FINANCIAL REPORT 3RD QUARTER 1998

ELSA

ELSA AG FINANCIAL REPORT THIRD QUARTER 1998

ELSA AG is a leading supplier of PC peripherals for computer graphics and data communications. The Company has been a pioneer of these markets since the early days of the PC in the mid-nineteen eighties, and its innovations and developments have contributed to shape the market. ELSA's Computer Graphics business division develops, produces and markets 2D and 3D graphics boards and color monitors, while its Data Communications division comprises high-speed modems, ISDN adapters, Internet access routers and videoconferencing systems. Both business divisions offer products for professional users and the ambitious consumer.

THE PC MARKET

In the third quarter of the year, the PC market continued to be characterized by intense price pressure and weakness in sales. In the U.S. in particular, the market for professional graphic systems, due to a changing competitive situation, was difficult. Expectations for a reversed trend and improvements of market conditions for ELSAs products are fueled by the upturn in the market which is already evident in the fourth quarter of 1998.

COMPUTER GRAPHICS

The trends dominating the PC market as a whole directly affected the computer graphics market, and hence the sales of ELSA in this segment. Sales declined slightly in the first three quarters of the year compared with the same period for the previous year; despite an increase in the number of units sold and a resulting improvement in market share. This shows the continued strong price pressure in this segment, and especially in the consumer area, due to excess supply and an ongoing reduction in inventories by both the Company's retail partners and the major PC manufacturers.

DATA COMMUNICATIONS

In its Data Communications business division, ELSA managed to escape the overall negative market trend. Sales in this segment were maintained at a constant level, thus stabilizing market share at a high level despite a general decline in prices. The extremely high acceptance of ELSA's new products is gratifying. For example, 3rd quarter sales of the *LANCOM* Internet access router increased by 220% compared to the previous quarter. Equally, the highly positive reception given to the new *ELSA MicroLink Office* modem by trade press and customers has boosted business. As a result, both products will contribute to additional sales.

SALES

Sales in the first three quarters of the current fiscal year amounted to DM 200.7 million, compared to DM 207.3 million for the same period last year. Of this, DM 138.7 million or 69% were generated by the Computer Graphics business division, and DM 62.0 million or 31% by Data Communications.

EARNINGS

As of the current fiscal year, ELSA has been preparing its accounts according to US GAAP (Generally Accepted Accounting Standards). As a result, the figures can only be compared to a limited extent with those for previous years, which were prepared in accordance with HGB (the German Commercial Code) standards. The trend in earnings recorded during the second quarter continued into the third, resulting in, according to US GAAP, net income of minus DM 4.2 million for the nine months ended. Consolidated DVFA/SG earnings resulted to minus DM 5.1 million or minus 1,46 DM/share.

In particular, ELSA's international business activities continued to impact the Company's results. Start-up losses for the Taiwanese and Japanese subsidiaries were according to plan. Earnings of the U.S. subsidiary were strongly affected by a changing structure of the professional computer graphics market segment, whereas the entry into the mass-volume consumer graphics segment is only starting to show results during the current 4th quarter.

EMPLOYEES

At September 30, 1998, ELSA AG employed 566 staff worldwide, three more employees than in the previous quarter.

BUSINESS OUTLOOK

Sales increased early in the current 4th quarter, continuing the September trend. In the consumer segments, the positive effects of the Christmas season can clearly be recognized. ELSA AG regards this upswing as a first sign of a general trend reversal, ending a difficult cycle for the semiconductor industry, which in turn effects the Company.

ELSA expects its new products to have a positive effect on sales, particularly in the Data Communications area. The announcement of the first European cable modem at the beginning of October 1998 has established

ELSA in this important future market. Cable modems provide low cost and high speed Internet access via conventional TV cable networks. Independent market research is forecasting that the market for this new technology will reach almost two billion dollars in the next five years, with high double-digit annual growth rates. ELSA will expand its market share for data communications products, and will continue to build on its strong position to exploit the positive opportunities offered by the market. The Data Communications division is recording first successes in Great Britain, the first market targeted as part of the European expansion strategy.

ELSA's computer graphics products are currently scoring top marks in various test reports and consumer surveys by major trade publications. Thus, for example, the new 3D games graphics card *ELSA ERAZOR™ II* received excellent reviews even before its retail availability. As a result, ELSA expects its new products to contribute significantly to sales in the coming months. Efforts to establish ELSA in the US consumer graphics market have already led to increasing sales during the present quarter. Here, too, ELSA expects sales to increase in particular due to the positive reception awarded to ELSA products in the U.S. computer trade press. For Japan, the ELSA board expects business to improve significantly in the wake of the Company's current breakthroughs. A break-even in Japan is thus expected for 1999.

