

## **Corporate Profile**

Software AG International, Inc., through its subsidiary, Software AG of North America, Inc., develops, markets, and supports an integrated line of "off the shelf" computer systems software packages. The Company's primary product is ADABAS, a data base management system which manages storage, retrieval, and manipulation of data contained on computer storage devices. Other products include: NATURAL, an applications programming language; COM-PLETE, a teleprocessing system to control and manage online environments; the Data Base Machine, which offloads a main computer by function; and ADABAS-M for mini-computers. The Company markets its products in the U.S. through a direct sales force, and internationally (outside of Europe), through independent distributors. In Europe, Software AG of Darmstadt (SAG) markets ADABAS and NATU-RAL for its own account. SAG also markets in Europe, on a royalty basis, COM-PLETE and other products developed by the Company.

Customers include banks, insurance companies, manufacturers, merchandising companies, energy corporations, and educational and governmental institutions in the U.S., Europe, the Far East, Central and South America, Canada, South Africa, Australia, the Middle East, and Mexico. The Company also provides consulting and time-sharing capabilities through its Consulting and Education Services and Computer Services divisions.

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### **Selected Consolidated Financial Data**

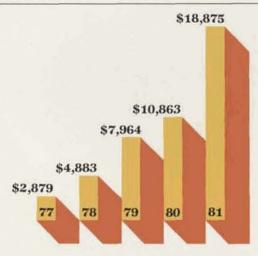
Year ended May 31,	1981	1980	1979	1978	1977
Revenues	\$18,875,070	\$10,863,319	\$7,963,862	\$4,883,425	\$2,878,634
Net Income	\$ 2,318,160	\$ 368,369*	\$ 885,651	\$ 340,772	\$ 234,583
Net Income Per Common Share	\$ .50	\$ .08*	\$ .20	\$ .08	\$ .05
Number of Shares Used to Compute Net Income Per					
Common Share	4,610,550	4,501,162	4,500,003	4,500,003	4,500,003
Working Capital	\$ 1,817,559	\$ 560,937	\$1,258,459	\$ 741,963	\$ 254,459
Total Assets	\$21,582,135	\$ 8,099,894	\$6,384,016	\$2,858,319	\$1,766,928
Total Stockholders' Equity	\$ 5,329,610	\$ 2,445,262	\$1,819,608	\$ 933,957	\$ 593,185

Note: No dividends have been paid.

<sup>†</sup>The Company completed its initial public stock offering in June 1981. Applying the results of the offering to the above information at May 31, 1981, Working Capital would have increased to \$14,468,086, Total Assets would have increased to \$31,763,570, and Total Stockholder's Equity would have increased to \$24,830,130.

\*Includes Loss on Investment in Subsidiary — Note 11 of Notes to Consolidated Financial Statement

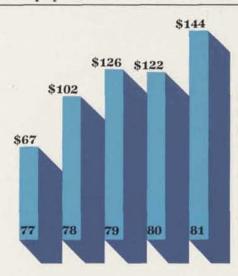
#### Revenue (in Thousands)



#### Net Income (in Thousands)



#### Revenue Per Employee (in Thousands)





### To Our Stockholders:

sources to continue and build base and the necessary rea diverse and expanding user aggressive marketing strategy, We have an appropriate and use "off the shelf" products. market with excellent easy-to-Software AG is in a growing and corporate expansion. growth rates for informational and facilitates corresponding mation for all personnel levels, ity and easier access to inforstaffing, allows faster availabilrequire increased technical systems software does not most on market needs. Our crucial area that we capitalize personnel shortfall. It is in this the DP industry: a technical number one problem facing All our products meet the

It's with the greatest confidence that we've adopted a largest systems software company in the world.

nbou bast successes.

John Norris Magnire Chairman of the Board, President and Chief Executive Officer

Kenneth D. Rardin Chief Operating Officer, Executive Vice President and Secretary

New and outstanding members of the Board of Directors:

☐ Charles B. Branch, refired Chairman of the Board and CEO of Dow Chemical Co.

M.H. Conzen, Chairman of the Executive Committee of the Board and retired Chairman of the Board and CEO of Schering-Plough Corporation

□ Peter M. Schnell, President of Software AG, Darmstadt, West Germany.

An exceptional employee team: which has the highest revenueper-average number of employees of any major software systems company — over \$144,000 revenue in fiscal 1981.

As we look to the decade of the Eighties, your Company's position in the marketplace and potential for success is a strong, vital one.

We are in the fastest growing segment of the data processing (DP) industry — systems software. According to IMPUT, the U.S. software products market in 1979 was estimated at nearly factority and \$8.4 billion revegrowth and \$8.4 billion reverouses by 1965. We are, in short, where the market action is . . . where the market action is . . .

New Products

Important new state-of-the-art Distributed Data Processing support systems: The Data Base Machine, the

The Data Base Machine, the first commercially available backend processor, off-loads data base processing from a central computer for improved rate computer for improved data base efficiency.

The ADABAS/VM option enables one data base management system to be used by several users in different ways. The Channel to Channel Com-

The Channel to Channel Communications System is the communications link between the host computer and backend computer; it makes it possible to offload specific data processing functions onto separate processors.

Management

John V. Okulski, Senior Vice President of Finance, Chief Financial Officer and Treasurer, joined the company in December, 1980. He was formerly Vice President and Controller of UNC Resources, Inc.

Michael E. Jakes, Senior Vice President, has been with the company since 1975 and was elected to his new position in 1981.

> We are very pleased to make this first Annual Report to our stockholders. Fiscal year 1981 (May 31.

Fiscal year 1981 (May 31, 1981) revenues were \$18,875,000, an increase of \$48,875,000, an increased five-during the year increased five-fold to \$2,318,000. Earnings-per-share were \$.50 compared to \$.08 in fiscal 1980.

As these figures reflect, 1981 was a successful and important year for your Company. Significant progress was made across-the-board, Briefly, highlights of 1981 were:

### Financial and Operations

A successful public stock offering immediately follow-ing fiscal year-end raised \$19,486,000 through the sale of common shares; use of \$9,305,000 of the proceeds enabled us to retire indebtedness.

Renegotiation of our royalty agreement with Software AG of Darmstadt, West Germany, resulted in a new royalty fee of only 5% for North American sales.

marketing efforts. Seattle — intensified U.S. sulting centers in Denver and and new educational and conconsulting center in Reston; expanded educational and port center in Denver; an Seattle; a new technical supment and research center in an expanded product develop-City, Houston and Los Angeles; Reston, Chicago, New York marketing and sales offices in Francisco; expanded regional sales offices in Atlanta and San Expansion of facilities — new

## Our Corporate Goal: The Largest Systems Software Company in the World

...Conducting business in packaged software, the fastest growing sector of the computer industry... products designed to become the industry standards ...an increasing service market business...

Software AG is conducting business in the fastest growing sector of the entire computer industry — packaged software systems for data base management and programming aids.

The market for our range of products has barely been tapped. Today, IBM and IBM-compatible computers, for example, number nearly 40,000. Yet, no more than 10% of those computers have a data base management system (DBMS).

We believe that almost every single one of those computers eventually will have a DBMS. Our ADABAS product has been specifically developed and produced to fill that market need and to fill it in such a way that our software packages are ready for use with little or no modification required by our customers.

