updating customer relations

update

2002

Annual Report update software AG

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Investor Relations

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Shares & Options of the members of the boards

	Member of	Shares	Options
Hans Bodingbauer	Supervisory Board	2,540	15,915
Gilbert Hödl	Supervisory Board	93,815	0
Frank Hurtmanns	Supervisory Board	435	0
Thomas Deutschmann from 6.11.02	Management Board	0	100,000
Monika Fiala	Management Board	0	25,939
Arno Huber	Management Board	848,334	0
Gerhard Schuberth till 5.11.02	Management Board	5,000	0

All sections in English are translated from the German text.

Letter of the CEO

Dear Shareholders, Customers,
Employees of update software AG,

2002 proved a difficult year economically for most of us, and it was one of the IT industry's most difficult years to date. The software industry responded by setting new goals. Growth, market capitalisation and ground-breaking innovation all took a back seat to one, single objective: survival.
Numerous software companies failed to meet this objective. If we look at the situation in terms of an economic Darwinism, they belong to the class which is unable to sufficiently adapt to a changing environment. It's all about survival of the fittest.

It finally became clear in 2002 that the software industry is subject to the same economic mechanisms as any other industry: only those companies capable of delivering products to customers from whom long-term revenues can be made have any right to exist. Although update was not quite able to buck the economic trend in 2002, it nevertheless stood up well to the competition. Compared with an overall decline in the CRM market of 25 per cent, according to analysts, update posted a mere 11 per cent decline in revenues.

update's value proposition – to tailor a high-value, tried and tested product to the precise needs of its target markets, thereby enabling quicker implementation, and to offer its product under attractive conditions – has paid off. Many existing customers, such as Roche AG, Beiersdorf AG and Philips Medical Systems, extended their installations and update was also able to add a number of new, discerning customers such as Europ Assistance GmbH and Hannover Leasing GmbH to its portfolio.

update spent 2002 continually adapting its structures to new market conditions. The cost burden was reduced from € 5.7 million in the first quarter to € 5.1 million in the fourth quarter of 2002. At the same time, the number of staff was cut from 184 to 136.

The fourth quarter saw new executive board members Monika Fiala as CFO and myself as CEO heading up a fundamental review of update's previous corporate strategy and orientation and taking the appropriate steps to correct the company's course. The aim was to focus on the company's strengths, re-align the product and sales strategies to new market conditions and to establish a cost structure capable of sustaining profitability even in the face of a continued economic slump. A number of measures were implemented in the fourth quarter, while the effects of other steps will only become apparent in the first two quarters of 2003.

update kicks off 2003 as an agile, adaptable company with highly educated and motivated employees, a competitive cost structure, a superior product and an impressive customer portfolio.

update's future has been made easier by the behaviour of many of its competitors on the European CRM market. US companies are refocusing and are consequently pulling out of continental Europe. Many software companies are not in a position to adapt their cost structures quickly enough and are therefore unable to offer their products at competitive prices.

They have therefore become unattractive as vendors, in particular to mid-sized companies, removing them entirely from the equation as far as the rapidly developing east European markets are concerned. Given that the CRM market for mid-sized companies in western Europe still holds considerable potential and that the market in central and eastern Europe is largely unexploited, there is a large vacuum to be filled.

As a vendor with a European, financially attractive and highly sophisticated product on offer, we are in a position to fill this vacuum. In the course of 2003, and in spite of difficult economic conditions, we will achieve the success that you as shareholders, customers and employees have come to expect.

Thomas Deutschmann

Contents:

Report of the supervisory board

update is Europe's leading vendor of standard software solutions for handling professional Customer Relationship Management (CRM) processes. More than 75,000 users in over 700 renowned companies operating throughout the world and in various sectors have been using update's solutions for 14 years, which bears testimony to the vendor's competence.

update's latest product suite, marketing.manager Generation V®, can be seamlessly integrated into any existing IT environment. Several sophisticated add-on programs can be combined with the flagship product, marketing.manager® 5.0, allowing for often unprecedented functionality: communication modules enabling channel and device-independent communication, interfaces or analysis tools for monitoring success. update's Generation V® sets new standards in terms of flexibility and mobility. Rapid implementation at comparatively low cost versus competing vendors ensures a quick Return on Investment (ROI).

update began focusing even more on the development of its strategic partnerships in mid 2001. update now has over 50 partners throughout Europe, including Siemens SBS, EDS Systematics, Plaut, Netragon, Cognos, Synavant and Atos Origin.

update, originally named Marketing Informationssysteme GmbH, was founded in Vienna in 1988 by Gilbert Hödl and Arno Huber. The company's core business has always been the development and sale of software designed to manage sales and marketing processes. Following significant growth during the 1990s, the company name was changed to update.com software AG in 1999. update has been listed on the Frankfurt Neuer Markt since April 2000 and was renamed update software AG in May 2002 following a shareholders' resolution.

Dear Shareholders,

The 2002 business year was a continuation of 2001 in that it witnessed further consolidation. The generally poor economic climate worsened more than had been expected, necessitating more radical changes to the cost structure than had originally been planned in a bid to keep the drain on cash reserves to a minimum. Additionally, every effort was made to focus on CRM core competence and on core markets.

The supervisory board appointed both a new CFO and CEO to the management team with the aim of driving forward further consolidation and preparing the company for renewed growth.

The supervisory board thanks the executive board and all employees for their hard work and for their loyal cooperation. During regular meetings, the supervisory board has been kept up-to-date on company developments by the executive board and has met all of its legal and statutory obligations. The annual accounts have been examined by KPMG Alpen-Treuhand Wirtschaftsprüfungs- und Steuerberatungs- GmbH, Vienna. Since the inspection yielded no grounds for objection, an unqualified audit certificate has been issued.

The supervisory board is in agreement with the annual report submitted by the executive board for the business year 2002 and with the proposal for profit distribution. The year-end accounts have therefore been approved pursuant to § 125, paragraph 2 of the stock corporation law *(Aktiengesetz, AktG)*.

We are entirely confident of further success in 2003 and are convinced that update software AG will strenghten its position as a leading CRM software vendor.

Dr. Hans Bodingbauer   Mag. Gilbert Hödl

Dkfm. Frank Hurtmanns

Market and business sector

2002 saw update software AG, as well as most of its competitors, up against an extremely poor economic climate.

It was the software industry‘s most difficult year to date. update responded quickly and efficiently to the continual slump on the share markets and to the heavy decline in investment. Costs were reduced and radical restructuring steps were taken.

The IT sector in particular benefited from significant investment between the mid 1990s and the beginning of 2001. The situation changed during 2001, having worsened considerably by the end of the year and the start of 2002. IT spending was reduced considerably, while older technologies were replaced by newer ones at a much slower pace than before.

A growth market turned into a hostile market in many areas. The CRM market was particularly badly affected. Lower revenues against previous years became the rule rather than the exception. Many companies were unable to rise to the challenge and were ousted from the market.

Reorientation of the CRM concept

The positive effect of this market pressure was the reorientation of the CRM concept, both from a customer and a vendor point of view. Visible and measurable financial benefits were becoming key criteria in the choice of CRM vendor. Large, complex, strategic projects gave way to smaller, more pragmatic, tactical ones.

The principle behind CRM – the need to improve interaction with the customer using IT systems – was never questioned, but was put into a more sober commercial context. Customers were demanding products which were easier to implement and which could already handle a large number of business processes.

CRM vendors responded to this trend by restructuring their companies and focusing on concepts and regions. All of the US software vendors began cutting down on their European activities, with many companies focusing their efforts on specific vertical markets.

Although update was unable to avoid the poor market climate, it was able to profit from it. update’s marketing.manager is traditionally superior to competing products in terms of implementation costs and availability for specific vertical markets. At the same time, the withdrawal of US competitors created a vacuum which update was able to fill. Given the low receptivity of the market in 2002, this has not yet become fully apparent, but the decline in turnover against the previous year posted by update is significantly lower than that of its US competitors in Europe.

