

# **Financial Statements as of December 31, 2003 of Telekom Austria AG**

**(according to Austrian  
Commercial Code – HGB)**

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## Telekom Austria Aktiengesellschaft, Vienna, Austria

## Annex I/1

**Balance Sheet as of December 31, 2003**

with prior year's comparative figures in thousands of Euro (TEUR)

**Assets:**

	As of Dec 31, 2003 EUR	As of Dec 31, 2002 TEUR
<b>A. Fixed assets</b>		
<b>I. Intangible assets</b>		
1. Licenses, industrial property rights and similar rights	43.632.691,00	47.246
2. Goodwill	588.037,00	2.722
	<b>44.220.728,00</b>	<b>49.968</b>
<b>II. Property, plant and equipment</b>		
1. Land, similar rights and buildings including buildings on non-owned land	401.188.958,02	437.094
2. Technical plants and machinery	2.806.062.374,62	3.299.995
3. Other plants, furniture and fixtures	88.371.228,07	75.397
4. Assets under construction	49.657.615,04	85.084
	<b>3.345.280.175,75</b>	<b>3.897.570</b>
<b>III. Financial assets</b>		
1. Investments in affiliated companies	1.339.061.931,53	1.323.769
2. Investments	6.333.947,45	13.799
3. Securities	4.445.195,58	3.783
4. Other loans	78.147.531,09	143.093
	<b>1.427.988.605,65</b>	<b>1.484.444</b>
	<b>4.817.489.509,40</b>	<b>5.431.982</b>
<b>B. Current assets</b>		
<b>I. Inventories</b>		
1. Raw materials and supplies	40.238.612,00	30.272
2. Merchandise	6.059.984,48	13.320
3. Services not yet chargeable	1.477.885,27	3.084
4. Prepayments	0,00	28
	<b>47.776.481,75</b>	<b>46.704</b>
<b>II. Accounts receivable</b>		
1. Accounts receivable - trade	404.826.719,22	406.421
2. Accounts receivable - affiliated companies	556.954.613,79	445.155
3. Accounts receivable - associated companies	242.632,61	1.400
4. Other receivables and assets	84.817.697,92	86.225
	<b>1.046.841.663,54</b>	<b>939.201</b>
<b>III. Short-term investments</b>		
1. Investments in affiliated companies	1.163.448,51	0
2. Other securities	1.621.377,32	3.130
	<b>2.784.825,83</b>	<b>3.130</b>
<b>IV. Cash and cash equivalents</b>	<b>1.920.287,82</b>	<b>1.278</b>
	<b>1.099.323.258,94</b>	<b>990.313</b>
<b>C. Prepaid expenses</b>	<b>16.018.622,18</b>	<b>13.294</b>
	<b>5.932.831.390,52</b>	<b>6.435.589</b>

## Telekom Austria Aktiengesellschaft, Vienna, Austria

## Annex I/2

**Liabilities and Shareholders' equity:**

	As of Dec 31, 2003 EUR	As of Dec 31, 2002 TEUR
<b>A. Shareholders' equity</b>		
<b>I. Common stock</b>	1.090.500.000,00	1.090.500
<b>II. Additional paid-in capital</b>		
Appropriated	928.000.856,33	928.001
<b>III. Taxed reserves</b>		
Other reserves (unrestricted reserves)	300.000.000,00	0
<b>IV. Net profit</b>		
Profit for the year	69.710.200,52	0
	<b>2.388.211.056,85</b>	<b>2.018.501</b>
<b>B. Untaxed reserves</b>		
1. Reserves from special depreciation	2.326.641,91	2.434
2. Other untaxed reserves	56.819.977,17	119.808
	<b>59.146.619,08</b>	<b>122.242</b>
<b>C. Accruals</b>		
1. Accrued severance payments	12.597.379,75	11.924
2. Accrued taxes	13.012.488,72	10.507
3. Other accruals	237.854.897,45	200.494
	<b>263.464.765,92</b>	<b>222.925</b>
<b>D. Liabilities</b>		
1. Bonds	151.871.261,90	174.552
2. Bank loans and overdrafts	1.512.042.741,96	1.851.744
3. Payments received in advance	1.284.774,97	184
4. Accounts payable - trade	262.675.667,84	308.249
5. Accounts payable - affiliated companies	835.666.412,89	1.250.918
6. Accounts payable - associated companies	5.542.033,94	10.216
7. Other liabilities	343.991.874,00	368.430
thereof due to taxes: EUR 31,410,005.69; prior year: TEUR 229		
thereof due to social security: EUR 3,064,361.13; prior year: TEUR 2,579		
	<b>3.113.074.767,50</b>	<b>3.964.293</b>
<b>E. Deferred income</b>	<b>108.934.181,17</b>	<b>107.628</b>
	<b>5.932.831.390,52</b>	<b>6.435.589</b>
Contingent liabilities	1.769.019.581,91	1.239.231

**Profit and Loss Accounts for the Business Year 2003**

with prior year's comparative figures in thousands of Euro (TEUR)

