PSI

Annual Report 1998

PSI Aktiengesellschaft
für Produkte und Systeme
der Informationstechnologie

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The PSI Group at a glance

	1995 DM ’000	1996 DM ’000	1997 DM ’000	1998 DM ’000	1999 e DM ’000
Turnover	110,551	111,741	128,786	186,211	233,100
Gross earnings	22,814	26,891	31,359	52,752	85,000
Operating result	–1,626	–2,068	–4,181	968	8,900
Result before tax	794	–2,621	–10,288	2,549	
Total assets	116,168	118,098	133,329	198,047	
Shareholders’ equity (all above figures according to US GAAP)	26,320	26,415	24,275	109,150	
Employees as at 31. 12.	655	620	669	833	

Organs of PSI

Supervisory Board

Dr. André Warner
Berlin, Chairman

Kurt Kasch
Berlin, Vice-Chairman

Franz Niedermaier
Munich

Dietrich Walther
Iserlohn

Wolfgang Fischer
Aschaffenburg,
Employee Representative

Siegfried Hartmann
Aschaffenburg,
Employee Representative

Board of Management

Björn S. Eriksen
Berlin

Dietrich Jaeschke
Berlin

Kurt Schmaltz
Aschaffenburg

Content

Foreword by the Board of Management

Dear shareholders and friends of PSI,

1998 was a milestone in the successful history of PSI. Flotation not only resulted in an inflow of new funds for the company, it also significantly raised its profile. A new, modern image also contributed towards growth in all quantitative and qualitative aspects.

This growth was achieved in an environment of continuing market expansion and dramatic processes of change. PSI met this challenge head-on by focusing even more strongly on attractive market segments in which PSI was able to further develop its strong position.

By going public on 31 August, PSI has demonstrated that it is possible to successfully place interesting technology shares even in a difficult stock market climate, given a clear corporate strategy. The inflow of capital allows us to speed up investment in central product development and marketing, with a strong international component.

The marked increase in turnover to DM 180 million (according to US GAAP) is a reflection of this determined forward strategy. Both PSI's business activities, products (PSIPENTA) and systems, show growth rates which are above market growth, enabling PSI to gain market shares in both businesses.

The further increase of investments in internationalisation and in opening up new markets in the product business was offset by the substantial rise in profits in the systems business, so that a balanced result was achieved in the Group as a whole. From 1999, these investments will lead to strong earnings increases.

The purpose of the acquisitions at the end of the year was above all to round off the ERP product (Enterprise Resource Planning) PSIPENTA, but also to supplement know-how in the field of e-commerce, which is of equal importance for the systems and product business.

Market trends back up PSI's growth-oriented strategy: Having dealt with the "Year 2000 problem", the IT markets will get new impetus from a renewed increase in strategic investment. This trend is driven by, amongst other things, the deregulation of energy markets, e-commerce and supply chain management. PSI has the basic technologies required in these fields.

Planning for 1999 is geared towards this, and resolutely pursues the existing strategy of growth and of concentrating on strengthening our customers' competitiveness, and thus our own competitiveness.

Björn S. Eriksen   Dietrich Jaeschke   Kurt Schmaltz

The PSI market

In 1998, the global information technology market was once again marked by growth exceeding 10 %. According to EITO (European Information Technology Observatory), a further acceleration of growth is expected for 1999. This is driven in particular by the software and service segments which PSI concentrates on. Total market volume for software in 1998 was, according to IDC (International Data Corporation) US$ 127 billion, with growth rates of about 15 % expected for the next five years.

As far as the European market for information technology is concerned, EITO expects the 9.3 % growth in turnover to 192 billion Euro in 1998 to be topped by growth of 9.5 % to 210 billion Euro in 1999. In Europe, too, the main engines for growth are the software and service segments, which combined at 56 % already represent more than half of the IT market. In 1998 the software segment achieved 12.4 % growth in Europe, in 1999 it is expected to reach 13.5 %. Growth rates in the service sector are around 15 %.

In the German information technology market, the trade association on information technology within the Machine and Plant Manufacturer's Association (VDMA), and the National Union of the Electro-Technical Industry (ZVEI) forecast 8.6 % growth for 1999, after 8.1% in 1998. In Germany, too, developments are particularly positive in IT services and software, in which PSI is traditionally strong. Growth in the German software market reached double-digit figures for the first time in 1998, and a volume of DM 22 billion (11.25 billion Euro).

As the largest individual European market, and one of the world's most important IT markets, Germany is very attractive to global IT providers. Success in this keenly competitive environment offers PSI excellent preconditions for successfully expanding its international presence.

The driving forces of market growth

From 1999, the special influence exerted by the Year 2000 problem and the introduction of the Euro as the driving forces of market growth will recede into the background. From the second half of 1999, their place will be taken by renewed emphasis on strategic investment. Changes such as the globalisation of competition and the deregulation of the energy markets are forcing companies to invest in improving their competitiveness.

According to the Gartner Group, IT investments in the next five years will no longer be geared towards rationalisation, but rather towards differentiation from competitors. IT support in administrative areas does not offer much potential in this respect. Market growth in the coming years will therefore be driven predominantly by investments in optimising the core business processes of production and distribution. Technological trends such as object orientation, component software, supply chain management and e-commerce will act as a further boost.

Market segments

Since its foundation, PSI has concentrated on supporting the core processes in the production and distribution of energy and goods. Here, PSI focuses on specific market segments in which the company traditionally occupies a leading position in Germany. PSI's key focus is in the areas of:

Energy supply: PSI has further strengthened its leading position in control technology for networks and transport systems for electricity, gas and oil. Other fields of activity are power stations and consultancy services with respect to deregulation. There will be a further surge in growth in the fields of control technology and consultancy in the coming years as a result of European integration and continuing deregulation.

Industry: PSI offers its own software to support all business processes in an industrial enterprise. This means that PSI supplies both individual solutions for the core processes of production and distribution, as well as a complete product for medium-sized enterprises. Here, too, the integration of markets and customer demand for tailor-made products and shorter delivery times increases the demand for software which is flexible and efficient in adapting to continuous change, and supports all the core processes of industrial enterprises.

Service providers: Energy suppliers, industrial enterprises and government authorities are increasingly becoming service providers. Alongside them, completely new service sectors specialising in directing energy, goods, information and transport flows are emerging. Managing these dynamic and integrated business processes requires special IT solutions. PSI software for these services acts as a link to the service providers' customers.

Competitive position

PSI has maintained its position on the German market for information technology for 30 years, and has achieved a strong, indeed leading, position in its own market segments. Typical competitors are, on the one hand, globally operating providers such as IBM, Siemens or Oracle with whom very successful co-operation exists in practice, but on the other hand also a large number of niche suppliers which are frequently geared to regional operations. With its successful flotation in August 1998, PSI has created the preconditions for becoming a leading player by international standards, too. This applies particularly to the product business, but also to the systems business. Here, PSI is able to build on the technological expertise acquired in a large number of projects, and on the thorough knowledge it has of its own customers' business processes. This knowledge will continue to give PSI a major competitive edge in the future.

The architecture

The software architecture of the product PSIPENTA is based on object orientation and handy software components that can be assembled individually for current requirements. By supporting global standards, PSIPENTA is accessible to the components of other manufacturers, offering the customer a high degree of autonomy in designing his own business processes.

The structure of PSI

The abbreviation PSI stands for the two businesses in which PSI AG operates, and thus reflects its activities:

***P**roducts and **S**ystems for **I**nformation technology.*

In the product business, PSI develops and markets the Enterprise Resource Planning (ERP) product PSIPENTA for medium-sized enterprises involved in discrete manufacturing. In the systems business, PSI develops solutions for the production and distribution of energy and goods. With both these businesses, PSI is operating in rapidly growing markets which offer excellent prospects for the future. PSI thus occupies a strong position in two attractive markets of international dimension and has been able to further consolidate this in 1998.

Since June 1994, PSI has had ISO 9001 certification by complying with ISO 9000-3 for software producers and the stricter regulations of ITQS for European IT companies.

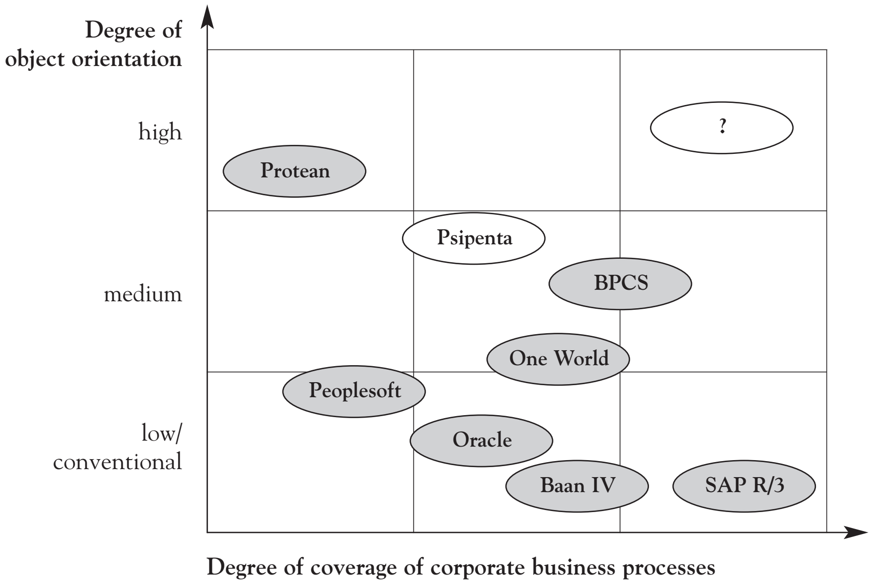
The product business

With PSIPENTA, PSI AG has a complete Enterprise Resource Planning (ERP) product which was developed specially for the medium-sized manufacturing industry. PSIPENTA has an object-oriented software architecture and is particularly well suited for companies producing complex products to order. Its functions cover the entire value-added chain and range from order management via production logistics, supply chain management to accounting and project management. PSIPENTA is developed and marketed by the PSI subsidiary Psipenta Software Systems GmbH.

