update go relate™

update software AG | a european leader in Customer Relationship Management | solutions that fit your needs | from anywhere at any time

2005 Annual Report

Ready, steady, »*go*relate«! Sounds good. Feels good. Because relationships determine our lives. And our actions. Both professionally and personally. The world turns around them. We do too. We live relationships. »*go*relate«

Relationship 1

When we promise our clients »*go*relate«, we keep that promise by listening closely to their needs. We understand their goals and think ahead. To simple and better solutions. So they work in the long term. We also rise immediately to new challenges – focused on the client, ready for action.

»*go*relate«
our approach is the passion to understand

Relationship 2

»*go*relate« is our clients keeping promises to their clients. Because they are inspired. Because they have an individually tailored relationship management solution. Because they utilise all available information to surprise their clients again and again.

»*go*relate«
when data turns into real touch points

Relationship 3

For our staff and partners, »*go*relate« means commitment and open communication. Valuing everyone's individual contributions. Pursuing and achieving common goals. An active exchange for motivational drive.

»*go*relate«
the driving force for mutual advantage

Can we really make things so simple? We are convinced we can. In fact no other option - the quantity of our daily contacts is rising and the quality must keep pace. Without using complicated systems but rather with solutions which simplify – and multiply – excellent relationships. Close to people. Living relationships. »*go*relate«

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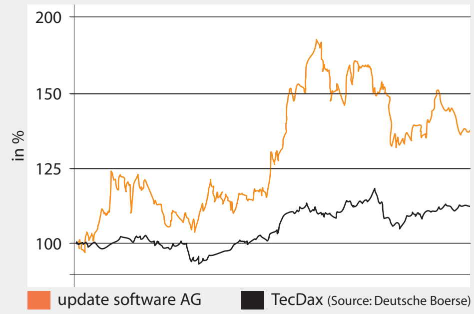
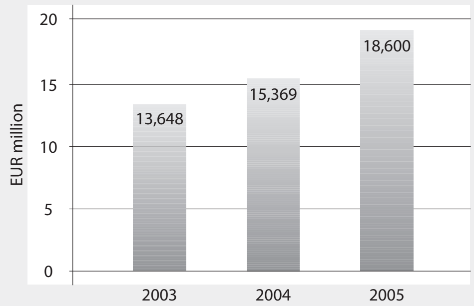
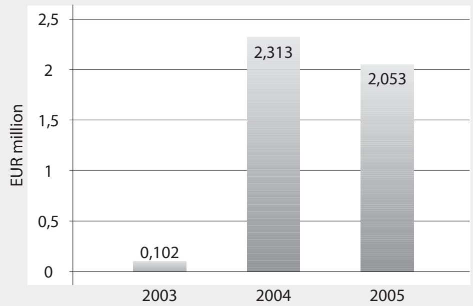


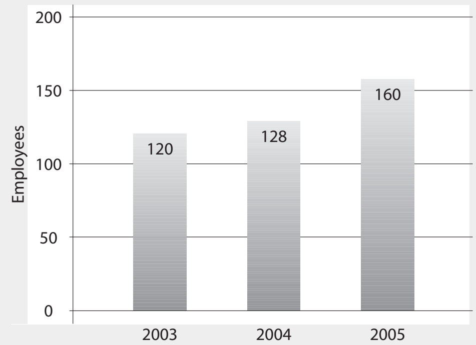
Sales Revenue



Operating Income



Employees (incl. freelancer)



Letter of the CEO

Dear shareholders, customers and colleagues,

It gives us great pleasure to be able to inform you in this annual report about another successful year for update software AG. 2005 was marked by growth for update and by far-reaching capital spending with solid profitability. After several years of severe restraint in capital spending – primarily in Europe, update's core market – the overall situation from the perspective of IT providers is once again somewhat more positive. While the overall IT market in Europe is displaying signs of recovery and the software and CRM markets are showing moderate growth, update is posting growth figures clearly above the market average in sales volume and revenue. In fact, higher sales volumes more than compensated for declining price levels across broad sections of the software industry.

In 2005, update posted revenue growth of 21 %, compared to an average market growth of 6 %, while at the same time making sizeable investments in the company's future. On the one hand, these investments served to support organic growth. The company invested in the expansion of the workforce in order to strengthen all company divisions, and earmarked resources for the continued development of its core products in order to ensure their competitiveness. On the other hand, investments were made in inorganic growth on the basis of healthy organic growth, robust profitability, and liquidity. In the first quarter of the year under review, the acquisition of Process4E S.A. initiated in 2004 was completed. In the fourth quarter, the acquisition of the German CRM specialist REGWARE GmbH was initiated and was completed in the first quarter of 2006. The fact that profitability was approximately the same in absolute numbers but showed a decline in relation to the 21 % revenue growth must be seen against this backdrop.

Investors were once again pleased by the company's operating profit and strategic direction. The price of update's share increased by approximately 37 % during the course of 2005, which made update one of the most attractive software shares on the German stock exchange (Deutsche Boerse). Fostered by the successful capital increase undertaken in the first quarter, the liquidity of the shares was increased by more than 250 % compared to the previous year.

The CRM market experienced yet another transformation in 2005. After very difficult periods from 2001 to 2003, the market showed gradually increasing demand for CRM software. The question facing decision-makers in our target markets was not so much as to whether CRM should be implemented at all. Rather the question increasingly focused on "how" and "which CRM." The majority of CRM users, particularly in Europe, increasingly recognised, or are recognising, that reducing their competitive strategy to just the product or just the price shows little promise in times of globalisation and permanently intensifying competition. With comparable products and price wars in international competition that are difficult to win, more and more companies are counting on increasing the efficiency and effectiveness of their interactions with customers and markets in order to differentiate themselves from the competition. It is precisely these interfaces that urgently require modern CRM systems.

In light of this development, more and more software companies are laying claim to this field as part of their expertise. While leading software manufacturers such as Oracle wish to open up these markets for themselves by means of acquisitions, others such as Microsoft are developing new solutions or, for example SAP, are improving their already existing systems. For update, this means that the competition intensifies while the markets are growing – a situation that most recently confronted the industry in 2000 and 2001. However, unlike five years ago, user demand for functionality, stability, and above all economic efficiency of IT systems has changed from a basically positive attitude with sometimes little differentiation to a clear and sophisticated expectation. This is the foundation on which update's unique opportunity as a specialist in the CRM market has been built for 18 years. Our product quality, the very high skill levels of our employees, and not least the experience gathered from over 800 customers make update one of the prime companies in the CRM software sector. Even when other companies appear to have superior expertise at first glance due to their size.

During 2005, we completed a major release, i.e. a new, fundamentally re-engineered version of our core product, and launched it on the market in the first quarter of 2006. With this new version, we once again take a leading position in the field of CRM software. It was not just functions that were added or improved: in particular, substantially new methods and technologies were introduced, solely for the purpose of making our product even more flexible, more powerful, and still easier to implement and integrate. Furthermore, components were integrated that were previously not offered, such as a dedicated analysis and statistics product. These modifications take into account the increasing demand for specific interpretations of data sets, so-called business intelligence applications. And with all of this, we never disregarded the facet of cost effectiveness for our customers. Our new generation of CRM software, update.seven, is thus more efficient and at the same time, more economical for our customers than all prior versions.

2005 was the first year of operations for our Polish acquisition and newly founded subsidiary in Hungary. Results were within expectations in Poland; in Hungary, they were even exceeded. The successful development of partnerships in Russia and project awards in other Eastern European countries such as Romania complete the picture of successful regional expansion. Total revenue in Eastern Europe in 2005 more than tripled in comparison with 2004. Our strategy of focusing on these high-growth markets with little competition, even if on a comparatively lower basis, was successfully confirmed in 2005. Gartner, the renowned research and advisory company, believes we are already in a leading position in these sectors – and increasingly more so.

CRM is gradually changing from a generic application to a sector and industry-specific application for supporting core processes. Many features of a CRM application that could still be showcased as progress in the 1990s are today considered to be "commodities," i.e. as arbitrary and indistinguishable characteristics. Companies that failed to incorporate these developments now find themselves in very difficult times with regard to the competition. Several of them have already been acquired or pushed out of the market. For years, update has pursued a consistent focus on particular industries and their typical processes. Not only were we proven right with this strategy in general through revenue growth in 2005, but we also won individual projects that were contested by the biggest players in the software industry. Our specific know-how in our focused industries was surely of critical importance in this respect.

update completed 2005 with strong growth, robust profitability, and significantly above-average share performance. With an additional 16,000 new licenses, update also succeeded in increasing its user base to 96,000 users in 830 companies. We acquired this high number of satisfied customers over the course of many years, and they represent one of three pillars supporting the foundation of our future development. We were also able to achieve clear progress with our other two pillars: our core product, which we further developed into a fundamentally new version, as well as the motivation and talent of our workforce, which we broadly expanded.

Against this backdrop, update looks forward to 2006 with both confidence and focus. On the one hand, competitive conditions will continue to intensify; on the other hand, we will see positive developments in our target markets. However, most important in 2005 – and this applies equally to 2006 – was securing both our operating profit and the sustainable, long-term strategic success of the company. We see ourselves as well-positioned to continue to do so in the future as well.

You have given us your trust as a shareholder or customer or have worked hard to contribute to this as our partner or employee. For this I would like to sincerely thank you on behalf of the entire update team and the Management Board.

Thomas Deutschmann

Report of the Supervisory Board

The 2005 financial year just ended was strongly characterised by growth for update. The company attained revenue growth of 21 %, while at the same time ensuring solid profitability. As a result, additional major milestones for the company's successful future were reached in 2005. The first notable milestone was the successfully executed capital increase, which was heavily oversubscribed. This shows very clearly that the capital markets are acknowledging the company's positive development. In addition, the Polish CRM company Process4E S.A. was acquired in the course of update's expansion in Eastern Europe.

The company's strategy of focusing on specific industries was also continued. In October 2005, update presented an offer to purchase REGWARE GmbH, a leading German provider of CRM solutions in the pharmaceutical and healthcare field. REGWARE agreed to the acquisition in January 2006.

A change in the composition of the Supervisory Board can also be reported. At the 2005 ordinary shareholders' meeting, Mr. Richard Roy was elected as a new member of the Supervisory Board.

The Supervisory Board thanks the Management Board and all employees for their hard work and their loyal co-operation. The development and situation of update software AG was discussed in regular meetings between the Supervisory Board and the Management Board in the 2005 financial year. The Supervisory Board performed the duties entrusted to it under the law and the Articles of Association based on this continual exchange of information.

These 2005 annual financial statements and the accompanying management report were audited by Deloitte Wirtschaftsprüfungs GmbH, Vienna, Austria. The audit gave no grounds for an objection and an unqualified audit opinion has been issued.

The Supervisory Board is in agreement with the annual report submitted by the Management Board for the 2005 financial year and the proposed distribution of profits. The annual financial statements are thus adopted pursuant to Section 125(2) of the Austrian Stock Corporation Act.

Based on the development to date, we are confident that update will be able to continue its successful growth strategy.

Vienna, 26 April 2006

Frank Hurtmanns
(Chairman of the Supervisory Board)

Hans Strack-Zimmermann
(Deputy Chairman of the Supervisory Board)

Richard Roy
(Member of the Supervisory Board)

Company Information

update software AG, founded in 1988, is one of the leading European providers of software-supported customer relationship management (CRM). The company has its headquarters in Vienna with subsidiaries in Germany, Switzerland, the Netherlands, France, Hungary, Poland, and the Czech Republic. Furthermore, update is represented by established partners throughout the world.

The CRM Success Factor

CRM is a strategy that supports companies in gaining customers – primarily with the aid of software – in order to subsequently develop a long-term and mutually profitable customer relationship. Customers are a company's most valuable resource. The strategic significance of CRM directly arises from this fact: The identification of lucrative or potential customer segments makes it possible to pool one's own essential resources.

In the wake of general globalisation and consolidation of business models, one's own diversification becomes increasingly important. Vertical process depth as the decisive component grows in significance, since a "one-size-fits-all" approach thwarts the real situation in terms of demand. This trend will continue to intensify. In order to satisfy this demand, update software AG has been delivering industry-specific solutions for companies in the fields of pharmaceuticals, financial services, construction and construction suppliers, manufacturing, consumer goods, capital goods, and the media for many years. The update Competence Centers for Financial Services and Pharmaceutical/Healthcare reflect the company's focus on selected industries.

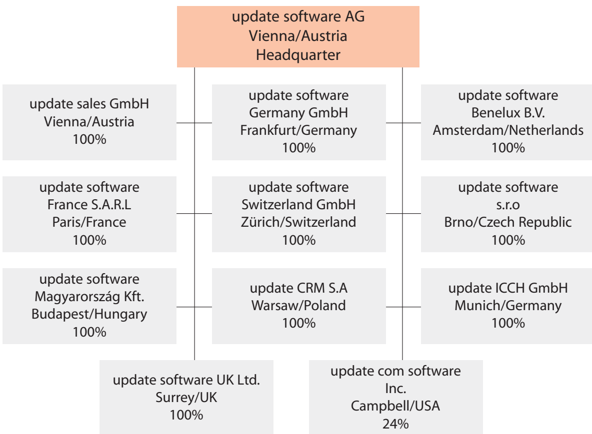
Our ability to offer customer relationship management in individual industry models and our ability to understand our customers' strategies and mutually implement them constitutes an essential factor for rapid success. The flexibility of the update CRM solution with its short implementation time represents the ideal basis for the optimal cost-benefit ratio for customers.

With various but always compatible access channels such as Windows, the Web, PDAs, smart phones, and Blackberry devices, update offers a complete CRM suite with innovative and extremely user-friendly interfaces for the use of all CRM functions for marketing, sales, and services. In addition, all functions as well as "on demand services" can be offered in the form of a leasing model (update's readyCRM). In this connection, the flexible update solution is the right partner for dynamic companies that are faced with new challenges on a daily basis.

As a European manufacturer, update places great value on local customer needs and now makes CRM software available in 21 languages. Innovation and continual further development are particular matters of concern for the company. In all this, the continued goal for the future is to never lose sight of leading industry standards, upward compatibility of implementations, as well as the principle of minimal migration and training expenses.

Alongside positive customer feedback, update's CRM approach has been confirmed by its winning the coveted ISM CRM Software Award. Since 1992, this award has been conferred by ISM Inc., a U.S. research and advisory company specialising in CRM issues. With the 2005 accolade, update won its eighth consecutive ISM award.

Company Structure



The United Kingdom subsidiary was closed in January 2003.

