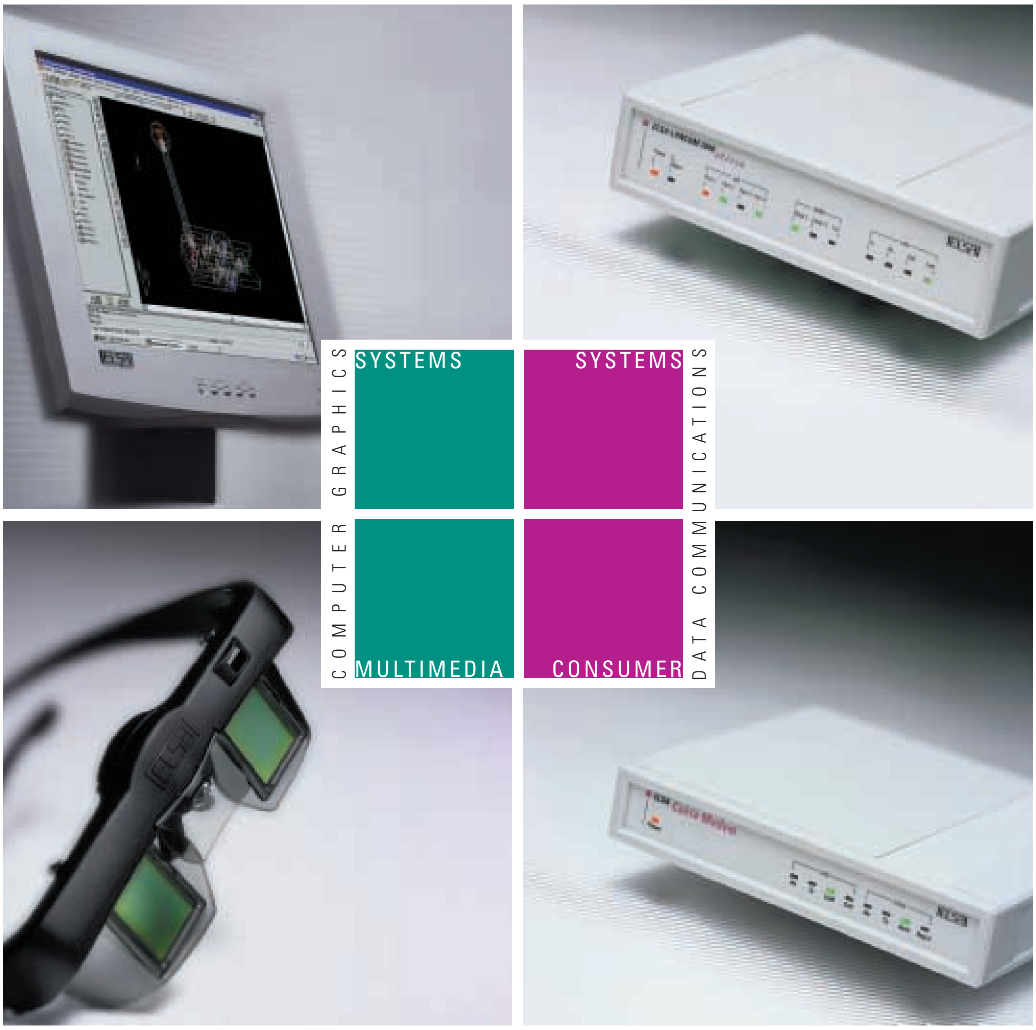
1998

ANNUAL REPORT 1998

ELSA

	1995 in KDM	1996 in KDM	1997 in KDM	1998 in KDM	Changes 97-98
SALES	118,891	226,163	286,565	299,511	4.5%
COMPUTER GRAPHICS	80,049	144,727	196,692	213,500	8.5%
DATA COMMUNICATIONS	38,842	81,436	89,873	86,011	-4.3%
EXPORT RATE	12.6%	12.8%	27.1%	24.0%	–
EBDIT	7,285	17,747	19,148	-11,319	–
RESULT FROM ORDINARY ACTIVITIES	4,602	14,121	13,853	-17,107	–
NET INCOME FOR THE YEAR	2,193	7,312	6,548	-17,514	–
RESULT ACCORDING TO DVFA/SG	2,638	6,143	6,965	-10,639	–
CASH FLOW ACCORDING DVFA/SG	4,186	9,022	10,348	-6,403	–
INVESTMENTS	2,116	7,618	5,586	12,558	124.8%
EQUITY/TOTAL ASSETS AS OF DEC. 31	18.7%	17.7%	14.8%	64.0%	–
RETURN ON EQUITY	28.6%	58.0%	43.7%	-20.9%	–
RETURN ON SALES	3.8%	5.9%	4.5%	-5.9%	–
STAFF AS OF DEC. 31	238	413	511	566	–

1995 and 1996 company result ELSA GmbH,
since 1997 group result ELSA AG


COMPUTER GRAPHICS
SYSTEMS
MULTIMEDIA
DATA COMMUNICATIONS
SYSTEMS
CONSUMER

Letter from the Management Board

TO OUR VALUED SHAREHOLDERS AND FRIENDS,

We are delighted to present you with our first annual report since our public offering. We are continuing to pursue a policy of regular, transparent communication in order to provide you with comprehensive and up-to-date information regarding our activities.

The past fiscal year was predominantly characterized by growth in terms of the number of units sold. Sales growth was impacted by a market price collapse and the Asian economic crisis. Consolidation processes, particularly on the supplier side, increased predatory competition, as well as inventory reduction measures by the leading PC manufacturers and continued price pressure impacted mainly the Computer Graphics division. The Data Communications division was heavily influenced by the debate on new data transfer standards in the first half of 1998. Despite difficult overall business conditions, ELSA AG was able to maintain its leading position, especially in the domestic market. Based on recent successes in the course of the establishment of our European distribution network, a series of promising alliances, imminent acquisition opportunities and, last but not least, attractive new products, we anticipate favorable results for the current fiscal year.

INITIAL PUBLIC OFFERING

Since June 15, 1998, ELSA's shares are traded on the Neuer Markt of the Frankfurt Stock Exchange. The initial public offering was extremely successful. The additional capital amounting to DM 80 million can now be used to rapidly expand our international activities and to strengthen our R&D team in specific areas. As a listed company, we are more in the public eye than before, both at home and abroad. Our increased visibility and positive image have enabled us not only to significantly improve our position in our sales and purchasing markets, but also to become increasingly attractive as a partner to OEM manufacturers. For example, we were able to gain NEC Japan as a new partner during the last fiscal year.

SALES AND EARNINGS

Despite the difficult market situation, ELSA was able to record a 4.5% increase in sales compared to the previous year. Total sales thus rose by DM 12.9 million to DM 299.5 million. The net loss for the year according to US GAAP amounted to DM 5.9 million. We were able to expand our leadership position in Germany in a market generally characterized by strong predatory competition; the share of domestic sales rose from 73% to 76% of total sales.

Theo Beisch

PRODUCTS

The launch of numerous new products in 1998 enabled us to underscore our position as innovation leader once again. ELSA AG ranked first in numerous tests and reader polls conducted by industry publications, confirming the market readiness and high performance levels of our products. The introduction of the first European cable modem met with an extremely positive response. Substantial investments in research and development in 1998 set the course for numerous product innovations in the current year.

CUSTOMERS

We would like to thank our customers and sales partners for their cooperation. We are confident that the steps we have taken to strengthen our sales and marketing activities will create the conditions necessary for the rapid, joint expansion of our market position.

EMPLOYEES

ELSA created 55 new jobs in the past fiscal year; ten of these were outside Europe. On December 31, 1998, ELSA employed 566 people worldwide.

We would also like to thank all of our employees, who worked above and beyond the call of duty for ELSA and its customers.

OUTLOOK FOR 1999

We have set ambitious goals for the current fiscal year – to increase sales through international expansion, and to significantly reduce costs. Our overall goal is to record a distinctly positive result in 1999.

In 1999, we are aiming to achieve a seamless presence across Europe in the data communications segment. A high-powered, experienced team of marketing and sales specialists has been engaged as partners in the sales agencies established in February for the growth markets France, Italy and the United Kingdom. The establishment of additional agencies is in preparation. In the current fiscal year, the identification of suitable acquisition targets will constitute another important focus of investment, with the aim of reinforcing our market position and considerably improving profitability.

Close cooperation with renowned partners in development and sales will also be of strategic importance in 1999. The professional combination of expertise and marketing activities will serve to increase the visibility of the ELSA brand, anchoring it in customers' minds as a synonym for quality, high performance and reliability.

Fiscal year 1998 was marked by a changed and unexpectedly difficult market environment for ELSA. Our management and employees would particularly like to extend thanks to those who, convinced of the Company's future success, maintained their support for ELSA. We are confident that we will be able to repeat the strong performance of previous years in this fiscal year, and we are devoting all of our efforts to reaching this goal.

For the Management Board,

Theo Beisch, Chairman of the Management Board

Corporate Strategy: Focus on the PC

PC-based solutions have become an integral part of both business and private life. In particular, the range of applications for personal computers has significantly increased since the launch of Windows NT. The use of PCs in corporate networks and the rapidly growing field of data communications via public networks (the Internet) place constantly increasing demands on the transmission speeds and graphical display capabilities (video, 3D) of equipment.

ELSA recognized this fundamental trend at an early stage and specialized in powerful PC components for computer graphics and data communications during the start-up phase of the PC market. Today, its range of award-winning products makes ELSA one of the leading suppliers in these future growth markets.

As one of the few suppliers with many years of experience in both the high-end and low-end solutions segments, ELSA is well-prepared for the high-growth SOHO (Small Office/Home Office) market.

ELSA has grouped its business activities into four key business units in order to best meet the requirements of the various markets and target groups:

- Graphics Systems
- Multimedia
- Communications Systems
- Consumer Communications

Each of these four business units focuses its efforts on and specializes in a clearly defined product segment, either in the high-end or in the consumer market. Thanks to these four "pillars of success", ELSA is able to fully exploit its sales opportunities in all market segments.

On January 1, 1999, ELSA assigned its monitor marketing activities from its Graphics Systems business unit to a new, separate business unit called Professional Displays. The concentration of all display activities in a dedicated business unit creates optimum conditions for the further development of the monitors segment.

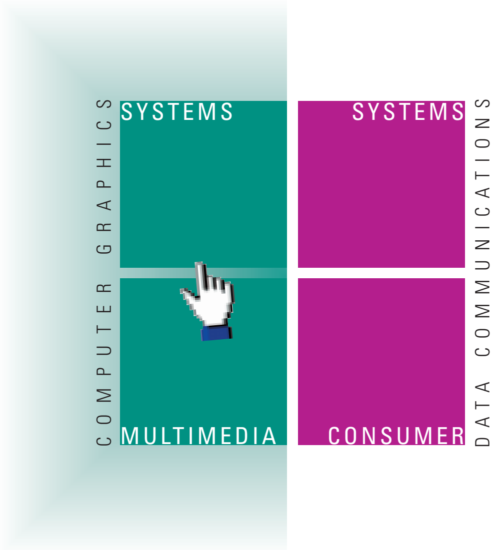
The ELSA brand stands for top-quality, user-friendly, high-tech products and exceptional customer service. In particular, commercial customers, whose business success depends on functioning PCs, appreciate the comprehensive service and warranty package (online support, free replacement equipment, up to 6-years’ warranty).

Corporate Strategy: Focus on the PC

Increased investment in R&D enables ELSA to operate quickly and flexibly in the market and to set standards for the competition. Approximately one-third of the staff in Aachen are involved in this area, thus securing the Company's innovative capacity.

ELSA has long-standing, successful business relationships with leading global OEMs (Original Equipment Manufacturers) such as Compaq, Hewlett-Packard and Siemens-Nixdorf and with many international telecommunications companies. As one of the few German IT companies, ELSA has firmly established itself in the international market. The marketing of its products in Europe, the USA and Asia is a significant contributory factor towards ensuring future growth at the global market level.

Computer Graphics Division



ELSA's Computer Graphics division covers the complete range of graphics boards and monitors for all market segments:

- High-end graphics boards for 3D engineering workstations
- 2D and 3D graphics boards for the office and corporate desktop segment
- High-performance graphics boards for PC games and edutainment
- Color monitors with 17 to 24-inch screen diagonals
- TFT flat-screen monitors

To achieve an optimum customer approach, the professional high-end users and discriminating consumers target groups are served by separate business units.

GRAPHICS SYSTEMS

ELSA is one of the leading suppliers of powerful professional graphics systems worldwide. Consistent concentration on the PC from the very beginning has proven to be very successful. PC-based solutions running on Windows NT are increasingly replacing proprietary UNIX networks and introducing new user groups to professional graphics solutions for small and medium-sized companies, as well as freelancers and the self-employed. The graphics boards in the *ELSA GLoria* product line upgrade PCs to powerful high-end workstations.

