updating customer relations update

2003

Annual Report update software AG

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Security code number 934 523 Symbol: up2

Shares & Options of the members of the boards

	Member of	Shares	Options
Gilbert Hödl	Supervisory Board	93,815	0
Frank Hurtmanns	Supervisory Board	435	0
Hans Strack-Zimmermann	Supervisory Board	0	0
Thomas Deutschmann	Management Board	0	100,000
Monika Fiala	Management Board	0	25,939
Arno Huber	Management Board	848,334	0

This English translation is provided for convenience only. In case of any discrepancies the German original shall prevail.

Letter of the CEO

Dear Shareholders, Customers and Employees,

2003 was the third economically difficult year in a row, not only for the IT industry but also for many other industries. We are therefore all the more pleased to be able to report on several positive developments in our company in this annual report.

update was able to successfully address the market's current challenges – in particular as compared to the previous year. The primary goal, the return to profitability, was reached starting in the second quarter and for every subsequent quarter as well as for the year as a whole.

But other key ratios were also positive. For example, starting in the second quarter, revenue climbed consistently quarter-on-quarter. Not only that: compared to the previous year's quarters, sales revenue grew by 12.9 % and 14.2 % in the third and fourth quarter respectively. The return to profitability with a concurrent increase in revenue shows that the restructuring measures initiated in late 2002 can be considered as successfully concluded.

Despite this, it cannot be left unsaid that annual sales revenue for the financial year just ended was 7.8 % below that of the previous year. However, in relation to others in the market, this is a comparatively low decline, so that a growing share in the target markets can be assumed. This operating growth also had a very positive effect on update's share price, which soared by 343 % during the course of 2003.

In the past year, as a medium-sized software company in international competition against the big players in the industry, update was able to hold its own again and again. We attracted new customers such as Magna, Roche and several internationally active private banks despite very difficult competitive conditions. update now has 16 years of experience in this young market, and its approach, with its typical customer centricity and industry-specific offering, is often seen by the customers as more important than the mere size with which some competitors attempt to score points. Overall, update was able to either maintain or strengthen its market position in all relevant markets. From this viewpoint, the development in the EU accession countries, where the company improved its leadership position, was especially gratifying.

One significant reason for maintaining its position amidst heavy competition is the further development of our core product, marketing.manager. In the fourth quarter of the past year, the product was presented to prospects, analysts and the trade press in several European countries, and met with an extraordinarily good response. In addition to a linear enhancement of the software's functionality, which once again significantly increased the product's value for our customers, from a technological viewpoint, the basis was laid for a long-term perspective into the future. By applying state-of-the-art software architecture, marketing.manager can thus continue to be positioned as a cutting-edge product. As a result, update is among the few vendors offering its customers the choice between traditional, well-established solutions and future-oriented, Web-based forms of implementation that require absolutely no infrastructure on the part of the user.

Against this backdrop, the outlook for 2004 allows cautious optimism. Almost all economic institutions are predicting at least minor economic growth. Irrespective of such forecasts, however, update is assuming three positive trends:

• In our target markets, companies have increased earnings predominantly via cost reductions. These options are being exhausted, so that the expectations of investors can only be met by increases in revenues. update offers products

Contents:

and solutions for all measures to be carried out in this connection.

• Secondly, for the above-mentioned reasons a certain backlog of capital spending has built up at companies in our target markets. The technology found in use is often not only functionally deficient but also technologically obsolete, which makes the operation of the solutions increasingly uneconomical. An investment in a functionally adequate and technologically superior solution can therefore be amortised rapidly.

• The most important point however is the altered perception of CRM solutions. If, in the past, there were many voices questioning the usefulness of such solutions in principle, there now exists a broad consensus that for companies there is neither a methodological nor technological alternative to uncompromising customer focus.

As shareholders or customers you have trusted update, for which I would like to thank you personally and on behalf of the entire team. We used 2003 to improve the company's economic situation and to further develop a truly great software product. It should also be noted that we succeeded in acquiring almost 80 new customers for update. What counts most, however, is that our customers reap tangible benefits from deploying our solutions and are happy to work with them as individuals.

In 2004 as well, we will consider the satisfaction of our customers as one of the key parameters for our success, because we are convinced that shareholder value can be increased and sustained over the long term only by a sufficiently large number of satisfied customers.

Thomas Deutschmann

Report of the Supervisory Board

Dear Shareholders,

The 2003 financial year continued to be characterised by an uncertain overall economic environment. In spite of this, update was able to successfully implement the restructuring measures presented to the extraordinary shareholders' meeting on 8 January 2003. As a result, for the first time since going public, revenue as well as earnings increased three quarters in a row. The company's position in its core markets was also stabilised or even strengthened and the partnership sales strategy was developed further.

We can also report a change in the composition of the Supervisory Board. Since the 2003 ordinary shareholders' meeting, we welcomed Mr. Hans Strack-Zimmermann, who holds a Master of Science degree in Physics, as a new member of the Supervisory Board.

The Supervisory Board thanks the Board of Management and all employees for their hard work and their loyal cooperation. The Supervisory Board was kept informed on company developments by the Board of Management during regular meetings and performed the duties entrusted to it under the law and the Articles of Incorporation. These annual financial statements have been audited by Deloitte & Touche GmbH, Vienna, Austria. The audit gave no grounds for objection and an unqualified auditor's opinion has been issued.

The Supervisory Board is in agreement with the annual report submitted by the Board of Management for the 2003 financial year and with the proposed profit distribution. The annual financial statements are thus adopted pursuant to Section 125(2) of the Stock Corporation Act (Aktiengesetz – AktG).

We are convinced that the company's roadmap to growth will prove successful in 2004 and that update software AG will be able to further strengthen its position as a leading CRM software vendor.

Frank Hurtmanns Gilbert Hödl
Hans Strack-Zimmermann

Market and Industry Sector

update

With over 700 customers and 75,000 users, update software AG is a leading European provider of customer relationship management (CRM) software solutions. Based in Vienna, the company has subsidiaries in Germany, Switzerland, the Netherlands, France and the Czech Republic, and is represented throughout Europe by a number of established partners. update is focused on improving customer-related business processes in sales, marketing and services.

The marketing.manager 6 product suite comprises a variety of applications, and offers a flexible standard solution for operative, collaborative and analytical CRM. marketing.manager is available in 18 languages.

Founded in Vienna in 1988, the company has concentrated on businesses in vertically structured markets and currently offers industry-specific solutions for the following industries: pharmaceutical, construction, manufacturing, capital goods, energy and financial services. Renowned customers include 3M, Baiersdorf, DuPont, ESTAG, Imperial Tobacco, LBS Nord, Magna Steyr, Philips Medical Systems and Roche. Successful system implementation is guaranteed through the internal Professional Services Group, as well as via a network of experienced system integrators (amongst others Atos Origin, Dendrite, EDS Systematics, IDS-Scheer, Netragon, Softlab and Siemens SBS).

After an extremely difficult year for the software industry in 2002, early signs of stabilisation could be seen in the fiscal year just ended.

Starting in the second half of the year, the software industry regained some growth momentum, however it would be premature to speak of a recovery at this time. As before, the sector was characterised by deferred capital expenditures, consolidation and restructuring. Depending on the individual market, these factors were manifested in various ways.

While the software industry continued to grow in Asia, and growth signals could be seen from the USA, particularly in the fourth quarter, early signs of stabilisation also became apparent in Europe. Although the markets in Western Europe, especially in Germany, were still depressed, growth was achieved in the Eastern European countries. However, because its current market volume remains low, development in Eastern Europe had only a minor influence on the overall European market.