	2003		2002	
	EUR	EUR	TEUR	TEUR
1. Net sales		2.159.798.194,96		2.195.172
2. Change in services not yet chargeable		-1.605.572,73		-1.962
3. Own work capitalized		26.240.301,85		27.464
4. Other operating income				
a) Income from disposal of fixed assets excluding financial assets	5.918.610,41		10.343	
b) Income from reversal of accruals	16.654.449,57		22.971	
c) Sundry	<u>40.258.802,89</u>	62.831.862,87	<u>85.286</u>	118.600
5. Cost of materials and other production services				
a) Cost of materials	-67.400.303,76		-65.966	
b) Cost of services	<u>-479.915.899,87</u>	-547.316.203,63	<u>-487.483</u>	-553.449
6. Personnel expenses				
a) Salaries	-101.073.691,21		-99.939	
b) Severance expense	-2.230.086,51		-7.481	
c) Pension expense	-4.949.390,67		-4.318	
d) Expenses for statutory social security and payroll related taxes and contributions	-26.803.597,68		-25.165	
e) Other social benefits	<u>-3.915.084,84</u>	-138.971.850,91	<u>-7.104</u>	-144.007
7. Depreciation of intangible assets, property, plant and equipment		-786.137.143,79		-835.483
thereof: extraordinary depreciation of fixed assets according to § 204 (2) HGB: EUR 1,807,135.94; prior year: TEUR 2,826				
8. Other operating expenses				
a) Taxes	-5.347.724,11		-7.053	
b) Sundry	<u>-824.312.252,71</u>	-829.659.976,82	<u>-966.078</u>	-973.131
<b>9. Subtotal from line 1 to 8</b>		<b><u>-54.820.388,20</u></b>		<b><u>-166.796</u></b>
10. Income from investments		487.473.142,21		312.896
thereof from affiliated companies: EUR 485,722,835.45; prior year: TEUR 310,091				
11. Income from other long-term securities of financial assets		117.033,00		0
12. Other interest and similiar income		15.156.703,93		24.399
thereof from affiliated companies: EUR 1,137,034.24; prior year: TEUR 7,086				
13. Income from disposal and revaluation of financial assets and short-term securities		23.516.290,95		333
14. Expenses for financial assets and short-term securities thereof depreciation: EUR 5,114,341.59; prior year: TEUR 32,511		-5.516.341,59		-32.707
15. Interest and similiar expense		-150.472.697,14		-182.581
thereof for affiliated companies: EUR 30,883,244.05; prior year: TEUR 37,403				
<b>16. Subtotal from line 10 to 15</b>		<b><u>370.274.131,36</u></b>		<b><u>122.340</u></b>
<b>17. Ordinary business result</b>		<b><u>315.453.743,16</u></b>		<b><u>-44.456</u></b>
<b>18. Extraordinary result</b>		0,00		-47.439
19. Taxes on income		-8.839.346,08		-916
<b>20. Net profit/loss for the year</b>		<b><u>306.614.397,08</u></b>		<b><u>-92.811</u></b>
21. Reversal of untaxed reserves		63.095.803,44		81.998
22. Reversal of additional paid-in capital		0,00		10.813
23. Allocation to taxed reserves		-300.000.000,00		0
<b>24. Net result</b>		<b><u>69.710.200,52</u></b>		<b><u>0</u></b>

## **Notes to the Financial Statements for the Business Year 2003**

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## **1. Accounting and Valuation Methods**

### **1.1. General Principles**

The annual financial statements were prepared according to the Austrian Commercial Code and generally accepted accounting principles in Austria with the general objective of providing a true and fair view of the balance sheet, the financial position and the operating results of the Company.

The principle of completeness was observed in preparing the annual financial statements.

The principles of individual valuation and going concern were observed in valuing the Company's assets and liabilities.

The principle of prudence was observed in so far as only those profits were recognized that were realized and earned as of the balance sheet date. All identifiable risks and contingent losses were taken into account.

The statement of operations was prepared in accordance with the total expenditure format. All figures presented in the notes to the financial statements are shown in thousand Euros (TEUR). The balance sheet date is December 31.

### **1.2. Long-lived assets**

Intangible assets are valued at cost and amortized according to the straight-line method. The useful lives of intangible assets range from 3 to 15 years; fixed line rights are amortized over the terms of the relevant agreements. No impairment charges were recorded for intangible assets and property, plant and equipment in 2003. The useful life of goodwill, which is amortized using the straight-line method, ranges from 3 to 15 years.

Property, plant and equipment are valued at acquisition or production cost less depreciation. The production cost of plant and equipment manufactured by the Company includes both direct costs and a proportional share of overheads, but

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**Appendix III/2**

excludes social security expenses as defined under § 203 Par. 3 of the Austrian Commercial Code as well as directly allocated interest expense on borrowed capital.

Depreciation was calculated in accordance with the straight-line method based on the following useful lives and depreciation rates:

	Useful life in years	Depreciation rate in %
Buildings	20 – 50	2 – 5
Technical plants and buildings	3 – 20	5 – 33
Tools, measuring and testing equipment	5 – 10	10 – 20
Computer equipment	4 – 5	20 – 25
Motor vehicles	4 – 8	12.5 – 25
Warehouse and shop fittings and equipment	10	10
Office machines and other small machinery	5	20

In accordance with § 7 Par. 2 of the Austrian Income Tax Act, full-year depreciation was applied for additions made during the first half-year, and half of a full-year's depreciation for additions made during the second six months. With the exception of low value items, measuring and testing equipment and ADSL modems, all low value assets with an individual purchase price of up to TEUR 0.4 were expensed as incurred in the year of acquisition in accordance with § 13 of the Austrian Income Tax Act. These items are shown as additions and retirements in the assets analysis. The constant value set for office equipment pursuant to § 209 Par. 1 of the Austrian Commercial Code amounted to TEUR 8,988 as of the balance sheet date.

In 2003 impairment charges of TEUR 1,807 (2002: TEUR 2,826) were recorded for intangible assets and property, plant and equipment.

Buildings with a value of TEUR 5,560 were reclassified from long-lived assets to current assets because of their planned sale.

In 1998 and 1999 the Company entered into a number of contracts with US trusts for the sale of digital switching equipment. These assets were subsequently leased back by Telekom Austria Aktiengesellschaft on the basis of leasing contracts. Telekom Austria Aktiengesellschaft is entitled to re-purchase the assets at a contractually fixed priced after approximately 10 years.

In 2001 the Company leased digital switching equipment to a US trust. This equipment was subsequently leased back by the Company on the basis of leasing contracts. Telekom Austria Aktiengesellschaft remains the beneficial owner of these assets.

Interests in affiliated companies and securities recorded as long-lived assets are generally recorded at cost. Write-downs are recorded if the fair value on the balance sheet date is lower than the carrying amount of the asset, and the decrease is assumed to be permanent. Write-downs totaling TEUR 3,863 (2002: TEUR 28,828) were recorded in 2003.

### **1.3. Current assets**

Inventories are valued at acquisition or production cost, based on the lower of cost or market principle. The value of inventory is determined according to the moving average method.