Performance Figures at a Glance

(EUR million)	2003	2004	2005
Sales revenue	13.648	15.369	18.600
EBIT	0.102	2.313	2.053
EBIT margin (in %)	0.7	15.0	11.0
Net profit for the year	-0.419	2.605	2.874
Cash and cash equivalents	4.119	5.756	7.686
Cash flow	+0.634	+1.637	+1.930
Shareholders' equity	4.197	6.849	12.236
Employees	120	128	160

Customers and Partners

update Customers

Since 1988, update software AG has conducted research and development of industry and process-based standard software for marketing and sales management for integrated support of its customers' CRM strategies. Since the early years, a multitude of customers have been among the satisfied users of update's CRM solution. Further development is based upon close and continuous dialogue with customers. The customers appreciate this close contact and, with their apparent and stated success, have contributed to the significant increase in the number of new customers in 2005.

As part of numerous international projects, customers benefit from transparency during the entire customer relationship management cycle. With currently over 900 customers and 100,000 users (including customers of the acquired REGWARE GmbH) in international companies, update is one of the leading European solution providers for customer relationship management (CRM).

Even if CRM is today often regarded as a "corporate function" and is positioned as a standard management tool, the vertical process depth increases in significance. For years, update has been meeting this demand by delivering industry-specific solutions. The ability to offer customer relationship management in individual industry models and to implement strategies together with customers constitutes another essential factor for rapid and mutual success.

2005 was a very successful year for update with more than 80 new customers and 16,000 new users. In addition to this, many existing customers migrated to the current version of marketing.manager or further expanded their use of the solution.

From the pharmaceutical and healthcare industry, companies such as ALK-Abello A/S (Denmark) or WALA Heilmittel GmbH (Germany) are among our new customers. In this industry, the project with ratiopharm is worth noting in particular. The ratiopharm group is one of the leading international generic drug suppliers and the most-often used medication brand in Germany, with world-wide revenue of EUR 1.459 billion (2004). Approximately 600 internal and external sales and marketing employees at ratiopharm in Germany work with the update Pharma CRM system. In a multi-level selection procedure, the update CRM solution was able to beat out numerous competitors.

"We were a panel of around 20 specialists and yet our decision was unanimous. update has three key advantages: it's a sophisticated, but standard CRM solution for the pharmaceutical industry. However, we were able to tailor this pharma/OTC solution to our specific needs with very little time and effort. update clearly offered the best value for our money." Stefan Langthaler (Head of Distribution Systems), ratiopharm GmbH, 2005.

From the media industry it was, for example, Braunschweiger Zeitungsverlag (Germany), Immobilien Scout GmbH (Germany), or Verlag Dashöfer GmbH (the Czech Republic, Cyprus, Germany). The Bild newspaper group, which belongs to Axel Springer AG and which was acquired as a customer in late 2004/early 2005, similarly is among update's most notable projects. The project encompasses the implementation of the marketing.manager system on 300 workstations in the advertising department at the Bild newspaper group in conjunction with Sensix IT Solutions. The rollout of the new CRM system is intended to improve customer-related processes in the newspaper group's advertising department, and reduce and eliminate system crashes in the production process.

"The CRM solution from update, combined with our expertise in media, gave us the opportunity to develop a true, forward-looking industry solution that we have jointly marketed with great success to date." Nicholas Pöschl (Managing Director), Sensix IT Solutions GmbH, 2005.

From the areas of industry, services, and construction, companies such as Robert Bosch Kft (Hungary), Industria Technische Verlichting B.V. (the Netherlands), Thyssen Krupp Xervon (Germany) or De Dietrich Thermique (France) have chosen the update CRM solution. Stahlton Bauteile AG was also acquired as a new customer. This Zurich-based company offers innovative solutions with supplementary components for masonry and exterior insulation. In addition to manufacturing, delivering and installing the products, the company renders comprehensive services for structural engineers, architects, building contractors, and the building material trade. An essential goal pursued by Stahlton Bauteile AG with the implementation of the update CRM system is the optimisation of the sales process.

"All customer-related processes to include contact – and lead management in marketing, sales and service are documented exclusively in the marketing.manager allowing for easy understanding and user-friendly access. update recognizes the challenges and strives to provide industry-oriented solutions." Beat Meier (Head of Marketing/Sales), Stahlton Bauteile AG, 2005.

Examples of projects with new customers from the financial services sector include GZS Gesellschaft für Zahlungssysteme (Germany) and the Capital Invest Kapitalanlagegesellschaft mbH (Austria) and projects with existing customers include HVB Bank Hungary Rt. (Hungary) or the BAWAG P.S.K. group (Austria). The project with BAWAG P.S.K., the fourth largest banking group in Austria, encompasses the introduction of a new marketing database – marketing.manager for financial services – in all of the group's branch offices. In a fully Web-based variant specially developed for the financial services sector, the CRM system replaces the previous marketing database in 1,300 Austrian post offices in order to strengthen the role of the BAWAG P.S.K. group as the leading retail bank in Austria.

"We were already convinced of this promising solution in 2000 and have therefore deployed marketing.manager in BAWAG's offices." Herbert Legradi (Management Board Director), BAWAG P.S.K., 2005.

Awards
Two update customers received three prizes at the renowned CRM Best Practice Award at the CRM expo 2005 in Nuremberg, Germany. In the "medium-sized enterprises" category, the German Imparat Farbwerk Iverson & Mähl GmbH & Co. KG received first prize and was honoured with a gold award. In the "business-to-business" category, the silver award was conferred to Schülke & Mayr GmbH, a manufacturer of hygiene and infection prevention products in Norderstedt. Among the first place winners in the three prize categories for the CRM Best Practice Award, the jury awarded an additional grand prize: the competition's "Best-of-Best Award" went to update's customer Imparat, the winner in the medium-sized enterprises category. In their rationale, the jury gave special attention to the 2005 focus topic of the CRM Best Practice Award: "CRM – what employees actually implement."

"Today, the customer is actually our source of added value. The numbers prove that Imparat's K.I.M. (communication information marketing) strategy adds up: in 2005, Imparat's revenues as well as customer contact frequency increased significantly, and new client acquisition has increased 7-fold within one year." Torsten Oberhardt (Sales Director), Imparat Farbwerke Iversen & Mähl GmbH & Co KG, 2005.

update Partners

The rapid expansion of globalisation and shortened cycle times in many industry sectors create outstanding growth opportunities for update software AG. But they also pose very high demands with regard to fast and flexible project implementation in an international environment. In addition, there is an increasing importance of industry-specific processes that require deep insight into the target market with its respective local characteristics.

For years, update software AG has successfully expanded its partner business. The company is convinced that combining the local market insight of a partner on-site with the experience of a European software manufacturer offers tremendous benefits to the customer. Instead of an outdated and conflict-ridden model of competing direct and indirect distribution channels, update has opted for an intelligent collaboration with partners based on co-operation and trust.

By selecting competent partners, the company can satisfy the posed demands at any time. The strategic collaboration with global partners such as Atos Origin, Columbus, Hewlett Packard, IDS Scheer or Siemens Business Services on the one hand, as well as strong regional and local partners such as Part (D), Synergon (HU), Bluedesk (Benelux), Lumena (PL), Axians (F), CS Compex (CZ), Custium (DK), Gruppo Formula (I), Sputnik Consulting (RU), SRC (SLO) or Acom and Sensix (A + D) on the other hand, provides the right solution for every customer and every CRM project. The partners offer the customer a reliable base in nearly all European countries and many other regions of the world. A complete list of update partners can be found on the update software AG website.

update's partners in Europe

Building on sophisticated core processes, the collaboration between update and its partners is tailored to the requirements of each case. A comprehensive training and certification program, close project collaboration, and an intensive co-ordination of business plans ensure a sustainable and high quality co-operation (alliance management). This makes it possible to guarantee update's customer an efficient implementation of projects and reliable support at all locations.

update Events

CRM-expo 2005
The CRM-expo has been the most important CRM event in Europe since 1999. In the course of two days in November 2005, corporate decision makers and users met with suppli-

er experts and specialists. The event was marked by action and interaction during rounds of talks about software tests and software competitions as well as panel discussions, the presentation of studies and expert reports up until the annual climax of the program – the bestowal of the coveted CRM Best Practice Award. As part of the CRM-expo, update organised its second "construction" industry day. Representatives of update customers and prospects discussed "Best Practices Approaches" for CRM strategies in the construction and building supplier industry. The exchange of practical experiences was of particular value to participants and created identification with update's solution competence in this specific industry.

CRM Solution Day 2005

The 6th CRM Solution Day – update's own international CRM trade fair – took place in October. More than 500 visitors from across Europe convened in Vienna in order to learn about the latest trends and information on customer management from top-class opinion makers and experts such as, for example, Prof. Reinhold Rapp or Wolfgang Mantler (Canon GmbH Austria). In addition, the "update Customer Excellence Award" was awarded in four categories: it went to Farbwerke Imparat (Germany), Meuùs (the Netherlands), 3M Hungary (Hungary), and the Donau-Universität Krems (Austria). The 18 real-world oriented lectures focused in particular on topics such as the successful execution of CRM projects, the development of a consistent CRM model for a decentralised, international organisation, and the return on investment from CRM projects.

Pharma Sales Force 06

The Pharma Sales Force 06 took place in Frankfurt/Main in December 2005. As the main sponsor of the event, update welcomed renowned customers and prospects such as, for example, Hermal, Astra Zeneca, Schering, Lunbeck, and many more. Presentations at the two-day conference were devoted to innovative and efficient CRM solutions in pharmaceutical sales. A special highlight was the presentation of the update ICCH (International Competence Center Healthcare).

TCD

update also took part in the Telecommerce Dagen (TCD) in April 2005 in Utrecht (the Netherlands) as an exhibitor. The event took place for the sixth consecutive time and is oriented towards solutions portfolios of contact centres, CRM, direct marketing, and e-marketing. The event was used to consolidate one's own relationship marketing approach. Furthermore, it was a good opportunity to personally assure oneself of update's capabilities.

update University

An additional asset for customers and partners is update University, which offers training and know-how for update's CRM solutions and products. The customised education and training plan is based upon a detailed needs analysis that is jointly prepared with the respective customer and/or partner. The courses are integrated into the work process and accompanies both the project and the product life cycles, which gives the customer an even faster return on investment, higher growth rates, and consistently higher user productivity.

update's internal CRM Strategy

update not only sells leading CRM solutions for various industry requirements; it also deploys its own products. All company employees work with the update CRM solution that is at the same time an industry solution for the IT services industry.

This way, all processes of the various departments are available in the system and ensure a complete customer view and support the entire process from initial contact, through lead management, up to becoming a customer with the account management and ongoing monitoring activities required here.

update's internal solution has existed since the beginning of the company and has always been migrated to each new version before it became available, which enhances the process coverage. This gives the customer the benefit that update itself deploys the solution in all departments – sales, marketing, professional services, product management, or research and development – and obtains valuable feedback for further developing the solution.

An important characteristic is the fact that the update management team uses the CRM solution and personally gains the insights required in order to guide the company.

"With our own CRM system, I'm able to obtain up to-the-second information on our business development no matter where I am. A scheduled meeting with a customer does not require lengthy briefings since the information is transparently available in the system." Monika Fiala (CFO), update software AG, 2005.

Capital Market

2005 was marked by a broad upturn in the international stock markets. Of the leading markets, Japan in particular stood out. The Dow Jones, the American leading index, showed a slight decline in 2005, dampened by both interest rate increases by the US Federal Reserve and rising energy prices.

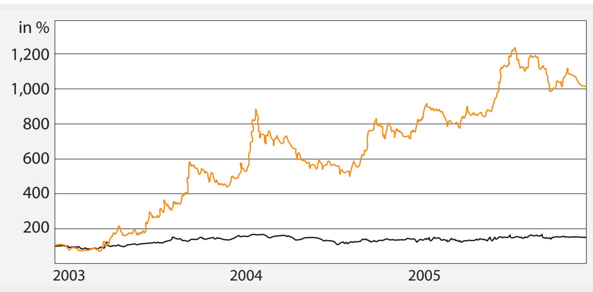
The European markets performed very well in the year just ended. In particular, the German stock market outperformed in 2005. The market was primarily driven by the early federal parliamentary elections, improved economic prospects for Germany, and low interest rates in Europe.

update's Share

Listing	Deutsche Boerse (General Standard segment) as well as local German stock exchanges
IPO	11 April 2000
Type of shares	no-par shares
ISIN	AT0000747555
WKN	934523
Ticker symbol	UP2

Shares of update software AG performed very well in the general climate described above. The share rose by 37.3 % in 2005 (based on XETRA) and with that also outperformed the standard German technology indices (TechDAX, Technologie All, Prime Software). Liquidity (XETRA and Frankfurt) also increased further. The annual exchange trading was approximately EUR 51 million, an increase of 259.1 % compared with 2004 (approximately EUR 14 million). On average, about 59,000 shares were traded per day in the 2005 financial year (2004: about 23,000 shares per trading day). All in all, this performance shows that the stock market is also acknowledging the positive development of update software AG.

Development of the update Share 2003 - 2005



Figures at a Glance

	2003	2004	2005
Number of shares	9,381,967	9,381,967	10,320,163
Market capitalisation at year's end	EUR 14.542 mio.	EUR 23.924 mio.	EUR 36.843 mio.
Price at year's end	EUR 1.55	EUR 2.55	EUR 3.57
Annual high	EUR 1.99	EUR 3.10	EUR 4.37
Annual low	EUR 0.26	EUR 1.52	EUR 2.53
Earnings per share	EUR -0.04	EUR 0.28	EUR 0.28
Price-earnings ratio	N/A	9.1	12.8
Price-to-book ratio	3.5	3.5	3.0

Quotation of prices and market capitalisation in accordance with XETRA; P/E ratio: price at year's end.

Capital Increase

In February 2005, update executed a 10 % capital increase with 10:1 subscription rights. The goal was the continued financing of the adopted expansion strategy. 938,196 new shares were placed with private (40 %) and institutional (60 %) investors at a subscription price of EUR 2.61 per share. The proceeds from the capital increase totalled EUR 2.449 million. The issue was oversubscribed by a multiple.

In December 2005 the Management Board decided to utilise the contingent authorised capital approved at the ordinary shareholders' meeting on 2 June 2005. This contingent capital increase was intended to service the employee share option plan, which means that the share capital may increase over the next few years by a maximum of EUR 1,032,016.00, or 1,032,016 shares, depending on the conversion of the options to shares by the employees.

In the next five years, the following number of options will become vested:

Until 2005	In 2006	In 2007	In 2008	In 2009	In 2010
235,234	260,383	282,171	264,438	86,533	10,812

Investor Relations

The basic principle of update's investor relations activities, which consists in conducting an open and continuous dialogue with shareholders and future investors, continued to be heeded in 2005. In this regard, detailed quarterly reports were prepared, regular meetings were held with journalists, press releases and ad-hoc announcements were published, the information available on the website was improved, and analyst and investor talks were conducted. The increased number of road shows conducted in the last financial year gave update the opportunity to present itself to the financial community in Frankfurt, Hamburg, Linz, Vienna, and Zurich. The attendance of update at the equity capital forum in Germany in November 2005 was also used to speak with journalists and analysts as well as to conduct one-on-one discussions with potential investors. All in all, there is a growing international interest in the update share. The road show in Paris in February 2006 is also worth mentioning in this context.

