SOFTWARE AG ANNUAL REPORT 1998

SOFTWARE AG

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ACCEPT NO LIMITS

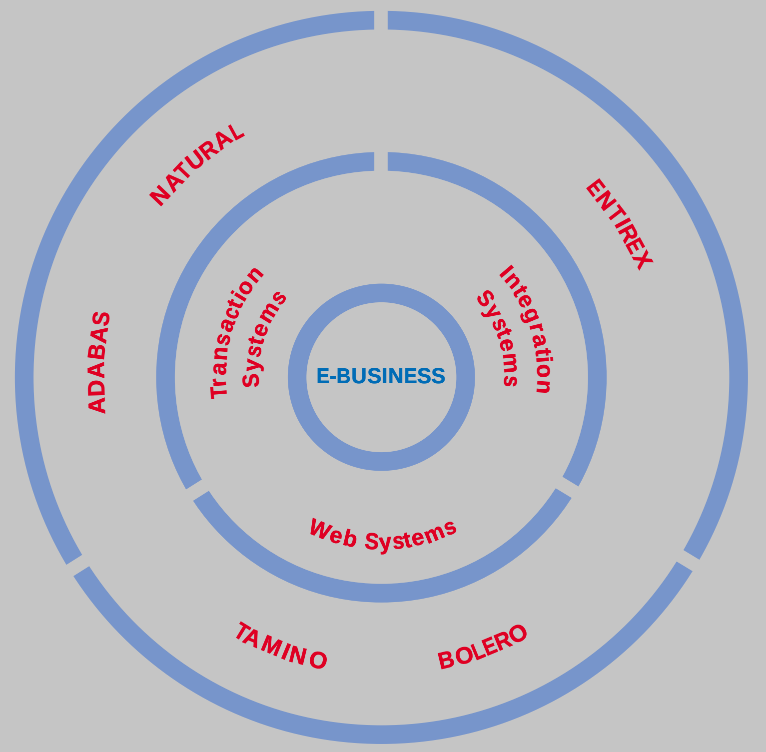
KEY FIGURES

DM million, unless stated	1996*	1997*	1998
Revenues	531,2	575,2	626,4
From: Licensing (%)	28,3	27,8	30,1
Maintenance (%)	36,6	37,7	34,3
Professional Services (%)	33,5	32,9	34,7
Other turnover (%)	1,6	1,6	0,9
Earnings (loss) before interest and taxes	–34,1	70,9	79,4
as % of turnover		12,3	12,7
Profit (loss) before tax	–35,6	64,7	87,3
Net profit (loss)	–36,1	55,0	52,2
as % of turnover		9,6	8,3
Earnings per share (DM)** (according to DVFA/SG)	n/a	1,50	1,82
Total assets	403,3	415,2	508,3
Cash and equivalents	15,6	106,3	215,9
Shareholders' equity	43,0	96,7	148,6
as % of total assets	10,7	23,3	29,2
Employees at year end	2468	2096	2186

*Restated cf. p. 26

**Software AG began trading on the Main Market segment (Amtlicher Handel) of the Frankfurt Stock Exchange on 26 April 1999 (Bloomberg: SOW GR, Reuters: SOWG.F, SIC: 724 260)

CORE COMPENTENCIES AND PRODUCTS



ELECTRONIC BUSINESS

Responding to the explosive growth of Internet communication, Software AG has, with its electronic business offering, opened up an area of activity with enormous potential. With the products Bolero and Tamino, we are concentrating principally on the business-to-business market segment that supports business processes between enterprises. Using our Application Factory Bolero, users can comfortably develop custom-tailored applications for handling electronic business processes.

Tamino is an innovative high-performance information server specially designed for the storage, administration and transfer of data across the Internet.

INTEGRATION SYSTEMS

The ability of information technology (IT) to provide business advantage depends principally on the reliable communication of data between typically heterogeneous IT systems. This is the task of software solutions that integrate applications across multiple operating systems and hardware platforms (Enterprise Application Integration). With the product EntireX, we are active in a market segment that analysts currently estimate is growing at an annual rate of 35 to 40 percent.

ONLINE TRANSACTION SYSTEMS

All enterprises use information systems to support their core business areas such as invoicing, logistics and customer service. Thousands of users access the data in these systems stored in large databases. These kind of systems are referred to as transactional systems.

Reflecting the growth and expansion of the enterprise itself, these systems have to support ever growing numbers of users, increasing data volumes and more frequent access rates. Supporting these systems is the most frequent application of Software AG's transaction systems products: Adabas, our database management system, and Natural, our tool set for developing mission-critical enterprise applications. Both products have been available for many years and their proven quality and reliability results in a high degree of customer loyalty. Systems developed with these tools can be easily applied to support electronic business and Internet applications. Thus, Software AG ensures that its customers gain long term benefits from their IT investments.

GLOBAL PRESENCE

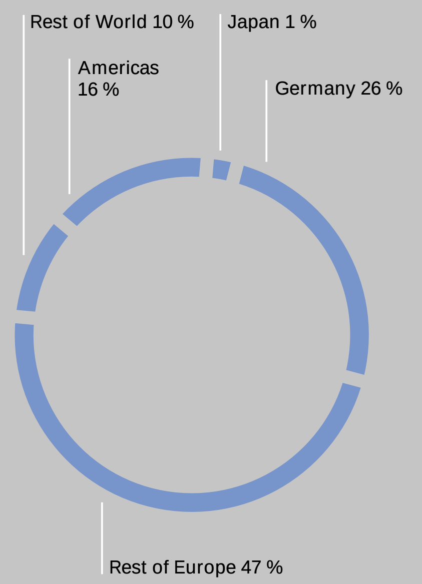
SALES REGIONS

Denmark
Germany
United Kingdom
Belgium
The Netherlands
France
Italy
Spain
Portugal
Austria
Switzerland

Turkey
Czech Republic
Hong Kong
Malaysia
Philippines
Singapore
Near/Middle East

North and
South America:
Israel
Japan
South Africa
Australia
New Zealand
Korea
Taiwan

REVENUE BY REGIONS – LIZENSES AND MAINTENANCE 1998



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MISSION STATEMENT

TO BE THE LEADING SUPPLIER OF CROSS-PLATFORM SYSTEM SOFTWARE FOR MISSION CRITICAL ELECTRONIC BUSINESS APPLICATIONS.

CONTENTS

FOREWORD

DEAR SHAREHOLDERS,
DEAR BUSINESS PARTNERS,

1998 was an extremely successful year for Software AG. The measures taken the previous year to strengthen the company's earnings power proved effective, while the Group recorded the highest operating result in the company's history. At the same time, key components in the drive towards the technological renewal and extension of our product portfolio started to produce compelling results. We also implemented a series of measures designed to improve the company's international market visibility, especially among our customers and the trade press.

The double-digit growth in our sales of product licenses is particularly satisfactory. This applies both to Software AG's classic product portfolio in the database and application development tools areas and, in particular, to the Enterprise Application Integration (EAI) area. Our new EntireX product, which was introduced at the end of 1997, generated substantial business in this area and contributed to a year-on-year rise in EAI sales of 34 percent. It is also extremely encouraging that we were able to win a large number of new customers in this market segment. In Professional Services we also recorded double-digit growth in 1998, along with a further increase in productivity.

This growth and the positive developments in income and productivity were reflected in the positive results for nearly all Group companies. At the same time, the company's capital resources and liquidity improved considerably. The Group continued to be free of bank debt at the end of the fiscal year and has significant – and substantially increased – liquidity reserves.

In addition to strengthening our position on the EAI market, we have set initial signals on the growth market for electronic business. The move towards electronic business products and services is one of the key trends in the IT sector at present, and is an increasingly important economic factor for companies in all sectors. In November 1998, the company launched Bolero, an Application Factory for Electronic Business that was specifically designed for developing and running application systems for electronic business in conjunction with Java technology. In addition, we have laid the foundations for substantially extending our electronic business market presence in the course of the coming year.

We are convinced that the market for electronic business will generate considerable impetus for the growth our company in the medium term. We are working at full steam to continue our company's successful development in the coming year. Software AG's acceptance by the public, the market and our customers has grown substantially. The IPO planned for 1999 will substantially increase public awareness of our company, the confidence of our customers, our ability to win new customers and not least the motivation of our employees. As a result, we are looking forward to the current fiscal year with confidence.