We've designed ADABAS, our DBMS, and NATURAL — a unique interactive programming language developed to enhance ease of use and productivity — to become the industry standards.

During the coming decade, virtually all corporations will have to employ data base technology in order to keep up with their expanding information needs and to improve the productivity of their most limited and expensive resource — personnel.

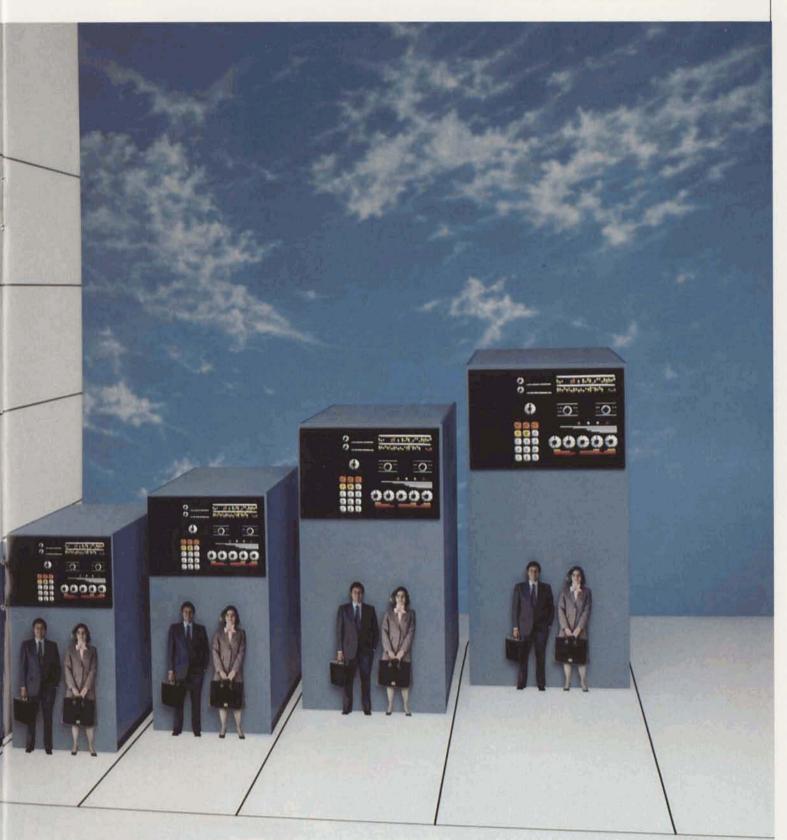
Because of our superior products, we've been able to steadily increase our revenues. Last year alone, revenues increased 74% over fiscal 1980.

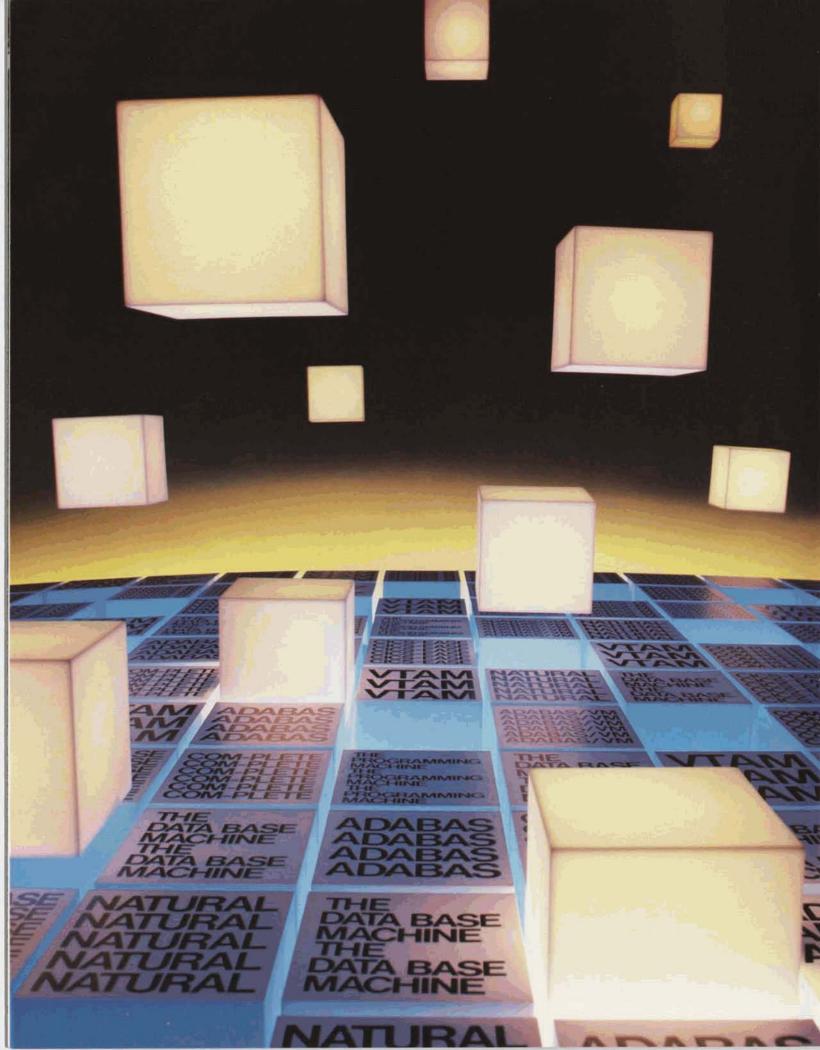
The future holds even greater promise. Because of our public offering, we have been able to enlarge our domestic sales and marketing organizations in order to further increase the level of our market penetration. As we move toward becoming the industry standard and the applications industry uses our products as their tools, Software AG product offerings will be bundled into those applications systems. This will provide an additional boost to our distribution network, supporting and broadening the efforts of our enlarged domestic sales organization.

Further solidifying our market position and guaranteeing future growth is Software AG's Consulting and Computer Services divisions. Specializing in our own product line, we offer a full range of consulting services including on-site programming and design and fixed price projects. Our Computer Services Division offers remote time-sharing capabilities for permanent and temporary users through our corporate computer center.

We're increasing our distribution network and expanding our service activities . . . more ways of achieving our goal of becoming the world's largest system software company. 2.0 1.5 1.0 80

According to Fortune Magazine, (April 1981) in 1980 there were 1.4 computers to each computer specialist in the U.S. By 1985, there will be 2.5 computers to each specialist.





## Our Products Today and Tomorrow: Easy to Use, Easy to Install, Reliable, Efficient, and Improve Productivity

...A complete line of systems software products ... used independently or as a fully integrated solution ... successful because of ease-of-use, the number one priority of DBMS users ... designed to meet today's needs, with plans for developing the best of tomorrow's products ...

What Software AG provides to all customers is a comprehensive line of systems software products. They can be purchased independently or as a fully integrated solution. One of the major benefits your Company achieves from this is recurring revenues from annual customer payments and additional purchases to upgrade and expand existing Software AG systems. In fiscal 1979, this recurring revenue source grew 46% over the previous year; in fiscal 1980 it increased another 123%; and in 1981, it was up 85% more.

