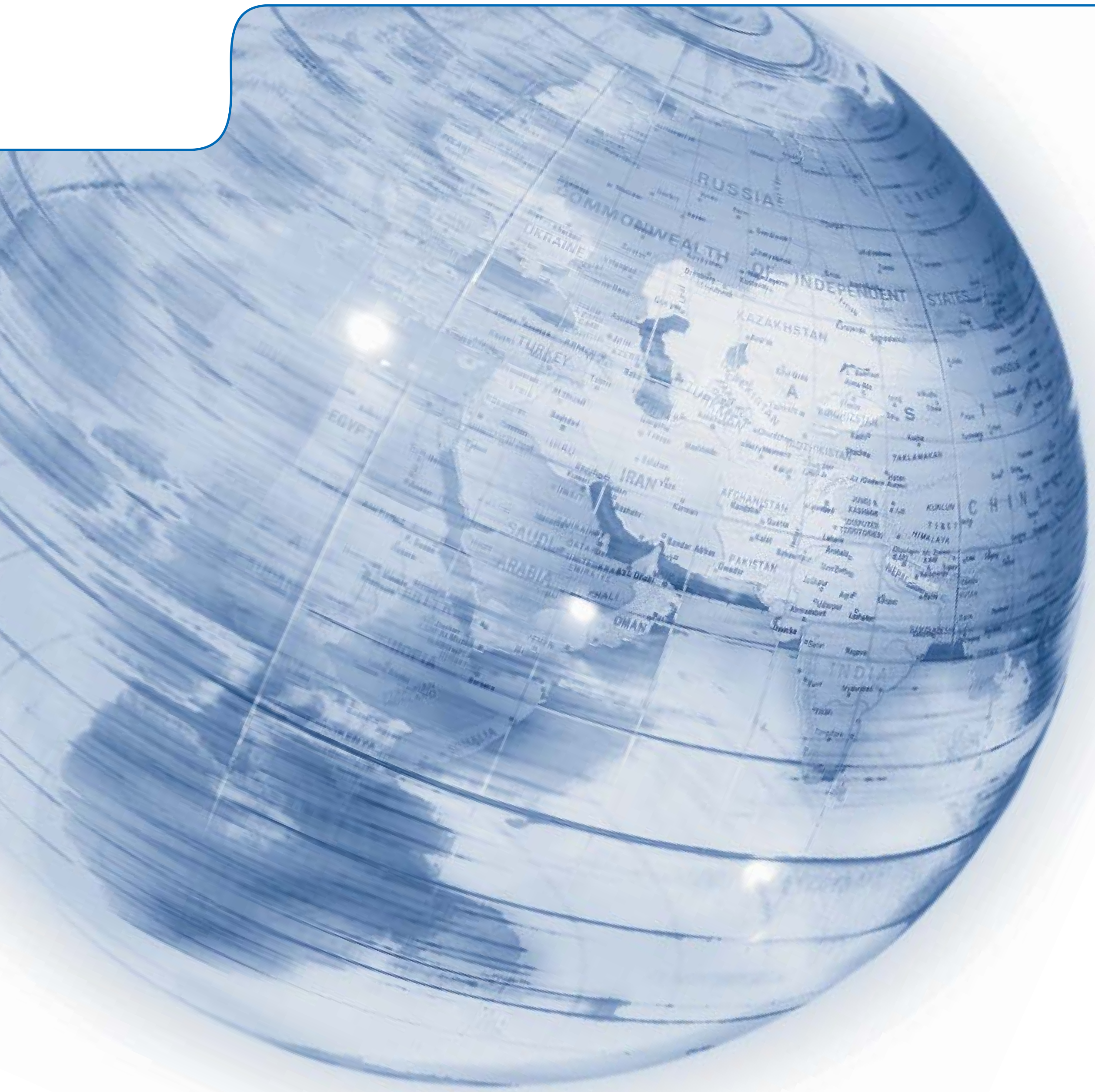
Third-quarter report 2004

Q3/04



SOFTWARE AG
THE XML COMPANY

Key figures
IFRS, unaudited

€ millions (unless stated)	Sep 30, 2004	Sep 30, 2003	Q3 2004	Q3 2003
Revenue	**298.6**	**305.0**	**96.6**	**98.7**
Products	214.6	212.3	71.1	71.2
of which licensing	77.7	68.7	25.1	22.9
of which maintenance	136.9	143.6	46.0	48.3
Professional services	82.8	91.4	25.2	27.1
Other	1.2	1.3	0.3	0.4
Adjusted EBIT	**60.4**	**41.2**	**21.0**	**15.7**
as % of revenue	20%	14%	22%	16%
Income from investments	24.5	0	0	0
Restructuring expenses	0	– 31.8	0	0
EBIT	**84.9**	**9.4**	**21.0**	**15.7**
Income before taxes	**87.3**	**11.6**	**21.9**	**16.4**
as % of revenue	29%	4%	23%	17%
Income after taxes	**61.9**	**2.9**	**12.7**	**6.5**
as % of revenue	21%	1%	13%	7%
Earnings per share (€)	**2.27**	**0.11**	**0.47**	**0.24**

	Q3 2004	Q3 2003
Employees (quarterly average)	**2,445**	**2,743**
of which in Germany	776	978

€ millions (unless stated)	Sep 30, 2004	Dec 31, 2003
Total assets	**515.2**	**509.1**
Cash and cash equivalents	**110.2**	**74.2**
Shareholders' equity	**312.7**	**269.2**
as % of total assets	61%	53%

Profile

Software AG is an international provider of systems software and XML integration and data-management services. We offer integration solutions based on XML (eXtensible markup language), a key technology for the smooth exchange of data and documents, and a powerful means of introducing state-of-the-art applications into existing IT architectures. We are the European No. 1 and one of the world leaders in this area.

In August 2004, Software AG streamlined its international structure (see second-quarter report, events subsequent to the balance-sheet date). The Company's activities are now organized into three regions:

- North America/Northern Europe (USA, Canada, United Kingdom, Scandinavia, South Africa)
- South (Southern Europe, South and Central America)
- Central/Asia (German-speaking countries, Eastern Europe, Middle East, Asia, Australia)

This second-quarter report is still based on the four regions structure to make comparison with the previous quarter and the first half of 2004 easier.

Karl-Heinz Streibich
Chief Executive Officer

Firm foundations for growth

Software AG has made great progress in terms of strategy over the past nine months, and is significantly stronger as a result. Our future growth plans are clearly oriented toward achieving market leadership.

Increased profitability, a more stable revenue base, and greater depth in terms of financial resources – they were the ambitious goals we set for fiscal 2004. And we left no stone unturned in their pursuit: Our strategic orientation, service portfolio, and internal organizational structures are all now more clearly focused on and driven by customer requirements.

The changes are already paying dividends. Software AG today offers its customers outstanding added value. And we have significantly consolidated our market position. Allied with improvements in the economy as a whole, this has laid the groundwork for successful future growth.

Consolidating and leveraging solutions expertise
At the same time as optimizing our Enterprise Transaction Systems offering, we have also been working hard to develop the XML Business Integration Portfolio, successfully adding complete integration solutions: At the beginning of the year, the portfolio consisted solely of Integration Services and the EntireX and Tamino XML Server product lines. In the first half of the year, we added Integration Packages, and during the third quarter, Integration Solutions. These were based on concepts first developed in the regions and adapted for the international market. Each one embodies outstanding best practices and draws on our in-depth project experience. All the new solutions leverage existing strengths and apply them on a global level.

International demand for integration

Companies are increasingly looking to achieve tight integration. To succeed in today's marketplace, they need to react rapidly to changing requirements. And to do this, they need to exchange information between a diverse range of systems and applications – not only internally, but also with customers, suppliers, and partners. E-government, too, is playing an increasingly prominent role, with official bodies placing greater emphasis on data transfer as a result. In both areas, systems integration is central to effective collaboration, accelerated processes, and optimized costs. As a result, it is a major success factor – in both the private and public sectors.

The enhancement of our Integration Portfolio expands our footprint in this promising market. Software AG is already beginning to exploit some of the opportunities for sustainable growth in this area. We are convinced that XML will make an increasing contribution to our development. And the initial response to our broader portfolio confirms these positive expectations.

Focus on market leadership

The success we are witnessing in systems integration is indicative of the performance of Software AG as a whole. In the future, market leadership will remain a major challenge, which we will tackle head on. And our status as a cutting-edge technology company with a firm customer focus, international presence, and healthy business foundations means that we are exceptionally well placed to make great strides toward this goal in 2005.

