# Sophos Limited

(formerly Sophos Plc)

Directors' report and consolidated financial statements

Registered number 2096520

March 31, 2011

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## Directors' report

The directors of Sophos Limited (the Company) present their annual report with the audited consolidated financial statements of Sophos Limited and its subsidiaries (the Group) for the year ended March 31, 2011

### *Principal activities*

Sophos Limited (Sophos) is a world leader in IT security and data protection Following the acquisition of Endforce in 2007 and the Utimaco Group (Utimaco) in October 2008 it offers organizations complete protection and control by defending against known and unknown malware, spyware, intrusions, unwanted applications, spam, policy abuse and data leakage whilst providing comprehensive network access control (NAC) With the proposed acquisition of Astaro Software AG (Astaro), a Network Security Vendor, Sophos will become the first Group in the industry to deliver coordinated threat and data protection from every endpoint to any network boundary for greater security effectiveness

Sophos has over 20 years of experience and its products protect over 100 million users in around 150 countries with reliably engineered security solutions and services Recognized for its high level of customer satisfaction and powerful yet easy to use solutions, Sophos has received many industry awards and is rated as a market leader in endpoint protection and data protection by Gartner

The Group's solutions are backed by Genotype technology and security intelligence expertise from SophosLabs™, a global network of threat research centers which analyze web and email traffic 24 hours a day, 7 days a week to provide real-time detection and protection against emerging threats

Sophos remains focused on serving the enterprise market, including small and medium sized businesses, large global corporations, educational institutions and government agencies

### *Business review*

Sophos expanded its email and web security product lines to more broadly appeal to both smaller and larger organizations through the introduction of new 100-series devices, new deployment modes for the web appliances to fit within corporate architectures and virtualized appliance deployment options Critical features to meet the mid-market were also expanded to provide more enhanced reporting capabilities over web traffic and enhanced DLP technology over email to facilitate better oversight of corporate sensitive data

Sophos further broadened its data protection portfolio with the release of SafeGuard 5 50 which added support for MacOS, Windows7 and 64-bit platforms to the product Further investments in robustness, simplicity and ease of use have also been made and continue to be a focus of the Company

Sophos also extended its endpoint security product line with two new releases Version 9 5 added 'Live Protection', a cloud lookup service to SophosLabs™ to block access to malicious websites at the endpoint and provide real-time malware protection capabilities Version 9 7 added further protection and performance enhancements allowing Sophos to maintain its position as a class leading provider of anti-malware solutions

*Summary of key performance indicators*

| | Year ended March 31, 2011 | Year ended March 31, 2010 | Growth |
|---|---|---|---|
| Billings[1] | $343 6m | $334 6m | 2 7% |
| Adjusted operating profit/(loss)[2] | $61 6m | $24 6m | 150% |
| Cash EBITDA[3] | $94 8m | $77 4m | 22 5% |
| Unlevered free cash flow[4] | $73 7m | $56 4m | 30 7% |

Key performance indicators (KPIs) are the measures of success that management uses to monitor the performance of the Group As a result of its subscription-based model, Sophos uses billings (rather than revenue) and Cash EBITDA (vs reported EBITDA) as key business metrics

Billings represent the full value of the products and services to be delivered under a subscription agreement typically lasting between 1 to 3 or more years, with customers paying Sophos in cash up-front for such subscriptions once the Company initially delivers the applicable products and/or services to them Under International Financial Reporting Standards ("IFRS") and U S GAAP, subscription revenue is deferred and results from the spreading of the billings value over the life of the contract

While the business is growing, billings exceed reported revenue while cash costs, on the other hand, are usually incurred and reported in the same period Billings are broadly equivalent to the cash receipts in a period and reflect the current performance of the business, while revenue is a reflection of historical performance

Management, in conjunction with its existing lenders, defines Cash EBITDA as billings minus cost of sales and other operating costs Cash EBITDA is viewed by management as a more appropriate earnings and cash flow measure than reported EBITDA Management deems the costs and operating expenses of the business to be the same for both Cash EBITDA and reported EBITDA due to the following factors

Approximately 60% of the technical support costs in a given year relate to billings in that same year, as a majority of the technical support costs relating to a given subscription typically occur on or shortly after the initiation date Total technical support costs in FY2011 were $15 4 million or 6 7% of total operating costs

Despite continued challenging economic conditions, which have been further influenced by environmental factors such as the volcanic ash cloud in April 2010 and the earthquake in Japan early in 2011, Sophos has been able to demonstrate continued success with billings growth of 2 7% from $334 6m to $343 6m (5% at constant exchange rates) Sophos was able to achieve this growth due to strong retention and growth in the existing customer base In addition our core product sales have performed strongly this year, with sales of email and web appliances up 20% year on year Sophos is a strong contender within the industries in which it operates, improving sales to large customers as well as the broader SME market during the year

[1] Billings is defined as the value of products and services invoiced to customers after first receiving a purchase order from them and delivering the product/service to the customer, or for which there is no right to a refund for undelivered elements

[2] Operating profit adjusted to add back depreciation of tangible assets, amortization of intangible assets, stock option charges, and exceptional costs

[3] Adjusted operating profit with billings income replacing recognized revenue, further adjusted for unrealized foreign exchange and other one off items

[4] Net cash flow from operating activities less purchase of property, plant and equipment and purchase of intangible assets

Growth rates varied by region with growth in the major geographies of 2% in North America, 15% in the UK and overall growth of 3% This revenue growth can be attributed to offering a compelling value proposition in the mid market based on a portfolio that has broad functionality but low cost of ownership

The majority of Sophos' products are licensed on a subscription basis allowing customers to benefit from the security intelligence generated by SophosLabs™ and access to technical support throughout the subscription period which is generally between one and five years Revenue is then recognized ratably over the subscription period Data Protection products differ in that customers purchase a perpetual license with revenue recognized at the date of delivery Maintenance, in both instances, is recognized over the length of the maintenance contract Consequently, the revenue relating to a significant amount of the billings booked during the year is deferred and recognized in future periods Whilst this guarantees a future revenue stream, it is not the most effective measure of current performance Revenue recognized during the year was $306 8m (growth of 8 8% on prior year revenue of $281 9m)

Deferred revenue increased from $302 6m to $352 8m Of this, $197m will be released to the Consolidated Income Statement in the year ending 31 March 2012 Long-term deferred revenue remains relatively stable at 44% of total deferred revenue (2010 42 8%)

Adjusted operating profit includes cost of sales of $39 4m (2010 $51 0m) This represents 11 5% of billings (2010 15 2%) Excluding exceptional costs, operating costs (comprising sales and marketing costs, research and development costs and administration costs) decreased from $259 3m to $230 6m in 2011 Included within this cost is amortization on Utimaco intangibles of $18 1m (2010 $34 4m), the decrease reflects the Group policy to amortize these assets on a reducing balance basis Excluding depreciation, amortization, share based payments, exceptional and one-off costs the underlying decrease in operating expenses was $17 4m (from $206 2m in 2010 to $188 9m in 2011) Adjusted operating profit increased from $24 6m in 2010 to $61 6m in 2011

Unlevered free cash flow increased by $17 3m to $73 7m in 2011 (2010 $56 4m) The Sophos business model encourages strong cash flows as invoices are raised at the beginning of the license period Cash collection remains a key driver of unlevered free cash flow and it remained strong at 55 days (2010 52 days)

## *Board of directors and staff*

Average staff number increased slightly during the year from 1,473 to 1,573 However the upward movement in headcount does not reflect the actions taken during the second half of the year as part of our investment re-alignment This is however reflected within our year end headcount The yearend headcount has decreased from 1,584 to 1,471

The directors who held office during the year were

| | Title |
|---|---|
| Peter Gyenes | Non-Executive Chairman and Chairman of the Remuneration Committee |
| Steve Munford | Chief Executive Officer |
| Nick Bray | Chief Financial Officer (appointed December 8, 2010) |
| Sandra Bergeron | Non-Executive Director (appointed December 1, 2010) |
| Nanci Caldwell | Non-Executive Director and Chairman of the Remuneration Committee (resigned June 14, 2010) |
| Hazem Ben-Gacem | Non-Executive Director (resigned October 8, 2010) |
| Edwin Gillis | Non-Executive Director and Chairman of the Audit Committee |
| Jan Hruska | Non-Executive Director |
| Peter Lammer | Non-Executive Director |
| Ajit Nedungadi | Non-Executive Director (resigned June 14, 2010) |
| Roy Mackenzie | Non-Executive Director (appointed July 30, 2010) |
| Salim Nathoo | Non-Executive Director (appointed July 30, 2010) |

## *Change of ownership*

On June 15, 2010, Sophos stockholders sold a majority stake in the Group to Apax Partners, a global private equity group, in a transaction valuing the Company at $830 million The founders, Peter Lammer and Jan Hruska continue to retain a significant stake in the Group Apax Partners is one of the world's leading private equity investment groups It operates across the United States, Europe and Asia and has more than 30 years of investing experience Funds under the advice and management of Apax Partners globally total approximately $40 billion These Funds provide long-term equity financing to build and strengthen world-class companies

On October 8, 2010 ITPU Holdings Limited sold its stake in the Company The Company is now 100% owned by Shield Bidco Limited

## *Principal risks and uncertainties*

The main risks and uncertainties that management believes could have a material impact on the Group's long-term performance are set out below

The IT security market is competitive and competition is expected to increase Many recent or new entrants to the market have significant financial backing and technical resources Sophos may lack the financial and other resources necessary to maintain its current competitive position This risk is managed through building and maintaining strong relationships with its partners and end-users The proposed acquisition of Astaro Software AG in June 2011 will help to strengthen the Group's position in the market as does continued investment in research and development

The Group's products and services are complex to develop and maintain and there is a risk that they may contain defects, vulnerabilities or errors that may not be detected until after their commercial release and installation by customers Such errors or defects may impair the reliability of its products and services and adversely affect their marketability Further, Sophos continually updates its products as part of its ongoing commitment to customers The quality of its products and services is therefore dependent upon these continual updates Sophos is partly dependent upon third-party suppliers for timely delivery of its product updates Rigorous and continual testing and quality control measures help to mitigate this risk

The integration of Astaro requires management focus There is a risk that this may remove focus from the core business and ensuring that we continue to provide customers with the level of service that they have come to expect This is managed by ensuring that these projects are managed by dedicated teams and by strengthening the management team where necessary There is a further risk that, should the Astaro entity not perform as expected, the investment could be at risk of impairment Management's focus on, and commitment to, the ongoing performance of the Group helps to mitigate this risk

Sophos owns substantial intellectual property rights and relies on a combination of patents, copyrights, contractual rights, trademarks and trade secrets to establish and protect proprietary rights in its products Any infringement of these rights could cause loss of revenue and adversely affect business operations Conversely there is a risk that Sophos could inadvertently infringe the intellectual property rights of others or may be called on to defend itself against alleged infringement claims Focus on internal research and development, quality assurance and testing helps to mitigate this risk

The economic environment leads to continued uncertainty in foreign exchange rates and increases the credit risk of our customers, as well as a more challenging business environment Sophos generally invoices its customers in their local currency and typically also pays expenses in local currency to partially hedge the currency risk However, the Group is also exposed to exchange differences arising on the translation of results into the Group's reporting currency of US dollars Sophos does not make speculative use of derivatives, currency or other financial instruments The credit risk primarily relates to trade receivables and is mitigated by the use of third party credit checks and the regular review of outstanding balances by local country credit controls and the management team

## *Proposed dividend*

The directors do not recommend the payment of a dividend (2010 $nil) The dividend shown in the financial statements relates to a dividend paid by Utimaco to its minority interest stockholders

## *Market value of land and buildings*

Sophos maintains its global headquarters in a building designed and constructed for the Company The building's open market value, based on typical rental yields of non-specialist commercial properties, would be below the net book value recorded in the financial statements However, it is the opinion of the directors that as Sophos intends to occupy the building as its global headquarters for the foreseeable future, the value in use of the building exceeds the book value

## *Research and development*

Sophos continues to undertake research and development relating to the principal activities of the Group Prior to its acquisition by the Group, Utimaco Safeware had capitalized research and development costs of $6 8m (at the time of acquisition) and this is being written off over its useful economic life

## *Employees*

Sophos has undertaken several cost saving initiatives in the year The overall headcount has been reduced to 1,471 at the end of FY2011 from c 1,650 in Q2-FY2011 These reductions have been focused on "back end" and administrative areas, and include the closure of three locations Columbus (US), Bracknell (UK) and Vantaa (Finland) Sophos has reduced travel and entertainment and all non staff related costs Management has reduced staff in "fringe" sites, administrative staff and non-quota carrying staff while focusing on key market areas To streamline general finance and administration spend, Sophos undertook the creation of central hubs, the consolidation of the German finance function and the elimination of duplication and inefficiency Sophos has been able to streamline its marketing costs by reducing the external spend while focusing on pipeline creating activities and eliminating non-core heads, while engineering costs have been made more efficient by closing the Columbus facility and removing non-core staff Sophos continues to invest to drive future growth A key objective of the Group is to achieve a shared commitment by all employees to the success of the business Throughout Sophos there is consultation between employees and management on matters of mutual interest and information is disseminated through team and Company briefings, the intranet and individual development reviews Employees are encouraged to promote and participate in the progress and profitability of the Group through the employee stock purchase plan, stock option plans and other incentive schemes

Sophos provides full consideration to applications for employment from disabled persons where the requirements of the role can be adequately fulfilled by a disabled person Where existing employees become disabled it is the Group's policy, wherever practicable, to provide continuing employment under normal terms and conditions and to provide training and career development to disabled employees wherever appropriate

*Environment*

Sophos recognizes the importance of its environmental responsibilities and aims to reduce any damage that might be caused by its activities Initiatives including recycling and reducing energy consumption continue to minimize the impact on the environment

*Political and charitable donations*

Sophos made no political donations during the year (2010 $nil) Contributions to charities totaled $34,082 (2010 $18,458)

*Policy and practice on payment of creditors*

Sophos policy is to pay creditors on a timely basis Trade creditors as at March 31, 2011 were equivalent to 37 days purchases (2010 36 days), based on the average daily amount invoiced by suppliers during the year

*Disclosure of relevant information to auditors*

The directors who held office at the date of approval of this directors' report confirm that, so far as they are each aware, there is no relevant audit information of which the Company's auditors are unaware and each director has taken all the steps that he or she ought to have taken as a director to make them aware of any relevant audit information

*Auditors*

In accordance with Section 487 of the Companies Act 2006, a resolution for the re-appointment of KPMG LLP as auditors of the Company is to be proposed at the forthcoming Annual General Meeting

