Annual Report 2002

THE XML COMPANY

Analyze, plan, implement

When our customers' IT reaches its limits, we find pragmatic solutions.

Key Figures

EUR, in million, unless stated	Dec. 31, 2002	Dec. 31, 2001	Dec. 31, 2000	Dec. 31, 1999
Revenues	**475.0**	**588.5**	**416.6**	**365,9**
from:				
Licensing	113.0	199.1	132.9	113.7
Maintenance	200.9	196.0	127.9	122.5
Professional Services	159.6	190.3	154.9	128.1
Other turnover	1.5	3.1	0.9	1.6
EBITDA	**82.7**	**100.4**	**114.1**	**70.1**
as % of revenues	17	17	27	19
Income before taxes	**50.7**	**70.3**	**112.9**	**66.3**
as % of revenues	11	12	27	18
Income after taxes	**33.5**	**38.7**	**66.6**	**38.4**
as % of revenues	7	7	16	10
Total assets	**440.8**	**504.0**	**424.6**	**361.2**
Cash and cash equivalents	**75.4**	**50.2**	**215.3**	**197.1**
Shareholders' equity	**214.5**	**196.2**	**200.9**	**138.7**
as % of total assets	49	39	47	38
Employees	**3,013**	**3,326**	**2,846**	**2,639**
of these in Germany	1,243	1,306	1,292	1,257

Stock Key Figures

Frankfurt (Prime Standard/TecDAX), German stock identification number 724 264, ISIN DE 0007242646, symbol SOW4

	Dec. 31, 2002	Dec. 31, 2001	Dec. 31, 2000	Dec. 31, 1999	April 26, 1999*
Price (XETRA-closing price, in EUR)	9.01	43.00	82.66	60.50	30.00**
Market capitalization in billion EUR	0.25	1.17	2.18	1.58	0.78
Number of stocks	27,266,752	27,261,483	26,397,228	26,090,000	26,090,000

* Software AG IPO ** Issue price

	2002	2001	2000	1999
Dividend per share (EUR)	0.00*	0.43	0.38	0.28
Earnings per share (EUR)	1.23	1.44	2.55	1.47
Earnings per share (EUR) according to DVFA/SG	-0.29	1.33	1.51	1.34
Price/earnings ratio at fiscal year-end	7	30	32	41
Operating cash flow per share (EUR) at fiscal year-end	1.49	3.05	-0.71	2.70
High	44.10	87.00	167.00	63.55
Low	8.41	35.90	57.00	22.50

* The Supervisory Board and the Executive Board have resolved to fully retain fiscal 2002 earnings.



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“Outstanding technology and innovative solutions are the foundations of our strategy.”

Andreas Zeitler, Member of the Executive Board responsible for Sales and Marketing

Planning is the key to realizing your vision

If you have ambitious goals, you need solid foundations. Our proven data management technology enables customers to increase productivity – now and in the future.

Letter to our stockholders

Dear stockholders,

Fiscal 2002 was a very difficult year for Software AG. 2001 had already been a tough year for the software industry but Software AG bucked the trend and grew by acquiring its long-time US distributor. However, expectations that the market would pick up significantly in 2002 were not fulfilled.

As a result of the harsh economic climate and uncertain mid-term business outlook, many Software AG customers were reluctant to invest in IT. This not only effected revenue from upgrades, updates and enhancements to our enterprise transaction products, but also the number of new e-business projects. Consequently, we experienced falling demand from the first quarter of 2002, in particular for software licenses.

Restructuring bears fruit

In response to this trend, we initiated a comprehensive restructuring program in March 2002. The aim was to gradually align our costs with our lower sales revenue. This enabled us to slow the decline in earnings to some extent, and post a profit in fiscal 2002.

While reining in costs, we pushed ahead with our strategic focus on XML technology. Version 4.1 of Tamino XML Server is a comprehensive solution for generating and managing XML documents. We also added EntireX XML Mediator to the EntireX integration platform.

Another key aspect of our strategy is continued investment in research and development with a view to ensuring that our enterprise transaction products remain highly competitive for years to come. Above all, we are committed to guaranteeing that our Adabas and Natural software systems remain compatible with emerging industry standards. We also offer solutions that make it possible to flexibly and cost-effectively adapt these systems to new requirements, such as Web-based access. This approach protects our customers' investment, because they can continue to use Software AG products in conjunction with the emerging technology.

Our e-business offering goes one step further. We are currently developing solutions, including content management and Web services, for selected industries (banking and insurance, pharmaceuticals, healthcare, the public sector, and media and technology). This work is being undertaken partly in collaboration with our partners.

Chronicle of events in 2002

Feb. 27 Tamino 3.1 wins 2001 InfoWorld Technology of the Year Award in the XML category.

Feb. 28 Software AG extends the functionality of its EntireX integration platform by establishing a technology partnership with Savvion, Inc., Santa Clara, California, a leading vendor of business process management software.

From left to right: Arnd Zinnhardt, Karl Heinz Achinger, Andreas Zeitler, Dr. Detlef Purschke

Professional services and sales organization restructured

In keeping with our role as consultants for the entire project lifecycle, we redefined our professional services, creating three units: preparation and planning of IT projects, assistance in selecting suitable technology, and development of solutions tailored to our customers' unique requirements.

Our sales organization was realigned in early 2002 to help attract new customers and provide improved service to existing customers. In particular, we are looking to more actively target prospects, improve management of strategic accounts around the globe, and to recruit additional sales partners. As a result of the adverse development of the market, the restructuring has yet to produce the desired results. However, we believe that by re-organizing and intensifying our sales activities, we are now well placed to broaden our customer base.

We do not expect business to pick up significantly in 2003. For this reason, Software AG believes that its revenues will remain largely unchanged. Against this background, ensuring profitability is our top priority. At the same time, we are enhancing our position as a leading provider of systems software and services for mission-critical enterprise information technology by developing solutions.

The Software AG Executive Board

Karl Heinz Achinger
Chairman and Chief Executive Officer

Dr. Detlef Purschke
Member of the Executive Board responsible for Services

Andreas Zeitler
Member of the Executive Board responsible for Sales and Marketing

Arnd Zinnhardt
Chief Financial Officer

Mar. 6 In cooperation with Tridion B.V., the Netherlands, and Stellent Inc., USA, Software AG launches end-to-end content management solutions.

Mar. 13 Software AG and IXOS, Germany, introduce XML-based document archiving.

Mar. 20 Record number of visitors to Software AG booth at CeBIT exhibition, Hanover, Germany.

Report of the Supervisory Board

During the year under review, the Supervisory Board monitored the management of the Company, regularly reviewing the Company's position and major business developments. A total of seven meetings took place in 2002, with at least one per quarter.

The Supervisory Board and Executive Board discussed and analyzed current business developments and corporate strategy in detail. Transactions requiring the Supervisory Board's consent by law or by the Company's Articles of Association were examined and discussed individually before approval was given.

Issues addressed at the meetings included the financial state of the Company and its subsidiaries, the current and longer-term development of the various business units, and the Company's product, sales and marketing strategies. In addition to these meetings, the Executive Board submitted written reports to the Chairman of the Supervisory Board on a monthly basis.

The Supervisory Board formed the following committees:

- The Committee for Compensation and Succession Issues
- The Stock Options Committee
- The Audit Committee (formed in accordance with the resolution passed on December 18, 2002)

The Committee for Compensation and Succession Issues convened on four occasions in the year under review. The Stock Option Committee deals primarily with issues relating to employee stock options to be served by means of authorized capital. However, because it was not possible to exercise options based on authorized capital during 2002, the Stock Option Committee did not convene.

The Audit Committee held its constituent meeting on February 28, 2003.

The following changes in the composition of the Executive Board and Supervisory Board took place during the year under review:

Volker Dawedeit, member of the Executive Board responsible for finance and administration (Chief Financial Officer) resigned his position for personal reasons, effective April 30, 2002, the date of the Annual Stockholders' Meeting. The Supervisory Board appointed Arnd Zinnhardt as his replacement, effective as of May 1, 2002.

Dr. Erwin Königs resigned as Chairman of the Executive Board, also for personal reasons, effective November 30, 2002. In lieu of an immediate successor, the Supervisory Board appointed Karl Heinz Achinger as acting Chairman for an initial term of six months in accordance with Section 105, Subsection 2 of the German Public Companies Act (AktG), effective December 1, 2002. While Mr. Achinger holds this position, his membership in the Supervisory Board is suspended. Mr. Achinger is a highly experienced and skilled manager with a exceptionally successful 30-year track record in the IT industry.

The Annual Stockholders' Meeting on April 30, 2002 elected the two members of the Supervisory Board appointed by the Darmstadt Municipal Court, namely Frank F. Beelitz and Karl Heinz Achinger.

One of the employee representatives on the Supervisory Board, Detlef Winterstein, resigned his position, effective April 30, 2002. He was replaced as of May 1, 2002 by Reinhard Springer.

April 29 Adabas now with new SQL engine and support for multiprocessor environments.

May 1 Arnd Zinnhardt succeeds Volker Dawedeit as CFO.

June 27 Software AG unveils EntireX XML Mediator.

July 10 Software AG's Justus workflow solution successfully implemented at the Ministry of Justice in the German State of Baden-Württemberg.

Frank F. Beelitz, Chairman of the Supervisory Board

Dietrich-Kurt Frowein, Chairman of the Supervisory Board of Software AG, resigned his position in accordance with prior arrangements, effective September 30, 2002, upon reaching the age of 65. He retained his position as an ordinary member of the Supervisory Board until November 30, 2002.

The Supervisory Board elected the previous Deputy Chairman, Frank F. Beelitz, as its new Chairman, effective October 1, 2002. The position of Deputy Chairman was held by Karl Heinz Achinger from October 1 to November 30, 2002. Upon Mr. Achinger's appointment to the Executive Board, the Supervisory Board appointed Dr. Peter Lex as its Deputy Chairman for such period as Mr. Achinger's membership of the Supervisory Board remains suspended. This decision was made during the meeting held on December 18, 2002.

Mr. Justus Mische was appointed as Mr. Frowein's successor, effective December 9, 2002, following a resolution of the Darmstadt Municipal Court.

At its meeting on December 18, 2002, the Supervisory Board gave its approval, following an in-depth discussion, of the Corporate Governance Guidelines, and made a Declaration of Compliance in accordance with the German Corporate Governance Code.

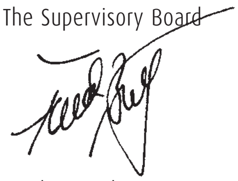
In accordance with the resolution of the Stockholders' Meeting, the Supervisory Board appointed BDO Deutsche Warentreuhand Aktiengesellschaft, Frankfurt am Main, Germany, to audit the year-end financial statements and consolidated financial statements for 2002.

The year-end financial statements for Software AG, the consolidated financial statements for the Software AG Group, the management report and the accounts, were audited by BDO and certified without qualification.

The audit report was submitted to the Supervisory Board, and the auditors explained the report's findings in person to all Supervisory Board and Executive Board members. The Audit Committee and the Supervisory Board examined the report in detail at its meeting on February 28, 2003, and has declared itself in agreement with the auditor's findings. The annual account and the consolidated financial statements are hereby approved.

The Supervisory Board wishes to thank the Executive Board and all Software AG employees for their dedication and commitment throughout fiscal 2002.

Darmstadt, February 2003
The Supervisory Board



Frank F. Beelitz
Chairman

Aug. 1 Natural Engineer WebStar makes its debut.

Oct. 10 Workflow-supported XML-document management introduced at DaimlerChrysler for diagnostics data in development, production and customer service processes.

Dec. 1 Karl Heinz Achinger succeeds Dr. Erwin Königs as Chairman and CEO on an interim basis.

Dec. 11 Software AG launches version 4.1 of Tamino XML Server.

Software AG stock

Software AG to be listed on the Prime Standard and TecDAX

Global stock market downturn
After what was already a grim 2001, the bear market intensified in 2002. The global economic slowdown dented earnings, while accounting scandals and the threat of military action in the Gulf region shook investor confidence, and encouraged a switch to government bonds. The German stock market was particularly hard hit by the change in climate, with Frankfurt's DAX index of leading shares dropping nearly 44 percent over the year. The European market in general, reflected by the Stoxx50 index, slid 35 percent. Losses in the US were less pronounced, where the Dow Jones index shed 17 percent, and the Nasdaq fell 31 percent.

Software AG stock price in line with Neuer Markt index
An analysis of the last two years shows clearly that investors tend to regard Software AG primarily as a tech stock. Over the two-year period, the Nemax index of fifty leading technology shares fell 87 percent, and Software AG shares 89 percent. German midcap index MDAX, meanwhile, slipped only 35 percent.

Having bucked the industry-wide downward trend in fiscal 2001, Software AG was hit unexpectedly hard by the software industry slump in the first quarter of 2002. Falling license revenues prompted two profit warnings in the first quarter. Unfortunately, this did lasting damage to investor confidence in company guidance, and put Software AG's share price under severe pressure. A cost-cutting package was immediately implemented, which helped the company end the year in the black. Nevertheless, the share price ended the year close to an all-time low.

Regaining confidence by focusing on shareholder value and greater transparency
The year-end share price indicates that we still have not succeeded in rekindling broad-based investor interest in Software AG. Although moves to curb costs ensured the long-term viability of the company, this was not enough to provide stock-price momentum. Changes in global economic fundamentals and in patterns of demand for IT solutions call for a further realignment of Software AG strategy, as well as continued strict cost control. The action we have taken, boosted by solid quarterly earnings, should help us regain investor confidence in fiscal 2003.

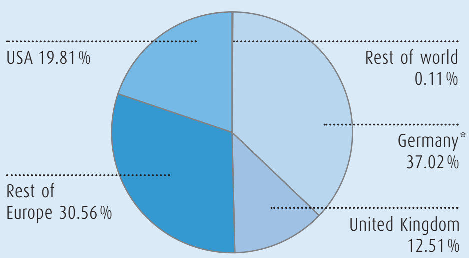
Against this background, the implementation of the German Code of Corporate Governance is an important milestone. Transparent, value-based management, and effective supervision, are increasingly important criteria for the analysis and valuation of

1
Shareholders by region in percentage of Free Float as of December 31, 2002

*excluding Software AG foundation

2
Shareholder structure in percentage of share capital as of December 31, 2002

1



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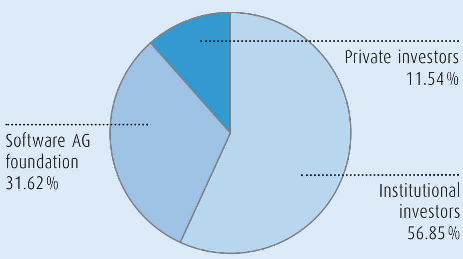


today's quoted companies. Software AG was already in compliance with many of the principles set down in the code. We welcome the initiative, as a standard code will consolidate international investor confidence in German management and regulation. The Executive and Supervisory Boards of Software AG therefore adopted the code.