Karl-Heinz Streibich
Chief Executive Officer

Share price continues to rise

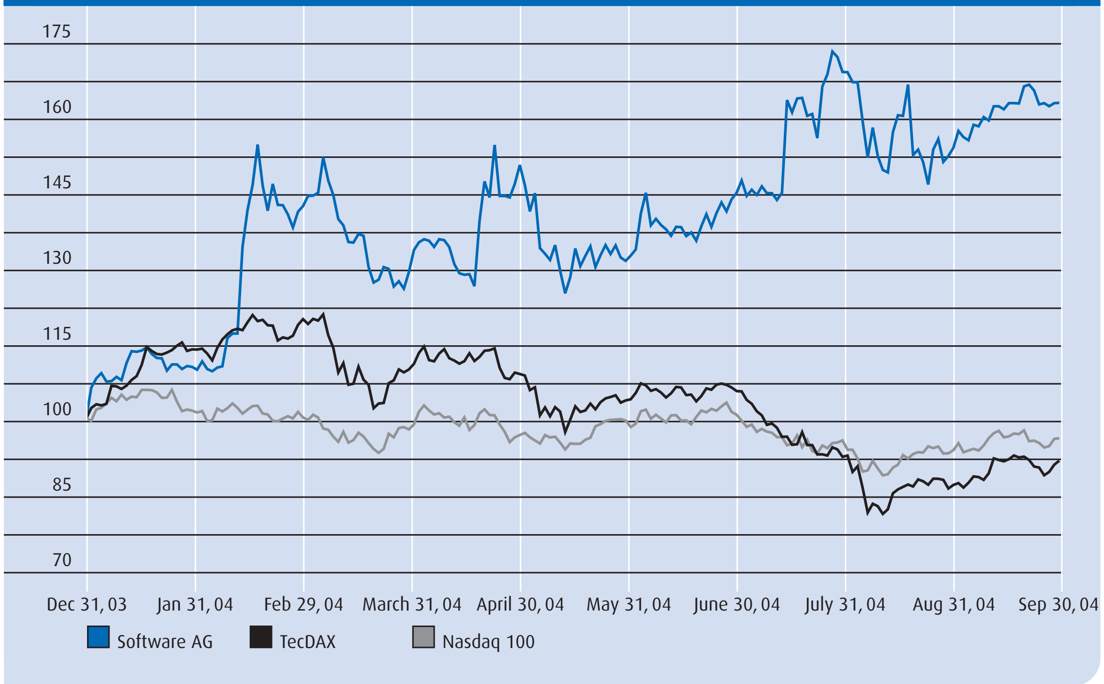
Software AG stock profited from positive business development during the third quarter. The upswing experienced in the first six months continued into the following period: Company shares made a 63 percent gain over the first nine months, significantly outperforming both the TecDAX and Nasdaq 100 indices of leading tech stocks. Furthermore, Software AG stepped up investor-relations activities during the third quarter. We also made a significant contribution to Deutsche Börse's XBRL initiative: We delivered our reports in the new format and provided backbone technology for the new system – helping to improve the transparency and effectiveness of German financial markets.

Stock markets sensitive to oil price

Once again in the third quarter of 2004, the price of oil was the key macro-economic factor on global bourses. As the cost of 'black gold' continued to escalate, the economic outlook worsened. Major indices such as the Dow Jones and DAX were affected, posting negative third-quarter development. Tech stocks also took a tumble, with considerable losses for the TecDAX and Nasdaq 100 between July and September.

However, despite the broader economic woes, Software AG shares bucked the trend to continue the positive development of the first six months. Having ended 2003 at €16.30, stock closed trading on September 20 at €26.51 – significantly outperforming tech-stock benchmarks TecDAX and Nasdaq 100. These indices posted losses of 8 percent and 4 percent, respectively.

Comparison of Software AG share performance with the TecDAX and Nasdaq 100 over the first nine months of 2004



Increased interest from US investors

We stepped up IR activities in the third quarter, making important contacts at investor conferences and roadshows in Germany and leading European financial centers. However, these events were not restricted to Europe: We responded to increased US interest by holding two investor conferences in New York. In the future, we will increase efforts to attract investment from North America.

The number of analysts providing coverage of Software AG shares remained high in the third quarter, at 21. Positive recommendations remained at 16, following publication of third-quarter results on October 28. Four analysts rated the stock as “sell” or “underperform”. One “hold” was downgraded to a “sell”. And there is one remaining “hold” recommendation. The average target price was €30.

Quarterly reports available in innovative new XBRL format

Since October 2004, Software AG quarterly reports have been available in a new format: The traditional HTML, PDF, and print versions are now supplemented by XBRL (eXtensible Business Reporting Language). XBRL is a freely available XML-based standard for handling corporate financial information, designed to significantly streamline the exchange and comparison of data. The new language enables direct access, rapid availability, and automatic processing. This benefits financial institutions, investors, companies, and analysts. This will cut the costs of generating, publishing, and distributing financial data. Furthermore, automatic conversion, rather than manual transfer, will increase the quality and integrity of data.

We are also supporting Deutsche Börse’s pilot XBRL project with essential technology expertise: Financial reports uploaded to the DB system are saved and managed using our latest Tamino XML Server software. And Software AG has also been tasked with operation of the XBRL portal for the German stock-exchange organization.

This project provides further evidence that our innovative solutions are successfully gaining ground in the marketplace.

For further information on the XBRL initiative and to view quarterly reports in the new format, visit http://xbrl.deutsche-boerse.com/xbrl/index-en.html.

Software AG stock

	September 30, 2004	September 30, 2003
Share price (XETRA closing, in €)	26.51	15.57
No. of shares	27,266,752	27,266,752
Market capitalization (in € millions)	723	425
52-week high/low (in €)	28.17/17.30	

Frankfurt (Prime Standard/TecDAX), ISIN DE 0003304002, ticker SOW

Business development stable, profits rising

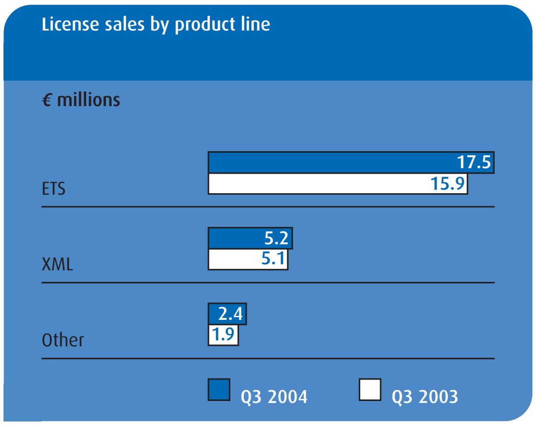
The positive trend of the first six months continued into the third quarter of 2004. Once again, Software AG enjoyed significant gains in terms of profitability, with dynamic growth in its important license business.

Third-quarter earnings before interest and tax (EBIT) outperformed the corresponding 2003 figure by 34 percent, at €21.0 million. Earnings before tax (EBT) rose to €21.9 million. The bottom line improved by 95 percent: Net profit totaled €12.7 million. Adjusted for currency translation effects, total revenues matched 2003 levels, at €96.6 million. However, the high-margin licensing segment posted an above-average gain of 10 percent.

Strong license sales across both business lines

Between July and September, new software licenses generated €25.1 million (€22.9 million in Q3 2003). The lion's share was attributable to Enterprise Transaction Systems (ETS), which enjoyed 10 percent growth to €17.5 million. This business line, which is focused on mainframe modernization, profited from the positive customer response to our innovative product packages. For example, the packages designed to increase the productivity and performance of IT systems, launched in the first half of the year, as well as the Adabas SQL Gateway, contributed over €1 million.

In the systems integration segment, licensing revenues gained 2 percent to €5.2 million. In this area, too, the enhanced offering prompted an increase in demand. However, the new, optimized XML Business Integration portfolio remains relatively new to the marketplace; its full impact on sales figures will not be felt until 2005.



Third-quarter product revenues (licensing and maintenance) amounted to €71.1 million (€71.2 million in Q3 2003). Maintenance services generated €46.0 million (€48.3 million). Adjusted for currency effects, this is a 1 percent fall. Revenues from professional services totaled €25.2 million (€27.1 million), impacted by the sluggish German market and the traditional dip in sales at this time of year in Southern Europe.

Buoyant license trade in Europe

In spite of weak economic fundamentals in the eurozone, third-quarter revenues outperformed 2003 figures by 7 percent in Southern and Western Europe, and by 5 percent in Central and Eastern Europe. Both regions posted above-average gains in the key licensing segment. In Southern and Western Europe, license sales increased by 56 percent, and in Central and Eastern Europe by 61 percent – accounting for nearly one third of both regions' total revenues.

Revenues by region		
€ millions	Q3 2004	Q3 2003
Americas	29.6	34.5
Southern and Western Europe	26.6	24.9
Central and Eastern Europe	23.3	22.1
Northern Europe, Asia/Pacific, South Africa	17.2	17.3

In Northern Europe, Asia/Pacific, South Africa, revenues were unchanged over 2003. Business was muted in the USA, as public-sector organizations delayed spending decisions in the run-up to the presidential elections.

Profitability

Increased efficiency drives earnings growth

The Company's streamlined cost base continued to generate significant savings during the third quarter. Allied with improved operating margins, this led to significant profit growth. Earnings before interest, tax, and exceptional items (EBIT) rose to €21 million, and EBIT margin to 22 percent. Earnings before tax (EBT) climbed by more than one third to €21.9 million. Earnings per share nearly doubled, climbing to €0.47 (€0.24 in Q3 2003). Consolidated net profit increased to €12.7 million (€6.5 million), or 13 percent of revenues.