On behalf of the Board

**Steve Munford**
CHIEF EXECUTIVE OFFICER
June 23, 2011

## Statement of directors' responsibilities in respect of the Directors' Report and the financial statements

The directors are responsible for preparing the Directors' Report and the Group and parent Company financial statements in accordance with applicable law and regulations

Company law requires the directors to prepare Group and parent Company financial statements for each financial year Under that law they have elected to prepare the Group financial statements in accordance with International Financial Reporting Standards ('IFRSs') as adopted by the EU and applicable law and have elected to prepare the parent Company financial statements in accordance with UK Accounting Standards and applicable law (UK Generally Accepted Accounting Practice)

Under company law the directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the Group and parent Company and of their profit or loss for that period

In preparing each of the Group and parent Company financial statements, the directors are required to

- select suitable accounting policies and then apply them consistently,
- make judgments and estimates that are reasonable and prudent,
- for the Group financial statements, state whether they have been prepared in accordance with IFRSs as adopted by the EU,
- for the parent Company financial statements, state whether applicable UK Accounting Standards have been followed, subject to any material departures disclosed and explained in the financial statements, and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the Group and the parent Company will continue in business

The directors are responsible for keeping adequate accounting records that are sufficient to show and explain the parent Company's transactions and disclose with reasonable accuracy at any time the financial position of the parent Company and enable them to ensure that its financial statements comply with the Companies Act 2006 They have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the Group and to prevent and detect fraud and other irregularities

The directors are responsible for the maintenance and integrity of the corporate and financial information included on the Company's website Legislation in the UK governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions

KPMG LLP
Arlington Business Park
Theale
Reading
RG7 4SD
United Kingdom

## Independent auditor's report to the members of Sophos Limited

We have audited the financial statements of Sophos Limited for the year ended 31 March 2011 set out on pages 11 to 56 The financial reporting framework that has been applied in the preparation of the Group financial statements is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the EU The financial reporting framework that has been applied in the preparation of the parent Company financial statements is applicable law and UK Accounting Standards (UK Generally Accepted Accounting Practice)

This report is made solely to the Company's members, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006 Our audit work has been undertaken so that we might state to the Company's members those matters we are required to state to them in an auditor's report and for no other purpose To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company and the Company's members, as a body, for our audit work, for this report, or for the opinions we have formed

### Respective responsibilities of directors and auditor

As explained more fully in the Directors' Responsibilities Statement set out on page 8, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view Our responsibility is to audit, and express an opinion on, the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland) Those standards require us to comply with the Auditing Practices Board's (APB's) Ethical Standards for Auditors

### Scope of the audit of the financial statements

A description of the scope of an audit of financial statements is provided on the APB's website at www frc org uk/apb/scope/private cfm

### Opinion on financial statements

In our opinion

- the financial statements give a true and fair view of the state of the Group's and of the parent Company's affairs as at 31 March 2011 and of the Group's profit for the year then ended,
- the Group financial statements have been properly prepared in accordance with IFRSs as adopted by the EU,
- the parent Company financial statements have been properly prepared in accordance with UK Generally Accepted Accounting Practice,
- the financial statements have been prepared in accordance with the requirements of the Companies Act 2006

### Opinion on other matter prescribed by the Companies Act 2006

In our opinion the information given in the Directors' Report for the financial year for which the financial statements are prepared is consistent with the financial statements

## Independent auditor's report to the members of Sophos Limited *(continued)*

**Matters on which we are required to report by exception**

We have nothing to report in respect of the following matters where the Companies Act 2006 requires us to report to you if, in our opinion

- adequate accounting records have not been kept by the parent Company, or returns adequate for our audit have not been received from branches not visited by us, or
- the parent Company financial statements are not in agreement with the accounting records and returns, or
- certain disclosures of directors' remuneration specified by law are not made, or
- we have not received all the information and explanations we require for our audit

Tudor Aw **(Senior Statutory Auditor)**
**for and on behalf of KPMG LLP, Statutory Auditor**
*Chartered Accountants*
Arlington Business Park
Theale
Reading
RG7 4SD

23 June 2011

## Consolidated income statement

For the year ended March 31, 2011

| | Note | 2011 $'000 | 2010 $'000 |
|---|---|---|---|
| Billings* | 3 | **343,637** | 334,559 |
| Revenue | 2 | **306,781** | 281,902 |
| Cost of sales | | **(39,388)** | (51,019) |
| Gross profit | | **267,393** | 230,883 |
| Sales and marketing | | **(121,250)** | (112,244) |
| Research and development | | **(58,754)** | (62,851) |
| General finance and administration | | | |
| - Non-exceptional | | **(50,933)** | (84,229) |
| - Exceptional | 4 | **(16,574)** | (8,475) |
| Operating profit/(loss) | | **19,882** | (36,916) |
| Finance income | 9 | **4,467** | 1,754 |
| Finance expense | 10 | **(1,245)** | (4,384) |
| Profit/(Loss) before tax | | **23,104** | (39,546) |
| Income tax (charge)/credit | 11 | **(4,912)** | 9,059 |
| Profit/(loss) for the year | | **18,192** | (30,487) |
| Attributable to | | | |
| Equity stockholders of the parent | | **18,294** | (30,968) |
| Non-controlling interest | | **(102)** | 481 |
| Profit/(loss) for the year | | **18,192** | (30,487) |

* Billings do not represent the Group's statutory revenue (see accounting policies within the notes to the accounts for the definition)

All results relate to continuing operations

The notes on pages 16 to 46 form part of these financial statements

## Consolidated statement of comprehensive income

For the year ended March 31, 2011

| | 2011<br>$'000 | 2010<br>$'000 |
|---|---|---|
| Profit/(loss) for the year | **18,192** | (30,487) |
| Other comprehensive income | | |
| Foreign exchange translation differences | **(3,844)** | 16,936 |
| Net gain on hedge of net investments in foreign operations | **(2,554)** | 2,305 |
| Deferred tax on IFRS 2 stock options charge | - | 617 |
| Total comprehensive income for the year | **11,794** | (10,629) |
| Attributable to | | |
| Equity stockholders of the parent | **11,543** | (11,165) |
| Non-controlling interest | **251** | 536 |
| Total comprehensive income for the year | **11,794** | (10,629) |

The notes on pages 16 to 46 form part of these financial statements

## Consolidated statement of financial position

*At March 31, 2011*
Registered Number 2096520

| | Note | 2011 $'000 | 2010 $'000 |
|---|---|---|---|
| **Non-current assets** | | | |
| Intangible assets | 13 | **225,806** | 236,981 |
| Property, plant and equipment | 12 | **47,464** | 48,078 |
| Deferred tax assets | 15 | **28,412** | 43,334 |
| Other receivables | 17 | **1,303** | 1,512 |
| | | **302,985** | 329,905 |
| **Current assets** | | | |
| Stocks of inventories | 16 | **2,372** | 3,247 |
| Trade and other receivables | 17 | **124,597** | 79,652 |
| Cash and cash equivalents | 18 | **81,590** | 103,213 |
| | | **208,559** | 186,112 |
| Total assets | | **511,544** | 516,017 |
| **Current liabilities** | | | |
| Trade and other payables | 19 | **50,333** | 52,059 |
| Deferred revenue | 20 | **352,792** | 302,621 |
| Income tax payable | | **9,633** | 4,585 |
| Other financial liabilities | 21 | - | 72,789 |
| Provisions | 22 | **6,305** | - |
| | | **419,063** | 432,054 |
| **Non-current liabilities** | | | |
| Trade and other payables | 19 | - | 222 |
| Other financial liabilities | 21 | **1,035** | 9,560 |
| Provisions | 22 | **1,668** | 1,811 |
| Deferred tax liabilities | 15 | **12,337** | 18,950 |
| | | **15,040** | 30,543 |
| Total liabilities | | **434,103** | 462,597 |
| Net assets | | **77,441** | 53,420 |
| Represented by | | | |
| Stock capital | 24 | **106** | 105 |
| Stock premium | | **56,850** | 35,287 |
| Retained (deficit)/earnings | | **1,208** | (26,170) |
| Stock based payment reserves | | **3,777** | 17,959 |
| Translation reserves | | **7,852** | 14,039 |
| Sophos Limited Group Stockholders' equity | | **69,793** | 41,220 |
| Non-controlling interest | | **7,648** | 12,200 |
| Total equity | | **77,441** | 53,420 |

These financial statements were approved by the board of directors on June 23, 2011 and were signed on its behalf by

**Nick Bray**
*CHIEF FINANCE OFFICER*
The notes on pages 16 to 46 form part of these financial statements

## Consolidated statement of changes in equity

*For the year ended March 31, 2011*

| | Stock premium $'000 | Retained earnings $'000 | Stock based payment reserves $'000 | Translation reserve $'000 | Total $'000 | Non-controlling interest $'000 | Total $'000 |
|---|---|---|---|---|---|---|---|
| At March 31, 2009 | 31,196 | 4,864 | 10,986 | (3,083) | 43,963 | 12,486 | 56,449 |
| Loss for the year | - | (30,968) | - | - | (30,968) | 481 | (30,487) |
| *Other comprehensive income* | | | | | | | |
| Exchange differences | 1,708 | - | 355 | 14,817 | 16,880 | 55 | 16,935 |
| Net gain on hedge of net investment in foreign operations | - | - | - | 2,305 | 2,305 | - | 2,305 |
| Total comprehensive income | 1,708 | (30,968) | 355 | 17,122 | (11,783) | 536 | (11,247) |
| Issue of stock | 2,383 | - | - | - | 2,383 | - | 2,383 |
| Increase in Utimaco AG stockholding | - | 756 | - | - | 756 | (756) | - |
| Credit to equity for stock-based payments | - | - | 6,618 | - | 6,618 | - | 6,618 |
| Dividend paid to non-controlling interest | - | (822) | - | - | (822) | (66) | (888) |
| At March 31, 2010 | 35,287 | (26,170) | 17,959 | 14,039 | 41,115 | 12,200 | 53,315 |
| Profit for the year | - | **18,294** | - | - | **18,294** | **(102)** | **18,192** |
| *Other comprehensive income* | | | | | | | |
| Exchange differences | **3,621** | - | - | **(7,818)** | **(4,197)** | **353** | **(3,844)** |
| Net loss on hedge of net investment in foreign operations | - | - | - | **(2,554)** | **(2,554)** | - | **(2,554)** |
| Total comprehensive income | **3,621** | **18,294** | - | **(10,372)** | **11,543** | **251** | **11,794** |
| Issue of stock | **17,942** | - | - | - | **17,942** | - | **17,942** |
| Increase in Utimaco AG stockholding | - | **(2,501)** | - | - | **(2,501)** | **(3,864)** | **(6,365)** |
| Credit to equity for stock-based payments | - | - | **3,777** | - | **3,777** | - | **3,777** |
| Transferred | **(4,185)** | **11,585** | **(11,585)** | **4,185** | - | - | - |
| Dividend paid to non-controlling interest | - | - | - | - | - | **(939)** | **(939)** |
| Debit to equity for forfeited options | - | - | **(6,374)** | - | **(6,374)** | - | **(6,374)** |
| Cancellation of warrant | **4,185** | - | - | - | **4,185** | - | **4,185** |
| At March 31, 2011 | **56,850** | **1,208** | **3,777** | **7,852** | **69,687** | **7,648** | **77,335** |

The following describes the nature and purpose of each reserve within owner's equity

| | |
|---|---|
| Stock capital | Amount subscribed for stock capital at nominal value |
| Stock premium | Amount subscribed for stock capital in excess of nominal value |
| Retained earnings | Cumulative net gains and losses recognized in the financial statements |
| Stock based payment reserve | Amount representing the cumulative charge recognized under IFRS2 in respect of stock options |
| Translation reserve | Foreign exchange differences arising on translating into the reporting currency |

The notes on pages 16 to 46 form part of these financial statements

## Consolidated statement of cash flows

For the year ended March 31, 2011

| | Note | 2011 $'000 | 2010 $'000 |
|---|---|---|---|
| Profit/(loss) for the year | | **18,192** | (30,487) |
| adjusted for | | | |
| Depreciation | 12 | **6,401** | 7,007 |
| Amortization of intangible assets | 13 | **21,332** | 40,046 |
| Unrealized foreign exchange | | **(5,226)** | 3,032 |
| Stock based payments | 7 | **(2,598)** | 6,001 |
| Finance income | 9 | **(4,467)** | (1,754) |
| Finance costs | 10 | **1,245** | 4,384 |
| Profit on disposal of assets | | **-** | (204) |
| Income tax charge/(credit) | 11 | **4,912** | (9,059) |
| | | **39,791** | 18,966 |
| Decrease in inventories | | **875** | 233 |
| Increase in trade and other receivables | | **(7,327)** | (13,997) |
| (Decrease)/increase in trade and other payables | | **(3,757)** | 4,714 |
| Increase in deferred revenue | | **40,537** | 55,848 |
| Decrease/(increase) in provisions | | **6,152** | (1,380) |
| **Cash generated from operations** | | **76,272** | 64,384 |
| Income taxes paid | | **1,609** | (2,991) |
| **Net cash flow from operating activities** | | **77,881** | 61,393 |
| **Investing activities** | | | |
| Purchase of property, plant and equipment | | **(3,333)** | (3,963) |
| Acquisition of subsidiary net of cash acquired | | **-** | (3,182) |
| Purchase of intangible assets - software | | **(892)** | (1,007) |
| Proceeds on sale of assets | | **-** | 205 |
| Finance income | | **136** | 598 |
| **Net cash flow from investing activities** | | **(4,089)** | (7,349) |
| **Financing activities** | | | |
| Proceeds from issue of stocks | | **152** | 2,422 |
| Payment from borrowings | | **(74,270)** | (33,403) |
| Interest expense paid on behalf of parent Company | | **(19,244)** | - |
| Finance costs | | **(631)** | (2,898) |
| Dividends paid to non-controlling interest | | **(939)** | (1,370) |
| **Net cash flow from financing activities** | | **(94,932)** | (35,249) |
| **Increase/(decrease) in cash and cash equivalents** | | **(21,140)** | 18,795 |
| Net foreign exchange differences | | **(483)** | 1,914 |
| Cash and cash equivalents at the start of the year | | **103,213** | 82,504 |
| Cash and cash equivalents at the end of the year | 18 | **81,590** | 103,213 |
| Unlevered free cash flow | | **73,655** | 56,423 |

*Unlevered free cash flow is defined as net cash flow from operating activities less the purchase of property, plant and equipment and the purchase of software