German Corporate Governance Code

In December 2002, the Company issued the following declaration of compliance in accordance with section 161 and in conjunction with section 15 of the Stock Corporation Act:

"The Supervisory Board and the Management Board of Software AG hereby declare that the Company complies with the recommendations of the Government Commission on the German Corporate Governance Code with the following exceptions:

Subsection 3.8, sentence 3:
The current Directors and Officers (D&O) insurance policy specifies a deductible of 5,100 euros for each insured person. The Company believes this figure to be appropriate. Because the Code does not define an appropriate amount, it is disclosed in this report.

Subsection 4.5.1, sentence 2:
There is currently no age limit for members of the Supervisory Board. An age limit of 70 will be proposed at the next meeting of shareholders.

Subsection 5.4.5, sentence 3:
The chair and members of committees do not currently receive any additional compensation.

Subsection 7.1.1, sentence 3:
Annual and interim reports are currently published according to the German Commercial Code (HGB). From 2004, the Company plans to publish reports according to the International Accounting Standards (IAS)."

Listing on the TecDAX index

German stock market operator Deutsche Börse AG has decided on a new segmentation of its Frankfurt exchange. Software AG fulfilled the requirements for the new Prime Standard, which it joined on January 1, 2003. This segment demands the highest standards of investor relations and transparency. At the same time, Deutsche Börse restructured its index family. Software AG moved from the MDAX to the newly created TecDAX index, where it is one of the larger companies in terms of trading volumes and market capitalization. The TecDAX comprises the top thirty German tech stocks outside the DAX30, providing an appropriate point of reference for international investors. Software AG's inclusion on this index should ensure a high and positive profile among both private and institutional investors.

Development of Software AG's stock price in comparison with MDAX and Nemax-All-Share (indexed)

■ Software AG
■ MDAX
■ NAS

Applied technology

IT decision-making in a harsh economic climate
The current downturn is impacting all sectors, not just the IT industry. In all four corners of the globe, executives face new and harsher economic realities which call for a realignment of their business strategy in general, and their IT strategy in particular. In response to a recent survey by Forrester Research, 76 percent of companies stated that they needed to initiate new IT projects to maintain their competitiveness. This puts IT decision-makers in the hot seat. However, with the powerful, effective solutions and reliable, professional support of Software AG, companies in all industries, and of all sizes, can master these challenges.

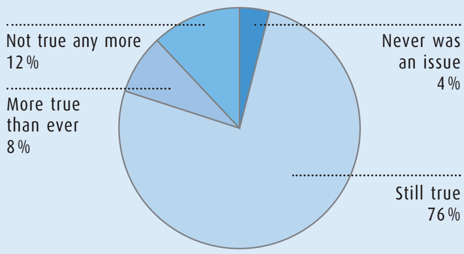
IT strategies aimed at cutting costs and increasing customer loyalty
Competition is particularly fierce in the financial services market. In the wake of the economic downturn and the recent spate of bankruptcies, banks and insurance companies are also saddled with billions of euros worth of bad debt. They have responded to the squeeze with mergers and acquisitions, and by laying off staff. Consultants AT Kearney expect an unprecedented period of market consolidation over the next two decades, slashing the number of significant global players to between five and seven. Throughout the industry, action is being taken to weather the storm, the overriding goal being to increase customer loyalty and slash costs.

At Heller Bank AG, headquartered in Mainz, Germany, an XML-based document management solution from Software AG has achieved significant savings. Each and every month, this factoring specialist generates and mails around 200,000 documents, with a total of 500,000 pages, to customers and business partners. The system created for the bank by Software AG has reduced administrative overhead for document generation, seamlessly integrated diverse communications channels, and now reliably tracks all correspondence.

Telekurs Finanzinformationen AG, Switzerland, and Colonial First State, Australia's leading fund managers, also profit from Software AG's expertise. Both organizations have achieved tangible customer service enhancements by means of XML-based solu-

"Competitive pressure compels firms to start new projects. Is this still true?"

Source: Forrester Research, Inc., March 2002



tions. The Swiss company leverages the meta language to generate financial information and deliver it quickly and efficiently to its customers. Every day, Telekurs provides tailored reports to banks and institutional investors based on over 300,000 news items. The Australian bankers have, with the help of a Software AG integration solution, combined their mainframe-based fund management system with their Web application. This enables customers and partners to conduct business transactions online. Colonial First State is also harnessing Software AG's IT skills to automate internal business processes. This will improve customer service and, at the same time, cut costs.

Public sector efficiency – e-government initiatives

Public sector organizations, too, are seeking to rein in expenses. Government agencies' primary goal is to improve the services available to citizens, to remove red tape and to increase responsiveness. But they are also under increased pressure to demonstrate that they are able to streamline administrative procedures, to make good use of taxpayers' money, and modernize both their approach and their image. Against this background, the Internet is set to become the key channel of communication between public sector organizations and citizens. This is the finding of a study by Forrester Research, which suggests that 2003 is likely to be a "trial period" for e-government. Thereafter, they argue, government agencies will reorganize, and restructure their services for the online age.

One of the earliest movers in the e-government space is the Ministry of Justice in the German state of Baden-Württemberg. The first step was to deploy high-speed networks and introduce Internet access, followed by the development of new software for judicial procedures. The new Web-based solution, based on open standards such as Java and XML, supports practically all processes, from the opening of judicial proceedings to the court judgment, by means of highly efficient document and workflow management. The technology and expertise were provided by Software AG. In addition to an online database of court records, employees have electronic access to the commercial register and the land reg-

Up-to-the minute information and high-speed transactions for the financial community: Software AG solutions have enabled Schweizer Telekurs Finanzinformationen AG and Colonial First State to enhance their services to investors.

"Integration solutions geared to real-life needs offer a rapid return on investment. That´s why partners and customers bet their business on our products and services."

Dr. Detlef Purschke, Member of the Executive Board responsible for Services ister. The new solution is a significant step towards the "paperless office."

Paperless, Web-based processes that deliver speed and efficiency were also high on the agenda of the government of the eastern Canadian province of Nova Scotia. Today, the Nova Scotia Public Service Commission, responsible for human resources management, employs an intranet application that is integrated seamlessly with back-end systems. Communications between employees and the commission, based in Halifax, take place online. With the help of Software AG's integration solution, the established systems, which have been working smoothly on the basis of Adabas and Natural for a number of years, can be migrated to new platforms, such as intranets.

Integration as the key to competitiveness

The logistics market is also fiercely contested. As Andrew Thorndike, logistics expert at McKinsey, explains, "In Europe, the profit margins for simply transporting something from A to B are practically zero. Competitive pressure is so extreme that it is scarcely possible to make money [simply with transportation]." In fact, customers now expect much more than trucks that arrive on time. Logistics companies are expected to provide additional services, such as goods tracking, quality control or simple assembly tasks. In other words, they assume responsibility for the complete flow of goods on their customers' behalf. However, few logistics players have the information technology they need to master these challenges. But things are changing fast. DaimlerChrysler, for example, is to equip its trucks with systems that help optimize the use of available capacity. The project, known as FleetBoard, was made possible by the expertise of Software AG.

The key to surviving and thriving in this environment is the introduction of state-of-the-art supply chain management solutions and the end-to-end automation of processes, delivering greater performance at lower cost. At northAmerican Logistics (nAL), for example, every dollar invested in a new integration project is, according to the Inter-

The Ministry of Justice of the German State of Baden-Württemberg is an e-government pioneer. It is streamlining workflow by introducing electronic court records – using Software AG solutions.

national Data Corporation (IDC), expected to create savings of US $ 3.18. Since the early 1990s, integration solutions from Software AG have helped nAL create a robust, future-proof IT environment. The first step for the Indiana-based company was to integrate its own, home-grown applications - automating internal business processes and significantly reducing process costs. Its second step was to open up its software to customers and business partners, helping to create a fully automated supply chain that supports the seamless exchange of data on the basis of XML. The new solution not only saves time and money, but also strengthens customer relations.

Return on investment as the yardstick for IT projects

The message from the front line is loud and clear: IT decision-makers throughout the world expect external partners to deliver pragmatic, practical answers to their needs, creating solutions that build on existing infrastructures and are precisely geared to individual company strategies. It is a message that Software AG understands, and a challenge that Software AG can master, as is clearly illustrated by a recent survey conducted by Meta Group. In terms of performance, Software AG is ranked among the top ten e-business solution vendors in the world. The survey polled 248 user companies in a variety of industries. The high rating is also a result of the market recognizing the fact that Software AG, with its 30-year track record, is a consistent innovator. The new Web services and content management offerings are just a few examples. But new as these concepts may be, they must still deliver tangible improvements at low cost and high speed for key business processes. Return on investment is the overriding objective.

Today, logistics means much more than just getting goods from A to B – solutions from Software AG help DaimlerChrysler and northAmerican Logistics (nAL) create value-added supply-chain services.

One step ahead In today's fast-moving business environment, agility is vital to success. Our XML-based solutions enable customers to respond rapidly even to unexpected market conditions.

Combined Management Report of Software AG and Software AG Group as of December 31, 2002

Economic climate and market developments: Stagnation

Prolonged market weakness

After a difficult 2001, hopes for economic recovery in 2002 remained unfulfilled. Growth in the world's two most important economies, North America and Europe, remained weak. As a result, company earnings fell almost across the board in 2002, leading to cost-cutting measures and lower investment. Moreover, entire industries, such as aviation, financial services and telecommunications, were plagued by structural problems.

The poor economic climate exacerbated the downturn in the software industry over the course of 2002. As such prolonged weakness was unprecedented in this market, many software companies were caught by surprise. A large percentage of market participants had expected an upturn in the second half of 2002.

Lower license revenue and falling margins for services put many IT players under severe pressure. Only companies that succeeded in paring back their costs in response to decreasing revenues were able to conclude 2002 with a positive bottom line. Software AG was one of them.

Strong decline in license sales for enterprise transaction products

Software AG's offering in the enterprise transaction products segment consists of Adabas, the database management system, and Natural, a development tool. There was worldwide decline in revenues from licenses for enterprise transaction products during fiscal 2002. Many factors contributed to this drop in demand, not least the weak global economy. Additionally, many enterprises were reluctant to upgrade existing software applications and did not see an urgent need to invest in increased data management capacity. This can be attributed to the difficult business climate, the large number of major software projects in the run-up to the millennium changeover (Y2K), and exceptionally high levels of investment during the boom years of 1999 and 2000.

Faster ROI drives the integration market

The economic downturn also left its mark on the integration technology market. Data and application integration enables higher automation and greater transparency in business processes, leading to reduced costs. However, many projects of this type were abandoned or delayed due to their high complexity, and the difficulties of evaluating and quantifying potential benefits. The integration market in 2002 was characterized by smaller, simpler projects, and by a focus on faster return on investment.

Postponement of e-business projects

The downward trend in the e-business products market, first detected two years ago, continued in fiscal 2002. Many e-business projects are not yet considered mission-critical. Therefore, postponement of further investments does not have a direct impact on the user's business processes. The value of projects continued or launched in 2002 was often only a fraction of the amount witnessed in previous years.

Despite the current lack of interest from the market, the strategic importance of e-business projects has not waned. But if they are to deliver the desired results in terms of cost-savings and greater efficiency, it is necessary to integrate existing applications and model entire business processes. The corresponding increase in project scope and expense, coupled with greater involvement of top executives, has led to lengthier, slower decision-making. In other words, investments have been delayed, first, as a consequence of the growing complexity of e-business projects, and, second, by cost constraints brought on by the current economic situation.

Excess capacity in the IT services market

The IT services market faced enormous pressures in terms of cost and margin in 2002. This was triggered by the excess capacity of most systems integrators. As a result of the weak economy, customers limited spending to those projects regarded as unavoidable, and numerous contracts were withheld.

When choosing service providers, customers placed added emphasis on industry-specific expertise and on evidence of a rapid return on investment. Only specialist companies operating in niche markets succeeded in warding off cost and margin pressures.

A shift in strategic emphasis: From technology supplier to integration partner

Software AG's XML technology: The key to effective solutions

Software AG is a leading provider of systems software and services for mission-critical IT. For more than 30 years, the Company has been dedicated to the development of innovative technologies for efficient data management. Since 1997 we have increasingly shifted the focus of our portfolio of products and applications toward data and document exchange. This includes the integration of established IT systems into today's Web-based environments, and is achieved using the XML standard (eXtensible Markup Language).

XML is a proven e-business standard, and a key enabling technology in the integration of data and applications. Our XML products do more than support inter-enterprise data transfer; they lay the foundations for seamless integration of business processes. The resulting increase in automation boosts productivity, eliminates human error, and cuts costs. It also becomes possible, on the basis of standard technology, to quickly and easily extend processes beyond the enterprise, to include customers, partners and suppliers. XML enables inter-enterprise collaboration, without forcing customers to abandon tried-and-trusted internal processes. Software AG's XML technology harnesses existing IT investment: Established, tried-and-trutsed software can still be employed, in modified form.

Blazing a trail with tailor-made solutions based on standard components

Customers now expect much more from their software vendors. Corporate IT environments have become highly complex landscapes comprising disparate hardware platforms and operating systems. Our customers' primary concern is no longer to develop an infrastructure for data management and exchange. More important to them is integration of data and applications, both within and beyond enterprise boundaries. The goal is the creation of end-to-end, automated solutions for given tasks, such as contract management or supplier relationship management.

However, the prohibitive risks and costs of developing applications in-house mean that more and more companies are looking for external answers to their needs. Customers want tailor-made solutions, based on proven components that guarantee rapid return on investment. With this in mind, we do not simply offer software components, but have taken steps to broaden our portfolio. Software AG's Executive Board has therefore moved to accelerate the Company's journey from technology supplier to solution provider and systems consultant. Our efforts in 2002 focused on:

- Enhancing our product and service portfolio.
- Close cooperation with solution providers.
- Development or acquisition of software and software components.
- End-to-end customer service.
- Greater focus on specific industries.
- Solution-oriented sales and marketing.

We implemented a range of measures to achieve these goals:

New XML solutions

Software AG's Tamino XML Server Version 4.1 offers a significantly expanded solution for the generation, deployment and management of XML data. In addition, we have enhanced our integration platform with the launch of EntireX XML Mediator, a powerful tool for the coordination of XML applications. This provides customers with a fast and simple way to use XML applications.

The next step was the further development of our XML technology in order to target potential high-growth markets, such as content management, Web services and industry-specific software solutions.

