SOPHEON 2006

ANNUAL REPORT

sopheon

The Knowledge To Compete®

Sopheon is an international provider of software and services that increase the business impact of innovation. Sopheon's software applications automate the product development process and provide strategic decision support that helps organizations generate more revenue and profit from new products.

2006 was a milestone year for Sopheon.

From break-even EBITDA to substantial growth

in numbers of clients and end-users,

we made important headway throughout the business.

We advanced our products and fortified our market position.

We stayed focused, gained valuable experience, and

continued to refine our strategic direction.

We demonstrated a capacity to scale,

and our disciplined fiscal execution further prepared us

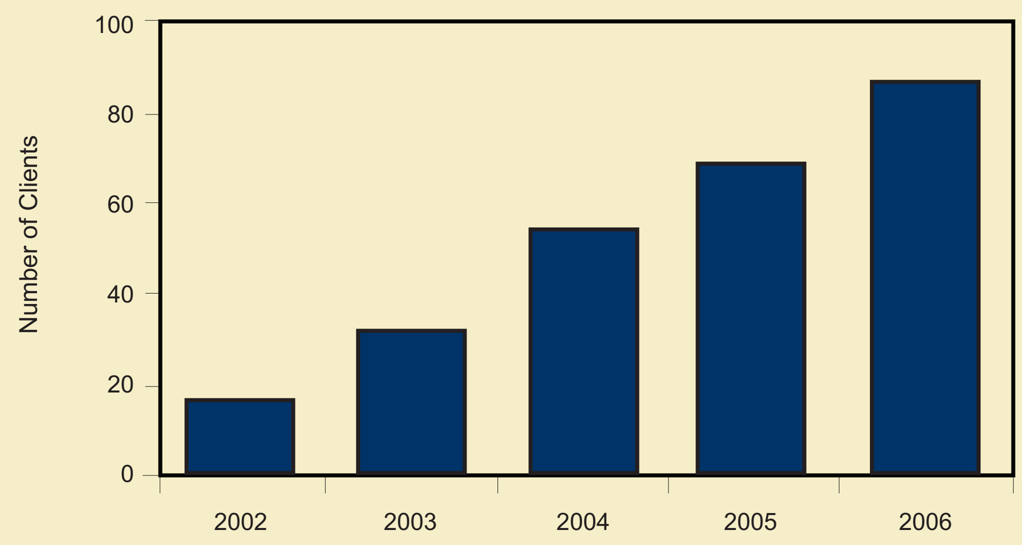
for the exciting opportunities that lie ahead.

The record shows, we have made great progress.

IN THE PAST FIVE YEARS...

WE HAVE GROWN THE NUMBER OF COMPANIES THAT HAVE LICENSED OUR SOFTWARE TO

EIGHTY SEVEN CUSTOMERS



"Having the right systems to support our innovation efforts is essential to our ability to take advantage of new market opportunities. We are making Sopheon's solution an integral component of our innovation infrastructure."

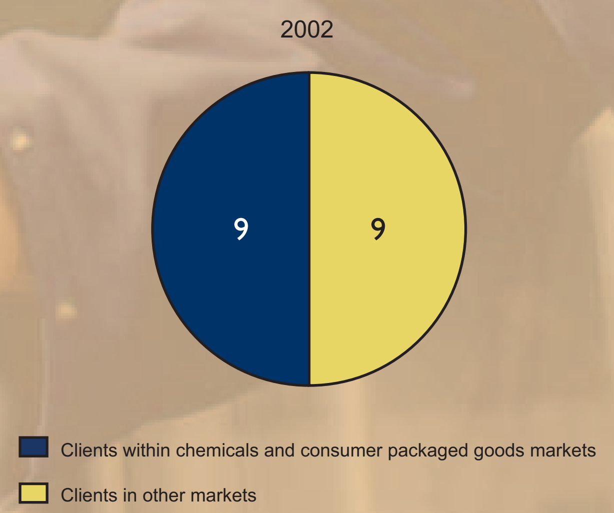
– Thomas Meyer, Coordinator of Global Research, BASF

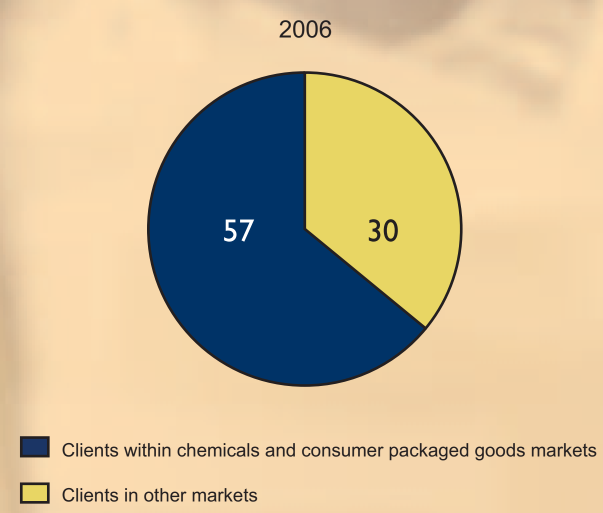
IN THE PAST FIVE YEARS...

BY FOCUSING ON CHEMICALS AND CONSUMER PACKAGED GOODS COMPANIES WE HAVE ACHIEVED

TWICE THE CUSTOMER GROWTH

FROM THOSE VERTICALS THAN FROM OTHER SEGMENTS





"Sopheon's Accolade® allows us to incorporate input from regulatory affairs, product stewardship, marketing, and operations – not just R&D. The solution helps us ensure that we make our highest-value projects our first priority."

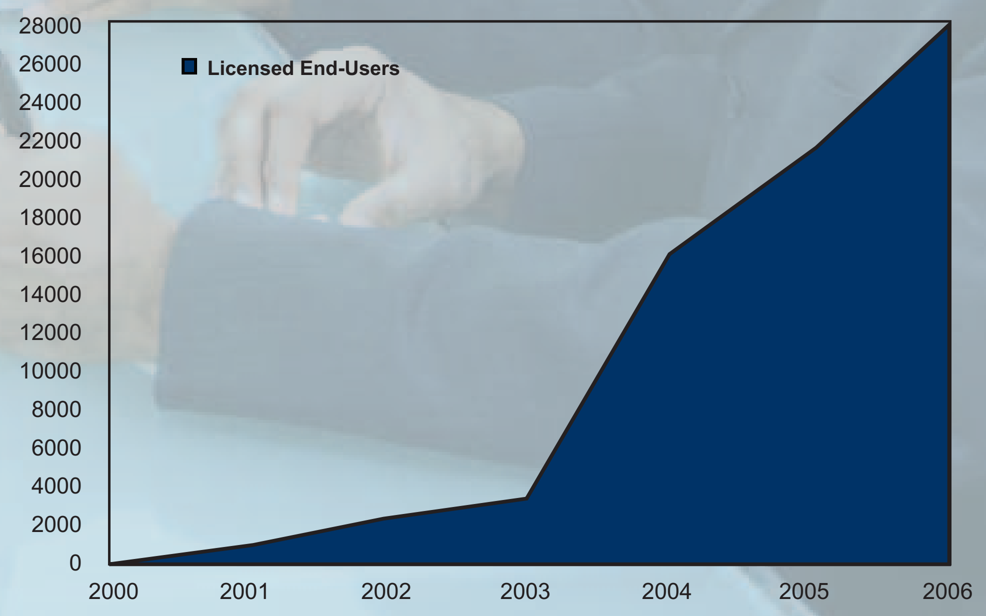
– Wim Vanderpoorten, Innovation Process Director, Cytec Specialty Chemicals

IN THE PAST FIVE YEARS...

THE NUMBER OF INDIVIDUAL ACCOLADE END-USERS

HAS GROWN FROM 900 TO

MORE THAN 27,000



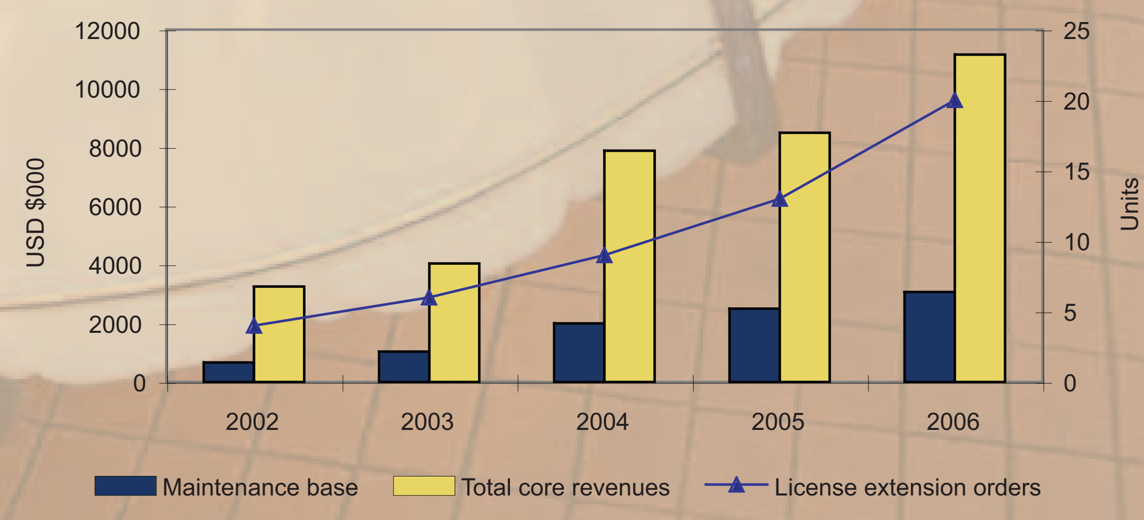
"Innovation is essential to our business success. Accolade will automate our product development process and assist us in setting project priorities. Its capabilities will help to ensure that the right new products get to market, and get there on time."

– Tom Gruetzmacher, Vice President of Research and Development, Land O'Lakes

IN THE PAST FIVE YEARS...

SOPHEON'S MAINTENANCE BASE HAS **INCREASED FOUR-FOLD**, AND WE HAVE SIGNED 52 LICENSE EXTENSION ORDERS.

IN US DOLLAR TERMS, SINCE THE LAUNCH OF ACCOLADE OUR CORE BUSINESS HAS DELIVERED **ANNUALIZED GROWTH OF 47%**



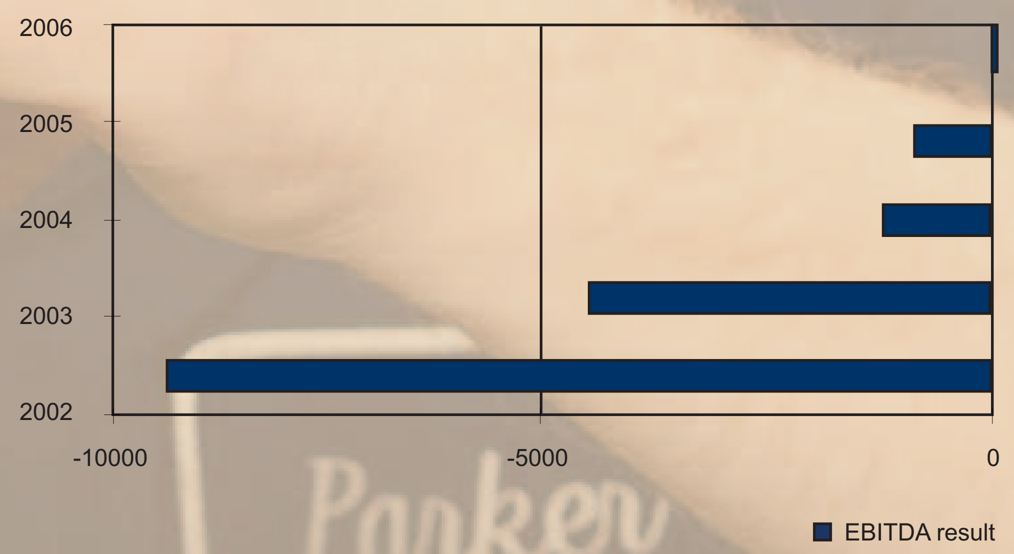
"Once the Sopheon software was implemented [at Parker Hannifin], about half the projects in play disappeared overnight. And there's been a significant financial payoff as well: For the last two years, Parker Hannifin has achieved 8% organic growth."

