

The parent company Software AG is the worldwide operative holding of the Software AG group. The business situation of the parent company Software AG depends on the combined business of the group. On these grounds the Software AG executive board combine the management reports of both group and Software AG.

Earnings significantly improved

Software AG's key objectives for 2004 were to stabilize revenue and significantly increase profitability. With revenue stable, at constant currency rates, and significant profit growth, both objectives were achieved. The consistent implementation of the company strategy also created a solid base for future profitable growth.

Overall economy

Strong growth of the global economy continues

In 2004, the global economy experienced a growth of almost 5 percent. This growth, which was strongest during the first half of the year, was driven primarily by the economies of the USA, China, and other Asian countries. In the USA, massive tax cuts as well as expansive monetary policies strengthened the economy, which grew by 4.3 percent. With growth of 4.4 percent in 2004, the economic recovery of 2003 continued in Japan. In the south-east Asian countries, GDP grew by 4.6 percent. China proved to be the strongest market in the region, with 9.5 percent growth. In Latin America, the GDP increased by 4.6 percent, supported by a general economic recovery, rising raw material prices and stronger domestic demand.

Bull market in the eurozone

Economic growth within the eurozone improved slightly in 2004. The real GDP of the Euro countries increased by 2 percent – following roughly 1.5 percent in 2003. Although the eurozone is still far from meeting the objectives defined in the Lisbon agenda, both production and business climate still showed slight improvements. Consumer confidence

and retail revenue did not meet expectations. At the same time, the strong Euro, which gained 10 percent on the US dollar over the year, had an increasing impact on exports.

In Germany, economic growth was somewhat restrained. According to the OECD, it amounted to around 1.2 percent in 2004. The United Kingdom, however, registered a 2.9 percent GDP increase. In the countries that joined the European Union, growth expectations were met. Their economies were driven by high earnings and direct investments.

Economy within the sector

IT investments on the upswing

In the year under review, world-wide spending for information technology increased significantly for the first time in years. In the United States, 15 percent growth was recorded in the first half of the year; in the months that followed, however, growth rates receded. For Western Europe, the autumn prognosis of the European Information Technology Observatory (EITO) reckoned that IT spending grew by 2.3 percent in 2004. The development of the German IT market was considerably weaker; here, EITO reckoned growth of 1.9 percent. The federal association Bitkom reckoned 3.5 percent growth for the German software market.

Investments in information technology booming

The USA and Eastern Europe remained the key regions in the global IT market. The American market accounts for about 43 percent of the global IT and Communications sales, and the Western European market for roughly one quarter. In the growth markets of India, China and Eastern Europe, the demand for information technology increased sharply. Asia already accounts for 10 percent of international spending for information and telecommunications.

Software market development

Compared to 2003, spending on software licenses and maintenance decreased by 0.5 percent worldwide to \$147 billion. Software investments were made primarily under the aspect of rationalization.

Expenses for system infrastructure rose by 0.3 percent to \$76 billion, and those for information management by 2.5 percent to \$17 billion. \$23 billion was spent on business applications, 3.5 percent less than in the previous year. Expenses for other applications were reduced by 1.8 percent to \$31 billion.

Real-time as a central criterion

Integration of existing applications and comprehensive access to relevant information in real time enhances the transparency of business activities. In 2004, this was a key objective in software investments. Four core segments address the real-time access to processes, business data, and information requested by customers:

- Extended Business Intelligence systems record all key data regarding ongoing business activities, evaluate them, and forward them as individually defined.
- Business Integration technologies use business process models and are able to integrate the processing of both long-term and short-term transactions. This capability is a key requirement for business-to-business integration.
- Supply Chain Event Management enables realtime access to all information along the supply chain.
- XML technology is used to an increasing degree; it allows the automation of processes, internally and between companies.

Trading volume

Decline of sales volumes stopped

In this overall economic and industry environment, Software AG achieved consolidated sales of €411.4 million in 2004 (2003: 420.0). We generated a significant portion of our revenue outside of the Euro region, mainly in the US dollar zone. Accordingly, the strong Euro clearly affected the reported revenue, even though at constant currency rates, the sales volume rose slightly above that of 2003.

Increase of the promising license business

More than one quarter of our total revenue was generated in the strategically important software license business. The licensing revenue, which offers attractive margins, increased by 10 percent to €114.2 million. Besides expansion and replacement investments by our established customers, new customer projects in particular contributed to this growth.