2005 Ordinary Shareholders' Meeting

The ordinary shareholders' meeting took place on 2 June 2005 and for the first time at TechGate Vienna. There were 1,617,962 voting shares present. The shareholders approved all agenda items that were put to the vote either unanimously or with a majority. The shareholders' approval of authorised contingent capital for servicing the employee share option plan, which has existed since 1999, as well as the authorisation of the Management Board to increase the capital with approval of the Supervisory Board by up to 50 % until 31 May 2008 were among the important outcomes of this meeting. Additionally, Mr. Richard Roy was elected as a new member to the Supervisory Board due to the departure of Mr. Gilbert Hödl.

Market and Industry Sector

The software markets showed signs of recovery in 2005. The world-wide stagnation in capital spending could not persevere because companies did not wish to miss out on the now booming markets in Asia, Eastern Europe, South America and – to a limited extent – North America.

After past unrealistic expectations, followed by general pessimism, companies have now accepted that a co-ordinated CRM strategy is a critical corporate task. Based on these indicators, analysts expect overall growth in the market for CRM software, services and maintenance of between 5 to 6 % annually for the next two years. Considered in isolation, various market analysts expected world-wide revenue growth in CRM software licenses of USD 1.2 billion in the 2005 reporting period. A moderate average growth rate of 3.7 % is expected in this field until 2010, strongly influenced by economic momentum, economic upturn and consumer behaviour.

Providers of dynamic total CRM solutions that grow with corporate demands will enjoy the greatest and most sustainable market success in this respect. Only those who manage to succeed in most parts of the necessary mix of customer intimacy, industry expertise, modularity, user-friendliness, integratability and price sensitivity, together with technological leadership and scalability, will be able to establish themselves successfully over the long haul in the hard-fought CRM market.

Competitive Environment

The competitive environment in 2005 was primarily characterised by the following three factors:

Firstly, the idea of offering "software as a service" under the name "on demand" was positioned with great media publicity in the market for small and medium businesses (SMB). In this context, it was often observed that the lack of verticalisation in such solutions, as well as their often insufficient process depth and maturity, resulted in customer turnover balancing out new entrants. An additional increase in the number of providers of such lease models is expected, although this is usually viewed as an additive or temporary solution for customers with few employees or lacking sufficient infrastructure.

Following Microsoft's hitherto rather restrained entry into the CRM market, the introduction of a new version of its CRM solution will likely garner greater attention for Microsoft in the European market as well. Indicators corroborating this assessment are Microsoft's high degree of name recognition and vast resources, as well as its desired repositioning together with the integration into its office applications. However, the manufacturer's verticalisation strategy, which remains unexecuted to date, together with the restricted functional depth, could undermine its success.

In addition, market consolidation continues in the software market in general and in the CRM market in particular. More than 20 providers of CRM solutions were taken over in the 2005 reporting period alone. Both true industry specialists as well as additive-functional providers were acquired in order to advance the medium and long-term success of promising specialisation on the one hand, and to close gaps in the portfolio through targeted acquisitions on the other hand. A smaller number of providers with higher aspirations has changed the nature of the competition and greatly intensified it in many fields.

Market Trends

Processes with in-depth Industry Focus
The dominant trend that has long characterised the field of CRM is without a doubt its explicit focus on specific industries.

Horizontal, generic solutions only work for companies that have few industry-specific characteristics or whose processes appear less well pronounced. Every company that understands and uses CRM as a critical corporate strategy will be bound to identify and optimise each customer-relevant process and implement it within the CRM solution. This requires highly qualified industry specialists who know and understand the respective requirements of the industry and its problems. This is the only way to ensure long-term success of CRM projects.

Process Mobility
The looming trends concentrate on the essence of a customer relationship management system – the user. Everything that facilitates the day-to-day work for these users will increasingly come into play. In this connection, the triumph of mobile end devices such as PDAs, smart phones, and in particular, the Blackberry play an important role. As a consequence of expanding 3G networks, combined with steadily falling connection costs – not least due to an oversupply of flat rate offers – users are becoming able to access their Internet infrastructure almost anytime and anywhere.

Field sales employees in particular are developing a vital interest in the ability to access the most recent data on every CRM process while away from the office. This ability will be increasingly demanded from providers of CRM software. A leaner client for all mobile end devices, which is more flexibly adaptable to the various needs of users and processes, will therefore more often represent an exclusion criterion for all serious CRM providers wishing to enter the market with a complete product portfolio.

Process Analysis
CRM makes it possible to increase both customer satisfaction and customer profitability. The link between these two tasks, which is often missing, is increasingly created in customer relationship management by using an analytic approach. The solutions prevailing to date were mostly company-wide, universally deployable business intelligence solutions which, while very powerful, are also relatively cost intensive to procure and adapt to CRM requirements – the majority of which only require a fraction of the functionality offered – and also costly to maintain.

The integral analytical tools of a CRM solution are better because they are explicitly developed for the demands placed on analytical CRM. Driven by the diverse analyses and reporting tasks during a customer relationship cycle, it is necessary to create a balance between function and utility. To do this, OLAP and data warehouse based analytic CRM tools are necessary, which, however, need to be seamlessly integrated in the company's process flows and must be usable at all times.

Process Usability
The increased demand for a high degree of user friendliness, especially with complex software products, is clearly identifiable. This applies particularly to critical CRM solutions, as a rapid and efficient interaction is extremely important here. New technologies such as AJAX (Asynchronous JavaScript and XML) combined with invested usability expertise relieve software development of these continually recurring requirements. Concentrating on the core process requirements allows for a transparent usability philosophy and results in a considerable reduction in training expenses. Exemplary user friendliness without cutting back on functional diversity can therefore make the decisive difference between being in the middle of the pack and market leadership.

Business Performance of update software AG

The company is the group headquarters and is responsible for strategic activities such as planning, research and development, marketing, corporate finance and investor relations.

Sales revenues consisted essentially of royalties and service charges with subsidiaries and totalled EUR 7.738 million, which corresponds to an increase of 8.3 % compared to 2004 (EUR 7.145 million). The result from ordinary business activities declined from EUR 2.631 million in 2004 to EUR 2.227 in 2005, primarily through increased staff costs due to staff additions.

The accumulated deficit from the previous year totalling EUR 3.563 million was reduced to EUR 1.456 million through the net profit generated in 2005 totalling EUR 2.107 million.

As of the end of 2005, shareholders' equity was EUR 10.578 million (2004: EUR 6.022 million), which represents an increase of 75.7 % year-on-year. This enormous rise was a result of the capital increase (EUR 2.449 million) carried out in February on the one hand, and the net profit for the year of EUR 2.107 million.

Business Performance of the Group

Change in Accounting Standards

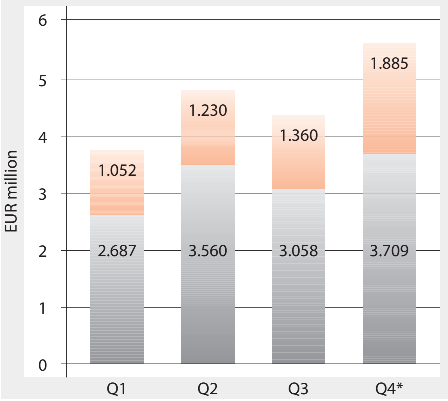
As of 01/01/2005, update software AG has been conducting its accounting pursuant to the principles of the International Financial Reporting Standards (IFRS). EU Regulation 1606/2002 requires publicly traded companies, with some exceptions, to prepare and publish their consolidated accounts as of 2005 under the IFRS [formerly, International Accounting Standards (IAS)]. The amounts of the resulting differences from US-GAAP (up to 31/12/2004) at update software AG, with the exception of the expenses for the existing employee share option plan, are considered insignificant. Under IFRS, the employee share option plan resulted in an additional expense of EUR 0.113 million for the 2005 financial year.

Sales Revenue

update software AG increased its consolidated sales revenue in 2005 by 21.0 % from EUR 15.369 million to EUR 18.600 million. This is the second-highest total revenue in the group's history. This encouraging development is due to the above-average growth of all sales segments (licenses, services and maintenance).

Maintenance revenues increased by 5.7 % and service revenues jumped by 51.1 %. The 16.5 % increase in licensing revenues is above the growth rate for the global CRM market forecast by analysts and market experts for 2005 and allows the conclusion that update software AG further expanded its market positions. It must also be mentioned that the largest portion of total revenue is attributable to licensing revenues.

With the end of 2005, update has now continued its growth course for the 10th quarter in a row – in relation to each corresponding prior-year quarter – which resulted in the following for the financial year just ended: Total sales revenue was EUR 3.739 million in the first quarter of 2005, an increase of 6.4 %. In the second quarter, EUR 4.790 million was earned, an increase of 22.0 %, and EUR 4.418 million (+ 16.5 %) in the third quarter. Sales revenue climbed by 36.6 % in the fourth quarter to EUR 5.653 million and is the highest in update's history since the fourth quarter of 2000. When examining quarterly sales, it should be noted that the first and the third quarters are traditionally the weakest in the software industry.



Revenues 2005

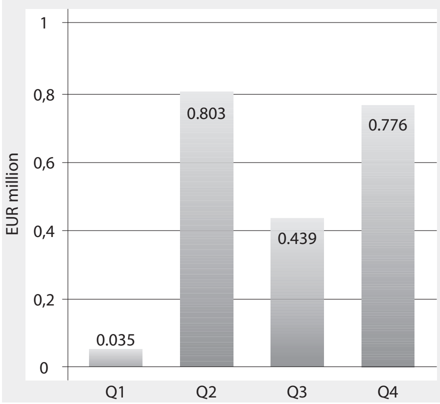
The sales revenue was increased by 21.0 % compared to 2004.

**excl. other revenues of EUR 0,059 million*

Finally in this connection, the more than 80 new customers gained and the more than 16,000 new users (including the users from 2005 projects for existing customers) ought to be mentioned, which impressively underscores the sales trend yet again.

Earnings Performance

Operating income (EBIT) at update software AG totalled EUR 2.053 million in the 2005 financial year. The approximately 11 % decline in operating profit compared to 2004 (EUR 2.313 million) is attributable on the one hand to expenses for the one-time restructuring of customer support (Solution Center) of EUR 0.128 million, and on the other hand, to expenses related to the employee share option plan of EUR 0.113 million incurred through the mandatory change in accounting standards (see "Change in Accounting Standards") from US-GAAP to IFRS. Until the end of 2004, update software AG had disclosed the corresponding annual expenses of the employee share options in the notes to the financial statements in the pro-forma earnings. As of 1 January 2005 however, these accounting expenses flow directly into the operating profit. Adjusted for these two effects (EUR 0.241 million), 2005 EBIT was EUR 2.294 million and corresponds to a marginal decline of 0.8 % from 2004.



Operating income 2005

The EBIT 2005 declined by 11.2 % compared to 2004. The EBIT includes expenses for the one-time restructuring of customer support and expenses related to the employee share option plan.

It must be noted in this context that relevant outlays were made in sales, marketing and professional services to attain the revenue growth in the 2005 financial year just ended. In the service division in particular, the number of employees was increased in order to continue to be able to guarantee customers the highest level of service despite further strong growth. Additional employees were also hired for research and development to further expand the performance of the product suite and the high technological level of update's products (see "Research and Development"). These "investments" also created the basis for the growth planned in 2006.

In addition to the effects already mentioned, this resulted in an increase in operating expenses of 26.7 % to EUR 16.547 million compared to 2004. This increase is essentially attributable to the 25 % increase in staff as well as a sharp increase in subcontractor services. Sales and marketing expenses also increased by 20.8 % to EUR 5.760 million. With an increase of 0.6 % to EUR 1.952 million, administrative expenses were held to approximately the prior year's level. Expenditure for research and development climbed by 8.4 % to EUR 3.127 million.

2005 cost structure (EUR million)	Q1	Q2	Q3	Q4	Total 2005
Cost of goods sold	1.138	1.360	1.404	1.804	5.706
Sales and marketing	1.314	1.333	1.384	1.730	5.761
Research and development	0.773	0.810	0.746	0.799	3.128
General administration	0.479	0.485	0.445	0.543	1.952
Total expenses	**3.704**	**3.988**	**3.979**	**4.876**	**16.547**

The cost of goods sold, which also include the personnel expenses for implementation services and costs for subcontractor services, totalled EUR 5.706 million, an increase of 65.0 % compared to 2004, resulting in a gross profit of EUR 12.894 million.

Despite the increased operating expenses, earnings before taxes (EBT) declined by only 6.4 % to EUR 2.210 million. The primary cause for this was higher interest income due to increased cash on hand.

The capitalisation of deferred taxes resulted in a total tax income of EUR 0.664 million for the 2005 financial year, which in turn resulted in an annual profit of EUR 2.874 million. This corresponds to an increase of 10.3 % over prior-year earnings.

Profitability indicators (in %)	2003	2004	2005
EBIT margin	0.7	15.0	11.0
Profit margin	N/A	16.9	15.5
Return on investment	N/A	22.4	16.0
Return on equity	N/A	38.0	23.5

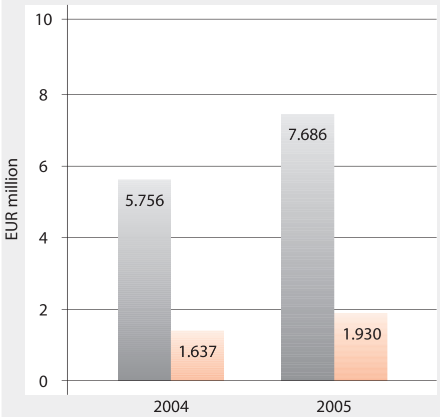
Balance Sheet

Total assets of update software AG were EUR 17.942 million as of 31 December 2005. Compared to EUR 11.610 million at the end of 2004, this corresponds to an increase of 54.5 %.

Balance sheet structure (EUR million)	2004		2005		Difference from prior year in %
	Absolute	in %	Absolute	in %	
Assets					
Current assets	10.646	91.7	15.097	84.1	+41.8
Non-current assets	0.964	8.3	2.845	15.9	+195.1
Equity and liabilities					
Current liabilities	4.078	35.1	5.253	29.3	+28.8
Non-current liabilities	0.683	5.9	0.453	2.5	-33.7
Shareholders' equity	6.849	59.0	12.236	68.2	+78.7

Assets

The rise in current assets resulted on the one hand from the 33.5 % increase in cash and cash equivalents (as of the end of 2005: EUR 7.686 million), which was due to the positive development of the company's business (operating cash flow EUR + 1.446 million) as well as the capital increase. Cash on hand was reduced by the payment of the purchase price in the course of the acquisition of Process4E S.A., as well as the early repayment of a bank loan. With regard to cash and cash equivalents, it must be mentioned that, in addition to a certain safety function, the increased balance is intended for additional expansion and growth.