PSIPENTA was developed in object-oriented software architecture and as a result it occupies an internationally leading technological position. Because it has fully integrated the Microsoft development environment VisualBasic for Applications (VBA), and supports the Microsoft object standards, modifications of the business processes displayed in PSIPENTA, and connections to other applications, are simple to carry out while operational. PSIPENTA thus offers medium-sized enterprises in particular the possibility of unrestricted configuration to allow them to respond flexibly to customer requirements and changed market conditions.

This is also confirmed by neutral market observers. The following assessment by Diebold Germany, which was published in the Diebold Management Report in February 1998, illustrates the leading technological position occupied by PSIPENTA:

Object orientation of selected standard software products



Source: Diebold Management Report 2/98

The market focus

PSIPENTA was developed with a clear focus on the medium-sized manufacturing sector. The scale of functions, flexibility and easy use are geared to its requirements. Medium-sized enterprises in particular see constant change as normal. PSIPENTA supports all business processes with simple tools.

The British publishing house JPC also singled out PSIPENTA in 1998 as currently the most technologically advanced, fully object-oriented business software for the manufacturing industry. At the most important British IT trade fair for industrial companies, CIM'98 in Birmingham, PSIPENTA was awarded the "Best Software Solution at CIM'98" prize.

The market for ERP standard software is characterised by high growth rates. In 1998, the international ERP market grew by more than 40 %, according to AMR Research, and reached a total volume of US$ 15 billion. AMR Research forecasts 30 % market growth and a total volume of US$ 19.5 billion for 1999. It anticipates a change in investment behaviour and renewed acceleration of growth after the year 2000, which can already be detected in 1999. The special impact made by the Year 2000 problem and European Monetary Union will recede into the background. The focus of ERP investment will be on differentiation from competitors by improving the key business processes of production and distribution. According to the Gartner Group, this includes control of world-wide logistics chains, change from series production to customer-specific made-to-order production, with simultaneously shortened delivery times. Medium-sized enterprises in particular can only meet these challenges by using new, flexible standard software. Consequently, a large number of obsolete systems will have to be replaced in this market segment in the next few years, since they offer companies neither the necessary flexibility nor the desired security for the future.

PSIPENTA was developed right from the start to meet the needs of the medium-sized manufacturing sector, and it therefore dispenses with functional extras. The ERP product is based on PSI's many years of experience in the field of planning and controlling complex production processes, and is therefore particularly well suited for the made-to-order discrete, variant and project manufacture of complex products.

Thanks to this clear market focus, PSIPENTA has an outstanding competitive advantage. This is demonstrated by the results of the 1998 analysis conducted by the META Group concerning competitiveness and image: In terms of competitive strength in relation to medium-sized enterprises (companies with up to 399 employees), PSIPENTA occupies third place among 41 IT suppliers, in terms of competitive strength in the target market of discrete manufacturing, fourth place among 39 IT suppliers.

The systems business

In the systems business, PSI concentrates on projects in four areas which are implemented in four closely linked competence centres:

- Control technology for energy suppliers
- Production management for industrial enterprises
- Information logistics for service companies
- Consulting for processes of change

PSI has extensive experience in these fields which has been acquired over the last 30 years in a large number of projects. PSI supplies complete solutions which support the core business processes and are therefore of great strategic importance for the customers.

In the field of control technology for energy suppliers, PSI develops and installs complete solutions for energy management systems. These systems include energy management and control systems for electricity, gas and oil. They include strong telecommunications components and are based on PSI's proprietary software components and specific know-how. PSI concludes long-term service and maintenance agreements with customers in this field and guarantees a high level of availability.

It is expected that the deregulation of European energy markets will lead to further attractive growth potential. PSI is convinced that it is well prepared for this because of its strong position in Germany and its special technological position. We plan to further strengthen our own position and offer additional solutions, for example for the settlement of accounts and simulation in the electricity business. PSI has been investing in this market for 18 months.

PSI has many years of experience in offering solutions in the field of production management for industrial enterprises. PSI's special expertise is documented by the excellent references from major industries. In this field, PSI combines the automation of systems with commercial data processing and thus covers the entire logistics chain from the supplier to the customer with solutions in process management, material management, production control and order management. In this field, the focus is on the steel, print and chemicals sectors, where PSI has thorough know-how about the customers' core business processes.

The energy market

The deregulation of the energy markets is a great challenge for the energy supply industry. New components for transmitting the current and invoicing have to supplement existing software for network control technology and energy management, and integrate both into a functioning whole. PSI has developed designs for this purpose, already has the necessary software available, and is therefore able to consolidate its leading position in this target market.

At the same time, the product management section is also an important partner for PSIPENTA, because it provides experience in the field of production technologies and acts as a system integrator for major PSIPENTA projects. According to IDC, the industry continues to be the leading sector, well ahead of the banks, when it comes to investment in information technology. PSI occupies an excellent position in this market and is among the first suppliers to successfully use artificial intelligence for controlling complex production processes.

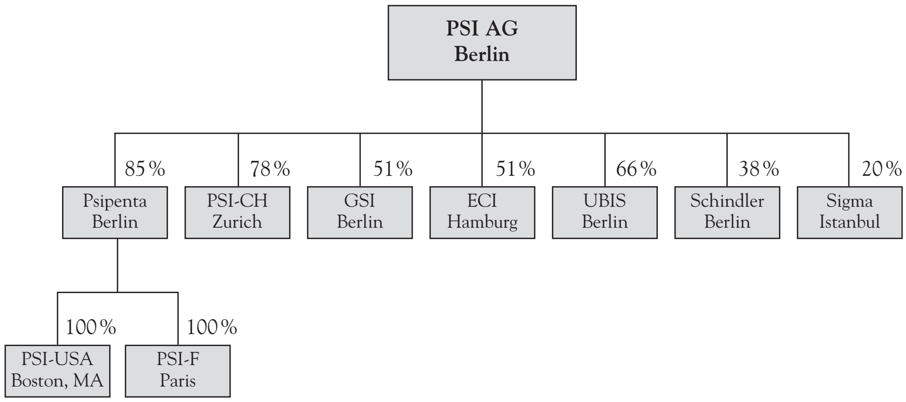
In the competence centre specialising in information logistics for service companies, PSI is developing systems for comprehensive logistics chains to manage goods, information and transport flows. By controlling complex work processes and information flows, it is possible to achieve optimum efficiency in value-added chains and value-added networks. Typical customers in this field are distributors, freight hauliers, the railway, post office, airports and airlines, network operators, service providers and of course industry.

Since only few competitors in Germany are capable of providing such comprehensive and complex logistics systems, PSI is in a very good position to increase its own market share through above-average growth in Germany and other European countries.

The know-how of the competence centre specialising in consulting for processes of change is the result of PSI's many years of experience in implementing a large number of projects. Here, the focus is on project management, business process reengineering, the use of information technology and organisational development. In addition, PSI has its own training centre which offers training programmes for customers, partners and PSI staff. The growth of the consulting competence centre is driven in particular by the processes of change in the markets in which PSI operates.

Group structure

PSI AG is the parent company of a three-tier group structure. PSI AG has the following shares in the companies:



The majority holdings in GSI and UBIS were only acquired at the beginning of 1999.

The company in Switzerland is only active for the regional PSIPENTA business, covering sales, consultancy, installation and maintenance.

GSI mbH develops the PSIPENTA components for personnel management, production control and project management.

ECI GmbH develops standard software products for stock management which are used both in the product and the systems business.

UBIS GmbH focuses its operations on the development and implementation of business process optimisation and solutions in e-commerce.

The business purpose of Schindler & Partner GmbH is planning, consultancy and the installation of computer and communications networks.

With the newly acquired majority holdings in ECI GmbH, GSI mbH and UBIS GmbH, PSI has rounded off its own range of products and services and is now in a position to offer the customers in both lines of business even more extensive support for their business processes.

The stock exchange

PSI has been listed on the Neuer Markt of the Frankfurt Stock Exchange since 31 August 1998. The flotation on the stock market demonstrated that interesting technology shares can be successfully placed even in a difficult stock market climate, given a clear corporate strategy. The resulting inflow of capital allows the acceleration of overall development and single-minded internationalisation.

Shareholder structure

Of the currently 8,303,750 PSI ordinary shares, 3,066,250 bearer shares have been admitted for trading on the Neuer Market of the Frankfurt Stock Exchange. In total, 5,237,500 registered shares are held by around 440 shareholders, who are predominantly staff and former staff of PSI.

Also admitted for trading on the Neuer Markt is contingent capital of up to DM 2,187,500 from the 1997 contingent capital increase, divided into up to 437,500 new bearer shares. The convertible profit-sharing certificates of a total amount of DM 3,500,000 given to staff and outside interested parties in 1997 can be exchanged for new bearer shares from the contingent capital increase one year after flotation at the earliest.

Business development in 1998

The past financial year of the PSI Group has been marked by significant growth in all major areas:

- Orders
- Sales
- Operating result
- Funding and
- Staff

and is thus a good starting base for achieving the set objectives next year, too. The PSI Group was able to further strengthen and extend its strong position as a professional product and systems supplier to industry, energy and service providers.

Orders

The Group's incoming orders rose by 51% to DM 173.7 million last year. This successful acquisition of new business markedly outstripped the original budget estimates. The spread over the two businesses, products and systems, is also more or less in line with proportionate shares of turnover.

In the systems business, which provides solutions for the production and distribution of energy and goods, the intake of new orders was restricted as a result of full capacity utilisation and the tightness of the labour market. In the product business, which offers the standard software package PSIPENTA with its derivative services, licence sales increased noticeably.