The business area of Enterprise Transaction Systems (ETS) accounted for most of the license sales. With the products Adabas and Natural, it is geared

Customer base enlarged in both business segments

towards the upgrading of databases. Demand was reinforced through the extension of our product line by enhanced IT system productivity and performance packages. Another boost in the Enterprise Transaction Systems area came from our intensive global customer contact program. Both effects enabled 12 percent growth of license revenues to €85.9 million.

The performance of existing applications of the German Federal Securities Administration, the Belgian Railway, and the state of California and others were boosted during 2004. Adabas is still one of the world's fastest and most reliable databases. New Adabas customers included the Bank of Tirol & Vorarlberg, the Russian Gorki Automotive Plant, and the Central Government Organization in Italy.

Integration ever more in demand

In the XML Business Integration segment, the business year was somewhat subdued at first. In the course of the year, however, XML revenues were increased, which more than compensated for the slow beginning. The extended range of XML Business Integration products and services offered also contributed to the flourishing business in this sector. With integration packages and integration solutions, our portfolio was significantly enhanced in the second quarter. The first positive effects of the introduction of these packages was to strengthen revenue, which amounted to €26.1 million

(2003: 26.2). Net of currency effects, this value lay slightly above that of 2003. Our integration customer base was expanded to include, amongst others, the state of Florida, the Spanish financial institutions Mapfre Vida and Mapfre Caja Salud, and the French association Prism, which operates in the health sector.

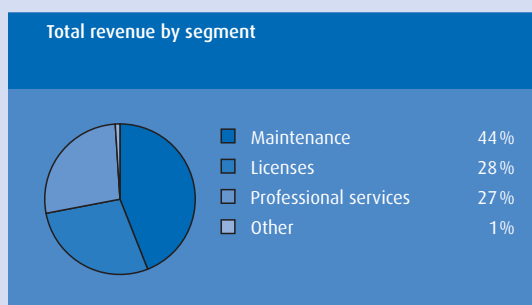
Higher products revenue

Maintenance revenue fell by 1 percent, at constant currency rates, to €182.6 million. We were able to more than compensate for this slight decrease through the sale of software licenses, a very positive development. Therefore, the combined revenue from both product license and maintenance sales increased to €296.8 million. Before currency effects, this corresponded to an increase of 4 percent.

Restraint regarding professional services

Businesses now only order professional services when these also result in a reduction of their costs. Accordingly, in 2004 we once again operated in a professional service environment characterized by excess capacities and pricing pressure. We only accepted service projects that met our fixed profitability criteria. Our withdrawal from unprofitable segments is reflected in reported revenue, which fell by 8 percent to €112.8 million.

Revenue by segments			
€ millions	2004	2003	Change in %
Licenses	114.2	104.3	9
Maintenance	182.6	191.2	- 4
Professional services	112.8	122.9	- 8
Other	1.8	1.6	13
Total	411.4	420.0	- 2

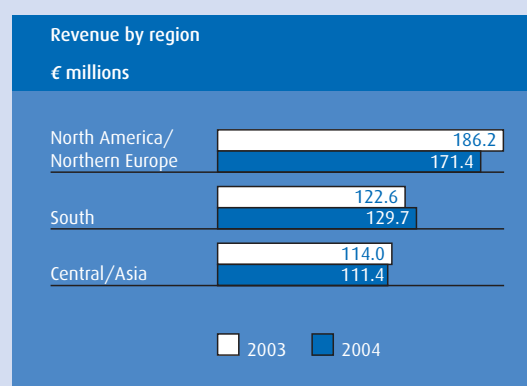


In the Central/Asia region, we achieved revenue of €111.4 million. Half of the nominal 2.7 million decline is due to currency effects. Declining volumes in the professional services area were countered by growing maintenance and license sales. In the license business, the region achieved a revenue increase of 16 percent, to €32.6 million.

For details, please see the segment reports on page 75

Regional revenues profit from the license business

In the North America/Northern Europe region, Software AG generated revenue of €171.4 million (2003: 186.2). At least two thirds of the revenue in this region is determined by the American market. Correspondingly, the exchange rates changes compared to 2003 had a strong impact on the regional result. Before currency effects, the revenue reported was €180.4 million, that is 3 percent below the 2003 figure.



The revenue in region South increased by 6 percent to €129.7 million. A quarter of all sales were generated from new software licenses. With 44 percent growth, the licensing revenue increased significantly to €32.3 million.

Revenue by region			
€ millions	North America/ Northern Europe	South	Central/Asia
Maintenance	100.3	31.4	51.5
Licenses	49.7	32.3	32.6
Professional Services	20.9	65.5	27.0

Strong international market position

Software AG is the second-largest software house in Germany, one of the largest software vendors in Europe, and a world leader in XML technology. We operate in two segments:

- The high-performance database market and
- integration.