As a result of a marked upturn in high-margin license sales, EBITA quadrupled in Central and Eastern Europe to €4.2 million. In the Americas region, operating earnings, at €9.2 million, remained at 2003 levels, in spite of a dip in revenues. Investment relating to the penetration of the South American market, combined with increased R&D spending to localize solutions for the Spanish market, led to EBITA slipping in the Southern and Western Europe region to –€0.6 million (€1.7 million in Q3 2003). In Northern Europe, Asia/Pacific, South Africa, operating earnings fell by €0.9 million to €4.0 million.

Earnings development		
€ millions	Q3 2004	Q3 2003
EBIT	21.0	15.7
EBT	21.9	16.4
Consolidated net profit	12.7	6.5
Earnings per share (€)	0.47	0.24

Strategic progress

Integration solutions take offering to a new level

One of the cornerstones of our growth strategy is the continuous development of the Software AG service portfolio, based on future customer and market needs. The XML and ETS portfolios have been optimized to give them a greater focus on customer needs, and we are now adding XML Integration Solutions. The XML offering previously centered on integration products and services, but in 2004 we added two new levels: Level 3 comprises Integration Packages, forming a horizontal technology platform; level 4 includes additional vertical solutions. The higher the level, the greater the added-value for customers.

Level 4 is based on industry-specific solutions developed in the regions, which we adapt to the needs of international markets. During the third quarter, this led, in particular, to new financial services, healthcare, and public-sector solutions.

In the Enterprise Transaction System segment, we launched Adabas Replication Server during the third quarter. This innovative product was developed in response to the needs of 28 individual customers around the world, and reflects our customer-driven go-to-market strategy.

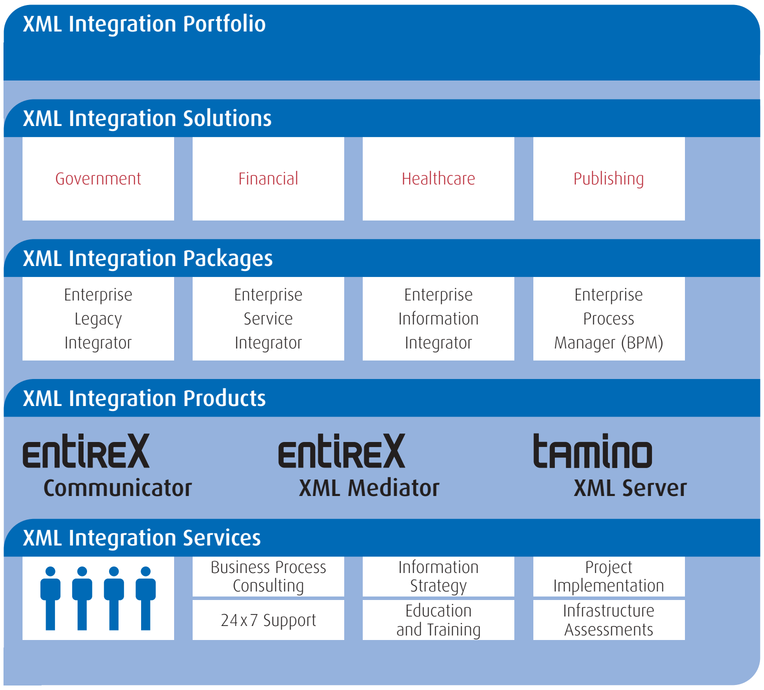
Growth via geographical diversification

There are exciting growth opportunities for Software AG in the emerging markets, particularly Eastern Europe, China, and South America. The Company has now directly entered the South American market and has already won major contracts with high-profile reference customers in Chile: We are providing consulting services to the Chilean government on the implementation of XML as a standard integration tool, with advice and support for the Health Ministry regarding the possibilities offered by e-government. Other customers include the national post office organization and two major healthcare companies that operate hospitals and GP practices.

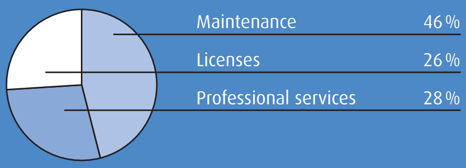
Expanded partner network

Software AG and Novell, Inc. have formed a new technology partnership for XML-based products operating under Suse Linux. The two companies are collaborating to create solutions for vertical markets. Novell Alliance Partner status is helping Software AG to become more innovative, providing greater opportunities in the open-source space, and facilitating the penetration of new markets.

We also collaborated with Sun Microsystems on two major XML integration projects in the UK: A Linux portal was implemented at Dorset County Council, and Tewkesbury Borough Council received a new solution to aid compliance with the UK Government's electronic-service legislation. Our partnership with Shanghai 5A Technology Development Co. Ltd. enabled us to win the Shanghai Government as an important XML Business Integration customer.



Breakdown of revenues



First nine months of fiscal 2004

Stable revenues with increased license sales

Consolidated revenues for the first three quarters of 2004 totaled €298.6 million. The slight year-on-year dip in sales of 2 percent is solely attributable to the buoyant euro. Adjusted for currency translation effects, revenues rose by 1 percent. Product revenues (licensing and maintenance) increased to €214.6 million (€212.3 million in 2003). Licensing alone generated €77.7 million (€68.7 million), representing an increased share of total revenues from 23 percent to 26 percent. On September 30, 2004, the Software AG Group employed 2,468 employees, 333 fewer than on September 30, 2003.

Ninefold increase in EBIT

There was a significant improvement in the Software AG cost base during the period, with administrative, sales, and R&D expenses falling by €26.0 million over 2003 to €135.8 million. The largest percentage saving was realized for R&D costs, which fell 22 percent, followed by administrative costs, down 18 percent.

EBIT, which rose from €9.4 million to €84.9 million, includes exceptional income in the amount of €24.5 million. This sum was generated by the second-quarter divestment of Software AG's stockholding in SAP Systems Integration AG (SAP SI).

High cash flow, healthy balance sheet

Restructuring costs during the period were nearly twice the 2003 figure, at €23.4 million. The organic cash flow increased to €42.4 million (€40.9 million). Free cash flow also rose, to €11.4 million (€5.7 million).

Total assets climbed to €515.2 million (€494.2 million), in spite of a reduction in fixed assets through the SAP SI share sale. Cash and cash equivalents rose to 21 percent of assets, at €110.2 million (€74.8 million in 2003). The Company has no bank debt. The rise in equity, up at €312.7 million, took the equity-to-total-assets ratio to 61 percent (53 percent in 2003).

Earnings development

€ millions	September 30, 2004	September 30, 2003
EBIT	84.9	9.4
EBT	87.3	11.6
Net earnings	61.9	2.9
EPS (€)	2.27	0.11

Growth strategy ensures bright future

Positive business development during the first nine months has clearly underlined the value of our strategic decision to focus on two product lines. Software AG is now well placed to face the challenges of 2005. But our growth strategy does not stop there: We intend to further expand our portfolio, leverage international market opportunities, and strengthen our presence through strategic partnerships.

Stable revenues and marked upturn in earnings in 2004

Before currency effects, full-year consolidated revenues are still expected to remain stable. However, as a result of a successful drive to increase efficiency, EBIT margin is on course to grow by over 20 percent, with a 40 percent increase in EBIT, to approximately €83 million. The divestment of our stockholding in SAP Systems Integration AG (SAP SI) generated further exceptional income of €24.5 million. EPS will be in the range of €2.75 to €2.85, including €0.88 attributable to the SAP SI stock sale.

Double-digit revenues growth in the mid term

In 2005, we expect a slight increase in IT spending to lead to single-figure growth. In the mid term, however, we look forward to double-figure expansion, with stable margins. Steady sales are forecast in the mainframe segment, with growth projected for XML Integration solutions. By tapping into new markets, we hope to generate added momentum.

Consolidated income statement for the nine months ended September 30, 2004 (January 1 to September 30, 2004)

IFRS, unaudited

€ thousands	Sep 30, 2004	Sep 30, 2003	3Q 2004	3Q 2003
Revenue				
Products	214,563	212,382	71,052	71,212
of which licensing	77,663	68,747	25,057	22,929
of which maintenance	136,900	143,635	45,995	48,283
Professional services	82,846	91,368	25,222	27,064
Other	1,202	1,206	361	404
Total revenue	**298,611**	**304,956**	**96,635**	**98,680**
Total costs of sales	– 101,901	– 111,478	– 32,903	– 34,797
Gross profit	**196,710**	**193,478**	**63,732**	**63,883**
Research and development	– 36,948	– 47,218	– 11,353	– 15,448
Sales, marketing and distribution	– 65,414	– 74,006	– 22,346	– 23,305
Administrative costs	– 33,488	– 40,635	– 11,321	– 12,968
Total operating expenses	**– 135,850**	**– 161,859**	**– 45,020**	**– 51,721**
Other income/expenses	– 477	9,576	2,321	3,585
Restructuring expenses	0	– 31,780	0	0
Income from sale of SAP-SI shares	24,539	0	0	0
Interest income/expenses	**2,345**	**2,200**	**845**	**679**
Profit before tax	**87,267**	**11,615**	**21,878**	**16,426**
Taxes	**– 25,366**	**– 8,717**	**– 9,137**	**– 9,967**
Net income	**61,901**	**2,898**	**12,741**	**6,459**
Earnings per share (EUR, basic)	2.27	0.11	0.47	0.24
Earnings per share (EUR, diluted)	2.27	0.11	0.47	0.24
Weighted average shares outstanding (basic)	27,266,752	27,266,752	27,266,752	27,266,752
Weighted average shares outstanding (diluted)	27,266,752	27,266,752	27,266,752	27,266,752