– "Priming the Product Pipeline"
Managing Automation Magazine, October 2006

IN THE PAST FIVE YEARS...

SOPHEON HAS MOVED FROM REPORTING ANNUAL LOSSES OF £9 MILLION TO BREAKING INTO

POSITIVE EBITDA



Statement from the Chairman and Chief Executive Officer

A year of operational progress

We achieved much in 2006. In headline terms, we grew revenues to £6.0m from £4.7m in 2005. This was underpinned by 36 license orders and extensions, taking the total number of licensed customers to 87. Full-year revenues were 30% higher than the prior year, and we achieved breakeven EBITDA (earnings before interest, tax, depreciation and amortization) for the first time in our history. Coming into 2007 we continue to enjoy high levels of activity in our sales pipeline, reinforcing our belief that we are the leading independent vendor in the market for Product Portfolio Management (PPM) solutions. This market is projected to triple in size between 2006 and 2010. Implementing a system like Accolade represents a serious commitment for any organization and this continues to weigh on our sales cycles. However, as our business matures in scale we believe that this area, which has always brought unpredictability to our revenues, will show improvement.

A year of strategic extension

At the start of 2006, we made a strategic decision to move beyond the chemicals, materials, and food & beverage markets that have historically been our focus. In particular, we began to pursue opportunities in non-food & beverage segments of the consumer packaged goods sector. This effort encompassed marketing programs and targeted business development activity. It led to our securing a number of new clients, exemplified by Timex, the leading watchmaker in North America, and Electrolux, the world's leading international appliance company. Leveraging our partnerships will be critical to achieving our longer term goals in this area, and we were delighted to announce our first major automobile customer, secured in collaboration with Hewlett-Packard. Geographical reach was also extended with sales for the first time in Scandinavia, France, Israel, Portugal and New Zealand. Some of these were secured through our growing reseller channel.

A stable organization

Our ability to deliver value to our customers is a testament to Sopheon people in all parts of our company, many of whom have been working tirelessly for several years to build the business we have today. We thank them for their contribution to our growing success.

Sopheon's executive management team has also been in place for several years and comprises a team of five, which includes the two of us and our CFO Arif Karimjee, in addition to Paul Heller our CTO and Huub Rutten our head of research. The Sopheon plc board includes the three executive directors, in addition to three non-executive directors who bring a wealth of knowledge and experience to our business. Details about each of us are on the inside back cover of this report.

Outlook

With the achievement of a breakeven EBITDA result, our business crossed a financial milestone during 2006. As we approach the next milestone of 100 licensees for our software, the scale and maturity for which we have been striving since the launch of Accolade six years ago is, we believe, finally coming through. This is contributing both to rising revenue stability, and to rising market recognition. We will build on our achievements by attending to five key areas:

- Secure more business from our existing customer base
- Extend our hold in established chemicals, materials, and food and beverage markets
- Expand the Accolade product in depth, functionality, integration and scalability
- Enter new vertical markets
- Develop and expand our partner network

In addition, we will carefully consider potential acquisitions that offer both strategic and operational benefits. As always, we recognize the need both to drive Sopheon forward strategically, and to stay focused on financial performance. This challenge will continue to shape our thinking in the exciting times ahead.

Barry Mence
Executive Chairman

Andy Michuda
Chief Executive Officer

28 March 2007

Financial & Operating Review

Trading performance

Sopheon's consolidated turnover grew to £6.0m (2005: £4.7m). This overall result included a strong new sales performance by our European business, which grew revenues by 68% in the year. This was offset by a relatively flat performance in the US, accentuated by the weakening of the US dollar in global currency markets. This growth pattern is the opposite of what took place in 2005, when we experienced stronger growth in North America. Over the years we have invested heavily in maintaining a truly international footprint for our business and this is proving to be both a key differentiator in our business development and implementation efforts, and a source of balance for our revenue performance. Since the introduction of Accolade six years ago, our average annualized growth in US dollar terms continued to hold at approximately 50%.

Overall, Sopheon's revenues for 2006 were 30%, higher than the preceding year. Unlike in 2005, however, revenues were evenly spread across the first and second half. Although we look forward to strong growth, we believe that our performance in any particular period will remain relatively unpredictable for some time to come. This is a function of sales cycle time and of transaction value.

Business mix

During 2006 we closed 16 new license customers and 20 extension orders from existing customers. In past statements we have noted the growing influence of larger sales, which have the potential to increase revenue volatility, but also underpin growth. Such transactions also have the effect of pulling through substantial consulting and other service opportunities due both to the more extensive nature of the implementations in question, and also to a growing trend of existing customers returning to Sopheon to support expansion efforts through additional configuration and consultancy work following the initial roll-out. During 2006, we enjoyed £0.6m of such repeat services business.

In addition to license and services revenues, our third major revenue stream is recurring maintenance income which coming into 2007 has grown to £1.7m, compared to £1.4m a year before. In 2006 our business delivered a 37:25:38 ratio of license, maintenance, service respectively compared to 40:25:35 in the prior year. We expect our consulting revenues to continue to grow strongly and to provide another source of stability and maturity to our business. However, we believe that this will be offset as a proportion of our total revenues by the effect of license business coming through our expanding reseller network, for which associated services work is unlikely to be performed by Sopheon. We expect maintenance to hold at approximately a quarter of our overall revenues.

As we first signaled in 2005, the higher proportion of services in our revenue mix has required us to make extensive use of subcontractor partners. This requirement has increased as the scope of deployments and the geographic spread of our customers have continued to expand. A recent example was our Accolade installation at Electrolux, where we contracted with Arthur D Little to perform the bulk of the implementation work. In spite of this we achieved an overall gross margin, measured after deducting the costs of such partners as well as our own client services resources, of 72% (2005: 73%).

Research & Development expenditure

During 2006, our R&D effort focused on three different areas. During the year we developed and launched the Accolade Accelerators, a group of new applications which expand Accolade's out-of-the-box capabilities in key process automation areas such as Stage-Gate® implementations, roadmapping and planning, and product portfolio management. The Accelerators feature built in best-practice content and reports that allow a company to leverage Accolade in these areas with much reduced configuration effort.

Stage-Gate® is a registered trademark of the Product Development Institute.

In addition, we completed the majority of the effort required to transfer our legacy healthcare protocol management system onto the Accolade platform, and our hospital clients have now started the upgrade process. Finally, we continued to invest substantial resources in developing the next release of Accolade which is due in late 2007. This release will bring a host of new features to our flagship offering, enabling Sopheon to maintain its leadership position and expand to new markets.

As a result of the above, £0.5m (2005: £0.4m) of our 2006 R&D expenditure met the criteria of IAS38 for capitalization.

Operating costs

As noted in the Remuneration Report a bonus was earned by the majority of the group's employees in respect of the 2006 performance. This has resulted in an increase in payroll costs relative to 2005 in all areas, with the principal exception of members of Sopheon's sales teams for whom incentives are tied to individual or territory results.

More specifically, if the effect of the capitalization and amortization of R&D costs is added back, we increased total R&D expenditure by £0.2m. In particular, this reflects the formation of an internal organization that we call RAD, short for Research & Application Development. The group is chartered to work with clients to investigate and create new software applications built on the Accolade platform that would extend the utility and value of the core offering; the Accelerators described above were developed by the RAD team.

Distribution costs are slightly lower than the previous year in spite of the higher revenues. Some of this apparent reduction is attributable to the reclassification of certain employees into the RAD team; however, other than the bonus noted above both administrative and distribution costs remained tightly contained. Although we do not currently plan to increase direct sales representation in 2007, we do plan to raise investment in channel development and marketing in order to continue to drive growth.

We achieved a breakeven consolidated EBITDA position (2005: £0.75m loss). This total reflects a deduction of share based payments of £0.1m (2005: £0.2m). It excludes depreciation and amortization charges of £0.3m (2005: £0.5m) for the year. Including these items, the resultant retained loss for the year was £0.3m (2005: £1.2m) reducing the loss per ordinary share to 0.2p (2005: 0.9p).

Financing and balance sheet

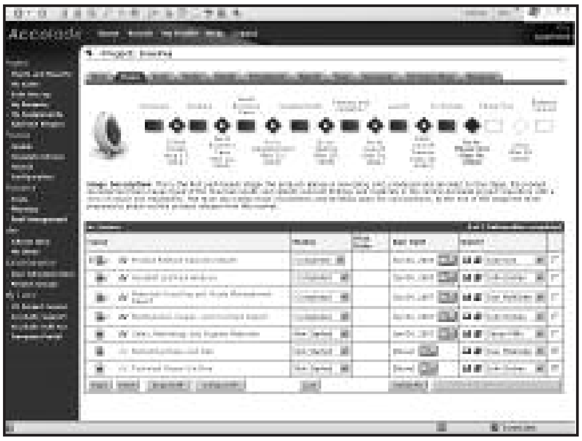
Net assets at the end of the year stood at £1.6m (2005: £2m) and include £0.8m (2005: £0.8m) being the net book value of capitalized research and development arising from the application of IAS38. Cash resources at 31 December 2006 amounted to £1.0m (2005 - £2.0m). A surge of sales at the end of the year resulted in trade receivables of £2.5m compared to £1.7m at the end of 2005.

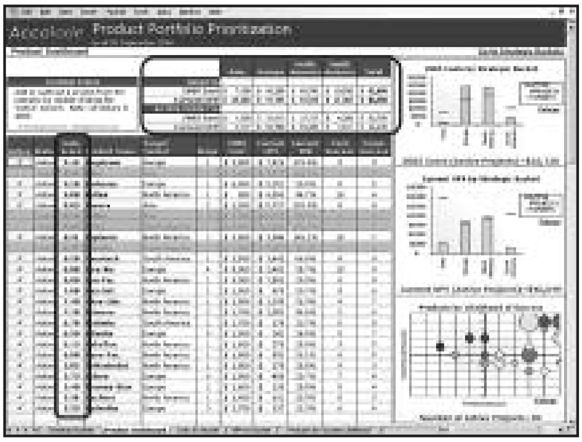
At the end of 2005 Sopheon renewed its €10 million equity line of credit facility with GEM Global Yield Fund Limited until December 2007, securing continued access to a source of equity-based funding over which the company retains a substantial degree of control. The facility was not used during 2006 and over 90% of the original equity line remains untapped.

Product and Market Overview

Sopheon's Core Solution

Sopheon addresses one of the most universal challenges facing manufacturing companies today. It is the challenge of operationalizing research and development (R&D) so that results are predictable and can be continuously improved. Historically R&D has been a "black box" into which manufacturers threw money and hoped for positive outcomes. Sopheon's technology application introduces a new working environment for cross-functional teams charged with global product development. It creates a work environment that demystifies R&D and provides a level of visibility and alignment across the enterprise that allows R&D, marketing, manufacturing and finance to work together efficiently, in many cases for the first time.





Sopheon's Accolade system is used by companies to automate their process for developing new products. The software provides at-a-glance updates on the status of all projects in the developmental pipeline, and gathers and analyzes data to support investment decisions.

