuban-GSM) | 124,396 | 66,919 |
| Bashkortostan Republic (BM Telecom) | 48,932 | 48,932 |
| Five regions of Asian Russia (Telecom-900) | 84,395 | 34,237 |
| Rostov region (Dontelecom) | 22,067 | 22,067 |
| Krasnoyarsk region, Taimyr region and Khakassia Republic (Sibchallenge) | 52,625 | |
| Tomsk region (TSS) | 49,282 | |
| Tatarstand Republic (TAIF Telcom) | 68,407 | |
| Ukraine (UMC) | 151,857 | |
| Seven regions of European Russia | 19,503 | 19,503 |
| Other | 8,212 | 8,212 |
| | <u> </u> | <u> </u> |
| Licenses, at cost | 960,127 | 530,321 |
| Accumulated amortization | (257,024) | (143,402) |
| | <u> </u> | <u> </u> |
| Licenses, net | <u>\$ 703,103</u> | <u>\$ 386,919</u> |

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Amortization expense for the years ended December 31, 2003, 2002 and 2001 amounted to \$113.6 million, \$63.7 million and \$42.1 million, respectively.

Based on the licenses existing at December 31, 2003, the estimated amortization expense is \$149.5 million during 2004, \$145.3 million during 2005, \$140.7 million during 2006, \$106.6 million during 2007, \$63.4 million during 2008 and \$97.6 million thereafter. Actual amortization expense to be reported in future periods could differ from these estimates as a result of new intangible assets acquisitions, changes in useful lives and other relevant factors.

The following table summarizes GSM-900/1800 telecommunication licenses held by the Group at December 31, 2003:

| License region | GSM-900 | | GSM-1800 | |
|---|----------------|-------------------|----------------|-------------------|
| | Licensee | Expiry date | Licensee | Expiry date |
| Moscow License Area | | | | |
| Moscow | MTS OJSC | April 28, 2008 | MTS OJSC | April 28, 2008 |
| Moscow Region | MTS OJSC | April 28, 2008 | MTS OJSC | April 28, 2008 |
| St. Petersburg License Area | | | | |
| St. Petersburg | Telecom XXI | April 28, 2008 | Telecom XXI | April 28, 2008 |
| Leningrad Region | Telecom XXI | April 28, 2008 | Telecom XXI | April 28, 2008 |
| Regional License Areas European Russia | | | | |
| Adygeya Republic | Kuban-GSM | April 28, 2008 | Kuban-GSM | April 28, 2008 |
| Arkhangelsk | Telecom XXI | April 28, 2008 | Telecom XXI | April 28, 2008 |
| Bashkortostan Republic | BM Telecom | August 22, 2007 | BM Telecom | August 22, 2007 |
| Belgorod | MTS OJSC | April 28, 2008 | MTS OJSC | April 28, 2008 |
| Belgorod | ReCom | May 15, 2008 | | |
| Bryansk | ReCom | May 15, 2008 | MTS OJSC | April 28, 2008 |
| Chuvashia Republic ⁽¹⁾ | MTS OJSC | December 30, 2013 | MTS OJSC | December 30, 2013 |
| Dagestan Republic ⁽¹⁾ | MTS OJSC | December 30, 2013 | MTS OJSC | December 30, 2013 |
| Ivanovo | MTS OJSC | April 28, 2008 | MTS OJSC | April 28, 2008 |
| Ingushetia Republic ⁽¹⁾ | MTS OJSC | December 30, 2013 | MTS OJSC | December 30, 2013 |
| Kabardino-Balkar Republic ⁽¹⁾ | | | MTS OJSC | December 30, 2013 |
| Kaliningrad | Telecom XXI | April 28, 2008 | Telecom XXI | April 28, 2008 |
| Kalmykia Republic ⁽¹⁾ | BIT | January 25, 2011 | MTS OJSC | December 30, 2013 |
| Kaluga | MTS OJSC | April 28, 2008 | MTS OJSC | April 28, 2008 |
| Karachaevo-Cherkessia Republic ⁽¹⁾ | MTS OJSC | December 30, 2013 | MTS OJSC | December 30, 2013 |
| Karelia | Telecom XXI | April 28, 2008 | Telecom XXI | April 28, 2008 |
| Kirov | MTS OJSC | April 28, 2008 | MTS OJSC | April 28, 2008 |
| Komi Republic | MTS OJSC | August 22, 2007 | MTS OJSC | April 28, 2008 |
| Komi-Permyatsk ⁽¹⁾ | MTS OJSC | April 28, 2008 | MTS OJSC | April 28, 2008 |
| Kostroma | MTS OJSC | April 28, 2008 | MTS OJSC | April 28, 2008 |
| Krasnodar Region | Kuban-GSM | May 30, 2007 | Kuban-GSM | May 30, 2007 |
| Kursk | ReCom | May 15, 2008 | MTS OJSC | April 28, 2008 |
| Lipetsk | MTS OJSC | April 28, 2008 | MTS OJSC | April 28, 2008 |
| Lipetsk | ReCom | May 15, 2008 | | |
| Mari-El Republic ⁽¹⁾ | Mar Mobile GSM | January 15, 2012 | Mar Mobile GSM | January 15, 2012 |

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| | | | | |
|--|--------------|--------------------|--------------|----------------------------------|
| Mordovia Republic ⁽¹⁾ | MTS OJSC | December 30, 2013 | MTS OJSC | December 30, 2013 |
| Murmansk | Telecom XXI | April 28, 2008 | Telecom XXI | April 28, 2008 |
| Nenetsk region | Telecom XXI | April 28, 2008 | Telecom XXI | April 28, 2008 |
| Nizhny Novgorod | MTS OJSC | April 28, 2008 | MTS OJSC | April 28, 2008 |
| Novgorod | Telecom XXI | April 28, 2008 | Telecom XXI | April 28, 2008 |
| Orel | MTS OJSC | April 28, 2008 | MTS OJSC | April 28, 2008 |
| Orel | ReCom | May 15, 2008 | | |
| Orenburg | MTS OJSC | April 28, 2008 | MTS OJSC | April 28, 2008 |
| Perm | MTS OJSC | April 28, 2008 | MTS OJSC | April 28, 2008 |
| Rostov | Dontelecom | July 1, 2005 | Dontelecom | July 1, 2005 |
| Pskov | MTS OJSC | October 1, 2006 | | |
| Pskov | Telecom XXI | April 28, 2008 | Telecom XXI | April 28, 2008 |
| Ryazan | MTS OJSC | April 28, 2008 | MTS OJSC | April 28, 2008 |
| Samara ⁽¹⁾ | MTS OJSC | December 30, 2012 | MTS OJSC | December 30, 2012 |
| Saratov | MTS OJSC | July 11, 2012 | MTS OJSC | July 11, 2012 |
| Severnaya Osetia-Alania Republic | | | MTS OJSC | December 30, 2013 ⁽¹⁾ |
| Smolensk | MTS OJSC | April 28, 2008 | MTS OJSC | April 28, 2008 |
| Stavropol region ⁽¹⁾ | MTS OJSC | December 30, 2013 | MTS OJSC | December 30, 2013 |
| Tambov | MTS OJSC | April 28, 2008 | MTS OJSC | April 28, 2008 |
| Tatarstan Republic | TAIF Telcom | June 26, 2007 | TAIF Telcom | June 26, 2007 |
| Tula | MTS OJSC | April 28, 2008 | MTS OJSC | April 28, 2008 |
| Tver | MTS OJSC | April 28, 2008 | MTS OJSC | April 28, 2008 |
| Udmurt Republic | MTS OJSC | April 28, 2008 | MTS OJSC | April 28, 2008 |
| Udmurt Republic | UDN-900 | February 21, 2007 | | |
| Ulyanovsk ⁽¹⁾ | | | MTS OJSC | December 30, 2013 |
| Vladimir | MTS OJSC | April 28, 2008 | MTS OJSC | April 28, 2008 |
| Vologda | Telecom XXI | April 28, 2008 | Telecom XXI | April 28, 2008 |
| Voronezh | ReCom | May 15, 2008 | MTS OJSC | April 28, 2008 |
| Yaroslavl | MTS OJSC | April 28, 2008 | MTS OJSC | April 28, 2008 |
| Asian Russia | | | | |
| Altai Region | MTS-Barnaul | September 8, 2010 | MTS-Barnaul | September 8, 2010 |
| Altai Republic | SCS-900 | July 19, 2011 | MTS OJSC | December 30, 2013 |
| Amur region | ACC | January 10, 2007 | ACC | January 10, 2007 |
| Chelyabinsk | MTS OJSC | April 28, 2008 | MTS OJSC | April 28, 2008 |
| Chukotka ⁽¹⁾ | BIT | July 19, 2011 | | |
| Evenkia autonomous region ⁽¹⁾ | MTS OJSC | December 30, 2013 | MTS OJSC | December 30, 2013 |
| Kemerovo ⁽¹⁾ | MTS OJSC | December 30, 2013 | MTS OJSC | December 30, 2013 |
| Khabarovsk | FECS-900 | January 10, 2007 | FECS-900 | January 10, 2007 |
| Khakassia Republic | Sibchallenge | September 13, 2011 | Sibchallenge | September 13, 2011 |
| Khanty Mansiysk region | MTS OJSC | April 28, 2008 | MTS OJSC | April 28, 2008 |
| Krasnoyarsk region | Sibchallenge | December 21, 2010 | Sibchallenge | September 13, 2011 |
| Kurgan | MTS OJSC | April 28, 2008 | MTS OJSC | April 28, 2008 |
| Novosibirsk | SCS-900 | February 21, 2007 | SCS-900 | February 21, 2007 |
| Omsk | MSS | December 20, 2006 | MSS | December 20, 2006 |
| Sakhalin ⁽¹⁾ | BIT | July 19, 2011 | | |
| Sverdlovsk Region | Uraltel | March 1, 2006 | Uraltel | March 1, 2006 |
| Sverdlovsk Region | | | MTS OJSC | April 28, 2008 |

| | | | | |
|--------------------------------------|--------------|-------------------|--------------|--------------------|
| Taimyr autonomous region | Sibchallenge | December 21, 2010 | Sibchallenge | September 13, 2011 |
| Tomsk | TSS | June 5, 2008 | TSS | June 5, 2008 |
| Tyumen | MTS OJSC | April 28, 2008 | MTS OJSC | April 28, 2008 |
| Tyva Republic ⁽¹⁾ | BIT | July 19, 2011 | MTS OJSC | December 30, 2013 |
| Yamalo-Nenetsk region ⁽¹⁾ | MTS OJSC | April 28, 2008 | MTS OJSC | April 28, 2008 |
| Ukraine | | | | |
| Ukraine | UMC | December 3, 2013 | UMC | December 3, 2013 |

⁽¹⁾ Our regional license areas in which the licensee has not commenced commercial operations as at December 31, 2003. Each of the Group's licenses, except the licenses covering the Moscow license area, contains a requirement for service to be commenced and for subscriber number and territorial coverage targets to be achieved by a specified date. The Group has met these targets or received extensions to these dates in those regional license areas in which the Group has not commenced operations. The management believes that the Group is in compliance with all material terms of our licenses.

The Group's operating licenses do not provide for automatic renewal. The Group has limited experience with the renewal of its existing licenses. However, management believes that licenses required for the Group's operations will be renewed upon expiration.

22. COMMITMENTS AND CONTINGENCIES

Capital Commitments As of December 31, 2003, MTS had executed non-binding purchase agreements in the amount of approximately \$266.1 million to subsequently acquire property, plant and equipment.

Operating lease The Group has entered into lease agreements of space for telecommunication equipment and offices, which expire in various years up to 2052. Rental expenses under these operating leases of \$32.0 million, \$15.6 million and \$9.5 million for the years ended December 31, 2003, 2002 and 2001, respectively, are included in operating expenses in the accompanying statements of operations. Future minimum lease payments due under non-cancelable leases at December 31, 2003 were:

| | |
|---|-----------|
| Payments due in the year ended December 31, | |
| 2004 | \$ 10,248 |
| 2005 | 4,497 |
| 2006 | 2,924 |
| 2007 | 1,932 |
| 2008 | 1,376 |
| Thereafter | 12,389 |
| | <hr/> |
| Total | \$ 33,366 |
| | <hr/> |

Operating licenses When MTS commenced its operations in 1994, licenses generally contained certain provisions for unspecified fees to be paid for utilization of frequencies. Most of MTS current licenses now provide for payments to be made for finance telecommunication infrastructure

improvements, which in the aggregate could total approximately \$110.2 million, as at December 31, 2003. However, a decision on the terms and conditions of such payments has not been finalized. Accordingly, MTS has not made any payments to date pursuant to any of current operating licenses. Further, management believes that MTS will not be required to make any such payments. If such payments would be required in the future, management believes that it would be limited to purchasing certain equipment for its own use in the related license area. In relation to these uncertainties, MTS has not recorded a contingent liability in the accompanying financial statements.

Provision for doubtful accounts The increase in the provision for doubtful accounts to \$32.6 million at December 31, 2003 from \$7.0 million at December 31, 2002 was primarily attributable to a \$16.7 million provision related to dealer and subscriber fraud. Certain dealers and subscribers together fraudulently exploited billing time lags by placing a sizeable amount of domestic and international long-distance calls using subscriber accounts registered under false names. MTS discovered the fraud in March 2003 and has taken measures to prevent further fraud of this nature.

Issued guarantees As of December 31, 2003, the Group has issued guarantees to third party banks for the loans taken by Invest-Svyaz-Holding, a shareholder of the Group and a wholly owned subsidiary of Sistema for a total amount of \$21.6 million (see also Note 18 Related Parties). The Group issued additional guarantees on behalf of MTS-Belarus, an equity investee, for the total amount of \$14.5 million. Under these guarantees the Group could be potentially liable for a maximum amount of \$36.1 million in case of the borrower's default under the obligations. The guarantees expire by August 2005.

As of December 31, 2003, no event of default has occurred under any of the guarantees issued by the Group.

Contingencies The Russian economy continues to display certain traits consistent with that of an emerging market. These characteristics have in the past included higher than normal inflation, insufficient liquidity of the capital markets, and the existence of currency controls which cause the national currency to be illiquid outside of Russia. The continued success and stability of the Russian economy will be subject to the government's continued actions with regard to supervisory, legal, and economic reforms.

On January 1, 2004, a new Law on telecommunications came into effect in Russia. The law sets the legal basis for the telecommunications business in Russia and defines the status that state bodies have in the telecommunications sector. The Group cannot predict with any certainty how the new law will affect MTS. The new law creates a new interconnect pricing regime in 2004 that should be more transparent and unified and it creates a universal service charge calculated as a percentage of revenue which will be introduced from 2005. The new law may increase the regulation of the MTS's operations and until the time when appropriate regulations consistent with the new law are promulgated, there will be a period of confusion and ambiguity as regulators interpret the legislation.

Russia currently has a number of laws related to various taxes imposed by both federal and regional governmental authorities. Applicable taxes include value added tax (VAT), corporate income tax (profits tax), a number of turnover-based taxes, and payroll (social) taxes, together with others. Laws related to these taxes have not been in force for significant periods, in contrast to more developed market economies; therefore, the government's implementation of these regulations is often inconsistent or nonexistent. Accordingly, few precedents with regard to tax rulings have been

established. Tax declarations, together with other legal compliance areas (for example, customs and currency control

matters), are subject to review and investigation by a number of authorities, which are enabled by law to impose extremely severe fines, penalties and interest charges. These facts create tax risks in Russia that is more significant than typically found in countries with more developed tax systems.

In recent years, the Russian government has initiated revisions of the Russian tax system. Effective January 1, 1999, the first part of the Tax Code was enacted. Effective January 1, 2001, the second part of the Tax Code was enacted and effective January 1, 2002 new regulations, relating to federal income tax were enacted. The new tax system is generally intended to reduce the number of taxes, the overall tax burden on businesses, and to simplify the tax laws.

Generally, tax declarations remain open and subject to inspection for a period of three years following the tax year. As of December 31, 2003, substantially all of the tax declarations of the Group for the preceding three years were open to further review.

In the ordinary course of business, MTS may be party to various legal and tax proceedings, and subject to claims, certain of which relate to the developing markets and evolving fiscal and regulatory environments in which MTS operates. In the opinion of management, the MTS's liability, if any, in all pending litigation, other legal proceeding or other matters, will not have a material effect upon the financial condition, results of operations or liquidity of MTS.

Management believes that it has adequately provided for tax liabilities in the accompanying consolidated financial statements; however, the risk remains that relevant authorities could take differing positions with regard to interpretive issues and the effect could be significant.

23. SEGMENT INFORMATION

SFAS No. 131, Disclosures about Segments of an Enterprise and Related Information, established standards for reporting information about operating segments in financial statements. Operating segments are defined as components of an enterprise engaging in business activities about which separate financial information is available that is evaluated regularly by the chief operating decision maker or group in deciding how to allocate resources and in assessing performance. The Group's business is organized based on geographical operations. Management of the Group regularly reviews certain operational and statistical information by license area, however currently no discrete financial information is available on this basis, therefore the performance is measured and decisions about resource allocation are made by management based on operating income by legal entities as an aggregate of the license area information.

Intercompany eliminations presented below consist primarily of the following items: intercompany sales transactions, elimination of gross margin in inventory and other intercompany transactions conducted under the normal course of operations.

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At December 31, 2003, the Group has several operating segments, of which three are reportable segments MTS OJSC (merged with Rosico), UMC and Telecom XXI. UMC is located in Ukraine whereas all other operating segments are located in RF.

| | Year ended December 31, | | |
|---|-------------------------|---------------------|-------------------|
| | 2003 | 2002 | 2001 |
| Revenue: | | | |
| MTS OJSC | \$ 1,471,198 | \$ 1,044,877 | \$ 831,857 |
| UMC ⁽¹⁾ | 394,038 | | |
| Telecom XXI | 210,460 | 79,166 | |
| Other | 601,171 | 291,143 | 64,780 |
| Intercompany eliminations | (130,669) | (53,430) | (3,390) |
| Total revenue | \$ 2,546,198 | \$ 1,361,756 | \$ 893,247 |
| Depreciation and amortization: | | | |
| MTS OJSC | \$ 199,946 | \$ 144,004 | \$ 114,923 |
| UMC ⁽¹⁾ | 66,392 | | |
| Telecom XXI | 36,782 | 17,343 | |
| Other | 114,484 | 48,333 | 18,395 |
| Intercompany eliminations | (1,688) | | |
| Total depreciation and amortization | \$ 415,916 | \$ 209,680 | \$ 133,318 |
| Operating income: | | | |
| MTS OJSC | \$ 527,837 | \$ 365,698 | \$ 316,894 |
| UMC ⁽¹⁾ | 131,704 | | |
| Telecom XXI | 80,632 | 2,331 | |
| Other | 198,176 | 100,531 | 8,039 |
| Intercompany eliminations | (15,751) | (4,189) | (824) |
| Total operating income | \$ 922,598 | \$ 464,371 | \$ 324,109 |
| Total operating income | \$ 922,598 | \$ 464,371 | \$ 324,109 |
| Currency exchange and translation losses (gains) | (693) | 3,474 | 2,264 |
| Interest income | (18,076) | (8,289) | (11,829) |
| Interest expense | 106,551 | 44,389 | 6,944 |
| Other (income)/expenses | 3,420 | (2,454) | (2,672) |
| Income before provision for income taxes and minority interest | 831,396 | 427,251 | 329,402 |
| Additions to long-lived assets: | | | |
| MTS OJSC | \$ 389,446 | \$ 360,598 | \$ 415,336 |
| UMC ⁽¹⁾ | 900,465 | | |
| Telecom XXI | 174,128 | 175,361 | |
| Other | 566,475 | 169,378 | 176,211 |
| Total additions to long-lived assets | \$ 2,030,514 | \$ 705,337 | \$ 591,547 |

(1) Acquired in March 2003.

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| | As of December 31, | |
|---------------------------|---------------------------|---------------------|
| | 2003 | 2002 |
| Long-lived assets: | | |
| MTS OJSC | \$ 1,454,570 | \$ 1,288,062 |
| UMC ⁽¹⁾ | 648,812 | |
| Telecom XXI | 288,256 | 150,533 |
| Other | 899,920 | 435,236 |
| Intercompany eliminations | (19,702) | (4,189) |
| | <u>\$ 3,271,856</u> | <u>\$ 1,869,642</u> |
| Total long-lived assets | | |
| | <u>\$ 3,271,856</u> | <u>\$ 1,869,642</u> |
| Total assets: | | |
| MTS OJSC | \$ 3,245,545 | \$ 1,908,018 |
| UMC ⁽¹⁾ | 394,470 | |
| Telecom XXI | 296,042 | 130,011 |
| Other | 558,091 | 557,801 |
| Intercompany eliminations | (268,797) | (330,867) |
| | <u>\$ 4,225,351</u> | <u>\$ 2,264,963</u> |
| Total assets | | |
| | <u>\$ 4,225,351</u> | <u>\$ 2,264,963</u> |

(1) Acquired in March 2003.

24. SUBSEQUENT EVENTS

Acquisition of additional interests In March 2004, MTS acquired an additional 11% shares in SCS-900. The value of consideration equals \$8.5 million. SCS provides GSM mobile services in the Novosibirsk region and Altay Republic.

On April 16, 2004, MTS acquired an additional 40% stake in FECS-900 from Far East Telecommunications Company OJSC, increasing its ownership in the company to 100%. The value of consideration equals \$8.3 million. FECS-900 provides GSM-900/1800 services under the MTS brand in the Khabarovsk region.

On April 13, 2004 MTS acquired an additional 7.5% stake in MSS from Sibirtelecom OJSC, increasing its ownership in the company to 91.0%. The value of consideration paid equals \$2.2 million. MSS provides GSM-900/1800 services under MTS brand in the Omsk region.

The purchase price allocation for these acquisitions has not been finalized at the date of these statements.

Payment to Cetel B.V. On March 17, 2004, MTS settled a balance of \$27.5 million due to Cetel B.V., a wholly owned subsidiary of Deutsche Telekom AG, due for UMC acquisition (see Note 4 Business Acquired).

License expansions In December 2003, at the open tender organized by the State Committee for Radio Frequencies and the Ministry of Defense MTS acquired additional GSM-900/1800 frequency licenses to operate in 11 new regions of Russia. MTS has also received 900 MHz license extensions to existing licenses in several regions. The term of the 900/1800 MHz GSM license for the Moscow Region has been extended until December 2008.

Total purchase consideration paid for the licenses and extensions identified above was less than \$0.1 million.

Additional loan facility In April 2004, the Group entered into a short-term loan facility with Credit Suisse First Boston International in the amount of \$200.0 million. The proceeds were used to repay the floating rate notes. Amounts outstanding under the loan facility agreement bear interest at LIBOR + 2.25% per annum.

Redemption of the floating rate notes On May 5, 2004 the Group redeemed all of the outstanding \$300.0 million floating rate notes, issued on August 5, 2003 in the principal amount plus accrued interest thereon to the date of redemption.

UMC During 2003, MTS acquired 100% of the outstanding voting interest of UMC (see also Note 4 Business Acquisition) from various parties. On June 7, 2004, the General Prosecutor of Ukraine filed a claim against MTS and others in the Kiev Commercial Court seeking to unwind the sale by Ukrtelecom of its 51% stake in UMC to MTS. The complaint also seeks an order that would prohibit MTS from alienating 51% of its stake in UMC until the claim is resolved. As of the date of these statements MTS has started the process of evaluating the claim. The Company believes that it acquired UMC in full compliance with Ukrainian law and intends to vigorously defend its acquisition of UMC.

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POLSKA TELEFONIA CYFROWA SP. Z O.O.

**CONSOLIDATED FINANCIAL STATEMENTS
TOGETHER WITH REPORTS OF
INDEPENDENT PUBLIC ACCOUNTANTS
FOR THE YEARS ENDED
DECEMBER 31, 2003 (UNAUDITED), DECEMBER 31, 2002 (UNAUDITED)
AND DECEMBER 31, 2001**

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POLSKA TELEFONIA CYFROWA SP. Z O.O.

**CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEARS ENDED
DECEMBER 31, 2003 (UNAUDITED), 2002 (UNAUDITED)
AND 2001**

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This report is a copy of a previously issued Andersen affiliate report and the Andersen affiliate has not reissued the report.

REPORT OF INDEPENDENT PUBLIC ACCOUNTANTS

To the Supervisory Board of Polska Telefonia Cyfrowa Sp. z o.o.

We have audited the accompanying consolidated balance sheets of Polska Telefonia Cyfrowa Sp. z o.o. (a Polish limited liability company) and its subsidiaries as of December 31, 2001, 2000 and 1999, and the related consolidated statements of operations, consolidated statements of changes in equity and consolidated statements of cash flows for each of the consecutive three years ended December 31, 2001. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of Polska Telefonia Cyfrowa Sp. z o.o. and its subsidiaries, as at December 31, 2001, 2000 and 1999, and the results of their operations and their cash flows for each of the consecutive three years ended December 31, 2001 in accordance with Statements of International Accounting Standards ("IAS") issued by the International Accounting Standards Board ("IASB").

Accounting practices used by the Company in preparing the accompanying consolidated financial statements conform with IAS but do not conform with accounting principles generally accepted in the United States ("US GAAP"). A description of these differences and a reconciliation of net income and shareholders' equity from accounting principles generally accepted under IAS and US GAAP are set forth in Note 32.

As explained in Note 4.1.b to the consolidated financial statements, the Company has given retrospective effect to the change in its revenue recognition policy relating to multiple-element contracts.

Arthur Andersen Sp. z o.o.

Warsaw, Poland
March 1, 2002

POLSKA TELEFONIA CYFROWA SP. Z O.O. AND SUBSIDIARIES**Consolidated Income Statements**

for the years ended December 31, 2003, December 31, 2002 and December 31, 2001

(in thousands of PLN)

| | Notes | Year ended December 31, 2003 | Year ended December 31, 2002 | Year ended December 31, 2001 |
|---------------------------------------|-------|------------------------------------|------------------------------------|------------------------------------|
| Net sales | 6 | 5,601,277 | 4,929,824 | 4,344,896 |
| Cost of sales | 7 | (3,594,121) | (2,989,193) | (2,727,437) |
| Gross margin | | 2,007,156 | 1,940,631 | 1,617,459 |
| Operating expenses | 7 | (845,788) | (790,115) | (785,429) |
| Operating profit | | 1,161,368 | 1,150,516 | 832,030 |
| Non-operating items | | | | |
| Interest and other financial income | 8 | 336,577 | 266,454 | 316,616 |
| Interest and other financial expenses | 9 | (763,233) | (848,132) | (694,546) |
| Profit before taxation | | 734,712 | 568,838 | 454,100 |
| Taxation charge | 10 | (80,790) | (222,362) | (26,879) |
| Net profit for the year | | 653,922 | 346,476 | 427,221 |

The accompanying notes are an integral part of these consolidated financial statements.

POLSKA TELEFONIA CYFROWA SP. Z O.O. AND SUBSIDIARIES**Consolidated Balance Sheets**

as at December 31, 2003 and December 31, 2002

(in thousands of PLN)

| | Notes | As at December 31, 2003 | As at December 31, 2002 |
|---|-------|-------------------------------|-------------------------------|
| Current assets | | | |
| Cash and cash equivalents | 26 | 20,880 | 54,412 |
| Short-term investments and other financial assets | 11 | 110,538 | 12,143 |
| Debtors and prepayments | 12 | 751,122 | 620,749 |
| Inventory | 13 | 185,866 | 234,545 |
| | | <u>1,068,406</u> | <u>921,849</u> |
| Long-term assets | | | |
| Property, plant and equipment | 14 | 3,023,831 | 3,438,686 |
| Intangible fixed assets | 15 | 2,829,980 | 2,651,130 |
| Financial assets | 16 | 248,373 | 171,288 |
| Deferred costs and other long-term assets | 17 | 122,880 | 82,091 |
| | | <u>6,225,064</u> | <u>6,343,195</u> |
| Total assets | | <u>7,293,470</u> | <u>7,265,044</u> |
| Current liabilities | | | |
| Accounts payable | 18 | 290,405 | 285,277 |
| Amounts due to State Treasury | 18 | 69,385 | 57,756 |
| Interest-bearing liabilities | 18 | 101,445 | 121,122 |
| Accruals | 20 | 220,595 | 185,569 |
| Deferred income and other liabilities | 18 | 211,787 | 224,358 |
| | | <u>893,617</u> | <u>874,082</u> |
| Long-term liabilities | | | |
| Interest-bearing liabilities | 19 | 3,811,750 | 4,583,365 |
| Non-interest-bearing liabilities | 19 | 118,357 | 165,159 |
| Deferred tax liability | 10 | 290,563 | 268,171 |
| Provisions for liabilities and charges | 20 | 91,952 | 21,740 |
| | | <u>4,312,622</u> | <u>5,038,435</u> |
| Total liabilities | | <u>5,206,239</u> | <u>5,912,517</u> |
| Capital and reserves | | | |
| Share capital | 21 | 471,000 | 471,000 |
| Additional paid-in capital | | 409,754 | 409,754 |
| Hedge reserve | | (3,262) | (86,649) |
| Accumulated profit | | 1,209,739 | 558,422 |
| | | <u>2,087,231</u> | <u>1,352,527</u> |
| Total equity and liabilities | | <u>7,293,470</u> | <u>7,265,044</u> |



The accompanying notes are an integral part of these consolidated financial statements.

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POLSKA TELEFONIA CYFROWA SP. Z O.O. AND SUBSIDIARIES**Consolidated Statements of Cash Flows**

for the years ended December 31, 2003, December 31, 2002 and December 31, 2001
(in thousands of PLN)

| | Year ended December 31, 2003 | Year ended December 31, 2002 | Year ended December 31, 2001 |
|--|------------------------------------|------------------------------------|------------------------------------|
| CASH FLOWS FROM OPERATING ACTIVITIES: | | | |
| Net profit before taxation | 734,712 | 568,838 | 454,100 |
| Adjustments for: | | | |
| Depreciation and amortization | 942,272 | 909,983 | 850,572 |
| Charge to provision and write-offs of doubtful debtors | 33,242 | 29,224 | 67,626 |
| Charge to provision for inventory | 4,136 | 7,333 | 11,151 |
| Charge to provision for construction in progress | 13,223 | | |
| Other provisions long-term | 25,762 | 1,089 | 7,744 |
| Foreign exchange (gains)/losses, net and changes in financial instruments fair value | 90,067 | 145,394 | (91,609) |
| Loss/(gain) on disposal of tangibles and intangibles | 12,874 | 10,804 | (1,582) |
| Interest expense, net | 336,589 | 436,283 | 469,539 |
| Operating cash flows before working capital changes | 2,192,877 | 2,108,948 | 1,767,541 |
| Decrease/(increase) in inventory | 44,543 | (74,764) | 31,025 |
| Increase in debtors, prepayments and deferred cost | (174,761) | (101,165) | (129,383) |
| Increase in trade payables and accruals | 124,038 | 90,529 | 24,560 |
| Cash from operations | 2,186,697 | 2,023,548 | 1,693,743 |
| Interest paid | (501,754) | (482,978) | (450,820) |
| Interest received | 14,798 | 17,182 | 15,213 |
| Income taxes paid | (98,357) | (1,618) | (1,325) |
| Realization of financial instruments | (78,784) | (32,973) | (94,411) |
| Net cash from operating activities | 1,522,600 | 1,523,161 | 1,162,400 |
| CASH FLOWS USED IN INVESTING ACTIVITIES: | | | |
| Purchases of intangible fixed assets | (127,274) | (257,314) | (1,372,058) |
| Purchases of tangible fixed assets | (287,811) | (379,923) | (1,128,118) |
| Proceeds from short-term investments | | 91,456 | 199,699 |
| Proceeds from sale of equipment and intangibles | 11,201 | 18,344 | 25,250 |
| Net cash used in investing activities | (403,884) | (527,437) | (2,275,227) |
| CASH FLOWS (USED IN)/FROM FINANCING ACTIVITIES: | | | |
| (Repayment of)/net proceeds from Bank Credit Facilities | (468,708) | (322,201) | 1,288,594 |
| Repayment of Loan Facility | | | (836,158) |
| (Redemption of)/proceeds from the Notes | (709,621) | (655,622) | 704,141 |
| Net cash (used in)/from financing activities | (1,178,329) | (977,823) | 1,156,577 |
| Net (decrease)/increase in cash and cash equivalents | (59,613) | 17,901 | 43,750 |
| Effect of foreign exchange changes on cash and cash equivalents | 114 | (12) | (362) |
| Cash and cash equivalents at beginning of period (see Note 26) | 54,400 | 36,511 | (6,877) |
| Cash and cash equivalents at end of period (see Note 26) | (5,099) | 54,400 | 36,511 |



The accompanying notes are an integral part of these consolidated financial statements.

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POLSKA TELEFONIA CYFROWA SP. Z O.O. AND SUBSIDIARIES

Consolidated Statements of Changes in Equity

for the years ended December 31, 2003, December 31, 2002 and December 31, 2001

(in thousands of PLN)

| | Share Capital | Additional paid-in capital | Hedge reserve | Accumulated profit/(loss) | Total |
|--|------------------|----------------------------------|------------------|------------------------------|------------------|
| Balance as at January 1, 2001 | 471,000 | 409,754 | | (193,807)* | 686,947 |
| Effects of adopting IAS 39 | | | | (21,468) | (21,468) |
| Fair value losses on cash flow hedge, net of tax | | | (96,955) | | (96,955) |
| Net profit for the period | | | | 427,221 | 427,221 |
| Balance as at December 31, 2001 | 471,000 | 409,754 | (96,955) | 211,946 | 995,745 |
| Balance as at January 1, 2002 | 471,000 | 409,754 | (96,955) | 211,946 | 995,745 |
| Cash flow hedge: | | | | | |
| net fair value loss, net of tax | | | (17,717) | | (17,717) |
| reclassified and reported in net profit | | | 30,210 | | 30,210 |
| deferred tax on reclassified item | | | (8,459) | | (8,459) |
| deferred tax change in rates | | | 6,272 | | 6,272 |
| Net profit for the period | | | | 346,476 | 346,476 |
| Balance as at December 31, 2002 | 471,000 | 409,754 | (86,649) | 558,422 | 1,352,527 |
| Balance as at January 1, 2003 | 471,000 | 409,754 | (86,649) | 558,422 | 1,352,527 |
| Cash flow hedge: | | | | | |
| net fair value gain, net of tax | | | 75,886 | | 75,886 |
| hedging instrument replacement, net of tax | | | (7,833) | | (7,833) |
| reclassified and reported in net profit | | | 20,388 | | 20,388 |
| deferred tax on reclassified item | | | (5,505) | | (5,505) |
| deferred tax change in rates | | | 451 | | 451 |
| Net profit for the period | | | | 653,922 | 653,922 |
| Effect of subsidiary closing (see Note 2) | | | | (2,605) | (2,605) |
| Balance as at December 31, 2003 | 471,000 | 409,754 | (3,262) | 1,209,739 | 2,087,231 |

* The amount of PLN 193,807 representing accumulated deficit as at January 1, 2001 includes PLN 11,736 (decrease of accumulated deficit) of the revenue recognition retrospective adjustment.

The accompanying notes are an integral part of these consolidated financial statements.

POLSKA TELEFONIA CYFROWA SP. Z O.O. AND SUBSIDIARIES

Notes to the Consolidated Financial Statements

for the years ended December 31, 2003, December 31, 2002 and December 31, 2001

(in thousands of PLN)

1. Incorporation and Principal Activities

Polska Telefonia Cyfrowa Sp. z o.o. (the Company) is located in Warsaw, Al. Jerozolimskie 181 and was incorporated by the Notarial Deed dated December 20, 1995 and entered on the National Court Register kept by the District Court in Warsaw, XIX Economic Department of National Court Register, Entry No. KRS 0000029159.

The principal activities of the Company are providing cellular telephone communication services in accordance with the GSM 900 and 1800 licenses granted by the Minister of Communications and the sale of cellular telephones and accessories compatible with its cellular services. On December 20, 2000 the Minister of Communications granted the Company a license to provide telecommunication services according to the Universal Mobile Telecommunication System (UMTS) standard. The UMTS services should be implemented not earlier than on January 1, 2004 and not later than on January 1, 2006 (see Notes 2, 3.5 and 15).

The principal activities of the Company are not significantly seasonal or cyclical.

Authorization of the consolidated financial statements

These consolidated financial statements have been issued by the Company's Board of Directors on March 17, 2004.

2. Significant events in 2003

On January 20, 2003 the Company has been informed that Telekomunikacja Polska SA (TP SA) lodged cassation to the Supreme Court against the Antimonopoly Court's judgement relating to international traffic rates terminating in the Company's network. The Supreme Court rejected the cassation lodged by TP SA on March 9, 2004 (see also Note 4).

On February 12, 2003 the Company repurchased on the market the principal amount of EUR 3,000 thousand of the 10 7/8% Notes 1.5% of the total initial principal amount (see Note 19a).

On March 7, 2003 the Company repurchased on the market the principal amount of EUR 2,000 thousand of the 10 7/8% Notes 1.0% of the total initial principal amount (see Note 19a).

On June 30, 2003 the Company exercised its call option and repurchased the outstanding amount of 10 3/4% Notes at the principal value of USD 126,215 thousand (see Notes 3.2 and 19a).

On July 1, 2003 the Company was informed that Tele2 (a local operator) had placed a request to the Office for Telecommunication and Post Regulation (OTPR), the Regulator for the Telecommunication Market in Poland, for setting interconnection rates between Tele2 and the Company's network. On October 16, 2003 the Company and Tele2 signed an interconnection agreement, the rates agreed related to future interconnect traffic which are based on market rates.

POLSKA TELEFONIA CYFROWA SP. Z O.O. AND SUBSIDIARIES

Notes to the Consolidated Financial Statements

for the years ended December 31, 2003, December 31, 2002 and December 31, 2001

(in thousands of PLN)

2. Significant events in 2003 (cont.)

On July 10, 2003 the Company submitted a joint application with other operators to the OTRP to shift UMTS start obligations to January 2006 from January 2005, at the same time leaving the option to start in 2004 unchanged.

On September 9, 2003, the Regulator for the Telecommunication Market in Poland issued a favourable decision to move the UMTS launch deadlines. The Company is required to begin providing commercial UMTS services not later than January 1, 2006. At the same time, the Regulator modified certain provisions of the UMTS license as follows:

Moved the date for achieving a 20 percent population coverage of the UMTS services from December 31, 2005 to December 31, 2007.

Removed the requirement to achieve 40 percent population coverage.

On October 31, 2003 the Company has liquidated its wholly-owned subsidiary PTC International Finance B.V. (see Note 3.2) as a result of repurchasing of the remaining 10 3/4% Notes in June 2003.

In November 2003 the Polish Parliament approved the reduction of the corporate income tax rate from 27 percent to 19 percent for the year 2004 and thereafter.

In November 2003 the Company repurchased on the market the principal amount of EUR 2,000 thousand (0.7% of the total initial principal amount) of the 11 1/4% Notes and EUR 21,465 thousand of the 10 7/8% Notes (10.7% of the total initial principal amount) (see Note 19a).

In November 2003 the Company changed its Notes refinancing plans and effectively shortened the term of coupon payments exposure (see Notes 5a and 23).

In December 2003 the Company repurchased on the market the principal amount of EUR 12,508 thousand (4.2% of the total initial principal amount) of 11 1/4% Notes and EUR 4,420 thousand of 10 7/8% Notes (2.2% of the total initial principal amount) (see Note 19a). The Company will apply the Luxembourg Stock Exchange to delist the principal amount of the all repurchased in 2003 11 1/4% Notes and 10 7/8% Notes.

In December 2003, as a result of refinancing decision, the Company discontinued hedge accounting in relation to part of the coupon payments on EUR denominated Notes that will not occur (see Notes 5a and 23). As at December 31, 2003 PLN 55,115 previously recognized in equity and relating to coupons that, as a result of refinancing plans, are no longer expected to occur, has been reported as financial income in the income statement for 2003.

In December 2003, the Company received a decision of the Regulator for Telecommunication Market in Poland together with Antimonopoly Office that it is considered a significant operator on the Polish telecommunications market in relation to interconnect. This decision was not effective as at the day of the authorization of the consolidated financial statements as the Company is appealing against this decision. As at the day of the authorization of the consolidated financial statements no decision concerning the appeal has been issued.

POLSKA TELEFONIA CYFROWA SP. Z O.O. AND SUBSIDIARIES

Notes to the Consolidated Financial Statements

for the years ended December 31, 2003, December 31, 2002 and December 31, 2001

(in thousands of PLN)

3. Principal Accounting Policies

3.1. Basis of preparation

The Company maintains its accounting books in accordance with accounting principles and practices employed by enterprises in Poland as required by the Polish Accounting Standards (PAS). The accompanying consolidated financial statements reflect certain adjustments not reflected in the Company s statutory books to present these statements in accordance with International Financial Reporting Standards (IFRS) issued by the International Accounting Standards Board (IASB).

The differences between IFRS and generally accepted accounting principles in the United States (US GAAP) and their effect on the net results for the years ended December 31, 2003, 2002 and 2001 have been presented in Note 29 to these consolidated financial statements.

The consolidated financial statements have been prepared under the historical cost convention, modified by the revaluation of financial assets and financial liabilities held for trading or designated as hedging items.

The preparation of the consolidated financial statements in conformity with IFRS requires to use estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities as at the date of the consolidated financial statements and reported amounts of revenue and expenses during the reporting period. Although those estimates are based on the Management s best knowledge of current events and actions, actual results ultimately may differ from these estimates.

The IFRS standards that were mandatory as at December 31, 2003 were applied to these consolidated financial statements.

POLSKA TELEFONIA CYFROWA SP. Z O.O. AND SUBSIDIARIES

Notes to the Consolidated Financial Statements

for the years ended December 31, 2003, December 31, 2002 and December 31, 2001

(in thousands of PLN)

3. Principal Accounting Policies (cont.)

3.2. Group Accounting

The attached consolidated financial statements include the financial statements of Polska Telefonía Cyfrowa Sp. z o.o. and its wholly owned subsidiary PTC International Finance (Holding) B.V. (consolidated).

All intercompany balances and transactions are eliminated on consolidation.

On June 17, 1997, PTC International Finance B.V. was incorporated under the laws of the Netherlands for the purpose of issuing long term Notes. The Company acquired 40 fully paid shares with a par value of 1,000 Netherlands Guilders each, issued by PTC International Finance B.V. PTC International Finance B.V. had no subsidiaries of its own. In 2003 the Company liquidated its wholly-owned subsidiary PTC International Finance B.V. The subsidiary was incorporated for the purpose of issuing 10 ¾% Notes which were fully repurchased by the Company in June 2003 (see Notes 2 and 19a). As a result of the liquidation the net assets of the subsidiary have been transferred to the Company's consolidated income statement for the year ended December 31, 2003 as other financial income.

On November 5, 1999 PTC International Finance II S.A. was incorporated under the laws of Luxembourg and on November 16, 1999, PTC International Finance (Holding) B.V. was incorporated under the laws of the Netherlands for the purpose of issuing long term Notes. The Company acquired 40 fully paid shares with a par value of 1,000 Netherlands Guilders each, issued by PTC International Finance (Holding) B.V.

Additionally, the Company acquired 125 fully-paid shares with a par value of EUR 1,000 each issued by PTC International Finance II S.A. and contributed all of its shares except one, (owned by the Company, but held locally, due to legal requirements) to PTC International Finance (Holding) B.V. in exchange for 1 additional share of PTC International Finance (Holding) B.V. As a result, PTC International Finance II S.A. became a fully owned subsidiary of PTC International Finance (Holding) B.V. PTC International Finance II S.A. has no subsidiaries of its own.

3.3. Measurement Currency

The Company generates and expends cash through its operating activities mostly in Polish zloty (PLN). The majority of the Company's receivables, a large part of its short-term liabilities and some of long-term liabilities are denominated in PLN. Therefore, the Management has designated the PLN as the reporting (functional) currency of the Company. The accompanying consolidated financial statements are reported in PLN thousand (unless stated otherwise).

3.4. Property, plant and equipment

Property, plant and equipment are shown at historical cost less accumulated depreciation.

The costs of property, plant and equipment include borrowing costs - interests and foreign exchange differences to the extent that they are regarded as an adjustment to interest resulting from payments or valuation of liabilities financing the relevant property, plant and equipment acquisition or construction.

POLSKA TELEFONIA CYFROWA SP. Z O.O. AND SUBSIDIARIES**Notes to the Consolidated Financial Statements**

for the years ended December 31, 2003, December 31, 2002 and December 31, 2001

(in thousands of PLN)

3. Principal Accounting Policies (cont.)**3.4. Property, plant and equipment (cont.)**

Repairs and maintenance are charged to the income statement during the financial period in which they are incurred. The cost of major renovations is included in the carrying amount of the asset when it is expected that future economic benefits in excess of the originally assessed standard of performance of the existing asset will flow to the Company. The renovations are depreciated over the remaining useful life of the related asset.

Depreciation is calculated using the straight-line method over the estimated useful life of the assets. The following depreciation rates have been applied:

| | Annual rate in % | Estimated Useful Lives in years |
|--|-----------------------------|--|
| | <hr/> | <hr/> |
| Buildings under capital lease | 2.5% | 40 |
| Other buildings | 4.0% | 25 |
| Plant and equipment | 10.0 - 33.0% | 3 - 10 |
| Motor vehicles | 12.5 - 30.0% | 3 - 8 |
| Other | 10.0 - 30.0% | 3 - 10 |
| Leasehold improvements (operating lease) | | lease term |
| Land | not depreciated | |

Where the carrying amount of an asset is greater than its estimated recoverable amount, it is written down immediately to its recoverable amount.

Gains and losses on disposals are determined by comparing proceeds with carrying amount and are included in operating profit.

3.5. Intangible Fixed AssetsLicenses

Intangible fixed assets include three licenses (GSM 900, GSM 1800 and UMTS licenses), which the Company acquired from the Polish State. Telecommunication licenses are measured at cost less accumulated amortization. As the payments are deferred beyond normal credit terms the cost of license is the cash price equivalent. The difference between this amount and total payments is recognized as an interest expense over the period of credit unless it is capitalized to the license value during its development period. The cost of UMTS license includes also interests on liabilities financing the license acquisition and foreign exchange differences to the extent that they are regarded as an adjustment to interest. The licenses are amortized using the straight-line method over their estimated useful lives, being the period of usage from the date of operational start-up of the underlying service until the end of the licence term, i.e. GSM 900 license over 14.5 years (173 months), GSM 1800 license over 14.5 years (174 months) and UMTS license will be amortized over the period of usage from the date of the operational start-up of the underlying services. For further disclosure see Note 15.

POLSKA TELEFONIA CYFROWA SP. Z O.O. AND SUBSIDIARIES

Notes to the Consolidated Financial Statements

for the years ended December 31, 2003, December 31, 2002 and December 31, 2001

(in thousands of PLN)

3. Principal Accounting Policies (cont.)

3.5. Intangible Fixed Assets (cont.)

Computer software

Costs associated with maintaining computer software programmes are recognized as an expense as incurred. Costs that are directly associated with the development of identifiable and unique software products controlled by the Company and that will probably generate economic benefits exceeding costs beyond one year, are recognized as intangible assets.

Expenditure which enhances or extends the performance of computer software programmes beyond their original specifications is recognized as a capital improvement and added to the original cost of the software.

Computer software development costs recognized as assets are amortized using the straight-line method over their useful lives which is from 2 to 5 years for office software and from 1.2 to 10 years for network software.

Other intangible assets

Expenditure to acquire patents, trademarks and licences other than telecommunication licenses is capitalized and amortized using the straight-line method over their useful life, not exceeding 10 years.

3.6. Impairment of long-lived assets

Property, plant and equipment and intangible assets are reviewed for impairment losses whenever events or changes in circumstances indicate that the carrying amount may not be recoverable.

An impairment loss is recognized for the amount by which the carrying amount of the assets exceeds its recoverable amount which is the higher of an asset's net selling price and value in use.

Recoverable amount is estimated for an individual asset or, if this is not possible to do so, it is determined for the cash-generating unit to which asset belongs.

3.7. Debtors

Amounts due from debtors are measured at cost net of provisions for doubtful accounts. The provisions are based on specific amounts due where the realization is unlikely and on a general basis, calculated using historic collection experience.

3.8. Inventories

Inventories are stated at the lower of cost and net realizable value. The cost of inventories is principally assigned by using the weighted average cost formulas.

The Company writes down the cost of inventories to net realizable value. The costs of inventories become unrecoverable if those inventories are damaged, become wholly or partially obsolete or if their selling price declines.

The current or planned promotions do not affect provisions for handset inventory.

POLSKA TELEFONIA CYFROWA SP. Z O.O. AND SUBSIDIARIES

Notes to the Consolidated Financial Statements

for the years ended December 31, 2003, December 31, 2002 and December 31, 2001

(in thousands of PLN)

3. Principal Accounting Policies (cont.)

3.9. Leasing

The Company acquired its head-office premises under finance lease conditions and initially recognized assets and liabilities in the balance sheet at amounts equal to the present value of the minimum lease payments. In calculating the present value of the minimum lease payments the Company's incremental borrowing rate was used.

The interest element of the leasing finance cost is charged to the income statement over the lease period so as to produce a constant periodic interest rate on the remaining balance of the liability for each period.

The finance lease liability was initially measured at an amortized cost. After the bifurcation of embedded derivative (Index swaps see Notes 3.14 and 23) it has two components: main liability measured at amortized costs and the indexing (embedded derivative) measured at fair value. See also Property, plant and equipment held under capital lease in Note 14, Finance lease in Note 19c.

3.10. Borrowings

a. Notes

The Company is full and unconditional guarantor of the Notes issued by its subsidiaries (see Note 19a). The Notes were recognized at the fair value of consideration received less transaction costs plus the call options initial value. They are amortized according to effective interest rates. Any difference between the proceeds (net of transaction costs) and the redemption value including the initial value of options, if bifurcated, is recognized in the income statement over the period of the borrowings.

b. Bank Credit Facility

Bank Credit Facility was initially recognized at the proceeds received and is subsequently recorded at costs plus accrued interest (see Note 19b). Transaction costs attributable to the Bank Credit Facility are classified as intangible assets.

3.11 Advertising expenses

The Company charges the cost of advertising to expense as incurred.

3.12. Deferred income tax

Deferred income tax is calculated using the balance sheet liability method. Under the balance sheet liability method the expected tax effects of temporary differences are determined using the enacted tax rates and reported either as liabilities for taxes payable or assets representing the amounts of income taxes recoverable in future periods in respect of deductible temporary differences and the carry forward of unused tax losses and credits. Temporary differences are the differences between the carrying amount of an asset or a liability in the balance sheet and its tax base.

POLSKA TELEFONIA CYFROWA SP. Z O.O. AND SUBSIDIARIES

Notes to the Consolidated Financial Statements

for the years ended December 31, 2003, December 31, 2002 and December 31, 2001

(in thousands of PLN)

3. Principal Accounting Policies (cont.)

3.12. Deferred income tax (cont.)

Deferred tax assets are recognized for all deductible temporary differences to the extent that it is probable that taxable profit will be available against which the deductible temporary differences can be utilized.

3.13. Provisions

Provisions are recognized when the Company has a present legal or constructive obligation as a result of past events, it is probable that an outflow of resources will be required to settle the obligation, and a reliable estimate of the amount can be made. In 2003 the Company revised its estimation of the asset retirement obligation (see Note 20).

3.14. Derivatives

Derivative financial instruments are initially recognized in the balance sheet at cost and subsequently are remeasured at their fair value. The Company recognizes derivatives embedded in the host contracts and account for them as separate derivatives if economic characteristics and risks of the derivative are not closely related to the host contract.

The gain or loss resulting from remeasurement of derivatives to fair value is recognized in the income statement in the period they occur, unless the derivative is designated to hedge accounting.

The Company designates certain derivatives as hedge of the fair value of a recognized asset or liability (fair value hedge) or hedge of forecasted transactions (cash flow hedge) (see Note 5a). Changes in the fair value of derivatives that are designated and qualify as fair value hedges and that are highly effective, are recorded in the income statement, along with any changes in the fair value of the hedged asset or liability that is attributable to the hedged risk.

Changes in the fair value of derivatives that are designated and qualify as cash flow hedges and that are highly effective are recognized in shareholders' equity, net of tax effect. Amounts deferred in shareholders' equity are transferred to the income statement and classified as financial income or expense in the period when the hedged forecasted transactions accrue in the income statement.

Derivatives that are designated as cash flow hedges are regularly reviewed for the effectiveness and the gain or loss relating to the ineffective portion of the derivatives is recognized in the income statement immediately. In the following cases:

- hedge fails the effectiveness test,
- hedging instrument is sold, terminated or exercised,
- the Management decides to undesignate

the Company retains in equity the cumulative gains or losses which were previously reported directly in equity until the forecasted transaction occurs.

The reclassification to the income statement may take place when a previously forecasted transaction is no longer expected to occur.

POLSKA TELEFONIA CYFROWA SP. Z O.O. AND SUBSIDIARIES

Notes to the Consolidated Financial Statements

for the years ended December 31, 2003, December 31, 2002 and December 31, 2001

(in thousands of PLN)

3. Principal Accounting Policies (cont.)

3.14. Derivatives (cont.)

A derivative financial asset (or its portion) is derecognised if the Company loses control of the contractual rights that comprise the derivative financial asset (or its portion). A derivative financial liability (or its part) is removed from the balance sheet when, and only when, it is extinguished that is when the obligation specified in the contract is discharged, cancelled, or expires. For further disclosure see Note 23.