The software industry witnessed no significant developments in 2002, which was a year of evaluation of the developments introduced in the previous years, such as the use of PDAs in professional environments or the use of various wireless technologies. update responded quickly to both of these developments with solutions which were well received by its customers.

Customers were more interested in the adaptation of existing technologies to existing business processes rather than the exploration of new technologies. update was able to exploit this trend thanks to several years’ experience. update was able to offer specific solutions to all of the markets on which it focused.

In conclusion, it is safe to say that update was able to hold its own against its competitors in an extremely difficult economic climate, in terms of both technological innovation and commercial aspects such as investment security, suitability of products to business processes and Return on Investment. The positive effects of update’s repositioning and consequently improved market position will become fully apparent in 2003.

Business trends

The fiscal year of update software AG was driven by continuous cost reduction, focussing on core markets and the expansion of the partner network.

update software AG

During the ordinary shareholders' meeting of 22nd May 2002, the company name was changed from update.com software AG to update software AG. The AG (*Aktiengesellschaft*, public limited company) is the company headquarters and is responsible for strategic activities such as Planning, Research & Development, Marketing, Corporate Finance and Investor Relationship management. Sales revenues were posted at € 4.4 million, consisting primarily of royalties and service charges with subsidiary companies. The result from ordinary business operations (EGT) is € -5.3 million, representing an improvement of over 67 per cent against the previous year.

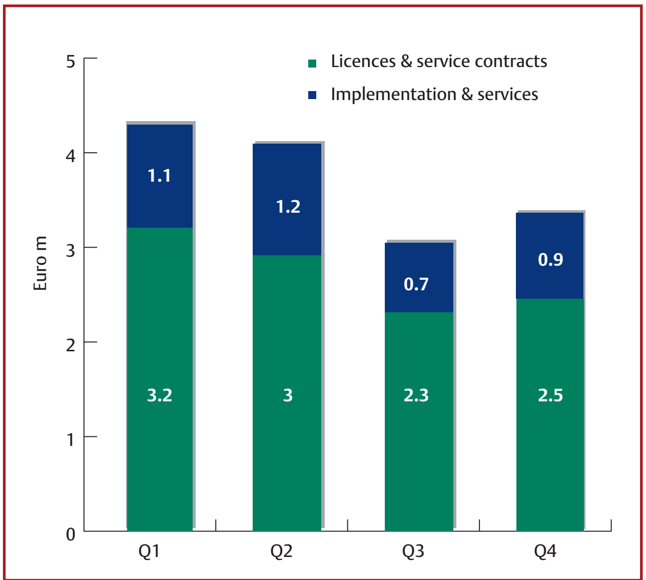
Accumulated retained earnings, based on net loss for the year, movement of reserves and loss carried forward from previous fiscal years, comes to € 68.8 million. Remaining equity capital comes to € 2.39 million as of 31st December 2002. Given that the total stockholders' equity was already less than half of the common stock in November 2002, falling short by around € 470,000, the executive board called an extraordinary shareholders' meeting on 8th January 2003, pursuant to § 83 of the stock corporation law *(Aktiengesetz, AktG)*. At the shareholders' meeting, the new executive board presented its restructuring plan, described here under "Restructuring".

Group

Sales revenues

First quarter revenue came to € 4.3 million, representing a drop in revenue against the same period of the previous year of 4.8 per cent. This quarter witnessed sales of licenses to partners at a value of around € 600,000. Given further license sales to partners in the sum of € 700,000, the second quarter was more positive than the same quarter of the previous year (revenues of € 4.1 million, +27.2 per cent). The third quarter saw a drop in revenues of 19.8 per cent (€ 3.05 million), caused by a drop in sales of licenses to partners coupled with the poor economic climate, and the increase in revenues in the fourth quarter over the previous quarter (+10.4 per cent) was below that of the previous year at € 3.37 million (-35 per cent). It must be pointed out that the executive board changes were made during the third and fourth quarter.

Total revenue was posted at € 14.8 million, representing a drop against the previous year of 11.4 per cent. Revenue from licenses and maintenance saw a drop of 9.8 per cent, while revenue from services fell by 15.5 per cent.



Revenues 2002 by quarter

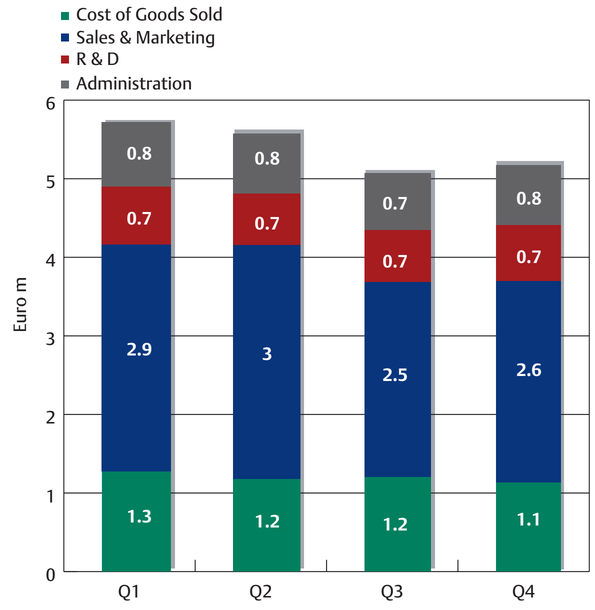
Despite the huge efforts made to cut costs, it was still impossible to reach break-even point. The new executive board quickly came up with a restructuring plan, which it began to put into practice, just a few days after its appointment, during the final quarter.

Operating costs

	2001	2002
Cost of Goods Sold	7,884	4,779
Sales & Marketing	15,002	10,920
Research & Development	6,419	2,757
General Administration	3,903	3,076
Total Costs	33,208	21,532

Costs were continually reduced from the beginning of the year: cost of goods sold were cut by 39 per cent from

€ 7.88 to € 4.78 million. Costs in Sales & Marketing were cut by 27 per cent from € 15 to € 10.9 million, in Research & Development by 57 per cent from € 6.4 to € 2.76 million (by terminating joint development contracts) and in General Administration by 21 per cent from € 3.9 to € 3.08 million. In total, costs were cut by 35.2 per cent (€ 11.68 million). Consequently, the gross operating result (gross margin) was increased by € 1.2 million (+13.7 per cent) against the previous year.



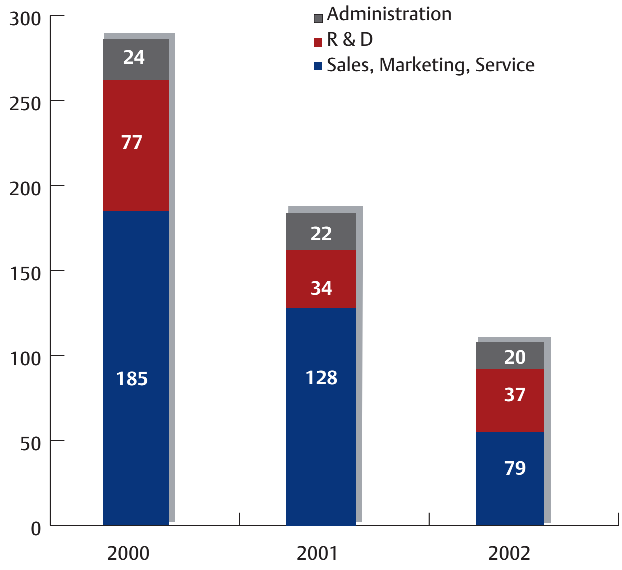
Costs by quarter: Significant cost savings allowed for a considerable improvement in the operating result.

Result

Significant cost savings allowed for a considerable improvement in the operating result, from € -16.5 million to € -6.7 million (+59.4 per cent). The cash drain came to € 3.959 million in 2002, representing an improvement of 79.5 per cent against 2001 (cash drain of € 19.3 million).

