A N N U A L   R E P O R T   1 9 9 7

ELSA

KDM	1995	1996	1997	Changes 96-97 in %
REVENUES	118.891	226.163	286.565	26,7%
COMPUTER GRAPHICS	80.049	144.727	196.692	35,9%
DATA COMMUNICATIONS	38.842	81.436	89.873	10,4%
EXPORT RATE	12,6%	12,8%	27,1%	–
EBDIT	7.285	17.747	19.148	7,9%
RESULT FROM ORDINARY ACTIVITIES	4.602	14.121	13.853	-1,9%
NET INCOME FOR THE YEAR	2.193	7.312	6.548	-10,4%
RESULT ACCORDING TO DVFA/SG	2.638	6.143	6.965	10,7%
CASH FLOW ACCORDING TO DVFA/SG	4.186	9.022	10.348	14,7%
INVESTMENTS (incl. minor assets)	2.116	7.618	5.586	-26,7%
EQUITY/TOTAL ASSETS AS OF 12/31/97	18,7%	17,7%	14,8%	–
RETURN ON EQUITY	28,6%	58,0%	43,7%	–
RETURN ON SALES	3,8%	5,9%	4,5%	–
PERSONNEL AS OF 12/31/97	238	413	511	–

*1995 and 1996 ELSA GmbH,
1997 ELSA AG, consolidated

COMPUTER GRAPHICS

SYSTEMS

MULTIMEDIA

SYSTEMS

CONSUMER

DATA COMMUNICATIONS

ELSA focuses on the divisions

Computer Graphics and Data Communications.

The know-how acquired in the development of innovative

high-tech solutions for the professional market

is put to efficient use by developing attractive solutions

for the consumer market.

DEAR FUTURE SHAREHOLDERS,
DEAR FRIENDS,

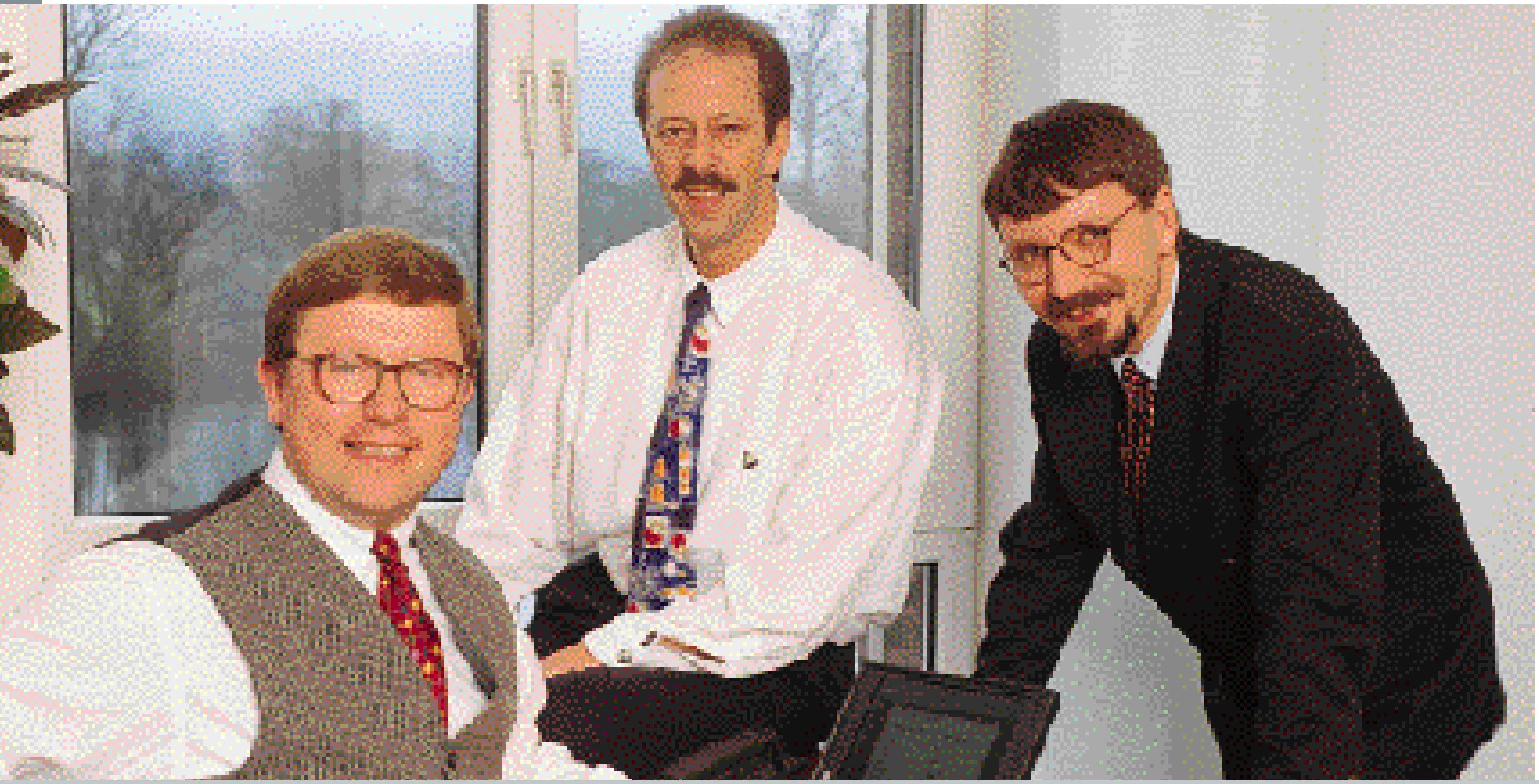
We are delighted to present to you the first annual report for ELSA AG. The annual report is part of the open dialogue we would like to establish between the company and its shareholders.

Since the early stages of the PC market in the mid-80s, ELSA has been selling PC peripherals into the computer graphics and data communications segments of the market. In both of these segments we produce products that help people to deal with their tasks quickly and efficiently.
Our products support and improve the use of PCs for communications, display quality, ergonomics and performance. We also put the knowledge we gain while developing innovative high-tech solutions to efficient use by creating attractive solutions for the consumer business. This gives us a competitive edge in the market.

REVENUES AND EARNINGS

In the last fiscal year, ELSA has made considerable progress toward becoming a global supplier of computer graphics and data communications products. Total sales increased by 26.7 % from DM 226.2 million to DM 286.6 million. Our operating result amounted to DM 13.9 million.

We were able to solidify our leading domestic market position in all business units. Parallel to this, we expanded our international activities considerably. By establishing subsidiaries in Taiwan and Japan last year we strengthened our presence in Asia.



As a result of our international expansion that we initiated and will pursue in the coming years, the percentage of sales from international markets rose from 12.8% to 27%. Our business grew by more than the market average, particularly in international markets, allowing us to continue abroad the success we enjoy in Germany.

CUSTOMERS

We would like to thank our customers and distribution partners for their co-operation. We are confident that, in the current year, we can continue and further expand the success we have enjoyed so far. We remain committed to fulfilling your needs with excellent service and state-of-the-art products.

PERSONNEL

In the past year we created 145 jobs, resulting in an average annual headcount of 489 employees world-wide. We would like to express our thanks to all our staff who, with above-average performance and much personal dedication, have ensured the realization of our strategy for success.

TARGETS FOR 1998

We have set ambitious sales and revenue targets for 1998. We are confident that we will be able to further improve ELSA's worldwide market position in the current fiscal year. We intend to meet these targets by focusing on our core competencies, tightening our product range, investing in the expansion of our infrastructure and our subsidiaries, as well as specific measures to strengthen our European sales network.

We plan to go public in mid-1998, with ELSA shares to be listed on the Neuer Markt at the Frankfurt Stock Exchange, which will secure the funds required for our growth and considerably increase the company's visibility in the market. We believe that ELSA shares will be an attractive investment.

We would like to develop the same partnership with our shareholders as we have with our customers, suppliers and employees. Therefore, we will personally do our utmost to maintain what makes ELSA so special both in terms of internal relations as well as in terms of our co-operation with all our partners.

Theo Beisch　　Peter Gueldenberg　　Josef Beisch

ELSA AG was incorporated, on August 25, 1997, thereby converting ELSA GmbH to ELSA AG. ELSA's first supervisory board was appointed by the founding shareholders and consisted of Mr. Max Beisch (Dipl.-Kfm.), Mr. Friedhelm Hammer (Attorney) and Dr. Hanno Schmitz-Hueser (Auditor and Tax advisor). A special meeting was held on December 18, 1997, at which the following persons were elected as the new members of ELSA's supervisory board:

Mr. Wolfgang Dondorf (Dipl. Ing.), chairman

Mr. Theodor Ludger Lieven, deputy chairman

Dr. Hanno Schmitz-Hueser, deputy chairman

The supervisory board considered verbal and written reports concerning ELSA's business affairs during fiscal year 1997. In its meetings, the supervisory board addressed fundamental questions of business strategies, cost development, investment and financial planning.

In addition to the resolutions adopted at its meetings, the supervisory board supported the management board on an ongoing basis.
In particular, all processes which statutorily require the consensus of the supervisory board were addressed.

The annual financial statements presented by the ELSA AG management board, the consolidated financial statements and the annual report have been examined by Arthur Andersen Wirtschaftsberatungsgesellschaft—Steuerberatungsgesellschaft, Hamburg, Germany, and received an unqualified auditor's opinion.

LETTER FROM THE SUPERVISORY BOARD

The supervisory board has examined this report, agrees with the findings of the auditors and has approved the underlying annual financial statements presented by the management board. The supervisory board agrees with the suggestion for utilization of the retained earnings.

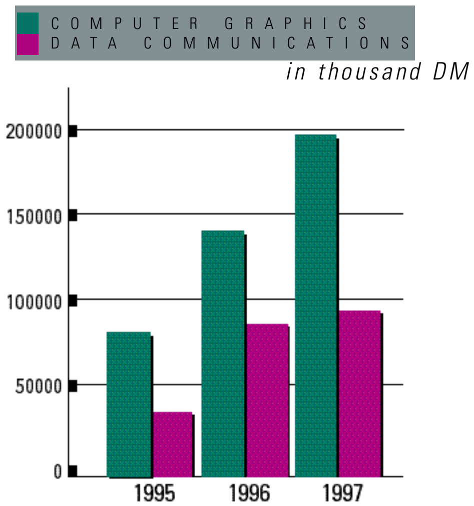
The supervisory board would like to thank the members retiring from the supervisory board, the management board and all of the employees for their excellent and successful work.