Dr. Erwin Königs
Chairman and CEO

REPORT OF THE SUPERVISORY BOARD

During the past fiscal year, the Supervisory Board supervised the activities of the Management Board and kept itself informed in detail of the development of the company and all major transactions. At a total of seven meetings with the Management Board it discussed fundamental matters relating to the development of the company and examined and made decisions on specific transactions which required approval in accordance with legal regulations or the Articles of Association of the company.

Discussions also focused on the economic position of the subsidiaries and the longer-term development of the individual business units.

In addition, the Management Board provided monthly written status reports to the members of the Supervisory Boards.

Dr. Eberhard Rauch as Chairman of the Supervisory Board on December 31, 1998 and left the Supervisory Board with effect from the same date. The Supervisory Board and the company would like to thank Dr. Rauch for his dedication and commitment as well as his valuable contributions and advice.

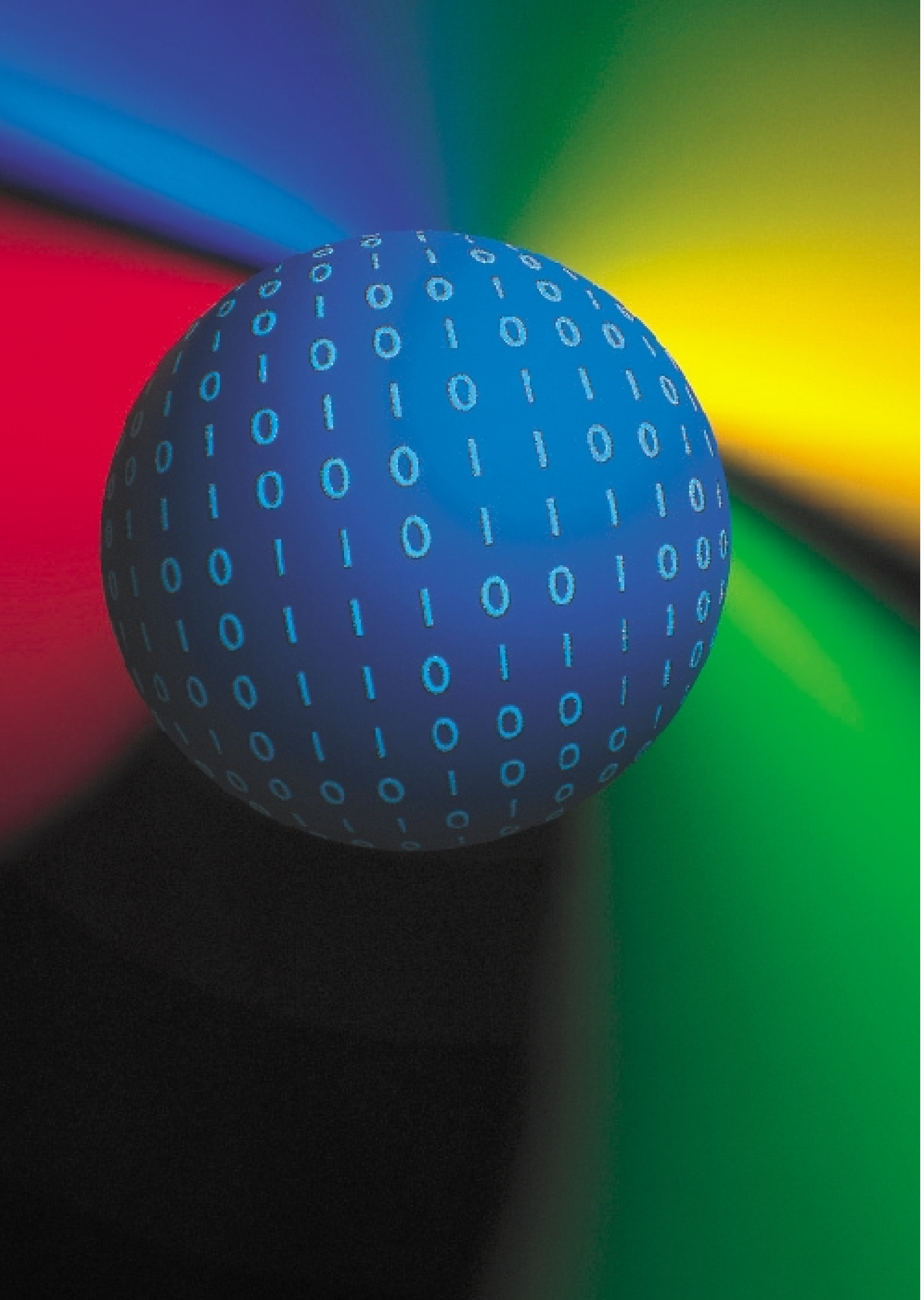
The Extraordinary Shareholders' Meeting on December 8, 1998 elected Mr. Dietrich-Kurt Frowein and Dr. Peter Lex to the Supervisory Board with effect from January 1, 1999. Subsequently, the Supervisory Board elected Mr. Frowein as its Chairman with effect from the same date.

The annual financial statements and the consolidated financial statements as of December 31, 1998, the management report and the accounting were audited by BDO Deutsche Warentreuhand Aktiengesellschaft, Frankfurt am Main, which issued an unqualified auditor's opinion.

The Supervisory Board concurs with the results of the audit and approves the annual financial statements and the consolidated financial statements. The submitted annual financial statements have thus been adopted.

Darmstadt, March 1999

The Supervisory Board



GROUP MANAGEMENT REPORT FOR SOFTWARE AG AND SOFTWARE AG GROUP AS OF 31 DECEMBER 1998

THE MARKET

The market in which Software AG is active was fundamentally positive during the past fiscal year. Our customers invested heavily in information technology (IT). One topic that was discussed at length in the media, especially in North America and Great Britain, was Year 2000 conversion. The fears expressed on the market that this could lead to investments in other IT segments being postponed do not seem to have materialized, at least for Software AG.

The easing of the market in the Far East and Russia in the second half of the year in particular also impacted our company's business. However, in view of the relatively minor proportion of sales generated in this area, this weakness had no more than a minor impact on Software AG's overall positive development.

INDUSTRY OVERVIEW

The change in emphasis in information technology, which has been evident for a number of years, continued in 1998. The focus here is on solutions with which IT applications that are already installed can be integrated at an enterprise-wide level, or combined with those of business partners. This preserves the value of previous investments in IT and allows their cost-effective redeployment for new areas of activity, such as electronic business. In our opinion, the following requirements and trends currently dominate the IT sector:

INCREASING INTEGRATION OF HETEROGENEOUS IT ENVIRONMENTS

One of the greatest challenges facing IT is the integration of multiple different IT systems which have been the subject of continuous further development, in order to ensure they can communicate with each other. Companies generally use mainframes and central servers to store data and run mission-critical applications, since these offer especially reliable security mechanisms, can be adapted relatively easily to dynamic increases in capacity requirements and allow cost-effective central management. At the same time, competitive pressure is demanding that applications be developed and enhanced in such a way that they can be used on PCs. For example, a company can gives sales staff throughout the world reliable, secure access to inventory information via an internal Intranet. Another challenge is the integration of different companies' IT systems – e.g. to enable communication between customer and supplier systems or to consolidate IT systems following mergers. Industry experts expect the Enterprise Application Integration (EAI) market to grow by an average of 35 – 40 percent per annum, and to exceed USD 5 billion in 2001.

A NEW CONCEPT – COMPONENTWARE

Companies today are moving away from developing in-house solutions for specific business applications, mainly because of cost pressures, and are increasingly installing standard software packages instead. However, these often only offer a subset of the functionality and performance of company-specific business applications. As a result, the ability to integrate standard applications with existing custom solutions is needed. The approach taken is known as component-based software development, or componentware; in which standardized, reusable software components are combined to produce complete applications. Componentware allows the fast, cost-effective integration of existing and new business applications. We have been active in this market segment since the introduction of EntireX in 1997, and recorded strong demand in the past fiscal year.