Consolidated balance sheet as of September 30, 2004

IFRS, unaudited

€ thousands	Sep 30, 2004	Sep 30, 2003	Dec 31, 2003
Assets			
A. Cash and cash equivalents			
1. Cash on hand and bank balances	88,146	58,465	53,083
2. Securities	22,102	16,342	21,076
	110,248	74,807	74,159
B. Current assets			
1. Inventories	356	360	387
2. Trade receivables	126,120	113,483	124,578
3. Other receivables and other assets	7,043	6,974	7,701
	133,519	120,817	132,666
C. Fixed assets			
1. Intangible assets	1,306	1,047	1,491
2. Goodwill	176,472	176,591	176,472
3. Property, plant and equipment	44,853	48,537	47,880
4. Financial assets	6,182	21,629	25,028
	228,813	247,804	250,871
D. Deferred taxes	36,465	43,848	44,959
E. Deferred expenses	6,214	6,957	6,476
Total assets	515,259	494,233	509,131
Equity and liabilities			
A. Current liabilities			
1. Current financial liabilities	3,757	5,826	6,546
2. Trade payables	17,508	19,420	26,770
3. Other current liabilities	18,291	24,810	25,294
4. Current provisions	46,496	60,247	77,791
	86,052	110,303	136,401
B. Non-current liabilities			
1. Non-current financial liabilities	3,887	5,268	4,356
2. Trade payables	0	0	22
3. Other non-current liabilities	3,560	3,615	3,641
4. Provision for pension	20,748	19,047	19,666
5. Non-current provisions	835	4,091	5,596
	29,030	32,021	33,281
C. Deferred taxes	11,944	15,303	12,798
D. Deferred income	75,362	74,182	57,330
E. Minority interest	126	159	126
F. Equity			
1. Share capital	81,800	81,800	81,800
2. Capital reserve	132	132	132
3. Retained earnings	156,454	149,358	149,358
4. Consolidated income	61,901	2,898	7,096
5. Currency translation differences	– 26,870	– 20,300	– 32,340
6. Other comprehensive income	39,328	48,377	63,149
	312,745	262,265	269,195
Total equity and liabilities	515,259	494,233	509,131

Statement of cash flows for the nine months ended September 30, 2004 (January 1 to September 30, 2004)

IFRS, unaudited

€ thousands	Sep 30, 2004	Sep 30, 2003	3Q 2004	3Q 2003
Income after taxes	61,901	2,898	12,741	6,459
Depreciation	6,784	8,692	2,253	2,635
Income from sale of SAP-SI shares	– 24,539	0	0	0
Income from sale of other assets	231	379	237	16
Interest result	– 2,345	– 2,200	– 846	– 679
Income taxes	24,146	7,090	8,778	9,466
Cash generated from operations	66,178	16,859	23,163	17,897
Changes in inventories, receivables and other current assets	– 1,073	16,978	11,770	16,371
Changes in payables and other liabilities	– 34,012	– 1,386	– 22,317	– 26,252
Income taxes paid	– 17,637	– 23,695	– 10,861	– 6,924
Interest paid	– 693	– 949	– 174	– 317
Interest received	2,928	3,010	996	930
Net cash used in/provided by operating activities	**15,691**	**10,817**	**2,577**	**1,705**
Cash received from the sale of tangible/intangible assets	72	699	16	152
Investments in tangible/intangible assets	– 3,480	– 4,081	– 1,564	– 1,100
Cash received from the sale of financial assets	26,273	21	135	15
Investments in financial assets	– 846	– 1,033	– 98	– 195
Net cash used in/provided by investing activities	**22,019**	**– 4,394**	**– 1,511**	**– 1,128**
Proceeds from issue of minority share capital	0	159	0	159
Repayment of loans from acquisitions and other finance liabilities	– 2,308	– 5,111	– 811	– 678
Net cash used in/provided by financing activities	**– 2,308**	**– 4,952**	**– 811**	**– 519**
Change in cash funds from cash relevant transactions	**35,402**	**1,471**	**255**	**58**
Adjustment from currency translation	**687**	**– 2,087**	**– 473**	**– 313**
Net change in cash and cash equivalents	**36,089**	**– 616**	**– 218**	**– 255**
Cash and cash equivalents at the beginning of the period	74,159	75,423	110,466	75,062
Cash and cash equivalents at the end of the period	**110,248**	**74,807**	**110,248**	**74,807**

Segment report for the nine months ended September 30, 2004 (January 1 to September 30, 2004)

IFRS, unaudited

€ thousands	Americas	Southern and Western Europe	Northern Europe, Asia/Pacific, South Africa	Central and Eastern Europe	Total	Central functions, R&D and Consolidation	Total Group
Licenses	20,784	17,473	21,022	18,384	77,663	0	77,663
Maintenance	57,646	20,856	28,708	29,716	136,926	– 26	136,900
Services	10,990	47,666	5,693	18,773	83,122	– 276	82,846
Other	279	365	101	100	845	357	1,202
Total revenue	**89,699**	**86,360**	**55,524**	**66,973**	**298,556**	**55**	**298,611**
EBITA	27,017	5,268	14,163	10,921	57,369	3,014	60,383
Amortization							0
Interest result							2,345
Income from SAP-SI sale							24,539
Profit before tax							87,267
Taxes							– 25,366
Net income							61,901
Total revenue proportion per region	30.0 %	28.9 %	18.6 %	22.5 %	100.0 %		
Product revenue	78,430	38,329	49,730	48,100	214,589		
Proportion per region	36.5 %	17.9 %	23.2 %	22.4 %	100.0 %		

Segment report for the nine months ended September 30, 2003 (January 1 to September 30, 2003)

IFRS, unaudited

€ thousands	Americas	Southern and Western Europe	Northern Europe, Asia/Pacific, South Africa	Central and Eastern Europe	Total	Central functions, R&D and Consolidation	Total Group
Licenses	25,558	13,444	17,073	12,683	68,758	– 11	68,747
Maintenance	63,963	20,757	27,969	30,967	143,656	– 21	143,635
Services	13,117	48,659	5,305	25,002	92,083	– 715	91,368
Other	108	118	313	118	657	549	1,206
Total revenue	**102,746**	**82,978**	**50,660**	**68,770**	**305,154**	**– 198**	**304,956**
EBITA	28,527	7,827	12,819	3,623	52,796	– 11,601	41,195
Amortization							0
Interest result							2,200
Restructuring expense							– 31,780
Profit before tax							11,615
Taxes							– 8,717
Net income							2,898
Total revenue proportion per region	33.7 %	27.2 %	16.6 %	22.5 %	100.0 %		
Product revenue	89,521	34,201	45,042	43,650	212,414		
Proportion per region	42.1 %	16.1 %	21.2 %	20.6 %	100.0 %		

Segment report for Q3 2004 (July 1 to September 30, 2004)

IFRS, unaudited

€ thousands	Americas	Southern and Western Europe	Northern Europe, Asia/Pacific, South Africa	Central and Eastern Europe	Total	Central functions, R&D and Consolidation	Total Group
Licenses	7,164	5,383	5,381	7,130	25,058	– 1	25,057
Maintenance	18,953	7,171	10,096	9,777	45,997	– 2	45,995
Services	3,496	13,899	1,695	6,295	25,385	– 163	25,222
Other	5	150	35	57	247	114	361
Total revenue	**29,618**	**26,603**	**17,207**	**23,259**	**96,687**	**– 52**	**96,635**
EBITA	9,230	– 573	4,017	4,234	16,908	4,125	21,033
Amortization							0
Interest result							845
Income from SAP-SI sale							0
Profit before tax							21,878
Taxes							– 9,137
Net income							12,741
Total revenue proportion per region	30.6 %	27.5 %	17.8 %	24.1 %	100.0 %		
Product revenue	26,117	12,554	15,477	16,907	71,055		
Proportion per region	36.7 %	17.7 %	21.8 %	23.8 %	100.0 %		

Segment report for Q3 2003 (July 1 to September 30, 2003)

IFRS, unaudited

€ thousands	Americas	Southern and Western Europe	Northern Europe, Asia/Pacific, South Africa	Central and Eastern Europe	Total	Central functions, R&D and Consolidation	Total Group
Licenses	8,842	3,447	6,248	4,437	22,974	– 45	22,929
Maintenance	21,475	7,124	9,180	10,518	48,297	– 14	48,283
Services	4,076	14,210	1,865	7,066	27,217	– 153	27,064
Other	60	75	43	34	212	192	404
Total revenue	**34,453**	**24,856**	**17,336**	**22,055**	**98,700**	**– 20**	**98,680**
EBITA	9,270	1,677	4,904	938	16,789	– 1,042	15,747
Amortization							0
Interest result							679
Restructuring result							0
Profit before tax							16,426
Taxes							– 9,967
Net income							6,459
Total revenue proportion per region	34.9 %	25.2 %	17.6 %	22.3 %	100.0 %		
Product revenue	30,317	10,571	15,428	14,955	71,271		
Proportion per region	42.5 %	14.8 %	21.7 %	21.0 %	100.0 %		

