



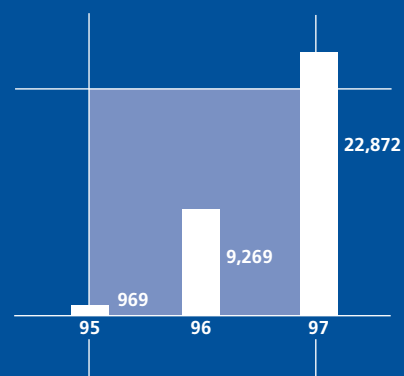
Annual Report
1997



KEY DATA FOR THE 1&1 GROUP

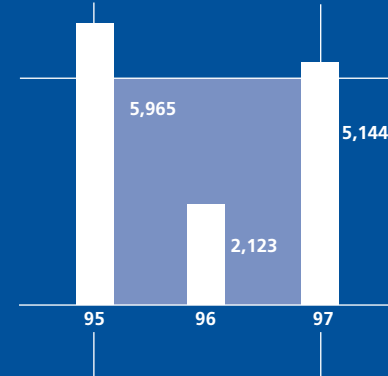
		1995	1996	1997
Result				
Turnover	DM '000	159,139	157,357	135,510
– Merchandise turnover	DM '000	72,813	54,938	29,735
– Turnover excluding merchandise	DM '000	86,326	102,419	105,775
Result from operating operations	DM '000	10,838	3,944	13,857
Net income	DM '000	6,522	2,282	7,775
Balance sheet				
Fixed assets	DM '000	6,234	12,046	24,309
Current assets	DM '000	36,563	44,337	43,566
Equity	DM '000	3,625	6,348	10,822
Balance sheet total	DM '000	59,002	56,735	68,867
Capital investments				
Investment volume	DM '000	5,202	6,450	14,119
Marketing programmes	DM '000	2,856	3,304	2,856
Internet value-enhanced applications	DM '000	11	490	10,857
Miscellaneous	DM '000	2,335	2,656	406
Employees (31,12,)				
Full-time employees	Total	373	439	530
Part-time employees	Total	140	194	200
Personnel costs	DM '000	22,178	31,120	32,548

Cash Flow acc. to US-GAAP
(in DM '000)



(For calculation of cash flow, see the flow of funds analysis on Page 48/49)

Result acc. to DVFA/SG
(in DM '000)



OUR VISION

„Our task is to be a reliable link between providers and customers in the fastest-moving and most dynamic of all markets. And our vision is to become the number one in this sector!“

1&1 is Germany's leading marketing specialist in the IT and telecommunication market. Our expertise ranges from hardware and software, through the Internet, to telephony.

The principle underlying our approach could be summarised by the slogan „Fastest is best“. The crucial factor behind our success is our flexibility and speed in a market that is changing at a breathtaking pace. We have the skills to develop new products very rapidly, and are regularly bringing innovations onto the market.

We fully embrace the spirit of enterprise, and are prepared to take risks if we believe that they are justified above all by the potential long-term benefits and not just the prospect of short-term gains.

We believe a forward-looking market attitude is more important than short-term profits. Growth in earnings takes priority over impressive turnover figures.

Above all, we strive to work hand in hand with our customers. Their success is our success.

We have created a good working atmosphere with flat hierarchies and open structures.

We allow our employees to participate in the success of the company.

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LADIES AND GENTLEMEN,

This is the first Annual Report to be published by 1&1 Holding GmbH, which was transferred to 1&1 Aktiengesellschaft & Co. KGaA in January 1998. Since its founding in 1988, 1&1 has developed into one of Germany's leading marketing services companies on the strength of its successful marketing, service and sales concepts.

Last year, we made all the necessary preparations for „going public“. We were able to boost profits significantly and regained the strength of earlier years, demonstrating that the poor result for 1996 was merely a temporary reversal.

The process of surrendering loss-making operations, which commenced mid-way through 1996, was finally completed at the start of last year. We are now concentrating our commercial business exclusively on profitable activities.

Our success in 1997 is due in no small measure to the booming service sector. Our traditional line of business, the marketing of electronic subscriptions, developed healthily. The specialist hotline service for companies in the IT and telecommunications industry was able to sign up a large number of customers. And we made a successful entry into the electronic bank accounts market: we were able to forge a partnership with Bank 24 AG, one of the pioneers of Internet banking and a leading German direct banking company.

At the same time, we launched the new segment of Internet value-enhanced applications:

- Our own Internet service was started, and within a very short space of time, it demonstrated its superior qualities in numerous consumer tests, e.g. earning the distinction of „Best for Quality“ in a comparison of leading services conducted by the magazine „Computerbild“.
- The advertising network AdLink, launched in 1996, was positioned in the market.

- Preparations were made for the creation of the Zweibrücken Multi-Media Internet Park. This support centre for young Internet companies was opened in January 1998.
 - Preparations were made for the establishment of our equity investment company, 1&1 Beteiligungsgen GmbH & Co. KG. It commenced business in January 1998.
- Through these measures we have paved the way for success in this rapidly expanding segment.

To provide a clearer picture of our wide-ranging activities we have prepared the balance sheet in this Annual Report according to two methods: the US-GAAP international standard and the German Commercial Code (HGB).

We are taking another major step this year by going public. What are the reasons behind this decision?

- Until now, we have financed our growth from our own resources. Our desire to expand now dictates that we broaden our capital base: in addition to promoting the growth of our current activities, we are planning to step up our level of involvement in promising Internet and multi-media companies in the near future.
- A further consideration is that we will then be able to expand our activities on an international scale. By floating the company we will be able to secure sufficient capital for these plans and make suitable acquisitions as the opportunity arises.
- By being quoted on the stock exchange we will have better scope for enabling our management and employees to participate directly in our entrepreneurial success. We will be giving about 19,000 shares to our employees and introducing a share option plan for management personnel.

The success story of 1&1 is closely linked to the people who have built up the company. We have therefore opted for the corporate form of a commercial partnership limited by shares (KGaA), as this modern legal structure will preserve our motivation to manage the company successfully for many years to come. Our management's involvement thus becomes a long-term measure, and we will be able to continue making decisions rapidly and flexibly - one of the most crucial success factors in our volatile line of business.

We relish the prospect of steering the company towards an even brighter future through our diverse partnerships.

With best wishes,

Ralph Dommermuth

Michael Scheeren

1 & 1 AND ITS MARKETS

Modern information technology and telecommunications have created sustained economic growth.

1&1 is active in the principal markets of the future through its partnership with major companies such as Bank 24, Compaq, Deutsche Telekom, Deutsche Messe AG, Microsoft and Talkline, over 1,000 mid-size companies from the IT industry, around 2,500 companies and institutions for which 1&1 provides support for online marketing, and its base of 1=2E2 million direct customers:

- We market around 300,000 electronic subscriptions each year for Internet access, Internet banking, mobile communications and ISDN. We have, for example, been the leading marketing partner for T-Online for many years.
- We are investing in the development of our own Internet service provider for this major growth market; in conjunction with various companies and institutions, it offers loyalty schemes such as the „electronic customer journal“.
- We are starting to market our Internet advertising network on a large scale.
- We are obtaining participating interests in companies which offer Internet value-enhanced services.
- We are the market leader for co-operative marketing systems for companies in the IT industry.
- Our call centre in Dortmund, which operates hotline services for more than 20 leading suppliers to the IT and telecommunications sector, is the market leader in Germany.

The prospects for growth in our principal markets are excellent:

Internet-access

Germany is the largest market for online services in Europe, with some 5 million users. The market researchers MediaGruppe München estimate that the total Internet turnover (fees, commercial transactions, software and service) will rise from the present level of DM 300 million to DM 1.2 billion by the year 2000. This is more than one-quarter of the Internet turnover in Europe.

In Germany, the three biggest online services together have more than 2.6 million subscribers. T-Online is the market leader with around 2 million connections, followed by AOL, a subsidiary of the American-based world's largest online service America Online and Bertelsmann, with around 400,000 subscribers, and the provider CompuServe, which was taken over by America Online in 1997.

The evolution of „online communities“ with low-price Internet access is a new market trend. The principal users are companies and institutions which are striving to loyalise and activate customers through electronic contact schemes.

Electronic banking

The number of online accounts almost doubled in 1997: 3.5 million (1996: 1.8 million) of some 80 million accounts in Germany are already handled via T-Online. The management consultants Booz, Allen & Hamilton estimate that 16 percent of all customers will perform their financial transactions online by the year 2000. The key factor behind this growth will be the increasing availability of home banking on the Internet, now that new systems are able to assure the security of such transactions. Some 100,000 accounts are already managed directly via the Internet.

Electronic commerce

In 1997, German companies and service providers sold goods to the value of more than DM 900 million via the Internet and other data networks. The Federation of German Internet Businesses (Eco) anticipates that this business volume will treble to DM 2.7 billion in 1998. Its target is around DM 40 billion turnover from electronic commerce in five years' time, 95 percent of which will pass via the Internet.

The International Data Corporation (IDC) forecasts that Internet commerce will expand to \$US 220 billion by 2001. This would be equivalent to almost one percent of global economic volume and over 20 times the anticipated figure for 1997 of \$US 10.6 billion. Digital money should be in circulation worldwide by 2001, and it should be possible to transfer confidential data via secure networks. Direct inter-company transactions are also likely to increase, according to the IDC: in 1997, spending by companies on the Web outstripped spending by private online shoppers.

Electronic advertising (Internet advertising)

The Internet has now become an established channel of communication for most German companies. Research findings indicate that more than half of all large companies have set up their own Internet website. Nearly two-thirds of the remaining companies are planning to promote themselves on the Internet. It is estimated that Germany's ten largest sectors of industry alone will be investing some DM 2 billion in their Internet presence over the next five years.

Advertising is needed - above all on the Internet itself - to attract visitors to special Internet websites.

Although Germany's online advertising turnover for 1997 totalled only DM 20 million, in a survey conducted by Forsa more than three-quarters of those companies interviewed expect that this sector will be significantly more important in five years' time. Total advertising spending in Germany is over DM 20 billion per year.

Call centres

Many companies already use call centres. The German Direct Marketing Federation estimates that expenditure for customer telephones rose from DM 1.5 billion in 1988 to DM 3.7 billion in 1996. The federation expects this spending to increase by 25 percent in 1997.

According to a study by Gemini Consulting, the number of jobs in call centres will rise to 140,000 over the next four years. In 1995, the number of people employed at such telephone centres was a mere 30,000. Call centres handle thousands of incoming customer calls and orders each day, including outside normal business hours. There are around 1,000 call centres in Germany.

More and more companies are contracting out their hotlines and service numbers to call centres, which often provide a better quality of telephone service and are able to cope more easily with peak demand through well-balanced client mixes and rational human resources management. These call centres are specialising increasingly in certain sectors and areas.

Voice services

Germany's telecommunications market was completely liberalised on January 1, 1998. Around three dozen new telephone companies are now competing with the former monopolist Deutsche Telekom for the landline network. Prices of long-distance calls in particular are set to fall. Some companies are offering savings of over 40 percent. By the end of 1998, private competitors will have secured a 10 percent slice of the market for landline networks, and experts estimate that this share will reach 30 percent by 2005. The overall market volume will simultaneously grow by six percent.

The German mobile communications sector is booming, with almost 200,000 new subscribers per month. In the course of 1997, the number of mobile phone users in Germany leaped from 5.5 to about 8 million. Around 15 to 17 million mobile phones are expected to be in use by 2000.

OUR CUSTOMERS

Long-standing partnerships

We gauge customer satisfaction both on the basis of individual discussions and by conducting regular, systematic surveys

are one of the principal factors

among our customers. The findings are resoundingly positive.

behind our success.

For example, 94 percent of 1&1 Direkt GmbH's customers

would recommend 1&1 to friends and acquaintances.

MANAGEMENT REPORT

General economic situation

The upturn in the global economy continued in 1997. Production and demand grew in almost all industrialised nations. With inflation held in check, long-term interest rates also remained low.

Exports were the driving force behind economic buoyancy in Western Europe. The marked depreciation of almost all European currencies made products from these countries more able to compete in the international marketplace.