Write-downs were required, in particular, due to the limited possibilities for use or unusually slow turnover, and reflect decreased market prices as of the balance sheet date moving items.

Services not yet invoiced are recorded at production cost. Production cost include direct material and labor as well as a proportional share of material and production overheads.

Receivables and other assets are stated at nominal value, unless the lower fair value is recorded to reflect recognizable individual risk. General credit risk is accounted for by recording provisions on an individual or lump sum basis. Where necessary, the later maturity of receivables is reflected through discounting.

Foreign currency receivables are stated at the average exchange rate as of the transaction date or at the lower average exchange rate as of the balance sheet date.

Receivables due from and liabilities due to the same international carrier were netted and the resulting balance was recorded in accordance with the lower of cost or market principle.

#### **1.4. Accruals**

Accruals for severance payments are recorded for legal and contractual obligations to members of the Management Board and for employees transferred back to the Company from Telekom Austria Personalmanagement GmbH as of December 31, 2003. The calculation is based on the principles of financial mathematics using the Austrian method "Teilwertverfahren" with a discount rate of 4% and a fluctuation discount of 4%.

Other accruals are recorded at the amount of expected utilization. They reflect all identifiable risks and undetermined liabilities as of the balance sheet date.

#### **1.5. ABS – Asset backed securitization**

In 2002 Telekom Austria AG sold receivables due from domestic telephone customers to a "master purchaser" (trustee) in Ireland within the framework of an asset backed securitization transaction. This master purchaser holds the receivables in trust for Telekom Austria AG and, on the other hand, for an investor.

The total volume of receivables sold is limited to a combined maximum of TEUR 290,000 for Telekom Austria and mobilkom austria, which also carried out a similar transaction. The maximum individual limit for Telekom Austria is set at TEUR 250,000. In December 2003 the total volume was increased to TEUR 350,000 with a maximum individual limit of TEUR 300,000 for Telekom Austria.

This transaction represents a type of artificial factoring, since the risk of default remains with the seller and the seller therefore remains the economic owner of these assets. For this reason, receivables and valuation adjustments are shown unchanged on the balance sheet. Since Telekom Austria AG, as the seller, is responsible for the creditworthiness of the receivables, this transaction must be viewed as a loan that is secured through the assignment of receivables. Net financial liabilities to the trustee

are comprised of the Initial Purchase Price (IPP) less the Deferred Purchase Price (DPP). These amounts are netted because of their similarity, identical terms, and identical creditor and debtor, and are reported under other financial liabilities. The discount is recorded under prepaid expenses.

### **1.6. Liabilities**

Liabilities are recorded at their repayment amount in accordance with the principle of prudence. Foreign currency liabilities are recorded at the average exchange rate on the balance sheet date, if this value exceeds the carrying amount. In the international settlement area, receivables due from and liabilities due to the same carrier were offset and the resulting balance was recorded in accordance with the lower of cost or market principle.

### **1.7. Prepaid income**

This item includes primarily deferred revenue as well as deferred income from cross-border lease contracts.

## **2. Notes to the Balance Sheet**

### **2.1. Long-lived assets**

The development of individual items recorded under long-lived assets and the classification of annual depreciation by category is reported as part of the fixed assets table (Appendix 3).

Property, plant and equipment includes land, similar rights and buildings including buildings on non-owned land with a total value of TEUR 57,487 (December 31, 2002: TEUR 60,266).

Loans with a remaining maturity of up to 1 year amount to TEUR 6,043 (December 31, 2002: TEUR 6,044).

Liabilities in connection with the use of fixed assets not included in the balance sheet amount to:

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**Appendix III/6**

	Dec. 31, 2003 TEUR	Dec. 31, 2002 TEUR
Rental and lease commitments for the next 5 years	127,611	138,820
Thereof rental and lease commitments in the following year	28,739	36,224

Affiliated companies and equity investments of Telekom Austria Aktiengesellschaft with a holding of 20% or more:

Name and corporate seat	Share in capital as of Dec. 31, 2003  %	Book value of equity as of Dec. 31, 2003 TEUR	Net income/ loss 2003  TEUR
<b>Affiliated companies</b>			
mobilkom austria AG & Co KG, Vienna	74.999	1,250,234	304,780
mobilkom austria AG, Vienna	75.0 <sup>1</sup>	42	-27
Österreichische Fernmeldetechnische Entwicklungs- und Förderungsgesell- schaft mbH, Vienna <sup>2</sup>	100.0	277	184
Telekom Projektentwicklungs GmbH, Vienna	100.0	314	282
Telekom Austria Personalmanagement GmbH, Vienna	100.0	623,727	0
Jet2Web Stream Slovakia s.r.o, Bratislava <sup>3</sup>	100.0	347	-46
Jet2Web Stream Hungary Kft, Budapest <sup>3</sup>	100.0	270	-324
Telekom Austria Beteiligungen GmbH, Vienna <sup>3</sup>	100.0	20,560	-10
"IVS" INTERACTIVE VIDEO SERVICES GMBH, Pinkafeld	66.67	-113	-379
TA Mreza d.o.o., Ljubljana <sup>3</sup>	100.0	-29	-37
World-Direct eBusiness Solutions GmbH, Vienna <sup>3</sup>	100.0	281	-59
<b>Other investments</b>			
Omnimedia Werbegesellschaft mbH, Vienna <sup>4</sup>	26.0	2,861	2,317
Output Service GmbH, Vienna	25.1	55	21

<sup>1</sup> 75% less one share

<sup>2</sup> Figures as of December 31, 2003

<sup>3</sup> Figures according to package at December 31, 2003, "local GAAP"

<sup>4</sup> Balance sheet date June 30, 2003

Telekom Austria Personalmanagement GmbH is bound by contract to transfer its profit to the Company.

**2.2. Receivables and other assets**

The maturity and structure of the receivables is shown in the accounts receivable table (Appendix 1).

At year-end, lump sum valuation adjustments of TEUR 3,057 (December 31, 2002: TEUR 2,812) were recorded for trade accounts receivable.