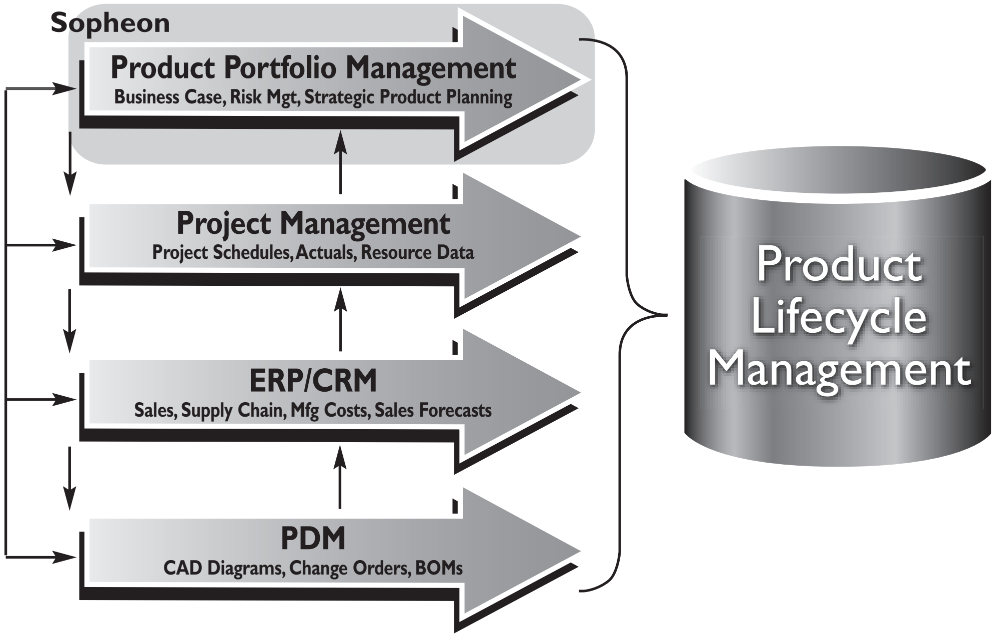
Sopheon's flagship solution is called Accolade. It is a modular software system specifically designed to improve work activity and decision-making within the processes manufacturers use to develop new products. Accolade delivers these improvements by automating the product development process. The software also provides centralized storage for all data and information on projects in the adopting organization's developmental pipeline. This centralization, augmented by easy access to the stored data, enables executives and product development teams to make quicker, more informed decisions related to all aspects of a product's life, from its inception as an idea until its retirement from the marketplace.

Benefits reported by Accolade users include faster time-to-market, reductions in new product failures, and substantial increases in the financial contribution from the new products that are commercialized. Some Sopheon customers have credited Accolade with enabling them to grow the amount of profit and revenue they generate from new products by as much as 20% to 40% over historical performance.

THE PLM MARKET TOTALED NEARLY $7 BILLION IN 2005, AND WILL NEARLY DOUBLE TO MORE THAN $13 BILLION BY THE END OF 2010, RISING AT A COMPOUND ANNUAL GROWTH RATE (CAGR) OF ROUGHLY 14% OVER THE NEXT FIVE-YEAR PERIOD.

– ARC Advisory Group

"Product Lifecycle Management Solutions Worldwide Outlook Market Analysis and Forecast through 2010," July 2006



Business analysts have placed Accolade in a sub-class of product life cycle management solutions referred to as product portfolio management systems.

The Market

Sopheon's Accolade belongs to a major class of software applications that concentrate on supporting product life cycle management (PLM). The purpose of this applications group is to help companies create and execute their product strategies.

The PLM market is made of multiple submarkets. Some of these submarkets, such as product data management (PDM), are mature. Others are new and emerging. One of the emerging submarkets is called "Product Portfolio Management" (PPM). It is the area where Sopheon is focused. Analyst research indicates that PPM is among the fastest growing submarkets within PLM. This research also forecasts that its exceptional rate of expansion will continue. While most facets of product life cycle management concentrate on the engineering or technical challenges involved in developing and managing a product, PPM addresses the business challenges.

Most companies have tried to build their innovation processes around commonly used methodologies such as Stage-Gate®, PACE® and waterfall. But studies have shown that, when companies attempt to deploy these methodologies without the assistance of technology, they fail 48% of the time. That's because a manual approach is complex and difficult. The administrative burden imposed on users is excessive. Information supporting the process is almost always out of date, so portfolio decision-making is slow and poorly supported. In the absence of good information, decisions are often based upon gut-feel rather than sound business rationale.

Accolade automates the innovation process, enabling companies to strengthen the alignment between their innovation strategies and operational activity within product development. It provides real-time access to the status, commercial potential, and other details of product innovation initiatives in progress. This visibility and the resulting insight improve product-development decision making and increase the revenue and profit returns generated by high-risk R&D investments.

Analysts have labeled Accolade as best-of-breed among solutions in the product portfolio management sub-class. They view PPM as a strategically critical applications area. Their research has determined that adoption of PPM methodologies by cross-functional team members is essential to achieving business impact and success. Companies that implement their product portfolio management and product development processes using Sopheon's software system gain a range of important advantages, including the capacity to continuously measure and track process improvements.

Independent research has confirmed that Accolade users have a significant edge over other companies endeavoring to implement product portfolio management processes. In late 2006, Aberdeen Group, the IT research and advisory firm, completed a benchmarking report on PPM best-practices for which they surveyed more than 150 manufacturers. Sopheon clients participating in the study ranked best-of-class in a variety of key areas. For instance:

- Sixty-three percent of Accolade customers reported that 75% or more of intended users within their organizations had adopted their portfolio management processes. Among users of other systems, an average of only 37% had achieved comparable levels of process use. The exceptionally high process adoption rates that Accolade produces are a primary reason that its deployment consistently leads to increased process efficiencies and higher business returns from investments in new products.

- Eighty-six percent of the Sopheon clients participating in the study reported being able to gather critical portfolio management data in less than 2 weeks. Among non-Accolade users, only 45% on average could match that level of retrieval efficiency. The data-access advantage enjoyed by companies deploying Accolade translates into faster, more informed portfolio decisions.

- The study also showed that Accolade users excel in process execution, such as meeting product development cost goals and hitting targeted launch dates.

"Best-in-class companies use more technology to manage product portfolios than their lower performing competition. Technology allows companies to implement and enforce common processes, helps gather information required to analyze key performance indicators, facilitates greater collaboration, and increases the efficiencies of processes."

Aberdeen Group
"The Product Portfolio Management Benchmark Report
Achieving Maximum Product Value," August 2006

In 2006 we saw considerable movement in the PLM market among both established suppliers and new entrants. Many of the more established PLM vendors were involved in mergers and acquisitions. We expect that this will continue in 2007, as evidenced by the recent high-profile acquisition of UGS by Siemens. These changes are introducing some confusion in the marketplace, but they are also increasing demand. These factors will continue to challenge Sopheon to sustain its position of market leadership. Our response to this challenge is set out below.

Growth Strategy

Sopheon will pursue a five-part strategy for growth.

1) Expand Within Client Base

During 2006, we received 20 license orders from existing customers intent on extending the use of our software across their organizations. This is up from 13 extension orders in 2005, further validating that we have a sticky application with strong growth potential inside our client base.

"We measure innovation by the amount of business and shareholder value it generates. Our goal is to continue to lead our industry in revenues and profits from innovation by supplying the market with a steady stream of premium, new-to-the-world products that consumers want. We chose Sopheon's Accolade because it is the most complete tool we've found for supporting the business of innovation."

Johan Hjertonsson, Director of Consumer Innovation, AB Electrolux

2) Expand Within Target Markets

Our primary focus has been on manufacturers of chemicals, paper and, within the consumer packaged goods sector, food & beverage producers. Sopheon signed sixteen new customers in 2006, seventy-five percent of which were in our target verticals. We exited the year with 87 clients. In each of the markets we have targeted, our current level of penetration is minimal, leaving substantial room for additional growth. We will continue to focus on this opportunity in 2007.

The number of Accolade end-users grew by 30% in 2006. This escalation is traceable partly to the fact that, while early implementations of Accolade were on the department level, the solution is increasingly being deployed on an enterprise-wide scale. A number of our customers are using the system throughout their global operations. Accolade users can now be found in 58 countries worldwide.

"In the past, [innovation] was driven by research and development, so there was lots of disconnect between R&D and brand managers. That's a typical problem in many companies because engineers and brand managers talk in different languages…We now have the numbers about market size, products, and other variables needed to make intelligent product decisions faster. [Accolade] lets you focus your resources on the biggest opportunities and on your investments."

Bernd Becker, SVP Product Development & Innovation, Timex Corporation

3) Expand Product

2006 was a year in which we witnessed the emergence of a substantial number of new applications for Accolade. With our system operating among an ever-expanding population of users, we found it being tested and applied in ways we had never imagined. This exposure, even when involving first-time uses, has consistently verified the remarkable versatility, scalability and efficacy of our solution—a tribute to the high quality work put forth by our own product development team—resulting in easy adoption, high levels of acceptance and exceptional satisfaction rates among users.

In 2006, Sopheon convened its first Product Advisory Council (PAC) sessions in both North America and Europe. The PAC group is comprised of executive-level decision-makers from client companies in a mix of industries. The following companies are currently represented:

North America: Cytec, Hospira, Land O'Lakes, Nautilus, Parker Hannifin, Verizon Wireless, Timex

Europe: BASF, Campina, Cadbury Schweppes, Celanese, Electrolux, Nestle

We are fortunate to have a user community made up of such caring clients. Their input related to such areas as our product road maps and go-to-market strategies has been extremely valuable.

"In order to realize the benefits of information access, decision-support systems and time-savings, automation software tools, such as Accolade by Sopheon, are increasingly being adopted by leading businesses…Accolade integrates strategy, portfolio management, Stage-Gate® and idea management – a business decision support system for making innovation investment decisions more effectively and efficiently."

from, Lean, Rapid, and Profitable New Product Development,
authored by Drs. Robert G. Cooper and Scott J. Edgett,
co-founders of the Product Development Institute

In late 2006, Sopheon introduced a set of add-on applications for its Accolade solution. Referred to collectively as Accolade Accelerators, the new offerings are designed to enable companies to more quickly achieve the next level of maturity in the governance of their innovation processes and realize the associated higher levels of business performance. There are three applications in the set, including:

Product Planning and Roadmapping Accelerator: This application makes it easier to develop credible and reliable product plans, and to ensure successful plan execution. It provides clear short- and long-term views of product development schedules. It charts interdependencies among projects, allowing the user to see potential bottlenecks far in advance and eliminate them before they derail launch plans. Users of the Product Planning and Roadmapping Accelerator are able to better forecast and manage the timing of product introductions, leading to such benefits as improved new product revenue and margin performance and reduced product cannibalization.

Innovative Process Accelerator: This application reduces the time required for an organization to put a fully functional innovation process in place. It supplies the automated structure for multiple process models, including introductory, traditional, fast-track and post-launch versions. The application can be used to manage a product from the time it is conceived as an idea until it is retired from the market.

Portfolio Management Accelerator: This application provides the industry's first software-based process model for portfolio management. In essence, it provides the best-practice keys to successful product portfolio management implementation, including answers to such questions as:

What is product portfolio management?
How can we most effectively manage a portfolio of products?
How can we use metrics to improve portfolio performance?

Advanced charts and reports are rooted in metrics and algorithms that allow users to enter what-if inquiries and receive visual representations of the impact of adding or removing particular projects from the developmental pipeline.

The Accelerator offerings were created by an internal organization formed in 2005 called RAD (Research & Application Development). The charter of the RAD group is to generate new applications that leverage the strength of the Accolade platform but don't require investment in the creation of product code.

In October of 2006, we announced that we would augment the current use of Microsoft tools within Accolade by integrating the software system with Microsoft Office® Project Server 2007. Adoption of the Microsoft product will broaden and deepen aspects of Accolade's capacity to provide governance support for the product innovation process. The integration will be introduced in the next major version of Accolade, scheduled for commercialization in late 2007.