GROWING IMPORTANCE OF THE INTERNET AND ELECTRONIC BUSINESS

The rapid advance of the Internet is the biggest challenge currently facing the IT sector. Thanks to its global standards, the Internet has open interfaces and an open architecture that makes adding new applications easy. This applies above all to the use of this medium as an information platform as well as increasingly for business transactions. The name commonly given to Internet-based transactions between business and consumers is "electronic commerce", while business-to-business transactions are known as "electronic business". According to IDC (International Data Corporation), sales in the electronic business segment are growing by an average of more than 100 percent per annum, from USD 7.0 billion in 1997 to roughly USD 200 billion in 2001. What is more, the same experts expect electronic business to grow substantially faster than electronic commerce.

Electronic business is generating growing demand for new types of database management products that enable the storage, management and Internet usage of new Web data types for use in business applications. These new data types include, for example, images, audio and biometric data such as fingerprints or retina patterns. The latter are becoming increasingly important in electronic business applications, especially for user identification and the prevention of unauthorized access. Given the especially promising growth prospects for electronic business, Software AG is concentrating on this market. Our goal is to become one of the leading suppliers of systems software solutions and cross-platform integration software for electronic business applications.

CLEAR PRIMACY OF MAINFRAMES AND CENTRAL SERVERS

Due to the technical and economic limits which client-server applications hit, once they get above a certain size, many large and medium-sized companies run key business applications on mainframes and central servers. These systems can be particularly easily adapted to increases in capacity and can be managed centrally with relatively little effort. Thanks to these characteristics, mainframes and central servers will continue to play a key role in the processing of core business transactions, and analysts continue to predict strong growth for this segment. Thus, IDC estimates that the overall market for online transaction processing (OLTP) software was worth USD 24.0 billion in 1997, and that it will rise to USD 40.0 billion by 2001.

THE YEAR 2000 BOOM

The past fiscal year saw the discussion of the problems that the millennium date change is causing – a discussion on which was particularly intense in the United States and Great Britain – spread to the IT industry as a whole. In Germany, too, this led in 1998 to increased demand for products and services for IT systems analysis and conversion in order to ensure Y2K compatibility. In the meantime, work is well underway at users of our Adabas and Natural product lines. In addition, we are offering a standby service for the 1999/2000 New Year in order to be able to solve any problems occurring in our customers' application systems directly and in good time.

OUR SOLUTIONS AND PRODUCTS

Software AG develops and markets enterprise systems software and provides related services in the following market segments:

- Online Transaction Processing (OLTP),
- Enterprise Application Integration (EAI), and
- Electronic Business.

Our products are used to develop and integrate application systems and to store and provide data and information in large and medium-sized companies in particular.

In the year under report, Software AG launched Bolero, its first electronic business product. Bolero, the Application Factory for Electronic Business, is a completely new technology. A further major technological innovation – Tamino, our Information Server for Electronic Business – is planned for 1999.

ONLINE TRANSACTION PROCESSING (OLTP)

In the OLTP segment our classic product lines Adabas and Natural maintained their strong position once again in the past fiscal year, with license revenues increasing by 17 percent to DM 128.0 million. In total, the two lines accounted for 68 percent of license income.

Fully Y2K compatible versions of the Adabas and Natural product lines have been available since the beginning of 1998. In addition, the company launched a suite of software tools onto the market to support conversion of existing Natural applications at customer sites. Numerous Year 2000 projects have been successfully completed.

Adabas is Software AG's high-performance database for OLTP applications, and offers maximum internal flexibility and robustness. It was the first Software AG product to be launched on the market and was a global success right from the start. Adabas is currently number two on the global mainframe market. More than 3,000 companies use it, in most cases for mission-critical applications. The database is available for a large number of platforms: mainframe systems, Unix, Windows NT and key proprietary server platforms.

Adabas experienced considerable further development in the year under report. One example is the new add-on tool, AdabasVista, which further enhances the reliable management of and response times for extremely large volumes of data. AdabasVista also allows on-the-fly segmentation of Adabas databases without Adabas users being affected in any way. This is particularly beneficial where data volumes or the number of transactions that the database must manage at one and the same time are growing rapidly.

Natural, the suite of software tools for industrial application development, is another key item in our product portfolio. Natural comprises a fourth-generation programming language and a comprehensive tool environment for the logical and physical design and implementation of business applications. Natural enables systems support for enterprise-wide business processes to be developed more rapidly, reliably and cost-effectively and maintained better than is the case with conventional programming languages such as C or Cobol.

In the year under report, Natural underwent systematic further development. For example, Natural@Web – the Web integration component for Natural applications – was substantially enhanced. The Natural syntax for the various systems platforms was harmonized, thus improving the efficiency of Natural projects for heterogeneous environments and the portability of Natural programs across platform boundaries. The performance of our RPC (Remote Procedure Call) technology for communication between distributed Natural components was improved. These enhancements also serve to meet the requirements made of Natural applications in the rapidly growing electronic business segment. Natural Lightstorm, our PC component, was also developed further, and now enables complete Natural applications to be developed on cost-effective PCs, regardless of where they will subsequently be deployed. NaturalX, the version of Natural used for developing DCOM components, was successfully implemented at customer sites.

ENTERPRISE APPLICATION INTEGRATION

The Enterprise Application Integration (EAI) market segment comprises software solutions for integrating applications across all operating systems and hardware platforms. EAI software – also known as middleware – enables heterogeneous IT systems to communicate and cooperate. According to the analysts, this market segment is currently growing by 35 to 40 percent per annum - an extremely attractive growth proposition for our company, especially as large companies are placing particular emphasis on the integration and long-term use of their business applications.

Software AG generated a 46 percent increase in sales of EAI products thanks to its EntireX product, which was first released at the end of 1997. Around 40 percent of EntireX license sales were to new customers who had not previously used Software AG products.

EntireX is a component-based Enterprise Application Integration product for linking software applications across heterogeneous operating systems. EntireX is primarily designed for enterprises that wish to protect their IT investments by making the various components of their existing infrastructure interoperable. Software AG's customers use EntireX to integrate such mission-critical functions as electronic business applications, call-center systems, and enterprise resource planning (ERP) applications.

EntireX is built around Entire Broker, a high-performance, cross-platform message server that provides guaranteed delivery of application messages, multiple programming language interfaces (C, C++, Java, Cobol, Natural), and remote application management and security integration functionality. One specific feature of EntireX is its ability to establish a two-way link between Unix or mainframe applications and Microsoft's Windows platform using Microsoft's DCOM component interface.

Substantial development work was performed on EntireX in the year under report. For example, a component manager was added to enable the distribution and administration of application components across heterogeneous EntireX platforms. In addition, a security access facility (SAF) was added. This allows user access to decentralized systems running EntireX to be controlled by the security system running on the central mainframes. This simplifies and improves user control and system security. EntireX's DCOM component was extended to enable its use not only with the Natural, C and C++ programming languages but also with Cobol applications. This represents a significant increase in EntireX's range of deployment for distributed applications.

ELECTRONIC BUSINESS

Electronic business began several years ago with the introduction of the EDI (Electronic Data Interchange) standard. However, the rise of the Internet/Web has led to exponential growth setting in. Business is keen to exploit the new opportunities for doing business electronically, but is searching for reliable technical solutions at acceptable prices. Software AG specializes in providing support for business-to-business transactions. We know the specific requirements and can build on many years' experience in this area.

The challenge here is on the one hand to revamp existing corporate applications for Internet usage, and on the other to master the floods of information which it brings. New applications have to be developed in order to support the new types of business processes required by the Internet. While there are a large number of – mainly small – software suppliers offering specific components for this purpose, the problem of how to integrate new systems with existing applications and the seamless incorporation of the increasingly complex floods of data and information is still largely unsolved. This is where our products come in: Bolero for the development and operation of new commercial application systems and Tamino for storage and providing access to complex data. EntireX is also important, because it supports the integration of existing applications and databases.

Bolero is a software platform built on Java technology used for the professional development of electronic business applications. Bolero was launched in March 1998, and released for commercial shipment in November of the same year. Based on state-of-the-art industry standards, Bolero provides a comprehensive infrastructure which includes a user-friendly business programming language and utilizes the Java platform.

The Bolero Component Studio provides an integrated visual development environment, while the Bolero Application Server combined with the Java Virtual Machine provides support for the operation of electronic business applications. Using Bolero, programmers can substantially reduce the amount and complexity of code necessary to generate commercial applications. The Bolero Component Studio includes reusable application templates, a component for programming graphical user interfaces (GUI Builder), as well as automatic reporting functions. The Bolero Application Server enables management of complex business transaction flows and provides automated, standards-based access to multiple databases.