Sales revenue and expenses

Sales revenue rose overproportionally – compared with market growth in the IT sector. The growth rate was 44.5% and turnover reached a volume of DM 186.2 million. As planned, growth in the product business was markedly above that of the systems business.

Segmentation of total business into the two businesses of products and systems gives the following picture:

	Product business DM million	Systems business DM million	PSI Group DM million
Software production and consultancy	30.6	115.3	145.9
Licences	28.6	1.4	30.0
Hardware	3.4	6.9	10.3
Total sales	**62.6**	**123.6**	**186.2**
Cost of sales	– 41.3	– 92.2	–133.5
Gross sales revenue	**21.3**	**31.4**	**52.7**
Operating expenses	– 31.9	–19.8	– 51.7
Operating income	**–10.6**	**11.6**	**1.0**

Sales in the systems business rose by 25.6 %, those in the product business by 105.4 %. The shift of sales share towards the product business is in line with medium-term planning. In 1997, the product business contributed a quarter to total sales, in 1998, a third.

Licence sales nearly doubled compared to the previous year; the expansion of sales for software production and consultancy in the Group as a whole was approx. 44 %. The hardware business remained at the previous year's level.

The combined group operating result improved markedly from DM – 4.2 million to DM +1.0 million. These aggregate earnings are the result of the continuing increase in sales returns from the systems business (from DM 6.3 million to DM 11.6 million) and the – compared to the previous year – nearly identical operating result from the product business (DM –10.6 million).

The following figures for the individual businesses illustrate the trend:

Product business

	1998 DM million	1997 DM million
Sales revenue	62.6	30.5
Cost of sales	– 41.3	–22.3
Gross sales revenue absolute	21.3	8.2
relative	34.1%	26.9 %
Distribution costs	–20.3	–11.6
General administrative costs	– 6.4	– 3.0
Development costs	–14.1	– 8.8
Current development costs	10.5	6.0
Depreciation of current development costs	–1.9	–1.2
Other income	0.3	0.0
Operating expenses	–31.9	–18.6
Operating result	**–10.6**	**–10.4**

As in the past, the development of the product business is being funded from the positive results of the systems business. Because of the increased marketing and distribution costs and administrative and development costs, it was not possible – despite the strongly increased gross sales revenue – to achieve a better operating result.

Systems business

	1998 DM million	1997 DM million
Sales revenue	123.6	98.4
Cost of sales	– 92.2	– 75.2
Gross sales revenue absolute	31.4	23.2
relative	25.4 %	23.6 %
Distribution costs	– 11.6	– 10.0
General administrative costs	– 9.7	– 7.2
Other income	**1.5**	**0.3**
Operating expenses	– 19.8	– 16.9
Operating result	**11.6**	**6.3**

A positive net interest income and the sale of shares in Psipenta GmbH led to a positive interest and investment result. Pre-tax profits were distinctly above break-even point.

The internal audit for the years 1990–1995 closed with payments of tax arrears. Since it is unlikely that the tax carryover accumulated as at 31 December 1998 will be used up within the original budget period, a valuation adjustment was made for the deferred tax position of the Group companies' accumulated losses brought forward amounting to DM 8.4 million. Due to the tax charges totalling DM 5.4 million, the Group ended with a net loss for the year of DM 2.8 million. In the previous year, the loss was DM 10 million.

Research and Development

Customers demand shorter development times, architecture with a guaranteed future, and comprehensive functions with improved quality from application software. PSI safeguards its customers' investment plans with innovative software solutions, normally with fixed cost calculations and firm deadlines.

Components developed in-house, and software from third parties are integrated into tailor-made solutions in the systems business. The costs for the further development of sector-specific components are part of current expenditure.

In the product business, further and new developments are carried out by organisational development groups – separate from implementing specific customer requirements. Function, cost and time plans provide an overview of the status of each development. With respect to the PSIPENTA product, the completion of version 3.0 a and version 4.0 was in the forefront of development work in the last financial year. The main focus was on

- the Euro conversion
- the Business Object Broker
- the EDM interface and
- the integration of cost accounting

With the implementation of European Economic and Monetary Union, customers had a corresponding dual currency system at their disposal in good time. At the same time, the Year 2000 problems were solved.

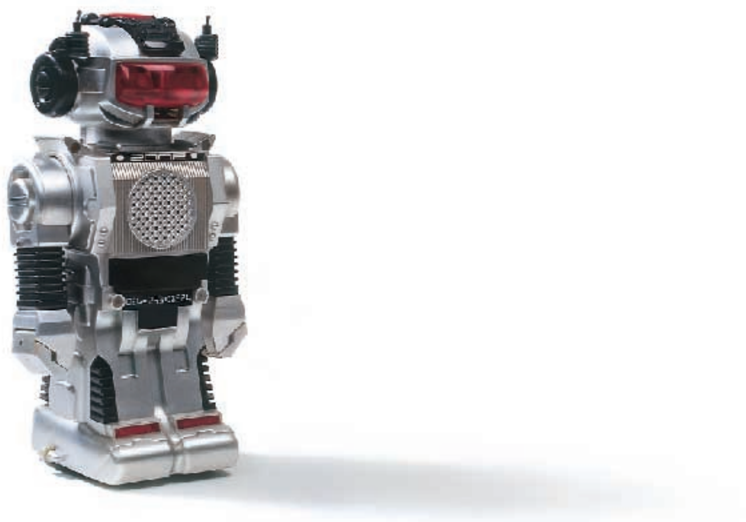
The Business Object Broker is the new, object-oriented system core of PSIPENTA. This allows the integration of new components from proprietary PSIPENTA and outside systems.

With the EDM (Engineering Data Management) interface, it becomes possible to link PSIPENTA to the design department, i. e. documents and data from the CAD system can be used in connection with specific orders.

The comprehensive business solution is completed with an integrated cost accounting system. The cost accounting system, operating as part of the PSIPENTA system architecture, supports all common cost accounting procedures, cost centre accounting and job order cost accounting.

Total development costs in 1998 amounted to DM 14.1 million.

In the current year, the key focus of version 4.1 will be on workflow and multi-site structures (spread-out corporate structures).



The technology

Artificial Intelligence (AI) has been a success in all areas where complex processes have to be optimised or adaptation to changed customer requirements is demanded. Here, PSI has done pioneering work. Both in energy and production management, vital competitive advantages are gained as a result of AI systems.

Investments

The combined Group invested DM 21.7 million in intangible assets and in property, plant and equipment. Of this, about half related to the capitalised development costs for the PSIPENTA product. More than 60 % of purchases for hardware and software and for intangible assets for the purpose of production, sales and administration were funded from internal resources through depreciation.

Financing

The stock market listing of the PSI shares on the Neuer Markt of the Frankfurt Stock Exchange was an outstanding event. In preparation for the flotation, the subscribed capital was increased from corporate funds, by a resolution of the general meeting on 1 August 1998, by DM 18,481,500 to DM 30,802,500. On 31 August 1998, 2,039,500 individual share certificates with a theoretical par value of DM 5.00 were issued on the Neuer Markt. Subscribed capital thus increased to DM 41,000,000. The share premium of DM 84,639,250 was allocated to capital reserves. In addition, 130,000 shares from existing holdings of a selling shareholder were exchanged.

Interest in the PSI share was overwhelming. At the end of the book-building phase, orders were of a magnitude of 80.7 million shares with a total value of DM 3.7 billion.

From the first trading day, the market price developed very positively, despite the fact that PSI was faced with subdued market sentiment.

The Board of Management is very satisfied with the price trend so far.

Price trend since flotation

Staff

Qualified and highly motivated employees are the No. 1 key to success of an IT company. The success in the PSI companies is due substantially to the co-operation between management and staff. Open information and communication structures encourage keenness to perform well and creativity, which are the main bases for economic and market success. Moreover, sharing in the company's growth strengthens identification with one's own work and the corporate aims.

Until flotation, PSI's capital resources came mainly from the employee shareholders. Approx. 80 % of capital was held in widespread share ownership by the present or former employees. After flotation, nearly 60 % continues to be held by employee shareholders and management, with no significant concentration. Employees' share of the total capital stock is concentrated in shares with limited transferability which have not yet been admitted to dealings on the stock exchange.

The people

A highly qualified and motivated staff are the most important capital of every company. In a difficult market for IT specialists, PSI succeeded last year in exceeding its own plans for recruiting new staff. This created the main precondition for further growth in the coming years.

As part of the flotation, all employees of the PSI Group were offered the option of subscribing to a total of 100,000 individual share certificates at issue price. The share-buying programme for staff was significantly oversubscribed.

Despite the tight labour market, it was possible to create 163 new jobs in the year under review, i.e. the number of employees increased by a quarter.

Their distribution across the two businesses, systems and products, and their main functions, were as follows as at 31 December 1998:

	Product business	Systems business	PSI Group
Sales/marketing	63	29	92
Software production/consultancy	151	425	576
Research/development	89	0	89
Administration	26	50	76
Total	**329**	**504**	**833**

In-house and external training took place both to gain technical qualifications as well as to improve sales and project management skills. External training costs were increased by approx. 75 % over the previous year.

Forward-looking personnel concepts such as extending variable pay, performance-related pay and payment by result at all levels of the company, annual working hours and flattened hierarchies, were further developed. The changes in company social welfare contributions towards more personalised, individual provision create the preconditions for a more flexible incomes policy.

The basic values of the PSI corporate culture cover the following triangle:

- a clear commitment to technology as an incentive to outstanding performance
- Openness in communication and deliberate promotion of open systems
- Success as the driving force for our own work and for ensuring the customer's success.

Management

The Board of Management consists of three members:

- Dietrich Jaeschke
- Kurt Schmaltz
- Björn S. Eriksen

The company's founder, Dietrich Jaeschke, is responsible for Marketing and Sales. Kurt Schmaltz is the head of Technology and Development. Since 1 March 1999, Björn S. Eriksen, as the new Board member, has been responsible for the Finance Department. Christian Seefeldt, his predecessor, by mutual consent ended his period of office on 31 October 1998.