Aachen, April 1998

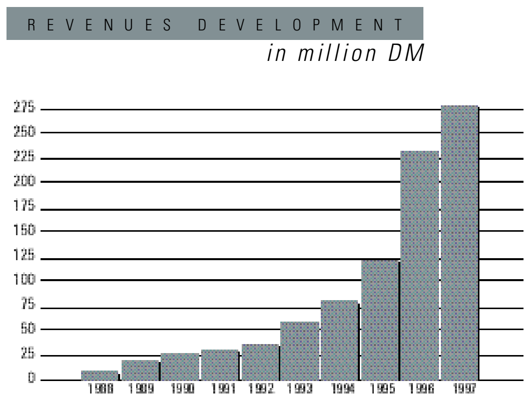
Wolfgang Dondorf | Theo Lieven | Dr. Hanno Schmitz-Hueser

The Supervisory Board

SUPERVISORY BOARD



E L S A 1 9 9 7



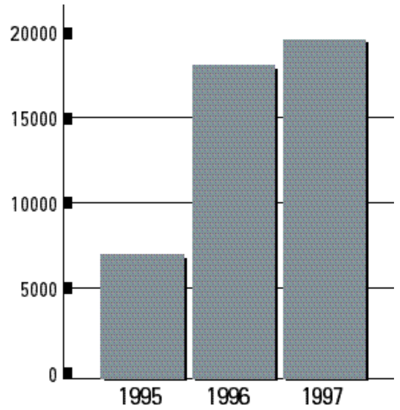
The 1997 fiscal year was characterized by various factors:

- *Strong growth in Windows NT workstations in the US*
- *Moderate adaptation of the Internet in Germany, particularly with regard to high-speed modems due to lack of standardization*
- *Temporary weakness in PC sales in the second quarter*

Despite a market environment which was at times difficult, ELSA was able to continue in 1997 the success of previous years.

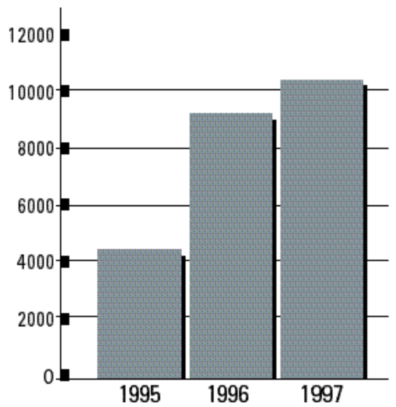
E B D I T 1 9 9 5 - 1 9 9 7

in thousand DM



C A S H F L O W 1 9 9 5 - 1 9 9 7

in thousand DM



REVENUES

Revenues, which were consolidated at the group level for the first time in 1997, amounted to DM 286.6 million compared to DM 226.2 million in the previous year. The Computer Graphics division accounted for 69%, the Data Communications division contributed 31%. Dynamic growth was sustained by both divisions. The percentage of international sales rose from 12.8% in 1996 to 27% in 1997.

COST OF MATERIALS

The cost of materials increased from DM 182.7 million to DM 212.7 million at company level and DM 212.9 million on a consolidated basis and thereby remained in proportion to total revenues.

PERSONNEL

Due to the expansion of research and development as well as pre and post-sales activities, our increase in personnel expenses was slightly disproportionate to sales. We invested DM 9 million in research and development alone, an increase of DM 2.7 million compared to the previous year.

OPERATING RESULTS

Pre-tax income for the group totalled DM 13.9 million in 1997, thereby remaining close to the previous year's level of DM 14.1 million. The effect of the unexpectedly weak demand in the German PC consumer market and the one-time expense of the company's conversion to a stock corporation and the planned initial public offering and listing on the Neuer Markt at the Frankfurt Stock Exchange were almost balanced out by the success of the American subsidiary, ELSA Inc.

INVESTMENTS

Investments in tangible assets amounted to DM 5.6 million in 1997, mainly relating to the expansion of the company's facilities in Aachen. The new development center, in use since 1996, and other office and production buildings were completed. Investments in operations and business equipment mainly related to IT and workstations. In total, ELSA invested over DM 13 million in the expansion of its facilities in Aachen during the last two years. To strengthen our international market position, a financial investment of DM 1.6 million was made to establish our new subsidiaries in Japan and Taiwan.

STRUCTURE OF BALANCE SHEET

Equity accounted for 26.2 % of the consolidated balance sheet total at December 31, 1997. 84 % of current assets are complemented by 16 % of fixed assets.

The company plans to go public in 1998, which will result in a significant increase in equity and will permit further long-term growth.

The transition from a service-oriented society to an information society is characterized by the merging of computers, communications technologies and, increasingly, home entertainment products. We anticipated this development early on and focused on those segments which lie at the center of this convergence: computer graphics and data communications.

Divided into the two business divisions, Computer Graphics and Data Communications, ELSA has been supplying the PC market since its early stages in the mid-80s. The PC is the focal point of the company's activities.

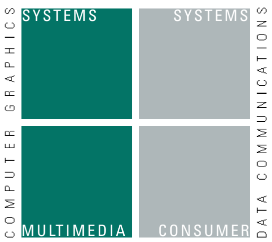
Constant improvement of the products is required in order to achieve and maintain a leading market position in these areas. ELSA has been successfully meeting this challenge for years through increasing investments in research and development.

Important factors which contribute to the continued success of all product groups are early entry into the market, innovative leadership and a high degree of acceptance.

B U S I N E S S   D I V I S I O N S

COMPUTER GRAPHICS

ELSA's Computer Graphics division offers a wide range of graphics boards and monitors:



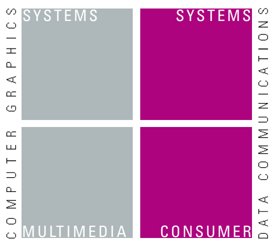
- High-end graphics boards for 2D and 3D engineering workstations
- 2D and 3D graphics boards for the office and corporate design markets
- High-performance graphics boards for game enthusiasts and PC beginners
- 17" to 24" color monitors
- TFT flat-screen monitors

Our sales strategy in the past year mainly focused on Original Equipment Manufacturers (OEMs) who, by entering the PC workstation market, have had considerable influence on the trend to move away from proprietary UNIX solutions towards Windows NT.

For this reason, ELSA continues to rely on its own strong Research and Development division in order to timely integrate important market trends and new technologies into its own products.

DATA COMMUNICATIONS

For the Data Communications division, the important growth factors are the Internet and the spread of ISDN technology in the telecommunications area with its advantageous impact on communications costs. ELSA succeeded in further improving its excellent position in the German market with the following products:



- High-speed modems
- ISDN adapters
- Videoconferencing systems
- ISDN routers

In the coming years we will strengthen our distribution network with a view to offering our data communications products throughout Europe. ELSA fulfills the needs of professional and private users with top-of-the-line products in the computer graphics and data communications segments.

B U S I N E S S   D I V I S I O N S

The know-how acquired in the development of innovative high-tech solutions is put to efficient use by developing attractive solutions for the consumer market.

The Computer Graphics and Data Communications divisions are subdivided into four focused business units to meet the specific needs of the different markets and target groups.

- Graphics Systems
- Multimedia
- Communications Systems
- Consumer Communications

With these four pillars of success, ELSA can make optimal use of the sales opportunities in all product groups, as the activities of each of the four business units are focused on and specialized in a dedicated market segment either in the high-end or consumer business.

GRAPHICS SYSTEMS

High-end 2D and 3D graphics boards. ELSA is a pioneer in terms of professional 2D and 3D graphics boards. With a market share of approximately 20% (source: 3Dlabs), ELSA became the world market leader in the high-end 3D market under Windows NT last year. To further increase its market share the Graphics Systems business unit will be strengthened in the U.S. and will expand into the Asian market as well. New innovative products, a close collaboration with OEM partners and new OEM customers will support this strategy.

The graphics boards of the *ELSA GLoria* product family are used in Windows NT workstations based on PCs. They enable comparatively low priced PC technology to be used for applications that were previously only available on more expensive proprietary UNIX workstations. The increasing spread of Windows NT workstations caused an increasing demand for graphics boards. In 1997, ELSA sold more than 39,000 units compared to 9,000 in the previous year. Renowned PC manufacturers such as Acer, Compaq, Dell, Hewlett-Packard and Siemens Nixdorf have already decided to use ELSA graphics boards. For the coming years, independent market surveys predict an average growth of 40% per year for the professional Windows NT workstation market (sources: IDC, Intel).

The new high-end 3D products, among others, are establishing the basis for continued growth. ELSA continues its diversification in vertical market segments. ELSA's multi-screen technology—which allows multiple independent monitors to be driven by one PC and which has been used successfully in CAD construction workstations—will also be developed further in order to make them attractive for other users, e.g. in the rapidly growing financial markets with a need of more 'screen real estate'.

C O M P U T E R   G R A P H I C S

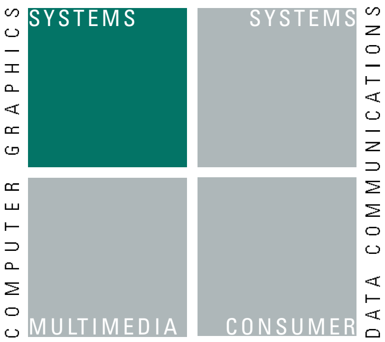
PROFESSIONAL MONITORS

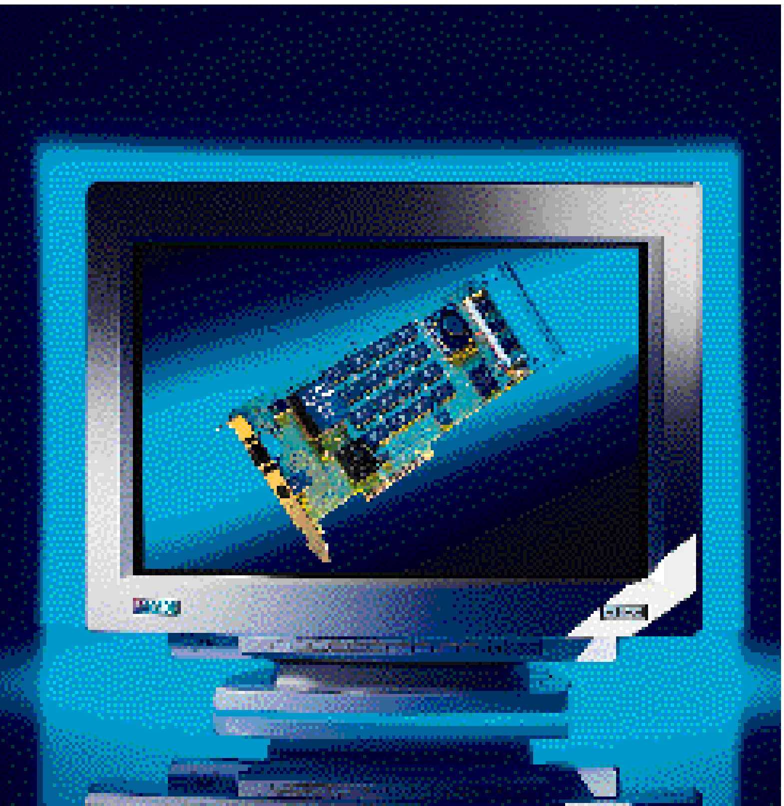
In the past year, ELSA has been working on establishing its own monitor brand for professionals. The company developed its own product line of 17 to 24 inch monitors, branded *ELSA ECOMO.* Its target markets are primarily in Germany and neighboring countries.

Graphics systems sales increased by 38.7 % during the past fiscal year. By selling more than 15,000 large monitors in the 20 inch + category, ELSA holds an important position in the German monitor market.

In 1998, ELSA will start develop and introduce a product line of digital interface TFT flat-screen monitors.

Graphics systems for professional applications are high-end products. ELSA belongs to the worldwide leaders in this attractive market segment.