Partner for integration projects in major corporations

In the high-performance database market we are amongst the leading enterprises, world-wide. This strong position provides the basis for our expansion into the growing integration market. The integration market is fragmented with a large number of small suppliers. In this context, our target group still mainly consists of major enterprises. Through the size of the corporation, Software AG is in an optimal position to implement the large projects which are relevant to this group of customers. This holds for both the complexity of projects, and also the international aspects of project design.

Software AG's position in the up-and-coming e-government segment has been significantly reinforced. In 2004 we acquired a double-digit number of new customers.

Profitability

Profitability significantly increased

The restructuring process, started in 2003, was completed in 2004. It provides Software AG with an efficient corporate structure, in-line with the sales volume, and at the same time, guaranteeing a strong, growth-promoting performance. In 2004, the results of our restructuring program resulted in considerable cost reductions. Compared to 2003, administration, marketing and sales, plus research and development expenses were reduced by €32.9 million.

In combination with the growth of the profitable license business, these efficiency gains provided a significant increase in income. The operating EBIT grew by 42 percent to €83.9 million. In addition, Software AG generated an extraordinary income of €24.5 million through the sale of the remaining SAP Systems Integration AG (SAP SI) shares in the second quarter.

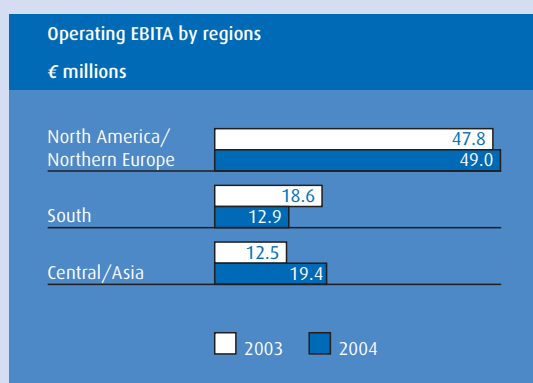
Income		
€ millions	2004	2003
Operating EBIT	83.9	59.1
Income from the sale of SAP SI-shares	24.5	0
Restructuring charges	0	48.8
Financial performance	3.3	2.7
Pretax profit	111.7	13.0
Taxes	- 34.5	- 5.9
Net income	77.2	7.1
Earnings per share (in €)	2.83	0.26

Increasing income in the regions

In the North America/Northern Europe region, the operating earnings were increased by 3 percent to €49.0 million. This corresponds to an EBIT margin of 29 percent. This region, which contributed 42 percent of the total revenue, accounts for 58 percent of the group's operating EBIT.

The operating EBIT of the Central/Asia region were increased by 55 percent to €19.4 million. This strong growth is mainly due to an increase in the profitable license business. This was boosted by more favorable business development in Germany, where Software AG successfully implemented a turnaround in 2004.

In the region South, operative earnings fell to €12.9 million (2003: 18.6). Besides expenses for R&D activities in Spain, this decrease is mainly due to investments in the development of the South American market.



Investments in buildings and IT equipment

Investments totaled €6.9 million (2003: 7.6), with the main part accounted for by tangible and intangible assets. About half of this amount was spent on construction, including the establishment of the new Customer Briefing Center in Darmstadt, Germany, and the branch office in Spain. Another main focus was investments in the internal IT infrastructure and technology, particularly new hardware purchases. The financial assets were reduced by €19.9 million, essentially due to the sale of the SAP SI shares.

Financial power strengthened once again

Its solid financial structure is a characteristic feature of Software AG. Total assets grew to €510.7 million (2003: 505.6); the decrease in fixed assets by €25.4 million is essentially due to the sale of the remaining SAP SI shares. With €119.1 million (2003: 74.1), cash and cash equivalents came to

almost one quarter of the total assets at the end of the year. Our equity increased by €54.3 million to €323.6 million. This results in a further equity to total assets increase ratio to 63 percent (2003: 53 percent). As in 2003, the company has no bank debts.

Balance sheet structure

Strong operating cash flow

The operating cash flow - before the SAP SI revenue - more than doubled to €28.9 million, in comparison to 2003. Almost one quarter of this amount flowed into investments. In the course of restructuring, we spent €23.4 million. Provisions for restructuring of €30.7 million had been made in 2003. In 2004, the organic cash flow was €54.7 million (2003: 55.1). This corresponds to 13 percent of the total revenue, or about 10 percent of the shareholder value at the end of the year, or €2.00 per share.