Employees

Cost-cutting and restructuring measures led to a reduction in the number of employees in 2002 from 184 to 136 (as of end-December 2002), representing a drop of 26 per cent. The lion's share of the savings were accounted for by Sales & Marketing. The reason behind this was a move from direct to indirect sales. Further savings were made by increasing efficiency in General Administration. The restructuring measures implemented in the fourth quarter brought the number of staff down by a further 30 employees (number of employees as of end-May 2003: 106). This encompasses mainly employees in the Danish, UK and US subsidiaries which were closed down or sold as of the beginning of 2003. Despite the large reduction in the number of staff and continual restructuring measures, the update team remains highly motivated and focused on achieving the objectives which have been set.



Employess 2000 - 2002: The lion's share of the savings were accounted for by Sales & Marketing.

Customers and Partners

Although most companies re-evaluated their relationships with suppliers and made drastic cut-backs, 2002 was a positive year for update as far as customers and partners were concerned. In 2002, update was not only able to forge closer relationships with existing customers such as Roche AG, Beiersdorf AG and Philips Medical Systems, but also managed to acquire several new customers. These include:

Industriellenvereinigung – Austria
tesa AG - Germany
Hannover Leasing GmbH & Co. KG - Germany
Armand von Ernst & Cie. AG – Switzerland
Les Grands Chais de France – France
Intesa Trade Sim SpA - Italy
Europ Assistance GmbH

Furthermore, update was able to enter into new strategic partnerships at both national and international level with partners such as EDS and Synavant. Together with Synavant, a global vendor of specialist solutions for the biopharmaceutical and healthcare industries, update will be able to meet the needs of the entire European CRM market in the pharmaceuticals sector.

Research & Development

2002 saw the implementation of a decision made at the end of 2001, namely to re-focus on core competence and concentrate on the marketing.manager product suite. Thus the "J2EE" product line was discontinued, existing joint developments in this area were wound up and product development was brought under one roof at HQ. Furthermore, software development and quality assurance processes were further optimised, one example of which is a greater focus on automated interface-based testing.

During the period under review, a total of 7 product releases and 23 service releases were produced and delivered. For marketing.manager Version 5.0, 3 service packs containing functional enhancements were released onto the market.

Furthermore, within the framework of software maintenance, 3 service releases were produced for Version 4.6. The development team was primarily focused on the development of marketing.manager 5.0, which will be available as a new release in the third quarter of 2003.

The code base has been entirely re-written in order to establish the foundations for a new generation of the marketing.manager product suite. At the same time, the other products of the Generation V suite also underwent development in order to improve configurability and interaction.

The launch of update.pda 2.0 for WinCE Clients also means that mobile business needs can be covered. Development of its successor, Version 3.0, was begun in 2002 and customers were given a first glimpse of update.pda 3.0 for WinCE Devices in March 2003.

update.groupware is a response to all those of update's customers who have frequently asked for greater integration with Groupware systems. update.groupware for Lotus Notes was introduced in the fourth quarter, with the Outlook version following in the first quarter of 2003.

Both the update.groupware and update.pda products were developed considerably in 2002, allowing marketing.manager to be integrated with any XML-compatible system. update will continue to innovate in 2003, with the development of web services as interfaces to marketing.manager.

Restructuring

update reacted quickly and efficiently to the aforementioned difficult market situation with a comprehensive restructuring package designed to streamline the cost structure and lay the foundations for increased sales.

Cost and revenue goals determined the operative planning and implementation of the restructuring measures, which were set in motion in 2002 and which will probably see completion in summer 2003. Despite having to react quickly to market changes, the management has never lost sight of the company's long-term strategy. Each operative measure was taken with the long-term objectives of the company in mind, particularly as regards product development, market positioning and the choice of strategic partners. Every step was taken in a bid not only to maintain but also to consolidate update's leading position on the European CRM market.

Three operative goals were set during restructuring:

1. Streamlining of cost structures and evaluation of added-value in each business unit
2. Focusing on the markets and sectors in which update is already strongly positioned or has several years' experience
3. 100% concentration on the needs of the market and customers during the optimisation of the sales strategy

1. Streamlining of cost structures and evaluation of added-value in each business unit

Any business unit which lay below a critical revenue mass, which was not profitable and did not contribute to achieving strategic objectives was closed. This affected the UK and Denmark, while the US office became a minority shareholding within the framework of a management buy-out.

Cost objectives were defined for all other business units and threshold values set based on values for a worst-case scenario should revenue fall further. Costs in Research & Development remained more or less unchanged, while considerable cost savings were made in general administration and middle management.

While defining these cost objectives, considerable emphasis was placed on flexibility in determining the key financial figures and on performance-orientation as regards employee salaries, in particular those of the management.

In cutting costs by around 40 per cent, the company will be able to achieve a balanced result even if revenues decline further, and will be able to fulfil its financial obligations towards its suppliers, the public and its employees.

2. Focusing on the markets and sectors in which update is already strongly positioned or has several years' experience

update's focus has traditionally been split across two levels. On the one hand, direct sales have been concentrated in Austria, Germany, Switzerland, the Czech Republic, the Netherlands and France, while on the other hand, update has focused on companies of a certain size in specific vertical markets.

update offers solutions for several vertical markets. These special solutions have frequently been developed in collaboration with customers and are therefore particularly well suited to the business processes of customers in these markets. update has been particularly strong in the pharmaceuticals/chemicals, manufacturing and financial services sectors, for example. 12 of the 15 largest pharmaceuticals companies operating in Europe are using update's products to manage their sales.

Sales support measures and the sales organisation have gradually been geared towards meeting the needs of companies of a certain size in these vertical markets. update has thus been able to consolidate its position in these market sectors, while at the same time increasing the efficiency of its sales processes.

3. 100% concentration on the needs of the market and customers

The sales strategy has been gradually developed according to the company's recognised strengths. Whereas a small group of companies are looked after directly because of contract size, strategic interests or joint development projects, other companies are looked after by a growing number of specialised partners.

By maintaining direct contact with key customers, update is able to monitor the market and customer needs closely, which is vital to the quality and further development of its products. update has concentrated on acquiring partners whose specialist knowledge of technology or business processes enables them to contribute added value to customer solutions and who can therefore increase update's sales opportunities. In conjunction with this strategic orientation, all processes have been examined, dead wood removed and in all cases emphasis placed on performance-orientation within the framework of salary structures.

Outlook

To sum up, all three operative goals must be achieved in order to ensure the long-term profitability of the company. The executive board is convinced – and the results of the first quarter of 2003 substantiate its belief – that the company is already well on the way to achieving these objectives. Although the quarterly results still show an operative loss of € 0.4 million and a decline in revenues of 27 per cent, the 38 per cent cut in costs against the same period of the previous year means that the operative loss has been reduced by 70 per cent. The positive results have led to a cash influx of € 1.4 million in the first quarter, representing an improvement of 125 per cent against the same period of the previous year.

Given the quarterly results, successful restructuring and an improved economic climate, the executive board is confident of breaking even in 2003.

Consolidated Balance Sheets as of December 31st, 2002
according to US GAAP

Compared with the previous year's figures

	Dec. 31st, 2002 1,000 Euro	Dec. 31st, 2001 1,000 Euro
Assets		
Current assets		
Cash and cash equivalents (note 3)	**3,485**	**7,444**
Trade accounts receivable	5,400	8,226
less: Allowance for doubtful accounts (note 4)	-1,263	-1,198
Total trade accounts, net	**4,137**	**7,028**
Inventory	113	275
Prepaid Expenses	281	172
Other current assets (note 5)	197	281
Total current assets	**8,213**	**15,199**
Property and equipment, net (note 7)	1,358	2,138
Intangible assets (note 6)	0	268
Investment securities (note 9)	92	114
Other non current assets (note 8)	0	84
Total Assets	**9,663**	**17,804**
Liabilities and Stockholders' Equity:		
Current liabilities		
Payable to banks	363	363
Trade accounts payable	959	1,386
Accrued liabilities (note 10)	2,555	3,423
Deferred revenues	464	243
Total current liabilities	**4,341**	**5,415**
Long-term debt (note 11)	848	1,090
Employee benefits (note 12)	218	133
Obligations under capital leases, excluding current installments (note 13)	7	11
Total liabilities	**5,414**	**6,649**
Stockholders' equity		
Common stock	9,382	9,382
No par value shares issued and circulating 2002: 9,381,967 (2001: 9,229,490)		
Additional paid-in capital	57,728	57,728
Retained earnings	-62,876	-55,617
Treasury stock (note 15)	0	-352
Unrealised value changes for securities	-6	-4
Foreign exchange gains/losses	21	18
Total stockholders' equity	**4,249**	**11,155**
Total liabilities and stockholders' equity	**9,663**	**17,804**

See accompanying notes to consolidated financial statements.