The next level of heads of business divisions is staffed with experienced managers who, in addition to their management qualities, also have excellent knowledge of the markets and about the business processes of their customers.

Outlook

PSI is starting the year 1999 well-endowed with all strategic factors. This applies both to the dynamics of growth resulting from 1998 as well as the comfortable level of orders and the excellent market position. New developments and investments provide added momentum.

PSI has proven in 1998 that a high-tech company with a clear strategy is able to carry out a successful first flotation even in a difficult stock market climate. As a result, PSI not only has the necessary funds to finance planned growth, but is also benefiting from the higher profile which significantly helps the sales processes. PSI will continue to pursue its chosen path of focused market positioning and gaining market share. This applies both for PSI's product business and the systems business.

Growth

PSI was able to gain significant market share even in 1998. In 1999, growth is to be accelerated simultaneously in four areas:

- Turnover
- Profit
- International activity
- Business processes

In relation to turnover and profit, PSI wants to meet its own targets and the shareholder expectations. The aim of its global operations is not only to make a mark in the USA and Europe, but also to increase their share of sales. Qualitatively, PSI will support its customers' business processes with software in such a way that their competitiveness is strengthened.

Technology

PSI will continue to make sure that its technological edge is maintained and further strengthened. For this reason, PSI continuously invests in new areas of application, basic technologies and infrastructures. Since 1998, the key focus has been on:

SCM:	Supply Chain Management (managing complete logistics chains)
LCM:	Life Cycle Management as a completely new approach to customer relations
Deregulation:	The deregulation of the European energy market opens up completely new areas of work for companies in the software sector.
E-commerce:	With the Internet now being used for information and advertising, complete business processes are beginning to be carried out using it.

These new approaches are major elements in the future strategies of PSI's customers. Therefore, PSI must and will possess these new technologies.

Change

For PSI customers, change has become the routine. It relates not only to ever shorter cycles of innovation for products and systems, but also to organisations and strategies. PSI supports this change with suitable software architecture. Clearly, PSI also meets this challenge in-house by continuous processes of adjustment. This also applies to building partnerships, and thus a stronger virtuality and globalisation of the company.

The real challenge for PSI is in a shift in the customers' perspective towards sales and marketing. There, too, the customer increasingly becomes the central focus. For this reason, PSI's software must reach as far as the customers' customers. The Internet offers an outstanding infrastructure for this purpose, too.

PSI software supports the production and distribution of energy and goods. It follows the changes in these business processes. In this process, new tasks open up new business segments.

The new perspective: the customers' customers.

Berlin, 25 March 1999

The Board of Management

US-GAAP consolidated financial statements

as of December 31, 1998

together with auditors report

Consolidated balance sheet as of December 31, 1998

Assets	31.12.1998 TDM	31.12.1997 TDM	31.12.1996 TDM
Current assets			
Cash or cash equivalents	66,914	9,160	9,335
Trade receivables	43,866	33,550	23,624
Inventories	23,577	39,359	49,481
Prepaid expenses	2,128	1,215	449
Other receivables	3,538	5,331	1,146
Total current assets	140,023	88,615	84,035
Non current assets	2,952	0	0
Financial assets	855	1,580	2,145
Property, plant and equipment (net)	20,813	18,707	17,221
Intangible assets (net)	33,404	21,531	12,420
Deferred tax assets	0	2,896	2,277
Total assets	198,047	133,329	118,098

Liabilities	31.12.1998 TDM	31.12.1997 TDM	31.12.1996 TDM
Current liabilities			
Current financial laibilities	431	1,125	4,496
Trade payables	13,388	15,599	9,731
Payments received on account of orders	31,416	46,421	50,296
Deferred income	1,908	1,159	675
Other accruals	12,689	6,852	3,500
Other liabilities	8,978	9,530	8,888
Total current liabilities	68,810	80,686	77,586
Deferred taxes	900	0	0
Long term portion of other participating rights	454	481	131
Special reserves from investment grants	969	1,295	0
Long term portion of participating capital	3,500	3,438	0
Long term portion of pension accruals	14,264	12,814	11,502
Long term portion of liabilities	0	10,340	2,464
Equity			
Capital stock	41,000	12,321	10,268
Capital reserves	76,850	15,566	9,405
Revenue reserves	2,386	2,727	2,727
Unrealized gains on securities	2	11	35
Difference relating to currency translation	–360	38	78
Minority interests	532	430	699
Net retained profits/net accumulated deficit	–11,260	–6,818	3,203
Total equity	109,150	24,275	26,415
Total liabilities and equity	198,047	133,329	118,098

Consolidated income statement for the financial years 1998, 1997 and 1996

	1998 TDM	1997 TDM	1996 TDM
Net sales			
Software production and maintenance	145,872	101,558	91,400
Licenses	30,009	16,984	9,061
Hardware	10,330	10,244	11,280
	186,211	128,786	111,741
Cost of sales			
Software production and maintenance	117,030	85,440	73,544
Licenses	7,378	3,654	2,361
Hardware	9,051	8,333	8,945
	133,459	97,427	84,850
Gross profit on sales	52,752	31,359	26,891
Operating expenses			
Selling expenses	31,906	21,516	18,883
General and administrative expenses	16,164	10,313	9,106
Research and development costs	14,090	8,769	8,169
Capitalized research and development costs	–10,470	–6,039	–4,446
Depreciation of capitalized research and development costs	1,939	1,255	724
Other revenues or gains	–1,845	–274	–3,477
	51,784	35,540	28,959
Operative result	968	–4,181	–2,068
Net interest, net investment income	1,581	–1,141	–553
Extraordinary result	0	–4,966	0
Result before income tax	2,549	–10,288	–2,621
Taxes on income	–5,391	248	2,108
Group net profit/less	–2,842	–10,040	–513
Minority interests	2,474	19	–197
Profit brought forward	–6,818	3,203	3,913
Appropriation of results (prior year result PSI AG)	–4,074	0	0
Group retained earnings/accumulated deficits	–11,260	–6,818	3,203
Result per share			
in DM per share with par value (DM 5 share)	–0,06	–4,23	–0,69

Change in group equity of the financial years 1996, 1997 and 1998

	Number of chares issued		Capital stock	Capital reserves	Revenue reserves	Retained earnings/ accumulated deficit	Unrealized gains on securities	Minority interests	Difference related to currency translation	Total equity
	2,500 DM	5 DM	TDM	TDM	TDM	TDM	TDM	TDM	TDM	TDM
As of December 31, 1995	3,902	0	9,755	9,062	2,727	3,913	203	529	131	26,320
Group net loss						–710		197		–513
Currency translation									–53	–53
Issuance of shares	205	0	513	343						856
Other changes in minority interests								–27		–27
Unrealized gains on securities							–168			–168
As of December 31, 1996	4,107	0	10,268	9,405	2,727	3,203	35	699	78	26,415
Group net loss						–10,021		–19		–10,040
Currency translation									–40	–40
Issuance of shares	0	410,700	2,053	6,161						8,214
Other changes in minority interests								–250		–250
As of December 31, 1997							–24			–24
As of December 31, 1997	4,107	410,700	12,321	15,566	2,727	–6,818	11	430	38	24,275
Group net loss for the year						–368		–2,474		–2,842
Appropriation of result for the financial year 1997 of PSI AG					1,910	–1,910				0
Appropriation of result for the profit carryforwards of PSI AG					2,165	–2,165				0
Conversion of capital stock in shares with par value	–4,107	2,053,500								0
Issuance of shares										
– Capital increase from company funds		3,696,300	18,482	–14,066	–4,416					
– Capital increase from cash contribution		2,039,500	10,197	84,639						94,836
– Offsettting of going public costs				–9,289						–9,289
Change in minority interests										
– Capital increase at Psipenta GmbH								1,800		1,800
– Other								776		776
Currency translation									–398	–398
Other changes						1	–9			–8
As of December 31, 1998	0	8,200,000	41,000	76,850	2,386	–11,260	2	532	–360	109,150

Statement of cash flow for the financial years 1998, 1997 and 1996

	1998 TDM	1997 TDM	1996 TDM
Net income/loss	– 2,842	– 10,040	– 513
Adjustments to reconcile net income to net cash			
Depreciation of intangible assets and of property, plant and equipment	7,727	5,312	4,340
Net reversal of/provision to deferred taxes	3,796	– 619	– 2,336
Net transfer to / release of pension reserves	1,451	1,312	– 590
Minority interests	2,474	19	– 197
Operative cash flows	12,606	– 4,016	704
Change in assets and liabilities:			
Decrease/increase in inventory	15,782	10,122	4,238
Decrease/increase in trade receivables	– 10,316	– 9,926	– 517
Decrease/increase in other assets	1,793	– 4,185	6,841
Increase in non-current receivables	– 2,952	0	0
Decrease/increase in prepaid expenses	– 913	– 766	101
Increase/decrease in other accruals	5,837	3,352	– 2,593
Increase/decrease in trade payables	– 2,211	5,758	– 774
Increase/decrease in payments received on account of orders	– 15,005	– 3,875	9,854
Increase/decrease in other liabilities	– 552	752	– 460
Increase/decrease in deferred income	749	483	– 509
Cash flows from operating activities	– 7,788	1,715	16,181
Additions to capitalized research and development costs	– 10,470	– 6,039	– 4,446
Net additions to property, plant, equipment and other intangible assets	– 11,236	– 9,870	– 4,105
Cash Flow from investment activities	– 21,706	– 15,909	– 8,551
Increase/decrease in financial liabilities	– 11,034	4,505	– 1,915
Issue of profit participating rights/profit participation certificate capital	35	3,788	0
Increase in special item for investment grants	– 326	1,295	0
Increase/decrease in minority interests	102	– 269	170
Decrease/increase in financial assets	725	566	856
Issue of shares	85,547	8,214	856
Other changes in equity	– 407	– 64	– 1,340
Cash flows from financing activities	74,642	18,035	– 1,373
Increase (decrease) in cash and cash equivalents	57,754	– 175	6,961
Cash at the beginning of the year	9,160	9,335	2,374
Cash at the end of the year	66,914	9,160	9,335

A. Summary of the main accounting and valuation principles

I. Description of business operations

The business operations of the Group comprise the production and distribution of IT products and systems, consulting and training in the area of data processing as well as the sale of electronic equipment and systems. The Company's headquarters are located in Berlin.