Users of our enterprise transaction products, Adabas and Natural, are also reaping the benefits of Software AG's XML strategy. Using Web services, it is now possible to adapt existing applications to changing needs. This protects existing investments and opens up new opportunities.

Web services: Building bridges between IT environments

Implementing Web-services architectures is becoming an increasingly important aspect of Software AG's business. Web services based on Tamino XML Server and EntireX, are a key enabling technology for the integration of diverse software systems – for instance, systems deployed by the various participants in a process chain, such as manufacturers, logistics providers and customers. It ensures seamless data transfer between the various applications and operating systems employed along the chain. The decisive factor is that the Web services are based on standards such as XML, SOAP, UDDI and WSDL, using the Internet as infrastructure. One software component controls the entire business process, and all process chain participants can access this component via standard Internet browsers. In other words, Web services build cost-effective, technology-independent bridges between systems and applications.

Software AG implemented Web services for many of its customers in fiscal 2002, based on XML e-business products EntireX and Tamino XML Server. Users were able to increase flexibility and enhance communication channels between, for example, employees and customers. At the same time, the relevant data and functions are made available to internal and external users all along the process chain. Moreover, Web services allow greater responsiveness to new customer requirements: Changes to business processes only require individual components to be rearranged, and not wholesale reprogramming of the entire process.

XML-based content management: harvesting knowledge from information

Software AG's XML product portfolio offers added value: not just for managing business-critical processes, but also for management information from diverse data sources (including websites, Excel spreadsheets, multimedia presentations, video files). XML creates the basis for state-of-the-art content management. In addition to our own product portfolio, partnerships with other best-of-breed providers have extended our coverage to include document, Web-content and digital-asset management also.

Companies are turning to content management to streamline the way they handle and utilize information. With the help of XML, users can access data with ease and speed – across the boundaries of operating systems, applications and communications channels. Content management systems support business processes throughout the information life cycle: from generating, editing, and updating, to organizing, publishing, and, most important, reusing knowledge. In today's information society, with ballooning data volumes and accelerating communications, this is vital.

Mobile computing: XML enables data transfer on the move

One of Software AG's current projects is the addition of mobile computing to our portfolio of XML-based platforms. Mobile technology is of growing importance in the optimization of business processes involving employees who are frequently on the move (such as service technicians, sales teams and logistics specialists). Mobile computing allows field operatives to enter data on site, and transfer that data to the central enterprise IT environment. This end-to-end, seamlessly integrated process increases responsiveness and lowers costs. Human error and delays are minimized by removing any need for re-entry of data by office-based employees. Software AG's XML expertise is helping establish new milestones in this area. XML data is ideal for mobile communications, as it allows the use of a wide variety of devices.

One-stop solutions: consulting, implementation, and support

We reorganized and optimized our range of professional services in 2002, creating three service lines:

- Business Innovation Services
- Business Integration and Technology Services
- Business Operations Services

Software AG's three service lines offer customers one-stop solutions – from consulting and software implementation to tailor-made transaction system support. We are also focusing more closely on industry-specific and solution-oriented services. Our first step was to identify customer-specific applications developed by our software consultants with potential to form the basis of standard solutions. In other words, we can leverage existing development work to create solutions that are attractive to customers in similar industries or facing similar challenges. We are also creating a global network of competence centers dedicated to specific topics, initially for content and document management, Web services and mobile solutions.

Focus on industry-specific expertise

A greater focus on software solutions demands closer alignment with the needs of specific industries. Software AG is therefore committed to promoting greater industry-specific expertise among its sales force – because tailoring our sales approach to individual customers is central to our transformation from technology supplier to solution provider and systems consultant. Targeted marketing, too, is helping to communicate the new Company profile, and successfully position Software AG in the market.

Products: Focusing on investment protection and efficient data management

Adabas safeguards your IT investments

Adabas, our high-performance database for mainframes, has set new standards for processing speed and availability. It is acknowledged to be the fastest database system on the market, handling up to 157,000 queries per second. Several thousand companies worldwide now use Adabas for their mission-critical processes. The database runs on a number of operating systems, and offers outstanding performance, even when accessed by a large number of concurrent users.

In view of these considerable strengths, many of our customers have invested heavily in Adabas technology. As a result, it is increasingly important that we not only deliver high performance and rich functionality, but also ensure interoperability with other software applications and development environments.

For example, the new Adabas SQL Server 5 enables our customers to use standardized SQL database software in conjunction with Adabas. A key factor in this development was enhanced and accelerated access to Adabas.

In addition, we improved our around-the-clock availability and increased the maximum number of concurrent transactions. Adabas also allows data to be archived quickly and easily on an external storage system using a specially developed interface.

Adabas for Linux

The poor economic climate forced many customers to cut back IT spending last year. Software AG supported their cost-cutting strategies by providing a new version of Adabas for Unix and Windows platforms that includes a version for Linux, an operating system that is growing in popularity on account of its low cost.

Standardization of Unix environments on the basis of Linux can reduce overall IT expenditure. Linux S/390, for example, allows an unlimited number of virtual Linux machines to run on a single physical server.

In addition, we plan to further accelerate processing speed for future versions of Adabas for Unix and Windows platforms. We are also optimizing SQL functionality and will introduce support for Windows Terminal Server.

Web-enabling Natural-built applications

In 2002, enhancements to Natural, our development environment, did not just enable users to better build new applications, but also to Web-enable existing software for deployment on the Internet or an intranet. This highly productive tool helps our customers to make better use of their systems and to pare back software development costs.

Natural Engineer WebStar is a new solution that allows existing Natural-based software to be used via a standard browser. This increases the speed and degree of user acceptance for applications by delivering a familiar Web-technology look and feel, and extends the life cycle of existing systems. The new re-engineering tool separates business logic from presentation logic. This significantly improves re-usability, ease of maintenance and scalability. Applications modified with Natural Engineer WebStar subsequently also support Internet standards such as XML and XSL (eXtensible Stylesheet Language).

Our Single Point of Development concept was introduced with the launch of Natural Version 5 in late 2001. This enables programmers to use a familiar Windows-based environment to create applications for all supported operating systems. In 2002, this functionality was extended to a number of other platforms.

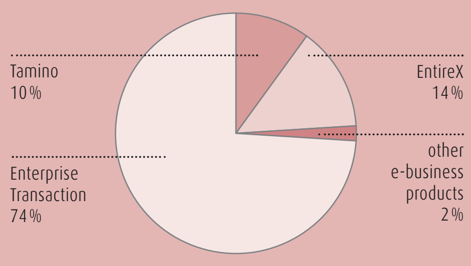
Tamino: Number one for management of XML data

In 2002, Tamino XML Server strengthened its position as the leader in the XML database market. According to the annual International Data Corporation (IDC) survey, Tamino increased its market share and also became the leading technology for native storage (storage in XML format) of XML data and documents.

This achievement is attributable in large part to projects undertaken for major international players such as DaimlerChrysler, BASF, Novartis, VoiceStream and Japan Airlines.

Version 4.1, launched in late 2002, features a number of new and enhanced functions relating to today's international XML standards, such as XML Schema, XML Namespaces, XML Signatures and XQuery. This cemented Software AG's role as one of the frontrunners in what is very much a cutting-edge technology.

Licensing revenue in 2002 by product group: 113 million EUR



Tamino XML Server is an end-to-end solution for creating, implementing and managing XML data. Tamino integrates seamlessly with database, integration, and application servers already in place. Its open architecture enables existing systems to interoperate with applications run by business partners and customers. This reduces the strain on hardware resources while raising productivity and cutting costs throughout the value chain.

Integration of XML applications using EntireX XML Mediator

The introduction of EntireX XML Mediator in 2002 significantly extended the scope of our integration tools. EntireX software integrates existing applications to create new e-business solutions, simplifying enterprise-wide consolidation of applications and data. For instance, it links Web-based applications with conventional programs and standard software. EntireX significantly reduces the programming effort of integration work. An intuitive graphical interface enables IT professionals to work more quickly and productively. EntireX is also XML-capable.

EntireX XML Mediator is a new tool for integrating XML applications quickly and efficiently. The latest addition to the EntireX family automates processing and exchange of XML documents by applying rules based on their content and structure. For example, the system routes documents and messages to their intended destination or converts content from various XML formats and presentation standards, such as HTML, PDF and WML. In doing so, it builds bridges between diverse system environments, such as PCs and mainframes.

In the course of 2002, a new version of EntireX XML Mediator with SOAP support was launched. SOAP (Simple Object Access Protocol) plays a key role in the implementation of Web services, enabling business applications to communicate and exchange documents over the Internet. The new version of EntireX XML Mediator enables developers to integrate Web service functionality into their existing XML applications.

Sales and marketing: Broadening the customer base

Software AG's sales organization has a new focus: XML products

In 2002, the sales and marketing department focused on the Company's transformation from an infrastructure software provider to an integration partner for XML technology and solutions. We are not only looking to sell XML products to our installed base, but also to leverage this exciting technology to attract entirely new customers. With this in mind, we divided our sales activities into four groups in early 2002. The largest serves the installed base, and is supported by a newly established customer service center. The second group is dedicated to winning new customers and a third is tasked with ensuring effective collaboration with our sales partners. The fourth deals with around a hundred key global accounts.

To better meet individual customer needs, we are aligning our activities with selected industries, including banking and insurance, pharmaceuticals, healthcare, the public sector, and media and technology.

Global marketing campaigns

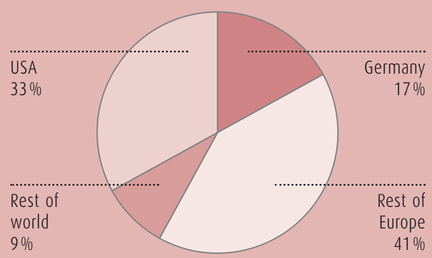
Our drive to attract new customers is reinforced by centrally managed, worldwide marketing campaigns. We distinguish between product-oriented content for IT specialists and solution-driven messages, targeted at business decision-makers. In particular, we focus on core technologies such as Tamino XML Server, EntireX, Natural and Adabas Cluster Services, but also key emerging topics, including content management and Web services. In other words, XML-based integration.

More than 5,000 companies attended our events and seminars on these topics.

Cooperation with sales partners

Software AG, which until 2000 only employed direct sales channels, continued to forge closer ties with its partners in 2002. In particular, we sought closer cooperation with companies offering XML-based solutions.

Revenue in 2002 by region: 475 million EUR



Services: Dedicated to customer satisfaction

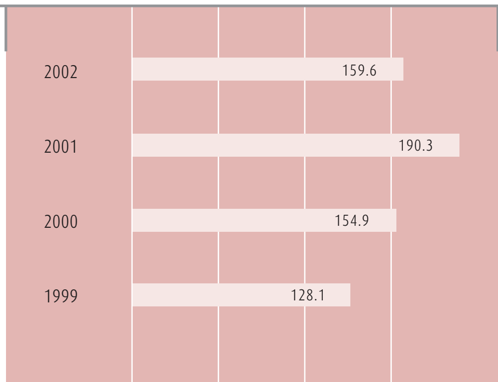
IT services for the entire software life cycle
Providing a comprehensive range of IT services is one of our core competencies, and continues to be a central feature of Software AG's long-term strategy. For 30 years, we have not only delivered state-of-the-art software, but also responsive support and other high-quality services throughout its life cycle. Scores of the world's largest enterprises and public sector organizations implement and operate sophisticated IT environments with the help of Software AG. We consistently score top marks in customer satisfaction ratings and have won many awards, but we do not rest on our laurels: When it comes to service delivery, we believe in building expert teams and in honing their skills through regular training.

Integrating processes for speed and productivity
Integration is our customers' top priority, and they require end-to-end services that help meet this target as quickly and effectively as possible. In particular, they wish to connect back-end systems with Web infrastructures. This is central to streamlining and automating a wide variety of business processes. When managing an IT environment, it is increasingly critical to integrate new technologies into existing systems – regardless of whether they are standard or custom solutions. In order to leverage IT as a driver of value, businesses require much more than just state-of-the-art technology. They also need end-to-end consulting, service and support. Our customers demand tailored solutions based on tried-and-tested applications. We also know that quality of service, a comprehensive service portfolio, responsiveness to customers' needs and around-the-clock availability are equally important. Moreover, we understand the specific needs of the industries we serve, and have a strong local and international presence, as well as strategic partnerships with systems integrators, consultants, and software and hardware vendors.

Three service lines for optimized support
In the course of 2002, Software AG took steps to align its offering with the new challenges faced by its customers, forming three new service lines:

Business Innovation Services
Business Innovation Services offer technical coaching, in-depth consulting, feasibility studies, and user

Development of revenue from Project Services
(Business Innovation Services, Business Integration and Business Technology Services) 1999 - 2002 (in million EUR)



training for customers implementing new technologies or industry-specific solutions. In this preliminary stage of the IT life cycle, accurately identifying and defining the customer's goals is critical. Examples include establishing the most effective way of employing XML technology and calculating the potential return on investment. In this respect, our customers benefit significantly from the expertise of our Business Innovation team, drawing on our unique skills as an XML pioneer and an experienced partner for implementing cost-effective, business-critical processes.

Business Integration and Technology Services

This service line is founded on our extensive expertise in the development and deployment of made-to-measure IT systems. Our teams employ carefully selected technologies to create future-proof solutions that will deliver lasting benefit. Our portfolio spans application development and integration, implementation, data integration, project management and systems engineering. Cross-industry solutions, such as content management, Web services and technology platforms for mobile portals, are central elements of our offering.

Business Operations Services

For an IT manager, the question of the scope and type of support services his company requires to ensure smooth day-to-day operations is one of the most difficult to answer. The more complex the systems environment grows, the more important tailored, expert support becomes. Software AG's interactive approach to support helps identify and resolve problems in good time, before they impact our customers' business. Issues that are business-critical are given priority. We offer a variety of service levels, and help our customers achieve greater reliability and lower downtime, all backed by expert advice and troubleshooting from highly committed and skilled experts.

By restructuring its service offering, Software AG is now even better placed to foster long-term partnerships with its customers. It is not just our state-of-the-art software that sets standards for our competitors to follow – our consulting and support services are also one step ahead of the pack.

Financial position and result of operations

Lower revenue

Total consolidated revenue fell 19 percent to 475.0 million euros in 2002. License sales, maintenance and professional services experienced contrasting fortunes.

Maintenance revenue grew from 196.0 million euros to 200.9 million euros. However, when comparing year-on-year results, it is important to note that our American-based subsidiary contributed to consolidated revenue for only eleven months of 2001. This was matched in 2002 by currency translation differences impacting revenue by around the same value. Maintenance revenue is an important indicator of customer satisfaction and loyalty. In the current poor climate in the IT industry, Software AG is one the few companies to be bolstered by a long-established customer base and a service portfolio that has gradually expanded over a number of years.