ELSA is continuing its drive to internationalize this business unit, thus creating a secure basis for growth. The leading global manufacturers of PC workstations such as Hewlett-Packard, Compaq or NEC, which demand highest quality of their partners, are integrating ELSA's graphics solutions into their top models. Moreover, *ELSA WINNER* and *GLoria* graphics systems are not only increasingly being used around the world in high-end systems, but in mid-range and entry-level systems as well.

ELSA develops optimized tools and drivers in-house exclusively for ELSA graphics systems. These are tools and drivers available to users as the tailored software package *ELSA Software Advantage*, offering professionals who wish to use their PCs as efficient work tools considerable increases in productivity.

PROFESSIONAL DISPLAYS

ELSA is one of the leading suppliers of high-end monitors in Europe. *ELSA ECOMO* monitors with 17-to 24-inch screen diagonals have an excellent reputation in all sectors requiring maximum levels of detail. ELSA is benefiting here from the change in purchasing behavior of users, who increasingly opt for high-quality, ergonomically optimized large screens at their workstations. The concept of quality and service for professionals at consumer prices was further extended in the monitor sector in 1998. ELSA AG is the global market leader for 24-inch monitors, recording a 54% year-on-year increase in sales in this segment. In the 21-inch monitor segment, ELSA did even better, recording sales growth of 266% compared to the previous year.

The launch of the TFT flat-screen monitor line in 1998 established ELSA in another future-oriented market segment. ELSA will profit from this market's high growth rates as space-saving flat screens will gradually replace conventional monitors in offices in the years to come.

MULTIMEDIA

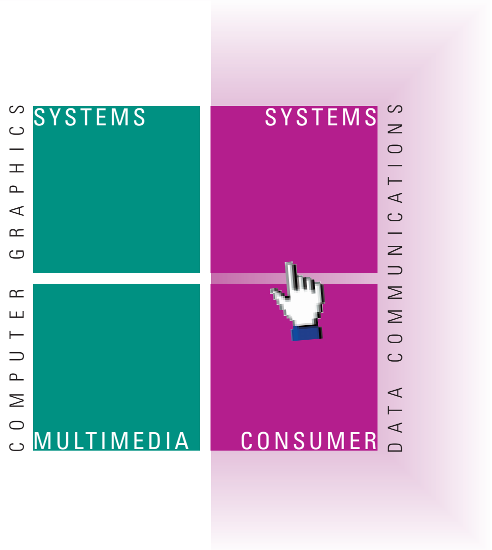
In the fiercely competitive, high-growth multimedia market, ELSA is holding its own with sophisticated 2D and 3D graphics accelerators for top-of-the-line home and office computers. Users of the *ELSA WINNER*, *ELSA VICTORY* and *ELSA ERAZOR* product lines benefit from ELSA's long-standing development edge in the high-end segment. ELSA is a master at turning innovative graphics board technology for professional users into market-oriented consumer products.

As one of the first companies in this market segment, ELSA has enhanced the functionality of its graphics cards by adding forward-looking features such as integration of video-in/out (e.g. for videoconferencing) and real 3D display with 3D shutter glasses (e.g. for virtual reality and 3D games).

In tests and reader polls carried out by leading industry publications, ELSA's graphics products were highly successful in 1998. *ELSA ERAZOR II*, the new 3D games board, was reviewed extremely favorably in these publications even before it was available on the market.

New applications such as the display of Web sites, videos and television programs require more powerful graphics boards for home PCs and will continue to stimulate the consumer graphics segment in the future. In addition to ELSA's existing OEM partnerships, the successful move into the US retail market at the end of 1998 laid the foundation for further growth.

DATA COMMUNICATIONS DIVISION



In the Data Communications division, ELSA was able to successfully maintain its excellent position in the German market with the following products:

- ISDN routers for network communications
- Videoconferencing systems
- High-speed modems
- PC cards for mobile data communications
- ISDN adapters

Two separate sub-divisions – Professional Communications Systems and Consumer Communications business units – allow a high level of customer orientation.

COMMUNICATIONS SYSTEMS

Modern business requires rapid information exchange capabilities and unrestricted accessibility. The extensive use of computers throughout offices and the growing availability of more and more bandwidth form the basis for the development of the PC into a multimedia communications station. ELSA's Communications Systems unit offers professional data communications solutions for commercial and industrial users.

In the pioneering segment of videoconferencing systems, ELSA is able to leverage the synergy effects resulting from its experience in the Computer Graphics and Data Communications divisions. Although it was considered merely a toy in the past, video communication – especially in the industrial sector – is now establishing itself as a serious, profitable tool. The range of possible applications includes video surveillance, telelearning, remote diagnosis and (customer) information terminals, among others.

Additional growth is stimulated by the increasing importance of the telecommuting segment. Sales of video-conferencing systems in the *ELSAvision* product family rose by 30% in 1998 compared to the previous year. As in 1997, ELSA participated in projects with well-known key accounts, particularly in the automotive industry.

The Internet and ISDN Network Communications sub-unit also developed very satisfactorily. *ELSA LANCOM*, the ISDN router family launched at the end of 1997, is successfully established on the market, with sales in the routers segment doubling in 1998. During fiscal year 1999, ELSA's introduction of innovative products will stimulate the market even further. The company is concentrating on ADSL future technologies for high-speed access via telephone cables and wireless radio connections for small and mid-sized networks.

DATA COMMUNICATIONS DIVISION

Excellent customer service, a continued, long-standing market presence and the widespread acceptance of the ELSA brand portfolio by customers and industry publications contribute to the continued success of all of ELSA's product groups. ELSA will benefit considerably from the high growth rates expected in the coming years in the video communications and network routers segments.

CONSUMER COMMUNICATIONS

Modern applications such as online shopping and home banking are making the Internet attractive for an increasingly broad group of customers. The European Information Technology Observatory (EITO) expects that by 2001, the number of Internet users will have more than doubled as compared to 1998. The rise in the number of private households connected to the Internet means that solutions for fast, efficient data exchange are becoming increasingly important in the consumer communications area as well.

As a pioneer in the field of analog modem technology, ELSA has always known how to anticipate promising technology trends at an early stage and convert them into market-ready products. This tradition was also continued in 1998:

In October, ELSA introduced the first European cable modem, which will be available in mid-1999. Using the conventional cable television network, ELSA cable modems will enable transmission rates measured in megabits, twenty times the current maximum values. Independent market researchers forecast that this innovative technology will have sales potential of more than eight million units within the next four years in Western Europe alone. This corresponds to a sales volume of USD 1.9 billion. Today, 51% of Western German and as many as 64% of Eastern German households have a cable connection (source: German Federal Statistical Office, Einkommens- und Verbrauchsstichprobe 1998 (1998 Income and Consumption Sample Survey)).

In 1998, ELSA presented *ELSA MicroLink 56k pro*, the first analog high-speed modem that complies with the new V.90 standard with download rates of up to 56,000 bps. Market reaction to this modem was extremely favorable. The new *MicroLink* product generation presented at CeBIT ´99 will attract attention because of its unusual product design, in addition to its USB connection and proven ELSA quality at an entry-level price.

Thanks to the *ELSA MicroLink* product line's versatile, user-friendly communication solutions, ELSA also occupies an excellent position in the ISDN technology growth market. At least partially as a result of the radical changes in pricing policy it initiated in 1999, Deutsche Telekom expects the number of new basic ISDN connections to increase by approximately 100,000 per month over the next few years. ELSA will benefit from this trend due to its high-quality products with a competitive price-performance ratio.

Together with leading banks and online services, ELSA is increasingly becoming involved in the rapidly growing market segment for start-up sets for ISDN and Internet connections. For example, Postbank, 1&1, the Commerzbank subsidiary ComdirectBank, and T-Online all integrate ELSA's products into their product packages for new customers. ELSA is not only benefiting from increasing sales, but also from these companies' extensive advertising campaigns in the end-user market, which will further increase the visibility of the ELSA brand.

EMPLOYEES

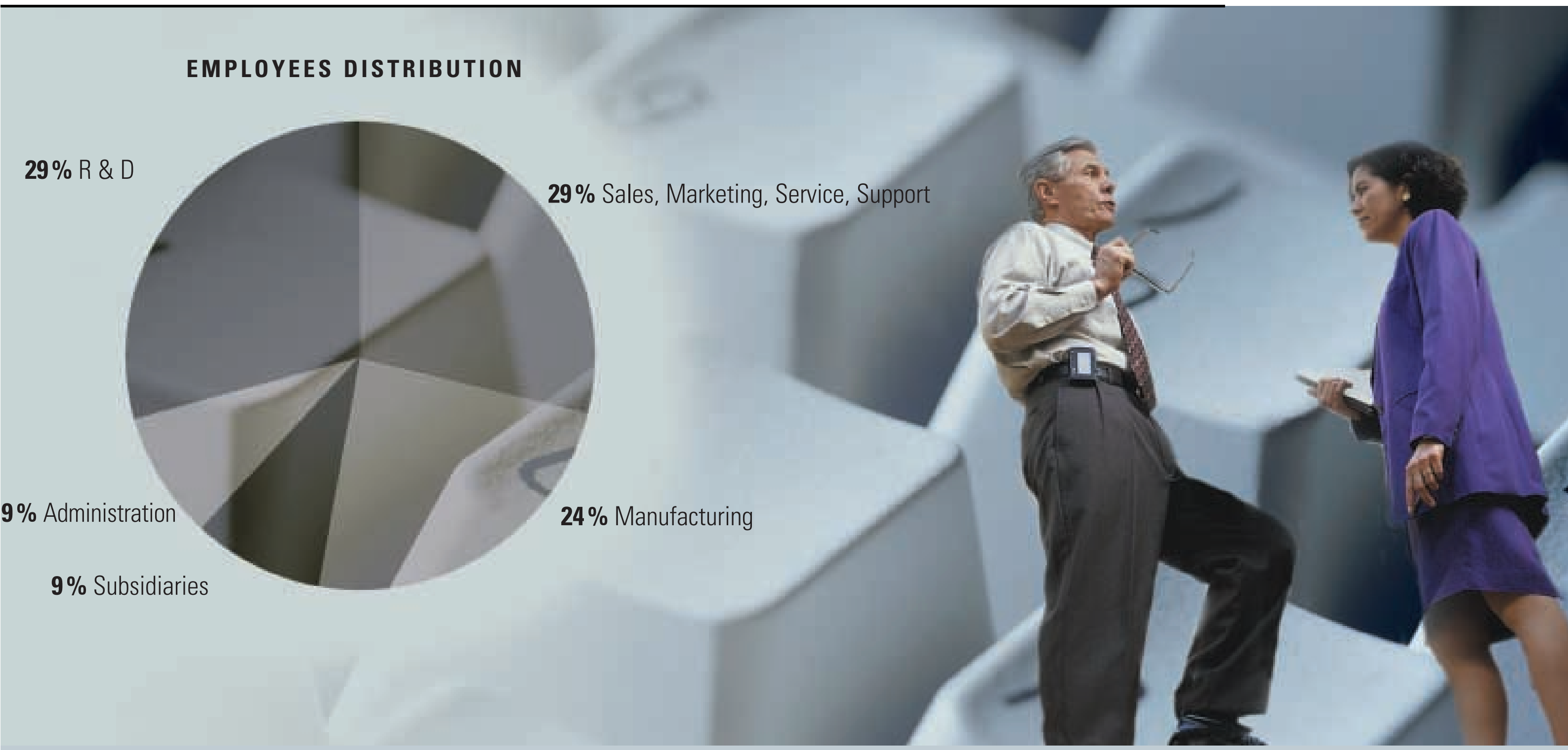
ELSA's success is largely attributable to the people whose creativity and commitment day in, day out breathe life into the high standards of quality, innovation and customer orientation. ELSA has room for unconventional thinkers who have the courage to leave the beaten path and actively take on new challenges.

Established in 1980 around the renowned Technical University of Aachen (RWTH), ELSA's proximity to the university is a distinct advantage in competing for the new generation of highly-qualified engineers. The Company regularly takes part in university contact fairs in order to build close links with university graduates at an early stage. By offering technical internships and closely cooperating with students working on their diploma theses, ELSA attracts the interest of tomorrow's developers while they are still in training.

ELSA created 55 new jobs in 1998, 10 of which were outside Europe. On December 31, 1998, 566 people worked for ELSA worldwide.

ELSA is a young company: the average age of its employees is only 33. Flat hierarchies afford employees a high degree of responsibility for their work as well as promoting cost and quality awareness at all levels. Friendly, unbureaucratic communications allow ELSA to transfer expertise actively and implement promising ideas quickly.

Over 75% of all employees subscribed to ELSA shares in the course of the IPO and are thus personally involved in the economic success of the Company. An attractive executive stock option program increases identification with the Company.



EMPLOYEES


EMPLOYEES DEVELOPMENT
600
550
500
450
400
350
300
250
200
150
100
50
0
1988
1989
1990
1991
1992
1993
1994
1995
1996
1997
1998

INNOVATION

There's just no end to our team's ideas. However, tangible success—the finished product—is the pinnacle of our work.

Wolfgang Hottgenroth (hardware developer)

Our goal is always to have the right feel for the market and trends.