Other receivables include accrued interest income of TEUR 12,528 (December 31, 2002: TEUR 12,266) that will become due and payable after the balance sheet date.

**2.3. Prepaid expenses**

This item consists primarily of deferrals related to the stock option plan, insurance and rental expenses, and capitalized financing costs (EMTN program).

As of December 31, 2003 non-recorded deferred tax assets that are expected to be realized in the following years totaled TEUR 79,659 (December 31, 2002: TEUR 68,642).

**2.4. Shareholders' equity**

The common stock of Telekom Austria Aktiengesellschaft remained unchanged at TEUR 1,090,500 and is divided into 500,000,000 bearer shares. ÖIAG holds 47.2% and Telekom Italia International N.V., Amsterdam 14.8% of the shares. A total of 38.0% of the shares represent a free float.

**Dividend payout**

With the consent of the Supervisory Board, the Management Board will propose at the shareholders' meeting taking place on June 3, 2004 to distribute a dividend of EUR 0.13 per entitled share. The remaining retained earnings will be carried forward.

**Authorized capital stock**

According to § 159 Par. 3 of the Austrian Stock Corporation Act, the Management Board was authorized at the shareholders' meeting on June 4, 2003 to increase the share capital of the Company to EUR 21,810,000.00 by issuing up to 10 million new ordinary bearer shares or new ordinary registered shares with no par value in order to serve options. This authorization is valid for 5 years. The stock option program shall have a duration period of 1 to 7 years. The right to exercise options shall depend on the profitability of the Company as determined on the basis of indicators widely used in the telecommunications industry. The exercise price shall be calculated in consideration of the stock exchange quotation and shall amount to a minimum of EUR 9 per share.

**2.5. Untaxed reserves**
**Reserves from special depreciation**

	Balance on Jan. 1, 2003 TEUR	Release TEUR	Balance on Dec. 31, 2003 TEUR
Continuation of special depreciation as per § 8 and 122 of the Austrian Income Tax Act 1972	2,191	106	2,085
Transfer of hidden reserves as per § 12 of the Austrian Income Tax Act	243	1	242
	<u>2,434</u>	<u>107</u>	<u>2,327</u>

### Other untaxed reserves

Year	Balance on Jan. 1, 2003 TEUR	Release TEUR	Balance on Dec. 31, 2003 TEUR
Investment allowance as per § 10 of the Austrian Income Tax Act			
1996	639	639	0
1997	11,086	9,676	1,410
1998	9,137	6,347	2,790
1999	50,585	45,517	5,068
2000	48,361	809	47,552
	<u>119,808</u>	<u>62,988</u>	<u>56,820</u>

### 2.6. Accrued liabilities

Accrued tax liabilities as of December 31, 2003 relate primarily to income tax, municipal duties and fees to the chamber of commerce.

Other accrued liabilities include provisions for:

	Dec. 31, 2003 TEUR	Dec. 31, 2002 TEUR
Outstanding purchase invoices	66,059	62,427
Customer discounts	41,766	43,546
Miscellaneous	39,545	25,472
Estimated losses from retirement of local telephone network	39,000	0
Estimated real estate devaluations	37,581	50,600
Operating and maintenance costs for vacant and terminated objects	7,555	10,624
Unused vacation	6,349	7,825
	<u>237,855</u>	<u>200,494</u>

### 2.7. Liabilities

The maturity and structure of liabilities is shown in the table of liabilities (Appendix 2).

## 2.8. Other financial commitments

### Contingencies

	Dec. 31, 2003 TEUR	Dec. 31, 2002 TEUR
Guarantee for Telekom Finanzmanagement GmbH in the course of the EMTN program	750,000	0
Obligations arising from cross-border lease	707,726	828,302
Bank guarantee for loans of Mobilkom International GmbH & Co KEG	305,000	305,000
Bank guarantees	5,973	409
Comfort letter for "IVS" INTERACTIVE VIDEO SERVICES GMBH	320	320
Bank guarantee for mobilkom austria AG & Co KG	0	5,200
Guarantee for loans to Telekom Finanzmanagement GmbH	0	100,000
	<u>1,769,019</u>	<u>1,239,231</u>
thereof pertaining to affiliated companies	1,055,320	410,520

On June 30, 2003, Telekom Austria AG (TA) und Telekom Finanzmanagement GmbH (TFG) initiated a Euro Medium Term Note (EMTN) Programme. The payment of all amounts due in respect of notes issued by Telekom Finanzmanagement GmbH under this framework agreement will be unconditionally and irrevocably guaranteed by TA.

The maximum aggregate nominal amount of all notes outstanding at any time under the programme will not exceed the equivalent of EUR 2,500,000.

On July 10, 2003, TFG successfully launched and placed a Eurobond offering which raised TEUR 750,000 with a 10-year maturity and a coupon of 5.00%.

The notes were issued at a re-offer price of 99.193% and used to refinance existing debt.

TA guarantees the interest rate swaps entered into by TFG.

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**Appendix III/11**

	Dec. 31, 2003 TEUR	Dec. 31, 2002 TEUR
Other obligations		
Order purchase obligations for long-lived assets <sup>5</sup>	32,000	27,700

### 3. Notes on the Statement of Operations

#### 3.1. Revenues

	2003 TEUR	2002 TEUR
Switched voice base monthly & other voice revenues	564,093	552,289
Switched voice base traffic	447,336	495,877
Data & IT-solutions	334,759	326,995
Wholesale voice & internet	311,343	305,556
Internet access & media	185,455	170,013
Wholesale data	104,340	98,799
Payphones & VAS	67,502	81,840
Other	144,970	163,803
	<u>2,159,798</u>	<u>2,195,172</u>

#### 3.2. Other operating income

	2003 TEUR	2002 TEUR
Income from the retirement of long-lived assets, with the exception of financial assets	5,919	10,343
Income from the reversal of accrued liabilities	16,654	22,971
Other	40,259	85,286
	<u>62,832</u>	<u>118,600</u>

Other operating income is comprised of the following:

	2003 TEUR	2002 TEUR
Rental and lease income	8,639	7,628
Settlement of damage claims	8,752	6,945
Miscellaneous	22,868	70,713
	<u>40,259</u>	<u>85,286</u>