We posted software license sales of 113.0 million euros in 2002, a drop of 43 percent in comparison to the record year of 2001. This is a result of weak demand for both new electronic business technology and for updates and upgrades of existing software systems operated by long-standing customers.

Enterprise transaction products accounted for 83.6 million euros, or 74 percent, of license sales. The remaining 26 percent, totaling 29.4 million euros, were generated by our electronic business products, with Tamino XML Server contributing 11.6 million euros and EntireX 15.2 million euros.

159.6 million euros of total revenue are attributable to professional services, 16 percent less than in fiscal 2001. This is a result of low demand, and corresponding excess capacity, in the IT services market. As a result, we withdrew from unprofitable segments, leading to the closure of a professional services unit in the US. We were also able to adjust capacity by reducing the use of subcontractors, who are employed on a project-by-project basis.

Regional breakdown of revenue largely unchanged

As in the past, Software AG's largest single market was the US. Despite a weakening dollar, this region contributed 33 percent of total consolidated revenue. Europe accounted for 58 percent, with Germany leading the field with more than 17 percent of total revenue. The regional pattern remained very similar to 2001.

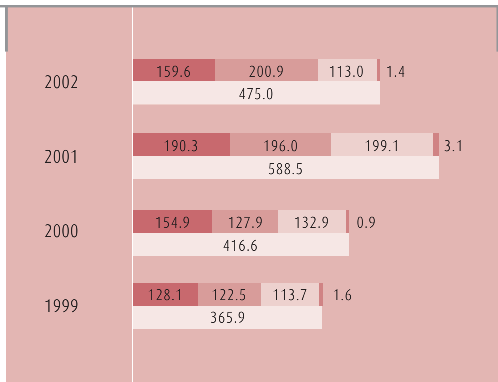
Earnings per share of 1.23 euros

The Company responded to falling revenue in fiscal 2002 with a restructuring program. As a result, cost of materials dropped 20.8 percent from 52.3 million euros to 41.4 million euros. Personnel expenses fell 8.3 percent to 258.0 million euros.

Other operating expenses declined 6.9 million

Revenue 1999 - 2002
(in million EUR)

- Professional Services
- Maintenance
- Licensing
- Other revenue
- Total revenue



euros to 149.2 million euros. This item primarily comprises the cost of subcontractors employed on a project-by-project basis, third-party sales commissions, travel expenses and in-house IT costs. Restructuring charges amounted to 17.6 million euros.

The company posted a slight negative financial result in 2002. The streamlining of our equity portfolio led to financial assets being written down by 3.3 million euros.

Despite the poor market environment, Software AG posted operating income before taxes of 31.6 million euros. Income before taxes of 50.7 million euros includes proceeds from the sale of holdings in SAP SI AG to a value of 36.7 million euros, and restructuring costs of 17.6 million euros.

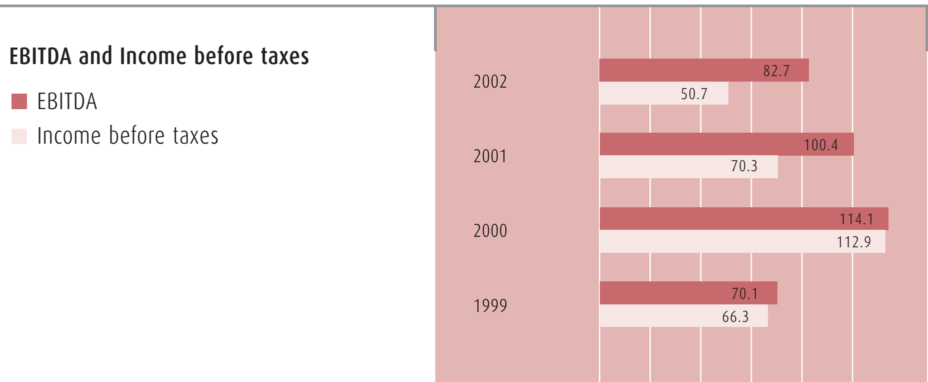
EBITDA (earnings before interest, tax, deprecation and amortization) margin increased, adjusted for income and expenses attributable to other accounting periods, rose slightly from 17.1 in 2001 to 17.4 percent in 2002.

Consolidated net income for the year was 33.5 million euros, with a slightly improved margin of 7.1 percent. The Company posted earnings per share of 1.23 euros.

Reconciliation of income before taxes to operating income before taxes

in million EUR	2002	2001	Change in %
Income before taxes	50.7	70.3	-27.9
Net proceeds from the sale of SAP SI AG shares	36.7	-	-
Restructuring costs	17.6	20.7	-15.0
Operating income before taxes	31.6	91.0	-65.3

EBITDA and Income before taxes



Increased liquidity

At year-end 2002, the Group had cash and cash equivalents of 75.4 million euros. This represented an increase of 50.2 percent in comparison with 2001.

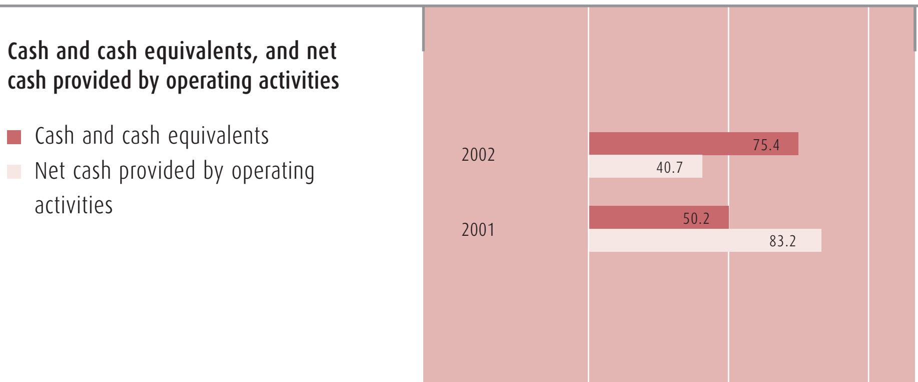
Net cash provided by operating activities totaled 40.7 million euros. On December 31, 2002, the Group had unused credit lines of 43.6 million euros.

A healthy balance sheet

Total assets fell from 504.0 million euros to 440.8 million euros. The most important changes to the balance sheet compared with year-end 2001 were as follows:

- Intangible assets consist primarily of goodwill. Goodwill is subject to straight-line amortization over a period of 10 years from the date of acquisition. In fiscal 2002, goodwill amortization amounted to 21.8 million euros, with 176.6 million euros remaining on the balance sheet.
- Tangible assets declined from 41.6 million euros to 37.0 million euros, chiefly as a result of lower capital expenditure, prompted by lower business volumes during fiscal 2002.
- Financial assets fell from 8.4 million euros to 5.9 million euros. Long-term investments rose to 5.3 million euros, whereas the value of participations sank to 0.5 million euros as a result of writing down one particular holding.
- As a result of lower business volumes, a lower number of days' sales outstanding (DSO), and currency translation effects, receivables and other assets declined to 132.6 million euros. DSO fell from 110 in 2001 to 93 in 2002. Receivables to the value of 16.4 million euros were factored during 2002.
- Despite a dividend for 2001 of 11.7 million euros, shareholders' equity increased to 214.5 million euros. The primary causes were a consolidated net income for 2002 of 33.5 million euros, and currency translation effects when consolidating subsidiaries. Equity-to-total-assets ratio for the Group increased from 39 to 49 percent.
- Provisions declined from 114.9 million euros to 108.7 million euros. Due to the reduced payroll, personnel-related provisions were lower. During the year, provisions totaling of 17.6 million euros were formed for restructuring. Of this amount, 6.3 million euros remained unused.
- Liabilities fell to 35.9 million euros, partly as a result of lower business volumes but also because of the repayment of debt arising from acquisitions. On December 31, 2002, there were no amounts due to banks.
- Deferred income fell by 33.6 million euros to 81.7 million euros, a key reason being currency translation effects.

Cash and cash equivalents, and net cash provided by operating activities



Breakdown of costs

in million EUR	2002	2001	Change in %
Revenue	475.0	588.5	-19.3
Cost of materials As a percentage of revenue	41.4 8.7	52.3 8.9	-20.8 -
Personnel expenses As a percentage of revenue	258.0 54.3	281.5 47.8	-8.3 -
Depreciation and amortization (excluding write-down of financial assets) As a percentage of revenue	 32.0 6.7	 31.3 5.3	 +2.2 -
Other operating expenses As a percentage of revenue	149.2 31.4	156.1 26.5	-4.4 -

Balance sheet

in million EUR	Dec. 31, 2002	Dec. 31, 2001	Change in %
Assets			
Fixed assets	221.1	247.9	-10.8
Cash and cash equivalents	75.4	50.2	+50.2
Other current assets	137.2	194.3	-29.4
Prepaid expenses	7.1	11.6	-38.8
Total	**440.8**	**504.0**	**-12.5**
Equity and liabilities			
Equity	214.5	196.2	+9.3
Provisions	108.7	114.9	-5.4
Liabilities	35.9	77.6	-53.7
Deferred income	81.7	115.3	-29.1
Total	**440.8**	**504.0**	**-12.5**

Risk report

Competitor XML products

All leading vendors of database software have announced their intention to XML-enable their products. Our major rivals have less powerful technologies, requiring conversion of XML data, whereas our products handle native XML data. Nevertheless, this will erode one of Software AG's key competitive differentiators. Customers may react with a wait-and-see approach to this relatively new technology. This would negatively impact XML product sales until reference projects corroborate our superiority in terms of technology and return on investment.

Customer preference for standard industry-specific solutions

Today's economic fundamentals demand thrift from our customers – this means IT capital investment is limited to projects with strong return on investment. Customers are looking to minimize implementation risk by using proven industry-specific packages. Software AG is to realign its development focus accordingly, placing greater emphasis on standard software. We are currently working on solutions of this kind in a number of areas, including mobile computing. Once the benefits become apparent to customers, this should provide a major boost to sales of our XML products.

Project margins under pressure

The sustained economic slowdown has led to a glut of software consulting capacity. This put pressure on margins in 2002, only partially offset by reduced overall employee numbers at the Company. Market fundamentals are not expected to recover in 2003. This will probably prompt software consultants to charge below fully absorbed costs for their services, in order to at least generate a contribution margin. This situation may be exploited by major players, by using their greater financial resources to force smaller competitors from the market.

High volatility of US dollar

Approximately 36.6 percent of all Software AG sales are invoiced in US dollars. As a result of the dollar weakening against the euro, 2002 sales figures were 2.3 percent lower than the previous year. The impact on earnings was limited, however, due to the use of currency hedging. The Company uses such tools to protect against the risks posed to earnings by worldwide currency fluctuations.

Investment

Capital expenditure is kept reasonably low at Software AG – at around 14 million euros per year, of which the majority is spent on office equipment and furnishings. Investment in software development – 64.3 million euros in 2002 – is not capitalized, but carried as operating expenses. There is a particularly high risk of R&D resource misallocation in the IT industry. Software AG's response is to monitor and control this risk using business case analysis.

Goodwill accounts for 80 percent of Company fixed assets. After the 2001 acquisition of US company Saga Systems Inc., Software AG goodwill totaled 196.2 million euros. In accordance with the German Commercial Code (HGB), this item is amortized over ten years using the straight-line method. As of December 31, 2002, goodwill totaled 176.6 million euros, including 2 million euros capitalized in 2002. We currently see no reason for impairment of goodwill.

Stable client base

A core of several thousand established customers account for around 80 percent of Software AG revenues. These are predominantly users of Adabas or Natural systems for mainframe environments. Maintenance revenues remain stable for this customer group, indicating no erosion of the Company's client base. However, in the long term, we expect the number of users to decline. This decline is likely to be gradual, and we are confident it can be offset by expansion of Software AG's client base, as well as by the introduction of new products and services. The Company is not overly dependent on any individual customer.

Revenues by region

More than 80 percent of Company revenues are generated outside Germany. Software AG's global presence, spanning more than 70 countries across the world, limits the impact of economic fluctuations in any one market. In recent years, the breakdown of revenues by region has remained largely unchanged.

Financial market risks

As an international company, Software AG is exposed to exchange rates risk, interest rate risk, and credit risk.

Using futures and options, we hedge against the exchange rate risk inherent in foreign currency receipts.

Derivatives are used to hedge against valuation risk with regard to currency fluctuations for individual balance sheet items.

Company guidelines for limiting credit risk stipulate that financial assets shall be restricted to bank deposits and securities with an "investment grade" rating.

“Ever-changing markets call for flexible, innovative employees. They are the backbone of any software company.”

Arnd Zinnhardt, Chief Financial Officer

Employees: Our most important resource

Flat hierarchies, opportunities for development, an attractive working environment

Our human resource management strategy is geared to promoting the ability of Software AG to adapt, innovate and grow. To achieve this, we have created flat hierarchies, and offer each employee a positive working environment with a wealth of personal and professional development opportunities. We believe this is fundamental to the success of the organization.

Flexible work times and performance-related pay for greater employee motivation

A key focus in 2002 was to consolidate the human resources measures we introduced in 2001. In Germany, we launched a restructured model for working hours, as well as introducing teleworking and partial retirement models.

In 2002, we created a number of new options for employees. For example, the “long-term time accounts” program enables staff in Germany to convert a portion of their gross income into a sabbatical or early retirement. We also continued to enhance and expand our system of performance-related remuneration. This fosters an entrepreneurial mindset, because employees are rewarded for reaching, and exceeding, pre-defined targets. The practice of agreeing goals at regular intervals has been embraced at all levels of the enterprise. The performance-related remuneration system has been extended to further employee groups.

Change management and virtual teams top the curriculum

In the year under review, we added topics such as change management and virtual teams to our range of training courses. Our human resources development strategy continues to focus on coaching and teamwork.

The large number of university graduates employed at Software AG underlines the highly skilled nature of the workforce.

Adjusting capacity: The workforce falls nine percent to 3,013

In the course of 2002, the number of people employed at Software AG declined from 3,326 to 3,013. In light of reduced revenues, this was an unavoidable step. The largest numbers of staff were cut at our foreign-based subsidiaries and particularly in their administration and professional services units. In line with our new, industry-specific focus, we recruited a number of new sales employees for specific tasks. We did not actively cut the payroll in research and development, the small reduction in this area is attributable to natural attrition.