Martin Schwarzer (software developer)

ELSA's research and development team is the largest unit—29% of the staff in Aachen. By focusing heavily on recruitment for R&D, ELSA is living up to its stated goal of continually expanding its own market position through state-of-the-art technology and further pursuing the competitive advantage offered by a short time-to-market period.

In the area of data communications, ELSA is one of the pioneers who entered the market with an analog modem immediately after the deregulation of the telecommunications market. Since then, the ELSA brand has established itself as a guarantee for leadership in innovation.

ADSL is another new high-speed technology for data transfer in addition to cable modems; according to independent experts, it will enter European households as early as 1999. ELSA's active participation in the ADSL Forum underscores the fact that it has been involved with this technology from the very beginning. ADSL (Asymmetric Digital Subscriber Line) is a variant of DSL technology and provides three channels for separate speech and data transfer via conventional copper cables. This approach optimally utilizes the existing copper cable network and enables transmission rates at multiples of conventional rates (speeds of up to 9 Mbps).

Innovation

In addition to data communications via cable, ELSA is carrying out research regarding professional RF (radio frequency) technology for wireless network connections by radio. The networking of multiple terminal devices without additional cabling will become a significant demand from both domestic and commercial customers in the near future. The cooperation with Siemens in this area provides ELSA a considerable competitive edge in development.

One of ELSA's trailblazing successes was the development of our first chip for data communications, which was completed in November 1998. *ELSAcon* laid the foundation for future innovations which will help to further increase the performance of ELSA's communications products. At the same time, *ELSAcon* offers potential savings in materials costs.

In the computer graphics segment, ELSA was able to make noticeable headway in 3D technology in 1998, further minimizing the difference between personal computers and professional workstations. Innovative software solutions, such as the further development of multi-screen technology, will attract new user groups in 1999, especially in financial markets.

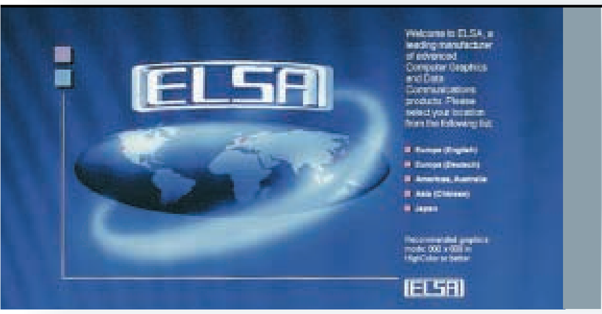
Our intensive cooperation with software manufacturers (independent software vendors—ISVs) in all phases of development also enables ELSA to produce top-quality, high-performance software drivers, thereby securing a material competitive advantage.

ELSA ONLINE

As an internationally oriented data communications pioneer, ELSA depends on a comprehensive presence on the World Wide Web as part of its communications and service concept. ELSA's Web sites, which were created in 1995, are some of the most frequently visited Web sites among German computer companies, with an average of over 9,000 hits per day. The strong degree of interest in ELSA and ELSA's products is indicated by the significant increase in hits for the www.elsa.de and www.elsa.com pages since the initial public offering in June 1998. Due to extensive cooperation with CompuServe Network Services and the resulting direct connection to CompuServe's high-bandwidth backbone, ELSA's WWW/FTP offerings can be accessed easily worldwide.

In a comparison of Internet sites in the IT sector, ELSA was ranked eighth in 1998 out of a total of 1,500 Web sites tested. This evaluation was performed by the ProfNet project group at the Fachhochschule Dortmund (Dortmund University of Applied Technology), which for the first time scrutinized the Internet presence of hardware and software companies, as well as systems suppliers and dealers in the IT sector. The test involved 85 criteria judging usability, layout, content and interactivity.

In addition to comprehensive information about the current product range, the clearly laid out Web pages also include manuals and software updates for dealers and customers to download, current training schedules and direct access to technical support. On the Press Room page, ELSA regularly makes up-to-date texts and photos available online to authorized trade journalists. And since the initial public offering, shareholders have been able to find all important company data and press releases, as well as a direct e-mail link for correspondence to the Investor Relations department, on ELSA's Investor Relations page.



The European homepage also enables visitors to access the homepages of ELSA USA, ELSA Japan and ELSA Asia with a click of the mouse.

CONTENTS OF THE www.elsa.com SITE (ENGLISH)

- Company profile and information
- Investor Relations
- Press Room and press releases
- Current product information
- Exclusive area for dealers and distributors
- Technical support, data base
- Software updates and manuals
- Job listings

ELSA International

An international market presence is a decisive factor for success in the IT sector. In 1998, ELSA successfully accelerated the extension of its global market position. As of December 31, 1998, approximately 10% of ELSA's staff was employed in sales and marketing companies outside of Germany. ELSA's subsidiaries in Taiwan (Taipeh), Japan (Tokyo and Osaka) and the USA (Santa Clara, California) are actively pursuing the Company's goal of establishing itself in the international market.

As part of its European expansion, ELSA established independent sales and marketing companies at the beginning of 1999 in France, the UK and Italy. The growth of ELSA's presence in Europe will enable the Company to step up its activities to make the entire product range available throughout this area, as well as to significantly increase its market share and sales abroad. Cooperation with additional European partners is planned.

The construction and completion of the European logistics center in Aachen, Germany, completed in mid-1999 will allow the coordination of distribution across Europe from a single site.

Cooperation with leading PC manufacturers worldwide was expanded further in the global markets of the USA and the Far East in order to ensure growth in the coming years. In addition to existing OEM partnerships, e.g. with Compaq, Hewlett-Packard and Siemens-Nixdorf, ELSA Japan was able to win NEC as a new partner in 1998. Furthermore, ELSA also started to supply classic retail sales channels and systems integrators in the United States for the first time in 1998.

As in previous years, ELSA will present itself to international market players in 1999 at the best known computer trade shows worldwide, such as CeBIT in Hanover and Comdex in Las Vegas. According to the US-based market research institute Jon Peddie Associates, ELSA is already among the top ten international brand name manufacturers of graphics boards worldwide, in terms of the number of units sold.

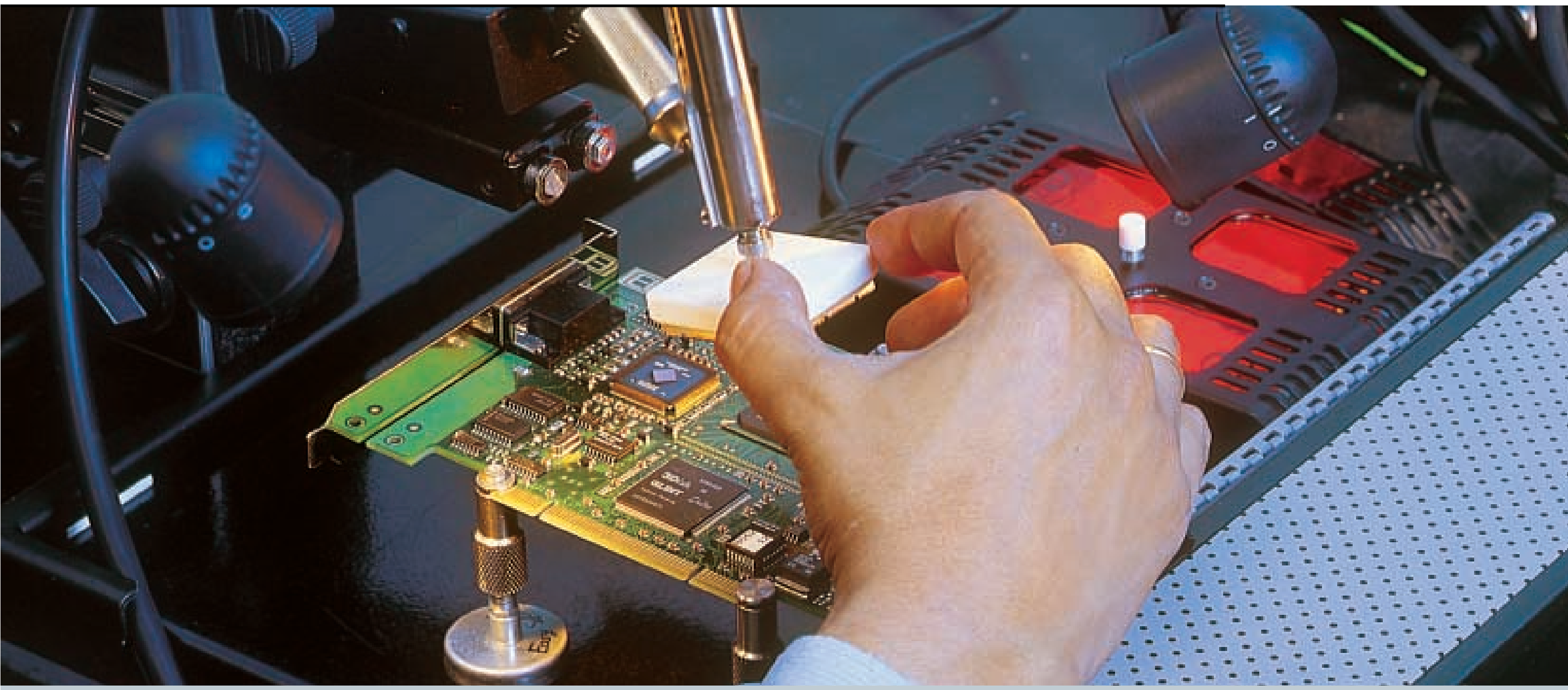
Production and Quality Control

ELSA attributes its long-standing success to a healthy mix of innovation and customer loyalty. New products are not launched until they are fully developed and clearly benefit the user. Close cooperation with leading hardware manufacturers and software developers from the development phase onwards along with detailed, comprehensive testing procedures ensure a consistently high level of product quality. ELSA complies, among other things, with the strict worldwide supplier guidelines issued by Compaq and Hewlett-Packard.

Supply chains have been optimized using a supplier-managed inventory system in order to help reduce ELSA's inventory risk even further by shifting this risk upstream. ELSA's audit teams not only analyze ELSA's own business processes, but also those of suppliers in order to ensure compliance with ELSA's high quality standards.

ELSA was able to continue to decentralize production in 1998 by qualifying new global assembly service companies. According to this model, future product generations will be tested for compliance with ELSA's quality standards while still at the service provider's location, then packaged ready for sale and delivered to ELSA.

The Year 2000 problem was addressed by ELSA early on. All hardware and software products developed as of June 15, 1998 or later will be able to make the change to the year 2000 without errors. The functionality of these ELSA products beyond January 1, 2000 is also ensured to be free of any adverse effects on the processing of data or the storage of files relying on date information.



Investor Relations

Since the initial public offering, open and transparent communication of all important information has been one of the main goals of ELSA AG.

ELSA is committed to a long-term investor relations policy, which is why the Company established an Investor Relations unit in the past fiscal year. The timely provision of information by ELSA enables current and potential shareholders to have access to all relevant company data at all times.

Quarterly reports according to US GAAP and HGB (German Commercial Code) as well as our regular press work make its easy for investors to obtain detailed information. In addition, ELSA seeks an ongoing dialog with German and international analysts and investors; analysts' meetings and roadshows are held regularly at major international stock exchanges.

Up-to-the-minute information on ELSA and its shares is to be found on the ELSA homepage at www.elsa.com. Interested investors can register on the site in an investors' database; they then regularly receive ELSA AG's most recent publications via e-mail.