Strategic progress

Setting the course for future growth

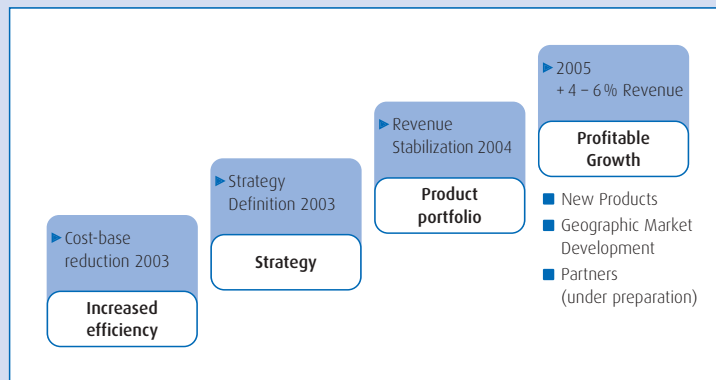
These were essential focal points of our strategy:

- Continuously increasing efficiency for higher profitability
- Focusing on core competencies through the formation of two business lines
- Definition and market-driven development of the portfolio
- Geographic consolidation with a new regional structure to reinforce our presence in specific countries
- Diversification into newly industrialized countries penetrating regional growth markets.

*Equity to
total assets
ratio reaches
63 percent*

Steps to profitable growth

2005 Target: Profitable Growth



Increased efficiency – Higher profitability

We continued our process of increasing efficiency through specific focused activities. In order to enhance profitability, the company analyzed market demands and adapted the number of employees to market requirements. As a result of the drop in sales experienced over the last few years, we reduced our staff in the research and development sector by 35 percent in the first quarter of 2004.

Structuring business sectors

Since 2003, Software AG has been focusing on the business lines Enterprise Transaction Systems and XML Business Integration Portfolio. The Enterprise Transaction Systems sector's main focus lies in supporting customers in increasing their productivity and efficiency. XML Business Integration facilitates the integration of highly diverse customer data and applications. This results in consistent access to all information, as well as the ability of diverse applications to communicate with each other on different platforms.

To help us focus on our core business areas, in 2004 we integrated market-relevant functions such as marketing and product management, along with research and development, directly into the

business lines. This brought lasting improvements in competence, flexibility, and customer orientation. Today, specific features of different business areas can be integrated much more thoroughly. Research and development is linked to the market much more closely. This strengthens our ability to identify customer requirements in advance and directly implement them in market-driven, innovate product, services and solutions. Our market position therefore benefits, especially in the fast developing field of integration based on XML technology.

Extended range of products to meet market needs

To enhance the 'value add' for our customers, we extended our range of products and services. In the first quarter, the Enterprise Transaction Systems business line introduced new product packages to the market. Our optimized range of solutions reinforced our traditional position in the business area of high-performance databases. It assisted our customers in optimizing, expanding and managing their database applications and platforms.

In the second quarter, Software AG also expanded the XML Business Integration portfolio. Integration packages completed the existing range of services and products, adding technology platforms for the integration of data and information. The focus lies on system integration (Enterprise Legacy Integrator), data integration (Enterprise Information Integrator) and service integration (Enterprise Service Integrator).

In order to expand our integration business, we established a Business Process Management (BPM) unit. BPM enhances the efficiency of business processes along the entire value chain of an enterprise. BPM is therefore a logical expansion of the Software AG integration business portfolio.

Company portfolio defined and extended

Besides the horizontal, non-industry specific integration packages, we added specific vertical industry focused integration solutions in the third quarter. Software AG strengthened its profile as a technology and solution provider. The company has already released integration solutions for financial service providers, health services, and public administration with further industry solutions to follow.

Geographic consolidation

With a new international organizational structure, the company is now aiming for growth in traditional markets and fast, effective development of new markets. Three regions now support the 59 countries where we have either branch offices or distribution partners. This makes it easier to cater to specific customer requirements, as well as to diverse market, economic and cultural characteristics. Each of the regions is headed by an executive board member.

- Region North America/Northern Europe – including the USA, Canada, the United Kingdom, Scandinavia, and South Africa. This grouping promotes cooperation between the primarily English-speaking countries. At the same time, the exchange of knowledge and experience between countries is intensified. In adopting this structure, the company benefits from the traditionally close connections within the English-speaking culture group.
- Region South – including Southern Europe and South America. With this grouping, the company not only makes use of the common linguistic base of these countries, but also finds future growth on the historically close cultural and economic relationships between Spain and the South American countries.

- Region Central/Asia – including the central and Eastern European countries, Russia, the Middle East, plus Asia and Australia. With this structure and added support from Germany, the company caters to the special characteristics of these promising growth markets.