The reason for the success of our products in the market-place is a simple one: ease of use, the number one priority of DBMS users according to an Infosystems survey. Further, an example of market receptivity and regard for our products has been provided by Datapro, the largest independent research organization in the computer industry. During the past four years we've been ranked at the top by nation-wide DBMS users for reliabil-

ity, ease of use, ease of installation, vendor maintenance and overall satisfaction.

## **Today**

Today, the product line that has won this industry praise consists of:

#### ADABAS, The Adaptable Data Base Management System:

An end-user-oriented data base system, ADABAS allows users to store all data in a prescribed manner and all levels of personnel to access it through the many tools provided by the system. These tools and the benefits obtained include: more central control of information; reduction of corporate development time and money; end-user query languages; report writers; facilities for security and data validity protection; faster applications development;

common data access languages for all personnel levels to reduce training time and enhance personnel flexibility. And, ADABAS-M has been specifically developed to provide the same high service level for minicomputers.

#### COM-PLETE, The Teleprocessing System Without Complexity:

In a Datapro survey, COM-PLETE ranked high in all categories, with perfect scores in reliability and ease of use. It's the only teleprocessing system ever to have received the International Computer Programs' Million in One Award in its introductory year. COM-PLETE controls and manages on-line environments, i.e., terminal, computer and software interaction. It also includes program development tools which make it possible for programmers to write their applications easier and much more efficiently.

#### NATURAL, For Instant Online Applications:

NATURAL was the first applications development and ad hoc query system ever developed specifically for a major DBMS. It reduces applications time by 90% because it makes many of the steps of common programming languages unnecessary. A 100 line COBOL program, for example, can be written in less than 10 NATURAL lines. Like COM-PLETE, NATURAL received the ICP Million in One Award in its introductory year.

#### The Data Base Machine, The Future State of the Art in Distributed Data Processing:

Software AG's Data Base Machine was the first such commercially available product in the computer industry. The Data Base Machine offloads a customer's main computer by function, thereby providing users a wide range of utilization alternatives and options. It represents our commitment and ability to define and mold the future. We don't follow, we lead.

### Tomorrow

Tomorrow, we're planning products for:

- Geographically distributed data base communication
- Distributed networks that allow minicomputers and mainframes to communicate with each other
- Applications programs which can run in both mainframe and minicomputer environments without alteration.

Ease-of-use, reliability, efficiency . . . all hallmarks of the Software AG fully integrated systems software product line of today and tomorrow.

Software AG's comprehensive product line meets today's most sophisticated data processing demands — and effectively anticipates the expanding needs of the future.



### Software AG Products in Action

m.In 1979, 400 Software AG products were installed; in 1980, it rose to 530; in 1981, 830 in place Software AG systems... diverse and varied clients...large and small financial, natural resource and manufacturing corporations, educational and governmental institutions... Cross-industry products used worldwide...Europe, the Far worldwide...Europe, the Far Last, Central and South America, the Middle East, Mexico, and the Middle East, Mexico, and the Widdle East, Mexico, and the U.S....

A New York-based international communications firm:

system. cancelled plans to test another so favorably impressed that it written and the company was COBOL programs had been system was in place, 15 COM-PLETE, an accounting 5-week trial installation of maximum productivity. After a anajor asset was insuring teleprocessing system whose computer staff, they needed a production. With a new small ucts without interrupting inhouse facility with our prodcomputer time-sharing to an The transition was made from

> An international food products manufacturer's dilemma:

Lacking room for any more application programs in their existing computer, they were faced with being forced to buy another very expensive piece of bardware AG's Data Base Software AG's Data Base Software AG's Data Base simplified data processing environment and a significant cost decrease.

A Fortune 500 conglomerate needed an online order system to market and track a new mail-order product: The entire system was imple-

The entire system was implemented in 5 days...with NATURAL. In two days, more than 50 non-technical people were fully trained. They began taking orders immediately and within six months, over 1,500 products had been sold with a products had been sold with a major cost-of-sales reduction.

A Houston-based onle company needed one DBMS to satisfy a wide variety of functions:

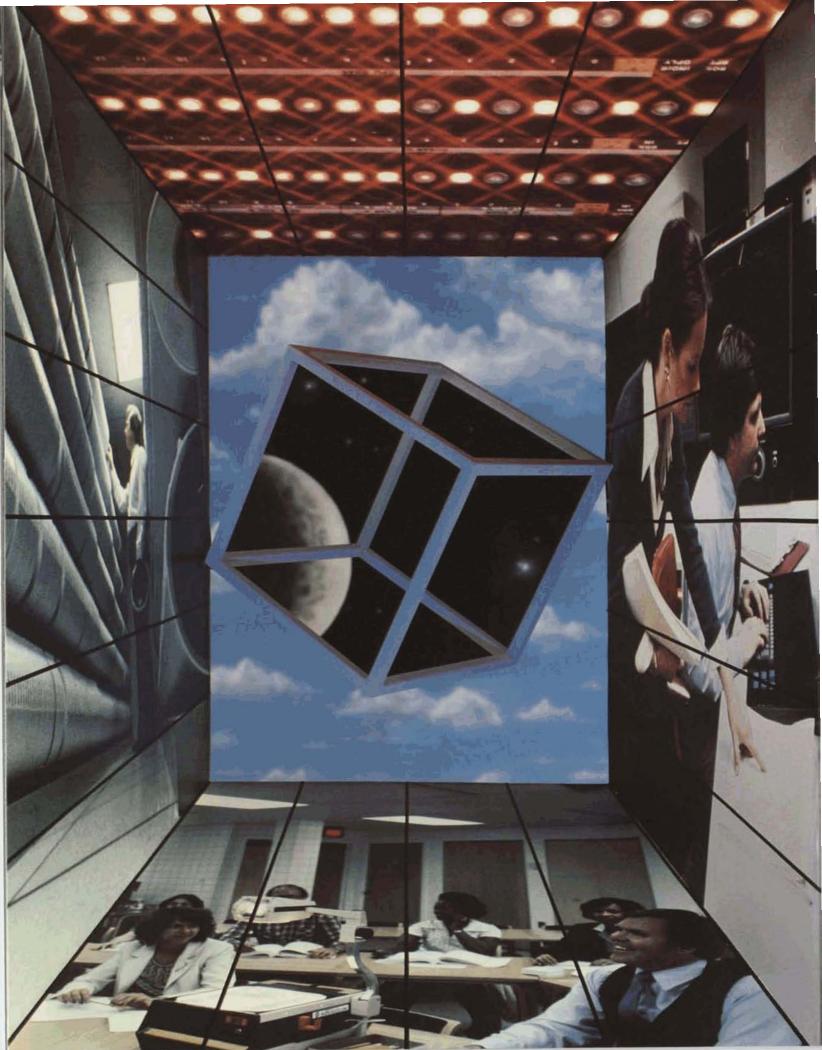
ADABAS has been used here to implement new systems for accounts payable, tax and revenue accounting, geophysicated and also management, daily call data management, daily

systems. suced to creating applications been able to devote the time grammers' time, that they've queed the demands on procapability has so greatly reown reports. The ADABAS query data and create their trained to use ADABAS to technical people have been come. Plus, over 80 nonproduction, and royalty incal data management, daily revenue accounting, geophysicounts payable, tax and implement new systems for ac-

The county retirement
administration of a state in
the Western U.S. could only
process three or four information requests daily:
Software AG consultants
analyzed the problem and the
manual operations procedure
manual operations procedure
was then replaced by an online

analyzed the problem and the manual operations procedure was then replaced by an online environment of ADABAS, COM-PLETE and NATURAL. The integrated system was operational within just two weeks. Today, it takes less than a minute to answer any given request.