The notes on pages 16 to 46 form part of these financial statements

## Notes to the consolidated financial statements

*(Forming part of the financial statements)*

**Reporting entity**

Sophos Limited ('the Company') is a company domiciled in the United Kingdom The Company's registered office is Sophos Limited, The Pentagon, Abingdon Science Park, Abingdon, Oxfordshire, OX14 3YP, United Kingdom The consolidated financial statements of the Company as at and for the year ended March 31, 2011 comprise the Company and its subsidiaries (together referred to as 'the Group') The Group is primarily involved in the provision of endpoint security, data protection and network access control solutions

**Statement of compliance**

The consolidated financial statements have been prepared using International Financial Reporting Standards as adopted by the European Union (Adopted 'IFRSs') as they apply to the Group

**Accounting policies**

Convention

The Group has considerable financial resources together with contracts with a large number of customers and across different geographic areas and industries As a consequence, the directors believe that the Group is well placed to manage its business risks successfully despite the current uncertain economic outlook

The directors have a reasonable expectation that the Group has adequate resources to continue in operational existence for the foreseeable future Thus they continue to adopt the going concern basis in preparing the annual financial statements

Further information regarding the Group's business activities, together with the factors likely to affect its future development, performance and position is set out in the Business Review on pages 2 to 4 Further information regarding the financial position of the Group, its cash flows, liquidity position and borrowing facilities are described in the Directors' Report and the notes to the financial statements In addition note 23 to the financial statements includes the Group's objectives, policies and processes for managing its capital, its financial risk management objectives, and its exposures to credit risk and liquidity risk

The consolidated historical financial information has been prepared under the historical cost convention and is presented in US dollars All values are rounded to the nearest thousand ($'000) unless otherwise indicated

The accounting policies used in preparing the consolidated historical financial information for the year ended March 31, 2011 have been consistently applied to all years presented and are set out below

Basis of consolidation

The historical financial information consolidates the financial information of Sophos Limited and the entities it controls (its subsidiaries) at March 31, 2011 Control is achieved where the Company has the power to govern the financial and operating policies of an investee entity so as to obtain benefits from its activities

The financial information of the subsidiaries is prepared for the same reporting period as the parent Company, using consistent accounting policies

Subsidiaries are fully consolidated from the date of acquisition, being the date on which the Group obtains control, and continue to be consolidated until the date that such control ceases

All intra-Group balances, transactions, income and expenses and profits and losses resulting from intra-Group transactions that are recognized in the Statement of Financial Position, are eliminated in full

## Notes to the consolidated financial statements *(continued)*

Foreign currency translation

The functional currency of Sophos Limited is Sterling The Group uses US dollars as its presentation currency to aid comparability of its financial information with that of its peers whose information is generally presented in US dollars The individual historical financial information of each Group company is prepared in the currency of the primary economic environment in which it operates (its functional currency) Each entity in the Group determines its own functional currency and items included in the historical financial information of each entity are measured using that functional currency

In preparing the financial information of the individual companies, transactions in foreign currencies are recorded at the rate of exchange prevailing at the date of the transaction Monetary assets and liabilities in foreign currencies are translated at the exchange rate prevailing at the reporting date All exchange differences are taken to the Consolidated Income Statement, except for differences on monetary assets and liabilities that form part of the Group's net investment in a foreign operation These are taken directly to equity until the disposal of the net investment, at which time they are recognized in the Consolidated Income Statement Tax charges and credits attributable to exchange differences on those borrowings are also dealt with in equity Non-monetary items that are measured in terms of historical cost in a foreign currency are translated using the exchange rates as at the dates of the initial transactions Any goodwill arising on the acquisition of a foreign operation and any fair value adjustments to the carrying amounts of assets and liabilities arising on the acquisition are treated as assets and liabilities of the foreign operation and translated at the closing rate

On consolidation, assets and liabilities of foreign subsidiaries are translated into the presentation currency (US dollars) at the exchange rate prevailing at the reporting date Income and expense items are translated into US dollars at the prior monthly closing rate to that in which the transaction took place because they approximate the rate of exchange at transaction dates Exchange differences arising on the translation of opening net assets of entities not denominated in US dollars, together with differences arising from the translation of the net results at average or actual rates to the exchange rate prevailing at the reporting date, are taken to equity

On disposal of a foreign entity, the deferred accumulated amount recognized in equity relating to that particular foreign operation is recognized in the Consolidated Income Statement

Critical accounting judgments and key sources of estimation uncertainty

The preparation of historical financial information requires management to make estimates and assumptions that affect the amounts reported for assets and liabilities as at the reporting date and the amounts reported for revenues and expenses during the period The nature of estimation means that actual outcomes could differ from those estimates

In the process of applying the Group's accounting policies described in this note, management has made the following judgments that have a significant effect on the amounts recognized in the historical financial information

The key assumptions concerning the future, and other key sources of estimation uncertainty at the reporting date, that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year, are discussed below

*Deferred taxation*

Deferred tax assets are recognized for all unused tax losses to the extent that it is probable that taxable profit will be available against which the losses can be utilized Management judgment is required to determine the amount of deferred tax assets that can be recognized, based upon the likely timing and level of future taxable profits, together with future tax planning strategies The Group has not recognized deferred tax assets in respect of tax losses at March 31, 2011 of $19,789,000 (2010 $4,916,000) and the unrecognized tax losses and investment tax credits at March 31, 2011 were $8,927,000 (2010 $10,286,000) In addition, a deferred tax asset of $2,483,000 (2010 $2,199,000) in relation to building costs has not been recognized Further details are contained in note 15

## Notes to the consolidated financial statements *(continued)*

*Impairment of goodwill and intangibles*

The Group determines whether goodwill is impaired at least on an annual basis This requires an estimation of the "value in use" of the cash-generating units to which the goodwill is allocated Estimating a value in use amount requires management to make an estimate of the expected future cash flows from the cash-generating unit and also to choose a suitable discount rate in order to calculate the present value of those cash flows The carrying amount of goodwill at March 31, 2011 was $187,212,000 (2010 $179,184,000) Further details are given in notes 13 and 14

*Stock based payments transactions*

The fair value of employee stock options and stock warrants issued to third parties are measured using the Black-Scholes model Measurement inputs includes stock price on the measurement date, exercise price of the instrument, expected volatility (based on weighted average historic volatility adjusted for changes expected due to publicly available information), weighted average expected life of the instruments (based on historical experience and general option holder behavior), expected dividends, and the risk-free interest rate Service and non-market performance conditions attached to the transactions are not taken into account in determining fair value

*Research and development costs*

Development costs are capitalized in accordance with the accounting policy in this note Determining the amounts to be capitalized requires management to make assumptions regarding the expected future cash generation of the assets, discount rates to be applied and the expected period of benefits At March 31, 2011, the best estimate of the carrying amount of development costs that meet the criteria for capitalization as intangible assets was $1,937,000 (2010 $3,952,000) The capitalized development costs arose with the acquisition of Utimaco and are shown within intangible assets No further development costs have been capitalized

*Business combinations*

Management is required to make an assessment of the intangible assets to be recognized as a result of the business acquisition Furthermore, management is required to make an assessment as to whether the intangible assets are separable and their fair values as at the time of acquisition This is based on certain assumptions including the expected future cash flows arising from use of the intangibles, discount rates and estimated economic lives of the intangibles

Property, plant and equipment

Property, plant and equipment is stated at cost less accumulated depreciation and accumulated impairment losses Cost comprises the aggregate amount paid and the fair value of any other consideration given to acquire the asset and includes costs directly attributable to making the asset capable of operating as intended

Except for freehold land, depreciation is provided to write off the cost less the estimated residual values of all property, plant and equipment on a straight-line basis over their estimated useful life as follows

| | |
|---|---|
| Freehold buildings | 25 years |
| Leasehold improvements | over the lease period |
| Computer equipment | 3 years |
| Other plant and equipment | 5 years |
| Motor vehicles | 4 years |
| Fixtures and fittings | 6 - 10 years |

The carrying values of property, plant and equipment are reviewed for impairment if events or changes in circumstances indicate the carrying value may not be recoverable, and are written down immediately to their recoverable amount

## Notes to the consolidated financial statements *(continued)*

Property, plant and equipment *(continued)*

An item of property, plant and equipment is derecognized upon disposal or when no future economic benefits are expected to arise from the continued use of the asset Any gain or loss arising on de-recognition of the asset is included in the Consolidated Income Statement in the period of de-recognition

The assets' residual values, useful lives and methods of depreciation are reviewed, and adjusted if appropriate, at each financial year end

Business combinations and goodwill

Business combinations are accounted for using the acquisition accounting method This involves recognizing identifiable assets (including previously unrecognized intangible assets) and liabilities (including contingent liabilities and excluding future restructuring) of the acquired business at fair value

Business combinations on or after April 1, 2004 are accounted for under IFRS 3 Any excess of the cost of the business combination over the Group's interest in the net fair value of the identifiable assets, liabilities and contingent liabilities is recognized in the Consolidated Statement of Financial Position as goodwill and is not amortized To the extent that the net fair value of the acquired entity's identifiable assets, liabilities and contingent liabilities is greater than the cost of the investment, a gain is recognized immediately in the Consolidated Income Statement Goodwill recognized as an asset as at March 31, 2004 is recorded at its previous carrying amount under UK GAAP and is not amortized

After initial recognition, goodwill is stated at cost less any accumulated impairment losses, with the carrying value being reviewed for impairment, at least annually and whenever events or changes in circumstances indicate that the carrying value may be impaired For the purpose of impairment testing, goodwill is allocated to the related cash-generating units monitored by management, usually at business segment level Where the recoverable amount of the cash-generating unit is less than its carrying amount, including goodwill, an impairment loss is recognized in the Consolidated Income Statement

The carrying amount of goodwill allocated to a cash-generating unit is taken into account when determining the gain or loss on disposal of the unit, or of an operation within it

Intangible assets

Intangible assets are carried at cost less accumulated amortization and accumulated impairment losses

Intangible assets acquired separately from a business are carried initially at cost An intangible asset acquired as part of a business combination is recognized outside goodwill if the asset is separable or arises from contractual or other legal rights and its fair value can be measured reliably Expenditure on internally developed intangible assets is taken to the Consolidated Income Statement in the period in which it is incurred to the extent that the expenditure does not qualify for capitalization under research and development costs

Where computer software is not an integral part of a related item of computer hardware, the software is classified as an intangible asset The capitalized costs of software for internal use include external direct costs of materials and services consumed in developing or obtaining the software, and payroll and payroll-related costs for employees who are directly associated with and who devote substantial time to the project Capitalization of these costs ceases no later than the point at which the software is substantially complete and ready for its intended internal use

Intangible assets with a finite life have no residual value and are amortized over their expected useful lives as follows

| | | |
|---|---|---|
| Intellectual property (ActiveState and Endforce) | - | 3 years (straight-line basis) |
| Intellectual property relating to Safeguard technology | - | 15 years (reducing balance basis) |
| Brand names | - | 15 years (reducing balance basis) |
| Customer base | - | 10 years (reducing balance basis) |
| All other intangibles | - | 3 years (straight-line basis) |

## Notes to the consolidated financial statements *(continued)*

Intangible assets *(continued)*

The amortization expense on intangible assets with finite lives is recognized in the Consolidated Income Statement as a general finance and administration cost The amortization period and the amortization method for an intangible asset with a finite useful life are reviewed at least annually

The carrying value of intangible assets is reviewed for impairment whenever events or changes in circumstances indicate the carrying value may not be recoverable

Intangible assets with indefinite useful lives are tested for impairment annually either individually or at the cash generating unit level Such intangibles are not amortized The term of their useful life is reviewed annually to determine whether indefinite life assessment continues to be supportable

Research and development costs

Expenditure on research activities is expensed as incurred

Development expenditure is recognized as an intangible asset when its future recoverability can reasonably be regarded as assured and technical feasibility and commercial viability can be demonstrated

During the period of development, the asset is tested for impairment annually Following the initial recognition of the development expenditure, the cost model is applied requiring the asset to be carried at cost less any accumulated amortization and accumulated impairment losses Amortization of the asset begins when development is complete and the asset is available for use It is amortized over the period of expected future sales

Development expenditure incurred on minor or major upgrades, or other changes in software functionalities does not satisfy the criteria, as the product is not substantially new in its design or functional characteristics Such expenditure is therefore recognized as an expense in the Consolidated Income Statement as incurred

The Group has not capitalized any development costs during the year as the qualifying amounts are not significant On the basis that development projects meet the technical and commercial feasibility requirement at the end of their development, subsequent costs that qualify for capitalization are not material to the financial statements Capitalized development costs acquired with Utimaco are being written off over a useful economic life of five years

Impairment of assets

At least annually, or when otherwise required, management reviews the carrying amounts of the Group's tangible and intangible assets to determine whether there is any indication that those assets have suffered an impairment loss If any such indication exists, the recoverable amount of the asset is estimated in order to determine the extent of any impairment loss

Where the asset does not generate cash flows that are independent from other assets, the Group estimates the recoverable amount of the cash generating unit to which the asset belongs

The recoverable amount is the higher of fair value less costs to sell and value in use In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money as well as risks specific to the asset for which the estimates of future cash flows have not been adjusted

If the recoverable amount of an asset or cash-generating unit is estimated to be less than its carrying amount, the carrying amount of the asset or cash-generating unit is reduced to its recoverable amount An impairment loss is recognized as an expense immediately

Where an impairment loss subsequently reverses, the carrying amount of the asset is increased to the revised estimate of its recoverable amount, but not beyond the carrying amount that would have been determined had no impairment loss been recognized for the asset in prior years A reversal of an impairment loss is recognized immediately as income, although impairment losses relating to goodwill may not be reversed

## Notes to the consolidated financial statements *(continued)*

Inventories

Inventories are stated at the lower of cost and net realizable value Cost includes all costs incurred in bringing each product to its present location and condition The cost of raw materials, consumables and goods for resale is based on the purchase cost and is determined on a first-in, first-out basis

Net realizable value is based on estimated selling price less any further costs expected to be incurred to completion and disposal

Financial instruments

Financial assets and liabilities are recognized on the Group's Statement of Financial Position when the Group becomes a party to the contractual provisions of the instrument When financial instruments are recognized initially, they are measured at fair value, being the transaction price plus, in the case of financial assets and financial liabilities not at fair value through profit or loss, directly attributable transaction costs

*Trade receivables*

Trade receivables, which generally have 30-90 day terms, are carried at original invoice amount, including value added tax and other sales taxes, less an estimate made for doubtful receivables based on a review of any outstanding amounts at the period end and on historical performance Bad debts are written off in the period in which they are identified

*Cash and cash equivalents*

Cash and cash equivalents comprise cash in hand and bank deposits repayable in 90 days or less For the purpose of the Consolidated Statement of Cash Flows, cash and cash equivalents consist of cash in hand and bank deposits net of outstanding bank overdrafts