3.15. Measurement base for financial assets and liabilities

The fair value of derivatives held for trading is based on quoted market price at the balance sheet date. The fair value of cross-currency interest rate swaps (CC swaps) is calculated as the present value of estimated future cash flows. The fair value of forward foreign exchange contracts is determined using forward exchange market rates at the balance sheet date.

In assessing the fair value of non-traded derivatives and other financial instruments, the Company uses a variety of methods and makes assumptions that are based on market conditions existing at each balance sheet date. Option pricing models and estimated discounted value of future cash flows are used to determine the fair value of options split from the Notes and derivatives split from trade contracts.

All regular way purchases of financial assets are accounted for at the trade date.

POLSKA TELEFONIA CYFROWA SP. Z O.O. AND SUBSIDIARIES**Notes to the Consolidated Financial Statements**

for the years ended December 31, 2003, December 31, 2002 and December 31, 2001

(in thousands of PLN)

3. Principal Accounting Policies (cont.)**3.15. Measurement base for financial assets and liabilities (cont.)**

The table below presents the measurement categorization of financial assets and liabilities

| <i>Category</i> | <i>Balance sheet item</i> | <i>Measurement</i> |
|---|---|------------------------------------|
| <u>Financial assets</u> | | |
| Held for trading | Cash and cash equivalents, | Fair value |
| | Derivatives: Forward contracts, Note options, Index swaps, Currency options | Fair value model using market data |
| | Short-term investments | Amortized cost |
| Held to maturity Loans and receivables originated by the Company Hedging derivatives | Trade and other debtors | Original recorded cost |
| | CC swaps | Fair value model using market data |
| | Forward contracts | Fair value model using market data |
| <u>Financial liabilities</u> | | |
| Held for trading | Forward contracts | Fair value model using market data |
| | Index swaps | Fair value model using market data |
| Non-trading liabilities | License liabilities | Amortized cost |
| | Construction payables | Amortized cost |
| | Trade and other creditors | Amortized cost |
| | Long-term Notes | Amortized cost |
| | Finance lease | Amortized cost |
| | Bank Credit Facilities | Costs plus accrued interest |
| | Overdrafts | Costs plus accrued interest |
| | Accruals | Original recorded cost |
| | CC swaps | Fair value model using market data |
| Hedging derivatives | Forward contracts | Fair value model using market data |

3.16. Revenue recognition

Net sales consist of the value of sales (excluding value added tax) of goods and services in the normal course of business but exclude extraordinary disposals of inventory and other assets. Revenue is recognized when the services are provided or goods are shipped out. Sales allowances are accounted in the same period when the related portion of revenue is recognized.

The Company set criteria for the recognition of multiple-element transactions and their presentation in the IFRS consolidated financial statements as initiated by SAB 101 and further interpretations, including SAB 104.

POLSKA TELEFONIA CYFROWA SP. Z O.O. AND SUBSIDIARIES**Notes to the Consolidated Financial Statements**

for the years ended December 31, 2003, December 31, 2002 and December 31, 2001

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3. Principal Accounting Policies (cont.)**3.16. Revenue recognition (cont.)**

The multiple-element transactions with post-paid clients are classified as separable or non-separable contracts whereas the prepaid services are treated as separable transactions. The initial revenue from a multiple-element arrangement that is non-separable (handset price and activation fee) is deferred and recognized ratably over the average expected life of the customer. The direct cost of a product sold in this contract is also deferred in line with the revenue. The initial excess of cost over the revenue is immediately expensed. The revenue from separable multiple-element transactions and costs related to those transactions are recognized in the income statement as incurred.

The accounting treatment of revenues and relevant costs for multi-element arrangements is summarized in the following table:

Multi-element contract (handset, activation and telecommunication service)

| | Separable | Non-separable |
|----------------------|--|---|
| Accounting treatment | Activation represents up-front non-refundable fee. Handset is sold separately from the rest of the multi-element contract | Handset, activation and service are treated as multi-element contract that is non-separable. |
| Revenue recognition | Activation and handset revenue is recognized immediately, to the extent of cash received. | <i>Multiple Element Revenue:</i> Activation and handset revenue is deferred over average expected life of the customer. |
| Cost recognition | Cost of the activation card and handset is recognized immediately. | <i>Multiple Element Cost:</i> Cost of activation card and cost of handset equal to activation and handset revenue is deferred over average expected life of the customer. The excess of the costs over revenues is immediately expensed. |

Total sales price of handsets sold together with prepaid service cards is allocated on a pro-rata basis based on the relative fair value of the elements.

3.17. Transactions in foreign currencies

Foreign currency transactions are translated into measurement currency using the exchange rates prevailing at the dates of the transactions. Foreign exchange gains and losses resulting from settlement of such transactions and from translation of monetary assets and liabilities denominated in foreign currencies using the exchange rates prevailing at the end of the reporting period, are recorded in the income statement, except when capitalized to cost of qualifying assets.

The financial statements of the Company's subsidiary as being integral to the Company's operations are translated using the same standards and procedures as if the transactions had been those of the Company itself.

POLSKA TELEFONIA CYFROWA SP. Z O.O. AND SUBSIDIARIES

Notes to the Consolidated Financial Statements

for the years ended December 31, 2003, December 31, 2002 and December 31, 2001

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3. Principal Accounting Policies (cont.)

3.18. Capitalization of borrowing costs

Borrowing costs (including interest, foreign exchange gains and losses to the extent that they are regarded as an adjustment to interest, and the discount relating to the present value of license payments) that are attributable to the acquisition, construction or production of qualifying assets are capitalized as a part of the cost of those assets. The borrowing costs capitalized are only those incurred during the period of construction or production of qualifying assets.

3.19. Capital

Additional paid-in capital is classified in the equity as the probability of its payback to the shareholders is low and depends on certain law and contractual restrictions.

3.20. Presentation of Cash Flow Statement

The Company reconsidered the nature of the overdraft facility as an integral part of the Company's cash management and included the overdraft balance of PLN 25,979 and PLN 12 in cash and cash equivalents in consolidated statements of cash flows for the years ended December 31, 2003 and December 31, 2002, respectively.

3.21. New accounting standards

The Company will implement effective from January 1, 2004 the new revenue recognition policy, which adopts best industry practices, based on EITF 00-21. As a result of new revenue recognition policy implementation the revenue and costs related to sales of phones and activation will be recognized in income statement immediately when incurred, except for the contracts where fair value analysis will indicate revenue (and costs) deferral.

The Company is planning to implement changes to IFRS mandatory from January 1, 2005 and is currently analyzing the potential influence of new standards, including: IFRS 1 First-time Adoption of International Financial Reporting Standards (effective from January 1, 2004), IFRS 2 Share-based Payments, IAS 1 Presentation of Financial Statements, IAS 2 Inventories, IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors, IAS 10 Event After the Balance Sheet Date, IAS 15 Information Reflecting the Effects of Changing Prices (withdrawn as at January 1, 2005), IAS 16 Property, Plant and Equipment, IAS 17 Leases, IAS 21 The Effects of Changes in Foreign Exchange Rates, IAS 24 Related Party Disclosures, IAS 27 Consolidated and Separate Financial Statements, IAS 28 Accounting for Investments in Associates, IAS 31 Interests in Joint Ventures, IAS 32 Financial Instruments: Disclosure and Presentation, IAS 33 Earnings per Share, IAS 36 Impairment of Assets, IAS 38 Intangible Assets, IAS 39 Financial Instruments: Recognition and Measurement and IAS 40 Investment Property

As at the date of authorization of the consolidated financial statements the impact of the new standards has not yet been determined.

POLSKA TELEFONIA CYFROWA SP. Z O.O. AND SUBSIDIARIES

Notes to the Consolidated Financial Statements

for the years ended December 31, 2003, December 31, 2002 and December 31, 2001

(in thousands of PLN)

3. Principal Accounting Policies (cont.)

3.22. Change in estimates

In 2003 the Company changed its estimation of the asset retirement obligations. As a result of this change the Company increased the gross asset at the amount of PLN 44,449, the provision for retirement and restoration costs at the amount of PLN 59,629 and increased the depreciation costs by PLN 17,520 and interest expense by PLN 15,180 in the twelve month period ended December 31, 2003. The depreciation of the asset is calculated using the straight-line method over the useful life of the network equipment related assets.

3.23. Cash and cash equivalents

Cash comprises cash on hand and demand deposits. Cash equivalents are short term highly liquid investments that are readily convertible to known amount of cash and which are subject to insignificant risk of changes in value.

4. Events after the balance sheet date

On January 22, 2004 the Company concluded the selection process of vendor who will supply for the development of its third generation mobile network. Siemens Information and Communication Mobile Group was selected as a supplier of advanced UMTS technology, to be implemented in the Warsaw area.

On March 9, 2004 the Supreme Court rejected the cassation lodged by TP SA in 2003 against the Antimonopoly Court's judgement relating to international traffic rates terminating in the Company's network (see Note 2).

5. Financial risk management

The Company's treasury function is responsible for managing financial risk in accordance with the Company's hedging policy. Principle exposures and methods used by the Company to mitigate those exposures are described below.

The hedging policy approved by the Supervisory Board provides principles for overall financial risk management in the Company. This policy sets a framework within which the hedging activity should operate. However, it also allows some discretion in the precise hedging strategy to be adopted, to allow the treasury function to react to market conditions. According to the hedging policy, each year the treasury function prepares a hedging strategy regarding cash flow and balance sheet risk, which is later submitted to the Management Board and Supervisory Board's Finance Committee.

The ultimate responsibility for agreeing the details of the annual hedging strategy rests with the Management Board and the Supervisory Board's Finance Committee based on the recommendations of the Risk Management Committee consisting of the CFO, the Treasurer, the Controller and the Tax Manager. The responsibility for the execution of foreign exchange and interest rate hedge transactions, within the agreed strategy and in conformity with the hedging policy, rests with the treasury function of the Company. On the other hand, the Management Board and the Supervisory Board's Finance Committee must approve any actions taken to hedge cash flow and balance sheet risk.

POLSKA TELEFONIA CYFROWA SP. Z O.O. AND SUBSIDIARIES

Notes to the Consolidated Financial Statements

for the years ended December 31, 2003, December 31, 2002 and December 31, 2001

(in thousands of PLN)

5. Financial risk management (cont.)

a. Foreign exchange risk

A significant proportion of the financing liabilities of the Company is denominated in foreign currencies (EUR and USD). The financial risk management is aimed at managing to within acceptable limits both the volatility of cash flows, in PLN terms, arising from fluctuations in the exchange rate of the PLN against other currencies and the adverse effect of movements in exchange rates on the earnings and book value of the Company in PLN terms.

The treasury function manages the foreign exchange exposure based on forecasts of cash flows denominated in foreign currencies. These forecasts distinguish between forecasts of cash flows where there is significant certainty as to both the amount and timing of the cash flow (Committed Exposures) and those where there is some uncertainty about the amount and/or timing of the cash flow (Uncommitted Exposures).

Hedge activities are undertaken on the basis of short- to long-term cash flow forecasts provided by treasury function and business units of the Company. The Company normally seeks to cover Committed Exposures by range of means agreed by the Management Board and the Supervisory Board's Finance Committee on at least an annual basis, providing hedging can be obtained at acceptable cost. The Company may undertake actions to cover individually identified Uncommitted Exposures providing they are in compliance with hedging policy and constitute an integral part of annually accepted hedging strategies.

The Company does not speculate in foreign currency. Speculation is defined as taking any action to increase an exposure beyond that which exists due to an underlying commercial activity, in the expectation of making a foreign currency gain.

Foreign exchange risk management transactions of the Company may be undertaken using the following instruments:

- forward and non-delivery forward transactions (NDF contracts/transactions),
- currency swaps,
- CC swaps,
- foreign exchange options (currency options).

Prior to 2003, the Company hedged its long-term foreign exchange exposure arising from coupon payments on EUR and USD denominated Notes with use of CC swaps (see Notes 3.14 and 23). In November 2003 the Company changed its Notes refinancing plans and effectively shortened term of coupon payments exposure. As a result maturity of some outstanding CC swap cash flows exceeded the planned date of Notes refinancing. In order to match those CC swap cash flows with the new refinancing plan the Company restructured the outstanding CC swaps. All USD CC swaps were terminated while the remaining planned coupon payments were hedged by new forwards. In respect to EUR CC swaps, cash flows due after Notes refinancing would hedge other expected exposures than coupon payments. The fair value changes of those CC swaps are reflected in the income statement.

Prior to 2003 the Company hedged its short- and medium-term foreign exchange exposure arising from anticipated Notes repayments of a part of principal on EUR denominated Notes on the respective first call dates by concluding foreign exchange forwards subordinated to Bank Credit Facilities (see Notes 19b and 23).

POLSKA TELEFONIA CYFROWA SP. Z O.O. AND SUBSIDIARIES

Notes to the Consolidated Financial Statements

for the years ended December 31, 2003, December 31, 2002 and December 31, 2001

(in thousands of PLN)

5. Financial risk management (cont.)

a. Foreign exchange risk (cont.)

In respect of short-term hedging the Company entered into a series of foreign exchange forward and NDF contracts together with foreign exchange options to reduce volatility of current operating and financial cash flows resulting from foreign exchange rate fluctuations (see Note 23).

b. Interest rate risk

The Company is exposed to interest rate risk related to short- and long-term credit facilities. Interest rate risk exposure arises from external financing denominated both in domestic and foreign currencies. The Company's interest bearing liabilities are based on fixed and floating interest rates.

Debt liabilities outstanding as at December 31, 2003 based on fixed interest rate are as follows (see Note 19a):

- the 11 ¼ Notes with a face value of USD 150,000,000
- the 11 ¼ Notes with a face value of EUR 268,242,000
- the 10 7/8 Notes with a face value of EUR 156,615,000

Debt liabilities based on floating interest rates consist of Bank Credit Facilities (see Note 19b). The Company may utilize all facilities by individual drawdowns for the maturity of one, three, six or twelve months. The interest rate related to each drawdown is determined at the drawdown date and fixed for the maturity of the respective drawdown.

The interest rate exposure consists of a risk of increasing short-term interest rates, which would result in higher financing costs.

Interest rate exposure also arises from the possibility of decreasing long-term interest rates that would result in relative increase of financing costs versus market yields. The Company has limited risk of such a scenario by series of prepayment options embedded into all Notes (Note options).

The Company's interest rate exposure is managed by:

- varying the maturity periods of investments and borrowings,
- varying the proportions of debt which bears interest on a fixed and a floating basis,
- varying the period of time for which the interest rate is fixed in respect to the Bank Credit Facilities.

In addition to the interest rate management tools described above, the Company may, in line with its hedging policy enter into the following interest rate hedging transactions:

- forward rate agreements (FRAs),
- interest rate swaps,
- interest rate options (caps, floors, collars).

POLSKA TELEFONIA CYFROWA SP. Z O.O. AND SUBSIDIARIES**Notes to the Consolidated Financial Statements****for the years ended December 31, 2003, December 31, 2002 and December 31, 2001****(in thousands of PLN)****5. Financial risk management (cont.)****c. Credit risk***Commercial credit risk*

The Company operates in one industry segment, providing cellular telephone communication services. Substantially all of the Company's trade debtors are Polish businesses and individuals. Further, the Company has established a network of dealers within Poland to distribute its products. The dealers share many economic characteristics thus receivables from each of these dealers present similar risk to the Company. The Company generally does not require collateral from its customers.

Concentrations of credit risk with respect to trade receivables are limited due to the large number of customers comprising the Company's customer base.

The Company maintains provisions for estimation of existing credit losses and such losses in the aggregate, have not exceeded Management's expectations. With the exception of TP SA, which purchases terminating interconnection services from the Company, no single customer accounts for 10% or more of revenues.

The balance of receivables as at December 31, 2003, representing the total net commercial credit risk exposure as at this date, is presented in Note 12.

Financial credit risk

There is a risk that the counterparties may be unable to meet their obligations related to financial instruments. This credit risk is monitored and measured by the treasury function in the Company. In order to minimize the risk the Company limits its counterparties to a sufficient number of major banks and financial institutions with high financial ratings.

The balance of financial assets, short-term investments and other financial assets as at December 31, 2003, representing the total financial credit exposure, is presented in Notes 11 and 16.

6. Net sales

| | Year ended December 31, 2003 | Year ended December 31, 2002 | Year ended December 31, 2001 |
|-----------------------------------|---|---|---|
| Service revenues and fees | 5,411,402 | 4,753,445 | 4,123,555 |
| Sales of handsets and accessories | 189,875 | 176,379 | 221,341 |
| | 5,601,277 | 4,929,824 | 4,344,896 |

The Company operates in one segment (providing cellular telecommunication services and the ancillary sale of cellular handsets and accessories) and in one market (the Republic of Poland). The main sources of the Company's revenue are airtime charges, consisting primarily of monthly service fees (from incoming and outgoing calls), and charges for voice calls and non-voice services that originate or terminate in the Company's network, and calls placed by the Company's subscribers on foreign networks (roaming calls).

POLSKA TELEFONIA CYFROWA SP. Z O.O. AND SUBSIDIARIES**Notes to the Consolidated Financial Statements****for the years ended December 31, 2003, December 31, 2002 and December 31, 2001****(in thousands of PLN)****6. Net sales (cont.)**

In 2003 the Company netted PLN 30,329 cost from revenue related to premium calls and premium SMS, as a result of adoption principals of EITF 99-19. The netting is applied to premium calls and premium SMS, when the Company is acting as an agent providing telecommunication services without being the primary obligor in delivery of the relevant service.

7. Costs and expenses

| | Year ended December 31, 2003 | Year ended December 31, 2002 | Year ended December 31, 2001 |
|---|---|---|---|
| Cost of sales: | | | |
| Cost of services sold | 2,356,497 | 2,018,636 | 1,778,687 |
| Cost of sales of handsets and accessories | 1,237,624 | 970,557 | 948,750 |
| | <u>3,594,121</u> | <u>2,989,193</u> | <u>2,727,437</u> |
| Operating expenses: | | | |
| Selling and distribution costs | 610,179 | 545,404 | 585,463 |
| Administration and other operating costs | 235,609 | 244,711 | 199,966 |
| | <u>845,788</u> | <u>790,115</u> | <u>785,429</u> |
| | <u>4,439,909</u> | <u>3,779,308</u> | <u>3,512,866</u> |

Costs and expenses include research and development costs that were expensed when incurred. The research and development costs were immaterial in the above periods.

The rental expenses included in costs and expenses amounted to PLN 151,112, PLN 147,133 and PLN 129,053 for the years ended December 31, 2003, December 31, 2002 and December 31, 2001, respectively.

The following costs and expenses were included in cost of sales:

| | Year ended December 31, 2003 | Year ended December 31, 2002 | Year ended December 31, 2001 |
|-------------------------------|---|---|---|
| External services | 1,396,939 | 1,083,417 | 869,995 |
| Merchandise sold | 1,235,771 | 969,642 | 949,805 |
| Depreciation and amortization | 842,116 | 822,993 | 790,796 |
| Staff costs | 79,310 | 80,626 | 81,315 |
| Other | 39,985 | 32,515 | 35,526 |
| | <u>3,594,121</u> | <u>2,989,193</u> | <u>2,727,437</u> |

POLSKA TELEFONIA CYFROWA SP. Z O.O. AND SUBSIDIARIES**Notes to the Consolidated Financial Statements****for the years ended December 31, 2003, December 31, 2002 and December 31, 2001****(in thousands of PLN)****7. Costs and expenses (cont.)**

The following costs and expenses were included in selling and distribution costs:

| | Year ended December 31, 2003 | Year ended December 31, 2002 | Year ended December 31, 2001 |
|---|------------------------------------|------------------------------------|------------------------------------|
| External services including advertising costs | 297,221 | 252,651 | 292,367 |
| Staff costs | 185,258 | 183,887 | 158,700 |
| Depreciation and amortization | 69,035 | 58,441 | 40,213 |
| Other including bad debt expense | 58,665 | 50,425 | 94,183 |
| | 610,179 | 545,404 | 585,463 |

The following costs and expenses were included in administration costs:

| | Year ended December 31, 2003 | Year ended December 31, 2002 | Year ended December 31, 2001 |
|-------------------------------|------------------------------------|------------------------------------|------------------------------------|
| External services | 94,505 | 103,437 | 87,100 |
| Staff costs | 85,655 | 84,031 | 77,904 |
| Depreciation and amortization | 31,121 | 28,549 | 19,563 |
| Other | 24,328 | 28,694 | 15,399 |
| | 235,609 | 244,711 | 199,966 |

8. Interest and other financial income

| | Year ended December 31, 2003 | Year ended December 31, 2002 | Year ended December 31, 2001 |
|-----------------------------------|------------------------------------|------------------------------------|------------------------------------|
| Gains on valuation of derivatives | 167,826 | 130,081 | 81,944 |
| Foreign exchange gains | 152,901 | 119,191 | 207,911 |
| Interest income | 14,798 | 17,182 | 26,761 |
| Other financial income | 1,052 | | |
| | 336,577 | 266,454 | 316,616 |

POLSKA TELEFONIA CYFROWA SP. Z O.O. AND SUBSIDIARIES**Notes to the Consolidated Financial Statements****for the years ended December 31, 2003, December 31, 2002 and December 31, 2001****(in thousands of PLN)****9. Interest and other financial expenses**

| | Year ended December 31, 2003 | Year ended December 31, 2002 | Year ended December 31, 2001 |
|------------------------------------|---|---|---|
| Foreign exchange losses | 339,230 | 344,551 | 54,020 |
| Interest expense | 348,133 | 446,673 | 496,300 |
| Losses on valuation of derivatives | 71,564 | 50,115 | 144,226 |
| Other financial expenses | 4,306 | 6,793 | |
| | 763,233 | 848,132 | 694,546 |

10. Taxation

| | Year ended December 31, 2003 | Year ended December 31, 2002 | Year ended December 31, 2001 |
|--------------------------------------|---|---|---|
| Polish current tax (charge)/benefit | (88,410) | 402 | |
| Polish deferred tax benefit/(charge) | 8,893 | (220,744) | (25,460) |
| Foreign current tax charge | (1,273) | (2,020) | (1,419) |
| Tax charge | (80,790) | (222,362) | (26,879) |

Tax loss carry forwards available as at December 31, 2003 amounted to PLN 89,353. The loss can be fully offset against taxable income in year 2004.

According to the Polish tax regulations, the tax rates in effect in 2003 was 27% and 28% for both 2002 and 2001. The tax rate for 2004 and the following years is set to be 19% (see Note 2). The Company recognized the effect of the change in the income tax rate on deferred tax in the income statement for the period ended December 31, 2003.

POLSKA TELEFONIA CYFROWA SP. Z O.O. AND SUBSIDIARIES

Notes to the Consolidated Financial Statements

for the years ended December 31, 2003, December 31, 2002 and December 31, 2001

(in thousands of PLN)

10. Taxation (cont.)

The reconciliation between tax charge and the product of accounting profit or loss multiplied by the applicable statutory tax rates is as follows:

| | Year ended December 31, 2003 | | Year ended December 31, 2002 | | Year ended December 31, 2001 |
|---|------------------------------------|----------|------------------------------------|----------|------------------------------------|
| Profit before taxation | 734,712 | | 568,838 | | 454,100 |
| Tax rate | 27 | % | 28 | % | 28 |
| | (198,372 |) | (159,274 |) | (127,148 |
| Tax charge using statutory rate | | | | |) |
| Non-taxable differences | (43,055 |) | (15,649 |) | 12,309 |
| Change in temporary differences for which realization is not probable | 15,779 | | 10,871 | | 32,653 |
| Effect of different tax rates and rules in foreign entities | (1,375 |) | 803 | | 1,881 |
| Change in enacted tax rates | 128,182 | | (68,184 |) | 51,803 |
| Refiling of previous years tax return | 3,631 | | 402 | | |
| Adjustments to deferred taxes | 14,420 | | 8,669 | | 1,623 |
| Tax charge | (80,790 |) | (222,362 |) | (26,879 |

The deferred tax expense credited to equity after reclassification a part related to CC swaps and forward contracts to the income statement was PLN 765 in 2003, and deferred tax income credited to equity in 2002 and 2001 was PLN 4,703 and PLN 27,346, respectively.

POLSKA TELEFONIA CYFROWA SP. Z O.O. AND SUBSIDIARIES**Notes to the Consolidated Financial Statements****for the years ended December 31, 2003, December 31, 2002 and December 31, 2001****(in thousands of PLN)****10. Taxation (cont.)**

| | Year ended December 31, 2003 | Year ended December 31, 2002 |
|---|---|---|
| | <u> </u> | <u> </u> |
| Deferred tax assets in Poland: | | |
| Tax loss carry forward | 16,977 | 138,659 |
| Bad debt provision | 38,306 | 71,524 |
| Asset retirement provision | 6,213 | |
| Accrued interest | 8,625 | 37,729 |
| Unrealized foreign exchange loss, net | 43,388 | 1,661 |
| Financial instruments, net | | 27,449 |
| Accrued expenses | 25,246 | 51,040 |
| Inventory provision | 7,199 | 9,094 |
| Accrued advertising | 3,265 | 5,677 |
| Revenue recognition | 21,227 | |
| | <u> </u> | <u> </u> |
| | 170,446 | 342,833 |
| Temporary differences for which realization is not probable (valuation allowance) | (20,959) | (46,568) |
| | <u> </u> | <u> </u> |
| | 149,487 | 296,265 |
| Deferred tax liabilities in Poland: | | |
| Book versus tax basis of GSM /UMTS licenses | (360,826) | (498,295) |
| Book versus tax basis of fixed assets | (47,929) | (66,141) |
| Financial instruments, net | (31,295) | |
| | <u> </u> | <u> </u> |
| Net deferred tax liability | (290,563) | (268,171) |
| | <u> </u> | <u> </u> |

The amounts of valuation allowance as at December 31, 2003 and December 31, 2002 consist primarily of the bad debt provision for which tax deductibility is uncertain. The valuation allowance as at December 31, 2001 amounted to PLN 54,585.

11. Short-term investment and other financial assets

| | As at December 31, 2003 | As at December 31, 2002 |
|----------------------------|--|--|
| | <u> </u> | <u> </u> |
| Forward contracts | 68,289 | |
| Currency options | 20,826 | |
| CC swaps | 10,040 | |
| Trade contract derivatives | 7,784 | 8,445 |
| Index swaps | 3,599 | 3,698 |
| | <u> </u> | <u> </u> |
| | 110,538 | 12,143 |



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POLSKA TELEFONIA CYFROWA SP. Z O.O. AND SUBSIDIARIES**Notes to the Consolidated Financial Statements****for the years ended December 31, 2003, December 31, 2002 and December 31, 2001****(in thousands of PLN)****11. Short-term investment and other financial assets (cont.)**

Currency options are used to reduce the risk of currency fluctuation and are valued based on the market value (see Note 23).

Trade contract derivatives represent short-term portion of the derivatives separated from trade contracts (see also Notes 3.14, 16, 18 and 23).

Index swaps represent short-term portion of the derivatives bifurcated from Finance lease (see Notes 3.9, 3.14, 19c and 23).

12. Debtors and prepayments

| | As at December 31, 2003 | As at December 31, 2002 |
|---------------------------------------|-------------------------------|-------------------------------|
| | <u> </u> | <u> </u> |
| Trade debtors and accrued revenue | 808,902 | 710,130 |
| Prepaid expenses | 12,260 | 18,412 |
| Other debtors | 13,623 | 10,427 |
| Amounts due from State Treasury | 11,908 | 2,213 |
| Accounts receivable from shareholders | 3,939 | 1,332 |
| | <u> </u> | <u> </u> |
| Provision for doubtful debtors | 850,632 (99,510) | 742,514 (121,765) |
| | <u> </u> | <u> </u> |
| | 751,122 | 620,749 |
| | <u> </u> | <u> </u> |

Movements of the provision for doubtful debtors were as follow:

| | As at December 31, 2003 | As at December 31, 2002 | As at December 31, 2001 |
|-----------------|-------------------------------|-------------------------------|-------------------------------|
| | <u> </u> | <u> </u> | <u> </u> |
| Opening balance | (121,765) | (183,940) | (221,821) |
| Increase | (66,445) | (86,333) | (138,842) |
| Write off | 55,498 | 91,399 | 105,507 |
| Release | 33,202 | 57,109 | 71,216 |
| | <u> </u> | <u> </u> | <u> </u> |
| Closing balance | (99,510) | (121,765) | (183,940) |
| | <u> </u> | <u> </u> | <u> </u> |

POLSKA TELEFONIA CYFROWA SP. Z O.O. AND SUBSIDIARIES**Notes to the Consolidated Financial Statements****for the years ended December 31, 2003, December 31, 2002 and December 31, 2001****(in thousands of PLN)****13. Inventory**

| | As at December 31, 2003 | As at December 31, 2002 |
|-------------------------------------|--|--|
| | <u> </u> | <u> </u> |
| Cellular handsets | 118,323 | 163,470 |
| Network spare parts and accessories | 67,543 | 71,075 |
| | <u>185,866</u> | <u>234,545</u> |

14. Property, plant and equipment

| | As at December 31, 2003 | As at December 31, 2002 |
|--------------------------|--|--|
| | <u> </u> | <u> </u> |
| Land and buildings | 219,340 | 224,546 |
| Plant and equipment | 2,171,110 | 2,544,135 |
| Motor vehicles | 5,617 | 17,343 |
| Other fixed assets | 535,214 | 537,254 |
| Construction in progress | 92,550 | 115,408 |
| | <u>3,023,831</u> | <u>3,438,686</u> |

During the year ended December 31, 2003 the Company capitalized PLN 2,713 of foreign exchange losses, PLN 3,590 of interest expense and PLN 287 of hedging gains on CC swaps and forward contracts and during the year ended December 31, 2002 the Company capitalized PLN 5,459 of foreign exchange losses, PLN 10,127 of interest expense and PLN 504 of hedging expenses on CC swaps.

The effective capitalization rate used to determine borrowing costs to be capitalized was 20.2% in 2003 and 19.0% in 2002.

POLSKA TELEFONIA CYFROWA SP. Z O.O. AND SUBSIDIARIES

Notes to the Consolidated Financial Statements

for the years ended December 31, 2003, December 31, 2002 and December 31, 2001

(in thousands of PLN)

14. Property, plant and equipment (cont.)

The movement in each year was as follows:

| | <u>Land and Buildings</u> | <u>Plant and equipment</u> | <u>Motor vehicles</u> | <u>Other fixed assets</u> | <u>Construction in progress</u> | <u>Total</u> |
|---|-------------------------------|--------------------------------|---------------------------|-------------------------------|-------------------------------------|------------------|
| Cost | | | | | | |
| As at January 1, 2002 | 200,097 | 3,995,617 | 35,221 | 631,026 | 208,114 | 5,070,075 |
| Additions | 116 | | | 5,949 | 353,082 | 359,147 |
| Transfers | 46,492 | 325,242 | 7,412 | 61,973 | (440,755) | 364 |
| Disposals | | (82,363) | (4,683) | (2,677) | (5,033) | (94,756) |
| As at December 31, 2002 | 246,705 | 4,238,496 | 37,950 | 696,271 | 115,408 | 5,334,830 |
| Depreciation | | | | | | |
| As at January 1, 2002 | 13,624 | 1,173,664 | 16,421 | 82,556 | | 1,286,265 |
| Charge | 5,989 | 582,906 | 8,528 | 78,523 | | 675,946 |
| Transfer | 2,546 | (3,016) | | 527 | | 57 |
| Disposals | | (59,193) | (4,342) | (2,589) | | (66,124) |
| As at December 31, 2002 | 22,159 | 1,694,361 | 20,607 | 159,017 | | 1,896,144 |
| Net book value as at December 31, 2002 | 224,546 | 2,544,135 | 17,343 | 537,254 | 115,408 | 3,438,686 |

| | <u>Land and Buildings</u> | <u>Plant and equipment</u> | <u>Motor vehicles</u> | <u>Other fixed assets</u> | <u>Construction in progress</u> | <u>Total</u> |
|---|-------------------------------|--------------------------------|---------------------------|-------------------------------|-------------------------------------|--------------|
| Cost | | | | | | |
| As at January 1, 2003 | 246,705 | 4,238,496 | 37,950 | 696,271 | 115,408 | 5,334,830 |
| Additions | | 4,660 | | 6,858 | 279,710 | 291,228 |
| Asset retirement obligation | | | | 44,449 | | 44,449 |
| Transfers | 887 | 233,534 | 2,898 | 47,286 | (284,605) | |
| Disposals | | (45,509) | (17,272) | (4,462) | (4,740) | (71,983) |
| As at December 31, 2003 | 247,592 | 4,431,181 | 23,576 | 790,402 | 105,773 | 5,598,524 |
| Depreciation | | | | | | |
| As at January 1, 2003 | 22,159 | 1,694,361 | 20,607 | 159,017 | | 1,896,144 |
| Charge | 6,093 | 603,950 | 7,450 | 82,664 | | 700,157 |
| Charge from asset retirement obligation | | | | 17,520 | | 17,520 |
| Provision for construction in progress | | | | | 13,223 | 13,223 |
| Disposals | | (38,240) | (10,098) | (4,013) | | (52,351) |
| As at December 31, 2003 | 28,252 | 2,260,071 | 17,959 | 255,188 | 13,223 | 2,574,693 |

| | | | | | | |
|---|----------------|------------------|--------------|----------------|---------------|------------------|
| Net book value as at December 31, 2003 | 219,340 | 2,171,110 | 5,617 | 535,214 | 92,550 | 3,023,831 |
|---|----------------|------------------|--------------|----------------|---------------|------------------|

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POLSKA TELEFONIA CYFROWA SP. Z O.O. AND SUBSIDIARIES**Notes to the Consolidated Financial Statements****for the years ended December 31, 2003, December 31, 2002 and December 31, 2001****(in thousands of PLN)****14. Property, plant and equipment (cont.)**

In 2003, as a result of change in estimation of the asset retirement obligation, the Company capitalized the cost at the amount of PLN 44,449 to the network equipment and increased the depreciation costs by PLN 17,520 (see Notes 3.13, 3.22 and 20).

Property, plant and equipment held under capital leases without later improvements (included in the previous schedule):

| | As at December 31, 2003 | | | As at December 31, 2002 | | |
|--------------------------|----------------------------|-----------|--------|----------------------------|-----------|--------|
| | Land | Buildings | Other | Land | Buildings | Other |
| Cost | 6,293 | 197,806 | 990 | 6,293 | 197,806 | 990 |
| Accumulated depreciation | | (24,697) | (438) | | (18,848) | (338) |
| Net | 6,293 | 173,109 | 552 | 6,293 | 178,958 | 652 |

As at January 1, 2002 the Company transferred the improvements made in leased buildings from Other fixed assets to Land and Buildings. As at December 31, 2003 gross value and accumulated depreciation of the improvements amounted to PLN 42,419 (as at December 31, 2002 PLN 41,430) and PLN 3,332 (as at December 31, 2002 PLN 3,069), respectively.

15. Intangible fixed assets

| | As at December 31, 2003 | As at December 31, 2002 |
|-------------------------------|-------------------------------|-------------------------------|
| GSM and UMTS licenses | 2,523,010 | 2,335,836 |
| Computer and network software | 284,640 | 287,323 |
| Trademark | 104 | 118 |
| Transaction costs | 22,226 | 27,853 |
| | 2,829,980 | 2,651,130 |

During the year ended December 31, 2003 the Company capitalized to intangible fixed assets PLN 109,136 of foreign exchange losses, PLN 171,438 of interest expense and PLN 16,273 of hedging gains on CC swaps and forward contracts. During the year 2003 the Company recognized in income statement financial expenses at the amount of PLN 46,624 as an excess of foreign exchange losses over the amount treated as an adjustment to interest cost. During the year ended December 31, 2002 the Company capitalized to intangible fixed assets PLN 104,142 of foreign exchange losses, PLN 160,316 of interest expense and PLN 5,394 of hedging expenses on CC swaps.

The effective annual capitalization rate for the whole period of capitalization from 2000 for external borrowing (i.e. excluding interest and foreign exchange rates from revaluation of UMTS license liability) was 14.6%.

The Company has no intangible assets generated internally.

POLSKA TELEFONIA CYFROWA SP. Z O.O. AND SUBSIDIARIES

Notes to the Consolidated Financial Statements

for the years ended December 31, 2003, December 31, 2002 and December 31, 2001

(in thousands of PLN)

15. Intangible fixed assets (cont.)

The movement in each year was as follows:

| | GSM & UMTS Licenses | Computer and network software | Trade Mark | Transaction costs | Total |
|---|------------------------------------|--|-------------------|------------------------------|------------------|
| Cost | | | | | |
| As at January 1, 2002 | 2,448,862 | 468,941 | 206 | 35,137 | 2,953,146 |
| Additions | | 197,480 | | 7,913 | 205,393 |
| Transfers | | (364) | | | (364) |
| Disposals | | (36,100) | | | (36,100) |
| Capitalization of borrowing costs | 269,852 | | | | 269,852 |
| As at December 31, 2002 | 2,718,714 | 629,957 | 206 | 43,050 | 3,391,927 |
| Amortization | | | | | |
| As at January 1, 2002 | 305,751 | 228,539 | 74 | 5,972 | 540,336 |
| Charge | 77,127 | 150,157 | 14 | 6,739 | 234,037 |
| Transfers | | (57) | | | (57) |
| Disposals | | (36,005) | | | (36,005) |
| Other | | | | 2,486 | 2,486 |
| As at December 31, 2002 | 382,878 | 342,634 | 88 | 15,197 | 740,797 |
| Net book value as at December 31, 2002 | 2,335,836 | 287,323 | 118 | 27,853 | 2,651,130 |

| | GSM & UMTS Licenses | Computer and network software | Trade Mark | Transaction costs | Total |
|-----------------------------------|------------------------------------|--|-------------------|------------------------------|--------------|
| Cost | | | | | |
| As at January 1, 2003 | 2,718,714 | 629,957 | 206 | 43,050 | 3,391,927 |
| Additions | | 141,037 | | 6,446 | 147,483 |
| Disposals | | (24,651) | | | (24,651) |
| Capitalization of borrowing costs | 264,301 | | | | 264,301 |
| As at December 31, 2003 | 2,983,015 | 746,343 | 206 | 49,496 | 3,779,060 |
| Amortization | | | | | |
| As at January 1, 2003 | 382,878 | 342,634 | 88 | 15,197 | 740,797 |
| Charge | 77,127 | 139,277 | 14 | 8,177 | 224,595 |
| Disposals | | (20,208) | | | (20,208) |
| Other | | | | 3,896 | 3,896 |
| As at December 31, 2003 | 460,005 | 461,703 | 102 | 27,270 | 949,080 |

Net book value as at December 31,
2003

2,523,010

284,640

104

22,226

2,829,980

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POLSKA TELEFONIA CYFROWA SP. Z O.O. AND SUBSIDIARIES

Notes to the Consolidated Financial Statements

for the years ended December 31, 2003, December 31, 2002 and December 31, 2001

(in thousands of PLN)

15. Intangible fixed assets (cont.)

Licenses

The balance of GSM and UMTS licenses consists of GSM 900, GSM 1800, UMTS and Lease line licenses acquired by the Company from the Polish State, represented by the Minister of Communications.

The GSM 900 license was acquired on February 23, 1996 and issued for a term of 15 years and allows the Company to apply for an extension for an agreed period of one year prior to its expiry date together with a permit to install and utilize telecommunication equipment and network, and allocation of frequencies in the ETSI/GSM 900 MHz band. The Company was required to pay the Polish government a fee equal to the PLN equivalent of EUR 218 million, which was fully paid by December 31, 2001.

The GSM 900 license is subject to a number of commercial and technical conditions. While Polish law provides that the license may be revoked or limited in the event that the Company fails to meet any of these conditions, the Company believes that it is currently in compliance with all of the GSM 900 license conditions.

The GSM 1800 license was acquired on August 11, 1999 and has been in use since March 1, 2000. The Company was required to pay the Polish government a fee equal to the PLN equivalent of EUR 100 million, which was fully paid by December 31, 2002.

Similar to the GSM 900 license, the GSM 1800 license requires that the Company meets certain coverage and technical criteria, including a requirement that the dropped call rate does not exceed 5% during peak hours and that the Company attains geographical coverage combined with the 900 MHz and 1800 MHz frequencies of 90% by June 2004. The Company has already exceeded this level of coverage and complies with the dropped call rate criteria.

On September 29, 2000 the Minister of Communications granted the Company a license to lease the telecommunication lines in the Company's network, including a permit to install and utilize telecommunication equipment and network (the Lease Lines License). The Lease Line License is valid for 15 years from the date when it was delivered to the Company and has been valued at the nominal value as the license fee was paid in a single installment.

On December 20, 2000 the Minister of Communications granted the Company a license to provide telecommunication services according to the UMTS standard in the 2 GHz band, including a permit to install and utilize telecommunication equipment and network, and allocation of frequencies in the 2 GHz band (the UMTS license). The UMTS license is valid for 22 years from the date of acquisition. The Company is required to pay to the Polish government a fee equal to the PLN equivalent of EUR 650 million, which is payable in 22 installments. For further disclosure of liability balance see Note 19d.

The UMTS license requires the Company to attain 20% population coverage by the end of 2007 and the Company is no longer obliged to meet the original 40% population coverage requirement (see Note 2).

The above-described GSM 900 license, GSM 1800 license, UMTS license and the Lease Lines licenses are not transferable assets.

POLSKA TELEFONIA CYFROWA SP. Z O.O. AND SUBSIDIARIES**Notes to the Consolidated Financial Statements****for the years ended December 31, 2003, December 31, 2002 and December 31, 2001****(in thousands of PLN)****16. Financial assets**

| | As at December 31, 2003 | As at December 31, 2002 |
|----------------------------|-------------------------------|-------------------------------|
| Note options | 123,307 | 127,029 |
| Trade contract derivatives | 28,823 | 38,207 |
| Forward contracts | 39,988 | 5,638 |
| CC swaps | 55,115 | 414 |
| Long term receivables | 1,140 | |
| | 248,373 | 171,288 |

Note options are prepayment options separated from the Notes.

Trade contract derivatives are separated from trade contracts denominated or linked to currency, which (i) is not the currency of the primary economic environment in which any substantial party to contract operates or (ii) is not a currency in which the price of the related good or service is routinely denominated in international commerce.

17. Deferred costs and Other long-term assets

| | As at December 31, 2003 | As at December 31, 2002 |
|------------------------------------|-------------------------------|-------------------------------|
| Multiple-element transaction costs | 118,344 | 76,011 |
| Other deferred costs | 3,322 | 4,939 |
| | 121,666 | 80,950 |
| Other long-term assets | 1,214 | 1,141 |
| | 122,880 | 82,091 |

Multiple-element transaction costs represent the deferred costs from non-separable contracts (see Note 3.16).

POLSKA TELEFONIA CYFROWA SP. Z O.O. AND SUBSIDIARIES**Notes to the Consolidated Financial Statements**

for the years ended December 31, 2003, December 31, 2002 and December 31, 2001
(in thousands of PLN)

18. Current liabilities

| | As at December 31, 2003 | As at December 31, 2002 |
|--|-------------------------------|-------------------------------|
| Accounts payable | | |
| Trade creditors | 146,676 | 154,808 |
| Construction payables | 142,223 | 125,728 |
| Accounts payable to shareholders | 1,506 | 4,741 |
| | 290,405 | 285,277 |
| Amounts due to State Treasury | 69,385 | 57,756 |
| Interest-bearing liabilities | | |
| Interest accrued on Notes | 56,915 | 76,483 |
| Interest accrued on Bank Credit Facilities | 3,415 | 26,557 |
| Finance lease payable (see Note 19c) | 15,136 | 18,070 |
| Overdraft facilities | 25,979 | 12 |
| | 101,445 | 121,122 |
| Accruals (see Note 20) | 220,595 | 185,569 |
| Deferred income and other liabilities | | |
| Deferred income | 183,247 | 153,100 |
| CC swaps | | 43,051 |
| Forward contracts (see Notes 3.14 and 23) | 22,091 | 22,258 |
| Social fund | 3,890 | 3,603 |
| Deposits from subscribers | 2,364 | 1,969 |
| Payroll | 195 | 377 |
| | 211,787 | 224,358 |
| | 893,617 | 874,082 |

The social fund is an employer's obligation arising from a government mandated calculation based on number of employees and the monthly minimum wage in Poland. The amounts calculated under this formula must be used for the benefit of the employees.

POLSKA TELEFONIA CYFROWA SP. Z O.O. AND SUBSIDIARIES**Notes to the Consolidated Financial Statements**

for the years ended December 31, 2003, December 31, 2002 and December 31, 2001
(in thousands of PLN)

19. Long-term liabilities (cont.)**a. Notes**

The Company is full and unconditional guarantor of the following Notes issued by its subsidiaries. The net proceeds from the Notes were loaned to the Company.

| | 11 ¼% Notes | 11 ¼% Notes | 10 7/8% Notes |
|---|--|--|--|
| Issuance date | November 23, 1999 | November 23, 1999 | May 8, 2001 |
| Issuer | PTC International Finance II S.A. | PTC International Finance II S.A. | PTC International Finance II S.A. |
| Nominal value | EUR 268* million | USD 150 million | EUR 157 ** million |
| Coupon | 11 ¼ | 11 ¼ | 10 7/8 |
| Interest payment | on each June 1 and December 1 | on each June 1 and December 1 | on each January 31 and July 31 |
| Maturity date | December 1, 2009 | December 1, 2009 | May 1, 2008 |
| Registered | in the United States (SEC); Luxembourg Stock Exchange | in the United States (SEC); Luxembourg Stock Exchange | in the United States (SEC); Luxembourg Stock Exchange |
| Market price as at December 31, 2003 (% of nominal value) | 109.50 | 110.00 | 110.00 |
| Carrying amount as at December 31, 2003 (including interest) | 1,255,315 | 552,897 | 758,745 |

On June 30, 2003 the Company called all the outstanding 10 ¾% Notes with a principal amount of USD 126,215 thousand, constituting 49.85% of the initial total amount of the Notes, at the price of 103.583%. The costs related to the redemption of 10 ¾% Notes incurred by the Company amounted to PLN 26,423, which include PLN 17,867 of premium cost and PLN 6,691 of 10 ¾% Note call option written off. The Notes were redeemed from investors on July 1, 2003 by the trustee.

* In 2003 the Company repurchased on the market 4.9% of the total principal amount of the 11 ¼% Notes of EUR 14,508 thousand. The principal amount of the repurchased Notes has been delisted from the Luxembourg Stock Exchange. The amount of EUR 268,242 thousand of the 11 ¼% Notes remain outstanding as at December 31, 2003 and continue to be listed on the Luxembourg Stock Exchange.

** In 2003 the Company repurchased on the market the principal amount of EUR 30,885 thousand of the 10 7/8% Notes (15.4% of the total initial principal amount). The principal amount of the repurchased Notes has been delisted from the Luxembourg Stock Exchange. The amount of EUR 156,615 thousand of the 10 7/8% Notes remain outstanding as at December 31, 2003 and continue to be listed on the Luxembourg Stock Exchange.

POLSKA TELEFONIA CYFROWA SP. Z O.O. AND SUBSIDIARIES**Notes to the Consolidated Financial Statements**

for the years ended December 31, 2003, December 31, 2002 and December 31, 2001

(in thousands of PLN)

19. Long-term liabilities (cont.)**a. Notes (cont.)**

The total financial cost related to open market buy backs of EUR 11 ¼% Notes and 10 7/8% Notes amounted to PLN 20,194.

The Company has right to the following call options embedded in the respective Notes:

| | 11 ¼% Notes | 10 7/8% Notes |
|-------------------------------|---|--|
| Period 1 | | |
| Date | December 1, 2004 December 1, 2009 | May 1, 2005 May 1, 2008 |
| Redemption amount | in whole or in part | in whole or in part |
| Redemption price range | 105.625% 100.00% of nominal value | 105.438% 100.00% of nominal value |
| Period 2 | | |
| Date | The Period 2 Issuer Call Option has not been exercised by the Issuer and expired in the last quarter of 2002. | May 8, 2001 May 1, 2004 |
| Redemption amount | | any amount up to 35% of the outstanding principal amount |
| Redemption price range | | 110.875% of nominal value |

Fair value of the Notes call options is presented in Note 23.

The Notes also have put options, which may be exercised (in any part) at 101% of nominal value by the Noteholders if a change of control event occurs. Change of control events are when: (1) if any person or group becomes the beneficial owner of 50% or more of the total voting power except for Permitted Holders and as a consequence at least two notches decline in the rating of the Notes or the rating is withdrawn, (2) substantially all the assets of the Company are sold or (3) certain changes in the Supervisory Board.

b. Bank Credit Facilities

On February 20, 2001 the Company signed the two loan facility agreements (Main Bank Facility Agreement amounting to EUR 550 million and Supplemental Bank Facility Agreement amounting to EUR 150 million (extended from EUR 100 million on September 21, 2001) together Bank Credit Facilities) with the consortium of banks organized by Deutsche Bank AG London, Deutsche Bank Polska S.A., Dresdner Bank Luxembourg S.A. and the European Bank for Reconstruction and Development.

As at December 31, 2003 the balance outstanding under the Main Bank Facility Agreement amounted to PLN 535.9 million, which consisted of PLN 250 million of the domestic tranche, USD 26 million and EUR 40 million of the multi-currency tranche.

POLSKA TELEFONIA CYFROWA SP. Z O.O. AND SUBSIDIARIES

Notes to the Consolidated Financial Statements

for the years ended December 31, 2003, December 31, 2002 and December 31, 2001

(in thousands of PLN)

19. Long-term liabilities (cont.)

b. Bank Credit Facilities (cont.)

The main terms of the Main Bank Facility Agreement are as follows:

| | |
|-------------------|--|
| Facilities limits | equivalent of EUR 550 million available under two tranches: the multi-currency tranche amounting to EUR 292.5 million and the domestic tranche of EUR 257.5 million available in PLN |
| Interests | LIBOR, EURIBOR, WIBOR plus negotiated margins |
| Collateral | pledge on the Company's assets and rights except for future real estates, the escrow fund for Notes and leased assets |
| Repayment date | quarterly reduction in facility limit starting from September 30, 2004 to February 20, 2006. |

The main terms of the amended Supplemental Bank Facility Agreement are as follows:

| | |
|-------------------|---|
| Facilities limits | equivalent of EUR 150 million available under two tranches: the multi-currency tranche amounting to EUR 20 million and the domestic tranche of EUR 130 million available in PLN |
| Interests | LIBOR, EURIBOR, WIBOR plus negotiated margins |
| Collateral | pledge on the Company's assets and rights except for future real estates, the escrow fund for Notes and leased assets |
| Repayment date | reduction in facility limit starting from September 30, 2005 to March 31, 2007. |

As at December 31, 2003 the Supplemental Bank Facility was not drawn.

In addition under Bank Credit Facilities the Company is obliged to satisfy as at December 31, 2003 the following covenants:

- Senior Debt to earnings before interest, tax, depreciation and amortization costs (EBITDA)* at the level below 3.5:1.0
- EBITDA to Interest Expense on Senior Debt at the level not less than 3.0:1.0
- EBITDA to Interest Expense on Total Debt at the level not less than 2.25:1.0

*EBITDA calculated as operating profit increased by the amortization and depreciation expenses.

As at the balance sheet date the Company met these covenants with comfortable margin.

POLSKA TELEFONIA CYFROWA SP. Z O.O. AND SUBSIDIARIES

Notes to the Consolidated Financial Statements

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(in thousands of PLN)

19. Long-term liabilities (cont.)c. Finance lease

On March 25, 1997 the Company entered into a finance lease agreement relating to its new headquarters building and underlying land (Finance lease). The headquarters lease obligation is denominated in USD and payable in PLN. The term of the lease is 15 years and the Company has a right to acquire the leased asset at the end of the lease not sooner than on April 30, 2013 and not later than by the July 31, 2013 (the value of the purchase option calculated as the leased space multiplied by the price per square meter amounts to USD 11,825). The minimum lease payments have been discounted at 11.338% (first building leased in second half of 1998) and at 11.174% (second building leased in July 1999), which approximated the Company's borrowing rate for USD as at the date of acquisition of the leased assets.

The timing and values of lease payments are presented below.

The future value payments under finance leases as at December 31, 2003 include future indexing of minimal lease payments.

As at

December 31, 2003

| | <u>Future Value</u> | <u>Interest</u> | <u>Discounted with index swaps</u> | <u>Discounted</u> | <u>Index swaps</u> |
|--|---------------------|-----------------|--|-------------------|--------------------|
| Not later than 1 year | 30,376 | 18,839 | 11,537 | 15,136 | (3,599) |
| Later than 1 year and not later than 5 years | 130,894 | 86,273 | 44,621 | 49,512 | (4,891) |
| Later than 5 years | 208,631 | 64,352 | 144,279 | 105,617 | 38,662 |
| | 369,901 | 169,464 | 200,437 | 170,265 | 30,172 |

As at

December 31, 2002

| | <u>Future Value</u> | <u>Interest</u> | <u>Discounted with index swaps</u> | <u>Discounted</u> | <u>Index swaps</u> |
|--|---------------------|-----------------|--|-------------------|--------------------|
| Not later than 1 year | 30,956 | 16,584 | 14,372 | 18,070 | (3,698) |
| Later than 1 year and not later than 5 years | 133,388 | 84,177 | 49,211 | 54,335 | (5,124) |
| Later than 5 years | 253,828 | 98,480 | 155,348 | 109,710 | 45,638 |
| | 418,172 | 199,241 | 218,931 | 182,115 | 36,816 |

POLSKA TELEFONIA CYFROWA SP. Z O.O. AND SUBSIDIARIES**Notes to the Consolidated Financial Statements****for the years ended December 31, 2003, December 31, 2002 and December 31, 2001****(in thousands of PLN)****19. Long-term liabilities (cont.)****d. License fee payables**

The fees for the Company's UMTS license was denominated in EUR and payable in installments. These deferred payments have been discounted at 12.06% for short-term and 12.11% for long-term installments of the UMTS license, which approximated the Company's borrowing rate for EUR as at the date of acquisition of the license. As at December 31, 2003 the value of the UMTS license liability amounted to PLN 577 million. The value was calculated as discounted future payments at current market interest rates. As at that date there was no GSM 900 or GSM 1800 license liability outstanding.