No matter what the industry, Software AG systems bring unmatched ease of use and cost effectiveness to even the most complex data processing environments.



## Our Continuing Corporate Commitment to Product and Customer Support and Enhancement

...Research and Development to maintain our industry leadership ...Technical Support to assist our customers...Education and Documentation to further facilitate product ease-of-use...Consulting and Computer Services to broaden our business base...

#### Research and Development

Approximately 10% of our revenue is devoted to R&D to maintain our position in the marketplace and keep our product line technologically superior. Software AG is recognized in the DP community as a leader in products and capabilities that provide ease-of-use, maximum productivity and outstanding cost-efficiency. We will remain in that position of marketplace primacy through:

- ☐ Centralization of all R&D activities in our facility in Seattle. Here, all staff and machines are exclusively dedicated to research, development and the goal of providing continuing state-of-the-art innovation in software products and enhancements.
- ☐ Continuing to devote special management attention to new software industry trends, applications, interfaces and enhancements suggested by our current customers.

□ Constant monitoring of hardware and software systems changes, as well as industry introductions of new machines, advanced peripheral devices and enhancements to standard operating systems.

#### **Technical Support**

Prior to distribution and installation, every new or updated product must be cleared by the Technical Support Division. Once these products are installed, Software AG insures its commitment to support our products and customers:

☐ "Hot Line" support is available 24 hours a day simply by picking up the telephone. Regional Technical Support Centers dispatch emergency service staff — specialists in each Software AG product — from any support center in the country.

☐ Instant On-site Support, an exclusive Software AG service, allows us to immediately dial into a remote user facility so we can diagnose and solve problems. It's like having our technicians right in the customer's computer room.

#### Education and Documentation

Last year our professional education staff trained over 5,000 of our clients' technical personnel. On-site customer training is supplemented by our regional training sites to provide a full curriculum of courses on all aspects of our product line. Classes combine lecture and demonstration techniques with hands-on workshop experience.

These education programs increase worker productivity and help keep customers in pace with the rapid expansion in state-of-the-art technology.

In the area of documentation, Software AG generates a wide variety of customer-directed technical reference material so as to provide users the best possible means of achieving maximum efficiency for all personnel levels — managers, end users, programmers and operations personnel.

#### Consulting and Computer Services

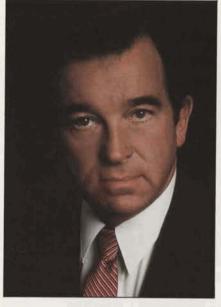
As a service to our customers and additional revenue generating capability for your Company, Software AG will continue to expand the activities of its Consulting and Computer Services Divisions. Currently, we offer:

- □ Consulting Services for virtually any type of business, including on-site programming and design, fixed-price projects and applications systems development
- Computer Services with a full range of remote timesharing capabilities for permanent and temporary users through our corporate computer center.

At Software AG, we have only one standard for our products and services — state-of-the-art. Maintaining this standard has helped us build a strong leadership position in the data processing industry, both for today and for the future.

## **Management Team**

John Norris Maguire
President,
Chief Executive Officer
Chairman of the Board



Kenneth D. Rardin Executive Vice President, Chief Operating Officer Secretary

Michael E. Jakes Senior Vice President

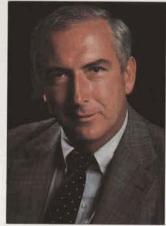




John V. Okulski Senior Vice President, Finance, Chief Financial Officer and Treasurer



Gary D. Bowers
Vice President,
Consulting
and Education Services



Edward J. Forman Vice President, Technical Operations



Larry D. Jones Vice President, Development

## Management's Discussion and Analysis of Operations

#### Liquidity

The Company's ability to generate adequate cash ("liquidity") to meet its needs depends upon cash flow from operations and, to a lesser extent, on the availability of bank financing. Cash flow from operations stems primarily from the collection of receivables under product license agreements and customer support contracts. The former provide either a single initial payment in the case of a perpetual license or periodic payments for term licenses. Support contracts call for payment of each year's fee in advance.

As the Company typically collects its receivables promptly and maintains no inventory, demands on cash arise principally from staff, marketing and occupancy expenses as well as royalty payments. In addition, the Company provides financing to those customers wishing to enter into term licenses which require periodic payments for up to five years. During 1979 and 1980, funds were required to support the growth of the Company's business, and payment of a portion of the royalty fees due Software AG of Darmstadt, Germany (SAG) for these years was deferred by mutual consent until January 1981. At that time the Company and SAG established the balance of the royalties due for those periods at \$2,000,000. The Company's future liquidity should be enhanced by the reduction of the rate at which royalties are payable on North American licenses of products developed by SAG. Additionally, royalty payments to SAG are only made on the basis of cash collections received by the Company. Shortly after the end of fiscal 1981, the Company had an initial public stock offering which resulted in an increase in working capital and the disposition of debt incurred in the renegotiation of the SAG agreement (See Note 15 of Notes to Consolidated Financial Statements).

#### Capital Resources

The Company's principal capital resource commitment was its obligation to pay \$7,305,085 in cash to SAG in connection with the restructured royalty and license agreement. In addition, the Company had borrowed \$2,000,000 from its commercial bank to satisfy royalties previously due and payable to SAG for fiscal years 1978, 1979 and 1980. These obligations have been satisfied after fiscal year end as indicated above and in Note 15 of Notes to Consolidated Financial Statements. The Company's other capital resource commitments consist primarily of its lease commitments for office space and computer equipment. The Company anticipates that it will require, within the next two to three years, additional space for its Reston. Virginia operations. The Company believes that its capital resources will be sufficient to meet this need.

#### **Results of Operation**

#### Fiscal 1981 Compared to Fiscal 1980

Revenues increased 74% to \$18,875,000 in fiscal 1981 compared to fiscal 1980. Customer support services fees included in revenues increased 85% to \$3,414,000, and revenues from foreign distributors nearly doubled to \$4,069,000 in fiscal 1981. In general, the increases are primarily attributable to a greater volume of licenses for the Company's products, resulting from a higher level of marketing and support activities in the present period and the previous fiscal year.

Salaries, wages, and commissions increased 58% to \$5,579,000 due primarily to increased staffing, secondarily to added commissions on higher sales volume and finally because of general salary increases. Royalty fee expense increased 25% to \$2,342,000, due to the increase in revenues from covered product. This increase was moderated by the reduction of royalty rates on licenses granted in North America covered by the royalty and license agreement with Software AG of Darmstadt, West Germany.

Other operating expenses increased 52%, due primarily to greater marketing expenses, secondarily to higher occupancy costs and finally to an increase in other sales-related expenses. The relatively large increase in revenues compared to the lower increases in total costs and expenses resulted in higher income before income taxes.

