

Letter To Our Shareholders

Dear Shareholder:

We are pleased to report on the progress of your company in the first quarter of 1998. We can report that BETA Systems' revenue grew by DM 2.2 million, or 20%, over 1997 and exceeded our internal forecast. Revenue growth resulted principally from higher license revenue, particularly in the areas of CPU upgrades and new licenses. The revenue development of our European and US subsidiaries was particularly gratifying. Together they generated more than three times as much new business as our German home base did. Revenues from CPU upgrades doubled and version upgrades were the same as a year ago. The latter was expected, since most of our customers have already bought the latest versions of our products, indicating that the transition period to Year-2000 compatible products is nearly over.

Our continued investment in selling, infrastructure and development, necessary to sustain our global expansion led to a higher loss than in the comparable first quarter last year. Remember that our revenue development during the year is highly seasonal with the weakest results being reported for the first quarter and the strongest for the last quarter of the fiscal year. Our revenue growth and the smaller than expected loss in the first quarter of 1998 makes us hopeful that we are back on track and will achieve our financial goals for the full year 1998.

We continue to believe that the market for mainframe software and the automation of the enterprise data center is vibrant. Our customers increased the MIPS capacity of their mainframe computers above our expectations and improved the revenues from CPU upgrades by 100% during the quarter.

Finally, we can also say with great confidence that the worst of the problems associated with the product transition to the newer version of our products BETA 92 and BETA 93 is behind us as new modifications were distributed to all customers in early May after extremely thorough testing. Such product transition issues adversely affected our fourth quarter results in 1997.

Revenue Development

First quarter 1998 revenues totaled DM 13.2 million, an increase of DM 2.2 million or 20.0% over the first quarter of 1997. Total license revenue increased by DM 1.4 million, or 42.3%, to DM 4.7 million, driven by CPU upgrades, particularly in Germany, and new license revenue, particularly in the United States. The Company is continuing to invest significant resources into the US and Europe to further increase sales of new licenses into these two markets. Our products BETA 44, BETA 45, BETA 88 and BETA 55 were the largest contributors to new license revenue during the first quarter of 1998. It is especially encouraging that the newer products BETA 45 and BETA 55 showed such strong revenue performance. The Company, however, expects increasing new licenses from BETA 93 and BETA 92 this year, as the version upgrades for these products decline. In total, the level of version upgrades for BETA 92 and BETA 93 was the same as in the first quarter of 1997.

Maintenance revenue in the 1998 first quarter aggregated DM 7.1 million, an increase of DM 0.6 million, or 8.5%, as compared to the same period in 1997. Since the revenue mix (i.e. new licenses, CPU and version upgrades) heavily influences maintenance revenue and the Company had very high revenues from version upgrades in the last two years, revenue from maintenance contracts grew significantly slower than in the past. The Company expects, however, a gradual recovery to historical growth rates as the transition to the newest product versions is completed and as sales of new licenses increase.

Services revenues in 1998 grew by 22.3%, or DM 0.3 million, to DM 1.4 million, primarily due to increased consulting revenues related to the migration of certain new customer sites to BETA products from competitors' software programs.

Growth By Region

BETA Systems' revenues are driven by an international strategy that focuses on customer product needs in various regions. Revenues from the sales regions Germany (including Austria and Switzerland), Europe and North America were 53%, 31% and 16%, respectively, in the first quarter of 1998, as compared to 58%, 29% and 13% in the 1997 period, reflecting an increased contribution from our international subsidiaries. Growth in the USA related principally to sales of new licenses, particularly BETA 45 and BETA 88, while Europe's growth related primarily to new licenses (BETA 44 and BETA 93) and CPU upgrades. The modest growth in Germany related primarily to increased CPU upgrades and maintenance revenues.

The growth of international sales is in line with our strategy of increasing our customer base in the USA and increasing our European market share with new customers and the sale of an increased number of products per customer. BETA Systems was particularly proud to win two new customers in the insurance industry against heavy competition: Zurich Insurance (USA) and HUK Coburg (Germany), as well as such new customers as Regional Capital Dresden (Germany), SunGuard Corporation (USA) and Talbot's (USA).

Cost and Expense Development

Gross profit was DM 9.5 million in the first quarter of 1998; an increase of 17.7% or DM 1.4 million as compared with the first quarter of 1997. The Company's gross margin declined slightly from 73.5% in the 1997 period to 72.1% in the 1998 period but was higher than management's expectations for the first quarter. Lower maintenance gross margins due to increased personnel costs to handle product transition issues were partially offset by higher license and service gross margins in the 1998 period.

Operating expenses aggregated DM 13.2 million, an increase of DM 3.1 million, or 30.6%, as compared to the first quarter of 1997 and slightly higher than management's expectations. As a percentage of total revenues operating expenses represented 91.9% in the 1997 period and 100% in the 1998 period. Such increases reflect BETA Systems' continued build-up of sales and marketing as well as administrative overhead to support its international expansion efforts and increased development spending, focused on quality assurance, which were not fully offset by growth in the Company's revenues, yet.

Due to growth of the Company's operating expenses exceeding revenue and gross profit development, its pre-tax loss increased to DM (3.3) million in the 1998 period as compared to DM (2.0) million in the 1997 period.

Management has taken measures in the first quarter of 1998 to realign its cost and expense structure with its projected revenue growth for the year.