Markets of the future – diversification into newly industrialized countries

Up-and-coming economic regions offer promising opportunities for Software AG. In 2004, we began to focus on these countries. Our strategic alliance with a Chinese partner strengthened our position in China. It is primarily geared towards the distribution of our integration products and solutions. Our previous sales cooperation in South Africa was replaced by our own representative office. Together with a local company, we initiated a Competence Center in Russia. Here, the focus lies on upgrading mainframe computers. In Bahrain, we set up a representative office, servicing 20 clients in Oman, Qatar, Bahrain, Kuwait, the United Arab Emirates, and Saudi Arabia. Last but not least, with our branch office in Chile, we succeeded in entering the South American market directly. Our geographic diversification led to almost instant success. In Chile, we are supporting the government, the ministry of health, and the Chilean mail service. Furthermore, newly-won customers include the Russian government, and the municipal government of Shanghai.

Restructuring of the regions

Stronger commitment abroad proves effective

*Customer's
requests
dominate
R&D activities*

Research and development

Market-driven innovation

The research and development department was further aligned to the market. New product and solution developments are now increasingly market-driven. Proven, field-tested solutions are developed into globally relevant applications, and integrated into the overall Software AG portfolio.

This development process ensures consistent market orientation. Specific characteristics of regional and vertical markets can be fully incorporated. This significantly reduces the time to market, therefore strengthening the competitive position of Software AG.

Progress through R&D

Enterprise Information Integrator (EII) is amongst the key innovate products and solutions of the past business year. Software AG developed it from a package which initially met the requirements of American customers asking for Single View tech-

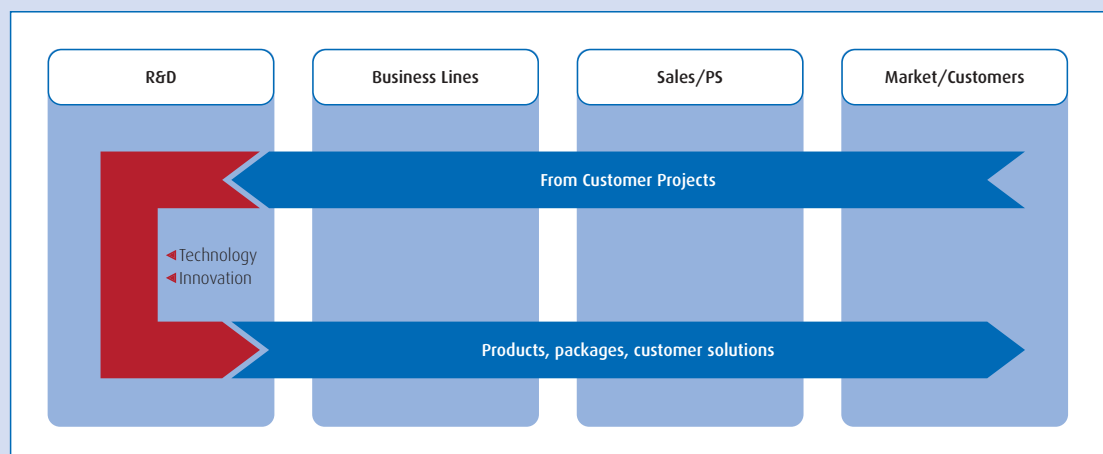
nology. It offers one-stop access to distributed data stored on different systems. In 2004, the technology was expanded into a generally usable package.

Further product developments include Replication and ISF. Replication was also created to meet customers' demands. In this case, to be able to automatically transmit changes to a data record to identical data records on servers all over the world. Therefore customers can access real-time data records anywhere within the network. ISF is an e-government-solution, allowing public authorities to provide online services for citizens in order to independently handle administrative processes. Originally developed in England, this solution is currently being implemented in the German city of Giessen.

High-potential cooperation

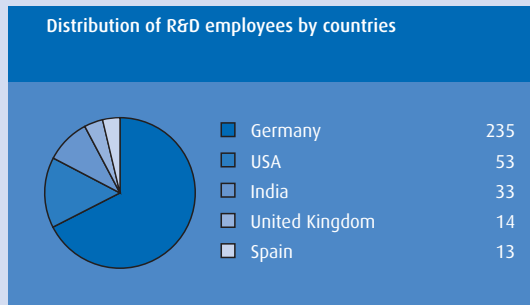
To optimize their products, Software AG entered a technology partnership with Ontoprise GmbH in 2004, focusing on the semantic interpretation of company data within a single view.