<sup>5</sup> statistical survey, to some extent estimated

### 3.3. Expenses for material and other purchased manufacturing services

	2003 TEUR	2002 TEUR
Cost of materials	67,400	65,966
Cost of purchased services	479,916	487,483
	<u>547,316</u>	<u>553,449</u>

### 3.4. Personnel expenses

Personnel expenses are comprised of the following:

	2003 TEUR	2002 TEUR
Salaries	101,074	99,939
Expenses for severance compensation	2,230	7,481
Expenses for pensions	4,949	4,318
Expenses for statutory social security contributions and payroll-related duties and other mandatory contributions	26,804	25,165
Other employee-related expenses	3,915	7,104
	<u>138,972</u>	<u>144,007</u>

As of June 30, 2000, the entire workforce of Telekom Austria Aktiengesellschaft – with the exception of top management – was transferred to Telekom Austria Personalmanagement GmbH. In 2003 a total of 201 (2002: 2,178) employees had been reassigned from Telekom Austria Personalmanagement GmbH to Telekom Austria Aktiengesellschaft in an ongoing transfer. A comparison with prior year data is therefore not useful. Personnel expenses charged by Telekom Austria Personalmanagement GmbH to Telekom Austria Aktiengesellschaft are included under "other operating expenses" as purchased services.

The average number of full-time employees during the reporting year was:

	2003	2002
Employees	<u>2,396</u>	<u>1,557</u>

On average during the business year, 10 interns (2002: 0) were employed by the Company.

**Telekom Austria Aktiengesellschaft, Vienna**
**Appendix III/13**

	2003 TEUR	2002 TEUR
Remuneration for members of the Management Board	2,103	1,441
Remuneration for members of the Supervisory Board	94	113
	<u>2,197</u>	<u>1,554</u>

**3.5. Expenses for severance compensation**

Expenses for severance compensation are classified as follows:

	2003 TEUR	2002 TEUR
Management Board	239	130
Managers	1,449	2,305
Other employees	5,491	9,364
	<u>7,179</u>	<u>11,799</u>

**3.6. Other operating expenses**

	2003 TEUR	2002 TEUR
Other operating taxes	5,348	7,053
Miscellaneous	824,312	966,078
	<u>829,660</u>	<u>973,131</u>

Other operating expenses include losses of TEUR 71,447 (2002: TEUR 99,518) due to the retirement of long-lived assets.

**3.7. Income from equity investments**

This item includes a transfer of profit totaling TEUR 139,112 from Telekom Austria Personalmanagement GmbH (2002: TEUR 113,694) and a withdrawal of TEUR 346,012 (2002: TEUR 195,771) from mobilkom austria AG & Co KG.

**3.8. Income taxes**

	2003 TEUR	2002 TEUR
Corporate income tax	8,823	869
Corporate income tax, prior periods	16	47
	8,839	916

No deferred taxes were recorded in 2003.

The reversal of untaxed reserves totaling TEUR 3,289 leads to an income tax burden of TEUR 1,118 (without consideration of loss carry-forward).

**4. Other Information**
**Stock Options**

On October 4, 2000, the shareholders of Telekom Austria Aktiengesellschaft authorized the implementation of a stock option plan. Under this program the Company may grant a total of 2,152,257 options, each of which gives the recipient the choice of receiving either a cash payment equal to the difference between the average quoted closing price for Telekom Austria stock during the five trading days preceding exercise of the options and the initial public offering (IPO) price of EUR 9, or purchasing the stock at an exercise price of EUR 9 per share. One option is convertible into one share. The granted options may be exercised on specific dates between May 31, 2002 and February 27, 2004, if the average closing price of the shares during the last five days before exercise of the options exceeds the IPO price by 30% or more.

Allotment of the options:

Management board	
Heinz Sundt	145,344
Stefano Colombo	145,344
Rudolf Fischer	145,344
Boris Nemsic	145,344
Managers	1,570,881
Management board, Supervisory board and managers of affiliated companies	1,116,593

In order to service the stock option plan and also hedge the risk of a stock price increase, Telekom Austria Aktiengesellschaft purchased an American call option from Merrill Lynch. This option expires on February 27, 2004. In contrast to the options granted, this option may be exercised at any time, independent of the stock price.

The purchase price for the option was capitalized under marketable securities and valued as of the balance sheet date. An accrual was also recorded for personnel expenses in the same amount of TEUR 1,587 (2002: TEUR 2,878). This personnel expense will be recognized over the term of the stock option program. New options were neither granted nor exercised in 2003.

### **Authorization from the shareholders' meeting**

According to § 65 Par. 1 no. 8 of the Austrian Stock Corporation Act, the Management Board was authorized to acquire up to 50 million own bearer or registered shares with no par value, which represent up to 10% of the share capital at the time of passing the resolution. The acquisition must be carried out within a period of 18 months following the day of the resolution at a price ranging between EUR 9.00 and 15.00 per share. The Management Board is authorized

- a) to reduce the share capital of the Company by up to EUR 109,050,000.00 by retirement of these registered or bearer treasury shares with no par value without a further shareholder resolution (according to § 65 Par. 1 no. 8 last sentence in connection with § 192 of the Austrian Stock Corporation Act). The Supervisory Board is authorized to change the statutes in connection with the retirement of the treasury shares.
- b) to use the treasury shares to serve stock options to be granted to employees, managers and members of the Management Board of the Company or an affiliated company.