The Microsoft Office Project 2007 integration initiative is the latest advance in a continuing strategic alliance between Sopheon and Microsoft. Since its inception, Sopheon's Accolade software has incorporated Microsoft products such as Microsoft Office Project Server and other components of the Microsoft Office system, focusing the capabilities of these horizontal platforms on helping manufacturers increase the business impact of new product innovation. Based on the strength and success of Sopheon's business application, the alliance between Sopheon and Microsoft has steadily grown. Sopheon has earned Microsoft's designation as a Gold Certified and "managed" partner.

"Sopheon's position as a leader in helping manufacturers solve business-critical problems in product innovation and product life cycle management is of particular importance to Microsoft. Sopheon's solution offers a range of valuable, differentiating advantages because it was built from the ground up to support the process of developing and commercializing new products."

Michael Angiulo, General Manager, Microsoft Office Project, Microsoft Corporation

4) Expand to New Markets

Throughout its history, Sopheon has made ongoing, nominal investments in select new markets as a way of evaluating opportunities to leverage existing technologies and drive additional business growth.

Consumer Packaged Goods (Non-food & beverage)
In 2006, Sopheon announced its expansion into non-food & beverage areas of the CPG market. Today we have a growing client base in this vertical, illustrated by such industry leaders as:

- Electrolux
- Freudenberg Household Products
- Nautilus
- Reckitt Benckiser, and
- Timex

These customers include several CPG companies that operate in light discrete manufacturing. Our initial experiences in discrete will dictate the level of investment and effort we undertake towards growing in the large discrete manufacturing market – which includes the auto, defence and aerospace industries. Leveraging our partnerships will be critical to achieving our longer term goals in this area, and we were delighted to announce our first major automobile customer, secured in collaboration with Hewlett-Packard.

Healthcare

Sopheon continues to support its historic position as a supplier to the healthcare protocol market. Our Qualiflow® technology is used by healthcare institutions to provide doctors, nurses and other medical practitioners with procedural guidelines at the point of care. We kicked off a project in 2005 to convert the current Qualiflow code base to the Accolade platform. The conversion to Accolade is expected to be completed in 2007. Expansion of our protocol management market activity is on hold until this platform transition has been proven successful. Sopheon will then readdress its strategies for growing this aspect of our business. A number of organizations in healthcare markets have also successfully used the Accolade platform to automate their process for conducting clinical trials of pharmaceutical products. And Sopheon has collaborated with one of the largest general hospitals in the Netherlands to develop an Accolade configuration that applies the industrial methodologies of new product development and portfolio management to their capital expenditure projects to improve prioritization, quality management and time-to-completion.

5) Expand Partnerships

Sopheon remains committed to growing its business through partnerships. We also know that it takes time and investment to develop a strong network of partners that can add value to the company.

In 2006, we concentrated on working with existing reseller partners to deepen their knowledge and understanding of our value proposition, the dynamics of our markets and the capabilities of our product offerings. Partner relationships resulted in Sopheon's signing its first clients in Israel, New Zealand, Portugal and Sweden, providing a critical foundation of local references to support expansion in these nascent sales territories. We were also active with our consulting partners, working together on a number of Accolade implementations in the U.S., Europe and Scandinavia.

We expect 2007 to be a year of further collaboration and business development efforts with our partners. Plans call for a continued focus on our existing network, as well as the addition of a small number of new members.

"Many of today's manufacturers are looking for ways to increase organic growth. That emphasis has translated into escalating demand for technology solutions that can improve the process of choosing and developing new products. There's a clear connection between Sopheon's strong business momentum and the capacity of its software to help manufacturers increase the returns on their investments in product innovation."

Kevin Parker, Editor, Manufacturing Business Technology Magazine

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Stage-Gate® is a registered trademark of the Product Development Institute.
PACE® is a registered trademark of PRTM.
Microsoft Office® is a registered trademark of Microsoft Corporation.

Directors and Advisers

Directors	Barry K. Mence	Executive Chairman
	Andrew L. Michuda	Chief Executive Officer
	Arif Karimjee ACA	Finance Director
	Stuart A. Silcock FCA	Non-executive Director
	Bernard P. F. Al	Non-executive Director
	Daniel Metzger	Non-executive Director
Secretary	Arif Karimjee	
Registered office	Surrey Technology Centre 40 Occam Road, Surrey Research Park Guildford, Surrey GU2 7YG	
Registered name and number	Sopheon plc Registered in England and Wales No. 3217859	
Auditors	BDO Stoy Hayward LLP 8 Baker Street London W1U 3LL	
Principal bankers	Silicon Valley Bank 3003 Tasman Drive Santa Clara California CA 95054 United States	Lloyds TSB Bank Plc 77 High Street Southend-on-Sea Essex SS1 1HT
Solicitors	Hammonds 7 Devonshire Square Cutlers Gardens London EC2M 4YH	Briggs and Morgan 2400 IDS Center, 80 South Eighth Street Minneapolis Minnesota 55402 United States
	Loyens & Loeff Fred Roeskestraat 100 1076 ED Amsterdam The Netherlands	
AIM Nominated Adviser and Broker	Seymour Pierce Limited Bucklersbury House 3 Queen Victoria Street London EC3N 8EL	
Euronext Paying Agent	Kempen & Co. Beethovenstraat 300 1077 WZ Amsterdam The Netherlands	
Registrars	Capita Registrars Northern House Woodsome Park Fenay Bridge Huddersfield HD8 0LA	
Financial PR Consultants	Hansard Communications Limited 14 Kinnerton Place South London SWIX 8EH	Citigate First Financial BV Assumburg 152A 1081 GC Amsterdam The Netherlands

Report on Directors' Remuneration

The remuneration committee of Sopheon Plc is responsible for oversight of the contract terms, remuneration and other benefits for executive directors, including performance related bonus schemes. The committee comprises two non-executive directors, B.P.F. Al, as chairman, and S.A. Silcock, together with B.K. Mence, other than in respect of his own remuneration. The committee makes recommendations to the board, within agreed parameters, on an overall remuneration package for executive directors and other senior executives in order to attract, retain and motivate high quality individuals capable of achieving the group's objectives. The package for each director consists of a basic salary, benefits and pension contributions, together with performance related bonuses and share options on a case by case basis. Consideration is given to pay and employment policies elsewhere in the group, especially when considering annual salary increases. From time to time, the remuneration committee may take advice from appropriate remuneration consultants.

Contracts

Service contracts between the company and the executive directors are terminable on 6 months' notice.

Fees for non-executive directors

The fees for non-executive directors are determined by the board. The non-executive directors are not involved in any discussions or decisions about their own remuneration.

Directors' remuneration

Set out below is a summary of the fees and emoluments received by all directors during the year, translated where applicable into sterling at the average rate for the period. Details of directors' interests in shares and options are set out in the Directors' Report.

	Pay and fees 2006 £	*Benefits 2006 £*	*Bonus 2006 £*	*Total 2006 £*	*Total 2005 £*
Executive directors					
B. K. Mence	113,442	2,196	26,750	142,388	124,692
A. L. Michuda	111,104	9,093	27,912	148,109	118,840
A. Karimjee	89,500	1,087	16,480	107,067	88,126
Non-executive directors					
S.A. Silcock	18,000	-	-	18,000	18,000
B.P.F. Al	18,000	-	-	18,000	18,000
A.M. Davis (resigned on 30 June 2006)	9,000	-	-	9,000	18,000
D. Metzger	18,000	-	-	18,000	18,000
	377,046	12,376	71,142	460,564	403,658

The remuneration committee establishes the objectives that must be met for each financial year if a cash bonus is to be paid. With the principal exception of members of Sopheon's sales teams, for whom incentives are tied to individual or territory results, the committee concluded that the cash incentive should be tied to the financial performance of the group as a whole, and in 2006 objectives were set with regard to both revenue and EBITDA performance. These measures were applied to, and a bonus was earned by, all members of the executive board and management committee of the group, as well as the majority of the group's employees.

In addition, pension contributions are made to individual directors' personal pension schemes. During 2006 contributions of £4,875, £2,228 and £4,167 (2005 - £4,875, £1,665 and £3,945) were paid respectively to the pension schemes of B. K. Mence, A. L. Michuda and A. Karimjee.

The emoluments of S. A. Silcock are paid to Lawfords Limited, of which Mr. Silcock is a director.

Directors' Report

The group's principal activities during the year continued to focus on the provision of software and services that improve the return on investment of product development, within the rapidly emerging product lifecycle management (PLM) market. A review of the development of the business during the year is given in the Statement from the Chairman and Chief Executive Officer on page 14 and the subsequent Financial Review. This also includes reference to the Group's future prospects. An overview of the Group's products and markets incorporating advances in research and development is provided on page 18.

Corporate Governance

The Sopheon board is committed to high standards of corporate governance and aims to follow appropriate governance practice, although as a company incorporated in the UK and listed on AIM and Euronext, the Company is not subject to the requirements of the new UK Combined Code or the Netherlands Tabaksblat Committee. The board currently comprises three executive directors and three independent non-executive directors. Their biographies appear on the inside back cover of this annual report, and demonstrate a range of experience and calibre to bring the right level of independent judgement to the board.

The board is responsible for the group's system of internal control and for reviewing its effectiveness. Such a system can only provide reasonable, but not absolute, assurance against material misstatement or loss. The board believes that the group has internal control systems in place appropriate to the size and nature of its business. The board is also responsible for identifying the major business risks faced by the group and for determining the appropriate course of action to manage those risks. Formal meetings are held quarterly to review strategy, management and performance of the group, with additional meetings between those dates convened as necessary. The audit committee, which comprises all of the non-executive directors and is chaired by Stuart Silcock, considers and determines actions in respect of any control or financial reporting issues they have identified or that are raised by the auditors. The board has a formal schedule of matters specifically reserved to it for decision. Details of the constitution of the remuneration committee are provided in the Report on Directors' Remuneration on page 25.

Principal risk areas

As with any business at its stage of development Sopheon faces a number of risks and uncertainties. The board monitor these risks on a regular basis. The key areas of risk identified by the board are summarized below.

Sopheon's markets continue to be at a relatively early stage of development and it is possible that Sopheon's products may not sell in the quantities or at the prices required to achieve sustained profitability. The broad market for Sopheon's software products continues to emerge and evolve. Sopheon has sought to focus its resources on the sub-segments that it believes offer the best short term opportunity for growth, and on developing functionality which its research indicates customers in those segments require. However, determining the potential size, growth rate and needs of a particular market segment remains challenging.

Sopheon has a history of losses and its prospects of achieving profitability are dependent on meeting sales targets. Sopheon has in past years experienced substantial net losses due, in part, to its investment in product development and marketing. Sopheon's ability to continue to finance its activities through to the point that its operations become cash generative on a sustained basis is dependent on the group maintaining sales growth, or in the absence of such growth, its ability to secure funding through the company's facilities or other sources. Details of the resources available to Sopheon and the reasons why management consider that the company is able to continue as a going concern are set out in Note 2 to the financial statements.

Some of Sopheon's competitors and potential competitors have greater financial resources than Sopheon. Sopheon remains a relatively small organization by global standards. Its resources are dwarfed by those of many larger companies that are capable of developing competitive solutions and it is difficult to overcome the marketing engine of a large global firm. Sopheon seeks to compete effectively with such companies by keeping its market communications focused, clear and consistent with its product and market strategy, and working to deliver first class quality of execution so that referenceability of the customer base is maximised.