CORPORATE CALENDAR 1999

March 18-24	CeBIT, Hanover
March 31	Financials press conference in Düsseldorf
March 31	DVFA analysts' meeting in Frankfurt am Main
May 28	Annual General Meeting in Aachen
May 28	Report on Q1 of 1999
August 20	Interim report on Q2 of 1999
October 18-22	Systems trade show, Munich
November 12	Interim report on Q3 of 1999
November 15-19	Comdex, Las Vegas (USA)

ELSA AG Investor Relations · Tel.: +49-(0)241-606-1188 · Fax: +49-(0)241-606-1998 · E-mail: investor@elsa.de

Subscribed capital:	DM 17.5 million (EUR 8.95 million)	
Authorized capital:	DM 8.0 million (EUR 4.09 million)	
Number of shares:	3.5 million no-par value shares	
Issuing price:	EUR 62.89	
Stock exchanges:	Frankfurt	Neuer Markt
	Berlin	OTC
	Düsseldorf	OTC
	Hamburg	OTC
	Munich	OTC
	Stuttgart	OTC
Securities Code Number:	507 360	
Symbol:	ELS	
Highest/lowest share price in 1998:	EUR 117.08/43.97	

STOCK PRICE JUNE 15, 1998 TO FEBRUARY 26, 1999

(Closing Prices Neuer Markt Frankfurt)

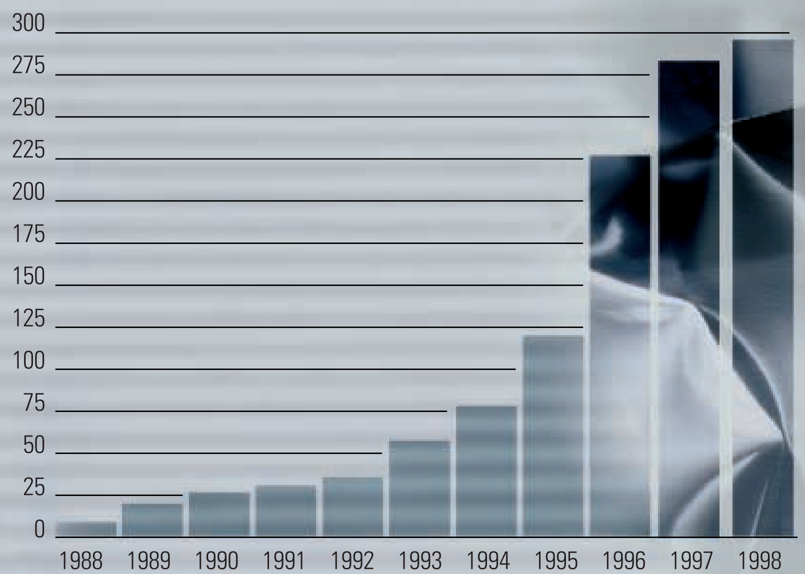
Shareholdings:	**20.00% free float**
	77.14% Theo Beisch
	1.43% Theodor Lieven
	1.43% S-UBG

AT A GLANCE: ELSA 1998

For ELSA as a manufacturer of PC components and peripherals for computer graphics and data communications, fiscal year 1998 was characterized by a changing business environment:

- Establishment of sales and marketing subsidiaries in Asia and Japan
- Initial public offering
- Strong pressure on prices for PC components and peripherals due to a sharp drop in prices for bought-in components (memory chips); this situation continued for an unusually long period because of the foreign currency requirements of Asian semiconductor manufacturers in particular, as a result of the Asian economic crisis
- Consolidation trend among upstream suppliers and competitors
- Strong predatory competition in the consumer graphics board business due to the entry of new market participants

TOTAL REVENUE 1988 – 1998 in DM million



Until 1996 ELSA GmbH, from 1997 on ELSA AG Group.

At a Glance: ELSA 1998

SALES

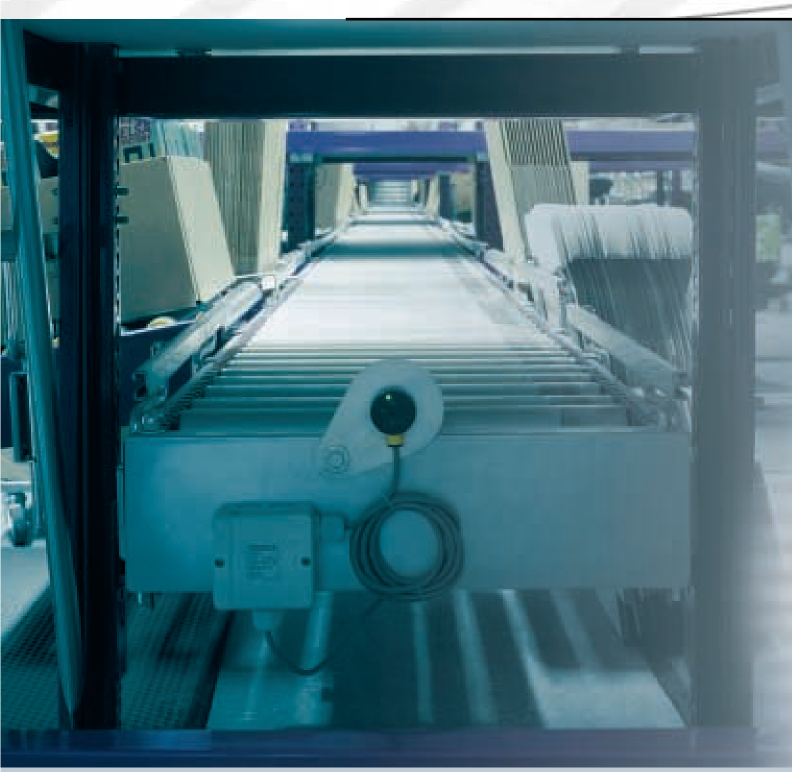
Consolidated sales at group level amounted to DM 299.5 million in 1998, up from DM 286.6 million the previous year. The Computer Graphics division was responsible for 71.3%, and the Data Communications division for 28.7% of this figure.

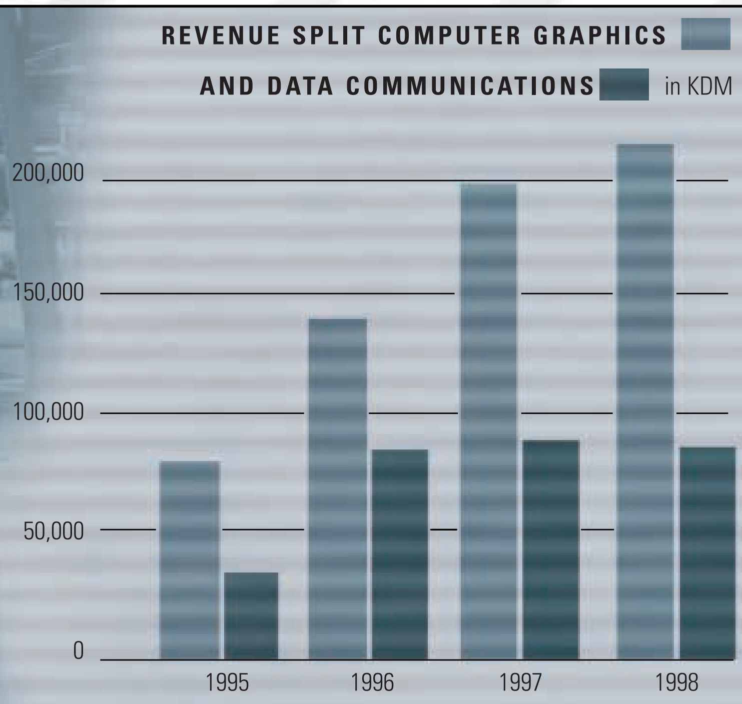
COST OF MATERIALS

The cost of materials at group level rose from DM 212.9 million to DM 237.3 million, which represents a material expenditure ratio of 78.8%.

EARNINGS SITUATION

Due to the general business environment described above, the net income for the period according to US GAAP totaled DM -5.9 million, as opposed to DM 7.3 million in the previous year. Income from continuing operations amounted to DM -17.1 million (previous year: DM 13.9 million). DVFA/SG earnings per share totaled DM -3.04 per share.





AT A GLANCE: ELSA 1998

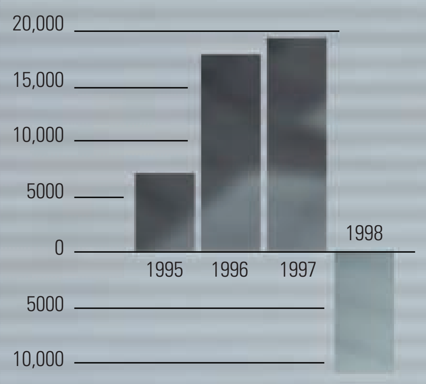
INVESTMENTS

Investments in 1998 amounting to DM 12.6 million were primarily used for expanding ELSA's international locations and for the European logistics center in Aachen. The new logistics center, which is currently under construction, will be operational in the third quarter of 1999.

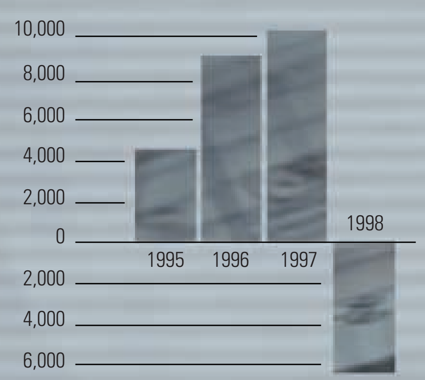
BALANCE SHEET STRUCTURE

Cash inflows from the initial public offering further improved the existing favorable equity structure. ELSA's equity ratio amounted to 64.0% at the balance sheet date. Current liabilities were further decreased in the past fiscal year. On December 31, 1998, current liabilities accounted for 23.8% of the balance sheet total of DM 130.9 million.

EBDIT 1995-1998 in KDM



CASH FLOW ACCORDING DVFA/SG 1995-1998 in KDM



Operational Goals: ELSA 1999

ELSA HAS SET THE FOLLOWING OPERATIONAL GOALS FOR 1999:

- European expansion

The agencies that were newly founded at the beginning of the year in the UK, France and Italy will be fully operational in time for CeBIT '99 in March. ELSA expects the high-caliber agency staff and experienced sales managers to generate significant sales growth in 1999.

- Ongoing decrease in inventories

As of December 31, 1998, ELSA was able to reduce inventories to less than DM 50 million from a peak of over DM 60 million, thus meeting an operational goal for 1998. The ongoing reduction in inventories is being achieved in particular by the transfer of inventories and inventory risks to upstream suppliers as part of a supplier-managed inventory strategy.

- Search for and evaluation of international cooperation and acquisition opportunities

A number of different partnerships and acquisitions are currently being discussed. The strategic goal is to increase the potential for value added, expand sales channels and strengthen technological expertise.

- Productivity increases and increased earnings

The internal restructuring of several business processes and the associated organizational units will serve to increase efficiency throughout the company by reducing interfaces and concentrating on core competencies.

- Market research: new Management Board report

The expansion of the Management Board announced in February and the establishment of a separate area of responsibility for marketing and market research are designed to manage the company's capacity for technological innovation in an even more focused manner, to strengthen ELSA's market orientation and to increase certainty in planning.

- Strategic new direction in sales

The appointment of a new Management Board member responsible for sales in February is part of the strategic reorientation of ELSA's sales activities. The operational goal here is to concentrate more strongly on the area of data communications, which currently has the greatest growth potential due to the Internet and e-commerce. The reinforcement of European activities is another aspect of this strategy.

- E-commerce

In the current fiscal year, our Internet activities, which have already won several awards, will be expanded further to establish an e-commerce unit. A separate area of responsibility at the Management Board level was established for this purpose, thus underscoring ELSA's intention to utilize innovative marketing channels for sales and customer service.

Report of the Supervisory Board

The Supervisory Board monitored the activities of and provided advice to the Management Board on an ongoing basis during fiscal year 1998. The Supervisory Board was fully informed of the situation of ELSA AG and its subsidiaries in the form of detailed written and oral reports. Fundamental issues relating to corporate policy, cost trends, investment and financial planning, and business strategy were discussed at four meetings on April 24, May 15, August 20 and November 26, 1998. Information was also exchanged on a regular basis between members of the Supervisory Board and the Management Board outside the meetings. All decisions which require the approval of the Supervisory Board by law or according to ELSA's Articles of Association were approved following detailed discussions.

In addition to discussing current and future business developments, the Supervisory Board's meetings focused on the following topics:

- the listing of ELSA shares on the Neuer Markt and the capital measures relating thereto,
- the continued internationalization of sales,
- planning for fiscal year 1999,
- measures for steps introduced by the Management Board to optimize workflows and cut costs, and
- support for the Management Board in the preparation of acquisitions and the development of new business activities.

The Supervisory Board has established a three-member committee for Management Board affairs. In 1998, the committee for Management Board affairs passed all resolutions by written consent.

Dr. Rüdiger Liebs was elected to the Supervisory Board as a shareholder representative by the General Meeting on May 15, 1998. His term of office began on the same date. On August 17, 1998, the employee representatives Mr. Arno Guse and Mr. Udo Brocker were elected as Supervisory Board members by the employees of ELSA AG. Their terms of office commenced on September 1, 1998.

The annual financial statements for fiscal year 1998, the consolidated financial statements and the combined management report for the AG and the Group prepared by the Management Board were presented to the Supervisory Board. They have been audited the Company's auditor, Arthur Andersen Wirtschaftsprüfungsgesellschaft-Steuerberatungsgesellschaft mbH, Hamburg, who issued an unqualified audit opinion. The auditor's audit reports were presented to the members of the Supervisory Board for inspection. Representatives of the auditor participated in the meeting of the Supervisory Board devoted to the annual financial statements and reported on the material results of the audit. They were also available for questions from Supervisory Board members. The Supervisory

Report of the Supervisory Board

Board took notice and approved of the results of the audit. No objections were raised as a result of the examination by the Supervisory Board of the annual financial statements, the consolidated financial statements and the combined management report. The Supervisory Board therefore approves the Company's annual financial statements as of December 31, 1998, prepared by the Management Board, and the management report. The annual financial statements are hereby adopted.

The Supervisory Board would like to take this opportunity to express its thanks and appreciation to the Management Board and all company employees for their dedication and performance.

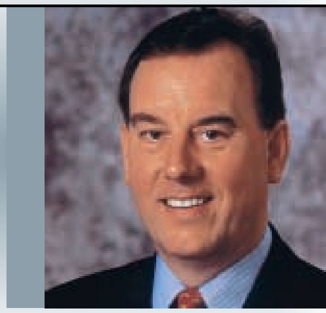
Mr. Peter Güldenberg, the ELSA AG Management Board member previously responsible for the sales and marketing departments, resigned from the company on February 28, 1999 by mutual agreement in connection with the strategic realignment of sales activities.