*Trade payables*

Trade payables are recognized at cost, which is deemed to be materially the same as the fair value

*Classification of stock as debt or equity*

Financial liabilities and equity instruments are classified according to the substance of the contractual arrangements entered into An equity instrument is any contract that evidences a residual interest in the assets of the Group after deducting all of its liabilities

When stock is issued, any component that creates a financial liability of the Group is presented as a liability in the Consolidated Statement of Financial Position, measured initially at fair value net of transaction costs and thereafter at amortized cost until extinguished on conversion or redemption The corresponding dividends relating to the liability component are charged as interest expense in the Consolidated Income Statement

Equity instruments issued by the Company are recorded as the proceeds received, net of direct issue costs Equity instruments are classified according to the substance of the contractual arrangements entered into An equity instrument is any contract that evidences a residual interest in the assets of the Group after deducting all of its liabilities

*Interest bearing loans and borrowings*

Obligations for loans and borrowings are recognized when the Group becomes party to the related contracts and are measured initially at fair value less directly attributable transactions costs

After initial recognition, interest bearing loans and borrowings are subsequently measured at amortized cost using the effective interest method

Gains and losses arising on the repurchase, settlement or otherwise cancellation of liabilities are recognized respectively in finance income and finance expense

## Notes to the consolidated financial statements *(continued)*

*Derivative financial instruments*

The Group sometimes uses derivative financial instruments, principally forward foreign currency contracts to reduce its exposure to exchange rate movements and interest rate caps to reduce its exposure to fluctuating interest rates The Group does not hold or issue derivatives for speculative or trading purposes

Derivative financial instruments are recognized as assets and liabilities measured at their fair values at the reporting date Changes in the fair values are recognized in the Consolidated Income Statement and this is likely to cause volatility in situations where the carrying value of the hedged item is either not adjusted to reflect fair value changes arising from the hedged risk or is so adjusted but that adjustment is not recognized in the Consolidated Income Statement Provided the conditions specified by IAS 39 are met, hedge accounting may be used to mitigate this income statement volatility

The Group expects that hedge accounting will not generally be applied to transactional hedging relationships, such as hedges of forecast or committed transactions

*De-recognition of financial assets and liabilities*

A financial asset or liability is generally de-recognized when the contract that gives rise to it is settled, sold, cancelled or expires

Where an existing financial liability is replaced by another from the same lender on substantially different terms, or the terms of an existing liability are substantially modified, such an exchange or modification is treated as a de-recognition of the original liability and the recognition of a new liability, such that the difference in the respective carrying amounts together with any costs or fees incurred are recognized in the Consolidated Income Statement

Leases

Leases are classified as finance leases whenever the terms of the lease transfer substantially all the risks and rewards of ownership to the lessee All other leases are classified as operating leases

Rentals payable under operating leases are charged to income on a straight-line basis over the term of the relevant lease Benefits received and receivable as an incentive to enter into an operating lease are also spread on a straight line basis over the lease term

Provisions

A provision is recognized when the Group has a legal or constructive obligation as a result of a past event and it is probable that an outflow of economic benefits will be required to settle the obligation and a reliable estimate can be made of the amount of the obligation If the effect is material, expected future cash flows are discounted using a current pre-tax rate that reflects, where appropriate, the risks specific to the liability

Where the Group expects some or all of a provision to be reimbursed, for example under an insurance policy, the reimbursement is recognized as a separate asset but only when recovery is virtually certain

The expense relating to any provision is presented in the Consolidated Income Statement net of any reimbursement

Where discounting is used, the increase in the provision due to unwinding the discount is recognized as a finance cost

Taxation

The tax expense represents the sum of the tax currently payable and deferred tax

The tax currently payable is based on taxable profit for the period Taxable profit differs from net profit as reported in the Consolidated Income Statement because it excludes items of income or expense that are taxable or deductible in other financial years and it further excludes items that are never taxable or deductible The Group's liability for current tax is calculated using tax rates that have been enacted or substantively enacted by the reporting date

## Notes to the consolidated financial statements *(continued)*

Taxation *(continued)*

Deferred tax is the tax expected to be payable or recoverable on differences between the carrying amounts of assets and liabilities in the historical financial information and the corresponding tax bases used in the computation of taxable profit, and is accounted for using the balance sheet liability method Deferred tax liabilities are generally recognized for all taxable temporary differences and deferred tax assets are recognized to the extent that it is probable that taxable profits will be available against which deductible temporary differences can be utilized Such assets and liabilities are not recognized if the temporary difference arises from goodwill or from the initial recognition (other than in a business combination) of other assets and liabilities in a transaction that affects neither the tax profit nor the accounting profit

In the United Kingdom, until June 15, 2010 the Group was entitled to a tax deduction for amounts treated as remuneration on exercise of certain employee stock options As explained under 'Stock based payments' below, a remuneration expense is recorded in the Consolidated Income Statement over the period from the award date to the vesting date of the relevant options Where there is a temporary difference between the accounting and tax bases, a deferred tax asset may be recorded Any deferred tax asset arising on stock option awards is calculated as the estimated amount of tax deduction to be obtained in the future (based on the Group's stock price at the reporting date) pro-rated to the extent that the services of the employee have been rendered over the vesting period If this amount exceeds the cumulative amount of the remuneration expense at the statutory rate, the excess is recorded directly in equity, against retained earnings Similarly, current tax relief in excess of the cumulative amount of the remuneration expense at the statutory rate is also recorded in retained earnings Following the acquisition by Apax Partners a deferred tax asset has not been recognized as, based on the Company's current ownership, it is not entitled to a future tax deduction

Deferred tax liabilities are recognized for taxable temporary differences arising on investments in subsidiaries, except where the Group is able to control the reversal of the temporary difference and it is probable that the temporary difference will not reverse in the foreseeable future The carrying amount of deferred tax assets is reviewed at each reporting date and reduced to the extent that it is no longer probable that sufficient taxable profits will be available to allow all or part of the asset to be recovered

Deferred tax is calculated at the tax rates that are expected to apply in the period when the liability is settled or the asset is realized Deferred tax is charged or credited in the Consolidated Income Statement, except when it relates to items charged or credited directly to equity, in which case the deferred tax is also dealt with in equity Deferred tax assets and deferred tax liabilities are offset if a legally enforceable right exists to set off current tax assets against current tax liabilities and the deferred taxes relate to the same taxation authority

Pensions and other post-retirement benefits

The Group operates defined contribution pension schemes for its employees The assets of the schemes are held separately from those of the Group in independently administered funds Contributions to defined contribution schemes are recognized in the Consolidated Income Statement in the period in which they become payable

In addition the Group acquired an unfunded defined benefit scheme with the acquisition of Utimaco in October 2008 The obligation under this scheme is recognized within provisions The obligation is valued by an approved actuary, with any movements in the liability recorded in the Consolidated Income Statement

Revenue recognition

Revenue is recognized to the extent that it is probable that the economic benefits will flow to the Group and the revenue can be reliably measured Revenue is measured at the fair value of the consideration received, excluding discounts, rebates, VAT and other sales taxes or duty The following specific recognition criteria must also be met before revenue is recognized

*Revenue from software licenses and service contracts*

The Group sells software products under fixed term contracts and perpetual licenses Where there is multi-element arrangement revenue is allocated to each element on a fair value basis regardless of any separate prices stated within the contract The portion of the revenue allocated to an element is recognized when the revenue recognition criteria for that element has been met

## Notes to the consolidated financial statements *(continued)*

*Fixed term contracts*

Customers who receive software products at the start of the contract under a fixed term license and are entitled to receive regular updates and upgrades for the duration of the license term which runs for periods ranging from 1 to 5 years

Revenue for these fixed rate contracts is recognized ratably over the period that the contractual obligation exists

Accrued and deferred revenue arising on long-term contracts is included in receivables as accrued income and payables as deferred revenue as appropriate

Where the Group contracts with an original equipment manufacturer (OEM) or a service provider, rather than an end user, it mirrors the above policy and recognizes the revenue in line with the contract terms granted to the end user

*Perpetual licenses*

Revenue is recognized immediately where customers purchase software products under a perpetual license Revenue in respect of support and maintenance contracts associated with perpetual licenses is recognized ratably over the life of the support / maintenance contract

*Sale of goods*

Revenue from the sale of goods is recognized ratably over the period of the associated software license contract because the hardware is only sold with the intention of being used together with the related software license

*Interest income*

Revenue is recognized as interest accrues using the effective interest method The effective interest rate is the rate that exactly discounts estimated future cash receipts through the expected life of the financial instrument to its net carrying amount

<u>Billings</u>

Billings is the value of products and services we invoiced to customers after receiving a purchase order from the customer and delivering our products and services to them, or for which there is no right to a refund for undelivered items Billings does not equate to revenue

<u>Stock based payments</u>

Employees (including senior executives) of the Group receive remuneration in the form of stock based payment transactions, whereby employees render services as consideration for equity instruments ("equity settled transactions")

The cost of equity-settled transactions with employees is measured by reference to the fair value at the date on which they are granted The fair value is determined by using an appropriate pricing model, further details of which are given in note 25

The cost of equity-settled transactions is recognized, together with a corresponding increase in equity, ending on the date on which the relevant employees become fully entitled to the award

At each reporting date before vesting, the cumulative expense is calculated, representing the extent to which the vesting period has expired and management's best estimate of the achievement or otherwise of non-market conditions and of the number of equity instruments that will ultimately vest or, in the case of an instrument subject to a market condition, be treated as vesting as described above The movement in cumulative expense since the previous reporting date is recognized in the Consolidated Income Statement, with a corresponding entry in equity

## Notes to the consolidated financial statements *(continued)*

Stock based payments *(continued)*

Where the terms of an equity-settled award are modified or a new award is designated as replacing a cancelled or settled award, the cost based on the original award terms continues to be recognized over the original vesting period In addition, an expense is recognized over the remainder of the new vesting period for the incremental fair value of any modification, based on the difference between the fair value of the original award and the fair value of the modified award, both as measured on the date of the modification No reduction is recognized if this difference is negative

Where an equity-settled award is cancelled, it is treated as if it had vested on the date of cancellation, and any cost not yet recognized in the Consolidated Income Statement for the award is expensed immediately Any compensation paid up to the fair value of the award at the cancellation or settlement date is deducted from equity, with any excess over fair value being treated as an expense in the Consolidated Income Statement

Exceptional items

Material items, by virtue of their size or incidence deriving from events or transactions falling within the ordinary activities of the Company, either individually or of a similar type in aggregate, are disclosed separately within the financial statements

Events after reporting date

Events between the reporting date and the date the financial statements are approved, favorable and unfavorable, providing evidence conditions that existed at the reporting date adjust the amounts recognized in the financial statements Those that indicate conditions arising after the reporting date are disclosed but are not recognized within the financial statements

**1 Business combinations**

In April 2009, Sophos Limited acquired 51% of Sophos Hong Kong Co Ltd for $994k Utimaco Safeware AG previously owned 49% of the company Sophos Hong Kong Co Ltd is a data protection company The acquisition is not material to the Group

Pre-acquisition carrying amounts were determined based on applicable IFRSs immediately before the acquisition The value of assets and liabilities recognized on acquisition are their estimated fair values

The goodwill recognized on the acquisition is attributable mainly to the skills and technical talent of Sophos Hong Kong Co Ltd's workforce, the future products that the Group expects to develop and the synergies that the Group expects to achieve

## Notes to the consolidated financial statements *(continued)*

### 2 Revenue

Revenue recognized in the Consolidated Income Statement is analyzed as follows

| | 2011 $'000 | 2010 $'000 |
|---|---|---|
| Rendering of services | **293,452** | 269,384 |
| Sale of goods | **13,329** | 12,554 |
| | **306,781** | 281,902 |

### 3 Segment information

For management reporting purposes, the primary segment reporting format is determined to be business segments as the Group's risks and rates of return are affected predominantly by the products and services provided to customers Secondary segment information is reported geographically The Group has only one business segment on the basis that the products and services offered to external customers are very similar and therefore do not result in different risks and rates of return for the Group

The Group's geographical segments are based on the location of the Group's assets

Billings are based on the geographic location of direct customers, OEMs and the distributors which purchase our products The geographic location of OEMs or distributors may be different from the geographic location of the end customers Revenue has been allocated to each geography in a manner consistent with the billings profile

Transfer prices between geographical segments are set on an arm's length basis in a manner similar to transactions with third parties

*Geographical segments*

The following tables present revenue, expenditure and certain asset information regarding the Group's geographical segments for the year ended March 31, 2011 and comparative periods

| **Year-ended March 31, 2011** | **North America $'000** | **UK $'000** | **Rest of Europe $'000** | **Rest of the World $'000** | **Total $'000** |
|---|---|---|---|---|---|
| **Billings[1]** | **120,326** | **74,683** | **97,682** | **50,946** | **343,637** |
| **Revenue** | | | | | |
| Revenue from continuing operations | **116,672** | **63,686** | **78,114** | **48,309** | **306,781** |
| **Other segment information** | | | | | |
| Segment assets | **25,689** | **146,211** | **66,284** | **16,460** | **254,644** |
| Unallocated assets | | | | | **256,900** |
| Total assets | | | | | **511,544** |
| **Capital expenditure** | | | | | |
| Property, plant and equipment | **904** | **1,714** | **616** | **99** | **3,333** |
| Intangible assets | **53** | **770** | **65** | **4** | **892** |
| | **957** | **2,484** | **681** | **103** | **4,225** |

## Notes to the consolidated financial statements *(continued)*

### 3 Segment information *(continued)*

| Year-ended March 31, 2010 | North America $'000 | UK $'000 | Rest of Europe $'000 | Rest of the World $'000 | Total $'000 |
|---|---|---|---|---|---|
| **Billings**[1] | 118,027 | 64,726 | 103,639 | 48,167 | 334,559 |
| **Revenue** | | | | | |
| Revenue from continuing operations | 112,334 | 43,068 | 85,020 | 41,480 | 281,902 |
| **Other segment information** | | | | | |
| Segment assets | 37,428 | 116,082 | 73,191 | 10,717 | 237,418 |
| Unallocated assets | | | | | 278,599 |
| Total assets | | | | | 516,017 |
| **Capital expenditure** | | | | | |
| Property, plant and equipment | 1,894 | 1,459 | 866 | 229 | 4,448 |
| Intangible assets | 311 | 776 | 43 | - | 1,130 |
| | 2,205 | 2,235 | 909 | 229 | 5,578 |

[1] Billings do not represent the Group's statutory revenue

Corporate assets not allocated to geographical segments relate to corporation and deferred tax, goodwill, intellectual property and other intangible assets (excluding computer software) acquired on acquisition of subsidiaries