The maturity of license fee payable as at December 31, 2003 was as follow:

| | EUR 000 | EUR 000 | PLN 000 |
|-----------------------|-------------------|-------------------|-------------------|
| | nominal | discounted | discounted |
| | <u> </u> | <u> </u> | <u> </u> |
| Between 2 and 5 years | 60,000 | 41,772 | 197,040 |
| Over 5 years | 330,000 | 80,525 | 379,835 |
| | <u>390,000</u> | <u>122,297</u> | <u>576,875</u> |

The maturity of license fee payable as at December 31, 2002 was as follow:

| | EUR 000 | EUR 000 | PLN 000 |
|-----------------------|-------------------|-------------------|-------------------|
| | nominal | discounted | discounted |
| | <u> </u> | <u> </u> | <u> </u> |
| Between 2 and 5 years | 45,000 | 29,477 | 118,502 |
| Over 5 years | 345,000 | 79,610 | 320,048 |
| | <u>390,000</u> | <u>109,087</u> | <u>438,550</u> |

POLSKA TELEFONIA CYFROWA SP. Z O.O. AND SUBSIDIARIES**Notes to the Consolidated Financial Statements**

for the years ended December 31, 2003, December 31, 2002 and December 31, 2001

(in thousands of PLN)

20. Accruals and Provisions for liabilities and charges

| | As at December 31, 2003 | As at December 31, 2002 |
|---|-------------------------------|-------------------------------|
| | <u> </u> | <u> </u> |
| Accruals | 220,595 | 185,569 |
| Provisions for liabilities and charges | | |
| Provision for loyalty program | | |
| Opening balance | 21,740 | 20,652 |
| Increase | 26,042 | 13,498 |
| Decrease | (21,123) | (12,410) |
| | <u> </u> | <u> </u> |
| Closing balance | 26,659 | 21,740 |
| Provisions for dismantlement and restoration costs (see Note 3.4, 3.13, 14) | 59,629 | |
| Other provisions for liabilities and charges | 5,664 | |
| | <u> </u> | <u> </u> |
| | 91,952 | 21,740 |
| | <u> </u> | <u> </u> |

The balance of accruals includes mainly operating costs not invoiced and employee bonuses.

The provision for dismantling and restoration costs results from the change of estimation made by the Company in year 2003 (see Note 3.4).

21. Capital

| | As at December 31, 2003 | As at December 31, 2002 |
|---|-------------------------------|-------------------------------|
| | <u> </u> | <u> </u> |
| Allotted, called-up and fully paid: | | |
| 471,000 ordinary shares of PLN 1,000 each | 471,000 | 471,000 |
| Additional paid-in capital | 409,754 | 409,754 |
| | <u> </u> | <u> </u> |
| | 880,754 | 880,754 |
| | <u> </u> | <u> </u> |

As at December 31, 2003 Company's shareholder structure was as follows:

| | Number of shares | Number of votes | Nominal value of shares | Percentage of share capital | |
|-------------------------------------|-----------------------------|-----------------------------|-------------------------------|--------------------------------|---|
| | <u> </u> | <u> </u> | <u> </u> | <u> </u> | |
| Elektrim Telekomunikacja Sp. z o.o. | 226,079 | 226,079 | 226,079 | 47.9998 | % |

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| | | | | | |
|-----------------------------|----------------|----------------|----------------|------------|----------|
| T Mobile Deutschland GmbH | 105,975 | 105,975 | 105,975 | 22.5 | % |
| MediaOne International B.V. | 105,975 | 105,975 | 105,975 | 22.5 | % |
| Polpager Sp. z o.o. | 18,840 | 18,840 | 18,840 | 4.0 | % |
| Carcom Warszawa Sp. z o.o. | 8,949 | 8,949 | 8,949 | 1.9 | % |
| Elektrim Autoinvest S.A. | 5,181 | 5,181 | 5,181 | 1.1 | % |
| Elektrim S.A. | 1 | 1 | 1 | 0.0002 | % |
| | <u>471,000</u> | <u>471,000</u> | <u>471,000</u> | <u>100</u> | <u>%</u> |

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POLSKA TELEFONIA CYFROWA SP. Z O.O. AND SUBSIDIARIES

Notes to the Consolidated Financial Statements

for the years ended December 31, 2003, December 31, 2002 and December 31, 2001

(in thousands of PLN)

23. Derivative financial instruments

| Type of derivative | Forward contracts | Note options | Currency options | CC swaps | Index swaps | Trade contract derivatives | Total |
|--|-------------------|----------------|------------------|---------------|------------------|----------------------------|----------------|
| Balance as at January 1, 2003 | | | | | | | |
| asset/(liability) | (16,620) | 127,029 | | (131,785) | (36,816) | 46,652 | (11,540) |
| Cash paid/(received) on realization | (17,970) | | 20,045 | 89,194 | (5,314) | (7,171) | 78,784 |
| Changes in the fair value together with realization reported in the income statement | 124,567 | (3,722) | 781 | (10,718) | 11,958 | (2,874) | 119,992 |
| Changes in the fair value reported in shareholders' equity (hedge reserve) | (3,791) | | | 118,464 | | | 114,673 |
| Balance as at December 31, 2003 | 86,186 | 123,307 | 20,826 | 65,155 | (30,172) | 36,607 | 301,909 |

Forward contracts are used by the Company to hedge foreign exchange risk related to operational and financial transactions. The Company applies hedge accounting for financial transactions.

Maturity of forward contracts is as follow:

| | Currency | Notional value in currency | Carrying value asset/(liability) |
|-----------------------|----------|----------------------------|----------------------------------|
| Within 1 year | USD | 184 million | (22,091) |
| Within 1 year | EUR | 115 million | 68,289 |
| Between 1 and 2 years | EUR | 60 million | 39,988 |
| | | | 86,186 |

Note options represent the estimated fair values of call options embedded in the Company's Notes. Upon exercise of the call option or upon redemption of the Notes by other means, the fair value of the relevant call option is written back to the income statement immediately. Any reduced interest payments resulting from the redemption of the relevant Notes are recognized as they accrue.

Call option value will be written down in line with planned bonds buy-backs and refinancing.

POLSKA TELEFONIA CYFROWA SP. Z O.O. AND SUBSIDIARIES**Notes to the Consolidated Financial Statements****for the years ended December 31, 2003, December 31, 2002 and December 31, 2001****(in thousands of PLN)****23. Derivative financial instruments (cont.)**

On March 18, 2003 a new treaty on avoidance of double taxation between Poland and the Netherlands became law. The new treaty will provide for a 5 percent withholding tax on interest payments whereas previously no tax was due. The Republic of Poland has requested an exemption period to the European Union (EU) Directive 2003/49/EC of June 3, 2003 on a common system of taxation applicable to interest and royalty payments made between associated companies of different member states providing for no withholding taxes to be levied on interest payments between EU members from January 1, 2004. Should Poland be granted the exemption and should the Company be unable to identify reasonable measures to avoid payment of the withholding tax, the Company may become entitled to redeem the 10 7/8% Notes and 11¼% Notes at face value plus accrued interests and therefore the Company's Management may decide to execute this tax redemption option. No decision has been taken in this respect as at the date of the authorization of the consolidated financial statements.

In November 2003 the Company has purchased the currency options in order to reduce the risk arising from currency fluctuation. The premium paid represents the initial option value.

CC swaps are designated (except for the contract described below) as hedges against exposure to changes in future cash flows arising from the foreign exchange risk on the future interest coupon payments.

The following CC swaps have been entered into by the Company:

| Issuance date | Notional in currency | Notional in PLN | PTC pays | PTC receives | Maturity date |
|----------------------|---------------------------------|----------------------------|-----------------|---------------------|----------------------|
| April 4, 2001 | EUR 60 million | 217,140 | PLN 15.20% | EUR 11 ¼ % | December 1, 2007 |
| May 21, 2001 | EUR 90 million | 314,640 | PLN 15.26% | EUR 11 ¼ % | December 1, 2007 |
| May 23, 2001 | EUR 100 million | 344,890 | PLN 13.96% | EUR 10 7/8 % | May 1, 2007 |
| December 10, 2001 | EUR 50 million | 181,700 | PLN 12.69% | EUR 10 7/8 % | May 1, 2007 |
| December 10, 2001 | EUR 75 million | 271,650 | PLN 13.56% | EUR 11 ¼ % | December 1, 2007 |

The timing of cash flows related to CC swaps is the same as for Notes interest obligation.

As presented in Note 5a, in November 2003 the Company changed its Notes refinancing plans and effectively shortened the term of coupon payments exposure. As a result the maturity of some outstanding CC swap cash flows would exceed the planned date of Notes refinancing. In order to match those CC swap cash flows with the new refinancing plan the Company restructured outstanding CC swaps. The USD CC swaps were terminated resulting in PLN 24,522 of the cumulative losses which were previously reported directly in equity being reclassified, because the forecasted transaction is no longer expected to occur.

In respect to EUR CC swaps, cash flows due after Notes refinancing would hedge other exposure than coupon payments namely EUR borrowings used for refinancing of part of EUR denominated Notes. The Company discontinued hedge accounting in relation to part of the coupon payments on EUR denominated Notes that are no longer expected to occur (see Notes 5a). As at December 31, 2003 PLN 55,115 thousand previously recognized in equity has been reported as financial income in the income statement for 2003, because the forecasted transaction is no longer expected to occur.

POLSKA TELEFONIA CYFROWA SP. Z O.O. AND SUBSIDIARIES**Notes to the Consolidated Financial Statements****for the years ended December 31, 2003, December 31, 2002 and December 31, 2001****(in thousands of PLN)****23. Derivative financial instruments (cont.)**

The market value of CC swaps related to the 10 ¾% Notes redeemed in June 2003 amounted to a liability of PLN 28,750 and was written off to income in June 2003 at the date of the Notes redemption. In relation to the remaining fixed USD cash flows due to the Company from the counterparty between January 2004 and July 2005 the Company does not apply hedge accounting. The change in fair value of those hedges was taken to income and classified as a forward in assets after the last 10 ¾% Note coupon was paid. In November 2003 this transaction was terminated resulting in PLN 24,271 of finance cost being reclassification of the cumulative losses which were previously reported directly in equity, because the forecasted transaction is no longer expected to occur.

24. Financial commitments**a. Operating leases (not included in liabilities)**

In 2003 the Company entered into the operating lease agreements for cars fleet management. The minimum annual rentals payable on this agreements are as follows:

| | As at |
|--|--------------------------|
| | December 31, 2003 |
| Not later than 1 year | 6,714 |
| Later than 1 year and not later than 5 years | 20,593 |
| | 27,307 |

The minimum annual rentals payable on operating leases (both cancelable and non-cancelable) are as follows:

| | As at | As at | As at |
|--|---------------------|---------------------|---------------------|
| | December 31, | December 31, | December 31, |
| | <u>2003</u> | <u>2002</u> | <u>2001</u> |
| Not later than 1 year | 113,250 | 112,563 | 118,654 |
| Later than 1 year and not later than 5 years | 351,047 | 354,935 | 361,141 |
| Later than 5 years | 173,845 | 210,353 | 257,698 |
| | 638,142 | 677,851 | 737,493 |
| Unlimited agreements (yearly) | 23,147 | 20,884 | 22,610 |

POLSKA TELEFONIA CYFROWA SP. Z O.O. AND SUBSIDIARIES**Notes to the Consolidated Financial Statements**

for the years ended December 31, 2003, December 31, 2002 and December 31, 2001

(in thousands of PLN)

24. Financial commitments (cont.)**a. Operating leases (not included in liabilities) (cont.)**

Assets under operating leases include primarily network sites, office space, retail outlets and warehouses.

b. Capital equipment commitments (not included in liabilities)

| | As at December 31, 2003 | As at December 31, 2002 | As at December 31, 2001 |
|-------------------------------|-------------------------------|-------------------------------|-------------------------------|
| Authorized and contracted | 127,839 | 166,982 | 393,841 |
| Authorized and not contracted | 812,511 | 574,057 | 709,780 |
| | 940,350 | 741,039 | 1,103,621 |

25. Dividend restriction

The Company's statutory financial statements are prepared in accordance with PAS. Dividends may only be distributed from the net profit reported in the unconsolidated Polish annual statutory financial statements.

As at December 31, 2003 the Company was in compliance with all covenants necessary to allow payment of dividends.

As at the day of authorization of the consolidated financial statements the Company's Shareholders' Meeting has not made a decision regarding 2003 profit distribution.

26. Supplementary cash flow information

Cash and cash equivalents consist of cash on hand, balances deposited with banks and short-term, highly liquid investments.

| | As at December 31, 2003 | As at December 31, 2002 | As at December 31, 2001 |
|---|-------------------------------|-------------------------------|-------------------------------|
| Balances deposited with banks: | | | |
| Current accounts | 14,612 | 13,127 | 10,416 |
| Term deposits with original maturity of less than 90 days | 3,551 | 40,482 | 25,609 |
| Social fund cash | 2,533 | 620 | 301 |
| Cash on hand | 184 | 183 | 185 |
| Cash and cash equivalents | 20,880 | 54,412 | 36,511 |
| Bank overdraft | (25,979) | (12) | |
| Cash and cash equivalents including overdrafts | (5,099) | 54,400 | 36,511 |

POLSKA TELEFONIA CYFROWA SP. Z O.O. AND SUBSIDIARIES**Notes to the Consolidated Financial Statements**

for the years ended December 31, 2003, December 31, 2002 and December 31, 2001
(in thousands of PLN)

27. Employment

| | As at December 31, 2003 | As at December 31, 2002 | As at December 31, 2001 |
|---------------------------|-------------------------------|-------------------------------|-------------------------------|
| Headcount at the year end | 3,803 | 3,702 | 3,684 |

28. Estimation of the fair values

The following table presents the carrying amounts and fair values of the Company's financial instruments outstanding as at December 31, 2003 and 2002, in million PLN. The carrying amounts in the table are included in the balance sheet under the indicated captions.

| | As at December 31, 2003 | | As at December 31, 2002 | |
|---|-------------------------------|------------|-------------------------------|------------|
| | million PLN | | million PLN | |
| | Carrying amount | Fair value | Carrying amount | Fair value |
| Financial Assets | | | | |
| Cash and cash equivalents | 21 | 21 | 54 | 54 |
| Short-term investments and other financial assets | 111 | 111 | 12 | 12 |
| Debtors and accrued revenue | 713 | 713 | 600 | 600 |
| Financial assets (long-term) | 248 | 248 | 171 | 171 |
| Financial Liabilities | | | | |
| Current liabilities and accruals | 599 | 593 | 645 | 645 |
| Long-term liabilities | 3,749 | 4,356 | 4,531 | 4,758 |

Debtors and accrued revenue, current liabilities and accruals

The carrying amounts are a reasonable estimate of the fair values because of the short maturity of such instruments.

The carrying amounts of forward foreign exchange contracts are based on quoted market forward rates as at the year-end balance sheet dates.

Cash and cash equivalents, short-term investments and financial assets (long-term)

The carrying amounts of cash and cash equivalents approximate fair values. The fair value of publicly traded short-term investments is based on quoted market values.

Long-term liabilities

The fair value of fixed rate long-term debt is estimated using the expected future payments discounted at market interest rates, except for the publicly traded liabilities, which are quoted at market values. The carrying amount of market-based floating rate long-term loans approximates their fair value.

POLSKA TELEFONIA CYFROWA SP. Z O.O. AND SUBSIDIARIES**Notes to the Consolidated Financial Statements****for the years ended December 31, 2003, December 31, 2002 and December 31, 2001****(in thousands of PLN)****29. Differences between IFRS and US GAAP**

The Company's consolidated financial statements are prepared in accordance with International Financial Reporting Standards, which differ in certain aspects from US GAAP.

The effects of the principal differences between IFRS and US GAAP in relation to the Company's consolidated financial statements are presented below, with explanations of certain adjustments that affect total comprehensive net income.

Reconciliation of consolidated net income:

| | Year ended December 31, 2003 | Year ended December 31, 2002 | Year ended December 31, 2001 |
|---|---|---|---|
| Net income under IFRS | 653,922 | 346,476 | 427,221 |
| US GAAP adjustments: | | | |
| (a) Removal of foreign exchange differences capitalized for IFRS | (91,766) | (109,601) | 107,075 |
| (b) Depreciation and amortization of foreign exchange differences | 9,738 | 9,528 | 9,268 |
| (c) Revenue recognition (SAB 101/EITF 00-21) | (96) | (45) | 1,151 |
| (d) SFAS 133/IAS 39 | (5,682) | (62,217) | (28,072) |
| (f) Asset retirement obligations | 24,285 | | |
| (g) Reclassification of CC swaps | (8,673) | | |
| (h) Deferred tax on above | 8,732 | 25,821 | (8,367) |
| Net income under US GAAP before cumulative effect of changes in accounting principles | 590,460 | 209,962 | 508,276 |
| Changes in accounting principles adjustments: | | | |
| (d) SFAS 133/IAS 39 implementation | | | (35,158) |
| (e) Transaction costs | | | 7,220 |
| (f) SFAS 143 cumulative effect | (24,285) | | |
| (h) Deferred tax on above | 4,614 | | 6,470 |
| Net income under US GAAP | 570,789 | 209,962 | 486,808 |

POLSKA TELEFONIA CYFROWA SP. Z O.O. AND SUBSIDIARIES

Notes to the Consolidated Financial Statements

for the years ended December 31, 2003, December 31, 2002 and December 31, 2001
(in thousands of PLN)

29. Differences between IFRS and US GAAP (cont.)

Reconciliation of comprehensive income:

| | Year ended December 31, 2003 | Year ended December 31, 2002 | Year ended December 31, 2001 |
|---|------------------------------------|------------------------------------|------------------------------------|
| | <u> </u> | <u> </u> | <u> </u> |
| Net income under US GAAP | 570,789 | 209,962 | 486,808 |
| Other comprehensive gain/(loss) (Hedge Reserve) | 86,800 | 4,408 | (96,955) |
| Effect of subsidiary closing (see Note 2) | (2,605) | | |
| | <u> </u> | <u> </u> | <u> </u> |
| Total comprehensive income under US GAAP after subsidiary closing | 654,984 | 214,370 | 389,853 |
| | <u> </u> | <u> </u> | <u> </u> |

Reconciliation of consolidated shareholders' equity:

| | As at December 31, 2003 | As at December 31, 2002 | As at December 31, 2001 |
|--|-------------------------------|-------------------------------|-------------------------------|
| | <u> </u> | <u> </u> | <u> </u> |
| Consolidated shareholders' equity under IFRS | 2,087,231 | 1,352,527 | 995,745 |
| US GAAP adjustments: | | | |
| (a) Removal of foreign exchange differences capitalized for IFRS | (193,356) | (101,590) | 8,011 |
| (b) Depreciation and amortization on above | 51,499 | 41,761 | 32,233 |
| (c) Revenue recognition (SAB 101/EITF 00-21) | (579) | (483) | (438) |
| (d) SFAS 133/IAS 39 | (95,971) | (90,289) | (56,869) |
| (f) Asset retirement obligations | 24,285 | | |
| (g) Reclassification of CC swaps | (8,673) | | |
| (h) Deferred tax on above | 26,631 | 17,899 | (1,299) |
| (j) Hedge reserve | (2,485) | (5,898) | |
| | <u> </u> | <u> </u> | <u> </u> |
| Consolidated shareholders' equity under US GAAP before cumulative effect of changes in accounting principles | 1,888,582 | 1,213,927 | 977,383 |
| Changes in accounting principles adjustments: | | | |
| (d) SFAS 133/IAS 39 implementation | | | 28,797 |
| (f) SFAS 143 | (24,285) | | |
| (h) Deferred tax on above | 4,614 | | (6,623) |
| | <u> </u> | <u> </u> | <u> </u> |
| Consolidated shareholders' equity under US GAAP | 1,868,911 | 1,213,927 | 999,557 |
| | <u> </u> | <u> </u> | <u> </u> |

POLSKA TELEFONIA CYFROWA SP. Z O.O. AND SUBSIDIARIES

Notes to the Consolidated Financial Statements

for the years ended December 31, 2003, December 31, 2002 and December 31, 2001

(in thousands of PLN)

29. Differences between IFRS and US GAAP (cont.)

a. Removal of foreign exchange differences capitalized for IFRS

In accordance with IAS 23 Borrowing Costs, the Company capitalizes financing costs, including interest and foreign exchange gains or losses and hedging gains and losses, into assets under construction.

For property, plant and equipment under construction, the Company capitalizes interest and foreign exchange gains or losses incurred and directly attributable to the acquisition and construction of the qualifying assets that would have been avoided if the expenditure on the qualifying assets had not been made. The financing costs are capitalized only during the period of construction of the qualifying assets (see Note 14). The Company capitalized financing costs attributable to the acquisition of its GSM 900, GSM 1800 and UMTS licenses, including interest on the related long-term obligation and foreign exchange losses because these licenses are integral parts of the network (see Note 15).

Under Statement of Financial Accounting Standards 52 *Foreign Currency Translation*, however, foreign exchange differences relating to financing obligations should be included in the income statement of the Company. Consequently, the amounts of foreign exchange differences capitalized in accordance with IAS 23 in the Company's consolidated financial statements are expensed under US GAAP.

b. Depreciation and amortization

The US GAAP adjustments for depreciation and amortization shown above represent the amounts of depreciation and amortization charges relating to capitalized foreign exchange differences and hedging gains and losses in the Company's IFRS consolidated financial statements. Since under US GAAP these foreign exchange differences and hedging gains and losses are not permitted to be capitalized and are instead expensed, the depreciation and amortization of these capitalized differences under IFRS has been reversed.

c. Revenue recognition (SAB 101/EITF 00-21)

Under IFRS the Company continues the revenue recognition policy applied to prior periods for multi element arrangements.

Under US GAAP, the Company implemented for the arrangements entered into on or after July 1, 2003 principles of EITF 00-21. EITF 00-21 gives detailed interpretation relating to revenue recognition and addresses certain aspects of the accounting of the elements of the multiple-deliverable arrangements as separate units of accounting.

As a result of implementation of EITF 00-21 the Company has identified multiple element arrangements as it pertains to the sale of handsets and the delivery of service. The effect in the income and expenses for the arrangements entered in the period from July 1, 2003 till December 31, 2003 that are deferred and recognized ratably over the average expected life of the customer under IFRS are immediately recognized in income statement account under US GAAP. Total revenues of PLN 58,646 and related costs of PLN 58,646 have thus been recorded for US GAAP.

The arrangements entered into before July 1, 2003 are settled under SAB 101 till termination.

POLSKA TELEFONIA CYFROWA SP. Z O.O. AND SUBSIDIARIES

Notes to the Consolidated Financial Statements

for the years ended December 31, 2003, December 31, 2002 and December 31, 2001

(in thousands of PLN)

29. Differences between IFRS and US GAAP (cont.)

d. SFAS 133

Statement of Financial Accounting Standards No. 133, *Accounting for Derivative Instruments and Hedging Activities*, requires every derivative instrument (including certain derivative instruments embedded in other contracts) to be recorded in the balance sheet as either an asset or liability measured at its fair value. The Statement requires that changes in the derivative instrument's fair value be recognized currently in earnings unless specific hedge accounting criteria are met. Special accounting for qualifying hedges allows a derivative instrument's gains and losses to offset related results on the hedged item in the income statement, to the extent effective, and requires that a company must formally document, designate, and assess the effectiveness of transactions that receive hedge accounting.

The Company separates call options from long-term Notes' host contract and accounts for as derivatives under IAS 39, while they are not recognized as embedded derivatives for US GAAP purposes.

The accounting change principles under US GAAP advise to include the cumulative effect in the net income of the period of the change. However, for qualifying cash flow hedge instruments a portion (or the entire amount) of the cumulative effect should be classified to other comprehensive income (hedge reserve), a component of shareholders' equity.

e. Transaction costs

IAS 39 requires transaction costs to be included in the initial measurement of financial assets and liabilities. Under US GAAP these costs should be presented as deferred costs in the amount of PLN 60,524 as at December 31, 2003, PLN 71,258 as at December 31, 2002 and PLN 83,645 as at December 31, 2001.

f. SFAS No. 143

On January 1, 2003 the Company adopted SFAS No. 143 *Accounting for Asset Retirement Obligations* (SFAS No. 143). Upon adoption, the Company recorded the fair value of the liabilities for asset retirement obligations and increased the carrying amount of the associated long-lived asset. The liability is being accreted to its present value each period through charges to operating expense. The capitalized asset retirement cost is being depreciated over the shorter of the related asset's useful life or the period to the expected settlement of the retirement obligation. As a result, the Company recorded an expense of PLN 19,671, representing a cumulative effect of the adoption of SFAS No. 143, net of taxes of PLN 4,614. Pro-forma effects for the year ended December 31, 2002 and 2001 assuming SFAS No. 143 was effective as of January 1, 2001, were not material to the liabilities, net income or per share amounts in accordance with US GAAP.

The Company has asset retirement obligations relating primarily to equipment and other leasehold improvements installed in leased network sites. Those leases generally contain provisions that require the Company to restore the sites to their original condition at the end of the lease term.

POLSKA TELEFONIA CYFROWA SP. Z O.O. AND SUBSIDIARIES**Notes to the Consolidated Financial Statements**

for the years ended December 31, 2003, December 31, 2002 and December 31, 2001
(in thousands of PLN)

29. Differences between IFRS and US GAAP (cont.)**f. SFAS No. 143 (cont.)**

The development of the liability for asset retirement obligations for the year ended December 31, 2003 is presented below:

| | |
|--|---------------|
| Cumulative effect change in adoption of accounting principle on liability as at January 1, 2003: | 54,011 |
| Accretion expense | 4,075 |
| New assets retirement obligations incurred | 1,543 |
| | <hr/> |
| Liability for asset retirement obligations as at December 31, 2003 | 59,629 |
| | <hr/> |

g. Reclassification of CC swaps

Under IFRS the Company discontinued hedge accounting and recognized in the income statement for 2003 PLN 55,115 of gains previously recognized in equity (see Notes 2, 5a and 23). Under US GAAP the cumulative gains at the amount of PLN 8,673 resulting from the hedge accounting discontinuance have been retained as hedge reserve pending completion of forecasted replacement financing cash-flows.

h. Deferred taxation

Under IFRS the Company may, if certain criteria are met, net deferred tax liabilities and assets and present a net balance in the balance sheet. Under US GAAP current and non-current portions, by tax jurisdiction, of the above should be disclosed separately. As at December 31, 2003 the Company recognized PLN 99,930 of net current deferred tax asset (PLN 234,320 as at December 31, 2002 and PLN 210,978 as at December 31, 2001) and PLN 360,896 of net long-term deferred tax liability (PLN 484,592 as at December 31, 2002 and PLN 271,021 as at December 31, 2001).

Under IFRS changes in the fair value of Note options are not taxable transactions, which causes the effective tax rate on US GAAP adjustments different compared to corporate income tax rates for the periods.

i. Extraordinary item

In the first quarter of 2001 the Company refinanced the existing Loan Facility by the new Bank Credit Facilities. The intangible asset related to the Loan facility arrangement amounting to PLN 10,122 was written-off, net of a tax benefit of PLN 2,834. According to U.S. GAAP the Company should recognize this costs as an extraordinary item. Under IFRS it is presented under amortization expense.

j. Other comprehensive income

The hedge reserve under US GAAP constitutes a part of other comprehensive income, a component of shareholders' equity. The changes in other comprehensive income (hedge reserve) are reflected in accumulated other comprehensive income. A sum of other comprehensive income and net income for the period represents comprehensive income for the period.

POLSKA TELEFONIA CYFROWA SP. Z O.O. AND SUBSIDIARIES

Notes to the Consolidated Financial Statements

for the years ended December 31, 2003, December 31, 2002 and December 31, 2001

(in thousands of PLN)

29. Differences between IFRS and US GAAP (cont.)

k. SFAS 95

The Company applied IAS 7 *Cash Flow Statement* so that cash flow from operating activities begins with net income before taxation, whereas Statement of Financial Accounting Standards No. 95, *Statement of Cash Flows* requires cash flow from operating activities to begin with net income after tax. Under IFRS the Company presents the overdraft facility in cash and cash equivalents in consolidated statements of cash flows (see Note 3.20) while under US GAAP the overdraft facility should be presented under financing activity.

l. New accounting standards

The implementation of the Statements No. 145 Rescission of FASB Statements No. 4, 44 and 64, Amendment of FASB Statement No. 13, and Technical Correction , No. 146 Accounting for Costs Associated with Exit or Disposal Activities and FASB issued Interpretation No. 45 (FIN 45) Guarantor s Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Officcons January 1, 2003 has not caused material changes to the Company s consolidated financial statements.

In January 2003, the FASB issued Interpretation No. 46 (FIN 46) Consolidation of Variable Interest Entities (VIEs). This interpretation changes the accounting and requirements for consolidation and disclosure of certain entities, including special purpose entities (SPEs). Under FIN 46, an entity is considered a VIE (and subject to consolidation) if its total equity at risk is determined insufficient to finance its activities without additional subordinated financial support, or if its equity investors lack certain characteristics that represent a controlling financial interest. An entity that is considered a VIE would be required to be consolidated by the enterprise that holds a majority of its variable interests (that is, the enterprise that has the most exposure to the economic risks and potential rewards from changes in the values of the VIE s assets and liabilities). The Company has adopted the Interpretation s disclosure provisions, effective for all financial statements issued after January 31, 2003, which require all holders of variable interests in VIEs to disclose the nature, purpose, size and activities of the VIEs, including the maximum exposure to losses. The consolidation requirements apply to all new VIEs created on and after February 1, 2003 with transitional provisions for VIEs that existed prior to that date. On December 24, 2003, the FASB issued a revised interpretation to FIN 46 (FIN 46R) to modify some of the provisions of FIN 46 and to exempt certain entities from its requirements. The Company adopted the provisions of FIN 46R to SPEs as at December 31, 2003, and plans to adopt the modified provisions of FIN 46R to all entities that are not SPE as at March 31, 2004. The determination of expected losses and expected residual returns is complex and requires the development of cash flow models. As described in Note 19c, the Company has a single finance lease agreement with Office Park Ltd. The lessor has been considered as a SPE due to single finance lease agreement, however the Company applies lease accounting to this arrangement and the related assets and liabilities are already reflected in the Company s consolidated financial statements. The Company is also reviewing certain dealers contracts to decide if they are VIE. The process of determination of potential VIE has not been finalized yet due to complexity of the analysis.

The Company implemented EITF 00-21 for arrangements entered into on or after July 1, 2003 (see Note 29c).

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Virgin Mobile Telecoms Limited

Report and Financial Statements

31 December 2003 (Unaudited)

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Virgin Mobile Telecoms Limited

Report and financial statements 2003

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Virgin Mobile Telecoms Limited

Directors' report

The directors present their annual report and the financial statements for the year ended 31 December 2003.

Principal activities

The principal activities of the group comprise of the sale of mobile phone handsets (both direct to end customers and to retailers) and the provision of mobile telecommunication services.

Business review and results

The turnover and profit for the financial year were £458,281,000 (2002 – £287,720,000) and £89,890,000 (2002 – £1,996,000) respectively. Details of the group's financial position as at 31 December 2003 are given in the group's Consolidated Balance Sheet.

No equity dividends were paid or proposed. A preference dividend of £9,011 (2002 – £9,011) per share totalling £2,703,300 (2002 – £2,703,300) has been calculated on the issue price of the 300 cumulative redeemable preference shares at the rate of 9% per annum. Interest on late payment of cumulative dividends of £1,852,000 (2002 – £1,235,000) is calculated at 11% above the Natwest lending rate and is included in the finance costs of non-equity shares. An indication of future developments of the business is given in the Chairman's Statement.

Financial position

As at 31 December 2003 the group had net liabilities of £69,863,000 (2002 – £159,753,000). The group is currently being financed by its previous shareholder, T-Mobile (see notes 25 and 26 to the financial statements), and the Virgin Group (see notes 25 and 26 to the financial statements). On 18 May 2004 the group repaid in full the syndicated bank loan (see note 16 to the financial statements). During 2003 the group repaid £25,588,000 of the syndicated bank loan and £69,412,000 was outstanding as at 31 December 2003. Following a renegotiation of the group's loans in January 2004 the T-Mobile loan is repayable in eight quarterly instalments commencing 31 March 2006, although this may be repaid earlier if the Virgin Group loan is repaid earlier than the T-Mobile repayment instalments are due. The Virgin Group loan is repayable upon demand, but the Virgin Group have indicated that they will not demand repayment of this loan during the next twelve months such that the group will not be able to meet its liabilities as they fall due.

Directors

The directors who served during the year were as follows:

| | |
|--------------------------|---|
| Sir Richard C.N. Branson | (Chairman – appointed as Chairman by rotation on 9 August 2003) |
| Julia S Chain | (resigned on 29 January 2004) |
| Thomas Dannenfeldt | (appointed on 30 June 2003; resigned on 29 January 2004) |
| Harris Jones | (Chairman – resigned as director and Chairman on 30 June 2003) |
| Brian J McBride | (Chairman – appointed as director and Chairman on 30 June 2003; resigned as Chairman by rotation on 9 August 2003; resigned as director on 29 January 2004) |
| Gordon D McCallum | |
| Andrew R Peters | (resigned on 30 June 2003) |
| Robert W Samuelson | |
| William E Whitehorn | (alternate director to Richard Branson) |

Details of directors' share interests are given in Note 7 to the accounts.

Supplier payment policy

The company's policy, which is also applied by the group, is to settle terms of payment with suppliers when agreeing the terms of each transaction, ensure that suppliers are made aware of the terms of payment and abide by the terms of

payment.

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Virgin Mobile Telecoms Limited

Directors' report

Employee consultation

The group places considerable value on the involvement of its employees and has continued to keep them informed on matters affecting them as employees and on the various factors affecting the performance of the group. Employee representatives are consulted regularly on a wide range of matters affecting current and future interests.

Disabled employees

Applications for employment by disabled persons are always fully considered, bearing in mind the aptitudes of the applicant concerned. In the event of members of staff becoming disabled every effort is made to ensure that their employment with the company continues and that appropriate training is arranged. It is the policy of the company that the training, career development and promotion of disabled persons should, as far as possible, be identical with that of other employees.

Auditors

On 1 August 2003, Deloitte & Touche transferred their business to Deloitte & Touche LLP, a limited liability partnership incorporated under the Limited Liability Partnerships Act 2000. The company's consent has been given to treating the appointment of Deloitte & Touche as extending to Deloitte & Touche LLP under the provisions of section 26(5) of the Companies Act 1989. The members of the Company have passed elective resolutions in accordance with Sections 366A, 252 and 386 of the Companies Act 1985 dispensing with the previous statutory requirements of holding annual general meetings, laying accounts before the company in general meetings and re-appointing auditors annually.

Approved by the Board of Directors
and signed on behalf of the Board

Peter Gram
Company Secretary

120 Campden Hill Road
London
W8 7AR
England

11 June 2004

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Virgin Mobile Telecoms Limited

Statement of directors' responsibilities

United Kingdom company law requires the directors to prepare financial statements for each financial year which give a true and fair view of the state of affairs of the company as at the end of the financial year and of the profit or loss of the company for that period. In preparing those financial statements, the directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and estimates that are reasonable and prudent;
- state whether applicable accounting standards have been followed;
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the company will continue in business.

The directors are responsible for keeping proper accounting records which disclose with reasonable accuracy at any time the financial position of the company and to enable them to ensure that the financial statements comply with the Companies Act 1985. They are also responsible for the system of internal control, for safeguarding the assets of the company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

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Virgin Mobile Telecoms Limited

Consolidated profit and loss account
Year ended 31 December 2003

| | Note | 2003 £'000 | 2002 £'000 |
|---|------|---------------|---------------|
| Turnover before exceptional item | | 442,039 | 287,720 |
| Exceptional turnover | 4 | 16,242 | — |
| Turnover | 2 | 458,281 | 287,720 |
| Cost of sales | | (238,403) | (175,682) |
| Gross profit | | 219,878 | 112,038 |
| Administrative expenses before exceptional item | | (128,963) | — |
| Exceptional operating costs | 4 | (23,575) | — |
| Administrative expenses | | (152,538) | (107,202) |
| Operating profit before exceptional items | | 74,673 | 4,836 |
| Exceptional items (net) | 4 | (7,333) | — |

| | | | |
|---|---|----------|----------|
| Operating profit | | 67,340 | 4,836 |
| Finance charges (net) | 3 | (10,629) | (11,841) |
| Profit (loss) on ordinary activities before taxation | 5 | 56,711 | (7,005) |
| Tax on loss on ordinary activities | 8 | 33,179 | 9,001 |
| Profit (loss) for the financial year | | 89,890 | 1,996 |
| Finance costs of non-equity shares | | (4,555) | (3,938) |
| Retained profit/(loss) for the year | | 85,335 | (1,942) |

All amounts derive from continuing operations.

There were no other recognised gains and losses in either year.

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Virgin Mobile Telecoms Limited

Consolidated balance sheet
31 December 2003

| | Note | 2003 £'000 | 2002 £'000 |
|--|------|---------------|---------------|
| Fixed assets | | | |
| Tangible assets | 10 | 28,730 | 24,828 |
| Current assets | | | |
| Stocks | 12 | 6,567 | 5,671 |
| Debtors | 13 | 70,570 | 43,705 |
| Deferred tax asset | 13 | 42,180 | 9,001 |
| Cash at bank and in hand | | 46,599 | 13,110 |
| | | 165,916 | 71,487 |
| Creditors: amounts falling due within one year | 14 | (263,250) | (112,924) |
| Net current liabilities | | (97,334) | (41,437) |
| Total assets less current liabilities | | (68,604) | (16,609) |
| Creditors: amounts falling due after more than one year | 15 | (1,259) | (143,144) |
| Net liabilities | | (69,863) | (159,753) |
| Capital and reserves | | | |
| Called up share capital | 17 | 19 | 19 |
| Share premium account | 18 | 30,036 | 30,036 |
| Profit and loss account | 18 | (99,918) | (189,808) |
| Accumulated deficit | 19 | (69,863) | (159,753) |
| Accumulated deficit may be analysed as: | | | |
| Equity interests | | (115,530) | (200,865) |
| Non-equity interests | | 45,667 | 41,112 |
| | | (69,863) | (159,753) |

These financial statements were approved by the Board of Directors on 11 June 2004 and signed on its behalf by:

Gordon D. McCallum
Director

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Virgin Mobile Telecoms Limited

Company balance sheet
31 December 2003

| | Note | 2003 £'000 | 2002 £'000 |
|--|------|---------------|---------------|
| Fixed assets | | | |
| Tangible assets | 10 | 28,644 | 23,735 |
| Investments | 11 | — | — |
| | | 28,644 | 23,735 |
| Current assets | | | |
| Stocks | 12 | 6,567 | 5,671 |
| Debtors | 13 | 75,703 | 49,399 |
| Deferred tax asset | 13 | 40,390 | 8,852 |
| Cash at bank and in hand | | 46,598 | 13,109 |
| | | 169,258 | 77,031 |
| Creditors: amounts falling due within one year | 14 | (263,101) | (112,778) |
| Net current liabilities | | (93,843) | (35,747) |
| Total assets less current liabilities | | (65,199) | (12,012) |
| Creditors: amounts falling due after more than one year | 15 | (53) | (141,729) |
| Net liabilities | | (65,252) | (153,741) |
| Capital and reserves | | | |
| Called up share capital | 17 | 19 | 19 |
| Share premium account | 18 | 30,036 | 30,036 |
| Profit and loss account | 18 | (95,307) | (183,796) |
| Accumulated deficit | | (65,252) | (153,741) |
| Accumulated deficit may be analysed as: | | | |
| Equity interests | | (110,919) | (194,853) |
| Non-equity interests | | 45,667 | 41,112 |
| | | (65,252) | (153,741) |

These financial statements were approved by the Board of Directors on 11 June 2004 and signed on its behalf by:

Gordon D. McCallum
Director

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 Virgin Mobile Telecoms Limited

 Consolidated cash flow statement
 Year ended 31 December 2003

| | Note | 2003 £'000 | 2002 £'000 |
|--|------|---------------|---------------|
| Net cash inflow from operating activities | 20 | 82,812 | 34,712 |
| Returns on investments and servicing of finance | 21 | (4,291) | (7,746) |
| Capital expenditure and financial investment | 21 | (19,211) | (18,315) |
| Cash inflow before financing | | 59,310 | 8,651 |
| Financing | 21 | (25,821) | (5,255) |
| Increase in cash in the year | 22 | 33,489 | 3,396 |

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 Virgin Mobile Telecoms Limited

 Notes to the accounts
 Year ended 31 December 2003

1. Accounting policies

The financial statements are prepared in accordance with applicable United Kingdom accounting standards. The particular accounting policies adopted, all of which have been applied consistently throughout the current and prior year, are described below.

Basis of preparation

The financial statements are prepared under the historical cost convention.

The group has considered the implication of adopting Financial Reporting Standard 5 "Reporting the Substance of Transactions", Application Note G "Revenue Recognition" for the first time in the year ending 31 December 2003. The group has determined that Application Note G does not have a material impact on its financial results and has continued to adopt the accounting policies as set out below.

Basis of consolidation

The group accounts consolidate the accounts of Virgin Mobile Telecoms Limited and its subsidiary undertaking drawn up to 31 December each year. The results of subsidiaries acquired are consolidated for the periods from which

control passed. Acquisitions are accounted for under the acquisition method.

Turnover

Turnover represents amounts receivable for handset and airtime services provided in the normal course of business, net of VAT and trade discounts.

Handset, and other equipment, revenue is recognised based on the amounts receivable at the date of sale. Airtime turnover derived from customers is recognised based on the usage of the network in the period. Prepaid airtime sales are deferred until the customer uses the stored value.

Subscriber acquisition costs

Subscriber acquisition costs, which include the commission costs associated with acquiring new customers and other incremental costs of customer acquisition, are recognised in the profit and loss account as incurred.

Tangible fixed assets

Tangible fixed assets are stated at cost, net of depreciation and any provision for impairment. Depreciation is provided on all tangible fixed assets at rates calculated to write off the cost or valuation, less estimated residual value, of each asset on a straight-line basis over its expected useful life, as follows:

| | |
|------------------------|-----------|
| Leasehold improvements | 3 years |
| Computer systems | 2-3 years |
| Fixtures and fittings | 3 years |
| Office equipment | 3 years |

Residual value is calculated on prices prevailing at the date of acquisition. Depreciation is not charged on assets in the course of construction until they are ready for service.

Web site development costs

Design and content development costs are capitalised only to the extent that they lead to the creation of an enduring asset delivering benefits at least as great as the amount capitalised. If there is insufficient evidence on which to base reasonable estimates of the economic benefits that will be

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Virgin Mobile Telecoms Limited

Notes to the accounts
Year ended 31 December 2003

1. Accounting policies (Continued)

generated in the period until the design and content are next updated, the costs of developing the design and content are charged to the profit and loss account as incurred.

Investments

Fixed asset investments are shown at cost less provision for impairment. Current asset investments are stated at the lower of cost and net realisable value.

Stocks

Stocks are stated at the lower of cost and net realisable value. Net realisable value is based on estimated selling price, less further direct selling costs. Provision is made for obsolete, slow-moving or defective items where appropriate.

Pension costs

For defined contribution schemes the amount charged to the profit and loss account in respect of pension costs and other post-retirement benefits is the contributions payable in the year. Differences between contributions payable in the year and contributions actually paid are shown as either accruals or prepayments in the balance sheet.

Taxation

Corporation tax is provided on taxable profits at the current rate.

Deferred tax is provided in full on all timing differences which result in an obligation at the balance sheet date to pay more tax, or a right to pay less tax, at a future date, at rates expected to apply when they crystallise based on current tax rates and laws. Timing differences arise from the inclusion of items of income and expenditure in taxation computations in periods different from those in which they are included in the financial statements. Deferred tax assets are recognised to the extent that it is regarded as more likely than not that they will be recovered. Deferred tax assets and liabilities are not discounted.

Leases

Assets obtained under hire purchase contracts or finance leases are capitalised in the balance sheet. Those held under hire purchase contracts are depreciated over their useful economic lives. Those held under finance leases are depreciated over their estimated useful lives or the leases' term, whichever is shorter.

The interest element of these obligations is charged to the profit and loss account over the relevant period. The capital element of the future payments is treated as a liability.

Rentals under operating leases are charged on a straight-line basis over the lease term, even if the payments are not made on such a basis. Benefits received and receivable as an incentive to sign an operating lease are similarly spread on a straight-line basis over the lease term, except where the period to the review date on which the rent is first expected to be adjusted to the prevailing market rate is shorter than the full lease term, in which case the shorter period is used.

Finance costs

Finance costs of debt and non-equity shares are recognised in the profit and loss account over the term of such instruments at a constant rate on the carrying amount. Where the finance costs for non-equity shares are not equal to the dividends on these instruments, the difference is also accounted for in the profit and loss account as an appropriation of profits. The finance cost charged in the period for non-equity shares is written back through the profit

and loss reserve if the company is unable to pay the dividend.

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Virgin Mobile Telecoms Limited

Notes to the accounts

Year ended 31 December 2003

1. Accounting policies (Continued)

Foreign currency

Transactions in foreign currencies are recorded at the rate of exchange at the date of the transaction or, if hedged, at the forward contract rate. Monetary assets and liabilities denominated in foreign currencies at the balance sheet date are reported at the rates of exchange prevailing at that date or, if appropriate, at the forward contract rate.

Derivative financial instruments

The group uses derivative financial instruments to reduce exposure to interest rate movements and foreign exchange risk. The group does not hold or issue derivative financial instruments for speculative purposes.

For an interest rate swap to be treated as a hedge the instrument must be related to actual assets or liabilities or a probable commitment and must change the nature of the interest rate by converting a fixed rate to a variable rate or vice versa. Interest differentials under these swaps are recognised by adjusting net interest payable over the periods of the contracts.

For a forward contract to be treated as a hedge the instrument must be related to actual foreign currency assets or liabilities or to a probable commitment. It must involve the same currencies or similar currencies as the hedged item and must also reduce the risk of foreign exchange movements on the group's operations. Gains and losses arising on these contracts are only recognised in the profit and loss account when the hedged transaction itself has been reflected in the group's accounts.

If an instrument ceases to be accounted for as a hedge, for example because the underlying hedged position is eliminated, the instrument is marked to market and any resulting profit or loss recognised at that time.

2. Segmental information

The group's operations and markets are located within the United Kingdom and form a segment with two types of product; service and equipment.

3. Finance charges (net)

| | 2003 | 2002 |
|---------------------------------------|---------|---------|
| | £'000 | £'000 |
| Bank loans and overdrafts | (5,969) | (6,944) |
| Finance lease interest | (16) | (57) |
| Interest payable to related companies | (5,566) | (5,362) |

| | | |
|--|----------|----------|
| Interest payable and similar charges | (11,551) | (12,363) |
| Interest receivable and similar income | 922 | 522 |
| | (10,629) | (11,841) |

4. Exceptional operating items

| | 2003 £'000 | 2002 £'000 |
|---|---------------|---------------|
| Revenue for previously withheld marketing support | 16,242 | — |
| Long term bonus | (23,575) | — |
| | (7,333) | — |

At the end of 2002, T-Mobile were withholding certain amounts for marketing support contributions. As a result of the settlement of various disputes involving Virgin Mobile, T-Mobile and certain

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Virgin Mobile Telecoms Limited

Notes to the accounts

Year ended 31 December 2003

4. Exceptional operating items (Continued)

Virgin Group companies, Virgin Mobile was entitled to receive certain amounts for previously withheld marketing support contributions that would be determined following future proceedings. The amount has now been determined with certainty and £16,242,000 has been recognised as turnover in the results for the year ended 31 December 2003 for disputed marketing support contributions for the periods ended prior to 31 December 2002 and the year 31 December 2003.

The expense for £23,575,000 relates to the implementation of the long term bonus paid to selected employees as a reward for growing the business in the period from launch to 31 December 2003.

5. Profit (loss) on ordinary activities before taxation

Profit (loss) on ordinary activities before taxation is stated after charging:

| | 2003 £'000 | 2002 £'000 |
|--|---------------|---------------|
| Depreciation and amounts written off tangible fixed assets | | |
| – Owned assets | 12,997 | 11,071 |
| – Leased assets | 322 | 215 |
| Operating lease rentals | | |
| – Leasehold property | 1,187 | 1,179 |
| Auditors' remuneration for audit services | 168 | 151 |

Amounts payable to the auditors by the company and its subsidiary undertaking in respect of non-audit services were £160,000 (2002 – £491,000).

6. Staff costs

The average monthly number of employees (including executive directors) was:

| | 2003 | 2002 |
|---|--------|--------|
| | No. | No. |
| Distribution | 112 | 43 |
| Marketing | 49 | 45 |
| Administration | 1,133 | 1,039 |
| | 1,294 | 1,127 |
| Their aggregate remuneration comprised: | | |
| | £ | '000 |
| Wages and salaries | 56,508 | 27,921 |
| Social security costs | 3,006 | 2,432 |
| Other pension costs (see note 24) | 955 | 776 |
| | 60,469 | 31,129 |

Included in the above for the year ended 31 December 2003 is an exceptional operating expense of £23,575,000 (2002 – £nil) relating to the implementation of the long term bonus paid to selected employees as a reward for growing the business in the period from launch to 31 December 2003 (see note 4).

7. Directors' remuneration, interests and transactions

Aggregate remuneration

Virgin Management Limited and T-Mobile each provide three directors of the company and receive a £45,000 (2002 – £45,000) consultancy fee for these executive services. The total amount of directors' remuneration and other benefits were £90,000 (2002 – £90,000).

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Virgin Mobile Telecoms Limited

Notes to the accounts

Year ended 31 December 2003

7. Directors' remuneration, interests and transactions (Continued)

Directors' interests

Sir Richard Branson is deemed to have an interest in the share capital of the company by virtue of being one of the principal beneficiaries of a number of trusts that own Virgin Group Investments Limited, the ultimate parent company of Bluebottle Investments Inc., Bluebottle Investments S.A. and Bluebottle UK Limited, which hold shares in the capital of the company.

Gordon D. McCallum is deemed to have an interest in the share capital of the company by virtue of being one of the beneficiaries of a trust that holds shares in the capital of the company.

8. Tax on profit (loss) on ordinary activities

The tax credit comprises:

| | 2003 £'000 | 2002 £'000 |
|---|---------------|---------------|
| Current tax | | |
| UK corporation tax | — | — |
| Total current tax | — | — |
| Deferred tax | | |
| Origination and reversal of timing differences | 33,179 | 9,001 |
| Total deferred tax (see note 13) | 33,179 | 9,001 |
| Total tax credit on profit (loss) on ordinary activities | 33,179 | 9,001 |

The differences between the total current tax shown above and the amount calculated by applying the standard rate of UK corporation tax to the loss before tax is as follows:

| | 2003 £'000 | 2002 £'000 |
|---|---------------|---------------|
| Profit (loss) on ordinary activities before tax | 56,711 | (7,005) |
| Tax on profit (loss) on ordinary activities at standard UK corporation tax rate of 30% (2002 – 30%) | 17,013 | (2,102) |
| Effects of: | | |
| Expenses not deductible for tax purposes | 231 | 158 |
| Depreciation in excess of capital allowances | 219 | 3,346 |
| Utilisation of brought forward losses | (17,463) | (1,402) |
| | — | — |

9. Profit (loss) attributable to Virgin Mobile Telecoms Limited

The retained profit for the financial period dealt with in the accounts of the company, Virgin Mobile Telecoms Limited, was £83,934,000 (2002 – loss of £630,000). As permitted by Section 230 of the Companies Act 1985, no separate profit and loss account is presented in respect of the company.