Mr. Manfred Hasseler and Mr. Helmut Nebgen were appointed ordinary members of the Management Board by the Supervisory Board on March 1, 1999 and March 15, 1999, respectively. Mr. Hasseler assumed overall responsibility for sales and for the newly created e-commerce area. Mr. Nebgen is responsible for the marketing and consumer goods business units.

Aachen, March 26, 1999

For the Supervisory Board

Wolfgang Dondorf



Consolidated Financial Statements and Financial Statements of ELSA AG 1998

Management Report of the ELSA AG Group and Management Report of ELSA AG for Fiscal Year 1998

Growth despite a difficult business environment

The growth of the PC market in 1998 was primarily expressed in the number of units sold, while a price slump and the Asian economic crisis dominated the overall market environment and limited sales growth. Consolidation processes, especially on the supplier side, increased predatory competition, inventory reduction measures taken by the leading PC manufacturers, and continued price pressure had a particular impact on Computer Graphics division. The Data Communications division was heavily influenced by the debate on new data transfer standards in the first half of 1998 in particular.

Market position expanded

Despite the generally negative environment, ELSA was once again able to increase its market share in key market segments and further expanded its position as market leader, especially on the domestic market. The percentage of sales generated in Germany increased from 73% to 76%.

Sales

In 1998, consolidated net sales increased by 4.5% from DM 286.6 million to DM 299.5 million. Sales by the Computer Graphics division amounted to DM 213.5 million in 1998, an increase of 8.5%. Sales by the Data Communications division fell by 4.3%, from DM 89.0 million to DM 86.0 million.

Earnings

Due to difficult market conditions and decreasing margins, the income from continuing operations in the last fiscal year amounted to minus DM 17.1 million (1997: profit of DM 13.9 million) and the net loss for the year amounted to DM 17.5 million (1997: net income of DM 6.5 million). International business was the principle cause of this negative result. The earnings situation of the American subsidiary, which incurred a loss in 1998, was impacted by the changing structure of the market for professional computer graphics systems. The start-up losses incurred by the subsidiaries established in Taiwan and Japan were in line with expectations for the first operational fiscal year. The cost of the initial public offering amounted to DM 6.3 million; also had a negative effect on the profit situation.

Employees

In 1998, ELSA increased the number of its employees by 55 to 566. Of these, 45 new jobs were created in Germany.

Research and development

ELSA increased its spending on research and development by 28% year-on-year in order to extend its positive market position and improve its earnings situation. As a result, R&D expenditure amounted to 4.2% of sales in 1998 compared to 3.3% in the previous year.

During the last fiscal year, ELSA was once again one of the first companies to present innovative products to the public, e.g. the first European cable modem which was announced in October.

Business outlook

We expect that sales in 1999 will be stimulated by newly launched products and the strengthening of marketing and sales.

The generally good opportunities for growth, especially on the Internet and on the PC market, will have a positive impact on ELSA's business situation when the IT market trends are reversed, as is to be expected. In particular, the cyclical price slump in the memory modules segment which reoccurs every couple of years is not expected in the current fiscal year. Hence, margins are expected to recover.

The initial public offering and the standing of the Company, which improved significantly as a result, have created the basis for catching up with key market players as regards purchasing and pass inventory risks to suppliers.

After the considerable expansion of research and development activities in 1998, the current fiscal year will focus on the Company's international expansion strategy, with the main emphasis being on Europe.

In addition, ELSA is actively pursuing alliances and attractive investment opportunities. The aim is to create the technological conditions to expand market share and unit sales.

Aachen, February 26, 1999
ELSA AG
The Management Board

Consolidated Balance Sheet as of December 31, 1998

Assets

		1998 DM	1997 DM
A.	**FIXED ASSETS**		
	I. Intangible assets		
	Concessions, industrial and similar rights and licenses in such rights and assets	**797,702.17**	**521,039.34**
	II. Property, plant and equipment		
	1. Land and buildings including buildings on third-party land	12,916,555.08	9,351,710.08
	2. Other equipment, operational and office equipment	5,459,864.72	4,759,648.35
	3. Advance payments and construction in progress	3,975,111.56	342,553.18
		22,351,531.36	**14,453,911.61**
	III. Financial assets		
	1. Shares in affiliated companies	0.00	1.00
	2. Other loans	588,530.04	525,853.87
	3. Advance payments on financial assets	0.00	744,342.43
		588,530.04	**1,270,197.30**
		23,737,763.57	**16,245,148.25**
B.	**CURRENT ASSETS**		
	I. Inventories		
	1. Raw materials and supplies	20,354,795.16	25,459,544.74
	2. Work-in-process	12,608,400.37	10,680,528.73
	3. Finished goods and merchandise	16,449,551.00	18,338,358.66
	4. Advance payments	6,685.74	8,118.37
		49,419,432.27	**54,486,550.50**
	II. Receivables and other assets		
	1. Trade receivables	30,200,434.99	21,723,680.03
	2. Other assets	9,700,964.99	3,532,403.26
		39,901,399.98	**25,256,083.29**
	III. Checks, cash-on-hand, postal giro balances, cash in banks	**16,960,327.85**	**4,023,370.26**
		106,281,160.10	**83,766,004.05**
C.	**DEFERRED TAX ASSETS**	**367,018.78**	**513,624.60**
D.	**PREPAID EXPENSES**	**549,922.41**	**406,902.47**
		130,935,864.86	**100,931,679.37**

Liabilities and equity

		1998 DM	1997 DM
A.	**EQUITY**		
	1. Subscribed capital	17,500,000.00	5,800,000.00
	2. Capital surplus	83,180,000.00	1,500,000.00
	3. Earned surplus	490,327.83	640,752.66
	4. Consolidated retained earnings	-17,399,846.52	7,000,195.45
	5. Minority interest	-15,309.19	40,656.00
		83,755,172.12	**14,981,604.11**
B.	**CAPITAL OF DORMANT PARTNERS**	**0.00**	**11,500,000.00**
C.	**ACCRUALS**		
	1. Accruals for pensions and reserves for similar obligations	603,977.50	508,951.00
	2. Accrued taxes	73,655.39	2,793,730.83
	3. Other accruels	5,399,442.88	3,820,366.68
		6,077,075.77	**7,123,048.51**
D.	**LIABILITIES**		
	1. Loans	877,500.00	0.00
	• *thereof convertible: DM 877,500.00 (prior year: DM 0.00)*		
	2. Advance payments received on account of orders	35,026.69	0.00
	3. Liabilities due to banks	11,777,555.59	41,631,987.91
	4. Trade payables	22,806,232.05	22,580,291.23
	5. Other liabilities	5,607,302.64	3,114,747.61
	• *thereof for taxes: DM 3,388,568.33 (prior year: DM 1,418,454.11)*		
	• *thereof for social security and similar obligations: DM 920,795.72 (prior year: DM 728,449.89)*		
		41,103,616.97	**67,327,026.75**
		130,935,864.86	**100,931,679.37**

Consolidated Income Statement for the Year ended December 31, 1998

	1998 DM	1998 DM	1997 DM
1. Sales		299,510,711.56	286,565,103.07
2. Increase in finished goods and work-in-process		1,369,014.92	5,026,124.51
3. Production for own plant and equipment capitalized		273,072.56	104,884.97
4. Other operating income		4,345,022.88	4,377,250.35
5. Cost of materials			
a) Cost of raw materials, supplies and			
trading stock	234,265,867.04		211,143,525.77
b) Cost of purchased services	3,032,982.89		1,796,292.00
		237,298,849.93	
6. Personnel expenses			
a) Wages and salaries	35,820,108.25		29,540,560.24
b) Social security, pension and other			
benefit costs			
• thereof for pensions: DM 243,797.40			
(prior year: DM 179,336.25)	5,926,354.74		4,928,989.12
		41,746,462.99	34,469,549.36
7. Depreciation on intangible assets			
and property, plant and equipment		4,141,917.01	3,298,008.52
8. Other operating expenses		37,771,118.05	29,515,621.63
9. Income from long-term loans		30,886.63	31,552.83
10. Other interest and similar income		293,008.46	15,416.48
11. Interest and similar expenses		1,970,046.48	2,044,137.83
12. **Result from ordinary activities**		**-17,106,677.45**	**13,853,197.10**
13. Extraordinary expenses		6,874,171.07	0.00
14. **Result from extraordinary activities**		**-6,874,171.07**	**0.00**
15. Taxes on income		-7,020,997.25	6,468,906.78
16. Other taxes		53,008.66	31,113.14
17. Profit share of dormant partners		500,729.17	805,381.95
18. **Consolidated net income for the year**		**-17,513,589.10**	**6,547,795.23**
19. Loss attributable to minority interest		91,407.32	0.00
20. Profit carried forward from the prior year		22,335.26	452,400.22
21. **Consolidated retained earnings**		**-17,399,846.52**	**7,000,195.45**

STATEMENT OF FIXED ASSETS MOVEMENTS DURING THE YEAR 1998

ACQUISITION AND PRODUCTION COST

	Jan 1, 1998 DM	Currency diff. DM	Additions DM	Disposals DM	Transfers DM	Dec 31, 1998 DM
I. INTANGIBLE ASSETS						
Concessions, industrial and similar rights and assets and licenses in such rights and assets	1,129,598.89	-2,779.86	611,343.37	8,033.86	0.00	1,730,128.54
II. PROPERTY, PLANT AND EQUIPMENT						
1. Land and buildings including buildings on third-party land	10,645,858.57	0.00	3,979,807.64	0.00	122,870.38	14,748,536.59
2. Other equipment, operational and office equipment	11,966,325.32	-49,768.07	4,197,610.56	929,228.43	0.00	15,184,939.38
3. Advance payments and construction in progress	342,553.18	0.00	3,769,520.76	14,092.00	-122,870.38	3,975,111.56
	22,954,737.07	**-49,768.07**	**11,946,938.96**	**943,320.43**	**0.00**	**33,908,587.53**
III. FINANCIAL ASSETS						
1. Shares in affiliated companies	252,115.44	0.00	0.00	0.00	-252,155.44	0.00
2. Other loans	525,853.87	0.00	87,021.66	24,345.49	0.00	588,530.04
3. Advance payments on financial assets	744,342.43	0.00	0.00	0.00	-744,342.43	0.00
	1,522,311.74	**0.00**	**87,021.66**	**24,345.49**	**-996,457.87**	**588,530.04**
	25,606,647.70	**-52,547.93**	**12,645,303.99**	**975,699.78**	**-996,457.87**	**36,227,246.11**

ELSA GROUP, AACHEN

ACCUMULATED DEPRECIATION						NET BOOK VALUES	
Jan 1, 1998 DM	Currency diff. DM	Additions DM	Disposals DM	Appreciation DM	Dec 31, 1998 DM	Dec 31, 1998 DM	Dec 31, 1997 DM
608,559.55	-527.85	327,150.53	2,755.86	0.00	932,426.37	797,702.17	521,039.34
1,294,148.49	0.00	537,833.02	0.00	0.00	1,831,981.51	12,916,555.08	9,351,710.08
7,206,676.97	-14,681.34	3,276,933.46	743,854.43	0.00	9,725,074.66	5,459,864.72	4,759,648.35
0.00	0.00	0.00	0.00	0.00	0.00	3,975,111.56	342,553.18
8,500,825.46	**-14,681.34**	**3,814,766.48**	**743,854.43**	**0.00**	**11,557,056.17**	**22,351,531.36**	**14,453,911.61**
252,114.44	0.00	0.00	0.00	252,114.44	0.00	0.00	1.00
0.00	0.00	0.00	0.00	0.00	0.00	588,530.04	525,853.87
0.00	0.00	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**	**0.00**	**588,530.04**	**1,270,197.30**
9,361,499.45	**-15,209.19**	**4,141,917.01**	**746,610.29**	**252,114.44**	**12,489,482.54**	**23,737,763.57**	**16,245,148.25**

Balance Sheet as of December 31, 1998

Assets

		1998 DM	1997 DM
A.	**FIXED ASSETS**		
	I. Intangible assets		
	Concessions, industrial and similar rights and licenses in such rights and assets	**765,245.00**	**487,229.00**
	II. Property, plant and equipment		
	1. Land and buildings including buildings on third-party land	12,916,555.08	9,351,710.08
	2. Other equipment, operational and office equipment	4,503,591.00	4,232,876.00
	3. Advance payments and construction in progress	3,975,111.56	342,553.18
		21,395,257.64	**13,927,139.26**
	III. Financial assets		
	1. Shares in affiliated companies	5,166,222.73	4,169,765.86
	2. Other loans	501,508.38	525,853.87
	3. Advance payments on financial assets	0.00	744,342.43
		5,667,731.11	**5,439,962.16**
		27,828,233.75	**19,854,330.42**
B.	**CURRENT ASSETS**		
	I. Inventories		
	1. Raw materials and supplies	20,354,795.16	25,459,544.74
	2. Work-in-process	12,608,400.37	10,680,528.73
	3. Finished products and merchandise	11,573,386.80	14,772,328.94
	4. Advance payments	6,685.74	8,118.37
		44,543,268.07	**50,920,520.78**
	II. Receivables and other assets		
	1. Trade receivables	21,107,275.06	14,572,774.13
	2. Receivables from affiliated companies	19,848,139.38	6,153,999.86
	3. Other assets	6,443,773.01	3,453,489.06
		47,399,187.45	**24,180,263.05**
	III. Checks, cash-on-hand, postal giro balances, cash in banks	**15,516,621.62**	**2,173,410.30**
		107,459,077.14	**77,274,194.13**
C.	**PREPAID EXPENSES**	**454,755.63**	**271,555.48**
	• thereof for discount: DM 97,888.00 (prior year: DM 0.00)		
		135,742,066.52	**97,400,080.03**