Consolidated Statements of Income as of 2002
according to US GAAP

Compared with the previous year's figures

	2002 1,000 Euro	2001 1,000 Euro
Net sales		
License and maintenance revenue	10,898	12,086
Service revenue	3,905	4,619
Total net sales	**14,803**	**16,705**
Cost of goods sold		
Cost of licenses and maintenance	1,181	2,215
Cost of services	3,598	5,669
Total cost of goods sold	4,779	7,884
Gross Profit	**10,024**	**8,820**
Operating Expenses		
Sales and Marketing	10,920	15,002
Research and Development	2,757	6,419
General & Administrative	3,076	3,903
Total operating expenses	**16,753**	**25,324**
Loss from operations	**-6,729**	**-16,504**
Interest income	168	581
Interest expense	-105	-108
Other income, net	-314	-540
Loss before income taxes	**-6,980**	**-16,571**
Income taxes (note 17)	-9	-47
Net loss	**-6,989**	**-16,618**
Basic and diluted loss per share (note 19) in Euro	**-0.75**	**-1.79**
Average number of common shares outstanding	9,259,300	9,292,669

See accompanying notes to consolidated financial statements.

Consolidated Statements of Stockholders' Equity as of 2002

Compared with the previous years figures

	Common stock	Additional paid-in capital	Retained earnings	Treasury stock	Unrealised value changes for securities	Foreign exchange gains/losses	Total
	1,000 Euro	1,000 Euro	1,000 Euro	1,000 Euro	1,000 Euro	1,000 Euro	1,000 Euro
Balances at December 31st, 2000	**9,382**	**57,728**	**-38,999**	**-32**	**0**	**32**	**28,111**
Treasury stocks	0	0	0	-320	0	0	-320
Net loss	0	0	-16,618	0	0	0	-16,618
Value changes for securities	0	0	0	0	-4	0	-4
Foreign exchange losses	0	0	0	0	0	-14	-14
Balances at December 31st, 2001	**9,382**	**57,728**	**-55,617**	**-352**	**-4**	**18**	**11,155**
Sales of own shares	0	0	-270	352	0	0	82
Net loss	0	0	-6,989	0	0	0	-6,989
Value changes for securities	0	0	0	0	-2	0	-2
Foreign exchange gains	0	0	0	0	0	3	3
Balances at December 31st, 2002	**9,382**	**57,728**	**-62,876**	**0**	**-6**	**21**	**4,249**

See accompanying notes to consolidated financial statements.

Consolidated Statements of Cash Flows as of 2002
according to US GAAP

Compared with the previous year's figures

	2002 1,000 Euro	2001 1,000 Euro
Operating activities:		
Net loss	**-6,989**	**-16,618**
Adjustments to reconcile net loss to net cash used for operating activities:		
Depreciation & amortisation	1,339	2,758
Changes in employee benefits	85	-48
Unrealised value changes for currency variations	3	-18
Changes in operating assets and liabilities:		
Increase in accounts receivable	2,890	1,129
Change in inventory	97	-166
Increase/decrease in accounts payable	-427	-4,524
Increase in deferred revenue	220	-54
Variation in accrued liabilities	-867	-1,331
Change in other assets and liabilities	58	436
Net cash used by operating activities	**-3,591**	**-18,436**
Investing activities:		
Cash paid for purchases of property and equipment	-361	-738
Proceeds from sales of property and equipment	137	257
Cash paid for investment securities	0	-45
Income from the sale of financial assets	20	0
Netto-Cashflow aus der Investitionstätigkeit	**-204**	**-526**
Financing activities:		
Change in obligations under capital leases	-4	-27
Changes in treasury stocks	82	-320
Variation in long-term loans	-242	0
Net cash provided by financing activities	**-164**	**-347**
Increase in cash and cash equivalents	-3,959	-19,310
Cash at beginning of year	7,444	26,754
Cash at end of year	**3,485**	**7,444**
Supplemental disclosure information:		
Cash paid during period for:		
Interest	105	102
Income taxes	9	48

See accompanying notes to consolidated financial statements.

Notes to Consolidated Financial Statements

1. Organisation and Operations of the Company

update software AG (the Company or “update”) was originally founded in 1988 as Marketing Informations-systeme Gesellschaft m.b.H as a limited liability company. In October 1989 the Company was renamed Update Marketing Service Gesellschaft m.b.H.. On April 29th, 1997 the Company converted to a public limited company *(Aktiengesellschaft)* and the name changed to Update Marketing Service AG to reflect the new legal form. On October 19th, 1999, the Company was renamed update.com software AG. On 22nd May 2002, the name was changed again to the company’s current name, update software AG. The registered office of the company is in Vienna, Austria. Unless otherwise noted, all references to the Company refer to update.com software AG and its predecessors.

update is a leading developer and implementer of Customer Relationship Management software solutions. Customer Relationship Management software solutions automate the key functions that enable enterprises to more effectively acquire, manage and retain customers, partners and other relationships.

The Company is subject to a number of risks, including, but not limited to, operating in a rapidly evolving market, competition from larger companies, dependence upon new products, dependence on key personnel, uncertain profit-ability, and concentration on one core product.
On 1st February 2003, the Company switched to the General Standard Segment of the *Deutsche Börse.*

2. Summary of Significant Accounting Policies and Practices

a) Basis of Consolidation

The consolidated financial statements, which have been prepared according to generally accepted accounting principles in the United States (US GAAP), include the accounts of the Company and its subsidiaries. All significant intercompany transactions and balances between companies have been eliminated in consolidation.

b) Use of Estimates

The financial statements have been prepared in accordance with US GAAP and necessarily include amounts based on estimates and assumptions by management. Actual amounts could differ from those amounts. Significant esti-mates include provisions for uncollectible trade accounts receivable, useful lives for fixed assets and intangibles.

c) Cash and Cash Equivalents

Cash and cash equivalents consist of cash and highly liquid investments with original maturities of three months or less when acquired and which are readily convertible to cash. The Company’s investments consist of bank certifi-cates of deposit with original maturities of three months or less, money market accounts and money market funds.

d) Investment Securities

The Company holds assets in various Investment Funds in Austria as required by Austrian tax law to allow for tax deduction of termination indemnity accruals.

e) Property and Equipment

Property and equipment are stated at cost less accumulated depreciation. Equipment held under capital leases is stated at the present value of minimum lease payments at the inception of the lease less accumulated depreciation. Depreciation of property and equipment is calculated using the straight-line method.
The useful lives of the assets are estimated as follows:

	Period of depreciation years
IT equipment	3 – 5
Software	3
Office equipment	8
Furniture	3 – 8

Equipment held under capital leases is depreciated over the shorter of the lease term and estimated useful life of the asset.

f) Intangible Assets

In 2001, intangible assets consisted of software, trademarks, patents and customer lists which were acquired as part of the Prospect Miner acquisition. These were fully amortised in 2002.

g) Inventory
Inventory consists of third party software held for resale. Inventory is held at the lower of cost or fair market value. A loss-free valuation is made by dealing with discounts, which are determined on the basis of the rating of commercialisation. For 2002 and 2001 allowances on inventory, shown in costs of goods sold, were made for T€ 65 and T€ 979.

h) Decline in values of long-lived assets
The Company reviews its long-lived assets for a decline in value if an event or circumstances indicate that such assets may not be maintaining their book value. The book values of long-lived assets are reviewed for impairment based upon the expected future cash flows (not discounted) associated with them. If this review indicates a deficit, the assets are depreciated to their market value.

i) Revenue Recognition and Deferred Revenue
Revenues from software sales are recognised in accordance with Statement of Position 97-2, "Software Revenue Recognition"(SOP 97-2), issued by the American Institute of Certified Public Accountants. The prerequisite for revenue recognition is the existence of a legally binding contract, completed delivery of the software, an established or determinable license fee, and probable receipt of payment. All prerequisites must be fulfilled.