### 4 Exceptional costs

Due to their significance and one-off nature during the year to March 31, 2011, consultancy expenses relating to the acquisition of the Sophos Group by Apax Partners of $6,097,000, investment realignment costs of $8,394,000 and due diligence costs of $2,083,000, totaling $16,574,000 are shown separately on the face of the Consolidated Income Statement

Exceptional expenses of $8,475,000 in the comparative period relate to expenditure incurred integrating Utimaco into the Sophos Group, and other consultancy services received in relation to the conversion of the accounts into USD and the acquisition of the Sophos Group by Apax Partners

## Notes to the consolidated financial statements *(continued)*

### 5 Profit/(loss) for the year

The profit/(loss) before taxation is stated after charging

| | 2011 | 2010 |
|---|---|---|
| | $'000 | $'000 |
| Depreciation of property, plant and equipment | 6,401 | 7,007 |
| Amortization of intangible assets | 21,332 | 40,046 |
| Research and development expenditure | 58,754 | 62,851 |
| Operating lease rentals | | |
| Property | 7,656 | 5,758 |
| Other | 809 | 738 |
| Auditor's remuneration (note 6) | 586 | 963 |
| Pension scheme contributions | 3,558 | 2,966 |
| Impairment of trade receivables | 320 | 1,831 |
| Net foreign currency differences | (4,420) | 1,815 |
| Other income | (58) | (59) |

Amortization is charged against General finance and administration expenses in the Consolidated Income Statement

### 6 Auditors' remuneration

The Group paid the following amounts to its auditors in respect of the audit of the historical financial information and for other services provided to the Group

| | 2011 | 2010 |
|---|---|---|
| | $'000 | $'000 |
| Audit of the financial statements | 358 | 310 |
| Other fees to auditors | | |
| Subsidiary local statutory audits | 78 | 128 |
| Other services | 150 | 107 |
| Other services included in exceptional costs | - | 418 |
| | 586 | 963 |

### 7 Employee costs

| | 2011 | 2010 |
|---|---|---|
| | $'000 | $'000 |
| Wages and salaries | 162,469 | 143,879 |
| Social security costs | 18,159 | 15,939 |
| Other pension costs | 3,558 | 2,966 |
| | 184,186 | 162,784 |
| Stock based payments | (2,598) | 6,001 |
| | 181,588 | 168,785 |

The Stock based payments expense arises from equity-settled stock based payment transactions Refer to note 25 for further information

## Notes to the consolidated financial statements *(continued)*

### 7 Employee costs *(continued)*

The average monthly number of employees during the period, analyzed by category, was as follows

| | 2011 | 2010 |
|---|---|---|
| Technical | 822 | 764 |
| Sales and marketing | 642 | 602 |
| Administration | 109 | 107 |
| | 1,573 | 1,473 |

### 8 Directors' remuneration

| | 2011 | 2010 |
|---|---|---|
| | $'000 | $'000 |
| Directors emoluments | 1,503 | 1,232 |
| Aggregate contributions to pension schemes | 19 | 15 |
| | 1,522 | 1,247 |

The number of directors accruing benefits under the defined contribution schemes as at March 31, 2011 was two (2010 one)

There were no directors (2010 none) in respect of whose services stocks were received or receivable under long-term incentive schemes and three directors (2010 none) who exercised stock options

The aggregate of emoluments of the highest paid director for the year ended March 31, 2011 was $792,826 (2010 $689,000), and Company pension contributions of $14,094 were made to a money purchase scheme on his behalf (2010 $12,000)

### 9 Finance income

| | 2011 | 2010 |
|---|---|---|
| | $'000 | $'000 |
| Interest on bank deposits | 126 | 1,754 |
| Derecognition of financial liabilities | 4,341 | - |
| | 4,467 | 1,754 |

### 10 Finance expense

| | 2011 | 2010 |
|---|---|---|
| | $'000 | $'000 |
| Interest expense on loans and borrowings | 225 | 3,889 |
| Amortization of facility fees | 614 | 346 |
| Net change in fair value of interest rate swaps | - | 97 |
| Other interest | 406 | 52 |
| | 1,245 | 4,384 |

## Notes to the consolidated financial statements *(continued)*

### 11 Taxation

| | 2011<br>$'000 | 2010<br>$'000 |
|---|---|---|
| Current income tax | | |
| UK corporation tax | - | 185 |
| Overseas tax | **5,826** | 6,278 |
| Adjustment in respect of previous years | **(3,219)** | 2,491 |
| Total current tax charge | **2,607** | 8,954 |
| | | |
| Deferred tax | | |
| Origination and reversal of temporary differences | **2,049** | (19,076) |
| Adjustment in respect of previous years | **256** | 1,063 |
| Total deferred tax charge/(credit) | **2,305** | (18,013) |
| | | |
| Total income tax charge/(credit) | **4,912** | (9,059) |

UK corporation tax for the year ended March 31, 2011 is calculated at 28% (2010 28%) of the estimated assessable profit/(loss) for the year

The charge/(credit) for the year can be reconciled to the profit/(loss) for the year before taxation per the Consolidated Income Statement as follows

| | 2011<br>$'000 | 2010<br>$'000 |
|---|---|---|
| Profit/(loss) for the year before taxation | **23,104** | (39,546) |
| Profit/(loss) for the year before taxation multiplied by the standard rate of corporation tax in the UK of 28% (2010 28%) | **6,469** | (11,073) |
| | | |
| Effects of | | |
| Expenses not deductible for tax purposes | **(603)** | (1,233) |
| Timing differences not recognized | **641** | - |
| Higher tax rates on overseas earnings | **1,537** | 778 |
| Research and development and other tax credits | **(1,186)** | (906) |
| Adjustments in respect of previous years | **(2,896)** | 3,554 |
| Change in tax rate during the year | **2,994** | - |
| Losses not recognized on acquisition | - | (507) |
| Other movements | **(2,044)** | 328 |
| Charge/(credit) for taxation on profit/(loss) for the year | **4,912** | (9,059) |

## Notes to the consolidated financial statements *(continued)*

### 12 Property, plant and equipment

| | Freehold land and buildings $'000 | Plant and machinery $'000 | Motor vehicles $'000 | Fixtures and fittings $'000 | Total $'000 |
|---|---|---|---|---|---|
| **Cost** | | | | | |
| At April 1, 2009 | 54,283 | 25,399 | 200 | 7,058 | 86,940 |
| Additions | - | 3,113 | - | 1,335 | 4,448 |
| Acquired on business acquisition | - | 2 | - | 9 | 11 |
| Disposals | - | (88) | - | (140) | (228) |
| Effect of movements in exchange rates | 3,139 | 1,736 | 9 | 739 | 5,623 |
| At March 31, 2010 | 57,422 | 30,162 | 209 | 9,001 | 96,794 |
| Additions | - | **2,292** | - | **1,041** | **3,333** |
| Acquired on business acquisition | - | - | - | - | - |
| Disposals | - | **(46)** | **(25)** | **(53)** | **(124)** |
| Effect of movements in exchange rates | **3,237** | **1,376** | **9** | **742** | **5,364** |
| At March 31, 2011 | **60,659** | **33,784** | **193** | **10,731** | **105,367** |
| **Depreciation** | | | | | |
| At April 1, 2009 | 13,968 | 21,716 | 200 | 3,327 | 39,211 |
| Charge for the year | 2,317 | 3,024 | - | 1,666 | 7,007 |
| Disposals | - | (88) | - | (140) | (228) |
| Effect of movements in exchange rates | 712 | 1,475 | 9 | 530 | 2,726 |
| At March 31, 2010 | 16,997 | 26,127 | 209 | 5,383 | 48,716 |
| Charge for the year | **2,250** | **2,692** | - | **1,459** | **6,401** |
| Disposals | - | **(23)** | **(25)** | - | **(48)** |
| Effect of movements in exchange rates | **1,028** | **1,191** | **9** | **606** | **2,834** |
| At March 31, 2011 | **20,275** | **29,987** | **193** | **7,448** | **57,903** |
| **Net book value** | | | | | |
| At March 31, 2010 | 40,425 | 4,035 | - | 3,618 | 48,078 |
| At March 31, 2011 | **40,384** | **3,797** | - | **3,283** | **47,464** |

At March 31, 2011 the Group had entered into contractual commitments for the acquisition of property, plant and equipment amounting to $642,000 (2010 $589,000)

Included in the net book value of property, plant and equipment are assets under finance lease of $Nil (2010 $Nil)

There has been no impairment to the property, plant and equipment held by the Group

## Notes to the consolidated financial statements *(continued)*

### 13 Intangible assets

| | Goodwill $'000 | Intellectual property $'000 | Software $'000 | Others $'000 | Total $'000 |
|---|---|---|---|---|---|
| **Cost** | | | | | |
| At April 1, 2009 | 173,131 | 67,762 | 4,014 | 52,008 | 296,915 |
| Additions | 1,254 | - | 1,130 | - | 2,384 |
| Effect of movements in exchange rates | 9,346 | (848) | 337 | 986 | 9,821 |
| At March 31, 2010 | 183,731 | 66,914 | 5,481 | 52,994 | 309,120 |
| Additions | - | - | 892 | - | 892 |
| Effect of movements in exchange rates | 7,841 | 3,238 | 323 | 2,578 | 13,980 |
| At March 31, 2011 | 191,572 | 70,152 | 6,696 | 55,572 | 323,992 |
| **Amortization** | | | | | |
| At April 1, 2009 | 3,562 | 16,482 | 2,510 | 11,392 | 33,946 |
| Charge for the year | - | 17,890 | 1,290 | 20,866 | 40,046 |
| Effect of movements in exchange rates | 985 | (2,354) | 163 | (647) | (1,853) |
| At March 31, 2010 | 4,547 | 32,018 | 3,963 | 31,611 | 72,139 |
| Charge for the year | - | 11,607 | 1,225 | 8,500 | 21,332 |
| Effect of movements in exchange rates | (187) | 2,407 | 278 | 2,217 | 4,715 |
| At March 31, 2011 | 4,360 | 46,032 | 5,466 | 42,328 | 98,186 |
| **Net book value** | | | | | |
| At March 31, 2010 | 179,184 | 34,896 | 1,518 | 21,383 | 236,981 |
| At March 31, 2011 | 187,212 | 24,120 | 1,230 | 13,244 | 225,806 |

Goodwill and intellectual property relate to the acquisition of ActiveState in the year ended March 31, 2004, Endforce in the year ended March 31, 2007 and Utimaco in the year ended March 31, 2009 Most of the intellectual property is written off on a reducing balance method over its estimated useful life of up to fifteen years Intellectual property arising on the ActiveState and Endforce acquisitions were written off on a straight-line basis over its estimated useful life of three years

Other intangible assets comprise patents recognized on the acquisition of Endforce in the year ended March 31, 2007 and brand names, the customer base and order backlog recognized on the acquisition of Utimaco in the year ended March 31, 2009 Patents are amortized on a straight line basis over a period of three years, brand names are amortized on a reducing balance basis over a period of fifteen years, the customer base on a reducing balance basis over ten years and the order backlog on a straight-line basis over 21 months Software is amortized on a straight line basis over 36 months

The Group has not capitalized any development costs in the year ended March 31, 2011 (2010 $Nil), the research and development expenditure that would qualify for capitalization was not significant and was therefore expensed Capitalized research and development costs acquired as part of the business combination with Utimaco are shown above within intellectual property and are written off over 5 years

Amortization charges and impairment losses on intellectual property, patents and other intangible assets are recognized within research and development expenses, amortization charges on brand names are recognized within administration expenses

The Group does not have any intangible assets with an indefinite useful life, except for goodwill

## Notes to the consolidated financial statements *(continued)*

### 14 Impairment of goodwill and intangibles

Impairment of goodwill and intangible assets is tested annually at the Group level, which represents the lowest level at which goodwill is monitored for internal management purposes Goodwill recognized on the acquisition of the Utimaco group, ActiveState and Endforce is utilized across all cash generating units in the Group Intangibles relating to the Utimaco group mainly represent intellectual property in data protection technology and ActiveState intangibles are also primarily intellectual property

Due to the continued integration of Utimaco it is not possible to separately identify the revenues, costs and cash flows relating to this entity

Goodwill is considered impaired if the carrying value of the cash generating units to which it relates is greater than the higher of fair value less costs to sell and the value in use On June 15, 2010, a majority stake in the Group was sold to Apax Partners in a transaction valuing the Group at $830m

The directors have considered the effects of buyer specific synergies and control premium, disposal costs, and any significant events occurring between March 31, 2011 and June 15, 2010 in concluding that the fair value less costs to sell of the Group of cash generating units is significantly in excess of their carrying value

In the prior year, there was no readily available calculation of the fair value of the cash generating unit Recoverable amounts were therefore determined as a measure of the value in use These were determined based on financial budgets approved by the Board covering a period of three to five years These projections apply probability weightings to growth rates in billings and costs, and a pre-tax weighted average cost of capital to reflect the risks associated with the business The discount rate applied was between 8 5% and 9 0% which represented the weighted average cost of capital for the cash generating unit The projections were most sensitive to changes in billings, which was the key assumption This was based upon management's plans in the medium term and expected inflationary growth in the long-term The recoverable amount of goodwill as indicated by these projections was higher than their carrying values and therefore, no provisions for impairment were booked

## Notes to the consolidated financial statements *(continued)*

### 15 Deferred tax

Deferred tax assets and liabilities are attributable to the following

| | 2011 | 2010 |
|---|---|---|
| | $'000 | $'000 |
| Deferred income tax assets | | |
| Arising on consolidation of deferred revenue | 23,556 | 28,801 |
| Tax value of carry forward losses of overseas subsidiaries | 1,589 | 2,362 |
| Advanced capital allowances of overseas subsidiaries | 790 | 745 |
| Tax effect of the purchase of the software asset from Sophos Inc | - | 971 |
| Stock based payments | - | 6,556 |
| Other timing differences | 2,477 | 3,899 |
| | 28,412 | 43,334 |

| | 2011 | 2010 |
|---|---|---|
| Deferred income tax liabilities | | |
| Accelerated depreciation for tax purposes | 11,585 | 2,305 |
| Acquired on acquisition of subsidiary | - | 16,645 |
| Other timing differences | 752 | - |
| | 12,337 | 18,950 |

The Group has unutilized tax losses and investment tax credits as at March 31, 2011 of $19,789,000 (2010 $10,286,000) upon which a deferred tax asset of $8,927,000 (2010 $4,916,000) has not been recognized In addition, a deferred tax asset of $2,483,000 (2010 $2,199,000) in relation to building costs has not been recognized