Sopheon is dependent upon skilled personnel, the loss of whom could have a material impact. While service agreements have been entered into with key executives, retention of key members of staff cannot be guaranteed and departure of such employees could be damaging in the short term. In addition, as the economic environment has improved, the competition for qualified employees continues to be difficult and retaining key employees has become accordingly more challenging and expensive.

Sopheon will require relationships with partners who are able to market and implement its products. Historically, Sopheon has devoted substantial resources to the direct marketing of its products, and its strategy to enter into strategic alliances and other collaborative relationships to widen the customer base and create a broad sales and implementation channel for its products is not yet mature. The successful implementation of this strategy is crucial to Sopheon's prospects and its ability to scale effectively. However, Sopheon cannot be sure that it will select the right partners, or that the partners it does select will devote adequate resources to promoting, selling and becoming familiar with Sopheon's products.

Sopheon could be subject to claims for damages for errors in its products and services. Sopheon may be exposed to claims for damages from customers in the event that there are errors in its software products or should support and maintenance service level agreements fail to meet agreed criteria. Sopheon has sought to protect itself from such risks through its development methodologies, its contract terms and insurance, and is not aware of any such claims at this time.

The extent to which Sopheon's research and development effort may be capitalized is not readily predictable. IAS 38 requires that certain software development expenditure must be capitalized and amortized based on detailed technical criteria, rather than automatically charging such costs in the profit and loss account as they arise. Sopheon's annual financial results are materially affected by such capitalization and amortization. However, the group's research and development efforts are not driven by such criteria but by Sopheon's tactical and strategic business objectives. This could lead to substantial variations year on year in the amount of R&D which qualifies for capitalization.

Share Option Schemes

Details of options granted are shown in Note 29 to the financial statements.

Supplier payment policy and practice

It is the company's policy that payments to suppliers are made in accordance with those terms and conditions agreed between the company and its suppliers, provided that all trading terms and conditions have been complied with. At 31 December 2006 the company had approximately 47 days' purchases outstanding (2005: 34 days).

Auditors

All of the current directors have taken all the steps that they ought to have taken to make themselves aware of any information needed by the company's auditors for the purposes of their audit and to ensure that the auditors are aware of that information. The directors are not aware of any relevant audit information of which the auditors are unaware.

A resolution to reappoint BDO Stoy Hayward as auditors will be put to the members at the Annual General meeting.

Financial instruments

Details of the group's financial instruments and its policies with regard to financial risk management are given in Note 23 to the financial statements.

Directors and their interests

The interests of the directors, who held office at the end of the year, in the share capital of the company (all beneficially held except those marked with an asterisk (*), which are held as trustee), were as follows:

	Share Options		*Ordinary Shares*	
At 31 December	*2006*	*2005*	*2006*	*2005*
B. K. Mence	285,000	185,000	14,423,847	14,423,847
A. L. Michuda	3,248,607	3,148,607	155,188	155,188
A. Karimjee	725,000	625,000	87,667	87,667
S. A. Silcock	-	-	918,716	918,716
S. A. Silcock*	-	-	98,077	98,077
B.P.F. Al	25,000	25,000	650,000	650,000
D. Metzger	-	-	-	-

Of the 14,423,847 ordinary shares mentioned above B. K. Mence beneficially owns and is the registered holder of 8,275,227 ordinary shares. A further 2,300,820 ordinary shares are held by Inkberrow Limited, a company in which his family trust is the major shareholder. In addition he is, or his wife or children are, potential beneficiaries under trusts holding an aggregate of 3,847,800 ordinary shares, of which trusts directors of Lawfords Ltd., in the Isle of Man, are trustees and are registered as the holders of such shares. S.A. Silcock is a shareholder in Lawfords Ltd and is a minority shareholder in Inkberrow Limited.

The following table provides summary information for each of the directors who held office during the year and who held options to subscribe for Sopheon ordinary shares. All options were granted without monetary consideration.

	Date of Grant	*Exercise price*	*At 31 December 2005*	*Granted during year*	*Exercised during year*	*At 31 December 2006*
B. K. Mence (1)	2 May 2001	77.5p	22,500	-	-	22,500
B. K. Mence (1)	30 April 2002	14.75p	100,000	-	-	100,000
B.K. Mence (7)	15 April 2005	25.25p	62,500	-	-	62,500
B.K. Mence (8)	3 May 2006	22p	-	100,000	-	100,000
A. L. Michuda (2)	15 September 2000	184p	187,600	-	-	187,600
A. L. Michuda (2)	15 September 2000	230p	7,846	-	-	7,846
A. L. Michuda (2)	15 September 2000	322p	12,501	-	-	12,501
A. L. Michuda (2)	15 September 2000	368p	1,756	-	-	1,756
A. L. Michuda (3)	2 October 2000	427.5p	16,280	-	-	16,280
A. L. Michuda (3)	1 January 2001	160p	5,030	-	-	5,030
A. L. Michuda (3)	2 May 2001	77.5p	54,662	-	-	54,662
A. L. Michuda (4)	30 April 2002	14.75p	487,932	-	-	487,932
A. L. Michuda (4)(5)	5 November 2003	16.25p	2,225,000	-	-	2,225,000
A.L. Michuda (7)	15 April 2005	25.25p	150,000	-	-	150,000
A.L. Michuda (8)	3 May 2006	22p	-	100,000	-	100,000
A. Karimjee (1)	22 November 1999	150p	100,000	-	-	100,000
A. Karimjee (1)	2 May 2001	77.5p	12,500	-	-	12,500
A. Karimjee (1)	30 April 2002	14.75p	150,000	-	-	150,000
A. Karimjee (5)(6)	5 November 2003	16.25p	300,000	-	-	300,000
A. Karimjee (7)	15 April 2005	25.25p	62,500	-	-	62,500
A. Karimjee (8)	3 May 2006	22p	-	100,000	-	100,000
B. P. F. Al (1)	2 May 2001	77.5p	25,000	-	-	25,000

(1) Exercisable between the third and tenth anniversary of the date of grant.
(2) Fully vested options, which were granted as part of the acquisition of Teltech Resource Network Corporation.
(3) One fourth of these options becomes exercisable on each of the first four anniversaries of the date of grant and they expire on the tenth anniversary of the date of grant.
(4) One third of these options are exercisable from the date of grant, one third from the first anniversary of the date of grant and one third from the second anniversary.
(5) Vesting of a proportion of these options is subject to performance conditions relating to the achievement of positive EBITDA in two successive quarters.
(6) 93,846 of these options are exercisable between the third and tenth anniversary of the date of grant and 206,154 options are exercisable as to one third immediately and one third on each of the first and second anniversaries of the date of grant.
(7) One third of these options are exercisable from the first anniversary of the date of grant, one third from the second anniversary, and the remainder from the third anniversary.
(8) Vesting of one half of these options was subject to performance conditions based on the achievement of certain financial objectives in 2006. The conditions were met.

The mid-market price of Sopheon ordinary shares at 31 December 2006 was 22.5p. During the financial year the mid-market price of Sopheon ordinary shares ranged from 17p to 25.25p.

Save as disclosed above, no director (or member of his family) or connected persons within the meaning of Section 346 of the Companies Act 1985 has any interest, beneficial or non-beneficial, in the share capital of the company.

Substantial Shareholdings

The Directors are aware of the following persons who as at 28 March 2007 were interested directly or indirectly in three per cent or more of the company's issued ordinary shares:

Name	*No. of ordinary Shares*	*% issued ordinary Shares*
B. K. Mence (director)	14,423,847	10.8
Norman Nominees Limited	9,691,260	7.3

Mr Mence's interest represents direct beneficial holdings as well as those of his family.

Approved by the Board on 28 March 2007 and signed on its behalf by:

A. Karimjee
Director

Statement of Directors' Responsibilities in Respect of the Financial Statements

Group financial statements
Company law requires the directors to prepare such financial statements in accordance with International Financial Reporting Standards, the Companies Act 1985 and Article 4 of the IAS Regulation.

International Accounting Standard 1 requires that financial statements present fairly for each financial year the company's financial position, financial performance and cash flows. This requires the faithful representation of the effects of transactions, other events and conditions in accordance with the definitions and recognition criteria for assets, liabilities, income and expenses set out in the International Accounting Standards Board's 'Framework for the preparation and presentation of financial statements'. In virtually all circumstances, a fair presentation will be achieved by compliance with all applicable International Financial Reporting Standards. A fair presentation also requires the Directors to:

- properly select and apply appropriate accounting policies;

- present information, including accounting policies, in a manner that provides relevant, reliable, comparable and understandable information; and

- provide additional disclosures when compliance with the specific requirements in IFRS is insufficient to enable users to understand the impact of particular transactions, other events and conditions on the entity's financial position and financial performance.

The directors are responsible for keeping proper accounting records which disclose with reasonable accuracy at any time the financial position of the company and of the group and enable them to ensure that the financial statements comply with the Companies Act 1985 and Article 4 of the IAS Regulation. They are also responsible for safeguarding the assets of the company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

Independent Auditors' Report to the Members of Sopheon plc

We have audited the group and parent company financial statements (the "financial statements") of Sopheon Plc for the year ended 31 December 2006 which comprise the Group Income Statement, the Group and Parent Company Balance Sheets, the Group and Parent Company Cash Flow Statements, the Group and Parent Company Statement of Change in Shareholders' Equity and the related notes. These financial statements have been prepared under the accounting policies set out therein.

Respective responsibilities of directors and auditors

The directors' responsibilities for preparing the Annual Report, the Directors' Remuneration Report and the financial statements in accordance with applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union are set out in the Statement of Directors' Responsibilities.

Our responsibility is to audit the financial statements in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland).

We report to you our opinion as to whether the financial statements give a true and fair view and have been properly prepared in accordance with the Companies Act 1985 and Article 4 of the IAS Regulations and whether the information given in the Directors' Report is consistent with those financial statements. We also report to you if, in our opinion, the company has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law regarding directors' remuneration and other transactions is not disclosed.

We read other information contained in the Annual Report and consider whether it is consistent with the audited financial statements. The other information comprises only the Directors' Report, the Report on Directors' Remuneration, the Statement from the Chairman and Chief Executive Officer, the Financial Review and the Market and Product Overview. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the financial statements. Our responsibilities do not extend to any other information.

Our report has been prepared pursuant to the requirements of the Companies Act 1985 and for no other purpose. No person is entitled to rely on this report unless such a person is a person entitled to rely upon this report by virtue of and for the purpose of the Companies Act 1985 or has been expressly authorized to do so by our prior written consent. Save as above, we do not accept responsibility for this report to any other person or for any other purpose and we hereby expressly disclaim any and all such liability.

Basis of audit opinion

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements. It also includes an assessment of the significant estimates and judgments made by the directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the group's and company's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the financial statements.

Opinion

In our opinion:

- the group financial statements give a true and fair view, in accordance with IFRSs as adopted by the European Union, of the state of the group's affairs as at 31 December 2006 and of its loss for the year then ended;

- the parent company financial statements give a true and fair view, in accordance with IFRSs as adopted by the European Union as applied in accordance with the provisions of the Companies Act 1985, of the state of the parent company's affairs as at 31 December 2006; and

- the financial statements have been properly prepared in accordance with the Companies Act 1985 and Article 4 of the IAS Regulation.

Emphasis of matter – going concern

In forming our opinion, which is not qualified, we have considered the adequacy of the disclosures made in note 2 to the financial statements regarding the uncertainty over the Group's ability to continue as a going concern, including the directors' assessment of the ability of the Group to achieve its forecasts.