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Virgin Mobile Telecoms Limited

Notes to the accounts
Year ended 31 December 2003

10. Tangible fixed assets

| Group | Leasehold improvements £'000 | Fixtures and fittings £'000 | Office equipment £'000 | Computer systems £'000 | Total £'000 |
|---------------------------------|------------------------------------|--------------------------------------|------------------------------|------------------------------|----------------|
| Cost | | | | | |
| At 1 January 2003 | 7,795 | 704 | 299 | 48,361 | 57,159 |
| Additions | 2 | 62 | 113 | 18,341 | 18,518 |
| Transfer to current assets | — | — | — | (2,594) | (2,594) |
| At 31 December 2003 | 7,797 | 766 | 412 | 64,108 | 73,083 |
| Accumulated depreciation | | | | | |
| At 1 January 2003 | 6,578 | 651 | 262 | 24,840 | 32,331 |
| Charge for the year | 1,133 | 40 | 44 | 12,102 | 13,319 |
| Transfer to current assets | — | — | — | (1,297) | (1,297) |
| At 31 December 2003 | 7,711 | 691 | 306 | 35,645 | 44,353 |
| Net book value | | | | | |
| At 31 December 2003 | 86 | 75 | 106 | 28,463 | 28,730 |
| At 31 December 2002 | 1,217 | 53 | 37 | 23,521 | 24,828 |

| Company | Leasehold improvements £'000 | Fixtures and fittings £'000 | Office equipment £'000 | Computer systems £'000 | Total £'000 |
|---------------------------------|------------------------------------|--------------------------------------|------------------------------|------------------------------|----------------|
| Cost | | | | | |
| At 1 January 2003 | 447 | 704 | 299 | 48,361 | 49,811 |
| Additions | — | 62 | 113 | 18,341 | 18,516 |
| Transfer to current assets | — | — | — | (2,594) | (2,594) |
| At 31 December 2003 | 447 | 766 | 412 | 64,108 | 65,733 |
| Accumulated depreciation | | | | | |
| At 1 January 2003 | 323 | 651 | 262 | 24,840 | 26,076 |
| Charge for the year | 124 | 40 | 44 | 12,102 | 12,310 |
| Transfer to current assets | — | — | — | (1,297) | (1,297) |
| At 31 December 2003 | 447 | 691 | 306 | 35,645 | 37,089 |
| Net book value | | | | | |
| At 31 December 2003 | — | 75 | 106 | 28,463 | 28,644 |
| At 31 December 2002 | 124 | 53 | 37 | 23,521 | 23,735 |

Tangible fixed assets include computer equipment and office equipment at a cost of £663,000 (2002 – £644,000) and net book value of £19,000 (2002 – £322,000) in respect of assets held under a finance lease.

Computer systems for the group and company includes £5,119,000 (2002 – £15,314,000) of assets in the course of construction.

£1,297,000 was transferred to current assets representing amounts owing from T-Mobile in respect of assets in the course of development.

Virgin Mobile Telecoms Limited

Notes to the accounts
Year ended 31 December 2003

11. Fixed asset investments
Subsidiary undertaking

Virgin Mobile Telecoms Limited has a £2 investment representing a 100% holding in Bluebottle Call Limited, a subsidiary undertaking, the principal business of which is property investment. Bluebottle Call Limited is incorporated in Great Britain.

12. Stocks

| | Group | | Company | |
|--------------------------------|-------|-------|---------|-------|
| | 2003 | 2002 | 2003 | 2002 |
| | £'000 | £'000 | £'000 | £'000 |
| Finished goods held for resale | 6,567 | 5,671 | 6,567 | 5,671 |

13. Debtors

| | Group | | Company | |
|--|--------|--------|---------|--------|
| | 2003 | 2002 | 2003 | 2002 |
| | £'000 | £'000 | £'000 | £'000 |
| Trade debtors | 33,898 | 27,542 | 33,898 | 27,542 |
| Amounts owed by other related companies (see note 25) | 33,619 | 13,019 | 33,619 | 13,019 |
| Amounts owed by subsidiary undertaking | — | — | 6,154 | 6,689 |
| Prepayments and accrued income | 3,053 | 3,144 | 2,032 | 2,149 |
| | 70,570 | 43,705 | 75,703 | 49,399 |
| Deferred tax asset | 42,180 | 9,001 | 40,390 | 8,852 |

A group deferred tax asset of £42,180,000 has been recognised at 31 December 2003 (2002 – £9,001,000). Detailed group budgets indicate that taxable profits will arise in the future. Based on these budgets the directors consider that a deferred tax asset of £42,180,000 in respect of tax losses and tax allowances should be recognised. As at 31 December 2003 there was no deferred tax asset which was not recognised (31 December 2002 – a deferred tax asset of £49,908,000 was not recognised in respect of certain tax losses and tax allowances as there remained a high enough degree of uncertainty regarding the future for these assets not to be regarded as more likely than not to reverse at that time).

A company deferred tax asset of £40,390,000 has been recognised at 31 December 2003 (2002 - £8,852,000).

14. Creditors: amounts falling due within one year

| | Group | | Company | |
|--|-------|-------|---------|-------|
| | 2003 | 2002 | 2003 | 2002 |
| | £'000 | £'000 | £'000 | £'000 |

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| | | | | |
|--|---------|---------|---------|---------|
| Bank loans | 69,412 | 23,000 | 69,412 | 23,000 |
| Obligations under finance lease contract | 6 | 233 | 6 | 233 |
| Trade creditors | 10,114 | 21,203 | 10,114 | 21,203 |
| Amounts owed to other related companies (see note 25) | 78,105 | 1,842 | 78,105 | 1,842 |
| Other taxation and social security | 6,314 | 5,415 | 6,375 | 5,478 |
| Other creditors | 1,159 | 392 | 1,159 | 392 |
| Accruals and deferred income | 98,140 | 60,839 | 97,930 | 60,630 |
| | 263,250 | 112,924 | 263,101 | 112,778 |

During the year ending 31 December 2003 the company has repaid £25,588,000 of the syndicated loan facility. The company's arrangements regarding bank and shareholder loans have changed post year end (see note 26). The loan facility is secured on the share capital and assets of the group.

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Virgin Mobile Telecoms Limited

Notes to the accounts

Year ended 31 December 2003

15. Creditors: amounts falling due after more than one year

| | Group | | Company | |
|--|-------|---------|---------|---------|
| | 2003 | 2002 | 2003 | 2002 |
| | £'000 | £'000 | £'000 | £'000 |
| Obligations under finance lease contract | 13 | — | 13 | — |
| Bank loans | — | 72,000 | — | 72,000 |
| Amounts owed to other related companies (see note 25) | — | 69,676 | — | 69,676 |
| Accruals and deferred income | 1,246 | 1,468 | 40 | 53 |
| | 1,259 | 143,144 | 53 | 141,729 |

The net finance lease obligations to which the group and company are committed and which are secured on the related assets are:

| | Group and Company | |
|---------------------------|----------------------|-------|
| | 2003 | 2002 |
| | £'000 | £'000 |
| In one year or less | 6 | 233 |
| Between one and two years | 13 | — |
| | 19 | 233 |

16. Derivatives and other financial instruments

Set out below is an explanation of the role financial instruments have had during the period in creating or changing the risks the group faces in its activities. The explanation summarises the objectives and policies for holding or issuing financial instruments and similar contracts, and the strategies for achieving those objectives that have been followed during the period.

The company has established treasury policies which are reviewed annually by the Board or Audit committee to ensure they remain relevant to rapid business change.

The major financial risks faced by the group are exchange rate, and interest rate exposure and liquidity risks. These are outlined below:

Foreign currency risk

About one-third of the handset purchases made by the company are from suppliers in continental Europe. These purchases are invoiced in Euros. The company's policy is to eliminate some currency exposure on purchases at the time of purchase through forward currency contracts. All other purchases are denominated in sterling.

Interest rate risk

The company has entered into interest rate swaps to hedge against adverse movements in LIBOR in relation to its syndicated loan facility. The company's policy is to keep between 50 per cent and 75 percent of the syndicated loan borrowing at fixed rates of interest. At the year-end, 58 per cent of the syndicated loan was at fixed rates after taking account of interest rate swaps.

The numerical disclosures in this note deal with financial assets and financial liabilities as defined in Financial Reporting Standard 13 "Derivatives and other financial instruments: Disclosures" ("FRS 13"). For this purpose non-equity shares issued by the company are dealt with in the disclosures in the same way as the group's financial liabilities but separately disclosed. Certain financial assets such as investments in subsidiary and associated companies are also excluded from the scope of these disclosures.

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Virgin Mobile Telecoms Limited

Notes to the accounts
Year ended 31 December 2003

16. Derivatives and other financial instruments (Continued)

As permitted by FRS 13, short term debtors and creditors have been excluded from the disclosures, other than the currency disclosures.

Liquidity risk

The company's overall objective is to ensure that it is, at all times, able to meet its financial commitments as and when they fall due. To this end, surplus funds are collected and invested with approved counterparties, within authorised limits, with the aim of maintaining short term liquidity while maximising yield.

Interest rate profile

The group has no financial assets other than cash at bank.

After taking into account interest rate swaps, the interest rate profile of the group's financial liabilities at 31 December 2003 was as follows:

| Currency | Total £'000 | 2003 | |
|---------------------|----------------|---------------------------|---------------------|
| | | Floating rate £'000 | Fixed rate £'000 |
| – Borrowings | 144,673 | 104,654 | 40,019 |
| – Non-equity shares | 30,050 | — | 30,050 |
| Total | 174,723 | 104,654 | 70,069 |

The profile at 31 December 2002 for comparison purposes was as follows:

| Currency | Total £'000 | 2002 | |
|---------------------|----------------|---------------------------|---------------------|
| | | Floating rate £'000 | Fixed rate £'000 |
| – Borrowings | 164,909 | 89,676 | 75,233 |
| – Non-equity shares | 30,050 | — | 30,050 |
| Total | 194,959 | 89,676 | 105,283 |

Further analysis of the interest rate profile at 31 December 2003 and at 31 December 2002 is as follows:

| Currency | 2003 Fixed rate | |
|--------------|--|--|
| | Weighted average interest rate (%) | Weighted average period for which rate is fixed Years |
| – Borrowings | 7.0 | 0.3 |

Virgin Mobile Telecoms Limited

Notes to the accounts

Year ended 31 December 2003

16. Derivatives and other financial instruments (Continued)

| | 2003 Fixed rate | |
|-------------------|------------------------------------|---|
| | Weighted average interest rate (%) | Weighted average period for which rate is fixed Years |
| Currency Sterling | | |
| – Borrowings | 7.4 | 1.0 |

Cumulative redeemable preference share dividends accrue on the non-equity shares at the rate of 9% per annum. Dividend interest on late payment is charged at 11% above the Natwest lending rate. As there is no defined maturity date, the non-equity shares have been excluded from the weighted average analysis.

The interest rate on the floating rate shareholder loans is at 4% above the three-month LIBOR rate. The interest rate on the floating rate element of the facility loan is linked to the LIBOR for a comparable period to that of the remaining term of the facility.

Currency exposures

As at 31 December 2003, after taking into account the effects of forward foreign exchange contracts the company had no currency exposures (2002 – £nil).

Maturity of financial liabilities

The maturity profile of the group's financial liabilities at 31 December 2003 was as follows:

| | Non-equity shares £'000 | Borrowings £'000 | Total £'000 |
|---|----------------------------|---------------------|----------------|
| In one year or less (see note 26) | — | 144,673 | 144,673 |
| In more than one year but not more than two years | — | — | — |
| In more than two years but not more than five years | — | — | — |
| In more than five years | 30,050 | — | 30,050 |
| Total | 30,050 | 144,673 | 174,723 |

The profile at 31 December 2002 for comparison purposes was as follows:

| Non-equity shares | Borrowings £'000 | Total £'000 |
|-------------------|---------------------|----------------|
|-------------------|---------------------|----------------|

| | £'000 | | |
|---|--------|---------|---------|
| In one year or less | — | 23,233 | 23,233 |
| In more than one year but not more than two years | — | 46,000 | 46,000 |
| In more than two years but not more than five years | — | 95,676 | 95,676 |
| In more than five years | 30,050 | — | 30,050 |
| Total | 30,050 | 164,909 | 194,959 |

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Virgin Mobile Telecoms Limited

Notes to the accounts

Year ended 31 December 2003

16. Derivatives and other financial instruments (Continued)
Borrowing facilities

The group had undrawn committed borrowing facilities at 31 December 2003 and 31 December 2002 in respect of which all conditions precedent had been met, as follows:

| | 2003 £'000 | 2002 £'000 |
|--|---------------|---------------|
| Expiring in one year or less | — | — |
| Expiring in more than one year but not more than two years | — | — |
| Expiring in more than two years | 10,000 | 15,000 |
| Total | 10,000 | 15,000 |

Fair values

Set out below is a comparison by category of book values and fair values of the group's financial liabilities at 31 December 2003 and 31 December 2002.

| | 2003 | | 2002 | |
|---|---------------------|---------------------|---------------------|---------------------|
| | Book value £'000 | Fair value £'000 | Book value £'000 | Fair value £'000 |
| Primary financial instruments held or issued to finance the group's operations | | | | |
| Short term financial liabilities and current portion of long term borrowings | 144,660 | 146,582 | 23,233 | 23,751 |
| Long term borrowings | 30,063 | 30,063 | 72,000 | 75,738 |
| Derivative financial instruments held to manage the interest rate and currency profile | | | | |
| Interest rate swaps | 168 | 331 | 375 | 1,778 |

Forward foreign exchange contracts — — — (165)

The fair value of the interest rate swaps and forward foreign exchange contracts have been determined by reference to prices available from the markets on which the instrument involved is traded. All the other fair values shown above have been calculated by discounting cash flows at prevailing interest rates.

The group believes that the fair value of the shareholder loans (see note 25) and the cumulative redeemable preference shares approximate their book value. As at 31 December 2002, the fair value of the shareholder loans and the cumulative redeemable preference shares were not presented as they were not publicly traded and the timing and nature of repayments were uncertain.

Gains and losses on hedges

The group enters into forward foreign currency contracts to eliminate some of the currency exposures that arise on purchases denominated in foreign currencies. It also uses interest rate swaps to manage its interest rate profile. Changes in the fair value of instruments used as hedges are not recognised in the accounts until the hedged position matures.

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Virgin Mobile Telecoms Limited

Notes to the accounts
Year ended 31 December 2003

16. Derivatives and other financial instruments (Continued)

An analysis of these unrecognised gains and losses is as follows:

| | 2003 | | |
|--|-------|---------|---------|
| | Gains | Losses | Net |
| | £'000 | £'000 | £'000 |
| Unrecognised gains and losses on hedges at 1 January 2003 | 165 | 1,403 | 1,238 |
| Gains and losses arising in previous years that were recognised in 2003 | (165) | (1,328) | (1,163) |
| Gains and losses arising before 1 January that were not recognised in 2003 | — | 75 | 75 |
| Gains and losses arising in 2003 that were not recognised in 2003 | — | 88 | 88 |
| Unrecognised gains and losses on hedges at 31 December 2003 | — | 163 | 163 |
| Of which: | | | |
| Gains and losses expected to be recognised in 2004 | — | 163 | 163 |
| Gains and losses expected to be recognised in 2005 or later | — | — | — |

An analysis of these unrecognised gains and losses in 2002 is as follows:

| | Gains £'000 | 2002 Losses £'000 | Net £'000 |
|--|----------------|-------------------------|--------------|
| Unrecognised gains and losses on hedges at 1 January 2002 | 287 | 1,313 | 1,026 |
| Gains and losses arising in previous years that were recognised in 2002 | (287) | (1,116) | (829) |
| Gains and losses arising before 1 January that were not recognised in 2002 | — | 197 | 197 |
| Gains and losses arising in 2002 that were not recognised in 2002 | 165 | 1,206 | 1,041 |
| Unrecognised gains and losses on hedges at 31 December 2002 | 165 | 1,403 | 1,238 |
| Of which: | | | |
| Gains and losses expected to be recognised in 2003 | 165 | 1,251 | 1,086 |
| Gains and losses expected to be recognised in 2004 or later | — | 152 | 152 |

17. Called up share capital

| | 2003 £ | 2002 £ |
|---|-----------|-----------|
| Authorised: | | |
| 10,000 'D' ordinary shares of £0.01 each | 100 | 100 |
| 475,000 non-voting preference 'B' shares of £0.01 each | 4,750 | 4,750 |
| 30,000 'E' shares of £0.02 each | 600 | 600 |
| 500,000,000 cumulative redeemable preference shares of £0.01 each | 5,000,000 | 5,000,000 |
| 485,000 preference voting 'A' shares of £0.02 each | 9,700 | 9,700 |
| 475,000 zero dividend voting 'C' shares of £0.01 each | 4,750 | 4,750 |
| | 5,019,900 | 5,019,900 |
| Called up, allotted and fully paid | | |
| 10,000 'D' ordinary shares of £0.01 each | 100 | 100 |
| 475,000 non-voting preference 'B' shares of £0.01 each | 4,750 | 4,750 |
| 13,500 'E' shares of £0.02 each | 270 | 270 |
| 300 cumulative redeemable preference shares of £0.01 each | 3 | 3 |
| 485,000 preference voting 'A' shares of £0.02 each | 9,700 | 9,700 |
| 475,000 zero dividend voting 'C' shares of £0.01 each | 4,750 | 4,750 |
| | 19,573 | 19,573 |

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Virgin Mobile Telecoms Limited

Notes to the accounts

Year ended 31 December 2003

17. Called up share capital (Continued)

The shareholders funds attributable to non-equity shares is the nominal value of the respective non-equity shares plus £45,653,000 (2002 – £41,098,000) attributable to the cumulative redeemable preference shares.

"D' Ordinary shares ("D' Shares")

'D' shares are entitled to receive a preferred dividend being a portion of the first £100 million to be distributed after payment of cumulative redeemable preference share dividends and any arrears of that dividend. Holders of 'D' shares together with 'B' shareholders are entitled to receive 50% of this preferred dividend. 'D' shareholders are also eligible to receive ordinary dividends. Holders of 'D' shares receive 1 vote per share. On a winding-up, 'D' shareholders together with 'B' shareholders are eligible to receive, after payment to the cumulative redeemable preference shareholders, a 50% share in the first £100 million to be distributed together with an equal share of any remaining surplus assets.

Non-voting preference 'B' shares ("B' shares")

'B' shares are entitled to receive a preferred dividend being a portion of the first £100 million to be distributed after payment of cumulative redeemable preference share dividends and any arrears of that dividend. Holders of 'B' shares together with 'D' shareholders are entitled to receive 50% of this preferred dividend. 'B' shareholders are also eligible to receive ordinary dividends. Holders of 'B' shares have no voting rights. On a winding-up, 'B' shareholders together with 'D' shareholders are entitled to receive, after payment to the cumulative redeemable preference shareholders, a 50% share in the first £100 million to be distributed together with an equal share of any remaining surplus assets.

'E' shares

'E' shares are only entitled to receive ordinary dividends (after cumulative redeemable preference share dividends and preferred dividends to 'A', 'B' and 'D' shareholders) at the earlier of 5 years after the date of issue of the shares and the date of realisation (being flotation, sale or a winding-up). After 5 years or realisation, 'E' shareholders are entitled to 1 vote per share. On a winding-up, they are entitled to receive a share in the surplus assets after payment to the cumulative redeemable preference shareholders and the 'A', 'B' and 'D' shareholders.

Cumulative redeemable preference shares

Cumulative redeemable preference shares carry an entitlement to dividend at the rate 9% per annum on the issue price and may be redeemed at £100,122 per share at any time at the option of the company. Holders of the cumulative redeemable preference shares have no voting rights. On a winding-up, the holders are entitled to receive, in priority to any other classes of shares, the sum of £100,122 per share together with any arrears of dividend.

Preference voting 'A' shares (" 'A' shares")

'A' shares are entitled to receive a preferred dividend of 50% of the first £100 million to be distributed after payment of cumulative redeemable preference share dividends and any arrears of that dividend. 'A' shareholders are also eligible to receive ordinary dividends and receive 1 vote per share. Holders of 'A' shares have the right on a winding-up to receive, after payment to the cumulative redeemable preference shareholders, a 50% share in the first £100 million to be distributed together with an equal share of any remaining surplus assets.

Zero dividend voting 'C' shares (" 'C' shares")

'C' shareholders are not entitled to receive any dividend income but have 1 vote per share. On a winding-up, they are entitled to receive a share in the surplus assets after payment to the cumulative redeemable preference shareholders and the 'A', 'B' and 'D' shareholders.

See note 26 for changes to called up share capital since the balance sheet date.

Virgin Mobile Telecoms Limited

Notes to the accounts

Year ended 31 December 2003

18. Reserves

| | Share premium account £'000 | Profit and loss account £'000 | Total £'000 |
|------------------------------------|--------------------------------------|--|----------------|
| Group | | | |
| At 1 January 2003 | 30,036 | (189,808) | (159,772) |
| Retained profit for the year | — | 85,335 | 85,335 |
| Finance costs of non-equity shares | — | 4,555 | 4,555 |
| At 31 December 2003 | 30,036 | (99,918) | (69,882) |
| | | | |
| | Share premium account £'000 | Profit and loss account £'000 | Total £'000 |
| Company | | | |
| At 1 January 2003 | 30,036 | (183,796) | (153,760) |
| Retained profit for the year | — | 83,934 | 83,934 |
| Finance costs of non-equity shares | — | 4,555 | 4,555 |
| At 31 December 2003 | 30,036 | (95,307) | (65,271) |

19. Reconciliation of movements in group shareholders' funds

| | 2003 £'000 | 2002 £'000 |
|-------------------------------------|---------------|---------------|
| Retained profit (loss) for the year | 85,335 | (1,942) |
| Finance cost of non-equity shares | 4,555 | 3,938 |
| Net movement to accumulated deficit | 89,890 | 1,996 |
| | (159,753) | (161,749) |
| Closing accumulated deficit | (69,863) | (159,753) |

20. Reconciliation of operating loss to operating cash flows

| | 2003 £'000 | 2002 £'000 |
|--|---------------|---------------|
| Operating profit | 67,340 | 4,836 |
| Depreciation charges | 13,319 | 11,286 |
| Increase in stocks | (896) | (744) |
| Increase in debtors | (25,573) | (4,701) |
| Increase in creditors | 28,622 | 24,035 |
| Net cash inflow (outflow) from operating activities | 82,812 | 34,712 |

21. Analysis of cash flows

| | 2003 £'000 | 2002 £'000 |
|---|-----------------|----------------|
| Returns on investments and servicing finance | | |
| Interest received | 922 | 522 |
| Interest paid | (5,202) | (8,220) |
| Interest element of finance lease rentals | (11) | (48) |
| Net cash outflow | (4,291) | (7,746) |
| Capital expenditure and financial investment | | |
| Purchase of tangible fixed assets | (19,211) | (18,315) |
| Financing | | |
| Repayment of loans secured on share capital and assets of the group | (25,588) | (5,000) |
| Repayment of capital element of finance lease | (233) | (255) |
| Net cash outflow | (25,821) | (5,255) |

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Virgin Mobile Telecoms Limited

Notes to the accounts

Year ended 31 December 2003

22. Analysis and reconciliation of net debt

| | 1 January 2003 £'000 | Cash flow £'000 | Other non-cash changes £'000 | 31 December 2003 £'000 |
|--|----------------------------|--------------------|---------------------------------------|---------------------------------|
| Cash in hand, at bank | 13,110 | 33,489 | — | 46,599 |
| Debt due within one year and after one year | (164,676) | 25,588 | (5,566) | (144,654) |
| Finance lease | (233) | 233 | (19) | (19) |
| Net debt | (151,799) | 59,310 | (5,585) | (98,074) |
| | | | 2003 £'000 | 2002 £'000 |
| Increase in cash in the period | | | 33,489 | 3,396 |
| Cash used to repay debt | | | 25,588 | 5,000 |
| Cash used to repay finance lease | | | 233 | 255 |
| Change in net debt resulting from cash flows | | | 59,310 | 8,651 |
| Other non-cash changes | | | (5,585) | (5,362) |
| Movement in net debt in period | | | 53,725 | 3,289 |
| Net debt brought forward | | | (151,799) | (155,088) |
| Net debt at 31 December | | | (98,074) | (151,799) |

The non-cash changes represent the interest on the shareholder loans that is rolled up into the principal on a quarterly basis (see note 16).

23. Financial commitments

Annual minimum lease commitments:

| | Group | | Company | |
|------------------------------|--------------------|-------|--------------------|-------|
| | Land and buildings | | Land and buildings | |
| Expiry date | 2003 | 2002 | 2003 | 2002 |
| | £'000 | £'000 | £'000 | £'000 |
| – within one year | — | — | — | — |
| – between two and five years | — | — | — | — |
| – after five years | 1,092 | 1,092 | 240 | 240 |
| | 1,092 | 1,092 | 240 | 240 |

The group and company have £nil (2002 – £776,000) of capital commitments contracted but not provided for.

24. Pension arrangements

The company operates a defined contribution scheme for which the pension cost charge for the year amounted to £955,000 (2002 – £776,000).

25. Related party transactions

T-Mobile, through T-Mobile (UK) Limited, and The Virgin Group, through Bluebottle Investments S.A. and Bluebottle Investment Inc, were joint venture partners in Virgin Mobile during the year. This relationship has changed since the balance sheet date (see note 26). The following transactions occurred with these partners in the year.

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Virgin Mobile Telecoms Limited

Notes to the accounts

Year ended 31 December 2003

25. Related party transactions (Continued)

T-Mobile

The company was partially financed by a loan facility provided by T-Mobile on which interest at variable rates accrues. The principal amount of £37,621,000 (2002 – £34,838,000) was outstanding as at 31 December 2003. Interest has been rolled up to the principal quarterly. Total interest for the year payable to T-Mobile is £2,783,000 (2002 – £2,609,000). As at 31 December 2003, there were no fixed repayment dates. However a repayment schedule has been agreed since the balance sheet date (see note 26).

Some handsets, service packs and other accessories are purchased by T-Mobile on behalf of the company. The total cost to the company in respect of such purchases amounted to £6,973,000 (2002 – £5,888,000) and of this £1,226,000 remained unpaid as at 31 December 2003 (2002 – £3,528,000).

T-Mobile pays a marketing support contribution to the company and the company pays charges to T-Mobile for the use of its network. The total income from marketing support contributions to the company, net of payments to T-Mobile for use of its network, amounted to £45,051,000 (2002 – £15,161,000) of which a net amount of £21,005,000 (2002 – £8,538,000) remained outstanding as at 31 December 2003.

T-Mobile distributes airtime vouchers to certain retailers on behalf of the company. The total amount invoiced during the period in respect of these vouchers, net of management and distribution fees, amounted to £5,921,000 (2002 – £11,716,000). £369,000 (2002 – £1,717,000) of this total remained outstanding from T-Mobile as at 31 December 2003.

T-Mobile incurred additional expenses, particularly third party recharges and staff time, which were recharged on to the company and the company incurred similar expenses which were recharged to T-Mobile. The net amount recharged by T-Mobile was £3,000 (2002 – £395,000). As at 31 December 2003, a net amount of £178,000 (2002 – £1,464,000) was owing from the company to T-Mobile. In addition, a further £1,297,000 was owing from T-Mobile to the company in respect of assets in the course of development.

T-Mobile provides three directors of the company and receives a £45,000 (2002 – £45,000) annual consultancy fee for these executive services. An amount of £109,000 (2002 – £64,000) remained outstanding at the end of 31 December 2003.

Virgin Group

The company was partially financed by a loan facility provided by Bluebottle UK Limited, a member of the Virgin Group, on which interest at variable rates accrues. The principal amount of £37,621,000 (2002 – £34,838,000) was outstanding as at 31 December 2003. Interest has been rolled up to the principal quarterly. Total interest for the year payable to companies within the Virgin Group was £2,783,000 (2002 – £2,681,000). As at 31 December 2003, there were no fixed repayment dates. Since the balance sheet date, the company and the Virgin Group have agreed that the loan is repayable upon demand subject to the syndicated bank loan having been repaid in full (see note 26).

During the period, handset, airtime vouchers and other stock items were sold through retailers who are members of the Virgin Group. These sales, net of charges with respect to the distribution channels, amounted to £19,484,000 (2002 – £22,991,000) of which £12,461,000 (2002 – £7,756,000) remained outstanding as at 31 December 2003.

Members of the Virgin Group performed additional services including printing, brand licensing and promotion, which were recharged on to the company. These amounted to £5,353,000 (2002 – £5,446,000) of which £2,797,000 (2002 – £1,408,000) remained unpaid as at 31 December 2003.

Virgin Management Limited provides three directors of the company and receives a £45,000 (2002 – £45,000) annual consultancy fee for these executive services. An amount of £8,000 (2002 – £19,000) remained outstanding at the end of 31 December 2003.

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Virgin Mobile Telecoms Limited

Notes to the accounts
Year ended 31 December 2003

25. Related party transactions (Continued)

The group uses some other sundry services provided by members of the Virgin Group. These are transacted on an arm's length basis under normal commercial terms.

26. Post balance sheet events

On 29 January 2004, the company, T-Mobile (UK) Limited and the Virgin Group shareholders announced that the three organisations had settled all outstanding litigation and established new agreements between the company and T-Mobile, with the approval of the bank syndicate.

The company and T-Mobile have entered into an enhanced telecoms supply agreement running for a minimum of ten years which provides substantial benefits for both the company and T-Mobile. Features include:

- the company maintaining its position in voice and text services with a long term, non-exclusive deal, including improved access to 2.5 and 3G services; and
- the end of the monthly marketing support contribution and the introduction of the company receiving inbound, as well as outbound, revenues.

Separately, the Virgin Group shareholders acquired T-Mobile's stake in the company and the 485,000 preference voting A' shares of £0.02 each were reclassified as 485,000 non-voting preference B' shares of £0.01 each and 485,000 zero dividend voting C' shares of £0.01 each. The loan facilities previously provided by T-Mobile and the Virgin Group remain in place. These loans are not repayable until the syndicated bank loan has been repaid in full. The T-Mobile loan is repayable in eight quarterly instalments commencing 31 March 2006, although this may be repaid earlier if the Virgin Group loan is repaid earlier than the T-Mobile repayment instalments are due. The Virgin Group loan is repayable upon demand, but the Virgin Group have indicated that they will not demand repayment of this loan during the next twelve months such that the group will not be able to meet its liabilities as they fall due. The bank facility agreement has been revised with all scheduled repayments now falling due within one year.

Also, on 18 May 2004 the group repaid in full the syndicated bank loan.

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VIRGIN MOBILE TELECOMS LIMITED

Report and Financial Statements (Unaudited)

31 December 2002

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VIRGIN MOBILE TELECOMS LIMITED

**REPORT AND FINANCIAL STATEMENTS 2002
(ACCORDING TO U.K. GAAP)**

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VIRGIN MOBILE TELECOMS LIMITED

CHAIRMAN S STATEMENT

I am delighted to be able to report a third successful full year of trading for Virgin Mobile. The business continued to thrive and prosper, to grow rapidly, and ended the year in profit. This is a remarkable achievement, and I should like to offer my congratulations to the management team and staff.

Virgin Mobile outperformed the targets of its business plan by some margin during the year. Its results and performance in respect of the financial year ended 31 December 2002 were, I am pleased to report, comfortably ahead of forecasts.

The numbers of customers attracted to Virgin Mobile continued to be high. The company consolidated its position as a credible alternative to the traditional networks, so much so that over the course of the year Virgin Mobile attracted more net new customers than rivals: Orange, O2 and Vodafone.

We passed several milestones, in particular, attracting our two millionth customer, in 2002. The fourth quarter of the year was our best-ever sales period, during which time we attracted 370,530 net new customers. This strong sales performance was against intense competition in the mobile sector.

Despite our aggressive rate of growth, operational costs remained tightly managed. And with greater economies of scale across the company and increasing revenues, 2002 was a year of profitable growth. Virgin Mobile achieved revenues of £288 million, EBITDA of £16.1 million and an operating profit of £4.8 million. As a consequence, we began repaying our bank facility ahead of schedule.

This robust financial performance was a reflection of consumers increasingly favourable sentiment to the Virgin Mobile brand, proposition and service. As testament to this, Virgin Mobile again collected several major industry awards, most notably, for the second year running, the Best Pre-Pay Package and the Best Customer Service Awards from Mobile Choice magazine, and the Best Retail and Consumer Services Award from Management Today magazine. The excellence of our human resources and training teams also contributed to Virgin Mobile winning the Best Customer Centre Induction Training Award at the annual European Call Centre Awards.

On the High Street, Virgin Mobile continued its expansion into new stores, such as specialists Phones 4 U and TOMO, and into more generalist retailers such as Comet and Woolworths. Elsewhere, we bolstered our existing presence in stores such as Carphone Warehouse and Tesco, where Virgin Mobile was regularly among the top sellers.

We maintain a strong relationship with Virgin Retail Group, which again provided a significant contribution, 22%, to Virgin Mobile s sales. During the year some of Virgin s V.SHOP estate was sold to Sanity, which continued to successfully retail Virgin Mobile. The other V.SHOP stores began a rebranding programme to a new retail format, Virgin Megastore Xpress.

Virgin Mobile pursued its tradition of innovation with the introduction of several new services and a range of leading-edge colour-screen phones into its product portfolio during the year.

The business was a keen participant in the industry-wide mobile phone recycling initiative, Fonebak. For every Virgin Mobile phone that is recycled under the scheme, the company makes a donation of £5 to The British Red Cross. Virgin Mobile was also an active supporter of other charities, and of the government and industry campaigns to reduce the incidence of mobile phone-related crime.

Unfortunately, towards the end of the year, disagreements between the shareholders and between T-Mobile and Virgin Mobile were escalated to the High Court in two separate cases. The prospect of further legal action remains for 2003. I am thankful for the ongoing support of our banks and employees during this time.

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With the continuing support of our customers, suppliers, and through the dedication of our people, I believe Virgin Mobile will enjoy a successful 2003 and beyond.

Harris Jones
Chairman

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VIRGIN MOBILE TELECOMS LIMITED

DIRECTORS REPORT

The directors present their annual report and the audited financial statements for the year ended 31 December 2002.

PRINCIPAL ACTIVITIES

The principal activities of the group comprise of the sale of mobile phone handsets (both direct to end customers and to retailers) and the provision of mobile telecommunication services.

BUSINESS REVIEW AND RESULTS

The turnover and profit for the financial year were £287,720,000 (2001 £173,860,000) and £1,996,000 (2001 loss of £58,939,000) respectively. Details of the group's financial position as at 31 December 2002 is given in the group's Consolidated Balance Sheet.

No equity dividends were paid or proposed. A preference dividend of £9,011 (2001 £9,011) per share totalling £2,703,300 (2001 £2,703,300) has been calculated on the issue price of the 300 cumulative redeemable preference shares at the rate of 9% per annum. Interest on late payment of cumulative dividends of £1,234,700 (2001 £893,700) is calculated at 11% above the Natwest lending rate and is included in the finance costs of non-equity shares. An indication of future developments of the business is given in the Chairman's Statement.

DIRECTORS

The directors who served during the year were as follows:

Sir Richard C.N. Branson

Julia S. Chain

Harris Jones

(Chairman)

Gordon D. McCallum

Andrew R. Peters

Alan D. Robbins

(alternate director to Gordon McCallum, revoked 15 February 2002)

Robert W. Samuelson

William E. Whitehorn

(alternate director to Richard Branson)

Details of directors' share interests are given in Note 6 to the accounts.

SUPPLIER PAYMENT POLICY

The company's policy, which is also applied by the group, is to settle terms of payment with suppliers when agreeing the terms of each transaction, ensure that suppliers are made aware of the terms of payment and abide by the terms of payment.

EMPLOYEE CONSULTATION

The group places considerable value on the involvement of its employees and has continued to keep them informed on matters affecting them as employees and on the various factors affecting the performance of the group. Employee representatives are consulted regularly on a wide range of matters affecting current and future interests.

DISABLED EMPLOYEES

Applications for employment by disabled persons are always fully considered, bearing in mind the aptitudes of the applicant concerned. In the event of members of staff becoming disabled every effort is made to ensure that their employment with the company continues and that appropriate training is arranged. It is the policy of the company that the training, career development and promotion of disabled persons should, as far as possible, be identical with that of other employees.

AUDITORS

During the year Arthur Andersen resigned as auditors. Deloitte & Touche were appointed to fill the casual vacancy. The members of the Company have passed elective resolutions in accordance with Sections 366A, 252 and 386 of the Companies Act 1985 dispensing with the previous statutory requirements of holding annual general meetings, laying accounts before the company in general meetings and re-appointing auditors annually.

Approved by the Board of Directors
and signed on behalf of the Board

Peter Gram
Company Secretary

120 Campden Hill Road
London
W8 7AR
England

16 April 2003

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VIRGIN MOBILE TELECOMS LIMITED

STATEMENT OF DIRECTORS RESPONSIBILITIES

United Kingdom company law requires the directors to prepare financial statements for each financial year which give a true and fair view of the state of affairs of the company as at the end of the financial year and of the profit or loss of the company for that period. In preparing those financial statements, the directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and estimates that are reasonable and prudent;
- state whether applicable accounting standards have been followed;
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the company will continue in business.

The directors are responsible for keeping proper accounting records which disclose with reasonable accuracy at any time the financial position of the company and to enable them to ensure that the financial statements comply with the Companies Act 1985. They are also responsible for the system of internal control, safeguarding the assets of the company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

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VIRGIN MOBILE TELECOMS LIMITED

CONSOLIDATED PROFIT AND LOSS ACCOUNT (UNAUDITED)

According to U.K. GAAP

Year ended 31 December 2002

| | Note | 2002 | 2001 |
|--|------|------------|------------|
| | | £ 000 | £ 000 |
| TURNOVER | 2 | 287,720 | 173,860 |
| Cost of sales | | (175,682) | (127,771) |
| GROSS PROFIT | | 112,038 | 46,089 |
| Administrative expenses | | (107,202) | (93,794) |
| OPERATING PROFIT (LOSS) | | 4,836 | (47,705) |
| Finance charges (net) | 3 | (11,841) | (11,234) |
| LOSS ON ORDINARY ACTIVITIES BEFORE TAXATION | 4 | (7,005) | (58,939) |
| Tax on loss on ordinary activities | 7 | 9,001 | |
| PROFIT (LOSS) FOR THE FINANCIAL YEAR | | 1,996 | (58,939) |
| Finance costs of non-equity shares | | (3,938) | (3,597) |
| Retained loss for the year | | (1,942) | (62,536) |

All amounts derive from continuing operations.

There were no other recognised gains and losses in either year.

The accompanying notes are an integral part of this consolidated profit and loss account.

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VIRGIN MOBILE TELECOMS LIMITED

CONSOLIDATED BALANCE SHEET (UNAUDITED)

According to U.K. GAAP

31 December 2002

| | Note | 2002 | 2001 |
|--|------|-------------------|-------------------|
| | | £ 000 | £ 000 |
| FIXED ASSETS | | | |
| Tangible assets | 9 | 24,828 | 16,798 |
| CURRENT ASSETS | | | |
| Stocks | 11 | 5,671 | 4,927 |
| Debtors | 12 | 52,706 | 33,749 |
| Cash at bank and in hand | | 13,110 | 9,714 |
| | | <u>71,487</u> | <u>48,390</u> |
| CREDITORS: amounts falling due within one year | 13 | (112,924) | (60,699) |
| NET CURRENT LIABILITIES | | <u>(41,437)</u> | <u>(12,309)</u> |
| TOTAL ASSETS LESS CURRENT LIABILITIES | | (16,609) | 4,489 |
| CREDITORS: amounts falling due after more than one year | 14 | (143,144) | (166,238) |
| NET LIABILITIES | | <u>(159,753)</u> | <u>(161,749)</u> |
| CAPITAL AND RESERVES | | | |
| Called up share capital | 16 | 19 | 19 |
| Share premium account | 17 | 30,036 | 30,036 |
| Profit and loss account | 17 | (189,808) | (191,804) |
| ACCUMULATED DEFICIT | 18 | (159,753) | (161,749) |
| Accumulated deficit may be analysed as: | | | |
| Equity interests | | (200,865) | (198,923) |
| Non-equity interests | | 41,112 | 37,174 |
| | | <u>(159,753)</u> | <u>(161,749)</u> |

These financial statements were approved by the Board of Directors on 16 April 2003 and signed on its behalf by:

Director

16 April 2003

The accompanying notes are an integral part of this consolidated balance sheet.

VIRGIN MOBILE TELECOMS LIMITED

COMPANY BALANCE SHEET (UNAUDITED)

According to U.K. GAAP

31 December 2002

| | Note | 2002 | 2001 |
|--|------|-------------------|-------------------|
| | | £ 000 | £ 000 |
| FIXED ASSETS | | | |
| Tangible assets | 9 | 23,735 | 13,387 |
| Investments | 10 | | |
| | | <u>23,735</u> | <u>13,387</u> |
| CURRENT ASSETS | | | |
| Stocks | 11 | 5,671 | 4,927 |
| Debtors | 12 | 58,251 | 40,017 |
| Cash at bank and in hand | | 13,109 | 9,713 |
| | | <u>77,031</u> | <u>54,657</u> |
| CREDITORS: amounts falling due within one year | 13 | (112,778) | (60,480) |
| NET CURRENT LIABILITIES | | <u>(35,747)</u> | <u>(5,823)</u> |
| TOTAL ASSETS LESS CURRENT LIABILITIES | | (12,012) | 7,564 |
| CREDITORS: amounts falling due after more than one year | 14 | (141,729) | (164,613) |
| NET LIABILITIES | | <u>(153,741)</u> | <u>(157,049)</u> |
| CAPITAL AND RESERVES | | | |
| Called up share capital | 16 | 19 | 19 |
| Share premium account | 17 | 30,036 | 30,036 |
| Profit and loss account | 17 | (183,796) | (187,104) |
| ACCUMULATED DEFICIT | | <u>(153,741)</u> | <u>(157,049)</u> |
| Accumulated deficit may be analysed as: | | | |
| Equity interests | | (194,853) | (194,223) |
| Non-equity interests | | 41,112 | 37,174 |
| | | <u>(153,741)</u> | <u>(157,049)</u> |

These financial statements were approved by the Board of Directors on 16 April 2003 and signed on its behalf by:

Director

16 April 2003

The accompanying notes are an integral part of this balance sheet.

VIRGIN MOBILE TELECOMS LIMITED

CONSOLIDATED CASH FLOW STATEMENT (UNAUDITED)

According to U.K. GAAP

Year ended 31 December 2002

| | Note | 2002 | 2001 |
|--|------|--------------|------------------|
| | | £ 000 | £ 000 |
| Net cash inflow (outflow) from operating activities | 19 | 34,712 | (54,065) |
| Returns on investments and servicing of finance | 20 | (7,746) | (4,208) |
| Capital expenditure and financial investment | 20 | (18,315) | (8,836) |
| | | <u>8,651</u> | <u>(67,109)</u> |
| Cash inflow (outflow) before financing | | | |
| Financing | 20 | (5,255) | 74,858 |
| | | <u>3,396</u> | <u>7,749</u> |
| Increase in cash in the year | 21 | 3,396 | 7,749 |

The accompanying notes are an integral part of this consolidated cash flow statement.

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VIRGIN MOBILE TELECOMS LIMITED

NOTES TO THE ACCOUNTS (unaudited)
Year ended 31 December 2002

1. ACCOUNTING POLICIES

The financial statements are prepared in accordance with applicable accounting standards. The particular accounting policies adopted are described below.

Accounting convention

The financial statements are prepared under the historical cost convention.

Financial Reporting Standard 19 Deferred Tax (FRS 19) has been adopted for the first time by the group in the year ended 31 December 2002. In previous years the group complied with Statement of Standard Accounting Practice 15 Deferred Tax (SSAP 15) which has now been superseded by the introduction of FRS 19. SSAP 15 required a provision to be made using the liability method to the extent that net deferred assets or liabilities were likely to crystallise in the foreseeable future. This method was commonly referred to as partial provisioning. FRS 19, by contrast, requires a form of full provisioning (see deferred tax accounting policy note). There has been no effect of the implementation of FRS 19 on previously reported results.

Basis of preparation and future funding

As at 31 December 2002 the group had net liabilities of £159,753,000 (2001 £161,749,000). The group is currently being financed by a syndicated bank loan (see note 15) and by its shareholders, T-Mobile and the Virgin Group (see note 25). The group had drawn down £100,000,000 under the £115,000,000 syndicated bank loan as at 31 December 2001. During 2002, the group did not draw down any further amounts and had repaid £5,000,000 of the loan by the year end. While there can be no certainty about the group's future operating performance, based on the group's five year business plan, approved on 22 March 2002 and which remains in force, and recent trading performance, the directors expect that the group will generate cash during the next twelve months so that scheduled loan repayments will be met and that the group will comply with the syndicated bank loan covenants. The shareholder loans are not repayable until the syndicated bank loan has been repaid in full. The directors do not believe any current legal dispute between the shareholders will have a material impact on the group's future funding (see note 26). Therefore, the directors have prepared these accounts on a going concern basis.

Basis of consolidation

The group accounts consolidate the accounts of Virgin Mobile Telecoms Limited and its subsidiary undertaking drawn up to 31 December each year. The results of subsidiaries acquired are consolidated for the periods from which control passed. Acquisitions are accounted for under the acquisition method.

Turnover

Turnover represents amounts receivable for handset and airtime services provided in the normal course of business, net of VAT and trade discounts.

Handsets, and other equipment, revenue is recognised based on the amounts received at the date of sale. Airtime turnover derived from customers is recognised based on the usage of the network in the period. Prepaid airtime sales are deferred until the customer uses the stored value.

Subscriber acquisition costs

Subscriber acquisition costs, which include the commission costs associated with acquiring new customers and other incremental costs of customer acquisition, are recognised in the profit and loss account as incurred.

VIRGIN MOBILE TELECOMS LIMITED**NOTES TO THE ACCOUNTS (unaudited) (Continued)**
Year ended 31 December 2002**Tangible fixed assets**

Tangible fixed assets are stated at cost, net of depreciation and any provision for impairment. Depreciation is provided on all tangible fixed assets at rates calculated to write off the cost or valuation, less estimated residual value, of each asset on a straight-line basis over its expected useful life, as follows:

| | |
|------------------------|-----------|
| Leasehold improvements | 3 years |
| Computer systems | 2-3 years |
| Fixtures and fittings | 3 years |
| Office equipment | 3 years |

Residual value is calculated on prices prevailing at the date of acquisition. Depreciation is not charged on assets in the course of construction until they are ready for service.

Web site development costs

Design and content development costs are capitalised only to the extent that they lead to the creation of an enduring asset delivering benefits at least as great as the amount capitalised. If there is insufficient evidence on which to base reasonable estimates of the economic benefits that will be generated in the period until the design and content are next updated, the costs of developing the design and content are charged to the profit and loss account as incurred.

Investments

Fixed asset investments are shown at cost less provision for impairment. Current asset investments are stated at the lower of cost and net realisable value.

Stocks

Stocks are stated at the lower of cost and net realisable value. Net realisable value is based on estimated selling price, less further direct selling costs. Provision is made for obsolete, slow-moving or defective items where appropriate.

Pension costs

For defined contribution schemes the amount charged to the profit and loss account in respect of pension costs and other post-retirement benefits is the contributions payable in the year. Differences between contributions payable in the year and contributions actually paid are shown as either accruals or prepayments in the balance sheet.

Taxation

Corporation tax is provided on taxable profits at the current rate.

Deferred tax is provided in full on all timing differences which result in an obligation at the balance sheet date to pay more tax, or a right to pay less tax, at a future date, at rates expected to apply when they crystallise based on current tax rates and laws. Timing differences arise from the inclusion of items of income and expenditure in taxation computations in periods different from those in which they are included in the financial statements. Deferred tax assets are recognised to the extent that it is regarded as more likely than not that they will be recovered. Deferred tax assets and liabilities are not discounted.

Leases

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Assets obtained under hire purchase contracts or finance leases are capitalised in the balance sheet. Those held under hire purchase contracts are depreciated over their useful economic lives. Those held under finance leases are depreciated over their estimated useful lives or the leases term, whichever is shorter.

The interest element of these obligations is charged to the profit and loss account over the relevant period. The capital element of the future payments is treated as a liability.

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VIRGIN MOBILE TELECOMS LIMITED

NOTES TO THE ACCOUNTS (unaudited) (Continued)
Year ended 31 December 2002

Rentals under operating leases are charged on a straight-line basis over the lease term, even if the payments are not made on such a basis. Benefits received and receivable as an incentive to sign an operating lease are similarly spread on a straight-line basis over the lease term, except where the period to the review date on which the rent is first expected to be adjusted to the prevailing market rate is shorter than the full lease term, in which case the shorter period is used.

Finance costs

Finance costs of debt and non-equity shares are recognised in the profit and loss account over the term of such instruments at a constant rate on the carrying amount. Where the finance costs for non-equity shares are not equal to the dividends on these instruments, the difference is also accounted for in the profit and loss account as an appropriation of profits.

Debt

Debt is initially stated at the amount of the net proceeds after deduction of issue costs. The carrying amount is increased by the finance cost in respect of the accounting period and reduced by payments made in the period. Convertible debt is reported as a liability unless conversion actually occurs. No gain or loss is recognised on conversion.

Foreign currency

Transactions in foreign currencies are recorded at the rate of exchange at the date of the transaction or, if hedged, at the forward contract rate. Monetary assets and liabilities denominated in foreign currencies at the balance sheet date are reported at the rates of exchange prevailing at that date or, if appropriate, at the forward contract rate.

Derivative financial instruments

The group uses derivative financial instruments to reduce exposure to interest rate movements and foreign exchange risk. The group does not hold or issue derivative financial instruments for speculative purposes.

For an interest rate swap to be treated as a hedge the instrument must be related to actual assets or liabilities or a probable commitment and must change the nature of the interest rate by converting a fixed rate to a variable rate or vice versa. Interest differentials under these swaps are recognised by adjusting net interest payable over the periods of the contracts.

For a forward contract to be treated as a hedge the instrument must be related to actual foreign currency assets or liabilities or to a probable commitment. It must involve the same currencies or similar currencies as the hedged item and must also reduce the risk of foreign exchange movements on the group's operations. Gains and losses arising on these contracts are only recognised in the profit and loss account when the hedged transaction itself has been reflected in the group's accounts.

If an instrument ceases to be accounted for as a hedge, for example because the underlying hedged position is eliminated, the instrument is marked to market and any resulting profit or loss recognised at that time.

2. SEGMENTAL INFORMATION

The group's operations and markets are located within the United Kingdom and form a single class of business.

VIRGIN MOBILE TELECOMS LIMITED

NOTES TO THE ACCOUNTS (unaudited) (Continued)
Year ended 31 December 2002

3. FINANCE CHARGES (NET)

| | <u>2002</u> | <u>2001</u> |
|--|------------------|------------------|
| | £ 000 | £ 000 |
| Bank loans and overdrafts | (6,944) | (6,004) |
| Finance lease interest | (57) | (58) |
| Interest payable to related companies | (5,362) | (5,655) |
| Interest receivable and similar income | 522 | 483 |
| | <u>(11,841)</u> | <u>(11,234)</u> |

4. LOSS ON ORDINARY ACTIVITIES BEFORE TAXATION

Loss on ordinary activities before taxation is stated after charging:

| | <u>2002</u> | <u>2001</u> |
|--|---------------|---------------|
| | £ 000 | £ 000 |
| Depreciation and amounts written off tangible fixed assets | | |
| Owned assets | 11,071 | 11,930 |
| Leased assets | 215 | 108 |
| Operating lease rentals | | |
| Leasehold property | 1,179 | 1,120 |
| Auditors' remuneration for audit services | 151 | 142 |
| | <u>13,616</u> | <u>14,300</u> |

Amounts payable to the auditors by the company and its subsidiary undertaking in respect of non-audit services were £491,438 (2001 £136,324).

5. STAFF COSTS

The average monthly number of employees (including executive directors) was:

| | <u>2002</u> | <u>2001</u> |
|----------------|--------------|-------------|
| | No. | No. |
| Distribution | 43 | 48 |
| Marketing | 45 | 32 |
| Administration | 1,039 | 892 |
| | <u>1,127</u> | <u>972</u> |

Their aggregate remuneration comprised:

| | <u>£ 000</u> | <u>£ 000</u> |
|-----------------------------------|---------------|---------------|
| Wages and salaries | 27,921 | 18,660 |
| Social security costs | 2,432 | 1,648 |
| Other pension costs (see note 23) | 776 | 549 |
| | <u>31,129</u> | <u>20,857</u> |

6. DIRECTORS REMUNERATION, INTERESTS AND TRANSACTIONS

Aggregate remuneration

Virgin Management Limited and T-Mobile each provide three directors of the company and receive a £45,000 (2001 £45,000) consultancy fee for these executive services. The total amount of directors remuneration and other benefits were £90,000 (2001 £90,000).

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VIRGIN MOBILE TELECOMS LIMITED

NOTES TO THE ACCOUNTS (unaudited) (Continued)
Year ended 31 December 2002*Directors' interests*

Sir Richard Branson is deemed to have an interest in the share capital of the company by virtue of being one of the principal beneficiaries of a number of trusts that own Virgin Group Investments Limited, the ultimate parent company of Bluebottle Investments Inc., Bluebottle Investments S.A. and Bluebottle UK Limited, which hold shares in the capital of the company.

Gordon D. McCallum is deemed to have an interest in the share capital of the company by virtue of being one of the beneficiaries of a trust that holds shares in the capital of the company.

7. TAX ON LOSS ON ORDINARY ACTIVITIES

The tax credit comprises:

| | 2002 | 2001 |
|--|--------------|--------------|
| | £ 000 | £ 000 |
| Current tax | | |
| UK corporation tax | — | — |
| Total current tax | | |
| Deferred tax | | |
| Origination and reversal of timing differences (see note 12) | 9,001 | — |
| Total deferred tax asset | 9,001 | — |
| Total tax credit on loss on ordinary activities | 9,001 | — |

The differences between the total current tax shown above and the amount calculated by applying the standard rate of UK corporation tax to the loss before tax is as follows:

| | 2002 | 2001 |
|--|--------------|--------------|
| | £ 000 | £ 000 |
| Loss on ordinary activities before tax | (7,005) | (58,939) |
| Tax on loss on ordinary activities at standard UK corporation tax rate of 30% (2001 30%) | | |
| Effects of: | | |
| Expenses not deductible for tax purposes | 158 | 111 |
| Depreciation in excess of capital allowances | 3,346 | 3,611 |
| Current year tax losses | (3,504) | (3,722) |

8. LOSS ATTRIBUTABLE TO VIRGIN MOBILE TELECOMS LIMITED

The loss for the financial period dealt with in the accounts of the company, Virgin Mobile Telecoms Limited, was £630,000 (2001 loss of £56,803,000). As permitted by Section 230 of the Companies Act 1985, no separate profit and loss account is presented in respect of the company.