Liabilities and equity

		1998 DM	1997 DM
A.	**EQUITY**		
	I. Subscribed capital	17,500,000.00	5,800,000.00
	II. Capital surplus	83,180,000.00	1,500,000.00
	III. Earned surplus		
	Other earned surplus	595.30	735.11
	IV. Retained earnings	-10,659,775.65	6,977,860.19
		90,020,819.65	**14,278,595.30**
B.	**CAPITAL OF DORMANT PARTNERS**	**0.00**	**11,500,000.00**
C.	**ACCRUALS**		
	1. Accruals for pensions and reserves for similar obligations	603,977.50	508,951.00
	2. Accrued taxes	0.00	470,849.46
	3. Other accruals	4,868,892.20	3,586,177.38
		5,472,869.70	**4,565,977.84**
D.	**LIABILITIES**		
	1. Loans	877,500.00	0.00
	• thereof convertible: DM 877,500.00 (prior year: DM 0.00)		
	2. Liabilities due to banks	11,777,555.59	41,631,987.91
	3. Trade payables	22,186,948.66	22,320,525.07
	4. Other liabilities	5,406,372.92	3,102,993.91
	• thereof for taxes: DM 3,988,568.33 (prior year: DM 1,406,700.41)		
	• thereof relating to social security and similar obligations: DM 920,795.72 (prior year: DM 728,449.89)		
		40,248,377.17	**67,055,506.89**
		135,742,066.52	**97,400,080.03**

Income Statement for the Year ended December 31, 1998

	1998 DM	1998 DM	1997 DM
1. Sales		296,588,483.98	275,279,848.41
2. Increase in finished goods and work-in-process		-281,173.61	2,231,638.48
3. Production for own plant and equipment capitalized		257,354.48	104,884.97
4. Other operating income		3,749,951.81	3,715,319.44
5. Cost of materials			
a) Cost of raw materials, supplies and trading stock	233,568,739.19		210,915,533.19
b) Cost of purchased services	3,032,982.89		1,796,292.00
		236,601,722.08	212,711,825.19
6. Personnel expenses			
a) Wages and salaries	30,650,389.50		26,760,411.92
b) Social security, pension and other benefit costs • *thereof for pensions: DM 243,739.40 (prior year: DM 179,336.25)*	5,926,354.74		4,928,989.12
		36,576,744.24	31,689,401.04
7. Depreciation on intangible assets and property, plant and equipment		3,905,337.76	3,189,708.67
8. Other operating expenses		29,750,982.37	23,864,671.34
9. Income from investments • *thereof from affiliated companies: DM 0.00 (prior year: DM 4,276,005.55)*		0.00	4,276,005.55
10. Income from long-term loans		30,886.63	31,552.83
11. Other interest and similar income • *thereof from affiliated companies: DM 337,403.76 (prior year: DM 38,351.17)*		522,793.69	52,098.52
12. Interest and similar expenses • *thereof to affiliated companies: DM 0.00 (prior year: DM 77,264.93)*		1,972,747.28	2,113,699.38
13. **Result from ordinary activities**		**-7,939,236.75**	**12,122,042.56**
14. Extraordinary expenses		6,874,171.07	0.00
15. **Result from extraordinary activities**		**-6,874,171.07**	**0.00**
16. Taxes from income		-4,707,370.00	4,320,064.52
17. Other taxes		53,008.66	31,113.14
18. Profit share of dormant partners		500,729.17	805,381.95
19. **Net income for the year**		**-10,659,775.65**	**6,965,482.97**
20. Profit carried forward from the prior year		0.00	12,377.22
21. **Retained earnings/accumulated deficit**		**-10,659,775.65**	**6,977,860.19**

Statement of Fixed Assets Movements during the Year 1998

ACQUISITION AND PRODUCTION COST

	Jan 1, 1998 DM	Additions DM	Disposals DM	Transfers DM	Dec 31, 1998 DM
I. INTANGIBLE ASSETS					
Concessions, industrial and similar rights and licenses in such rights and assets	1,087,863.69	594,337.01	8,033.86	0.00	1,674,166.84
II. PROPERTY, PLANT AND EQUIPMENT					
1. Land and buildings including buildings on third-party land	10,645,858.57	3,979,807.64	0.00	122,870.38	14,748,536.59
2. Other equipment, operational and office equipment	11,219,135.67	3,512,550.73	929,228.43	0.00	13,802,457.97
3. Advance payments and constructions in progress	342,553.18	3,769,520.76	14,092.00	-122,870.38	3,975,111.56
	22,207,547.42	**11,261,879.13**	**943,320.43**	**0.00**	**32,526,106.12**
III. FINANCIAL ASSETS					
1. Shares in affiliated companies	4,421,880.30	0.00	0.00	744,342.43	5,166,222.73
2. Other loans	525,853.87	0.00	24,345.49	0.00	501,508.38
3. Advance payments on financial assets	744,342.43	0.00	0.00	-744,342.43	0.00
	5,692,076.60	**0.00**	**24,345.49**	**0.00**	**5,667,731.11**
	28,987,487.71	**11,856,216.14**	**975,699.78**	**0.00**	**39,868,004.07**

ELSA AKTIENGESELLSCHAFT, AACHEN

ACCUMULATED DEPRECIATION					NET BOOK VALUES	
Jan 1, 1998 DM	Additions DM	Disposals DM	Appreciation DM	Dec 31, 1998 DM	Dec 31, 1998 DM	Dec 31, 1997 DM
600,634.69	311,043.01	2,755.86	0.00	908,921.84	765,245.00	487,229.00
1,294,148.49	537,833.02	0.00	0.00	1,831,981.51	12,916,555.08	9,351,710.08
6,986,259.67	3,056,461.73	743,854.43	0.00	9,298,866.97	4,503,591.00	4,232,876.00
0.00	0.00	0.00	0.00	0.00	3,975,111.56	342,553.18
8,280,408.16	**3,594,294.75**	**743,854.43**	**0.00**	**11,130,848.48**	**21,395,257.64**	**13,927,139.26**
252,114.44	0.00	0.00	252,114.44	0.00	5,166,222.73	4,169,765.86
0.00	0.00	0.00	0.00	0.00	501,508.38	525,853.87
0.00	0.00	0.00	0.00	0.00	0.00	744,342.43
252,114.44	**0.00**	**0.00**	**252,114.44**	**0.00**	**5,667,731.11**	**5,439,962.16**
9,133,157.29	**3,905,337.76**	**746,610.29**	**252,114.44**	**12,039,770.32**	**27,828,233.75**	**19,854,330.42**

Notes to the Consolidated Financial Statements and Notes to the Financial Statements as of December 31, 1998

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.

B Companies included in consolidation

Besides the parent company three companies abroad for which ELSA AG is directly or indirectly entitled to the majority of the voting rights of the shareholders are included in consolidation. See Shares in affiliated companies.

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 middle 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.

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 assets*

Intangible 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 depreciation as scheduled. 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.

- *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.

- *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.

- *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 other accruals are set up for all uncertain liabilities and potential losses. The accruals are set up in the amount necessary under prudent business judgment; they correspond to the expected expenditures and potential losses.

- *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 fixed assets movement schedules (page 34/35 and 40/41):

II Shares in affiliated companies

Name, seat	Share	Subscribed 1) capital Dec 31, 1998 DM	Equity 1) Dec 31, 1998 DM	Result 1) 1998 DM	Time of initial consolidation
ELSA, Inc., Santa Clara, California, USA.	100%	83,450.00	-414,883.36	-4,624,974.25	Jan 1, 1997
ELSA Japan, Inc., Tokio, Japan	95%	869,400.00	-787,193.38	-1,656,593.98	Dec 15, 1997
ELSA ASIA, Inc., Taipeh, Taiwan	95%	652,562.50	365,300.00	-287,265.50	Apr 1, 1998

1) For currency translation the exchange rates of the balance sheet date are used.

Reference is made to the explanations on 'Companies included consolidation'.

III 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.

IV Deferred taxes

Approx. KDM 287 of the deferred tax assets of the ELSA Group amounting to approx. KDM 387 result from the individual financial statements of the companies included in consolidation. Deferred tax assets of approx. KDM 343 contrast with deferred taxes on the liability side of KDM 56. Moreover deferred tax assets of approx. KDM 80 were shown in the balance sheet due to consolidation measures with effect on result pursuant to § 306 HGB.

V Subscribed capital

After the initial public offer, which has been carried out on the 10th of June 1998, the share capital of the company has a nominal value of DM 17,500,000, that is composed of 3,500,000 shares. In the course of the IPO 500,000 shares of conditional capital have been issued.

VI Capital surplus

The capital surplus of KDM 83,180 results from the premium paid in the context of the initial public offer (KDM 82,600). The amount of KDM 1,500 at the beginning of the fiscal year has been reduced by an increase in share capital (KDM 920) out of the capital surplus.

VII Earned surplus

Earned surplus has been increased in the fiscal year by the transfer of retained earnings to earned surplus (KDM 6,978) and has been decreased by an increase in share capital out of earned surplus (KDM 6,978).

VIII Profit carried forward from prior year

Profit carried forward from prior year decreased from KDM 7,000 by KDM 6,978 to KDM 22 due to a transfer to earned surplus.

IX Other accruals

Other accruals consist mainly of warranty obligations, reimbursement of storage costs and vacation claims.

X Liabilities

Liabilities of the **ELSA Group** as of December 31, 1998:

	Residual term				
	Less than 1 year DM	**2-5 years DM**	**More than 5 years DM**	**Total DM**	**Of which secured by land charges DM**
Loans	0.00	877,500.00	0.00	877,500.00	0.00
Liabilities due to banks	2,703,749.00	2,360,764.00	6,713,042.59	11,777,555.59	9,327,555.59
Advance payments received on account of orders	35,026.69	0.00	0.00	35,026.69	0.00
Trade payables	22,806,232.05	0.00	0.00	22,806,232.05	0.00
Other liabilities	5,607,302.64	0.00	0.00	5,607,302.64	0.00
Total liabilities	**31,152,310.38**	**3,238,264.00**	**6,713,042.59**	**41,103,616.97**	**9,327,555.59**

Liabilities of **ELSA AG** as of December 31, 1998:

	Residual term				
	Less than 1 year DM	**2-5 year DM**	**More than 5 years DM**	**Total DM**	**Of which secured by land charges DM**
Loans	0.00	877,500.00	0.00	877,500.00	0.00
Liabilities due to banks	2,703,749.00	2,360,764.00	6,713,042.59	11,777,555.59	9,327,555.59
Trade payables	22,186,948.66	0.00	0.00	22,186,948.66	0.00
Other liabilities	5,406,372.92	0.00	0.00	5,406,372.92	0.00
Total liabilities	**30,297,070.58**	**3,238,264.00**	**6,713,042.59**	**40,248,377.17**	**9,327,555.59**

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

The loans concern convertible bonds. The bonds with a nominal value of each DM 5.00 bear the right to be converted into one share of ELSA AG. The conversion price equals the price per share at the initial public offer. The conversion can be executed two years after the bonds have been issued at the earliest.

F Explanations to the income statement and the consolidated income statement

Sales

The sales of the fiscal year split up as follows:

ELSA Group

a)	1998 KDM
According to business segments:	
• *Computer graphics*	213,500
• *Data communication*	86,011
	299,511

b)	1998 KDM
According to geographical markets:	
• *Germany*	227,721
• *EU and bordering countries*	38,824
• *North America*	26,616
• *Asia*	6,291
• *Other*	59
	299,511

ELSA AG

a)	1998 KDM
According to business segments:	
• *Computer graphic*	210,578
• *Data communication*	86,010
	296,588

b)	1998 KDM
According to geographical markets:	
• *Germany*	227,721
• *EU and bordering countries*	38,823
• *North America*	23,430
• *Asia*	6,555
• *Other*	59
	296,588

II Extraordinary expenses and income

The extraordinary expenses result from the initial public offer (KDM 6,323) and from not realized acquisitions (KDM 552).

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..

ELSA AG has other financial obligations of KDM 356 resulting from lease obligations. Moreover, at the foreign Group companies the following obligations from rent, leasing and similar continuous obligations exist:

ELSA Group			
1999 KDM	2000 KDM	2001 and beyond KDM	Total KDM
340	13	0	353

The **ELSA Group** has other financial obligations amounting to approx. KDM 709.