II. Accounting principles

The consolidated financial statements have been prepared according to US accounting provisions ("United States Generally Accepted Accounting Principles" or "US-GAAP").

III. Consolidation principles

All major subsidiaries which are legally or factually controlled by PSI Aktiengesellschaft für Produkte und Systeme der Informationstechnologie AG (hereinafter: PSI AG) have been included in the consolidated financial statements. Capital consolidation is performed according to the book value method. Goodwill arising from the capital consolidation is capitalized and written off over a period of 10 years. All material intercompany transactions are eliminated for consolidation purposes.

IV. Associated enterprises

Significant equity investments are consolidated using the equity method when the PSI group holds between 20% and 50% of the shares.

V. Currency translation

Currency translation is performed according to the Statement of Financial Accounting Standards ("SFAS") No. 52 "Foreign Currency Translation". According to this standard the assets and liabilities of the subsidiaries are translated into German marks at the exchange rate prevailing on the balance sheet date and the income statement is translated using the annual average exchange rate. The equity of the investments is translated at the historical exchange rate. While held by the Group currency differences resulting from the use of different rates are recorded without effect on income and shown as a separate item under equity.

Gains and losses from transactions in foreign currency are recorded with effect on income.

VI. Revenue recognition

Revenue from licenses is recognized in accordance with the Statement of Position (for short SOP) 97-2 "Software Revenue Recognition" of the American Institute of Certified Public Accountants (for short AICPA).

Under US-GAAP revenue from licenses is recognized provided there is sufficient evidence that a contract has been concluded, delivery has been made, the license fee has been fixed or is determinable and receipt of payment is probable. Revenue from maintenance agreements is realized on a straight-line basis over the term of the agreement based on past experience. Income from consulting services and training is recognized as soon as the service has been rendered.

Revenues from long-term projects are recognized pursuant to SOP 97-2 in connection with ARB 45 (“Accounting Research Bulletin” on “Long Term Construction Type Contracts”) in accordance with the principles of revenue recognition for long-term construction. For long-term construction type contracts which satisfy the conditions of the Percentage of Completion Method revenue is recognized depending on the degree of completion. Revenue from all other construction type contracts is recognized according to the “Completed Contract Method” with partial or final acceptance and billing of the project.

VII. Product-related expenses

Expenses for advertising and sales promotion as well as other sales-related expenses are recorded with effect on income as they are incurred. Accruals for warranties are established when the products are sold. Expenses for research and development are recorded – unless capitalization is required pursuant to SFAS 86 (“Accounting for the Costs of Computer Software to Be Sold, Leased, or Otherwise Marketed”) – with effect on income.

VIII. Earnings per share

Earnings per share is computed in accordance with SFAS 128 (“Earnings per Share”) by dividing the group result by the weighted average number of shares in issue and the rights convertible into shares as a result of option rights. Group earnings represent the earnings generated by the group as a whole during the year. For purposes of computing the earnings per PSI AG share the minority interests are deducted or added.

IX. Current assets

Current assets consist of inventories, receivables, marketable securities and cash equivalents.

X. Cash and cash equivalents

Cash and cash equivalents comprise cash on hand, current bank balances as well as deposits that can be cashed at short notice with original terms of three months or less.

XI. Inventories

Raw materials, consumables and supplies are valued at acquisition cost giving consideration to the lower of cost or market principle.

Completed projects and work in process for which revenues are recognized according to the percentage of completion method are valued at manufacturing cost plus capitalizable partial profits and are shown as a receivable. Manufacturing cost contains material direct costs and material overheads as well as special direct labor costs. Valuation allowances were set up for risks related to diminished salability.

Finished project and work in process for which sales are recognized according to the Completed Contract Method are valued at manufacturing costs plus general and administrative costs. Valuation allowances were set up for risks related to diminished salability.

XII. Marketable securities

Securities are stated in accordance with SFAS 115 (“Accounting for Certain Investments in Debt and Equity Securities”) at current selling price (available-for-sale). Unrealized gains and losses are shown under equity. In the case of a permanent impairment of value securities and equity investments are written down.

XIII. Property, plant, equipment

Property, plant, equipment is stated at acquisition or manufacturing cost and depreciated using the straight-line method of depreciation over the useful life of the asset as follows:

	Useful life/depreciation rate	Method
Buildings and land improvements	10–50 years	straight-line/declining balance
Leasehold improvements	3–15 years	straight-line/term of rent agreement
Computers and accessories	3–4 years	straight-line
Office and factory equipment	5–10 years	straight-line
Low value assets, software up to DM 800	100%	in the year of acquisition

XIV. Intangible assets

Intangible assets including goodwill are valued at acquisition cost and depreciated over the useful life generally used in the company of three to ten years. Goodwill is tested as to its net realizable value as of each balance sheet date on the basis of estimated future cash flows.

The cost of the development of new software products and of significant improvements to existing software products are offset as expense until they are technically marketable; costs incurred subsequently are capitalized in accordance with SFAS 86 ("Accounting for the Costs of Computer Software to Be Sold, Leased, or Otherwise Marketed"). Costs incurred after the product is released for sale are recorded as expenses.

Capitalized software development costs are depreciated at the higher of the following two amounts:

- straight-line over the estimated useful life of the software (seven years) or
- in proportion of the current gross revenue from the sale of the software to the total amount of current and estimated future gross revenue from the sale of this software.

As of the balance sheet date the book value of the capitalized software developments is compared with the present value of the estimated future net sales revenue of the software. If the book value of the capitalized software development costs exceeds this present value, an appropriate valuation allowance is performed.

Software developments acquired from third parties that are integrated as modules in existing products of the Company are capitalized in accordance with APB-Opinion 17 ("Accounting Principles Board Opinion "Intangible Assets"). The acquired software developments are valued at acquisition cost and written off using the straight-line method over a useful life of three years. Capitalized third-party development costs are compared as of the balance sheet date with the present value of the estimated future net sales revenues. If the book value of the capitalized third party development costs exceeds this present value, an appropriate valuation allowance is performed.

For simplification purposes, low value assets with acquisition costs up to DM 800 are fully expensed in the year of acquisition. The differences from the capitalization compared to scheduled depreciation are immaterial.

XV. Accruals

The valuation of pension obligations is based on the projected unit credit method provided for in SFAS 87 (Employers' Accounting for Pensions).

Tax accruals and other accruals are established if there is an obligation to a third party, utilization is probable and the expected accrual amount can be reliably estimated.

Disclosures concerning the development of pension commitments are performed in accordance with SFAS 132 ("Employers' Disclosures about Pensions and Other Retirement Benefits").

XVI. Deferred taxes

Deferred tax assets and liabilities are established and valued in accordance with SFAS No. 109 (“Accounting for Income Taxes”) for temporary differences between the commercial balance sheet and the tax accounts. When determining the applicable tax rate the recommendations of the Emerging Issues Task Force of FASB on SFAS 109 are considered.

XVII. Leasing

PSI AG uses part of the office and factory equipment as lessee and has also concluded leasing agreements for its employees for company cars. In accordance with the special leasing rules under US-GAAP the chances and risks and thus the economic title to the leasing object remains with the lessor. The leasing object is thus not capitalized in the consolidated financial statements.

XVIII. Segment Reporting

In accordance with SFAS 131 (“Disclosures about Segments of an Enterprise and Related Information”), reporting as been performed on the basis of the organizationally separate segments within PSI AG – “systems business” and “product business”. Here, systems business includes all economic activity geared to creating, introducing, updating and maintaining customized software. Product business includes the marketing of its standard PSIPENTA software.

XIX. Use of estimates

When preparing the consolidated financial statements estimates have to be made to a certain extent and assumptions made which impact the assets, liabilities and contingent liabilities accounted for on the balance sheet date and the disclosure of income and expenses during the reporting period. The actual amounts may deviate from these estimates.

B. Consolidation group

The following companies are included in the consolidated financial statements as subsidiaries or associated enterprises:

1. Subsidiaries

	Shares as %	Equity as of December 31, 1998 TDM	Annual result 1998 TDM
Psipenta Software Systems GmbH, Berlin	85,00	17,479*	–15,820
PSI AG Produkte und Systeme der Informationstechnologie, Schwerzenbach, Switzerland	78,40	3,017	849
Psipenta USA Inc., Newton/Massachusetts, USA	85,00	–3,543	–2,148
Psipenta France S.a.r.l., Paris, France	85,00	–194	–208
ECI – Entwicklungsgesellschaft für computergestützte Industriesysteme mbH, Hamburg	51,00	–68	342
ECI Systems Ltd., London, UK	51,00	169	–65

*Including contributions of TDM 12,000 paid as part of the capital increase resolved.

The subsidiaries UBK Unternehmensberatung Kühl & Partner GmbH, Aschaffenburg and PSI Processturingen Informatiesystemen BV, Nieuwegein, Netherlands are not consolidated, as they have discontinued active business operation and are of subordinate interest for the consolidated financial statements of PSI AG. They are included on the basis of “at equity” valuation.

2. Associated enterprises

	Shares as %	Equity as of December 31, 1997* TDM	Annual result 1997* TDM
PSI Otomasyone ve Bilgi Sistemleri Ticaret Anonim Sirketi, Istanbul, Turkey	20.00	44	0
Schindler & Partner GmbH, Berlin	38.00	657	192
GSI Gesellschaft für Steuerungs- und Informationssysteme mbH, Berlin	26.38	193	60

*The final financial statements as of December 31, 1998 are not yet available.