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VIRGIN MOBILE TELECOMS LIMITED

NOTES TO THE ACCOUNTS (unaudited) (Continued)

Year ended 31 December 2002

9. TANGIBLE FIXED ASSETS

| Group | Leasehold improvements | Fixtures and fittings | Office equipment | Computer systems | Total |
|---------------------------------|-----------------------------------|----------------------------------|-----------------------------|-----------------------------|--------------|
| | £ 000 | £ 000 | £ 000 | £ 000 | £ 000 |
| Cost | | | | | |
| At 1 January 2002 | 7,792 | 662 | 273 | 29,116 | 37,843 |
| Additions | 3 | 42 | 26 | 19,245 | 19,316 |
| At 31 December 2002 | 7,795 | 704 | 299 | 48,361 | 57,159 |
| Accumulated depreciation | | | | | |
| At 1 January 2002 | 4,108 | 476 | 179 | 16,282 | 21,045 |
| Charge for the year | 2,470 | 175 | 83 | 8,558 | 11,286 |
| At 31 December 2002 | 6,578 | 651 | 262 | 24,840 | 32,331 |
| Net book value | | | | | |
| At 31 December 2002 | 1,217 | 53 | 37 | 23,521 | 24,828 |
| At 31 December 2001 | 3,684 | 186 | 94 | 12,834 | 16,798 |

| Company | Leasehold improvements | Fixtures and fittings | Office equipment | Computer systems | Total |
|---------------------------------|-----------------------------------|----------------------------------|-----------------------------|-----------------------------|--------------|
| | £ 000 | £ 000 | £ 000 | £ 000 | £ 000 |
| Cost | | | | | |
| At 1 January 2002 | 447 | 662 | 273 | 29,116 | 30,498 |
| Additions | | 42 | 26 | 19,245 | 19,313 |
| At 31 December 2002 | 447 | 704 | 299 | 48,361 | 49,811 |
| Accumulated depreciation | | | | | |
| At 1 January 2002 | 174 | 476 | 179 | 16,282 | 17,111 |
| Charge for the year | 149 | 175 | 83 | 8,558 | 8,965 |
| At 31 December 2002 | 323 | 651 | 262 | 24,840 | 26,076 |
| Net book value | | | | | |
| At 31 December 2002 | 124 | 53 | 37 | 23,521 | 23,735 |
| At 31 December 2001 | 273 | 186 | 94 | 12,834 | 13,387 |

Tangible fixed assets include computer equipment at a cost of £644,375 (2001 £644,375) and net book value of £321,922 (2001 £536,537) in respect of assets held under a finance lease.

Computer systems for the group and company includes £15,314,000 (2001 £2,108,000) of assets in the course of construction.

10. FIXED ASSET INVESTMENTS

Subsidiary undertaking

Virgin Mobile Telecoms Limited has a £2 investment representing a 100% holding in Bluebottle Call Limited, a subsidiary undertaking, the principal business of which is property investment. Bluebottle Call Limited is incorporated in England and Wales.

11. STOCKS

| | <u>Group</u> | | <u>Company</u> | |
|--------------------------------|--------------|--------------|----------------|--------------|
| | <u>2002</u> | <u>2001</u> | <u>2002</u> | <u>2001</u> |
| | <u>£ 000</u> | <u>£ 000</u> | <u>£ 000</u> | <u>£ 000</u> |
| Finished goods held for resale | 5,671 | 4,927 | 5,671 | 4,927 |

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VIRGIN MOBILE TELECOMS LIMITED

NOTES TO THE ACCOUNTS (unaudited) (Continued)
Year ended 31 December 2002

12. DEBTORS

| | Group | | Company | |
|---|---------------|---------------|---------------|---------------|
| | 2002 | 2001 | 2002 | 2001 |
| | £ 000 | £ 000 | £ 000 | £ 000 |
| Trade debtors | 27,542 | 17,189 | 27,542 | 17,189 |
| Amounts owed by other related companies (see note 25) | 13,019 | 13,271 | 13,019 | 13,271 |
| Amounts owed by subsidiary undertaking | | | 6,689 | 7,305 |
| Deferred tax asset | 9,001 | | 8,852 | |
| Other debtors | | 516 | | 493 |
| Prepayments and accrued income | 3,144 | 2,773 | 2,149 | 1,759 |
| | <u>52,706</u> | <u>33,749</u> | <u>58,251</u> | <u>40,017</u> |

A deferred tax asset of £9,001,000 has been recognised at 31 December 2002 (2001 £nil). Detailed group budgets indicate that taxable profits will arise in the future. Based on these budgets the directors consider that a deferred tax asset of £9,001,000 should be recognised. A deferred tax asset of £49,908,000 has not been recognised in respect of certain tax losses and tax allowances as there remains a high enough degree of uncertainty regarding the future for these assets not to be regarded as more likely than not to reverse.

13. CREDITORS: AMOUNTS FALLING DUE WITHIN ONE YEAR

| | Group | | Company | |
|---|----------------|---------------|----------------|---------------|
| | 2002 | 2001 | 2002 | 2001 |
| | £ 000 | £ 000 | £ 000 | £ 000 |
| Bank loans | 23,000 | | 23,000 | |
| Obligations under finance lease contract | 233 | 255 | 233 | 255 |
| Trade creditors | 21,203 | 21,664 | 21,203 | 21,664 |
| Amounts owed to other related companies (see note 25) | 1,842 | 2,874 | 1,842 | 2,874 |
| Other taxation and social security | 5,415 | 686 | 5,478 | 686 |
| Other creditors | 392 | 1,669 | 392 | 1,669 |
| Accruals and deferred income | 60,839 | 33,551 | 60,630 | 33,332 |
| | <u>112,924</u> | <u>60,699</u> | <u>112,778</u> | <u>60,480</u> |

14. CREDITORS: AMOUNTS FALLING DUE AFTER MORE THAN ONE YEAR

| Group | Company |
|-------|---------|
|-------|---------|

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| | 2002 | 2001 | 2002 | 2001 |
|---|---------|---------|---------|---------|
| | £ 000 | £ 000 | £ 000 | £ 000 |
| Obligations under finance lease contract | | 233 | | 233 |
| Bank loans | 72,000 | 100,000 | 72,000 | 100,000 |
| Amounts owed to other related companies (see note 25) | 69,676 | 64,314 | 69,676 | 64,314 |
| Accruals and deferred income | 1,468 | 1,691 | 53 | 66 |
| | 143,144 | 166,238 | 141,729 | 164,613 |

During the year ending 31 December 2002 the company has repaid £5 million of the syndicated loan facility. The loan facility is secured on the share capital and assets of the group.

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VIRGIN MOBILE TELECOMS LIMITED**NOTES TO THE ACCOUNTS (unaudited) (Continued)**
Year ended 31 December 2002*Finance Leases*

The net finance lease obligations to which the group and company are committed and which are secured on the related assets are:

| | Group and Company | |
|---------------------------|--------------------------|--------------|
| | 2002 | 2001 |
| | £ 000 | £ 000 |
| In one year or less | 233 | 255 |
| Between one and two years | | 233 |
| | 233 | 488 |

15. DERIVATIVES AND OTHER FINANCIAL INSTRUMENTS

Set out below is an explanation of the role financial instruments have had during the period in creating or changing the risks the group faces in its activities. The explanation summarises the objectives and policies for holding or issuing financial instruments and similar contracts, and the strategies for achieving those objectives that have been followed during the period.

The company has established treasury policies that are reviewed annually by the Board or Audit committee to ensure they remain relevant to rapid business change.

The major financial risks faced by the group are exchange rate, interest rate exposure and liquidity risk. These are outlined below:

Foreign currency risk

About one-third of the handset purchases made by the company are from suppliers in continental Europe. These purchases are invoiced in Euros. The company's policy is to eliminate some currency exposure on purchases at the time of purchase through forward currency contracts. All other purchases are denominated in sterling.

Interest rate risk

The company has entered into interest rate swaps to hedge against adverse movements in LIBOR in relation to its syndicated loan facility. The company's policy is to keep between 50 per cent and 75 percent of the syndicated loan borrowing at fixed rates of interest. At the year-end, 79 per cent of the syndicated loan was at fixed rates after taking account of interest rate swaps following the repayment of £5 million of the syndicated loan facility.

The numerical disclosures in this note deal with financial assets and financial liabilities as defined in Financial Reporting Standard 13

Derivatives and other financial instruments: Disclosures (FRS 13). For this purpose non-equity shares issued by the company are dealt with in the disclosures in the same way as the group's financial liabilities but separately disclosed. Certain financial assets such as investments in subsidiary and associated companies are also excluded from the scope of these disclosures.

As permitted by FRS 13, short term debtors and creditors have been excluded from the disclosures, other than the currency disclosures.

Liquidity risk

The company's overall objective is to ensure that it is, at all times, able to meet its financial commitments as and when they fall due. To this end, surplus funds are collected and invested with approved counterparties, within authorised limits, with the aim of maintaining short term liquidity while maximising yield.

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VIRGIN MOBILE TELECOMS LIMITED

NOTES TO THE ACCOUNTS (unaudited) (Continued)
Year ended 31 December 2002*Interest rate profile*

The group has no financial assets other than cash at bank.

After taking into account interest rate swaps, the interest rate profile of the group's financial liabilities at 31 December 2002 was as follows:

| | 2002 | | |
|-------------------|--------------|----------------------|-------------------|
| | Total | Floating rate | Fixed rate |
| | £ 000 | £ 000 | £ 000 |
| Currency | | | |
| Sterling | | | |
| Borrowings | 164,909 | 89,676 | 75,233 |
| Non-equity shares | 30,050 | | 30,050 |
| | <hr/> | <hr/> | <hr/> |
| Total | 194,959 | 89,676 | 105,283 |
| | <hr/> | <hr/> | <hr/> |

The profile at 31 December 2001 for comparison purposes was as follows:

| | 2001 | | |
|-------------------|--------------|----------------------|-------------------|
| | Total | Floating rate | Fixed rate |
| | £ 000 | £ 000 | £ 000 |
| Currency | | | |
| Sterling | | | |
| Borrowings | 164,802 | 89,314 | 75,488 |
| Non-equity shares | 30,050 | | 30,050 |
| | <hr/> | <hr/> | <hr/> |
| Total | 194,852 | 89,314 | 105,538 |
| | <hr/> | <hr/> | <hr/> |

Further analysis of the interest rate profile at 31 December 2002 and at 31 December 2001 is as follows:

| | 2002 | |
|--|-------------------|-------------------|
| | Fixed rate | |
| | Weighted | Weighted |
| | average | average |
| | interest | period for |
| | <hr/> | |

| | rate (%) | which rate is fixed Years |
|-----------------|---------------------|--|
| | <hr/> | <hr/> |
| Currency | | |
| Sterling | | |
| Borrowings | 7.4 | 1.0 |
| | <hr/> | <hr/> |

| | 2001 Fixed rate | |
|--|----------------------------|-------------------|
| | <hr/> | |
| | | Weighted |
| | | average |
| | | period for |
| | | which rate |
| | | is fixed |
| | | Years |
| | <hr/> | <hr/> |

| | | |
|-----------------|-------|-------|
| Currency | | |
| Sterling | | |
| Borrowings | 7.4 | 2.6 |
| | <hr/> | <hr/> |

Cumulative redeemable preference share dividends accrue on the non-equity shares at the rate of 9% per annum. Dividend interest on late payment is charged at 11% above the Natwest lending rate. As there is no defined maturity date, the non-equity shares have been excluded from the weighted average analysis.

VIRGIN MOBILE TELECOMS LIMITED**NOTES TO THE ACCOUNTS (unaudited) (Continued)****Year ended 31 December 2002**

The interest rate on floating rate shareholder loans is at 4% above the three-month LIBOR rate. The interest rate on the floating rate element of the facility loan is linked to the LIBOR for a comparable period to that of the remaining term of the facility.

Currency exposures

As at 31 December 2002, after taking into account the effects of forward foreign exchange contracts the company had no currency exposures (2001 £nil).

Maturity of financial liabilities

The maturity profile of the group's financial liabilities at 31 December 2002 was as follows:

| | Non-equity shares | Borrowings | Total |
|---|------------------------------|-------------------|--------------|
| | £ 000 | £ 000 | £ 000 |
| In one year or less | | 23,233 | 23,233 |
| In more than one year but not more than two years | | 46,000 | 46,000 |
| In more than two years but not more than five years | | 95,676 | 95,676 |
| In more than five years | 30,050 | | 30,050 |
| Total | 30,050 | 164,909 | 194,959 |

The profile at 31 December 2001 for comparison purposes was as follows:

| | Non-equity shares | Borrowings | Total |
|---|------------------------------|-------------------|--------------|
| | £ 000 | £ 000 | £ 000 |
| In one year or less | | 255 | 255 |
| In more than one year but not more than two years | | 23,233 | 23,233 |
| In more than two years but not more than five years | | 141,314 | 141,314 |
| In more than five years | 30,050 | | 30,050 |
| Total | 30,050 | 164,802 | 194,852 |

Borrowing facilities

The group had undrawn committed borrowing facilities at 31 December 2002 and 31 December 2001 in respect of which all conditions precedent had been met, as follows:

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| | <u>2002</u> | <u>2001</u> |
|--|---------------|---------------|
| | <u>£ 000</u> | <u>£ 000</u> |
| Expiring in one year or less | | |
| Expiring in more than one year but not more than two years | | |
| Expiring in more than two years | 15,000 | 15,000 |
| Total | <u>15,000</u> | <u>15,000</u> |

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VIRGIN MOBILE TELECOMS LIMITED

NOTES TO THE ACCOUNTS (unaudited) (Continued)
Year ended 31 December 2002*Fair values*

Set out below is a comparison by category of book values and fair values of the group's financial liabilities at 31 December 2002 and 31 December 2001.

| | 2002 | | 2001 | |
|---|------------|------------|------------|------------|
| | Book value | Fair value | Book value | Fair value |
| | £ 000 | £ 000 | £ 000 | £ 000 |
| Primary financial instruments held or issued to finance the group's operations | | | | |
| Short term financial liabilities and current portion of long term borrowings | 23,233 | 23,751 | 255 | 255 |
| Long term borrowings | 72,000 | 75,738 | 100,233 | 105,191 |
| Derivative financial instruments held to manage the interest rate and currency profile | | | | |
| Interest rate swaps | 375 | 1,778 | 266 | 1,256 |
| Forward foreign exchange contracts | | (165) | | 36 |

The fair value of the interest rate swaps and forward foreign exchange contracts have been determined by reference to prices available from the markets on which the instrument involved is traded. All the other fair values shown above have been calculated by discounting cash flows at prevailing interest rates.

The fair values of shareholder loans have not been presented (see note 25). As they are not publicly traded and repayment is not necessarily in cash, it would be impractical to make an estimate with sufficient reliability.

The fair values of the cumulative redeemable preference shares have not been presented. As they are not publicly traded and can be redeemed at any time at the option of the company, it would be impractical to make an estimate with sufficient reliability.

Gains and losses on hedges

The group enters into forward foreign currency contracts to eliminate some of the currency exposures that arise on purchases denominated in foreign currencies. It also uses interest rate swaps to manage its interest rate profile. Changes in the fair value of instruments used as hedges are not recognised in the accounts until the hedged position matures.

An analysis of these unrecognised gains and losses is as follows:

| | 2002 | | |
|--|--------|----------|--------|
| | Gains | Losses | Net |
| | £ 000 | £ 000 | £ 000 |
| Unrecognised gains and losses on hedges at 1 January 2002 | 287 | 1,313 | 1,026 |
| Gains and losses arising in previous years that were recognised in 2002 | (287) | (1,116) | (829) |
| Gains and losses arising before 1 January that were not recognised in 2002 | | 197 | 197 |

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| | | | |
|---|-----------------|-----------------|-----------------|
| Gains and losses arising in 2002 that were not recognised in 2002 | 165 | 1,206 | 1,041 |
| | <u> </u> | <u> </u> | <u> </u> |
| Unrecognised gains and losses on hedges at 31 December 2002 | 165 | 1,403 | 1,238 |
| | <u> </u> | <u> </u> | <u> </u> |
| Of which: | | | |
| Gains and losses expected to be recognised in 2003 | 165 | 1,251 | 1,086 |
| | <u> </u> | <u> </u> | <u> </u> |
| Gains and losses expected to be recognised in 2004 or later | | 152 | 152 |
| | <u> </u> | <u> </u> | <u> </u> |

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VIRGIN MOBILE TELECOMS LIMITED

NOTES TO THE ACCOUNTS (unaudited) (Continued)

Year ended 31 December 2002

An analysis of these unrecognised gains and losses is as follows:

| | 2001 | | |
|--|--------------|---------------|--------------|
| | Gains | Losses | Net |
| | £ 000 | £ 000 | £ 000 |
| Unrecognised gains and losses on hedges at 1 January 2001 | | 340 | 340 |
| Gains and losses arising in previous years that were recognised in 2001 | | (340) | (340) |
| Gains and losses arising before 1 January that were not recognised in 2001 | | | |
| Gains and losses arising in 2001 that were not recognised in 2001 | 287 | 1,313 | 1,026 |
| Unrecognised gains and losses on hedges at 31 December 2001 | 287 | 1,313 | 1,026 |
| Of which: | | | |
| Gains and losses expected to be recognised in 2002 | 164 | 766 | 602 |
| Gains and losses expected to be recognised in 2003 or later | 123 | 547 | 424 |

16. CALLED UP SHARE CAPITAL

| | 2002 | 2001 |
|---|------------------|------------------|
| | £ | £ |
| Authorised: | | |
| 10,000 D ordinary shares of £0.01 each | 100 | 100 |
| 475,000 non-voting preference B shares of £0.01 each | 4,750 | 4,750 |
| 30,000 E shares of £0.02 each | 600 | 600 |
| 500,000,000 cumulative redeemable preference shares of £0.01 each | 5,000,000 | 5,000,000 |
| 485,000 preference voting A shares of £0.02 each | 9,700 | 9,700 |
| 475,000 zero dividend voting C shares of £0.01 each | 4,750 | 4,750 |
| | 5,019,900 | 5,019,900 |
| Called up, allotted and fully paid | | |
| 10,000 D ordinary shares of £0.01 each | 100 | 100 |
| 475,000 non-voting preference B shares of £0.01 each | 4,750 | 4,750 |
| 13,500 E shares of £0.02 each | 270 | 270 |
| 300 cumulative redeemable preference shares of £0.01 each | 3 | 3 |
| 485,000 preference voting A shares of £0.02 each | 9,700 | 9,700 |
| 475,000 zero dividend voting C shares of £0.01 each | 4,750 | 4,750 |
| | 19,573 | 19,573 |

The shareholders funds attributable to non-equity shares is the nominal value of the respective non-equity shares plus £41,098,000 (2001 £37,160,000) attributable to the cumulative redeemable preference shares.

D Ordinary shares (D Shares)

D shares are entitled to receive a preferred dividend being a portion of the first £100 million to be distributed after payment of cumulative redeemable preference share dividends and any arrears of that dividend. Holders of D shares together with B shareholders are entitled to receive 50% of this preferred dividend. D shareholders are also eligible to receive ordinary dividends. Holders of D shares receive 1 vote per share. On a winding-up, D shareholders together with B shareholders are eligible to receive, after payment to the cumulative redeemable preference shareholders, a 50% share in the first £100 million to be distributed together with an equal share of any remaining surplus assets.

Non-voting preference B shares (B shares)

B shares are entitled to receive a preferred dividend being a portion of the first £100 million to be distributed after payment of cumulative redeemable preference share dividends and any arrears of that

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VIRGIN MOBILE TELECOMS LIMITED

NOTES TO THE ACCOUNTS (unaudited) (Continued)
Year ended 31 December 2002

dividend. Holders of B shares together with D shareholders are entitled to receive 50% of this preferred dividend. B shareholders are also eligible to receive ordinary dividends. Holders of B shares have no voting rights. On a winding-up, B shareholders together with D shareholders are entitled to receive, after payment to the cumulative redeemable preference shareholders, a 50% share in the first £100 million to be distributed together with an equal share of any remaining surplus assets.

E shares

E shares are only entitled to receive ordinary dividends (after cumulative redeemable preference share dividends and preferred dividends to A, B and D shareholders) at the earlier of 5 years after the date of issue of the shares and the date of realisation (being flotation, sale or a winding-up). After 5 years or realisation, E shareholders are entitled to 1 vote per share. On a winding-up, they are entitled to receive a share in the surplus assets after payment to the cumulative redeemable preference shareholders and the A, B and D shareholders.

Cumulative redeemable preference shares

Cumulative redeemable preference shares carry an entitlement to dividend at the rate 9% per annum on the issue price and may be redeemed at £100,122 per share at any time at the option of the company. Holders of the cumulative redeemable preference shares have no voting rights. On a winding-up, the holders are entitled to receive, in priority to any other classes of shares, the sum of £100,122 per share together with any arrears of dividend.

Preference voting A shares (A shares)

A shares are entitled to receive a preferred dividend of 50% of the first £100 million to be distributed after payment of cumulative redeemable preference share dividends and any arrears of that dividend. A shareholders are also eligible to receive ordinary dividends and receive 1 vote per share. Holders of A shares have the right on a winding-up to receive, after payment to the cumulative redeemable preference shareholders, a 50% share in the first £100 million to be distributed together with an equal share of any remaining surplus assets.

Zero dividend voting C shares (C shares)

C shareholders are not entitled to receive any dividend income but have 1 vote per share. On a winding-up, they are entitled to receive a share in the surplus assets after payment to the cumulative redeemable preference shareholders and the A, B and D shareholders.

17. RESERVES

| Group | Share premium account | Profit and loss account | Total |
|------------------------------------|-----------------------------|-------------------------------|------------|
| — | £ 000 | £ 000 | £ 000 |
| At 1 January 2002 | 30,036 | (191,804) | (161,768) |
| Retained loss for the year | | (1,942) | (1,942) |
| Finance costs of non-equity shares | | 3,938 | 3,938 |
| At 31 December 2002 | 30,036 | (189,808) | (159,772) |

VIRGIN MOBILE TELECOMS LIMITED

NOTES TO THE ACCOUNTS (unaudited) (Continued)
Year ended 31 December 2002

| Company | Share premium account | Profit and loss account | Total |
|------------------------------------|-----------------------------|-------------------------------|------------|
| | £ 000 | £ 000 | £ 000 |
| At 1 January 2002 | 30,036 | (187,104) | (157,068) |
| Retained loss for the year | | (630) | (630) |
| Finance costs of non-equity shares | | 3,938 | 3,938 |
| | | | |
| At 31 December 2002 | 30,036 | (183,796) | (153,760) |
| | | | |

18. RECONCILIATION OF MOVEMENTS IN GROUP SHAREHOLDERS FUNDS

| | 2002 | 2001 |
|-------------------------------------|------------|------------|
| | £ 000 | £ 000 |
| Retained loss for the year | (1,942) | (62,536) |
| Finance cost of non-equity shares | 3,938 | 3,597 |
| | | |
| Net movement to accumulated deficit | 1,996 | (58,939) |
| Opening accumulated deficit | (161,749) | (102,810) |
| | | |
| Closing accumulated deficit | (159,753) | (161,749) |
| | | |

19. RECONCILIATION OF OPERATING LOSS TO OPERATING CASH FLOWS

| | 2002 | 2001 |
|---|----------|-----------|
| | £ 000 | £ 000 |
| Operating profit (loss) | 4,836 | (47,705) |
| Depreciation charges | 11,286 | 12,038 |
| (Increase) decrease in stocks | (744) | 3,530 |
| Increase in debtors | (4,701) | (15,931) |
| Increase (decrease) in creditors | 24,035 | (5,997) |
| | | |
| Net cash inflow (outflow) from operating activities | 34,712 | (54,065) |
| | | |

20. ANALYSIS OF CASH FLOWS

| | <u>2002</u> | <u>2001</u> |
|---|-------------------|-------------------|
| | <u>£ 000</u> | <u>£ 000</u> |
| <i>Returns on investments and servicing finance</i> | | |
| Interest received | 522 | 483 |
| Interest paid | (8,220) | (4,619) |
| Interest element of finance lease rentals | (48) | (72) |
| | <u> </u> | <u> </u> |
| Net cash outflow | (7,746) | (4,208) |
| | <u> </u> | <u> </u> |
| <i>Capital expenditure and financial investment</i> | | |
| Purchase of tangible fixed assets | (18,315) | (8,836) |
| | <u> </u> | <u> </u> |
| <i>Financing</i> | | |
| Share capital receipts for shares issued in previous years | | 14 |
| Increase in loans secured on share capital and assets of the group | | 75,000 |
| Repayment of loans secured on share capital and assets of the group | (5,000) | |
| Repayment of capital element of finance lease | (255) | (156) |
| | <u> </u> | <u> </u> |
| Net cash (outflow) inflow | (5,255) | 74,858 |
| | <u> </u> | <u> </u> |

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VIRGIN MOBILE TELECOMS LIMITED

NOTES TO THE ACCOUNTS (unaudited) (Continued)
Year ended 31 December 2002

21. ANALYSIS AND RECONCILIATION OF NET DEBT

| | 1 January 2002 | Cash flow | Other non cash changes | 31 December 2002 |
|-------------------------|-------------------|--------------|------------------------------|------------------------|
| | £ 000 | £ 000 | £ 000 | £ 000 |
| Cash in hand, at bank | 9,714 | 3,396 | | 13,110 |
| Debt due after one year | (164,314) | 5,000 | (5,362) | (164,676) |
| Finance lease | (488) | 255 | | (233) |
| Net debt | (155,088) | 8,651 | (5,362) | (151,799) |

| | 2002 | 2001 |
|--|------------|------------|
| | £ 000 | £ 000 |
| Increase in cash in the period | 3,396 | 7,749 |
| Cash used to repay debt | 5,000 | |
| Cash inflow from increase in debt | | (75,000) |
| Cash used to repay finance lease | 255 | 156 |
| Change in net debt resulting from cash flows | 8,651 | (67,095) |
| Other non-cash changes | (5,362) | (6,299) |
| Movement in net debt in period | 3,289 | (73,394) |
| Net debt brought forward | (155,088) | (81,694) |
| Net debt at 31 December | (151,799) | (155,088) |

The non-cash changes represent the interest on the shareholder loans that is rolled up into the principal on a quarterly basis (see note 15).

22. FINANCIAL COMMITMENTS

Annual minimum lease commitments:

| Group | | Company | |
|--------------------|------|--------------------|------|
| Land and buildings | | Land and buildings | |
| 2002 | 2001 | 2002 | 2001 |
| | | | |

| | £ 000 | £ 000 | £ 000 | £ 000 |
|----------------------------|--------------|--------------|------------|------------|
| Expiry date | | | | |
| within one year | | | | |
| between two and five years | | | | |
| after five years | 1,092 | 1,092 | 240 | 240 |
| | <u>1,092</u> | <u>1,092</u> | <u>240</u> | <u>240</u> |
| | <u>1,092</u> | <u>1,092</u> | <u>240</u> | <u>240</u> |

The group and company have £776,000 (2001 £nil) of capital commitments contracted but not provided for.

23. PENSION ARRANGEMENTS

The company operates a defined contribution scheme for which the pension cost charge for the year amounted to £776,000 (2001 £549,000).

24. CONTINGENT ASSET

As a result of a High Court judgement on 6 March 2003, Virgin Mobile will be entitled to receive certain amounts for marketing support contributions that had been previously withheld by T-Mobile. Any amounts withheld have been fully provided for in the period in which they were withheld. The amounts that will be payable will be determined following future proceedings and any future payment by T-Mobile in

VIRGIN MOBILE TELECOMS LIMITED

NOTES TO THE ACCOUNTS (unaudited) (Continued)
Year ended 31 December 2002

relation to the previous marketing support contributions withheld will be reported as turnover in the results for the period in which the amount receivable can be determined with more certainty.

25. RELATED PARTY TRANSACTIONS

T-Mobile, through T-Mobile (UK) Limited, and The Virgin Group, through Bluebottle Investments S.A. and Bluebottle UK Limited, are joint venture partners in Virgin Mobile. The following transactions occurred with these partners in the year.

T-Mobile

The company was partially financed by a loan facility provided by T-Mobile on which interest at variable rates accrues. The principal amount of £34,837,922 (2001 £32,156,945) was outstanding as at 31 December 2002. Interest has been rolled up to the principal quarterly. Total interest for the year payable to T-Mobile is £2,680,977 (2001 £2,827,303). There are no fixed repayment dates, however this loan and associated interest does not become repayable until the bank syndicated loan (see note 15) has been repaid in full.

Some handsets, service packs and other accessories are purchased by T-Mobile on behalf of the company. The total cost to the company in respect of such purchases amounted to £5,888,061 (2001 £18,116,136) and of this £3,528,125 remained unpaid as at 31 December 2002 (2001 £880,190).

T-Mobile pays a marketing support contribution to the company and the company pays charges to T-Mobile for the use of its network. The total income from marketing support contributions to the company, net of payments to T-Mobile for use of its network, amounted to £15,160,603 (2001 £10,851,585) of which a net amount of £8,538,404 (2001 £2,552,222) remained outstanding as at 31 December 2002.

T-Mobile distributes airtime vouchers to certain retailers on behalf of the company. The total amount invoiced during the period in respect of these vouchers, net of management and distribution fees, amounted to £11,716,170 (2001 £26,769,848). £1,716,815 (2001 £2,041,684) of this total remained outstanding from T-Mobile as at 31 December 2002.

T-Mobile incurred additional expenses, particularly third party recharges and staff time, which were recharged on to the company and the company incurred similar expenses which were recharged to T-Mobile. The net amount recharged by T-Mobile was £395,463 (2001 £463,179). As at 31 December 2002, a net amount of £1,464,374 was owing from the company to T-Mobile (2001 £114,200 was owing from T-Mobile to the company).

T-Mobile provides three directors of the company and receives a £45,000 (2001 £45,000) annual consultancy fee for these executive services. An amount of £63,750 (2001 £18,750) remained outstanding at the end of 31 December 2002.

Virgin Group

The company was partially financed by a loan facility provided by Bluebottle UK Limited, a member of the Virgin Group, on which interest at variable rates accrues. The principal amount of £34,837,922 (2001 £32,156,945) was outstanding as at 31 December 2002. Interest has been rolled up to the principal quarterly. Total interest for the year payable to companies within the Virgin Group was £2,680,977 (2001 £2,827,303). There are no fixed repayment dates, however this loan and associated interest does not become repayable until the bank syndicated loan (see note 15) has been repaid in full.

During the period, handset, airtime vouchers and other stock items were sold through retailers who are members of the Virgin Group. These sales amounted to £22,990,506 (2001 £36,639,689) of which £7,755,801 (2001 £9,443,202) remained outstanding as at 31 December 2002.

Members of the Virgin Group performed additional services including printing, brand licensing and promotion, which were recharged on to the company. These amounted to £5,445,894 (2001 £8,300,147) of which £1,407,894 (2001 £2,532,076) remained unpaid as at 31 December 2002.

VIRGIN MOBILE TELECOMS LIMITED

NOTES TO THE ACCOUNTS (unaudited) (Continued)
Year ended 31 December 2002

Virgin Management Limited provides three directors of the company and receives a £45,000 (2001 £45,000) annual consultancy fee for these executive services. An amount of £18,750 (2001 £7,500) remained outstanding at the end of 31 December 2002.

The group uses some other sundry services provided by members of the Virgin Group. These are transacted on an arm's length basis under normal commercial terms.

26. SHAREHOLDERS' CONTRACTUAL DISPUTE

As at 31 December 2002 and 16 April 2003, there was a legal action pending between the Virgin Group shareholders and T-Mobile regarding an alleged event of default by T-Mobile under the Shareholders' Agreement. The Virgin Group shareholders are seeking a declaration from the court as to whether this event of default has occurred. Should the Virgin Group shareholders succeed in this action, the Virgin Group shareholders would have the right, but not the obligation, to serve a compulsory sale notice requiring that the shares in Virgin Mobile held by T-Mobile be offered for sale to the Virgin Group shareholders. While this could have implications for Virgin Mobile's bank funding, the directors understand that the Virgin Group shareholders would not serve a compulsory sale notice without obtaining appropriate waivers, under the syndicated bank loan agreement, from the syndicated banks.

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VIRGIN MOBILE TELECOMS LIMITED

US GAAP

CONSOLIDATED FINANCIAL STATEMENTS

**For the years ended 31 December 2001 and 2000 and for the period
from incorporation (29 January 1999) to 31 December 1999**

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This report is a copy of a previously issued Arthur Andersen report and Arthur Andersen has not reissued this report.

REPORT OF INDEPENDENT AUDITORS

To the Shareholders of Virgin Mobile Telecoms Limited:

We have audited the accompanying consolidated balance sheets of Virgin Mobile Telecoms Limited (a UK company) and subsidiary as of 31 December 2001 and 2000 and the related consolidated statements of operations, shareholders' equity and cash flows for the years ended 31 December 2001 and 2000 and for the period from its incorporation (29 January 1999) to 31 December 1999. These financial statements are the responsibility of Virgin Mobile Telecoms Limited's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Virgin Mobile Telecoms Limited and subsidiary as of 31 December 2001 and 2000, and the results of their operations and their cash flows for the year ended 31 December 2001 and 2000 and for the period from 29 January 1999 to 31 December 1999 in conformity with accounting principles generally accepted in the United States.

Arthur Andersen

6 June 2002

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VIRGIN MOBILE TELECOMS LIMITED

CONSOLIDATED BALANCE SHEETS

31 December 2001 and 2000

| | 31 December 2001 | 31 December 2000 |
|--|---------------------|---------------------|
| | £ 000 | £ 000 |
| Assets | | |
| Current assets: | | |
| Cash and cash equivalents | 9,714 | 1,965 |
| Accounts receivable, net of allowance for doubtful debts of £438,000 (2000 £481,000) | 17,189 | 7,575 |
| Due from other related companies | 13,271 | 3,215 |
| VAT receivable | 516 | 5,059 |
| Prepayments | 2,773 | 1,955 |
| Inventories | 4,927 | 8,457 |
| | <hr/> | <hr/> |
| | 48,390 | 28,226 |
| Non-current assets: | | |
| Deferred financing costs | 1,528 | 1,936 |
| Property and equipment, net of accumulated depreciation of £21,229,000 (2000 £9,043,000) | 17,307 | 22,215 |
| SIM cost deferral | 6,425 | 3,569 |
| | <hr/> | <hr/> |
| | 25,260 | 27,720 |
| | <hr/> | <hr/> |
| | 73,650 | 55,946 |
| | <hr/> | <hr/> |
| Liabilities | | |
| Current Liabilities: | | |
| Accounts payable | 21,664 | 12,527 |
| Accrued liabilities | 8,667 | 12,741 |
| Deferred revenue | 27,556 | 14,558 |
| Interest rate swaps and forward foreign exchange contracts | 1,292 | 7 |
| Capital lease | 255 | |
| Due to other related companies | 2,874 | 28,329 |
| Other accounts payable | 2,089 | 547 |
| | <hr/> | <hr/> |
| | 64,397 | 68,709 |
| Deferred revenue | 6,972 | 5,114 |
| Capital lease | 233 | |
| Bank loan | 100,000 | 25,000 |
| Due to other related companies | 64,314 | 58,659 |
| | <hr/> | <hr/> |
| | 235,916 | 157,482 |
| | <hr/> | <hr/> |
| Cumulative redeemable preference shares, £0.01 par value, 300 (2000 300) | 37,160 | 33,563 |
| Shareholders equity | | |
| D ordinary shares, £0.01 par value, 10,000 (2000 10,000) | | |
| Non-voting preference B shares, £0.01 par value, 475,000 (2000 475,000) | 5 | 5 |
| E shares, £0.02 par value, 13,500 (2000 13,500) | | |
| Preference voting A shares, £0.02 par value, 485,000 (2000 nil) | 10 | |
| Zero dividend voting C shares, £0.01 par value, 475,000 (2000 nil) | 4 | |
| Accumulated deficit | (199,445) | (135,104) |
| | <hr/> | <hr/> |
| | (199,426) | (135,099) |

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| | | |
|--|-------------------|-------------------|
| Shareholders' equity and cumulative redeemable preference shares | <u>(162,266)</u> | <u>(101,536)</u> |
| | <u>73,650</u> | <u>55,946</u> |

The accompanying notes are an integral part of these consolidated financial statements.

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VIRGIN MOBILE TELECOMS LIMITED

CONSOLIDATED STATEMENTS OF OPERATIONS

31 December 2001, 2000 and 1999

| | Year ended 31 December 2001 | Year ended 31 December 2000 | Period from incorporation to 31 December 1999 (11 month period) |
|--|-----------------------------------|-----------------------------------|---|
| | £ 000 | £ 000 | £ 000 |
| Revenues | | | |
| Equipment revenue, net of discounts | 25,782 | 20,013 | 8,175 |
| Service revenue | 137,940 | 47,929 | 719 |
| | <u>163,722</u> | <u>67,942</u> | <u>8,894</u> |
| Expenses | | | |
| Network and equipment cost | (118,192) | (78,198) | (13,806) |
| General and administrative expense | (82,442) | (82,210) | (20,033) |
| Depreciation and amortization | (12,186) | (8,043) | (1,681) |
| | <u>(49,098)</u> | <u>(100,509)</u> | <u>(26,626)</u> |
| Operating loss | <u>(49,098)</u> | <u>(100,509)</u> | <u>(26,626)</u> |
| Interest expense | (11,789) | (5,005) | |
| Interest income | 483 | 516 | 47 |
| | <u>(60,404)</u> | <u>(104,998)</u> | <u>(26,579)</u> |
| Loss before income taxes | <u>(60,404)</u> | <u>(104,998)</u> | <u>(26,579)</u> |
| Provision for income taxes | | | |
| | <u>(60,404)</u> | <u>(104,998)</u> | <u>(26,579)</u> |
| Net loss before cumulative effect of adoption of SFAS No. 133 | <u>(60,404)</u> | <u>(104,998)</u> | <u>(26,579)</u> |
| Cumulative effect of adoption of SFAS No. 133 | (340) | | |
| | <u>(60,744)</u> | <u>(104,998)</u> | <u>(26,579)</u> |
| Net loss | <u>(60,744)</u> | <u>(104,998)</u> | <u>(26,579)</u> |
| Financing cost of cumulative redeemable preference shares | (3,597) | (2,921) | (606) |
| | <u>(64,341)</u> | <u>(107,919)</u> | <u>(27,185)</u> |
| Net loss attributable to equity shareholders | <u>(64,341)</u> | <u>(107,919)</u> | <u>(27,185)</u> |

The accompanying notes are an integral part of these consolidated financial statements.

VIRGIN MOBILE TELECOMS LIMITED

CONSOLIDATED STATEMENTS OF SHAREHOLDERS EQUITY
31 December 2001, 2000 and 1999

| | Share capital | Accumulated Deficit | Total Shareholders Funds/ (Deficit) |
|--|--------------------------|--------------------------------|--|
| | £ 000 | £ 000 | £ 000 |
| At incorporation | | | |
| Shares issued | 5 | | 5 |
| Net loss attributable to equity shareholders | | (27,185) | (27,185) |
| Balance, 31 December 1999 | 5 | (27,185) | (27,180) |
| Net loss attributable to equity shareholders | | (107,919) | (107,919) |
| Balance, 31 December 2000 | 5 | (135,104) | (135,099) |
| Increase of share capital | 14 | | 14 |
| Net loss attributable to equity shareholders | | (64,341) | (64,341) |
| Balance, 31 December 2001 | 19 | (199,445) | (199,426) |

There was no other comprehensive income other than the results for the periods.

The accompanying notes are an integral part of these consolidated financial statements.

VIRGIN MOBILE TELECOMS LIMITED

CONSOLIDATED STATEMENTS OF CASH FLOWS

31 December 2001, 2000 and 1999

| | Year ended 31 December 2001 | Year ended 31 December 2000 | Period from incorporation to 31 December 1999 (11 month period) |
|---|-----------------------------------|-----------------------------------|---|
| | £ 000 | £ 000 | £ 000 |
| CASH FLOWS FROM OPERATING ACTIVITIES: | | | |
| Net loss | (60,744) | (104,998) | (26,579) |
| Adjustments to reconcile net loss to net cash provided by operating activities: | | | |
| Cumulative effective of adoption of SFAS No. 133 | 340 | | |
| Amortization of financing costs | 408 | 102 | |
| Depreciation and amortization | 12,186 | 8,043 | 1,681 |
| Add/(deduct) net changes in operating assets and liabilities: | | | |
| Accounts receivable | (9,614) | (6,049) | (1,526) |
| Due from other related companies | (10,056) | 1,686 | (4,901) |
| Other accounts receivable | 883 | (3,679) | (6,357) |
| Inventories | 3,530 | 2,370 | (10,827) |
| Accounts payable and accrued liabilities | 7,594 | 5,767 | 16,962 |
| Deferred revenue | 14,856 | 15,885 | 3,787 |
| Due to other related companies | (19,800) | 14,472 | 18,016 |
| Other accounts payable | 2,480 | 328 | 219 |
| Net cash used by operating activities | (57,937) | (66,073) | (9,525) |
| Cash flows from investing activities | | | |
| Net cash received in acquisition of subsidiary | | | 3,429 |
| Cash paid for property and equipment | (9,172) | (15,605) | (13,764) |
| Net cash used in investing activities | (9,172) | (15,605) | (10,335) |
| Cash flows from financing activities | | | |
| Financing costs incurred | | (2,038) | |
| Proceeds from issuance of share capital | 14 | | 5 |
| Proceeds from issuance of cumulative redeemable preference shares | | | 30,036 |
| Proceeds from unsecured loans from other related companies | | 49,500 | 1,000 |
| Proceeds from loans secured on share capital and net assets of the group | 75,000 | 25,000 | |
| Repayment of capital lease | (156) | | |
| Net cash provided by financing activities | 74,858 | 72,462 | 31,041 |
| Net increase/(decrease) in cash and cash equivalents | 7,749 | (9,216) | 11,181 |
| Cash and cash equivalents, beginning of year | 1,965 | 11,181 | |
| Cash and cash equivalents, end of year | 9,714 | 1,965 | 11,181 |

The accompanying notes are an integral part of these consolidated financial statements.

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VIRGIN MOBILE TELECOMS LIMITED

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

31 December 2001, 2000 and 1999

1 Background and organization

The company was incorporated on 29 January 1999 in the United Kingdom. The principal activities of the group comprise the sale of mobile phone handsets and the provision of mobile telecommunication services.

Virgin Mobile Telecoms Limited has a 100% holding in Bluebottle Call Limited. The only activity of this company is the leasing of property on behalf of Virgin Mobile Telecoms Limited. Together these two companies form the group.

2 Significant accounting policies

These financial statements have been prepared in accordance with accounting principles generally

accepted in the United States and are expressed in British Pounds Sterling. The significant accounting policies

are summarized as follows:

a) Basis of preparation

As at 31 December 2001 the group had a total shareholder deficit of £199,426,000 (2000 £135,099,000). The group is currently being financed by a syndicated bank loan (see note 4) and by its shareholders, T-Mobile and the Virgin Group (see note 8). The group has drawn down £100,000,000 under the £115,000,000 syndicated bank loan. The continued availability of this funding is based on achieving a number of financial and operating covenants (see note 4). While there can be no certainty about the group's future operating performance, based on the group's current approved plan for 2002 and forecasts for subsequent periods, the directors expect that the group will be cash neutral in the twelve months ending 31 December 2002 and that the group will comply with the syndicated bank loan covenants. Therefore, the directors have prepared these accounts on a going concern basis.

b) Basis of consolidation

The financial statements consolidate the financial statements of the Company and its subsidiary company after eliminating all intercompany transactions and balances.

c) Use of estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements, as well as the reported amounts of revenue and expenses during the reporting period. Actual amounts and results could differ from those estimates.

d) Foreign currencies

The consolidated financial statements are prepared in British Pounds Sterling. The functional currency is local currency in which the Company and its subsidiary are located (UK). Transactions in foreign currencies are translated at the exchange rate in effect at the date of each transaction. Differences in exchange rates during the period between the date a transaction denominated in a foreign currency is consummated and the date on which it is either settled or translated are recognized in the statement of operations.

The foreign currency exchange gain or loss recognized in the statement of income was a loss of £93,000 (2000 £4,000, 1999 £nil).

e) Cash and cash equivalents

For purposes of the statement of consolidated cash flows, the Company considers all highly liquid debt instruments purchased with an original maturity of three months or less to be cash. No such instruments were held during the period.

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VIRGIN MOBILE TELECOMS LIMITED

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
31 December 2001, 2000 and 1999

f) Accounts receivable trade

Accounts receivable trade are stated at nominal value less a provision for doubtful accounts. The provision is based on the risk of non-collectability then known. Amounts written off amounted to £206,000 (2000 £97,000, 1999 £nil) and the provision decreased by £43,000 (increased by £481,000 in 2000).

g) Revenue recognition

Equipment

Handsets

Handsets revenue is recognized based on the amounts received, net of rebates and commissions paid to the channels, at the date of sale. Commissions payable to channels are accrued when the channel has fulfilled the conditions to which the commission relates. This revenue is considered a separate earnings process to airtime and SIM card sales and hence is recognized upon delivery to the distributor.

SIM cards

SIM cards are sold to channels or directly to subscribers. The sale of a SIM card represents an ongoing commitment to provide service to a subscriber over the average subscriber's life. Revenue is therefore deferred and recognized over the average subscriber life commencing at the date of sale.

Service

Revenue earned directly from customers is recognized based on usage of the network in the period when services are rendered. No revenue is recognized on initial free airtime. Revenue is earned from third parties for the provision of services, including the network, to Virgin Mobile customers. This revenue is recognized in the period when services are rendered.

h) Direct costs related to revenue

Handset costs

Handset costs are recognized based on the amounts paid, net of rebates received from the suppliers, at the date of sale.

SIM cards

Costs are deferred and recognized over the average subscriber life commencing at the date of sale. Deferred costs are included within non-current assets.

Network charges

Network costs including the cost of providing initial free airtime are recognized on usage of the network.

i) Advertising costs

Advertising costs are expensed as incurred. Such costs are included in sales and general and administrative expenses in the accompanying consolidated statements of operations and for the year ended 31 December 2001 were £17,172,000 (2000 £17,844,000, 1999 £1,626,000).

j) Financing costs

Debt issuance costs relating to the Company's bank loans are deferred and amortized to interest expense using the effective interest method over the term of the bank loan.

k) Property and equipment

Property and equipment are stated at cost, net of accumulated depreciation. Maintenance repairs and minor renewals are charged to expense as incurred. Major renewals and improvements are capitalized and

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VIRGIN MOBILE TELECOMS LIMITED**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**
31 December 2001, 2000 and 1999

depreciated over their estimated useful lives. When assets are retired or otherwise disposed of, the cost is removed from the asset account and the corresponding accumulated depreciation is removed from the related reserve account. Any gain or loss resulting from such retirement or disposal is included in current income.

The recoverability of fixed assets is assessed whenever events or circumstances indicate a potential impairment. This assessment involves comparing the carrying value of the assets with management's best estimate of the future undiscounted cash flows to be generated by using the asset. Where this calculation indicates an impairment the asset is written down to its fair value, which is estimated based upon management's best estimate of future discounted cash flows.

Depreciation is provided on a straight-line basis over the estimated useful lives of the property and equipment as follows:

| | |
|------------------------|-----------|
| Leasehold improvements | 3 years |
| Fixtures and fittings | 3 years |
| Office equipment | 3 years |
| Computer systems | 2-3 years |

Assets under development are not depreciated until development has been completed and the fixed asset is fully operational.

l) Inventories

Inventories which comprise handsets held for resale are stated at the lower of standard cost and market value. Market value is based on estimated selling price, less further direct selling costs. Provision is made for obsolete, slow-moving or defective items where appropriate.

m) Income taxes

Income taxes are accounted for under the liability method in accordance with FAS 109, Accounting for Income Taxes. Deferred tax assets and liabilities are determined based on differences between the financial reporting and tax basis of assets and liabilities and are measured using the enacted tax rates and laws that will be in effect when the differences are expected to reverse. Deferred tax assets are reduced by a valuation allowance to the extent that it is more likely than not that a portion of the assets will not be realized.

n) Derivative financial instruments

The Company uses derivative financial instruments for the purpose of reducing its exposure to adverse fluctuations in interest rates, currencies and other market risks. The counterparties to these instruments are major financial institutions with high credit quality. The Company is exposed to credit loss in the event of non-performance by these counterparties.

On 1 January 2001, the Company adopted FAS 133, which establishes accounting and reporting standards for derivative instruments, including certain derivative instruments embedded in other contracts and used for hedging activities. All derivatives, whether designated for hedging relationships or not, are required to be recorded on the balance sheet at fair value. If the derivative is designated as a fair value hedge, all changes in the fair value of the derivative and changes in the fair value of the hedged item attributable to the hedged risk are recognized in earnings. If the derivative is designated as a cash flow hedge, the effective portions of the changes in the fair value of the derivative are recorded in other comprehensive income and are recognized in the statement of operations when the hedged item affects earnings. The ineffective portions of both fair value and cash flow hedges are immediately recognized in earnings.

The Company's interest rate swap has never been designated as an accounting hedge, consequently upon the adoption of SFAs No 133, this swap was recorded in the balance sheet at fair value at the transition date (1 January 2001). The resulting adjustment of £340,000 was recorded as the cumulative effect of adoption of SFAs No 133.

VIRGIN MOBILE TELECOMS LIMITED

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
31 December 2001, 2000 and 1999

After adoption of FAS 133, the interest rate swaps are accounted for at fair value, marking to market (fair value) any differences between periods through the statement of operations at the end of each reporting period. Swaps contracts are recorded at fair value and any differences between periods are recorded through the statement of operations at the end of each reporting period. The charge in the period is taken as a general and administrative expense.

n) Deferred revenue

Deferred revenue represents:

Deferred SIM card revenue. This revenue is recognized over the average subscriber life.

The balance of services due to pre-pay customers. This revenue is recognized upon usage.

The cash payments received as an incentive to sign rental agreements. This revenue is recognized over the term of the rental agreements.

o) Leases

Assets obtained under capital leases are capitalised in the balance sheet and depreciated over their estimated useful lives or the leases term, whichever is shorter. The interest element of these obligations is charged to the profit and loss account over the relevant period. The capital element of the future payment is treated as a liability.

Rentals under operating leases are charged on a straight-line basis over the lease term, even if the payments are not made on such a basis. Benefits received and receivable as an incentive to sign an operating lease are similarly spread on a straight-line basis over the lease term, except where the period to the review date on which the rent is first expected to be adjusted to the prevailing market rate is shorter than the full lease term, in which case the shorter period is used.

p) Recent accounting pronouncements

In June 2001, the Financial Accounting Standards Board issued FAS 143 Accounting for Asset Retirement Obligations. FAS 143 requires the fair value of a liability for asset retirement obligations to be recognised in the period in which it is incurred if a reasonable estimate of the fair value can be made. The associated asset retirement costs are capitalized as part of the carrying amount of the related long-lived asset.

FAS 143 is effective for financial statements issued for fiscal years beginning after June 15, 2002. The Company believes that the adoption of FAS 143 will have no impact on the company's financial statements.

In August 2001, the Financial Accounting Standards Board issued FAS 144 Accounting for the Impairment of Disposal of Long-Lived Assets to be Disposed Of. While it supersedes APB Opinion 30 Reporting the Results of operations Reporting the Effects of the Disposal of a Segment of a business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions it retains the presentation of discontinued operations but broadens that presentation to include a component of an entity (rather than a segment of a business). However, discontinued operations are no longer recorded at the net realisable value and future operating losses are no longer recognised before they occur. Under FAS 144, there is no longer a requirement to allocate goodwill to long-lived assets to be tested for impairment. It also establishes a probability weighted cash flow estimation approach to deal with situations in which there is a range of cash flows that may be generated by the asset being tested for impairment. FAS 144 also establishes criteria for determining when an asset should be treated as held for sale.

FAS 144 is effective for fiscal years beginning after December 15 2001 and interim periods within those fiscal years, with early application encouraged. The provisions of the Statement are generally to be applied prospectively. The Company currently has no plans to dispose of any operations and, accordingly, does not anticipate that adoption of FAS 144 will have any impact on its results of operations or its financial position.

In April 2002, the FASB issued SFAS 145 Rescission of FASB Statements No. 4, 44 and 64, Amendment of FASB Statement No. 13 and Technical Corrections. The principal change is that gains or

VIRGIN MOBILE TELECOMS LIMITED

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

31 December 2001, 2000 and 1999

losses from extinguishment of debt which are classified as extraordinary items by SFAS 4 will no longer be classified as such. The provisions of SFAS 145 are effective for fiscal years beginning after 15 May 2002 although early application of the Statement related to the rescission of SFAS 4 is encouraged. The Company plans to adopt SFAS 145 for its fiscal year ending 31 December 2003. When adopted, prior extraordinary items related to the extinguishment of debt will need to be reclassified.