Bolero supports standard component models including COM and JavaBeans. For 1999, Software AG plans to support Enterprise JavaBeans (EJB). Bolero runs on a large number of platforms such as Microsoft Windows and Windows NT, numerous variants of Unix and IBM mainframes. Many of the Bolero add-on modules are to be provided as Component Library Integration Packages (CLIPs) in the future, thus extending Bolero's functionality.

Tamino is a completely new Internet information server containing a database system based on the new XML (Extensible Markup Language) Web standard. Tamino has been specially designed for the storage, management and transfer of the structured and unstructured data that are increasingly needed for electronic business applications.

Tamino has a comprehensive database infrastructure based on Internet standards, such as the XML information storage and access module (X-Machine), the interface to existing databases (X-Node) and the Tamino Manager component. The X-Machine has been constructed in such a way as to substantially reduce the response times for electronic business applications. It stores XML information directly, without transforming it into other formats and provides special security, indexing and access functions for XML data. The Tamino Manager offers a suite of software tools for Internet-based database management. It can be used in a wide variety of environments thanks to its support for the Windows NT, Unix and mainframe platforms. Tamino was presented in public for the first time at CeBIT in March 1999; the initial product rollout is planned for the fourth quarter of 1999.

With Tamino, Bolero and EntireX, Software AG has a complete range of products for the integration and Internet-enablement of mission-critical software applications.

Total license sales for all Software AG products rose in the past fiscal year by 18 percent to DM 188.4 million.

PROFESSIONAL SERVICES

Software AG also provides a comprehensive range of services that is primarily aimed at helping large and medium-sized enterprises build, deploy and integrate enterprise applications. Professional Services generated DM 217.0 million in fiscal year 1998, up 15 percent on the previous year.

Software AG's Professional Services employs around 850 permanent employees plus 500 freelance software experts.

Professional Services can be divided into the following areas:

– **Business Consulting:** Systems software requirements analysis and support for application design and specification.

– **Application Development:** Development of customized software applications for enterprise transaction systems.

– **Technology Consulting:** Consulting on all aspects of systems implementation and integration, including technical customer support (24 x 7 if required), on-site installation and implementation services, remote analysis, automated customer assistance and Web-based electronic services.

– **Education and Training Services:** In-depth training for Software AG products in order to accelerate development, application integration and Year 2000 projects.

– **Outsourcing and Technology Services:** Network database management and performance optimization plus the outsourcing of entire business applications to Software AG.

– **Year 2000 Services and Products:** Comprehensive consulting services for solving the Year 2000 problem in business applications. Our offering here also includes licenses for the Year 2000 conversion product, Genart.

MARKETING AND SALES

Our license business in fiscal 1998 grew by double digits at nearly all subsidiaries. Our partner company in the USA, SAGA Software Inc., recorded particularly high growth. As a result of the continued high demand for technology for enterprise-wide online transaction processing, license sales for the Adabas and Natural product lines rose by 17 percent. EntireX, our new Enterprise Application Integration (EAI) product, considerably exceeded expectations by doubling its 1997 sales – a growth rate well above the industry average. EAI accounted for more than 20 percent of our license sales in the past year. Particularly gratifying is the fact that we were able to win a number of large customers for EntireX thanks to its ease of implementation and high performance.

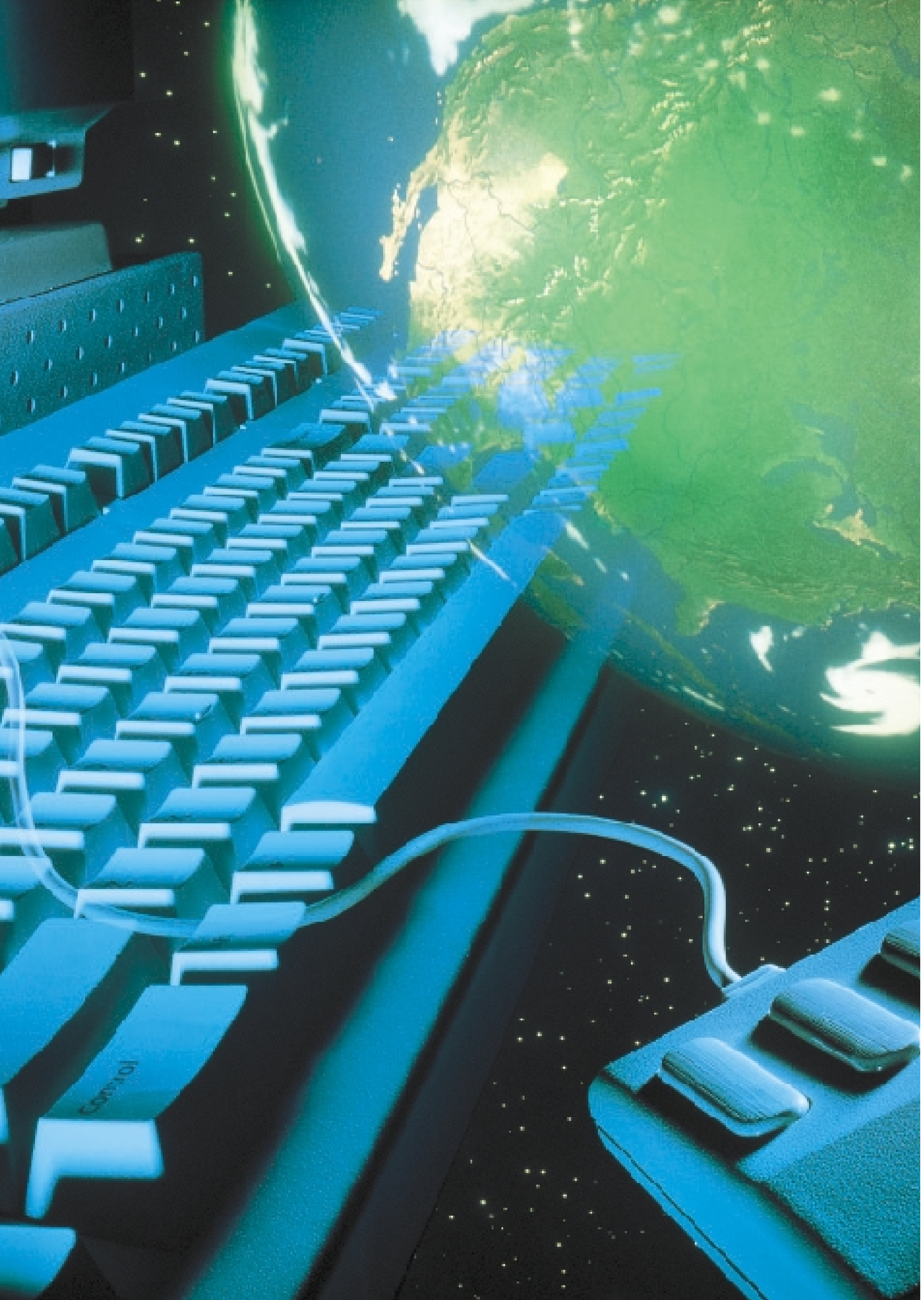
In order to exploit the high degree of market acceptance of EntireX and the release of Bolero, our Application Factory for Electronic Business, we substantially increased the number of sales representatives devoted to these new product lines at the end of the fourth quarter of 1998. These sales representatives are supported by highly-qualified software engineers. We are convinced that we can offer our customers a well-rounded portfolio of products and services guaranteeing the success of sophisticated integration and electronic business projects.

Software AG increased its market visibility with a large-scale global image campaign under the motto "Accept no limits". "Accept no limits" also applies to our products, our employees and in particular our sophisticated customers. The campaign met with an enthusiastic response from the market. We have also earmarked substantial funds for marketing in the current year, in order to ensure an adequate market presence for our offering.

OUR CUSTOMERS

We took particular measures in fiscal 1998 to help our customers convert their mission-critical applications to ensure Year 2000 compliance. Thanks to our high-performance products and services we were able to help our customers enable a large part of their applications by the end of 1998. A number of projects will run until the fourth quarter of 1999.

Customer surveys show that we are one of the companies with the greatest customer loyalty and above-average customer satisfaction. Thanks in particular to our new product, EntireX, we were able to win a number of new key accounts who had not previously used Software AG technology and who now utilize EntireX to integrate their heterogeneous environments.