3. Changes in the consolidation group

Compared to prior years the companies included in the consolidation changed as follows:

- In financial year 1998, PSI AG sold 15% of its shares in Psipenta Software Systems GmbH at a price of TDM 2,250.
- In financial year 1998, PSI AG acquired 51% of the shares in ECI – Entwicklungsgesellschaft für computergestützte Informationssysteme mbH at a purchase price of TDM 975. ECI – Entwicklungsgesellschaft für computergestützte Informationssysteme mbH is the sole shareholder of ECI Systems Ltd., London, UK, whose shares were acquired indirectly as part of the deal.
- In financial year 1998, PSI AG acquired 1.3% of the shares of PSI AG Produkte und Systeme der Informationstechnologie, Schwerzenbach, Switzerland, at a purchase price of TDM 40. Its participation thereby increased to 78.4%.
- In financial year 1998, the subsidiary Psipenta Software Systems GmbH founded Psipenta France S.a.r.l., Paris, France. The start-up capital of this distribution company totaled FFR 50,000 (TDM 15). Psipenta Software Systems GmbH has a 100% participation in Psipenta France S.a.r.l., Paris, France.
- In financial year 1998, PSI AG acquired 6% of the shares in GSI Gesellschaft für Steuerungs- und Informationssysteme mbH at a purchase price of TDM 264. Its share in the capital stock of this company thereby rose to 26.38%, as it holds a further indirect participation of 26% via PSI AG Produkte und Systeme der Informationstechnologie, Schwerzenbach, Switzerland, in which PSI AG holds a 78.4% participation.

4. Changes in the consolidation group following the balance sheet date

- Acquisition of shares in UBIS Unternehmensberatung für integrierte Systeme mbH, Berlin

  In December 1998, PSI AG acquired a 66 % share (nominal value: TDM 792) in UBIS Unternehmensberatung für integrierte Systeme mbH with economic effect from January 1, 1999, at a purchase price of TDM 6,534.

  At balance sheet date, UBIS Unternehmensberatung für integrierte Systeme mbH disclosed negative equity of TDM 4,231, fixed assets of TDM 1,480, and liabilities of TDM 9,258. In the purchase agreement, the selling shareholder of UBIS Unternehmensberatung für integrierte Systeme mbH guaranteed repayment of the company's debt and a working capital of TDM 350 as of the cut-off date for transfer of the shares. Restoration of the guaranteed equity of TDM 1,200 as of December 31, 1998 was ensured by means of an agreement of March 25, 1999.

  In 1998, UBIS Unternehmensberatung für integrierte Systeme mbH recorded sales of TDM 13,054 and a net loss for the year of TDM 8,030.

- Acquisition of shares and capital increase at GSI Gesellschaft für Steuerungs- und Informationssysteme mbH, Berlin

  In January 1999 PSI AG acquired a further 12 % of the shares in GSI Gesellschaft für Steuerungs- und Informationssysteme mbH at a purchase price of TDM 486, and performed a capital increase of the capital stock of TDM 15 plus a premium of TDM 750. The share of capital stock held indirectly and directly by PSI AG thus increased to 46.44 %.

C. Explanatory comments

1. Trade receivables

December 31, 1998 TDM	December 31, 1997 TDM
43,866	33,550

As in prior years, bad debt allowances were not necessary as the creditworthiness of the customers can be classified as good.

The increase in trade receivables is connected with the increase in sales in financial year 1998.

2. Inventories

	December 31, 1998 TDM	December 31, 1997 TDM
Work in process	10,129	28,516
Finished goods and trading goods	10,512	8,669
Advance payments	2,936	2,174
	23,577	39,359

Work in process contains capitalized manufacturing costs for projects whose sales are recognized according to the

- Completed Contract Method or
- Software Revenue Recognition (SOP 97-2).

Advance payments relate to goods that have not yet been delivered.

3. Other receivables

	December 31, 1998 TDM	December 31, 1997 TDM
Payments on account for contract services	742	0
Receivables due from tax office	685	412
Loans to sub-suppliers	350	0
Foreign receivables	304	0
Convertible profit participation rights	0	1,925
Investment grants ("GA-Mittel")	0	1,295
Receivables on convertible bonds	0	415
Other	1,457	1,284
	3,538	5,331

The advance payments for contract services are the result of pre-payments to third parties for development services.

The receivables due from the tax authorities mainly result from corporate income tax prepayments for financial year 1998.

4. Non-current receivables

December 31, 1998 TDM	December 31, 1997 TDM
2,952	0

The non-current receivables are the result of loans granted to the purchasers of 15% of the shares in Psipenta Software Systems GmbH for the purchase of (TDM 2,025) and participation in a capital increase decided on in 1998 (TDM 900), as well as interest payments due on these loans (TDM 27). The loans are due by December 31, 2002 at the latest.

5. Financial assets

	December 31, 1998 TDM	December 31, 1997 TDM
Marketable securities of PSI AG Switzerland	593	593
Associated enterprises valued “at equity”	227	448
Other marketable securities	35	539
	855	1,580

The marketable securities of PSI AG Switzerland contain various marketable securities of the subsidiary PSI AG Produkte und Systeme der Informationstechnologie, Schwerzenbach, Switzerland. No unrealized profits result from the marketable securities.

The participations in Schindler & Partner GmbH (TDM 159), GSI Gesellschaft für Steuerungs- und Informationssysteme mbH (TDM 59) and PSI Otomasyon ve Bilgi Sistemleri Ticaret Anonim Sirketi, Istanbul, Turkey (TDM 9) are disclosed under the associated enterprises valued “at equity”.

The acquisition costs and current selling values of the securities shown under financial assets break down as follows:

	December 31, 1998 TDM	December 31, 1997 TDM
Debt instruments of central, local and regional authorities		
• Acquisition cost	0	495
• Unrealized gains	0	10
• Current selling value	0	505
Debt instruments of domestic banks		
• Acquisition cost	33	33
• Unrealized gains	2	1
• Current selling value	35	34
	35	539

The majority of the securities are pledged or assigned as security.

6. Property, plant, equipment

	December 31, 1998 TDM	December 31, 1997 TDM
Acquisition cost:		
Land and buildings	20,702	20,702
Computers and accessories	18,012	14,047
Office and factory equipment	4,730	3,563
	43,444	38,312
Accumulated depreciation	−22,631	−19,605
Total property, plant, equipment	20,813	18,707

7. Intangible assets

Intangible assets contain other intangible assets and capitalized software development costs.
The book values of the intangible assets developed as follows:

	December 31, 1998 TDM	December 31, 1997 TDM
Other intangible assets	11,301	7,959
Capitalized software development costs	22,103	13,572
Total intangible assets	33,404	21,531

Other intangible assets comprise acquired software and acquired licenses as well as goodwill from the full consolidation of PSI AG Produkte und Systeme der Informationstechnologie, Schwerzenbach, Switzerland (TDM 58), ECI – Gesellschaft für computergestützte Industriesysteme mbH (TDM 1,151) and the "at equity" valuation of GSI Gesellschaft für Steuerungs- und Informationssysteme mbH (TDM 253).

	December 31, 1998 TDM	December 31, 1997 TDM
Capitalized amounts:		
Software and licenses	15,500	11,700
Goodwill	1,498	117
	16,998	11,817
Accumulated depreciation	–5,697	–3,858
Other intangible assets	11,301	7,959

The capitalized software development costs pertain to the development costs disclosed according to SFAS 86 for the product PSIPENTA, and developed as follows:

	Development costs TDM	Accumulated depreciation TDM	Book value TDM
As of January 1, 1997	9,836	1,048	8,788
Capitalization of the product development costs	6,039	0	6,039
Depreciation	0	1,255	–1,255
As of December 31, 1997	15,875	2,303	13,572
As of January 1, 1998	15,875	2,303	13,572
Capitalization of the product development costs	10,470	0	10,470
Depreciation	0	1,939	–1,939
As of December 31, 1998	26,345	4,242	22,103

8. Financial liabilities

December 31, 1998 TDM	December 31, 1997 TDM
431	1.125

In the financial year, PSI AG repaid all its liabilities to banks. At balance sheet date the subsidiaries have minor financial liabilities resulting from overdraft facilities.

9. Pension reserves

The Company has made pension pledges to various employees. These payments are based on the length of service and agreements in the employment contracts. In the following the actuarially computed pension obligation and the obligation shown in the balance sheet is presented:

	December 31, 1998 TDM	December 31, 1997 TDM
Change in the actuarial present value of the pension obligation		
• Actuarial present value at the beginning of the financial year	12,005	9,625
• Reconciliation difference to the pension reserves under German Commercial	809	884
	12,814	10,509
• Service cost (present value of the vested claims acquired during the financial year)	737	1,095
• Mark-up of expected pension obligations	838	1,329
• Period expenses	1,575	2,424
• Loss resulting from change in assumptions when computing pension reserves	1,949	0
• Pension payments	50	44
• Amortization of the reconciliation difference to the pension reserves under German Commercial Code	–75	–75
• Loss not considered resulting from change in assumptions when computing pension reserves	–1,949	0
• VActuarial present value at the end of the financial year	13,530	12,005
• Reconciliation difference to the pension reserves under German Commercial Code at the end of the financial year	734	809
• Pension obligations disclosed	14,264	12,814

To calculate the pension obligations in the financial year and the prior year, a discount of 7% and long-term salary increase rates of 1.5% were assumed.

The losses not considered in financial year 1998 as a result of a change in assumptions when computing pension reserves mainly relate to the changed mortality tables (Heubeck's Mortality Tables 1998). The difference ascertained in financial year 1998, totaling TDM 545, will be transferred to the pension reserves in equal installments over a period of 12.9 years from financial year 1999.

10. Equity

Capital stock

The fully paid in capital stock amounts to TDM 41,000.