Revenues from maintenance are recognised pro rata over the period of the contract. Consulting revenues from projects, including training, consultancy and implementation service, are recognised in accordance with SOP 97-2 and Statement of Position 81-1 "Accounting for Performance of Construction-Type and certain Construction-Type Contracts" (SOP 81-1). According to these documents, percentage-of-completion recognition based upon the project progress is carried out for long-term projects. Earnings from other consulting activities are recognised based upon the service performed.

In individual cases it might happen, that customers get the right to withdraw from a contract. In these cases the turnover is realised in consideration of an estimated feasibility of executing a withdrawal in accordance with SFAS 48 "Revenue Recognition When Right of Return Exists".

j) Cost of Goods Sold
Cost of licenses and maintenance includes the costs of media, product packaging, documentation and other production costs and third-party royalties. Also included are the costs of salaries, related taxes and benefits related to maintenance or help desk support personnel.

Cost of services consists primarily of salaries, related taxes and benefits as well as allocated overhead costs related to consulting, training and implementation services personnel.

k) Research and Development
Research and development costs, which consist primarily of software development costs, are expensed as incurred. Financial accounting standards provide for the capitalisation of certain software development costs after technological feasibility of the software is established. Under the Company's current practice of developing new products and enhancements, the technological feasibility of the underlying software is not established until substantially all product development is complete, including the development of a working model. Accordingly, the Company has not capitalised software development costs.

l) Advertising Costs
Advertising costs are expensed as incurred. Advertising expense was approximately T€ 398 for the year ended December 31st, 2002 and T€ 977 for the year ended December 31st, 2001.

m) Income Taxes
Income taxes have been accounted for under the liability method in accordance with Statement of Financial Accounting Standard 109, "Accounting for Income Taxes" (SFAS 109). Under this method, deferred tax assets and liabilities are recognised for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. Under SFAS 109, the effect on deferred tax assets and liabilities of a change in tax rates is recognised in the period that includes the enactment date.

n) Earnings per Share Computation
Basic earnings per share is computed by dividing net income (loss) available to common shareholders by the weighted average number of common shares outstanding for the period. Diluted earnings per share reflects the potential dilution of securities by including other common stock equivalents, including stock options and warrants, in the weighted average number of common shares outstanding for a period, if dilutive.

Pro forma earnings per share is calculated according to Statement of Financial Standards 123, (SFAS 123) "Accounting for Stock Based Compensation" by dividing net income (loss) including the pro forma expense by the weighted average number of common shares outstanding for the period.

o) Foreign Currency Conversion
The functional currency of the Company's foreign subsidiaries is the local currency in the country in which the subsidiary is located. Assets and liabilities denominated in foreign currencies are converted to Euro using the exchange rate in effect at balance sheet date. Revenues and expenses are converted at the average rates of exchange prevailing during the year. The conversion adjustment resulting from this process is shown within accumulated other comprehensive income (loss) as a component of shareholders' equity. Gains and losses on foreign currency transactions are included in the consolidated statement of income as

incurred. To date, gains and losses on foreign currency transactions have not been significant.

p) Stock-based Compensation

The Company accounts for its stock based compensation in accordance with SFAS 123, "Accounting for Stock-based Compensation". As provided by SFAS 123, the Company continues to measure compensation expense for awards granted to employees and directors under the provisions of Accounting Principles Board Opinion (APB 25), "Accounting for Stock Issued to Employees", and related interpretations. The exercise price of options granted under the Company's 1999 stock option plan (the "1999 Plan") is equal to the market price of the Company's stock on the date of grant, and accordingly, no compensation cost has been recorded under APB 25. The company's 2000 stock option plan (the "2000 Plan") is treated as a variable plan under APB 25 due to its provision that options may only be exercised if the price of a share amounts to at least 110 % of the exercise price. The excess of the stock price at balance sheet date over the exercise price is accrued over the service period. This resulted in no compensation expense being recognised during 2002.
SFAS 123 requires companies that continue to follow APB 25 to provide pro forma disclosures showing the impact of applying the fair value method of SFAS 123 (refer to Note 19).

q) Other Comprehensive Income (Loss)

The only items of other comprehensive income (loss) which the Company currently reports are foreign currency conversion adjustments and unrealised gains/losses from investment securities.

r) Employee Benefits

Austrian labour law requires payment to employees specific termination indemnities upon release from service or retirement at pension age. Employees leaving voluntarily or dismissed for good cause are not entitled to such indemnities. The company uses the projected unit credit method to determine termination indemnity cost and the related accrual for financial reporting purposes. The calculation was based on the following assumptions: Interest rate: 6 %, Future salary increases: 3% (2001: 2%).

s) Leases

The Company is lessee of equipment, principally cars and computer software. All leases, that meet certain specified criteria intended to represent situations where the substantive risks and rewards of ownership have been transferred to the lessee, are accounted for as capital leases. All other leases are accounted for as operating leases.

3. Cash and Cash Equivalents

Cash and cash equivalents consist of bank certificates of deposit with original maturities of three months or less, money market amounts and investments in money market funds. Cash and cash equivalents amount to T€ 3,485 at December 31st 2002, of which T€ 1,691 were mortgaged to ensure granted bank guarantees.

4. Trade Accounts Receivable

The allowance for doubtful accounts developed as follows:

	Dec 31st, 2002	Dec 31st, 2001
	T€	T€
Allowance for doubtful accounts at beginning of year	1,198	1,084
Additions charged to bad debt expense	745	783
Write-downs charged against the allowance	-640	-192
Reversal of unused allowance	-40	-477
Allowance for doubtful accounts at end of year	1,263	1,198

As of December 2002, the trade accounts receivable contained no intercompany accounts receivable.

5. Other Current Assets

	Dec 31st, 2002	Dec 31st, 2001
	T€	T€
Due from tax authorities	99	124
Rental and leasing deposits	47	49
Due from officers and employees	14	21
Other assets	37	87
	197	**281**

Other current assets include VAT and tax-prepayments, rental deposits, other deposits and other prepayments.

6. Intangible assets

Within the framework of technology purchases, intangible assets amounting to T€ 514 were capitalised. Amortisation of acquired and capitalised intangible assets during 2002 and 2001 came to T€ 268 (including write-offs for impairment of T€ 100) and T€ 171 respectively. In 2002 no in-process R&D projects were acquired.

7. Property and Equipment

	Dec 31st, 2002	Dec 31st, 2001
	T€	T€
Cost		
IT equipment	1,864	2,585
Software	745	1,205
Office equipment	823	1,054
Furniture	229	248
Other fixed assets	411	451
	4,072	5,543
Less: Accumulated depreciation	-2,714	-3,405
Net book value	**1,358**	**2,138**

Depreciation expense was T€ 1,002 and T€ 1,613 for the fiscal years ended December 31st, 2002 and 2001, respectively.

8. Other non current assets

Other non current assets include investments in affiliated companies, which consist of Update Sales & Marketing S.A. Spain (T€ 50). This subsidiary is not included in the consolidated financial statements as its operations are not material for the Company as a whole.

9. Investment Securities

Costs, gross unrealised holding gains, gross unrealised holding losses and fair value at December 31st, 2002 and 2001, were as follows:

	Costs	Gross unrealised holding gains	Gross unrealised holding losses	Fair value
Available-for-sale securities (Shares in funds)	T€	T€	T€	T€
Dec 31st, 2001	118	0	4	114
Dec 31st, 2002	98	0	6	92

10. Accrued Liabilities

	Dec 31st, 2002	Dec 31st, 2001
	T€	T€
VAT, payroll taxes and social security	211	809
Accrued payroll and travel expenses	782	1,073
Other accrued liabilities	1,562	1,541
	2,555	**3,423**

The decrease in accrued payroll and travel expenses is mainly due to the reduced number of employees.