Reverse Engineering



R&D locations world-wide

To ensure that its solutions and packages are always state-of-the-art, Software AG invested 16.5 percent of its licensing and maintenance revenue in research and development. With this percentage, Software AG reaches IT industry Best Practice investment level. In five countries, 348 employees are working on innovative products which anticipate and meet customers' requirements.



R&D awards

Readers of the US magazines XML Journal and Web Services Journal ranked Software AG products first in 14 out of 23 categories. In Switzerland, we integrated the central database solution of the Swiss Federal Roads Authority with all peripheral and heterogeneous solutions used by the road traffic departments of the different Cantons. By using EntireX, the applications used in the road traffic departments, based on various operating system platforms, were seamlessly connected to the central register of driving licenses in Bern. This facilitated a smooth bi-directional data flow. For this solution, Business Integration Journal awarded Software AG the title of runner-up for the best EAI solution.

Sales and marketing

Market position expanded

Software AG has reorganized its marketing and sales structure as well. In accordance with the new concept of market-oriented business lines, the central marketing department has been dissolved and integrated into the two business units. This makes it easier for our marketing specialists to match their activities efficiently and effectively to the requirements of the Enterprise Transaction Systems and XML Business Integration business lines. All marketing programs are planned and implemented in close cooperation with our regional offices.

In order to align Software AG's portfolio even more closely to customer needs, we internationalized our Customer First program. This ensures that customer orientation and market know-how is consolidated at all levels, and that customer requests can be implemented quickly. A new world-wide Software AG Customer Knowledge Base helps in optimally offering our customers the knowledge of our globally networked corporation.

Software AG's Internet presence received a makeover in 2004 to reflect both the new corporate identity and the business strategy. Moreover, the department supported marketing activities such as Software AG user groups, product presentations, participation in seminars and conferences, and trade show presences. All these activities serve to provide the market with comprehensive and reliable information regarding Software AG products and solutions. To complement our own sales activities, we expanded our partner network, with further growth in this area planned.

Marketing and sales directly allocated to business segments

High media coverage

Intensification of PR activities

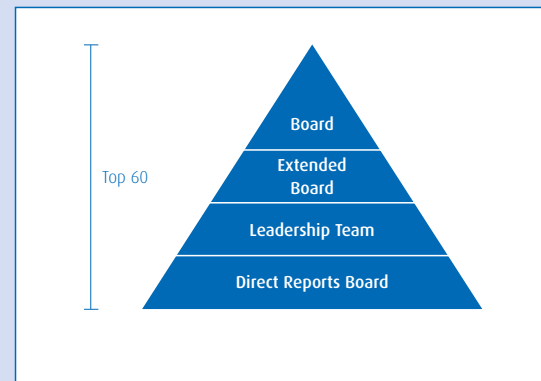
In order to enhance the visibility of the company cost-effectively among our customer base, and with the general public, we separated Public Relations and Investor Relations. This split immediately yielded measurable success. The circulation of articles reporting on Software AG increased by 800 percent in Germany. Whilst previously, media coverage had been handled mainly through local and online media, this base has now been expanded to include opinion-forming economic key media. Financial Times Germany, Frankfurter Allgemeine Zeitung, and Handelsblatt now report on the company on a regular basis. Leading agencies such as Reuters, Dow Jones, Bloomberg, and dpa-AFX provide world-wide coverage of Software AG. Moreover, through its regional structure, the company is in contact with key media globally. The TV presence of our CEO at CNBC, Bloomberg, and the Spanish financial broadcasting station "Encuentras a fondo" emphasizes the international attention enjoyed by Software AG.

Optimized top management structures

We have closely linked marketing and sales, as well as research and development. To this purpose, we modified our internal management structures during the year under review. The central Chief Technology Officer was replaced by two Vice Presidents. They are responsible for R&D in the Enterprise Transaction Systems and XML Business Integration business lines respectively. Marketing and product management is structured in the same way. All four Vice Presidents are part of the company's extended management team, and therefore directly involved in the Executive Board's decision-making processes.

Next in the leadership pyramid is the management team, with representatives from the leading six countries, and the "Direct Reports Board", which includes the 45 leading employees world-wide. These managers, 60 altogether, each visit five customers per quarter, therefore reinforcing the close link between market and strategy.

New top management structure



Executive Board and Supervisory Board

Executive and Supervisory Board changes

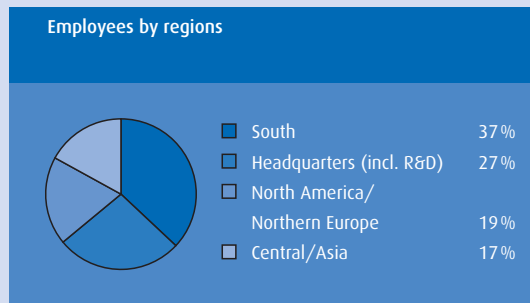
At the annual shareholders' meeting, Dr. Andreas Berezky was voted onto the Supervisory Board as the successor of Dr. Peter Lex. Monika Neumann joined the Supervisory Board as an employee representative. She follows Karl-Heinz Hageni in this function.