The CRM sector shows a similar picture. The European CRM market – update‘s primary target market – remained depressed in 2003 with one exception, namely Eastern Europe, which grew around 6 %. Companies like update, which provide software to support business processes (business management software), were also faced with three major challenges in the past financial year:

Restrained capital spending

Potential customers continued to be extremely restrained with capital expenditures. As a result of the economic conditions in almost all European countries, the priorities of companies in our target markets remained focussed more on increasing earnings through cost reductions than on increasing revenue through capital expenditures.

Increasing price pressure

The second tendency was increasing price pressure on all vendors in the IT field. This meant that disproportionate increases in sales volume were required to maintain last year‘s revenue level.

Increasing quality demands

Last, but not least, customers‘ quality demands increased greatly. Customers are not only placing a higher demand on the quality of enterprise software in general, but expectations as to the quality of the individual implementation and hence the modification to the company‘s specific processes have risen significantly.

In summary, it can be said that the tendency is for fewer customers demanding a more elaborate product at a lower price.

update recognised these facts and successfully adjusted to the needs of the market and customers. In so doing, it was able to further expand its market leadership in the German-speaking countries and to stabilise its position in the other Western European countries. update also took advantage of the opportunities in the growth market in Eastern Europe. In 2003, update further improved its position among the leading CRM vendors there.

Business Performance

The restructuring initiated in 2002 was successfully concluded in the past financial year. The programme aimed not only at the necessary turnaround, but rather set update's strategic course for the future. The basis for this was the action plan presented at the extraordinary shareholders' meeting on 8 January 2003.

update software AG

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

Sales revenue totalled around EUR 4.2 million and consisted essentially of royalties and service charges with subsidiaries. The result from ordinary business activities was moved into the black from minus EUR 5.3 million in 2002 to plus EUR 1 million in 2003.

The net loss for the year, movements of reserves and the loss carried forward from previous years resulted in an accumulated deficit of EUR 6.1 million, compared to an accumulated deficit of EUR 68.8 million in 2002. This change is primarily due to the dissolution of the related additional paid-in capital of EUR 61.7 million.

As of 31 December 2003, equity capital totalled EUR 3.4 million (2002: EUR 2.4 million) and thus represents an improvement of around 44 % year-on-year.

Group

Sales revenue

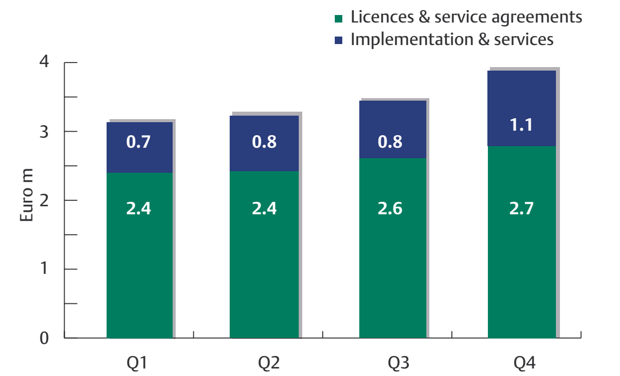
For the first time since going public, the company succeeded in achieving revenue growth three quarters in a row. Sales revenue in the first quarter totalled EUR 3.128 million and was increased in the second quarter to EUR 3.233 million, up 3.4 %. Growth in the third quarter was 6.5 % to EUR 3.443 million, as well as a considerable 11.7 % jump in the fourth quarter to EUR 3.845 million. Starting in the third quarter, sales revenue increased by 12.9 % and 14.2 %, respectively, over the corresponding quarters in the previous year.

Total sales revenue was EUR 13.648 million, around 7.8 % lower than for 2002. The decline in revenue from licences and maintenance agreements totalled 6.6 %, while service revenue declined by 11.1 %. These declines were attributable primarily to the closure of three unprofitable subsidiaries.

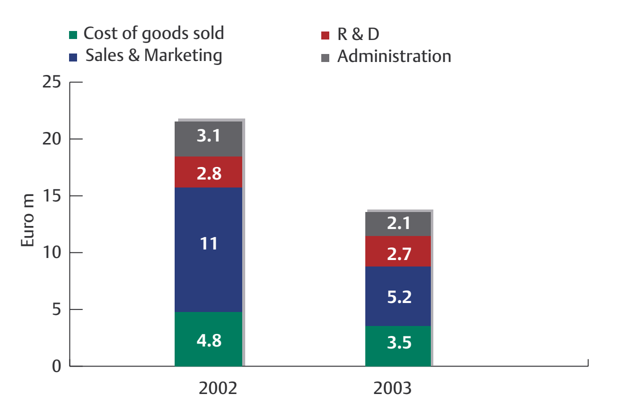
Costs

Expenditures were again drastically reduced in the individual corporate divisions. Marketing and sales expenditures were cut by a total of 52.3 % from EUR 10.92 million in 2002 to EUR 5.213 million in the 2003 financial year. Administrative costs were also reduced in 2003 by 31.7 % to EUR 2.1 million. Solely in research & development did expenditures remain almost unchanged, in order to ensure our continued technological leadership among CRM vendors.

Cost of goods sold were reduced by 26.1 % to EUR 3.535 million. These measures resulted in a 74 % increase in the gross margin. This corresponds to an increase of 6 percentage points compared to 2002.



Revenues by quarter: For the first time since going public, the company succeeded in achieving revenue growth three quarters in a row.



Costs: Expenditure was reduced by almost 37 % in 2003.

Earnings

Thanks to the successful restructuring, for the first time since going public, update attained an operating profit of EUR 0.102 million, while the operating loss in the prior period totalled EUR 6.729 million.

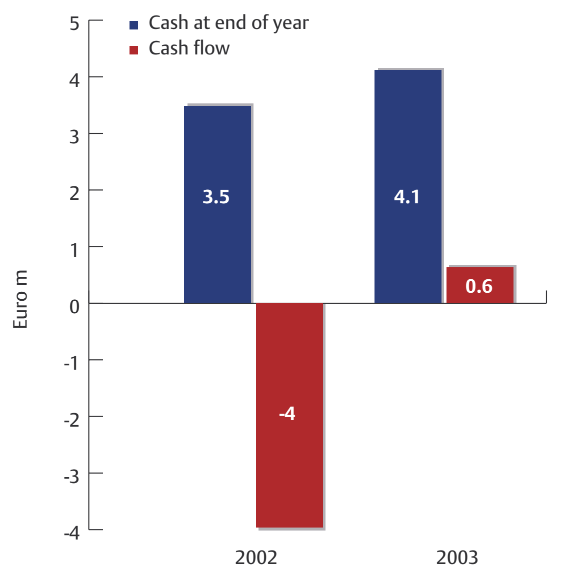
The net loss for the year was reduced by 94 % from approximately EUR 6.989 million in the prior period to EUR 0.419 million in 2003. This result was impaired mainly by negative exchange rate differences that were realised during the closure of the foreign subsidiaries.

The balance of liquid assets was also increased for the first time in 2003 by EUR 0.634 million, compared to the outflow of funds in 2002 of almost EUR 4 million.

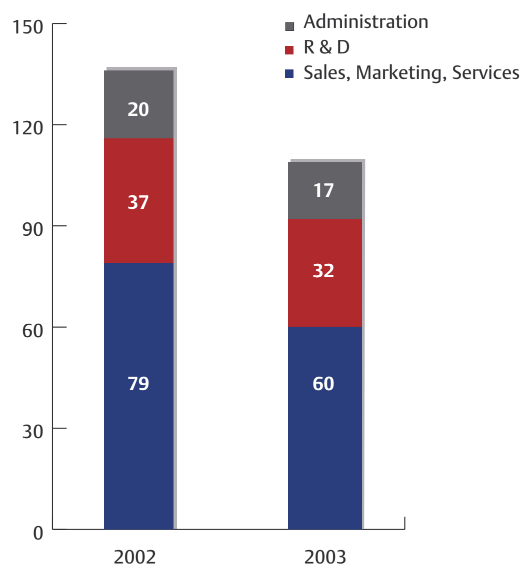
conducted with Magna Steyr, one of the world's leading automotive suppliers.