Statement of changes in equity for the nine months ended September 30, 2004 (January 1 to September 30, 2004)

IFRS, unaudited

€ thousands	Shares		Capital reserve	Retained earnings	Consolidated income	Currency translation differences	Other comprehensive Income	Total
	Number	Share capital						
As of January 1, 2004	27,266,752	81,800	132	156,454	0	– 32,340	63,149	**269,195**
Consolidated income for the period					61,901			61,901
Currency translation differences						5,470		5,470
Measurement of financial assets							– 18,112	– 18,112
Currency translation							– 5,709	– 5,709
As of September 30, 2004	27,266,752	81,800	132	156,454	61,901	– 26,870	39,328	**312,745**

Statement of changes in equity for the nine months ended September, 2003 (January 1 to September 30, 2003)

IFRS, unaudited

€ thousands	Shares		Capital reserve	Retained earnings	Consolidated income	Currency translation differences	Other comprehensive Income	Total
	Number	Share capital						
As of January 1, 2003	27,266,752	81,800	132	149,358	0	0	27,639	**258,929**
Consolidated income of the period					2,898			2,898
Currency translation differences						– 20,300		– 20,300
Measurement of financial assets								
Currency translation							20,738	20,738
As of September 30, 2003	27,266,752	81,800	132	149,358	2,898	– 20,300	48,377	**262,265**

Accounting principles

Basis

Since the beginning of 2004, the consolidated financial statements of Software AG have been prepared in accordance with the International Accounting Standards Board's (IASB) International Accounting Standards (IAS) and International Financial Reporting Standards (IFRS). Software AG complied with the IAS and IFRS, and IFRIC (International Financial Reporting Interpretations Committee, formerly SIC) interpretations applicable on December 31, 2003.

Figures in the consolidated financial statements are, unless otherwise stated, quoted in thousands of euros (€ thousands).

Principals of consolidation

The consolidated financial statements include Software AG and companies under its control. Control is generally taken to be proven where the Group holds, directly or indirectly, the majority of voting rights for authorized capital in a company, and/or can determine the fiscal or business policy of the company.

The financial statements of consolidated companies are compiled according to consistent accounting and valuation principles.

Subsidiaries established by Software AG are consolidated on the date they are formed. However, first-time consolidation occurred after the date of foundation for SAG-E, SAG-P, SAG-CH, and Softinterest Holding AG – which were consolidated for the first time in 1994 – as well as for Asian subsidiary SQL and for SAG-IRL.

The first-time consolidation of all companies was undertaken using the book value method. Subsequent consolidation is derived from the figures employed for first-time consolidation.

Debit balances arising from capital consolidation and relating solely to goodwill from acquisitions before January 31, 2001, were netted against capital reserves, pursuant to Section 309, Subsection 1, of the German Commercial Code (HGB). Goodwill from acquisitions after January 31, 2001, is capitalized, and amortized over ten years. In accordance with the option granted by IFRS 1.14, the Company has not applied IAS 22 retrospectively, but has continued to use the figures for mergers and acquisitions posted according to HGB.

Revenue, expenses and income, receivables, liabilities, and provisions arising between consolidated companies have been eliminated. Intercompany earnings from services provided within the Group were also eliminated where these were not realized from services to third parties.

Consolidated companies

On May 13, 2004, Software AG established SAG Systemhaus S.L., Madrid, Spain, with subscribed capital of €60 thousand. As of this date, the new company was consolidated as part of the Software AG Group. This was the only change to the scope of consolidation since December 31, 2003.

Estimates and assumptions

In a very limited number of instances, estimates and assumptions were made which could impact the statement and figures posted for balance-sheet assets, debt, income, expenses and contingent liabilities. True values may deviate from these estimates and assumptions.

Currency translation

The financial statements of foreign subsidiaries are translated using functional currencies: As these companies have organizational, financial, and commercial independence, the respective local currency is identical to the functional currency. Assets and liabilities are translated according to the currency exchange rate on the balance-sheet date, and expenses and income according to monthly averages. Currency translation differences are posted as such under equity, but not recognized in net profit or loss for the period.

In the individual financial statements for consolidated companies, foreign-currency items are translated on the balance-sheet date, and included in net profit or loss for the period. Translation differences from long-term intercompany net cash investments in non-German companies are excepted from this rule. These are posted as other comprehensive income under equity, but not recognized in net profit or loss for the period.

Cash on hand and bank balances

This item includes cash and short-term investments, plus short-term cash equivalents.

Securities include short-term, highly liquid financial investments which can be converted to cash at any time, and which are only subject to immaterial fluctuations in value.

Securities, financial assets, and derivatives

Financial assets are initially valued at the cost of acquisition, including transaction costs. The subsequent valuation depends on their classification.

Financial assets which are available for sale are valued according to their price on the balance-sheet date (i.e. the fair market value). Gains or losses are posted as other comprehensive income under equity, but not recognized in net profit or loss for the period.

Financial assets are recorded at their individual fair market values where this is possible to calculate and the assets have not been held until maturity. Loans and receivables included under this item which are not held for trading purposes, and assets with no publicly available price on an active market, where it is not possible to reliably calculate a fair market price, are valued at the adjusted cost of acquisition. All values are subject to regular, objective impairment testing, and value impairment, where it has occurred, is reflected in earnings for the period.

Software AG uses hedging instruments to protect against the risks posed by worldwide currency fluctuations. Company policy is to hedge against currency risks in their totality, and not take specific action for each individual transaction. Open positions in futures transactions are valued at the fair market value, and stated on the balance sheet under other assets or current provisions. Changes in the fair market value of derivative instruments used to offset the cumulative change in expected future cash flows from currency fluctuations are posted as other comprehensive income until such time as the underlying transaction is reclassified in net profit or loss for the period.

The ineffective portions of cash-flow hedges, and changes in the fair market value of derivatives which do not fulfill hedge accounting requirements, are immediately recognized in net profit or loss for the relevant year.

Inventories

Inventories are recorded at the lower of cost of acquisition/manufacture or net realizable value. Net realizable value is the estimated amount that would be raised from a sale during normal operations, less the estimated costs arising until manufacture is complete, less estimated sales costs.

Trade receivables
Trade receivables are posted at the fair value applicable when revenues are realized or services provided, and valued at the net book value, less any necessary value adjustments.

This item also includes unbilled services from projects for which a fixed price has been agreed, but for which the percentage of completion method is applied.

Other current assets
Other current assets are valued at cost of acquisition, which corresponds to fair market value.

Intangible assets
Concessions, industrial and similar rights and intangible assets, and licenses to such rights are capitalized at cost of acquisition and amortized over their useful economic lives according to the straight-line method. These assets are regularly subjected to impairment testing.

Goodwill
Debit balances arising from capital consolidation as defined by HGB are calculated according to book value, with no disclosure of hidden reserves. Before January 31, 2001, balances were offset against capital reserves, pursuant to Section 309, Subsection 1 of HGB. After this date, goodwill was capitalized and amortized over ten years according to the straight-line method. The term over which goodwill is amortized is established at the time of the acquisition, based on useful economic life. Software AG applies IFRS 1.13, which allows the Company to retain HGB valuations of goodwill arising before the transition to IFRS accounting on January 1, 2003. In accordance with IFRS 3, the historical HGB valuation of goodwill was posted at €176,591 thousand on this date. IFRS 3 requires that goodwill is no longer amortized, but subject to annual impairment testing and examination of future useful economic life. The residual book value is written down to its fair value where the value has been impaired.

Property, plant and equipment
Property, plant and equipment are stated at cost of acquisition or manufacture less accumulated depreciation and impairment costs. Where items are sold or scrapped, the relevant cost of acquisition and accumulated write-downs are eliminated – any realized income/loss from the disposal of the asset is shown on the income statement.

Tangible assets acquired for €410 or less are fully written down in the year they are first posted.

Cost of acquisition/manufacture comprises purchase price, including any customer payments and non-refundable income tax, and costs that are directly attributable to preparing the asset for its intended use. Expenditure such as maintenance incurred once the asset is in use is posted in the period during which it is incurred. Subsequent expenditure is only booked under assets where this improves the condition of the asset beyond its originally assessed standard of performance. Financing costs are not included under cost of acquisition/manufacture.

Property, plant and equipment are depreciated over their useful economic lives according to the straight-line method:

Buildings	50 years
Improvements to property	8 – 10 years
Office equipment	3 – 13 years
Computer hardware and accessories	1 – 4 years

Useful economic lives and methods of depreciation are periodically examined to ensure that theoretical values correspond with actual expected values.

Assets under construction are allocated to unfinished property, plant and equipment, and stated at cost of acquisition/manufacture. Depreciation only takes place once manufacture is complete and the asset is in use.