As at March 31, 2011, the aggregate amount of temporary differences associated with undistributed earnings of subsidiaries for which deferred tax liabilities have not been recognized was $nil (2010 $nil) No liability has been recognized because the Group is in a position to control the reversal of temporary differences and it is probable that such differences will not reverse in the foreseeable future

Deferred tax assets and liabilities are measured at the tax rates that are expected to apply in the period when the asset is realized or the liability settled, based on tax rates that have been acted or substantially enacted at the reporting date The March 2011 Budget announced that the main rate of UK corporation tax will reduce from 28% to 26% with effect from April 1, 2011 The Budget was substantively enacted on March 29, 2011 and therefore is applicable at the reporting date

The previously announced decreases to 25% from April 1, 2012 and further decrease to 23% are not expected to be substantively enacted until future finance bills are approved If the rate reduction to 25% had been substantively enacted on or before the reporting date it would have had the effect of reducing the deferred tax asset recognized at that date by $937,000 and reducing the deferred tax liability recognized at that date by $422,000 and would have reduced the amount of total unrecognized deferred tax assets at that date by $33,000

# Notes to the consolidated financial statements *(continued)*

## 16 Inventories

| | 2011 $'000 | 2010 $'000 |
|---|---|---|
| Work in progress | **279** | 253 |
| Finished goods and goods for resale | **2,093** | 2,994 |
| | **2,372** | 3,247 |

The amount of write-down of inventories recognized as an expense, within cost of sales, is $670,000 (2010 $927,000)

## 17 Trade and other receivables

| | 2011 $'000 | 2010 $'000 |
|---|---|---|
| **Current** | | |
| Trade receivables | **78,302** | 69,963 |
| Prepayments | **6,335** | 5,280 |
| Other receivables | **7,487** | 4,409 |
| Amounts due from Shield Bidco | **32,473** | - |
| | **124,597** | 79,652 |
| **Non-current** | | |
| Other receivables | **1,303** | 1,512 |

Trade receivables are non-interest bearing and are generally on 30-90 day terms depending on the geographical territory in which sales are generated The carrying value of trade and other receivables also represents their fair value During the year ended March 31, 2011, provision for impairment of $320,000 (2010 $1,831,000) recognized in operating expenses was made against receivables

## Notes to the consolidated financial statements *(continued)*

### 17 Trade and other receivables *(continued)*

As at March 31, 2011, trade receivables at nominal value of $3,684,000 (2010 $3,407,000) were impaired and fully provided for Movements in the provision for impairment of receivables were as follows

| | 2011 $'000 | 2010 $'000 |
|---|---|---|
| As at April 1 | **3,407** | 2,984 |
| Arising on business acquisition | - | - |
| Charge for the year | **320** | 1,831 |
| Amounts written off | **(216)** | (515) |
| Unused amounts reversed | **191** | (927) |
| Effects of movements in exchange rate | **(18)** | 34 |
| As at March 31 | **3,684** | 3,407 |

The analysis of trade receivables that were past due but not impaired is as follows

| | 2011 | 2010 |
|---|---|---|
| Up to 3 months | **13,281** | 13,197 |
| 3 to 6 months | **1,939** | 1,563 |
| Greater than 6 months | **1,433** | 495 |
| | **16,653** | 15,255 |

At March 31, 2011, non-current debtors comprise long term deposits held with third parties in relation to properties and a deposit with the bank against which a guarantee is provided by a third party of $278,000 (2010 $271,000)

### 18 Cash and cash equivalents

| | 2011 $'000 | 2010 $'000 |
|---|---|---|
| Cash at bank and in hand | **62,215** | 70,430 |
| Short-term deposits | **19,375** | 32,783 |
| | **81,590** | 103,213 |

Cash at bank earns interest at floating rates based on daily bank deposit rates Short-term deposits are made for varying periods of between one day and three months depending on the immediate cash requirements of the Group, and earn interest at the respective short-term deposit rates The fair value of cash and cash equivalents as at March 31, 2011 was $81,590,000 (2010 $103,213,000)

# Notes to the consolidated financial statements *(continued)*

## 19 Trade and other payables

| | 2011 $'000 | 2010 $'000 |
|---|---|---|
| **Current** | | |
| Trade payables | **8,541** | 7,975 |
| Accruals | **27,690** | 33,137 |
| Social security and other taxes | **8,209** | 6,132 |
| Other payables | **5,011** | 4,815 |
| Amounts due to parent | **882** | - |
| Trade and other payables due in less than one year | **50,333** | 52,059 |
| **Non-current** | | |
| Other payables | - | 222 |
| Trade and other payables due in more than one year | - | 222 |

Trade payables are non-interest bearing and are normally settled on 30-day terms or as otherwise agreed with suppliers Other payables are non-interest bearing and have an average term of four months (2010 four months)

## 20 Deferred revenue

| | 2011 $'000 | 2010 $'000 |
|---|---|---|
| **Current** | | |
| Due within 12 months | **197,398** | 173,000 |
| Due after 12 months | **155,394** | 129,621 |
| | **352,792** | 302,621 |

## 21 Financial liabilities

| | 2011 $'000 | 2010 $'000 |
|---|---|---|
| **Current** | | |
| Current installments due on bank loans | - | 72,789 |
| | - | 72,789 |
| **Non-current** | | |
| Non-current installments due on bank loans | - | - |
| Warrant on stock issued on acquisition of Utimaco | - | 8,525 |
| Liability component of preference stock | **1,035** | 1,035 |
| | **1,035** | 9,560 |
| | **1,035** | 82,349 |

The loan which was denominated in both Euros and US dollars with interest of 2-2 25% above LIBOR was repaid on June 15, 2010 Upon repayment, security over the buildings of Sophos Limited and certain of its investments in subsidiary companies was removed Further details of securitized assets are provided in note 28

## Notes to the consolidated financial statements *(continued)*

### 22 Provisions

| | Restructuring $'000 | Litigation $'000 | Pension liabilities $'000 | Other $'000 | Total $'000 |
|---|---|---|---|---|---|
| At April 1, 2009 | - | 583 | 1,351 | 1,462 | 3,396 |
| Arising during the year | - | - | 45 | 170 | 215 |
| Utilized | - | (261) | (96) | (1,145) | (1,502) |
| Released during the year | - | (341) | - | (20) | (361) |
| Exchange differences | - | 19 | 27 | 17 | 63 |
| At March 31, 2010 | - | - | 1,327 | 484 | 1,811 |
| Arising during the year | **8,394** | - | **351** | **2,083** | **10,828** |
| Utilized | **(4,060)** | - | **(90)** | **(112)** | **(4,262)** |
| Released during the year | - | - | - | **(414)** | **(414)** |
| Exchange differences | - | - | **2** | **8** | **10** |
| At March 31, 2011 | **4,334** | - | **1,590** | **2,049** | **7,973** |
| | | | | | |
| March 31, 2011 | | | | | |
| Current | **4,334** | - | - | **1,971** | **6,305** |
| Non-current | - | - | **1,590** | **78** | **1,668** |
| | **4,334** | - | **1,590** | **2,049** | **7,973** |
| | | | | | |
| March 31, 2010 | | | | | |
| Current | - | - | - | - | - |
| Non-current | - | - | 1,327 | 484 | 1,811 |
| | - | - | 1,327 | 484 | 1,811 |

Other provisions relate to a provision for dilapidations and a provision in relation to professional fees and expenses incurred during the due diligence work on the Astaro group which are expected to be utilized in Q1 and Q2 of the new financial year

The restructuring provision is in relation to the cost savings initiatives implemented during the year This provision is expected to be fully utilized by October 2013

## Notes to the consolidated financial statements *(continued)*

### 23 Financial risk management

Financial risk management is conducted at a Group level, applying treasury policies which have been approved by the Board The major financial risks to which the Group is exposed relate to interest rate risk, credit risk and movements in foreign currency exchange rates Where appropriate, cost effective and practicable, the Group uses various financial instruments to manage these risks The main purpose of these financial instruments is to ensure liquidity for the Group operations No speculative use of derivatives, currency or other instruments is permitted

The Directors review and agree policies for managing each of these risks as summarized below

*Interest rate risk*
Interest rate risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market interest rates The Group's exposure to the risk of changes in market interest rates relates primarily to the Group's long-term debt obligations with floating interest rates

The Group manages its interest rate risk by having variable rate loans and borrowings, and interest rate caps to limit any exposure to significant interest rate fluctuations

*Credit risk*
The Group's principal financial assets are cash and bank deposits and trade and other receivables

The Group's credit risk is primarily attributable to its trade receivables and cash balances In order to manage credit risk the directors set limits for customers based on a combination of payment history and third party credit references Credit limits are reviewed by the credit controller on a regular basis in conjunction with debt ageing and collection history

The amounts presented in the Consolidated Statement of Financial Position are net of allowance for doubtful debts An allowance for impairment is made where there is an identified loss event which, based on previous experience, is evidence of a reduction in the recoverability of cash flows The expense recognized in the Consolidated Income Statement in respect of doubtful debts during the year was $320,000 (2010 $1,831,000)

The Group has no significant concentration of credit risk in trade receivables, exposure is spread over a large number of counterparties and customers

With respect to cash and deposits, the Group's exposure to credit risk arises from the risk of default by the counterparty with a maximum exposure equal to the carrying amount of these assets To mitigate this risk, cash and deposits are only held with reputable banking institutions The Group reduces the concentrations of credit risk in cash and deposits by holding balances with a number of separate institutions

*Foreign currency risk*
The Group is exposed to translation and transaction foreign exchange risk Several other currencies in addition to the reporting currency of USD are used, including Sterling and the Euro The Group experiences currency exchange differences arising upon retranslation of monetary items (primarily short-term intercompany balances and long-term borrowings), which are recognized as an expense in the year the retranslation occurs The Group endeavors to match the cash inflows and outflows in the various currencies, the Group typically invoices its customers in their local currency, and pays its local expenses in local currency as a means to mitigate this risk The Group is also exposed to exchange differences arising from the translation of its subsidiaries' financial statements in to the Group's reporting currency of USD with the corresponding exchange differences taken directly to equity

## Notes to the consolidated financial statements *(continued)*

### 23 Financial risk management *(continued)*

The following table illustrates the movement that 10% in the value of Sterling or the Euro would have had on the Group's loss for the year and on the Group's equity as at the end of the year

| | 2011 $000 | 2010 $000 |
|---|---|---|
| 10% strengthening in Sterling | 377 | 217 |
| 10% strengthening in Euro | 4,052 | (540) |
| 10% weakening in Sterling | (460) | (265) |
| 10% weakening in Euro | (4,952) | 661 |

Any foreign exchange variance would be recognized as unrealized foreign exchange in the Consolidated Income Statement and have no impact on cash flows

*Liquidity risk*
The Group prepares budgets annually in advance This enables the Group's operating cash flow requirements to be anticipated and to ensure sufficient liquidity is available to meet foreseeable needs, financial obligations and to invest any surplus cash assets safely and profitably

The Group's objective is to maintain a balance between continuity of funding, minimizing finance costs and maintaining flexibility through the use of short-term deposits and intra-Group loan arrangements

*Capital management*
The primary objective of the Group's capital management is to ensure that it maintains a strong credit rating and healthy capital ratios in order to support its business and maximize stockholders' value

The capital structure of the Group consists of cash and cash equivalents as disclosed in note 18, borrowings as disclosed in note 21 and equity attributable to equity holders of the parent, comprising issued capital, reserves, and retained earnings as disclosed in note 24 and the Consolidated Statement of Changes in Equity respectively

The Group manages its capital structure and makes adjustments to it, in light of changes in economic conditions The Group reviews the capital structure on a regular basis and considers the cost of capital and the risks associated with each class of capital

## Notes to the consolidated financial statements *(continued)*

### 24 Issued capital

*Allotted, called up and fully paid*

| | Ordinary stock | | Convertible preferred ordinary stock | | Total | |
|---|---|---|---|---|---|---|
| | Thousands | $'000 | Thousands | $'000 | Thousands | $'000 |
| At April 1, 2009 | 126,685 | 75 | 46,516 | 26 | 173,201 | 101 |
| Issued under stock purchase plan | 990 | 1 | - | - | 990 | 1 |
| Issued on exercise of stock options | 294 | - | - | - | 294 | - |
| Exchange differences | n/a | 2 | n/a | 1 | n/a | 3 |
| At March 31, 2010 | 127,969 | 78 | 46,516 | 27 | 174,485 | 105 |
| Issued under stock purchase plan | 33 | - | - | - | 33 | - |
| Issued on exercise of stock options | 207 | - | - | - | 207 | - |
| Exchange differences | n/a | 1 | n/a | - | n/a | 1 |
| At March 31, 2011 | 128,209 | 79 | 46,516 | 27 | 174,725 | 106 |

All classes of stock are classified as equity stock and rank pari passu for any dividend declared by the Company On a qualifying listing or at the election of the holders, the convertible preferred ordinary stock converts into ordinary stock on a one-for-one basis The convertible preferred ordinary stock shall also carry priority over the assets of the stock purchased by employees under the employee stock purchase plan

During the year ended March 31, 2011, 32,700 ordinary stocks of £0 0004 each were issued under the Sophos employee stock purchase plan and 206,744 stocks under the Sophos employee stock option schemes for a total consideration of £11,992,000

For the year ended March 31, 2010, 1,063,990 ordinary stocks of £0 0004 were allotted under the Sophos employee stock purchase plan and 293,650 stocks under the Sophos employee stock option schemes for a total cash consideration of $2,537,000 Also in that year, 73,810 ordinary stocks of £0 0004 were sold under the Sophos employee stock purchase plan for a total cash consideration of $153,000

## Notes to the consolidated financial statements *(continued)*

### 25 Stock based payments

The stock based payment charge in respect of employee services received for the year ended March 31, 2011 was $3,776,000 (2010 $6,001,000), a credit of $6,374,000 was also recognized for forfeited unvested options resulting in a net credit of $2,598,000 Both the charge and the credit arise from equity settled stock based payment transactions

The Group operates an approved and an unapproved stock option scheme Vesting is over a four or five year period with a one year vesting cliff, thereafter options vest in even monthly installments Certain stock options vest on change of control of the Group If options remain unexercised after a period of 10 years from the date of grant, the options expire Options which have not vested are forfeited if an employee leaves the Group