Pressure on the cost of goods sold will continue in the last quarter of the year. However, the steady reduction in inventories, especially as a result of the holiday season business—now picking up strongly—will improve the situation. In the medium term, margins achieved with ELSA's new products are improving the Company's effective gross margins, returning these to regular levels.

While anticipated expectations from the acquisition of Hercules Computer Technology Inc. could not be confirmed and ELSA, in the interest of the Company and its shareholders, exercised its right to terminate the negotiations, the Company is continuing its strategy of international growth and expansion of its international sales channels.

Given the Company's excellent position, its innovative products (especially in the Data Communications business division) and prospects for further cooperative ventures and acquisitions, the board is looking to the future with optimism. With the anticipated changes in IT market trends, the fundamentally positive growth opportunities in both the Internet and the PC markets will soon translate into increased sales and improved earnings.

Aachen, November 1998

The Board

ELSA AG, AACHEN – CONSOLIDATED BALANCE SHEET AS OF SEPTEMBER 30, 1998 – HGB (UNAUDITED)

ASSETS	Dec. 31, 1997 DM	Sept.30, 98 DM
A. Fixed assets		
I. Intangible assets		
Concessions, industrial property rights and similar rights and assets and licenses in such rights and assets	521,039.34	1,000,903.15
II. Property, plant and equipment		
1. Land, land rights and buildings including buildings on third-party land	9,351,710.08	13,422,623.66
2. Other equipment, operating and office equipment	4,759,648.35	7,692,008.85
3. Payments on account and assets under construction	342,553.18	1,657,002.29
4. Depreciation on fixed assets		-2,789,070.62
	14,453,911.61	19,982,564.18
III. Financial assets		
1. Shares in affiliated companies	1.00	1.00
2. Other loans	525,853.87	507,813.87
3. Payments on account for financial assets	744,342.43	0.00
	1,270,197.30	507,814.87
	16,245,148.25	21,491,282.20
B. Current assets		
I. Inventories		
1. Raw materials and supplies	25,459,544.74	23,250,906.57
2. Work in process	10,680,528.73	15,121,529.06
3. Finished goods and merchandise	18,338,358.66	20,585,964.88
4. Payments on account	8,118.37	1,037,981.81
	54,486,550.50	59,996,382.32
II. Receivables and other assets		
1. Trade accounts receivable	21,723,680.03	24,148,067.37
2. Other assets	3,532,403.26	11,059,609.25
	25,256,083.29	35,207,672.62
III. Checks, cash-in-hand, postal giro and Bank balances	4,023,370.26	10,445,658.07
C. Deferred tax assets	513,624.60	0.00
D. Prepaid expenses	406,902.47	325,904.94
	100,931,679.37	127,466,904.15

ELSA AG, AACHEN – CONSOLIDATED BALANCE SHEET AS OF SEPTEMBER 30, 1998 – HGB (UNAUDITED)

EQUITY AND LIABILITIES	Dec. 31, 1997 DM	Sept. 30, 98 DM
A. Equity		
I. Subscribed capital	5,800,000.00	17,500,000.00
II. Capital reserves	1,500,000.00	83,180,000.00
III. Revenue reserves	735.11	595.30
IV. Consolidated retained earnings	7,000,195.45	-11,190,572.19
	14,300,930.56	89,490,023.11
B. Difference from capital consolidation	98,332.66	98,332.66
C. Minority interest	40,656.00	79,831.92
D. Currency translation adjustment	541,684.89	14,635.82
E. Dormant partner interest	11,500,000.00	0.00
F. Provisions		
1. Provisions for pensions	508,951.00	591,449.00
2. Tax provisions	2,793,730.83	0.00
3. Other provisions	3,820,366.68	3,830,191.98
	7,123,048.51	4,421,640.98
D. Liabilities		
1. Liabilities to banks	41,631,987.91	15,892,160.26
2. Trade accounts payable	22,580,291.23	15,305,969.12
3. Other liabilities	3,114,747.61	2,164,310.28
	67,327,026.75	33,362,439.66
	100,931,679.37	127,466,904.15

ELSA AG – CONSOLIDATED INCOME STATEMENT – HGB
FOR THE PERIOD JANUARY 1, 1998 TO SEPTEMBER 30, 1998
(UNAUDITED)

	Jan. – Sept. 1997 DM	Jan. – Sept. 1998 DM
1. Sales	207,173,256.85	200,650,461.54
2. Increase in finished goods inventories and work in process	-5,859,024.06	6,491,901.00
3. Own work capitalized	0.00	0.00
4. Other operating income	584,755.00	2,628,913.05
5. Cost of materials	135,370,831.03	152,181,957.73
6. Personnel expenses	24,980,729.08	30,484,530.55
7. Depreciation on intangible fixed assets and tangible assets	2,275,473.55	3,278,049.26
8. Other operating expenses	24,321,253.47	33,951,621.39
9. Income from long-term loans	440,023.00	0.00
10. Other interest and similar income	28,855.65	155,348.37
11. Interest and similar expenses	1,377,444.34	1,574,024.37
12. Results from ordinary activities	14,042,134.97	-11,543,523.34
13. Extraordinary results	0.00	-6,087,198.36
14. Taxes on income	5,254,286.92	-6,950,064.68
15. Other taxes	29,026.00	9,186.00
16. Profit attributable to dormant partner	845,620.00	500,729.17
17. Consolidated net income/net loss for the year	7,913,202.05	-11,190,572.19