The liquid assets were increased by 33.5 % compared with 2004.

On the other hand, the change in current assets was affected by the increase in trade accounts receivable (+39.2 %), which exceeded both the 2004 closing balance and the balance at the interim quarterly closing dates due to the strong fourth quarter in 2005.

Non-current assets increased due to adjustments to deferred taxes, which increased by EUR 0.774 million, and to the "Intangible assets and goodwill" account. This account was adjusted to reflect the capitalisation of the goodwill from the acquisition of Process4E S.A. as well as the re-implementation and improvement of the internal CRM system.

Equity and Liabilities

The change in current liabilities compared to 2004 can be explained primarily through the increase in the "Provisions and other liabilities" account. This account contains the increased provisions for personnel expenses due to the increase in staff, the provision for expenses from the restructuring of the customer support (Solution Center), as well as the provision for the portion of the purchase price for Process4E S.A. still outstanding.

In addition to the net profit for the year of EUR 2.874 million, the increase in shareholders' equity by 78.7 % to EUR 12.236 million resulted from the 10 % capital increase carried out in February 2005, when 938,196 new shares were issued at a subscription price of EUR 2.61 per share.

Balance sheet performance indicators	2003	2004	2005
Equity ratio	48.0	59.0	68.2
Days sales outstanding	66	63	60
Working capital (EUR million)	4.264	7.019	11.069

Acquisitions

The Polish CRM consulting and sales company Process4E S.A. (update CRM S.A. since November 2005) was acquired in March 2005. The strategic objective of this acquisition is for update to become the market leader in Poland within the next three years. The net purchase price totalled around EUR 1.100 million, payable via a three-year earn-out model.

Capital Expenditures

To further optimise the sales and organisational processes, the internal CRM system was adjusted in 2005 to meet the company's growth requirements. In so doing, expenses of EUR 0.126 million were incurred which, as already mentioned, were capitalised as internally generated assets.

Expenditures for improving the IT infrastructure and acquiring hardware and software totalled EUR 0.163 million.

Reorganisations

The previous Solution Center (customer hotline) in Germany was closed at the end of the year and integrated into the existing quality assurance and support team at headquarters in Vienna (Austria). This action will permit further improvements in quality and response speed due to the physical proximity to the development and testing department. The one-off restructuring expenses were EUR 0.128 million.

Employees

As of 31 December 2005 the company had 160 employees (including freelancers), compared to 128 employees at the end of 2004, which corresponds to an increase of 25.0 %. As an annual average, this was 149 individuals, who generated sales revenue of EUR 0.125 million (2004: EUR 0.128 million) per employee. The marginal decline of 2.0 % can be explained by the fact that new employees in revenue-generating positions reach the appropriate productivity level only after a certain break-in period (training, product expertise etc.). The integration of the Polish subsidiary acquired in 2005 must also be taken into account in this connection.

Highly qualified employees represent a software and service company's most valuable asset. For this reason update expanded its team in 2005 to include a human resources manager dedicated to employee development. Expenditures for training and continued education must also be mentioned in this regard, which totalled EUR 0.070 million in the financial year just ended (2004: EUR 0.018 million). Additional measures are planned in the area of employee retention to reduce the current turnover rate (based on full-time employees) of 22.0 %.

Employees	2004	2005	Difference in %
Research and development, product management	42	50	+19.1
Sales, marketing and services	68	88	+29.4
Administration	18	22	+22.2
Total	**128**	**160**	**+25.0**

Research and Development

The 2005 financial year was particularly eventful with regard to new products and new releases. update presented fundamental enhancements to the product suite extending beyond the periodic release of service packs during the reporting period and in April 2006 will present the all new major release, update.seven.

The first quarter of 2005 saw the launch of the "X-Pack" (eXtended Service Pack) release of update.web 3.0, whose extensive functional enhancements can be used by existing customers without any migration cost. As with the complementary "X-Pack" release of update.win already launched in December 2004, the substantive emphasis is on process visualisation and information compression as well as the integration of reporting and analysis functions into the day-to-day processes.

An additional focus in research and development was the availability of the off-line client for update.web in the summer of 2005. Users now have the exact same CRM processes available off-line, with an identical browser-based user interface, where online access is not possible due to a lack of network connections, for example in aircraft or areas with poor infrastructure. The sophisticated synchronisation mechanism, which also supports the distribution of individual adaptations, not only guarantees the integrity of the CRM data but also the integrity of the application – and therefore minimises administrative expenses.

An additional new product was made available to customers in the third quarter in spite of the concentration in research and development on the next major release: The update.web services product allows the bi-directional exchange of CRM data based on an international standardised protocol stack (SOAP, WSDL, XML) with a wide variety of external systems – be they ERP systems or quotation configurators – extending beyond system and platform limits. Based on the intelligent, integrated data transformation engine, update.webservices represents an ideal application integration platform.

From the perspective of the research and development department, the absolute high point of 2005 was without a doubt the next major release, which became available to new customers at the end of Q1/2006 under the name update.seven in the classic form as a Windows client almost at the same time as a Microsoft .NET 2.0-based Web client was released. update.seven was presented to the interested CRM community for the first time during the CRM-expo in November 2005 and presented in detail to update partners during the annual partner conference.

In addition to completely new graphical display formats of all CRM relevant interactions via innovative user interface controls, such as for example, a so-called "Timeline Control" and seamless integration of telephony support in the flow of the CRM process, the update.seven release offers new, pioneering concepts with regard to configurability and adaptability in order to further reduce the time-to-solution factor (the period between project launch and productive commencement of operations of a system). At the forefront of this is the dynamically expandable data model that, using update.seven's proven core data model, allows flexible enhancements to be migrated in fewer steps and therefore further increases the adaptability of the solution to industry or customer-specific processes over the long haul. It must be mentioned in this connection that such data model adaptations can be made at any time in CRM projects, as the changed data model can be distributed to all local installations of the update CRM application with the help of proven replication components. And of course all client channels of the update CRM suite can use the changed data model without restriction, i.e. benefit from the enhancements made centrally. update is taking another significant step toward minimising project implementation times by making so-called industry templates available, which can be thought of as bundled industry knowhow. With these templates, update offers the possibility of an additional, even more specific adaptation into a standalone layer that is largely independent of software versions. This is done via the already existing verticalisation through the software. update and its partners, who are invited to share their industry expertise in these templates, are using these templates to address new or subscription customers in particular, who wish to benefit from the tailored CRM packets through ready-made processes and the resulting shorter implementation times. Configurations are managed using a new type of graphical tool – the Cockpit. In addition to the ability to create, export and import configurations, the Cockpit allows system documentation to be generated at the touch of a button. Moreover, customers or systems providers can use it independent of the template technology.

update.seven allows for a cost-benefit ratio that is unique on the market. The total cost of ownership for customers was once again sustainably reduced compared to other providers thanks to the dynamic data model, the highly-developed verticalisation, which is further strengthened by the industry templates, the greater flexibility and the simplification of adjustments due to new configuration tools.

update.seven analytics, a significant component of the suite from REGWARE GmbH (see "Acquisitions") became generally available to update customers with the new update.seven release. update.seven analytics is an integral OLAP and data warehouse component that represents a new dimension in business intelligence for update. The data warehouse component of update.seven analytics combines CRM data with additional sources, such as from the back office, and permits the integration of market data, thus creating a new dimension in the quality of information used as the basis for decisions. OLAP operators are used to offer the user intuitive interactive methods for easy analysis and verification of complex issues. update.seven analytics thus provides effective control mechanisms, for example for increasing the efficiency of customer interactions, and is a perfect addition to operative CRM, while minimising incremental costs and further reducing the total cost of ownership.

Research and development expense was 18.9 % of total expenses, an increase of 8.4 % compared to the prior year.

Events after the Balance Sheet Date

Acquisitions
REGWARE GmbH, domiciled in Germany, was acquired on 10 January 2006. This company (update ICCH GmbH since March 2006) is a leading provider of CRM solutions for companies in the pharmaceutical and healthcare industry. With this acquisition update software AG intends to further expand its leading market position as a CRM provider in the European pharmaceutical and healthcare market. The purchase price of EUR 1.200 million will be financed from update software AG's current cash on hand based on a two-year earn-out model.

Legal Disputes
On 27 January 2006, update received a copy of the decision rendered by the Vienna Court of Appeals (Oberlandesgericht Wien) in the statement of claim requesting payment of EUR 0.705 million brought against update software AG in July 2002. The appeals court remitted the case to the original court of first instance for a new hearing.

Furthermore, on 14 February 2006 update received a statement of claim filed on 31 December 2005 requesting payment of approximately EUR 0.340 million. The plaintiff brought this action based on a license and OEM agreement entered into in August 2000.

Based on information currently available, update's legal counsel believes the outcome of both legal disputes will be favourable to update (see "Notes to the Financial Statements").

Products

The new major release of the update product suite, update.seven, was presented to the market in the first quarter of 2006. The company expects this to make an important contribution to additional growth (see "Research and Development").

Segment Reporting

Holding Company

The holding company has 70 employees, is the group headquarters and is responsible for centralised activities such as planning, research and development, marketing, corporate finance, product management and investor relations. As the holding company does not generate any operating revenues, it does not report any sales revenues in segment reporting. Corporate headquarters is financed from royalties that are charged to the subsidiaries. Due to the positive development of business in 2005, income from royalties increased from EUR 5.282 million in 2004 to EUR 5.891 million in the year under review. However, expenses also increased, in particular for corporate marketing and research and development. This resulted in an operating income of EUR -0.460 million, which constitutes a slight improvement over 2004 (EUR -0.484 million).

DACH

The DACH segment includes the Germany, Austria and Switzerland business units and comprises a total of 54 employees as of 31 December 2005. This segment remains update's largest and was responsible for 73.9 % of consolidated revenue in 2005. Sales revenue was EUR 13.740 million, an increase of 26.0 % vis-à-vis 2004. The corresponding operating income shows an increase of 37.3 % to EUR 1.755 million, compared to the 2004 performance of EUR 1.279 million. The positive development of the company in Germany was primarily responsible for this increase.

The business units in this segment acquired new customers such as ALK-Abello A/S, WALA Heilmittel GmbH, Braunschweiger Zeitungsverlag, Immobilien Scout GmbH, Verlag Dashöfer GmbH, GZS Gesellschaft für Zahlungssysteme mbH, Capital Invest Kapitalanlagegesellschaft mbH, ratiopharm GmbH, Brenntag CEE, Youtility AG and Stahlton Bauteile AG, among others.

CEE

The CEE segment comprises the business units in Poland, the Czech Republic and Hungary and generated sales revenue of EUR 1.589 million with 24 employees (as of 31 December 2005). Sales revenue more than tripled within the past year (2004: EUR 0.524 million). 8.5 % of consolidated revenue came from this segment. The increased share of revenue over 2004 (3.4 % from CEE) shows the increasing importance of this segment. A slightly negative EBIT of EUR -0.243 million (2004: EUR 0.123 million) was generated in 2005. This earnings scenario is not unusual for young, rapidly growing sales markets.

Here too, the individual business units gained renowned companies such as Copacking Service s.r.o., Vasa stravovacia spol. s.r.o., Practilub Kft., Robert Bosch Kft., Unimot and Trodat Polska sp. z o.o. as new customers.

ROE

This segment includes the business units in France, the Netherlands and Business Development, in which a total of twelve individuals were employed as of the end of 2005. An operating profit of EUR 1.001 million (2004: EUR 1.395 million) was earned on sales revenue of EUR 3.272 million (2004: EUR 3.938 million). The decline in revenue (-16.9 %) and lower EBIT (-28.3 %) compared to the previous year are due to a disproportionately large sales order obtained in this segment in 2004.

In addition, the ROE segment gained other interesting new customers such as Boisset, Nox France, De Dietrich Thermique, Visio, Industria Technische Verlichting B.V. and Friesland Foods Professional nv/sa.

Risk Report

As a software company, update software AG is exposed to a number of risks that are inseparably linked with its business conduct. The company's risk management comprises both operative and strategic corporate development. This is taken into account by the ongoing reporting requirements of division and country heads to the Management Board. In addition, Corporate Controlling and the internal legal department perform advisory and monitoring functions. The Management Board discusses operational and strategic business development in regular meetings. The Supervisory Board is also informed about developments in the company in regular meetings. Insurance has been taken out to minimise damage and liability risks.

With regard to the following risk overview, it must be noted that not every single risk can be listed, but rather that this is an overview of the most important potential risks.

General and Industry Risks

Economic Risks
Tight general economic conditions over the long term would have negative effects on the willingness of companies to invest in the purchase and implementation of software products or would delay spending on these products. Particularly in Europe, update's core market, such a development would have a negative impact on business and therefore the company's net assets, financial position, and earnings performance.

Market Risks
The software industry remains in a consolidation phase. While the possibility of a take-over of update by a competitor is possible, it must currently be classified as rather low.

In addition, the strong competition places continuing price pressure on the market, which update is also unable to elude.

Corporate Risks

Strategic Planning Risks
As strategic planning must also plan for future developments in addition to past and current factors, this planning always includes a certain degree of risk. These risks are subject to unforeseeable corporate and market developments and events. In spite of the permanent dialogue with the market, communication with industry experts, use of strategic control mechanisms, close co-operation of the Management Board with the operating company units and the departments, as well as the use of external specialists, update software AG cannot completely avoid these risks.

Customer Risks
update software AG has a broad customer base. For this reason, the company is not materially dependent on any single customer.

Product and Project Risks
The development of software that corresponds to customers' requirements requires long development and test periods, which could result in delays in planned rollouts. In addition, the technological development speed and life cycle of software products require ongoing further development of the products offered. There is also the risk that products contain unrecognised errors. Countermeasures are taken by closely co-operating with customers and a highly developed quality management system.

Implementing software solutions also requires that customers provide resources, on which update has only limited influence. In addition, installation processes contain risks that may entail a protraction of projects, which can negatively impact project costs and customer satisfaction. update counters these risks through structured project management.

Possible warranty and liability risks must also be mentioned in this connection.

IT Risks
This risk arises from the use of computer-supported data processing, information and communications programs, from which damage can result through breakdowns, user errors, viruses and hackers. update minimises this risk by using modern firewalls, encryption and authentication technologies as well as back-up systems.

Personnel Risks
The IT industry is generally deemed to be a personnel-intensive industry and therefore the company's economic success is strongly dependent on the know-how and commitment of its employees. update attempts to attract qualified personnel and create long-time loyalty through various measures such as the employee share option plan or training and continuing education measures. The fact that no personnel shortage currently exists in the labour market also minimises this risk.