Impairment of the value of intangible assets and property, plant and equipment
Where there is evidence that the value of intangible assets, property, plant and equipment has been impaired, these are immediately written down to their recoverable values, i.e. the higher of net realizable value and value in use. Value in use is the cash value of forecast future cash flows from the continued use of an asset and from disposal at the end of its useful economic life.

Leasing
Fixed assets include assets provided under leasing contracts. Software AG leases computer hardware and accessories, and office equipment. In accordance with IAS 17, leasing contracts are classified, according to opportunities and risks, as capital leases (where the leased asset is allocated to the lessee) or operating leases (where the leased asset is allocated to the lessor).

Capital leases: Leased items are posted on the balance sheet under both assets and leasing liabilities (at the same amount). The fair market value of the leased item at the beginning of the contract is used, or, where less, the cash value of the total minimum leasing payments. Calculation of this cash value is based on the interest rate of the overall lease agreement, where this figure can be practically identified. Otherwise, the lessee's threshold borrowing interest rate is used. Capital leases are amortized over their scheduled useful economic lives according to the straight-line method. Future lease installments are posted as financial liabilities.

Operating leases: Operating lease payments are expensed throughout the life of the leasing agreement.

Deferred taxes
Tax assets and liabilities are deferred according to the balance-sheet liability method for temporary differences between figures stated for tax purposes and those on the consolidated balance sheets. Taxes are also deferred on loss carryforwards.

Deferred taxes are calculated according to the tax rate expected to apply in the year in which they will be realized. Dividends are only included once the annual shareholders' meeting has voted on the use of earnings.

Deferred tax assets and liabilities are not discounted.

The book values of deferred taxes are regularly examined and, where necessary, adjusted.

Prepaid expenses
This item includes prepayments made by Software AG within the scope of license and rental agreements. Amounts are reversed and booked as expense in the accounting period when the service is delivered to Software AG.

Liabilities
Short-term liabilities are stated at their repayment or fulfillment value.

Long-term liabilities are stated at adjusted cost of acquisition, calculated according to the effective interest method, i.e. by discounting expected future repayments.

Provisions
Provisions are formed where the Company has a de jure or de facto obligation to a third party arising from an event in the past, where it is likely that the Company will have to settle this obligation, and a reliable estimate can be made of the value of the liability. Estimates are subject to regular examination and, where necessary, adjustment.

Where the effect of the time value of money is material, the amount of a provision is the present value of the expenditures expected to be required to settle the obligation.

Provisions for pensions
Software AG operates both defined-benefit and defined-contribution pension plans. The actuarial calculation of provisions for pensions follows the projected unit credit method described in IAS 19, whereby expected future increases in pensions and salaries are also included.

For the defined-contribution plan, Software AG has no obligations beyond its undertaking to pay all contributions to earmarked funds.

Deferred income
Deferred income includes prepayments from customers for maintenance services. Amounts are reversed and posted as revenues in the period Software AG delivers the service.

Other comprehensive income
Other comprehensive income comprises differences arising from the translation of the financial statements of commercially independent non-German subsidiaries, and effects from the valuation of financial instruments. Also included are translation differences from cash positions that are primarily part of a net investment in a commercially independent non-German subsidiary. Figures are quoted after tax.

Equity
Development of shareholders equity is shown on page 18.

In addition, contingent capital at September 30, 2004, comprised the following amounts:

1.) Up to €3,357 thousand in up to 1,118,962 no-par value shares, reserved to cover subscription rights granted under the first share-option plan (Management Incentive Plan I, MIP I) for Executive Board members and senior executives of the Software AG Group. The terms and conditions of this plan, as well as the numbers of shares allocated/exercised, are given on page 32.

2.) Up to €3,000 thousand in up to 1,000,000 no-par value shares, reserved to cover subscription rights granted under the second share-option plan (Management Incentive Plan II, MIP II) for Executive Board members and senior executives of the Software AG Group. The terms and conditions of this plan, as well as the numbers of shares allocated/exercised, are given on page 32.

3.) Up to €13,515 thousand in up to 4,505,000 no-par value shares, reserved to grant option rights to holders of warrants from cum-warrant bonds, and to grant conversion options to holders of convertible bonds in accordance with the bonds' terms. The Executive Board is authorized to issue such bonds, with a term of up to 10 years, once or more than once in the period to April 27, 2006, up to a total nominal value of €500,000 thousand. The Executive Board had not made use of this authorization by September 30, 2004. At the annual shareholders' meeting on April 30, 2004, the entitlement to draw on this capital was withdrawn and replaced by that detailed under section 4 below.

4.) Up to €36,000 thousand in up to 12,000,000 bearer shares, each with a €3 share of capital stock, reserved to grant option rights and to agree option obligations arising from cum-warrant bonds, and to grant conversion options and option obligations to holders of convertible bonds in accordance with the bonds' terms (agreed at the annual shareholders' meeting on April 30, 2004). Subject to the approval of the Supervisory Board, the Executive Board may authorize the exercise of these rights by Software AG or a (directly or indirectly) wholly owned subsidiary by April 29, 2009.

In this instance, shareholders are entitled to pre-emptive subscription rights, with the following exceptions:

- The Executive Board is authorized to exclude fractional amounts.
- Subject to the approval of the Supervisory Board, the Executive Board is authorized to totally exclude shareholders' subscription rights in the following instance: Where, upon due examination, the issue price of options or convertible bonds is not thought to be significantly less than its hypothetical market value (i.e. such value being calculated by accepted financial industry methods). However, this right to exclusion only applies to options and convertible bonds with rights or obligations for shares totaling no more than €8,180 thousand, or, where lower, 10 percent of capital stock at the time the subscription rights are excluded.

The Executive Board had not made use of this authorization by September 30, 2004.

At the balance-sheet date, the Executive Board is further authorized, with the consent of the Supervisory Board, to increase the Company's subscribed capital by up to €37,989 thousand once or more than once in the period to April 27, 2006, by issuing up to 12,663,036 registered shares against cash and/or non-cash contributions (authorized capital). With the exception of the cases detailed below, shareholders will be granted pre-emptive subscription rights:

- The Executive Board is authorized to exclude shareholders' preemptive subscription rights with respect to fractional amounts.
- The Executive Board is further authorized, with the consent of the Supervisory Board, to exclude shareholders' pre-emptive subscription rights with respect to capital increases against non-cash contributions effected for the purpose of acquiring participations, holdings, companies or business units.
- The Executive Board is also authorized, with the consent of the Supervisory Board, to exclude shareholders' pre-emptive subscription rights provided that the capital increase against cash effected on the basis of this authorization does not exceed 10 percent of the subscribed capital at the time this authorization is first exercised, and provided that the issue price is not significantly lower than the market value.
- Finally, the Executive Board is authorized, with the consent of the Supervisory Board, to exclude shareholders' pre-emptive subscription rights with respect to a nominal amount not exceeding €6,503 thousand in order to offer new shares to employees of Software AG and its affiliated companies (in accordance with sections 15 ff. of the German Stock Corporation Act) under an employee share option plan. The new shares can also be transferred to a bank on condition that sale is restricted to entitled persons in accordance with the Company's instructions.

At September 30, 2004, the Executive Board had not exercised its power to increase subscribed capital.

Revenues

Software AG primarily generates revenues from software licenses (for unlimited periods of usage), maintenance, and other services. Incoming monies from software licenses are only posted as revenues once a contract has been signed with the customer, all possible rights of return have expired, the software has been supplied, and a price has been agreed or can be established, and there is sufficient probability that payment will be made.

Maintenance revenues are prorated over the period of service provision.

Revenues from contract work invoiced according to man-hours are recognized once the services have been provided by Software AG.

Pursuant to IAS 11 and IAS 18, revenues from fixed-price service contracts are recognized according to the percentage of completion method where the revenues can be reliably measured, there is sufficient probability that Software AG will receive the economic benefits of the transaction, and that all related costs expected until completion of the service can be reliably measured.

Revenues figures are net of all discounts and rebates.

Costs of manufacture

Costs of manufacture include all production-related costs on the basis of normal utilization levels. They include individual unit costs that can be directly allocated to projects, plus fixed and variable overheads. Borrowing costs are not capitalized in costs of acquisition/manufacture. No unscheduled write-downs on inventories were required during the reporting period.

Research and development costs

Research and development costs are expensed in the income statement as they are incurred.

The creation of and subsequent improvements to software involve closely linked research and development phases. Accordingly, it is not possible to strictly separate expenses incurred for research from those incurred for development. Consequently the criteria for separately reporting development costs laid out in IAS 38, Section 41, in conjunction with 42, cannot be met.

Sales, marketing and distribution

These include personnel and materials costs, write-downs, and advertising expenses.

Administrative costs

These include personnel and materials costs, and applicable depreciation and amortization.

Earnings per share

Earnings per share are calculated by dividing net income allocable to shareholders for the period by the weighted number of shares outstanding during the period. Software AG only has common stock.

Notes on the first-time application of IAS/IFRS

Accounting and valuation

Pursuant to IFRS 1, International Accounting Standards (IAS)/International Financial Reporting Standards (IFRS) are applied retrospectively upon their initial adoption. Figures from previous periods are adjusted accordingly to allow effective comparison.

New standards published as part of the International Accounting Standards Board Improvement Project in December 2003, whose application is not compulsory until January 1, 2005, have not been employed for these financial statements.