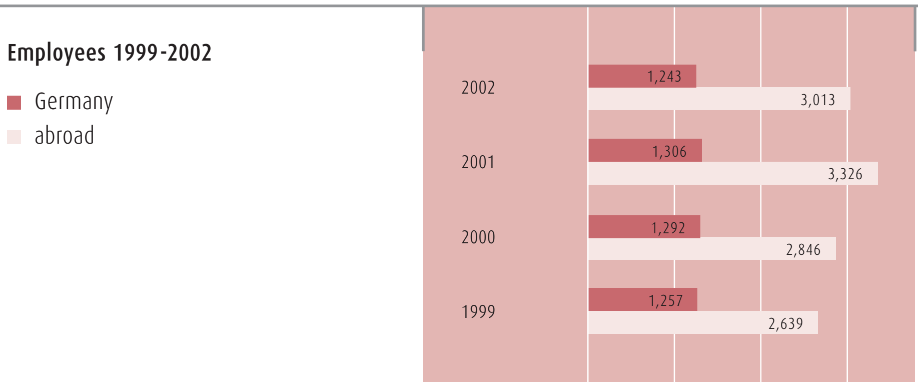
Strategic human resources development in 2003

Our policy for 2003 centers around a targeted approach to human resources development, in line with our strategic goals. We remain firmly committed to developing new skills in carefully selected areas, to retaining key employees, to creating challenging and rewarding career paths, and to aligning personal goals with those of the Company.

A word of thanks

The Executive Board would like to thank all employees for their dedication in what was a very difficult year. In 2003, their motivation and hard work will continue to be the keystone of Software AG's success.

Employees 1999-2002



Research and development: Keeping one step ahead

An unwavering commitment to R&D

Research and development are of vital importance to Software AG. For this reason, the company has maintained a high level of expenditure in this area, despite a difficult market environment. We have continued to invest in the development of new products and the enhancement of existing ones. This will help us to maintain our lead in terms of technology, and to strengthen our competitiveness. Our ongoing focus on R&D is especially important to customers who have been employing Software AG systems in mission-critical environments for a number of years. Mission-critical processes place particularly high demands on software quality, reliability and performance. Software AG's commitment to R&D guarantees a high degree of investment protection – customers can be sure that their systems can be adapted at any time to exploit and harness emerging technologies.

20.5 percent of product sales ploughed back into R&D

In fiscal 2002, we invested 64.3 million euros in research and development, corresponding to 20.5 percent of product sales. 55.1 percent of the R&D budget, amounting to 35.4 million euros, was allocated to our electronic business products, Tamino XML Server and EntireX. Enhancement of our enterprise transaction products, Adabas and Natural, accounted for a further 22.3 million euros.

Although the number of Software AG employees as a whole fell by 313 in 2002, the research and development team remained largely unaffected. More than 500 employees continue to work in this important area. Our R&D activities are concentrated in Germany, with additional centers in the USA, the UK, the Republic of Ireland and Latvia. The research and development unit is responsible for a total of 2,747 products, calculated on the basis of operating system versions.

The primary objective is to improve the stability and performance of our software. To ensure a product portfolio of the highest possible quality, we employ state-of-the-art processes for software development, optimizing quality, accelerating innovation and keeping costs in check.

Through our active involvement in W3C, the Internet standardization body, we play a key role in the further development of XML technology. As a leader in this area, our expertise has considerable influence on the future shape of this open standard.

Innovation as the basis for competitiveness

We launched a large number of new product variants during the reporting period, including innovative versions of our high-performance Adabas database for mainframes, Unix and Windows. Development of version 8 of our Adabas Server is also progressing well.

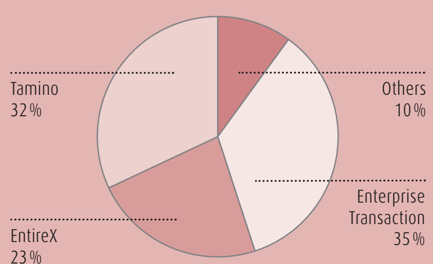
We also continue to work on the Natural single point of development concept. For 2003, we plan a new version of Natural for mainframes, with particular emphasis on new functionality and enhanced performance.

In 2002, the R&D priority for Tamino XML Server was Version 4.1, which supports the Windows NT, 2000 and XP operating systems. In the second quarter of 2003, the software will be enhanced to support 64-bit systems, and other operating systems, including Sun Solaris, HP-Unix, AIX, Linux and OS/390.

The launch of EntireX XML Mediator added an XML integration tool to the EntireX range.

Software AG's firm commitment to R&D spending in 2002 was crucial in helping the Company maintain its technological edge. Our competitiveness is built to a large degree on our expertise and on a tried and tested, but highly innovative portfolio of first-class products and services.

Total R&D spending in 2002:
64.3 million EUR



Events subsequent to the balance-sheet date

New partnerships

In February 2003, we agreed a strategic technology and sales partnership with Vordel, an Irish-based provider of security solutions for Web services.

In the same month, we also signed a new global partnership with iWay Software that will enable Software AG to incorporate iWay's adapter technology into our EntireX platform, making it easier to integrate IT systems on the basis of open standards.

New regional structure

Software AG's international subsidiaries have been regrouped into four regions, effective February 1, 2003. These are:

- Americas
- Northern Europe and Asia
- Southern and Western Europe
- Central and Eastern Europe

Overall responsibility for all business activities will lie with the corresponding regional management teams. We believe reorganization will result in knowledge transfer between Software AG companies around the world, and greater economies of scale.

An International Executive Board (IEB) was founded in January, consisting of the members of the Executive Board and the regional managers. IEB is tasked with preparing key strategic and operational decisions, and for monitoring their execution.

Forecast for 2003: Another year of consolidation

Stagnation in IT investment

The International Monetary Fund (IMF) does not expect significant economic recovery in the major industrialized nations during fiscal 2003. Excess capacity, price pressure and weak demand will force companies to maintain a tight rein on expenditure, and to implement far-reaching cost-cutting measures.

For these reasons, we do not foresee fundamental changes in the IT market in 2003. Decision-making cycles have become slower, with customers reluctant to invest in IT projects that do not promise a rapid, quantifiable return on investment (ROI). Although an IT project backlog is gradually becoming evident, this is not yet translating into actual deals. At present, there are no clear signs of an imminent upturn. This is confirmed by a recent survey of key IT decision-makers by investment bankers Goldman Sachs. 62 percent of respondents do not expect to see their IT budgets increase in comparison to 2002.

Our goal for 2003: To maintain revenue levels while increasing profitability

In 2003, we expect the company's total revenue, when adjusted for currency effects, to be largely in line with fiscal 2002. Maintenance services will remain a stable source of revenue during 2003. Our established customer base and long-term agreements allow us to realistically forecast that maintenance will account for some 40 percent of total revenues in 2003. The remainder will be generated by license sales and project services, where customer behavior is considerably more difficult to predict.

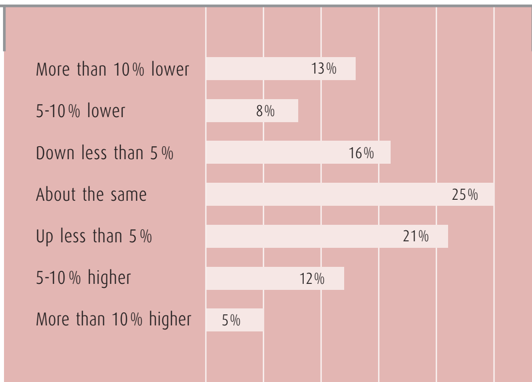
Our goals for the current fiscal year are to increase profitability, maintain our solid financial footing, and adapt our positioning in light of new market demands. We will remain committed to strict cost control. In 2003, our goal is to maintain operating results and margin at least at 2002 levels. In addition, we expect a positive operating cash flow. This will enable Software AG to remain free of financial liabilities.

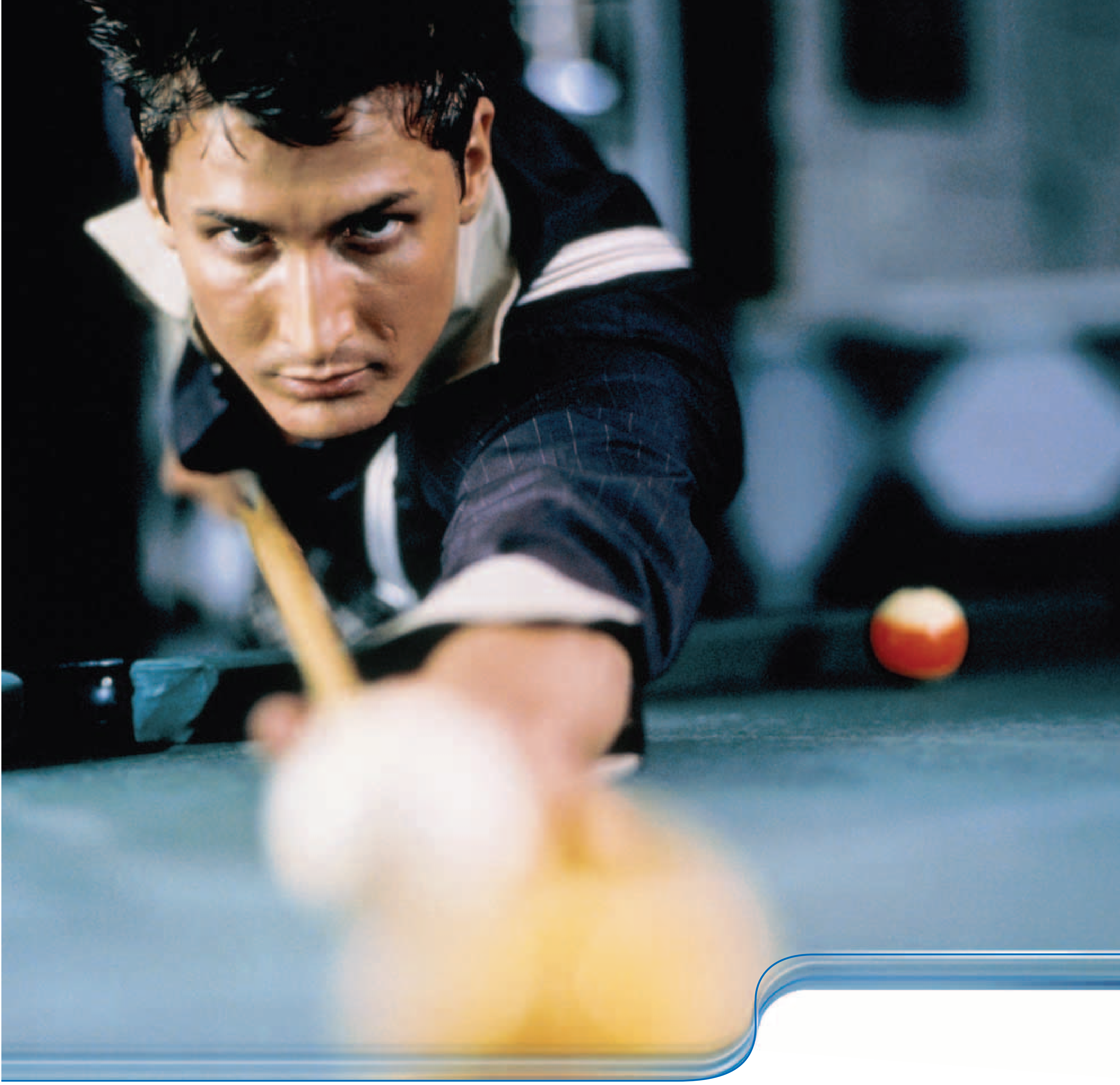
More standardized applications

Our future product portfolio will build on previous developments, particularly on our skills in XML technology. Beginning this year, we will shift the focus more toward standard XML-based solutions. The first of these, for mobile computing, will be showcased at CeBIT in March 2003. This new software increases the productivity of mobile personnel in sales and customer service, and is primarily intended for financial service providers and industrial enterprises.

How do you expect your overall 2003 IT spending to be relative to 2002?

Source: Goldman Sachs IT Survey; January 2, 2003





There´s more than one way to pot the nine ball

If you are pursuing several goals simultaneously, careful preparation is essential, every step of the way. Our project services experts have the experience and judgment to create made-to-measure solutions.

Consolidated Financial Statements of Software AG for the fiscal year ended December 31, 2002

Consolidated Balance Sheet

Assets

EUR thousand	Notes		Dec. 31, 2002	Dec. 31, 2001
A. Fixed assets	(1)			
Intangible assets				
Concessions, industrial and similar rights and assets and licenses in such rights and assets		1,551		1,768
Goodwill		176,591		196,190
			178,142	**197,958**
Tangible assets	(2)			
Land, land rights and buildings, including buildings on third-party land		26,033		27,570
Other equipment, operational and office equipment		10,967		13,929
Assets under construction		0		104
			37,000	**41,603**
Financial assets	(3)			
Shares in affiliated companies		25		25
Participations		484		3,373
Long-term investments		5,284		4,747
Other loans		144		235
			5,937	**8,380**
			221,079	**247,941**
B. Current assets				
Inventories	(4)			
Raw materials and supplies		111		136
Work in progress		3,873		3,684
Finished goods and merchandise		281		264
Prepaid inventories		363		0
			4,628	**4,084**
Receivables and other assets	(5)			
Trade receivables		122,160		179,330
Other assets		10,395		10,891
			132,555	**190,221**
Cash in hand, postal giro balances, bank balances			**75,423**	**50,244**
			212,606	**244,549**
C. Prepaid expenses	(6)		**7,135**	**11,550**
			440,820	**504,040**

Equity and liabilities

EUR thousand	Notes		Dec. 31, 2002	Dec. 31, 2001
A. Equity	**(7)**			
Subscribed capital			81,800	81,784
Contingent capital EUR thousand 19,872				
Capital reserves			132	0
Retained profit brought forward/retained earnings			99,013	75,735
Consolidated net income for the year			33,523	38,688
Minority interest			0	-38
			214,468	**196,169**
B. Special tax-allowable reserves			**6**	**7**
C. Provisions				
Provisions for pensions	(8)	8,781		8,628
Provisions for taxes	(9)	28,317		29,089
Other provisions	(10)	71,645		77,222
			108,743	114,939
D. Liabilities				
Liabilities to banks	(11)	0		2,573
Payments received on account of orders	(12)	2,791		1,181
Trade payables		11,154		21,029
Liabilities on bills accepted and drawn		3,395		3,637
Payable to affiliated companies		47		36
Other liabilities	(13)	18,488		49,144
			35,875	**77,600**
E. Deferred income	**(14)**		**81,728**	**115,325**
			440,820	**504,040**

Consolidated Income Statement of Software AG for the fiscal year 2002 (January 1 to December 31, 2002)