Economic progress by the Federal Republic of Germany in 1997 was satisfactory. Real gross domestic product rose by 2.3 percent compared with 1996.

Foreign trade made the biggest contribution to economic growth, with German exports which were raised by 10 percent. Exports were bolstered by the loss in value of the German Mark, particularly against the US Dollar.

Despite more intensive utilisation of industrial capacity, unemployment remained high. Most companies were evidently merely making fuller use of capacity already available. Private consumption was unable to stimulate growth.

Although the prices of imported goods rose in various European countries, the development in consumer prices did hardly give cause for concern.

The situation in the information technology and telecommunications sector

In 1997, the overall volume of the information & telecommunications market increased by some 8 percent to just over DM 180 billion. Information technology, which comprises the hardware, software and services markets, accounted for slightly less than half of this total turnover. The turnover for this sector is in the order of DM 80 billion. Every German spent an average of almost DM 1,000 on information technology last year.

Information technology and telecommunications generated sales revenue of more than DM 2,000 billion worldwide. The USA accounts for 35 percent of the global market, Europe for 30 percent and Japan for 15 percent. Within Europe, Germany is the largest sales market. Annual growth rates are running at more than 5 percent.

Development in turnover and result for the 1&1 Group

We achieved our targets in 1997. On the strength of our online expertise in videotex business (Btx Plus, videotex provider recruitment resourcing, decoder development, etc.), we were rapidly able to build up the new Internet Value-Enhanced Applications Division. It already has four key business areas: its own Internet service, the advertising network AdLink, the Zweibrücken Multi-Media Internet Park and 1&1 Beteiligungen GmbH & Co. KG (since January 1998). We have consequently branched out into a new, highly promising line of business.

The structural adjustments to our commercial business, which have been under way since mid-1996, accounted for the fall in the turnover of DM 25.2 million in 1997: the merchandise turnover for the entire Group fell from DM 72.8 million in 1995 to DM 54.9 million in 1996, and then to DM 29.7 million last year.

The continuing expansion of the services division, for which the turnover was up by DM 3.3 million (increase of 3.2 percent), was not able to compensate for this loss. Our overall turnover fell on balance by 13.9 percent, from DM 157.4 million to DM 135.5 million. The higher result for the 1&1 Group nevertheless surpassed our expectations by trebling in 1997. With a reported annual net profit after taxes of DM 7.8 (previous year: 2.2) million, we have re-established the pattern of positive results of previous years.

Our improved costs structure benefited the result for regular business activities of DM 13.8 (1996: 3.9) million; the cost of materials ratio in particular was reduced.

Our most important field of business, marketing programmes, yielded a result before taxes of DM 17.0 million. This result was encumbered by the capital investments in Internet value-enhanced applications to the tune of DM 10.9 million. After deduction of revenue and other costs, we recorded a loss of DM 2.4 million for this division

The income tax ratio rose slightly to 43.1 percent (previous year 40.5 percent). This increase was due to the higher trade tax levied on our Dortmund site.

The equity return of 111.1 percent was almost double the figure for the previous year (57.05 percent).

The progress of our individual subsidiaries was as follows:

1&1 Direkt GmbH: restructuring prompts a quantum leap in the result

The restructuring measures which we initiated in mid-1996 focused primarily on 1&1 Direkt, which specialises in the direct sale of multimedia products and electronic subscriptions.

By early 1997 we had surrendered a major portion of our commercial business. Our products - above all modems and ISDN components - were listed by retailers such as the computer discount outlet Vobis, the specialist retail chains Media-Markt and Saturn, and Karstadt department stores. This merchandise was to be sold together with T-Online and ISDN connections. However, the implementation of the concept proved highly problematic. Considerable numbers of our products were sold without the corresponding connection, with the result that this line of business was not profitable due to the absence of commission payments.

We also discontinued the marketing of CD-ROMs by mail order, as this activity was generating insufficient revenue.

The surrendering of loss-making business prompted a quantum leap in the result for 1&1 Direkt. The company secured around 180,000 new contracts for electronic subscriptions.

One of our main business areas is the placing of connections for T-Online, the largest online service in Europe with over 1.9 million customers. 1&1 is the largest marketing partner of this service. We are likewise one of the largest marketing partners for the procurement of new ISDN customers for Deutsche Telekom AG.

In February, we concluded (via 1&1 Telekommunikation GmbH) a new contract for the marketing of T-Online as of July 1, 1998, the terms of which do not yet take account of the volume of new customers which we have

scheduled. It has been agreed in writing, for example, that this aspect is to be negotiated shortly.

The consumer advertising campaign for Bank 24 AG, a direct banking subsidiary of Deutsche Bank AG, was successfully launched last year. Our concept of offering the account in conjunction with an Internet connection provided by 1&1 Internet GmbH & Co. KG attracted thousands of new customers. Internet access is available nationwide for the cost of a local call; two hours per month are free of charge and each additional hour costs DM 4.20.

At the end of 1997 we successfully tested the marketing of mobile communications contracts for our new partner Talkline and the D 2 mobile communications network.

The total number of 1&1 „pro-sellers“ has now risen to around 8,000. Pro-sellers are part-time agents who receive discounts on hardware and software (generally five percent) by way of a retainer, commission for the placement of telecommunication connections and bonus points for specified articles. They receive back-up from a special pro-seller team at 1&1's headquarters in Montabaur, in the form of advance information, newsletters, brochures and sales training courses.

We completely redesigned our online shop in 1997, and the number of visitors is steadily increasing. In December, it recorded around 17,000 visitors.

1&1 ServiceLine GmbH: turnover boosted by new customers

Business for our call centre, geared to the needs of the IT and telecommunication industry, flourished last year.

In 1997, several new clients were won, including such leading names as Borland, Corel, Epson and Microsoft. Further prominent companies who are among our clients are Compaq, CompuServe, Deutsche Telekom Online Service GmbH, Lexmark, Leitz, Lotus and Sharp.

With a portfolio of more than 20 clients, 1&1 ServiceLine moved into pole position as Germany's market leader among call centre service providers for IT and telecommunication users.

1&1 Internet GmbH & Co. KG: creating an Internet service

1&1 Internet established its own Internet service last year, based on the high-performance IP backbone of Deutsche Telekom AG that can be dialled nationwide for the cost of a local call.

Via the 1&1 Internet.plus service, our subsidiary creates online communities on the basis of attractively-priced, high-performance Internet access. Our partners in this venture are companies and institutions: thanks to a modular system, each company can offer individual Internet services with the aim of loyalising customers or members, and maintaining dialogue with them. The range of modules available

also includes games, chat, forums, news groups, news tickers, link searches and personal home-pages.

We have already signed up Bank 24 AG and ratiopharm GmbH as our first partners for this novel concept.

Also in 1997, we launched the online community PlusWorld, a premium service financed by micropayments (7 Pfennigs per minute); this service enables newcomers to T-Online to find their bearings with ease.

1&1 Marketing GmbH: successful Internet Park

1&1 Marketing GmbH has expanded its range of cooperative marketing services for medium-size companies.

Our main product innovation was the special Internet Park exhibition which we successfully tested at the CeBIT Home exhibition in autumn 1996. 53 companies presented their Internet-related services at CeBIT 1997. The number of registrations for the Internet Park at CeBIT 1998 has almost doubled.

Our special exhibition of software developed by small and medium-size businesses, a long-established feature at this trade fair, was again a sell-out in 1997. As in the previous year, almost 300 exhibitors opted for this means of promoting their software.

The number of customers for the software mart, a magazine supplement published jointly by medium-size software suppliers, rose from 724 to 806, making it the largest software mart since the emergence of this form of exchange back in 1988. Demand for advertising space in our CeBIT SPECIAL magazine supplement was also high; 51 exhibitors took this opportunity to present their products in this publication, in the run-up to the largest IT trade fair in the world. This supplement has been published jointly by 1&1 and Deutsche Messe AG since 1991.

1&1 Online Dialog GmbH:

concentrating on electronic advertising

1&1 Online Dialog has stepped up its electronic advertising since its introduction in 1996. The core service is the Internet advertising network AdLink, which offers the targeted placement of advertising banners on Internet sites. The most important new development in 1997 was the launching of a novel AdServer technology which uses dynamic superimposition instead of the conventional static form. Advertising banners are now inserted according to the individual user profile, and are no longer tied to a particular carrier page.

Another activity of 1&1 Online Dialog was the marketing of T-Online and ISDN on the basis of affinity programmes. Around 2,500 institutions and companies, most of them banks and savings banks, are our partners for this cooperative venture. In 1998 we intend to market further products in these segments. We therefore took the decision to transfer this line of business to 1&1 Telekommunikation GmbH on January 1, 1998, and the latter subsidiary will in future be responsible for supplying a wide range of telecommunication products to companies, associations and federations for customer/member loyalty enhancement measures.

1&1 Telekommunikation GmbH:

branching out into affinity programmes

1&1 Telekommunikation GmbH took charge of certain tasks in resourcing videotex providers on behalf of Deutsche Telekom AG in 1993, and the development and operation of its premium videotex service Btx plus in 1995. Now that videotex has been incorporated into T-Online and positioned closer to the Internet, these services are no longer required. In agreement with Deutsche Telekom AG, these activities were terminated early in 1997. The members of staff in sales, marketing, the computer centre and of the editorial staff have been transferred to other subsidiaries with an Internet emphasis.

Since January 1, 1998 we have been using the residual corporate shell to extend our affinity programmes (hitherto an activity of 1&1 Online Dialog GmbH). 1&1 Online Dialog now concentrates entirely on electronic advertising.

1&1 Multimedia Service GmbH:

Zweibrücken Multi-Media Internet Park opens its doors

1&1 Multimedia Service, established in 1997, devoted its first year to preparing the launch of the Zweibrücken Multi-Media Internet Park, which is being set up on a former US air base in conjunction with Rheinland-Pfalz.

The Internet market is increasingly being shaped by small, innovative companies offering niche products. These companies are young or experiencing a phase of Internet-led expansion, but are often lacking in financial capacity and business administration expertise. The Multi-Media Internet Park will be able to offer them financial assistance, advice and active support.

Capital investments in the Multi-Media Internet Park, which opened according to schedule in January 1998, led to an initial loss of DM 611 thousand. Rheinland-Pfalz intends to subsidise this project to the tune of some DM 35 million over the first five years.

1&1 Multimedia Service will act as scout for 1&1 Beteiligungen GmbH & Co. KG, which will invest in multi-media and Internet companies. This form of participation enables us to exploit market opportunities without assuming direct responsibility for the management of such

companies, thus strengthening our own range of services.

1&1 Beteiligungen GmbH & Co. KG: *investing in multi-media and Internet companies*

In 1994, we established the Karlsruhe-based company FUN Kommunikationssysteme GmbH, in which we hold a stake of one-third, together with Johannes Feulner and Klaus Nahr. This software company, with around 20 employees, boosted its turnover appreciably in 1997. The company concentrates on the further development of T-Online software, creates payment systems for the Internet and develops home banking products for corporate finance partners.

This participatory concept has proven so successful that we founded 1&1 Beteiligungen GmbH & Co. KG together with Kurt Dobitsch (holding: 40 percent) at the start of 1998 and intend to transfer our stake in FUN to the new company. Our new holding company acquires participating interests in companies from the multi-media/Internet sector. We expect to obtain a minority interest in at least four more companies in the course of 1998.

Cash flow

The cash flow of the 1&1 Group according to US-GAAP rose by 146.71 percent to DM 22.9 million. The rate of return on cash flow (cash flow / sales revenues) increased to 16.9 percent in the year under review (previous year 5.9 percent). The expansion of Internet value-enhanced applications was the focal point of investment activity in 1997. It was financed from available funds and current cash flow. The net level of debt fell.

Balance sheet structure

As a result of investment in Internet expansion, the balance sheet total rose by 21.3 percent to DM 68.9 million. On the assets side, the main effect of this investment is that the figure for property, plant and equipment is considerably higher. Fixed and financial assets rose to 35.3 percent of the balance sheet total (1996: 21.2 percent).