3 Property and equipment

Property and equipment consist of the following:

| | <u>Leasehold improvements</u> | <u>Fixtures and fittings</u> | <u>Office equipment</u> | <u>Computer systems</u> | <u>Total</u> |
|-----------------------|-----------------------------------|----------------------------------|-----------------------------|-----------------------------|--------------|
| | £ 000 | £ 000 | £ 000 | £ 000 | £ 000 |
| Cost | | | | | |
| At 1 January 2001 | 7,718 | 642 | 271 | 22,627 | 31,258 |
| Additions | 74 | 20 | 2 | 7,182 | 7,278 |
| | <hr/> | <hr/> | <hr/> | <hr/> | <hr/> |
| At 31 December 2001 | 7,792 | 662 | 273 | 29,809 | 38,536 |
| | <hr/> | <hr/> | <hr/> | <hr/> | <hr/> |
| Depreciation | | | | | |
| At 1 January 2001 | 1,591 | 263 | 78 | 7,111 | 9,043 |
| Charge for the period | 2,517 | 213 | 101 | 9,355 | 12,186 |
| | <hr/> | <hr/> | <hr/> | <hr/> | <hr/> |
| At 31 December 2001 | 4,108 | 476 | 179 | 16,466 | 21,229 |
| | <hr/> | <hr/> | <hr/> | <hr/> | <hr/> |
| Net book value | | | | | |
| At 31 December 2001 | 3,684 | 186 | 94 | 13,343 | 17,307 |
| | <hr/> | <hr/> | <hr/> | <hr/> | <hr/> |
| At 31 December 2000 | 6,127 | 379 | 193 | 15,516 | 22,215 |
| | <hr/> | <hr/> | <hr/> | <hr/> | <hr/> |

Property and equipment include computer equipment of £644,375 (2000 £nil) and net book value of £536,537 (2000 £nil) in respect of assets held under a capital lease.

4 Long term debt

The Group's long-term debt comprises the following:

| | <u>2001</u> | <u>2000</u> |
|--------------------------------|-------------|-------------|
| | £ 000 | £ 000 |
| Capital lease | 233 | |
| Bank loan | 100,000 | 25,000 |
| Due to other related companies | 64,314 | 58,659 |
| | <hr/> | <hr/> |
| | 164,547 | 83,659 |

As at 31 December 2001, contractual maturities of the Group's indebtedness were as follows:

| | Capital lease | Bank loan | Due to other related companies |
|-------------------------------|--------------------------|----------------------|---|
| | <u>£ 000</u> | <u>£ 000</u> | <u>£ 000</u> |
| Year ended 31 December | | | |
| 2002 | 255 | | |
| 2003 | 233 | 23,000 | |
| 2004 | | 46,000 | |
| 2005 | | 31,000 | |
| 2005 or later | | | 64,314 |
| | <u>488</u> | <u>100,000</u> | <u>64,314</u> |
| Total | 488 | 100,000 | 64,314 |

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VIRGIN MOBILE TELECOMS LIMITED

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
31 December 2001, 2000 and 1999

The bank loan is in the form of a syndicated loan facility. The loan facility is secured on the share capital and assets of the group. The interest rate on the floating rate element of the facility loan is linked to the LIBOR. The undrawn committed borrowings under this facility at 31 December 2001 was £15,000,000 (2000 £55,000,000). The continued availability of this facility is based on achieving a number of financial and operating covenants, the principal covenants being subscriber numbers and revenue and earnings to debt ratios.

The interest rate on floating shareholder loans for which there is no fixed repayment date is at 4% above the three-month LIBOR rate. These loans and associated interest do not become repayable until the bank has been repaid.

5 Shareholders equity

| | 2001 | 2000 |
|--|---------------|---------------|
| | £ | £ |
| <i>Authorised</i> | | |
| 10,000 D ordinary shares of £0.01 each | 100 | 100 |
| 475,000 non-voting preference B shares of £0.01 each | 4,750 | 4,750 |
| 30,000 E shares of £0.02 each | 600 | 600 |
| 485,000 preference voting A shares of £0.02 each | 9,700 | 9,700 |
| 475,000 zero dividend voting C shares of £0.01 each | 4,750 | 4,750 |
| | <u>19,900</u> | <u>19,900</u> |

| | 2001 | 2000 | |
|--|-----------------------------|-----------------------------|---------------|
| | Called-up and fully paid | Called-up and fully-paid | Called-up |
| | £ | £ | £ |
| <i>Allotted</i> | | | |
| 10,000 D ordinary shares of £0.01 each | 100 | 100 | 100 |
| 475,000 non-voting preference B shares of £0.01 each | 4,750 | 4,750 | 4,750 |
| 13,500 E shares of £0.02 each | 270 | 270 | 270 |
| 485,000 preference voting A shares of £0.02 each | 9,700 | | 9,700 |
| 475,000 zero dividend voting C shares of £0.01 each | 4,750 | 2 | 4,750 |
| | <u>19,570</u> | <u>5,122</u> | <u>19,570</u> |

D Ordinary shares (D shares)

D shares are entitled to receive a preferred dividend being a portion of the first £100 million to be distributed after payment of cumulative redeemable preference share dividends and any arrears of that dividend. Holders of D shares together with B shareholders are entitled to receive 50% of this preferred dividend. D shareholders are also eligible to receive ordinary dividends. Holders of D shares receive 1 vote per share. On a winding-up, D shareholders together with B shareholders are eligible to receive, after payment to the cumulative redeemable preference shareholders, a 50% share in the first £100 million to be distributed together with an equal share of any remaining surplus assets.

Non-voting preference B shares (B shares)

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B shares are entitled to receive a preferred dividend being a portion of the first £100 million to be distributed after payment of cumulative redeemable preference share dividends and any arrears of that dividend. Holders of B shares together with D shareholders are entitled to receive 50% of this preferred dividend. B shareholders are also eligible to receive ordinary dividends. Holders of B shares have no voting rights. On a winding-up, B shareholders together with D shareholders are entitled to receive, after payment to the cumulative redeemable preference shareholders, a 50% share in the first £100 million to be distributed together with an equal share of any remaining surplus assets.

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VIRGIN MOBILE TELECOMS LIMITED

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
31 December 2001, 2000 and 1999*E shares*

E shares are only entitled to receive ordinary dividends (after cumulative redeemable preference share dividends and preferred dividends to A, B and D shareholders) at the earlier of 5 years after the date of issue of the shares and the date of realisation (being flotation, sale or a winding-up). After 5 years or realisation, E shareholders are entitled to 1 vote per share. On a winding-up, they are entitled to receive a share in the surplus assets after payment to the cumulative redeemable preference shareholders and the A, B and D shareholders.

Preference voting A shares (A shares)

A shares are entitled to receive a preferred dividend of 50% of the first £100 million to be distributed after payment of cumulative redeemable preference share dividends and any arrears of that dividend. A shareholders are also eligible to receive ordinary dividends and receive 1 vote per share. Holders of A shares have the right on a winding-up to receive, after payment to the cumulative redeemable preference shareholders, a 50% share in the first £100 million to be distributed together with an equal share of any remaining surplus assets.

Zero dividend voting C shares (C shares)

C shareholders are not entitled to receive any dividend income but have 1 vote per share. On a winding-up, they are entitled to receive a share in the surplus assets after payment to the cumulative redeemable preference shareholders and the A, B and D shareholders.

6 Cumulative redeemable preference shares

Cumulative redeemable preference shares carry an entitlement to dividend at the rate 9% per annum on the issue price (being £30,036,000 paid in 1999) and may be redeemed at £100,122 per share at any time at the option of the company. Holders of the cumulative redeemable preference shares have no voting rights. On a winding-up, the holders are entitled to receive, in priority to any other classes of shares, the sum of £100,122 per share together with any arrears of dividend because the holders of the cumulative redeemable preference shares are the shareholders in, and have joint control of, the Company redemption is not under the control of the Company and according to EITF topic D-98, cumulative redeemable preference shares have not been classified as share capital. The following table presents a reconciliation of the carrying amount of the cumulative redeemable preference shares as of 31 December 2001, 2000 and 1999:

| | 31 December 2001 | 31 December 2000 | 31 December 1999 |
|---------------------------------------|-----------------------------|-----------------------------|-----------------------------|
| | £ 000 | £ 000 | £ 000 |
| Balance, beginning of the year/period | 33,563 | 30,642 | |
| Share capital | | | |
| Share premium | | | 30,036 |
| Financing cost cumulative dividend | 3,597 | 2,921 | 606 |
| Balance, end of the year | 37,160 | 33,563 | 30,642 |

7 Financial instruments

The company believes the amounts presented for financial instruments in the accompanying financial statements, consisting of cash equivalents, accounts receivables, accounts payables, are reasonable estimates of their fair value.

VIRGIN MOBILE TELECOMS LIMITED

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
31 December 2001, 2000 and 1999

The following table presents the carrying amounts and fair values at the Company's other financial instruments as of 31 December 2001 and 2000:

| | 2001 | | | 2000 | | |
|--------------------|---------------------|--------------------|---------------|---------------------|--------------------|---------------|
| | Principal Amount | Carrying Amount | Fair Value | Principal Amount | Carrying Amount | Fair Value |
| | £ 000 | £ 000 | £ 000 | £ 000 | £ 000 | £ 000 |
| Long-term debt | 100,233 | 100,233 | 105,191 | 25,000 | 25,000 | 26,797 |
| Interest rate swap | 75,000 | (1,256) | (1,256) | 20,000 | (7) | (347) |
| Forward contract | 6,250 | (36) | (36) | | | |

There were no financial instruments used in the year ended 31 December 1999.

The company has entered into interest rate swaps to hedge against adverse movements in LIBOR in relation to its syndicated loan facility. The company's policy is to keep between 50 per cent and 75 per cent of the syndicated loan borrowing at fixed rates of interest. At the year-end, 75 per cent of the syndicated loan was at fixed rates after taking account of interest rate swaps.

About one-third of the handset purchases made by the company are from suppliers in continental Europe. These purchases are invoiced in Euros. The company's policy is to eliminate some currency exposure on payments at the time of purchase through forward currency contracts. All other purchases are denominated in sterling.

The fair value of the interest rate swaps and foreign exchange contracts have been determined by reference to prices available from the markets on which the instrument involved is traded.

The fair value of the long term loan has been calculated by discounting cash flows at prevailing interest rates.

The fair values of shareholder loans have not been presented. As they are not publicly traded, it would be impractical to make an estimate with sufficient reliability.

The fair values of the cumulative redeemable preferences shares have not been presented. As they are not publicly traded and can be redeemed at any time at the option of the company, it would be impractical to make an estimate with sufficient reliability.

8 Taxes

The provision for income taxes is comprised of the following:

| | 31 December 2001 | 31 December 2000 | 31 December 1999 |
|---|---------------------|---------------------|---------------------|
| | £ 000 | £ 000 | £ 000 |
| Current tax payable | | | |
| Deferred tax asset due to property, plant and equipment | 6,189 | 2,374 | 279 |
| Deferred tax asset for carried forward losses | 52,311 | 36,999 | 7,297 |
| Cumulative valuation allowance | (58,500) | (39,373) | (7,576) |

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VIRGIN MOBILE TELECOMS LIMITED

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
31 December 2001, 2000 and 1999

The reconciliation of the tax expense with the product of accounting multiplied by the applicable tax rate is as follows:

| | Year ended 31 December 2001 | Year ended 31 December 2000 | 11 month period ended 31 December 1999 |
|---|-----------------------------------|-----------------------------------|---|
| | £ 000 | £ 000 | £ 000 |
| Loss before income taxes | (60,404) | (104,998) | (26,579) |
| Effective tax (rate 30%) | 18,121 | 31,499 | 7,974 |
| Tax effect of accelerated capital allowances | (3,815) | (2,095) | (279) |
| Tax effect of permanent differences (disallowable expenses) | 1,006 | 298 | (398) |
| Tax credit for the period | 15,312 | 29,702 | 7,297 |
| Valuation allowance for the period | (15,312) | (29,702) | (7,297) |
| Tax expense for the period | <u> </u> | <u> </u> | <u> </u> |

Total carried forward tax losses at 31 December 2001 were in the region of £174,000,000 (2000 £123,000,000, 1999 £24,000,000). These losses result in significant deferred tax assets, however management believes that recognition of these assets is not appropriate given the current position of the company.

9 Related party transactions

T-Mobile (formerly known as One 2 One), through One 2 One Personal Communications Limited, and The Virgin Group, through Bluebottle Investments S.A. and Bluebottle UK Limited, are joint venture partners in Virgin Mobile. The following transactions occurred with these partners in the year.

T-Mobile

The company was partially financed by a loan facility provided by T-Mobile on which interest at variable rates accrues. The principal amount of £32,156,945 (2000 £29,329,643) was outstanding as at 31 December 2001. Interest has been rolled up to the principal quarterly. Total interest for the year payable to T-Mobile is £2,827,303 (2000 £2,627,874). There are no fixed repayment dates, however this loan and associated interest does not become repayable until the bank syndicated loan (see note 4) has been repaid.

Some handsets, service packs and other accessories are purchased by T-Mobile on behalf of the company. The total cost to the company in respect of such purchases amounted to £18,116,136 (2000 £55,366,696) and of this £880,190 remained unpaid as at 31 December 2001 (2000 £28,088,902).

T-Mobile pay a marketing support contribution to the company and the company pays charges to T-Mobile both as a result of Virgin Mobile's customers' use of the network. The total income from marketing support contributions to the company, net of payments to T-Mobile for use of its network, amounted to £10,851,585 (2000 £2,307,600) of which a net amount of £2,552,222 (2000 £1,146,643) remained outstanding as at 31 December 2001.

T-Mobile distribute airtime vouchers to certain retailers on behalf of the company. The total amount invoiced during the period in respect of these vouchers, net of management and distribution fees, amounted to £26,769,848 (2000 £13,512,352). £2,041,684 (2000 £4,400,690) of this

total remained outstanding from T-Mobile as at 31 December 2001.

T-Mobile incurred additional expenses, particularly third party recharges and staff time, which were recharged on to the company and the company incurred similar expenses which were recharged to T-Mobile. The net amount recharged by T-Mobile was £463,179 (2000 £1,828,440). As at 31 December, a net amount of £114,200 was owing from T-Mobile to the company (2000 £230,000 was owing from the company to T-Mobile).

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VIRGIN MOBILE TELECOMS LIMITED**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****31 December 2001, 2000 and 1999**

T-Mobile provides three directors of the company and receives a £45,000 (2000 £45,000) annual consultancy fee for these executive services. An amount of £18,750 (2000 £64,000) remained outstanding at the end of December 2001.

Virgin Group

The company was partially financed by a loan facility provided by Bluebottle UK Limited, a member of the Virgin Group, on which interest at variable rates accrues. The principal amount of £32,156,945 (2000 £29,329,643) was outstanding as at 31 December 2001. Interest has been rolled up to the principal quarterly. Total interest for the year payable to companies within the Virgin Group was £2,827,303 (2000 £2,079,643). There are no fixed repayment dates, however this loan and associated interest does not become repayable until the bank syndicated loan (see note 4) has been repaid.

During the period, handset, airtime vouchers and other stock items were sold through retailers who are members of the Virgin Group. These sales amounted to £36,639,689 (2000 £33,909,281) of which £9,443,202 (2000 £3,197,681) remained outstanding as at 31 December 2001.

Members of the Virgin Group performed additional services including printing, brand licensing and promotion, which were recharged on to the company. These amounted to £8,300,147 (2000 £8,364,958) of which £2,532,076 (2000 £580,230) remained unpaid as at 31 December 2001.

Virgin Management Limited provides three directors of the company and receives a £45,000 (2000 £45,000) annual consultancy fee for these executive services. An amount of £7,500 (2000 £64,000) remained outstanding at the end of December 2001.

The group uses some other sundry services provided by members of the Virgin Group. These are transacted on an arm's length basis under normal commercial terms.

10 Financial Commitments

Annual commitments under non-cancellable operating leases are as follows:

| | Land and Buildings 2001 | Land and Buildings 2000 |
|---------------|--|--|
| | £ 000 | £ 000 |
| 2002 | 1,092 | 1,092 |
| 2003 | 1,092 | 1,092 |
| 2004 | 1,092 | 1,092 |
| 2005 | 1,092 | 1,092 |
| 2006 or later | 8,713 | 9,816 |
| | 13,081 | 14,184 |

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COMDIRECT BANK AKTIENGESELLSCHAFT

CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

For the years ended 31 December 2003 and 2002

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COMDIRECT BANK AKTIENGESELLSCHAFT

CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)
AS OF DECEMBER 31, 2003 AND 2002

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Income statement

Income statement of comdirect bank group according to IFRS/IAS

| thousand | Notes | 1.1. to 31.12. | |
|---|-------|----------------|----------------|
| | | 2003 | 2002 |
| Interest income | | 84,889 | 99,220 |
| Interest expenses | | 27,682 | 35,324 |
| Net interest income before provisions | (22) | 57,207 | 63,896 |
| Provision for possible loan losses | (23) | 35 | -2,037 |
| Net interest income after provisions | | 57,242 | 61,859 |
| Commission income | | 96,686 | 79,024 |
| Commission expenses | | 13,579 | 1,882 |
| Net commission income | (24) | 83,107 | 77,142 |
| Trading profit/loss | | 0 | -285 |
| Income/loss from investments and securities portfolio | (25) | 4,760 | 1,200 |
| Administrative expenses | (26) | 112,494 | 138,138 |
| Other operating result | (27) | 6,487 | 2,917 |
| Profit from ordinary activities | | 39,102 | 4,695 |
| Extraordinary result and restructuring costs | | 0 | -23,295 |
| Pre-tax profit/loss | | 39,102 | -18,600 |
| Taxes on income | (28) | 15,741 | -8,836 |
| After-tax profit/loss | | 23,361 | -9,764 |
| Net profit/loss | | 23,361 | -9,764 |
| Transfer to reserves/transfer from reserves | | -880 | 9,764 |
| Consolidated profit | | 22,481 | 0 |

Earnings per share

| | 1.1. to 31.12. | |
|--------------------|----------------|------|
| Earnings per share | 2003 | 2002 |
| | | |

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| | | | |
|---|----------|-------------|--------------|
| Net profit/loss | thousand | 23,361 | -9,764 |
| Average number of ordinary shares | Shares | 140,500,729 | 140,500,000 |
| Basic earnings per share | | 0.17 | -0.07 |
| Diluted earnings per share | | | |
| Net profit/loss | thousand | 23,361 | -9,764 |
| Adjustment to the number of ordinary shares issued due to outstanding option rights | Shares | 416,204 | 395,349 |
| Weighted average shares outstanding (diluted) | Shares | 140,916,933 | 140,895,349 |
| Diluted earnings per share | | 0.17 | -0.07 |

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Balance sheet

Balance sheet of comdirect bank group according to IFRS/IAS

Assets

| thousand | | as of 31.12. | |
|--------------------------------------|-------|------------------|------------------|
| | Notes | 2003 | 2002 |
| Cash reserve | (29) | 1,749 | 5,181 |
| Claims on banks | (30) | 1,310,434 | 1,294,419 |
| Claims on customers | (31) | 183,773 | 175,421 |
| Provision for possible loan losses | (32) | -5,766 | -6,355 |
| Investments and securities portfolio | (33) | 1,893,862 | 1,057,701 |
| Intangible assets | (34) | 11,905 | 14,094 |
| Fixed assets | (35) | 20,860 | 28,175 |
| Tax assets | (37) | 0 | 11,701 |
| Other assets | (38) | 9,313 | 8,936 |
| Total assets | | 3,426,130 | 2,589,273 |

Liabilities and equity

| thousand | | as of 31.12. | |
|-------------------------------------|-------|------------------|------------------|
| | Notes | 2003 | 2002 |
| Liabilities to banks | (39) | 0 | 14,913 |
| Liabilities to customers | (40) | 2,774,791 | 1,948,680 |
| Provisions | (41) | 18,556 | 21,108 |
| Tax liabilities | (42) | 7,370 | 0 |
| Other liabilities | | 24,509 | 24,247 |
| Subordinated capital | (43) | 16,617 | 16,617 |
| Equity | | 584,287 | 563,708 |
| Subscribed capital | | 140,503 | 140,500 |
| Capital reserve | | 367,240 | 367,221 |
| Retained earnings | | | |
| Legal reserve | | 0 | 0 |
| Other revenue reserves | | 55,359 | 55,658 |
| Revaluation reserve | | -1,296 | 329 |
| Consolidated profit | | 22,481 | 0 |
| Total liabilities and equity | | 3,426,130 | 2,589,273 |

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Statement of changes in equity

| thousand | Subscribed | Capital | Retained | Revaluation | Consolidated | Total | Total |
|---|----------------|----------------|---------------|---------------|---------------|----------------|----------------|
| | capital | reserve | earnings | reserve | profit/loss | 2003 | 2002 |
| Equity as of 1.1. | 140,500 | 367,221 | 55,658 | 329 | 0 | 563,708 | 578,110 |
| Issue of new shares | 3 | 19 | | | | 22 | 0 |
| Changes in revaluation reserve pursuant to IAS 39 | | | | -1,625 | | -1,625 | -754 |
| Changes in the difference arising from currency translation | | | -1,179 | | | -1,179 | -1,635 |
| Allocation to reserves/transfer from reserves | | 0 | 880 | | | 880 | -12,013 |
| Consolidated profit | | | | | 22,481 | 22,481 | 0 |
| Equity as of 31.12. | 140,503 | 367,240 | 55,359 | -1,296 | 22,481 | 584,287 | 563,708 |

No use was made of the authorisation of the annual general meeting on 7 May, 2003 to purchase own shares for the purpose of securities trading pursuant to Art. 71, (1), No. 7, German Stock Corporation Act (AktG) in financial year 2003.

No use was also made of the resolution of the annual general meeting on 7 May, 2003 for the authorisation to purchase own shares for other purposes than securities trading pursuant to Art. 71, (1), No. 8, AktG in financial year 2003.

Resulting from the exercise of option rights, a total of 3,350 new no-par-value bearer shares of comdirect bank AG were issued as part of our stock option programme. Each of these shares carries a proportion of the share capital in the sum of one euro. The relevant additional payment established in connection with the stock option programme was allocated to the capital reserve pursuant to Art. 270, German Commercial Code (HGB).

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Cash flow statement

| thousand | 1.1. to 31.12. | |
|--|----------------|----------------|
| | 2003 | 2002 |
| Net profit/loss | 23,361 | -9,764 |
| Non-solvent items and transfer to cash flow from operating activities contained in the result before profit transfer | | |
| Depreciation charges, valuation allowances, additions to fixed assets and financial investments and change in provisions | 13,952 | -5,001 |
| Loss/gain from the sale of financial investments and fixed assets | 67 | 455 |
| Other adjustments (on balance) | -48,240 | -59,966 |
| Sub-total | -10,860 | -74,276 |
| Change in assets and liabilities from operating activities after adjustment for non-solvent items | | |
| Claims | | |
| on banks | -16,147 | 392,538 |
| on customers | -8,905 | 87,561 |
| Securities | -846,101 | -183,058 |
| Other assets from operating activities | 11,003 | 6,490 |
| Liabilities | | |
| to banks | -14,913 | 14,913 |
| to customers | 826,111 | -340,647 |
| Other liabilities and equity from operating activities | 4,116 | -22,537 |
| Interest and dividends received | 77,356 | 96,843 |
| Interest paid | -27,682 | -35,324 |
| Income tax payments | -2,805 | -112 |
| Cash flow from operating activities | -8,827 | -57,609 |
| Changes in funds from investing activities (on balance) | 6,552 | 1,043 |
| Proceeds from capital increases | 22 | 0 |
| Cash flow from financing activities | 22 | 0 |
| Cash and cash equivalents as at the end of the previous period | 5,181 | 72,005 |
| Cash flow from operating activities | -8,827 | -57,609 |
| Cash flow from investing activities | 6,552 | 1,043 |
| Cash flow from financing activities | 22 | 0 |
| Effects from deconsolidation | 0 | -8,623 |
| Effects of changes in exchange rates | -1,179 | -1,635 |
| Cash and cash equivalents as at the end of the period | 1,749 | 5,181 |

Cash and cash equivalents correspond to the balance-sheet item cash reserve and include cash on hand and balances held at central banks.

Notes

Basis of accounting principles

The consolidated financial statements of comdirect bank as of 31 December, 2003 were prepared in accordance with the International Financial Reporting Standards (IFRS)/International Accounting Standards (IAS), which were approved and published by the International Accounting Standards Board (IASB)/International Accounting Standards Committee (IASC), and interpreted by the International Financial Reporting Interpretations Committee (IFRIC)/Standing Interpretations Committee (SIC).

A summary of all the regulations that have been applied can be found on pages 51 et seq.

As a subsidiary of Commerzbank AG, Frankfurt am Main, we are exempted in accordance with Art. 291, German Commercial Code (HGB), from the duty to present sub-group financial statements. As we have not presented the main differences between financial statements prepared in accordance with IFRS/IAS and those prepared in accordance with the German Commercial Code, these consolidated financial statements do not conform to the 4th and 7th EC directives and do not, therefore, exempt us from presenting consolidated financial statements in accordance with Art. 292a, HGB. The consolidated financial statements have been prepared in order to satisfy the admission requirements/subsequent obligations (Prime Standard) of the Deutsche Börse AG for the sub-section of the regular market.

The consolidated financial statements also reflect the standards approved by the German Accounting Standards Board (GASB) and published by the German Federal Ministry of Justice pursuant to Art. 342, (2), HGB.

The comdirect sub-group is included in the consolidated financial statements of our parent company. The consolidated financial statements of Commerzbank as of 31 December, 2002 were deposited with the lower regional court (Amtsgericht) of Frankfurt am Main under the commercial register no. 32000 and published in the Federal Gazette, no. 132, pages 12,264 to 12,308 of 19 July, 2003.

We report on both the implementation of the German legislation for control and transparency in the corporate sector (KonTraG) and on the risks posed by future development, pursuant to Art. 315, (1), HGB in the risk report as part of the group management report.

In addition to the income statement and the balance sheet, the consolidated financial statements also include the statement of changes in equity, the cash flow statement and the notes. Segment reporting by both business lines and by geographic market appears as part of the notes, on pages 82-84 (notes no. 50-51).

Unless otherwise indicated, all the amounts are shown in thousands of euros.

Accounting and measurement methods

(1) Basic principles

The consolidated financial statements of comdirect are based on the going concern principle.

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The principle of profit or loss for the period is applied in our consolidated financial statements. Income and expenses are recognised on a pro-rata basis; they are shown for the period to which they may be assigned in economic terms.

As a matter of principle, accounting is at net book value, with the exception of financial instruments as defined by IAS 39, which are shown at their fair value. These financial instruments appear under the balance-sheet item investments and securities portfolio. All financial instruments are shown in the balance sheet according to the method trade date accounting.

With the exception of comdirect private finance AG, all the companies included in the consolidation prepared their financial statements as of 31 December, 2003.

comdirect private finance AG prepared its financial statements for the short business year from 1 January, 2003 through 30 September, 2003. The company began operations on 1 October, 2003. We adjusted the financial statements for the short business year as of the reference date 31 December, 2003 pursuant to IAS 27.

(2) IAS, SIC and GASB rules applied

Within the comdirect group and within the Commerzbank group, to which it belongs, only those IFRSs/IASs and SICs are applied for accounting and measurement purposes, which had been approved and published by 31 December, 2003.

The consolidated financial statements are based on the IASB framework and the following IASs relevant for comdirect:

| | |
|--------|--|
| IAS 1 | Presentation of financial statements |
| IAS 7 | Cash flow statements |
| IAS 8 | Net profit or loss for the period, fundamental errors and changes in accounting policies |
| IAS 10 | Events after the balance-sheet date (uncertainties of success and events after the balance-sheet date) |
| IAS 12 | Income taxes |
| IAS 14 | Segment reporting |
| IAS 16 | Property, plant and equipment |
| IAS 17 | Leases |
| IAS 18 | Revenue |
| IAS 19 | Employee benefits |
| IAS 21 | The effects of changes in foreign exchange rates |
| IAS 22 | Business combinations |
| IAS 24 | Related party disclosures |
| IAS 27 | Consolidated financial statements and accounting for investments in subsidiaries |
| IAS 30 | Disclosures in the financial statements of banks and similar financial institutions |
| IAS 32 | Financial instruments: disclosure and presentation |
| IAS 33 | Earnings per share |
| IAS 35 | Discontinued operations |
| IAS 36 | Impairment of assets |
| IAS 37 | Provisions, contingent liabilities and contingent assets |
| IAS 38 | Intangible assets |
| IAS 39 | Financial instruments: recognition and measurement |

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We did not apply IAS 2, 11, 15, 20, 23, 26, 28, 29, 31, 34, 40 and 41 since they are either not relevant for us or are not applicable in the consolidated financial statements.

In addition to the Standards listed, we have taken into consideration the following SIC interpretations relevant for us in our consolidated financial statements:

| | | |
|--------|--|-------------|
| SIC-6 | Costs of modifying existing software (framework) | relates to: |
| SIC-7 | Introduction of the euro | IASB |
| SIC-12 | Consolidation special purpose entities | Framework |
| SIC-15 | Operating leases incentives | IAS 21 |
| SIC-17 | Equity costs of an equity transaction | IAS 27 |
| SIC-18 | Consistency - alternative methods | IAS 17 |
| | | IAS 32 |
| | | IAS 1 |

(3) Consolidated companies

Apart from the parent company, the consolidated companies consist of two subsidiaries, comdirect ltd, London/United Kingdom and comdirect private finance AG, Quickborn, and one special fund, a special purpose entity (SPV) in accordance with SIC-12.

comdirect bank AG holds 100% of the shares of the subsidiaries and the special purpose entity.

A detailed presentation of the operative holdings appears on page 88.

(4) Principles of consolidation

The consolidation of the capital accounts is based on the book-value method, whereby the historical cost of the holding in the subsidiary is set off against the proportion of the subsidiary's equity as of the date of acquisition.

Intra-group expenses and income, as well as claims and liabilities, are eliminated as part of the consolidation.

Holdings in subsidiaries that are not included in the consolidation due to their minor importance are shown at historical cost in the investments and securities portfolio.

(5) Currency translation

The items from the income statement and also the assets and liabilities from the balance sheet which are denominated in foreign currencies are translated at the spot rates of the balance-sheet date.

Holdings in affiliated companies that are denominated in foreign currencies appear at historical cost.

comdirect nets translation gains and losses from the consolidation of the capital accounts against retained earnings.

The annual financial statement prepared by our subsidiary comdirect ltd in foreign currency is translated at the spot rates of the balance-sheet date. Any income and expenses resulting from this appear in the income statement.

The most important exchange rate for comdirect bank group is the British pound (GBP). The GBP exchange rate as of 31 December, 2003 was 0.7048 (previous year: 0.6500).

(6) Claims

All claims on banks and customers originated by comdirect bank group are shown at amortised costs without valuation allowances.

Claims not originated by comdirect promissory notes that are not held for trading purposes are included in the item investments and securities portfolio.

Valuation allowances to claims appear under provision for possible loan losses.

(7) Provision for possible loan losses

We fully provide for the particular credit risks associated with banking business by forming individual valuation allowances, country valuation allowances and global valuation allowances.

Valuation allowances were formed exclusively for claims on customers in the 2003 consolidated financial statements.

Throughout the group, the relevant individual valuation allowances have been formed on the scale of the potential default to cover credit-standing risks related to claims on customers.

In business year 2003, comdirect bank group has formed country valuation allowances for the first time. These are only applied to claims in which security is provided via securities involving an enhanced transfer risk (country risk). We have reviewed the respective claim after deduction of the security that we have issued without taking into consideration the securities involving an enhanced transfer risk and formed a corresponding country valuation allowance based on the existing risk volume.

We cover latent credit risks by means of global valuation allowances. Past loan losses serve as a yardstick for the scale on which such valuation allowances have to be formed.

The provision for possible loan losses is shown separately from claims.

Unrecoverable accounts are written down immediately. Amounts received on such claims appear in the income statement. Claims are deemed unrecoverable if income from them is unlikely to be received in the foreseeable future or if they have been waived either wholly or in part.

(8) Investments and securities portfolio

Under investments and securities portfolio, we show all the securities which we have assigned solely to the available-for-sale category.

In addition, in accordance with IAS 39, we include in investments and securities portfolio all the claims on customers not originated by comdirect bank, in particular promissory notes.

On the balance-sheet date, all bonds, other fixed-income securities, equities, and other variable-yield securities (investment fund shares) not held for trading purposes were assigned to the available-for-sale category.

All the securities of this category were measured at their fair value.

Gains or losses on remeasurement are recognised with an income-neutral effect in the form of a revaluation reserve as part of equity, taking into account deferred taxes. Realised gains and losses only affect the income statement when the holdings are sold or written-off.

The earnings resulting from the sale or maturity of financial instruments, which are attributable to the category available-for-sale, amounted to 4,889 thousand at the end of business year 2003. Corresponding losses amounted to 315 thousand.

All the interest income generated by securities of the available-for-sale category is shown in the income statement under interest income.

This interest income amounts to 38,175 thousand as of the end of business year 2003.

(9) Intangible assets

Under intangible assets we exclusively include specialised software produced in-house. Purchased software is shown under fixed assets.

Software produced in-house is recognised if all the provisions of IAS 38 are met. Recognition is made at producer cost.

In principle, software produced in-house is amortised using the straight-line method and according to schedule against earnings over a period of five years.

In the course of the website relaunch, extraordinary write-down was effected in the business year to intangible assets in the amount of 324 thousand.

(10) Fixed assets

The item fixed assets shows land and buildings, the office furniture and equipment and purchased software.

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All the fixed assets are capitalised at historical cost. Office furniture and equipment as well as purchased software are depreciated using the straight-line method and according to schedule to reflect their probable useful economic lives.

In determining the useful life, its likely physical wear and tear, its technical obsolescence as well as legal and contractual restrictions are taken into consideration.

All fixed assets are depreciated over a period of 3 to 14 years.

Gains and losses arising from the sale of fixed assets are shown in the income statement under other operating result.

In the course of the website relaunch, extraordinary depreciation was effected in the business year to fixed assets in the amount of 280 thousand.

(11) Other assets

Other assets principally consist of other assets on Commerzbank AG and deferred items.

(12) Liabilities

Liabilities are shown at the respective amounts to be repaid.

(13) Other liabilities

Other liabilities consist of liabilities to Commerzbank not arising from banking activities, trade liabilities, tax liabilities not related to earnings and accruals.

(14) Provisions for pensions and similar commitments

For the Board of Managing Directors provision for old age is made both directly and through contributions to Versicherungsverein des Bankgewerbes a. G. (BVV), Berlin.

The members of the Board of Managing Directors earn a right to a pension for their work as member of the Board of Managing Directors at comdirect bank AG.

The commitments are based on the years of service, the pensionable salary and the current scales for employer subsidies.

In accordance with IAS 19, the projected unit-credit method was used to calculate pension commitments.

Commitments are calculated on the basis of actuarial surveys. The calculation also takes into account the rates of increase for salaries and pensions that can be expected in the future.

If actuarial commitments prove to be higher or lower, these are recognised under personnel costs.

Payment of the contributions to BVV are recognised as personnel costs for the current period.

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The commitments similar to those for pensions include deferred compensations, by which a specific group of employees gives up a portion of its gross salary for old-age pension benefits later on.

comdirect bank AG insured by means of a contractual trust agreement old-age pension commitments which are not covered against insolvency by Pensions-Sicherungs-Verein (PSV) in business year 2003.

In this connection, the trustee required for a bilateral trust was established by Commerzbank AG in the form of the Commerzbank Pension-Trust e. V. in business year 2002.

In business year 2003, comdirect bank AG made the first allocation to the trust's assets in the amount of 168 thousand.

In accordance with IAS 19, this pledged asset in the current value to be agreed upon is set off against the allocations to the pension provisions.

(15) Other provisions

Other provisions were formed on the scale deemed necessary for liabilities of uncertain amount towards third parties and for anticipated losses related to immatured contracts.

(16) Income taxes

Current tax assets and liabilities are calculated by applying the valid tax rates at which a refund from or a payment to, the relevant fiscal authorities is expected.

Deferred taxes were formed in accordance with IAS 12. Temporary differences are the result of the discrepancy between assigned values in accordance with IFRS/IAS and the respective tax rate that was applied. These temporary differences are measured using the German income-tax rates, which can be expected to apply for the period in which they are realised.

Deferred taxes on as yet unused losses carried forward are shown in the balance sheet if taxable profits are likely to occur at the same tax unit.

Deferred tax assets and liabilities are formed and carried such that depending on the treatment of the underlying item they are recognised either under taxes on income in the income statement or they are set off against the relevant equity items with no effect on the income statement.

Deferred tax assets and liabilities are netted against one another, as they exist towards the same tax authority.

Claims on tax authorities are shown under tax assets in the balance sheet.

Other taxes not related to income appear under other operating result in the income statement.

In business year 2003, turnover tax unity was maintained only with Commerzbank AG, Frankfurt am Main.

A breakdown of this item into current and deferred taxes can be found in these notes on page 65, note 28.

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(17) Conditional and authorised capital

Through the resolution adopted on 10 April, 2000, and its entry into the commercial register on 19 April, 2000, authorised capital of 60,000 thousand was created. The authorisation for the capital increase expires on 31 Mai, 2005.

In addition, since the resolution adopted on 11 May, 2000, and entered into the commercial register on 31 May, 2000, conditional capital of up to 3,600 thousand was created in order to service up to 3,600,000 subscription rights as part of the bank's stock option programme (conditional capital I).

As of 31 December, 2003, conditional capital I amounts to 3,596,650 due to the issue of 3,350 new bearer shares of comdirect bank AG.

Through the resolution adopted on 7 May, 2003, and its entry into the commercial register on 17 July, 2003, an additional conditional capital of 30,000 thousand was created (conditional capital II).

The conditional capital II will only be effected to the extent that the holders of any bonds with warrants and/or convertible bonds may exercise their option or conversion rights.

The Board of Managing Directors is authorised to issue, with the approval of the Supervisory Board, bearer shares of bonds with warrants and/or convertible bonds as mentioned above in either one or several tranches, by a maximum amount of 300,000. The term of these bonds is limited to a maximum of 20 years. This authorisation is limited until 6 May, 2008.

(18) Appropriation of profits

Basis for the appropriation of profits is the national legislation, especially the German Commercial Code and the Stock Corporation Act.

For business year 2003, comdirect bank AG reported a distributable profit according to federal legislation in the amount of 22,480,536.00.

The Board of Managing Directors and the Supervisory Board will propose to the annual general meeting a dividend payment in the amount of 0.16 per no-par-value bearer share.

The consolidated profit of comdirect bank group based on the applied IFRS/IAS also amounts to 22,481 thousand for business year 2003.

(19) Earnings per share

Earnings per share are calculated in accordance with IAS 33 and based on the net profit for the year. Both the earnings per share and the diluted earnings per share are shown below the income statement.

In working out the earnings per share, we have set off the net profit for the year against the average number of shares in the financial year.

The diluting effects result from a stock option programme launched in July 2000 with a maximum of 3,600,000 subscription rights, of which approximately 2.4 million option rights had been issued in four tranches per 31 December, 2003.

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In calculating the diluted results, we also set off the two subsets of rights under the stock option programme with their conditions against well-founded estimated values for them and took account of the residual amount.

Each no-par-value bearer share carries a proportion of the share capital in the sum of one euro.

(20) Stock option programme

Under the stock option programme as approved by the annual general meeting resolution of 11 May, 2000, up to 3,600,000 subscription rights may be issued.

Eligible participants are members of the Board of Managing Directors of comdirect bank AG, members of the executive bodies of affiliated companies, as well as executives and selected members of staff of comdirect bank AG and affiliated companies.

The Board of Managing Directors of comdirect bank AG individually selects the eligible participants. Where members of the Board of Managing Directors are concerned, the Supervisory Board of the company makes the decision.

The subscription rights may be granted at any time, but only until 1 July, 2005.

A total of 2,408,810 subscription rights in four tranches were issued through 31 December, 2003. Of these subscription rights issued, a total of 521,057 have expired.

The subscription rights are equally divided into two subsets, which are different with regard to the exercise hurdles and the exercise price. Half of the subscription rights are thus always granted as subset A, and the other half always as subset B.

Eligible participants receive the right to purchase one no-par-value bearer share of comdirect bank AG, which carries a proportion of the share capital in the sum of one euro, per subscription right under the stipulated conditions.

Subscription rights may only be exercised if stipulated targets are attained.

The following applies for subset A: The comdirect bank share outperforms the Prime Financial Services Price Index (previously NEMAX 50 Price Index) by more than five percentage points.

The following applies for subset B: The absolute rise in the price of the comdirect bank share for subscription rights granted in 2000 is at least 25% compared to the issuing price and for subscription rights granted beginning in 2001 or later a rise of at least 20% compared to an average price determined prior to the time that they were granted.

The price that an eligible participant has to pay to comdirect bank AG when exercising a subscription right corresponds to:

for subset A:

the daily rate at the time of exercise minus 1% for every full percentage point by outperformance of the index of over five percentage points, but at least 90% from the daily rate for options granted between 2000 and 2002 or 70% from the daily rate for options granted in 2003

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for subset B:

the daily rate at the time of exercise minus 1% for every full percentage point by which an absolute rise in the price of com-direct bank share developed better, but at least 50%, of the daily rate.

3,350 subscription rights were exercised in business year 2003. All subscription rights were apportionable to subset A. For these exercised subscription rights, the same number of no-par-value bearer shares of comdirect bank AG were issued.

As a result, the share capital of comdirect bank AG was increased by 3,350.00 and the relevant payment established in connection with the stock option programme was allocated to the capital reserve pursuant to Art. 270, HGB. The amount of the payment in business year 2003 totalled 19,151.00.

(21) Relations with affiliated companies

comdirect bank AG uses services provided by Commerzbank AG through a general agreement concluded in December 1999 (and effective as from 1 January, 1999), as well as services agreed separately on this basis.

The general agreement had a fixed term of five years until 31 December, 2003. It is automatically extended for a further period of three years, unless one of the parties to the agreement gives notice at least 18 months before the agreement expires.

On the basis of the general agreement, the following services were agreed upon and were used during the 2003 business year:

Trading Services
Processing Services
Printing services
Payments and cash dispenser service
IT services
Other services

On 8 February, 2000, comdirect concluded another general agreement with Commerzbank, in which Commerzbank undertook to provide internal auditing services on the basis of a plan to be agreed separately. The agreement was concluded for an indefinite period and since 31 December, 2002, may be terminated giving six months notice before the end of the calendar year.

Outside of the general agreement, a separate agreement was concluded with Commerzbank on 7 September, 2000, covering the usage of the electronic security trading system Warrant Trading System (WTS). The agreement was concluded for an indefinite period and can be terminated at any time without giving notice.

Within the general agreement, a new service agreement Determination of Risk Ratios was concluded on 7 January, 2003. As part of this service agreement, Commerzbank furnishes the daily determination of risk ratios based on data provided by comdirect bank AG.

comdirect bank AG is party to an agreement of Commerzbank with Brown Brothers Harriman, enabling comdirect to trade on US stock exchanges.

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On 22 March, 2000, comdirect concluded an agreement with Commerzbank concerning support for comdirect after its IPO. Among other things, the agreement relates to support for PR activities, compliance with stock exchange and other obligations resulting from admission to the stock exchange and advice on the holding of the public annual general meeting of shareholders.

On 29 May, 2000, comdirect bank AG concluded an agreement with Commerzbank concerning the cash receiving office and depository services for the shares of comdirect bank AG.

comdirect currently offers its customers approximately 4,600 funds from more than 80 investment companies, including investment companies of the Commerzbank group. In the 2003 business year, comdirect received commissions on portfolio holdings and sales at prevailing market rates from the investment companies of the Commerzbank group.

On 12 November, 2003, an agreement was concluded between Commerz Service Gesellschaft für Kundenbetreuung mbh (CSG), a 100% subsidiary of Commerzbank, and comdirect bank AG. In this agreement, both parties mutually agree to exchange services with regard to the areas of customer service, technical hotline and employee delegations.

In addition, comdirect bank AG unilaterally makes available to CSG personnel, technical and organisational resources. This provision of services was put into writing with a service agreement signed on 25 March, 2003.

Commerzbank and CSG received compensation in line with market rates for the goods and services they provided for comdirect.

When forming comdirect ltd, London/United Kingdom, in 1999, comdirect bank AG pledged to ensure compliance with the specific equity capital requirements of that country.

No new equity was injected to comdirect ltd in business year 2003.

comdirect ltd concluded an agreement with Lloyds TSB Bank plc., London, regarding the provision of services in securities dealings. In this context, comdirect bank AG has written a guarantee bond vis-à-vis Lloyds TSB Bank plc., submitted with a maximum amount of GBP3m, which can be drawn upon by written request. Vis-à-vis the additional guarantor, Commerzbank AG, London Branch, comdirect submitted a letter of indemnity in the case a claim is made on the guarantee bond written by Commerzbank AG. Both agreements were concluded on 1 October, 2002.

Commerzbank AG, London Branch, is co-signatory of a leasing agreement between comdirect ltd and Woodchester Investment Limited/Woodchester Lease Management Services Limited. Accordingly, it is jointly liable together with comdirect ltd for all tenant's duties. On account of a counter-indemnity, comdirect bank AG is contractually bound to keep Commerzbank AG free from all obligations resulting from this agreement.

In business year 2003, comdirect bank AG acquired 100% of an inventory company that was renamed to comdirect private finance AG with its registration on 15 September, 2003.

comdirect private finance AG received equity of 4,950 thousand from comdirect bank AG in business year 2003.

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As part of setting up the company, comdirect bank AG supported comdirect private finance AG. So far as services from third parties were used for the activities listed, comdirect was reimbursed for any payments made in this regard.

As security for the offices leased by comdirect private finance AG, comdirect bank AG submitted leasing guarantees for each office. The volume as of 31 December, 2003, amounted to a total of 81 thousand. The guarantees were allotted at prevailing market conditions.

To safeguard against repayment claims of insurance companies in the case of the cancellation of an agreement, comdirect bank AG submitted comfort letters for comdirect private finance AG. As a rule, the comfort letter is the prerequisite for a full repayment of the acquisition commissions and lean settlement processes.

comdirect bank AG and comdirect private finance AG concluded a profit and loss transfer agreement on 26 January, 2004 subject to the approval of the annual general meetings of both companies. The profit and loss transfer agreement is to correspond with the business year of comdirect private finance AG and will be valid retroactively as of 1 October, 2003.

With an agreement dated 9 January, 2003, comdirect bank AG acquired a holding in WST-Broker GmbH, Frankfurt am Main. WST-Broker GmbH routes customer's orders to execution on the exchanges with face to face trading on behalf of comdirect bank AG.

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Notes to the income statement**(22) Net interest income**

| thousand | 2003 | 2002 | Change in % |
|--|---------------|---------------|------------------------|
| Interest and dividends from shares and other variable-yield securities held in the available-for-sale portfolio | 344 | 1,004 | -65.7 |
| Interest income from fixed-income securities held in the available-for-sale portfolio and from government-inscribed debt | 37,831 | 35,615 | 6.2 |
| Other interest income including discount surplus | 46,714 | 62,601 | -25.4 |
| Interest income | 84,889 | 99,220 | -14.4 |
| Interest on profit-sharing certificates outstanding and subordinated liabilities | 1,494 | 840 | 77.9 |
| Other interest expenses | 26,188 | 34,484 | -24.1 |
| Interest expenses | 27,682 | 35,324 | -21.6 |
| Total | 57,207 | 63,896 | -10.5 |

(23) Provision for possible loan losses

The provisions of the comdirect bank group break down as follows:

| thousand | 2003 | 2002 | Change in % |
|--|-------------|---------------|------------------------|
| Allocations to provisions | -2,762 | -3,485 | -20.7 |
| Write-back of provisions | 2,904 | 1,556 | 86.6 |
| Direct write-downs | -122 | -118 | 3.4 |
| Income received on written-down claims | 15 | 10 | 50.0 |
| Total | 35 | -2,037 | -101.7 |

(24) Net commission income

| thousand | 2003 | 2002 | Change in % |
|-------------------------|---------------|---------------|------------------------|
| Securities transactions | 81,339 | 75,659 | 7.5 |
| Payment transactions | 1,640 | 1,406 | 16.6 |
| Other commissions | 128 | 77 | 66.2 |
| Total | 83,107 | 77,142 | 7.7 |

(25) Income/loss from investments and securities portfolio

Under the net result on investments and securities portfolio, the disposal proceeds and the gains and losses on available-for-sale securities, claims not originated by the bank, investments, investments in associated companies and holdings in subsidiaries which have not been consolidated are shown.

| thousand | 2003 | 2002 | Change in % |
|---|--------------|--------------|------------------------|
| Result on available-for-sale securities portfolio | 4,574 | 1,200 | 281.2 |
| Result on disposals and measurements of investments, investments in associated companies and holdings in subsidiaries | 186 | 0 | |
| Total | 4,760 | 1,200 | 296.7 |

All the investments, investments in associated companies and holdings in subsidiaries which have not been consolidated were subjected to an impairment test as of 31 December, 2003. Overall no relevant adjustments occurred.

(26) Administrative expenses

The comdirect bank group's administrative expenses consist of personnel costs, other administrative expenses, and depreciation on office furniture and equipment, and also on other intangible assets.

Personnel costs

| thousand | 2003 | 2002 | Change in % |
|---|---------------|---------------|------------------------|
| Wages and salaries | 26,273 | 32,263 | -18.6 |
| Compulsory social-security contributions | 4,113 | 5,555 | -26.0 |
| Expenses for pensions and other employee benefits | 1,287 | 903 | 42.5 |
| Total | 31,673 | 38,721 | -18.2 |

Breakdown of expenses for pensions and other employee benefits

| thousand | 2003 | 2002 | Change in % |
|---|--------------|-------------|------------------------|
| Costs of company pension scheme | 1,280 | 900 | 42.2 |
| Contributions to Versicherungsverein des Bankengewerbes a. G. (BVV) | 7 | 3 | 133.3 |
| Total | 1,287 | 903 | 42.5 |

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Other administrative expenses

| | | | Change |
|---------------------------|---------------|---------------|---------------|
| thousand | 2003 | 2002 | in % |
| Marketing costs | 12,364 | 14,530 | -14.9 |
| Communication costs | 4,042 | 10,792 | -62.5 |
| Consulting costs | 9,396 | 8,956 | 4.9 |
| External services | 17,942 | 23,477 | -23.6 |
| Sundry operating expenses | 20,553 | 18,402 | 11.7 |
| Total | 64,297 | 76,157 | -15.6 |

The expenses for operating lease contracts are considered as rental expenses and included in the sundry operating expenses.

Depreciation of office furniture and equipment and intangible assets

| | | | Change |
|--------------------------------|---------------|---------------|---------------|
| thousand | 2003 | 2002 | in % |
| Office furniture and equipment | 10,989 | 14,742 | -25.5 |
| Intangible assets | 5,535 | 8,518 | -35.0 |
| Total | 16,524 | 23,260 | -29.0 |

(27) Other operating result

The other operating result primarily comprises income from recoverable input taxes and income from the writing-back of provisions.

| | | | Change |
|--|--------------|--------------|---------------|
| thousand | 2003 | 2002 | in % |
| Other operating expenses | 1,702 | 1,529 | 11.3 |
| Payments to settle customers' complaints/provisions for process risks in Online Investment | 795 | 462 | 72.1 |
| Losses on the disposal of property, plant and equipment | 67 | 455 | -85.3 |
| Sundry expense items | 840 | 612 | 37.3 |
| Other operating income | 8,189 | 4,446 | 84.2 |
| Income from recoverable input taxes | 1,061 | 1,361 | -22.0 |
| Income from the writing-back of provisions and accruals | 4,257 | 1,228 | 246.7 |
| Gains on the disposal of non-current assets | 225 | 498 | -54.8 |
| Income from service level agreements | 1,327 | 0 | |
| Sundry expense items | 1,319 | 1,359 | -2.9 |
| Total | 6,487 | 2,917 | 122.4 |

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(28) Taxes on income

| thousand | 2003 | 2002 | Change in % |
|-------------------------|---------------|---------------|------------------------|
| Current taxes on income | 8,846 | 102 | 8,572.5 |
| Deferred taxes | 6,895 | -8,938 | -177.1 |
| Total | 15,741 | -8,836 | -278.1 |

Taxes on income include deferred tax expenses of 6,566 thousand from the writing-back of capitalised advantages

deriving from loss carry-forwards, which were used in business year 2003.

Transitional presentation of taxes on income

| thousand | 2003 |
|---|---------------|
| Profit from ordinary activities | 39,102 |
| multiplied by the German income-tax rate of 37.08% | |
| = Calculated income-tax paid in business year | 14,499 |
| - Effects to differing tax rates | 356 |
| + Non-deductible expenses with regard to the sale of holdings | 352 |
| + Non-application of tax losses carried forward | 1,599 |
| - Other effects | 353 |
| Total | 15,741 |

The income-tax rate selected as a basis for the transitional presentation is made up of the corporate income-tax rate of 26.5% introduced in Germany for 2003, plus the solidarity surcharge of 5.5%, and a rate of 14.5% for trade earnings tax. With the deductibility of trade earnings tax taken into consideration, the German income-tax rate is roughly 37.08%.

Notes to the balance sheet**(29) Cash reserve**

Cash reserve includes the following items:

| thousand | 31.12.2003 | 31.12.2002 | Change |
|--------------------------------|--------------|--------------|--------------|
| | | | in % |
| Cash on hand | 139 | 123 | 13.0 |
| Balances held at central banks | 1,610 | 5,058 | -68.2 |
| Total | 1,749 | 5,181 | -66.2 |

The minimum reserve requirement to be met at the end of December 2003 totalled 52,389 thousand

(2002: 38,257 thousand).