It is divided up into 3,066,250 bearer shares and 5,133,750 registered shares. From July 1, 1999 registered shares can be exchanged for bearer shares.

Capital increase

In preparation for the flotation of the company, the general shareholders' meeting of August 1, 1998 resolved to increase the capital stock by DM 18,481,500.00 from company funds to DM 30,802,500.00. Of this amount, DM 14,065,605.50 was taken from the capital reserve and DM 4,415,894.50 from other revenue reserves.

On August 31, 1998, 2,039,500 shares with a theoretical par value of DM 5.00 each were issued in the "Neuer Markt" segment of Deutschen Börse AG (German Stock Exchange). As a result of the flotation, capital stock further increased by DM 10,197,500.00. The premium of DM 84,639,250.00 resulting from the capital increase was transferred to the capital reserves.

In January 1999, in connection with the resolutions of the general shareholders' meetings of June 7, 1997 and August 1, 1998 concerning a contingent capital increase, the company's capital stock was increased by DM 518,750.00 to DM 41,518,750.00 by issuing 103,750 registered shares. The increase was performed by converting convertible bonds worth a nominal DM 207,500.00, netting them against the capital increase performed in financial year 1998 from company funds at a ratio of 1:2.5. The capital increase was filed with the Commercial Register on January 15, 1999.

Authorized capital

By virtue of a resolution of the general shareholders' meeting of May 16, 1998 and August 1, 1998, the management board was authorized, with the approval of the supervisory board, to increase the company's capital stock by up to DM 15,401,250.00 up until April 30, 2003 by issuing once or several times up to 3,080,250 bearer shares with a theoretical par value of DM 5.00 each in return for a contribution in cash or in kind.

In connection with the flotation on the "Neuer Markt" performed on August 31, 1998, the management board performed a capital increase of DM 10,197,500.00 by issuing 2,039,500 bearer shares at a par value of DM 5.00.

Newly authorized capital now amounts to DM 5,203,750.00. It was entered in the Commercial Register on January 15, 1999.

Participating capital

On November 1997, the general shareholders' meeting of PSI AG authorized the management board to issue once or several times convertible participation rights with a total par value of up to DM 3,500,000.00 to shareholders, employees, the legal representatives of the company and of affiliated enterprises, and to selected third parties. As of the balance sheet date, the convertible participation rights had been completely subscribed to and paid in. Subscription was mainly performed by shareholders and company employees. The convertible participation rights cannot be called in until December 31, 2003.

Interest will be paid on the convertible participation rights at 3 % p.a. of the par value from January 1, 1998. Interest will only be paid if it does not result in a net loss for the year. Correspondingly, no interest was paid in financial year 1998. The convertible participation rights participate in the loss of PSI AG in proportion to the ratio of convertible participation capital to the sum of equity and convertible participation capital and are subordinate to other creditors. They can be converted to PSI AG shares at a ratio of 4:1 12 months after the quotation of PSI AG on a stock exchange, but on July 1, 2000 at the latest. For the convertible participation rights, approval was given for a contingent capital increase of up to DM 875,000.00 by issuing up to 175,000 bearer shares at a par value of DM 5.00.

Convertible bonds

On June 7, 1997, the general shareholders' meeting of PSI AG authorized the management board to issue 83 convertible bonds made out to the bearer, with a total nominal value of DM 415,000.00. The convertible bonds with a nominal value of DM 5,000.00 (i.e. totaling DM 415,000.00) can be converted into registered shares with a nominal value of DM 2,500.00 (i.e. a total of DM 207,500.00) up until December 31, 1999. Interest will be paid on the convertible bonds at 3 % p.a. If the conversion option is taken up, interest payments cease. The convertible bonds do not participate in the loss of PSI AG and are not subordinate to other creditors.

In an agreement dated April 9, 1997, all convertible bonds were issued to Martlet Company Ltd., Isle of Man, UK, and had been completely paid in at balance sheet date.

Conversion was performed in September 1998, taking advantage of the contingent capital increase of DM 518,750.00 at a ratio of 1:2.5, and entered in the Commercial Register on January 15, 1999.

Other profit participation rights

In accordance with a resolution of the general shareholders' meeting on May 20, 1995 profit participation rights were issued. There were two categories (type A and type B).

The type A profit participation right has an indefinite term. The statutory blocking period ends on December 31, 2000. The profit participation rights have a nominal value of DM 100.00. Participation rights totaling DM 29,000.00 were issued. The profit participation rights bear interest according to the value added return, and in the case of a negative value added return is at most – 4 % and in the case of a positive value added return at most 15 %. The type A profit participation rights participate at a rate of 10 % in the nominal value of the loss of the Company and their claims are subordinate to those of other creditors.

Contrary to the type A profit participation right the statutory blocking period of the type B profit participation right ended as of June 30, 1997. In addition, they do not participate in the loss of the company. All other conditions apply by analogy to type A profit participation rights. Type B profit participation rights totaling DM 101,700.00 were issued. In the financial year 1997 type B profit participation rights of DM 65,200 were repaid or converted into profit participation capital. In financial year 1998, a further DM 26,500.00 of type B profit participation rights was repaid.

11. Other financial commitments

In the financial year, PSI AG sold 15 % of its shares in Psipenta Software Systems GmbH to three persons, two of whom were employed by Psipenta Software Systems GmbH, and one of whom worked freelance for the same company. The agreement was concluded with the planned flotation of Psipenta Software Systems GmbH in mind.

The purchasers of the shares are entitled to resell their shares to PSI AG at the latest when Psipenta Software Systems GmbH goes public. The conditions for sale are as follows:

1. If the option is exercised before December 31, 2001, then the repurchase price shall be the same as the 1998 selling price plus contributions from subsequent capital increases.
2. If the option is exercised between January 1, 2002 and January 31, 2002, then the repurchase price for the shares in Psipenta Software Systems GmbH shall be the same as a (fictitious) valuation on the "Neuer Markt" (i.e. market value).
3. After January 31, 2002 all rights resulting from the agreement shall expire.

12. Obligations from rent and leasing agreements

Office equipment, data processing systems and other equipment was rented on the basis of operating leasing agreements. In 1998 leasing charges of TDM 180 (TDM 241) were incurred for office equipment and of TDM 885 (TDM 614) for the rented data processing systems and other equipment.

Future leasing payments from existing leasing agreements amount to:

	TDM
1999	approx. 1,200
2000–2002	approx. 3,400
2003–2005	approx. 2,300

In the financial year 1996 PSI AG entered into a rent agreement for an office building in Berlin. The rent agreement expires on March 31, 2012. The rent payments from the rent agreement are as follows:

	TDM
1999	approx. 4,400
2000–2002	approx.14,000
2003–2005	approx.14,600
2006–2012	approx.33,500

13. Sales and other expenses

Sales and cost of sales

	1998 TDM	1997 TDM
Software production and maintenance		
• Sales	145,872	101,558
• Cost of sales	–117,030	–85,440
	28,842	16,118
Licenses		
• Sales	30,009	16,984
• Cost of sales	–7,378	–3,654
	22,631	13,330
Hardware		
• Sales	10,330	10,244
• Cost of sales	–9,051	–8,333
	1,279	1,911
Total		
• Sales	186,211	128,786
• Cost of sales	–133,459	–97,427
Gross profit on sales	52,752	31,359

14. Taxes on income

German corporate income tax law uses the tax credit system when taxing companies and shareholders. Retained earnings are initially taxed at a corporate income tax rate of 45% plus a solidarity surcharge of 5.5% of the corporate income tax balance due. Accordingly, this means that the effective corporate income tax rate is 47.475%. In the case of dividends distributed to shareholders, the corporate income tax rate is reduced to 30% (plus a solidarity surcharge of 5.5%), with the amount previously paid in excess of the effective tax rate on dividends of 31.650% being refunded. When profits are distributed, shareholders liable to German taxation receive a tax credit note against personal income tax equivalent to the corporate income tax, but not the solidarity surcharge, previously paid by the company.

To calculate anticipated tax expense, in accordance with the recommendations of the Emerging Issues Task Force of the FASB concerning SFAS 109 (“Accounting for Income Taxes”), the effective corporate income tax rate for retained earnings is stated at 47.475 % plus the effective rate of trade tax. This takes into account a basis of assessment for own and corporate income tax of 8.625 %. To calculate deferred taxes, a tax rate of 55.000 % is applied.

As of December 31, 1998, the following corporate income tax loss carryforwards:

	TDM
PSI AG	
• Tax loss 1998	2,355
Psipenta Software System GmbH	
• Loss carryforward 1997	17,722
• Tax loss 1998	25,770
	43,492
	45,847

Trade tax loss carryforwards exceed the corporate income tax loss carryforwards.

According to SFAS 109, deferred taxes have to be capitalized for tax loss carryforwards which will in all probability be used up in the next few years. A 55 % tax rate is also applied to these deferred taxes.

According to the tax planning statement, the fully utilized tax loss carryforwards accrued up to December 31, 1998 are not expected to be within the originally stated budget period. A valuation allowance of TDM 8,400 was therefore made for the deferred tax assets caption on the group companies’ loss carryforwards.

The deferred tax assets and liabilities result from accounting and valuation timing differences between the tax and the commercial balance sheets for the following balance sheet positions and from the tax loss carryforward, as is illustrated by the following table:

	December 31, 1998 TDM	December 31, 1997 TDM
Deferred tax assets resulting from the balance sheet positions:		
Property, plant, equipment	0	14
Special item for investment grants	532	712
	532	726
Deferred tax liabilities resulting from the balance sheet positions:		
Capitalized software development costs	−12,157	−7,465
Current assets, payments on account and salesrelated accruals	−5,955	−28
Other liabilities	0	−13
Other accruals	0	−45
Pension reserves	−135	−32
	−18,247	−7,583
Deferred tax assets resulting from tax loss carryforward:	25,215	9,753
Valuation allowance for deferred tax assets resulting from tax loss carryforward	−8,400	0
	16,815	9,753
Net deferred tax assets	−900	2,896

Of the deferred tax liabilities, TDM 5,955 have a term of less than one year as of the balance sheet date. Of the deferred tax assets, TDM 1,295 have a term of less than one year as of the balance sheet date. The remaining deferred tax liabilities and assets have a term of more than one year.