Other accrued liabilities include mainly consulting, legal fees, warranties and accrued expenses for other outside services.

11. Long-term Debt

	Carrying amount	Fair value
	T€	T€
Dec 31st, 2002	848	805
Dec 31st, 2001	1,090	1,037

In 1998, the Company entered into a loan agreement with Bank Austria Creditanstalt AG. Proceeds from the loan were T€ 1,453. The loan bears an interest rate of 6.25 % p.a. Interest is payable on June 30th and December 31st each year. The loan is guaranteed by Finanzierungsgarantie-Gesellschaft mbH (FGG) according to the rules of the "Technologie-Finanzierungsprogramm" (TFP). The loan must be repaid either by eleven installments of T€ 121 each on a half-year basis, starting December 31st, 2001, and ending June 30th, 2007, or pari passu earlier, if the VC-investors of the first financing round 1997 sell all of their shares. The fair value of the Company's long-term debt is calculated by discounting the future cash-flows at a rate currently offered to the Company for similar debt instruments of comparable maturity by the Company's banks.

12. Employee Benefits

The accrued employee benefits relate to termination indemnities.

	T€
Accrued obligation as of December 31st, 2000	**181**
Interest cost	11
Service cost	80
Payments of Benefits	-345
Actuarial loss	206
Accrued obligation as of December 31st, 2001	**133**
Interest cost	13
Service cost	61
Payments of Benefits	-147
Actuarial loss	158
Accrued obligation as of December 31st, 2002	**218**

13. Leases

The Company is obligated under capital leases for EDP software and other office equipment. At December 31st, 2002 and 2001 the gross amounts of equipment recorded under capital leases were as follows:

	Dec 31st, 2002	Dec 31st, 2001
	T€	T€
Office equipment	0	19
Cars	69	0
	69	19
less: Accumulated amortization	**-16**	**-6**
	53	**13**

Depreciation of assets held under capital leases is included in depreciation expense. In 2000 the company entered a non-terminable lease contract for offices. The costs thereby incurred amount to T€ 470 per year. The Company is also the lessee of several non-terminable operating leases, primarily for buildings, office facilities, cars and other equipment. Future minimum lease payments under non-terminable operating leases and future minimum capital lease payments as of December 31st, 2002 are:

	Capital leases	Operating leases
	T€	T€
Years ending December 31st		
2003	24	704
2004	24	635
2005	24	568
2006	10	487
2007	0	487
	82	2,881
less: Current installments of obligations under capital leases (included in accounts payable)	-75	
Obligations under capital leases, excluding current installments	7	

Future minimum operating lease payments as of December 31st, 2002 and 2001, were: T€ 2,881 and T€ 3,497, respectively. Future minimum obligations under capital leases, excluding current installments, as of December 31st, 2002 and 2001, were T€ 82 and T€ 18, respectively. Amortisation charge applicable to capitalised assets as of December 31st, 2002 is: T€ 16. Imputed interests in the capital leases as of December 31st, 2002 amount to T€ 7.

14. Research and Development Arrangements

The Company has entered into contractual arrangements with external contractors or companies to provide software programming or development resources to the company. These contracts are short term arrangements ranging from two to twelve months and all intellectual property developed as a result of these contracts belongs to the Company. The cost incurred in fiscal 2002 and 2001 relating to these contracts amounted to T€ 0 and T€ 1,570.

15. Treasury stock

Treasury stock can be broken down as follows:

Treasury stock:	Number	Type of stock	at cost in T€
Dec 31st, 2001	152,477	common stock	352
Dec 31st, 2002	0		0

16. International Operations and Segment Information

The Company operates in a single business segment and licenses and markets its products through direct and indirect channels in Europe, the United States and Asia-Pacific. The Company's customer base is dispersed across many different geographic areas consisting of companies in a variety of industries. During 2002 no single customer accounted for 10 % or more of total revenues. Information regarding revenues recognised based upon point of sale in different geographic regions is as follows:

	2002	2001
	T€	T€
Austria	3,496	4,364
Germany	5,795	6,714
Netherlands	2,131	2,436
Rest of world	3,381	3,191
Total revenues	**14,803**	**16,705**

No subsidiary operations have significant fixed assets.

17. Income Taxes

Total income tax benefit/expense for the years ended December 31st, 2002 and 2001 were allocated to income from continuing operations.
Income tax benefit/expense for the respective years consists of:

	Current	Deferred	Total
	T€	T€	T€
2002			
Austria	8	0	8
Foreign	1	0	1
	9	**0**	**9**
2001			
Austria	48	0	48
Foreign	0	-1	-1
	48	**-1**	**47**

Income tax benefit/expense differed from the amounts computed by applying the Austrian income tax rate of 34 % to pre-tax income from continuing operations as a result of the following:

	2002	2001
	T€	T€
Income before income taxes	-6,980	-16,573
Statutory tax rate	34 %	34 %
Expected income tax benefit	-2,373	-5,635
Actual income tax expense	-9	-47
Difference to be reconciled	**-2,382**	**-5,682**
Reconciliation		
Valuation allowance	1,917	3,914
Change in interest rate	0	468
Non tax-deductible expenses	0	240
Other	465	1,060
Total reconciliation	**2,382**	**5,682**

The tax effects of temporary differences that give rise to portions of the deferred tax assets at December 31st, 2002 and 2001 are presented below:

	2002	2001
	T€	T€
Deferred tax assets/liabilities		
Net operating loss carry forwards	32,871	30,482
Write-off of investments in affiliated companies	127	763
Depreciation of tangible and amortisation of intangible assets	0	25
Other	18	123
Total gross deferred tax assets/liabilities	**33,016**	**31,392**
Less: Valuation allowance	-33,016	-31,392
Net deferred tax assets	**0**	**0**

Most tax loss carry forwards can be carried forward indefinitely. Due to uncertainty of the realization, the Company has established a valuation allowance. Based on projected taxable results management believes, that it is more likely than not that the Company will not realize the benefits of these deductible differences.

18. Warrants

Bridge Loan Warrants – were granted to the investors at the financing round from May 28th, 1998 with the right to purchase 101,871 common stock at a strike price of € 4.45.

Type of warrant	Number	Amount (T€)	Expiration date	Exercise Price
Bridge Loan Warrant	101,871	453.24	Mai 28th, 2003	€ 4.45

19. Incentive Stock Plan

On May 19th, 1999, the Shareholders approved the 1999 Incentive Stock Plan (the "1999 Plan") after stock options, including incentive stock options, not qualified options, qualified stocks, growth stocks, bonus stocks, and Stock Appreciation Rights (SARs), may be granted to employees, consultants and directors, for up to 518,773 shares of common stock. The plan was implemented on May 19th, 1999.
This 1999 Plan is administered by the management board ("the Board"). The Board shall determine the term of each stock option (up to a maximum of 10 years) and the exercise price cannot be less than the fair market value of the common stock on the date the option is granted. Except as otherwise provided, options will be exercisable with respect to 25 % of the shares corresponding to the grant after the first year of service. Thereafter options will be exercisable with respect to 1/48th of the shares corresponding to the grant on the first day of each of the subsequent months after the first calendar year of service. Employees who received options and were employed prior to the implementation date of the Incentive Stock Plan were credited for vesting purposes with their service to date up to a maximum of one year.
In 1999, 340,873 options were granted, 33,045 options lapsed and 22,317 options were exercised within the framework of the 1999 plan. Between 1st January 2000 and 14th February 2000, 30,358 options were granted and 5,491 exercised.
The third ordinary shareholders' meeting held on February 15th, 2000 resolved to carry out a stock split at a 3 for 1 ratio. The consequence for the holder of stock options is the right to receive 3 stocks for 1 option, which increases the amount of exercisable shares from 518,773 to 1,556,319. At the same time the exercise price decreases to one third of the original exercise price. At the same shareholders' meeting the shareholders approved the 2000 Incentive Stock Plan (the "2000 Plan") whereby stock options may be granted to employees and directors, for up to 1,384,803 shares of common stock thereby reducing the total number of shares for which options may be granted by 171,516.
After February 15th, 2000 new options are granted only under the provisions of the 2000 Plan. After January 1st, 2000 options shall no longer be granted to members of the supervisory board. The 2000 Plan was implemented on February 15th, 2000. The 2000 Plan is administered by the Board. The Board shall determine the term of each stock option (up to a maximum of 10 years) and the exercise price cannot be less than the fair market value of the common stock on the date the option is granted. The fair market value is determined by the average of the cash price of the stocks of update software AG of the last 15 trading days before grant date, but must be at least € 1.00. Except as otherwise provided, options became exercisable with respect to 25 % of the shares corresponding to the grant after two years of service. Afterwards the options became exercisable in respect to 1/8th of the shares at the end of each following period of 6 months. Options can be exercised, if the market price exceeds the fair market value by 10 % at least at the date of declaration of excercise. Stocks under the 2000 Plan can be shares of authorised capital or own shares, that were purchased on the stock market or elsewhere. Therefore the company has the right to purchase it's own shares from a bank that tenders authorised capital.