(30) Claims on banks

| thousand | 31.12.2003 | Total | | Due on demand | | Other claims | |
|---------------|------------------|------------------|----------------|----------------|----------------|----------------|----------------|
| | | 31.12.2002 | Change in % | 31.12.2003 | 31.12.2002 | 31.12.2003 | 31.12.2002 |
| German banks | 1,159,686 | 1,192,167 | -2.7 | 560,349 | 657,867 | 599,337 | 534,300 |
| Foreign banks | 150,748 | 102,252 | | 150,748 | 95,746 | 0 | 6,506 |
| Total | 1,310,434 | 1,294,419 | 1.2 | 711,097 | 753,613 | 599,337 | 540,806 |

Claims on banks include foreign-currency amounts equal to 150,056 thousand (2002: 95,746 thousand).

Claims on banks primarily consist of overnight money and fixed-term deposits (1,269,398 thousand/2002: 1,293,095 thousand, incl. occurred interest).

(31) Claims on customers

| thousand | 31.12.2003 | Total | | Due on demand | | Other claims | |
|-------------------------------------|----------------|----------------|----------------|----------------|----------------|--------------|------------|
| | | 31.12.2002 | Change in % | 31.12.2003 | 31.12.2002 | 31.12.2003 | 31.12.2002 |
| Claims on domestic customers | 179,339 | 172,644 | 3.9 | 177,941 | 172,644 | 1,398 | 0 |
| Private customers | 179,339 | 172,644 | 3.9 | 177,941 | 172,644 | 1,398 | 0 |
| Claims on foreign customers | 4,434 | 2,777 | 59.7 | 4,434 | 2,777 | 0 | 0 |
| Private customers | 4,434 | 2,777 | 59.7 | 4,434 | 2,777 | 0 | 0 |
| Total | 183,773 | 175,421 | 4.8 | 182,375 | 175,421 | 1,398 | 0 |

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All claims on private customers are deemed to be due on demand. Claims on customers include 164,427 thousand (2002: 163,185 thousand) from loans to finance purchases of securities. These claims are loans secured by securities. In view of the concentration of credit risks, we point out that the original loan business is carried out with private customers only. Claims on customers include foreign-currency amounts equal to 440 thousand (2002: 196 thousand).

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(32) Provision for possible loan losses

| | Individual valuation allowances | | Country valuation allowances | | Global valuation allowances | | | Total 31.12.2002 | Change in % |
|--|------------------------------------|---------------|---------------------------------|------------|--------------------------------|------------|---------------|---------------------|----------------|
| | 31.12.2003 | 31.12.2002 | 31.12.2003 | 31.12.2002 | 31.12.2003 | 31.12.2002 | 31.12.2003 | | |
| thousand | | | | | | | | | |
| Balance as of 1 | | | | | | | | | |
| January | -6,306 | -4,905 | 0 | 0 | -49 | -31 | -6,355 | -4,936 | -28.7 |
| Allocations | -1,744 | -3,467 | -254 | 0 | -764 | -18 | -2,762 | -3,485 | 20.7 |
| Deductions | 3,351 | 2,066 | 0 | 0 | 0 | 0 | 3,351 | 2,066 | -62.2 |
| of which utilised | 447 | 510 | 0 | 0 | 0 | 0 | 447 | 510 | 12.4 |
| of which reversals | 2,904 | 1,556 | 0 | 0 | 0 | 0 | 2,904 | 1,556 | -86.6 |
| Provision for possible loan losses as of 31 | | | | | | | | | |
| December | -4,699 | -6,306 | -254 | 0 | -813 | -49 | -5,766 | -6,355 | 9.3 |

The adjusted value of non-interest bearing and non-productive claims amounts to 3,808 thousand (2002: 4,339 thousand).

comdirect bank group made a direct write-down of 122 thousand (2002: 118 thousand) and recorded receipts on written-down claims in an amount of 15 thousand (2002: 10 thousand).

The total balance of risk provisions for credit default risks breaks down as:

| thousand | 31.12.2003 | 31.12.2002 |
|-------------------|-------------------|-------------------|
| German borrowers | -4,674 | -6,236 |
| Foreign borrowers | -25 | -70 |
| Total | -4,699 | -6,306 |

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(33) Investments and securities portfolio

The item investments and securities portfolio consists of all bonds, notes and other fixed-income securities, shares and other variable-yield securities not held for trading purposes, as well as investments, holdings in subsidiaries not included in the consolidation and claims not originated by the bank promissory notes.

The financial instruments shown in the investments and securities portfolio are allocated to the category available-for-sale and, with the exception of investments and holdings in subsidiaries not included in the consolidation, are valued at market prices.

| thousand | 31.12.2003 | 31.12.2002 | Change in % |
|--|-------------------|-------------------|------------------------|
| Bonds, notes and other fixed-income securities of the available-for-sale portfolio | 1,816,568 | 1,012,377 | 79.4 |
| Money-market instruments | 452,437 | 0 | |
| issued by public-sector borrowers | 0 | 0 | |
| issued by other borrowers | 452,437 | 0 | |
| Bonds and notes | 1,364,131 | 1,012,377 | 34.7 |
| issued by public-sector borrowers | 27,693 | 24,031 | 15.2 |
| issued by other borrowers | 1,336,438 | 988,346 | 35.2 |
| Shares and other variable-yield securities of the portfolio available-for-sale | 14,668 | 31,658 | -53.7 |
| Investments | 0 | 866 | -100.0 |
| Holdings in subsidiaries | 27 | 12,800 | -99.8 |
| Claims on customers not originated by the company promissory notes | 62,599 | 0 | |
| Total | 1,893,862 | 1,057,701 | 79.1 |

As part of the securities lending business, financial instruments with a total market value of 13,954 thousand were lent as of the balance-sheet date on 31 December, 2003.

In January 2003, comdirect bank AG invested in WST-Broker GmbH, Frankfurt am Main, in the sum of 27 thousand. This company is to be excluded from the consolidation pursuant to IAS 27 since control does not exist.

On 29 August, 2003, Nasdaq Germany suspended trading. The investment in Nasdaq Germany in the amount of 866 thousand was therefore written down at a pro-memoria figure. In this context, comdirect bank AG transferred its holdings in the amount of 7.5% to Bremer Wertpapierbörse Holding AG (BWB) on 11 August, 2003.

The annual general meeting of comdirect bank S.p.A. i.L. declared the winding up of the business as completed on 22 May, 2003. The remaining assets of the company ascertained as part of the final balance of the liquidation was paid out to comdirect as the sole shareholder of comdirect bank S.p.A. i.L. in December 2003, after withdrawal from the Italian commercial register.

(34) Intangible assets

| thousand | 31.12.2003 | 31.12.2002 | Change in % |
|-------------------------|-------------------|-------------------|------------------------|
| Other intangible assets | 11,905 | 14,094 | -15.5 |

Changes in intangible assets are shown in the schedule of assets (note 36).

(35) Fixed assets

| thousand | 31.12.2003 | 31.12.2002 | Change in % |
|--------------------------------|-------------------|-------------------|------------------------|
| Land and buildings | 3,309 | 3,309 | 0.0 |
| Office and furniture equipment | 17,551 | 24,866 | -29.4 |
| Total | 20,860 | 28,175 | -26.0 |

Changes in fixed assets are shown in the schedule of assets (note 36).

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(36) Schedule of assets

| thousand | Land and buildings | Office furniture and equipment Software | Other |
|--|-----------------------|---|---------------|
| Book value as of 1 January, 2003 | 3,309 | 3,548 | 21,318 |
| Costs of acquisition/manufacture as of 1 January, 2003 | 3,309 | 15,154 | 58,262 |
| Additions 2003 | 0 | 492 | 3,281 |
| Disposals 2003 | 0 | -71 | -1,020 |
| Costs of acquisition/manufacture as of 31 December, 2003 | 3,309 | 15,575 | 60,523 |
| Cumulative write-downs as of 1 January, 2003 | 0 | 11,606 | 36,944 |
| Additions 2003 | 0 | 1,852 | 9,137 |
| Disposals 2003 | 0 | -37 | -955 |
| Cumulative write-downs as of 31 December, 2003 | 0 | 13,421 | 45,126 |
| Book value as of 31 December, 2003 | 3,309 | 2,154 | 15,397 |

| thousand | Intangible assets | Investments | Holdings in subsidiaries |
|--|----------------------|-------------|-----------------------------|
| Book value as of 1 January, 2003 | 14,094 | 866 | 12,800 |
| Costs of acquisition/manufacture as of 1 January, 2003 | 39,795 | 11,366 | 12,800 |
| Additions 2003 | 3,346 | 0 | 27 |
| Disposals 2003 | 0 | -866 | -12,800 |
| Costs of acquisition/manufacture as of 31 December, 2003 | 43,141 | 10,500 | 27 |
| Cumulative write-downs as of 1 January, 2003 | 25,701 | 10,500 | 0 |
| Additions 2003 | 5,535 | 866 | 0 |
| Disposals 2003 | 0 | -866 | 0 |
| Cumulative write-downs as of 31 December, 2002 | 31,236 | 10,500 | 0 |
| Book value as of 31 December, 2003 | 11,905 | 0 | 27 |

Additions to write-downs in business year 2003 relate to extraordinary write-downs of 604 thousand, that were made as part of the website relaunch. These are included in office furniture and equipment and intangible assets of the group.

(37) Tax assets

Tax assets break down as follows:

| thousand | 31.12.2003 | 31.12.2002 | Change in % |
|---|-------------------|-------------------|------------------------|
| Claims on the tax authorities from income taxes | 0 | 8,512 | -100.0 |
| Deferred tax claims | 0 | 3,189 | -100.0 |
| Total | 0 | 11,701 | -100.0 |

Deferred tax claims and liabilities are netted out, since they are both due to the same tax authority. As a result, we show deferred tax claims in business year 2003 (see also note 42).

Deferred tax claims were created in connection with the following balance-sheet items:

| thousand | 31.12.2003 | 31.12.2002 |
|--------------------------------------|-------------------|-------------------|
| Provision for possible loan losses | 0 | 1 |
| Investments and securities portfolio | 0 | -2,361 |
| Intangible assets | 0 | -4,796 |
| Fixed assets | 0 | 162 |
| Provisions | 0 | 3,617 |
| Equity | 0 | 6,566 |
| Total | 0 | 3,189 |

The domestic income-tax rate used to compute deferred taxes is composed of the applicable tax rates effective in Germany for corporate income tax (25.0%), which is valid again beginning in 2004, plus the solidarity surcharge (5.5%) and the trade tax (12.7%) taken together. This yields a domestic income-tax rate of 35.7%.

(38) Other assets

| thousand | 31.12.2003 | 31.12.2002 | Change in % |
|-----------------|-------------------|-------------------|------------------------|
| Deferred items | 2,790 | 3,111 | -10.3 |
| Sundry assets | 6,523 | 5,825 | 12.0 |
| Total | 9,313 | 8,936 | 4.2 |

Other assets break down as follows:

| thousand | 31.12.2003 | 31.12.2002 |
|--------------------------------|-------------------|-------------------|
| Claims on group companies | 882 | 4,709 |
| Claims on affiliated companies | 14 | 9 |
| Other | 5,627 | 1,107 |
| Total | 6,523 | 5,825 |

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(39) Liabilities to banks

| | Total | | Change | Due on demand | | Other liabilities | |
|-----------------|-------------------|-------------------|---------------|----------------------|-------------------|--------------------------|-------------------|
| thousand | 31.12.2003 | 31.12.2002 | in % | 31.12.2003 | 31.12.2002 | 31.12.2003 | 31.12.2002 |
| German banks | 0 | 1,926 | -100.0 | 0 | 1,926 | 0 | 0 |
| Foreign banks | 0 | 12,987 | -100.0 | 0 | 12,987 | 0 | 0 |
| Total | 0 | 14,913 | -100.0 | 0 | 14,913 | 0 | 0 |

(40) Liabilities to customers

| | Total | | Change | Due on demand | | With agreed maturity or withdrawal period | |
|---|-------------------|-------------------|---------------|----------------------|-------------------|--|-------------------|
| thousand | 31.12.2003 | 31.12.2002 | in % | 31.12.2003 | 31.12.2002 | 31.12.2003 | 31.12.2002 |
| Liabilities to domestic private customers | 2,577,648 | 1,822,191 | 41.5 | 1,600,471 | 1,749,450 | 977,177 | 72,741 |
| Liabilities to foreign private customers | 197,143 | 126,489 | 55.9 | 182,773 | 123,982 | 14,370 | 2,507 |
| Total | 2,774,791 | 1,948,680 | 42.4 | 1,783,244 | 1,873,432 | 991,547 | 75,248 |

Foreign-currency amounts equal to 143,237 thousand (2002: 85,067 thousand).

Through the German banks depositor protection fund of the German banking association Bundesverband deutscher Banken e. V., Cologne, each customer of comdirect bank AG is insured for deposits of up to 163 million. In addition, comdirect bank AG is a member of Entschädigungseinrichtung deutscher Banken GmbH.

(41) Provisions

| | | | Change |
|---|-------------------|-------------------|---------------|
| thousand | 31.12.2003 | 31.12.2002 | in % |
| Provisions for pensions and similar commitments | 3,520 | 2,470 | 42.5 |
| Other provisions | 15,036 | 18,638 | -19.3 |
| Total | 18,556 | 21,108 | -12.1 |

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The changes in provisions for pensions were as follows:

| thousand | as of 1.1.2003 | Utilised/ change | Depreciation | Allocation | as of 31.12.2003 |
|--|-------------------|---------------------|--------------|------------|---------------------|
| Pension expectations of active employees | 2,470 | 0 | 0 | 1.050 | 3,520 |

The allocations to pension provisions in 2003 break down as follows:

| | |
|---|----------------|
| Service cost: | 983 thousand |
| Interest cost: | 162 thousand |
| Cost arising from changes in actuarial assumptions: | 74 thousand |
| Assets to be offset: | - 169 thousand |

In business year 2003, comdirect bank AG made the first allocation to the assets of Commerzbank Pension-Trust e.V. In accordance with IAS 19, we set off these assets in the current values to be agreed upon against the allocations to the pension provisions.

Actuarial gains and losses are amortised over three years (2003: 74 thousand).

| Parameters | 31.12.2003 | 31.12.2002 | 31.12.2001 |
|---------------------------|------------|------------|------------|
| Calculatory interest rate | 5.50 | % 5.75 | % 5.75 |
| Changes in salaries | 3.25 | % 2.75 | % 3.00 |
| Changes in pensions | 1.25 | % 1.50 | % 1.50 |

Changes in other provisions:

| thousand | as of 1.1.2003 | Utilised/ change | Depreciation | Allocation | as of 31.12.2003 |
|---|-------------------|---------------------|--------------|--------------|---------------------|
| Provisions for staff | 2,753 | 2,699 | 24 | 3,123 | 3,153 |
| Provisions for anniversary bonuses | 40 | 0 | 0 | 5 | 45 |
| Provisions for non-income-related taxes | 542 | 0 | 0 | 18 | 560 |
| Provisions for contingent losses | 8,162 | 1,678 | 1,920 | 3,641 | 8,205 |
| Provisions for restructuring | 6,455 | 6,081 | 0 | 1,124 | 1,498 |
| Other provisions | 686 | 362 | 245 | 1,496 | 1,575 |
| Total | 18,638 | 10,820 | 2,189 | 9,407 | 15,036 |

Provisions for staff mainly relate to provisions for bonuses. The provisions for staff will probably be used in the 2004 financial year.

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Changes in provisions for contingent losses break down as follows:

| thousand | as of 1.1.2003 | Utilised/ change | Depreciation | Allocation | as of 31.12.2003 |
|--|-------------------|---------------------|--------------|--------------|---------------------|
| Implementation of the com one programme for the future | 6,318 | 1,346 | 1,911 | 0 | 3,061 |
| Products & Advertising | 0 | 0 | 0 | 3,641 | 3,641 |
| Restructuring | 1,507 | 4 | 0 | 0 | 1,503 |
| Other | 337 | 328 | 9 | 0 | 0 |
| Provisions for contingent losses | 8,162 | 1,678 | 1,920 | 3,641 | 8,205 |

The scale of the contingent losses for the implementation of the com one programme for the future and for products & advertising were measured on the basis of the information about expected expenses that was available when the financial statements were prepared.

(42) Tax liabilities

Tax liabilities are comprised as follows:

| thousand | 31.12.2003 | 31.12.2002 | Change in % |
|---------------------------------|--------------|------------|----------------|
| Current tax liabilities | 6,005 | 0 | |
| Provisions for income taxes | 6,005 | 0 | |
| Deferred tax liabilities | 1,365 | 0 | |
| Total | 7,370 | 0 | |

Deferred tax claims and liabilities are netted out, since they are both due to the same tax authority. As a result, we show deferred tax claims in business year 2003 compared to business year 2002 (see also note 37).

Deferred tax liabilities were created in connection with the following balance-sheet items:

| thousand | 31.12.2003 | 31.12.2002 |
|--------------------------------------|--------------|------------|
| Provision for possible loan losses | -7 | 0 |
| Investments and securities portfolio | 1,312 | 0 |
| Intangible assets | 4,304 | 0 |
| Fixed assets | -260 | 0 |
| Provisions | -2,951 | 0 |
| Equity | -1,033 | 0 |
| Total | 1,365 | 0 |

The domestic income-tax rate used to compute deferred taxes is composed of the applicable tax rates effective in Germany for corporate income tax (25.0%), which is valid again beginning in 2004, plus the solidarity surcharge (5.5%) and the trade tax (12.7%) taken together. This yields a domestic income-tax rate of 35.7%.

(43) Subordinated capital

| thousand | | | Change |
|---|-------------------|-------------------|---------------|
| | 31.12.2003 | 31.12.2002 | in % |
| Subordinated liabilities | 6,391 | 6,391 | 0.0 |
| of which: maturing within two years | 6,391 | 0 | |
| Profit-sharing certificates outstanding | 10,226 | 10,226 | 0.0 |
| of which: maturing within two years | 10,226 | 0 | |
| Total | 16,617 | 16,617 | 0.0 |

Subordinated liabilities meet the requirements of supplementary capital as defined by Art. 10, (5a) of the German Banking Act (KWG). The claims of creditors to repayment of these liabilities are subordinated to those of other creditors.

As end-2003, we held the following subordinated liabilities:

| Start of maturity | Amount | Interest rate | Maturity | Issuer |
|--------------------------|-----------------|-----------------------|-----------------|----------------|
| | thousand | per 31.12.2003 | date | |
| 1996 | 6,391 | 3.66% | 2006 | Commerzbank AG |

The interest rate on subordinated liabilities was fixed for the first three years of the term to maturity. Currently, the interest rate is adjusted annually for a one-year interest-rate period.

During the business year, comdirect bank AG incurred interest expenses on subordinated liabilities of 234 thousand (2002: 227 thousand).

The subordinated liability in the amount of 6,391 thousand was cancelled by mutual agreement in accordance with the agreement to revoke a debt dated 17 December, 2003 on the expiration of 31 December, 2003. After expiration of 31 December, 2003, the subordinated liability was reduced. With a letter dated 8 December, 2003, the Bundesanstalt für Finanzdienstleistungsaufsicht, the German financial authority, approved this reduction pursuant to Art. 10 (5a), sentence 5, KWG.

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As of the end of business year 2003, we held the following profit-sharing certificates

| Start of maturity | Amount thousand | Interest rate per 31.12.2003 | Maturity date | Issuer |
|--------------------------|----------------------------|---|--------------------------|----------------|
| 1998 | 10,226 | 6.00% | 2006 | Commerzbank AG |

During the business year, comdirect bank AG incurred interest expenses on profit-sharing certificates of 1,260 thousand (2002: 613 thousand).

Interest from profit-sharing certificates outstanding is paid only insofar as such payments do not lead to an accounting loss. In the case of such a situation, interest payments are to be made in the following business years. The claims of the holders of the profit-sharing certificates are subordinated to the claims of other creditors.

The profit-sharing certificate in the amount of 10,226 thousand was cancelled by mutual agreement in accordance with the agreement to revoke a debt dated 15 December, 2003 on the expiration of 31 December, 2003. After adoption of the financial statements showing a distributable profit, the profit-sharing certificate will be reduced. With a letter dated 2 December, 2003, the Bundesanstalt für Finanzdienstleistungsaufsicht, the German financial authority, approved this reduction pursuant to Art. 10 (5), sentence 4, KWG.

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(44) Maturities, by remaining lifetime

| | | Remaining lifetimes as of 31.12.2003 | | | | |
|--|------------------|--------------------------------------|-----------------------|-----------------------------|----------------------|-------------------------|
| | | Due on demand | | | | |
| thousand | Total | and unlimited in time | Up to three months | Three months to one year | One to five years | More than five years |
| Claims on banks | 1,310,434 | 711,097 | 354,337 | 185,000 | 60,000 | 0 |
| Claims on customers | 183,773 | 182,375 | 1,398 | 0 | 0 | 0 |
| Bonds, notes and other fixed-income securities of the available-for-sale portfolio | 1,816,568 | 0 | 51,261 | 537,197 | 1,132,062 | 96,048 |
| Claims on customers not originated by the bank promissory notes | 62,599 | 2,113 | 0 | 0 | 60,486 | 0 |
| Total | 3,373,374 | 895,585 | 406,996 | 722,197 | 1,252,548 | 96,048 |
| Liabilities to banks | 0 | 0 | 0 | 0 | 0 | 0 |
| Liabilities to customers | 2,774,791 | 1,783,244 | 751,053 | 237,852 | 2,642 | 0 |
| Subordinated capital | 16,617 | 0 | 16,617 | 0 | 0 | 0 |
| Total | 2,791,408 | 1,783,244 | 767,670 | 237,852 | 2,642 | 0 |

| | | Remaining lifetimes as of 31.12.2002 | | | | |
|--|------------------|--------------------------------------|-----------------------|-----------------------------|----------------------|-------------------------|
| | | Due on demand | | | | |
| thousand | Total | and unlimited in time | Up to three months | Three months to one year | One to five years | More than five years |
| Claims on banks | 1,294,419 | 753,613 | 207,147 | 211,220 | 122,439 | 0 |
| Claims on customers | 175,421 | 175,421 | 0 | 0 | 0 | 0 |
| Bonds and notes held in the available-for-sale portfolio | 1,012,377 | 0 | 127,563 | 188,317 | 584,148 | 112,349 |
| Total | 2,482,217 | 929,034 | 334,710 | 399,537 | 706,587 | 112,349 |
| Liabilities to banks | 14,913 | 14,913 | 0 | 0 | 0 | 0 |
| Liabilities to customers | 1,948,680 | 1,873,432 | 35,857 | 36,503 | 2,888 | 0 |
| Subordinated capital | 16,617 | 0 | 0 | 0 | 16,617 | 0 |
| Total | 1,980,210 | 1,888,345 | 35,857 | 36,503 | 19,505 | 0 |

Time remaining to maturity is considered as the period between the balance-sheet date and the contractual maturity of the claim or the obligation.

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(45) Claims on/liabilities to affiliated companies

| | | | Change |
|----------------------|-------------------|-------------------|---------------|
| thousand | 31.12.2003 | 31.12.2002 | in % |
| Claims on banks | 338,495 | 341,463 | -0.9 |
| Liabilities to banks | 0 | 14,913 | -100.0 |
| Subordinated capital | 16,617 | 16,617 | 0.0 |
| Total | 355,112 | 372,993 | -4.8 |

(46) Interest-rate risks

| | Interest assets | | Interest liabilities | | Interest gap | Interest differential |
|----------------------|------------------------|----------------------|-----------------------------|----------------------|---------------------|------------------------------|
| | million | interest in % | million | interest in % | million | % points |
| Up to one year | 2,196 | 2.72 | 2,728 | 1.66 | -532 | 1.06 |
| One to five years | 906 | 3.58 | 485 | 3.33 | 421 | 0.25 |
| More than five years | 59 | 4.17 | 0 | 0.00 | 59 | 4.17 |

| | GBP million | interest in % | GBP million | interest in % | GBP million | % points |
|----------------|--------------------|----------------------|--------------------|----------------------|--------------------|-----------------|
| Up to one year | 4 | 3.65 | 0 | 0.00 | 4 | 3.65 |

(47) Number of employees at the end of the reporting period

| | 31.12.2003 | | | 31.12.2002 | | | Change |
|---|-------------------|---------------|-------------|-------------------|---------------|-------------|---------------------|
| | Total | Female | Male | Total | Female | Male | (Total) in % |
| Employees at the end of the reporting period | 589 | 276 | 313 | 922 | 450 | 472 | -36 |
| In Germany | 512 | 254 | 258 | 859 | 431 | 428 | -40 |
| Abroad | 77 | 22 | 55 | 63 | 19 | 44 | 22 |
| At comdirect bank AG | 503 | 253 | 250 | 859 | 431 | 428 | -41 |
| of which: | | | | | | | |
| in the call centre | 184 | 101 | 83 | 366 | 184 | 182 | -50 |
| in the back office | 133 | 93 | 40 | 225 | 154 | 71 | -41 |
| in other areas | 186 | 59 | 127 | 268 | 93 | 175 | -31 |

The details listed above with regard to our employees include both full-time and part-time personnel.

(48) Income statement of comdirect bank group according to IFRS/IAS on a year-to-year comparison

| thousand | 01.01. to 31.12.2003 | 01.01. to 31.12.2002 | 01.01. to 31.12.2001 | 01.01. to 31.12.2000 |
|--|---------------------------------|---------------------------------|---------------------------------|---------------------------------|
| Interest income | 84,889 | 99,220 | 138,621 | 121,046 |
| Interest expenses | 27,682 | 35,324 | 64,538 | 63,329 |
| Net interest income before provisions | 57,207 | 63,896 | 74,083 | 57,717 |
| Provision for possible loan losses | 35 | -2,037 | -2,074 | -1,966 |
| Net interest income after provisions | 57,242 | 61,859 | 72,009 | 55,751 |
| Commission income | 96,686 | 79,024 | 96,957 | 192,656 |
| Commission expenses | 13,579 | 1,882 | 3,939 | 1,793 |
| Net commission income | 83,107 | 77,142 | 93,018 | 190,863 |
| Trading profit/loss | 0 | -285 | -29 | -133 |
| Income/loss from investments and securities portfolio | 4,760 | 1,200 | 344 | 0 |
| Administrative expenses | 112,494 | 138,138 | 224,317 | 220,951 |
| Personnel costs | 31,673 | 38,721 | 51,432 | 43,513 |
| Other administrative expenses | 64,297 | 76,157 | 144,179 | 159,162 |
| Marketing costs | 12,364 | 14,530 | 55,356 | 59,148 |
| Communication costs | 4,042 | 10,792 | 16,552 | 19,929 |
| Consulting costs | 9,396 | 8,956 | 12,510 | 22,105 |
| External services | 17,942 | 23,477 | 28,992 | 38,675 |
| Sundry operating expenses | 20,553 | 18,402 | 30,769 | 19,305 |
| Depreciation on office furniture and equipment and intangible assets | 16,524 | 23,260 | 28,706 | 18,276 |
| Other operating result | 6,487 | 2,917 | 6,659 | 35 |
| Profit from ordinary activities | 39,102 | 4,695 | -52,316 | 25,565 |
| Extraordinary result and restructuring costs | 0 | -23,295 | -98,264 | 0 |
| Pre-tax profit/loss | 39,102 | -18,600 | -150,580 | 25,565 |
| Taxes on income | 15,741 | -8,836 | 10,077 | 23,371 |
| After-tax profit/loss | 23,361 | -9,764 | -160,657 | 2,194 |
| Profit/loss attributable to minority interests | 0 | 0 | 0 | 484 |
| Net profit/loss | 23,361 | -9,764 | -160,657 | 2,678 |

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(49) Income statement of comdirect bank group according to IFRS/IAS on a quarterly comparison

| thousand | 2003 | | | |
|--|---------------|---------------|---------------|---------------|
| | Q1 | Q2 | Q3 | Q4 |
| Interest income | 20,854 | 19,566 | 18,883 | 25,586 |
| Interest expenses | 5,484 | 3,925 | 4,071 | 14,202 |
| Net interest income before provisions | 15,370 | 15,641 | 14,812 | 11,384 |
| Provision for possible loan losses | -370 | -247 | 0 | 652 |
| Net interest income after provisions | 15,000 | 15,394 | 14,812 | 12,036 |
| Commission income | 18,720 | 24,208 | 28,085 | 25,673 |
| Commission expenses | 2,793 | 3,207 | 3,817 | 3,762 |
| Net commission income | 15,927 | 21,001 | 24,268 | 21,911 |
| Trading profit/loss | 0 | 0 | 0 | 0 |
| Income/loss from investments and securities portfolio | 775 | 2,224 | 492 | 1,269 |
| Administrative expenses | 27,961 | 28,351 | 24,689 | 31,493 |
| Personnel costs | 8,101 | 7,934 | 6,808 | 8,830 |
| Other administrative expenses | 16,126 | 16,434 | 13,667 | 18,070 |
| Marketing costs | 3,031 | 2,439 | 2,661 | 4,233 |
| Communication costs | 1,697 | 858 | 778 | 709 |
| Consulting costs | 2,038 | 1,972 | 880 | 4,506 |
| External services | 4,832 | 4,420 | 3,820 | 4,870 |
| Sundry operating expenses | 4,528 | 6,745 | 5,528 | 3,752 |
| Depreciation on office furniture and equipment and intangible assets | 3,734 | 3,983 | 4,214 | 4,593 |
| Other operating result | 957 | 98 | 1,938 | 3,494 |
| Profit from ordinary activities | 4,698 | 10,366 | 16,821 | 7,217 |
| Extraordinary result and restructuring costs | 0 | 0 | 0 | 0 |
| Pre-tax profit/loss | 4,698 | 10,366 | 16,821 | 7,217 |
| Taxes on income | 2,275 | 4,164 | 6,093 | 3,209 |
| After-tax profit/loss | 2,423 | 6,202 | 10,728 | 4,008 |
| Net profit/loss | 2,423 | 6,202 | 10,728 | 4,008 |

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| thousand | 2002 | | | |
|--|---------------|---------------|----------------|---------------|
| | Q1 | Q2 | Q3 | Q4 |
| Interest income | 25,110 | 25,592 | 24,821 | 23,697 |
| Interest expenses | 8,457 | 8,916 | 9,698 | 8,253 |
| Net interest income before provisions | 16,653 | 16,676 | 15,123 | 15,444 |
| Provision for possible loan losses | -130 | -37 | -296 | -1,574 |
| Net interest income after provisions | 16,523 | 16,639 | 14,827 | 13,870 |
| Commission income | 22,592 | 17,964 | 19,621 | 18,847 |
| Commission expenses | 648 | 62 | 557 | 615 |
| Net commission income | 21,944 | 17,902 | 19,064 | 18,232 |
| Trading profit/loss | -169 | -116 | 0 | 0 |
| Income/loss from investments and securities portfolio | 318 | 530 | 308 | 44 |
| Administrative expenses | 38,911 | 33,459 | 33,201 | 32,567 |
| Personnel costs | 11,249 | 9,533 | 10,343 | 7,596 |
| Other administrative expenses | 22,129 | 18,025 | 17,102 | 18,901 |
| Marketing costs | 3,868 | 3,319 | 3,475 | 3,868 |
| Communication costs | 3,603 | 2,385 | 1,968 | 2,836 |
| Consulting costs | 1,984 | 2,130 | 3,226 | 1,616 |
| External services | 6,233 | 6,030 | 5,244 | 5,970 |
| Sundry operating expenses | 6,441 | 4,161 | 3,189 | 4,611 |
| Depreciation on office furniture and equipment and intangible assets | 5,533 | 5,901 | 5,756 | 6,070 |
| Other operating result | 593 | 742 | 812 | 770 |
| Profit from ordinary activities | 298 | 2,238 | 1,810 | 349 |
| Extraordinary result and restructuring costs | 0 | 0 | -31,967 | 8,672 |
| Pre-tax profit/loss | 298 | 2,238 | -30,157 | 9,021 |
| Taxes on income | 2,118 | 134 | -9,910 | -1,178 |
| After-tax profit/loss | -1,820 | 2,104 | -20,247 | 10,199 |
| Net profit/loss | -1,820 | 2,104 | -20,247 | 10,199 |

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(50) Segment reporting by business lines

| thousand | 1.1. to 31.12.2003 | | | | | |
|---|---------------------|----------------------|--|-------------------------------------|------|---|
| | comdirect online | comdirect offline | Group management/ consolidation/ others | comdirect bank group total | | |
| Net interest income before provisions | 57,184 | 23 | 0 | 57,207 | | |
| Provision for possible loan losses | 35 | 0 | 0 | 35 | | |
| Net interest income after provisions | 57,219 | 23 | 0 | 57,242 | | |
| Net commission income | 83,094 | 13 | 0 | 83,107 | | |
| Trading profit/loss | 0 | 0 | 0 | 0 | | |
| Income/loss from investments and securities portfolio | 4,760 | 0 | 0 | 4,760 | | |
| Administrative expenses | 109,044 | 4,209 | -759 | 112,494 | | |
| Other operating result | 7,217 | 29 | -759 | 6,487 | | |
| Profit/loss from ordinary activities | 43,246 | -4,144 | 0 | 39,102 | | |
| Extraordinary result and restructuring costs | 0 | 0 | 0 | 0 | | |
| Pre-tax profit/loss | 43,246 | -4,144 | 0 | 39,102 | | |
| Taxes on income | 14,828 | -1,033 | 1,946 | 15,741 | | |
| After-tax profit/loss | 28,418 | -3,111 | -1,946 | 23,361 | | |
| Net profit/loss | 28,418 | -3,111 | -1,946 | 23,361 | | |
| Acquisition costs of segment | 6,385 | 734 | | 7,119 | | |
| Depreciation on segment assets | 16,507 | 17 | | 16,524 | | |
| Cost/income ratio | 71.6 | % | 6,475.4 | % | 74.2 | % |
| Segment income | 195,252 | 89 | -782 | 194,559 | | |
| Segment expenses | 152,006 | 4,233 | -782 | 155,457 | | |
| Segment assets | 3,383,978 | 1,839 | -1,765 | 3,384,052 | | |
| Segment debt | 2,776,556 | 0 | -1,765 | 2,774,791 | | |

Allocation to the segments is based on the business lines of the comdirect bank group. Determination of the business lines was carried out in compliance with IAS 14 and its principles of materiality. A comparative presentation is not available for the primary reporting since comdirect private finance AG did not begin operations until 1 October, 2003.

(51) Segment reporting by geographical markets

| thousand | 1.1. to 31.12.2003 | | | |
|---|--------------------|--|--|-------------------------------------|
| | | comdiret Europe without Germany | Group management/ consolidation/ others | comdirect bank group total |
| Net interest income before provisions | 54,157 | 3,050 | 0 | 57,207 |
| Provision for possible loan losses | 35 | 0 | 0 | 35 |
| Net interest income after provisions | 54,192 | 3,050 | 0 | 57,242 |
| Net commission income | 76,764 | 6,343 | 0 | 83,107 |
| Trading profit/loss | 0 | 0 | 0 | 0 |
| Income/loss from investments and securities portfolio | 4,760 | 0 | 0 | 4,760 |
| Administrative expenses | 98,620 | 13,874 | 0 | 112,494 |
| Other operating result | 6,487 | 0 | 0 | 6,487 |
| Profit/loss from ordinary activities | 43,583 | -4,481 | 0 | 39,102 |
| Extraordinary result and restructuring costs | 0 | 0 | 0 | 0 |
| Pre-tax profit/loss | 43,583 | -4,481 | 0 | 39,102 |
| Taxes on income | 15,741 | 0 | 0 | 15,741 |
| After-tax profit/loss | 27,842 | -4,481 | 0 | 23,361 |
| Net profit/loss | 27,842 | -4,481 | 0 | 23,361 |
| Acquisition costs of segment assets | 7,119 | 0 | | 7,119 |
| Depreciation on segment assets | 14,411 | 2,113 | | 16,524 |
| Cost/income ratio | 69.4 | % 147.7 | % | 74.2 |
| Segment income | 183,742 | 10,817 | | 194,559 |
| Segment expenses | 140,159 | 15,298 | | 155,457 |
| Segment assets | 3,233,552 | 150,500 | | 3,384,052 |
| Segment debt | 2,631,559 | 143,232 | | 2,774,791 |

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Segment reporting by geographical markets

| thousand | 1.1. to 31.12.2002 | | | |
|---|--------------------|------------------|-----------------|----------------|
| | | Group management | | |
| | comdirect | Europe | / consolidation | comdirect bank |
| | Germany | without Germany | / others | group total |
| Net interest income before provisions | 63,639 | 1,760 | -1,503 | 63,896 |
| Provision for possible loan losses | -2,037 | 0 | 0 | -2,037 |
| Net interest income after provisions | 61,602 | 1,760 | -1,503 | 61,859 |
| Net commission income | 73,828 | 3,314 | 0 | 77,142 |
| Trading profit/loss | -285 | 0 | 0 | -285 |
| Income/loss from investments and securities portfolio | 1,200 | 0 | 0 | 1,200 |
| Administrative expenses | 122,128 | 16,010 | 0 | 138,138 |
| Other operating result | 2,949 | -32 | 0 | 2,917 |
| Profit/loss from ordinary activities | 17,166 | -10,968 | -1,503 | 4,695 |
| Extraordinary result and restructuring costs | -48,830 | 0 | 25,535 | -23,295 |
| Pre-tax profit/loss | -31,664 | -10,968 | 24,032 | -18,600 |
| Taxes on income | -8,836 | 0 | 0 | -8,836 |
| After-tax profit/loss | -22,828 | -10,968 | 24,032 | -9,764 |
| Net profit/loss | -22,828 | -10,968 | 24,032 | -9,764 |
| Acquisition costs of segment assets | 7,313 | 1,789 | 0 | 9,102 |
| Depreciation on segment assets | 20,991 | 2,269 | 0 | 23,260 |
| Cost/income ratio | 87.2 | % 317.5 | % | 96.2 |
| Segment income | 177,972 | 5,936 | -1,503 | 182,405 |
| Segment expenses | 162,006 | 16,904 | 0 | 178,910 |
| Segment assets | 2,430,426 | 95,941 | 0 | 2,526,367 |
| Segment debt | 1,878,527 | 85,066 | 0 | 1,963,593 |

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(52) Other liabilities

Rental and leasing agreements concluded by comdirect bank group will lead to expenses of 5,553 thousand during 2004 business year, 3,242 thousand for each of the years 2005 to 2008, and 2,037 thousand as of the year 2009.

(53) Off-balance-sheet commitments

| thousand | 31.12.2003 | 31.12.2002 | Change in % |
|--|------------|------------|----------------|
| Contingent liabilities from guarantees and indemnity agreements | | | |
| Leasing guarantees | 81 | 0 | |

(54) Letter of comfort

On the part of comdirect bank AG, letters of comfort were submitted for comdirect private finance AG, a fully-owned subsidiary of comdirect bank AG, vis-à-vis insurance companies with which comdirect private finance AG has concluded product delivery agreements.

comdirect bank AG therein obliges itself to the benefit of comdirect private finance AG that the company, as subsidiary of comdirect bank AG, will be managed and financially endowed and will remain endowed in such a manner that at all times it is able to meet in a timely manner its possible obligations of repayment of commissions and fees resulting from the brokerage of insurance business stemming from the commission and fee agreements with the insurance companies.

This letter of comfort is in effect until a profit and loss transfer agreement is concluded between comdirect bank AG and comdirect private finance AG. It is valid at most until 31 December, 2005.

These letters of comfort are subject to the laws of the Federal Republic of Germany. Place of jurisdiction is Hamburg, Federal Republic of Germany.

comdirect private finance AG started operating activities on October 1, 2003. As a consequence, the principle of materiality was applied in this case.

No additional letters of comfort were submitted for comdirect private finance AG or for other subsidiaries consolidated in the financial statements and special purpose vehicles.

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(55) Corporate Governance Code

comdirect bank AG submitted the Declaration of Compliance pursuant to Art. 161 of the German Stock Corporation Act (AktG) and has made it permanently available to the shareholders at the website www.comdirect.de.

(56) The company's boards

Supervisory Board

Martin Blessing
Frankfurt am Main
Chairman of the
Supervisory Board
Member of the Board
of Managing
Directors
of Commerzbank AG,
Frankfurt am Main

Angelika Kierstein
Quickborn
Chairman of Staff
Council

of comdirect bank AG
Commercial employee

Klaus Müller-Gebel

Frankfurt am Main
Deputy Chairman of
the Supervisory Board
Member of the
Supervisory Board

of Commerzbank AG,
Frankfurt am Main

Dr. Eric Strutz
Frankfurt am Main
CFO of Commerzbank
AG,

Frankfurt am Main
(Appointment to member
of the Board of
Managing Directors of
Commerzbank AG
as of 1 April, 2004)

Rainer Beaujean
Darmstadt
Member of the Board
of Managing
Directors
of T-Online
International AG,
Darmstadt

Maria Xiromeriti
Quickborn

Deputy Chairman of
Staff Council

of comdirect bank AG
Commercial employee

Board of Managing Directors

Dr. Achim Kassow, CEO

Dr. Andre Carls

Hans-Joachim Nitschke (until 6 November, 2003)

(57) Remuneration and loans to board members

The following remuneration was paid to members of the Board of Managing Directors and members of the Supervisory Board:

| thousand | 31.12.2003 | 31.12.2002 | Change in % |
|--|--------------|------------|----------------|
| Board of Managing Directors | 1,559 | 961 | 62 |
| of which: non-variable | 1,188 | 700 | 70 |
| of which: variable | 371 | 261 | 42 |
| Supervisory Board | 23 | 23 | 0 |
| of which: non-variable | 23 | 23 | 0 |
| of which: variable | 0 | 0 | |
| Former members of the Board of Managing Directors | 615 | 200 | 208 |

Neither advance payments nor loans were extended. comdirect did not take on any contingent liabilities.

Components with long-term incentive effect

Details on the value of the subscription rights from the stock option programme granted to members of the Board of Managing Directors:

| | Number | Value per option | 31.12.2003 Total value thousand |
|-----------------------|----------------|------------------------|---------------------------------------|
| Tranche 1, subset A | 0 | 0.59 | 0 |
| Tranche 1, subset B | 0 | 0.00 | 0 |
| Tranche 2, subset A | 6,750 | 0.73 | 5 |
| Tranche 2, subset B | 6,750 | 0.00 | 0 |
| Tranche 3, subset A | 32,500 | 0.73 | 24 |
| Tranche 3, subset B | 32,500 | 3.66 | 119 |
| Tranche 4, subset A | 45,000 | 0.00 | 0 |
| Tranche 4, subset B | 45,000 | 0.00 | 0 |
| Total tranches | 168,500 | | 148 |

As of the balance-sheet date, no exercise window existed for any of the tranches.

To determine a value as per the balance-sheet date of the subscription rights from the stock option programme, we met the following assumptions:

- 1.) The exercise price of the option is the XETRA closing price of the comdirect bank share on 30 December, 2003 of 7.33
- 2.) The final quotation of the Prime Financial Services Price Index is 285.22.

Holdings

| Name | Domicile | Share of capital held in % | | Equity in thousand |
|------------------------------|------------------------------|---|-----|-----------------------------------|
| comdirect ltd | London/United Kingdom | 100.0 | GBP | 9,857 |
| comdirect nominee ltd | London/United Kingdom | 100.0 | GBP | (1.00) |
| comdirect private finance AG | Quickborn/Germany | 100.0 | EUR | 5,000 |
| WST-Broker GmbH | Frankfurt am Main/Germany | 54.0 | EUR | 50 |

Quickborn, 16 February, 2004
The Board of Managing Directors

Dr. Achim Kassow

Dr. Andre Carls

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COMDIRECT BANK AKTIENGESELLSCHAFT

CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

For the years ended 31 December 2002 and 2001

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COMDIRECT BANK AKTIENGESELLSCHAFT

**CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)
AS OF DECEMBER 31, 2002 AND 2001**

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**INCOME STATEMENT OF
COMDIRECT BANK GROUP
ACCORDING TO IAS (UNAUDITED)**

| | Notes | 1.1.-31.12.2002 | 1.1.-31.12.2001 |
|---|--------------|------------------------|------------------------|
| | | (thousand) | (thousand) |
| INCOME STATEMENT | | | |
| Interest income | | 99,220 | 138,621 |
| Interest expenses | | 35,324 | 64,538 |
| Net interest income before provisions | (21) | 63,896 | 74,083 |
| Provision for possible loan losses | (22) | (2,037) | (2,074) |
| Net interest income after provisions | | 61,859 | 72,009 |
| Commission income | | 79,024 | 96,957 |
| Commission expenses | | 1,882 | 3,939 |
| Net commission income | (23) | 77,142 | 93,018 |
| Trading profit/loss | (24) | (285) | (29) |
| Result from financial investments | | 1,200 | 344 |
| Administrative expenses | (25) | 138,138 | 224,317 |
| Other operating result | (26) | 2,917 | 6,659 |
| Profit from ordinary activities | | 4,695 | (52,316) |
| Extraordinary results and restructuring costs | (27) | (23,295) | (98,264) |
| Pre-tax profit/loss | | (18,600) | (150,580) |
| Taxes on income | (28) | (8,836) | 10,077 |
| After-tax profit/loss | | (9,764) | (160,657) |
| Net loss | | (9,764) | (160,657) |
| Transfer to reserves/Transfer from reserves | | 9,764 | 160,657 |
| Consolidated profit/loss | | 0 | 0 |

EARNINGS PER SHARE

| | | 1.1.-31.12.2002 | 1.1.-31.12.2001 |
|-----------------------------------|-------------|------------------------|------------------------|
| EARNINGS PER SHARE | | | |
| Net loss | (thousand) | (9,764) | (160,657) |
| Average number of ordinary shares | Shares | 140,500,000 | 140,500,000 |
| Basic earnings per share | | (0.07) | (1.14) |

| | | <u>1.1.-31.12.2002</u> | <u>1.1.-31.12.2001</u> |
|---|-------------|-----------------------------|-----------------------------|
| DILUTED EARNINGS PER SHARE | | | |
| Net loss | (thousand) | (9,764) | (160,657) |
| Adjustment to the number of ordinary shares issued due to outstanding option rights | Shares | 395,349 | 97,278 |
| Weighted average shares outstanding (diluted) | Shares | 140,895,349 | 140,597,278 |
| | | <u> </u> | <u> </u> |
| Diluted earnings per share | | (0.07) | (1.14) |
| | | <u> </u> | <u> </u> |

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**BALANCE SHEET OF
COMDIRECT BANK GROUP
ACCORDING TO IAS (UNAUDITED)**

| <u>ASSETS</u> | <u>Notes</u> | <u>as of 31.12.2002</u> | <u>as of 31.12.2001</u> |
|------------------------------------|--------------|-------------------------|-------------------------|
| | | (thousand) | (thousand) |
| Cash reserve | (29) | 5,181 | 72,005 |
| Claims on banks | (30) | 1,294,419 | 1,684,112 |
| Claims on customers | (31) | 175,421 | 263,728 |
| Provision for possible loan losses | (32) | (6,355) | (4,936) |
| Trading assets | (33) | 0 | 2,164 |
| Financial investments | (34) | 1,057,701 | 861,212 |
| Intangible assets | (35) | 14,094 | 22,076 |
| Fixed assets | (36) | 28,175 | 45,816 |
| Tax assets | (38) | 11,701 | 9,634 |
| Other assets | (39) | 8,936 | 18,200 |
| Total assets | | 2,589,273 | 2,974,011 |

| <u>LIABILITIES AND EQUITY</u> | <u>Notes</u> | <u>as of 31.12.2002</u> | <u>as of 31.12.2001</u> |
|-------------------------------------|--------------|-------------------------|-------------------------|
| | | (thousand) | (thousand) |
| Liabilities to banks | (40) | 14,913 | 0 |
| Liabilities to customers | (41) | 1,948,680 | 2,289,327 |
| Provisions | (42) | 21,108 | 51,351 |
| Tax liabilities | (43) | 0 | 10,444 |
| Other liabilities | | 24,247 | 28,162 |
| Subordinated capital | (44) | 16,617 | 16,617 |
| Equity | | 563,708 | 578,110 |
| Subscribed capital | | 140,500 | 140,500 |
| Capital reserve | | 367,221 | 394,327 |
| Retained earnings | | | |
| Other revenue reserves | | 55,658 | 42,200 |
| Revaluation reserve | | 329 | 1,083 |
| Consolidated profit/loss | | 0 | 0 |
| Total liabilities and equity | | 2,589,273 | 2,974,011 |

**STATEMENT OF CHANGES IN EQUITY
OF COMDIRECT BANK GROUP
(UNAUDITED)**

| | <u>Subscribed capital</u> | <u>Capital reserve</u> | <u>Retained earnings</u> | <u>Revaluation reserve</u> | <u>Consolidated profit/loss</u> | <u>Total 2002</u> | <u>Total 2001</u> |
|--|-------------------------------|----------------------------|------------------------------|--------------------------------|-------------------------------------|-----------------------|-----------------------|
| | | | | (thousand) | | | |
| Equity as of 1.1 | 140,500 | 394,327 | 42,200 | 1,083 | 0 | 578,110 | 739,698 |
| Booking of valuation differences due to swap transactions pursuant to IAS 39 | | | 0 | | 0 | 0 | (2,646) |
| Changes in revaluation reserve pursuant to IAS 39 | | | 0 | (754) | 0 | (754) | 1,083 |
| Appropriation of consolidated loss | | | 0 | | 0 | 0 | 0 |
| Consolidated profit/loss | | | 0 | | 0 | 0 | (160,657) |
| Changes in differences arising from currency translation | | | (1,635) | | 0 | (1,635) | 632 |
| Transfer from reserves/allocation to reserves | | (27,106) | 15,093 | | 0 | (12,013) | 0 |
| Equity as of 31.12 | 140,500 | 367,221 | 55,658 | 329 | 0 | 563,708 | 578,110 |

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**CASH FLOW STATEMENT
OF COMDIRECT BANK GROUP
(UNAUDITED)**

| | <u>1.1.-31.12.2002</u> | | <u>1.1.-31.12.2001</u> |
|---|------------------------|---|------------------------|
| | (thousand) | | |
| Cash and cash equivalents as at the end of the previous period | 72,005 | | 515 |
| Cash flow from operating activities | (57,609 |) | 91,321 |
| Cash flow from investing activities | 1,043 | | (7,394) |
| Cash flow from financing activities | 0 | | (13,069) |
| Effects from deconsolidation | (8,623 |) | 0 |
| Effects of changes in exchange rates | (1,635 |) | 632 |
| | <u>5,181</u> | | <u>72,005</u> |
| Cash and cash equivalents as at the end of the period | 5,181 | | 72,005 |

Cash and cash equivalents correspond to the balance-sheet item Cash reserve and include cash on hand and balances held at central banks.

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COMDIRECT BANK GROUP

NOTES (UNAUDITED)

Basis of accounting principles

The consolidated financial statements of comdirect bank as of 31 December, 2002 were prepared in accordance with the International Accounting Standards (IAS), which were approved and published by the International Accounting Standards Committee (IASC) and interpreted by the Standing Interpretations Committee (SIC).

A summary of all the regulations that have been applied can be found on pages 43 - 44.

As a subsidiary of Commerzbank AG, Frankfurt am Main, we are exempted in accordance with Art. 291 of the German Commercial Code (HGB), from the duty to present sub-group financial statements. As we have not presented the main differences between financial statements prepared in accordance with IAS and those prepared in accordance with the German Commercial Code, these consolidated financial statements do not conform to the 4th and 7th EC directives and do not, therefore, exempt us from presenting consolidated financial statements in accordance with Art. 292a, HGB. The consolidated financial statements have been prepared in order to satisfy the admission requirements/subsequent requirements of the Deutsche Börse AG for the Neuer Markt.

The consolidated financial statements also reflect the standards approved by the German Accounting Standards Board (GASB) and published by the German Federal Ministry of Justice pursuant to Art. 342, (2), HGB.

The comdirect sub-group is included in the consolidated financial statements of our parent company. The consolidated financial statements of Commerzbank as of 31 December, 2001 were deposited with the lower regional court (Amtsgericht) of Frankfurt am Main under the commercial register no. 32000 and published in the Federal Gazette, no. 110, page 8077 and following of 19 June, 2002.

We report on both the implementation of the German legislation for control and transparency in the corporate sector (KonTraG) and on the risks posed by future development, pursuant to Art. 315, (1), HGB in the risk report as part of the Group management report.

In addition to the income statement and the balance sheet, the consolidated financial statements also include the statement of changes in equity, the cash flow statement and the notes. Segment reporting appears as part of the notes, on page 67 (note no. 49).

Unless otherwise indicated, all the amounts are shown in thousands of euros.

Accounting and measurement methods

(1) Basic principles

The consolidated financial statements of comdirect are based on the going concern principle.

The principle of profit or loss for the period is applied in our consolidated financial statements. Income and expenses are recognised on a pro-rata basis; they are shown for the period to which they may be assigned in economic terms.

As a matter of principle, accounting is at net book value, with the exception of financial instruments as defined by IAS 39, which are shown at their fair value. These financial instruments appear under the balance-sheet item Financial investments. All financial instruments are shown in the balance sheet according to the method trade date accounting.

All the companies included in the consolidation prepared their financial statements as of 31 December, 2002.

(2) IAS, SIC and GASB rules applied

Within the comdirect Group and within the Commerzbank Group, to which it belongs, only those IASs and SICs are applied for accounting and measurement purposes, which had been approved and published by 31 December, 2002.