Dr. Peter Mossack and Gary Voight resigned from the Executive Board. As of April 1, 2005, the Supervisory Board appointed Dr. Peter Kürpick as a member of the Executive Board. He will be responsible for Software AG's integration business line including research and development.

Employees

International employee structure

The process of restructuring was completed faster than anticipated. During the second half of the year, the number of employees was slightly increased. The personnel structure was reinforced in particular in customer-oriented areas. As of December 31, 2004, Software AG had 2,438 employees within the group (translated into full-time positions), 139 fewer than on the same day of the previous year. Reflecting our international line-up, two thirds of our employees are working outside of Germany.



In 2004, the International Conference of the Software AG personnel department focused on the global coordination of human resources. Personnel managers from all regions worked out new methods of cooperation. The first projects, including a group-wide guideline for the deployment of employees to foreign countries, were already implemented in 2004.

To Software AG, employees are an important asset. Accordingly, great emphasis is placed on additional training. We do not link training investments to employee numbers. Thus, despite a decrease in the number of employees, advanced training expenses in Germany rose by 4 percent.

As a partner of the Technical University of Darmstadt, Germany, Software AG is involved with the pilot project "ProIT Professionals". The key issue is the development of real life, hands-on curricula and generally applicable grading systems in IT training. Above all, the quality of bachelor and master study programs is to be guaranteed.

Changes in the company culture

Our operating and structural progress is accompanied by changes in our company culture. Customer orientation, exchange of Best Practices, and teamwork are becoming increasingly important. Strategic reorientation intentions and measures are openly communicated. This allows employees to develop, evaluate and understand planned changes, therefore reinforcing motivation and commitment. Open dialog was further promoted through an employee survey, designed to identify potential for improvement.

Through the internal changes, the role played by our headquarters was expanded. For example, the newly initiated Customer Briefing Center (CBC) now supports countries in the qualified development of essential customer relations. It compiles strategic customer data and distributes it throughout the group, and encourages visits by international key customers to the company headquarters.

Commitment to education and advanced training

Headquarter opened to customers worldwide

Risk Report

Risks through lawsuits

With the development of jurisdiction regarding patent laws in the USA and the European Union, software increasingly becomes subject to patent protection. This means that Software AG is also increasingly involved in patent lawsuits.

At the moment, two such lawsuits are underway in the USA. Provisions have been made for both procedures. For detailed information, please see the appendix in the Notes.

Moreover, there is a risk of becoming involved in court proceedings regarding sales disputes. Software AG was involved in such a legal dispute with a software house in Israel. This dispute was settled in January 2005. The amount of this settlement is fully incorporated in the annual financial statement for 2004.

Risks through US export regulations

The US restrictions regarding exports to countries which are under US embargo, or business partners who are blacklisted by the US government, have an impact on our research and development in the USA. The US export regulations are also applied to products that merely contain some components manufactured in the USA. Software AG also maintains a research facility in the USA. As soon as this facility contributes more than 10 percent to the development of the company's products, these products will be subject to the US laws and regulations which govern the export restrictions. Software AG, with customers in more than 70 countries world-wide, works around these tight export restrictions by keeping the amount of research contributed by the American research center to well under 10 percent.

Securing acquisitions

The acquisition of enterprises in order to expand the range of technologies offered is part of Software AG's growth strategy. In order to ensure successful acquisition, Software AG has defined processes in both the pre- and post-acquisition phases.

- Pre-acquisition phase: When selecting an object for acquisition, the economic situation is carefully analyzed. This is followed by a thorough assessment as to whether the technology represents a logical and consistent extension of the product portfolio, and whether the company culture of the enterprise in question is compatible with that of Software AG.
- Post-acquisition phase: In order to identify possible problem areas as early as possible, finances, legal issues, research and development, sales, marketing and internal communications are all analyzed as closely as possible.

Loss of intellectual assets

Software AG is a technology leader in the development of high performance databases and integration. Therefore, employees with extensive knowledge in this area are subject to recruiting attempts by competitors. Software AG guards itself against such recruiting attempts through the following measures:

- identification of key intellectual assets
- motivation
- (in part) agreement on a non-competition clause.