Despite the higher balance sheet total, our equity ratio moved up to 15.7 percent (previous year 11.1 percent). This development is attributable to the increase in capital surplus and the reserve for own shares, together with higher retained earnings. Despite the capital investments made, liabilities fell by 15.4 percent to DM 33.5 million.

Capital investments and financing

The 1&1 Group invested a total of DM 14.1 million in the year under review, compared with DM 6.4 million in the previous year. Capital investments were consequently equivalent to 10.4 percent of the turnover. Our strategic

objective of developing Internet value-enhanced applications necessitated high investment in property, plant and equipment, such as the computer centre in Montabaur. A total of DM 10.8 million was dedicated to Internet value-enhanced applications, and DM 2.8 million to marketing programmes.

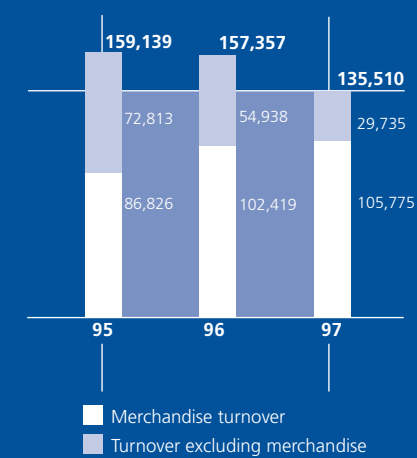
Outlook

Export-oriented sectors are anticipating a significant rise in production in 1998 and will therefore continue to underpin the German economy. Economic researchers predict that the gross domestic product will achieve growth in excess of 2 percent.

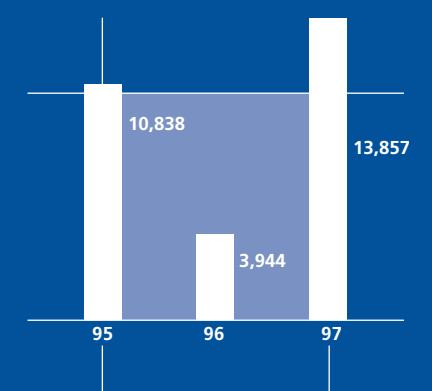
1&1's turnover and result for 1998 will probably rise at rates much faster than the average. In accordance with the US-GAAP recommendations, we have divided our Group companies into two categories: the companies involved in Marketing programmes will continue to record a profit in 1998. In the field of Internet value-enhanced applications, we will once again invest a large portion of the operating result in order to compensate for startup losses. We are in addition acquiring a participatory interest in promising companies. Funds from the initial public offering of our company's shares will in addition be used to provide financial cover for these investments.

1&1 Group

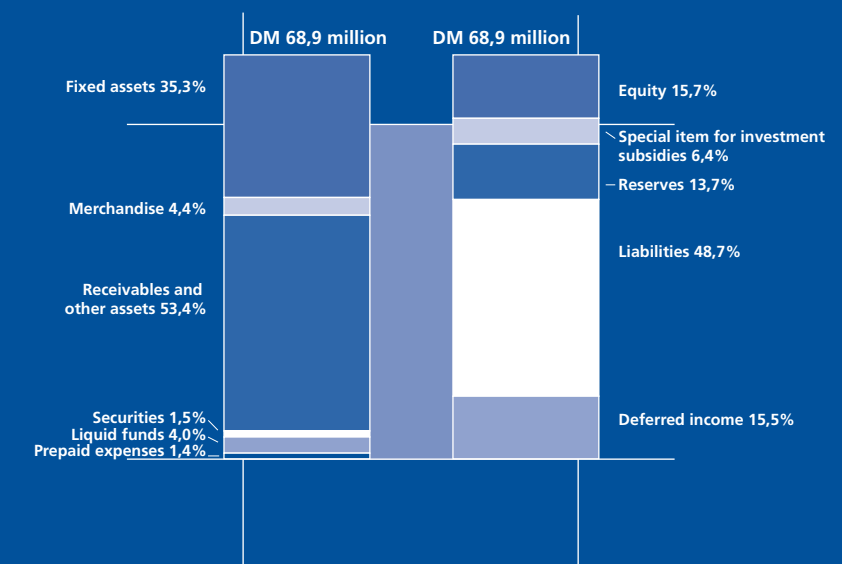
Development in turnover
(in DM '000)



Result from ordinary operations
(in DM '000)



Balance sheet structure, 1997



OUR EMPLOYEES

Group personnel costs rose from DM 31.1 million to DM 32.5 million. Last year, the total number of our employees continued its upward trend, rising from 644 to 751. The number of full-time employees for the group as a whole was up from 438 to 530, and the number of part-time employees rose from 187 to 200.

Personnel development

In 1997, we introduced appraisals by subordinates as a personnel development tool. This measure joins a large number of management tools that we have been deploying for some time: we use management and target agreements throughout the company, and conducted a round of appraisals company-wide for the first time in 1996.

We carried out an employee survey in October 1997. The emphasis of this survey was on our corporate image, our management principles and various general aspects of everyday life at the company. The findings of this anonymous survey were analysed according to subsidiary. One of the most outstanding statistics was that over 85 percent rate the working atmosphere in their department as „good“ or „very good“.

Our staff newspaper „MaZ“, produced by the employees themselves, is a further reflection of their strong commitment. Several editions a year are published.

Further training

Last year, we held training courses on telephone marketing, relations with business associates, sales, rhetoric and presentation techniques for a wide variety of teams. We organised an assessment centre for junior management

on strengths and weaknesses in working together. New managerial staff attended a three-day seminar on the basics of management at 1&1.

Trainees and apprentices

In October 1997, we recruited six graduates for a one-year trainee programme. These trainees are assigned to selected subsidiaries for two to three months, working in the fields of product management, marketing, advertising and sales. This practice-oriented scheme also includes training units on sales, rhetoric, presentations and an assessment centre at the end of the course. We have been running such trainee programmes since February 1996. All trainees to date have been taken on as permanent staff.

At the end of 1997 we employed a total of 18 apprentices, who are receiving vocational training as office, advertising, data processing and information and telecommunication systems clerks, and information technologists specialising in applications development. In order to give apprentices a broad spectrum of experience, they are assigned to between seven and ten different departments in the course of their training. We are regularly in a position to offer these young people permanent employment upon completion of their training.

OUR MANAGEMENT PRINCIPLES

Our management personnel are responsible for their staff.

We will address each other openly and equitably.

We will make assessments based on results.

We will define our objectives together.

We will support our employees.

We will coordinate decisions.

We will delegate and accept responsibility.

We will keep each other informed.

We will solve conflicts together.

Annual Financial Statements according
to German Commercial Code (HGB)

CONSOLIDATED

AND SINGLE

*1&1 Holding GmbH,
Montabaur, Germany*

FINANCIAL STATEMENTS

AS OF DECEMBER 31,

1997 AND 1996

Annual Financial Statements acc. to HGB

CONSOLIDATED BALANCE SHEET FOR THE FINANCIAL YEARS ENDED DECEMBER 31, 1997 AND DECEMBER 31, 1996

ASSETS	December 31, 1997 DM	December 31, 1996 DM
FIXED ASSETS		
Intangible assets	1,723,376.00	2,013,083.00
Property, plant and equipment		
<i>Land and buildings</i>	8,991,601.00	755,526.00
<i>Other equipment, factory and office equipment</i>	5,569,979.00	4,953,183.00
<i>Construction in progress</i>	5,485,318.37	0,00
	20,046,898.37	5,708,709.00
Long-term investments		
<i>Shares in associated companies</i>	551,663.48	269,938.00
<i>Limited partner's shares</i>	0.00	1,000,000.00
<i>Other loans</i>	1,987,080.94	3,054,348.71
	2,538,744.42	4,324,286.71
	24,309,018.79	12,046,078.71
CURRENT ASSETS		
Merchandise	3,034,215.33	6,372,534.84
Receivables and other assets		
<i>Accounts receivables, trade</i>	33,323,845.62	30,808,106.46
<i>Receivables from shareholders</i>	178,200.00	0.00
<i>Other assets</i>	3,251,607.76	3,954,857.44
	36,753,653.38	34,762,963.90
Securities		
<i>Own shares</i>	1,000,000.00	0.00
Postal giro balances, cash in banks	2,778,473.34	3,201,409.90
	43,566,342.05	44,336,908.64
DEFERRED CHARGES AND PREPAID EXPENSES	991,774.09	352,427.35
	68,867,134.93	56,735,414.70

EQUITY AND LIABILITIES	December 31, 1997 DM	December 31, 1996 DM
EQUITY		
Subscribed capital	1,030,000.00	1,000,000.00
Capital surplus	4,970,000.00	3,000,000.00
Reserve for own shares	1,000,000.00	0.00
Retained earnings	3,822,433.12	2,347,932.09
	10,822,433.12	6,347,932.09
SPECIAL ITEMS FOR INVESTMENT SUBSIDIES	4,406,344.00	0.00
CONTRIBUTIONS MADE FOR IMPLEMENTATION OF THE CAPITAL INCREASE	0.00	2,995,000.00
RESERVES AND ACCRUED LIABILITIES		
Pension reserves	164,816.00	138,010.00
Accrued taxes	2,899,846.81	2,874,842.38
Other reserves and accrued liabilities	6,381,991.80	4,821,775.56
	9,446,654.61	7,834,627.94
LIABILITIES		
Liabilities due to banks	14,151,623.86	15,672,340.29
Advance payments	4,923,636.49	4,362,630.57
Accounts payable, trade	4,872,704.40	9,816,161.57
Notes payable	0.00	6,000,000.00
Liabilities to shareholders	0.00	1,000,000.00
Other liabilities	9,577,392.45	2,702,969.30
	33,525,357.20	39,554,101.73
DEFERRED INCOME	10,666,346.00	3,752.94
	68,867,134.93	56,735,414.70

Annual Financial Statements acc. to HGB

SINGLE FINANCIAL STATEMENTS FOR 1&1 HOLDING GMBH BALANCE SHEETS AS AT DECEMBER 31, 1997 AND DECEMBER 31, 1996

ASSETS	December 31, 1997 DM	December 31, 1996 DM
FIXED ASSETS		
Intangible assets	875,450.00	384,737.00
Property, plant and equipment		
<i>Land and buildings</i>	760,464.00	755,526.00
<i>Other equipment, factory and office equipment</i>	2,597,090.00	2,219,589.00
	3,357,554.00	2,975,115.00
Financial assets		
<i>Shares in affiliated companies</i>	3,478,449.74	3,378,449.74
<i>Loans due from affiliated companies</i>	3,500,000.00	0.00
<i>Investments</i>	51,000.00	51,000.00
<i>Limited partner's share</i>	0.00	1,000,000.00
<i>Other loans</i>	1,987,080.94	3,036,495.00
	9,016,530.68	7,465,944.74
	13,249,534.68	10,825,796.74
CURRENT ASSETS		
Receivables and other assets		
<i>Accounts receivables, trade</i>	963,768.80	189,179.31
<i>Receivables from affiliated companies</i>	23,560,367.92	14,289,694.08
<i>Receivables due to shareholders</i>	178,200.00	0.00
<i>Other assets</i>	79,423.00	61,985.41
	24,781,759.72	14,540,858.80
Securities		
<i>Own shares</i>	1,000,000.00	0.00
Cash on hand, cash in banks	282,780.25	59,990.64
	26,064,539.97	14,600,849.44
DEFERRED CHARGES AND PREPAID EXPENSES	201,990.00	80,446.90
	39,516,064.65	25,507,093.08