MULTIMEDIA

The multimedia market is a fast growing, but fiercely competitive market. ELSA successfully faces this challenge with sophisticated 2D and 3D graphics accelerators for home and office computers. ELSA has one of the most successful solutions for ambitious 3D gamers—the *ELSA VICTORY Erazor.*

At present, the office PC is mainly used for word-processing and spreadsheets, but the Internet as well as presentation and publishing applications are gaining more importance in this market. The graphics boards of the *ELSA WINNER* product line are well equipped for these and future requirements—for example, the future market for videoconferencing.

In the multimedia market, the focus of our sales strategy is on co-operation with original PC manufacturers who integrate the ELSA graphics solutions in their computers as a standard item.

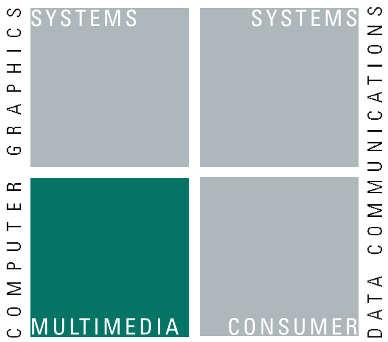
In 1997, ELSA was ranked for the first time among the top ten of the world's most renowned vendors of consumer graphics boards. With a world market share of 4%, ELSA managed to jump straight into fifth place (source: Jon Peddie Associates).

C O M P U T E R   G R A P H I C S

The Multimedia business unit consistently takes advantage of synergies stemming from its own experiences in the professional graphics market. Developments in the innovative technologies of the high-end market are transferred to consumer products. This means that the consumer-market user benefits from early market availability of highly developed graphics board technologies with a reasonable price/performance ratio. Our existing OEM partnerships with the leading international PC manufacturers are the basis for our further growth.

The Multimedia business unit's product portfolio is being further developed by the expansion into related technologies. These include, for example, video input and output ports, digital video support (Digital Versatile Disk = DVD), analog and digital television and virtual reality.

Further growth will help ELSA to expand its market position in Europe, the U.S. and Asia. As in the past, ELSA expects to participate both in the strong growth of the market and in the quest for new market shares.

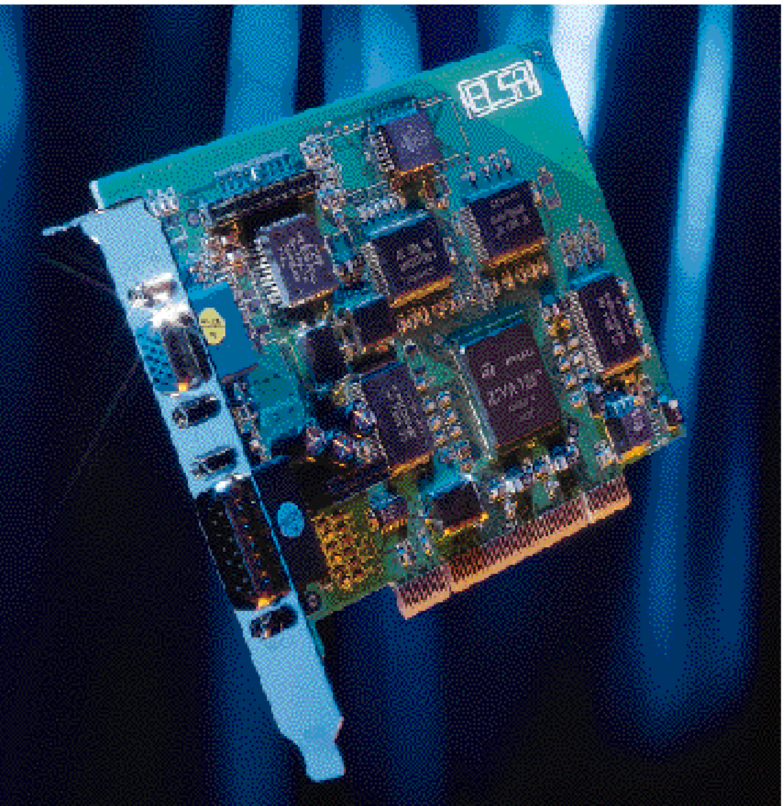


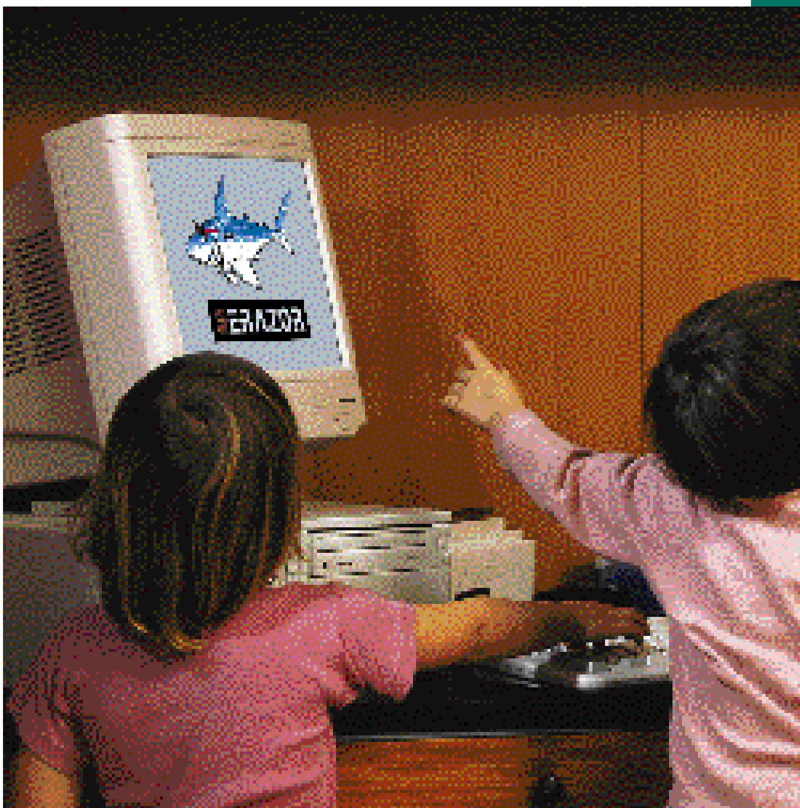
The multimedia market is growing

at a breathtaking speed worldwide.

ELSA intends to seize the opportunities

offered by this dynamic market.





COMUNICATIONS SYSTEMS

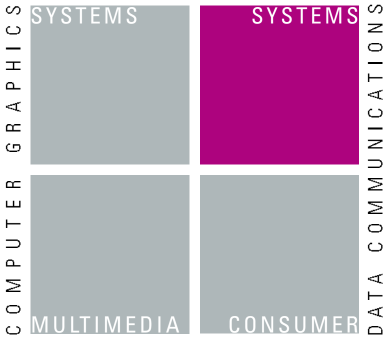
In the data communications market, ELSA offers professional PC based videoconferencing systems and ISDN routers for Internet access and communications solutions for small networks. The main applications are in video communications, data transfer, fax, Internet, intranet, remote access and remote maintenance. In a market that demands quick reactions and up-to-date knowledge, ELSA has a substantial competitive advantage through its many years of research.

With *ELSAvision*, ELSA has secured a strong position in the videoconferencing market. In developing its video-conferencing technology, ELSA was able to take advantage of its experience in computer graphics and data communications. After premiering the world's first videoconferencing solution for Windows NT 4.0 in 1997, we now offer network functionality for the system. ELSA has already carried out successful projects with major customers such as Deutsche Telekom, BMW and Bosch.

D A T A C O M M U N I C A T I O N S

The breakthrough in the future market of videoconferencing systems is expected soon. With faster processors and increasing bandwidths, the systems will soon achieve TV quality at prices attractive to consumers. Both acceptance and distribution will, therefore, increase significantly.

With its ISDN routers, ELSA is also strongly involved in the rapidly growing networking market. The total European sales volume in this market is expected to increase from US $ 332.5 million in 1996 to over US $ 600 million in 1998 (source: Frost & Sullivan). ELSA's new router family which meets the increasing requirements of the SOHO (Small Office/Home Office) market is currently in the initial phase of market introduction, and the first reactions from customers and the trade press are encouraging. We are confident that this new generation of products will be a success.



The transition away from

the services age towards

the information age demands

that communications systems

be optimized. This presents

ELSA with an ongoing challenge.

CONSUMER COMMUNICATIONS

Due to the rapidly increasing availability of online services and the quick spread of the Internet, data communications are increasingly becoming a standard feature in private households. In addition to attractive pricing, products in this market must offer a high degree of user-friendliness, a comprehensive set of product features and a complete range of support services. ELSA has positioned itself in this growing market with high-speed modems, PC cards for laptops and notebooks as well as ISDN cards and adapters.

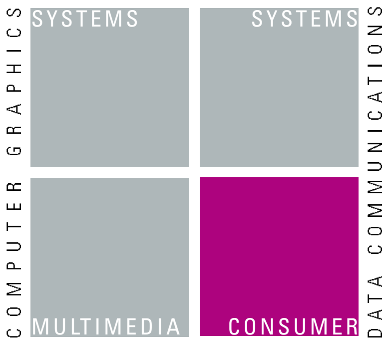
ELSA is one of the pioneers providing analog modem technologies immediately after the German telecommunications market was deregulated more than 10 years ago. Despite increased competition, ELSA was able to increase the number of units sold in 1997 and strengthen its market position. The increasing use of the Internet will ensure a continued strong demand for high-speed modems.

D A T A   C O M M U N I C A T I O N S

The recent global standardization of analog 56k modems (V.90) will also contribute to this favorable market environment. This new technology, which is, among other features, incorporated in the *ELSA MicroLink 56k,* provides users of the analog telephone network with a real alternative to ISDN transfer rates. The new transmission standards will also increase the product life of analog modems and stimulate sales for an extended period of time.

By offering PC cards for laptops and notebooks, ELSA is responding to the trend towards increased mobility in data communications.

In the ISDN solutions market, ELSA offers internal PC boards and external terminal adapters. Due to the simple installation and user-friendliness of its products, ELSA has received numerous awards from the trade press. The growing acceptance of ISDN solutions in Europe will have a positive impact on ELSA's further international expansion.



More and more private users

are turning to online communications.

With its powerful modems and

ISDN adapters, ELSA is a pioneer

of this future market.

RESEARCH & DEVELOPMENT

Among ELSA's main success factors are the company's research into new technologies and the timely development of products in accordance with market demands.

As a core competence of the company, research and development is mainly carried out internally. This ensures a competitive edge in terms of know-how and shortens the time to market both for graphics and data communications products. ELSA's development process meets the high expectations of the high-tech markets with respect to performance and quality as well as the feasibility of large-scale production. On average, it only takes four to seven months for a product to progress from the initial idea to the manufacturing stage, which allows ELSA to successfully service even short-lived markets. ELSA engineers consider time to market an important strategic

T E C H N O L O G Y

factor which is constantly improved to strengthen the company's market position. Market-oriented thinking—combined with knowledge of the newest trends and technologies—secures a leading role for ELSA in PC-based graphics and communications products.