## 5. Members of the Management Board and Supervisory Board

### Management Board:

Heinz Sundt		(Chairman and Chief Executive Officer)
Stefano Colombo		(Vice-Chairman)
Rudolf Fischer		(COO Wireline)
Boris Nemsic		(COO Wireless)

### Supervisory Board:

Peter Michaelis		(Chairman of the Supervisory Board)
Edith Hlawati		(Deputy Chairwoman)
Hans Haider	since June 4, 2003	
Stephan Koren		
Harald Sommerer	since June 4, 2003	
Harald Stöber	since June 4, 2003	
Rainer Wieltzsch		
Otto G. Zich		
Wilhelm Eidenberger		
Kurt Friedl	since October 21, 2003	
Walter Hotz	since December 9, 2003	
Michael Kolek		
Gerhard Zeiler	until June 4, 2003	
Erich Huhndorf	until November 11, 2003	
Karl-Heinz Muik	until August 16, 2003	

Vienna, March 2004

The  
Management  
Board

Heinz Sundt

Stefano Colombo

Rudolf Fischer

Boris Nemsic

**Accounts receivable table**

amounts in TEUR	balance sheet value	maturity	
		up to 1 year	exceeding 1 year
1. Accounts receivable - trade	404.827	404.827	0
2. Accounts receivable - affiliated companies			
- prepayments	12	12	0
- trade	26.763	26.763	0
- financial	328.084	327.584	500
- other receivables and assets	202.095	202.095	0
	556.954	556.454	500
3. Accounts receivable - associated companies			
- prepayments	0	0	0
- trade	243	243	0
- financial	0	0	0
- other receivables and assets	0	0	0
	243	243	0
4. Other receivables and assets			
- financial	62.810	60.233	2.577
- others	22.008	21.943	65
	84.818	82.176	2.642
<b>Accounts receivable</b>	<b>1.046.842</b>	<b>1.043.700</b>	<b>3.142</b>

**Table of liabilities**

amounts in TEUR	balance sheet value	maturity		
		up to 1 year	1 - 5 years	exceeding 5 years
1. Bonds	151.871	3.255	148.616	0
2. Bank loans and overdrafts	1.512.043	417.591	1.080.281	14.171
3. Payments received in advance	1.285	1.285	0	0
4. Accounts payable - trade	262.676	262.398	277	1
5. Accounts payable - affiliated companies				
- payments received in advance	0	0	0	0
- trade	7.124	7.124	0	0
- financial	549.132	19.132	530.000	0
- others	279.410	219.296	60.114	0
	835.666	245.552	590.114	0
6. Accounts payable - associated companies				
- payments received in advance	0	0	0	0
- trade	5.542	5.542	0	0
- others	0	0	0	0
	5.542	5.542	0	0
7. Other liabilities				
- financial	215.124	215.124	0	0
- others	128.868	46.123	28.137	54.608
	343.992	261.247	28.137	54.608
<b>Accounts payable</b>	<b>3.113.075</b>	<b>1.196.870</b>	<b>1.847.425</b>	<b>68.780</b>

**Telekom Austria Aktiengesellschaft, Vienna**
**Appendix III/20**
**Table of fixed assets**
**Annex 3**

	Cost of acquisition				Dec 31, 2003	Accumulated Depreciation	Book Value		Depreciation Fiscal Year 2003
	Jan 1, 2003	Additions	Disposals	Changes			Dec 31, 2003	Dec 31, 2002	
	TEUR	TEUR	TEUR	TEUR	TEUR	TEUR	TEUR	TEUR	TEUR
<b>I. Intangible assets</b>									
1. Licenses, industrial property rights and similar rights	117.972	17.732	25.040	-685	109.979	66.346	43.633	47.246	19.453
2. Goodwill	7.124	0	235	0	6.889	6.301	588	2.722	1.980
	<b>125.096</b>	<b>17.732</b>	<b>25.275</b>	<b>-685</b>	<b>116.868</b>	<b>72.647</b>	<b>44.221</b>	<b>49.968</b>	<b>21.433</b>
<b>II. Property, plant and equipment</b>									
1. Land, similar rights and buildings including buildings on non-owned land	665.519	4.807	17.121	7.344	660.549	259.360	401.189	437.094	37.902
2. Technical plants and machinery	7.537.715	178.847	271.422	53.578	7.498.718	4.692.656	2.806.062	3.299.995	691.387
3. Other plants, furniture and fixtures	219.352	39.806	12.452	13.023	259.729	171.358	88.371	75.397	35.415
4. Assets under construction	85.894	37.047	23	-73.260	49.658	0	49.658	85.084	0
	<b>8.508.480</b>	<b>260.507</b>	<b>301.018</b>	<b>685</b>	<b>8.468.654</b>	<b>5.123.374</b>	<b>3.345.280</b>	<b>3.897.570</b>	<b>764.704</b>
<b>III. Financial assets</b>									
1. Investments in affiliated companies	1.547.813	30.878	238.846	1.109	1.340.954	1.892	1.339.062	1.323.769	1.023
2. Investments	15.094	1.883	5.399	-1.109	10.469	4.135	6.334	13.799	2.840
3. Securities	3.783	688	26	0	4.445	0	4.445	3.783	0
4. Other loans	168.986	5.256	62.314	0	111.928	33.780	78.148	143.093	16.292
	<b>1.735.676</b>	<b>38.705</b>	<b>306.585</b>	<b>0</b>	<b>1.467.796</b>	<b>39.807</b>	<b>1.427.989</b>	<b>1.484.444</b>	<b>20.155</b>
	<b>10.369.252</b>	<b>316.944</b>	<b>632.878</b>	<b>0</b>	<b>10.053.318</b>	<b>5.235.828</b>	<b>4.817.490</b>	<b>5.431.982</b>	<b>806.292</b>

## **Management Report Telekom Austria Aktiengesellschaft January 1 – December 31, 2003**

### **First signs of economic recovery**

Although economic growth in Austria slowed notably to 0.7% in 2003 after an increase of 1.4% in 2002, the signs of economic recovery grew stronger during the reporting year. Domestic demand rose by 1.1%, while exporters were faced with the appreciation of the euro versus the US dollar, particularly during the second half of the year. This exchange rate development had a positive impact on inflation, which fell from 1.8% in the prior year to 1.3% in 2003. According to calculations by Eurostat, the unemployment rate in Austria rose from 4.1% to 4.5% during the reporting year. With an average of 0.6%, GDP growth of the EU-15 was slightly below the Austrian figure.

### **Competition in Austria remains aggressive**

While recent years were characterized by changes of management in many telecommunications companies, 2003 was marked by extensive restructuring programs. Plans to improve efficiency and cut investments led to a substantial reduction in the debt accumulated during previous years.