Co-operation with existing customers was also expanded. For example, in the fiscal year just ended, international groups such as Roche or 3M deployed marketing.manager in additional national organisations (for example, 3M Hungary, 3M Italy, Roche Morocco, Roche South Africa).

In addition, the expansion of the partner network was accelerated. Strategic partnerships were entered into with Hewlett Packard in Poland, AAM Technologies in Hungary and Softlab (a company of the BMW Group) in Austria, to name but a few. These partnerships further strengthen update both vertically and regionally.



Liquid assets and cash flow: Liquid assets were increased by EUR 634,000 in 2003.



Employees: Additional streamlining in sales and administration in 2003.

Employees

Due to cost-cutting and restructuring measures the number of employees decreased in 2003 from 136 to 109 (as of end of December 2003). This equals a reduction of 19.9 %. The decline is attributable on the one hand to the closure or sale of subsidiaries in Denmark, the UK and the USA, and on the other hand to additional streamlining in sales and administration. The number of employees is expected to remain unchanged in 2004.

Customers and partners

In spite of the difficult starting situation in the target markets, update was able to beat out industry leaders and gain additional renowned customers. New customer projects were successfully concluded for example with Illbruck GmbH (Germany), Mokveld Valves (Belgium), Raiffeisen Informatik Zentrum (Austria), NVM (Netherlands) and the Vienna University of Economics and Business Administration (Austria). Special mention must be given to the project

Sales strategy pays off

The market and customer-driven combination of direct and indirect sales proved itself in 2003. Strategic customers such as Magna Steyr, which implemented the latest Web-based version of marketing.manager, are serviced directly. Other projects are handled together with renowned partners (collaborative approach) to obtain the maximum benefits for the customer. One example of this is Dexia Bank in Slovakia. There, the project was implemented jointly with Siemens Business Services.

The award of the "CRM Best Practice Award 2003" shows that this strategy guarantees the customer the best possible solutions. This award recognised especially successful examples of CRM practice that have already proven their financial worth. In the category for medium-sized firms, two of the three prizes were awarded to update customers Gerhard D. Wempe KG and Gasversorgungsgesellschaft Rhein-Erft. These projects were implemented jointly with our partners Netragon AG and with Fichtner Consulting & IT GmbH, respectively.

Research and development

For a software company, investments in research and development are of fundamental significance for the company's future. In spite of the difficult market situation set out above, update was able to maintain research and development expenditures at the high level of the previous year and thus justify its title as an European product and technology leader – in particular in the CRM aspects of sales and marketing.

In the autumn of 2003, the general version of both core products of the 6th generation of marketing.manager, update.win and update.web, were presented at update's in-house trade fair, the "CRM Solution Day".

This was followed in March 2004 by the financial services and pharmaceutical versions including the version's migration and language packets. In the near future additional products of the marketing.manager 6 product suite will successively become available on the market.

marketing.manager 6 is available in three different technological layouts (multi-channel approach). Depending on the customer's requirements and infrastructure situation, either the classic Windows client (update.win), the browser-based update.web, or the mobile client update.pda – or any desired combination of these applications can be deployed.

Flexible solutions for increasing mobility

The combination of update.web and update.pda takes account of the requirements of increasing mobility. With the flexible update.pda, the most important data and business processes are also available off-line and when used with GSM or GPRS modules, it can access central corporate data in real time on-demand.

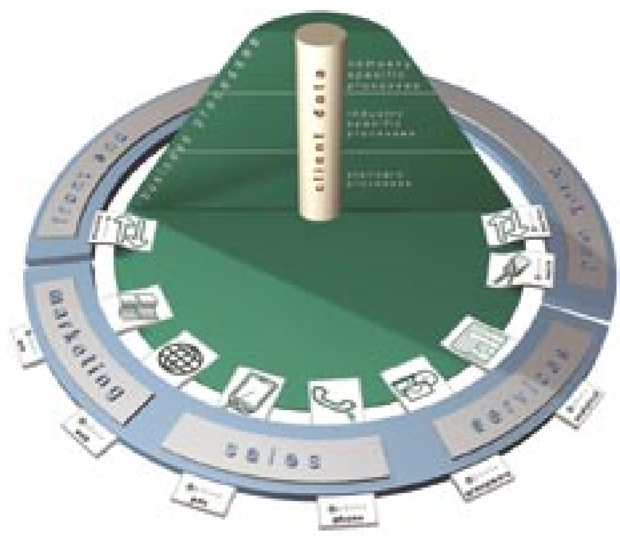
update.web, which has been completely re-developed, is based on the future-oriented Microsoft .NET technology. The successful development of this Web version is attributable to the special and longstanding expertise of update's development department as well as the close development partnership with Microsoft. update.web not only offers the full range of features of a superior CRM application but, due to its architecture and high scalability, is also suitable for CRM in ASP operation, which will allow update to open up additional business fields. In addition, update.web represents the technological basis for future CRM Web services and thus the seamless integration in Web portals.

An additional emphasis is the integration of marketing.manager in existing systems and applications. For example, update.groupware supports the bi-directional exchange of data between marketing.manager and Outlook or Lotus Notes. Using industry standards, update.phone allows the intelligent linking of CRM and telephony. Using the integration hub, update.interface, any desired integration scenarios can be implemented, for instance with ERP systems such as SAP/R3, Internet applications or other business applications using a wide variety of technologies (XML via HTTP, (D)COM, etc.).

The product portfolio is rounded out by applications for data purging (update.match) as well as by update.analytical for analysing customer data.

Intensive co-operation with customers

In order to be able to adjust to rapidly changing customer needs the company develops its products in close co-operation with its customers. To institutionalise this co-operation, update created the "Architects Council" in 2003. This platform provides a regular exchange of experience with selected customers.



marketing.manager 6: update's new product suite was launched in autumn 2003.

Market successes and innovations

Our product innovations have been well accepted by the market. On the one hand, this was shown by the increase in revenue in the fourth quarter of 2003, while winning special awards confirms the acceptance and quality of the solutions offered by update. For example, in the international ISM Award update competed against 400 CRM solutions and won the "ISM Top 15 CRM Award". This prize is awarded annually by ISM Inc., headquartered in the USA. The jury based their decisions on thorough tests, where CRM solutions were evaluated against 202 criteria.

Outlook 2004

update is assuming profitable growth based on the "growth engines" of specialisation of specific industries, regional expansion and technological innovation in 2004.

It is still difficult to present an outlook for 2004 as material factors influencing the company's business activities cannot be forecasted reliably.

Even if positive trends are clearly discernible with respect to the company and the market, unfavourable political as well as macroeconomic developments could have a negative impact on the development of update's revenue and earnings.

For 2004, update plans on profitable growth from internal forces. The good position of the company and its product and service portfolio can also allow growth above the market average.

This assumption is derived from a positioning of the product in a segment with a relatively low saturation but high demand.

The segment for small and very small CRM applications with little functionality and no industry-specific orientation is being covered by a large number of manufacturers. update does not address this segment because, on the one hand the product's capability is not in demand there, and on the other hand, the potential licensing revenues are less attractive. At the upper end of the scale, for corporate solutions with several thousand workstations, there is strong competition between the major vendors in the industry. This competitive environment and the high saturation in this field make this segment unattractive for update as well.

Instead, update aims at the middle segment with a market saturation of sometimes less than 40 %. This segment is characterised by a high demand for industry orientation and specialisation, and customers expecting an economical as well as rapid implementation of the product. It is exactly these requirements for which update's product portfolio is designed.