EQUITY AND LIABILITIES	December 31, 1997 DM	December 31, 1996 DM
EQUITY CAPITAL		
Subscribed capital	1,030,000.00	1,000,000.00
Capital surplus	4,970,000.00	3,000,000.00
Reserve for own shares	1,000,000.00	0.00
Retained earnings	3,949,486.75	2,142,342.82
	10,949,486.75	6,142,342.82
CONTRIBUTIONS MADE FOR IMPLEMENTATION OF THE CAPITAL INCREASE	0.00	2,995,000.00
RESERVES AND ACCRUED LIABILITIES		
Pension reserves	164,816.00	138,010.00
Accrued taxes	2,888,946.81	2,744,934.32
Other reserves and accrued liabilities	4,433,381.88	2,154,271.52
	7,487,144.69	5,037,215.84
LIABILITIES		
Liabilities due to banks	16,737,470.35	8,416,589.85
Accounts payable, trade	963,268.03	445,252.70
Accounts to affiliated companies	231,140.91	0.00
Liabilities to shareholders	0.00	1,000,000.00
Other liabilities	3,147,553.92	1,470,691.87
	21,079,433.21	11,332,534.42
	39,516,064.65	22,512,093.08

Annual Financial Statements acc. to HGB

CONSOLIDATED INCOME STATEMENT FOR THE 1997 AND 1996 FINANCIAL YEARS

	1997 DM	1996 DM
Sales	135,510,490.81	157,356,549.34
Other operating income	9,425,276.62	2,168,433.71
Cost of materials		
<i>Cost of trading stock</i>	- 31,466,212.68	- 50,901,262.32
<i>Cost for services purchased</i>	- 43,115,106.47	- 51,122,708.38
Personnel expenses		
<i>Wages and salaries</i>	- 27,369,727.11	- 26,323,968.23
<i>Social security</i>		
<i>pension and other benefit costs</i>	- 5,177,917.74	- 4,796,460.13
<i>- therefor pensions: DM 25,689.32</i>		
<i>(previous year: DM 47,331.00)</i>		
Depreciation and amortization		
<i>On intangible assets and property,</i>		
<i>plant and equipment</i>	- 4,286,943.98	- 4,011,108.25
Other operating expenses	- 19,666,667.76	- 17,618,565.50
Result for associated companies	451,017.85	218,938.00
Other interest and similar income	708,090.12	549,302.19
Interest and similar expenses	- 1,155,611.00	- 1,575,114.87
RESULT FROM ORDINARY OPERATIONS	13,856,688.66	3,944,035.56
Taxes on income	- 5,971,591.35	- 1,599,163.40
Other taxes	- 110,597.00	- 62,821.40
NET INCOME	7,774,500.31	2,282,050.76

SINGLE FINANCIAL STATEMENTS FOR 1 & 1 HOLDING GMBH INCOME STATEMENT FOR THE 1997 AND 1996 FINANCIAL YEARS

	1997 DM	1996 DM
Sales	10,340,074.00	13,218,346.28
Other operating income	228,783.06	416,136.63
Personnel expenses		
<i>Wages and salaries</i>	- 3,137,281.39	- 3,158,709.49
<i>Social security</i>		
<i>pension and other benefit costs</i>	- 556,198.65	- 574,479.49
<i>- there of pensions: DM 25,689.32</i>		
<i>(previous year: DM 47,331.00)</i>		
Depreciation and amortization		
<i>On tangible assets and property,</i>		
<i>plant and equipment</i>	- 1,050,193.03	- 1,390,123.84
Other operating expenses	- 7,672,512.67	- 10,115,173.10
Income from investments	270,149.13	319,617.86
<i>- of which from affiliated companies: DM 0,00</i>		
Income from control and profit and loss absorption agreements	21,920,582.60	6,631,217.57
Other interest and similar income	1,029,601.32	803,399.45
<i>- of which from affiliated companies:</i>		
<i>DM 707,408.00 (previous year: DM 728,037.46)</i>		
Losses absorbed	- 151,559.65	- 1,558,639.01
Other interest and similar expenditure	- 810,720.89	- 884,152.42
<i>- thereof to affiliated companies:</i>		
<i>DM 490,108.91 (previous year: DM 226,387.82)</i>		
RESULT FROM ORDINARY OPERATIONS	20,410,723.83	3,707,440.44
Extraordinary expense	- 6,110,567.87	0.00
Taxes on income	- 6,071,009.00	- 1,563,703.89
Other taxes	- 122,003.00	- 40,035.40
NET INCOME	8,107,143.96	2,103,701.15

Annual Financial Statements acc. to HGB

DEVELOPMENT OF CONSOLIDATED FIXED ASSETS IN THE 1997 FINANCIAL YEAR

	AT COST					ACCUMULATED DEPRECIATION				NET BOOK VALUES	
	01.01.1997 DM	Additions DM	Disposals DM	31.12.1997 DM		01.01.1997 DM	Additions DM	Disposals DM	31.12.1997 DM	01.01.1997 DM	31.12.1997 DM
INTANGIBLE ASSETS											
Licences	1,812,984.36	110,357.42	17,075.20	1,906,266.58		1,736,531.31	54,288.42	13,844.15	1,776,975.58	76,453.05	129,291.00
Software	4,018,981.47	1,121,718.31	605,333.37	4,535,366.41		2,082,351.52	1,186,488.26	327,558.37	2,941,281.41	1,936,629.95	1,594,085.00
Goodwill	326,725.57	0.00	0.00	326,725.57		326,725.57	0.00	0.00	326,725.57	0.00	0.00
Low value items	0.00	118,217.57	118,217.57	0.00		0.00	118,217.57	118,217.57	0.00	0.00	0.00
	6,158,691.40	1,350,293.30	740,626.14	6,768,358.56		4,145,608.40	1,358,994.25	459,620.09	5,044,982.56	2,013,083.00	1,723,376.00
PROPERTY, PLANT AND EQUIPMENT											
Land and buildings	763,072.80	8,323,953.60	0.00	9,087,026.40		7,546.80	87,878.60	0.00	95,425.40	755,526.00	8,991,601.00
Plant and equipment	6,846,321.11	3,062,401.41	1,092,294.47	8,816,428.05		3,845,949.11	1,837,476.41	913,401.47	4,770,024.05	3,000,372.00	4,046,404.00
Office equipment	944,129.98	107,718.88	1,872.85	1,049,976.01		656,027.98	103,063.88	1,872.85	757,219.01	288,102.00	292,757.00
Improvements	460,266.86	0.00	0.00	460,266.86		226,444.86	62,107.00	0.00	288,551.86	233,822.00	171,715.00
Motor vehicles	2,496,828.37	294,832.68	608,585.25	2,183,075.80		1,065,941.37	515,818.68	457,787.25	1,123,972.80	1,430,887.00	1,059,103.00
Construction in progress	0.00	5,485,318.37	0.00	5,485,318.37		0.00	0.00	0.00	0.00	0.00	5,485,318.37
Low value items	0.00	321,605.16	321,605.16	0.00		0.00	321,605.16	321,605.16	0.00	0.00	0.00
	11,510,619.12	17,595,830.10	2,024,357.73	27,082,091.49		5,801,910.12	2,927,949.73	1,694,666.73	7,035,193.12	5,708,709.00	20,046,898.37
FINANCIAL ASSETS											
Shares in associated companies	269,938.00	281,725.48	0.00	551,663.48		0.00	0.00	0.00	0.00	269,938.00	551,663.48
Limited partner's share	1,000,000.00	0.00	1,000,000.00	0.00		0.00	0.00	0.00	0.00	1,000,000.00	0.00
Other loans	3,054,348.71	0.00	1,067,267.77	1,987,080.94		0.00	0.00	0.00	0.00	3,054,348.71	1,987,080.94
	4,324,286.71	281,725.48	2,067,267.77	2,538,744.42		0.00	0.00	0.00	0.00	4,324,286.71	2,538,744.42
	21,993,597.23	19,227,848.88	4,832,251.64	36,389,194.47		9,947,518.52	4,286,943.98	2,154,286.82	12,080,175.68	12,046,078.71	24,309,018.79

Annual Financial Statements acc. to HGB

SINGLE FINANCIAL STATEMENTS FOR 1&1 HOLDING GMBH DEVELOPMENT OF FIXED ASSETS IN THE 1997 FINANCIAL YEAR

	At COST					ACCUMULATED DEPRECIATION				NET BOOK VALUES	
	01.01.1997 DM	Additions DM	Disposals DM	31.12.1997 DM		01.01.1997 DM	Additions DM	Disposals DM	31.12.1997 DM	01.01.1997 DM	31.12.1997 DM
INTANGIBLE ASSETS											
Licences	48,834.46	126,357.77 (90,541.12)	0.00	175,192.23	30,505.46	44,865.77 (25,796.12)	0.00	75,371.23	18,329.00	99,821.00 (64,745.00)	
Software	962,327.30	857,974.41 (816,172.86)	0.00	1,820,301.71	595,919.30	448,753.41 (182,503.86)	0.00	1,044,672.71	366,408.00	775,629.00 (633,669.00)	
Low value items	0.00	15,635.47	15,635.47	0.00	0.00	15,635.47	15,635.47	0.00	0.00	0.00	
	1,011,161.76	999,967.65 (906,713.98)	15,635.47	1,995,493.94	626,424.76	509,254.65 (208,299.98)	15,635.47	1,120,043.94	384,737.00	875,450.00 (698,414.00)	
PROPERTY, PLANT AND EQUIPMENT											
Land and buildings	763,072.80	15,200.00	0.00	778,272.80	7,546.80	10,262.00	0.00	17,808.80	755,526.00	760,464.00	
Plant and equipment	989,420.80	1,443,218.81 (1,325,567.72)	16,259.20	2,416,380.41	403,601.80	637,923.81 (420,436.72)	8,798.20	1,032,727.41	585,819.00	1,383,653.00 (905,131.00)	
Office equipment	246,777.35	18,314.75 (12,533.00)	0.00	265,092.10	120,749.35	48,797.75 (3,273.00)	0.00	169,547.10	126,028.00	95,545.00 (9,260.00)	
Motor vehicles	1,865,968.09	206,547.34 (36,526.00)	215,315.27	1,857,200.16	592,047.09	435,245.34 (25,712.00)	116,270.27	911,022.16	1,273,921.00	946,178.00 (10,814.00)	
Improvements	438,306.36	0.00	0.00	438,306.36	204,485.36	62,107.00	0.00	266,592.36	233,821.00	171,714.00	
Low value items	0.00	4,324.18	4,324.18	0.00	0.00	4,324.18	4,324.18	0.00	0.00	0.00	
	4,303,545.40	1,687,605.08 (1,374,626.72)	235,898.65	5,755,251.83	1,328,430.40	1,198,660.08 (449,421.72)	129,392.65	2,397,697.83	2,975,115.00	3,357,554.00 (925,205.00)	
FINANCIAL ASSETS											
Shares in affiliated companies	3,378,449.74	100,000.00	0.00	3,478,449.74	0.00	0.00	0.00	0.00	3,378,449.74	3,478,449.74	
Loans due from affiliated companies	0.00	3,500,000.00	0.00	3,500,000.00	0.00	0.00	0.00	0.00	0.00	3,500,000.00	
Investments	51,000.00	0.00	0.00	51,000.00	0.00	0.00	0.00	0.00	51,000.00	51,000.00	
Limited partner's shares	1,000,000.00	5,000,000.00	6,000,000.00	0.00	0.00	0.00	0.00	0.00	1,000,000.00	0.00	
Other loans	3,036,495.00	7,080.94 (7,080.94)	1,056,495.00	1,987,080.94	0.00	0.00	0.00	0.00	3,036,495.00	1,987,080.94 (7,080.94)	
	7,465,944.74	8,607,080.94 (7,080.94)	7,056,495.00	9,016,530.68	0.00	0.00	0.00	0.00	7,465,944.74	9,016,530.68 (7,080.94)	
	12,780,651.90	11,294,653.67 (2,288,421.64)	7,308,029.12	16,767,276.45	1,954,855.16	1,707,914.73 (657,721.70)	145,028.12	3,517,741.77	10,825,796.74	13,249,534.68 (1,630,699.94)	

The figures in brackets refer to additions in connection with the collapse of 1&1 Internet GmbH & Co. KG.

COMBINED NOTES TO THE SINGLE FINANCIAL STATEMENTS AND THE CONSOLIDATED FISCAL STATEMENTS FOR THE FISCAL YEAR ENDING DECEMBER 31, 1997

The single financial statements and consolidated financial statements of 1&1 Holding GmbH have been prepared in accordance with German Commercial Code.