OUR PARTNERS

As the integration of cross-platform applications is one of the most urgent tasks in information technology today, our customers expect that our software systems run seamlessly on all leading platforms and will comply with all key industry standards. In fiscal 1998 we focused in particular on partnerships with other leading manufacturers in order to be able to offer state-of-the-art solutions on as many platforms as possible.

Many of our customers run their mission-critical applications on IBM mainframes, which is why we continued our close technical cooperation with IBM last year, in order to offer our joint customers optimal performance and resource usage. IBM has classed Bolero as best of breed for creating electronic business components for transaction environments on IBM mainframes. Our technology cooperation with IBM for the Bolero product line is designed to develop EJB (Enterprise JavaBeans) components for the S/390 platform.

The EntireX product line's provision of the Microsoft standard DCOM on Unix and mainframes led to closer cooperation in sales and marketing between the two companies last year. Together we managed to win a number of new customers who use our software for the seamless integration of Microsoft environments and existing IT infrastructures.

We also maintained our close relationships with Compaq/Digital and Siemens for the benefit of our mutual customers.

Last but not least, we intensified our cooperation with Sun Microsystems as part of our development of Bolero, one of the largest projects ever undertaken with Java.

OUR EMPLOYEES

The number of employees in the Group rose as of December 31, 1998 to 2,186. Software AG's attractiveness as an employer increased continuously, as can be seen from the increasing number of applications, whether unsolicited or in response to job advertisements. Increasing use is being made of Software AG's job advertisements on the Web, which allow potential candidates to submit applications direct online. A staff increase of up to ten percent is planned for the current year.

International team. It is not only our products that have a talent for integration – this is also the daily reality and corporate culture at Software AG. At our German sites alone, employees from 30 different countries come together to develop and market software products together. An openness for different cultures, mutual understanding and readiness to learn from each other are valuable team factors that have a long tradition at Software AG.

Training – Pursuing joint goals. Equally important for success against the competition are our employees' specialist expertise and leadership qualities. Specialist career paths are as important as management ones at Software AG. Specialists receive customized ongoing training which may take place either internally or externally, at home or abroad. All staff with management responsibilities in Germany go through a uniform training program in accordance with our corporate principles (this applies only to Germany). The application of uniform management principles promotes effective cooperation between all staff, improves the individual success rate and hence increases the productivity of everyone in the company.

Following Software AG's IPO in 1999, the company plans to enable all staff to participate long-term in the success of the company via a stock option plan. This profit-sharing scheme – an American idea that has been adapted to the situation in Germany – will further increase Software AG's attractiveness as an employer both at home and abroad.

NET WORTH, FINANCIAL POSITION AND EARNINGS

Following the successful turnaround in fiscal 1997, last year saw growth of 18 percent in license business and 15 percent in professional services, plus a significant improvement in the company's equity base and liquidity – two key preconditions for a further expansion in business volumes in 1999.

Operating revenues (on a comparable basis to 1997) rose by 9 percent, to DM 626 million. The measures taken in 1997 to increase productivity and profitability led to a strong increase in profits in fiscal 1998. Profit before tax rose by 35 percent to DM 87.3 million (1997: DM 64.7 million) after allowing for the sale of our majority shareholding in the former 100 % subsidiary Software AG Systems, Inc. based in America. Net income for the year declined (1998: DM 52.2 million, 1997: DM 55.0 million) due to the larger tax loss carryforwards available in 1997 compared with 1998.

All regions of operations and the Group as a whole recorded positive results in 1998. Two small Asian subsidiaries disclosed minor losses (down on 1997), despite cost-cutting measures. The reason for this is the drop in demand for licenses and the termination of maintenance contracts as a result of the collapse of exchange rates in certain Asian countries.

Other highlights of 1998 were the further increases in equity and liquidity providing additional resources in particular for acquisations. Thanks to the positive development in results and the drive to reduce receivables, bank balances rose from DM 109.8 million as of December 31, 1997 to DM 226.1 million, despite the increase in the volume of business. In addition, the Group had unused lines of credit at year end 1998 amounting to roughly DM 100 million.

This positive business development laid the financial basis for investments to extend our product portfolio and strengthen our sales channels in 1999. Initial results for fiscal 1999 point to positive results for the year.

RESEARCH AND DEVELOPMENT

Software AG has always committed substantial resources to Research and Development (R&D). In fiscal 1998, R&D expenditure amounted to roughly DM 90 million, or more than 14 percent of total sales. As of December 31, 1998, 449 staff were employed on R&D.

R&D is structured by product line. Projects are performed at development sites throughout the world, although the main work is performed at Software AG's headquarters in Darmstadt. In order to keep pace with developments in the United States and develop products that are tailored to the US market, Software AG employs around 60 software developers and programmers in Reston (Virginia) and Denver (Colorado), USA. These staff are employed by SAGA, but take their orders from Software AG. Other R&D centers are to be found in Berlin, Madrid (Spain) and Derby (Great Britain). In addition, Software AG has a development site in the Philippines and uses contract software developers in Lithuania and Ireland, either directly or via partners.

One of Software AG's key corporate goals is to provide a complete architecture for the development, deployment and management of mission-critical electronic business systems. To achieve this goal, we have focused in two areas in our research and development. Firstly, we shall expand the Adabas and Natural product lines to incorporate new object models and connectivity standards, in order to enable these products to meet current and future (electronic business) integration requirements in heterogeneous IT systems environments. Secondly, EntireX and Bolero will undergo substantial further development in the areas of future component models, and to provide a greater range of platforms. In addition, the Bolero product line, which is currently proving itself in its first customer installations, will be expanded to include special components for vertical applications. Work on Tamino is also proceeding at high speed, in order to meet the planned rollout in the fourth quarter of 1999.

OUTLOOK

Overall, fiscal 1998 was an extremely gratifying year for Software AG. The result before taxes is the highest recorded in the company's nearly 30 year history.

The clear growth in both software licenses and services is particularly satisfactory. Both our traditional products and, increasingly, our new offerings contributed to this. Once again, we were able to improve the company's capital resources as against the previous year. The substantial increase in liquidity is worthy of particular mention here.

The company succeeded in positioning itself on attractive growth markets with new products. Business in the Enterprise Application Integration area increased significantly. Although our new electronic business products have yet to prove themselves in the marketplace, we are confident that they will make a growing contribution to our business in future. Our goal is for these new products to contribute over half of all license sales in the next two to three years.

On March 2, 1999 Software AG acquired the French software services provider GOAL Technologies with effect from January 1, 1999. With the takeover of GOAL, Software AG is putting its stated acquisition strategy into practice, expanding its Professional Services and considerably strengthening its position on the French market. GOAL Technologies is active in the same business segments as Software AG, and brings with it key accounts in the French banking, insurance and telecommunications sectors. The previously independent company reported revenues in fiscal 1998 (September 30) of approximately FFR 65 million, and currently employs over 100 staff.

We expect the overall positive market environment to continue in 1999 as well, even though a certain degree of uncertainty cannot be ruled out as a result of global economic developments and a potential bottleneck in the resources needed to deal with the Year 2000 problem.

Despite this, our target is to roughly match sales for the previous year and to further improve results.

We are convinced that the planned IPO will provide a further positive impetus both on the market and within the company.

We are therefore taking a confident stance on the current business year.