BDO Stoy Hayward LLP
Chartered Accountants and Registered Auditors
London

28 March 2007

Consolidated Income Statement for the Year Ended 31 December 2006

	Notes	*2006 £'000*	*2005 £'000*
Continuing operations			
Revenue	3	6,045	4,664
Cost of sales		(1,690)	(1,264)
Gross profit		4,355	3,400
Distribution costs		(2,401)	(2,473)
Research and development expenses		(1,028)	(974)
Administrative expenses		(1,232)	(1,175)
Operating loss		(306)	(1,222)
Finance revenue	8	39	53
Finance costs	9	(36)	(67)
Loss before tax		(303)	(1,236)
Income tax	10	-	-
Loss for the year attributable to equity shareholders of the parent (all from continuing operations)		(303)	(1,236)
Loss per share			
From continuing operations – basic and diluted (pence)	12	(0.2p)	(0.9p)
EBITDA	12	33	(746)

Balance Sheets at 31 December 2006

		Group		*Company*	
	Notes	*2006* *£'000*	*2005* *£'000*	*2006* *£'000*	*2005* *£'000*
Assets					
Non-current assets					
Property, plant and equipment	13	110	101	-	-
Intangible assets	14	848	764	-	-
Investments in subsidiaries	15	-	-	6,119	6,119
Non-current receivables	16	10	10	-	-
		968	875	6,119	6,119
Current assets					
Trade and other receivables	17	2,484	1,741	36	38
Cash and cash equivalents	18	1,034	1,970	741	1,209
		3,518	3,711	777	1,247
Total assets		4,486	4,586	6,896	7,366
Liabilities					
Current liabilities					
Short-term borrowings	19	414	370	1	1
Trade and other payables	20	2,444	2,253	332	347
Obligations under finance leases	21	3	3	-	-
Total current liabilities		2,861	2,626	333	348
Non-current liabilities					
Obligations under finance leases	21	5	9	-	-
Total liabilities		2,866	2,635	333	348
Net assets		1,620	1,951	6,563	7,018
Equity and reserves					
Capital and reserves					
Share capital	24	6,679	6,665	6,679	6,665
Other reserves	25	72,827	72,931	65,062	65,166
Translation reserve	26	(164)	(31)	-	-
Retained losses	26	(77,722)	(77,614)	(65,178)	(64,813)
Total equity (all attributable to equity holders of the parent company)		1,620	1,951	6,563	7,018

Approved by the Board and authorized for issue on 28 March 2007

Barry K. Mence
Director

Arif Karimjee
Director

Consolidated Statement of Recognized Income and Expense for the Year Ended 31 December 2006

	Group		*Company*	
	2006	*2005*	*2006*	*2005*
	£'000	*£'000*	*£'000*	*£'000*
Exchange differences on translation of foreign operations	(133)	86	-	-
Net (expense)/income recognized directly in equity	(133)	86	-	-
Loss for the year	(303)	(1,236)	(576)	(915)
Total recognized income and expense for the year (all attributable to equity holders of the parent company)	(436)	(1,150)	(576)	(915)

Cash Flow Statement for the Year Ended 31 December 2006

	Notes	Group 2006 £'000	Group 2005 £'000	Company 2006 £'000	Company 2005 £'000
Operating activities					
Loss for the year		(303)	(1,236)	(576)	(915)
Adjustments for:					
Investment revenues		(39)	(53)	(35)	(51)
Finance costs		36	67	13	33
Depreciation of property, plant and equipment		33	74	-	-
Amortization of intangible assets		305	392	-	-
Share-based payment expense		62	143	78	143
Intra-group credits and charges		-	-	(239)	(226)
Provisions against intra-group loans		-	-	258	557
Operating cash flows before movements in working capital		94	(613)	(501)	(459)
(Increase)/decrease in receivables		(925)	158	2	69
Increase/(decrease) in payables		329	307	(15)	(56)
Cash outflow from operations		(502)	(148)	(514)	(446)
Research and development tax credits received		-	81	-	-
Interest paid		(36)	(67)	(13)	(33)
Net cash used in operating activities		(538)	(134)	(527)	(479)
Investing activities					
Interest received		39	53	35	51
Purchases of property, plant and equipment		(54)	(42)	-	-
Recognition of development costs		(495)	(427)	-	-
Intra-group loans		-	-	(19)	(364)
Net cash used in investing activities		(510)	(416)	16	(313)
Financing activities					
Proceeds of issues of shares		43	1,068	43	1,068
Repayment of borrowings		(4)	(29)	-	-
Increase/(decrease) in lines of credit		92	259	-	(1)
Net cash from financing activities		131	1,298	43	1,067
Net (decrease)/ increase in cash and cash equivalents		(917)	748	(468)	275
Cash and cash equivalents at the beginning of the year		1,211	878	934	670
Effect of foreign exchange rate changes		11	10	-	-
Cash and cash equivalents at the end of the year					
Bank balances and cash	18	1,034	1,970	741	1,209

1. GENERAL INFORMATION

Sopheon plc ("the company") is a public limited company incorporated in England and Wales. The address of its registered office and principal place of business is set out on page 24. The principal activities of the company and its subsidiaries are described in Note 3.

2. SIGNIFICANT ACCOUNTING POLICIES

The financial statements have been prepared in accordance with International Financial Reporting Standards and Interpretations issued by the International Accounting Standards Board as adopted by the European Union and those parts of the Companies Act 1985 which apply to companies preparing their financial statements under IFRS. The principal accounting policies are set out below. The policies have been applied consistently to all the years presented, and on the going concern basis.

The group has elected not to early adopt IFRS 7 *Financial Instruments*. IFRS 7 will apply to the group for accounting periods beginning on or after 1 January 2007 and contains provisions relating to the disclosure of the significance of financial instruments, the risk exposures arising therefrom and the approach taken in managing those risks, replacing the existing provisions of IAS 32.

IFRS 8 Operating Segments will apply to the group for accounting periods beginning on or after 1 January 2009 and will replace the existing provisions of IAS 14. The Board will monitor the effect of the standard on the future disclosure of segment information by the group.

Going Concern

In 2006 the group's revenues from continuing operations were £6.0 million and it achieved a breakeven financial result on an EBITDA (earnings before interest, tax, depreciation and amortization) basis. This represented growth of 30% over the prior year. At the year end the group reported consolidated net assets of £1.6 million and gross cash resources of £1 million. The group has access to a $1 million (£583,000) bank line of credit with Silicon Valley Bank, which is secured against the trade debtors of Sopheon Corporation Minnesota. At 31 December 2006, $800,000 (£409,000) was drawn against this facility. The facilities with Silicon Valley Bank have been in place since 1999, and are renewable annually.

The directors remain positive about the direction, focus and momentum of the business and believe that this, together with the group's existing resources provide it with adequate funding to support its activities through to the point at which they anticipate that trading will become cash generative on a sustained basis. This is in turn dependent on the group delivering substantial sales growth.

Should this not be the case, Sopheon continues to have access to its equity line of credit facility from GEM Global Yield Fund Limited ("GEM") for an aggregate of €10 million. The facility was renewed in December 2005 for a further two year term, expiring in December 2007. GEM's obligation to subscribe for shares is subject to certain conditions linked to the prevailing trading volumes and prices of Sopheon shares on the Euronext stock exchange. To date Sopheon has made just one call on the equity line of credit facility, raising under €1 million in March 2004, leaving over €9 million (£6 million) available.

While uncertainties remain as to the achievement of the expected sales growth and the continued availability of facilities, the directors believe that together, these factors enable the group to continue as a going concern for the foreseeable future. The financial statements do not include the adjustments that would be required if the company or group were unable to continue as a going concern.

Basis of consolidation

The consolidated financial statements incorporate the financial statements of the company and entities controlled by the company ("subsidiaries"). Control is achieved where the company has the power to govern the financial and operating policies of an entity and to obtain benefits from its activities. All intra-group transactions, balances, income and expenses are eliminated on consolidation.

Business combinations

The acquisition of subsidiaries is accounted for using the purchase method. The cost of the acquisition is measured at the aggregate of the fair values at the date of exchange, of assets given, liabilities incurred or assumed, and equity instruments issued by the group in exchange for control of the entity being acquired, together with any costs directly attributable to the business combination. The results of the acquired entities are included in the consolidated income statement from the date on which effective control is obtained. The identifiable assets, liabilities and contingent liabilities of the entity being acquired that meet the conditions for recognition under IFRS 3 *Business Combinations* are recognized at their fair values of the date of acquisition.

Significant accounting estimates and judgements

Management is required to make judgements, estimates and assumptions about the carrying amounts of assets and liabilities that are not readily apparent from other sources. The estimates and associated assumptions are based on historical experience and other factors that are considered to be relevant. Actual results may differ from these estimates, and accordingly they are reviewed on an ongoing basis. Revisions to accounting estimates are recognized in the period in which the estimate is revised if the revision affects only that period, or in the period of the revision and future periods if the revision affects both current and future periods. Assumptions regarding the depreciation of property, plant and equipment, and the amortization of intangible assets, are set out in notes 13 and 14 respectively. The group's policy with regard to impairment of such assets is set out below.

Goodwill

Goodwill arising on the acquisition of a subsidiary represents the excess of the cost of acquisition over the group's interest in the net fair value of the identifiable assets, liabilities and contingent liabilities of the subsidiary at the date of acquisition. If, after reassessment, the group's interest in the net fair value of the identifiable assets, liabilities and contingent liabilities of the entity being acquired exceeds the cost of the business combination, the excess is recognized immediately in profit or loss. Goodwill is initially recognized at cost and is subsequently measured at cost less any accumulated impairment losses.

For the purposes of impairment testing, goodwill is allocated to those cash-generating units of the group expected to benefit from the synergies of the business combination. Cash-generating units to which goodwill has been allocated are tested for impairment annually, or more frequently when there is an indication that the unit may be impaired. If the recoverable amount of the cash-generating unit is less than the carrying value of the unit, the impairment loss is allocated firstly to reduce the carrying cost of any goodwill allocated to the unit and then to any other assets of the unit pro rata to the carrying value of each asset of the unit. An impairment loss recognized for goodwill is not reversed in a subsequent period.

Revenue recognition

Revenue is measured at the fair value of the consideration received or receivable and represents amounts receivable for goods and services provided in the normal course of business, net of discounts and sales related taxes.

Sales of software products are recognized on delivery, and when no significant vendor obligations remain. Revenues relating to maintenance and post contract support agreements are deferred and recognized over the period of the agreements.

Revenues from implementation and consultancy services are recognized as the services are performed, or in the case of milestone based or long term contracts, recognized on a percentage basis as the work is completed and any relevant milestones are met, using latest estimates to determine the expected duration and cost of the project.

Leases

Assets held under finance leases are recognized as assets of the group at their fair value at the inception of the lease or, if lower, at the net present value of the minimum lease payments. The corresponding liability to the lessor is included in the balance sheet as a finance lease obligation. Lease payments are apportioned between finance charges and reduction of the lease obligation so as to achieve a constant rate of interest on the remaining balance of the liability. Finance charges are charged to profit or loss.

Rentals payable under operating leases are charged to profit or loss on a straight-line basis over the term of the relevant lease.

Borrowing costs

All borrowing costs are recognized in profit or loss in the period in which they are incurred.

Retirement benefit costs

Payments to defined contribution retirement benefit plans are charged as an expense as they fall due. The group does not operate any defined benefit retirement benefit plans.

Foreign currencies

The individual financial statements of each group entity are presented in the currency of the primary economic environment in which the entity operates (its functional currency). For the purpose of the consolidated financial statements, the results and financial position of each entity are expressed in sterling, which is the functional currency of the parent company, and the presentation currency for the consolidated financial statements.

In preparing the financial statements of the individual entities, transactions in currencies other than the entity's functional currency (foreign currencies) are recorded at rates approximating to the transaction rates. At each balance sheet date, monetary items denominated in foreign currencies are retranslated at the rates prevailing on the balance sheet date. Non-monetary items carried at fair value that are denominated in foreign currencies are retranslated at the rates prevailing on the date when the fair value was determined. Non-monetary items that are measured in terms of historical cost in a foreign currency are not retranslated.