## Management's Discussion and Analysis of Operations (Continued)

#### Fiscal 1980 Compared to Fiscal 1979

Revenues increased 36% to \$10,863,000 due to a greater volume of licenses of the Company's products. The rate of growth in revenues declined as compared to prior years primarily because of the reorganization of the Company's sales force and the transfer of certain salesmen to sales management positions. License fees for the Company's major products remained unchanged for the entire year. Revenues from foreign distributors rose to \$2,078,000 in fiscal 1980 from \$1,639,000 in the previous fiscal year. Customer support revenues increased from \$629,000 to \$1,847,000 during the year.

Salaries, wages, and commissions increased 47% to \$3,535,000 in fiscal 1980 primarily as a function of increased staff, secondarily as a function of increased commissions due to increased license revenue, and finally, as a function of increased salaries. Royalty fee expense increased only 8% to \$1,871,000, reflecting a negotiated reduction in the effective rate of royalties.

Other operating expenses increased 101% to \$4,283,000, a disproportionately high percentage compared to other periods, which, along with the loss on investment in CAT of approximately \$700,000, materially contributed to the reduction in net income for the fiscal year ended May 31, 1980. The Company incurred these other operating expenses in order to expand its support and sales facilities in anticipation of a higher volume of business. The Denver technical support office, the Seattle research facility and computer center, the Reston computer, operations and training centers, and sales offices in several cities were opened during 1980, contributing to the increase in other operating expenses. Travel, telephone and computer communication expenses increased substantially as a result of the decentralization of the Company's activities. Increased expenditures were made for advertising, promotional and marketing materials, services and supplies. Fees for professional services increased substantially during the year, all contributing to the increase in other operating expenses.

#### Fiscal 1979 Compared to Fiscal 1978

Between 1978 and 1979, revenues increased 63% to \$7,964,000, while costs and expenses increased 47% to \$6,268,000, resulting in a 160% increase in net income to \$886,000. Most of the additional revenues were the result of an increased number of licenses of the Company's products. The license fee for ADABAS DOS version, a major product of the Company, was increased to \$99,000 per copy from \$88,000 in the middle of the fiscal year. The license fees for all other products remained unchanged between fiscal 1978 and 1979, Customer support services income increased over the previous fiscal year by approximately \$261,000, Revenues from foreign distributors increased 57% to \$1,639,000.

Salaries, wages, and commissions increased 83% to \$2,412,000 in fiscal 1979 as a function, in order of importance, of increased salaries, staff and commissions on sales.

Royalty fee expense increased 47% to \$1,728,000 as a function of increased revenue subject to royalty fee payments to SAG, but was moderated by a negotiated reduction in effective royalty rates. Other operating expenses increased 20% to \$2,127,000, because of higher depreciation and amortization and to a lesser extent because of increases in other components of this expense category, and other costs associated with increased business volume.

## **Consolidated Statements of Income**

Software AG International, Inc. and Subsidiaries For the Three Years Ended May 31, 1981

	1981	1980	1979
Revenues (Notes 2 and 10)	\$18,875,070	\$10,863,319	\$7,963,862
Costs and Expenses			
Salaries, Wages and Commissions	5,579,309	3,535,297	2,412,624
Royalty Fees (Note 5)	2,341,997	1,871,262	1,728,352
Other Operating Expenses (Note 12)	6,518,604	4,282,789	2,127,235
Loss on Investment in CAT, Inc. (Note 11)		699,602	HE IN THE
Total Costs and Expenses	14,439,910	10,388,950	6,268,211
Income Before Income Taxes	4,435,160	474,369	1,695,651
Income Taxes (Note 6)	2,117,000	106,000	810,000
Net Income	\$ 2,318,160	\$ 368,369	\$ 885,651
Net Income Per Common Share	\$.50	\$.08	\$.20
Weighted Average Number of Shares Outstanding (Note 1)	4,610,550	4,501,162	4,500,003

See accompanying notes to consolidated financial statements.

## **Consolidated Balance Sheets**

Software AG International, Inc. and Subsidiaries May 31, 1981 and 1980

	1981	1980
Assets		
Current Assets:		
Cash and Short Term Investments	\$ 26,497	\$ 11,290
Accounts Receivable	5,238,562	2,939,966
Current Portion of Lease Contracts Receivable (Note 2)	2,272,401	1,071,928
Current Portion of Notes Receivable from Officers and Employees (Note 3)	75,928	497,193
Income Taxes Receivable	828,398	- 5101
Other Current Assets	364,081	229,762
Total Current Assets	8,805,867	4,750,139
Property, Equipment and Leasehold Improvements, less Accumulated		
Depreciation and Amortization (Note 4)	1,486,007	1,342,934
Computer Software Marketing License, Net of Amortization (Note 5)	6,571,010	
Lease Contracts Receivable (Note 2)	3,789,423	1,705,359
Other Assets (Note 3)	929,828	301,462
Total Assets	\$21,582,135	\$8,099,894

	1981	1980
Liabilities and Stockholders' Equity	THE PROPERTY OF THE PARTY OF TH	171 175 175 175
Current Liabilities:		
Short Term Debt (Note 15)	\$ 2,082,138	\$ 86,288
Current Portion of Royalties Payable (Note 5)	363,134	2,269,672
Accounts Payable	1,009,998	195,771
Income Taxes Payable		374,289
Deferred Income Taxes (Note 6)	2,397,794	448,825
Capitalized Lease Obligations (Note 9)	151,987	160,624
Other Current Liabilities (Note 8)	983,257	653,733
Total Current Liabilities	6,988,308	4,189,202
Computer System Software Marketing License Payable (Notes 5 and 15)	7,555,085	
Royalties Payable (Note 5)	280,906	685,707
Capitalized Lease Obligations (Note 9)	235,001	326,114
Deferred Income Taxes (Note 6)	1,027,627	263,596
Other Liabilities	165,598	190,013
Total Liabilities	16,252,525	5,654,632
Stockholders' Equity: Preferred Stock, \$10 Par Value; Authorized 2,500,000 Shares, None Issued Common Stock, \$.01 Par Value; Authorized 10,000,000 Shares, Issued 4,923,363	_	-
and 4,459,503 shares respectively	49,234	44,595
Additional Paid-In Capital	820,239	258,690
Retained Earnings	4,460,137	2,141,977
Total Stockholders' Equity	5,329,610	2,445,262
Commitments and Contingencies (Notes 9 and 14)		
Total Liabilities and Stockholders' Equity	\$21,582,135	\$8,099,894

See accompanying notes to consolidated financial statements. The effects of the Company's initial public stock offering are contained in Note 15.