Options granted to CEO Thomas Deutschmann, are subject to special Stock Option Agreements. The options granted to Thomas Deutschmann can be exercised in relation to 33,000 units after one year of membership of the Board, a further 33,000 units after another year and 34,000 units after a full 3 years' employment at the Company.

Stock Option Activity

In the following summary of stock option activity the stock split on February 15th, 2000 was taken into account in the period from May 19th, 1999 until December 31st, 1999:

	Options available for grant	Outstanding Options		
		Number of shares	Range	Weighted average exercise price
Outstanding at Dec. 31st, 2000	**405,489**	**772,658**	**€ 4.3 - 23**	**€ 6.1**
Options granted	(288,170)	288,170	€ 1.15 - 2.21	€ 1.47
Options cancelled	595,417	(595,417)	€ 1.15 - 23	€ 6.0
Options exercised	0	0	0	0
Outstanding at Dec. 31st, 2001	**712,736**	**465,411**	**€ 1.15 - 23**	**€ 4.6**
Options granted	(189,729)	189,729	€ 1 - 1.37	€ 1.09
Options cancelled	348,565	(348,565)	€ 1 - 23	€ 3.04
Options exercised	0	0	0	0
Outstanding at Dec. 31st, 2002	**871,572**	**306,575**	**€ 1 - 23**	**€ 4.21**

The following table summarises information concerning currently outstanding and exercisable options under the 1999 Plan at December 31st, 2001 and December 31st, 2002. The stock split dated February 15th, 2000 was taken into account.

Plan 1999

Outstanding as of December 31st, 2001					
Outstanding				**Exercisable**	
Range of exercise prices	Options outstanding	Weighted remaining contractual life	Weighted average exercise price	Options exercisable	Weighted average exercise price
€		years	€		€
4.3	139,608	7.5	4.3	112,216	4.3
6.0	10,920	7.8	6.0	6,531	6.0
7.3	7,020	7.9	7.3	3,882	7.3
4.3 – 7.3	157,548	7.5	4.6	122,629	4.5

Outstanding as of December 31st, 2002					
Outstanding				**Exercisable**	
Range of exercise prices	Options outstanding	Weighted remaining contractual life	Weighted average exercise price	Options exercisable	Weighted average exercise price
€		years	€		€
4.3	113,451	6.5	4.3	112,361	4.3
6.0	7,800	6.8	6.0	6,661	6.0
7.3	6,240	6.9	7.3	5,004	7.3
4.3 – 7.3	127,491	6.5	4.5	124,026	4.5

The following table summarizes information concerning currently outstanding and exercisable options under the 2000 Plan at December 31st, 2002. The stock split on February 15th, 2000 was taken into account.

Plan 2000 (Exercisable since 01-04-2002)

Outstanding as of December 31st, 2001			
Outstanding			
Range of exercise prices	Options outstanding	Weighted remaining contractual life	Weighted average exercise price
€		years	€
23.0	18,980	8.2	23.0
18.7	8,320	8.5	18.7
8.8	12,675	8.8	8.8
3.4	9,880	9.0	3.4
2.2	7,020	9.2	2.2
1.5	158,380	9.5	1.5
1.2	79,228	9.8	1.2
1.3	13,380	10.0	1.3
1.2 – 23	307,863	9.4	3.6

As of December 31st, 2002					
Outstanding				Exercisable	
Range of exercise prices	Options outstanding	Weighted remaining contractual life	Weighted average exercise price	Options exercisable	Weighted average exercise price
€		years	€		€
23.0	2,340	7.2	23.0	878	23.0
18.7	3,900	7.5	18.7	1,463	18.7
8.8	6,955	7.8	8.8	2,088	8.8
3.4	6,500	8.0	3.4	1,625	3.4
2.2	4,420	8.2	2.2	845	2.2
1 - 1.4	154,969	9.8	1.04	0	0.0
1 - 23	179,084	9.6	2.13	6,898	10.6

Proforma Information
The Company continues to apply APB 25 in accounting for its stock based incentive plans. Accordingly, no compensation cost has been recorded in the consolidated statements of operations of the stock options plans. Had compensation cost for the Company's stock based compensation plans been determined in accordance with the fair value method prescribed by SFAS 123, the Company's proforma net loss and loss per share as of December 31st, 2002 would have been as follows:

	Year ended Dec. 31st, 2002	Year ended Dec. 31st, 2001
	T€	T€
Net loss, as reported	-6,989	-16,618
Pro forma Statement 123 expense	-55	-310
Net loss, pro forma	-7,044	-16,928
Basic and diluted loss per share, as reported	€ -0.75	€ -1.79
Pro forma basic and diluted loss per share	€ -0.75	€ -1.82

The weighted average fair value per option granted during 2002 was € 0.25 (2001: € 1.21). The fair value of each grant is estimated on the date of grant using the Black Scholes pricing model with the following assumptions: Risk-free interest rate of 4.0 %, corresponding to government securities with original maturities similar to the estimated option life; option lives of 5 years for the 2000 Plan; annual volatility of the Company's stock price of 112 % for 2002 and 103 % for 2001; and a dividend yield of 0 %.

20. Commitments and Contingencies

The Company may, from time to time, become party to legal proceedings.

Regarding the complaint filed by a customer against update software AG in July 2002 for alleged non-performance of preliminary contractual duties in the sum of € 705,000, the first hearing of evidence took place on 3rd December 2002. In the opinion of both an external expert and update's legal advisor, a favourable outcome for update is likely. Therefore, no accrual has been set up.

Based upon advice from outside legal counsel, management is of the opinion that the Company is not involved in any further litigation at December 31st, 2002, that could have any effect on earnings or the financial position of the company.

21. Transactions with related parties

A member of the supervisory board holds a senior position within a company with which update software AG has a business relationship. All contracts and transactions will be concluded under the generally applicable standard terms and conditions.

	2002	2001
	T€	T€
Accounts receivable as of 31st December	522	332
Liabilities as of 31st December	-10	-51
Sales revenues in fiscal year	687	384

22. Liquidity and Capital Resources

From 1997 through 1999, the Company primarily financed its operations through private placements of common stock. Through December 31st, 1999, gross proceeds from three private placement rounds of common stock totaled € 22.4 million. On April 11th, 2000, the Company's shares were listed on the *Neuer Markt* of the German Stock Exchange as part of an Initial Public Offering. Net proceeds from the IPO amounted to € 43.6 million. To a lesser extent, the Company has financed its operations through equipment financing and traditional financing.The Company is taking steps to restructure the business and reduce costs in order to reduce current expenses. The Company plans a positive cash-flow for 2003.

23. Subsequent Events

On 8th January 2003 an extraordinary shareholders' meeting took place, during which the executive board announced the loss of half the share capital pursuant to § 83 of the stock corporation law *(Aktiengesetz, AktG)*.
On 24th February 2003, the US subsidiary Update Marketing, Inc. was sold within the framework of a management buy-out. The buy-out saw the transfer of a 76 per cent interest to the new shareholders.