In addition to its market-related development activities, the Research & Development department is already laying the technological foundation for servicing the markets of the future and creating a basis for future product generations and trends such as xDSL, ATM, IEEE1394, videoconferencing and cable modems.

29% of ELSA's employees work in Research & Development. This demonstrates ELSA's commitment to achieving its declared goal of improving its market position through first-rate technological performance.

MANUFACTURING

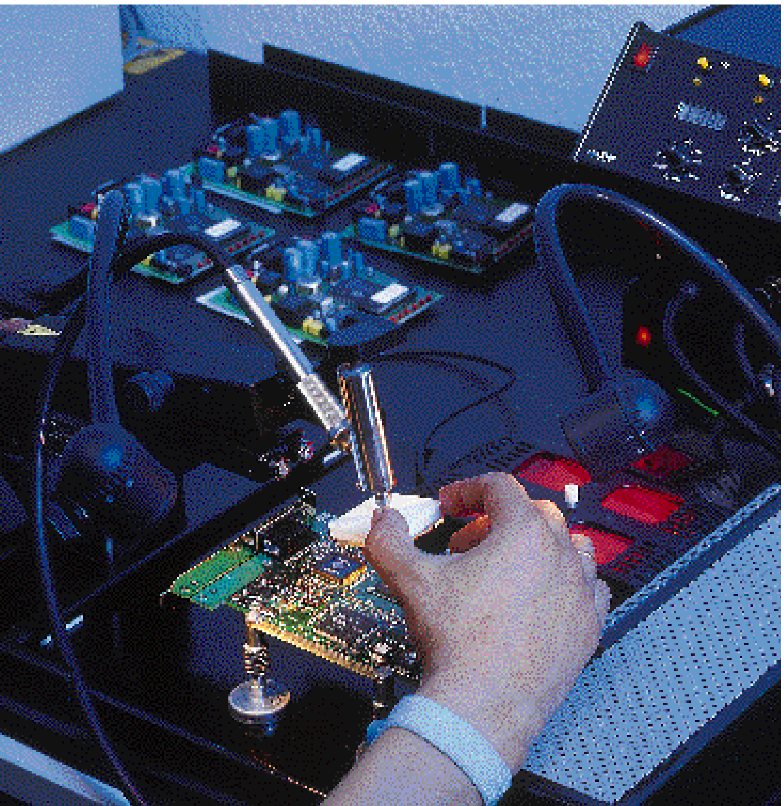
Production planning, selection of suppliers and distribution are performed in-house at ELSA. The entire procurement process is subject to quality control. ELSA's teams monitor the operations of suppliers to ensure compliance with quality standards.

Because of the short innovation cycles in this industry, outsourcing the capital-intensive production of electronic assemblies and monitors has considerable advantages:

- flexibility in case of fluctuating production volumes, especially for short-term high-volume ramp up
- no capital tied up in expensive production equipment
- reduction of costs

This strategy allows ELSA to devote its resources to activities with a higher value-added quota and to avoid production shortages. In the course of our OEM business expansion, additional globally operating production service companies are being qualified to deliver to large customers directly on-site.

ELSA's internal processes are subject to equally high standards. Besides being DIN EN ISO 9001 certified, ELSA meets the strict World Wide Supplier guidelines of, among others, Compaq, Dell, Hewlett-Packard, Packard Bell NEC or Siemens Nixdorf.



SERVICE & SUPPORT

For each of its products ELSA provides extensive pre and post-sale services which are available free of charge to users, OEM partners, distributors and value added resellers. The services ELSA offers are an important competitive factor. Our services accompany the customer from product selection to purchase and thereafter throughout the entire life of the product. To ELSA, service means, above all, that products must be user-friendly. When a customer buys an ELSA solution, he not only receives the technology, but also a comprehensive package of services that ensures the reliability of the product. This package includes:

- up to 6 years' warranty
- immediate exchange of defective products within the first 100 days after purchase
- on-site service for the repair and exchange of color monitors

Our European call center, staffed with over 50 qualified engineers and technicians, provides fast and efficient support on all technical questions over our hotline. Our support specialists are available for immediate help on ten telephone hotlines, divided by product group. Customer feedback is recorded and analysed to help with the continuous further development and improvement of the quality of our products and services.

In addition to the conventional communication channels of telephone and fax, any interested person or user can utilize these electronic media 24 hours a day:

- Internet
- ELSA LocalWeb
- Service and Support faxline

ELSA intends to expand its services and enhance its support system. One of the steps will be the implementation of a knowledge database available via the Internet that should contribute to the further improvement of availability and response times.

MARKETING & SALES

Continuous marketing efforts and a user-specific approach in the high-end and consumer markets contribute to the company's long-term success. In 1997, ELSA presented itself to international market participants at the best-known computer trade shows in the world, for example Siggraph in Los Angeles and at the largest specialized trade fairs of the industry, CeBIT in Hannover and Comdex in Las Vegas.

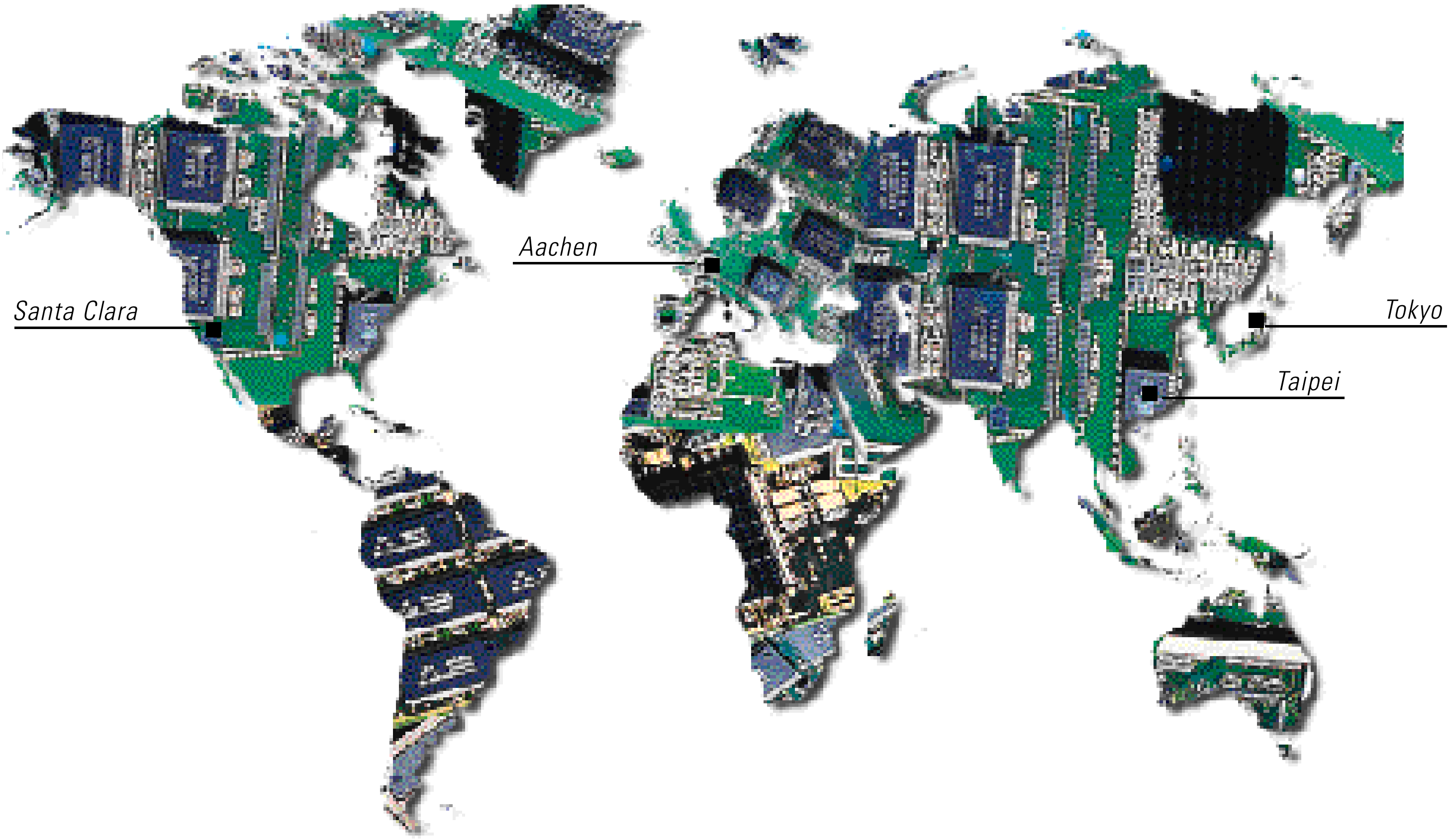
ELSA distributes its products exclusively through external distribution partners who are supported by our own international distribution organization. To ensure optimal coverage of different customer groups, ELSA utilizes a variety of distribution channels. By co-operating with all partners, ELSA achieves comprehensive market coverage which also ensures geographic proximity to the end user.

Europe, the Middle East and Africa are serviced from Aachen. Our U.S. subsidiary controls distribution activities in Canada, North America, Australia and New Zealand. Our Taiwan and Japan based subsidiaries, incorporated in 1997, are responsible for the Asian region. With its representation in the most important intercontinental markets, ELSA has laid the foundation for its global market presence.

ELSA, Inc., located in Santa Clara, California, was founded in 1993. Its location in Silicon Valley, the center of the world's computer industry, is next door to the major chip and software manufacturers. Our close co-operation with the chip industry ensures the global marketability and user acceptance of ELSA products already in the development phase. We are particularly pleased about our continuously increasing sales and marketing success in the U.S., which is still the most important PC market in the world. In 1997, our U.S. subsidiary achieved sales totalling US $ 23 million (compared to US $ 10 million in the previous year), and thus not only increased ELSA's export ratio but, for the first time, contributed significantly to the group's operating result.

ELSA Japan, Inc. was founded at the end of 1997. An experienced management team with the necessary contacts to the major national manufacturers and familiar with the market ensures our success in this strategically important region. With a population of 120 million and its high industrialization, the Japanese market is an attractive target. The Japanese industry's demand for highly professional CAD workstations is growing constantly.

Established in 1994 as a purchasing organization, ELSA Asia, Inc. in Taiwan significantly assisted ELSA's entry into the consumer market for computer graphics and data communications products. The central location in Asia secures access to one of the most important international procurement markets in the industry. Through intensive market analysis and cultivation of relationships with suppliers, ELSA Asia Inc. makes a significant contribution to market research and to the optimization of logistics and production processes. Since 1997, ELSA Asia, Inc. also conducts sales and marketing activities, with special emphasis on servicing our Asian OEM customers.

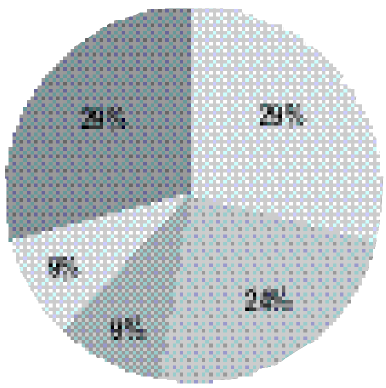


E L S A   I N T E R N A T I O N A L

Our increased international activity constitutes the foundation for global expansion and for the establishment of our brand. ELSA hopes to utilize the enormous potential of these markets to establish its position as a global player in the areas of computer graphics and data communications.