Exchange differences arising on the settlement of monetary items and on the retranslation of monetary items are included in profit or loss for the period. Exchange differences arising on the retranslation of non-monetary items carried at fair value are included in profit or loss for the period except for differences on the retranslation of non-monetary items in respect of which gains or losses are recognized directly in equity. For such non-monetary items any exchange component of that gain or loss is also recognized directly in equity.

For the purpose of presenting consolidated financial statements, the assets and liabilities of the group's foreign operations (including comparatives) are expressed in sterling using exchange rates prevailing on the balance sheet date. Income and expense items (including comparatives) are translated at the average exchange rates for the period. Exchange differences arising (including exchange differences on intra-group loans) are classified as equity and transferred to the group's translation reserve. Such translation differences are recognized in profit or loss in the period in which the foreign operation is disposed of.

On disposal of a foreign operation the cumulative exchange differences recognized in the foreign exchange reserve relating to that operation up to the date of disposal are transferred to the income statement as part of the profit or loss on disposal.

Deferred tax

Deferred tax is recognized on differences between the carrying amounts of assets and liabilities in the financial statements 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, but deferred tax assets are recognized only to the extent that it is probable that taxable profits will be available against which deductible temporary differences can be utilised.

Deferred tax is calculated at the tax rates that are expected to apply in the period when the liability is settled or the asset realised. Deferred tax is charged or credited to profit or loss, except when it relates to items charged or credited directly to equity, in which case the deferred tax is also dealt with in equity.

Property, plant and equipment

Computer equipment and fixtures and fittings are stated at cost less accumulated depreciation and any accumulated impairment losses. Depreciation is charged so as to write off the costs of assets over their estimated useful lives, using the straight-line method.

Assets held under finance leases are depreciated over their expected useful lives on the same basis as owned assets, or, when shorter, over the term of the relevant lease.

The gain or loss arising on the disposal or retirement of an item of property, plant and equipment is determined as the difference between the sale proceeds and the carrying amount of the asset and is recognized in profit or loss.

Investments

Investments in subsidiaries are stated at cost less any provision for impairment. Impairment is considered when there is an indication that there is a permanent reduction in the carrying value of the investment.

Externally acquired intangible assets

Externally acquired intangible assets are initially recognized at cost and subsequently amortized on a straight-line basis over their useful economic lives. The amortization expense is included in administration costs in the income statement.

Intangible assets are recognized on business combinations if they are separable from the acquired entity or give rise to other contractual or legal rights. The amounts ascribed to such intangible assets are arrived at using appropriate valuation techniques.

Internally generated intangible assets (research and development expenditure)

Development expenditure on internally developed software products is capitalized if it can be demonstrated that:

- it is technically feasible to develop the product
- adequate resources are available to complete the development
- there is an intention to complete and sell the product
- the group is able to sell the product
- sales of the product will generate future economic benefits; and
- expenditure on the product can be measured reliably.

Capitalized development costs are amortized over the period over which the group expects to benefit from selling the product developed.

Development costs not satisfying the above criteria and expenditure on the research phase of internal projects are recognized in profit or loss as incurred.

Impairment of tangible and intangible assets (excluding goodwill)

At each balance sheet date, the group reviews the carrying amounts of its 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 the impairment loss (if any). Where it is not possible to estimate the recoverable amount of an individual asset, the group estimates the recoverable amount of the cash-generating unit to which the asset belongs.

Recoverable amount is the higher of the fair value less costs to sell and value in use. In assessing the value in use, the estimated future cash flows are discounted to their net present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset.

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 immediately in the administrative expenses line item in the income statement, unless the relevant asset is carried at a revalued amount, in which case the impairment loss is treated as a revaluation decrease.

Where an impairment loss subsequently reverses, the carrying value of the asset or cash-generating unit is increased to the revised recoverable amount, but so that the increased carrying amount does not exceed the carrying amount which would have been determined had no impairment loss been recognized in prior years. A reversal of an impairment loss is recognized immediately in profit or loss, unless the relevant asset is carried at a revalued amount, in which case the reversal of the impairment loss is treated as a revaluation increase.

Financial instruments

Financial assets and liabilities are recognized on the group's balance sheet when the group becomes a party to the contractual provisions of the instrument.

Trade receivables
Trade receivables are measured at initial recognition at fair value. Appropriate allowances for estimated irrecoverable amounts are recognized in the administrative expenses line item in the income statement when there is objective evidence that the asset is impaired.

Cash and cash equivalents
Cash and cash equivalents comprise cash on hand and demand deposits, and other short-term highly liquid investments that are readily convertible to a known amount of cash and are subject to insignificant risk of changes in value.

Financial liabilities and equity instruments
Financial liabilities and equity instruments issued by the group are classified according to the substance of the contractual arrangements entered into and the definitions of a financial liability and an equity instrument. An equity instrument is any contract that evidences a residual interest in the assets of the group after deducting all of its liabilities. The accounting policies adopted for specific financial liabilities and equity instruments are set out below.

Bank borrowings
Interest-bearing bank loans, overdrafts and lines of credit are initially measured at fair value. Any difference between the initial fair value and the settlement or redemption of borrowings is recognized over the term of the borrowings in accordance with the group's accounting policy for borrowing costs.

Trade payables
Trade payables are initially measured at fair value, and are subsequently measured at amortized cost, using the effective interest rate method.

Equity instruments
Equity instruments issued by the company are recorded at the proceeds received, net of direct issue costs.

Share-based payments

The group issues equity-settled share-based payments to certain employees. Equity-settled share-based payments are measured at fair value (excluding the effect of non-market-based vesting conditions) at the date of grant. The fair value determined at the date of grant is expensed on a straight-line basis over the vesting period, based on the group's estimate of the shares that will eventually vest and adjusted for the effect of non-market-based vesting conditions.

Fair value is measured by the binomial option-pricing model. The expected life used in the model had been adjusted, based on management's best estimate, for the effects of non-transferability, exercise restrictions and behavioural considerations.

3. REVENUE

All of the group's revenue in respect of the years ended 31 December 2006 and 2005 derived from continuing operations and from the group's single business segment, the design, development and marketing of software products with associated implementation and consultancy services.

	2006	*2005*
	£'000	*£'000*
Continuing operations		
Software and associated consultancy services	6,045	4,664

4. GEOGRAPHICAL SEGMENTS

The group's primary reporting format for segment information is geographical segments. Information relating to the group's geographical segments, which are the United States, the United Kingdom and the Netherlands, where the group's operations are located, is given below.

For management purposes, the group is organised as a single business segment, namely the design, development and marketing of software products with associated implementation and consultancy services. Therefore, no analysis of the group's trading result and balance sheet in terms of a secondary reporting format for business segments is presented in this note.

The information in following table relating to sales revenue provides an analysis by the location of customer, irrespective of the origins of the goods and services.

Year ended 31 December 2006	*North America £'000*	*United Kingdom £'000*	*Rest of Europe £'000*	*Total £'000*
Income Statement				
External revenues	2,733	682	2,630	6,045
Inter-segment revenues	820	-	315	1,135
Net loss before interest and tax	(122)	(125)	(59)	(306)
Depreciation and amortization	333	37	3	373
Balance Sheet				
Capital expenditure	50	-	4	54
Total assets	3,106	1,146	234	4,486
Total liabilities	(1,743)	(829)	(294)	(2,866)

Year ended 31 December 2005	*North America £'000*	*United Kingdom £'000*	*Rest of Europe £'000*	*Total £'000*
Income Statement				
External revenues	2,693	586	1,385	4,664
Inter-segment revenues	321	10	242	573
Net loss before interest and tax	(865)	(340)	(17)	(1,222)
Depreciation and amortization	454	5	7	466
Balance Sheet				
Capital expenditure	473	-	8	481
Total assets	2,342	1,666	578	4,586
Total liabilities	(1,444)	(746)	(445)	(2,635)

5. LOSS FOR THE YEAR

The loss for the year has been arrived at after charging/(crediting):

	2006 £'000	*2005 £'000*
Continuing operations		
Net foreign exchange losses/(gains)	35	(1)
Research and development costs including amortization	1,028	974
Depreciation of property, plant and equipment	33	74
Operating lease rentals – land and buildings	298	302
Operating lease rentals – equipment and vehicles	78	80

6. AUDITORS' REMUNERATION

	2006 £'000	2005 £'000
Audit of the financial statements of the group	55	47

7. STAFF COSTS

	2006 £'000	2005 £'000
Wages and salaries	3,476	3,236
Social security costs	270	246
Pension contributions	65	65
Employee benefits expense	201	171
Share-based payments expense (all equity-settled)	62	143
	4,074	3,861

The average monthly number of employees during the year was made up as follows:

	2006 Number	2005 Number
Development and operations	28	31
Sales and management	35	32
	63	63

The above staff costs and the numbers of employees during the year include the executive directors.

The fees and emoluments of all directors were as follows:

	2006 £'000	2005 £'000
Fees and emoluments	397	403
Pension contributions	11	10
Share-based payments expense (all equity-settled)	21	70
	429	483

No director exercised share options during the year (2005: None).

Pension contributions are to personal defined contribution schemes and have been made for three directors (2005: three) who served during the year.

The emoluments of the highest paid director were as follows:

	2006 £'000	2005 £'000
Emoluments	139	110
Benefits	9	9
Pension contributions to defined contribution schemes	2	2
Share-based payments expense (all equity-settled)	9	58
	159	179

8. FINANCE REVENUE

	2006 £'000	2005 £'000
Interest on bank deposits	39	53

9. FINANCE COSTS

	2006 £000	2005 £000
Interest on bank loans, overdrafts and finance lease	36	67

10. INCOME TAX EXPENSE

	2006 £000	2005 £000
Income tax expense for the year	-	-

The charge for the year can be reconciled to the accounting loss as follows:

	2006 £'000	2006 %	2005 £'000	2005 %
Loss before tax	(303)		(1,236)	
Tax credit at the UK corporation tax rate of 30%	91	30%	371	30%
Tax effect of expenses that are not deductible in determining taxable losses	(29)	(9%)	(65)	(5%)
Temporary differences arising from the capitalisation and amortization of internally generated development costs	57	18%	11	1%
Losses for the year not relievable against current tax	(119)	(39%)	(317)	(26%)
	-	-	-	-

The group has an unrecognized deferred tax asset arising from its unrelieved trading losses, which has not been recognized owing to uncertainty as to the level and timing of taxable profits in the future.

The unrecognized deferred tax asset is made up as follows:

	2006 £'000	2005 £'000
Shortfall of tax depreciation compared to book depreciation	165	164
Effect of timing differences arising from capitalisation of internally generated development costs	(374)	(336)
Unrelieved trading losses	20,329	20,483
Unrecognized deferred tax asset	20,120	20,311

At 31 December 2006, tax losses estimated at £50 million were available to carry forward by the Sopheon plc group, arising from historic losses incurred. These losses represent a potential deferred tax asset of £20.3million, based on the tax rates currently obtaining in the relevant tax jurisdictions.

Of these tax losses, an aggregate amount of £12.1 million (representing £5.3 million of the potential deferred tax asset) represents pre-acquisition tax losses of Sopheon Corporation (Minnesota) and of Orbital Software Inc. The future utilisation of these losses may be restricted under section 382 of the US Internal Revenue Code, whereby the ability to utilise net operating losses arising prior to a change of ownership is limited to a percentage of the entity value of the corporation at the date of change of ownership.

11. LOSS DEALT WITH IN THE FINANCIAL STATEMENTS OF THE PARENT COMPANY

The loss dealt with in the financial statements of the parent company for the year ended 31 December 2006 was £560,000 (2005: £915,000). The loss in 2006 included a net provision of £268,000 (2005: £557,000) against the company's investment in and loans to subsidiary companies. Advantage has been taken of Section 230 of the Companies Act 1985 not to present an income statement for the parent company.