The following tables illustrate the number and weighted average exercise prices (WAEP) of, and movements in, stock options in the year

| | 2011<br>Options number | 2010<br>Options number |
|---|---|---|
| Outstanding at the start of the year | **22,608,934** | 18,015,385 |
| Awarded | **46,009,563** | 6,048,856 |
| Forfeited | **(6,892,668)** | (1,161,657) |
| Exercised | **(15,716,266)** | (293,650) |
| Outstanding at the end of the year | **46,009,563** | 22,608,934 |
| Exercisable at the end of the year | **Nil** | 10,830,547 |

| | 2011<br>WAEP cents | 2010<br>WAEP cents |
|---|---|---|
| Outstanding at the start of the year | **127 4** | 104 9 |
| Awarded | **16 6** | 182 3 |
| Forfeited | **158 2** | (117 6) |
| Exercised | **106.2** | (114 0) |
| Outstanding at the end of the year | **16 6** | 127 4 |
| Exercisable at the end of the year | **Nil** | 96 8 |

During the year the Sophos stock option schemes ceased due to the change of control of the Group All unvested stock options were forfeited on June 15, 2010 as the options holders did not meet the service conditions Pentagon Holdings SARL offered a new stock option scheme to the employees As there is a one year vesting cliff for the Pentagon scheme, no stock options were exercisable at March 31, 2011 The March 31, 2010 yearend figures which relate solely to the Sophos schemes have been restated in US dollar to aid comparability

The fair value of equity-settled stock options granted is estimated as at the date of grant using a Black-Scholes model, taking into account the terms and conditions upon which the options were granted

## Notes to the consolidated financial statements *(continued)*

### 25 Stock based payments *(continued)*

The following table illustrates the inputs into the Black-Scholes model in the year

| | 2011 | 2010 |
|---|---|---|
| Weighted average stock price (cents) | **57 2** | 205 4 |
| Weighted average exercise price (cents) | **16 6** | 182 3 |
| Expected volatility | **36 0%** | 41 6% |
| Expected life of options (years) | **4 5 to 5 5** | 4 5 to 6 5 |
| Risk free rate | **1.0%** | 2 5% |
| Expected dividends | **Nil** | Nil |
| Weighted average fair value of options (cents) | **37.7** | 98 9 |
| Range of exercise price (cents) | **2 5 to 30.3** | 182 3 |

The expected life of the options is based on historical data and is not necessarily indicative of exercise patterns that may occur The expected life used in the model has been adjusted, based on management's best estimate, accounting for the effects of exercise restrictions and behavioral considerations

Expected volatility was determined by calculating the historical volatility of comparable listed companies The expected volatility reflects the assumption that the historical volatility is indicative of future trends, which may not necessarily be the actual outcome

No other conditions relating to the options granted were incorporated into the measurement of fair value

### 26 Pension schemes

The Group contributes to money purchase personal pension schemes in the UK and to similar or state pension schemes overseas for the benefit of the employees and directors The assets of the schemes are administered by trusts or other bodies in funds independent from the Group In addition, the Group has a defined benefit scheme in Germany arising from the Utimaco acquisition in October 2008

The pension cost charge for the year represents contributions payable by the Group to the funds and increases to the defined benefit scheme provision and amounted to $3,558,000 (2010 $2,966,000)

Contributions of $Nil (2010 $120,000) to the defined contribution pension scheme were outstanding at the year end

The defined benefit scheme is an unfunded scheme as is usual in Germany with the deficit on the scheme financed by accruals established within the Utimaco accounts As at March 31, 2011 the scheme had 1 active member and 6 deferred members

The principal assumptions used in the valuation of the scheme liabilities were

| | |
|---|---|
| Discount rate | 5 23% |
| Rate of increase in salaries | n/a |
| Rate of increase of pensions in payment | 2 00% |
| Inflation assumption | 2 00% |

The charge to the Consolidated Income Statement in respect of the defined benefit scheme was $68,000, of which $2,000 represented the current service cost and $66,000 the interest expense The charge for 2012 is expected to be approximately $69,000

## 26 Pension schemes *(continued)*

The movement in the valuation of the defined benefit obligation was

| | 2011 $'000 |
|---|---|
| Present value of obligation at March 31, 2010 | **1,327** |
| Current service cost | **2** |
| Interest expense | **66** |
| Benefits paid | **(90)** |
| Exchange differences | **2** |
| Present value of obligation at March 31, 2011 | **1,307** |

The present value of obligations as at March 31, 2011 is included in provisions Given the unfunded nature of the scheme there is no offsetting asset

## 27 Related party transactions

*Ownership*

The Company's immediate parent company is Shield Bidco Limited, a company registered in England and Wales The smallest group within which the Companies financial statements are consolidated is that headed by the Company The largest group within which these financial statements are consolidated is headed by Shield Midco Limited, a company incorporated in England and Wales The ultimate parent undertaking is Apax Partners LP (incorporated in Delaware, USA) and the ultimate controlling parties are the fund holders of Apax

*Subsidiaries*

The consolidated financial information includes the financial information of Sophos Limited and the subsidiaries listed in the following table

| Subsidiary undertaking | Country of incorporation | Principal activity | Class of stocks held | Percentage of stocks held |
|---|---|---|---|---|
| Sophos Inc | USA | Selling IT security solutions | Ordinary | 100% |
| Sophos GmbH | Germany | Selling IT security solutions | Ordinary | 100% |
| Sophos Pty Ltd | Australia | Selling IT security solutions | Ordinary | 100% |
| Sophos Sarl | France | Selling IT security solutions | Ordinary | 100% |
| Sophos KK | Japan | Selling IT security solutions | Ordinary | 100% |
| Sophos Italy Srl | Italy | Selling IT security solutions | Ordinary | 100% |
| Sophos Anti-Virus (Asia) Pte Ltd | Singapore | Selling IT security solutions | Ordinary | 100% |
| Sophos Inc | Canada | Selling IT security solutions | Common | 100% |
| Sophos Nominees Limited | UK | Stock nominee company | Ordinary | 100% |
| Sophos Holdings GmbH | Germany | Holding company | Ordinary | 100% |
| Umbrella Acquisitions GmbH | Germany | Holding company | Ordinary | 100% |
| Utimaco* | Germany | Selling IT security solutions | Ordinary | 95% |
| Sophos AB | Sweden | Selling IT security solutions | Ordinary | 100% |
| Sophos Benelux B V | Netherlands | Selling IT security solutions | Ordinary | 100% |
| Utimaco Safeware Ltd** | UK | Selling IT security solutions | Ordinary | 95% |
| Sophos Oy | Finland | Selling IT security solutions | Ordinary | 100% |

## Notes to the consolidated financial statements *(continued)*

### 27 Related party transactions *(continued)*

| | | | | |
|---|---|---|---|---|
| Utimaco Safeguard Systems International GmbH** | Germany | Holding company | Ordinary | 95% |
| Sophos (Schweiz) AG | Switzerland | Selling IT security solutions | Ordinary | 100% |
| Sophos Iberia Srl | Spain | Selling IT security solutions | Ordinary | 100% |
| Sophos Technology Solutions India Private Ltd | India | Selling IT security solutions | Ordinary | 100% |
| Sophos Hong Kong Co Ltd*** | Hong Kong | Selling IT security solutions | Ordinary | 97% |

* Stocks held by Sophos Holdings GmbH
** Stocks held by Utimaco
*** 51 % of stocks held by Sophos Limited and 49% by Utimaco

*Other related parties*

During the year the Group entered into transactions, in the ordinary course of business, with other related parties Transactions entered into, and trading balances outstanding with other related parties, are as follows

| | Sales to related party $'000 | Purchases from related party $'000 | Amounts owed by related party $'000 | Amounts owed to related party $'000 |
|---|---|---|---|---|
| Entities related through common directors' interest | | | | |
| Virus Bulletin limited | | | | |
| Year-ended March 31, 2011 | **49** | **95** | **49** | - |
| Year-ended March 31, 2010 | 59 | 30 | - | - |

During the year ended March 31, 2011, no provisions were made for doubtful debts relating to amounts owed by related parties (2010 $Nil)

Sales and purchases between related parties are made at normal market prices Outstanding balances with entities other than subsidiaries are unsecured, interest free and cash settlement is expected within 60 days of invoice Terms and conditions for transactions with subsidiaries are the same, with the exception that balances are placed on intercompany accounts with no specified credit period

The Group has not provided or benefitted from any guarantees for any related party receivables or payables

*Compensation of key management personnel (including directors)*

| | 2011 $'000 | 2010 $'000 |
|---|---|---|
| Short-term employee benefits | **3,106** | 4,991 |
| Post-employment benefits | **49** | 70 |
| Termination benefits | - | 254 |
| Stock-based payment | **525** | 1,390 |
| | **3680** | 6,705 |

## Notes to the consolidated financial statements *(continued)*

### 28 Commitments and contingent liabilities

*Operating lease arrangements*

| | 2011 $'000 | 2010 $'000 |
|---|---|---|
| Amounts recognized for the year | | |
| Minimum lease payments | **8,465** | 6,496 |
| Net rent expense for the year | **8,465** | 6,496 |

At the reporting date, the Group had outstanding commitments for future minimum lease payments under non-cancellable operating leases, which fall due as follows

| | 2011 $'000 | 2010 $'000 |
|---|---|---|
| Within one year | **7,852** | 8,211 |
| In the second to fifth years inclusive | **15,415** | 13,498 |
| After five years | **11,617** | 2,159 |
| | **34,884** | 23,868 |

*Security and guarantees*
At March 31, 2011 the Group had a $278,000 (2010 $271,000) deposit with a bank against which a guarantee is provided by the bank to a third party

The immediate parent undertaking, Shield Bidco Limited has bank loans totaling $310 7m which are secured on the trade and assets of the Group

### 29 Principal exchange rates

The translation of Sterling into US dollars has been included at the following rates (£ $1)

| | Average | Closing |
|---|---|---|
| Year-ended March 31, 2011 | **£0.6443** | **£0 6238** |
| Year-ended March 31, 2010 | £0 6286 | £0 6592 |

The translation of Euros into US dollars has been included at the following rates (€ $1)

| | Average | Closing |
|---|---|---|
| Year-ended March 31, 2011 | **€0.7567** | **€0 7047** |
| Year-ended March 31, 2010 | €0 7102 | €0 7391 |

### 30 Events after the reporting period

On May 4, 2011, the Company reached agreement through a newly formed entity in Germany, Altstadtsee 160 V V GmbH (to be renamed Sophos Astaro Holdings GmbH) with the selling stockholders of Astaro Software AG ("Astaro") to acquire all stock in Astaro for a purchase price of $160 million Completion of the transaction is subject to certain customary conditions being satisfied

## Company balance sheet

*At March 31, 2011*
Registered number 2096520

| | Note | 2011 £'000 | 2010 £'000 |
|---|---|---|---|
| **Fixed assets** | | | |
| Intangible assets | 2 | **1,683** | 3,029 |
| Tangible assets | 3 | **27,071** | 28,171 |
| Investments | 4 | **115,985** | 117,313 |
| | | **144,739** | 148,513 |
| **Current assets** | | | |
| Stocks of inventory | 5 | **107** | 293 |
| Debtors | 6 | **199,141** | 114,165 |
| Cash at bank and in hand | | **29,344** | 35,298 |
| | | **228,592** | 149,756 |
| Creditors amounts falling due within one year | 7 | **(125,362)** | (157,364) |
| Net current assets | | **103,230** | (7,608) |
| Total assets less current liabilities | | **247,969** | 140,905 |
| Creditors amounts falling due after more than one year | 7 | **(87,510)** | (64,408) |
| Provisions for liabilities | 8 | **(3,933)** | - |
| Net assets | | **156,526** | 76,497 |
| Capital and reserves | | | |
| Called up share capital | 9 | **69** | 69 |
| Share premium | 10 | **35,464** | 23,472 |
| Share warrant | 10 | - | 2,759 |
| Other reserve | 10 | **888** | 4,588 |
| Profit and loss account | 10 | **120,105** | 45,609 |
| Shareholder's funds | 11 | **156,526** | 76,497 |

These financial statements were approved by the board of directors on June 23, 2011 and were signed on its behalf by

**Nick Bray**
CHIEF FINANCE OFFICER

The notes on pages 48 to 56 form part of these financial statements

# Notes to the Company financial statements

## Principal accounting policies

The following accounting policies have been applied consistently in dealing with items which are considered material in relation to the parent Company's financial statements

Basis of preparation

The Company has considerable financial resources together with contracts with a large number of customers and across different geographic areas and industries As a consequence, the directors believe that the Company is well placed to manage its business risks successfully despite the current uncertain economic outlook

The directors have a reasonable expectation that the Company has adequate resources to continue in operational existence for the foreseeable future Thus they continue to adopt the going concern basis in preparing the annual financial statements

Further information regarding the Company's business activities, together with the factors likely to affect its future development, performance and position is set out in the Business Review on pages 2 to 4 Further information regarding the financial position of the Company, its cash flows, liquidity position and borrowing facilities are described in the Directors' Report and the notes to the financial statements

The financial statements have been prepared in accordance with applicable accounting standards under UK Generally Acceptable Accounting Policies (UK GAAP) and under the historical cost accounting rules

Under section 408 of the Companies Act 2006, the Company is exempt from the requirement to present its own profit and loss account

Under the exemption within Financial Reporting Standard 8 (amended) transactions with wholly owned Group companies are not disclosed All transactions with non-wholly owned Group companies are made in the ordinary course of business and are arms length transactions

The Company is exempt from the requirements to prepare a cash flow statement under Financial Reporting Standard 1 "Cash flow statements (revised 1996)" on the grounds that it prepares consolidated financial statements which are publicly available

Turnover

Turnover represents the amounts (excluding value added tax) derived from the provision of goods and services to third party customers

Customers generally enter into annual or longer term contracts with the Company Most commonly, customers receive software products at the start of the contract under a fixed term license and are also entitled to receive regular updates or other services for the duration of the license term The Company also offers hardware appliances with new software licenses as an integrated platform on which certain software products can be operated Revenue attributable to hardware, software products, updates or other services is recognized ratably over the duration of the contract

Where the Company contracts with an OEM or a service provider rather than an end user, it mirrors the above policy and recognizes the revenue in line with the contract term granted to the end user

Investments

Investments in subsidiary undertakings are stated at cost, less any provision for impairment

Intangible fixed assets and amortization

Purchased intangible fixed assets are capitalized at their cost and amortized by equal annual installments over their estimated economic lives as follows

Goodwill and intellectual property - 33⅓% per annum

## Notes to the Company financial statements *(continued)*

Tangible fixed assets and depreciation

Tangible fixed assets are stated at cost less accumulated depreciation and any accumulated impairment losses Depreciation is provided to write off the cost less the estimated residual value of tangible fixed assets by equal installments over their estimated useful economic lives as follows

| | | |
|---|---|---|
| Freehold buildings | - | 4% per annum |
| Leasehold improvements | - | over the life of the lease |
| Computer equipment | - | 33⅓% per annum |
| Other plant and equipment | | 20% per annum |
| Motor vehicles | - | 25% per annum |
| Fixtures and fittings | - | 15% per annum |