Legal Risks
update software AG is exposed to various national legal standards, which give rise to risks for legal transactions. Based on information currently available, the respective legal representatives deem the outcome of the material legal disputes currently pending against update as favourable to the company.

Acquisition Risks
A portion of update's strategy is also based on inorganic growth (Process4E S.A. in 2005 and REGWARE GmbH in 2006). However, an acquisition holds risks with regard to the purchase decision as well as the integration of the acquired company. There is also always the possibility that the expectations placed in an acquired company are not met. update counters these risks through an extensive and careful due diligence, as well as through structured preparation, implementation and monitoring of the take-over and integration processes.

Financial Management Risks

Liquidity Risks
In order for update to be able to fulfil its payment obligations at all times, the appropriate liquidity must be avail-

able. Based on the company's current financial position (earnings performance, cash on hand and the positive cash flow from operating activities), the liquidity risk is limited.

Default Risks
Because update delivers its products on account, the risk exists that bad debts may arise due to customer insolvency. Appropriate receivables management and controlling reduce this risk.

Foreign Currency Risks
As a company operating on an international scale, update is also subject to foreign currency risks. Important currencies in this regard are the Swiss Franc, Hungarian Forint, Polish Zloty and Czech Koruna. However, the majority of transactions are settled in Euros.

In summary it can be said that the total risk to which update is exposed, taking the application of risk management into account, can be viewed as limited and manageable. As of the date this report was prepared, there were no risks jeopardising update's continued existence.

Outlook

The outlook for 2006 must be viewed from at least three perspectives. Firstly, we need to take into account the macroeconomic conditions and – on a more granular level – the state of update's targeted and targetable markets, the companies in these markets and the countries in which update operates. The second perspective is governed by changes in the IT market in general and the behaviour of software providers, or more precisely, of CRM software suppliers in particular. And thirdly, the capabilities, limits, and potentials of update must be assessed. Obviously this equation contains too many unknowns and may only be solved through individually formed assumptions. Hence this outlook cannot be taken as a certain forecast.

Overall, all economic leading indicators for 2006 are substantially more positive than they were a year ago. However, the analysis that the mood is simply better than the real market conditions cannot be completely dismissed. After all, as long as the macroeconomic conditions in Western Europe do not move away from the current state of just low single-digit growth rates, unresolved questions regarding welfare systems, and lingering deregulation deficits, presumably no company can expect to be propelled to success by general market development alone. This obviously applies to both companies in update's target markets as well as update itself. Eastern European markets, which arouse much higher growth expectations, will again have increasing significance for the IT market in general in 2006 and, in terms of relative numbers, will disproportionately contribute to the aspired growth of the company.

In considering the total market, it also holds true for next year that update can continue to assume that focusing its offer on companies with high momentum, agility, and thus greater competitiveness, will be an advantage to the company. Such companies are predominantly medium-sized in structure and organisation. This market segment has also disproportionately contributed to economic growth in previous years, and this can be assumed to occur again this year. Not only can a comparably low saturation level of CRM technology be found in these companies in the "upper-middle class" with internationally competitive products or services. Numerous companies with substitution requirements for obsolete systems, some from providers that are no longer active in the market, can also be found here. An additional positive fact is that a majority of these companies are now again operating with high profitability, but on the other hand see themselves exposed to increasing international competitive pressure. As they obviously do not want or are unable to counter this competitive pressure with flexible prices, and because reducing the competition to the product in and of itself would not be conducive in many industries, these companies often think about competing for prospects and customers by focusing on customer proximity and the quality of their interaction. It is precisely here that update can offer a sensible support solution that creates value.

To sum up: The companies in update's target markets recognise the necessity and sense of an investment in CRM in a completely different scope than just a few years ago. And they are much more likely to see themselves in the position to make these investments than they were prepared to do between 2002 and 2004.

The supplier market has again visibly changed compared to last year. Consolidation has continued to advance. The most conspicuous example was probably Oracle's acquisition of Siebel, the market leader of CRM software. However, other companies have disappeared from the market as independent suppliers through acquisitions. For example, the Swiss supplier Team Brendel was taken over by the Norwegian SuperOffice and Epiphany by SSA Global. update also actively participated in this process with the acquisition of REGWARE GmbH. In a moderately growing market – approximately 6 % world-wide, in Europe, however, considerably weaker with about 3 % – some companies such as update were able to grow well over the market average. This implies that other competitors have stagnated or lost market share through declining revenues. It can be assumed with a high degree of certainty that these processes will also continue in 2006.

In addition to this general market mechanism, another change is probably noteworthy, namely the increasing "fanning out" of the CRM market under the aspect of what CRM is specifically understood to be. While the product range was still comparatively homogenous a few years ago, there are fundamentally different layouts of software packages today that all operate under the acronym "CRM." This applies both to the functional demand for CRM solutions made by user companies as well as to the degree of industry-specific software layouts. While on the one hand there is a defined market that is served by simple, uncomplicated solutions from companies such as Microsoft or salesforce.com, another market is developing in the "high-end" sector for very powerful, functionally rich systems that can – and must – map complicated and specific processes in companies. Today, these markets are only seldom overlapping. Analogously, this applies to industry orientation: Solutions that have successfully proven themselves in the financial services sector are of very little use when competing for a mechanical engineering company. update consistently continued its positioning strategy in the area of highly process-compatible and industry-specific solutions in the year under review and will continue to do so in 2006. The company believes it can successfully utilise its 18 years of experience and over 800 customers in this segment and that, as a specialist, it offers significantly more credibility than suppliers that are relatively new to the market or that want to appeal to the market through a generic portfolio. Naturally, it should also be kept in mind that this kind of CRM solutions and products will be implemented in the understanding of true economic use to the customers and thus other value and price definitions are possible than in the "light-weight" CRM solutions sector.

update will consistently pursue its strategy of focusing on high market shares in the Eastern European countries in 2006. In so doing, Process4E S.A. in Poland, which was acquired in 2005, will play just as significant a part as will the subsidiary which was organically built in Hungary in late 2004, the subsidiary in the Czech Republic, which was established in the 1990s, and the continually developing partnerships in all other Eastern European countries. Although the development in these countries will reflect less in terms of high absolute numbers, this strategy is still relevant in two aspects. On the one hand, these countries are displaying a lasting and far stronger growth of total economic performance, which results in a highly interesting outlook over the medium term for update, given its leading position in a promising future market such as CRM. On the other hand, expertise and presence in these countries create a considerable competitive advantage with tender invitations in Western Europe, where an Eastern European presence and execution capability is increasingly required. For example, should a German pharmaceutical company decide on a global or at least a European solution, a local support capability is increasingly being demanded, including in Eastern European countries. update's strategy is in sync with the strategy of many of its customers, which directly increases its competitiveness over the medium term.

Continuing the company's focus on particular industries will be an essential cornerstone of the 2006 strategy. This strategy, which was initiated three years ago, has been successful to date, and the company intends to intensify that success in the future. The acquisition of REGWARE GmbH in Germany in January 2006 is to be seen in this context. Over the years, REGWARE GmbH developed an outstanding reputation as a specialist for the pharmaceutical market and was attractive to update both from the aspect of its customer base as well as the specialised talent in the company. However, update did not limit itself to simply acquiring the company; rather it merged this new corporate unit with its own specialists into an "International Competence Center for Healthcare" (ICCH) and runs the centre as a separate company. Pooling these combined powers created an expertise that is highly attractive to European pharmaceutical and healthcare companies.

This type of organisation will increasingly be chosen also for other industries as part of our advancing focus. In fact, the company is once again accommodating its customers in that update's organisational form mirrors that of its customers: i.e. update's Competence Center corresponds to a customer's corporate headquarters, while local support for the customers' branches is offered in the respective countries.

The new product generation will have a significant influence on 2006. update has enhanced its product suite for more than two years. This allows update to launch its new core product, update.seven, on the markets. This will show that undertaking the strategy of higher-than-average investments in research and development is the right way to go from the perspective of long-term and sustainable success, because software remains a highly innovative asset. Additionally, products in this industry sector exhibit a substantially shorter life cycle than those in traditional industries. update.seven, the company's new core product, reflects the traditional values of all previous update solutions: Cost-effective implementation, user friendliness, and deep process compatibility for the target industries with a quality that is unprecedented to date. Furthermore, the new product suite is setting standards for the increasingly important criteria of integratability and flexibility. With the new suite, update additionally offers a dedicated product for the business intelligence component of CRM (so-called analytical CRM) that will permit the company to expand the average project size through a larger scope of services. With the new update.seven product suite, the company is excellently positioned for the second half of the decade. It can be assumed that these product innovations will generate incremental sales growth.

This will also be necessary in order to compensate for the continuing price decline in the industry, which is caused by the competitive pressure in the software and CRM market previously mentioned. If one assumes further price erosions of at least 10 % per year, it quickly becomes clear that significant increases in sales volumes are required in order to continue to increase revenue in 2006. In fact, this was already the case in 2005 and 2004, during which the company posted percentage revenue increases well into the double digits.

Altogether, update assumes that it will be able to continue its growth course with growth rates clearly over the market average and with solid profitability. This assumption is based less upon the estimated or real improvement of market conditions than it is upon concentration on update's own strengths: namely update's ability to offer a highly competitive product at a competitive price with a maximum of customer benefits for 18 years.

Vienna, March 2006

Thomas Deutschmann | Monika Fiala, MBA | Arno Huber

Consolidated Income Statement for the 2005 Financial Year

	2004 EUR (000)	2005 EUR (000)
Sales revenue (Note no. 1)		
Revenues from licenses and maintenance agreements	11,711	13,014
Revenues from implementation and service	3,658	5,527
Own work capitalised and other operating income	0	59
Total sales revenues	**15,369**	**18,600**
Cost of goods sold		
Costs of licenses and maintenance agreements	853	929
Costs of implementation and service	2,606	4,777
Total cost of goods sold	**3,459**	**5,706**
Gross profit	**11,910**	**12,894**
Operating expenses		
Sales and marketing	4,770	5,761
Research and development	2,887	3,128
General and administrative costs	1,940	1,952
Total operating expenses	**9,597**	**10,841**
Operating income	**2,313**	**2,053**
Interest income	102	205
Interest expenses	-53	-46
Other income and expenses, net (Note no. 2)	0	-2
Earnings before taxes (EBT)	**2,362**	**2,210**
Income taxes (Note no. 3)	243	664
Net profit for the year	2,605	2,874
Earnings per share (basic and diluted)	**0.28**	**0.28**
Average number of shares issued	9,381,967	10,320,163

The accompanying notes to the consolidated financial statements are an integral part of this consolidated income statement.

Consolidated Balance Sheet as of 31 December 2005

	31/12/2004 EUR (000)	31/12/2005 EUR (000)
ASSETS:		
A. Current assets		
Cash and cash equivalents (Note no. 4)	5,756	7,686
Trade accounts receivable	5,555	7,295
Less: Allowance for doubtful accounts	-1,078	- 1,065
Net total trade accounts receivable (Note no. 5)	4,477	6,230
Unbilled work (Note no. 6)	0	586
Other current assets (Note no. 7)	413	595
B. Non-current assets		
Intangible assets and goodwill (Note no. 8)	8	1,103
Property, plant and equipment (Note no. 9)	439	449
Investment securities (Note no. 10)	66	68
Deferred tax assets (Note no. 11)	451	1,225
TOTAL ASSETS	**11,610**	**17,942**
EQUITY AND LIABILITIES:		
A. Current liabilities		
Current instalments on long-term liabilities (Note no. 12)	242	0
Trade accounts payable	779	1,075
Provisions and other liabilities (Note no. 13)	3,057	4,178
B. Non-current liabilities		
Non-current liabilities (Note no. 14)	364	65
Long-term provisions (Note no.15)	316	386
Liabilities from capital leases, excluding current instalments (Note no. 16)	3	2
C. Shareholders' equity (Note no. 17)		
Share capital (Authorised capital 5,160,081.00)	9,382	10,320
No-par value shares issued and outstanding 2005: 10,320,163 (2004: 9,381,967)		
Additional paid-in capital	252	1,769
Other reserves	429	487
Accumulated deficit	-3,214	-340
Total shareholders' equity	**6,849**	**12,236**
TOTAL LIABILITIES AND SHAREHOLDERS´ EQUITY	**11,610**	**17,942**

The accompanying notes to the consolidated financial statements are an integral part of this consolidated balance sheet.

Consolidated Cash Flow Statement for the 2005 Financial Year

	2004 EUR (000)	2005 EUR (000)
Operating activities:		
Net profit for the year	**2,605**	**2,874**
Reconciliation of the net profit for the year to net cash flow from operating activities		
Depreciation	373	253
Asset disposals	0	1
Change in accrued pension and other employee benefits	77	70
Change in deferred tax assets	-451	-774
Unrealised re-measurement gains/losses on currency differences	47	55
Changes in assets and liabilities		
Change in trade accounts receivable	-927	-1,553
Change in inventories	51	0
Change in trade accounts payable	206	207
Change in deferred income	-294	335
Change in provisions	468	781
Change in other assets and liabilities	-171	-803
Net cash flow from operating activities	**1,984**	**1,446**
Cash flow from investing activities:		
Expenditures for the acquisition of businesses less cash and cash equivalents acquired	0	-1,100
Capital expenditures for intangible assets	0	-134
Capital expenditures for property, plant and equipment	-186	-195
Proceeds from disposal of property, plant and equipment	62	0
Proceeds from disposal of financial assets	22	0
Net cash flow from investing activities	**-102**	**-1,429**
Cash flow from financing activities:		
Change in non-current liabilities from capital leases	-3	-1
Change in liabilities to banks	0	-242
Change in long-term loans	-242	-299
Proceeds from the capital increase	0	938
Additional paid-in capital	0	1,517
Net cash flow from financing activities	**-245**	**1,913**
Change in cash and cash equivalents	1,637	1,930
Cash and cash equivalents at beginning of financial year	4,119	5,756
Cash and cash equivalents at end of financial year	**5,756**	**7,686**
Supplemental disclosures:		
Cash expenditures during reporting period for:		
Interest	52	46
Income taxes	40	110

The accompanying notes to the consolidated financial statements are an integral part of this consolidated cash flow statement.