CONSOLIDATED BALANCE SHEET OF SOFTWARE AG
AS OF DECEMBER 31, 1998

CONSOLIDATED BALANCE SHEETS AS OF DECEMBER 31, 1998

ASSETS

	DM	December 31, 1998 DM	Restated 1997 DM thousand
A. Fixed Assets:			
Intangible Assets:			
Intellectual property and similar rights and licenses in such rights	4,847,976.11		2,885
Goodwill	0.00	4,847,976.11	0
Tangible Assets:			
Land, land rights and buildings including buildings on third-party land	49,993,037.35		51,346
Other equipment, operational and office equipment	19,860,110.44	69,853,147.79	19,059
Financial Assets			
Shares in affiliated companies	53,041.60		53
Participations	15,916,256.00		13,504
Long term investments	584,546.44		596
Other loans	318,887.60	16,872,731.64	624
		91,573,855.54	88,067
B. Current Assets:			
Inventories:			
Raw materials and supplies	476,647.00		136
Work in process	6,581,413.09		5,915
Finished goods and merchandise	1,238,688.94		1,656
Payments on account	990.00	8,297,739.03	0
Receivables and other assets:			
Trade receivables	144,709,534.55		171,029
Receivables from affiliated companies	0.00		121
Receivables from companies in which participations are held	18,644,349.81		18,203
Other assets	8,985,402.81	172,339,287.17	14,989
Securities			
Other securities		10,270,802.56	3,436
Cash in hand, postal giro balances and bank balances		215,889,129.63	106,333
		406,796,958.39	321,818
C. Prepaid expenses		9,938,500.12	5,276
		508,309,314.05	415,161

CONSOLIDATED BALANCE SHEETS AS OF DECEMBER 31, 1998

EQUITY AND LIABILITIES

	DM	December 31, 1998 DM	Restated 1997 DM thousand
A. Equity:			
Subscribed capital		115,450,000.00	115,450
(Authorized but unissued capital – DM 8,658,750.00)			
Capital reserves		1,095,596.46	1,096
Accumulated losses brought forward		–20,143,672.48	–74,819
Net income (loss) for the year		52,210,343.22	55,007
Minority interest		–8,815.41	–14
		148,603,451.79	96,720
B. Special items with an equity portion		9,716.41	8
C. Provisions/Accruals:			
Provisions for pensions	14,272,263.29		13,879
Provisions for taxes	30,124,382.96		7,209
Other provisions	121,325,495.66	165,722,141.91	81,749
D. Liabilities:			
Liabilities to banks	9,391,330.26		23,183
Payments received on account of orders	15,501,519.17		20,468
Trade payables	22,504,305.33		29,153
Notes payable	5,013,715.38		2,855
Payables to affiliated companies	91,715.45		14
Payables to companies in which participations are held	94,346.09		30
Other liabilities	30,198,306.29	82,795 237.97	42,496
E. Deferred income		111,178 765.97	97,397
		508,309 314.05	415,161

CONSOLIDATED PROFIT AND LOSS STATEMENT FOR THE YEAR ENDED DECEMBER 31, 1998

		December 31, 1998	Restated 1997
	DM	DM	DM thousand
Revenues		626,385,897.56	575,170
Increase (decrease) in work-in-process and finished goods		400,229.47	1,739
Other operating income		49,067,356.40	95,087
Cost of raw materials:			
a) Cost of raw materials and supplies, and of purchased merchandise	–1,411,185.15		–8,878
b) Cost of purchased services	–83,244,528.38	–84,655,713.53	–74 315
Personnel expenses:			
a) Wages and salaries	–232,436,297.71		–229,996
b) Social security and other pension costs	–43,485,866.61	–275,922,164.32	–38,302
Depreciation and amortization on intangible assets and property, plant and equipment		–14,292,605.70	–27,275
Other operating expenses		–221,613,203.02	–222,359
Earnings before interest and taxes		79,369,796.86	70,871
Interest income		2,447,940.01	52
Amortization of financial assets		–366.98	–1,081
Interest and similar income		7,697,792.29	3,219
Interest and similar expenses		–2,174,122.49	–8,381
Extraordinary expenses		0,00	0
Profit (loss) before tax		87,341,039.69	64,680
Income tax expense	–30,813,430.96		–6,016
Other taxes	–4,317,265.51	–35,130,696.47	–3,657
Net profit (loss)		**52,210,343.22**	55,007

CONSOLIDATED STATEMENT OF FIXED ASSET MOVEMENTS

Gross Fixed Assets (DM thousand)

	January 1, 1998	Additions	Transfers	Differences from currency translation	December 31, 1998
I. Intangible assets					
Concessions industrial rights and similar rights and assets and licenses in such rights	48,395	4,570	–1,235	–323	51,407
Goodwill	30	0	0	0	30
	48,425	4,570	–1,235	–323	51,437
II. Tangible assets					
Land, land rights and buildings including buildings on third-party land	89,744	1,267	–681	–157	90,173
Other equipment, operational and office equipment	103,568	12,080	–10,900	–1,201	103,547
	193,312	13,347	–11,581	–1,358	193,720
III. Financial assets					
Shares in affiliated companies	569	0	0	0	569
Participations	20,954	0	0	–37	20,917
Long-term investments	614	15	–24	–2	603
Other loans	624	4	–309	0	319
	22,761	19	–333	–39	22,408
Total	264,498	17,936	–13,149	–1,720	267,565

Cumulative Depreciation and Amortization (DM thousand)

	January 1, 1998	Additions	Transfers	Asset Appreciation	Differences from currency translation	December 31, 1998	**Net Book Value December 31, 1998**
I. Intangible assets							
Concessions industrial rights and similar rights and assets and licenses in such rights	45,510	1,916	–554	0	–313	46,559	4,848
Goodwill	30	0	0	0	0	30	0
	45,540	1,916	–554	0	–313	46,589	4,848
II. Tangible assets							
Land, land rights and buildings including buildings on third-party land	38,398	2,456	–620	0	–54	40,180	49,993
Other equipment, operational and office equipment	84,509	9,921	–9,713	0	–1,030	83,687	19,860
	122,907	12,377	–10,333	0	–1,084	123,867	69,853
III. Financial assets							
Shares in affiliated companies	516	0	0	0	0	516	53
Participations	7,451	0	0	–2,413	–37	5,001	15,916
Long-term investments	18	0	0	0	0	18	585
Other loans	0	0	0	0	0	0	319
	7,985	0	0	–2,413	–37	5,535	16,873
Total	176,432	14,293	–10,887	–2,413	–1,434	175,991	91,574

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS AS OF AND FOR THE FISCAL YEAR ENDED DECEMBER 31, 1998

1. RESTATEMENT OF FINANCIAL STATEMENTS

The restatement of the historical consolidated financial statements was carried out in accordance with German GAAP and were audited by BDO Deutsche Warentreuhand AG. The material differences are as follows:

Different Date of Initial De-consolidation of Software AG Systems, Inc. („SAGSI“)
Although the Company sold 90% of the shares of SAGSI on March 31, 1997, for purposes of the restatement, SAGSI was de-consolidated as of December 31, 1995. This subsidiary was de-consolidated as if it had left the group as of December 31, 1995. As of and for the year ended December 31, 1995, there was no impact on the consolidated profit and loss statement. In the restated consolidated financial statements, SAGSI's assets and liabilities were replaced by the book value of Software AG's remaining participation in SAGSI.

The change in the date of de-consolidation of SAGSI from March 31, 1997 to December 31, 1995 resulted in approximately a DM 7 million increase in restated consolidated net profit for the year ended December 31, 1997.

In addition, inter-company receivables and payables between SAGSI and Software AG were allocated in accordance with Software AG's ongoing participation in SAGSI as at December 31, 1998.

Different Date of Initial Consolidation of SQL Datenbanksysteme GmbH, Berlin („SQL“)
In the historical consolidated financial statements, as of and for the year ended December 31, 1997, SQL was consolidated for the first time as of January 1, 1997. In the restated consolidated financial statements, SQL was consolidated for the first time as of January 1, 1996. Hence, the book value of the parent company's participation in SQL in the historical consolidated balance sheet was replaced by SQL's assets and liabilities in the restated balance sheet. In addition, instead of recognizing a one-time write-off on its investment of DM 12.0 million, in the restated consolidated financial statements for the year ended December 31, 1997, the Company recognized DM 12.0 million amortization of goodwill. Accordingly, net profit in 1997 was not affected.

Other Adjustments
In the consolidated balance sheet as of December 31, 1998, the consolidated capital accounts were reclassified in line with the share capital of the parent company. The capital accounts shown on the restated consolidated financial statements as of and for the year ended December 31, 1997 were adjusted accordingly. Capital reserves in the amount of DM 36 million were reclassified as accumulated losses brought forward.

2. CONSOLIDATION, ACCOUNTING AND VALUATION PRINCIPLES

The consolidated financial statements as of and for the year ended December 31, 1998 were prepared in accordance with the German Commercial Code and German Corporation law before such provisions were amended by the Corporate Supervision and Transparency Act of 27 April, 1998.