In addition to this positioning, the company's regional focus allows an optimistic estimate of growth opportunities. In addition to the European core markets, update is focussing in particular on the new EU member countries, for whom higher growth rates than in Western Europe are expected in the coming years. Already in the second half of 2003 it became apparent that update can leverage its leading position to achieve above-average growth in these regions. In contrast to many competitors, update already has its own branches as well as a proven and successful partnership infrastructure in these countries. In addition, the product is available in eight Eastern European languages, which represents an advantage in particular compared to Anglo-Saxon competitors.

Besides the aspect of the promising positioning through specialisation and/or verticalisation of the product on the one hand and the regional focus on the other, the company's innovative ability also gives cause for growth-oriented planning.

With the new version of marketing.manager, update has a product at the latest state of the art. In addition to this competitive advantage, the product's technology and architecture allow for totally new forms for use, integration and distribution, for example so-called ASP models, in which the software is no longer acquired by licence but rather operated outside of the company and is procured in rented models. In spite of divided opinions by experts on the speed with which this model is spreading, it can be assumed that this form of software usage will increase in significance over the mid-term. update can already provide these models today and thus shows that it is also well positioned for the future in this area.

To summarise, it can be said that update is assuming profitable growth in 2004 based on the "growth engines" of specialisation in specific industries, regional expansion and technological innovation.

Consolidated Balance Sheet as of 31 December 2003

pursuant to US-GAAP

including previous year's comparative figures

	31 Dec. 2003 EUR (000)	31 Dec. 2002 EUR (000)
Assets:		
Current assets		
Cash and cash equivalents (Note 3)	**4,119**	**3,485**
Trade accounts receivable	4,743	5,400
less: Allowance for doubtful accounts (Note 4)	-1,193	-1,263
Net total trade accounts receivable	**3,550**	**4,137**
Inventories	51	113
Prepaid expenses	98	281
Other current assets (Note 5)	144	197
Total current assets	**7,962**	**8,213**
Fixed assets, net (Note 6)	697	1,358
Investment securities (Note 7)	88	92
Total assets	**8,746**	**9,663**
Equity and liabilities:		
Current liabilities		
Current instalments on long-term liabilities	242	363
Trade accounts payable	573	959
Accruals and other liabilities (Note 8)	2,277	2,555
Deferred income	606	464
Total current liabilities	**3,698**	**4,341**
Long-term liabilities (Note 9)	606	848
Accrued liabilities for severance pay (Note 10)	239	218
Liabilities from capital leases, excluding current instalments (Note 11)	6	7
Total liabilities	**4,549**	**5,414**
Shareholders' equity		
Share capital (Autorised capital 4,690,983.00)	9,382	9,382
No-par value shares issued and outstanding 2003: 9,381,967 (2002: 9,381,967)		
Additional paid-in capital	222	57,728
Accumulated deficit	-5,789	-62,876
Other reserves	382	15
Total shareholders' equity	**4,197**	**4,249**
Total equity and liabilities	**8,746**	**9,663**

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

Consolidated Income Statement for the 2003 financial year
pursuant to US-GAAP

including previous year's comparative figures

	2003 EUR (000)	2002 EUR (000)
Sales revenue		
Revenues from licenses and maintenance agreements	10,175	10,898
Revenues from implementation and service	3,473	3,905
Total sales revenues, net	**13,648**	**14,803**
Cost of goods sold		
Cost of licenses and maintenance agreements	849	1,181
Implementation and services costs	2,686	3,598
Total cost of goods sold	3,535	4,779
Gross profit	**10,113**	**10,024**
Operating expenses		
Sales and marketing	5,213	10,920
Research and development	2,702	2,757
General and administration expenses	2,096	3,076
Total operating expenses	**10,011**	**16,753**
Operating income	**102**	**-6,729**
Interest income	84	168
Interest expenses	-76	-105
Other income and expenses, net (Note 14)	-523	-314
Loss before income taxes	**-413**	**-6,980**
Income taxes (Note 13)	-6	-9
Net loss for the year	**-419**	**-6,989**
Loss per share (basic and diluted) (Note 15) in Euro	**-0.04**	**-0.75**
Average number of shares issued	9,381,967	9,259,300

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

Consolidated Statement of Changes in Equity
and Comprehensive Income for the 2003 financial year

including previous year's comparative figures

	Share capital EUR (000)	Additional paid-in capital EUR (000)	Accumulated deficit EUR (000)	Other reserves EUR (000)	Total EUR (000)
Balance at 31 December 2001	**9,382**	**57,728**	**-55,617**	**-338**	**11,155**
Net loss for the year	0	0	-6,989	0	-6,989
Remeasurement gains/losses on financial instruments	0	0	0	-2	-2
Currency translation adjustments	0	0	0	3	3
Comprehensive income/loss	0	0	0	0	-6,988
Sale of own shares	0	0	-270	352	82
Balance at 31 December 2002	**9,382**	**57,728**	**-62,876**	**15**	**4,249**
Net loss for the year	0	0	-419	0	-419
Remeasurement gains/losses on financial instruments	0	0	0	-1	-1
Currency translation adjustments	0	0	0	136	136
Exchange losses reclassified in the net loss for the year	0	0	0	232	232
Comprehensive income/loss	0	0	0	0	-52
Dissolution of additional paid-in capital	0	-57,506	-57,728	0	0
Balance at 31 December 2003	**9,382**	**222**	**-5,789**	**382**	**4,197**

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

Consolidated Cash Flow Statement for the 2003 financial year

pursuant to US-GAAP

including previous year's comparative figures

	2003 EUR (000)	2002 EUR (000)
Operating activities:		
Net loss for the year	**-419**	**-6,989**
Reconciliation of the net loss for the year to net cash flow from operating activities:		
Depreciation	644	1,339
Changes in accrued pension and other employee benefits	20	85
Unrealised remeasurements gains/losses on currency differences	368	3
Changes in assets and liabilities:		
Change in trade accounts receivable	587	2,890
Change in inventories	62	97
Change in trade accounts payable	-386	-427
Change in deferred income	144	220
Change in accruals	-278	-867
Change in other assets and liabilities	234	58
Net cash flow from operating activities	**976**	**-3,591**
Cash flow from investing activities:		
Capital expenditures for fixed assets	-47	-361
Proceeds from disposal of fixed assets	64	137
Proceeds from disposal of financial assets	4	20
Net cash flow from investing activities	**21**	**-204**
Cash flow from financing activities:		
Change in long-term liabilities from capital leases	0	-4
Change in own shares	0	82
Change in liabilities to banks	-121	0
Change in long-term loans	-242	-242
Net cash flow from financing activities	**-363**	**-164**
Change in cash and cash equivalents	634	-3,959
Cash and cash equivalents at beginning of year	3,485	7,444
Cash and cash equivalents at end of year	**4,119**	**3,485**
Supplemental disclosures:		
Cash expenditures during the reporting period for:		
Interest	76	105
Income taxes	6	9

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

Notes to the Financial Statements as of 31 Dec. 2003 pursuant to US-GAAP

1. Organisation and operations of the company

update software AG (the Company or "update") was founded in 1988 as "Marketing Informationssysteme Gesellschaft m.b.H.". In October 1989, the Company was renamed Update Marketing Service Gesellschaft m.b.H. On 29 April 1997, the Company was converted into a stock corporation (Aktiengesellschaft) and its name changed to Update Marketing Service AG. On 19 October 1999, the Company was renamed update.com software AG. On 22 May 2002, the name was changed yet again to the company's current name, update software AG. The Company's registered office is in Vienna, Austria. Unless otherwise noted, all information relates to update software AG and its predecessors.

update is 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 on new products, dependence on skilled personnel, uncertain profitability, and concentration on a single core product.
Effective 1 February 2003, the Company was moved to the General Standard segment of Deutsche Börse, the German stock exchange.