# **Consolidated Statements of Changes in Financial Position**

Software AG International, Inc. and Subsidiaries For the Three Years Ended May 31, 1981

	1981	1980	1979
Sources of Working Capital:		THE PLANTS	
Net Income Items Which do not Use (Provide) Working Capital: Depreciation and Amortization of Property, Equipment and	\$ 2,318,160	\$ 368,369	\$ 885,651
Leasehold Improvements	351,659	239,265	115,600
Amortization of Marketing License Provisions for Deferred Income Taxes	464,333 764,031	(459,037)	419,942
Working Capital Provided by Operations	3,898,183	148,597	1,421,193
Increase in Royalties Payable			600,242
Proceeds from Shares Issued to Officers	189,699	48,605	
Donation of Common Stock	ARCH 17 = 1700	209,085	
Issuance of Common Stock for Marketing License	376,489		
Marketing License Obligation	7,555,085		
Decrease in Other Assets		68,410	
Increase in Capitalized Lease Obligations			408,283
Decrease in Lease Contracts Receivable	CARL TO STORY	201,496	
	12,019,456	676,193	2,429,718
Uses of Working Capital:	ALC: HAVE THE REAL PROPERTY.		
Additions to Property and Equipment	494,732	720,441	897,624
Marketing License	7,035,343		261
Increase in Lease Contracts Receivables	2,084,064		953,815
Increase in Other Assets	628,366		61,783
Decrease in Royalties Payable	404,801	571,105	E To Sell
Decrease in Capitalized Lease Obligations	91,113	82,169	
Decrease in Other Liabilities	24,415		-
	10,762,834	1,373,715	1,913,222
Increase (Decrease) in Working Capital	\$ 1,256,622	\$ (697,522)	\$ 516,496

	1981	1980	1979
Summary of Changes in Working Capital:		NAME OF THE PERSON OF THE PERS	1 1 1 10 10
Increase (Decrease) in Current Assets:			
Cash	\$ 15,207	\$ 5,268	\$ 4,454
Accounts Receivable	2,298,596	1,066,131	574,054
Current Portion of Lease Contracts Receivable	1,200,473	(75,341)	921,062
Income Taxes Receivable	828,398	Delin Control	
Current Portion of Notes Receivable from Officers and			
Employees	(421,265)	284,747	100,412
Other Current Assets	134,319	30,630	127,353
	4,055,728	1,311,435	1,727,335
Increase (Decrease) in Current Liabilities Short Term Debt Current Portion of Royalties Payable Accounts Payable	\$ 1,995,850 (1,906,538) 814,227	\$ 35,768 1,499,368 (160,756)	367,892
Short Term Debt Current Portion of Royalties Payable Accounts Payable	(1,906,538)	1,499,368	367,892 165,708
Short Term Debt Current Portion of Royalties Payable	(1,906,538) 814,227	1,499,368 (160,756)	367,892 165,708 4,756
Short Term Debt Current Portion of Royalties Payable Accounts Payable Income Taxes Payable Deferred Income Taxes Capitalized Lease Obligations	(1,906,538) 814,227 (374,289) 1,948,969 (8,637)	1,499,368 (160,756) 303,419 5,921 24,509	367,892 165,708 4,756 257,384 136,115
Short Term Debt Current Portion of Royalties Payable Accounts Payable Income Taxes Payable Deferred Income Taxes	(1,906,538) 814,227 (374,289) 1,948,969	1,499,368 (160,756) 303,419 5,921	367,892 165,708 4,756 257,384 136,115
Short Term Debt Current Portion of Royalties Payable Accounts Payable Income Taxes Payable Deferred Income Taxes Capitalized Lease Obligations	(1,906,538) 814,227 (374,289) 1,948,969 (8,637)	1,499,368 (160,756) 303,419 5,921 24,509	\$ (40,101 367,892 165,708 4,756 257,384 136,115 319,085

See accompanying notes to consolidated financial statements.

# Consolidated Statements of Stockholders' Equity

Software AG International, Inc. and Subsidiaries For Three Years Ended May 31, 1981

	Common Stock \$.01 Par Value		Additional Paid-In	Retained
	Shares	Amount	Capital	Earnings
Balance June 1, 1978 Net Income	4,500,003	\$45,000	\$ 1,000 —	\$ 887,957 885,651
Balance May 31, 1979 Shares Donated and Retired Sale of Shares to Officers Net Income	4,500,003 (180,000) 139,500	45,000 (1,800) 1,395	1,000 209,085 48,605	1,773,608 — — 368,369
Balance May 31, 1980 Shares Issued to Purchase Marketing License (Note 5) Sale of Shares to Officers Net Income	4,459,503 232,560 231,300	44,595 2,326 2,313	258,690 374,163 187,386	2,141,977 — — 2,318,160
Balance May 31, 1981	4,923,363	\$49,234	\$820,239	\$4,460,137

See accompanying notes to consolidated financial statements. The effects of the Company's initial public stock offering are contained in Note 15.

### **Notes to Consolidated Financial Statements**

Software AG International, Inc. and Subsidiaries

#### 1. Summary of Significant Accounting Policies

#### (a) Principles of Consolidation and Domestic and International Operating Arrangements

The Consolidated Financial Statements include the accounts of the Company and its wholly owned subsidiary Software AG of North America, Inc.

#### (b) Revenue Recognition

The Company sells, or leases under arrangements equivalent to a sale, a license to use its systems software products. Revenue is recognized when the contract is executed. Ten percent of the price is deferred and reflected in revenues when the product is installed. In contracts where the terms indicate a sale upon the satisfaction of other criteria, such as acceptance upon approval, revenue recognition is delayed until those specific terms are met.

There are no significant future costs associated with the Company's products that are not a part of the ongoing conduct of its business; these costs therefore are charged to operations as incurred. All costs associated with development and improvement of software products are charged to operations as incurred. Accordingly, maintenance fees received from customers are recorded as revenue when billed.

#### (c) Short Term Investments

The Company invests its excess operating funds in money market accounts. Funds are available immediately for operations.

#### (d) Property, Equipment and Leasehold Improvements

Property, equipment and leasehold improvements are carried at cost. Certain items of equipment acquired under capital lease agreements have been capitalized and the related lease obligations are classified as long term liabilities on the Consolidated Balance Sheet.

Property and equipment, including property covered by capital leases, are depreciated on a straight line basis over their respective estimated useful lives. Leasehold improvements are amortized on a straight line basis over their respective lease terms.

#### (e) Income Taxes

Deferred income taxes are provided to reflect the tax effect of timing differences between financial and tax reporting resulting primarily from accelerated depreciation and cash basis reporting for tax purposes. The Company accounts for investment tax credit as a reduction of income tax expense in the year in which such credits are allowable for tax purposes.

#### (f) Net Income Per Common Share

Net income per common share is net income divided by the weighted average number of common shares outstanding during each period. Shares issuable upon the exercise of stock option grants have not been included in the per share computations because they would not have a material effect on earnings per share.

#### 2. Lease Contracts Receivable

The Company recognizes revenue upon entering into salestype leases for the license of products. The receivable from such leases consists of the following as of May 31.

	1981	1980
Minimum Lease Payments Receivable Less: Unearned Interest Income	\$8,516,880 (2,455,056)	\$4,219,990 (1,442,703)
Net Lease Contracts Receivable Less: Current Portion	6,061,824 (2,272,401)	2,777,287 (1,071,928)
Lease Contracts Receivable — Long Term	\$3,789,423	\$1,705,359

Future minimum amounts receivable from contracts under sales-type leases for each of the next five years and all later years are:

Total	\$8,516,880
Later Years	87,000
1986	583,187
1985	908,483
1984	1,470,068
1983	2,407,976
1982	\$3,060,166

Unearned interest income represents the interest factor implicit in the lease payments. Interest income earned on lease contract receivables for the years ended May 31, 1981, 1980 and 1979 was \$721,352, \$525,777 and \$362,062, respectively.