No depreciation is provided on freehold land

Foreign currencies

Transactions in foreign currencies are recorded using the rate of exchange ruling at the date of the transaction Monetary assets and liabilities denominated in foreign currencies are translated using the rate of exchange ruling at the Balance Sheet date and the gains or losses on translation are included in the profit and loss account Non-monetary assets and liabilities denominated in foreign currencies are stated at historical foreign exchange rates

Leases

Operating lease rentals are charged to the profit and loss account on a straight-line basis over the period of the lease

Long term inter-company loans

The balance outstanding on loans made to subsidiary undertakings for the specific purpose of funding an acquisition have been designated as long term loans

Post retirement benefits

The Company operates a defined contribution pension scheme The assets of the scheme are held separately from those of the Company in an independently administered fund The amount charged against profits represents the contributions payable to the scheme in respect of the accounting period

Research and development expenditure

Expenditure on research and development is expensed in the year in which it is incurred

Stocks of inventory

Stocks of inventory are stated at the lower of cost and net realizable value In determining the cost of raw materials, consumables and goods purchased for resale, the FIFO method is used

Taxation

The charge for taxation is based on the profit for the year and takes into account taxation deferred because of timing differences between the treatment of certain items for taxation and accounting purposes Deferred tax is recognized in respect of all such timing differences which have arisen but not reversed by the Balance Sheet date, except as otherwise required by FRS 19

## Notes to the Company financial statements *(continued)*

Share based payments

The share option program allows employees to acquire stock in the Group The fair value of options granted is recognized as an employee expense with a corresponding increase in equity The fair value is measured at grant date and spread over the period during which the employees become unconditionally entitled to the options The fair value of the options granted is measured using an option pricing model, taking into account the terms and conditions upon which the options were granted The amount recognized as an expense is adjusted to reflect the actual number of share options that vest except where variations are due only to share prices not achieving the threshold for vesting

Where the Company grants options over its own shares to the employees of its subsidiaries it recognizes, in its own financial statements, an increase in the cost of investment in its subsidiaries equivalent to the equity-settled share based payment charge with the corresponding credit being recognized directly in equity

Interest bearing loans and borrowings

Obligations for loans and borrowings are recognized when the Group becomes party to the related contracts and are measured initially at fair value less directly attributable transactions costs

After initial recognition, interest bearing loans and borrowings are subsequently measured at amortized cost using the effective interest method

Gains and losses arising on the repurchase, settlement or otherwise cancellation of liabilities are recognized respectively in finance income and finance expense

Arrangement fees relating to loans are capitalized and written off over the term of the loan Capitalized arrangement fees are included within creditors

### 1 Profit and loss account

The profit after tax dealt with in the books of the Company was £71,252,000 (2010 profit of £7,242,000) Under section 408 of the Companies Act 2006 the Company is exempt from the requirement to present its own profit and loss account The directors do not recommend the payment of a dividend (2010 £nil)

## Notes to the Company financial statements *(continued)*

### 2 Intangible assets

| | ActiveState Intellectual Property £'000 | Endforce Intellectual Property £'000 | Utimaco Goodwill £'000 | Total £'000 |
|---|---|---|---|---|
| **Cost** | | | | |
| At March 31, 2010 | 7,166 | 4,036 | 4,039 | 15,241 |
| At March 31, 2011 | **7,166** | **4,036** | **4,039** | **15,241** |
| **Amortization** | | | | |
| At March 31, 2010 | 7,166 | 4,036 | 1,010 | 12,212 |
| Charge for the year | - | - | **1,346** | **1,346** |
| At March 31, 2011 | **71,66** | **4,036** | **2,356** | **13,558** |
| **Net book value** | | | | |
| At March 31, 2010 | - | - | 3,029 | 3,029 |
| At March 31, 2011 | - | - | **1,683** | **1,683** |

### 3 Tangible assets

| | Freehold land and buildings £'000 | Plant and machinery £'000 | Motor Vehicles £'000 | Fixtures and fittings £'000 | Total £'000 |
|---|---|---|---|---|---|
| **Cost** | | | | | |
| At March 31, 2010 | 37,593 | 11,231 | 84 | 644 | 49,552 |
| Additions | - | **1,599** | - | **8** | **1,607** |
| Disposals | - | **(9)** | - | **(2)** | **(11)** |
| At March 31, 2011 | **37,593** | **12,821** | **84** | **650** | **51,148** |
| **Depreciation** | | | | | |
| At March 31, 2010 | 11,155 | 9,543 | 84 | 599 | 21,381 |
| Charge for the year | **1,446** | **1,228** | - | **22** | **2,696** |
| At March 31, 2011 | **12,601** | **10,771** | **84** | **621** | **24,077** |
| **Net book value** | | | | | |
| At March 31, 2010 | 26,438 | 1,688 | - | 45 | 28,171 |
| At March 31, 2011 | **24,992** | **2,050** | - | **29** | **27,071** |

At 31 March, 2011 the Company had entered into contractual commitments for the acquisition of property, plant and equipment amounting to £397,000 (2010 £204,000)

Within freehold land and buildings the gross cost which is depreciable is £36,399,000 (2010 £36,399,000)

## Notes to the Company financial statements *(continued)*

### 4 Investments

| | £'000 |
|---|---|
| At April 1, 2010 | 117,313 |
| Credit against investment | (1,328) |
| At March 31, 2011 | 115,985 |

| Subsidiary undertaking | Country of incorporation | Activity | Class of shares held | Percentage of shares held |
|---|---|---|---|---|
| Sophos Inc | USA | Selling IT security solutions | Ordinary | 100% |
| Sophos GmbH | Germany | Selling IT security solutions | Ordinary | 100% |
| Sophos Pty Ltd | Australia | Selling IT security solutions | Ordinary | 100% |
| Sophos Sarl | France | Selling IT security solutions | Ordinary | 100% |
| Sophos KK | Japan | Selling IT security solutions | Ordinary | 100% |
| Sophos Italy Srl | Italy | Selling IT security solutions | Ordinary | 100% |
| Sophos Anti-Virus (Asia) Pte Ltd | Singapore | Selling IT security solutions | Ordinary | 100% |
| Sophos Inc | Canada | Selling IT security solutions | Common | 100% |
| Sophos Nominees Limited | UK | Share nominee company | Ordinary | 100% |
| Sophos Holdings GmbH | Germany | Holding company | Ordinary | 100% |
| Umbrella Acquisitions GmbH | Germany | Holding company | Ordinary | 100% |
| Utimaco Safeware AG* | Germany | Selling IT security solutions | Ordinary | 95% |
| Sophos AB | Sweden | Selling IT security solutions | Ordinary | 100% |
| Sophos Benelux | Netherlands | Selling IT security solutions | Ordinary | 100% |
| Utimaco Safeware Ltd** | UK | Selling IT security solutions | Ordinary | 95% |
| Sophos Oy | Finland | Selling IT security solutions | Ordinary | 100% |
| Utimaco Safeguard Systems International GmbH** | Germany | Holding company | Ordinary | 95% |
| Sophos (Schweiz) AG | Switzerland | Selling IT security solutions | Ordinary | 100% |
| Sophos Iberia Srl | Spain | Selling IT security solutions | Ordinary | 100% |
| Sophos Technology Solutions India Private Ltd | India | Selling IT security solutions | Ordinary | 100% |
| Sophos Hong Kong Co Ltd*** | Hong Kong | Selling IT security solutions | Ordinary | 97% |

* Shares held by Sophos Holdings GmbH
** Shares held by Utimaco AG
*** 51% shares held by Sophos Limited and 49% by Utimaco Safeware AG

### 5 Stocks of inventory

| | 2011 £'000 | 2010 £'000 |
|---|---|---|
| Finished goods and goods for resale | 107 | 293 |

## Notes to the Company financial statements *(continued)*

### 6 Debtors

| | 2011 £'000 | 2010 £'000 |
|---|---|---|
| Amounts falling due within one year | | |
| Trade debtors | **15,845** | 12,257 |
| Amounts owed by group undertakings | **83,391** | 61,965 |
| Other debtors | **58** | 37 |
| Prepayments | **3,785** | 733 |
| Deferred tax asset | **-** | 3,146 |
| | **103,079** | 78,138 |
| Amounts falling due after more than one year | | |
| Amounts owed by group undertakings | **96,062** | 36,027 |
| Total debtors | **199,141** | 114,165 |

### 7 Creditors

| | 2011 £'000 | 2010 £'000 |
|---|---|---|
| Amounts falling due within one year | | |
| Trade creditors | **1,531** | 3,167 |
| Current installments due on loans | **-** | 47,985 |
| Amounts due to Group undertakings | **23,522** | 17,354 |
| Deferred tax liability | **711** | - |
| Corporation tax | **-** | 635 |
| Social security and other taxes | **2,975** | 2,023 |
| Other creditors | **143** | 211 |
| Accruals | **7,370** | 8,659 |
| Deferred revenue | **89,110** | 77,330 |
| | **125,362** | 157,364 |
| Amounts falling due after more than one year | | |
| Amounts due to Group undertakings | **13,237** | - |
| Liability component of preference shares | **3,485** | 3,485 |
| Deferred revenue | **70,788** | 60,923 |
| | **87,510** | 64,408 |
| Total creditors | **212,872** | 221,772 |

Outstanding amounts due in respect of the defined contribution scheme payable at the reporting date were £79,630 (2010 £79,353)

The loan denominated in both Euros and US dollars incurred interest at 2-2 25% above LIBOR (2010 2-2 25%) The loan was repaid on June 15, 2010 and security provided over the buildings of Sophos Limited and certain of its investments in subsidiary companies was lifted on repayment

## Notes to the Company financial statements *(continued)*

### 8 Provisions

| | Deferred tax £'000 | Other £'000 | Total £'000 |
|---|---|---|---|
| At April 1, 2010 | - | - | - |
| Provisions reversed during the year | - | - | - |
| Provisions made during the year | - | 3,933 | 3,933 |
| At March 31, 2011 | - | 3,933 | 3,933 |

Other provisions relate to professional fees and expenses incurred during the due diligence work on the Astaro group which are expected to be utilized in Q1 and Q2 of the new financial year

### 9 Called up share capital

*Allotted, called up and fully paid shares*

| | Ordinary shares | | Convertible preferred ordinary shares | | Total | |
|---|---|---|---|---|---|---|
| | Thousands | £'000 | Thousands | £'000 | Thousands | £'000 |
| At April 1, 2010 | 127,969 | 51 | 46,516 | 18 | 174,485 | 69 |
| Issued under share purchase plan | 33 | - | - | - | 33 | - |
| Issued on exercise of share options | 207 | - | - | - | 207 | - |
| At March 31, 2011 | 128,209 | 51 | 46,516 | 18 | 174,725 | 69 |

All classes of shares are classified as equity shares and rank pari passu for any dividend declared by the Company On a qualifying listing or at the election of the holders, the convertible preferred ordinary shares convert into ordinary shares on a one-for-one basis The convertible preferred ordinary shares shall also carry priority over the assets of the shares purchased by employees under the employee share purchase plan

During the year ended March 31, 2011, 32,700 ordinary shares of £0 0004 each were issued under the Sophos employee share purchase plan and 206,744 shares under the Sophos employee share option schemes for a total consideration of £11,992,000

For the year ended March 31, 2010, 1,063,990 ordinary shares of £0 0004 were allotted under the Sophos employee share purchase plan and 293,650 shares under the Sophos employee share option schemes for a total cash consideration of $1,594,000 Also in that year, 73,810 ordinary shares of £0 0004 were sold under the Sophos employee share purchase plan for a total cash consideration of $96,000

## Notes to the Company financial statements *(continued)*

### 10 Reserves

| | Share premium £'000 | Other reserves £'000 | Share warrant reserve £'000 | Profit and loss account £'000 |
|---|---|---|---|---|
| At April 1, 2010 | 23,472 | 4,588 | 2,759 | 45,609 |
| Profit for the year | - | - | - | 71,252 |
| Share based payment expense | - | 207 | - | 134 |
| Reclassification | - | (3,907) | - | 3,907 |
| Foreign exchange | - | - | - | (797) |
| Cancellation of share warrant | | - | (2,759) | - |
| Premium on shares issued | 11,992 | - | - | - |
| At March 31, 2011 | 35,464 | 888 | - | 120,105 |

### 11 Reconciliation of movements in shareholder's funds

| | 2011 £'000 | 2010 £'000 |
|---|---|---|
| Profit for the year | 71,252 | 7,242 |
| New share capital subscribed (net of issue costs) | 11,992 | 1,708 |
| Share based payment expense | 134 | 1,505 |
| Deferred tax on share option costs | - | 407 |
| Foreign exchange | (797) | (725) |
| Investment in subsidiaries | 207 | 2,168 |
| Cancellation of share warrant | (2,759) | - |
| Net addition to shareholder's funds | 80,029 | 12,305 |
| Opening shareholder's funds | 76,497 | 64,192 |
| Closing shareholder's funds | 156,526 | 76,497 |

### 12 Commitments and contingencies

**Operating lease arrangements**

| | 2011 £'000 | 2010 £'000 |
|---|---|---|
| Within one year | 11 | 132 |
| In the second to fifth years inclusive | 2 | - |
| After five years | - | - |
| Net rent expense for the period | 13 | 132 |

*Security and guarantees*

The immediate parent undertaking, Shield Bidco Limited has bank loans totaling $310 7m which are secured on the trade and assets of the Group

## Notes to the Company financial statements *(continued)*

### 13 Related party transactions

The Company has taken advantage of the exemption in FRS 8 not to disclose transactions with wholly owned subsidiaries During the year, the Company entered into material transactions, in the ordinary course of business, with its 95% subsidiary, Utimaco Safeware AG

Transactions entered into, and trading balances outstanding at March 31, 2011 are as follows

| | Sales to Utimaco Safeware AG £'000 | Purchases from Utimaco Safeware AG £'000 | Amounts owed from Utimaco Safeware AG £'000 | Amounts owed to Utimaco Safeware AG £'000 |
|---|---|---|---|---|
| Year ended March 31, 2011 | **104** | **13,573** | **104** | **11,236** |
| Year ended March 31, 2010 | 350 | 10,442 | 350 | 3,041 |

No amounts have been written off in the year or provided against at year end in respect of the amounts shown

### 14 Ultimate parent undertaking

The Company's immediate parent company is Shield Bidco Limited, a company registered in England and Wales The Company's Group financial statements are the smallest within which these Company financial statements are consolidated The largest group within which these Company financial statements are consolidated is headed by Shield Midco Limited The ultimate parent undertaking is Apax Partners LP (incorporated in Delaware, USA) and the ultimate controlling parties are the fund holders of Apax