EUR thousand	Notes		Dec. 31, 2002	Dec. 31, 2001
Revenue	(15)		474,960	588,465
Increase in finished goods, inventories and work in progress			549	-3,162
Other operating income	(16)		55,789	25,774
Cost of materials	(17)			
a) Cost of raw materials and supplies, and of purchased merchandise		-873		-2,006
b) Cost of purchased services		-40,561		-50,319
			-41,434	**-52,325**
Personnel expenses	(18)			
a) Wages and salaries		-215,936		-237,334
b) Social security and other pension costs		-42,038		-44,178
			-257,974	**-281,512**
Depreciation and amortization				
a) of intangible assets and property, plant and equipment (of which goodwill 21,840 EUR thousand; 19,799 EUR thousand in 2001)	(19)	-31,986		-30,775
b) of current assets where the level of depreciation exceeds the normal level		0		-569
			-31,986	**-31,344**
Other operating expenses	(20)		-149,189	-156,120
Income from other investments and long-term loans			0	2
Amortization of financial assets			-3,250	-1,500
Other interest and similar income	(21)		3,712	5,964
Interest and similar expenses	(21)		-517	-3,218
Income before taxes			**50,660**	**91,024**
Extraordinary charges			0	-20,676
Extraordinary earnings			0	-20,676
Income tax expense	(22)	-14,895		-28,856
Other taxes		-2,254		-2,809
			-17,149	**-31,665**
Income after taxes			**33,511**	**38,683**
Minority interests			12	5
Consolidated net income			**33,523**	**38,688**

Statement of Fixed Asset Movements

EUR thousand	Gross fixed assets: Balance on Jan. 1, 2002	Additions	Disposals	Transfers	Differences from currency translation	Balance on Dec. 31, 2002
I INTANGIBLE ASSETS						
Concessions, industrial and similar rights and assets, licenses in such rights and assets	29,645	1,179	-123	0	-409	30,292
Goodwill	216,004	2,241	0	0	0	218,245
	245,649	**3,420**	**-123**	**0**	**-409**	**248,537**
II TANGIBLE ASSETS						
Land, land rights and buildings, including buildings on third-party land	60,818	1,224	-655	20	-2,177	59,230
Other equipment, operational and office equipment	65,211	5,185	-9,518	81	-3,335	57,624
Assets under construction	104	0	-3	-101	0	0
	126,133	**6,409**	**-10,176**	**0**	**-5,512**	**116,854**
III FINANCIAL ASSETS						
Shares in affiliated companies	25	0	0	0	0	25
Participations	5,137	360	0	-1,500	0	3,997
Long-term investments	4,171	3,666	-2,908	1,500	0	6,429
Other loans	235	4	-95	0	0	144
	9,568	**4,030**	**-3,003**	**0**	**0**	**10,595**
Total	**381,350**	**13,859**	**-13,302**	**0**	**-5,921**	**375,986**

EUR thousand	Accumulated depreciation: Balance on Jan. 1, 2002	Additions	Disposals	Transfers	Differences from currency translation	Balance on Dec. 31, 2002	Book value: Balance on Dec. 31, 2002
I INTANGIBLE ASSETS							
Concessions, industrial and similar rights and assets, licenses in such rights and assets	27,877	1,338	-116	0	-358	28,741	1,551
Goodwill	19,814	21,840	0	0	0	41,654	176,591
	47,691	23,178	-116	0	-358	70,395	178,142
II TANGIBLE ASSETS							
Land, land rights and buildings, including buildings on third-party land	33,248	2,008	-413	0	-1,646	33,197	26,033
Other equipment, operational and office equipment	51,282	6,800	-8,780	0	-2,645	46,657	10,967
Assets under construction	0	0	0	0	0	0	0
	84,530	8,808	-9,193	0	-4,291	79,854	37,000
III FINANCIAL ASSETS							
Shares in affiliated companies	0	0	0	0	0	0	25
Participations	1,763	3,250	0	-1,500	0	3,513	484
Long-term investments	-575	0	220	1,500	0	1,145	5,284
Other loans	0	0	0	0	0	0	144
	1,188	**3,250**	**220**	**0**	**0**	**4,658**	**5,937**
Total	**133,409**	**35,236**	**-9,089**	**0**	**-4,649**	**154,907**	**221,079**

A. General disclosures on the consolidated financial statements and on consolidation and accounting policies

The annual financial statements and management report as of December 31, 2002 were prepared in accordance with German statutory requirements.

Consolidated companies

The following affiliated companies are members of the Software AG Group (parent company: Software AG):

a) German-domiciled companies	Holding %	Abbreviation
Software GmbH Marketing, Darmstadt	100	SAG-MK
SAG East GmbH, A Software Company, Darmstadt	100	SAG-ME
SQL Datenbanksysteme GmbH, Berlin	100	SQL
SAG Systemhaus GmbH, Darmstadt	100	SAG-D

b) Companies domiciled outside Germany	Holding %	Abbreviation
Software AG of the United Kingdom Ltd., Derby/England	100	SAG-UK
with its subsidiary:		
Software AG Belgium S.A., Brussels/Belgium	100	SAG-B
in which Software AG also has a direct holding		
Software AG France S.A., Irvy sur Seine/France	100	SAG-F
Software AG Italia S.p.A, Milan/Italy	100	SAG-I
Software AG Nederland B.V., Amsterdam/The Netherlands	100	SAG-NL
with its subsidiary:		
Software AG Management Services B.V., Neuwegein/The Netherlands	100	SAG-MS
and its indirect holding:		
IC-Group B.V., Capelle/The Netherlands	100	IC-Group
Software AG Nordic A/S, Taastrup/Denmark	100	SAG-DK
with its subsidiaries:		
Software AG Norge A/S, Oslo/Norway	100	SAG-N
Software AG Sverige AB, Stockholm/Sweden	100	SAG-S
Oy Software AG Finland, Espoo/Finland	100	SAG-SF
Software AG Österreich, Vienna/Austria	100	SAG-A
Software AG Polska Sp.z o.o., Warsaw/Poland	100	SAG-PL
Software AG s.r.o., Prague/Czech Republic	100	SAG-CS
Software AG Bilgi Sistemleri Ticaret A.S., Istanbul/Turkey	100	SAG-TR
Softinterest Holding AG, Zug/Switzerland	100	SIH
with its subsidiaries:		
Software Systems AG, Dietikon/Switzerland	100	SAG-CH
Software AG España S.A., Madrid/Spain	100	SAG-E
and its indirect holding:		
Software AG Portugal Lda., Lisbon/Portugal	100	SAG-P
Software AG, Inc., Reston, VA/USA	100	SAG-USA
with its subsidiaries:		SAG-USA Group
Software AG Technologies, Inc., Delaware/USA	100	
and its indirect holding:		
Software AG Atlantic, L.L.C., Delaware/USA	100	
Software AG, LLC, San Ramon, CA/USA	100	
and its indirect holding:		
Software AG Australia (Holdings) Pty. Ltd., Melbourne/Australia	100	SAG-AUS (Holding)
with its subsidiary:		
Software AG Australia Pty. Ltd., North Sydney/Australia	100	SAG-AUS
Software AG Funding Corp., Delaware/USA	100	
Software AG International, Inc., Delaware/USA	100	
Software AG (Canada), Inc., Ontario/Canada	100	
Software AG S.A. de C.V. Lomas de Chapultepec/Mexico	100	

b) Companies domiciled outside Germany	Holding %	Abbreviation
SGML Technologies Ltd., London/England	100	SGML-UK
Software AG R&D Ireland Ltd., Dublin/Ireland	100	SAG-IRL
Software AG (Hong Kong) Ltd./Hong Kong	100	SAG-HK
Software AG (Singapore) Pte. Ltd./Singapore	100	SAG-SIN
with its subsidiary:		
Software AG (Asia Pacific) Support Centre Pte Ltd./Singapore	100	SAG-AP
Software AG (Malaysia) Sdn. Bhd., Kuala Lumpur/Malaysia	100	SAG-MAL
Software AG Philippines Ltd., Manila/The Philippines	100	SAG-PHI
Software AG Taiwan Ltd., Taipei/Taiwan	100	SAG-TW
Software AG South Africa (Pty.) Ltd., Rivonia/South Africa	100	SAG-ZA

On January 1, 2002, the Company acquired the remaining 19.96 percent of shares in IC-Group, increasing our holding to 100 percent. This eliminated the minority interests reported last year for this company. The final tranche was purchased for 2.050 million euros. In fiscal 2002, the IC-Group posted revenue of 2.918 million euros (4.642 million euros in 2001) and a net loss of 890 thousand euros (net income of 247 thousand euros in 2001).

The annual financial statements of Software GmbH Marketing (equity: 37 thousand euros, net income: 5 thousand euros in 2002) were not included in the consolidated financial statements in accordance with section 296 (2) of the German Commercial Code, since this company is insignificant and only has a minor influence on the Group's financial position and results of operations.

In 2002, Software AG acquired the remaining ten percent of holdings in its Turkey-based subsidiary. This eliminated the minority interests published for 2001. The holding was purchased for 140 thousand euros. In fiscal 2002, this company posted revenue of 1.508 million euros (2.006 million euros in 2001) and a net loss of 375 thousand euros (-541 thousand euros in 2001).

The list of equity interests is contained in the Notes to the Financial Statements of the parent company.

Software AG South Africa (Pty.) Ltd., Rivonia/South Africa was first included in the consolidated financial statements on March 4, 2002, the date on which it was founded. In the year under review, this company posted revenue of 28 thousand euros and a net loss of 92 thousand euros.

Software AG Management Services B.V., headquartered in Nieuwegein, The Netherlands, was established on December 23, 2002. The company, with total equity of 1.018 million euros, was included in consolidated financial statements from this date.

Fiscal year and consolidation period

The consolidated financial statements were prepared as of December 31, 2002, the balance sheet date of the parent company. Since all companies included in consolidated accounts also prepare their financial statements as of this date, there is no need for them to draw up interim financial statements.

With the approval of the respective shareholders' meetings, SAG East GmbH, SAG Systemhaus GmbH and SQL Datenbanksysteme GmbH Berlin made use of the exemption rule under section 264 (3) clause 4 of the German Commercial Code.

Consolidation principles

The financial statements of the consolidated companies have been prepared in accordance with consistent accounting and valuation principles. With the exception of one company of insignificant size that is not subject to statutory auditing requirements, they have been audited by public accountants, who issued unqualified audit opinions in all cases. The overwhelming majority of the auditors outside Germany are members of BDO International or belong to another reputable international accounting and auditing organization.

Currency translation

The annual financial statements of the subsidiaries prepared in the relevant local currency are translated as follows for the consolidated financial statements:

- Balance sheet items have been translated at the rates prevailing on the balance sheet date, with the exception of shareholders' equity and of the equity interests.
- Shareholders' equity of subsidiaries included in consolidation is translated at historic rates. The gains and losses in equity of consolidated subsidiaries resulting from currency variations are aggregated and included as part of the foreign currency translation adjustment. This results in the profit brought forward deviating from the retained earnings of the previous year.
- In 2002, gains and losses on subsidiaries' income statements resulting from currency variations are, for the first time, aggregated and included as part of the adjustment for currency translation differences. This complies with the draft DRS standard 18 (currency translation) of the German Accounting Standards Committee. This led to a reduction in the group equity of 2.494 million euros. In 2001, they totaled 1.010 million euros and were reported as other operating income.
- In the statement of fixed-asset movements, additions, write-ups, transfers, disposals and write-downs for the year are calculated at the average rates for 2002, starting from the previous year's acquisition and manufacturing costs (as of December 31, 2001), with the year-end positions being translated at the rate prevailing at the balance sheet date. Any resulting exchange rate differences in fixed asset movements are carried on the face of the statement of fixed asset movements.

Consolidation methods

Statutory full consolidation pursuant to sections 300 ff. of the German Commercial Code was applied to the preparation of the consolidated financial statements. As a result, all intercompany assets and liabilities and all intercompany income and expenses were eliminated.

- Software AG consolidates subsidiaries which it founded itself on the date of formation. However, with respect to Softinterest Holding AG and its subsidiaries – which were consolidated for the first time in 1994 – as well as the Asian subsidiaries, SQL and SAG-IRL, first-time consolidation occurred after the date of formation.
- In the case of all other companies included in the consolidated financial statements, the date of acquisition was chosen as the consolidation date.
- The first-time consolidation of all companies was undertaken using the book value method (section 301 (1) sentence 2 clause 1 of the German Commercial Code). Subsequent consolidation is based on the figures stated at the time of first-time consolidation.
- Debit balances arising from capital consolidation and relating solely to goodwill from acquisitions from 2001 onwards were carried as assets and will be amortized over ten years. In previous years, goodwill was netted against capital reserves, with the exception of goodwill from the SAG-USA Group.
- In the consolidation of debt, translation differences were included in foreign currency translation adjustment, without affecting the income statement. Other netting differences were treated as income or expense.
- As of December 31, 2002, all outstanding material intercompany services rendered had already been invoiced to customers. This obviated the need to eliminate inter-company profits. In contrast, intercompany sales of intangible assets are corrected through elimination of intercompany profits.

Consolidated balance sheet and consolidated income statement

The income statement has been prepared in accordance with section 275 of the German Commercial Code using the nature of expense method. The following table summarizes the details that are required to be stated in the balance sheet and the income statement:

I. Balance sheet

EUR thousand	2002	2001
a) Assets		
1) Trade receivables	122,160	179,330
of which due in over one year	20,969	34,068
2) Other assets	10,395	10,891
of which due in over one year	306	204
b) Equity and liabilities		
1) Liabilities to banks	0	2,573
of which due within one year	0	2,573
of which secured by land charges	0	2,535
2) Payments received on account of orders	2,791	1,181
of which due within one year	2,791	1,181
3) Trade payables	11,154	21,029
of which due within one year	11,154	21,029
4) Liabilities on bills accepted and drawn	3,395	3,637
of which due within one year	3,395	3,637
5) Payables to affiliated companies	47	36
of which due within one year	47	36
6) Other liabilities	18,488	49,144
of which due within one year	14,163	41,598
of which due in over five years	207	0
of which taxes	7,022	11,964
of which social insurance contributions	4,525	4,316

II. Income statement

Pension costs	7,469	7,422

Valuation principles

Intangible assets and tangible assets are valued at their cost of acquisition, generally less straight-line depreciation and amortization over the standard useful life in compliance with German commercial law and at the maximum amount permitted by tax law. In the case of buildings, the declining-balance method of depreciation has been applied in some instances.

Participations and long-term investments are valued at the lower of purchase cost or market value.

Inventories are valued at their cost of acquisition or manufacture. In addition to individual unit costs, the manufacturing costs of work in progress include an appropriate share of overheads and depreciation (section 255 (2) sentences 2 and 3 of the German Commercial Code).

Receivables from software licenses are recognized only if there is a signed contract with the customer, any rights of return have expired and the software has been delivered in accordance with the terms of the contract. Receivables and other assets are carried at their nominal value, unless specific write-downs were necessary to take account of default risks. As in previous years, provision was made for the general default risk by means of a general reserve adjustment. Standard discounts have been applied to take account of receivables with maturities in excess of one year.