2. Summary of accounting principles

a) Consolidation principles

The consolidated financial statements include the financial statements of the parent company and its subsidiaries ("the Company"). All intercompany transactions and balances have been eliminated during consolidation.

b) Use of estimates

The financial statements have been prepared in accordance with US-GAAP 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 fixed assets.

c) Cash and cash equivalents

Cash and cash equivalents comprise cash and short-term investments with residual maturities of three months or less when acquired and which are readily convertible to cash. The Company's cash investments consist of time deposits with residual maturities of three months or less, fixed term deposit accounts and money market funds.

d) Investment securities

The Company holds shares in various investment funds in Austria, as provided by Austrian law to cover taxable severance payment claims.

e) Fixed assets

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

The useful lives of the assets are estimated as follows:

	Deprecation period in years
IT hardware	3 – 4
Software	2 – 4
Office equipment	7
Office furniture	5 – 7

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

f) Inventories

Inventories consist of software licences purchased for resale. Inventories are measured at the lower of the average acquisition cost or fair market value. A loss-free measurement is made by taking discounts determined on the basis of estimated marketability. In the 2003 and 2002 financial years, inventory adjustments recognised in cost of goods sold were EUR 0 and EUR 65,000, respectively.

g) Measurement of long-term assets

The Company conducts impairment tests on its long-term assets if events or circumstances indicate that the value of such assets may have fallen below their carrying value. This impairment test compares the estimated future undiscounted cash flows from the asset with its carrying value. If this test indicates a deficit, the asset is written down to its market value.

h) Revenue recognition and deferred revenue

Revenues from the sales of software licenses are recognised in accordance with Statement of Position (SOP) 97-2, "Software Revenue Recognition", issued by the American Institute of Certified Public Accountants. The prerequisite for revenue recognition is the existence of a valid contract, completed delivery of the software, a fixed or determinable licence fee, and probable collectability of the receivable. All of these prerequisites must be fulfilled.

Revenues from support and maintenance agreements are posted as deferred revenues when invoiced and recognised pro rata over the period of the agreement. Revenues from services comprise training, consultancy and implementation services and are recognised in accordance with SOP 97-2 and SOP 81-1 "Accounting for Performance of Construction-Type and certain Construction-Type Contracts". That means that, for long-term projects, recognition is made pursuant to the percentage of completion method based on milestones. Earnings from other services are recognised when performed.

A project is deemed concluded upon acceptance by the customer.

Customers may have a contractual right of withdrawal in individual cases. In these cases, revenues are realised pursuant to SFAS 48 "Revenue Recognition When Right of Return Exists" taking into account an estimated probability of the exercise of any such right of withdrawal.

i) Cost of goods sold

Costs of revenues from licences and maintenance agreements include the costs of data media, product packaging, documentation and other production costs as well as licence fees to third parties. Also included in this category are the costs of salaries, other payroll costs and premiums for maintenance and hotline support personnel.

Costs of revenues from services consists primarily of salaries, other payroll costs and premiums as well as allocated overhead costs related to staff who provide consulting, training and implementation services.

j) Research and development

Research and development costs, which consist primarily of software development costs, are recognised as incurred. Accounting standards provide for the capitalisation of certain software development costs after the software's technological feasibility has been established. Under the Company's current practice of developing new products and enhancements, technological feasibility of the underlying software is not established until substantially all product development is complete, including the development of a functioning prototype. Accordingly, the Company has no capitalised software development costs.

k) Advertising costs

Advertising costs are expensed as incurred. Advertising costs for the financial year ended 31 December 2003 were EUR 174,000 and EUR 398,000 for the financial year ended 31 December 2002.

l) Income taxes

Income taxes are determined using the liability method in accordance with the Statement of Financial Accounting Standard (SFAS) 109, "Accounting for Income Taxes". Under this method, deferred tax assets and liabilities are recognised for estimated future tax consequences that are attributable to differences between the carrying amounts on the consolidated balance sheet and amounts on the tax balance sheet. Taxation is measured using the tax rates to be in effect for taxable income in the years in which those temporary differences are expected to be settled. Under SFAS 109, the effect on deferred tax assets and liabilities of a change in tax rates is recognised in the period in which the new tax rate takes effect.

As part of its tax reform package starting in 2005, the Austrian federal government plans to reduce the corporate tax rate from currently 34 % to 25 %. The overall effect for the update software Group cannot yet be estimated.

m) Calculation of earnings per share

Earnings per share are calculated by dividing consolidated net income (loss) by the weighted average number of ordinary shares outstanding for the period. Diluted earnings per share takes into account not only outstanding shares, but also shares receivable due to options (employee share participation, warrants) if these have a dilutive effect.

Pro forma earnings per share is calculated by dividing net income (loss) including pro forma expenses pursuant to SFAS 123 "Accounting for Stock-Based Compensation" by the weighted average number of ordinary shares outstanding for the period.

n) Currency translation

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 statements 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 comprehensive income". Other gains and losses on currency translation adjustments are recognised in the consolidated income statement when incurred.

o) Employee share option plan
The Company accounts for its employee share option plan in accordance with SFAS 123, "Accounting for Stock-Based Compensation". As permitted under SFAS 123, the Company continues to measure compensation expense for share options granted to employees and senior executives under the provisions of Accounting Principles Board Opinion (APB) 25, "Accounting for Stock Issued to Employees", and its related interpretations. The exercise price of options granted under the Company's 1999 share option plan (the "1999 Plan") is equal to the market price of the Company's share on the grant date, and accordingly, pursuant to APB 25, no compensation cost has been recognised. The 2000 plan is treated as a fixed plan under APB 25, due to fixed exercise prices and service periods. The excess of the market price as of the balance sheet date over the exercise price is recognised as deferred compensation expense over the service period. No compensation expense from options was recognised in 2003.

Pursuant to SFAS 123, companies that continue to follow APB 25 are required to provide pro forma disclosures showing the effects of application of the fair value method under SFAS 123 (see Note 15).

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

q) Accrued liabilities for severance pay
Austrian labour law requires the Company to pay employees certain severance payments upon termination or retirement. Employees leaving voluntarily or dismissed for good cause are not entitled to such severance pay.

The company uses the projected unit credit method to determine severance pay expenses and the related accruals for financial reporting purposes. The calculation is based on the following assumptions: interest rate: 6 %, future salary increases: 3 %.

r) Lease agreements
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. All other lease agreements are accounted for as operating leases.

3. Cash and cash equivalents

The Company's cash investments consist of time deposits with maturities of three months or less, fixed term deposit accounts and money market funds.
As of 31 December 2003, the Company's cash and cash equivalents totalled EUR 4,119,000, of which EUR 246,000 were pledged to secure granted bank guarantees. The Dutch subsidiary has established a restricted account in the amount of EUR 130,000 in connection with pending ABASE proceedings against update Benelux B.V. The attorney for update Benelux B.V. estimates that this account will not be accessible prior to 2005.

4. Trade accounts receivable

The allowance for doubtful accounts developed as follows:

	31 Dec. 2003	31 Dec. 2002
	EUR (000)	EUR (000)
Allowance for doubtful accounts at beginning of year	1,263	1,198
Additions	498	745
Usage	-295	-640
Reversal of unused allowances	-273	-40
Allowance for doubtful accounts at end of year	1,193	1,263

As of 31 December 2003, the trade accounts receivable contained no intercompany accounts receivable.