Although Telekom Austria has an edge over similar companies in other countries in this consolidation process, steady competitive pressure requires ongoing efforts in this area. With a number of roughly 30 competitors, the market environment is among the most competitive in Europe. The resulting low price level for mobile communications has also triggered a shift in voice telephony from fixed line to mobile communications networks. In spite of this situation, Telekom Austria has been able to maintain its market position in nearly all business areas and, at the same time, improve profitability. Although a market shakeout is considered unavoidable, particularly in the wireless segment, it cannot be precisely forecasted.

### **Important regulatory decisions**

In order to meet European Union guidelines, a new telecommunications law was enacted in Austria last year. The most important change involves the definition of markets subject to sector specific regulation. Prior to this amendment, Austrian law recognized four distinct markets – fixed line, leased line, interconnection and mobile communications. The new classification identifies 18 separate markets. The impact of this change on Telekom Austria can only be estimated after the definition process of all submarkets, currently in process, has been completed.

In the wireline segment, the regulatory authority approved the discontinuation of the minimum tariff. Customers affected by this decision were transferred to the standard tariff with a higher monthly rental but lower traffic fees. They also had the opportunity to change to the lower priced TikTak tariff. Shortly before the end of the year Telekom Austria withdrew its resale offer covering access lines. This step had become necessary following the regulatory authority's rejection of Telekom Austria's request to introduce attractive new tariffs. Without these tariffs, aimed at offsetting the expected decline in revenues, Telekom Austria did not consider itself in a position to make the investment necessary to facilitate the resale of access lines.

### **Investments**

At the end of 2003 mobilkom austria AG & CO. KG is the most important investment of Telekom Austria AG.

The market entry of two new competitors made the Austrian mobile communications sector undoubtedly one of the most competitive in Europe. In spite of this development, mobilkom austria was able to record impressive subscriber growth of 5.4% and to defend its market leadership with a market share of 43.3%.

In Croatia VIPnet was able to benefit from the opportunities provided by higher market penetration, and recorded growth of 10.3% in the number of customers. The market environment in Slovenia is consistently difficult primarily due to regulatory framework conditions. Nevertheless, Si.mobil was able to increase the number of customers by 3.6%. The total number of wireless customers in the Telekom Austria Group rose by 6.4% to more than 4.7 million for the reporting year. In the reporting year, mobilkom austria recorded a net income of EUR 304.8 million.

In the course of the year, the stake in the Croatian company VIPnet GSM d.o.o was increased from 80% to 99%.

### **Development of results**

Business development in the wireline segment continued to stabilize throughout the reporting year. Despite a steady decline in voice minutes due to the migration of call volumes to mobile communications networks, the overall market share based on minutes including Internet dial-up slightly rose from 55.3% in the previous year to 55.6%.

In accordance with a ruling of the Austrian supreme court, Telekom Austria is no longer considered the primary obligor for value added services provided by third parties and ceased reporting revenues on a gross basis, beginning on October 1, 2003. The equal reduction of revenues and costs did not have an impact on operating income.

Net income amounted to EUR 306.6 million in the reporting year, whereas a net loss of EUR 92.8 million was reported for the previous year. Based on this positive development, the Management Board will recommend that the annual general meeting approve payment of the first dividend since the initial public offering of Telekom Austria AG in 2000, at EUR 0.13 per share. The remaining profit will be carried forward.

Income from disposal of financial assets includes a gain of EUR 18.4 million resulting from the sale of the 26% stake in Herold Business Data AG.

Additions to fixed assets amounted to EUR 316.9 million in 2003. Thereof additions to property, plant and equipment amounted to EUR 260.5 million and concerned mainly investments in the core network, the major component of expenditures involved demand-related capacity adjustments and network optimization.

On June 30, 2003 Telekom Austria Finanzmanagement GmbH, a 100% subsidiary of Telekom Austria, initiated a EUR 2.5 billion "Euro Medium Term Note (EMTN) Program". Within the framework of this program, the first euro bond was issued on July 10, 2003 with a nominal value of EUR 750 million, a ten-year maturity and a coupon of 5.00%. The issue was rated BAA2 by Moody's and BBB by Standard & Poor's.

### **Number of employees**

At the end of 2003, Telekom Austria AG had 2,458 employees (2002: 2,282) none of which were civil servants. The number of employees increased by 176 compared to the previous year because of the ongoing transfer of employees from Telekom Austria Personalmanagement GmbH to Telekom Austria AG.

### **Research and Development**

A key element of the wireline business strategy is represented by technology and innovation leadership. Telekom Austria's R&D activities are focused on improving customer convenience. In this regard, important progress was made in the use of the broadband network, particularly for TV broadcasting services. The Company's wide-ranging network of research partnerships plays a fundamental role in the successful achievement of its R&D objectives.

In 2003 Telekom Austria AG spent TEUR 31.100 on research and development, which is an increase of 23% compared to the previous year.

## Outlook

In the wireline segment, the migration of voice minutes to mobile networks is expected to carry on throughout 2004. For this reason, it is anticipated that revenues will show a slight but slower decline in spite of the dynamic growth in broadband access lines. However, operational profitability is expected to rise, which shall enable Telekom Austria to further increase the dividend.

Cash flow is expected to remain positive because of continued restraint on investments as well as the strong earning power. The development of net debt will depend on the realization of possible expansion steps as well as the repurchase of stocks authorized by the last annual general meeting.

## Major subsequent events

On January 21, 2004 Telecom Italia International N.V sold its remaining stake of 73.9 million shares, or 14.78% of common stock, in Telekom Austria through a private placement to institutional investors. This transaction increased the percentage of Telekom Austria's free float to 52.8%. The remaining shares are held by ÖIAG (Republic of Austria). ÖIAG and Telekom Austria have concluded lock up agreements covering the sale and issue of Telekom Austria shares, which are valid through May 31, 2004.