Consolidated Statement of Changes in Equity for the 2005 Financial Year

Consolidated equity for the 2005 financial year changed as follows:

	Share capital EUR (000)	Additional paid-in capital EUR (000)	Accumulated deficit EUR (000)	Other provisions EUR (000)	Total EUR (000)
Balance as of 31/12/2003	**9,382**	**222**	**-5,789**	**382**	**4,197**
Net profit for the year			2,605		2,605
Remeasurement gains/losses on financial instruments				2	2
Currency translation adjustments				45	45
Capital increase					
Options granted		30	-30		
Balance as of 31/12/2004	**9,382**	**252**	**-3,214**	**429**	**6,849**
Net profit for the year			2,874		2,874
Remeasurement gains/losses on financial instruments				3	3
Currency translation adjustments				55	55
Capital increase	938	1,404			2,342
Options granted		113			113
Balance as of 31/12/2005	**10,320**	**1,769**	**-340**	**487**	**12,236**

The changes disclosed in the 2004 financial year in options granted and the accumulated deficit concern personnel expenses from previous periods for employee share options granted.

The accompanying notes to the financial statements are an integral part of this consolidated statement of changes in equity.

Notes to the Consolidated Financial Statements as of 31 December 2005

A. General Disclosures

Organisation and Business Activities

update software AG ("the company" or "update") was founded in 1988 as "Marketing Informationssysteme Gesellschaft m.b.H". On 29 April 1997 the company was converted to a share corporation (*Aktiengesellschaft*) and changed its name to "Update Marketing Service AG." The most recent change to the currently effective name, update software AG, was effected on 22 May 2002. The company's registered office is in Vienna, Austria. Unless otherwise indicated, all information pertains to update software AG.

update is a company active in the development and implementation of customer relationship management (CRM) software solutions. By automating key functions, these solutions enable enterprises to more effectively acquire, manage and retain customers, partners and other business relationships.

The company is subject to various risks, including, but not limited to, operating in a rapidly evolving market, competition from larger companies, dependence upon new products, dependence on trained personnel, uncertain profitability, and concentration on a single core product.

Effective 1 February 2003, the company moved from the high-tech stock exchange (Neue Markt) to the General Standard segment of Deutsche Börse, the German stock exchange.

Reporting pursuant to IFRS (International Financial Reporting Standards)

The consolidated financial statements as of 31 December 2005 were the first to be prepared pursuant to the principles of IFRS. EU Regulation 1606/2002 requires publicly traded companies, with some exceptions, to prepare and publish their consolidated accounts as of 2005 under the International Financial Reporting Standards (IFRS).

Changes were made in the classification of the balance sheet in the course of the changeover from US-GAAP to IFRS.

Note on Rounding

When adding rounded amounts and information given as a percentage, rounding differences may occur due to the use of automated calculation methods.

B. Consolidation Principles

Reporting Entity Structure

The reporting entity structure was determined pursuant to the principles of the IAS 27 (Consolidated and Separate Financial Statements). Accordingly, in addition to update software AG, one domestic and eight foreign subsidiaries in which the company holds 100 % of the shares, directly or indirectly, were included in the consolidated financial statements as of 31 December 2005.

All included companies were fully consolidated.

Name, equity interest and registered office of the subsidiaries included in the consolidated financial statements:

Company	Registered office	% share
update Sales GmbH	Vienna, Austria	100
update software Germany GmbH	Dreieich, Germany	100
update software Switzerland GmbH	Dietikon, Switzerland	100
update software UK Ltd.	Berkshire, England	100
update software Magyarország Kft.	Budapest, Hungary	100
update software Benelux B.V.	Amsterdam, The Netherlands	100
update software CZ s.r.o.	Brno, The Czech Republic	100
update software France S.A.R.L.	Paris, France	100
update CRM S.A.	Warsaw, Poland	100

The Polish subsidiary update CRM S.A. (previously Process4E S.A.) was acquired and consolidated for the first time in January 2005.

First-time consolidation of a subsidiary is made at the time at which control over the assets and business of such company is actually transferred to the parent.

Consolidation Methods

The annual financial statements of the companies included in the consolidated financial statements are subject to uniform accounting and measurement principles.

All receivables and liabilities, income and expenses from intercompany settlement between consolidated companies are eliminated.

Currency Translation Adjustments

The annual financial statements of the companies included in the consolidated financial statements that use foreign currency are translated into Euros using the functional currency concept pursuant to IAS 21 (The Effects of Changes in Foreign Exchange Rates).

The functional currency of the company's foreign subsidiaries is the local currency in the country in which the subsidiary is domiciled. Assets and liabilities denominated in foreign currencies are translated into Euros using average exchange rates as of the balance sheet date. Equity is translated using historical rates. Income and expense items are translated using the monthly average exchange rates during the respective financial year.

The resulting currency translation adjustments, as well as those from long-term group loans, are recognised directly in equity in the consolidated statement of changes in shareholders' equity under other reserves. Other gains and losses on currency translation adjustments are recognised in the consolidated income statement when incurred.

C. Accounting and Measurement Principles

Use of Estimates

The financial statements have been prepared in accordance with IFRS and also include amounts based on estimates and assumptions by management. Actual amounts could differ from these estimated values. Among the most significant estimates are adjustments for uncollectible trade accounts receivable and estimated useful lives for non-current assets.

Cash and Cash Equivalents

Cash and cash equivalents comprise all cash and short-term capital investments that are easily convertible into cash. The company's cash deposits consist of time deposits, fixed term deposit accounts and money market funds.

Trade Accounts Receivable and Other Receivables

Receivables are capitalised at cost. Recognisable risks are taken into account through the formation of appropriate allowances. Receivables in foreign currency are measured using the average currency exchange rate as of the balance sheet date.

Trade Accounts Payable and Other Payables

Liabilities are recognised using the repayment amount. Liabilities in foreign currency are measured using the average currency exchange rate as of the balance sheet date.

Property, Plant and Equipment

Property, plant and equipment are measured using the cost model, i.e. they are recognised at cost less the 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, plant and equipment is calculated using the straight-line method.

Their useful lives are estimated as follows:

	Depreciation period in years
IT hardware	2 – 4
Office equipment	7
Office furniture	5 – 7

Assets held under capital leases are depreciated over the shorter of the lease term or the estimated useful life of the asset.

Intangible Assets

Intangible assets are recognised at cost less accumulated depreciation.

Their useful lives are estimated as follows:

	Depreciation period in years
Software	2 – 4
Internally generated assets	4

Investment Securities

The company holds shares in various investment funds in Austria, which are intended for coverage of the taxable severance payment claims.

Measurement of Non-current Assets

Non-current assets are subjected to an impairment test if events or changes in circumstances indicate an impairment. An impairment loss is recognised if the carrying value is higher than net proceeds from disposal or value in use. The net proceeds from disposal are the recoverable disposal proceeds less the cost directly allocable to the sale. The value in use equals the present value of the estimated future net cash flows from the utilisation of the asset and its disposal value at the end of its expected useful life.

Revenue Recognition and Deferred Income

Revenue from the sale of software licenses is recognised in accordance with IAS 18. Revenues from the sale of software licenses are recognised at the time the risks and rewards are transferred to the buyer. Additional requirements are the existence of a reliable estimate of the revenues and expenses related to the sale, as well as probable collectibility of the receivable.

Revenues from support and maintenance agreements are posted as deferred income when invoiced and recognised pro rata over the period of the agreement.

The sales revenues from services comprise training, consulting and implementation services, some of which are recognised in accordance with IAS 11 (Construction Contracts). That means that, for long-term projects, recognition is made pursuant to the percentage of completion method based on milestones. Income from other services is recognised at the time the services are provided, pursuant to IAS 18 (Revenue). A project is deemed concluded after acceptance by the customer.

Cost of Goods Sold

Costs of sales from licenses and maintenance agreements includes the costs of data media, product packaging, documentation and other production costs as well as license fees to third parties. Also included in this category are the costs of salaries, other payroll costs and bonus payments for maintenance and hotline support personnel.

Costs of sales from services comprise salaries, other payroll costs and bonus payments as well as allocated overhead costs for those members of staff who carry out the consulting, training and implementation services.

Research and Development

There is a prohibition on capitalisation for research expenses. Development costs also normally represent a periodic expense. They may only be capitalised if a probable future economic benefit will be obtained from the internally generated intangible asset. In addition, all of the criteria listed under IAS 38 (Intangible Assets) must be met.

Income Taxes

Assets and liabilities from income taxes are recognised in the "Other current assets," "Provisions" and "Other liabilities" accounts. Current income tax assets and liabilities are recognised using the amounts in which settlement with the respective tax authorities is expected.

Deferred taxes are calculated using the temporary concept, which compares the carrying amounts of the assets and liabilities on the balance sheet with the carrying amounts applicable to taxation of the respective group company. Deviations between these carrying amounts result in temporary differences, for which deferred tax assets or deferred tax liabilities must be recognised – regardless of when these differences will be reversed. Deferred taxes in the individual group companies are calculated using the country-specific tax applicable in the future.

Deferred taxes on unused tax loss carry-forwards are only recognised if it is probable that taxable profits in the same company will become available in an appropriate amount in the future. Deferred taxes are not discounted.

Earnings per Share

To calculate basic earnings per share, the consolidated net income is divided by the weighted average number of ordinary shares outstanding in the respective period. Diluted earnings per share takes into account not only outstanding shares, but also shares receivable due to options (employee share options, warrants), if these have a dilutive effect.

Employee Share Option Plan

The company grants its employees an employee share option plan in the form of share options. Accounting and measurement is made pursuant to IFRS 2 (Share-based Payment), which requires that acquired claims be recognised as an expense and the consideration as shareholders' equity.

As the consolidated financial statements as of 31 December 2005 were the first to be prepared pursuant to IFRS principles, the company incurred a personnel expense in connection with the employee share option plan for the first time in the 2005 financial year. In the consolidated financial reports for previous years, which were prepared under US-GAAP, the expenses for employee share options were disclosed in the pro forma information. They were not disclosed either in the income statement or in shareholders' equity.

The personnel expenses from previous periods in the amount of EUR 30,000 are disclosed directly in equity.

Other Changes in Equity not recognised in the Income Statement

The only items of other changes in equity not recognised in the income statement which the company currently reports are currency translation adjustments and unrealised gains/losses from investment securities.

Provisions for Severance Pay

Austrian labour law requires the company to pay employees certain severance payments upon termination or retirement based upon length of employment. Employees leaving voluntarily or dismissed for good cause are not entitled to such severance pay.

The calculation of the provision for severance pay corresponds to IAS 19 (Employee Benefits) and is based on the following assumptions: interest rate: 4 %, future salary increases: 1 %.

Leases

The company leases office and operating equipment, principally vehicles. All lease agreements that meet certain specified criteria and cover situations in which substantial benefits and risks have been transferred to the lessee with the leased asset, are accounted for as capital leases.

Government Grants

Government grants are recognised pursuant to IAS 20 (Accounting for Government Grants and Disclosure of Government Assistance) but only if there is a reasonable assurance that the company will comply with conditions attached to them and that the grants will be received. Grants related to income are presented in the income statement as a reduction to personnel expenses. Low-interest loans granted are recognised in the balance sheet as non-current liabilities.

Borrowing Costs

Pursuant to IAS 23, borrowing costs are recognised as an expense in the period in which they are incurred.

D. Explanatory Remarks to the Income Statement and the Balance Sheet

(1) Sales Revenue

Please see "Segment Reporting" (see "E. Other Disclosures" - page 34) with regard to the composition of sales revenues.

(2) Other Income and Expenses

Other income essentially includes revenues from reversals of provisions and reversals of unused allowances for doubtful accounts. Other expenses are composed essentially of exchange rate losses and losses on receivables.

	2004 EUR (000)	2005 EUR (000)
Reversal of provisions	54	201
Reversal of unused allowances for doubtful accounts	410	61
Asset disposals	49	2
Other income	244	124
Exchange rate losses	-87	-99
Losses on receivables	-39	-25
Addition to allowances for doubtful accounts	-386	-106
Other expenses	-245	-160
Other income and expenses, net	**0**	**-2**

(3) Income Taxes

Total tax income/expense for the financial years ended 31 December 2005 and 2004 were allocated to the respective earnings from current operations.

Tax income/expense for the respective years was as follows:

	Current EUR (000)	Deferred EUR (000)	Total EUR (000)
2004			
Austria	-178	451	273
Foreign	-30	0	-30
	-208	**451**	**243**
2005			
Austria	-120	380	260
Foreign	9	395	404
	-111	**775**	**664**

Tax expenses differed from the amounts computed by applying the Austrian income tax rate of 25 % to pre-tax earnings from current operations. This difference can be derived as follows:

	2004 EUR (000)	2005 EUR (000)
Earnings before taxes	2,362	2,210
Group income tax rate	34 %	25 %
Expected tax expense	-803	-553
Difference from differing foreign tax rates	7	-84
Loss carry-forwards	952	1,316
Miscellaneous	87	-15
Tax income reported	**243**	**664**

(4) Cash and Cash Equivalents

The company's cash and cash equivalents consist of time deposits, fixed term deposit accounts and money market funds and totalled EUR 7,686,000 as of December 31, 2005. Of this amount, EUR 314,000 was pledged to secure granted bank guarantees. A restricted account in the amount of EUR 130,000 was established in the Dutch subsidiary in connection with the pending ABASE proceedings against update Benelux B.V.

(5) Trade Accounts Receivable

The allowance for doubtful accounts developed as follows:

	31/12/2004 EUR (000)	31/12/2005 EUR (000)
Allowance for doubtful accounts at beginning of financial year	1,193	1,078
Additions	393	106
Usage	-97	-58
Reversal of unused allowances	-411	-61
Allowance for doubtful accounts at end of financial year	1,078	1,065

(6) Unbilled Work

	31/12/2004 EUR (000)	31/12/2005 EUR (000)
Unbilled work	0	586

Unbilled work is measured in accordance with IAS 11 (Construction Contracts).

The revenue was calculated using the percentage of completion method (POC method). The total order amount of the projects is EUR 894,000, of which a total of EUR 753,000 is attributable to service revenues. As of the balance sheet date, the percentage of completion was 77.75 %; expenses were EUR 530,000. As of 31 December 2005, a profit of EUR 55,000 had been generated.

(7) Other Current Assets

	31/12/2004 EUR (000)	31/12/2005 EUR (000)
Receivables from tax authorities	142	109
Receivables from senior executives and employees	17	25
Rental and leasing deposits	30	31
Other assets	17	47
Prepaid expenses	207	383
	413	**595**

Other current assets include VAT credits and other tax prepayments, rental deposits, other deposits and other advance payments.

(8) Intangible Assets and Goodwill

	31/12/2004 EUR (000)	31/12/2005 EUR (000)
Costs		
Software	1,271	1,279
Internally generated assets	0	126
Goodwill	0	982
	1,271	**2,387**
Less: Accumulated depreciation	- 1,263	-1,284
Carrying amount	**8**	**1,103**

The depreciation expense for the 2005 financial year totalled EUR 21,000.

Development expenses for internally-developed software were capitalised for the first time in the 2005 financial year. The internally-developed intangible assets are measured at cost, less depreciation. The costs include all costs allocable to the development process.