#### 3. Notes Receivable from Officers and Employees

The Company has extended loans to certain officers and employees primarily for the purchase of its common stock. The loans are evidenced by unsecured notes bearing interest at 8 or 9% and, at May 31, 1981 and 1980, total \$297,928 and \$722,193 respectively. The long term portion of the notes receivable is included in Other Assets and amounts to \$222,000 and \$225,000 at May 31, 1981 and 1980 respectively. Substantially all of the notes were paid subsequent to May 31, 1981.

### Notes to Consolidated Financial Statements (Continued)

Estimated

Software AG International, Inc. and Subsidiaries

#### 4. Property, Equipment and Leasehold Improvements

A summary of property, equipment and leasehold improvements at May 31 is as follows:

	Marie Co.	THE REAL	Life (Years)
	1981	1980	New York
Office Furniture, Fixtures and			
Equipment Leasehold	\$1,104,370	\$ 712,362	5-10
Improvements Transportation	349,727	256,659	2-5
Equipment Capitalized	81,255	78,319	3-6
Equipment Leases	672,449	665,729	2-5
Less: Accumulated Depreciation and	2,207,801	1,713,069	
Amortization	721,794	370,135	
Net Property, Equipment and			

#### 5. Computer Systems Software Marketing License

\$1,486,007

\$1,342,934

Leasehold Improvements

In January 1981, the Company renegotiated its license with Software AG of Darmstadt, West Germany (SAG), an affiliate, for the ADABAS system, its principal product, and acquired a fifteen year exclusive right to market ADABAS together with all related improvements developed by the Company, SAG or any licensee, in North, Central and South America, Africa, the Middle East, Far East and Australia, and an option to continue the right beyond the fifteen-year period. The total consideration for these rights is \$7,929,765 consisting of cash and common stock of the Company. This amount is reduced by \$894,422 which represents the effect of the reduction in royalty expense applicable to the Lease Contracts Receivable at May 31, 1980. The net amount of \$7,035,343 will be amortized on a basis related to revenues which management estimates will amortize the cost over approximately seven years.

The agreements provide that the Company will pay SAG royalties ranging from 5% of the standard user's fee for licenses granted in North America to 50% of the fees received for licenses or maintenance for users elsewhere. The agreement also provides that SAG will pay the Company royalties ranging from 15% of revenues for maintenance and support services to 25 to 50% of the fees received for products licenses by SAG.

Cash consideration of \$7,305,085 was paid on July 15, 1981 to SAG from the proceeds of the common stock offering.

Amortization expense for the year ended May 31, 1981 with respect to the marketing license was \$464,333.

#### 6. Income Taxes

The provisions for taxes on income consists of the following:

Year Ended May 31,	1981	1980	1979
Federal:			
Current	\$ (546,000)	\$390,268	\$117,467
Deferred	2,393,000	(320,489)	582,327
HOUSE MANY	1,847,000	69,779	699,794
State:			
Current	(50,000)	27,660	27.714
Deferred	320,000	8,561	82,492
	270,000	36,221	110,200
Walter British	\$2,117,000	\$106,000	\$810,000

The difference between the effective income tax rate and that computed by applying the statutory federal income tax rate is summarized as follows:

Year Ended May 31,	1981	1980	1979
Statutory Federal Income	NEW BEE		
Tax Rate	46.0%	46.0%	48.0%
Surtax Exemption	(.4)	(4.1)	(8.)
State Income Taxes (net of			
federal tax benefit)	3.2	4.2	3.4
Investment Credit	(1.3)	(9.1)	(1.8)
Credit for Foreign Tax		10000	
Withheld	(.3)	(14.7)	(1.9)
Other	.5		.9
	47.7%	22,3%	47.8%

Deferred income tax expense resulting from timing differences between taxable and financial statement income is summarized as follows:

Year Ended May 31,	1981	1980	1979
Revenue Recognition (Cash to Accrual) Excess Tax Over Book	\$2,801,957	\$(316,116)	\$687,781
Depreciation	54,100	46,309	15,285
Excess Book Over Tax From Foreign Taxes Withheld Excess Book Over Tax from Investment Tax	(86,798)	(42,121)	(38,247)
Credits	(56,259)		
	\$2,713,000	\$(311,928)	\$664,819

As of May 31, 1981 the Company had available investment, jobs and foreign tax credit carry-forwards for income tax purposes, amounting to approximately \$213,000. Of this amount \$48,000 expires in 1984 and \$165,000 expires in 1987.

#### 7. Retirement Benefit Plan

The Company has maintained a defined contribution retirement plan for its employees since May 31, 1978. Contributions to the Plan are at the discretion of the Board of Directors and for fiscal years 1980 and 1979 were \$159,165 and \$127,411 respectively. During 1981 the Company's president made a personal contribution of 30,000 of his shares of the Company's common stock to the Plan.

#### 8. Other Current Liabilities

Other current liabilities at May 31 are as follows:

	1981	1980
Salaries, Wages, Commissions and	MADE IN	ATTENDED.
Related Expenses	\$589,923	\$366,568
Liabilities Related to the Disposition of		
CAT, Inc.	55,790	197,582
Deferred Revenue (Note 1)	330,197	89,163
Other	7,347	420
THE RESIDENCE OF THE PARTY OF T	\$983,257	\$653,733

#### 9. Leases

The future minimum lease payments under capital leases included in property, equipment and leasehold improvements as of May 31, 1981 are as follows:

1982	\$197,444
1983	161,279
1984	119,443
1985	32,962
1986	7,207
Total minimum lease payments	518,335
Amount representing interest	131,347
Present value of minimum lease payments	\$386,988

Depreciation of these assets is included in Other Operating

The future minimum rental payments required under operating leases at May 31, 1981 are as follows:

	Equipment	Facility	Total
1982	\$ 75,639	\$531,080	\$ 606,719
1983	38,449	225,228	263,677
1984	18,688	73,304	91,992
1985	11,408	42,984	54,392
1986	5,764	10,477	16,241
THE PERSON NAMED IN COLUMN	\$149,948	\$883,073	\$1,033,021

#### 10. Business Segment and Foreign Revenues

The company is engaged in one industry segment, the development and marketing of system software, both domestically and worldwide. Sales to customers in foreign countries were as follows:

Year Ended May 31,	1981	1980	1979
Geographical Region		TO STATE OF THE PARTY OF THE PA	SECTION S
Japan, Far East and			
Australia	\$1,505,542	\$1,172,469	\$ 509,279
Mexico and South			
America	511,344	184,336	294,938
Mid-East and South			
Africa	662,467	346,530	327,018
Canada and Europe	1,389,501	374,999	508,120
	\$4,068,854	\$2,078,334	\$1,639,355

#### 11. Loss on Investment in Subsidiary

In fiscal 1980, the Company purchased all the capital stock of Computer Aided Transcriptions, Inc. ("CAT") and subsequently suspended the start-up and development of CAT's business after approximately nine months of activities. Loss on such activities including the cost of the purchase of stock, cash advances to CAT, and the satisfaction of CAT's liabilities amounted to \$699,602 which has been recorded in the year of purchase as CAT did not become fully operational.