Liabilities are stated at their repayment amount. Provisions for pensions are set up on the basis of actuarial rules and tax principles using an interest rate of six percent. Provisions for taxes and other provisions have been set up as deemed necessary and reasonable in accordance with prudent business practice.

Currency translation

Foreign currency income and expenses arising during the year are recorded at the rates prevailing at the time such income is recognized and expenses are incurred. Receivables and liabilities were valued at the rate prevailing at the balance sheet date, provided that this rate was not higher (in the case of receivables) or lower (in the case of liabilities) than the rate prevailing at the transaction date. In cases of hedging transactions, the applicable hedging rates are used.

B. Notes to the consolidated balance sheet

(1) Fixed assets

The gross values comprise all assets held at the balance sheet date.

Intangible assets

The intangible assets relate mainly to the goodwill from holdings in SAG-USA Group, the IC-Group in The Netherlands, and to software licenses and rights to software programs purchased from third parties.

(2) Tangible assets

Land included in this item primarily refers to land owned by the parent company.

During the fiscal year, approximately 5.185 million euros was invested in other equipment, operational and office equipment – mainly IT equipment.

(3) Financial assets

Participations relate principally to holdings in SAG-MK.

Long-term investments comprise investments in securities funds made to cover the value of employee time accounts in case of insolvency, as well as shares in SAP SI AG, Dresden.

Other loans consist of loans made to employees.

Current assets

(4) Inventories

Inventories principally include services relating to customer orders that have not yet been invoiced. These inventories are valued at the cost of manufacture, based on the appropriate hourly rate. Other items disclosed here are finished goods (documentation). Stocks of paper carried under raw materials and supplies have been stated at a standard value wherever possible. Other raw materials and merchandise are stated at acquisition cost.

(5) Receivables

Trade receivables decreased over the previous year. This was due to reduced revenues and a fall in the value of the dollar in late 2002.

Other assets

At the balance sheet date, this item consisted largely of claims for tax refunds.

(6) Prepaid expenses

This item relates primarily to deferred license fees and prepaid rental expenses.

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(7) Equity:

Equity as of December 31, 2002, comprised the following:

EUR thousand

Subscribed capital as of Jan. 1, 2002 Options exercised	81,784 16	**81,800**
Capital reserves as of Jan. 1, 2002 Premium on capital increase due to options exercised	0 132	**132**
Equity earned by the group as of Jan. 1, 2002* Dividend paid in 2002 Consolidated net income	111,158 -11,722 33,523	132,959
Translation differences as of Jan. 1, 2002* Change during fiscal 2002	3,265 -3,688	-423
Equity as of December 31, 2002		**214,468**

* Equity was reported according to DRS Standard 7 of the German Accounting Standards Committee for the first time in 2002, i.e. all material currency translation differences were taken into account.

In addition, contingent capital on December 31, 2002 comprised the following amounts:

1) Up to 3.357 million euros in up to 1,118,962 no-par value shares, reserved to cover subscription rights granted under the first share option plan (Management Incentive Plan I, MIP I) for Executive Board members and senior executives of Software AG Group. In fiscal 2002, the beneficiaries exercised a total of 5,269 subscription rights (of which the Executive Board exercised none). This increased subscribed capital by 16 thousand euros. As of December 31, 2002, 245,846 subscription rights had been granted under MIP I to Executive Board members and 374,430 to senior executives. However, these rights could not be exercised until after the balance sheet date.

The options have a term of seven years from the grant date. They can be exercised after a vesting period of 24 months from the grant date, but not earlier than 12 months after the initial public offering. The options can only be exercised once a quarter, following the publication of annual, half-yearly or quarterly results.

The exercise price of an option corresponds to the issue price minus a 20 percent discount, but not less than 28.12 euros (DM 55.00). As the issue price was 30 euros, the minimum price applied.

Options can only be exercised where the following three conditions are met:

1.1) The Group's income from operations must have increased by 30 percent between 1997 and 1999.

1.2) The Group's income from operations must have amounted to at least 10 percent of revenue in the year preceding exercise of the option.

1.3) The share price must be higher than the minimum option exercise price.

2) Up to 3 million euros in up to 1 million no-par value shares, reserved to cover subscription rights granted under the second share option plan (Management Incentive Plan II, MIP II) for Executive Board members and senior executives employed by the Software AG Group. None of the beneficiaries were permitted to exercise subscription rights in fiscal 2002. At December 31, 2002, 100,000 subscription rights were granted to Executive Board members, and 99,450 to senior executives, under MIP II. These rights could not be exercised until after the balance sheet date.

The exercise price corresponds to the average price in the XETRA closing auction on the

Frankfurt Stock Exchange over the five trading days preceding the grant date.

Options can only be exercised where the following conditions are met:

2.1) The Group's revenue in the year preceding exercise of the option was at least 10 percent higher than the previous year.

2.2) The Group's income from operations amounted to at least 10 percent of the revenue in the year preceding exercise of the option.

The option's term, vesting period and vesting time periods correspond to the conditions described above for MIP I.

3) Up to 13.515 million euros in up to 4,505,000 no-par value shares, reserved to grant option rights to holders of warrants from cum-warrant bonds, and to grant conversion options to holders of convertible bonds in accordance with the bonds' terms. The Executive Board is authorized to issue such bonds, with a term of up to 10 years, once or more than once in the period to April 27, 2006, up to a total nominal value of 500 million euros. The Executive Board did not yet make use of this authorization.

As of the balance-sheet date, the Executive Board is further authorized, with the consent of the Supervisory Board, to increase the company's subscribed capital by up to 37.989 million euros once or more than once in the period to April 27, 2006, by issuing up to 12,663,036 registered shares against cash and/or non-cash contributions (authorized capital). With the exception of the cases detailed below, shareholders will be granted pre-emptive subscription rights.

- The Executive Board is authorized to deviate from shareholders' pre-emptive subscription rights with respect to fractional amounts.

- The Executive Board is further authorized, with the consent of the Supervisory Board, to deviate from shareholders' pre-emptive subscription rights with respect to capital increases against non-cash contributions effected for the purpose of acquiring holdings, companies or business units.

- The Executive Board is also authorized, with the consent of the Supervisory Board, to deviate from shareholders' pre-emptive subscription rights provided that the capital increase against cash effected on the basis of this authorization does not exceed 10 percent of the subscribed capital at the time this authorization is first exercised, and provided that the issue price is not significantly lower than the market value.

- Finally, the Executive Board is authorized, with the consent of the Supervisory Board, to deviate from shareholders' pre-emptive subscription rights with respect to a nominal amount not exceeding 6.503 million euros in order to offer new shares to employees of Software AG and its affiliated companies (in accordance with sections 15 ff. of the German Stock Corporation Act) under an employee share option plan. The new shares can also be transferred to a bank on condition that sale is restricted to entitled persons in accordance with the company's instructions.

During fiscal 2002, the Executive Board did not exercise its power to increase subscribed capital.

The 132 thousand euro premium resulting from the capital increase was transferred to capital reserves.

In fiscal 2002, the parent company distributed 11.723 million euros in dividends to shareholders.

Following Software AG's IPO and in accordance with section 20 of the German Stock Corporation Act, the Software AG Stiftung (Foundation) disclosed on August 3, 1999, that it does not hold a majority interest in Software AG.

Provisions

(8) Provisions for pensions

The provisions for pensions relate exclusively to commitments to certain employees. They are based on the calculations of an actuarial consultant.

The new British pensions accounting standard, FRS 17, requires a change in the way pension assets are valued. This has led to a deficit of 10.357 million euros in the pension fund operated by SAG-UK that is not included on the balance sheet. This deficit represents an indirect financial liability on the part of the Software AG Group and, according to Article 28 of the EGHGB (Introductory Act to the German Commercial Code), does not need to be disclosed on the balance sheet.

(9) Provisions for taxes

The provisions for taxes relate to income and other taxes. These include taxes payable for the period 1993 to 1997 as a result of the current audit of Software AG by the German tax authorities.

(10) Other provisions

In 2002, other provisions principally comprised provisions for restructuring, accounts payable, litigation and bonuses as well as for vacation and overtime entitlements. The company has formed appropriate provisions for future operating expenses.

In addition, appropriate and adequate provision has been made to cover all risks evident at the balance sheet date.

Liabilities

(11) Liabilities to banks

All liabilities to banks were repaid in the course of 2002.

(12) Payments received on account of orders

This item chiefly comprises payments received for services relating to customer projects that still have to be invoiced.

(13) Other liabilities

This item relates principally to liabilities associated with the acquisition of Instrumatic 2000 S.p.A., Milan, Italy and of the IC-Group B.V., Capelle, The Netherlands, as well as tax liabilities and social insurance contributions.

(14) Deferred income

This item mainly consists of maintenance income attributable to subsequent years.

Contingent liabilities

Liabilities from warranty agreements:

3.590 million euros (3.289 million euros in 2001)

The contingent liabilities at the balance sheet date mainly relate to guarantees provided by banks on behalf of Group companies and liabilities from guarantees to customers.

Other financial commitments

Rental and leasing commitments for the next fiscal year, 2003, amount to 24.661 million euros. Commitments for future years total 69.098 million euros.

C. Notes to the consolidated income statement

As in the previous year, the nature of expense method was applied.

(15) Revenue

Revenue is broken down by business sector and region as shown in the segment report (see note D).

(16) Other operating income

Other operating income in the year under review amounted to 55.789 million euros. In the main, this is income from the sale of SAP SI stock to the value of 36.679 million euros. It also includes foreign currency gains, proceeds from the recovery of amounts previously written off as unrecoverable, rental receipts, and income from provisions written back.

(17) Cost of materials

Cost of raw materials and supplies

The cost of raw materials and supplies principally relates to printing supplies and obligations to external product partners.

Cost of purchased services

In addition to external development work, the cost of purchased services primarily includes the use of external companies for service projects, thus allowing greater flexibility in the Group's cost structure.

(18) Personnel expenses

As a result of restructuring in 2002, personnel expenses fell from 281.512 million euros to 257.974 million euros.

(19) Depreciation and amortization of intangible assets and property, plant and equipment

In 2002, this item comprised amortization of goodwill totaling 21.840 million euros.

(20) Other operating expenses

The other operating expenses in the year under review totaled 149.189 million euros. This is primarily third-party sales commissions, rental of premises, consulting costs, travel expenses, IT costs, other staff-related costs, and marketing and advertising expenses. Restructuring costs of 17.634 million euros are also included in this item.

The income attributable to other accounting periods totaled 3.876 million euros; expenses attributable to other accounting periods totaled 2.293 million euros.

(21) Interest income/expenditure

Due to positive cash flow and improved liquidity, interest income rose to 3.195 million euros, despite lower interest rates on the money and capital markets.

(22) Taxes

Tax expense fell as a result of both lower income tax expense (13.961 million euros) and reduced other taxes (555 thousand euros).

The lower income tax expense was largely due to reduced earnings, deductions resulting from losses carried forward in certain countries, and tax-free divestment of holdings.

The total value of deferred tax liabilities was 1.855 million euros.

D. Segment report (January 1 to December 31)

During the period under review, the Software AG Group was divided into six segments according to geographical and organizational criteria.

1) "North America" comprises the SAG-USA Group, Software AG (Canada), Inc., Ontario, Software AG S.A. de C.V. Lomas de Chapultepec, Mexico, and revenues of sales partners in South America, Japan and Israel.

2) "Central Europe" includes Software AG in addition to SAG-D, SAG-A, SAG-CH, SIH, SAG-DK (including its subsidiaries SAG-N, SAG-S, and SAG-SF), and SQL.

3) SAG-F, SAG-NL, SAG-MS, IC-Group, SAG-IRL and SAG-UK, together with the latter's subsidiary SAG-B, are included in the "Western Europe" segment.

4) The "Southern Europe" segment comprises SAG-E, SAG-P and SAG-I.

5) The "Asia" segment includes SAG-AUS, SAG-AUS (holding), in addition to Software AG's Asian companies.

6) SAG EAST, SAG-CS, SAG-TR, SAG-PL, and SAG-ZA form the "Rest of World" segment.

The figures from 2001 were adjusted to the new structure shown above.

All intercompany assets and liabilities and all intercompany income and expenses within each segment have been offset against one another.

The elimination amount in the segment's assets comprises interests in associates, goodwill and receivables from affiliated companies.

Liabilities payable to affiliated companies are consolidated in the segment's liabilities. The elimination of investments in long-term segment assets results from the capital consolidation.

	North America		Central
EUR thousand	**2002**	**2001**	**2002**
Revenue:			
Licenses	48,207	89,544	46,338
Maintenance	95,157	87,646	85,718
Professional Services	29,028	43,272	44,965
Other sales	1,229	1,754	20,783
Total sales	173,621	222,216	197,804
Result:			
Depreciation/amortization	-2,760	-2,925	-4,854
Interest income	6,905	7,950	1,459
Interest expenses	-433	-247	-5,742
Interest income/expenses	6,472	7,703	-4,283
Income from participations	0	0	2,898
Taxes on income	-10,089	-8,729	2,015
Extraordinary charges	0	-18,034	0
Net profit for the period	23,377	49,457	29,224
Balance sheet:			
Segment assets	312,363	340,439	513,998
Equity interests	0	0	0
Investment in long-term segment assets	1,467	997	7,725
Segment liabilities	29,982	35,037	273,522
Average number of employees	576	731	1,385

Europe	Western Europe		Southern Europe		Asia		Rest of World		Elimination		Group	
2001	2002	2001	2002	2001	2002	2001	2002	2001	2002	2001	2002	2001
71,141	14,690	37,298	13,954	16,709	2,850	5,300	6,979	12,254	-20,038	-33,159	112,980	199,087
75,792	27,963	28,989	15,302	14,579	7,865	8,417	13,516	14,281	-44,650	-33,671	200,871	196,033
53,224	36,343	40,570	49,169	52,721	2,117	3,177	214	361	-2,276	-3,021	159,560	190,304
7,856	1,323	2,092	78	204	17	136	55	100	-21,936	-9,101	1,549	3,041
208,013	80,319	108,949	78,503	84,213	12,849	17,030	20,764	26,996	-88,900	-78,952	474,960	588,465
-6,883	-1,234	-1,327	-902	-907	-332	-339	-64	-95	-21,840	-19,799	-31,986	-32,275
2,998	1,377	1,288	758	615	70	55	80	183	-6,937	-7,125	3,712	5,964
-8,652	-108	-53	-270	-304	-799	-977	-118	-121	6,953	7,136	-517	-3,218
-5,654	1,269	1,235	488	311	-729	-922	-38	62	16	11	3,195	2,746
158	0	0	0	0	0	0	0	0	-2,898	-158	0	0
-6,577	-3,787	-8,593	-3,411	-4,229	263	-511	-124	-219	238	2	-14,895	-28,856
-1,000	0	0	0	0	0	0	0	0	0	-1,642	0	-20,676
-31,172	7,275	16,334	9,958	10,296	-884	247	-417	5,141	-35,023	-11,620	33,510	38,683
504,809	86,163	101,232	73,437	65,609	6,675	8,124	11,207	9,494	-563,023	-525,667	440,820	504,040
3,250	4	4	480	120	0	0	0	0	0	0	484	3,374
387,532	2,970	1,279	1,609	777	82	262	196	34	-190	-167,302	13,859	223,579
271,470	25,193	32,137	24,911	26,888	16,746	18,054	6,288	3,728	-232,024	-194,775	144,618	192,539
1,420	438	475	603	641	85	106	31	33	0	0	3,118	3,406