The Polish subsidiary, update CRM S.A. (previously Process4E S.A.), was acquired for consideration in January 2005. The purchase price totalled PLN 6.6 million (EUR 1,671,000).

The assets and liabilities as of the acquisition date were as follows:

	1/1/2005 PLN (000)	1/1/2005 EUR (000)
Non-current assets	190	47
Current assets	925	227
Cash and cash equivalents	2,340	573
Current liabilities	613	150
Non-current liabilities	22	5
Contingent liabilities	600	147

The company focuses on CRM services and solutions as well as on process analysis.

The goodwill reported in the consolidated balance sheet relates solely to the acquired Polish company and totals EUR 982,000.

The incidental acquisition costs in the amount of EUR 29,000 relate to legal and consulting expenses in connection with the acquisition.

As of the acquisition date, the shareholders' equity of Process4E S.A. was PLN 2,820,101.00 (EUR 691,201.23).

update CRM S.A. generated sales revenues totalling EUR 534,000 in the 2005 financial year. The loss for the 2005 financial year was EUR 224,000.

IFRS 3 (Business Combinations) requires that goodwill acquired in connection with a business combination be initially recognised at cost less all accumulated impairment losses. Goodwill must be tested for impairment at least once per year pursuant to IAS 36 (Impairment of Assets). If there are indications for an impairment, and the present values of the future net cash flows are less than the carrying amounts (shareholders' equity and goodwill), a write-down to the lower fair value is recognised pursuant to IAS 36. There was no need for an impairment loss in 2005.

The classification of the intangible asset items and goodwill summarised in the consolidated balance sheet and their development in the 2005 financial year is presented in the attached statement of changes in non-current assets (Appendix 1).

(9) Property, Plant and Equipment

	31/12/2004 EUR (000)	31/12/2005 EUR (000)
Costs		
Hardware	1,083	1,206
Office equipment	702	753
Office furniture	131	134
Other property, plant and equipment	349	349
	2,265	**2,442**
Less: Accumulated depreciation	-1,826	-1,993
Carrying amount	**439**	**449**

The depreciation expense for the 2005 financial year totalled EUR 233,000.

The classification of the property, plant and equipment items summarised in the consolidated balance sheet and their development in the 2005 financial year is presented in the attached statement of changes in non-current assets (Appendix 1).

(10) Investment Securities

Historical costs, unrealised losses and fair value as of 31 December 2005 and 2004 are comprised as follows:

	Historical costs EUR (000)	Unrealised loss EUR (000)	Fair value EUR (000)
Available-for-sale securities (investment funds)			
31/12/2004	71	5	66
31/12/2005	71	3	68

(11) Deferred Tax Assets

The tax effects of temporary differences that lead to increases in deferred tax assets as of 31 December 2005 and 2004, respectively, are presented below:

	31/12/2004 EUR (000)	31/12/2005 EUR (000)
Long-term deferred tax assets		
Loss carry-forwards	18,217	17,970
Write-down of investments in affiliated companies	80	20
Depreciation on property, plant and equipment and intangible assets	2	-28
Miscellaneous	5	-7
Total gross deferred tax assets	**18,304**	**17,955**
Less: Valuation allowance	-17,853	-16,730
Net deferred tax assets	**451**	**1,255**

The majority of the loss carry-forwards (EUR 71,879,000) can be carried forward indefinitely. Due to the uncertainty with regard to the use of all temporary differences, only a portion has been capitalised.

(12) Current Instalments on Non-current Liabilities

In 1998, the company entered into a loan agreement with Bank Austria AG. According to the agreement the loan was to be repaid in twelve semi-annual instalments of EUR 121,000 each, whereby the first instalment was due on 31 December 2001 and the final instalment on 30 June 2007. The repayment amount of EUR 606,000 still outstanding was paid back early and in full in June 2005. The current portion of the instalments in 2004 totalled EUR 242,000.

(13) Provisions and Other Liabilities

	31/12/2004 EUR (000)	31/12/2005 EUR (000)
Other provisions	2,159	2,311
Liabilities from VAT, payroll taxes & social security	495	507
Other Liabilities	91	713
Deferred income	312	647
	3,057	**4,178**

Other provisions developed as follows:

	As of 1/1/2005 EUR (000)	Usage EUR (000)	Reversal EUR (000)	Allocation EUR (000)	As of 31/12/2005 EUR (000)
Bonus payments	911	780	64	894	961
Other provisions	484	232	129	417	540
Unused holidays	444	77	0	128	495
Legal and consulting expenses	151	119	7	93	118
Restructuring costs	0	0	0	103	103
Provisions for taxes	169	169	0	93	93
	2,159	**1,377**	**200**	**1,728**	**2,311**

One-off restructuring costs of EUR 128,000 were incurred upon closing the customer help desk in the German subsidiary, update software Germany GmbH, Dreieich.

(14) Non-current Liabilities

A loan in the amount of EUR 129,000 was granted by Österreichische Forschungsgesellschaft mbH (FFG). 50 % of the granted loan was paid out by FFG in the 2005 financial year. The stipulated interest is 2 % p.a. and is charged in arrears at the end of each six-month period. The entire amount is to be repaid on 30 June 2009.

A loan agreement was entered into with Bank Austria AG in 1988. The loan was paid back early and in full in June 2005.

(15) Non-current Provisions

The non-current provisions comprise in their entirety the accrued liability for severance pay. Provisions for severance pay are related to severance payments to be made upon termination.

	EUR (000)
Provisions as of 31/12/2003	**239**
Interest expense	12
Service cost	79
Severance pay	-14
Provisions as of 31/12/2004	**316**
Interest expense	13
Service cost	85
Severance pay	-28
Provisions as of 31/12/2005	**386**

(16) Liabilities from Capital Leases, excluding Current Instalments

The company has liabilities in connection with capital leases for vehicles. As of 31 December 2005 and 2004, the following amounts were treated as capital leases:

	31/12/2004 EUR (000)	31/12/2005 EUR (000)
Vehicles	36	11
Less: Accumulated depreciation	-25	-9
	11	**2**

Depreciation of assets held under capital leases is included in depreciation expenses. The future minimum lease payments for capital leases as of 31 December 2005 were:

	Capital leases EUR (000)
Financial year ended 31 December	
2006	7
2007	2
	9
Less: Current instalments for liabilities from capital leases (are included in current liabilities)	-7
Liabilities from capital leases, excluding current instalments	**2**

The future minimum liabilities in connection with capital leases (excluding current instalments) as of 31 December 2005 totalled EUR 9,000. The depreciation on capitalised assets in the 2005 financial year totalled EUR 3,000. Interest included in the capital leases as of 31 December 2005 was EUR 2,000.

(17) Shareholders' Equity

In January 2005, based on the authorisation vested in the Management Board at the ordinary shareholders' meeting of update software AG on 4 May 2001, the Management Board carried out a capital increase utilising a portion of the authorised capital. The company's share capital was increased from EUR 9,381,967.00 to EUR 10,320,163.00 by issuing 938,196 no-par bearer shares in exchange for cash contributions of EUR 938,196.00. The issue price per share was EUR 2.61. The shareholders' subscription right was not excluded. The new shares are authorised to participate in profit as of 1 January 2004.

Additional paid-in capital increased in the 2005 financial year by EUR 1,404,000 due to the capital increase carried out. The expenses incurred through the capital increase totalled EUR 106,000 and were charged to the additional paid-in capital.

In the ordinary shareholders' meeting of 2 June 2005, the Management Board was authorised to increase the share capital until 31 May 2008, with the approval of the Supervisory Board, by up to an additional EUR 5,160,081.00 by issuing up to 5,160,081 new bearer ordinary shares (no-par shares) for cash or contributions in kind, and to determine the issue price as well as the issue terms and conditions in consultation with the Supervisory Board (authorised capital within the meaning of Section 169 Austrian Stock Corporation Act).

Further, at the ordinary shareholders' meeting of 2 June 2005, the Management Board was authorised, with the approval of the Supervisory Board, to conduct a contingent capital increase by up to a nominal amount of EUR 1,032,016.00 by issuing up to 1,032,016 bearer ordinary shares (no-par shares) at an issue price of at least EUR 1.00 per share in return for cash contributions and under exclusion of the subscription right of previous shareholders. This contingent capital is intended to service the employee share option plan approved in the ordinary shareholders' meeting of 15 February 2000 for employees, senior executives and members of the Management Board of the company or any of its affiliates.

E. Other Disclosures

Segment Reporting

Segment reporting, in accordance with the risks/rewards structure, is recorded using the following regions:

DACH = Germany, Austria, Switzerland
CEE = Central and Eastern Europe
ROE = Rest of Europe

The holding company is the group headquarters and is responsible for centralised activities such as planning, research and development, marketing, corporate finance and investor relations.

In the course of the restructuring of the business segments currently underway, update software AG will include a secondary segment report classified by industry beginning with the next financial year.

Segment figures developed as follows:

	Holding company		DACH		CEE		ROE		Consolidation		Group	
EUR (000)	2004	2005	2004	2005	2004	2005	2004	2005	2004	2005	2004	2005
Sales revenue	0	0	10,907	13,739	524	1,589	3,938	3,272	0	0	15,369	18,600
Regular depreciation *	302	170	53	48	3	25	15	11	0	0	373	254
Extraordinary depreciation**	51	0	0	0	0	0	0	0	0	0	51	0
Operating income	-484	-460	1,279	1,755	123	-243	1,395	1,001	0	0	2,313	2,053
Segment assets	5,959	10,303	4,862	5,706	200	1,661	1,609	1,984	-1,020	-1,712	11,610	17,942
Segment liabilities	2,486	2,478	1,662	2,244	25	381	588	603	0	0	4,761	5,706
Capital expenditures for property, plant and equipment	96	132	71	46	2	55	17	9	0	0	186	242
Capital expenditures for intangible assets	0	1,116	0	0	0	0	0	0	0	0	0	1,116

* Intangible assets and property, plant and equipment ** Inventories

Option Plan

On 19 May 1999, the ordinary shareholders' meeting approved the 1999 share option plan (the "1999 Plan"), under which share options, including incentive share options, unqualified options, restricted shares, growth shares, bonus shares, and stock appreciation rights (SARs), may be granted to employees, consultants and senior executives, for up to 518,773 ordinary shares. The plan went into effect on 19 May 1999. The 1999 Plan is administered by the Management Board. The Management Board determines the duration of the respective share option (maximum 10 years); the exercise price may not be less than the fair value of the ordinary share on the option grant date. Unless otherwise provided, after the first year of employment, options may be exercised for 25 % of the number of shares granted. Thereafter, options for 1/48th of the shares granted may be exercised on the first day of each subsequent month following the first calendar year of employment. Employees who received options and were employed prior to the effective date of the share option plan are credited with a maximum of one year's employment.

The third ordinary shareholders' meeting held on 15 February 2000 approved a 3:1 share split. The consequence for holders of share options is that 3 shares can be acquired for each 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 ordinary shareholders' meeting, the shareholders approved the 2000 share option plan (the "2000 Plan") whereby share options may be granted to employees and senior executives for up to 1,384,803 ordinary shares. As a result, the total number of shares available was reduced 171,516 shares. After 15 February 2000 share options will only be issued under the terms of the 2000 Plan. The re-issuance of expired options granted under the 1999 Plan may now only be made under the 2000 Plan. After 1 January 2000, options may no longer be granted to members of the Supervisory Board. The 2000 Plan went into effect on 15 February 2000. The 2000 Plan is administered by the Management Board. The Management Board determines the duration of the respective share option (maximum 10 years); the exercise price may not be less than the "reasonable fair value" of the ordinary share on the option grant date. The "reasonable fair value" is defined as the average of the official cash quotation for the last 15 trading days prior to the option's grant date, but must be at least EUR 1.00. Unless otherwise provided, after two years of employment 25 % of the total options granted may be exercised. Afterwards, 1/8th of the total options granted may be exercised at the end of each subsequent 6-month period. Options may only be exercised if the share's market price on the date the declaration of conversion becomes valid exceeds the option's exercise price by at least 10 %. Shares subject to the 2000 Plan may be shares issued from authorised capital or own shares acquired on the stock market or otherwise. For purposes of this Plan, the company is also authorised to purchase its own shares from an intermediary bank that tenders authorised capital.

To date, a total of 206,656 options have been converted into shares in connection with the option plans.

Options that were granted to Management Board Member Thomas Deutschmann upon his joining the Board are subject to special exercise agreements. The options granted to Mr. Thomas Deutschmann may be exercised with respect to 33,000 shares after the first year of board membership, then for another 33,000 shares after an additional year and 34,000 shares after a total of three years of employment with the company.

The Supervisory Board granted the board members 500,000 options upon the renewal of the employment agreements of the Management Board members on 1 June 2005. Of these, Mr. Thomas Deutschmann received 300,000 options; Ms. Monika Fiala received 100,000, and Mr. Arno Huber 100,000. These issued options are subject to separately stipulated exercise conditions: one third of the options may be exercised after the first year of the renewal of the agreement, an additional one-third after the second year, and the final one-third after expiration of the third year of the agreement. If there is a change in control at update, then the conditions precedent with regard to all granted options are deemed to be satisfied, and the optionees can immediately exercise their options (including outside of the exercise window). In this case, a cash redemption is also possible. Within the meaning of this provision, a "change in control" exists if either (1) a shareholder or several shareholders acting together hold at least 50 % of the voting share capital in the company, (2) as soon as two or more members of the Supervisory Board as composed on the date of these option conditions change or are changed at the instigation of a shareholder or several shareholders acting together, who holds/hold least 15 % of the voting share capital of the company, or (3) a public take-over offer for company's shares has been made. The term "acting together" (*gemeinsam vorgehen*) is to be understood within the meaning of the Austrian Takeover Act.

The ordinary shareholders' meeting of 2 June 2005 approved authorised contingent capital in the amount of 1,032,016 ordinary bearer shares (no-par shares) at an issue price of at least EUR 1.00 per share in return for cash contributions and excluding previous shareholders for servicing the employee share option plan. The Management Board resolved on 22 December 2005 to utilise this authorisation and to carry out a contingent capital increase for the company by up to EUR 1,032,016.00. The corresponding publication of the report pursuant to Section 159 Austrian Stock Corporation Act was made on 28 December 2005.

Based on this contingent capital increase, a modification of the existing employee share option plan (2005 Plan) was resolved and made on 22 December 2005. The most significant modification in the 2005 Plan is the fixing of three exercise windows per year: (1) In each case, ten trading days after the day of the company's ordinary shareholders' meeting in which the annual financial statements are approved; (2) In each case, seven weeks after the day of the publication of the company's semi-annual results, and (3) In each case, seven weeks after the day of the publication of the company's third financial quarter (Q3) results.