5. Other current assets

	31 Dec. 2003	31 Dec. 2002
	EUR (000)	EUR (000)
Receivables from tax authorities	99	99
Receivables from senior executives and employees	17	14
Rental and leasing deposits	21	47
Other assets	7	37
	144	**197**

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

6. Fixed assets

	31 Dec. 2003	31 Dec. 2002
	EUR (000)	EUR (000)
Costs		
IT hardware	1,786	1,864
Software	746	745
Office equipment	733	823
Office furniture	128	229
Other fixed assets	375	411
	3,768	4,072
less: Accumulated depreciation	-3,071	-2,714
Carrying value	**697**	**1,358**

Depreciation expense for the financial years ended on 31 December 2003 and 2002 totalled EUR 642,000 and EUR 1,002,000, respectively.

7. Investment securities

Historical costs, unrealised gains, unrealised losses and fair value as of 31 December 2003 and 2002, were as follows:

	Historical costs	Unrealised gain/loss		Fair value
	EUR (000)	EUR (000)	EUR (000)	EUR (000)
Available-for-sale securities (investment funds)				
31 December 2002	98	0	6	92
31 December 2003	95	0	7	88

Securities totalling EUR 4,000 were sold in 2003. The resulting proceeds essentially correspond to the carrying value.

8. Accruals and other liabilities

	31 Dec. 2003	31 Dec. 2002
	EUR (000)	EUR (000)
VAT, payroll taxes and social security	518	211
Payroll and travel expenses	433	782
Other accruals	1,326	1,562
	2,277	**2,555**

The decrease in payroll and travel expenses is attributable to the reduced number of employees at year's end.

Other accrued liabilities include primarily accruals for consulting and legal expenses, accruals for unused holidays, as well as employee commissions.

9. Long-term liabilities

	Carrying value	Fair value
	EUR (000)	EUR (000)
31 December 2002	848	869
31 December 2003	606	617

In 1998, the Company entered into a loan agreement with Bank Austria AG. Proceeds from the loan were EUR 1,453,000. The interest rate on the loan is 6.25 % per annum. Interest is payable on 30 June and 31 December each year. The loan is secured by a payment guarantee from Austria Wirtschaftsservice GmbH (AWS) pursuant to the guidelines of the Austrian Technology Financing Program [Technologie-Finanzierungsprogramm (TFP)]. The loan must be repaid either in eleven semi-annual instalments of EUR 121,000, where the first instalment is due on 31 December 2001, and the final instalment on 30 June 2007, or earlier as applicable if the venture capitalists of the 1997 first financing round sell all of their shares. The fair value of the Company's long-term liabilities is calculated by discounting the future cash flows using the rate currently offered to the Company by its banks for similar debt securities of comparable maturity.

10. Accrued liabilities for severance pay

Accrued liabilities for severance pay are related to severance payments to be made upon termination.

	EUR (000)
Accruals as of 31 December 2001	**133**
Interest expense	13
Service cost	61
Severance pay	-147
Actuarial losses	158
Accruals as of 31 December 2002	**218**
Interest expense	94
Service cost	53
Severance pay	-124
Actuarial losses and severance payments	216
Accruals as of 31 December 2003	**239**

11. Lease agreements

The Company has liabilities arising from capital leases for IT software and other operating assets. As of 31 December 2003 and 2002, the following amounts were treated as capital leases:

	31 Dec. 2003	31 Dec. 2002
	EUR (000)	EUR (000)
Vehicles	53	69
less: Accumulated depreciation	-17	-16
	36	**53**

Depreciation of assets held under capital leases is included in depreciation expense. In December 2000, the Company concluded a 5-year non-terminable lease agreement for offices. The annual rental lease payments incurred under this lease are EUR 426,000. The Company also has several non-terminable operating leases, primarily for buildings, office facilities, vehicles and other equipment. As of 31 December 2003, the future minimum lease payments for non-terminable operating and capital leases were:

	Capital leases	Operating leases
	EUR (000)	EUR (000)
Financial year as of 31 December		
2004	26	632
2005	24	548
2006	9	478
2007	0	444
2008	0	444
	59	**2,546**
less: Current instalments for liabilities from capital leases (are included in current liabilities)	-53	
Liabilities from capital leases, excluding current instalments	6	

The future minimum payments for operating leases totalled EUR 2,546,000 and EUR 2,881,000 as of 31 December 2003 and 2002, respectively. Future minimum obligations under capital leases, excluding current instalments, as of 31 December 2003 and 2002, were EUR 59,000 and EUR 82,000. Depreciation on capitalised assets was EUR 17,000 in 2003. Interest included in the capital leases as of 31 December 2003 was EUR 6,000.

12. International operations and segment reporting

The Company licenses and markets its products through direct and indirect distribution channels in Europe. The Company's customers are spread over numerous geographic regions around the world and consist of companies in a wide variety of industries. During 2003, no single customer accounted for more than 4 % of total revenues. Revenue distribution by sales offices was as follows:

	2003	2002
	EUR (000)	EUR (000)
Austria	5,258	3,496
Germany	4,295	5,795
Netherlands	1,754	2,131
Rest of world	2,341	3,391
Total revenues	**13,648**	**14,803**

The subsidiaries' business operations do not require significant fixed assets.

13. Income taxes

Total tax income/expense for the financial years ended 31 December 2003 and 2002 were allocated to the respective earnings from current operations.

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

	Current	Deferred	Total
	EUR (000)	EUR (000)	EUR (000)
2002			
Austria	8	0	8
Foreign	1	0	1
Total	**9**	**0**	**9**
2003			
Austria	6	0	6
Foreign	0	0	0
Total	**6**	**0**	**6**

Tax expenses differed from the amounts computed by applying the Austrian income tax rate of 34 % to pre-tax earnings from current operations. This difference can be derived as follows:

	2003	2002
	EUR (000)	EUR (000)
Earnings before taxes	-413	-6,980
Tax rate (%)	34 %	34 %
Expected tax income	-140	-2,373
Actual tax expense	-6	-9
Difference to be reconciled	**-147**	**-2,382**
Reconciliation		
Adjustment	-1,268	1,917
Change in tax rate	0	0
Non tax-deductible expenses	0	0
Other	1,415	465
Total reconciliation	**147**	**2,382**

"Other" essentially includes write-downs on holdings and accruals for severance pay.

The tax effects of temporary differences that lead to increases in deferred tax assets as of 31 December 2003 and 2002, respectively, are presented below:

	31 Dec. 2003	31 Dec. 2002
	EUR (000)	EUR (000)
Long-term deferred tax assets/liabilities		
Loss carry-forwards	30,237	32,871
Write-down of investments in affiliated companies	1,219	127
Depreciation and amortisation	0	0
Other	0	18
Total gross deferred tax assets	**31,455**	**33,016**
less: Valuation allowance	-31,455	-33,016
Net deferred tax assets	**0**	**0**

The majority of the loss carry forwards can be carried forward indefinitely. Due to the uncertainty with regard to realisability, the Company has established a valuation allowance in the full amount.

14. Other income and expenses

Other operating income includes proceeds from asset disposals, reversals of accruals, and reversals of unused allowances for doubtful accounts receivable. Other operating expenses are composed of exchange rate losses and losses on receivables.

	2003	2002
	EUR (000)	EUR (000)
Reversal of accruals	120	918
Reversal of unused allowances for doubtful accounts	412	0
Asset disposals	16	7
Other income	124	454
Exchange rate losses	-374	-31
Losses on receivables	-155	-134
Addition to allowances for doubtful accounts	-480	-725
Other expenses	-186	-648
Reorganisation	0	-155
Other income and expenses, net	**-523**	**-314**

On 24 February 2003 the American subsidiary, Update Marketing, Inc., was sold in a management buy-out. In the course of this takeover, 76 % of the shares were transferred to the new shareholders. Exchange rate losses of EUR 232,000 were incurred during the deconsolidation.