#### 12. Supplementary Information

Amounts charged to Other Operating Expenses include the following:

Year Ended May 31,	1981	1980	1979
Depreciation and		100000	A TOTAL
Amortization of			
Property, Equipment			
and Leasehold	Table I need	· commune	
Improvements	\$351,659	\$239,265	\$115,600
Taxes other than Income	Taxes:		
Payroll	244,920	109,671	85,978
Other	27,723	3,630	31,156
Advertising	246,015	69,976	48,072
Interest Expense	214,701	53,490	7,578
Rental Expense for			
Operating Leases	837,475	343,401	154,471

### Notes to Consolidated Financial Statements (Continued)

Software AG International, Inc. and Subsidiaries

#### 13. Stock Options

The Company has currently granted common stock options to some of its key employees under the Key Employee Incentive Plan of 1981, which provides that the Company may grant up to a maximum of 450,000 shares prior to termination of the Plan on April 1, 1991. The option price shall be the fair value on the date of grant. Options may be exercised in installments over an option period, as determined by the Compensation Committee of the Board of Directors which is made up of non-participating directors.

The Plan provides, at the discretion of the Committee, that a participant will at the time of exercise of the exercisable stock options receive stock or a cash payment in an amount equal to the difference between the option price and the fair market value at the time of surrender of the shares. Accordingly, payment may be made in cash, in shares, or in a combination of both.

At May 31, 1981 45,550 options at \$7.50 per share were outstanding. No option may be exercised prior to January 1, 1982.

#### 14. Litigation

In 1978, the Company acquired a product represented to be an inverted list data base management system designed for Digital Equipment Corporation minicomputers, with the belief that the product was ready to be marketed. The Company also agreed to employ the designer of the product to continue to develop and maintain the product. Part of the consideration agreed to be paid by the Company was a 10-year royalty equal to approximatly 10% of the gross sales of the product in North America. The product, however, was not ready to be marketed, and the Company was required to expend substantial efforts and funds to create a marketable product. After expending in excess of \$750,000, the Company introduced ADABAS-M in late 1980.

In March 1981, the seller of the product brought an action against the Company in the state court in Seattle, Washington, seeking to recover damages or to confirm its right to royalties on gross sales of ADABAS-M. Predicting that revenues from ADABAS-M will equal \$65 million during the term of the contract, the seller seeks royalty fees of \$6.5 million or, in the alternative, an order compelling the Company to honor the contract.

On June 29, 1981, the seller amended his complaint to include principal stockholders and certain officers of the Company and Software AG of West Germany as defendants. In addition to previous claims, the amended complaint seeks damages based upon several additional legal theories including willful failure of consideration, conspiracies to induce breach of contract and to convert sellers product, violations of the Washington Consumer Protection Act and misappropriation of trade secrets. The amended complaint seeks damages, rescission of the contract of sale, and an injunction against future licensing of ADABAS-M and related technology by the defendants. Aggregate damages claimed are in excess of \$25,000,000. The Company has asserted counterclaims against the seller, alleging breach of contract, breach of warranties, negligent misrepresentations, fraud and violation of the Washington Consumer Protection Act. Principal stockholders subsequently removed the case to federal court which removal is presently being challenged by the plaintiff. As of June 29, 1981, the aggregate of revenues derived from licenses of ADABAS-M was approximately \$250,000.

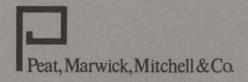
Management intends to vigorously defend each claim made by the seller. In the event that monetary damages are awarded by the court, it is the opinion of management, based upon review with counsel as to the extent of potential monetary damages, that monetary damages, if any, would not have a material adverse effect on the Company's financial position.

#### 15. Subsequent Events (Sale of Common Stock to Public and Satisfaction of Certain Obligations)

In June, 1981 the Company made its first sale of common stock to the public resulting in an increase in shares outstanding from 4,923,363 at May 31, 1981 to 6,135,863. Shareholders equity was increased with the proceeds of the sale net of expenses in the amount of \$19,486,520. Part of the proceeds of the sale was used to satisfy short term debt and bank borrowings totaling \$2,000,000 and Computer Systems Software Marketing License Payable in the amount of \$7,305,085.

Assuming the above described transactions took place on May 31, 1981 the as reported balance sheet would have reflected the following balances.

Total Current Assets Increased to	\$19,456,394
Total Current Liabilities Decreased to	4,988,308
Working Capital Increased to	14,468,086
Computer System Software Marketing	
License Payable Reduced to	250,000
Short Term Debt Reduced to	Nil
Stockholders Equity Increased to	24,830,130
Total Assets, Total Liabilities and	
Stockholders Equity Increased to	31,763,570



Certified Public Accountants

1990 K Street, N.W. Washington, D.C. 20006

The Board of Directors Software AG International, Inc.:

We have examined the consolidated balance sheets of Software AG International, Inc. and Subsidiaries as of May 31, 1981 and 1980 and the related consolidated statements of income, stockholders' equity, and changes in financial position for each of the years in the three-year period ended May 31, 1981. Our examinations were made in accordance with generally accepted auditing standards and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the aforementioned consolidated financial statements present fairly the financial position of Software AG International, Inc. and Subsidiaries at May 31, 1981 and 1980 and the results of their operations and the changes in their financial position for each of the years in the three-year period ended May 31, 1981 in conformity with generally accepted accounting principles applied on a consistent basis.

Feat Marwile Mitchell + 6.

August 5, 1981

### **Worldwide Offices**

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Chicago, Illinois
Denver, Colorado
Houston, Texas
Kansas City, Kansas
Los Angeles, California
Orlando, Florida
New York, New York
San Francisco, California
Seattle, Washington
Washington, D.C.

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SPL (Israel) Ltd. 63 Petach Tivka Road Tel Aviv, Israel

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R.D. Nickel and Associates, Inc. P.O. Box 1087 Cambridge (G) Ontario Canada N1R 5Y2

Telephone: 519-653-6142 Telex: 06959451

Systems Programming (PTY) Ltd. P.O. Box 78081 Sandton 2146 Transvaal Republic of South Africa

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APOYO Computacional, S.A. Ave. San Fernando No. 106 ESQ. Madero Tlalpan, Mexico 22 DF Mexico

Telex: 1772074

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## **Directors**

#### Transfer Agent and Registrar

Manufacturers Hanover Trust Company 4 New York Plaza New York, New York 10015

#### Stock Information

The common stock of Software AG, International, Inc. is traded in the Over-the-Counter market (NASDAQ Symbol: SAGA).

The 1981 Annual Meeting of Stockholders will be held at 4:00 p.m., local time, on October 1, 1981, at Windows On The World, 106th Floor, One World Trade Center, New York, New York, John Norris Maguire Chairman of the Board and President Software AG International, Inc.

- ■□ Charles B. Branch
  Retired Chairman of the
  Board and Chief Executive
  Officer
  Dow Chemical Company
- ■□ W.H. Conzen
  Chairman, Executive
  Committee of the Board
  Retired Chairman of the
  Board and Chief Executive
  Officer
  Schering-Plough
  Corporation

Kenneth D. Rardin Chief Operating Officer, Executive Vice President and Secretary Software AG International, Inc.

- Peter M. Schnell
   President
   Software AG
   Darmstadt, West Germany
- Audit Committee

  □ Compensation Committee

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