Of the new standards published during the previous quarter, whose application is not compulsory until January 1, 2005, or later, Software AG chose to apply the provisions of IFRS 3 relating to the impairment testing of goodwill to these financial statements.

Application of IAS/IFRS involves the following material deviations from the accounting and valuation principles set out in German law:

- Goodwill is no longer amortized, but subject to regular impairment testing
- Securities available for sale are valued at their fair market value, even where this exceeds the cost of acquisition. Gains and losses are included in other comprehensive income under equity, but are not recognized in net profit or loss.
- Derivative instruments are valued at their fair market value, even where this exceeds the cost of acquisition. Both gains and losses are recognized in net profit or loss for the period.
- Revenues are recognized according to the percentage-of-completion method.
- Propertyis depreciated according to its useful economic life, and not according to tax scales.
- Capital leases, according to the more restrictive IFRS provisions, are posted as assets and leasing liabilities.
- Provisions are only formed where obligations to third parties exist, and where the probability that these obligations will be fulfilled is at least 50 percent. Medium and long-term provisions are stated at cash values. Provisions are not formed for failure to perform maintenance or for other expenses.
- Provisions for pensions are formed according to the projected unit credit method.
- Deferred taxes are calculated according to the balance-sheet liability method. Deferred taxes on loss carryforwards are formed where the Company expects to be able to make use of these loss carryforwards.
- Cash positions in foreign currencies are valued at the balance-sheet-date rate and recognized in net profit or loss for the period. However, translation differences from long-term intercompany net cash investments in non-German companies are posted in other comprehensive income under equity, but are not recognized in net profit or loss for the period.

Balance-sheet reconciliation on January 1, 2003 (HGB to IFRS)

€ thousands	Note	HGB Jan 1, 2003	Income statement/ equity related changes	Reclassifications	IFRS Jan 1, 2003
Assets					
A. Cash and cash equivalents					
Cash on hand and bank balances		75,423	0	0	75,423
Securities		0	0	0	0
		75,423	**0**	**0**	**75,423**
B. Current assets					
Inventories	(1)	4,628	0	– 3,873	755
Trade receivables	(1)	122,160	616	3,873	126,649
Other receivables and other assets	(2)	10,395	1,048	0	11,443
		137,183	**1,664**	**0**	**138,847**
C. Fixed assets					
Intangible assets		1,551	0	0	1,551
Goodwill		176,591	0	0	176,591
Property, plant and equipment	(3)	37,000	15,776	0	52,776
Financial assets	(4)	5,937	9,909	0	15,846
		221,079	**25,685**	**0**	**246,764**
D. Deferred taxes	(5)	**188**	**38,060**	**0**	**38,248**
E. Deferred expenses		**6,947**	**0**	**0**	**6,947**
Total assets		**440,820**	**65,409**	**0**	**506,229**
Equity and liabilities					
A. Current liabilities					
Current financial liabilities	(6)	3,395	3,016	0	6,411
Trade payables	(7)	13,992	0	8,474	22,466
Other current liabilities	(7)	18,046	0	12,934	30,980
Current provisions	(8)	97,950	– 16,110	– 28,413	53,427
		133,383	**– 13,094**	**– 7,005**	**113,284**
B. Non-current liabilities					
Non-current financial liabilities	(6)	0	8,395	0	8,395
Trade payables		0	0	0	0
Other non-current liabilities	(7)	448	0	3,393	3,841
Provisions for pensions	(9)	8,781	10,653	0	19,434
Non-current provisions	(7)	0	0	3,612	3,612
		9,229	**19,048**	**7,005**	**35,282**
C. Deferred taxes	(5)	**2,012**	**14,994**	**0**	**17,006**
D. Deferred income		**81,728**	**0**	**0**	**81,728**
E. Equity					
Share capital		81,800	0	0	81,800
Capital reserves		132	0	0	132
Retained earnings		132,959	34,552	– 18,153	149,358
Consolidated income		0	0	0	0
Currency translation differences		– 423	0	423	0
Other comprehensive income	(10)	0	9,909	17,730	27,639
		214,468	**44,461**	**0**	**258,929**
Total equity and liabilities		**440,820**	**65,409**	**0**	**506,229**

Notes on the balance-sheet reconciliation from HGB to IFRS (January 1, 2003):

(1) Work in progress as defined by HGB was recognized and posted as non-invoiced receivables according to the percentage of completion method (including margin).

(2) Derivative instruments are valued at fair market value, even where this exceeds the cost of acquisition.

(3) Depreciation of property was adjusted to take account of expected useful economic life. Assets from capital leases were capitalized.

(4) This change is a result of the fair-market valuation of securities. The change is included in other comprehensive income under equity, but not recognized in net profit or loss for the period.

(5) Deferred tax assets are primarily formed for loss carryforwards and provisions. Deferred tax liabilities are primarily formed for deferred expense and property, plant and equipment.

(6) Long and short-term financial liabilities include capitalized liabilities from capital leases.

(7) Certain provisions under HGB were reclassified as short or long-term liabilities to comply with IFRS.

(8) The adjustment of provisions (recognized in net profit or loss) primarily comprises dissolved provisions for expenses (maintenance, guarantees) and provisions where the probability of the obligation having to be settled is less than 50 percent (legal costs, contingent losses, general risks). Reclassifications comprise provisions which, according to IFRS, are to be posted as liabilities. See also note (7).

(9) The increase in pension provisions is primarily a result of the requirement under IFRS to include indirect pension obligations at SAG UK. These were not previously included, in accordance with the option granted by Article 28 of the Introductory Act to the German Commercial Code (EGHGB).

(10) Other comprehensive income includes unrealized gains from the fair-market valuation of securities and differences from the translation of long-term intercompany cash positions in foreign currencies (i.e. not in euros).

Reconciliation of equity on January 1, 2003 (HGB to IFRS)

€ thousands	Note	
Equity in accordance with HGB as at Jan 1, 2003		**214,468**
Revenue recognised according to percentage of completion	(1)	616
Depreciation of buildings	(3)	8,884
Finance leases	(3), (6)	– 4,519
Market value of securities and financial derivatives	(2), (4)	10,957
Deferred tax assets	(5)	38,060
Adjustments to other accruals	(8)	16,110
Adjustments ot pension accrual	(9)	– 10,653
Deferred tax liabilities	(5)	– 14,994
Equity in accordance with IFRS as at Jan 1, 2003		**258,929**

Balance-sheet reconciliation on September 30, 2003 (HGB to IFRS)

€ thousands	Note	HGB September 30, 2003	Income Statement/ equity related changes	Reclassifications	IFRS September 30, 2003
Assets					
A. Cash and cash equivalents					
Cash on hand and bank balances		58,465	0	0	58,465
Securities		16,342	0	0	16,342
		74,807	**0**	**0**	**74,807**
B. Current assets					
Inventories	(1)	4,323	0	– 3,963	360
Trade receivables	(1)	108,582	938	3,963	113,483
Other receivables and other assets	(4)	6,190	784	0	6,974
		119,095	**1,722**	**0**	**120,817**
C. Fixed assets					
Intangible assets		1,047	0	0	1,047
Goodwill	(2)	160,202	16,389	0	176,591
Property, plant and equipment	(3)	34,518	14,019	0	48,537
Financial assets	(4)	6,950	14,679	0	21,629
		202,717	**45,087**	**0**	**247,804**
D. Deferred taxes	(5)	**23,794**	**20,054**	**0**	**43,848**
E. Deferred expenses		**6,957**	**0**	**0**	**6,957**
Total assets		**427,370**	**66,863**	**0**	**494,233**
Equity and liabilities					
A. Current liabilities					
Current financial liabilities	(6)	2,810	3,016	0	5,826
Trade payables	(7)	12,114	4	7,302	19,420
Other current liabilities	(7)	12,730	0	12,080	24,810
Current provisions	(8)	92,073	– 4,960	– 26,866	60,247
		119,727	**– 1,940**	**– 7,484**	**110,303**
B. Non-current liabilities					
Non-current financial liabilities	(6)	0	5,268	0	5,268
Trade payables		0	0	0	0
Other non-current liabilities	(7)	222	0	3,393	3,615
Provisions for pensions	(9)	8,394	10,653	0	19,047
Non-current provisions	(7)	0	0	4,091	4,091
		8,616	**15,921**	**7,484**	**32,021**
C. Deferred taxes	(5)	**1,021**	**14,282**	**0**	**15,303**
D. Deferred income		**74,182**	**0**	**0**	**74,182**
E. Minority Interest		**159**	**0**	**0**	**159**
F. Equity					
Share capital		81,800	0	0	81,800
Capital reserves		132	0	0	132
Retained earnings		146,017	21,494	– 18,153	149,358
Consolidated income		– 3,485	2,426	3,957	2,898
Currency translation differences	(10)	– 799	0	– 19,501	– 20,300
Other comprehensive income	(11)	0	14,680	33,697	48,377
		223,665	**38,600**	**0**	**262,265**
Total equity and liabilities		**427,370**	**66,863**	**0**	**494,233**

Notes on balance-sheet reconciliation from HGB to IFRS (September 30, 2003):

(1) Work in progress as defined by HGB was recognized and posted as non-invoiced receivables according to the percentage of completion method (including margin).