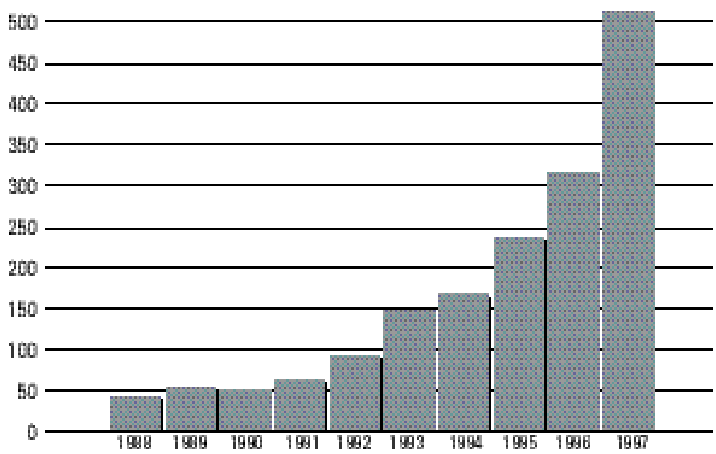
PERSONNEL DISTRIBUTION

■	*R & D*	*29%*
■	*Administration*	*9%*
■	*Subsidiaries*	*9%*
■	*Manufacturing*	*24%*
■	*Sales, Marketing, Service, Support*	*29%*



E L S A

PERSONNEL DEVELOPMENT



PERSONNEL

Knowledge and experience are the most important factors for transforming visions into successes. This applies to competitive industries in general, but holds particularly true for high-tech companies. Due to its proximity to the renowned Technical University of Aachen (RWTH), ELSA has immediate access to new generations of highly qualified engineers. With an average employee age of only 32 years, ELSA is a young company. Pioneering spirit, enthusiasm and creativity are the success factors which enable ELSA to stand its ground in a competitive and fast-paced market.

Despite its tremendous growth in the past years, ELSA has maintained its open and friendly atmosphere which is characterized by the unbureaucratic, friendly communication across all business divisions and levels of management.

In order to further improve its market position, ELSA created 133 new jobs last year at its Aachen location alone. Worldwide, 145 new employees joined. ELSA employed an average of 489 people worldwide in 1997.

ELSA is an attractive environment for its employees. Each individual's performance counts, and every employee is encouraged to make suggestions. The company values the skills of each individual, which in turn motivates creativity and promotes team-oriented problem-solving. The low staff turnover at ELSA is evidence of the high degree of employee satisfaction.

C O M M U N I C A T I O N S

INTRANET & INTERNET

As early as 1995, ELSA began to establish its presence on the World Wide Web. ELSA's web site, which can be reached at www.elsa.de and www.elsa.com, currently comprises almost 700 editorially managed pages and more than 4000 automatically generated pages. In March 1998, the ELSA server counted an average of 5,300 hits per day, which is more than double the number of visitors compared to the previous year. In order to meet the increasing demand and provide fast worldwide access with a high bandwidth, the server was connected directly to a high-bandwith line in the U.S.

ELSA's customer services and technical staff can be contacted directly through the WWW, so that questions and issues can be submitted instantly around the clock and then be processed efficiently.

In 1997, Computer Reseller News voted ELSA's web site the "Dealer-Friendliest Web Site" of all large modem and ISDN manufacturers.

ELSA is also relying on modern Internet technologies for internal communications. The in-house intranet provides all ELSA employees with convenient access to all relevant information.

THE ELSA WEB SITE OFFERS THE FOLLOWING INFORMATION:

- corporate profile and company information
- job offers
- investor relations
- latest news
- product information
- press reactions to ELSA products and press releases
- exclusive areas for dealers, distributors and journalists
- support information
- software and driver updates

TARGETS

We have set the following targets for 1998:

- further improvement of our time to market
- reduction of inventory by reducing turn-around time
- decentralization of production by qualification of new, globally operative production service companies
- increase of return

To achieve these goals we will focus on the following:

- expansion of our development capacities
- increase of our sales activities in Europe, the U.S. and Asia
- merging of the three German logistics locations into our new European logistics center
- implementation of the new version of our own PPS software
- staff training

Results for the first quarter of the current financial year have met our projections. This leads us to expect the measures we have taken to be successful and that we will achieve our targets. The company believes that the PC and our target markets in computer graphics and data communications continue to offer excellent opportunities for growth.

The market trends in the area of communications promise a 100-fold increase in bandwidth in the near future at prices affordable for the average consumer. This will create the technological basis for implementing completely new applications.

New products are currently in development and will be introduced to the market in 1998. New projects are being negotiated with our largest customers. Increased costs will be offset against growing economies of scale. A rise in unit turnover should result from our efforts toward increased expansion into new geographical markets. In furtherance of our goals, we will be recruiting new staff for our distribution units, especially in Europe, and for research and development.

Going public will provide the financial basis for ELSA's future growth. In addition, the listing of ELSA shares on the Neuer Markt of the Frankfurt Stock Exchange will facilitate future strategic acquisitions to increase the long-term value of the company as a whole.

GROUP APPENDIX & APPENDIX AS OF 12/31/1997

The Group management report prepared for the first time in 1997 and the management report of ELSA AG have been combined pursuant to § 315 (3) of the German Commercial Code (HGB). If not stated otherwise the statements apply both to the position of the Group and that of ELSA AG.

GROUP MANAGEMENT REPORT

Markets

The high demand for PC products continued in 1997. Demand was created by the continuation of investment activities on the part of industry and the steadily increasing importance of the computer in the consumer sector. The growing expansion of the Internet also contributed to maintaining the boom in the PC market.

ELSA

ELSA has emerged from the intense competition taking place in Germany over the last few years as the clear market leader. With its divisions of Computer Graphics and Data Communications ELSA now competes first and foremost with international suppliers, predominantly from the United States and Canada. In order to be successful in global competition ELSA is planning to go public. In preparation for this step the Company was converted to the legal form of a stock corporation (AG) in November 1997.

Products

The high product quality and the wide-spread popularity and utilization of the Windows NT operating systems have enabled ELSA to tap new sales markets for high-end 3D Computer Graphics products. Good growth rates in the Internet are an excellent prerequisite for the activities in the business segment of Data Communications.

Exports

The internationalization which has begun in 1996 was continued successfully in 1997. The Group export rate rose to 27 % in comparison with the AG export rate of 13 % in the prior year. This development was also supported by the American subsidiary for the first time. In order to further expand international business the establishment of branches in Japan and Taiwan has begun in 1997.

Development of sales

The net sales of the Group were increased by 26,8% to DM 287 million in 1997, for ELSA AG by 22% to DM 275 million (prior year DM 228 million). Both divisions contributed to this growth. In the division of Computer Graphics ELSA achieved the highest growth rates at 36%.

Result of operations

The result from ordinary activities calculated for the first time on a consolidated basis amounted to DM 13.9 million. The temporary weakness of the German consumer market had a negative effect on this result with the AG result of DM 12.1 million DM 2.0 million lower than the prior year. Development projects and expenses that cannot be 2.7 million capitalized in connection with the conversion into a stock corporation (AG) and the planned initial public offering also had a negative impact on the result. These negative influences were largely compensated by the positive result from ELSA Inc., so that 1997 also yielded a good result.

Employees

In 1997 ELSA increased the number of employees in the Group from 344 to 489. Consequently 133 new jobs were created at ELSA AG and 12 new jobs at the Group subsidiaries or at the sales outlets.

Research & development

In order to maintain the Company's leading market position product development is still of decisive importance. In the last fiscal year ELSA invested 28 % (DM 9.3 million) of direct expenses incurred in the Research and Development division. These expenses related to the development of new products and the maintenance and expansion of existing product lines. For 1998 an even greater increase in development activities is planned.

Further business prospects

In the first few months of 1998 sales and income increased again. The orders on hand, which remain high, and additional OEM orders are expected to lead to further increases in sales and income in 1998.

Aachen, March 1998

ELSA AG

The Management Board

Assets

		1997 DM
A.	**FIXED ASSETS**	
	I. Intangible assets	
	concessions, industrial and	
	simular rights and licenses	
	in such rights and assets	**521,039.34**
	II. Property, plant and equipment	
	1. Land and buildings including	
	buildings on third-party land	9,351,710.08
	2. Other equipment, operational and office equipment	4,759,648.35
	3. Advance payments and construction in progress	342,553.18
		14,453,911.61
	III. Financial assets	
	1. Shares in affiliated companies	1.00
	2. Other loans	525,853.87
	3. Advance payments on financial assets	744,342.43
		1,270,197.30
		16,245,148.25
B.	**CURRENT ASSETS**	
	I. Inventories	
	1. Raw materials and supplies	25,459,544.74
	2. Work-in-process	10,680,528.73
	3. Finished goods and merchandise	18,338,358.66
	4. Advance payments	8,118.37
		54,486,550.50
	II. Receivable and other assets	
	1. Trade receivables	21,723,680.03
	2. Other assets	3,532,403.26
		25,256,083.29
	III. Checks, cash-on-hand, postal giro balances,	
	balances at bank	**4,023,370.26**
		83,766,004.05
C.	**DEFERRED TAX ASSETS**	**513,624.60**
D.	**PREPAID EXPENSES**	**406,902.47**
		100,931,679.37

Liabilities and equity

		1997 DM
A.	**EQUITY**	
	I. Subscribed capital	5,800,000.00
	II. Capital surplus	1,500,000.00
	III. Earned surplus	
	Other earned surplus	735.11
	IV. Consolidated retained earnings	7,000,195.45
	V. Difference from capital consolidation	98,332.66
	VI. Currency translation adjustment	40,656.00
	VII. Minority interest	541,684.89
		14,981,604.11
B.	**CAPITAL OF DORMANT PARTNERS**	**11,500,000.00**
C.	**ACCRUALS**	
	1. Accruals for pensions and reserves for similar obligations	508,951.00
	2. Accrued taxes	2,793,730.83
	3. Other accruals	3,820,366.68
		7,123,048.51
D.	**LIABILITIES**	
	1. Liabilities due to banks	41,631,987.91
	2. Trade payables	22,580,291.23
	3. Other liabilities	3,114,747.61
	• *thereof for taxes: DM 1.418.454,11*	
	• *thereof for social security and similar obligations: DM 728.449,89*	
		67,327,026.75
		100,931,679.37

		1997
	DM	DM
1. Sales		286,565,103.07
2. Increase in finished goods inventories and work-in-process		5,026,124.51
3. Production for own plant and equipment capitalized		104,.884.97
4. Other operating income		4,377,250.35
5. Cost of materials		
a) Cost of raw materials, supplies and		
trading stock	211,143,525.77	
b) Cost of purchased services	1,796,292.00	
		212,939,817.77
6. Personnel expenses		
a) Wages and salaries	29,540,560.24	
b) Social security, pension and other		
benefit costs		
• thereof for pensions: DM 179.336,25	4,928,989.12	
		34,469,549.36
7. Depreciation on intangible assets		
and property, plant and equipment		3,298,008.52
8. Other operating expenses		29,515,621.63
9. Income from long-term loans		31,552.83
10. Other interest and similar income		15,416.48
11. Interest and similar expenses		2,044,137.83
12. Result from ordinary activities		13,853,197.10
13. Taxes on income		6,468,906.78
14. Other taxes		31,113.14
15. Profit share of dormant partners		805,381.95
16. **Consolidated net income for the year**		**6,547,795.23**
17. Profit carried forward from the prior year		452,400.22
18. **Consolidated retained earnings**		**7,000,195.45**