Net Income, Tax rate and Earnings per Share

BETA Systems' tax rate for the first quarter of 1998 was 50.7% compared to 60.2% in the first quarter of 1997. As a result, the net loss for the 1998 period was DM (1.6) million, or DM (0.88) per diluted share, as compared to DM (0.8) million, or DM (0.77) per share in the 1997 period. The weighted average number of diluted shares outstanding was 1,851,426 and 1,050,000 in the first quarter of 1998 and 1997, respectively.

Financial Position

The balance sheet as of March 31, 1998, reflects cash and short term investments of DM 70.2 million, total debt of DM 1.9 million, and stockholders' equity of DM 78.6 million, providing a strong base for future growth.

Outlook

For 1998, the Company expects to achieve growth in revenues and net income at rates in excess of those achieved in 1997. The Company anticipates that its traditional development of quarterly operating results will continue in 1998 with losses occurring in the first half year and high levels of profitability in the second half year, particularly in the fourth quarter. We anticipate higher operating losses in the first half of 1998 as compared to the first half of 1997 due to (i) lower revenue growth as a result of an unusually strong performance in the first half of 1997, (ii) a shift in the Company's revenue mix in 1998 towards new licenses (with longer lead times) as opposed to version upgrades and (iii) higher operating expenses related to BETA Systems' investment in direct sales personnel and subsidiary infrastructure to further its strategic objectives outside Germany. Our first quarter results combined with the results of our expense realignment undertaken during the quarter give us confidence in meeting our revenue and net income targets for the year.

Berlin, May 20, 1998

BETA Systems Software AG
Consolidated Statements of Income
(DM in thousands, except per share amounts)
(unaudited)

	Quarter Ended March 31,	
	1997	1998
	<u> </u>	<u> </u>
Revenues		
Product license	3,308	4,706
Maintenance	6,505	7,047
Services	1,166	1,426
Total revenues	<u>10,979</u>	<u>13,179</u>
Cost of revenues:		
Product license	296	384
Maintenance	1,711	2,303
Services	901	993
	<u>2,908</u>	<u>3,680</u>
Gross profit	8,071	9,499
Operating expenses:		
Selling	6,075	7,804
General and administrative	2,392	3,221
Research and development	1,408	1,915
Amortization of intangible assets	213	233
	<u>10,088</u>	<u>13,173</u>
Operating income (loss)	<u>(2,017)</u>	<u>(3,674)</u>
Other income (expense)	181	33
Interest income (expense)	<u>(148)</u>	<u>319</u>
Income (loss) before income taxes	(1,984)	(3,322)
Provision (benefit) for income taxes	(1,194)	(1,684)
Minority interest in earnings of subsidiary	17	-
Net income (loss)	<u><u>(807)</u></u>	<u><u>(1,638)</u></u>
Weighted average number of shares outstanding during the period		
Basic	1,050,000	1,800,000
Diluted	1,050,000	1,851,426
Net income (loss) per ordinary share		
Basic	(0.77)	(0.91)
Diluted	(0.77)	(0.88)
Number of employees at period end	231	262

BETA Systems Software AG
Condensed Consolidated Balance Sheet
(DM in thousands)
(unaudited)

	<u>At December 31, 1997</u>	<u>At March 31, 1998</u>
Current assets:		
Cash and cash equivalents	55,594	70,242
Accounts receivable, net	30,249	22,031
Other current assets	5,950	9,789
Total current assets	<u>91,793</u>	<u>102,062</u>
Property and equipment, net	5,263	5,213
Intangible assets, net	3,342	3,178
Capitalized software development costs, net	3,339	3,525
Other assets	1,857	2,538
Total assets	<u><u>105,594</u></u>	<u><u>116,516</u></u>
Current liabilities:		
Short-term debt incl. current portion of long-term debt	663	243
Accounts payable	4,423	3,461
Deferred revenue	6,921	21,589
Other current liabilities	8,442	7,180
Total current liabilities	<u>20,449</u>	<u>32,473</u>
Long-term debt	1,303	1,624
Other liabilities	3,600	3,822
Total liabilities	<u>25,352</u>	<u>37,919</u>
Shareholders' equity	<u>80,242</u>	<u>78,597</u>
Total liabilities and shareholders' equity	<u><u>105,594</u></u>	<u><u>116,516</u></u>

BETA Systems Software AG
Condensed Statements of Cash Flows
(DM in thousands)
(unaudited)

	Quarter Ended March 31, 1997	1998
Operating activities		
Net income (loss)	(807)	(1,638)
Adjustment to reconcile net income (loss) to net cash provided by operating activities:		
Depreciation and amortization	824	897
Change in working capital and other adjustments	15,209	16,123
Net cash provided by operating activities	15,226	15,382
Investing activities		
Purchase of property and equipment, net of sale proceeds	(549)	(406)
Capitalization of software development costs	(273)	(340)
Net cash provided by investing activities	(822)	(746)
Financing activities		
Net change in short-term borrowings and long-term debt	(7,756)	(138)
Net cash provided by financing activities	(7,756)	(138)
Increase in cash and cash equivalents	6,648	14,498
Effect of exchange rate changes on cash	(13)	150
Cash and cash equivalents at beginning of period	2,256	55,594
Cash and cash equivalents at end of period	8,891	70,242