(2) Scheduled amortization of goodwill pursuant to HGB was reversed as, according to IFRS 1, where IFRS 3 is voluntarily applied to 2004, it must be applied to 2003. Accordingly, 2003 goodwill was not amortized according to the straight-line method.

(3) Depreciation of property was adjusted to take account of expected useful economic life. Assets from capital leases were capitalized.

(4) This change is a result of the fair-market valuation of securities. The change is included in other comprehensive income under equity, but not recognized in net profit or loss for the period. Derivative instruments are valued at fair market value, even where this exceeds the cost of acquisition.

(5) Deferred tax assets are primarily formed for loss carryforwards and provisions. Deferred tax liabilities are primarily formed for deferred expense and property, plant and equipment.

(6) Long and short-term financial liabilities include capitalized liabilities from capital leases.

(7) Certain provisions under HGB were reclassified as short or long-term liabilities to comply with IFRS.

(8) The adjustment of provisions (recognized in net profit or loss) primarily comprises dissolved provisions for expenses (maintenance, guarantees) and provisions where the probability of the obligation having to be settled is less than 50 percent (legal costs, contingent losses, general risks). Reclassifications comprise provisions which, according to IFRS, are to be posted as liabilities. See also note (7).

(9) The increase in pension provisions is primarily a result of the requirement under IFRS to include indirect pension obligations at SAG UK. These were not previously included, in accordance with the option granted by Article 28 of the Introductory Act to the German Commercial Code (EGHGB).

(10) All currency translation differences were posted since the changeover to IFRS accounting methods. As permitted by IFRS 1.22, the HGB figure was reset to zero for the IFRS statements on January 1, 2003.

(11) Other comprehensive income includes unrealized gains from the fair-market valuation of securities and differences from the translation of long-term intercompany cash positions in foreign currencies (i.e. not in euros).

Reconciliation of equity on September 30, 2003 (HGB to IFRS)

€ thousands	Note	
Equity in accordance with HGB as at Sep 30, 2003		**223,665**
Revenue recognised according to percentage of completion	(1)	938
Correction to goodwill amortization	(2)	16,389
Depreciation of buildings	(3)	8,911
Finance leases	(3), (6)	– 3,176
Market value of securities and financial derivatives	(2), (4)	15,463
Deferred tax assets	(5)	20,054
Adjustments to other accruals	(8)	4,960
Adjustments to pension accrual	(9)	– 10,653
Deferred tax liabilities	(5)	– 14,282
Other		– 4
Equity in accordance with IFRS as at Sep 30, 2003		**262,265**

Reconciliation of net income/loss on September 30, 2003 (HGB to IFRS)

€ thousands	Note	
Net loss in accordance with HGB as at Sep 30, 2003		**– 3,485**
Revenue recognised according to percentage of completion	(1)	322
Correction to goodwill amortization	(2)	16,389
Depreciation of buildings	(3)	27
Finance leases	(3), (6)	1,343
Market value of securities and financial derivatives	(4)	– 265
Deferred tax assets	(5)	– 4,948
Adjustments to other accruals	(8)	– 11,150
Adjustments to pension accrual	(9)	0
Deferred tax liabilities	(5)	712
Other		3,953
Net gain in accordance with IFRS as at Sep 30, 2003		**2,898**

Seasonal effects

The following table shows a breakdown of revenues and pre-tax profits (adjusted for restructuring costs) over the four quarters of 2003:

€ thousands	Q1 2003	Q2 2003	Q3 2003	Q4 2003	2003
Revenues	103,140	103,136	98,680	115,086	420,042
% of revenues at year-end	24.6 %	24.5 %	23.5 %	27.4 %	100.0 %
Pre-tax profit	8,728	18,241	16,426	18,420	61,815
% of net income at year-end	14.1 %	29.5 %	26.6 %	29.8 %	100.0 %

The development of revenues over the four quarters followed the same pattern as in previous years. This is largely a result of customers, purchasing behavior. However, it is important to note that fourth-quarter figures for the previous year were heavily influenced by strong license sales. Restructuring activities in the first half of 2003 and in the first three months of 2004 generated significant cost savings and a corresponding increase in pre-tax profit.

Contingent liabilities

At September 30, 2004, no provisions had been formed for the following contingent liabilities (stated at face values), for which it was deemed improbable that the Company would have to fulfill obligations:

€ thousands	
Bank guarantees	5,660
Other	1,168
	6,828

Share-option plans

The Software AG Group runs share-option plans for Executive Board members, senior executives, and other employees which are not expensed in the consolidated financial statements.

First share-option plan: At September 30, 2004, Executive Board members held 145,846 subscription rights to shares in the Company, and senior executives 69,069 – unchanged over December 31, 2003. These rights cannot be exercised before September 30, 2004. Options have a term of seven years from the date on which they are granted, and may only be exercised, after an initial blocking period of 24 months as of the Software AG IPO, on four occasions during each fiscal year: after the publication of quarterly, biannual, and annual earnings figures.

The subscription price per share is the issue price less a 20 percent mark-down, but no less than €28.12. As Company stock was floated at €30, this minimum applied.

Holders of subscription rights must fulfill the following three conditions before they may exercise their conversion rights:

- Consolidated earnings from ordinary activities (according to HGB) must have increased by 30 percent between 1997 and 1999.

  This condition was fulfilled between 1997 and 1999.

- Consolidated earnings from ordinary activities must total at least 10 percent of revenues for the fiscal year prior to conversion.
- The share price must exceed the minimum conversion price.

Second share-option plan: At September 30, 2004, Executive Board members held 153,375 subscription rights to shares in the Company, and senior executives 568,275. These rights cannot be exercised before September 30, 2004. During the third quarter, 11,125 new options were issued to Executive Board members, and 133,525 to senior executives. No rights could be exercised during the period.

The subscription price is the average XETRA closing price over the previous five trading days on the Frankfurt Stock Exchange before the date of conversion.

Holders of subscription rights must fulfill the following two conditions before they may exercise their conversion rights:

- Consolidated revenues must have increased for the fiscal year prior to conversion by at least 10 percent in comparison to the previous year.
- Consolidated earnings from ordinary activities (according to HGB) must total at least 10 percent of revenues for the year prior to conversion.

The terms, blocking period, and conversion dates correspond to those of the first share-option plan.

Other financial obligations

Software AG has entered into rental and leasing contracts for buildings, real estate, IT and PBX systems, and vehicles. Obligations from these contracts (where the contracts are still within their minimum durations) until the end of fiscal 2004 total €4,560 thousand. Obligations until the end of fiscal 2008 total €36,037 thousand. The leasing contracts are operating leases as defined by IAS 17.

Significant transactions during the reporting period

During the second quarter of 2004, the sale of shares in SAP SI generated income of €24,539 thousand.

Software AG spent a total of €23,430 thousand on restructuring during the first nine months of 2004, of which €4,093 thousand during the third quarter. This amount was covered by provisions for restructuring in the amount of €30,682 thousand, formed in 2003.

Employees

The Software AG workforce averaged 2,445 during the third quarter of 2004, and totaled 2,468 on September 30, 2004, 333 less than on the same date in 2003. The reduction in headcount largely took place in Germany, in particular at headquarters. 68 percent of Software AG employees work outside Germany.

Executive Board and Supervisory Board
On September 30, 2003, the composition of the Supervisory Board had changed as follows in comparison to December 31, 2003:

By resolution of the annual shareholders' meeting on April 30, 2004, Dr. Andreas Bereczky, Director of Production at German public-service TV broadcaster ZDF, Mainz, was elected to succeed Dr. Peter Lex on the Software AG Supervisory Board.

Karl-Heinz Hageni (employee representative) left the Supervisory Board on April 30, 2004. On June 25, 2004, employees elected Monika Neumann, chair of the General Works' Council, Schliersee, as Mr. Hageni's replacement.

Dr. Peter Mossack (research and development) left the Executive Board on July 31, 2004.

Gary Voight (Americas region) left the Executive Board on September 10, 2004.

Events subsequent to the balance-sheet date

Further restructuring activities are expected to generate costs totaling €2.7 million during the fourth quarter of the year.

In November 2004, Software AG appointed Dr. Peter Kürpick to the Executive Board. The appointment takes effect as of April 1, 2005. The XML Business Integration business line will report directly to Dr. Kürpick whose responsibility will also include Research & Development and product marketing. As Senior Vice President at SAP AG, Dr. Kürpick was responsible for the development of SAP NetWeaver integration technology in six development centers across the world.

Financial Calendar

January 17–19, 2005	CA Cheuvreux German Corporate Conference, Kronberg, Germany – CFO
February 15, 2005	Unaudited Q4/FY 2004 financial figures
April 28, 2005	Q1 2005 financial figures
May 13, 2005	Annual General Shareholders' Meeting, Frankfurt, Germany
June 02, 2005	8th German Corporate Conference, Deutsche Bank AG, Frankfurt, Germany – CEO
July 28, 2005	H1/Q2 2005 financial figures
October 28, 2005	Q3 2005 financial figures

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