COMDIRECT BANK GROUP

NOTES (UNAUDITED) (Continued)

The following list provides a summary of the International Accounting Standards (IAS) applied in comdirect's 2002 Group financial statements.

| | |
|--------|--|
| IAS 1 | Presentation of financial statements |
| IAS 7 | Cash flow statements |
| IAS 8 | Net profit or loss for the period, fundamental errors and changes in accounting policies |
| IAS 10 | Events after the balance-sheet date (uncertainties of success and events after the balance-sheet date) |
| IAS 12 | Income taxes |
| IAS 14 | Segment reporting |
| IAS 16 | Property, plant and equipment |
| IAS 17 | Leases |
| IAS 18 | Revenue |
| IAS 19 | Employee benefits |
| IAS 21 | The effects of changes in foreign exchange rates |
| IAS 22 | Business combinations |
| IAS 24 | Related party disclosures |
| IAS 26 | Accounting and reporting by retirement benefit plans |
| IAS 27 | Consolidated financial statements and accounting for investments in subsidiaries |
| IAS 30 | Disclosures in the financial statements of banks and similar financial institutions |
| IAS 32 | Financial instruments: disclosure and presentation |
| IAS 33 | Earnings per share |
| IAS 35 | Discontinued operations |
| IAS 36 | Impairment of assets |
| IAS 37 | Provisions, contingent liabilities and contingent assets |
| IAS 38 | Intangible assets |
| IAS 39 | Financial instruments: recognition and measurement |

The following list provides the SIC interpretations relevant for comdirect, which in addition to the Standards we have taken into consideration in our 2002 Group financial statements.

| | | |
|--------|--|------------------------------|
| SIC-6 | Costs of modifying existing software (framework) | Relates to: IAS Framework |
| SIC-7 | Introduction of the euro | IAS 21 |
| SIC-12 | Consolidation special purpose entities | IAS 27 |

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| | | |
|--------|---------------------------------------|--------|
| SIC-15 | Operating leases incentives | IAS 17 |
| SIC-17 | Equity costs of an equity transaction | IAS 32 |
| SIC-18 | Consistency alternative methods | IAS 1 |

(3) Consolidated companies

Apart from the parent company, the consolidated companies consist of one subsidiary, comdirect ltd, London/Great Britain and one special fund, a special purpose entity (SPV) in accordance with SIC-12. comdirect bank AG holds 100% of the shares of comdirect ltd. A detailed presentation of holdings appears on page 71.

(4) Principles of consolidation

The consolidation of the capital accounts is based on the book-value method, whereby the historical cost of the shares held by the parent company in each individual subsidiary and the share of each subsidiary's capital held by the parent company are set off against the proportion of the subsidiary's equity that was acquired.

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COMDIRECT BANK GROUP

NOTES (UNAUDITED) (Continued)

Intra-group expenses and income, as well as claims and liabilities, are eliminated as part of the consolidation.

On 25 February, 2002, the partners of comdirect bank S.p.A., Milan/Italy decided on the liquidation of the company. As a result, the company is to be excluded from the consolidation according to International Accounting Standards.

Also no longer included in the consolidation was comdirect S.A., Paris/France, which was transferred to ProCapital S.A. on 8 April, 2002.

As defined by the true and fair view approach, the deconsolidation of the companies was done effective 1 January, 2002.

(5) Currency translation

The items from the income statement and also the assets and liabilities from the balance sheet which are denominated in foreign currencies are translated at the spot rates of the balance-sheet date.

Holdings in affiliated companies that are denominated in foreign currencies appear at historical acquisition costs.

comdirect nets translation gains and losses from the consolidation of the capital accounts against retained earnings.

The annual financial statement prepared by our subsidiary in foreign currency is translated at the spot rates of the balance-sheet date. Any income and expenses resulting from this appear in the income statement.

The most important exchange rate for the comdirect Group is the British pound (GBP). The GBP exchange rate as of 31 December, 2002 was 0.6500 (previous year: 0.6085).

(6) Claims

All claims on banks and customers are shown at amortised costs without valuation allowances.

Valuation allowances to claims appear under provisions for possible loan losses.

On the balance-sheet date, we had no acquired claims, i.e., sections of a credit originated by another lender, in our portfolio.

(7) Provision for possible loan losses

Valuation allowances, in the form of individual and lump sum valuation allowances, are formed exclusively for claims on customers.

Throughout the Group, the relevant individual valuation allowances are formed on the scale of the potential default to cover credit-standing risks related to claims on customers.

We cover latent credit risks by means of lump sum valuation allowances. Past loan losses serve as a yardstick for the scale on which such lump sum valuation allowances have to be formed.

Unrecoverable accounts are written down immediately. Amounts received on such claims appear in the income statement. Claims are deemed unrecoverable if income from them is unlikely to be received in the foreseeable future or if they have been waived either wholly or in part.

(8) Financial investments

Under Financial investments, we show all the securities, which we have assigned to the available for sale category.

On the balance-sheet date, all bonds, other fixed-income securities, equities, and other variable-yield securities (investment fund shares) not held for trading purposes were assigned to the available for sale category.

All the securities of this category were measured at their fair value.

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COMDIRECT BANK GROUP
NOTES (UNAUDITED) (Continued)

Gains or losses on remeasurement are recognised with an income-neutral effect in the form of a revaluation reserve as part of equity, taking into account deferred taxes.

The earnings resulting from the sale or maturity of financial instruments, which are attributable to the category available for sale, amounted to 1,510 thousand at the end of the financial year 2002. Corresponding losses amounted to 310 thousand.

All the interest income generated by securities of the available for sale category is shown in the income statement under Interest income.

This interest income amounts to 36,619 thousand at the end of the financial year 2002.

(9) Intangible assets

Under Intangible assets we exclusively include specialised software produced in-house. Purchased software is shown under Fixed assets.

Software produced in-house is recognised if all the provisions of IAS 38 are met. Recognition is made at producer cost.

In principle software produced in-house is amortised against earnings over a period of five years.

Extraordinary write-offs are shown in the year under review in the income statement under Extraordinary results and restructuring costs.

(10) Fixed assets

The balance-sheet item Fixed assets comprises land and buildings, office furniture and equipment and purchased software.

All the fixed assets are capitalised at cost. Office furniture and equipment as well as purchased software are depreciated using the straight-line method to reflect their probable useful economic lives.

In determining the useful economic life of an asset, its likely physical wear and tear, its technical obsolescence as well as legal restrictions are taken into consideration. All fixed assets are depreciated over a period of three to ten years.

Gains and losses arising from the sale of fixed assets are shown in the income statement under Other operating result.

We made extraordinary depreciations on fixed assets in the year under review when the amount that could probably be achieved through future use had fallen below their book value.

(11) Other assets

Other assets mainly consist of other assets on Commerzbank AG and deferred items.

(12) Liabilities

Liabilities are shown at the respective amounts to be repaid.

(13) Other liabilities

Other liabilities consist of liabilities to Commerzbank not arising from banking activities, trade liabilities, tax liabilities not related to earnings and accruals.

(14) Provisions for pensions and similar commitments

The pension commitments shown exist towards three members of the Board of Managing Directors and two former members of the Board of Managing Directors of comdirect bank AG. The commitments are based on the years of service, the pensionable salary and the current scales for employer subsidies.

In accordance with IAS 19, the projected unit-credit method was used to calculate pension commitments.

COMDIRECT BANK GROUP
NOTES (UNAUDITED) (Continued)

Commitments are calculated on the basis of actuarial surveys. The calculation also takes into account the rates of increase for salaries and pensions that can be expected in the future.

If actuarial commitments prove to be higher or lower, these are recognised under Personnel costs.

(15) Other provisions

Other provisions were formed for liabilities of uncertain amount towards third parties.

In addition, we have formed provisions for contingent losses for existing adverse agreements, in which the expense required in order to fulfil the agreement is greater than the income generated by the agreement.

The majority of provisions for contingent losses were formed on account of restructuring measures with the scope of implementing our com one programme for the future.

(16) Taxes on income

Tax expenses are shown effecting the current result under Taxes on income. A breakdown of this item into current and deferred taxes on income can be found in these notes on page 54, note 28.

Deferred taxes were formed in accordance with IAS 12. Temporary differences are the result of the discrepancy between assigned values in accordance with IAS and the respective tax rate that was applied. These temporary differences are measured using the specific income-tax rates which apply in the country where the company in question has its seat and which can be expected to apply for the period in which they are realised. Deferred taxes on the credit side on as yet unused losses carried forward are shown in comdirect bank AG.

Deferred tax assets and liabilities are netted against one another in Germany, as they exist towards the same tax authority.

Claims on tax authorities are shown under Tax assets in the balance sheet.

Other taxes not related to income appear under Other operating result in the income statement.

When the profit-and-loss-transfer agreement was terminated on 31 December, 1999, it was assumed with the agreement of the tax authorities that, for accounting purposes, the integrated inter-company relationship between comdirect bank AG and Commerzbank AG had ceased to exist. In a final judgement in the fourth quarter 2001, it was decided that this relationship continued to exist as regards turnover and trade tax for the 2000 and 2001 assessment periods.

As a result of the amendments to Germany's legislation on the further development of corporate taxation, the fiscal unity in terms of trade tax ended on 31 December, 2001.

Consequently, fiscal unity was maintained only with regard to turnover tax in the 2002 financial year.

(17) Conditional and authorised capital

Through the resolution adopted on 10 April, 2001, and its entry into the commercial register on 19 April, 2000, authorised capital of 60,000 thousand was created. The authorisation for the capital increase expires on 31 May, 2005.

In addition, since the resolution adopted on the same date and entered into the commercial register on 31 May, 2000, conditional capital of 3,600 thousand was created in order to issue subscription rights as part of the bank's stock option scheme.

(18) Transfer from reserves

We charged the annual net loss incurred in the financial year 2002 in the amount of 9,764 thousand against the reserves.

As part of the deconsolidation of comdirect bank S.p.A. and comdirect S.A., a debit from the reserves is recorded in the amount of 2,249 thousand.

COMDIRECT BANK GROUP
NOTES (UNAUDITED) (Continued)

(19) Earnings per share

Earnings per share calculated in accordance with IAS 33 are based on the net profit/loss for the year. We show both the earnings per share and the diluted earnings per share below the income statement.

In working out the earnings per share, we have set off the net profit/loss for the year against the average number of shares in the financial year.

The diluting effects result from a stock option scheme launched in July 2000 with a maximum of 3,600,000 subscription rights, of which approximately 1.8 million option rights had been issued in three tranches per 31 December, 2002.

In calculating the diluted results, we also set off the two sub-sets of rights under the stock option scheme with their conditions against well-founded estimated values for them and took account of the residual amount.

Each no par value bearer share carries a proportion of the share capital in the sum of one euro.

(20) Relations with affiliated companies

comdirect uses services provided by Commerzbank AG through a general agreement concluded in December 1999 (and effective as from 1 January, 1999), as well as services agreed separately on this basis.

The general agreement has a fixed term of five years and ends on 31 December, 2003. It is automatically extended for a further period of three years, unless one of the parties to the agreement gives notice at least 18 months before the agreement expires.

On the basis of the general agreement, the following services were agreed upon and were used during the 2002 financial year:

- Trading services
- Processing services
- Payments and cash dispenser service
- IT services
- Other services

In February 2000, comdirect concluded another general agreement with Commerzbank, in which Commerzbank undertook to provide internal auditing services on the basis of a plan to be agreed separately. The agreement was concluded for an indefinite period and may be terminated giving six months notice before the end of the calendar year, but not before 31 December, 2002.

comdirect is party to an agreement of Commerzbank with Commerzbank Capital Markets, respectively Brown Brothers Harriman, enabling comdirect to trade on US stock exchanges.

On 22 March, 2000, comdirect concluded an agreement with Commerzbank concerning support for comdirect after its IPO. Among other things, the agreement relates to support for PR activities, compliance with stock exchange and other obligations resulting from admission to the stock exchange and advice on the holding of the public annual general meeting of shareholders.

In May 2000, comdirect concluded a general agreement with Commerzbank regarding security loans, on which basis comdirect lent securities to Commerzbank in the financial year.

comdirect currently offers its customers approximately 4,200 funds from more than 70 investment companies, including investment companies of the Commerzbank Group. In the 2002 financial year, comdirect received commissions on portfolio holdings and sales at prevailing market rates from the investment companies of the Commerzbank Group.

Commerzbank received compensation in line with market rates for the goods and services it provides for comdirect.

When forming comdirect ltd, London/Great Britain, comdirect pledged to ensure compliance with the specific equity capital requirements of that country.

COMDIRECT BANK GROUP
NOTES (UNAUDITED) (Continued)

In this context, comdirect ltd received equity of 10,537 thousand in the 2002 financial year.

comdirect ltd concluded an agreement with Lloyds TSB Bank plc regarding the provision of services in securities dealings. In this context, comdirect has written a guarantee bond vis-à-vis Lloyds TSB Bank plc, submitted with a maximum amount of £3m, which can be drawn upon by written request. Vis-à-vis the additional guarantor, Commerzbank AG, London Branch, comdirect submitted a letter of indemnity in the case a claim is made on the guarantee bond written by Commerzbank AG. Both agreements were concluded on 1 October, 2002.

(21) Net interest income

| | <u>2002</u> | <u>2001</u> |
|--|----------------------|----------------------|
| | (thousand) | |
| Interest and dividends from shares and other non-fixed interest securities held in the available for sale portfolio | 1,004 | 18,589 |
| Interest income from fixed-income securities held in the available for sale portfolio and from government-inscribed debt | 35,615 | 43,143 |
| Other interest income including discount surplus | 62,601 | 76,889 |
| Interest on profit-sharing certificates outstanding and subordinated liabilities | (840) | (1,050) |
| Other interest expenses | (34,484) | (63,488) |
| Total | <u>63,896</u> | <u>74,083</u> |

(22) Provision for possible loan losses

The provisions of the comdirect Group break down as follows:

| | <u>2002</u> | <u>2001</u> |
|--|------------------------|------------------------|
| | (thousand) | |
| Allocations to provisions | (3,485) | (4,215) |
| Write-back of provisions | 1,556 | 2,356 |
| Direct write-downs | (118) | (222) |
| Income received on written-down claims | 10 | 7 |
| Total | <u>(2,037)</u> | <u>(2,074)</u> |

(23) Net commission income

| | <u>2002</u> | <u>2001</u> |
|-------------------------|----------------------|----------------------|
| | (thousand) | |
| Securities transactions | 75,659 | 89,316 |
| Payment transactions | 1,406 | 3,335 |
| Other commissions | 77 | 367 |
| Total | <u>77,142</u> | <u>93,018</u> |

(24) Trading profit

All the financial instruments assigned to the Assets held for trading purposes are measured at fair value. The results arising from trading activities are included along with interest and dividend income, attributable to instruments shown under Assets held for dealing purposes, in the Trading profit.

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COMDIRECT BANK GROUP
NOTES (UNAUDITED) (Continued)

| | <u>2002</u> | <u>2001</u> |
|--|---------------|---------------|
| | (thousand) | |
| Result of securities trading | (134) | (332) |
| Result from trading in both bonds and notes | 0 | 9 |
| Result from trading in shares and debentures | (134) | (341) |
| Other trading result | 787 | (726) |
| Result from trading in interest-rate risks | 787 | (726) |
| Valuation result | (938) | 1,029 |
| Interest-rate derivatives | (938) | 1,029 |
| Total | (285) | (29) |

(25) Administrative expenses

Personnel costs

| | <u>2002</u> | <u>2001</u> |
|---|------------------|------------------|
| | (thousand) | |
| Wages and salaries | (32,263) | (42,484) |
| Compulsory social-security contributions | (5,555) | (8,398) |
| Expenses for pensions and other employee benefits | (903) | (550) |
| Total | (38,721) | (51,432) |

Breakdown of expenses for pensions and other employee benefits

| | <u>2002</u> | <u>2001</u> |
|---|---------------|---------------|
| | (thousand) | |
| Costs of company pension scheme | (900) | (535) |
| Contributions to Versicherungsverein des Bankengewerbes a.G (BVV) | (3) | (15) |
| Total | (903) | (550) |

Other administrative expenses

| <u>2002</u> | <u>2001</u> |
|-------------|-------------|
|-------------|-------------|

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| | (thousand) | |
|---------------------------|------------------|-------------------|
| Marketing costs *) | (14,530) | (55,356) |
| Communication costs | (10,792) | (16,552) |
| Consulting costs | (8,956) | (12,510) |
| External services | (23,477) | (28,992) |
| Sundry operating expenses | (18,402) | (30,769) |
| | <hr/> | <hr/> |
| Total | (76,157) | (144,179) |
| | <hr/> | <hr/> |

*) In the previous year, the term read Costs of advertising, PR and representation
The expenses for operating lease contracts are considered as rental expenses and included in the sundry operating expenses.

Depreciation of office furniture and equipment and intangible assets

| | 2002 | 2001 |
|--------------------------------|------------------|------------------|
| | <hr/> | <hr/> |
| | (thousand) | |
| Office furniture and equipment | (14,742) | (23,986) |
| Intangible assets | (8,518) | (4,720) |
| | <hr/> | <hr/> |
| Total | (23,260) | (28,706) |
| | <hr/> | <hr/> |

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COMDIRECT BANK GROUP
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(26) Other operating result

The Other operating result primarily comprises income from recoverable input taxes and income from the writing-back of provisions. Other details on taxes and tax consolidation can be found in Note 16.

| | <u>2002</u> | <u>2001</u> |
|--|---------------------|---------------------|
| | (thousand) | |
| Other operating expenses | (1,529) | (6,146) |
| Payments to settle customers' complaints/provisions for process risks in direct brokerage business | (462) | (2,305) |
| Depreciation of goodwill | 0 | (2,043) |
| Losses on the disposal of property, plant and equipment | (455) | (114) |
| Sundry expense items | (612) | (1,684) |
| Other operating income | 4,446 | 12,805 |
| Income from recoverable input taxes | 1,361 | 2,630 |
| Income from the writing-back of provisions and accruals | 1,228 | 1,465 |
| Gains on the disposal of non-current assets | 498 | 8 |
| Income from tax consolidation | 0 | 4,153 |
| Sundry expense items | 1,359 | 4,549 |
| Total | <u>2,917</u> | <u>6,659</u> |

(27) Extraordinary result and restructuring costs

comdirect's extraordinary result and restructuring costs mainly comprise the following expenses and income:

| | <u>2002</u> | <u>2001</u> |
|---|-------------------------|-------------------------|
| | (thousand) | |
| Extraordinary expenses | (37,431) | (98,340) |
| extraordinary depreciation of goodwill | 0 | (25,924) |
| extraordinary depreciation of book value of investments | 0 | (10,500) |
| extraordinary depreciation on intangible and fixed assets | (5,545) | (21,196) |
| Restructuring costs (especially personnel costs and expenses arising from current contracts) | (31,883) | (21,575) |
| Costs of disposal/liquidation | 0 | (17,398) |
| Sundry expenses | (3) | (1,747) |
| Extraordinary income | 14,136 | 76 |
| Proceeds from disposal | 0 | 76 |
| Income from the restructuring of comdirect S.A., Paris and comdirect bank S.p.a. i. L., Milan | 14,136 | 0 |
| Total | <u>(23,295)</u> | <u>(98,264)</u> |

(28) Taxes on income

| | <u>2002</u> | <u>2001</u> |
|-------------------------|--------------|-------------|
| | (thousand) | |
| Current taxes on income | 102 | (906) |
| Deferred taxes | (8,938) | 10,983 |

| | | |
|--------------|-------------------|-------------------|
| Total | <u> </u> | <u> </u> |
| | (8,836) | 10,077 |
| | ————— | ————— |

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COMDIRECT BANK GROUP
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Transitional presentation of taxes on income

| | <u>2002</u> |
|---|-----------------|
| | (thousand) |
| Profit from ordinary activities | 4,695 |
| multiplied by the German income-tax rate of 36.93% | |
| = Recalculated income-tax expenses financial year | 1,734 |
| + Effects of different tax rates on current income taxes and deferred taxes | 813 |
| Effects due to extraordinary results | 11,821 |
| + Other causes | 438 |
| | <hr/> |
| Total | (8,836) |
| | <hr/> |

(29) Cash reserve

Cash reserve breaks down as follows:

| | <u>31.12.2002</u> | <u>31.12.2001</u> |
|--------------------------------|-------------------|-------------------|
| | (thousand) | |
| Cash on hand | 123 | 232 |
| Balances held at central banks | 5,058 | 71,773 |
| | <hr/> | <hr/> |
| Total | 5,181 | 72,005 |
| | <hr/> | <hr/> |

The minimum reserve requirement to be met at the end of December 2002 totalled 38,257 thousand (2001: 44,756 thousand).

(30) Claims on banks

| | <u>Total</u> | | <u>Due on demand</u> | | <u>Other claims</u> | |
|---------------|-------------------|-------------------|----------------------|-------------------|---------------------|-------------------|
| | <u>31.12.2002</u> | <u>31.12.2001</u> | <u>31.12.2002</u> | <u>31.12.2001</u> | <u>31.12.2002</u> | <u>31.12.2001</u> |
| | (thousand) | | | | | |
| German banks | 1,192,167 | 1,600,166 | 657,867 | 1,098,541 | 534,300 | 501,625 |
| Foreign banks | 102,252 | 83,946 | 95,746 | 46,446 | 6,506 | 37,500 |
| | <hr/> | <hr/> | <hr/> | <hr/> | <hr/> | <hr/> |
| Total | 1,294,419 | 1,684,112 | 753,613 | 1,144,987 | 540,806 | 539,125 |
| | <hr/> | <hr/> | <hr/> | <hr/> | <hr/> | <hr/> |

Claims on banks include foreign-currency amounts equal to 95,746 thousand (2001: 39,310 thousand).

Claims on banks primarily consist of overnight money and fixed deposits (1,293,095 thousand/2001: 1,634,874 thousand, incl. occurred interest).

(31) Claims on customers

| | Total | | Due on demand | | Other claims | |
|-------------------------------------|-------------------|-------------------|----------------------|-------------------|---------------------|-------------------|
| | 31.12.2002 | 31.12.2001 | 31.12.2002 | 31.12.2001 | 31.12.2002 | 31.12.2001 |
| | (thousand) | | | | | |
| Claims on domestic customers | 172,644 | 261,293 | 172,644 | 261,293 | 0 | 0 |
| Public-sector entities | 0 | 0 | 0 | 0 | 0 | 0 |
| Private customers | 172,644 | 261,293 | 172,644 | 261,293 | 0 | 0 |
| Claims on foreign customers | 2,777 | 2,435 | 2,777 | 2,435 | 0 | 0 |
| Private customers | 2,777 | 2,435 | 2,777 | 2,435 | 0 | 0 |
| Total | 175,421 | 263,728 | 175,421 | 263,728 | 0 | 0 |

All claims on private customers are deemed to be due on demand. Claims on customers include 163,185 thousand (2001: 250,603 thousand) from loans to finance purchases of securities. These claims are loans secured by securities. In view of the concentration of credit risks, we point out that the original loan business is carried out with private customers only. Claims on customers include foreign-currency amounts equal to 196 thousand (2001: 75 thousand).

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(32) Provision for possible loan losses

| | Credit default risks | | General provisions | | Total | |
|---|----------------------|-----------------|--------------------|--------------|-----------------|-----------------|
| | 31.12.2002 | 31.12.2001 | 31.12.2002 | 31.12.2001 | 31.12.2002 | 31.12.2001 |
| | (thousand) | | | | | |
| Balance as of 1 January | (4,905) | (3,149) | (31) | (31) | (4,936) | (3,180) |
| Allocations | (3,467) | (4,215) | (18) | 0 | (3,485) | (4,215) |
| Deductions | 2,066 | 2,459 | 0 | 0 | 2,066 | 2,459 |
| of which utilised | 510 | 103 | 0 | 0 | 510 | 103 |
| of which written back | 1,556 | 2,356 | 0 | 0 | 1,556 | 2,356 |
| Exchange-rate changes | 0 | 0 | 0 | 0 | 0 | 0 |
| Provision for possible loan losses as of 31 December | (6,306) | (4,905) | (49) | (31) | (6,355) | (4,936) |

The adjusted value of non-interest bearing and non-productive claims amounts to 4,339 thousand. (2001: 4,943 thousand).

comdirect made a direct write-down of 118 thousand (2001: 222 thousand) and recorded receipts on written-down claims in an amount of 10 thousand (2001: 7 thousand).

The total balance of risk provisions for credit default risks breaks down as:

| | 31.12.2002 | 31.12.2001 |
|-------------------|-----------------|-----------------|
| | (thousand) | |
| German borrowers | (6,236) | (4,831) |
| Foreign borrowers | (70) | (74) |
| Total | (6,306) | (4,905) |

(33) Trading assets

Under this item, financial instruments acquired as part of the small trading portfolio are shown at fair value. Derivative financial instruments assigned to trading are shown with positive fair value including interest for the respective period.

| | 31.12.2002 | 31.12.2001 |
|---|-------------|--------------|
| | (thousand) | |
| Shares and other non-fixed interest securities | 0 | 1,226 |
| Shares | 0 | 0 |
| German shares | 0 | 0 |
| Foreign shares | 0 | 0 |
| Other non-fixed interest securities | 0 | 1,226 |
| Positive market value attributable to derivate financial instruments | 0 | 938 |
| Interest-rate derivatives | 0 | 938 |

| | | |
|--------------|----------|--------------|
| Total | 0 | 2,164 |
|--------------|----------|--------------|

There were no restrictions on the disposal of any of the trading assets as of the balance-sheet date.

(34) Financial investments

All the financial instruments shown under Financial investments are assigned to the available for sale category and are measured at fair value. Excepted from this are holdings in subsidiaries and investments, which are shown at book value under Extraordinary appreciation and depreciation charges.

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COMDIRECT BANK GROUP
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| | <u>31.12.2002</u> | <u>31.12.2001</u> |
|--|-------------------------|-----------------------|
| | (thousand) | |
| Bonds and other fixed-income securities of the available for sale portfolio | 1,012,377 | 840,719 |
| Bonds and notes issued by public-sector borrowers | 1,012,377 | 840,719 |
| issued by other borrowers | 24,031 | 0 |
| Shares and other non-fixed interest securities of the available for sale portfolio | 988,346 | 840,719 |
| Investments | 31,658 | 20,493 |
| Holdings in subsidiaries | 866 | 0 |
| | <u>12,800</u> | <u>0</u> |
| Total | <u>1,057,701</u> | <u>861,212</u> |

There were no restrictions on the disposal of any of the financial assets as of the balance-sheet date.

On the balance-sheet date, no write-downs were made due to permanent impairment on financial instruments measured at fair value. In the financial year, the book value of the comdirect bank S.p.A. which is currently in liquidation was written up to the anticipated amount of the liquidation payout. The write-up in the amount of 6,426 thousand is part of the Extraordinary result.

In the item Investments, only the investment in Bremer Wertpapierbörse AG, which was renamed to Nasdaq Deutschland AG in January 2003, in the amount of 7.5 percent is shown.

(35) Intangible assets

| | <u>31.12.2002</u> | <u>31.12.2001</u> |
|-------------------------|-------------------|-------------------|
| | (thousand) | |
| Other intangible assets | 14,094 | 22,076 |

Changes in intangible assets are shown in the schedule of assets (note 37).

(36) Fixed assets

| | <u>31.12.2002</u> | <u>31.12.2001</u> |
|--------------------------------|----------------------|----------------------|
| | (thousand) | |
| Land and buildings | 3,309 | 0 |
| Office and furniture equipment | 24,866 | 45,816 |
| Total | <u>28,175</u> | <u>45,816</u> |

Changes in fixed assets are shown in the schedule of assets (note 37).

(37) Schedule of assets

| | Land and buildings | Office furniture and equipment | |
|--|-----------------------|-----------------------------------|---------------|
| | | Software | Other |
| | | | |
| | (thousand) | | |
| Book value as of 1 January, 2002 | 0 | 5,637 | 40,179 |
| Costs of acquisition/manufacture | 0 | 21,198 | 98,344 |
| Exchange-rate changes | 0 | 0 | (434) |
| Additions 2002 | 3,309 | 324 | 2,523 |
| Disposals 2002 | 0 | (6,368) | (42,171) |
| Costs of acquisition/manufacture as of 31 December, 2002 | 3,309 | 15,154 | 58,262 |
| Cumulative write-downs as of 1 January, 2002 | 0 | 15,561 | 58,165 |
| Exchange-rate changes | 0 | 0 | (92) |
| Additions 2002 | 0 | 2,352 | 12,390 |
| Disposals 2002 | 0 | (6,307) | (33,519) |
| Cumulative write-downs as of 31 December, 2002 | 0 | 11,606 | 36,944 |
| | | | |
| Book value as of 31 December, 2002 | 3,309 | 3,548 | 21,318 |

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COMDIRECT BANK GROUP
NOTES (UNAUDITED) (Continued)

| | <u>Intangible assets</u> | <u>Investments</u> | <u>Holdings in subsidiaries</u> |
|--|------------------------------|--------------------|-------------------------------------|
| | (thousand) | | |
| Book value as of 1 January, 2002 | 22,079 | 0 | 0 |
| Costs of acquisition/manufacture | 33,739 | 10,500 | 0 |
| Exchange-rate changes | (199) | 0 | 0 |
| Additions 2002 | 6,255 | 866 | 12,800 |
| Disposals 2002 | 0 | 0 | 0 |
| Costs of acquisition/manufacture as of 31 December, 2002 | 39,795 | 11,366 | 12,800 |
| Cumulative write-downs as of 1 January, 2002 | 11,663 | 10,500 | 0 |
| Exchange-rate changes | (25) | 0 | 0 |
| Additions 2002 | 14,063 | 0 | 0 |
| Disposals 2002 | 0 | 0 | 0 |
| Cumulative write-downs as of 31 December, 2002 | 25,701 | 10,500 | 0 |
| Book value as of 31 December 2002 | 14,094 | 866 | 12,800 |

Additions to write-downs in 2002 relate to extraordinary write-downs of 5,545 thousand. This is included solely in the balance-sheet item Intangible assets.

(38) Tax assets

Tax assets breaks down as follows:

| | <u>31.12.2002</u> | <u>31.12.2001</u> |
|---|-------------------|-------------------|
| | (thousand) | |
| Claims on the tax authorities from income taxes | 8,512 | 9,634 |
| Deferred tax claims | 3,189 | 0 |
| Total | 11,701 | 9,634 |

Deferred tax claims and liabilities are netted out in Germany, since they are both due to the same tax authority. As a result, we show a deferred tax claim in the financial year 2002 (see also note 43).

Deferred tax claims were created in connection with the following balance-sheet items:

| | <u>31.12.2002</u> | <u>31.12.2001</u> |
|------------------------------------|-------------------|-------------------|
| | (thousand) | |
| Provision for possible loan losses | 1 | 0 |
| Financial investments | (2,361) | 0 |

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| | | |
|-------------------|-------------------|-------------------|
| Intangible assets | (4,796 |) 0 |
| Fixed assets | 162 | 0 |
| Provisions | 3,617 | 0 |
| Equity | 6,566 | 0 |
| | <u> </u> | <u> </u> |
| Total | 3,189 | 0 |
| | <u> </u> | <u> </u> |

The domestic income-tax rate used to compute deferred taxes is composed of the applicable tax rates effective in Germany for corporate income tax (25.0%), plus the solidarity surcharge (5.5%) and the trade tax (12.7%) taken together. This yields a domestic income-tax rate of 35.7%.

(39) Other assets

| | <u>31.12.2002</u> | <u>31.12.2001</u> |
|----------------|-------------------|-------------------|
| | (thousand) | |
| Deferred items | 3,111 | 5,693 |
| Sundry assets | 5,825 | 12,507 |
| | <u> </u> | <u> </u> |
| Total | 8,936 | 18,200 |
| | <u> </u> | <u> </u> |

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COMDIRECT BANK GROUP**NOTES (UNAUDITED) (Continued)**

Other assets breaks down as follows:

| | <u>31.12.2002</u> | <u>31.12.2001</u> |
|--------------------------------|---------------------|----------------------|
| | (thousand) | |
| Claims on Group companies | 4,709 | 8,494 |
| Claims on affiliated companies | 9 | 0 |
| Other | 1,107 | 4,013 |
| Total | <u>5,825</u> | <u>12,507</u> |

(40) Liabilities to banks

| | <u>Total</u> | | <u>Due on demand</u> | | <u>Other liabilities</u> | |
|---------------|----------------------|-------------------|----------------------|-------------------|--------------------------|-------------------|
| | <u>31.12.2002</u> | <u>31.12.2001</u> | <u>31.12.2002</u> | <u>31.12.2001</u> | <u>31.12.2002</u> | <u>31.12.2001</u> |
| | (thousand) | | | | | |
| German banks | 1,926 | 0 | 1,926 | 0 | 0 | 0 |
| Foreign banks | 12,987 | 0 | 12,987 | 0 | 0 | 0 |
| Total | <u>14,913</u> | <u>0</u> | <u>14,913</u> | <u>0</u> | <u>0</u> | <u>0</u> |

(41) Liabilities to customers

| | <u>Total</u> | | <u>Due on demand</u> | | <u>With agreed maturity or withdrawal period</u> | |
|---|-------------------------|-------------------------|-------------------------|-------------------------|--|----------------------|
| | <u>31.12.2002</u> | <u>31.12.2001</u> | <u>31.12.2002</u> | <u>31.12.2001</u> | <u>31.12.2002</u> | <u>31.12.2001</u> |
| | (thousand) | | | | | |
| Liabilities to domestic private customers | 1,822,191 | 2,196,023 | 1,749,450 | 2,150,113 | 72,741 | 45,910 |
| Liabilities to foreign private customers | 126,489 | 93,304 | 123,982 | 92,433 | 2,507 | 871 |
| Total | <u>1,948,680</u> | <u>2,289,327</u> | <u>1,873,432</u> | <u>2,242,546</u> | <u>75,248</u> | <u>46,781</u> |

Foreign-currency amounts equal to 85,067 thousand (2001: 28,846 thousand).

Through the German banks depositor protection fund of the German banking association Bundesverband deutscher Banken e. V., Cologne, each customer is insured for deposits of up to 171m. In addition, comdirect bank AG is a member of Entschädigungseinrichtung deutscher Banken GmbH.

(42) Provisions

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| | <u>31.12.2002</u> | <u>31.12.2001</u> |
|---|-------------------|-------------------|
| | (thousand) | |
| Provisions for pensions and similar commitments | 2,470 | 1,775 |
| Other provisions | 18,638 | 49,576 |
| | <u>21,108</u> | <u>51,351</u> |

The changes in provisions for pensions developed as follows:

| | <u>as of 1.1.2002</u> | <u>Utilised/ change</u> | <u>Depreciation</u> | <u>Allocation</u> | <u>as of 31.12.2002</u> |
|--|---------------------------|-----------------------------|---------------------|-------------------|-----------------------------|
| | (thousand) | | | | |
| Pension expectations of active employees | 1,775 | 0 | 0 | 695 | 2,470 |

The allocations to pension provisions in 2002 break down as follows:

| | | |
|--|-------------|--|
| | (thousand) | |
| Service cost | 584 | |
| Interest cost | 112 | |
| Cost arising from changes in actuarial assumptions | (1) | |

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COMDIRECT BANK GROUP
NOTES (UNAUDITED) (Continued)

Actuarial gains and losses are amortised over three years (2002: 2 thousand).

| <u>Parameters</u> | <u>31.12.2002</u> | | <u>31.12.2001</u> | | <u>31.12.2000</u> | |
|---------------------------|-------------------|---|-------------------|---|-------------------|---|
| Calculatory interest rate | 5.75 | % | 5.75 | % | 6.50 | % |
| Changes in salaries | 2.75 | % | 3.00 | % | 3.50 | % |
| Changes in pensions | 1.50 | % | 1.50 | % | 2.00 | % |

Changes in other provisions:

| | <u>as of</u> | | | | <u>as of</u> |
|---|-----------------|-----------------|-----------------|-------------------|-------------------|
| | <u>1.1.2002</u> | <u>Utilised</u> | <u>Reversal</u> | <u>Allocation</u> | <u>31.12.2002</u> |
| | | | | | |
| | | | (thousand) | | |
| Provisions for staff | 2,229 | 1,985 | 95 | 2,604 | 2,753 |
| Provisions for anniversary bonuses | 41 | 0 | 1 | 0 | 40 |
| Provisions for non-income-related taxes | 1,022 | 480 | 0 | 0 | 542 |
| Provisions for contingent losses | 18,336 | 8,811 | 7,681 | 6,318 | 8,162 |
| Provisions for restructuring | 26,602 | 26,517 | 9 | 6,379 | 6,455 |
| Other provisions | 1,346 | 913 | 172 | 425 | 686 |
| Total | 49,576 | 38,706 | 7,958 | 15,726 | 18,638 |

Provisions for staff mainly relate to provisions for bonuses. The provisions for staff will probably be used in the 2003 financial year.

Changes in provisions for contingent losses break down as follows:

| | <u>as of</u> | | | | <u>as of</u> |
|--|-----------------|-----------------|-----------------|-------------------|-------------------|
| | <u>1.1.2002</u> | <u>Utilised</u> | <u>Reversal</u> | <u>Allocation</u> | <u>31.12.2002</u> |
| | | | | | |
| | | | (thousand) | | |
| Provisions for contingent losses | 18,336 | 8,811 | 7,681 | 6,318 | 8,162 |
| Implementation of the com one programme for the future | 0 | 0 | 0 | 6,318 | 6,318 |
| Restructuring | 13,992 | 4,804 | 7,681 | 0 | 1,507 |
| Other | 4,344 | 4,007 | 0 | 0 | 337 |

The scale of the contingent losses for the implementation of the com one programme for the future were measured on the basis of the information about expected expenses that was available when the financial statements were prepared.

(43) Tax liabilities

Tax liabilities are comprised as follows:

| | <u>31.12.2002</u> | <u>31.12.2001</u> |
|---------------------------------|-------------------|-------------------|
| | (thousand) | |
| Current tax liabilities | 0 | 5,683 |
| Provisions for income taxes | 0 | 5,683 |
| Deferred tax liabilities | 0 | 4,761 |
| | <u> </u> | <u> </u> |
| Total | 0 | 10,444 |
| | <u> </u> | <u> </u> |

Deferred tax assets and liabilities are netted out in Germany, since they are both due to the same tax authority. As a result, we show a deferred tax asset in the financial year 2002 (see also note 38).

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COMDIRECT BANK GROUP
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Deferred tax liabilities were created in connection with the following balance-sheets items:

| | <u>31.12.2002</u> | <u>31.12.2001</u> |
|------------------------------------|-------------------|-------------------|
| | (thousand) | |
| Provision for possible loan losses | 0 | 23 |
| Trading assets | 0 | 347 |
| Financial investments | 0 | 2,300 |
| Intangible assets | 0 | 7,575 |
| Fixed assets | 0 | (68) |
| Provisions | 0 | (2,226) |
| Equity | 0 | (3,190) |
| | <u>0</u> | <u>4,761</u> |

(44) Subordinated capital

| | <u>31.12.2002</u> | <u>31.12.2001</u> |
|---|-------------------|-------------------|
| | (thousand) | |
| Subordinated liabilities | 6,391 | 6,391 |
| Profit-sharing certificates outstanding | 10,226 | 10,226 |
| | <u>16,617</u> | <u>16,617</u> |

The subordinated capital meets the requirements of supplementary capital as defined by Art. 10, (5a) of the German Banking Act (KWG). The claims of creditors to repayment of these liabilities are subordinated to those of other creditors.

Terms of subordinated liabilities:

| <u>Start of maturity</u> | <u>Amount</u> thousand | <u>Interest rate</u> per 31.12.2002 | <u>Maturity</u> date |
|--------------------------|---------------------------|--|-------------------------|
| 1996 | 6,391 | 3.06 | % 2006 |

The interest rate on subordinated liabilities was fixed for the first three years of the term to maturity. Currently, the interest rate is adjusted annually for a one-year interest-rate period.

During the financial year, comdirect incurred interest expenses on subordinated liabilities of 227 thousand (2001: 317 thousand).

Interest from profit-sharing certificates outstanding is paid only insofar as such payments do not lead to an accounting loss. The claims of the holders of the profit-sharing certificates are subordinated to the claims of other creditors.

Terms of the profit-sharing certificates outstanding:

| <u>Start of maturity</u> | <u>Amount thousand</u> | <u>Interest rate per 31.12.2002</u> | <u>Maturity date</u> |
|--------------------------|----------------------------|---|--------------------------|
| 1998 | 10,226 | 6.00 | % 2006 |

During the financial year, comdirect incurred interest expenses on profit-sharing certificates of 613 thousand (2001: 733 thousand). As a net loss is shown, the interest payment for the current profit-sharing right will not be made.

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COMDIRECT BANK GROUP
NOTES (UNAUDITED) (Continued)

(45) Maturities, by remaining lifetimes

Remaining lifetimes as of 31.12.2002

| | Total | Due on demand and unlimited in time | Up to three months | Three months to one year | One to five years | More than five years |
|--|--------------------|--|-------------------------------|-------------------------------------|------------------------------|---------------------------------|
| | (thousand) | | | | | |
| Claims on banks | 1,294,419 | 753,613 | 207,147 | 211,220 | 122,439 | 0 |
| Claims on customers | 175,421 | 175,421 | 0 | 0 | 0 | 0 |
| Bonds and notes held in the available for sale portfolio | 1,012,377 | 0 | 127,563 | 188,317 | 584,148 | 112,349 |
| Total | 2,482,217 | 929,034 | 334,710 | 399,537 | 706,587 | 112,349 |
| Liabilities to banks | 14,913 | 14,913 | 0 | 0 | 0 | 0 |
| Liabilities to customers | 1,948,680 | 1,873,432 | 35,857 | 36,503 | 2,888 | 0 |
| Subordinated capital | 16,617 | 0 | 0 | 0 | 16,617 | 0 |
| Total | 1,980,210 | 1,888,345 | 35,857 | 36,503 | 19,505 | 0 |

Remaining lifetimes as of 31.12.2001

| | Total | Due on demand and unlimited in time | Up to three months | Three months to one year | One to five years | More than five years |
|--|--------------------|--|-------------------------------|-------------------------------------|------------------------------|---------------------------------|
| | (thousand) | | | | | |
| Claims on banks | 1,684,112 | 1,144,987 | 339,125 | 50,000 | 150,000 | 0 |
| Claims on customers | 263,728 | 263,728 | 0 | 0 | 0 | 0 |
| Bonds and notes held in the available for sale portfolio | 840,719 | 20,873 | 51,362 | 163,860 | 501,083 | 103,541 |
| Total | 2,788,559 | 1,429,588 | 390,487 | 213,860 | 651,083 | 103,541 |
| Liabilities to banks | 0 | 0 | 0 | 0 | 0 | 0 |
| Liabilities to customers | 2,289,327 | 2,242,546 | 20,052 | 24,844 | 1,885 | 0 |
| Subordinated capital | 16,617 | 0 | 0 | 0 | 16,617 | 0 |
| Total | 2,305,944 | 2,242,546 | 20,052 | 24,844 | 18,502 | 0 |

(46) Claims on/liabilities to affiliated companies

| | <u>31.12.2002</u> | <u>31.12.2001</u> |
|--------------------------|-----------------------|-----------------------|
| | (thousand) | |
| Claims on banks | 341,463 | 754,471 |
| Liabilities to banks | 14,913 | 0 |
| Liabilities to customers | 0 | 0 |
| Subordinated capital | 16,617 | 16,617 |
| Total | <u>372,993</u> | <u>771,088</u> |

(47) Interest-rate risks

| | <u>Interest assets</u> | | <u>Interest liabilities</u> | | <u>Interest gap</u> | <u>Interest differential</u> |
|----------------------|------------------------|----------------------|-----------------------------|----------------------|---------------------|------------------------------|
| | <u>million</u> | <u>interest in %</u> | <u>million</u> | <u>interest in %</u> | <u>million</u> | <u>% points</u> |
| Up to one year | 2,021 | 3.69 | 2,010 | 1.27 | 11 | 2.42 |
| One to five years | 361 | 4.27 | 434 | 3.31 | (73 |) 0.96 |
| More than five years | 17 | 4.92 | 0 | 0.00 | 17 | 4.92 |

| | <u>GBP</u> | | <u>GBP</u> | | <u>GBP million</u> | <u>% points</u> |
|----------------|----------------|----------------------|----------------|----------------------|--------------------|-----------------|
| | <u>million</u> | <u>interest in %</u> | <u>million</u> | <u>interest in %</u> | | |
| Up to one year | 7 | 3.80 | 0 | 0.00 | 7 | 3.80 |

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COMDIRECT BANK GROUP
NOTES (UNAUDITED) (Continued)

(48) Number of employees at the end of the reporting period

| | <u>31.12.2002</u> | <u>31.12.2001</u> |
|-----------------------------|-------------------|-------------------|
| Group | 922 | 1,291 |
| in Germany | 859 | 1,117 |
| abroad | 63 | 174 |
| At comdirect bank AG | 859 | 1,117 |
| of which: | | |
| in the call centre | 366 | 517 |
| in the back office | 225 | 317 |
| in other areas | 268 | 283 |

(49) Segment reporting

Segment reporting, by geographical markets in the 2002 financial year:

| | <u>comdirect Germany</u> | <u>comdirect Europe, excluding Germany</u> | <u>Group management/ others/ consolidation</u> | <u>comdirect bank group total</u> |
|---|------------------------------|--|--|---|
| | (thousand) | | | |
| Net interest income before provisions | 63,639 | 1,760 | (1,503) | 63,896 |
| Provision for possible loan losses | (2,037) | 0 | 0 | (2,037) |
| Net interest income after provisions | 61,602 | 1,760 | (1,503) | 61,859 |
| Net commission income | 73,828 | 3,314 | 0 | 77,142 |
| Trading profit/loss | (285) | 0 | 0 | (285) |
| Result from the securities portfolio (available for sale) | 1,200 | 0 | 0 | 1,200 |
| Administrative expenses | 122,128 | 16,010 | 0 | 138,138 |
| Other operating result | 2,949 | (32) | 0 | 2,917 |
| Profit/loss from ordinary activities | 17,166 | (10,968) | (1,503) | 4,695 |
| Extraordinary results and restructuring costs | (48,830) | 0 | 25,535 | (23,295) |
| Pre-tax profit/loss | (31,664) | (10,968) | 24,032 | (18,600) |
| Taxes on income | (8,836) | 0 | 0 | (8,836) |
| After-tax profit/loss | (22,828) | (10,968) | 24,032 | (9,764) |
| Profit/loss attributable to minority interests | 0 | 0 | 0 | 0 |
| Net profit/loss | (22,828) | (10,968) | 24,032 | (9,764) |
| Acquisition costs of segment assets | 7,313 | 1,789 | 0 | 9,102 |
| Depreciation on segment assets | 20,991 | 2,269 | 0 | 23,260 |
| Cost-income-ratio | 0.8715 | 3.1753 | | 0.9615 |
| Segment income | 177,972 | 5,936 | (1,503) | 182,405 |
| Segment expenses | 162,006 | 16,904 | 0 | 178,910 |
| Segment assets | 2,430,426 | 95,941 | 0 | 2,526,367 |
| Segment debt | 1,878,527 | 85,066 | 0 | 1,963,593 |

Allocation to the segments is based on the domicile of the consolidated companies.

(50) Other liabilities

Rental and leasing agreements concluded by comdirect bank Group will lead to expenses of 6,326 thousand during 2003 financial year, 5,122 thousand for each of the years 2004 to 2007, and 6,336 thousand as of the year 2008.

(51) Letter of comfort

comdirect bank AG provides no general letter of comfort for the subsidiaries included in the consolidated financial statements.

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COMDIRECT BANK GROUP
NOTES (UNAUDITED) (Continued)

(52) Corporate Governance Code

comdirect bank AG submitted the Declaration of Compliance pursuant to Art. 161 of the German Stock Corporation Act (AktG) and has made it permanently available to the shareholders at the website www.comdirect.de.

(53) The company's boards

Supervisory board

Martin Blessing (since 10 May, 2002)

Frankfurt am Main

Chairman of the Supervisory Board

Member of the Board of Managing Directors of

Commerzbank AG, Frankfurt am Main

Klaus-Peter Müller (until 10 May, 2002)

Frankfurt am Main

Chairman of the Supervisory Board

Chairman of the Board of Managing Directors of

Commerzbank AG, Frankfurt am Main

Klaus Müller-Gebel

Frankfurt am Main

Deputy Chairman of the Supervisory Board

Member of the Supervisory Board of

Commerzbank AG, Frankfurt am Main

Dr. Eric Strutz (since 10 May, 2002)

Frankfurt am Main

Head of Corporate Controlling of

Commerzbank AG, Frankfurt am Main

Dr. Franz-Georg Brune (until 10 May, 2002)

Frankfurt am Main

Co-manager of Frankfurt am Main main branch of

Commerzbank AG, Frankfurt am Main

Rainer Beaujean (since 8 October, 2002)

Darmstadt

Member of the Board of Managing Directors of

T-Online International AG, Darmstadt

Burkhard Graßmann (until 1 October, 2002)

Darmstadt

Member of the Board of Managing Directors of

T-Online International AG, Darmstadt

Angelika Kierstein

Quickborn

Chairman of Staff Council of

comdirect bank Aktiengesellschaft

Commercial employee

Maria Xiromeriti

Quickborn

Deputy Chairman of Staff Council of
comdirect bank Aktiengesellschaft

Commercial employee

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COMDIRECT BANK GROUP
NOTES (UNAUDITED) (Continued)

Board of Managing Directors

Dr. Achim Kassow,

Chairman (since 1 June, 2002)

Dr. Andre Carls

Hans-Joachim Nitschke

Bernt Weber (until 31 May, 2002)

Christian Jessen (until 30 June, 2002)

(54) Shares of comdirect bank AG

Number of shares held by the boards:

| | <u>31.12.2002</u> | <u>31.12.2001</u> |
|---|-------------------|-------------------|
| Members of the Board of Managing Directors | 0 | 700 |
| Dr. Achim Kassow (since 1 June, 2002) | 0 | |
| Dr. Andre Carls | 0 | 0 |
| Christian Jessen (until 30 June, 2002) | | 200 |
| Hans-Joachim Nitschke | 0 | 0 |
| Bernt Weber (until 31 May, 2002) | | 500 |
| Members of the Supervisory Boards | 150 | 150 |
| Martin Blessing (since 10 May, 2002) | 0 | |
| Klaus-Peter Müller (until 10 May, 2002) | | 0 |
| Klaus Müller-Gebel | 0 | 0 |
| Dr. Eric Strutz (since 10 May, 2002) | 0 | |
| Dr. Franz-Georg Brune (until 10 May, 2002) | | 0 |
| Rainer Beaujean (since 8 October, 2002) | 0 | |
| Burkhard Graßmann (until 1 October, 2002) | | 0 |
| Angelika Kierstein | 100 | 100 |
| Maria Xiromeriti | 50 | 50 |

The number of options held to subscribe to comdirect bank AG shares breaks down as follows:

| | <u>31.12.2002</u> | <u>31.12.2001</u> |
|---|-------------------|-------------------|
| Members of the Board of Managing Directors | 129,000 | 90,000 |
| Dr. Achim Kassow (since 1 June, 2002) | 40,000 | |
| Dr. Andre Carls | 38,500 | 13,500 |
| Christian Jessen (until 30 June, 2002) | | 25,500 |
| Hans-Joachim Nitschke | 50,500 | 25,500 |
| Bernt Weber (until 31 May, 2002) | | 25,500 |
| Members of the Supervisory Boards | 0 | 0 |
| Martin Blessing (since 10 May, 2002) | 0 | |
| Klaus-Peter Müller (until 10 May, 2002) | | 0 |
| Klaus Müller-Gebel | 0 | 0 |
| Dr. Eric Strutz (since 10 May, 2002) | 0 | |
| Dr. Franz-Georg Brune (until 10 May, 2002) | | 0 |

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| | | |
|---|---|---|
| Rainer Beaujean (since 8 October, 2002) | 0 | |
| Burkhard Graßmann (until 1 October, 2002) | | 0 |
| Angelika Kierstein | 0 | 0 |
| Maria Xiromeriti | 0 | 0 |

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COMDIRECT BANK GROUP
NOTES (UNAUDITED) (Continued)

(55) Remuneration and loans to board members

The following remuneration was paid to members of the Board of Managing Directors and members of the Supervisory Boards:

| | <u>2002</u> | <u>2001</u> |
|-----------------------------|--------------|-------------|
| | (thousand) | |
| Board of Managing Directors | 961 | 1,290 |
| of which: non-variable | 700 | 794 |
| of which: variable | 261 | 496 |
| Supervisory Boards | 23 | 87 |

Neither advance payments nor loans were extended. comdirect did not take on any contingent liabilities.

Holdings

| <u>Name</u> | <u>Domicile</u> | <u>Share of capital held in %</u> | <u>Equity in thousand</u> |
|----------------------------|-----------------------|---|-------------------------------|
| comdirect ltd. | London/United Kingdom | 100.0 | GBP 9,857 |
| comdirect nominee ltd. | London/United Kingdom | 100.0 | GBP (1.00) |
| comdirect bank S.p.A. i.L. | Milan/Italy | 100.0 | EUR 12,800 |

Quickborn, 14 February, 2003
The Board of Managing Directors

Dr. Achim Kassow

Dr. Andre Carls

Hans-Joachim Nitschke

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