REPORTING ENTITY

In addition to 1&1 Holding GmbH, the reporting entity includes nine domestic subsidiaries.

Compared with the previous year, three companies have been included for the first time. 1&1 Internet GmbH & Co. KG was included for the first time, as the controlling company was able to exercise significant influence on the company and collapsed into 1&1 Holding GmbH before the end of the financial year due to the withdrawal of the unlimited partner. In this respect, the figures for the controlling company are comparable only to a limited extent. In addition, 1&1 Multimedia Service GmbH and 1&1 Internet

PRINCIPLES OF CONSOLIDATION

Capital consolidation was performed according to the book value method by offsetting the cost of acquisition of consolidated subsidiaries against their equity capital at the time of acquisition or initial consolidation, in accordance with § 301 of German Commercial Code in conjunction with § 309 of German Commercial Code. The balance on initial consolidation was always shown as goodwill and depreciated over the anticipated effective life. All goodwill was fully written off as at December 31, 1995.

The inventories do not include any inter-company results from intra-group trade.

The income statement of Earnings is based on the cost summary method.

GmbH were included in the consolidated financial statements for the first time. Both companies were first established in the past financial year.

The equity investment company is consolidated at equity and recognised in the accounts as an associated company.

The share ownership of 1&1 Holding GmbH is listed separately in Annex 1 in the Notes. In accordance with the regulation on exceptions in § 286 Para. 3 Sentence 1 No. 2 of the German Commercial Code, the data for two

Receivables and payables for the fully consolidated companies were offset against each other in the consolidated financial statements.

Cash in banks of a similar nature and amounts due to banks amounting to DM 26,772 thousand were offset against each other for the purpose of consolidating third-party liabilities.

Intra-company turnover, expenses and income items were offset against each other.

ACCOUNTING AND VALUATION PRINCIPLES

All assets and debts of the companies included in the consolidated financial statements have been valued uniformly.

The development of consolidated fixed assets and of the fixed assets of the GmbH are shown in separate movement schedules.

Intangible assets are shown at acquisition cost when purchased, and have been depreciated according to plan.

Property, plant and equipment are valued at cost by using the declining balance method throughout the group, less scheduled depreciation according to the average effective life. Additions from 1995 onwards have always been depreciated by using the declining balance method. Use has been made of the simplification rule according to R 44 Para. 2 of the Income Tax Act (full annual depreciation for additions up to June 30, half annual depreciation for additions thereafter). Additions dating from before 1995 have been depreciated according to the straight-line method.

Software and licences for the same have been depreciated over a period of 2 to 4 years. Buildings have normally been depreciated over 50 years, and plant and equipment over 4 to 5 years. Tenant improvements are depreciated over the term of the tenancy agreement. The average effective life of office equipment is 8 to 10 years, and 4 to 5 years for motor vehicles.

Minor long-term assets are fully written off in the year of addition; for the sake of simplicity, their disposal is assumed to take place simultaneously. Holdings in affiliated companies and participations are shown at acquisition cost or the lower applicable value on the balance sheet date.

Associated companies are valued at equity in the consolidated financial statements. Loans are stated at their nominal value.

Inventories are valued at acquisition cost. Appropriate provision has been made for obsolete items and slow moving items.

Receivables and other assets are stated at their nominal value or at the lower market value. Provision is made for evident single bad debt risks in the form of appropriate value adjustments. Adequate provision is made for the general credit risk through the general allowance on receivables.

Own shares are valued at acquisition cost.

Appropriate and adequate reserves have been established for contingent liabilities and evident risks. Pension reserves are accrued according to actuarial principles. Reserves have been formed for deferred taxes resulting from the difference between commercial and tax books.

Liabilities are shown at repayment value.

NOTES TO THE CONSOLIDATED AND SINGLE FINANCIAL STATEMENTS OF 1&1 HOLDING GMBH

Intangible assets and property, plant and equipment

In the past financial year, the group's investments were in respect of the purchase and extension of buildings in Zweibrücken and, above all, replacement and supplementary investments in the field of Internet value-enhanced applications.

The additions for the subsidiaries are primarily replacement investments and new purchases for 1&1 Internet GmbH & Co. KG, such as hardware and the development of a client-server architecture.

The collapse of 1&1 Internet GmbH & Co. KG has an effect on 1&1 Holding GmbH. The gross method of recording additions to fixed assets was chosen. Accordingly, additions resulting from the collapse of 1&1 Internet KG are shown at their historical cost of acquisition and manufacture, offset against the cumulative depreciation at the time of collapse. The accrued amounts are shown in brackets in the assets movement schedule.

Financial Assets

Additions for the GmbH are the result of the contribution to 1&1 Internet GmbH & Co. KG (DM 5,000 thousand) and the founding of 1&1 Multimedia Service GmbH (DM 50 thousand), and also the acquisition of 1&1 Internet GmbH (DM 50 thousand). The contribution to 1&1 Internet GmbH & Co. KG was used to finance investment and payments charged as expenses arising in the context of the company's development. A loan of DM 3,500 thousand was in

addition made to 1&1 Multimedia Service GmbH to finance its investments. The disposals for the limited partner's shares result from the collapse and extinction of 1&1 Internet GmbH & Co. KG. Other loans refer to loans to employees, for the most part with no limited term. The disposal refers to the repayment of a loan, with interest, to a manager upon his withdrawal, and the acquisition of his shares by the company.

Inventories

Group inventories fell by DM 3,200 thousand on the previous year. This decrease was mainly attributable to measures for adjusting stock levels to the lower merchandise turnover, and to further improvements in stock management.

Adequate provision against risks was made in the form of extensive reductions in the range, coupled with the elimination of non-moving articles.

Receivables and other assets

For accounts receivable, trade, the companies performed single bad debt reserves according to value stability. Definite bad debts were taken out of the books.

Other assets for the GmbH and the group include receivables due from the tax authorities,

short-term loans, the guaranty fund as covering security for the special pension agreement and entitlements to investment subsidies.

Of total receivables and other assets, DM 79 thousand have a residual term of more than one year.

Prepayments and accrued income

This item includes miscellaneous expenditure, insofar as it represents an expense after the balance sheet date.

Subscribed capital

The subscribed capital of 1&1 Holding GmbH is DM 1,030 thousand. Pursuant to the resolutions of the shareholders of July 10 and August 20, 1996, the capital was increased by DM 30 thousand. The contributions made in 1996 for implementation of the capital increa-

se totalled DM 2,995 thousand, with the outstanding DM 5 thousand contributed in the 1997 fiscal year. The capital increase was entered in the trade register on February 13, 1997.

Capital surplus and reserve for own shares

The premium of DM 2,970 thousand contributed towards the capital increase was allocated to the capital reserve. Of this sum, DM 1,000 thousand was transferred to the reserve for

own shares, to finance the acquisition of own shares, with the result that there remains an amount of DM 4,970 thousand in the capital surplus.

Annual Financial Statements acc. to HGB

Retained earnings

The retained earnings for the GmbH and the group has developed as follows.

	1997 DM '000	1996 DM '000
1&1 Group		
Profit carried forward	2,347,932.09	2,625,292.94
Net income	7,774,500.31	2,282,050.76
Distribution of profits	- 6,300,000.00	- 2,600,000.00
Previous profits retained from first-time reporting at equity	0.00	40,588.39
Retained earnings	3,822,432.40	2,347,932.09
1&1 Holding GmbH		
Profit carried forward	2,142,342.82	2,638,641.67
Net income	8,107,143.96	2,103,701.15
Dividend payout	- 6,300,000.00	- 2,600,000.00
Retained earnings	3,949,486.78	2,142,342.82

Following the shareholders' resolution of January 19, 1998 a dividend payout of DM 3,920 thou-

sand was made in the new financial year from the remaining retained earnings for 1997.

Special item for investment subsidies

To support its business development, 1&1 Multimedia Service GmbH receives regional subsidies and funds from the State Development Scheme in the form of investment subsidies and expense subsidies, to compensate for startup losses. The investment subsidies are included in the special item and released in instalments over the effective life of the sub-

sidised investments. None of these subsidies have yet been released, as the investment measures are not yet complete. The effect of subsidies to compensate for startup losses on the current period result is shown in other operating income (DM 2,095 thousand) on the basis of expenses incurred.

Reserves and accrued liabilities

Pension reserves refer to a special agreement, and have been calculated according to actuarial principles at the going-concern value in accordance with § 6a of Income Tax Law, applying an interest rate of 6 percent. There exist guaranty funds, included in other assets, as covering security for these reserves.

Reserves have been set up for all uncertain liabilities, the amount or nature of which is indefinite, in the other reserves and accrued liabilities of the GmbH and the group. These include prudential reserves, in particular for invoices not yet received, deferred rent, legal and consulting expenses, and for other personnel expenses.

Liabilities

Group liabilities with a residual term of more than five years, totalling DM 9,133 thousand, relate exclusively to liabilities due to banks. There are total liabilities of DM 9,400 thousand covered by mortgages. In addition, security in the form of a blanket assignment of receivables and the transfer of property was provided on a loan (DM 750 thousand). All security refers to amounts owed to banks.

Other liabilities for the GmbH refer largely to amounts due to the tax authorities. DM 1,129 thousand of this item result from capital gains tax on the advanced distribution of profit from the current result for the 1997 financial year. Other liabilities for the group moreover include investment and expense subsidies amounting to DM 5,051 thousand, as they refer to expenditure for future fiscal years (DM 2,705 thousand) and investments not yet made (DM 2,346 thousand).

The customary retention of title applies to trade payables.

Advance payments received refer, in the main, to advance payments by customers of stand rental for the CeBIT exhibition.

The liabilities movement schedules for the 1&1 Group and 1&1 Holding are shown separately overleaf.

Annual Financial Statements acc. to HGB

ANALYSIS OF LIABILITIES	31.12.97 DM	31.12.97	31.12.97	31.12.97	31.12.96 DM '000
		Due in up to 1 year DM	Due in 1 to 5 years DM	Due in over 5 years DM	
1&1 Group					
Liabilities due to banks	14,151,623.86	4,077,022.53	941,988.90	9,132,612.43	15,672
Advance payments	4,923,636.49	4,923,636.49	0.00	0.00	4,363
Accounts payable, trade	4,872,704.40	4,872,704.40	0.00	0.00	9,816
Notes payable	0.00	0.00	0.00	0.00	6,000
Liabilities due to shareholders	0.00	0.00	0.00	0.00	1,000
Other liabilities	9,577,392.45	9,577,392.45	0.00	0.00	2,703
- there of in respect of social security: DM 840,698.68 (previous year: DM '000 615)					
- there of taxes: DM 3,298,682.55 (previous year: DM '000 1,306)					
1&1 Holding					
Liabilities due to bank	16,737,470.35	15,812,869.02	107,988.90	816,612.43	8,417
Trade payables	963,268.03	963,268.03	0.00	0.00	445
Amounts owed to affiliated companies	231,140.91	231,140.91	0.00	0.00	0
Liabilities due to shareholders	0.00	0.00	0.00	0.00	1,000
Other liabilities	3,147,553.92	3,147,553.92	0.00	0.00	1,471
- there of in respect of social insurance: DM 130,469.47 (previous year: DM '000 79)					
- there of taxes: DM 2,972,555.34 (previous year: DM '000 1,333)					

Deferred income

In March 1997, the company agreed to dissolve and renegotiate a cooperation agreement with a major client.

The new cooperation agreement envisage a one-off payment of DM 15,000 thousand which is intended to compensate for investments made by 1&1 and for disadvantages resulting from the contractual change.

To counterbalance one-off expenses such as personnel costs and depreciation, together with certain other disadvantages, an instalment of DM 4,403 thousand was transferred to net income in the financial year. The balance of DM 10,597 thousand is included in accruals and deferred income and will be transferred to net income over the next two financial years.

Sales

The sales for the business year were generated exclusively in Germany.

The sales of the controlling company predominantly comprise charges to subsidiaries for services.