II Number of employees

The number of employees developed as follows during fiscal year 1998:

ELSA Group		
	On average	
	1998	**1997**
White-collarworkers	417	340
Blue-collarworkers	69	65
Temporary staffand students	73	84
	559	489

ELSA AG		
	On average	
	1998	**1997**
White-collarworkers	363	315
Blue-collarworkers	69	65
Temporary staffand students	73	84
	505	464

III Bodies

a) **The Board of Management**

The board of the ELSA AG has the following members:

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

In 1998 the total remuneration of the Board members amounted to KDM 1,365.

b) **Supervisory Board**

The Supervisory Board of ELSA AG has the following members:

Chairman:

Dipl.-Ing. Wolfgang Dondorf, Marienheide

Deputies:

Theodor Ludger Lieven, Thinnister-Clermont (B)

Dipl.-Kfm. Dr. Hanno Schmitz-Hüser, Stolberg

Dr. Rüdiger Liebs, Düsseldorf (from May 15, 1998 on)

Representatives of the employees:

Dipl.-Inform. Udo Brocker, Simmerath (from August 18, 1998 on)

Arno Guse, Aachen (from August 18, 1998 on)

The total remuneration of the Supervisory Board amounts to DM 52,000.00 in 1998.

Aachen, February 26, 1999

ELSA AG

The Board of Management

AUDITORS' OPINION

Based upon our audit, we herewith render the following unqualified opinion on the financial statements and the consolidated financial statements of **ELSA AG**, Aachen, as of December 31, 1998 and on the combined management report and Group management report for fiscal year 1998:

> *"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 AG*** *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, February 26, 1999

ARTHUR ANDERSEN
Wirtschaftsprüfungsgesellschaft
Steuerberatungsgesellschaft mbH

Jäckel
Wirtschaftsprüfer

Driesch
Wirtschaftsprüfer

Consolidated Financial Statements according to US-GAAP

REPORT OF INDEPENDENT PUBLIC ACCOUNTANTS

TO THE SHAREHOLDERS OF ELSA AG:

We have audited the accompanying consolidated balance sheets of ELSA AG and subsidiaries as of December 31, 1998 and 1997, and the related consolidated statements of income, cash flows and stockholder's equity for the years then ended.
These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.
We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.
In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of ELSA AG and subsidiaries as of December 31, 1998 and 1997, and the results of their operations and their cash flows for the years then ended in conformity with U.S. generally accepted accounting principles.

ARTHUR ANDERSEN
Wirtschaftsprüfungsgesellschaft
Steuerberatungsgesellschaft mbH

- signed -	- signed -
Jäckel	Driesch
Wirtschaftsprüfer	Wirtschaftsprüfer

Hamburg, Germany
March 6, 1998

Consolidated Statements of Shareholders' Equity

	Capital stock		Capital reserve	Cumulative translation adjustment	Retained earnings
	Number of Shares	Amount DM	Amount DM	Amount DM	Amount DM
Balance, January 1, 1998	1,160,000	5,800,000.00	1,500,000.00	743,979.30	9,066,681.92
Capital increase	2,340,000	11,700,000.00	82,600,000.00	0.00	0.00
Initial public offer costs	0	0.00	-6,322,534.78	0.00	0.00
Increase in share capital out of capital reserve/retained earnings	0	0.00	-920,000.00	0.00	-6,978,000.00
Loss attributable to minorities	0	0.00	0.00	0.00	91,407.32
Net loss	0	0.00	0.00	0.00	-5,869,371.83
Translation adjustment for the period	0	0.00	0.00	-487,688.78	0.00
Balance, December 31, 1998	**3,500,000**	**17,500,000.00**	**76,857,465.22**	**256,290.52**	**-3,689,282.59**

See accompanying Notes to Consolidated Financial Statements.

Consolidated Balance Sheets as of December 31, 1998

	1998 DM	1997 DM
ASSETS		
CURRENT ASSETS		
Cash and cash equivalents	16,960,327.85	4,023,370.26
Accounts receivable trade	30,140,885.68	21,780,238.73
Other receivables	9,615,855.28	3,241,092.91
Inventories	49,468,441.29	54,779,017.66
Prepaid expenses	556,608.15	1,501,916.45
Other current assets	13,294.58	291,310.35
Deferred tax assets	4,511,728.12	0.00
	111,267,140.95	**85,616,946.36**
PROPERTY, PLANT AND EQUIPMENT		
Land, land improvements and buildings	13,441,445.08	9,693,398.08
Machinery and equipment	6,916,770.72	6,101,829.35
Advance payments	3,975,111.56	0.00
	24,333,327.36	**15,795,227.43**
LONG TERM INVESTMENTS	**588,530.04**	**525,854.87**
INTANGIBLE ASSETS		
Licenses and similar rights	797,702.17	521,039.34
Software costs	4,585,845.40	2,839,992.86
	5,383,547.57	**3,361,032.20**
TOTAL ASSETS	**141,572,545.92**	**105,299,060.86**

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

	1998 DM	1997 DM
LIABILITIES AND SHAREHOLDERS' EQUITY		
CURRENT LIABILITIES		
Short-term borrowings incl. current portion		
of long-term debt	2,738,775.69	33,846,485.39
Accounts payable trade	22,806,232.05	22,580,291.23
Accounts payable other	5,607,302.64	3,114,747.61
Accrued liabilities	5,473,098.27	6,614,097.51
	36,625,408.65	**66,155,621.74**
NON-CURRENT LIABILITIES		
Long-term debt	9,073,806.59	7,785,502.52
Provision for pensions	541,832.00	478,647.00
Deferred tax liability	3,544,834.72	2,227,972.38
	13,160,473.31	**10,492,121.90**
	49,785,881.96	**76,647,743.64**
DORMANT PARTNER	**0.00**	**11,500,000.00**
LOANS	**877,500.00**	**0.00**
MINORITY INTERESTS	**-15,309.19**	**40,656.00**
SHAREHOLDERS' EQUITY		
Capital stock	17,500,000.00	5,800,000.00
Capital reserve	76,857,465.22	1,500,000.00
Retained earnings	-3,689,282.59	9,066,681.92
Cumulative translation adjustment	256,290.52	743,979.30
	90,924,473.15	**17,110,661.22**
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	**141,572,545.92**	**105,299,060.86**

Consolidated Statement of Income for the Year ended December 31, 1998

	1998 DM	1997 DM
Revenues	299,510,711.56	286,565,103.07
Cost of goods sold	244,463,313.41	217,906,895.56
	55,047,398.15	**68,658,207.51**
Selling expenses	48,855,969.94	36,674,497.72
Research and development expenses	11,487,817.62	8,289,580.54
General and administrative expenses	12,475,648.71	9,858,554.15
Other revenues and gains	4,287,471.20	4,327,707.66
Operating loss/income	**-13,484,566.92**	**18,163,282.76**
Interest income	323,895.09	46,969.31
Interest expense	2,470,775.65	2,849,519.78
Income from continuing operations	**-15,631,447.48**	**15,360,732.29**
Income taxes	-10,313,711.94	7,782,757.32
Non operational result	-551,636.29	0.00
Cumulative effects of changes in accounting principles (less applicable income tax of DM 0.00; 1997: DM 371,358.37)	0.00	-279,815.93
Net income	**-5,869,371.83**	**7,298,159.04**
Cumulative effects of changes in accounting principles per share	0.00	-0.24
Earnings per share	-1.68	6.29
Individual/ordinary shares outstanding	**3,500,000**	**1,160,000**

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

CONSOLIDATED STATEMENT OF CASH FLOWS

Cash flows from operating activities

	1998 DM	1997 DM
Net income	-5,869,371.83	7,298,159.04
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	6,530,311.61	4,079,969.95
Change in provision for pensions	63,185.00	54,440.00
Change in inventories	5,310,576.37	-25,222,814.91
Change in trade accounts receivable	-8,360,646.95	1,596,717.60
Change in other assets	-9,663,166.42	-4,482,566.76
Change in accruals for taxes	1,316,862.34	1,377,612.57
Change in other accruals	-1,140,999.24	-3,456,382.52
Change in trade accounts payable	225,940.82	1,769,893.98
Change in other accounts payable	2,492,555.03	-481,696.47
Net cash provided by (used in) operating activities	**-9,094,753.27**	**-17,466,667.52**
Cash flows from investing activities:		
Intangible asset additions	-5,143,987.94	-3,294,828.39
Tangible fixed asset additions	-11,946,938.97	-4,731,760.97
Change in financial fixed assets	-62,675.17	3,857,529.44
Net cash provided by (used in) investing activities	**-17,153,602.08**	**-4,169,059.92**
Cash flows from financing activities:		
Change in short-term borrowings, net	-31,107,709.70	20,481,336.47
Increase in loans	877,500.00	0.00
Increase in long-term debt	1,288,304.07	2,552,664.89
Change in minority interest	-55,965.19	40,656.00
Change in dormant partnership	-11,500,000.00	5,500,000.00
Increase in capital stock	11,700,000.00	500,000.00
Increase in paid-in capital	75,357,465.22	1,500,000.00
Change retained earnings except income/loss	-6,886,592.68	-7,300,000.00
Net cash provided by (used in) financing activities	**39,673,001.72**	**23,274,657.36**
Cumulative translation adjustment	**-487,688.78**	**743,979.30**
Increase in cash and cash equivalents	12,936,957.59	2,382,909.22
Cash and cash equivalents at beginning of year	4,023,370.26	1,640,461.04
Cash and cash equivalents at end of year	**16,960,327.85**	**4,023,370.26**

See accompanying Notes to Consolidated Financial Statements.

Notes to Consolidated Financial Statements according to US-GAAP for Fiscal Year ended December 31, 1998

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Description of business

ELSA AG, Aachen (the Company), and its subsidiaries develop, market and support multimedia hardware as well as communication hardware, both for the home consumer and the corporate desktop and the small office/home office markets respectively. All of its computergraphic products and most of the communication products have been developed in-house and are distinguished by their high quality.

Basis of presentation

The consolidated financial statements have been prepared in accordance with U.S. generally accepted accounting principles ("U.S. GAAP"). All amounts in the accompanying consolidated financial statements are presented in Deutsche Mark ("DM").

Principles of consolidation

The consolidated financial statements include the accounts of the Company and all of its majority-owned subsidiaries. All intercompany balances and transactions have been eliminated in accordance with Statement of Financial Accounting Standards ("SFAS") No. 94 "Consolidation of All Majority-owned Subsidiaries". Business combinations are recorded under the purchase method of accounting.

The financial statements of the Company's foreign entities are measured in the currency in which that entity primarily conducts its business (the functional currency). The functional currency of all the Company's foreign entities is the applicable local currency. When translating foreign functional currency financial statements in Deutsche Mark, year-end exchange rates are applied to asset and liability accounts, while average annual rates are applied to income statement accounts. The foreign currency translation is based on an US-Dollar per Deutsche Mark closing rate of 1.67 (1997: 1.78) and an average rate of 1.76 (1997: 1.74), Yen per Deutsche Mark closing rate and average rate 0.052, Taiwan-Dollar per Deutsche Mark closing rate 0.015 and an average rate 0.013. Adjustments resulting from the translation process are recorded in a separate component of shareholders' equity. Foreign currency transaction gains and losses resulting from the settlement of amounts receivable or payable denominated in a currency other than the functional currency are credited or charged to income.

Cash and cash equivalents

For purposes of the statement of cash flows, the Company considers all highly liquid financial investments purchased with an original maturity of three months or less to be cash equivalents. Cash and cash equivalents is not deducted by short-term liabilities due to banks.

Inventories

Inventories are stated at the lower of cost or market value, which is principally determined on an average basis with the exception of raw materials, which have been valued according to the FIFO-method since 1997. The cumulative effect of this change in accounting principles has been disclosed separately in the consolidated income statement of 1997. Inventory reserves are established for slow-moving or obsolete inventory based on the passage of time and historical and projected sales activity.

Fixed assets, depreciation and maintenance

Property, plant and equipment are stated at cost. The Company computes depreciation on fixed assets using the straight-line method. The estimated useful lives are as follows: 40 years for buildings, 5 to 8 years for machinery and 4 years for office equipment. Expenditures for maintenance and repairs are expensed; expenditures for renewals and improvements are generally capitalized. Upon sale or retirement of an asset, the related cost and accumulated depreciation or impairments are removed from the accounts and any gain or loss is recognized. In the event that facts and circumstances indicate that assets may be impaired, an evaluation of recoverability would be performed.

Intangible assets

Intangible assets include licenses as well as capitalized software development costs if technological feasibility has been established. Periodic costs such as maintenance and on-going customer support are expensed. Depreciation on licenses is computed using the straight-line method and an estimated useful life of 3 years.

Research and development

Research and development costs are charged to expenses as incurred, except for certain software development costs.