On February 20, 2004 Telekom Austria announced its decision to exercise 3,326,881 American call options acquired in 2000. On March 3, 2004, Telekom Austria acquired treasury shares representing 0.67% of common stock by means of an over-the-counter transaction at a price of EUR 9 each.

The treasury shares shall be used to fulfill obligations from current and future stock option programs. The transaction takes place for the first time by exercising the authorization to buy back up to 50 million shares, which was granted by the Annual General Meeting on June 4, 2003.

Within the scope of the IPO a stock option program was initiated for the Management Board and a number of managers of Telekom Austria AG. As the performance hurdle was met at the end of February 2004, 61 participants in the stock option program are entitled to exercise up to 2,152,257 options or to demand a cash settlement in the amount of EUR 2.7 per option.

**Auditor's Report**

We have audited the **financial statements** which have been set up in accordance with the Austrian Commercial Code as of **December 31, 2003** of

**Telekom Austria Aktiengesellschaft,  
Vienna, Austria.**

These financial statements are the responsibility of the Company's Management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with Austrian GAAS. 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 audit provides a reasonable basis for our opinion.

After completion of our audit we render the following unqualified **opinion** according to § 274 (1) HGB (Austrian Commercial Code):

"As the result of our due audit we can certify that the accounting records and the financial statements comply with the legal regulations. The financial statements give a true and fair view of the Company's assets, liabilities, financial position and profit or loss in conformity with generally accepted accounting principles. The Management Report corresponds with the financial statements."

Vienna, March 9, 2004

*KPMG Alpen-Treuhand GmbH  
Wirtschaftsprüfungs- und Steuerberatungsgesellschaft*

Mag. Michael Schlenk                      Mag. Helmut Kerschbaumer  
Austrian Chartered Accountants

## Report of the Supervisory Board

Dear Ladies and Gentlemen,

Telekom Austria can look back on a successful year in 2003. Steady pursuit of the company's value-enhancing strategy is reflected by the favorable development of financial results, which will allow a dividend payment for the first time. Capital markets also acknowledged the efforts of the Telekom Austria Group to improve earnings with an increase in the share price following the complete withdrawal of Telecom Italia in January 2004.

The activities of the Supervisory Board in 2003 were concentrated on an intensive strategic dialogue with the Management Board as well as important changes in the area of corporate governance. The new election of the Supervisory Board at last year's Annual General Meeting further strengthened the transformation of this body into a panel of experts. The reelection of five members, including the Chairing Committee and the Chairman of the Financial Committee, will guarantee the necessary continuity.

The business development of the Telekom Austria Group was discussed extensively during seven meetings of the Supervisory Board, three meetings of the Financial Committee and one meeting of the Audit Committee. Furthermore, the progress of key strategic projects as well as the efficiency of risk management and internal control systems were also monitored.

The strategic orientation of the group was discussed in detail together with the Management Board at a strategy workshop in May 2003. The Supervisory Board fully supports the strategic positioning of the Telekom Austria Group and, above all, sees an exceptional opportunity in the value-oriented expansion strategy of the wireless segment. Two meetings of the Supervisory Board were dedicated to the general growth potential of the mobile communications market in southeastern Europe and, in particular, to a possible expansion project in Bulgaria. The group's strategy is also reflected in the budget for 2004 and business plan for 2004 - 2007, which were both approved at the Supervisory Board meeting in December 2003.

The successful placement of a corporate bond to extend the maturity profile of financial liabilities was monitored on a regular basis by the Supervisory Board and the Financial Committee. This corporate bond, the largest ever issued in Austria to date, will not only safeguard the economic flexibility of the Telekom Austria Group, but also provide a sound financial base for the successful implementation of the group's strategy.

The Supervisory Board of Telekom Austria is highly committed to compliance with the Austrian Corporate Governance Code and to responsible company management and control aimed at creating sustainable value. Telekom Austria is also subject to US capital market regulations because of its listing on the New York Stock Exchange. American corporate governance rules were amended through far-reaching changes as a result of the Sarbanes-Oxley Act, which was enacted to strengthen investor confidence. Most of the implementation rules for foreign issuers were only enacted during the course of 2003, and the Management Board will therefore only be able to issue a declaration of compliance with the Austrian Corporate Governance Code this year.

The heart of US reforms in the field of corporate governance is formed by the strengthening of the audit committee to monitor the correctness of financial reporting. Long before the requirements of the Sarbanes-Oxley Act took effect, the Supervisory Board of Telekom Austria equipped the Financial Committee with the powers of an audit committee and issued special rules of procedure for this body.

In its constitutive meeting the Audit Committee approved the scope of all audit and non-audit services to be performed by the group's auditors for the years 2003 and 2004, and thereby made an important contribution to overseeing the independence of the auditing firm. Strict, standardized reporting requirements for the auditor in dealing with the Audit Committee meet US capital market regulations. They also improve the transparency and quality of discussions by this body on the annual financial statements of Telekom Austria and consolidated financial statements for 2003.

The annual financial statements of Telekom Austria AG and consolidated financial statements were audited by KPMG Alpen-Treuhand GmbH Wirtschaftsprüfungs- und Steuerberatungsgesellschaft and awarded unqualified opinions. The management report and group management report are consistent with the annual financial statements and consolidated financial statements.

The Supervisory Board approved the annual financial statements for 2003 after extensive discussions and examination in accordance with § 125 Par. 2 of the Austrian Stock Corporation Act. Furthermore, the Supervisory Board approved the consolidated financial statements, which were prepared in accordance with § 245 a of the Austrian Commercial Code pursuant to U.S. GAAP, as well as the reconciliation report that was prepared in accordance with § 245 a of the Austrian Commercial Code, the management report and the group management report.

The Supervisory Board agreed with the recommendation made by the Management Board to pay EUR 0.13 per each share that is entitled to a dividend and carry forward the remaining amount.

In conclusion I would like to express my appreciation to the management and employees of the Telekom Austria Group, whose performance and innovative power played an important role in the development of the company. I would also like to thank all Telekom Austria customers and shareholders for their confidence and support. Please remain with the company on its successful journey into the future.

Peter Michaelis  
Chairman of the Supervisory Board  
Vienna, March 2004