15. 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 share 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 by 171,516 shares. After 15 February 2000 share options will only be issued under the terms of the 2000 Plan. The reissuance 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 daily quote 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 exercise 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 elsewhere. For purposes of this Plan, the Company is also authorised to purchase its own shares from an intermediary bank that tenders authorised capital.

Options that were granted to Management Board Member Thomas Deutschmann are subject to special exercise agreements. These granted options may be exercised for 33,000 shares after the first year of membership on the Management Board. An additional 33,000 shares may be obtained after an additional year and 34,000 shares after a total of three years of employment with the Company.

Overview of the share option plans

In the following tables, 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	Range in EUR	Weighted average exercise price in EUR
As of 31 December 2001	**712,736**	**465,411**	**1.15 - 23**	**4.6**
Options granted	(189,729)	189,729	1 - 1.37	1.09
Expired options	348,565	(348,565)	1 - 23	3.04
Options exercised	0	0	0	0
As of 31 December 2002	**871,572**	**306,575**	**1 - 23**	**4.21**
Options granted	(37,715)	37,715	1 - 1.57	1.06
Expired options	53,053	(53,053)	1 - 23	4.85
Options exercised	0	0	0	0
As of 31 December 2003	**886,910**	**291,237**	**1 - 23**	**3.68**

The following table provides an overview of currently outstanding and exercisable options under the 1999 Plan as of 31 December 2002 and 31 December 2003. The share split on 15 February 2000 has been taken into account.

1999 Plan

As of 31 December 2002

Issued				Exercisable	
Spread of the exercise price	Issued options	Weighted remaining exercise period	Weighted average exercise price	Exercisable options	Weighted average exercise price
EUR		in years	EUR		EUR
4.3	113,451	6.5	4.3	112,361	4.3
6.0	7,800	6.8	6.0	6,661	6.0
7.3	6,240	6.9	7.3	5,004	7.3
4.3 – 7.3	127,491	6.5	4.5	124,026	4.5

As of 31 December 2003

Issued				Exercisable	
Spread of the exercise price	Issued options	Weighted remaining exercise period	Weighted average exercise price	Exercisable options	Weighted average exercise price
EUR		in years	EUR		EUR
4.3	85,128	5.5	4.3	85,128	4.3
6.0	4,680	5.8	6.0	4,680	6.0
7.3	3,120	5.9	7.3	3,120	7.3
4.3 - 7.3	92,928	5.5	4.5	92,928	4.5

The following table provides an overview of options that are currently outstanding and exercisable under the 2000 Plan as of 31 December 2003 and 31 December 2002. The share split on 15 February 2000 has been taken into account.

2000 Plan

As of 31 December 2002

Issued				Exercisable	
Spread of the exercise price	Issued options	Weighted remaining exercise period	Weighted average exercise price	Exercisable options	Weighted average exercise price
EUR		in years	EUR		EUR
23	2,340	7.2	23	878	23
18.7	3,900	7.5	18.7	1,463	18.7
8.8	6,955	7.8	8.8	2,088	8.8
3.4	6,500	8	3.4	1,625	3.4
2.2	4,420	8.2	2.2	845	2.2
1 - 1.4	154,969	9.8	1.04	0	0
1 - 23	179,084	9.6	2.13	6,898	10.6

As of 31 December 2003

Issued				Exercisable	
Spread of the exercise price	Issued options	Weighted remaining exercise period	Weighted average exercise price	Exercisable options	Weighted average exercise price
EUR		in years	EUR		EUR
23	780	6.2	23	488	23
18.7	3,120	6.5	18.7	1,950	18.7
8.8	4,615	6.8	8.8	2,657	8.8
3.4	5,460	7	3.4	2,730	3.4
2.2	2,340	7.2	2.2	943	2.2
1 - 1.57	181,994	9	1.03	34,900	1.02
1 - 23	198,309	8.8	1.65	43,668	2.70

Pro forma information

The Company continues to apply APB 25 in accounting for its Share Option Plan. Accordingly, no compensation expense has been recorded in the consolidated income statement. Had compensation expense been recognised in accordance with the fair value method prescribed by SFAS 123, the Company's pro forma net loss and loss per share as of 31 December 2003 would have been as follows:

	Financial year ended 31 Dec. 2003	Financial year ended 31 Dec. 2002
	EUR (000)	EUR (000)
Net loss for the year, as reported	-419	-6,989
Pro forma expense pursuant to Statement 123	-34	-55
Pro forma loss for the year	-453	-7,044
Basic and diluted loss per share	EUR -0.04	EUR -0.75
Pro forma basic and diluted loss per share	EUR -0.05	EUR -0.75

The weighted average fair value of options issued in 2003 was EUR 0.55 per option (2002: EUR 0.25). The fair value of an option is determined on the issue date using the Black-Scholes pricing model with the following assumptions at the end of the financial years ending 31 December 2003 and 2002, respectively: risk-free interest rate of 4.0 %, which corresponds to that of government bonds with similar original maturities as the estimated exercise period of the option; exercise period of 5 years for the 2000 Plan; annual volatility of the Company's share price of 134 % for 2003 and 112 % for 2002; and a dividend yield of 0 % for each financial year.

16. Financial commitments and contingent liabilities

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

With regard to the complaint filed against update software AG in July 2002 for alleged failure to perform preliminary contractual duties in the amount of EUR 705,000, three evidentiary hearings took place in 2003. In the opinion of both an external expert and update's legal advisor, a favourable outcome for update is likely. Therefore, no additional accrual has been set up.

The Berghuis/ABASE proceedings pending against update Benelux B.V. since 2000, were stayed in September 2002, after the complaining party was ordered by the court to present an expert opinion on various items in the petition 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. However, should the plaintiff comply, the update Holland's legal representative in the action considers the probability of the plaintiff prevailing as very low. Therefore, again in 2003, no accruals were formed with respect to these proceedings.

Based upon the estimate of outside legal counsel, the Management Board is of the opinion that the Company is not involved in any further legal proceedings, as of 31 December 2003, that could have a material effect on the Company's earnings or financial position.

17. Transactions with related parties

A member of the Supervisory Board, who was active until August 2003, held a senior position within a company with which update software AG maintains business relations.
All contracts and transactions are concluded under the generally applicable standard terms and conditions.

	2003	2002
	EUR (000)	EUR (000)
Receivables as of 31 December	82	522
Liabilities as of 31 December	0	-10
Sales revenue for the financial year	328	687

18. Liquidity and capital resources

From 1997 through 1999, the Company primarily financed its business operations through private placements of ordinary shares. Through 31 December 1999, gross proceeds from three private placement rounds of ordinary shares totalled EUR 22.4 million. Since 11 April 2000, the Company's shares have been traded on the Neuer Markt of the German stock exchange in Frankfurt. The net proceeds from the initial public offering were EUR 43.6 million. To a lesser extent, the Company also finances its business operations through capital project loans and traditional financing.

In the current financial year, the Company has undertaken steps to restructure business operations and reduce costs and was thus able to reduce current expenditures considerably. Thus, the financial year was concluded with a positive cash flow of EUR 634,000 (net cash flow from operating activities equalled EUR 976,000).