CONSOLIDATED INCOME STATEMENT
FOR THE YEAR ENDED DECEMBER 31, 1997

STATEMENT OF FIXED MOVEMENTS DURING THE YEAR 1997

ACQUISITION AND PRODUCTION COST

	Jan 1, 1997 DM	Currency diff. DM	Additions DM	Disposals DM	Transfer DM	Dec 31, 1997 DM
I. INTANGIBLE ASSETS						
Concessions, industrial and similar rights and assets and licenses in such rights and assets	617,390.81	0.00	512,208.08	0.00	0.00	1,129,598.89
II. PROPERTY, PLANT AND EQUIPMENT						
1. Land and buildings including buildings on third-party land	9,970,015.20	0.00	648,389.62	6,501.44	33,955.19	10,645,858.57
2. Other equipment, factory and office equipment	8,418,898.80	52,509.46	4,083,370.85	605,902.28	17,448.48	11,966,325.31
3. Advance payments and construction in progress	51,403.67	0.00	342,553.18	0.00	-51,403.67	342,553.18
	18,440,317.67	**52,509.46**	**5,074,313.65**	**612,403.72**	**0.00**	**22,954,737.06**
III. FINANCIAL ASSETS						
1. Shares in affiliated companies	252,115.44	0.00	0.00	0.00	0,00	252,115.44
2. Other loans	546,059.45	0.00	30,000.00	50,205.58	0.00	525,853.87
3. Advance payments	0.00	0.00	744,342.43	0.00	0.00	744,342.43
	798,174.89	**0.00**	**774,342.43**	**50,205.58**	**0.00**	**1,522,311.74**
	19,855,883.37	**52,509.46**	**6,360,864.16**	**662,609.30**	**0.00**	**25,606,647.69**

E L S A G R O U P , A A C H E N

ACCUMULATED DEPRECIATION					NET BOOK VALUES
Jan 1, 1997 DM	Currency diff. DM	Additions DM	Disposals DM	Dec 31, 1997 DM	Dec 31, 1997 DM
459,049.81	0.00	149,509.74	0.00	608,559.55	521,039.34
882,869.12	0.00	412,581.81	1,302.44	1,294,148.49	9,351,710.08
5,046,652.92	15,662.36	2,735,916.97	591,555.28	7,206,676.97	4,759,648.34
0.00	0.00	0.00	0.00	0.00	342,553.18
5,929,522.04	**15,662.36**	**3,148,498.78**	**592,857.72**	**8.500.825,46**	**14,453,911.60**
252,114.44	0.00	0.00	0.00	252,114.44	1.00
0.00	0.00	0.00	0.00	0.00	525,853.87
0.00	0.00	0.00	0.00	0.00	744,342.43
252,114.44	**0.00**	**0.00**	**0.00**	**252,114.44**	**1,270,197.30**
6,640,686.29	**15,662.36**	**3,298,008.52**	**592,857.72**	**9,361,499.45**	**16,245,148.24**

Assets

		1997 DM	1996 DM
A.	**FIXED ASSETS**		
	I. Intangible assets		
	Concessions, industrial and similar rights and licenses in such rights and assets	**487,229.00**	**158,341.00**
	II. Property, plant and equipment		
	1. Land, land rights and buildings including buildings on third-party land	9,351,710.08	9,087,146.08
	2. Other equipment, operational and office equipment	4,232,876.00	3,146,536.00
	3. Advance payments and construction in progress	342,553.18	51,403.67
		13,927,139.26	**12,285,085.75**
	III. Financial assets		
	1. Shares in affiliated companies	4,169,765.86	3,397,301.86
	2. Other loans	525,853.87	546,059.45
	3. Advance payments on financial assets	744,342.43	0.00
		5,439,962.16	**3,943,361.31**
		19,854,330.42	**16,386,788.06**
B.	**CURRENTS ASSETS**		
	I. Inventories		
	1. Raw materials and supplies	25,459,544.74	5,826,581.35
	2. Work-in-process	10,680,528.73	15,246,699.53
	3. Finished products and merchandise	14,772,328.94	8,186,046.65
	4. Advance payments	8,118.37	21,467.50
		50,920,520.78	**29,280,795.03**
	II. Receivable and other assets		
	1. Trade receivables	14,572,774.13	19,684,414.51
	2. Receivables from affiliated enterprises	6,153,999.86	3,692,541.82
	3. Other assets	3,453,489.06	223,158.26
		24,180,263.05	**23,600,114.59**
	III. Checks, cash-on-hand, postal giro balances, balances at banks	2,173,410.30	1,640,461.04
		77,274,194.13	**54,521,370.66**
C.	**PREPAID EXPENSES**	271,555.48	255,723.52
	• thereof for discount: DM 0,00 (prior year: DM 416,00)		
		97,400,080.03	**71,163,882.24**

Liabilities and equity

		1997 DM	1996 DM
A.	**EQUITY**		
	I. Subscribed capital	5,800,000.00	5.300.000.00
	II. Capital surplus	1,500,000.00	0.00
	III. Earned surplus		
	Other earned surplus	735.11	735.11
	IV. Retained earnings	6,977,860.19	7,312,377.22
		14,278,595.30	**12,613,112.33**
B.	**CAPITAL OF DORMANT PARTNERS**	**11,500,000.00**	**6,000,000.00**
C.	**ACCRUALS**		
	I. Accruals for pensions and reserves for similar obligations	508,951.00	424,207.00
	II. Accrued taxes	470,849.46	5,440,702.28
	III. Other accruals	3,586,177.38	3,681,032.75
		4,565,977.84	**9,545,942.03**
D.	**LIABILITIES**		
	I. Liabilities due to banks	41,631,987.91	18,597,986.55
	II. Trade payables	22,320,525.07	20,810,397.25
	III. Other liabilities	3,102,993.91	3,596,444.08
	• thereof for taxes: DM 1.406.700,41 (prior year: DM 2.139.601,28)		
	• thereof relating to social security and similar obligations: DM 728.449,89 (prior year: DM 551.994,30)		
		67,055,506.89	**43,004,827.88**
		97,400,080.03	**71,163,882.24**

		1997	1996
	DM	DM	DM
1. Sales		275,279,848.41	226,163,578.99
2. Increase in finished goods and work-in-process		2,231,638.48	13,435,604.01
3. Production for own plant and equipment capitalized		104,884.97	95,196.80
4. Other operating income		3,715,319.44	1,529,752.86
5. Cost of materials			
a) Cost of raw materials, supplies and trading stock	210,915,533.19		181,661,536.54
b) Cost of purchased services	1,796,292.00		975,085.89
		212,711,825.19	182,636,622.43
6. Personnel expenses			
a) Wages and salaries	26,760,411.92		18,920,547.53
b) Social security, pension and other benefit costs, • thereof for pensions: DM 179.336,25 (prior year: DM 510.170,25)	4,928,989.12		3,745,828.57
		31,689,401.04	22,666,376.10
7. Depreciation on intangible assets and property, plant and equipment		3,189,708.67	2,454,763.42
8. Other operating expenses		23,864,671.34	18,174,360.57
9. Income from investments • thereof from affiliated enterprises: DM 4.276.005,55 (prior year: DM 0,00)		4,276,005.55	0.00
10. Income from long-term loans		31,552.83	32,219.22
11. Other interest and similar income • thereof from affiliated enterprises: DM 38.351,17 (prior year: DM 0,00)		52,098.52	20,171.24
11. Interest and similar expenses • thereof to affiliated enterprises: DM 77.264,93 (prior year: DM 0,00)		2,113,699.38	1,223,205.83
13. **Result from ordinary activities**		**12,122,042.58**	**14,121,194.77**
14. Taxes on income		4,320,064.52	6,089,738.44
15. Other taxes		31,113.14	78,205.02
16. Profit share of dormant partners		805,381.95	641,666.97
17. **Net income for the year**		**6,965,482.97**	**7,311,584.34**
18. Profit carried forward from the prior year		12,377.22	792.88
19. **Retained earnings**		**6,977,860.19**	**7,312,377.22**

AG-INCOME STATEMENT FOR THE FISCAL YEAR 1997

Development of fixed assets in 1997

	ACQUISITION ANDPRODUCTION COST				
	Jan 1, 1997 DM	Additions DM	Disposals DM	Transfer DM	Dec 31, 1997 DM
I. INTANGIBLE ASSETS					
Concessions, industrial and similar rights and licenses in such rights and assets	617,390.81	470,472.88	0.00	0.00	1,087,863.69
II. PROPERTY, PLANT ANDEQUIPMENT					
1. Land and buildings including buildings on third-party land	9,970,015.20	648,389.62	6,501.44	33,955.19	10,645,858.57
2. Other equipment, factory and office equipment	8,088,808.97	3,718,780.50	605,902.28	17,448.48	11,219,135.67
3. Advance payments and construction in progress	51,403.67	342,553.18	0.00	-51,403.67	342,553.187
	18,110,227.84	**4,709,723.30**	**612,403.72**	**0.00**	**22,207,547.42**
III. FINANCIAL ASSETS					
1. Shares in affiliated companies	3,649,416.30	772,464.00	0.00	0.00	4,421,880.30
2. Other loans	546,059.45	30,000.00	50,205.58	0.00	525,853.87
3. Advance payments	0.00	744,342.43	0.00	0.00	744,342.43
	4,195,475.75	**1,546,806.43**	**50,205.58**	**0.00**	**5,692,076.60**
	22,923,094.40	**6,727,002.61**	**662,609.30**	**0.00**	**28,987,487.71**

ELSA AG, parent company

ACCUMULATED DEPRECIATION				NETBOOK VALUES	
Jan 1, 1997 DM	Additions DM	Disposals DM	Dec 31, 1997 DM	Dec 31, 1997 DM	Dec 31, 1996 DM
459,049.81	141,584.88	0.00	600,634.69	487,229.00	158,341.00
882,869.12	412,581.81	1,302.44	1,294,148.49	9,351,710.08	9,087,146.08
4,942,272.97	2,635,541.98	591,555.28	6,986,259.67	4,232,876.00	3,146,536.00
0.00	0.00	0.00	0.00	342,553.18	51,403.67
5,825,142.09	**3,048,123.79**	**592,857.72**	**8,280,408.16**	**13,927,139.26**	**12,285,085.75**
252,114.44	0.00	0.00	252,114.44	4,169,765.86	3,397,301.86
0.00	0.00	0.00	0.00	525,853.87	546,059.45
0.00	0.00	0.00	0.00	744,342.43	0.00
252,114.44	**0.00**	**0.00**	**252,114.44**	**5,439,962.16**	**3,943,361.31**
6,536,306.34	**3,189,708.67**	**592,857.72**	**9,133,157.29**	**19,854,330.42**	**16,386,788.06**

A Introductory remarks

The consolidated financial statements and the financial statements of ELSA AG shall be explained together as stated below; if not otherwise specified the statements made refer to both financial statements.