Exchange rate risks

As a global enterprise, Software AG operates in various currency zones and is therefore subject to exchange rate risks. Based on internal guidelines, financial derivatives are used in order to reduce the impact of exchange rate fluctuations. Besides securing existing foreign currency assets and liabilities, these hedging tools also secure planned payments as well as income from individual companies within the group, which is earned in foreign currency, against value changes through exchange rate fluctuations.

Outlook

Global economy keeps up dynamic growth

For 2005, the global economy is expected to grow by a good 4 percent. Compared to growth of 5 percent in 2004 the global economy will lose some of its momentum, but still experience above average growth. As before, positive incentives will be provided by the United States and the Asian threshold countries. The IMF is expecting 3.5 percent growth in the USA, and 7.5 percent in China. Due to falling export demand, the eurozone will lag behind the global economic trend, but still continue with a slight upswing. According to forecasts issued by the European Central Bank (ECB), economic growth of 1.9 percent is possible here.

In Germany, this will depend on whether the domestic demand is going to bolster the export-based bull market. The export impetus might slow down, due to the decreasing intensity of international growth. Against this background, the OECD predicts a 1.4 percent increase for the German economy.

Positive prognosis for the IT market

According to calculations by the market research institute Forrester Research, the global IT market will increase by 6 percent annually until 2008. IDC market researchers also forecast such growth for 2005. Above-average growth is expected for the regions of central and Eastern Europe, and the up-and-coming Asian states. According to a study by the market research institute Global Insight, the Eastern European market will expand by 11.9 percent annually, and the Chinese market by 9.3 percent until 2007.

Forecasts expect strongly growing IT market

The USA continues to offer good prospects, and for Western Europe, IDC forecasts a slight increase. According to EITO's calculations, the Western European IT market will boom in 2005 by 4.2 percent. For Germany, EITO is predicting 4.1 percent growth. The federal association Bitkom expects a 5.5 percent increase for software and IT services. Therefore, the IT sector would develop better in 2005 than the overall economy.

Software in particular demand

Integration remains the key issue in the IT world. The progressive use of networking between companies and related business processes will drive the demand for software and IT services. The linkage of individual applications, together with efficient access to existing information, still tops the list of priorities. There is a growing demand for flexible software, tailored to reflect each customer's unique situations, which is capable of adapting to individual business and user requirements.

Profitable growth to be expected

For 2005, Software AG is aiming for sales growth of 4 to 6 percent. In the medium term, two-digit sales growth is possible. This is assuming that increasing revenues from XML integration solutions will add to the stable revenue in the mainframe sector. Our focus still lies on profitable growth. We

are planning for consistently high margins and, for 2005, expect an operating free cash flow of roughly 2 Euros per share.

The focus of the ETS business segment still lies on consolidating our broad customer base. At the same time, we intend to benefit from the opportunities offered by integrating and modernizing the lucrative Cobol market. In XML Business Integration, we see great potential for industry solutions. We will further develop our go-to-market model, primarily in the direction of business value selling, and addressing decision makers.

Focus on emerging markets

We expect additional incentives from direct entry into new sales territories, especially in the newly industrialized countries. In realizing geographic growth potential, we have adopted a dual approach: Presence through owned subsidiaries as well as partners. For this, we see potential in China, Eastern Europe, Russia, and most of all in South America.

Additional strength through partners

We will supplement our own growth through alliances and acquisitions. However, our goal is not primarily the purchase of additional revenue. We rather intend to generate technological components which will enhance and further develop our product portfolio. This implies that we will restrict ourselves to purchases of a reasonable size, which also helps to ensure seamless integration.

*Integration
business yields
increasing
contributions*

Events subsequent to the balance-sheet date

Sabratec software completes portfolios

In February 2005, Software AG acquired Sabratec Ltd, the parent company in Israel and the firm's New York sales company. The Sabratec integration software, which is geared towards host systems, complements our ETS and integration portfolios. Therefore, this acquisition meets our strategy of enhancing Software AG's range of products by purchasing suitable technologies.

Fujitsu and Software AG opt for strategic alliance

Fujitsu Limited and Software AG signed an agreement on February 28, 2005, to jointly develop, market and sell a Service Oriented Architecture offering. Fujitsu and Software AG plan to use their complementary technology platforms and their global R&D know-how in order to offer a technical methodology with an integrated metadata storage. This will allow users to shorten development times, improve productivity, and create the necessary flexibility for adjusting to changing business requirements. Within the framework of this partnership, Fujitsu and Software AG are planning to market a mutual solution in the summer of 2005. Software AG already distributes Fujitsu's Business Process Management solution, the Interstage Business Process Manager.