E. Statement of cash flows

Statement of cash flows for January 1, 2002 to December 31, 2002

EUR thousand	2002	2001
Consolidated net income	33,523	38,688
Depreciation/amortization/asset write-ups	35,236	32,275
Increase/release of long-term provisions	153	369
Gain/loss from the disposal of fixed assets	-36,194	-302
Decrease/increase in inventories, receivables and other current assets	61,535	43,800
Decrease/increase in payables and other liabilities	-53,529	-31,669
Net cash used in/provided by operating activities	**40,724**	**83,161**
Cash received from the sale of tangible assets	1,719	927
Investments in tangible assets	-6,409	-6,693
Cash received from the sale of intangible assets	58	22
Investments in intangible assets	-1,304	-1,053
Cash received from the sale of financial assets	39,902	3,510
Investments in financial assets	-4,030	-108
Investments in associated companies	-2,050	-279,280
Net cash used in/provided by investing activities	**27,886**	**-282,675**
Contribution from capital increase	148	24,303
Dividends paid	-11,722	-10,123
Cash proceeds from short-term borrowings	2,050	92,212
Repayment of loans and liabilities from acquisitions	-30,192	-68,521
Net cash used in/provided by financing activities	**-39,716**	**37,871**
Change in cash funds for exchange rate movements, changes in group structure for cash funds	**-3,715**	**-3,438**
Net change in cash and cash equivalents	**25,179**	**-165,081**
Cash and cash equivalents at the beginning of the period	50,244	215,325
Cash and cash equivalents at the end of the period	**75,423**	**50,244**

Notes to the cash flow statement

"Cash and cash equivalents" correspond to the balance sheet item "Bank balances."

"Depreciation/amortization" comprises the amortization of goodwill from the acquisition of the SAG-USA Group, the IC-Group and SAG Turkey amounting to 21.840 million euros, depreciation of intangible and tangible assets totaling 10.146 million euros, and depreciation of financial assets amounting to 3.250 million euros. "Cash flow from operating activities" includes an outflow of 537 thousand euros in interest payments.

The change in financial assets is primarily due to a cash inflow from the sale of securities worth a total of 39.803 million euros. There was also an outflow of 3.588 million euros to cover the value of assets in employee time accounts in case of insolvency.

The purchase of the final tranche of 2.050 million euros in the IC-Group is included in "Investments in associated companies." Liabilities to the respective sellers of the same amount are included under "Cash proceeds from short-term borrowings".

"Repayment of loans and liabilities from acquistions" includes 27.619 million euros primarily related to the purchase of the SAG-USA Group, as well as repayment in full of the mortgage loan (2.573 million euros).

F. Other disclosures

Members of the Supervisory Board:

Frank F. Beelitz

Independent investment banker
Beelitz & Cie., Frankfurt am Main
Place of residence: Bad Homburg v.d.H.
Member until Feb. 28, 2002, Deputy Chairman from March 1, 2003 to Sep. 30, 2002, Chairman since Oct. 1, 2002

Supervisory Board mandates:

- Member of the Supervisory Board
  Syntec Capital AG, Munich
- Member of the Board of Directors
  Eon Labs, Inc., New York, USA
- Member of the Advisory Council
  Mero GmbH & Co. KG, Würzburg
  (until Oct. 31, 2002)

Karl Heinz Achinger

Independent management consultant
Place of residence: Seefeld
Deputy Chairman from Oct. 1, 2002 to Nov. 30, 2002
From Dec. 1, 2002, Mr. Achinger's membership of the Supervisory Board is suspended while he is acting Chairman of the Executive Board.

Supervisory Board mandates in Germany:

- Chairman of the Supervisory Board
  Heyde AG, Bad Nauheim (until May 5, 2002)
- Chairman of the Supervisory Board
  Magix AG, Munich
- Member of the Supervisory Board
  Tiscon AG, Neu-Ulm (Chairman from May 6, 2002)
- Member of the Supervisory Board
  debitel AG, Stuttgart
- Member of the Supervisory Board
  Dosch & Amand Systems AG, Munich
  (from July 1, 2002)
- Member of the Supervisory Board
  RWE Systems AG, Dortmund
- Member of the Supervisory Board
  USU AG, Möglingen
- Member of the Supervisory Board
  USU-Openshop AG, Neu-Ulm (from Feb. 6, 2002)

Membership of equivalent bodies outside Germany:

- Member of the Supervisory Board
  Augeo Software B.V., Nijkerk, The Netherlands
- Member of the Board of Directors
  Tecnomatix Technologies Ltd., Hereliya, Israel
  (until Nov. 10, 2002)

Dr. Peter Lex

Lawyer, Dr. Mohren+Partner, Munich
Place of residence: Munich
Deputy Chairman from Dec.18, 2002

Supervisory Board mandates: none

Justus Mische

Place of residence: Kelkheim (Taunus)
Member since Dec. 9, 2002

Supervisory Board mandates:

- Chairman of the Supervisory Board
  Altana AG, Bad Homburg v.d.H.
- Chairman of the Supervisory Board
  B. Braun Melsungen AG, Melsungen
- Chairman of the Supervisory Board
  Hoechst AG, Frankfurt am Main
- Member of the Supervisory Board
  mg-Technologies AG, Frankfurt am Main

Karl-Heinz Hageni

SAG Systemhaus GmbH employee,
Training/Consulting department
Place of residence: Alsbach-Hähnlein
Employee representative

Supervisory Board mandates: none

Reinhard Springer

Software AG employee,
Corporate IS department
Place of residence: Fränkisch-Crumbach
Employee representative
Member from May 1, 2002

Supervisory Board mandates: none

Dietrich-Kurt Frowein
Place of residence: Frankfurt am Main
Chairman to September 30, 2002, member from Oct. 1, 2002 to Nov. 30, 2002
Supervisory Board mandates:

- Member of the Supervisory Board Commerzbank AG, Frankfurt am Main (until May 31, 2002)
- Member of the Supervisory Board Heidelberger Druckmaschinen AG, Heidelberg
- Member of the Supervisory Board Schunk GmbH, Thale

Detlef Winterstein
Software AG employee, works council
Place of residence: Weiterstadt
Employee representative until April 30, 2002

In the year under review, the Executive Board comprised:

Karl Heinz Achinger
Place of residence: Seefeld
Chairman of the Executive Board, from Dec.1, 2002
Supervisory Board mandates:
see Members of the Supervisory Board

Volker Dawedeit
Place of residence: Seeheim-Jugenheim
Member of the Executive Board, until April 30, 2002
Supervisory Board mandates: none

Dr. Erwin Königs
Place of residence: Kelkheim/Taunus
Chairman of the Executive Board, until Nov. 30, 2002
Supervisory Board mandates: none

Dr. Detlef Purschke
Place of residence: Mainz
Member of the Executive Board
Supervisory Board mandates: none

Andreas Zeitler
Place of residence: Kelkheim/Taunus
Member of the Executive Board
Supervisory Board mandates: none

Arnd Zinnhardt
Place of residence: Kelkheim/Taunus
Member of the Executive Board, from May 1, 2002
Supervisory Board mandates: none

Remuneration of Software AG's Supervisory Board totaled 75 thousand euros. The members of the Executive Board received total annual remuneration of 1.661 million euros. In addition, they received performance-related bonuses of 704 thousand euros for 2002. Performance-related bonuses for fiscal 2001 of 1.328 million euros were also paid in 2002. Former members of the Executive Board received 682 thousand euros, of which 300 thousand euros were reimbursed by an insurance company. Pension provisions for former members of the Executive Board amounted to 2.247 million euros.

Number of employees

The average number of employees in the Software AG Group in 2002 was 3,118. As of Dec. 31, 2002, the Group had a total of 3,013 employees.

German Corporate Governance Code

In December 2002, the Company issued a declaration of compliance in accordance with section 161 and in conjunction with section 15 of the Stock Corporation Act.

Darmstadt, February 26, 2003
Software AG

K. H. Achinger A. Zeitler

A. Zinnhardt Dr. D. Purschke

Auditors’ report

Software AG, Darmstadt
Auditors’ report

We have audited the annual financial statements, together with the bookkeeping system, of the Software AG as well as the consolidated financial statements and its report on the position of the Company and the Group prepared by the Company for the business year from January 1, 2002 to December 31, 2002. The preparation of these documents in accordance with German commercial law are the responsibility of the Company's management. Our responsibility is to express an opinion on the annual financial statements, together with the bookkeeping system, as well as on the consolidated financial statements and the report on the position of the Company and the Group, based on our audit.

We conducted our audit of the annual and consolidated financial statements in accordance with § 317 HGB and the generally accepted German standards for the audit of financial statements promulgated by the Institut der Wirtschaftsprüfer in Deutschland e.V. (IDW). Those standards require that we plan and perform the audit such that misstatements materially affecting the presentation of the net assets, financial position and results of operations in the annual and the consolidated financial statements in accordance with principles of proper accounting and in the report on the position of the Company and the Group are detected with reasonable assurance. Knowledge of the business activities and the economic and legal environment of the Company and evaluations of possible misstatements are taken into account in the determination of audit procedures. The effectiveness of the accounting-related internal control system and the evidence supporting the disclosures in the books and records, the annual and consolidated financial statements and the report on the position of the Company and the Group are examined primarily on a test basis within the framework of the audit. The audit includes assessing the accounting and consolidation principles used and significant estimates made by management, as well as evaluating the overall presentation of the annual and the consolidated financial statements and the report on the position of the Company and the Group. We believe that our audit provides a reasonable basis for our opinion.

Our audit has not led to any reservations.

In our opinion, the annual and the consolidated financial statements give a true and fair view of the net assets, financial position and results of operations of the Company and the Group, respectively, in accordance with principles of proper accounting. On the whole the report on the position of the Company and the Group provides a suitable understanding of the Company's and the Group's position and suitably presents the risks of future development.

Frankfurt am Main, February 26, 2003

BDO Deutsche Warentreuhand
Aktiengesellschaft
Wirtschaftsprüfungsgesellschaft

Schumacher	Braun
Independent Auditor	Independent Auditor

Financial Calendar 2003

April 24, 2003	Results Q1 2003
April 29, 2003	Software Aktiengesellschaft’s Shareholders’ General Meeting (Darmstadt)
July 24, 2003	Results Q2 2003 and half-year report
July 25, 2003	Analyst Conference
October 23, 2003	Results Q3 2003

Photos
Getty Images, Zefa

Adabas
Software AG's high-performance database for mainframes is acknowledged to be the world's fastest. It is employed by several thousand customers, generally to provide centralized data management for mission-critical processes.

Cash flow
Cash receipts minus cash payments over the reporting period.

Content management
The term content management covers all processes related to digitally stored information: generation, editing, updating, organization, publication and reuse.

CRM
Customer relationship management – generic term for all activities geared to build and maintain lasting customer relationships. CRM systems are employed to capture, store, share and analyze information about customer-related transactions and activities.

EBITDA
Earnings before interest, taxes, depreciation and amortization.

E-government
Electronic government – electronic, particularly Internet-based, services provided to citizens.

Electronic business
Automated handling of business transactions. Includes electronic integration of enterprises, their customers, suppliers, banks, etc. on the basis of Web technologies.

Enterprise transaction products
Software for enterprise-wide handling of transactions and applications. The more reliable these products are, the more smoothly companies can handle their business processes, which is a major determinant of competitiveness. Software AG's Adabas and Natural are enterprise transaction products.

EntireX
Software AG's comprehensive, efficient integration toolset. Consists of several products that enable the integration of platforms, applications and data, as well as Web connectivity and XML data processing. Integration solutions that leverage EntireX can incorporate standard applications, traditional transaction systems, and cutting-edge Web services.

HTML
Hyper Text Markup Language – a file format for creating World Wide Web pages. HTML defines the layout, font and graphics, as well as hypertext links to other pages.

Middleware
Software that enables data to be exchanged between different applications on diverse systems platforms within an enterprise. Middleware is usually tailored to the needs of the relevant applications.

Mobile computing
Mobile computing – wireless access to functions and information via extranet, intranet and Internet portals using mobile devices.

Natural
Software AG's platform-independent application development environment (programming language and

workbench) for designing, developing and building business applications.

PDF
Portable Document Format – a universal data format that supports all typefaces, layouts, colors and graphical elements. Any document can be converted to PDF format and viewed regardless of the source program and operating system used.

SOAP
Simple Object Access Protocol. XML-based protocol used for accessing Web services, for instance. Enables communication between different programs that can reside on different computers and operating-system platforms. Information is exchanged using Internet technologies on an XML framework.

SQL
Structured Query Language – a standard programming language for updating and accessing information stored in relational databases.

Supply Chain Management
Process-based management and optimization of cash, material and information flows within and beyond organizational boundaries.

Tamino XML Server
Software AG's XML server. The server incorporates a range of products for application development and integration, as well as for processing, searching and storing data based on the XML standard. At the heart of Tamino XML Server is a database capable of storing information of all kinds. The database stores and processes XML documents in their native form, preserving their original structure.

UDDI
Universal Description, Discovery and Integration. An XML-based standard for directories listing companies and their Web services (the "Yellow Pages" of the Internet).

WAP
Wireless Application Protocol. Standard for Internet access via cell phones and other mobile devices. In existence since 1997, it is supported by all leading vendors. WAP is based on WML (Wireless Markup Language), an XML data description language.

Web services
Programs or program components that reside on an Internet server and can be called by other application components. Web services are listed in central, online industry directories known as UDDI repositories.

WML
Wireless Markup Language, is an XML-based language that allows text to be displayed on cellular telephones and personal digital assistants (PDAs).

WSDL
Web Service Description Language. An XML language employed to describe a Web service including technical details about how to call it up and use it.

XML
eXtensible Markup Language. A meta language for data description. XML enables standardized, platform- and application-independent data processing, and simplifies data exchange over the Internet. Separates content from presentation and allows information to be displayed in any format on any end-device.

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THE XML COMPANY