ELSA AG is a large corporation within the meaning of § 267 of the German Commercial Code (HGB).

The balance sheet and the income statement have been prepared in accordance with the format of §§ 266, 275 HGB and § 158 (1) of the Corporation Law (AktG); for the income statement the cost summary method has been used as in prior years.

B Companies included in consolidation

All companies in Germany and abroad for which ELSA AG is directly or indirectly entitled to the majority of the voting rights of the shareholders are included in consolidation. An exception applies for ELSA America, Inc., Santa Clara, which has not been consolidated pursuant to § 296 (2) HGB.

The following companies are included in consolidation:

Name, Headquarter	Share	Subscribed capital Dec 31, 1997 DM	Shareholders equity Dec 31, 1997 DM	Result 1997 DM	Date of initial consolidation
ELSA AG, Aachen	100%	5,800,000.00	14,278,595.30	6,965,482.97 2)	Jan 1st, 1997
ELSA, Inc., San Jose, California, USA	100%	77,740.00	7,331,616.07 1)	3,835,982.55	Jan 1st, 1997
ELSA Japan, Inc., Tokyo, Japan	95%	813,120.00	813,120.00 1)	0.00	Dec 15, 1997

1) Excluding item for currency translation adjustment amounting to a total of KDM 542.

2) The result of ELSA AG includes the simultaneous collection of the result of ELSA, Inc.

C Principles of consolidation

Capital consolidation is performed according to the book value method according to § 301 (1) sentence 2 no. 1 HGB. In this context the book values of the participations are compared to the prorated capital that must be consolidated at the time of the initial consolidation. Differences arising in this connection, if they relate to hidden reserves, are allocated to the appropriate assets. Any remaining differences are shown as differences from capital consolidation.

Intercompany results, sales, expenses and income as well as receivables and liabilities between the companies included in full consolidation are eliminated.

For the translation of shareholders' equity the historical average rate of exchange, for asset and liability items the exchange rate on the balance sheet date and for items of the income statement the annual average rate of exchange are used.

D Accounting and valuation principles

The assets and liabilities included in the consolidated financial statements are stated and valued uniformly on the basis of the accounting and valuation principles which are applicable and applied for the financial statements of ELSA AG. Valuation options pursuant to the German Commercial Code are used uniformly and the values stated in the individual financial statements of the Group companies adjusted in this respect.

The accounting and valuation principles applied to date have been retained with the exception of the valuation of inventories. In detail, the procedure was as follows:

■ *Intangible fixed assets*

Intangible fixed assets are valued at acquisition cost less depreciation. Depreciation is calculated according to the expected useful life of the assets, applying the straight-line method in accordance with tax regulations.

■ *Property, plant and equipment*

Property, plant and equipment is valued at acquisition or production cost and—if depreciable—less accumulated depreciation. Depreciation is based on the expected useful life of the assets; the straight-line or declining balance method is used in accordance with the tax regulations. In the case of the declining balance method, the transition to straight-line depreciation takes place as soon as the latter leads to higher depreciation. The simplification rule of R 44 (2) sentence 3 of the Income Tax Directive (EStR) for the calculation of the depreciation of movable assets acquired during a fiscal year is applied. Low-value assets are fully depreciated in the year of acquisition. For these fully depreciated low-value assets a disposal of the same amount is shown in the fixed assets movement schedule in addition to the depreciation.

■ *Financial assets*

Shares in affiliated companies are shown at acquisition cost or at the lower value attributable on the balance sheet date.

Other loans include loans to employees, which are stated at nominal value.
The item prepayments for financial assets contains the future share in the capital stock of ELSA Asia, Inc. in Taiwan. It has been valued at acquisition cost.

■ *Inventories*

Raw materials and supplies are valued according to the FIFO method, goods at the average acquisition cost or, if lower actual values were to be taken according to the lower of cost or market principle, at these values. Products and services are valued at production cost or at the lower actual value. The production costs of finished goods and services and work-in-process contain necessary overhead costs in addition to the directly allocable costs.

Cost components that do not have to be capitalized pursuant to tax regulations are not included in the production cost.

■ *Receivables and other assets*

Receivables and other assets are stated at nominal value. Sufficient individual bad debt allowances are set up for doubtful accounts. In addition trade receivables are reduced by an appropriate lump-sum reserve to cover the general collectibility risk.

■ *Cash on hand, balances at banks, prepaid expenses*

Cash, cash equivalents and prepaid expenses are stated at nominal value.

■ *Accruals*

Pension reserves are calculated actuarially on the basis of an interest rate of 6 % and valued according to the "Teilwertmethode" (a method similar to the "entry age method") according to § 6 a of the Income Tax Law (EstG).

The accrued taxes relate to the taxes not yet assessed for the fiscal year and the prior year.

The other accruals are set up for all other uncertain liabilities and potential losses. The accruals are set up in the amount necessary under prudent business judgment; they correspond to the expected expenditure and potential losses. All recognizable risks are accounted for.

■ *Liabilities*

Liabilities are stated at their repayment amount.

■ *Currency translation*

Receivables and liabilities in foreign currency are translated at the exchange rate at the time of occurrence; if the exchange rate as of the balance sheet date is lower for receivables or higher for liabilities, valuation is based on the exchange rate of the balance sheet date.

E Explanations to the balance sheet and the consolidated balance sheet

I Fixed assets

The development of fixed assets in the individual financial statements and in the consolidated financial statements can be seen in the following fixed assets movement schedule:

Shares in affiliated companies

As of December 31, 1997 ELSA AG has at least a 20% share in the following companies:

	Book values as of 31.12.1997 DM
ELSA, Inc., *San Jose, California, U.S.A.*	3,397,300.86
ELSA Japan, Inc., *Tokyo, Japan*	772,464.00
ELSA America, Inc., *Santa Clara, California, U.S.A.*	1.00
	4,169,765.86

ELSA, Inc. has prepared its financial statements as of December 31, 1997. The shareholders' equity stated therein amounts to US $ 2,248,285 excluding the net income for the year 1997. The net income for fiscal year 1997 amounts to US $ 2,145,284.

ELSA Japan, Inc. did not start operations in 1997. Its shareholders' equity amounts to Yen 60,000,000.00.

The financial statements of **ELSA America, Inc.** as of September 30, 1997 show a negative shareholders' equity of US $ 36,030.80. The net income for the year shown for fiscal year 96/97 amounts to US $ 191,760.20.

For the sake of correct presentation the item "Prepayments for financial assets" has been included in the balance sheet, showing the future share in the capital stock of **ELSA Asia, Inc.** in Taiwan.

Moreover we refer to our information given on the companies included in consolidation.

III *Inventories*

Raw materials and supplies have been valued in the fiscal year according to the FIFO order of consumption method (prior year: weighted average price). The change in the valuation method leads to a reduction in result of approx. *KDM 651*.

IV *Receivables and other assets*

There are no receivables and other assets with a residual term of more than one year at ELSA AG or the ELSA Group.

V *Receivables from affiliated enterprises*

As in the prior year, there are no receivables with a residual term of more than one year at ELSA AG or the ELSA Group.

VI *Deferred taxes*

KDM 234 of the deferred tax assets of the ELSA Group amounting to approx. *KDM 514* result from the individual financial statements of the companies included in consolidation. Deferred tax assets of approx. *KDM 278* contrast with deferred taxes on the liability side of *KDM 44*. Moreover deferred tax assets of approx. *KDM 280* were shown in the balance sheet due to consolidation measures with effect on result pursuant to § *306 HGB*.

VII *Subscribed capital*

The subscribed capital was increased by KDM 500 by a capital contribution by the shareholders' resolution of August 20, 1997.
In the context of the conversion of August 25, 1997 the Company issued 1,160,000 fully paid-in bearer shares with a nominal value of DM 5.00 each.

VIII Capital reserve

The capital reserve of *KDM 1,500* results from the premium paid in the context of the capital increase.

IX Difference from capital consolidation

The credit difference from capital consolidation amounting to KDM 98 results from exchange rate fluctuations between the time of the acquisition of the participation and the initial consolidation.

X Other accruals

Other accruals split up as follows:

ELSA Group		ELSA AG	
	12/31/1997 DM		**12/31/1997 DM**
Warranties	1,355,000.00	*Warranties*	1,355,000.00
Vacation claims	640,237.63	*Vacation claims*	563,371.00
Outstanding invoices	548,750.11	*Outstanding invoices*	526,540.12
Reimbursement of storage costs	480,000.00	*Reimbursement of storage costs*	480,000.00
Costs for advertising expenses	163,752.20	*Costs for advertising expenses*	163,752.20
Costs of financial statements	156,000.00	*Costs of financial statements*	156,000.00
Employer's liability insurance	150,000.00	*Employer's liability insurance*	150,000.00
Other	326,626.74	*Other*	191,514.06
	3,820,366.68		**3,586,177.38**

XI Liabilities

Liabilities of the **ELSA Group** as of December 31, 1997:

	Residual term				
	Less than 1 year DM	**2-5 years DM**	**More than 5 years DM**	**Total DM**	**Secured by land charges DM**
Liabilities due to banks	33,846,485.39	1,385,942.00	6,399,560.52	41,631,987.91	8,291,569.52
Trade payables	22,580,291.23	0.00	0.00	22,580,291.23	0.00
Other liabilities	3,114,747.61	0.00	0.00	3,114,747.61	0.00
Total liabilities	**59,541,524.23**	**1,385,942.00**	**6,399,560.52**	**67,327,026.75**	**8,291,569.52**

Liabilities of **ELSA AG** as of December 31,1997:

	Residual term				
	Less than 1 year DM	**2-5 years DM**	**More than 5 years DM**	**Total DM**	**Secured by land charges DM**
Liabilities due to banks	33,846,485.39	1,385,942.00	6,399,560.52	41,631,987.91	8,291,569.52
Trade payables	22,320,525.07	0.00	0.00	22,320,525.07	0.00
Other liabilities	3,102,993.91	0.00	0.00	3,102,993.91	0.00
Total liabilities	**59,270,004.37**	**1,385,942.00**	**6,399,560.52**	**67,055,506.89**	**8,291,569.52**

The usual retention of ownership for the delivery of raw materials, consumables and supplies and goods applies for the trade receivables.

F Explanation to the income statement and the consolidated income statement

I *Sales*

The sales of the fiscal year split up as follows:

ELSA Group

	1997 KDM
a)	
According to business divisions:	
• *Computer Graphics*	196,692
• *Data Communications*	89,873
	286,565

	1997 KDM
b)	
According to geographical markets:	
• *Germany*	209,038
• *EU and bordering countries*	34,676
• *North America*	40,539
• *Asia*	2,202
• *Others*	110
	286,565

ELSA AG

	1997 KDM
a)	
According to business divisions:	
• *Computer Graphics*	188,966
• *Data Communications*	86,314
	275,280

	1997 KDM
b)	
According to geographical markets:	
• *Germany*	209,038
• *EU and bordering countries*	34,676
• *North America*	29,254
• *Asia*	2,202
• *Others*	110
	275,280

II Expenses or income not relating to the period

There were no significant expenses or income not relating to the period in the fiscal year.