The following table reveals the source of group sales according to business segments:

	1997 DM '000	1996 DM '000
Marketing Services	126,723	152,154
Internet Services	8,787	5,203
	135,510	157,357

Other operating income

Other operating income consists mainly of income from the compensatory payment following the early termination of a contract, income from expense subsidies totalling DM 2,095 thousand relating to the development of operations of 1&1 Multimedia Service GmbH, and income from the disposal of property, plant

and equipment. Asset disposals refer primarily to disposals by 1&1 Telekommunikation GmbH resulting from the discontinuance of business lines. Income for previous periods amounts to DM 13 thousand for the GmbH and DM 597 thousand for the group.

Other operating expenses

This item is made up mainly of freight costs, rental and leasing expenses, legal and consult-

ing costs, postage and telephone costs, and expenses from the loss of receivables outstanding.

Extraordinary expenses

The single financial statements for 1&1 Holding GmbH report extraordinary expense of DM 6,111 thousand. This results from the collapse of the assets and liabilities of 1&1 Internet GmbH & Co. KG on December 31, 1997; 1&1 Holding was the sole limited partner of this company. 1&1 Internet Verwaltungs GmbH, which was the unlimited partner of 1&1 Internet GmbH & Co. KG, withdrew with effect

from December 31, 1997. 1&1 Internet GmbH & Co. KG was cancelled on January 9, 1998.

The loss reported for extraordinary expenses is attributable to the start-up losses incurred by 1&1 Internet GmbH & Co. KG, up to the date of collapse, of DM 337 thousand for 1996 and DM 5,774 thousand for 1997.

Taxes on income

Taxes on income have been calculated on the basis of an assumed dividend distribution of DM 3,920 thousand.

Average number of employees

OTHER INFORMATION

	Group	GmbH
Full-time employees	453	47
Part-time employees	176	22
Total	629	69

Company managers

In the financial year, the company managers of 1&1 Holding GmbH were:

Ralph Dommermuth, Urbar
Hans Huber, Bonn
(until December 31, 1997)
Michael Scheeren, Dreikirchen

Expenditure for company managers for the financial year amounted to DM 1,058 thousand. Reserves totalling DM 165 thousand have been created to cover future pension commitments to company managers.

Loans made to company managers in the previous year totalling DM 990 thousand were repaid at the end of the financial year; interest was charged at an annual rate of 6.0 percent.

Advisory Council

The members of the Advisory Council in the financial year were:

Heinz Paul Bonn, Cologne; Chairman
Dr. Erhard Pascher, Bad Homburg;
Deputy Chairman
Wendelin Abresch, Montabaur
Wolfgang Bensel, Hamburg
Kurt Dobitsch, Munich
Peter Gagg, Stuttgart
Jörg Schomburg, Hanover

Remuneration of the members of the Advisory Council in the past business year amounted to DM 75 thousand.

Contingencies

1&1 Holding GmbH bears joint and several liability for amounts due to banks by subsidiaries of the 1&1 Group totalling DM 3,866 thousand.

Other financial commitments

Other financial commitments arising out of tenancy and leasing agreements exist. These commitments are summarised in the following table:

	Group DM '000	GmbH DM '000
Liabilities from leasing and long-term tenancy commitments	15,573	14,046
there of with a residual term of up to one year	(3,846)	(3,064)
there of with a residual term of more than five years	(0)	(0)

Liabilities from leasing and long-term tenancy agreements relate mainly to tenancy agreements for the buildings in Montabaur and Dortmund.

There are profit and loss absorption agreements with six subsidiaries. We refer to the

information on share ownership. A profit and loss absorption agreement was concluded with one further subsidiary at the start of 1998. The company has liabilities, subsidised to 80 percent, amounting to DM 15.5 million from the construction of buildings in the Multimedia-Internet-Park.

1&1 Holding GmbH

Montabaur, January 29, 1998

The Company Managers

The accounting and the financial statements and the consolidated financial statements which we have audited in accordance with professional standards comply with the legal regulations. The financial statements and consolidated financial statements present, in compliance with generally accepted accounting principles, a true and fair view of the net work, financial position and results of the company and group. The management report and group management report is in agreement with the financial statements and financial statements.

The accounts, annual financial statements and consolidated financial statements, which we have audited in accordance with professional standards, comply with the legal requirements. The annual financial statements and consolidated financial statements present, in compliance with required accounting principles, a true and fair view of the net worth, financial position and results of the company and the group. The combined Management Report for both entities is in agreement with the annual and consolidated financial statements.

Montabaur, January 30, 1998

ARTHUR ANDERSEN
Wirtschaftsprüfungsgesellschaft
Steuerberatungsgesellschaft mbH

Fluck

Herzing
Wirtschaftsprüfer

Annual Financial Statements acc. to HGB

STATEMENT OF SHARE OWNERSHIP AS AT DECEMBER 31, 1997

	Equity capital of the company as at December 31, 1997 DM	Profit/loss for the 1997 financial year DM	Ownership in %
1&1 Direkt Gesellschaft zur Vermarktung von Informationstechnologien mbH, Montabaur ¹⁾	653,825.84	0.00	100.0
1&1 Telekommunikation GmbH, Montabaur ¹⁾	500,000.79	0.00	100.0
1&1 Marketing GmbH, Montabaur ¹⁾	1,000,000.00	0.00	100.0
1&1 Serviceline Gesellschaft für Sprach- kommunikation mbH, Montabaur ¹⁾	504,185.25	0.00	100.0
A 1 Marketing, Kommunikation und neue Medien GmbH, Montabaur ¹⁾	60,914.97	0.00	100.0
1&1 Online Dialog GmbH, Montabaur ¹⁾	646,174.91	0.00	100.0
1&1 Internet GmbH, Montabaur	50,000.00	0.00	100.0
¹⁾ A profit and loss absorption agreement exists with 1&1 Holding GmbH. The equity capital and net profit for the period are shown after the transfer of profit or loss.			

In accordance with the regulation on exceptions in
§ 286 Para. 3 Sentence 1 No. 2 of the German
Commercial Code, the data for two companies
have been not been included.

Consolidated Financial Statements acc. to US-GAAP

CONSOLIDATED

FINANCIAL STATEMENTS *1&1 Holding GmbH, Montabaur, Germany* AS OF DECEMBER 31, 1997 AND 1996

Consolidated Financial Statements

CONSOLIDATED INCOME STATEMENT FOR THE YEARS ENDED DECEMBER 31, 1997 UND 1996

	1997		1996	
	DM	%	DM	%
Net sales (Note 22)	135,510,491	100.0	157,422,723	100.0
Cost of Sales	- 117,285,789	(86.6)	- 141,117,743	(89.6)
GROSS MARGIN	18,224,702	13.4	16,304,980	10.4
Selling, General and administrative expenses	- 10,634,171	(7.8)	- 12,333,692	(7.8)
Other operating income/expense (Note 19)	6,945,776	5.1	624,141	0.4
OPERATING INCOME	14,536,307	10.7	4,595,429	2.9
Interest Expense	- 1,155,611	(0.9)	- 1,575,168	(1.0)
Interest Income	708,090	0.5	551,051	0.4
INCOME FROM CONTINUING OPERATIONS BEFORE INCOME TAX EXPENSE	14,088,786	10.4	3,571,312	2.3
Income tax expense (Note 20)	- 5,971,896	(4.4)	- 1,609,671	(1.0)
INCOME FROM CONTINUING OPERATIONS	8,116,890	6.0	1,961,641	1.2

Consolidated Financial Statements

CONSOLIDATED BALANCE SHEETS FOR THE YEARS ENDED DECEMBER 31, 1997 UND 1996

ASSETS	1997 DM	1996 DM
CURRENT ASSETS		
Cash	2,778,473	3,897,158
Own Shares (Note 9)	1,000,000	0
Accounts receivable (Note 11)	36,753,653	35,429,140
Inventory (Note 10)	3,034,216	6,372,535
Prepaid expenses	991,774	352,427
	44,558,117	46,051,260
NON-CURRENT ASSETS		
Equity investment in FUN	534,084	252,359
Other Loans (Note 9)	1,987,081	3,054,349
Property, Plant and Equipment (Note 8)	15,640,554	5,988,119
Intangible Assets (Note 7)	1,723,376	2,155,542
	19,885,095	11,450,369
TOTAL ASSETS	64,443,212	57,501,629

LIABILITIES AND EQUITY	1997 DM	1996 DM
LIABILITIES		
Current liabilities		
Accounts Payable, Trade	4,872,704	10,835,777
Due to Banks (Note 13)	4,799,634	19,927,984
Advanced Payments (Note 16)	4,923,636	4,362,631
Other Accounts Payable (Note 15)	9,577,392	2,741,146
Accrued Taxes	2,912,661	2,887,350
Other Accrued Liabilities	6,381,992	4,850,876
Deferred Income (Note 18)	7,134,346	0
	40,602,366	45,605,763
Non-current liabilities		
Due to Banks (Note 13)	9,351,990	1,744,959
Amounts Due to Shareholders (Note 12)	0	1,032,883
Accrued Pension Costs (Note 17)	131,407	110,712
Deferred Income (Note 18)	3,532,000	3,753
	13,015,397	2,892,307
TOTAL LIABILITIES	53,617,763	48,498,070
STOCKHOLDERS' EQUITY		
Subscribed Capital (Note 5)	1,030,000	1,000,000
Additional Paid in Capital (Note 6)	5,970,000	3,000,000
Fund provided for capital increase	0	2,995,000
Retained Earnings	3,825,449	2,008,559
	10,825,449	9,003,559
TOTAL STOCKHOLDERS' EQUITY	10,825,449	9,003,559
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	64,443,212	57,501,629

Consolidated Financial Statements

CONSOLIDATED CASH FLOW STATEMENTS FOR THE YEARS ENDED DEZEMBER 31, 1997 UND 1996

	1997 DM	1996 DM
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	8,116,890	1,961,641
ADJUSTMENTS TO RECONCILE NET INCOME TO NET CASH PROVIDED BY OPERATING ACTIVITIES		
Depreciation and amortization	4,286,491	4,065,336
Undistributed earnings of affiliate	(451,018)	(235,938)
Distributed earnings of affiliate	169,293	40,588
CHANGE IN ASSETS AND LIABILITIES		
(Increase)/Decrease in own shares	(1,000,000)	0
(Increase)/Decrease in accounts receivable	353,445	2,816,921
(Increase)/Decrease in other receivables	781,741	(1,743,203)
(Increase)/Decrease in inventory	3,338,320	9,458,991
(Increase)/Decrease in prepaid expenses	(639,347)	20,339
Increase/(Decrease) in accounts payable	(5,963,073)	(1,588,174)
Increase/(Decrease) in advanced payments	561,005	(210,269)
Increase in Other accrued liabilities	1,531,116	1,131,573
Increase/(Decrease) in accrued taxes	25,310	(3,138,997)
Increase/(Decrease) in other accounts payable	1,785,498	(3,039,918)
Increase/(Decrease) in deferred liabilities	10,662,593	(290,551)
Increase in accrued pension	20,695	20,649
Total adjustment	14,755,179	7,307,347
NET CASH PROVIDED BY (USED IN) OPERATING ACTIVITIES	22,872,069	9,268,988

	1997 DM	1996 DM
CASH FLOW FROM INVESTING ACTIVITIES		
Capital expenditure	(18,525,675)	(6,449,932)
Disposal of fixed assets (net book value)	612,117	475,273
Purchase of additional shares in associated companies	0	(34,000)
NET CASH PROVIDED BY (USED IN) INVESTING ACTIVITIES	17,913,558	(6,008,659)
CASH FLOWS FROM FINANCING ACTIVITIES		
Payment/Repayment of shareholder loan	(1,032,883)	27,558
Capital contribution	5,000	5,995,000
(Increase)/Decrease in loans	1,067,268	(3,054,349)
Dividends paid	(6,300,000)	(2,600,000)
Subsidies received	7,704,737	0
(Repayment)/Borrowings (to) from banks	(7,521,319)	208,142
NET CASH PROVIDED BY (USED IN) INVESTING ACTIVITIES	(6,077,196)	576,351
Net increase (decrease) in cash	(1,118,686)	3,836,680
Cash, beginning of the year	3,897,158	60,478
Cash, end of year	2,778,473	3,897,158
Supplement disclosures of cash flow information:		
Cash paid during the year for:		
Interest	1,155,611	1,575,168
Taxes	6,157,184	4,811,488