ELSA AG – CASH FLOW STATEMENT AS OF SEPTEMBER 30, 1998 – HGB (UNAUDITED)

		DM
1.	Consolidated net income for the year	-11,190,572.19
2.	Depreciation including low-value assets	3,278,049.26
3.	DVFA/SG cash flow	-7,912,522.93
4.	Increase/decrease in provisions	-2,701,407.53
5.	Increase/decrease in inventories	-5,509,831.82
6.	Increase/decrease in receivables	-9,951,593.33
7.	Other non-cash income and expenses	80,997.53
8.	Increase/decrease in liabilities	-8,224,759.44
9.	Net cash used in operating activities	-25,994,358.08
10.	Proceeds from the disposal of fixed assets	190,652.02
11.	Payments for investments in fixed assets	-8,449,968.46
12.	Proceeds from the disposal of financial assets	762,382.43
13.	Net cash used in investing activities	-7,469,934.01
14.	Increase in capital stock	86,379,664.74
15.	Distributions to shareholders	-11,460,824.08
16.	Capital consolidation/currency translation adjustments	-428,000.14
17.	Repayments of liabilities to banks	2,353,637.51
18.	Deferred tax assets	-513,624.60
19.	Net cash provided by financing activities	76,330,853.43
20.	Total increase in cash and cash equivalents	34,515,752.97
21.	Cash and cash equivalents at the beginning of the period	-29,823,115.13
22.	Cash and cash equivalents on 30 September, 1998	4,692,637.84

ELSA AG – CONSOLIDATED BALANCE SHEET AS OF SEPTEMBER 30, 1998 – US-GAAP (UNAUDITED)

ASSETS	Sept. 30, 98 DM
Current Assets	
Cash and cash equivalents	10,445,658.07
Trade accounts receivable	24,204,626.07
Other receivables	698,900.12
Inventories:	
Finished goods inventories	22,103,753.70
Work in process	15,261,378.94
Raw materials, consumables and supplies	23,250,906.57
Prepaid expenses	1,982,907.23
Other assets	10,360,709.13
	108,308,839.83
Property, plant and equipment	
Land, land improvements and buildings	11,006,300.97
Machinery and equipment	9,063,864.90
	20,070,165.87
Long-term investments	507,814.87
Deferred tax assets	
Intangible assets	
Licenses	1,000,903.15
Software	3,357,136.42
	4,358,039.57
	133,244,860.14

ELSA AG – CONSOLIDATED BALANCE SHEETS AS OF SEPTEMBER 30, 1998 – US-GAAP (UNAUDITED)

LIABILITIES AND SHAREHOLDERS' EQUITY	Sept. 30, 98 DM
Current Liabilities	
Short-term borrowings incl. current portion of long-term debt	5,753,020.23
Trade accounts payable	15,305,969.12
Other accounts payable	2,164,310.29
Other provisions	6,571,788.96
	29,795,088.60
Non-current liabilities	
Long-term debt	10,139,140.03
Provisions for pensions	561,145.00
Provisions for taxes incl. deferred tax liabilities	0.00
	10,700,285.03
Dormant partner interest	0.00
Minority interest	0.00
Shareholders' equity	
Capital stock	17,500,000.00
Capital reserves	77,092,801.64
Retained earnings	-2,140,077.27
Cumulative translation adjustments	296,762.14
	92,749,486.51
	133,244,860.14

ELSA AG – CONSOLIDATED INCOME STATEMENT – US-GAAP FOR THE PERIOD JANUARY 1, 1998 TO SEPTEMBER 30, 1998 (UNAUDITED)

		DM
1.	Revenues	200,730,650.61
2.	Cost of goods sold	157,787,497.33
3.	Gross margin on sales	42,943,153.28
4.	Selling costs	30,962,839.76
5.	Research and development expenses	8,964,393.06
6.	General and administration expenses	13,208,715.88
7.	Other revenues and gains	2,118,127.09
8.	Other expenses	989,219.17
9.	Interest income	155,384.37
10.	Interest expense	2,247,985.48
11.	Income from continuing operations	-11,156,488.61
12.	Income taxes	-6,950,064.68
13.	Cumulative effect of changes in accounting principles	0.00
14.	Net income or loss for the year	-4,206,423.93

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