Consolidated Companies
The following affiliated companies are members of the Software AG group:

a) German Companies

	Holding %	Abbreviation
Software GmbH Marketing, Darmstadt	100	SAG-MK
SAG EAST GmbH, Darmstadt	100	SAG-ME
SQL Datenbanksysteme GmbH, Berlin	100	SQL
SAG Systemhaus GmbH, Darmstadt	100	SAG-D
SAP SI GmbH, Alsbach-Hähnlein	40	SAP-SI

In accordance with Art. 296, Para. 2 of the German Commercial Code, the annual financial statements of Software GmbH Marketing (which as of December 31, 1998 had subscribed capital of DM 60,000 and for the year ended December 31, 1998 had net profit of DM 3,000) have not been included in the consolidated financial statements because the company is of minor importance and is not significant in relation to the requirement of presenting a true and fair view of the net worth, financial position and results of the Software AG group.

SAP-SI, a new joint venture established in April 1997 together with SAP AG, Walldorf, is included in the consolidated financial statements using the equity method, on the basis of the proportional results accruing to the parent company.

b) Foreign Companies

	Holding %	Abbreviation
Software AG of the United Kingdom		
Ltd., Derby (England)	100	SAG-UK
Software AG France S.A., Saint-Quen (France)	100	SAG-F
Software AG Italia S.p.A., Mailand (Italy)	100	SAG-I
Software AG Belgium S.A., Brussels (Belgium)	100	SAG-B
Software AG Nederland B.V., Amsterdam (Netherlands)	100	SAG-NL
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, Brömma (Sweden)	100	SAG-S
Oy Software AG Finland, Espoo (Finland)	100	SAG-SF
Software Aktiengesellschaft, Vienna (Austria)	100	SAG-A
Software AG s.r.o., Prague (Czech Republic)	100	SAG-CS
Software AG Bilgi Sistemleri Ticaret A.S., Istanbul (Turkey) (1)	90	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 the indirect holding		
Software AG Portugal Lda., Lisbon (Portugal)	100	SAG-P
Software AG (Hongkong) Ltd., Hongkong (China)	100	SAG-HK
Software AG (Singapore) Pte. Ltd., Singapore (Singapore)	100	SAG-SIN
Software AG (Malaysia) Sdn. Bhd., Kuala Lumpur (Malaysia)	100	SAG-MAL
Software AG Philippines Ltd., Manila (Philippines)	100	SAG-PHI
Software AG Taiwan Ltd., Taipeh (Taiwan)	100	SAG-TAI

(1) Minority interests in Software AG's Turkish subsidiary are held by a Turkish national (10%).

QVF Ltd., a fully consolidated company in 1997, was sold to a third-party during the course of 1998 and hence removed from the scope of the consolidated financial statements as of January 1, 1998. The disposition of QVF Ltd. resulted in income of DM 3.4 million.

Financial Year and Consolidation Period

The consolidated financial statements were prepared as of December 31, 1998. Since all companies included in consolidation also prepare their financial statements using a December 31 year-end, consolidation was based on each subsidiary's audited and certified financial statements.

Consolidation Principles

The financial statements of the consolidated companies have been prepared in accordance with uniform accounting and valuation principles. They have been audited by local public accountants, who issued unqualified audit opinions. The majority of the foreign auditors are members of the international BDO Deutsche Warentreuhand AG organization, 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 (except for shareholders' equity) have been translated at the rates prevailing on the balance sheet date.

– The DM value of the equity of subsidiaries included in the consolidation are translated at their respective historical cost as of the balance sheet date. Any resulting currency differences in the equity of the subsidiaries to be consolidated are then added to or deducted from „accumulated losses brought forward" on the consolidated balance sheet (in 1998, this currency difference amounted to an increase of DM 668,000 and in 1997, this currency difference amounted to a deduction of DM 1,304,000).

– Profit and loss statement items are translated at average rates (arithmetic mean of the end-of-month rates). Translation differences resulting from translation of the subsidiaries' profit and loss statements are shown as other operating income or expense on the consolidated profit and loss statement.

– In the statement of fixed asset movements, based on the acquisition and manufacturing costs of the previous year ending December 31, 1997, additions, write-ups, transfers, disposals and depreciation during the year are translated at the rate prevailing on the balance sheet date. Any resulting exchange rate differences in fixed asset movements are carried at book value on the statement of fixed asset movements.

Consolidation Methods

Statutory full consolidation in accordance with Sections 300 ff. of the German Commercial Code (Handelsgesetzbuch) was applied to the preparation of the consolidated financial statements. All inter-company assets and liabilities and all inter-company income and expense items were eliminated. The following additional principles and methods were also applied:

– Software AG has elected to consolidate subsidiaries which it created itself on the date of formation. However, with respect to Softinterest Holding AG and its subsidiaries and certain Asian subsidiaries, the first time consolidation occurred after the date of formation.

– The initial consolidation of all subsidiaries was undertaken using the book value method (Art. 301 Para. 1. Sentence 2 Clause 1 of the German Commercial Code).

– Goodwill from capital consolidations is generally offset against reserves. Negative goodwill is generally added to accumulated losses brought forward.

– In the consolidation of debt, the set-off differences are recognized as income or expense, as appropriate.

– As of December 31, 1998, all outstanding material inter-company services rendered between affiliated companies have already been invoiced to customers. This obviated the need to eliminate inter- company profits. In contrast, inter-company sales of intangible assets are consolidated through elimination of inter-company profits.

Consolidated Income Statement

The income statement is prepared using the total cost method as described in Section 275 of the German Commercial Code.

Additional Balance Sheet and Profit and Loss Statement Information

Under the German Commercial Code, the following notes are required to be included herein:

I. Balance Sheet	1998 DM	1997 DM
a) Assets		
1) Trade receivables with more than one year to maturity	11 021 126	10 444 899
2) Receivables from companies in which participants are held with more than one year to maturity	191 160	–
3) Other assets with more than one year to maturity	569 211	690 215
b) Equity and Liabilities		
1) Liabilities to banks with less than one year to mturity	2 356 650	22 293 136
2) Payments received on account of orders with less than one year to maturity	14 393 057	20 468 111
3) Trade payables with less than one year to maturity	22 504 305	29 153 200
4) Liabilities on notes payable with less than one year to maturity	5 013 715	2 854 674
5) Payables to affiliated companies with less than one year to maturity	91 715	14 367
6) Liabilities from companies in which participations are held with less than one year to maturity	94 346	–
7) Other liabilities with less than one year to maturity	26 246 665	42 495 664
of which thereof: taxes	13 525 216	18 400 169
of which thereof: social security and similar obligations	5 375 130	4 786 998
II. Income Statement		
Pension costs	10 820 571	3 202 462

Valuation Principles

Intangible and tangible assets are stated at cost. As a rule, depreciation is charged using the straight-line method over the standard useful life 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.

Equity participations are valued at the lower of cost or market value. The valuation of Software AG's remaining participation in SAGSI was not re-valued following the 1997 sale of SAGSI shares and hence is still valued at DM 5.7 million. Software AG's participation in SAP-SI is carried at equity using the book value method.

Loans (primarily to employees) are valued at their nominal values.

Inventories are valued at cost. In addition to individual unit costs, the manufacturing costs include an appropriate share of overhead and depreciation as permitted by Art. 255 Para. 2 Sentences 2 and 3 of the German Commercial Code.

Receivables from software licenses are recognised only if there is a signed contract with the customer, any rights of return has 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 general default risk by means of a lump-sum reserve. Standard discounts have been applied to take account of receivables with maturities in excess of one year.

Securities are stated at the lower of cost or market value.

Liabilities are stated at their repayment amount. Provisions for pensions are established on the basis of actuarial rules and tax principles using an interest rate of 6%. Provisions for taxes and other provisions are established as deemed necessary in accordance with prudent business judgment.

Currency Translation

Foreign currency income and expense arising during the year are recorded at the rates prevailing at the time such income is recognized and expenses incurred. Foreign currency receivables and liabilities existing at the balance sheet date are valued at the rate prevailing at the balance sheet date, where such rates were lower (credit items) or higher (debit items) than those at the date the receivable or liability arose. Unrealized foreign exchange gains are not recognized. Foreign currency bank loans are carried at the lowest agreed hedging rates.

3. NOTES REGARDING THE CONSOLIDATED BALANCE SHEET

Fixed Assets
The gross values stated herein include all assets held at the balance sheet date.

Intangible Assets
Intangible assets relate to software licenses purchased from third parties and to software marketed by the Software AG group, the rights to which it acquired from third parties.