Consolidated Financial Statements

CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY YEAR ENDEN DECEMBER 31, 1997 AND 1996

	1997 DM '000	1996 DM '000
CAPITAL STOCK		
Beginning balance	1,000,000	1,000,000
Additions	30,000	0
Ending balance	1,030,000	1,000,000
CAPITAL SURPLUS		
Beginning balance	3,000,000	0
Additions	2,970,000	3,000,000
Ending balance	5,970,000	3,000,000
RETAINED EARNINGS		
Beginning balance	2,008,559	2,646,917
Net income	8,116,890	1,961,641
Distribution	(6,300,000)	(2,600,000)
Ending balance	3,825,449	2,008,559
FUNDS PROVIDED FOR CAPITAL INCREASE	0	2,995,000
TOTAL SHAREHOLDERS' EQUITY	10,825,449	9,003,559

1. Organization and nature of business

1 & 1 Holding GmbH leads and supports nine subsidiaries in their efforts in two business segments, Marketing Services and Internet Services, in the Federal Republic of Germany. The company primarily engages, through its subsidiaries, in marketing and providing multimedia products, such as online applications and home banking software, modems, ISDN subscriptions and related hardware and multimedia PC's and upgrade accessories and more, to the consumer market. The Company also provides traditional advertising and electronic advertising to

2. Start up of Multimedia-Internet-Park

In 1997 the new business line was established by setting up a Multimedia-Internet-Park in Zweibrücken, Germany. It is intended to offer to entrepreneurs starting a multimedia business as well as to already established companies a bundle of services around their core business, including marketing and financial assistance, help in establishing business relations or back office work. For this purpose, a separate legal entity has been established, which acquired land and buildings of a former U.S. air base in Zweibrücken at a total consideration of DM 8,000 thousand (thereof DM 527 thousand land) and started with extensive remodelling work. A new office building including a well equipped computer center is under construction and will be rented to the multimedia companies.

CONSOLIDATED FINANCIAL STATEMENTS AS OF DECEMBER 31, 1997 AND 1996

businesses throughout Germany. In addition the company conducts a specialized call centre. Many of the products and services are offered in co-operation with other high quality providers. In 1997 the company entered in to the multimedia service business, where it acts as a service provider for multimedia companies. The company is located in Montabaur, Federal Republic of Germany with additional offices in Dortmund and Zweibrücken and operates mainly in leased premises.

The State Rheinland-Pfalz is subsidizing the major part of all of the capital expenditures related to the buildings. The total capital expenditure budgeted amount is approximately DM 17,800 thousand, thereof DM 14,240 thousand are already approved as subsidies. In 1997 DM 5,000 thousand of the approved funds have been received (thereof DM 593 thousand overpayments referring to 1998). The remaining portion is expected to be completely received in 1998. Further to these subsidies a significant part of the operating expenses are subsidized.

First contracts with multimedia companies have been concluded recently.

Subsequent to the balance sheet date another holding company has been set up for the purpose of acquiring minority interests in certain selected multimedia companies in order to support their business development and create a portfolio of multimedia investments.

3. Transactions with related parties

The company is controlled by the majority shareholder Ralph Dommermuth, chief executive officer of the company, who holds an interest of 63 percent in the company as of December 31, 1997. In 1997 his salary including a bonus payment amounted to DM 300 thousand.

The land and building related to the Multimedia-Internet-Park business in Zweibrücken was acquired from a company, where 90 percent of its shares are held by the majority shareholder. The total consideration paid was DM 8,000 thousand.

The company leases the major part of the premises from a company controlled by the municipality of Montabaur. The respective two rental agreements expire in June 30, 1999 and June 30, 2002. This company itself previously acquired two inheritable building rights in the related land from, among others, the majority shareholder of the company, who owns one third of the land. Upon expiration title in the buildings will be transferred to the owners of the land, who then intend to rent the buildings to the company.

Loans have been granted to several managers of the company in order to finance the capital surplus related to the share capital increase exercised by management (see Note 9).

4. Significant accounting policies

Certain accounting principles applied by the company in its accounts conform with generally accepted accounting principles in the Federal Republic of Germany but do not conform with generally accepted accounting principles in the United States. The financial statements as of and for the years ended December 31, 1997 and 1996 have been adjusted to comply with the United States generally ac-

cepted accounting principles for use by the company to meet certain reporting requirements with respect to an Initial Public Offering on the German Neuer Markt. Accordingly assets, liabilities, shareholders' equity and revenues and expenses were adjusted for that purpose. All amounts are in Deutsche Marks (DM), the functional currency of the parent company.

a) Principles of Consolidation

The accompanying consolidated financial statements include the accounts of 1&1 Holding GmbH and all its subsidiaries (the company) and investments. All significant intercompany balances and transactions have been eliminated in consolidation.

The investments are balanced as an associated enterprise at equity.

Effective December 31, 1997 the general partner of 1&1 Internet GmbH & Co. KG, a formerly fully owned subsidiary of the company, was discontinued. As a result of this,

1&1 Internet GmbH & Co. KG was merged into the company. The company includes the following subsidiaries:

- 1&1 Direkt Gesellschaft zur Vermarktung von Informationstechnologien mbH
- 1&1 Telekommunikation GmbH
- 1&1 Marketing GmbH
- 1&1 ServiceLine Gesellschaft für Sprachkommunikation mbH
- 1&1 Online Dialog GmbH
- 1&1 Internet GmbH
- 1&1 Multimedia Service GmbH
- A1 Marketing Kommunikation und neue Medien GmbH.

b) Accounts receivable, trade

Accounts receivable, trade, are stated at their nominal value net of allowances for doubtful accounts. In addition to specific allowances, which are calculated on an item by item basis,

a general allowance has been provided to cover the bad debt risk of accounts outstanding.

c) Inventories

Inventories are stated at the lower of cost or market on the average cost method of ac-

counting. An allowance is provided for slow moving and obsolete items.

d) Property, plant and equipment

Property, plant and equipment are recorded at cost. Maintenance and repairs which do not improve or extend the useful lives of the respective assets are expensed in the year of incurrence. Disposals are removed from both cost and accumulated depreciation accounts, with the resulting gain or loss reflected in the income statement.

is three times the amount according to the straight-line method and must not exceed 30 percent of acquisition cost in the year of acquisition of the asset. A change to the straight-line method is made when the straight line depreciation exceeds depreciation according to the declining-balance-method. Low value items (with acquisition costs under DM 800) are expensed in the year of acquisition.

Depreciation on assets is calculated using the declining balance method over the useful lives of the assets. The maximum depreciation rate

The following estimated useful lives have been used in calculating depreciation.

USEFUL LIFE IN YEARS

Buildings	50
Company cars	5
Plant and machinery	5 to 10
Office equipment and other assets	5 to 10

e) Intangible assets and goodwill

Intangible assets consist of software, software related rights/licenses and goodwill. Software and software related rights are amortized on a straight-line basis over estimated useful lives ranging from 2 to 4 years. Goodwill is amor-

tized over 10 to 15 years. Additional allowances for obsolete intangible assets are provided, when necessary.

f) Pensions

Provisions for pensions are based upon an actuarial computation. There is only one plan in existence for one of the company's executive managers. The commitment is reinsured.

Pension benefits are fixed at a monthly amount after age of retirement. Pension expense/(income) is determined in accordance with Statements of Financial Accounting Standards No. 87 „Employers' Accounting for Pensions“. The pension plan is not funded.

g) Other accrued expenses

All estimated expenses incurred up until the balance sheet date, but have not yet been billed or paid, including vacation, overtime

accruals and anniversary payments are included in other accrued expenses.

h) Recognition of revenues and income

Revenues and related expenses are recognized when earned and incurred, respectively.

i) Subsidies

Subsidies were obtained from the State Rheinland-Pfalz in connection with the development of the Multimedia-Internet-Park in Zweibrücken. The subsidies related to the capital expenditures are regarded as reduction of

costs. The subsidies related to operating expenses incurred are taken into other income. Overpayments referring to 1998 are reported as other liabilities.

j) Cash and cash equivalents

Cash consists of all cash in banks, checks and cash on hand.

k) Use of estimates in the Preparation of Financial Statements

The preparation of the consolidated financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts and disclosure of assets and liabilities and disclosure of contin-

gent assets and liabilities at the date of the financial statements, and the reported amounts of revenue and expenses during the reported period. Actual results could differ from those estimates.

5. Capital Stock

Capital stock amounts to DM 1,030 thousand. The shares are held as follows:

	1997 DM '000	1996 DM '000
Ralph Dommermuth Deutschland Investments (Holdings) IV, BV, Amsterdam/ Niederlande	655	700
3i Europe Investment Partners No. 1, 3i Europe Investment Partners No. 2, 3i Group plc., London	150	150
Michael Scheeren	50	50
Thomas Schieferstein	50	50
Private Equity Bridge Invest Ltd. Cayman/BWI	45	0
Klaus Günter Zulla (trustee)	20	30
Own Shares	10	0
Share capital registered	1,030	1,000

Consolidated Financial Statements

6. Capital surplus

In 1996 the shareholders of the Company made a contribution of DM 3,000 thousand. Moreover in 1996 the company decided to increase its share capital from DM 1,000 thousand to DM 1,030 thousand. The new shares were issued to five managers of the company

with a premium totalling DM 2,970 thousand. As up to December 1996 the capital increase was not yet registered, the respective capital stock was paid in and the capital surplus were recorded as contribution made with respect to the capital increase.

7. Intangible assets

	1997 DM '000	1996 DM '000
Cost:		
Software	4,535	4,164
Licences	1,906	1,815
Goodwill	327	327
	6,768	6,306
Less:		
accumulated depreciation	(5,045)	(4,150)
Intangible assets, net	1,723	2,156

The goodwill results from the consolidation of a subsidiary in 1995. At the acquisition date in 1995 the subsidiary had tax loss carryforward

which was completely utilized in the same year. The goodwill was totally amortized in 1995.

8. Property, plant and equipment

	1997 DM '000	1996 DM '000
Cost:		
Land and buildings	9,087	763
Company cars	2,183	2,497
Office equipment	8,816	7,175
Office furniture	1,050	944
Building improvements	460	460
Buildings under construction	5,486	0
less subsidies	(4,406)	0
	22,676	11,839
Less:		
accumulated depreciation	(7,035)	(5,851)
Property, plant and equipment, net	15,641	5,988

Due to the cancellation of a contract (see Note 18) some office equipment was obsolete and completely written off in 1997 (DM 306 thousand).

Buildings under construction represent of the building costs referring to the Multimedia-

Internet-Park Subsidies of DM 4,406 thousand relate to capital expenditure in fiscal year 1997 actually incurred in the buildings and are regarded as reduction of costs, whereas the remaining part of the received funds amounting to DM 2,346 thousand is recorded as other liabilities.

9. Other long-term assets

Other long-term assets include loans of DM 1,980 thousand with no scheduled maturity to four managers of the company to finance the purchase of the new shares issued by the company. The loans bear interest at 6.0 percent per annum (p. a.).

As of December 31, 1997 the company repurchased the shares issued in 1996 of one resigned manager at the nominal value of DM 1,000 thousand. The related loan of DM 990 thousand was repaid.

Consolidated Financial Statements

10. Inventories

Inventories consist of the following purchased hardware:

	1997 DM '000	1996 DM '000
T-Online-/Internet-products (modems)	1,267	2,923
ISDN-products (transformer and telephone)	426	2,590
CD ROM-discs	6	999
Personal Computers	1,587	589
Other	98	0
	3,384	7,101
Less: Provisions	(350)	(728)
Inventories, net	3,034	6,373

Inventories declined during the reported periods because of several reasons. Sales of personal computers dropped significantly and related inventories were reduced. The business with

CD ROM-discs was completely discontinued and the overall inventory management was improved.