19. Additional disclosures on the consolidated financial statements on the basis of Austrian accounting standards

a) Reporting pursuant to US Generally Accepted Accounting Principles (US-GAAP)

The consolidated financial statements as of 31 December 2003 were drawn up in accordance with US-GAAP. Consolidated financial statements drawn up in accordance with international standards are deemed to represent statements pursuant to Section 245a of the Austrian Commercial Code (Handelsgesetzbuch – HGB) if the terms stipulated in Section 245a(1) numbers 1 to 3 are met. The disclosures required to fulfil these terms are presented below.

b) Material differences between Austrian accounting standards (HGB) and US-GAAP

The accounting standards under HGB and US-GAAP are characterised in part by differing basic principles. While accounting under HGB emphasises the principle of conservatism and the protection of creditors, US-GAAP places greater emphasis on providing information relevant to decision-making for investors.
The significant differences between HGB and US-GAAP that are relevant for these financial statements concern the following accounting principles:

b1) Deferred taxes

Under US-GAAP, deferred tax assets and liabilities resulting from temporary differences between the carrying amounts of assets and liabilities in the US-GAAP balance sheet and their tax basis, as well as from expected benefits from tax loss carry-forwards, must be recognised. Under Austrian accounting, deferred tax liabilities must be recognised and there is an option to recognise deferred tax assets. Prevailing opinion is that the recognition of deferred tax assets on loss carry-forwards is not permitted under HGB.

b2) Other accruals

Pursuant to US-GAAP, accruals must be set up for liabilities to third parties when it is probable that the liability will be incurred and when it can be reliably measured. Under HGB, the formation of accruals is characterised by the principle of conservatism. In practice, this often leads to the formation of an accrual as soon as a liability becomes known.

b3) Measurement of securities held as financial assets

Under US-GAAP, with the exception of held-to-maturity securities, securities are measured at fair value. Depending on whether the securities are held for trading or as available for sale, unrealised measurement gains and losses are recognised as financial income in the income statement or as other comprehensive income directly in shareholders' equity. Under HGB, long-term securities must be stated at cost less extraordinary write-downs if there is a foreseeable lasting impairment loss (this is optional if the impairment is temporary). Short-term securities are stated at the lower of cost or market as of the balance sheet date under HGB.

b4) Measurement of foreign currency

Under US-GAAP, assets and liabilities denominated in foreign currencies are translated using the average exchange rate as of the balance sheet date. Both realised and unrealised gains and losses are recognised in income. HGB does not allow the recognition of unrealised exchange gains. Therefore, under HGB currency translation for monetary items must be made under the strict lower of cost or market principle (recognition of the lower value from the initial and closing exchange rate for receivables and of the higher value for liabilities).

b5) Operating lease/Capital lease

According to US-GAAP, an asset must be included in the lessee's balance sheet if all significant risks and rewards from the leased object have been transferred to the lessee. The tax rules applied in general practice for HGB extend from the same basic principle, but the economic approach is generally not shown to advantage. In certain circumstances this results in assets which are not recognised in the balance sheet of the lessee under HGB but must be recognised under US-GAAP.

b6) Costs relating to capital increases

According to US-GAAP, costs incurred in connection with an increase in capital are offset against the premium. This means that the proceeds from the capital increase are reduced by this amount and the reduced amount is posted to additional paid-in capital. HGB does not permit an offsetting of the costs incurred in connection with a capital increase from the corresponding proceeds. Therefore, under HGB, such costs must be recognised in the income statement.

c) Additional disclosures pursuant to HGB Section 245a (1) number 3

c1) Consolidated statement of changes in fixed assets

The development of fixed assets is presented in the asset analysis table.

c2) Maturities schedule for receivables and liabilities

Receivables and liabilities, excluding long-term liabilities (cf. Note 9), are entirely short-term with a remaining maturity of less than one year. The long-term liabilities in the amount of EUR 606,000 have a remaining maturity of between one and five years.

c3) Disclosures on the scope of consolidation

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

Company	Registered office	Interest in %
update sales GmbH	Vienna, Austria	100
update software Germany GmbH	Dreieich, Germany	100
update software Switzerland GmbH	Dietkon, Switzerland	100
update software UK Ltd.	Berkshire, England	100
update software Denmark ApS	Glostrup, Denmark	100
update software Benelux B.V.	Amsterdam, The Netherlands	100
update software CZ s.r.o.	Brno, Czech Republic	100
update software France S.A.R.L.	Paris, France	100

The average number of employees in 2003 was 108 (2002: 161).

Asset Analysis as of 31 December 2003

	Acquisition costs					Accumulated depreciation	Carrying value		Depreciation 2003
	As of 1 Jan. 2003	Additions	Disposals	Exchange Diff.	As of 31 Dec. 2003		As of 1 Jan. 2003	As of 31 Dec. 2003	
	EUR (000)	EUR (000)	EUR (000)	EUR (000)	EUR (000)	EUR (000)	EUR (000)	EUR (000)	EUR (000)
Fixed assets									
IT hardware	1,864	37	112	3	**1,786**	1,569	517	217	317
Software	745	1			**746**	710	179	36	143
Office equipment	823	5	91	4	**733**	525	338	208	105
Office furniture	229	3	104		**128**	102	61	26	22
Other fixed assets	411	2	37	1	**375**	165	263	210	55
Total fixed assets	**4,072**	**48**	**344**	**8**	**3,768**	**3,071**	**1,358**	**697**	**642**
Intangible assets	**514**	**0**	**0**	**0**	**514**	**514**	**0**	**0**	**0**
Securities	**98**	**0**	**3**	**0**	**95**	**7**	**92**	**88**	**1**
Other assets	**49**	**0**	**0**	**0**	**49**	**49**	**0**	**0**	**0**

Expenditures for severance pay are comprised as follows:

	Severance pay
	EUR (000)
Members of the Board of Management	4
Other employees	296
	300

Executive bodies of the company:

In the financial year under review, the management board was comprised of the following members:

Mr. Thomas Deutschmann, CEO
Mrs. Monika Fiala
Mr. Arno Huber

Total remuneration of the management board members was EUR 540,000.

In the financial year under review, the supervisory board was comprised of the following members:

Mr. Hans Bodingbauer (chairman until 6 August 2003)
Mr. Gilbert Hödl (deputy chairman)
Mr. Frank Hurtmanns (chairman since 6 August 2003)
Mr. Hans Strack-Zimmermann (member since 6 August 2003)

Expenses for supervisory board remuneration totalled EUR 66,000.

Vienna, 27 Febuary 2003 **The Board**

Thomas Deutschman

Monika Fiala

Arno Huber

Report of the independent auditor

We have audited the accompanying consolidated balance sheet of update software AG as at 31 December 2003, and the related consolidated income statement, cash flow statement and statement of changes in shareholders´ equity for the financial year ending at 31 December 2003. These consolidated financial statements are the responsibility of the company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audit.

The consolidated balance sheet of update software AG as at 31 December 2002, and the related consolidated income statement, cash flow statement and statement of changes in shareholders´ equity for the financial year ending at 31 December 2002 have been audited by KPMG Alpen-Treuhand GmbH Wirtschaftsprüfungs- und Steuerberatungsgesellschaft. The unqualified report of the independent auditors KPMG Alpen-Treuhand GmbH, containing an emphasis of matter with respect to the going concern of the company, was signed on 20 May 2003.

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

We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of update software AG and its subsidiaries at 31 December 2003 and the results of their operations, cash flows and changes in shareholders´ equity for the financial year ending at 31 December 2003 in accordance with General Accepted Accounting Principles in the United States (US-GAAP).

The group management report has to be audited according to Austrian commercial law (HGB) such as whether the legal requirements have been met for the exemption from the preparation of consolidated financial statements according to Austrian accounting principles.

We confirm that the group management report of update software AG is consistent with the consolidated financial statements and that the legal requirements have been met for the exemption from the preparation of consolidated financial statements according to Austrian accounting principles.

Vienna, 27 February 2004

Deloitte & Touche GmbH
Wirtschaftsprüfungs- und Steuerberatungsgesellschaft

Mag. Kurt Schweighart Mag.Erich Kandler
Auditor and tax consultant

This is a translation from German to English.

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

Imprint
Editor: update software AG, Operngasse 17-21, A-1040 Vienna
Concept, layout & producing: suXess Verlags- und Werbeges.m.b.H, A-1030 Vienna, Photos: update, Photodisc
Manufacturer: Inova, Vienna