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

During 1998, approximately DM 12.1 million was invested in operating and office equipment, principally IT equipment.

Financial Assets
The financial assets relate principally to participations in SAP-SI, Software AG Systems Inc. and SAG-MK. In addition, long-term loans to employees of the Software AG group and long-term investments are disclosed under this item.

Inventories
The inventories principally include services relating to customer orders that have not yet been invoiced. These inventories are valued at the cost of production. Other inventory items are primarily finished goods, including software manuals and other documentation. Stocks of paper carried under raw materials, consumables and supplies have been stated at a fixed value wherever possible. Other raw materials and merchandise are stated at acquisition cost.

Receivables
Due to substantially improved liquidity management, among other reasons, there has been a clear reduction in trade receivables over the previous year. Receivables from a company in which a participation is held relate to Software AG Systems Inc.

Other Assets
At the balance sheet date, this item included, among other things, claims for tax refunds and receivables from employees.

Securities
The securities portfolio is held exclusively by the parent company.

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

Equity
The equity section of the balance sheet as of December 31, 1998 can be classified as follows:

	DM thousand
Subscribed capital	115 450
Capital reserves	1 096
Accumulated losses brought forward	– 20 144
Net income for the year	52 210
Minority interests	– 9
	148 603

The subscribed capital of the Software AG group is the ordinary share capital of Software AG. This consists of 23,090,000 bearer shares.

In addition, at the balance sheet date, there was conditionally-authorized capital of up to DM 8,658,750, divided into up to 1,731,750 shares, which are available for the subscription rights that had been granted to members of the Management Board and certain eligible employees under the Management Incentive Plan.

In accordance with § 20 AktG of the German Stock Corporation Act, the Software AG — Stiftung has disclosed that it owns a majority of the Company.

„Minority interests“ consists of the interest of a Turkish national in SAG-TR.

During 1998, the parent company distributed DM1.0 million to Software AG-Stiftung.

Special Items with an Equity Portion
The special items with an equity portion of DM 10,000 disclosed in the balance sheet result from Software AG, Vienna and relate to special depreciation allowances available under Austrian tax law.

Provisions for Pensions
The provisions for pensions relate exclusively to commitments to certain employees.

Provisions for Taxes
The provisions for taxes relate to income and other taxes.

Other Provisions
In 1998, other provisions relate primarily to reserves for Year 2000 compliance-related risks, pending losses from project contracts, obligations incurred as part of the initial public offering of shares on the Frankfurt Stock Exchange, outstanding invoices, restructuring costs, employee bonuses and special payments, as well as provisions for employee vacation pay. In addition, additional reserves have been taken in respect of certain business risks, as deemed warranted by Software AG in its reasonable judgement.

Liabilities to Banks
At the balance sheet date, these liabilities existed principally at the parent company and at the Spanish subsidiary for the financing of an office building in Madrid.

The remaining maturities of all liabilities to banks are less than five years.

As collateral for certain bank liabilities of the parent company, certified land charges amounting to DM 9.4 million on land and buildings at Software AG's headquarters in Darmstadt have been provided for bank loans.

Payments Received on Account of Orders
This item includes payments received for services relating to customer projects of the English, Spanish and German sales and marketing companies, which have still to be invoiced.

Other Liabilities
This item relates principally to tax liabilities (DM 13.5 million) and social security and other obligations (DM 5.4 million).

Deferred Income
Maintenance income attributable to future years is now disclosed under this item.

Off-Balance Sheet Liabilities
Off-balance sheet liabilities amounted to DM 23.9 million in 1998 and DM 19.8 million in 1997. These relate primarily to guarantees and other commitments provided by banks on behalf of the Software AG group.

Other Financial Commitments
Rental and leasing commitments for the year ended December 31, 1999 amount to approximately DM 15.7 million. After 1999, such commitments have been estimated at approximately DM 56.2 million.

4. NOTES REGARDING THE CONSOLIDATED PROFIT AND LOSS STATEMENT:

As in prior years, the total cost method was applied.

REVENUES

Revenues are broken down by business sector and region as follows:

	Total DM million		Total DM million
Sales		**Regions**	
Licenses	188,4	Germany	193,8
Maintenance	214,8	Europe (outside Germany)	317,0
Services	217,0	USA	68,7
Miscellaneous	6,2	Rest of the world	46,9
Total	**626,4**	**Total**	**626,4**

OTHER OPERATING INCOME

During the year under review, other operating income amounted to DM 49.1 million. Major items included income from the reversal of provisions, realized foreign exchange rate gains, consolidation measures, income from the reversal of deferrals and reversals of prior years' write-offs on receivables.

COST OF RAW MATERIALS

Cost of Raw Materials and Supplies, and of Purchased Merchandise

The cost of raw materials and supplies relates principally to printing supplies. The cost of purchased merchandise relates to computer hardware transactions undertaken only in exceptional cases.

Cost of Purchased Services

Cost of purchased services relates to the utilization of non-employee software consultants and external companies in connection with services projects and certain research and development activities. This increases the flexibility of the group cost structure.

PERSONNEL EXPENSES

As a result of the slight increase in the average number of employees and increases in salaries, personnel expenses increased to DM 275.9 million in 1998 compared to DM 268.3 million in 1997. This increase was partially offset by a decrease in restructuring costs.

DEPRECIATION AND AMORTIZATION ON INTANGIBLE ASSETS AND PROPERTY, PLANT AND EQUIPMENT

Depreciation and amortization on intangible assets and property, plant and equipment in 1998 is below the previous year's amount due to the fact that in 1997 Software AG recognised goodwill depreciation of DM 12 million in respect of SQL.

OTHER OPERATING EXPENSES

Major items included in other operating expenses were expenses for sales commissions, property rental, consultancy fees, costs in connection with future risks arising from Year 2000 compliance, as well as marketing and advertising expenses.

Included in 1998 other operating expenses is approximately DM 3.7 million related to prior periods. Included in 1998 other operating income is approximately DM 21.4 million related to prior periods.

INTEREST AND SIMILAR INCOME

Due to Software AG's substantially improved liquidity position, Software AG received net interest income of DM 5.5 million.

TAXES

Taxes in 1998 were reduced by the use of certain tax loss carryforwards, primarily available to the parent company.

5. OTHER INFORMATION

BOARDS OF THE COMPANY

The members of the Supervisory Board of the parent company in 1998 were:
Dietrich-Kurt Frowein (Chairman), Frankfurt am Main (from 1 January 1999)

Dr. Eberhard Rauch (Chairman), Grünwald (until 31 December 1998)

Dieter Schacher (Deputy Chairman), Berlin

Dr. Peter Lex, Munich (from 1 January 1999)

Friedhelm Müller (employee representative of the parent company), Seeheim-Jugenheim

Karin Oppel (employee representative of the parent company), Seeheim-Jugenheim

Christian Wedell, Gröbenzell

During the year under review, the members of the Management Board were:

Dr. Erwin Königs (Chairman and Chief Executive Officer), Kelkheim, Taunus

Volker Dawedeit, Darmstadt

Dr. Helmut Wilke, Königstein

The remuneration of the Supervisory Board of Software AG amounted to DM 260,000, and payments to the members of the Management Board of the parent company totaled DM 3,536,000. Former members of the Management Board received DM 330,000. Pension reserves for former members of the Management Board amounted to DM 6,805,000.

NUMBER OF EMPLOYEES

The average number of employees in the Software AG group was 2,104 in 1998. At December 31, 1998, 2,186 employees were employed by the Software AG group.

Darmstadt, 10 March 1999

Software AG

Dr. E. Königs V. Dawedeit Dr. H. Wilke

REPORT OF THE INDEPENDENT AUDITOR

CONSOLIDATED FINANCIAL STATEMENTS AS OF AND FOR THE YEAR ENDED DECEMBER 31, 1998

We have audited the accompanying consolidated financial statements of Software AG as of and for the year ended December 31, 1998. These financial statements are the responsibility of the Company’s management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Software AG at December 31, 1998 and the results of their operations for the year ended December 31, 1998 in conformity with German generally accepted accounting principles.

Frankfurt am Main, as of March 12, 1999

BDO Deutsche Warentreuhand
Aktiengesellschaft
Wirtschaftsprüfungsgesellschaft

Dr. Jacob Braun
Wirtschaftsprüfer Wirtschaftsprüfer