11. Accounts receivable

	1997 DM '000	1996 DM '000
Trade accounts receivable	35,021	34,982
Less:		
• Specific allowance	(1,307)	(1,307)
• General allowance	(390)	(443)
Trade accounts receivable, net	33,324	33,232
Other accounts receivable		
<i>Claims against suppliers</i>	1,019	2,059
<i>Tax claims</i>	514	68
<i>Pension reinsurance</i>	79	58
<i>Approved subsidies</i>	1,753	0
<i>Others</i>	336	283
	3,701	2,468
Less:		
• Specific allowance	(271)	(126)
• General allowance	0	(145)
Other accounts receivable, net	3,430	2,197
	36,754	35,429

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12. Liabilities due to shareholders

	1997 DM '000	1996 DM '000
Loans	0	1,033
Less: current maturities	(0)	(33)
	0	1,000

Three loans totalling DM 1,000 thousand were granted by three shareholders, bearing interest at 15 percent p. a. until June 30, 1995 and 9 percent p. a. thereafter, until maturity on June 30, 2000. The loans were subordinated to all liabilities of the company.

Originally an earlier cancellation and repayment was possible only if the loan would be replaced by a comparable loan or by equity. Regardless of that the shareholder's resolution on June 30, 1997 decided to cancel the original contract and repay the loan without any alternative financing. Interest expenses amounted to DM 45 thousand in 1997 and DM 90 thousand in 1996.

13. Liabilities due to banks

	1997 DM '000	1996 DM '000
Loans	10,124	1,745
Less: Current maturities	(772)	(0)
Total Long-term Bank Loans	9,352	1,724
Current Maturities of Long-Term Debt	722	0
Overdrafts	4,028	13,928
Notes Payable	0	6,000
Total current liabilities due to banks	4,800	19,928
Total liabilities due to banks	14,152	21,673

14. Maturities and short-term credits

a) Maturity

Up to December 31, 1996 and 1997 the long-term liabilities include an interest-flavouring loan of DM 750 thousand from the European Economic Community of coal and steel, bearing interest at a fixed rate of 7.13 percent p. a. In 1994 and 1996 interest subsidies of ECU 18,237 each were given to the company by the European Economic Community of coal and steel for meeting the agreed utilization of the funds. The loan is secured by assignment of related equipment.

In July 1996, an annuity loan amounting to DM 1,000 thousand was entered into with a fixed interest rate of 6.25 percent p. a. and an initial annual amortization rate of 2.0 percent, secured by a mortgage.

In September 1997 two long term loans amounting to DM 4,000 thousand and DM 4,400 thousand were granted in connection with the acquisition of certain land in the airport area in Zweibrücken. The repayments begin in the year 2002 at 4 percent annually of the face value. The loans bear interest at a fixed rate of 5.40 percent p. a. and 6.39 percent p. a. respectively up to the year and are secured by mortgage and assignment of future receivables from renting the facilities.

The interest expenses on the total liabilities due to banks amounted to DM 1,111 thousand in 1997 and DM 1,485 thousand in 1996.

Long-term liabilities due to shareholders and banks, mature as follows:

	1997 DM '000	1996 DM '000
1998	772	772
1999	24	24
2000	25	1,025
2001	27	27
2002	113	897
thereafter	9,163	0
Total	10,124	2,745
thereof due to shareholders	0	1,000

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b) Short-term credits

The company has credit lines with several banks for short-term loans and overdrafts as follows:

	1997 DM '000	1996 DM '000
Available credit lines	44,250	45,000
Usage of credit lines	4,028	13,927
Average interest rate in %	6,825	6,825
Unused credit lines	40,222	31,073

15. Other accounts payable

	1997 DM '000	1996 DM '000
Subsidies	5,051	0
Taxes	3,318	1,800
Social Security	841	638
Other	367	303
	9,577	2,741

The subsidies are for the new Multimedia-Internet-Park activities and relate to capital expendi-

tures not yet spent (DM 2,346 thousand) and future expenses (DM 2,705 thousand).

16. Advance payments

	1997 DM '000	1996 DM '000
Advance payments	4,924	4,363

The company receives payments from customers in advance with respect to the annual

organization of a site at the computer exhibition CeBIT and CeBIT-Home.

17. Employee benefit plans

The company has a single pension agreement for one of its managers. The plan is non-contributory, unfunded but reinsured and guarantees a fixed retirement and disability pension per

month. In 1997, the pension accrual amounted to DM 131 thousand and in 1996 to DM 111 thousand.

Total pension expenses were:

	1997 DM '000	1996 DM '000
Defined benefit plans		
- Service cost	15	16
- Interest cost	6	5
Net periodic pension cost	21	21

The following table sets forth the funded status of the company's pension plans, amounts re-

cognized in the company's balance sheets, and the principal weighted averaged assumptions inherent in their documentation:

	1997 DM '000	1996 DM '000
Actuarial present value of pension obligations:		
Vested benefit obligation	0	0
Accumulated benefit obligation	105	86
Projected benefit obligation	125	125
Plan assets at fair value	79	58
Projected benefit obligation in excess of plan assets	46	47
Unrecognized net gain/(loss)	6	6
Prior service cost	0	0
Pension (asset) liability recognized in the balance sheet	131	111
Assumptions:		
Discount rate	7 %	7 %
Salary increase	0 %	0 %
Pension payment increase	2,5 %	2,5 %

18. Deferred income

In March 1997 the company negotiated a new contract with a major customer to replace a prior contract with this customer which lasted until December 31, 1999.

The customer agreed to a onetime payment of DM 15,000 thousand to compensate for the disadvantages resulting from the change of the contract.

In 1997 DM 4,403 thousand of the DM 15,000 thousand have been taken into income in order to set off the one time charges (personnel expenses, depreciation) and certain other disadvantages. The remaining amount of DM 10,597 thousand is reported as deferred income and released and taken into income during the next two years fiscal years.

19. Other income/expenses

Other income in fiscal year 1997 mainly includes the subsidies related to operating expenses (DM 2,095 thousand) at the Multimedia-Inter-

net-Park in Zweibrücken and DM 4,403 thousand out of the compensation payment from a customer (see Note 18).

20. Income taxes and deferred taxes

German trade tax on income is levied on a company's taxable income adjusted for certain revenues which are not taxable for trade tax purposes and for certain expenses which are not deductible for trade tax purposes. The trade tax rate is dependent on the municipalities in which the company operates. The average statutory trade tax rate was approximately 15 percent for all years presented. Trade tax is deductible for corporate income tax purposes.

Corporate income tax in Germany is levied at 45 percent (1995 and following) for retained earnings and at 30 percent on profits distributed. Additionally a solidarity surcharge of 7.5 percent (1998: 5.5 percent) on corporate income tax will be imposed. The corporate income taxes have been determined on the basis of a full profit distribution of the reported fiscal years.

Timing differences between financial and tax accounting are immaterial and deferred taxes are not applicable.

21. Commitments and contingents

a) Lease commitments and long-term rental agreements

Up to December 31, 1997 minimum rental commitments under operating leases were DM 3,846 thousand, DM 4,653 thousand, DM 2,809 thousand, DM 2,809 thousand and DM 1,453 thousand for 1998 through 2002, respectively. This represents the entire minimum payment of the rent up to DM 15,573 thousand.

b) Contingent liabilities

The company has commitments with respect to construction of the facilities at the Multimedia-Internet-Park by the amount of DM 15.5 million, which will be subsidized by 80 percent. Apart from that, the management is not aware

DM 921 thousand of the total rental commitments are accrued each year and payable at the end of the underlying rental contract on June 30, 1999.

of any matter that could give rise to any liabilities to the company that would have a material adverse effect on the company's business, financial conditions or results of operation.

22. Business segment reporting

The company operates in two major business lines, Marketing Services and Internet Services.

The business line Marketing Services includes the marketing and distribution of multimedia products in traditional media. The company primarily sells ISDN and T-Online subscriptions, mobil phone subscriptions and Internet bank accounts in addition with related hardware and software applications. This is connected with the marketing of home banking services on behalf of banks and financial institutions. Apart from that this market segment comprises cooperative advertising campaigns for different suppliers of multimedia products by using all relevant traditional communication channels. Additionally, the company is running a telephone hotline in order to help multimedia brand suppliers to give their customers support in solving user problems.

Within the business line Internet Service the company is acting as an Internet provider. In order to enable users the access to Internet, the company runs the required hardware (computer center, network) and delivers the related browser software. Moreover this market segment includes the placement of marketing campaigns of different companies in the online services by using a new technology, which enables to best select and address the relevant target groups.

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Net sales for the respective business segments for the years ended December 31, 1997 and 1996 were as follows:

	1997 DM '000	1996 DM '000
Sales		
Marketing Services	126,723	152,154
Internet Services	8,787	5,269
Total	135,510	157,423

Net sales figures represent consolidated figures excluding intrasegment sale.

In 1997 the largest customer of the company approximately represented 41 percent of the sales in the segment marketing services, the second largest 10 percent and the third

largest 4 percent. In 1996 the major customer represented 41 percent, the second and the third largest 1 percent each. In the meantime the sales of the major customer of the financial year 1998 represents, on the basis of the strong growth with new business models, approximately 25 percent.

Operating income (net sales less operating expenses) for the respective business segments

for the years ended December 31, 1997 and 1996 is shown in the following table:

	1997 DM '000	1996 DM '000
Operating income		
Marketing Services	16,956	4,154
Internet Services	-2,420	441
Summe Total	14,536	4,595

The loss within the Internet Services in 1997 is a result of low sales in the start up phase in relation to minimum operating ex-

penses required to provide the necessary service level.

	1997 DM '000	1996 DM '000
Identifiable Assets		
Marketing Services	42,394	48,712
Internet Services	15,182	1,692
Others	6,867	7,097
Total	64,443	57,501
Gross Plant Additions		
Marketing Services	2,856	3,304
Internet Services	10,857	490
Others	406	2,656
Total	14,119	6,450
Depreciation		
Marketing Services	2,369	2,612
Internet Services	876	63
Others	1,042	1,390
Total	4,287	4,065

Others consist of identifiable assets, additions and depreciation of the Holding-Company, which acts as a supporting backoffice for its

subsidiaries and develops the strategy of the company.

23. Events subsequent to the balance sheet date

In the beginning of 1998 a partnership limited by shares (Kommanditgesellschaft auf Aktien) was established. With respect to a subsequent

Initial Public Offering on the German Neuer Markt it is intended to merge the 1&1 Holding GmbH into the partnership limited by shares.

REPORT OF THE INDEPENDENT PUBLIC ACCOUNTANTS

We have audited the accompanying consolidated balance sheets of 1&1 Holding GmbH, Montabaur, and subsidiaries as of December 31, 1997 and 1996 the related consolidated statements of income and cash flows and shareholder's equity statement for each of the years then ended. 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 audits.

We conducted our audits in accordance with in the United States generally accepted auditing standards. 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 statements 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 financial position of 1&1 Holding GmbH, Montabaur, and subsidiaries as of December 31, 1997 and 1996 and the results of their operations and their cash flows for the years then ended, in conformity with generally accepted accounting principles.

Eschborn/Frankfurt am Main

January 30, 1998

ARTHUR ANDERSEN
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Timetable for 1998

- | | |
|------------------------------------------------------|---------------------------|
| ■ Interim report on the first quarter of 1998 | 1st week of May 1998 |
| ■ Interim report on the first half of 1998 | 1st week of August 1998 |
| ■ Investors' Conference | 1st week of August 1998 |
| ■ Interim report on the first three quarters of 1998 | 1st week of November 1998 |

Timetable for 1999

- | | |
|------------------------------------------------------|----------------------|
| ■ Provisional report on the 1998 financial year 1998 | Mid-February 1999 |
| ■ Balance Sheet Press Conference | Mid-March 1999 |
| ■ Meeting of the Supervisory Board | Start of April 1999 |
| ■ Interim report on the first quarter of 1999 | 1st week of May 1999 |
| ■ General Meeting for the financial year 1998 | Mid-May 1999 |