III Income from long-term loans

For the sake of correct presentation the item "Income from long-term loans" has been included in the income statement. In this case the prior year figures have been adjusted to the figures stated in 1997.

IV Extraordinary expenses and income

The net result for the year results exclusively from the result of ordinary activities. Therefore it is not necessary to divide up the tax expense amongst the partial results of ordinary and extraordinary activities.

G Other disclosures

I Contingent liabilities and other financial obligations

Other than the liabilities and accruals listed in the balance sheet there are no other significant contingent liabilities.

The other financial obligations of **ELSA AG** amount to KDM 2,.405 and mainly relate to the purchase agreement for the land and buildings of the Fuehren fabric factory.

Moreover, at the foreign Group companies the following obligations from rent, leasing and similar continuous obligations exist:

ELSA Group			
1998 TDM	1999 TDM	2000 and later TDM	Total TDM
479	366	13	858

Therefore the **ELSA Group** has other financial obligations amounting to approx. *KDM 3,263*.

II Number of employees

The number of employees developed as follows during fiscal year 1997:

ELSA Group

	03/31/97	06/30/97	09/30/97	12/31/97	ø1997
White-collar workers	307	339	347	365	340
Blue-collar workers	62	60	66	72	65
Temporary workers and students	103	87	73	74	84
	472	486	486	511	489

ELSA AG

	03/31/97	06/30/97	09/30/97	12/31/97	ø1997	ø1996
White-collar workers	290	315	319	337	315	204
Blue-collar workers	62	60	66	72	65	51
Temporary workers and students	103	87	73	74	84	76
	455	462	458	483	464	331

III Appropriation of profit

The Management Board suggests that the retained earnings are to be reinvested in full and transferred to the revenue reserve for the purpose of an increase in capital.

IV *Bodies*

a) **Management Board/Management**

Until the conversion of ELSA GmbH into a stock corporation Mr. Theo Beisch, Aachen, was the sole general manager of the Company.

On August 25, 1997 the Supervisory Board appointed the following Management Board :

Chairman:	Deputies:
Theo Beisch, Aachen	*Peter Gueldenberg, Eschweiler*
	Josef Beisch, Aachen

In 1997 the entire total remuneration of the management/Management Board amounted to *KDM 1,700*

b) **Supervisory Board**

The Supervisory Board of ELSA AG has the following members:

Chairman:

Max Beisch, Melsbach (until December 18,1997)

Dipl.-Ing. Wolfgang Dondorf, Marienheide (from December 18, 1997 on)

Deputies:

Friedhelm Hammer, attourney, Aachen (until December 18,1997)

Theodor Ludger Lieven, Thinnister-Clermont, Belgium (from December 18, 1997)

Dipl.-Kfm. Dr. Hanno Schmitz-Hüser, Certified Public Accountant/Tax Advisor, Stolberg

The total remuneration of the Supervisory Board amounts to *DM 17,000.00* in 1997.

Aachen, March 12, 1998

Theo Beisch	Peter Gueldenberg	Josef Beisch

Auditor's opinion

Based upon our audit, we herewith render the following unqualified opinion on the financial statements and the consolidated financial statements of ELSA Aktiengesellschaft, Aachen, as of December 31, 1997 and on the combined management report and Group management report for fiscal year 1997:

> *"The accounting, the financial statements and consolidated financial statements, which we have audited in accordance with professional standards, comply with the German legal provisions. The financial statements and the consolidated financial statements present, in compliance with generally accepted accounting principles, a true and fair view of the net worth, financial position and results of* ***ELSA*** *Aktiengesellschaft and of the Group. The combined management report and Group management report is in agreement with the financial statements and with the consolidated financial statements."*

Hamburg, March 13, 1998

ARTHUR ANDERSEN

Wirtschaftsprüfungsgesellschaft
Steuerberatungsgesellschaft mbH

Jäckel
Wirtschaftsprüfer

Ludwig
Wirtschaftsprüfer

	1997 DM
ASSETS	
CURRENT ASSETS	
Cash and cash equivalents	4,023,370.26
Accounts receivable trade	21,780,238.73
Other receivables	3,241,092.91
Inventories	54,779,017.66
Prepaid expenses	1,501,916.45
Other current assets	291,310.35
	85,616,946.36
PROPERTY, PLANT AND EQUIPMENT	
Land, land improvements and buildings	9,693,398.08
Machinery and equipment	6,101,829.35
	15,795,227.43
LONG TERM INVESTMENTS	**525,854.87**
INTANGIBLE ASSETS	
Licenses and similar rights	521,039.34
Software costs	2,839,992.86
	3,361,032.20
TOTAL ASSETS	**105,299,060.86**

The accompanying Notes are an integral part of these Consolidated Financial Statements.

	1997 DM
LIABILITIES AND SHAREHOLDERS' EQUITY	
CURRENT LIABILITIES	
Short-term borrowings incl. current portion of long-term debt	33,846,485.39
Accounts payable trade	22,580,291.23
Accounts payable other	3,114,747.61
Accrued liabilities	6,614,097.51
	66,155,621.74
NON-CURRENT LIABILITIES	
Long-term debt	7,785,502.52
Provision for pensions	478,647.00
Deferred tax liability	2,227,972.38
	10,492,121.90
	76,647,743.64
DORMANT PARTNER	**11,500,000.00**
MINORITY INTERESTS	**40,656.00**
SHAREHOLDERS' EQUITY	
Capital stock	5,800,000.00
Capital reserve	1,500,000.00
Retained earnings	9,066,681.92
Cumulative translation adjustment	743,979.30
	17,110,661.22
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	**105,299,060.86**

3D engineering workstation	Construction design workstation with CAD environment
ATM	Asynchronous Transfer Mode High-speed data transfer between computer networks.
Bandwith	The bandwidth determines the data transfer capacity of a data line. The corresponding measurement unit is "bits per second", abbreviated as bps. ISDN systems can reach a transfer capacity of 128 kbps, exceeding the bandwidth of conventional copper lines used in the telephone system.
Cable Modem	Special modem technology for transferring data on the TV cable network.
CAD	Computer Aided Design Modern workstations in all areas of the construction business employ computers as time and cost-saving construction tools. CAD workstations require particularly powerful computer systems, demanding both pro cessor performance and a fast graphics system. High demands are made of the graphics system, particularly in the area of three-dimensional visualisation.
Digital Video	Just as for sound recording – where digital technology has superseded analogue technology – digital recordings are revolutionising the way moving pictures are recorded. Digital video will gain popularity with DVD technology and the further spread of these drives, and the computer is an ideal tool for post-processing digital videos.
Graphics Board	Plug-in expansion board for the PC which prepares, processes and transfers graphics data (images) onto a graphics output unit (e.g. a monitor or projector). One or more special processors on the graphics board perform the intensive computational work required to display moving images on the computer monitor.
Grahics Card/Graphics Controller	Alternative terms for a graphics board.
Graphic System	A graphics system is a combination of a graphics board and a monitor.
IEEE1394	New standard for higher data transfer rates at the serial port of a computer.
Intranet	Internal company network based on the same protocols and graphical user interfaces as the Internet. Used for distributing information within a company.
ISDN	Integrated Services Digital Network Europe-wide standardised digital network for the use of voice and data services. Apart from its many convenience features, ISDN enables high-speed and secure data transfers.
ISDN Adapter	An external device or plug-in board for connecting a PC to the ISDN network. Thus the ISDN network can be used for transferring data to and from remote computers.
ISDN Router	A device that connects networks, in order to exchange data via the ISDN network. ISDN routers are mainly used for accessing remote systems and networks, such as the Internet.
LCD	Liquid Crystal Display Flat monitors using technology based on the physical behaviour of liquid crystals under the influence of variable currents and polarised light. LCDs offer the advantages of low space and energy requirements in comparison to conventional monitors.

Multi-screen Technology	Graphics information from one computer are displayed on multiple monitors. Multi-screen technology is applied, for example, at stock exchanges where different international stock exchanges can be monitored simultaneously at a multi-screen workstation.
Modem	Device for exchanging data between computers over analogue telephone lines.
OEM	Original Equipment Manufacturer Licensees of OEM products incorporate products from OEM licensors into their own range under their own brand name or use it as a component of an overall solution developed by them.
Operating System	The operating system can be viewed as the computer working environment and as the command interface between the user and the computer itself. Examples of operating systems are Windows and Unix.
Online Service	Service providers, such as CompuServe and AOL, furnish their members with access to online information sources and also to theInternet.
PC Cards	Credit-card sized cards for insertion into Laptops or Notebooks. PC cards enable the easy and flexible expansion of a computer's functionality. This means that, for example, a modem PC card can be used to connect a notebook to telephone networks for data exchange.
Remote Access	Access to the hardware and software of a remote system via a network connection. Unlike remote maintenance (remote control), the remote computer cannot be controlled, but its resources are made available. Typical remote access tasks are Internet access or the connection of staff in the field to the computer at their base.
Remote Control	Control of a remote computer from another PC via a network connection, for example, via telephone, ISDN, or a LAN (Local Area Network). Typical applications are performing maintenance and diagnostic activities on the remote system.
SOHO	Small Office/Home Office Describes the target market of small to medium-sized office environments and home workers.
Terminal Adapter	External ISDN desktop device for connecting a computer to the ISDN network (also ISDN adapter).
UNIX	An operating system that has been highly regarded among the various operating systems for about the last 30 years.
Video Input and Output Ports	Interface to graphics boards for processing analogue video signals and outputting digital images from computers in video signal format.
Videoconferencing System	Enables visual communication over large distances by transferring images, speech and data.
Virtual Reality	Representation of environments through three-dimensional computer modelling. In a near-perfect animated 3D surrounding, an observer can move freely in virtual space and experience views and perspectives in 3D.
xDSL	Digital Subscriber Line New, high-speed method of transferring data via the existing copper cabling of the analogue telephone network. xDSL includes four different protocols: ADSL, SDSL, HDSL and VDSL. The protocols differ primarily in terms of the transfer rates available for transmission and reception, and their maximum possible cable lengths.

1998

IPO – Neuer Markt in Frankfurt, Germany
Global expansion of manufacturing

1997

ELSA Japan, Inc., Tokyo, incorporated
ELSA Asia, Inc., Taipei, incorporated as sales and marketing organisation
ELSA converted from GmbH to ELSA AG, a stock corporation

1996

First international **OEM customer: Compaq**

1995

DIN EN ISO 9001 certification

1993

Strengthened U.S. entry: **ELSA, Inc.**, Santa Clara

1991

ELSA Asia, Inc. established as procurement office

1989

First overseas subsidiary: **ELSA America, Inc.**

1986

Computer Graphics at **ELSA**

1980

ELSA incorporated: first activity in industrial electronics

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52070 Aachen
Germany
Internet www.elsa.de

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2231 Calle De Luna
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USA
Internet www.elsa.com

ELSA Asia, Inc.
7F-11, No.188, Sec. 5
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Taipei 105
Taiwan, R.O.C.
Internet www.elsa.com

ELSA Japan, Inc.
Mita Suzuki Building 3F
5-20-14 Shiba, Minato-ku
Tokyo 108-0014
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Internet www.elsa.com