The Supervisory Board unanimously approved the resolutions of the Management Board on 3 February 2006. Employees who are still subject to the provisions of the 1999 Plan or the 2000 Plan will be transferred into the 2005 Plan during the course of 2006. After 22 December 2005 share options will only be issued under the provisions of the 2005 Plan.

Overview of the Share Option Plans

In the following table, the share split on 15 February 2000 was taken into account in the period from 19 May 1999 until 31 December 1999:

	Options still available	Options granted	Spread	Weighted average exercise price
As of 31/12/2003	**886,910**	**291,237**	**EUR 1-23**	**EUR 3.68**
Options granted	(321,540)	321,540	EUR 1.15-8.84	EUR 2.02
Options expired	18,640	(18,640)	EUR 1-18.69	EUR 4.03
Options exercised	0	0	0	0
As of 31/12/2004	**584,010**	**594,137**	**EUR 1-23**	**EUR 2.77**
Options granted	(613,088)	613,088	EUR 2.91-4.12	EUR 3.01
Options expired	67,654	(67,654)	EUR 1-4.33	EUR 2.39
Options exercised	0	0	0	0
As of 31/12/2005	**38,576**	**1,139,571**	**EUR 1-23**	**EUR 2.92**

The following table provides an overview of currently outstanding and exercisable options under the 1999 Plan as of 31 December 2004 and 31 December 2005. The share split on 15 February 2000 has been taken into account.

1999 Plan

Issued				Exercisable	
As of 31/12/2004					
Spread of the exercise price EUR	**Issued options**	**Weighted remaining exercise period in years**	**Weighted average exercise price EUR**	**Exercisable options**	**Weighted average exercise price EUR**
4.33	83,568	4.5	4.33	83,568	4.33
6	4,680	4.8	6	4,680	6
7.33	3,120	4.9	7.33	3,120	7.33
4.33-7.33	91,368	4.5	4.52	91,368	4.52

Issued				Exercisable	
As of 31/12/2005					
Spread of the exercise price EUR	**Issued options**	**Weighted remaining exercise period in years**	**Weighted average exercise price EUR**	**Exercisable options**	**Weighted average exercise price EUR**
4.33	76,458	3.5	4.33	76,458	4.33
6	4,680	3.8	6	4,680	6
7.33	3,120	3.9	7.33	3,120	7.33
4.33-7.33	84,258	3.5	4.54	84,258	4.54

The following table provides an overview of currently outstanding and exercisable options under the 2000 Plan as of 31 December 2005 and 31 December 2004. The share split on 15 February 2000 has been taken into account.

2000 Plan

Issued				Exercisable	
As of 31/12/2004					
Spread of the exercise price EUR	Issued options	Weighted remaining exercise period in year	Weighted average exercise price EUR	Exercisable options	Weighted average exercise price EUR
23	780	5.2	23	683	23
18.69	1,560	5.5	18.69	1,365	18.69
8.84	3,835	5.8	8.84	3,226	8.84
3.35	4,940	6.0	3.35	3,705	3.35
2.61	6,760	10.0	2.61	0	2.61
2.47	1,560	9.2	2.47	0	2.47
2.21	3,380	6.2	2.21	2,275	2.21
1-2	479,954	9.0	1.63	81,246	1.02
1-23	502,769	8.9	1.81	92,500	1.84

Issued				Exercisable	
As of 31/12/2005					
Spread of the exercise price EUR	Issued options	Weighted remaining exercise period in years	Weighted average exercise price EUR	Exercisable options	Weighted average exercise price EUR
23	780	4.2	23	780	23
18.69	1,560	4.5	18.69	1,560	18.69
8.84	3,835	4.8	8.84	3,835	8.84
4.12	10,000	9.8	4.12	0	4.12
3.67	7,000	10.0	3.67	0	3.67
3.35	4,940	5.0	3.35	4,940	3.35
3.04	2,500	9.5	3.04	0	3.04
3	500,000	9.4	3	0	3
2.91	74,000	9.2	2.91	0	2.91
2.61	5,200	9.0	2.61	0	2.61
2.47	1,300	8.2	2.47	0	2.47
2.21	3,120	5.2	2.21	2,893	2.21
1-2	441,078	8.0	1.62	136,969	1.02
1-23	1,055,313	8.7	2.49	150,977	1.62

Option Measurement pursuant to IFRS

Due to the obligatory changeover of accounting from US-GAAP to IFRS the corresponding option measurement was adjusted, as well as the 2004 comparative figures used in this section. This results in a weighted-average fair value per option issued in 2005 of EUR 1.22 (EUR 1.16 for 2004). The fair value of an option is determined based on IFRS 2 (Share-based Payments), whereby the following assumptions were made in the respective calculations as of 31 December 2005 and 31 December 2004: risk-free interest rate of 4 %; option term of 10 years; dividend income of 0 %; annual volatility of the company's share price of 32 % for 2005 and 59 % for 2004. The volatilities were taken from Bloomberg. When measuring options a liquidity discount of 15 % and an employee turnover discount of 5 % were also taken into account.

Employee Share Option Plan Expense
The expense from the employee share option plan caused by the obligatory changeover in accounting from US-GAAP to IFRS was EUR 112,975 for 2005.

Significant Legal Matters
No proceedings took place in 2004 with regard to the action for damages in the amount of EUR 705,000 brought against update software AG in July 2002 for alleged failure to perform pre-contractual disclosure duties. In a hearing on 25 January 2005 the plaintiff rejected the motion for the admission of an expert. In a decision on 26 July 2005, the trial court dismissed the action. However, the opposing party lodged an appeal on 19 September 2005. No provisions were set up in 2005.

The Berghuis/ABASE proceedings pending against update Benelux B.V. since 2000 were suspended in September 2002, after the plaintiff was ordered by the court to submit an expert opinion on various items in the statement of claim and to name witnesses for examination. However, these orders by the court were never complied with. It must therefore be assumed that the required response by the plaintiff will not occur in the foreseeable future and that the proceedings can no longer be continued. There were no proceedings or actions taken by the plaintiff in 2004 and 2005. However, should plaintiff take action, update Benelux's legal counsel in the action considers the probability of the plaintiff prevailing as very low. Therefore, no provisions were set up in 2005 with respect to these proceedings.

The Management Board is of the opinion that the company is not involved in any further legal dispute as of 31 December 2005 that could have a material effect on the company's earnings or financial position.

Other Financial Liabilities
The financial liabilities from rental and leasing contracts are as follows:

		31/12/2004 EUR (000)	31/12/2005 EUR (000)
Maturity	<1 year	737	792
Maturity	1<5 years	2,758	3,248
Maturity	>5 years	0	0

Events after the Balance Sheet Date
On 7 October 2005, update software Germany GmbH made an irrevocable offer to purchase REGWARE GmbH domiciled in Germering, Germany. On 10 January 2006, this offer was accepted by both contracting parties. The purchase price (excluding incidental acquisition costs) is EUR 1.2 million and will be financed from current cash on hand based on a two-year earn-out model. The incidental acquisition costs as of the balance sheet date total EUR 31,000.

REGWARE GmbH is a leading provider of CRM solutions for companies in the pharmaceutical and healthcare industry.

The assets and liabilities as of the acquisition date were as follows:

	1/1/2006 EUR (000)
Non current assets	12
Current assets	233
Cash and cash equivalents	36
Current liabilities	557

On 27 January 2006 update received a copy of the decision rendered by the appeals court in the legal matter of July 2002 (cf. Significant legal matters). In its decision the Oberlandesgericht Wien (Vienna Court of Appeals) allowed the plaintiff's appeal and remitted the case to the original court of first instance for a new decision following supplementary proceedings. The court of first instance was instructed to obtain an expert opinion and to clarify some issues with regard to update's duty to inform. Although the result of the continued evidentiary hearing naturally cannot be anticipated at the current time, based on information available to our legal counsel, they believe update's prospects in the case are favourable. Therefore, no provisions were set up.

On 14 February 2006, update received a statement of claim requesting payment of EUR 340,136.93 in an action brought before the Hamburg Commercial Court in Germany on 31 December 2005. However, because the plaintiff was neither the legal partner of update software AG, nor had it provided the contractually warranted service, and because in addition, the claims have also become time-barred due to the plaintiff's insolvency, the legal representative of update software AG filed a motion to dismiss the action and feels the prospects for success are favourable. Therefore, no provisions were set up.

Business Relationships with related Companies
As of 31 December 2005 there were no business relationships with related companies.

Personnel Expenses, Severance Pay Expenses and Information regarding Executive Bodies and Employees
The average number of employees (excl. freelancer) in 2005 was: 136 (2004: 106).

The personnel expenses contained in the cost of goods sold and other operating expenses total EUR 9,836,000.

Expenditures for severance pay are comprised as follows:

	Severance pay EUR (000)
Members of the Management Board	33
Other employees	150
	183

Executive Bodies of the Company

Supervisory Board
Mr. Frank Hurtmanns (Chairman)
Mr. Gilbert Hödl (Deputy chairman,until 2 June 2005)
Mr. Hans Strack-Zimmermann (Deputy chairman, as of 2 June 2005)
Mr. Richard Roy (as of 2 June 2005)

Expenses for Supervisory Board remuneration totalled EUR 75,000.

Management Board
Mr. Thomas Deutschmann, CEO (Chairman)
Ms. Monika Fiala, MBA, CFO
Mr. Arno Huber, CTO

Total remuneration of the Management Board members was EUR 801,000.

Vienna, 9 March 2006

Thomas Deutschmann | Monika Fiala, MBA | Arno Huber

Notes

Statement of Changes in Non-current Assets as of 31 December 2005 (Appendix 1)

	Acquisition costs						Accumulated		Carrying amouts		Write-ups	Depreciation
	Balance as of 1/1/2005	Addition through acquisition of a subsidiary	Additions	Disposals	Exchange difference	Balance as of 31/12/2005	Depreciation of the acquired subsidiary	Depreciation	Balance as of 1/1/2005	Balance as of 31/12/2005	2005	2005
	EUR (000)	EUR(000)	EUR(000)	EUR(000)	EUR(000)	EUR(000)	EUR(000)	EUR(000)	EUR(000)	EUR(000)	EUR(000)	EUR(000)
Property, plant and equipment												
IT hardware	1,083	21	155	-53	0	1,206	-9	-977	164	220	0	-119
Office equipment	702	16	46	-13	2	753	-6	-624	115	123	0	-56
Office furniture	131	2	2	0	-1	134	-1	-121	16	12	0	-8
Other property, plant and equipment	349	0	0	0	0	349	0	-255	144	94	0	-50
	2,265	**39**	**203**	**-66**	**1**	**2,442**	**-16**	**-1,977**	**439**	**449**	**0**	**-233**
Intangible assets												
Software	1.271	0	8	0	0	1,279	0	-1,269	8	10	0	-6
Internally generated assets	0	0	126	0	0	126	0	-15	0	111	0	-15
Goodwill	0	982	0	0	0	982	0	0	0	982	0	0
	1,271	**982**	**134**	**0**	**0**	**2,387**	**0**	**-1,284**	**8**	**1,103**	**0**	**-21**
Investment securities	**71**	**0**	**0**	**0**	**0**	**71**	**0**	**-3**	**66**	**68**	**2**	**0**
Other non-current assets	**49**	**0**	**0**	**0**	**0**	**49**	**0**	**-49**	**0**	**0**	**0**	**0**
Total	**3,656**	**1,021**	**337**	**-66**	**1**	**4,949**	**-16**	**-3,313**	**513**	**1,620**	**2**	**-254**

Note with Regard to the Interpretation of this Annual Report

This is an English translation of the original document drafted in German. In cases of uncertainty or conflict, the German version shall prevail.

Auditor´s report

We have audited the consolidated financial statements of update software AG, Vienna, for the fiscal year from 1 January 2005 to 31 December 2005. The company's management is responsible for the preparation and the content of the consolidated financial statements in accordance with International Financial Reporting Standards/IFRSs as adopted by the EU and for the preparation of the management report for the group in accordance with Austrian regulations. Our responsibility is to express an opinion on these consolidated financial statements based on our audit and to state whether the management report for the group is in accordance with the consolidated financial statements.

We conducted our audit in accordance with laws and regulations applicable in Austria and Austrian Standards on Auditing and International Standards on Auditing (ISA) issued by the International Federation of Accountants (IFAC). Those standards require that we plan and perform the audit to obtain reasonable assurance whether the consolidated financial statements are free from material misstatement and whether we can state that the management report for the group is in accordance with the consolidated financial statements. In determining the audit procedures we considered our knowledge of the business, the economic and legal environment of the group as well as the expected occurrence of errors. An audit involves procedures to obtain evidence about amounts and disclosures in the consolidated financial statements predominantly on a sample basis. 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.

Our audit did not give rise to any objections. In our opinion, which is based on the results of our audit, the consolidated financial statements are in accordance with legal requirements and present fairly, in all material respects the financial position of the company as of 31 December 2005 and of the results of its operations and its cash flows for the fiscal year from 1 January to 31 December 2005 in accordance with International Financial Reporting Standards/IFRSs as adopted by the EU. The management report for the group is in accordance with the consolidated financial statements.

Vienna, 9 March 2006

This is a translation from German to English.

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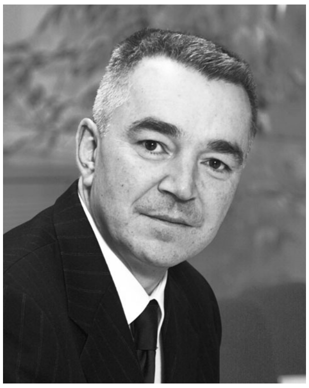
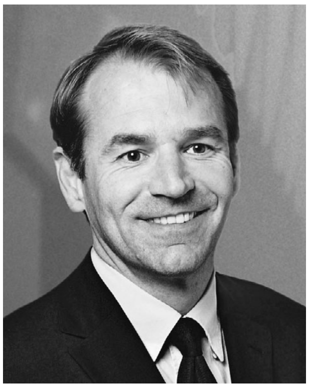
Management Board



CEO: Thomas Deutschmann
e-mail: thomas.deutschmann@update.com

CFO: Monika Fiala, MBA
e-mail: monika.fiala@update.com



CTO: Arno Huber
e-mail: arno.huber@update.com

Shares and Options of the Executive Bodies of the Company as of 31 December 2005

Name	Member of	Shares	Options
Gilbert Hödl	Supervisory Board (until 2/6/2005)	101,619*	0*
Frank Hurtmanns	Supervisory Board	4,278	0
Hans Strack-Zimmermann	Supervisory Board	0	0
Richard Roy	Supervisory Board (since 2/6/2005)	0	0
Thomas Deutschmann	Management Board	0	400,000
Monika Fiala	Management Board	10,000	125,939
Arno Huber	Management Board	848,334	100,000

* as of 2/6/2005