24. Additional Information on consolidated accounts on the basis of Austrian Accounting Standards

a) Reporting according to US Generally Accepted Accounting Principles

The consolidated financial statements as at December 31st, 2002 were drawn up in accordance with US GAAP. Consolidated financial statements drawn up in accordance with international standards are deemed to represent statements pursuant to section 245 a of the Austrian Commercial Code (HGB) if the terms stipulated in para. 1 subsec. 1 to 3 are satisfactorily met. Fulfillment of these terms is explained below.

b) Substantial differences between Austrian Accounting Standards (HGB) and US GAAP

Accounting standards of HGB and US GAAP are characterised by partly different basic principles. HGB underlines the principle of prudence and the protection of creditors, whereas US GAAP emphasises the usefulness of information for decision-making for investors. The significant differences between HGB and US GAAP that are relevant for these financial statements concern the following accounting principles:

b1) Deferred taxes

According to US GAAP, deferred tax assets and liabilities resulting from temporary differences between the carrying amount of an asset or liability in the US GAAP balance sheet and its tax base as well as from tax loss carry-forwards must be recognised. HGB calls for recognition of deferred tax liabilities and provides the option to recognise deferred tax assets. The recognition of deferred tax assets resulting from tax loss carry-forwards is generally not accepted.

b2) Other accruals

According to US GAAP, accruals have to be set up for obligations to third parties when it is probable that the obligation will have to be settled and when it can be reliably measured. Accruals according to HGB, by contrast, are based on the principle of prudence resulting that an accrual may be set up already based on recognisability of a liability.

b3) Valuation of securities of financial assets

According US GAAP securities, with the exception of held-to-maturity securities, are stated at fair value. Depending on whether the securities are held for trading or as available for sale, the unrealised gains and losses are recognised in income or as other comprehensive income in stockholders' equity. According to HGB long-term securities are stated at the lower of cost or market if the impairment is considered to be other than temporary (optional if reduction in value is temporary). Short-term securities are stated at the lower of cost or market.

b4) Measurement of foreign currency

According to US GAAP, foreign currency assets and liabilities are measured at the closing rate at the balance sheet date. Realised and unrealised gains and losses are recognised in income. HGB does not allow the recognition of unrealised gains. According to the principle of prudence, HGB assets denominated in foreign currency are converted applying the lower of the exchange rate at transaction date or at balance sheet date. Liabilities denominated in foreign currency are stated at the higher of the exchange rate at transaction date or balance sheet date.

b5) Operating Lease/Capital Lease

According to US GAAP assets have to be included in the balance sheet of the lessee, if significant risks and rewards have been passed to the lessee. Based on tax rules, HGB pursues the same basic principle, but the economic approach is less dominant. Therefore in certain circumstances assets not recognised in the balance sheet of the lessee in accordance with HGB must be recognised in accordance with US GAAP.

b6) Costs in relation to capital increases

According to US GAAP costs of increase in capital are deducted from additional paid-in capital. The proceeds of the share capital increase are reduced by the attributable costs. HGB does not permit deduction of such costs from additional paid-in capital. Such costs must be expensed.

c) Additional information to the statement according to HGB (§ 245a (1) Z 3 HGB)

c1) Fixed assets schedule

The development of fixed assets is illustrated in the Appendix.

c2) Maturity of receivables and liabilities

Accounts receivable and liabilities, excluding long-term liabilities (cf. note 11), are entirely short-term with a remaining maturity period of less than one year. The long-term liabilities in the sum of T€ 848 have a remaining maturity period of between one and five years.

c3) List of consolidated subsidiaries

Name, interest and location of the consolidated subsidiaries:

Asset analysis, December 31st 2002

	Acquisition costs					Accumulated Depreciation	Book value		Depreciation 2002
	As of Jan. 1st, 2002	Additions	Disposals	Exchange Diff.	As of Dec. 31st, 2002		As of Jan. 1st, 2002	As of Dec. 31st, 2002	
	T€	T€	T€	T€	T€	T€	T€	T€	T€
Fixed assets									
IT-Hardware	2,585	190	879	33	**1,864**	1,347	881	517	458
Software	1,205	66	525		**745**	566	352	179	240
Office equipment	1,054	85	316	1	**823**	484	501	338	206
Office furniture	248	4	23		**229**	169	89	61	32
Other fixed assets	451	16	50	7	**411**	148	314	263	67
Total fixed assets	**5,543**	**362**	**1,793**	**40**	**4,072**	**2,714**	**2,138**	**1,358**	**1,002**
Intangible assets	**514**	**0**	**0**	**0**	**514**	**514**	**268**	**0**	**268**
Securities	**118**	**0**	**20**	**0**	**98**	**6**	**114**	**92**	**6**
Other assets	**83**	**0**	**34**	**0**	**49**	**49**	**83**	**0**	**50**

Company	Location	Capital %
update sales GmbH	Vienna, Austria	100
update software Germany GmbH	Dreieich, Germany	100
update.com software (Switzerland) AG	Dietkon, Switzerland	100
update software Ltd.	Berkshire, England	100
update.com software USA Inc.	Grove City, USA	100
update software Denmark ApS	Glostrup, Denmark	100
update software Benelux B.V.	Amsterdam, Netherlands	100
update software CZ s.r.o.	Brno, Czech Republic	100
update.com software France S.A.R.L	Paris, France	100

Average number of employees 2002: 161 (2001: 227)

Expenditure on severance pay is comprised as follows:

	Severance pay
	T€
Members of the board	111
Management	180
Other employees	245
	536

Executive bodies of the company:

The following people were members of the managing board in 2002:

Thomas Deutschmann, CEO since November 6th, 2002
Mrs. Monika Fiala, since September 6th, 2002
Mr. Arno Huber
Mr. Gerhard Schuberth, CEO until November 5th, 2002
Mr. Marcus Mühlberger, until April 15th, 2002

Total remuneration of the members of the board came to T€ 784, of which T€ 449 for former members of the board.

The following people were members of the supervisory board in 2002:

Mr. Hans Bodingbauer, president since June 25th, 2002
Mr. Gilbert Hödl, vice-president since June 25th, 2002
Mr. Peter Hurwitz, president until June 25th, 2002
Mr. Frank Hurtmanns, since June 25th, 2002

Expenditure on remuneration for the supervisory board came to T€ 58.

Vienna, May 23rd, 2003

The Board

Thomas Deutschman

Mag. Monika Fiala

Dipl. Ing. Arno Huber

Auditor's Report

We have audited the accompanying balance sheet of update software AG as of December 31st, 2002, and the related consolidated profit and loss statement, the consolidated cash flow statement and the consolidated statement of equity for the year then ended. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audit.

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

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of update software AG as of December 31st, 2002, and the results of its operations and its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America (US GAAP).

According to the provisions of Austrian commercial law, the group report and the existence of legal requirements for exemption from the preparation of consolidated financial statements according to Austrian law must be examined.

We confirm that the group report of update software AG is consistent with the consolidated financial statements and that the legal requirements for exemption from the obligation to prepare consolidated financial statements under Austrian law have been fulfilled.

We observe that the continued existence of the company is threatened by risks which are outlined in the group report. As a result of the largely exhausted liquidity margin, the going concern of the company is dependent on the achievement of the number of orders forecast in the restructuring plan and on the further success of the measures introduced to reduce costs. These factors indicate the existence of a material uncertainty calling into question the ability of the company to continue as a going concern.

Vienna, 20th May 2003

KPMG Alpen-Treuhand GmbH
Wirtschaftsprüfungs- und Steuerberatungsgesellschaft

Dr. Walter Knirsch — Helmut Kerschbaumer
Auditor and tax consultant

This is a translation from German to English.

If publishing (with the exception of publication as required by law) or disclosing the consolidated annual accounts in any form which deviates from the certified version (e.g. abridged form or translation into other languages), the auditor's report may not be quoted or our audit referred to without our express permission.

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