15. Segment reporting – sales by geographically defined area

The following table provides geographical information in respect of sales:

1996	Germany TDM	Switzerland TDM	Other TDM	Total TDM
Software production and maintenance	83,468	5,326	2,606	91,400
Licenses	5,590	2,515	956	9,061
Hardware	11,109	101	70	11,280
Total	100,167	7,942	3,632	111,741
1997				
Software production and maintenance	93,887	4,784	2,887	101,558
Licenses	12,593	4,301	90	16,984
Hardware	8,766	902	576	10,244
Total	115,246	9,987	3,553	128,786
1998				
Software production and maintenance	133,251	7,380	5,241	145,872
Licenses	25,075	4,361	573	30,009
Hardware	8,269	1,790	271	10,330
Total	166,595	13,531	6,085	186,211

16. Segment reporting by systems and product business

	Systems business Millions of DM	Product business Millions of DM	PSI AG group Millions of DM
Net sales			
Software production and maintenance	115.3	30.6	145.9
Licenses	1.4	28.6	30.0
Hardware	6.9	3.4	10.3
	123.6	62.6	186.2
Cost of sales			
Software production and maintenance	85.4	31.6	117.0
Licenses	0.6	6.8	7.4
Hardware	6.2	2.9	9.1
	92.2	41.3	133.5
Gross profit on sales	31.4	21.3	52.7
Operating expenses			
Selling expenses	11.6	20.3	31.9
General and administrative expenses	9.7	6.4	16.1
Research and development costs	0.0	14.1	14.1
Capitalized research and development costs	0.0	–10.5	–10.5
Depreciation of capitalized research and development costs	0.0	1.9	1.9
Other revenues or gains	–1.5	–0.3	–1.8
	19.8	31.9	51.7
Operative result	11.6	–10.6	1.0
Net interest, net investment income	2.3	–0.7	1.6
Result before income tax	13.9	–11.3	2.6
Taxes on income	–3.6	–1.8	–5.4
Net profit/loss	10.3	–13.1	–2.8

Segment reporting for systems and product business was done on the basis of the income statements for the group companies included in comprehensive consolidation. The income statements were adjusted to eliminate intercompany effects.

The “systems business” segment mainly includes the economic activities of PSI AG, which mainly consist in the creation, introduction, maintenance and updating of customized software. In the financial year, there were no sales in which a single customer achieved a sales volume of more than 10% of total sales for the segment.

The “product business” segment includes the economic activities of Psipenta Software Systems GmbH, PSI AG Produkte und Systeme der Informationstechnologie, Schwerzenbach/Switzerland, ECI – Entwicklungsgesellschaft für computergestützte Industriesysteme mbH, Psipenta USA Inc., Newton/USA, Psipenta France S.a.r.l., Paris/France and ECI Systems Ltd., London/UK. In particular, product business comprises sales from the sale of the standard PSIPENTA software. In the financial year, there were no sales in which a single customer achieved a sales volume of more than 10% of total sales for the segment.

The non-current assets of PSI AG (consolidated) break down as follows by segment:

	Systems business Millions of DM	Product business Millions of DM	PSI AG group Millions of DM
Non-current receivables	2.9	0.0	2.9
Financial assets	0.3	0.6	0.9
Tangible assets (net)	17.0	3.8	20.8
Intangible assets (net)	3.0	30.4	33.4
	23.2	34.8	58.0

17. Result per share

For financial years 1996 to 1998, result per share was calculated as follows:

	1998 thousands of shares	1997 thousands of shares	1996 thousands of shares
Shares at the beginning of the year	2,464	2,054	0
Option rights at the beginning of the year	214	0	0
Shares at the end of the year	8,200	2,464	2,054
Option rights at the end of the year	541	214	0
Average	5,709	2,366	1,027
Group result	−2,842	−10,040	−513
Minority interest share in result	2,474	19	−197
	−368	−10,021	−710

	1998 DM/share	1997 DM/share	1996 DM/share
Result per share	−0,06	−4,23	−0,69

The option rights comprise long-term participation certificates outstanding (437,500 shares) and long-term profit participation rights (103,500 shares).

Report of independent puplic accountants

To the shareholders of

PSI Aktiengesellschaft für Produkte und Systeme der Informationstechnologie, Berlin ("PSI AG")

We have audited the accompanying consolidated balance sheets of the PSI AG and its subsidiaries ("Psipenta Software Systems GmbH", "PSI AG Produkte und Systeme der Informationstechnologie, Schwerzenbach, Switzerland", "Psipenta USA Inc., Newton/ Massachusetts, USA", "Psipenta France S.a.r.l., Paris, France", "ECI – Entwicklungsgesellschaft für computergestützte Industriesysteme mbH, Hamburg", "ECI Systems Ltd., London, UK") as of December 31, 1998 and the consolidated income statement, changes in shareholders' equity and cash flow for the financial year 1998. These financial statements are the responsibility of the Companies' management. Our responsibility is to express an opinion on these consolidated financial statements based on our audit.

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

In our opinion, the consolidated financial statements of PSI AG as of December 31, 1998 present fairly, in all material respects, the financial position and net worth of the PSI group and the results of their operations and their cash flow for the year then ended in conformity with generally accepted accounting principles in the United States of America.

Berlin, March 26, 1999

Plett	Dr. Wagener
Wirtschaftsprüfer	Wirtschaftsprüfer

Report of the Supervisory Board

In 1998, the Supervisory Board carried out the tasks required of it by law and the articles of association and regularly supervised the conduct of business of PSI AG. It examined all the business operations important for the company and consulted with the Board of Management about the major individual operations in 11 meetings.

The annual financial statements, the group accounts and the management report for the period from 1 January to 31 December 1998 were audited by Arthur Andersen Wirtschaftsprüfungs- und Steuerberatungs-Gesellschaft, Berlin, appointed by the Annual General Meeting on 16 May 1998, and were given unqualified approval. The Supervisory Board also examined the annual financial statements and the management report, and discussed them at the meeting on 25 March 1999, with the auditors present at that meeting and with the members of the management, and approved them. The annual financial statements are thus adopted.

Messrs. Claus-Peter Hoffer and Harald Pfeffer retired from the Supervisory Board as of 16 May 1998. The Supervisory Board wishes to thank these members for their long years of service on this body. Messrs. Wolfgang Fischer and Siegfried Hartmann were elected to the Supervisory Board as new employee representatives from that date. There were no changes in the shareholder representatives (Dr. Warner, Mr. Kasch, Mr. Niedermaier, Mr. Walther).

Mr. Christian Seefeldt was delegated by the Supervisory Board to sit on the Board of Management with effect from 1 January 1998. By mutual consent between Mr. Seefeldt and the Supervisory Board, his period of office ended on 31 October 1998. The Supervisory Board thanks Mr. Seefeldt for his work in PSI AG. On 2 February 1999, the Supervisory Board appointed Mr. Björn Eriksen as director of Finance and Controlling, with effect from 1 March 1999.

In 1998, the hard work of the previous years and in the year under review brought the long-term plans to fruition. At the General Meetings on 16 May 1998 and 1 August 1998, the shareholders of PSI AG also endorsed the major steps towards this development. PSI AG achieved admission to listing on the Neuer Markt at the Frankfurt Stock Exchange with effect from 1 September 1998. The Supervisory Board expresses its thanks to all the staff of PSI AG who actively contributed to this vital step in the company's history and helped to drive it forward. Our special thanks go to the members of the Board of Management, Mr. Jaeschke and Mr. Schmaltz, as well as to Mr. Götze and Ms. Klingbeil from the central business administration department of PSI AG.

The capital funds now available open up completely new prospects for the company, making an even more dynamic growth with corresponding profit expectations possible. The Board of Management and the Supervisory Board are involved in ongoing discussions to ensure that these funds are used in the most effective way for favourable investments. To this purpose, the Supervisory Board has established an investment committee consisting of Messrs. Fischer, Kasch and Warner, who will start meeting in 1999. Apart from this committee, a staff committee has been operating since 1997, consisting currently of Messrs. Hartmann, Kasch and Warner. The staff committee met once in 1998.

The law on control and transparency in the corporate sector (KonTraG) came into force on 1 May 1998. This law places even greater responsibilities on the Management Board as well as the Supervisory Board. One visible effect is that the Supervisory Board now directly orders the annual audit, which was previously the responsibility of the Board of Management. The company is obliged to establish a risk management system (early warning system) in 1999, which is both in its own interest and in that of the investors and the Group's employees.

The restructuring of the Group carried out in previous years showed the first results in 1998. Thus, PSI AG has developed much better than planned. The business divisions

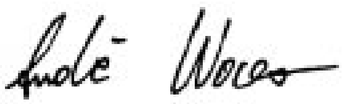
- energy management systems,
- services and document management systems,
- production, and
- consulting

as a whole have made outstanding advances and continue to form the basis for the company's sound and continuing growth.

Some of the main statements of the 1997 annual report can once again be repeated verbatim in this financial year. In the present period under review, the company has again made substantial investments in the PSIPENTA business segment, in order to gain market share relevant in its own target market, against international competition in a market for ERP products that continues to grow rapidly. Once again in 1998, PSI AG has procured the necessary funds by its own work as much as possible in the core business of project processing and consulting, with the capital market funds obviously providing additional support for rapid progress. Very large investments will also be necessary in 1999 which will, however, lead to the desired revenues as early as the following year.

All the signs and figures suggest that the path embarked upon two years ago must be single-mindedly pursued, and success further consolidated.

Berlin, 25 March 1999



Dr. André Warner
Chairman of the Supervisory Board

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