Software developments costs fulfilling the capitalization criteria established by SFAS No. 86 "Accounting for the Costs of Computer Software to be sold, leased, or otherwise marketed" are capitalized. Capitalized software development costs are amortized each reporting period by the greater:

- (a) the ratio of current gross revenues from sales of the product which the software forms an integral part of to the total of current and anticipated future gross revenues from sales of the respective product or
- (b) the straight-line method over the estimated useful life of the product which the software forms an integral part of (normally 10 to 15 months respectively).

Software development costs not fulfilling the capitalization criteria are charged to expenses as incurred.

Income taxes

The Company accounts for income taxes in accordance with SFAS No. 109 "Accounting for Income Taxes". Therefore, deferred tax assets and liabilities are recognized for the future consequences attributable to differences between the consolidated financial statements carrying amounts of existing assets and liabilities and their respective tax basis.

Revenue recognition

The Company's product revenues are recognized when the title to the product has passed to the customer, either at the time of shipment or upon receipt by the customer. Service and other revenues are recorded when services are performed.

Earnings per share

Basic earnings per share have been calculated dividing net income by the number of ordinary shares outstanding. Diluted earnings per share are neither disclosed nor computed as the Company has not issued any potential ordinary shares.

Use of estimates

The preparation of consolidated financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying notes. Actual results could differ from those estimates.

Concentration of credit risk

The Company is engaged in the production and sale of computer hardware products with a software component as integral part and thus potentially subject to a concentration of credit risk which consists primarily of cash and accounts receivable. By policy, the Company places cash and other liquid investments with high-quality financial institutions.

To reduce credit risk related to accounts receivable, the Company generally performs credit evaluations based on its customers' financial condition and references. The Company also maintains insurance contracts to protect them against certain potential uncollectable accounts. In case of uncollectability, the Company will receive 75% of the outstanding balance or the credit limit designated by the insurance company, whichever is lower. The insurance company requires collection actions to be documented by the Company and a customers insolvency proof.

2. ACCOUNTS RECEIVABLES

Accounts receivables amount to DM 39,756,740.96 (DM 25,021,331.64 at December 31, 1997), net of allowances for doubtful accounts of DM 701,314.00 (DM 757,226.11 at December 31, 1997).

3. INVENTORIES

Inventories consist of the following:

	1998 DM	1997 DM
Raw materials	20,662,667.95	25,920,995.70
Work-in-process	12,730,491.27	10,879,857.69
Finished goods	16,535,371.52	18,584,558.10
	49,928,530.74	55,385,411.49
Reserves	-460,089.45	-606,393.83
	49,468,441.29	54,779,017.66

4. PROPERTY, PLANT AND EQUIPMENT

Property, plant and equipment consist of the following:

	1998 DM	1997 DM
Land, land improvements and buildings	14,748,536.59	10,645,858.57
Machinery and equipment	17,336,777.85	13,783,807.15
Advance payments	3,975,111.56	0.00
	36,060,426.00	24,429,665.72
Accumulated depreciation	-11,727,098.64	-8,634,438.29
	24,333,327.36	15,795,227.43

5. INTANGIBLE ASSETS

The intangible assets include capitalized software development costs of DM 4,585,845.40 (1997: DM 2,839,992.86) and licenses or trade marks of DM 797,702.17 (1997: DM 521,039.34), net of accumulated amortization of DM 4,264,324.23 (1997: DM 1,257,716.29) and DM 932,426.37 (1997: DM 608,560.39) respectively.

6. SHORT-TERM AND LONG-TERM BORROWINGS

Substantially all of the borrowings are denominated in Deutsche Mark. Interest rate for this short-term debt amounts to 4.90%. As of the fiscal year end the Company had available approximately DM 59 Mio. under the agreed lines of credit.

Long-term borrowings, excluding the current portion of DM 253,749.00 (1997: DM 506,067.00), at December 31, 1998 DM 9,073,806.59 (1997: DM 7,785,502.52), consist of loans, which are generally secured by mortgage bonds on the Company's premises in Aachen. Interest rates range from 6.00 to 8.50%.

Principal payments of long-term debt are as follows:

	DM
1999	253,749.00
2000	437,004.00
2001	621,431.00
2002	640,791.00
Thereafter	7,374,580.59
	9,327,555.59

7. DORMANT PARTNER

The "S-UBG Aktiengesellschaft Unternehmensbeteiligungsgesellschaft der Wirtschafts-region Aachen" (S-UBG), Aachen, held a dormant partnership in ELSA AG, Aachen, that amounted to KDM 11,500 as of December 31, 1997. After the initial public offer the dormant partnership was paid back in June 1998.

8. LOANS

The loans concern convertible bonds that bear interests of 4% p. a. The bonds with a nominal value of each DM 5.00 bear the right to be converted into one share of ELSA AG. The conversion price equals the price per share at the initial public offer. The conversion can be executed two years after the bonds have been issued at the earliest.

9. MINORITY INTERESTS

This item comprises minority stockholders' in the equity of consolidated subsidiaries. In 1998, minority interests of DM –15,309.15 derive from a minority shareholder of ELSA Japan, Inc., Tokyo, Japan and ELSA Asia, Inc., Taipeh, Taiwan.

10. CAPITAL STOCK

After the initial public offer, which has been carried out on June 10, 1998, the share capital of the company has a nominal value of DM 17,500,000.00, that is composed of 3,500,000 individual shares. In course of the IPO 500,000 shares of conditional capital have been issued.

11. CAPITAL RESERVE

The capital reserve of KDM 83,180 results from the premium paid in the context with the initial public offer (KDM 82,600). The amount of KDM 1,500 at the beginning of the fiscal year has been reduced by an increase in share capital (KDM 920) out of the capital reserve.

12. PROVISIONS FOR PENSIONS

The pension obligations and their respective period pension costs are determined using the projected unit credit method in accordance with U.S. generally accepted accounting principles as defined by SFAS No. 87 "Employers' Accounting for Pensions". In Germany selected ELSA AG's key employees are covered by defined benefit plans that take years of service and salary earned into consideration.

The total net periodic pension cost is comprised of the following:

	1998 DM	1997 DM
Service cost	79,225.00	75,059.00
Interest cost	6,110.00	1,531.00
Net amortization	-6,244.00	-22,150.00
Net periodic pension cost	79,091.00	54,440.00

The status of all defined benefit plans based on the projected benefit obligation is as follows:

	1998 DM	1997 DM
Accumulated benefit obligation, thereof vested benefit obligation of: DM 0,00	180,928.00	101,837.00
Projected benefit obligation	180,928.00	101,837.00
Unrecognized net gain	6,509.00	265.00
Unrecognized transition gain	354,395.00	376,545.00
Provision for pensions	541,832.00	478,647.00

Actual values were computed with official tables based on the following assumptions:

	1998 DM	1997 DM
Interest rate	6.0%	6.0%
Cost-of-living adjustment rate	2.0%	2.0%

13. OTHER REVENUES AND GAINS

Other revenues and gains mainly include:

	1998 DM	1997 DM
Foreign exchange gains	1,644,039.61	2,013,012.88
Bad debt recoveries	595,874.99	830,919.26
Insurance compensations	335,588.07	281,903.69
Gains from appreciation	252,114.44	0.00
Refund from customs office	219,356.72	0.00
Income from the release of provision	218,346.29	655,758.80
Income from offset remuneration in kind	139,279.60	138,666.70
Subsidies for research and development	114,482.50	0.00
Gains on the disposal of non-current assets	0.00	224,192.26
Miscellaneous	768,388.98	183,254.07
	4,287,471.20	4,327,707.66

14. INCOME TAXES

The income tax provisions (benefits) are summarized as follows:

	1998 DM	1997 DM
Current -		
domestic	-4,707,370.00	4,691,422.89
foreign	-2,392,844.60	2,747,593.98
	-7,100,214.60	7,439,016.87
Deferred -		
domestic	-1,769,616.18	471,207.63
foreign	-1,443,881.16	-127,467.18
	-3,213,497.34	343,740.45
Income tax provision	-10,313,711.94	7,782,757.32

	1998 DM	1997 DM
Deferred tax assets		
Loss carry forwards	4,511,728.12	0.00
Deferred tax assets		
Inventories	79,813.92	279,485.42
Other	321,165.41	358,479.26
	400,979.33	637,964.68
Deferred tax liabilities		
Software costs	2,615,275.41	1,619,628.05
Property, plant and equipment	1,130,204.31	960,298.70
Inventories	31,762.83	171,421.82
Provision for pensions	35,441.14	17,282.16
Other	133,130.36	97,306.33
	3,945,814.05	2,865,937.06
Net deferred tax liability	3,544,834.72	2,227,972.38

A reconciliation of income taxes is displayed in the following. The applicable German federal corporate tax rate is 45% plus a surcharge of 5.5%, taking the planned accumulation of capital by retention of earnings into consideration. Moreover, the Company is subject to the federal tax benefit rate for trade taxes of 9.395%, leading to a combined statutory rate of 57.03%.

	1998 DM	1997 DM
Expected tax	-9,229,212.68	8,873,895.04
Foreign tax rate differential	1,650,461.75	-836,155.37
Non-taxable income/non-deductible expenses	0.00	251,194.32
Tax rate deduction	847,883.46	-22,931.70
Permanent difference according to IPO	-3,605,741.14	0.00
Other	22,896.67	-483,244.97
Income tax provision	-10,313,711.94	7,782,757.32

15. NON OPERATIONAL RESULT

The non operational result of DM 551,636.29 concerns consulting fees in circumstance with a planned but failed acquisition of an investment.

16. LEASES AND RENTALS

On July 1, 1997, the Company entered into a long-term operating lease for its Santa Clara facility. The lease term is for 27 months. The Company is responsible for its share of operating expenses based upon its percentage share of square footage leased.

During the year ended December 31, 1998, rental expense, including operating costs, under non-cancellable long-term operating lease obligations was DM 661,904.40 (1997: DM 383,849.22).

Future minimum operating lease payments as of December 31, 1998 are as follows:

ELSA Group			
1999 DM	2000 DM	2001 and thereafter DM	Total DM
340,030.38	13,276.90	0	353,307.28

17. RELATED COMPANIES

The Company holds shares in the following companies:

Name, seat	Portion of share capital in %	Equity Dec 31, 1998 DM	Financial year's result DM
ELSA, Inc., Santa Clara, California, USA.	100%	-414,883.36	-4,624,974.25
ELSA Japan, Inc., Tokyo, Japan	95%	-787,193.38	-1,656,593.98
ELSA Asia, Inc., Taipeh, Taiwan	95%	365,300.00	-287,265.50

18. SEGMENT REPORTING

Segment Information by Division	Year	Computergraphics KDM	Communication KDM	Others KDM	ELSA Consolidated KDM
External sales	1997	196,692	89,873	0	286,565
Total sales	1997	196,692	89,873	0	286,565
Operating Income	1997	15,836	2,327	0	18,163
Assets	1997	67,537	26,866	10,896	105,299
Depreciation	1997	926	593	3,377	4,896
Capital expenditures	1997	2,788	1,274	670	4,732

Segment Information by Division	Year	Computergraphics KDM	Communication KDM	Others KDM	ELSA Consolidated KDM
External sales	1998	213,500	86,011	0	299,511
Total sales	1998	213,500	86,011	0	299,511
Operating Income	1998	-12,815	-670	0	-13,485
Assets	1998	92,568	27,304	21,701	141,573
Depreciation	1998	2,657	1,178	2,751	6,586
Capital expenditures	1998	4,486	1,878	10,814	17,178

Group's revenues are made in the following geographical areas:

Segment Information by geographical area	Year	Germany KDM	Foreign Countries KDM	Eliminations KDM	ELSA Consolidated KDM
External sales	1997	209,038	77,527	0	286,565
Intersegment sales	1997	276	28,468	-28,744	0
Total sales	1997	209,314	105,995	-28,744	286,565
Operating Income	1997	11,940	6,319	-96	18,163
Assets	1997	102,045	12,951	-9,697	105,299

Segment Information by geographical area	Year	Germany KDM	Foreign Countries KDM	Eliminations KDM	ELSA Consolidated KDM
External sales	1998	227,721	71,790	0	299,511
Intersegment sales	1998	954	27,926	-28,880	0
Total sales	1998	228,675	99,716	-28,880	299,511
Operating Income	1998	-4,047	-9,438	0	-13,485
Assets	1998	130,577	10,996	0	141,573

Export sales thereof are KDM 38,883 (1997: KDM 37,774).

For the year ended December 31, 1998, 37.1% (1997: 33.6%) of total revenue consisted of sales for the five major customers.

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.

Graphics card/graphics controller
Alternative terms for a graphics board.

Graphics 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 the Internet.

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 modeling. 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

Stock market flotation

1997

ELSA Japan, Inc., founded in **Tokyo**, Japan
Group result **ELSA AG**

1996

ELSA'S international standing confirmed by **Compaq** as the first international **ELSA-OEM-Partner**

1995

DIN EN ISO 9001 Certification by the TÜV Rhineland, Germany

1993

Entry into the consumer market with products for demanding **private users**

1991

ELSA Asia, Inc., founded in **Taipeh**, Taiwan

1989

ELSA, Inc., founded in **Santa Clara**, California, USA

1986

Computer Graphics business division founded

1980

ELSA GmbH founded

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