12. LOSS PER SHARE AND EBITDA

Loss per share (from continuing operations)

	2006	*2005*
	£'000	*£'000*
Loss for the purpose of basic earnings per share	303	1.236
	'000s	*'000s*
Weighted average number of ordinary shares for the purpose of basic earnings per share	133,441	131,059

The loss attributable to ordinary shareholders and the weighted average number of ordinary shares for the purpose of calculating the diluted loss per ordinary share are identical to those used for calculating the basic loss per ordinary share in both 2006 and 2005. This is because the exercise of share options, details of which are set out in Note 29, would have the effect of reducing the loss per ordinary share and is therefore not dilutive.

EBITDA

EBITDA is defined as earnings before interest, tax, depreciation and amortization.

13. PROPERTY, PLANT AND EQUIPMENT

Group	*Computer Equipment £'000*	*Furniture & fittings £'000*	*Total £'000*
Cost			
At 1 January 2005	1,569	330	1,899
Additions	41	13	54
Exchange differences	34	9	43
At 1 January 2006	1,644	352	1,996
Additions	50	4	54
Exchange differences	(109)	(21)	(130)
At 31 December 2006	1,585	335	1,920
Accumulated depreciation			
At 1 January 2005	1,495	294	1,789
Depreciation charge for the year	43	31	74
Exchange differences	26	6	32
At 1 January 2006	1,564	331	1,895
Depreciation charge for the year	26	7	33
Exchange differences	(98)	(20)	(118)
At 31 December 2006	1,492	318	1,810
Carrying amount			
At 31 December 2006	93	17	110
At 31 December 2005	80	21	101

The following rates are used for the depreciation of property, plant and equipment:

Computer equipment	33% on a straight-line basis
Furniture and fittings	20% to 25% on a straight-line basis

Company
The company has no property, plant and equipment.

14. INTANGIBLE ASSETS

Group	*Development costs (internally generated)* £'000	*IPR & customer relationships* £'000	*Goodwill* £'000	*Total* £'000
Cost				
At 1 January 2005	1,385	1,509	17,546	20,440
Additions (internally generated)	427	-	-	427
Exchange differences	186	-	-	186
At 1 January 2006	1,998	1,509	17,546	21,053
Additions (internally generated)	495	-	-	495
Exchange differences	(275)	-	-	(275)
At 31 December 2006	2,218	1,509	17,546	21,273
Amortization				
At 1 January 2005	734	1,509	17,546	19,789
Charge for the year	392	-	-	392
Exchange differences	108	-	-	108
At 1 January 2006	1,234	1,509	17,546	20,289
Charge for the year	305	-	-	305
Exchange differences	(169)	-	-	(169)
At 31 December 2006	1,370	1,509	17,546	20,425
Carrying amount				
At 31 December 2006	848	-	-	848
At 31 December 2005	764	-	-	764

Goodwill and IPR & customer relationships represent goodwill and intellectual property rights and customer relationships arising from acquisitions and have been fully amortized in accordance with the group's amortization policies.

The amortization period for the internally generated development costs relating to the group's software products is four years.

Company
The company has no intangible assets.

15. SUBSIDIARIES

Company

	£'000
Cost	
At 31 December 2005 and 31 December 2006	52,519
Amounts provided	
At 31 December 2005 and 31 December 2006	35,441
Carrying amount	
At 31 December 2005 and 31 December 2006	17,078
Amount due to subsidiary undertaking	(10,959)
At 31 December 2005 and 31 December 2006	6,119

There are no plans for settlement of the amount due to subsidiary undertaking shown above nor is this likely to occur, and accordingly it has been accounted for as part of the company's investment in subsidiaries.

Details of the company's subsidiaries at 31 December 2006 are set out below. Companies marked with an asterisk* are held via Sopheon UK Ltd and those with an obelus† are held via Orbital Software Holdings plc.

Name of Company *Place of incorporation*	*Proportion of ownership Interest*	*Proportion of voting rights held*	*Nature of Business*
Sopheon Corporation Minnesota, USA	Common Stock	100%	Software sales and services
Sopheon Corporation Delaware, USA	Common Stock	100%	Software development
Sopheon NV The Netherlands	Ordinary Shares	100%	Software sales and services
Sopheon UK Ltd United Kingdom	Ordinary Shares	100%	Software sales and services
Orbital Software Holdings plc United Kingdom	Ordinary Shares	100%	Holding company
Orbital Software Inc.† Delaware, USA	Common Stock	100%	Dormant
Sopheon Edinburgh Ltd† United Kingdom	Ordinary Shares	100%	Dormant
Orbital Software Europe Ltd† United Kingdom	Ordinary Shares	100%	Dormant
Network Managers (UK) Ltd* United Kingdom	Ordinary Shares	100%	Dormant
AppliedNet Ltd* United Kingdom	Ordinary Shares	100%	Dormant
Future Tense Ltd* United Kingdom	Ordinary Shares	100%	Dormant
Polydoc Ltd United Kingdom	Ordinary Shares	100%	Dormant
Applied Network Technology Ltd* United Kingdom	Ordinary Shares	100%	Employee Share Ownership Trust

During 2006, the group invested £35,000 in acquiring minority holdings in companies established to market the group's software products in France and New Zealand. Full provision has been made against these investments during the year.

16. NON-CURRENT RECEIVABLE

	Group 2006 £'000	Group 2005 £'000	Company 2006 £'000	Company 2005 £'000
Non-current receivable	10	10	-	-

The non-current receivable represents a deposit paid in respect of a property leased by the group.

17. TRADE AND OTHER RECEIVABLES

	Group 2006 £'000	Group 2005 £'000	Company 2006 £'000	Company 2005 £'000
Amounts receivable from the sale of software and services	2,358	1,621	-	-
Other receivables	18	22	13	20
Prepayments and accrued income	108	98	23	18
	2,484	1,741	36	38

Trade and other receivables are stated net of allowances totalling £41,000 (2005: £4,000) for estimated irrecoverable amounts. The directors consider that the carrying amount of trade and other receivables approximates to their fair value.

Of the trade receivables £1,627,000 (2005: £868,000), being the trade receivables of Sopheon Corporation Minnesota, are charged to the Silicon Valley Bank as security for the bank line of credit disclosed in Note 19.

A full provision has been made against amounts totalling £38,270,000 (2005: £38,001,000) owed to the company by subsidiary undertakings, which are due after more than one year and are subordinated to the claims of all other creditors.

18. CASH AND SHORT-TERM BANK DEPOSITS

	Group 2006 £'000	Group 2005 £'000	Company 2006 £'000	Company 2005 £'000
Cash at bank	310	980	17	219
Short-term bank deposits	724	990	724	990
	1,034	1,970	741	1,209

Cash and short-term bank deposits comprise cash held by the group, bank current accounts and short-term bank deposit accounts with maturities of three months or less. The carrying amount of these assets approximates to their fair value.

Included in cash at bank of the group is an amount of £35,000 held by the group's employee share ownership trust.

19. BANK OVERDRAFTS AND LOANS

		Group		*Company*
	2006	*2005*	*2006*	*2005*
	£'000	*£'000*	*£'000*	*£'000*
Bank overdrafts	5	8	1	1
Bank lines of credit	409	362	-	-
	414	370	1	1

The borrowings are all repayable on demand or within one year.

The group's borrowings are denominated in the following currencies:

At 31 December 2006	*Sterling*	*US dollars*	*Total*
	£'000	*£'000*	*£'000*
Bank overdrafts	5	-	5
Bank line of credit	-	409	409
	5	409	414

At 31 December 2005	*Sterling*	*US dollars*	*Total*
	£'000	*£'000*	*£'000*
Bank overdrafts	8	-	8
Bank line of credit	-	362	362
	8	362	370

The average interest rates paid were as follows:

	2006	*2005*
	£000	*£000*
Bank line of credit	8%	8%

All the bank borrowings carry interest at floating rates, thus exposing the group to cash flow interest rate risk.

The directors consider that the carrying amounts of bank overdrafts and loans approximate to their fair values.

The bank line of credit is secured against the trade receivables of Sopheon Corporation Minnesota and bears interest at a rate of 2% above the bank's prime rate. At 31 December 2006 the group had available £102,000 (2005: £220,000) notionally available under the line of credit subject to the availability of qualifying trade receivables.

20. TRADE AND OTHER PAYABLES

	Group		Company	
	2006 £'000	2005 £'000	2006 £'000	2005 £'000
Trade payables	377	419	34	22
Other payables	229	256	76	83
Accruals	828	731	223	242
Deferred income	1,010	847	-	-
	2,444	2,253	333	347

Trade payables principally comprise amounts outstanding for trade purchases and ongoing costs.

The directors consider that the carrying amounts of trade and other payables approximate to their fair values.

21. OBLIGATIONS UNDER FINANCE LEASES

The present value of future lease payments is analysed as:

	Group		Company	
	2006 £'000	2005 £'000	2006 £'000	2005 £'000
Current liabilities	3	3	-	-
Non-current liabilities	5	9	-	-
	8	12	-	-

The group leases a telephone system with a net carrying value at 31 December 2006 of £8,000 (2005: £12,000).

Future lease payments are due as follows:

At 31 December 2006	Minimum lease payments £'000	Interest £'000 £'000	Present value £'000
Within one year	3	-	3
Due in one to five years	5	1	6
	8	1	9

At 31 December 2005	Minimum lease payments £'000	Interest £'000 £'000	Present value £'000
Within one year	3	-	3
Due in one to five years	10	1	9
	13	1	12

22. OPERATING LEASE ARRANGEMENTS

At the balance sheet date the group has outstanding commitments under operating leases in respect of which the total future minimum lease payments were due as follows:

	Land & buildings 2006 £'000	*Other 2006 £'000*	*Land & buildings 2005 £'000*	*Other 2005 £'000*
Due within one year	257	214	232	86
Due after one year and within five years	133	71	281	158
	390	285	513	244

Company
The company has no operating leases.

23. FINANCIAL INSTRUMENTS

Risk management

The group's financial instruments at 31 December 2006 primarily comprised cash, overdraft and line of credit balances in addition to operating items such as trade receivables and payables. These instruments are held in a variety of currencies. Accordingly the group is exposed to the following financial risks relating to the group's financial instruments:

- Liquidity risk
- Foreign currency risk
- Credit risk

The group aims to keep a balance of debt and equity finance that will maximize shareholder returns without exposure to undue risks. The group has established policies and procedures for managing these risks which are summarized below.

Liquidity risk

The liquidity risk of each group entity is managed centrally by the parent company. Budgets are established annually for each group entity and approved by the parent company, enabling the group's cash requirements to be anticipated. Certain group entities have committed overdraft facilities or bank lines of credit. All surplus cash is held centrally to maximise the returns on deposits.

Foreign currency risk

The group has operations in the United States, Holland and the United Kingdom. Assets and liabilities of group entities located in the United States and Holland are denominated respectively in US Dollars and Euros and are therefore exposed to fluctuations in exchange rates giving rise to gains or losses on retranslation into sterling. It is not the group's policy to hedge its net investments in foreign operations, because it judges that the necessary hedging techniques would involve risks to cash flow.

Foreign currency risk also arises where individual group entities enter into transactions denominated in currencies other than their functional currency, with fluctuations in exchange rates giving rise to gains or losses in the income statement. Where the foreign currency risk to the group is significant, consideration is given to hedging the risk through the forward currency market.

Credit risk

The group's principal financial assets are bank balances and cash and trade and other receivables. The credit risk on liquid funds is limited because the counter-parties are banks with high credit ratings assigned by international credit-rating agencies. The group's credit risk is primarily attributable to its trade receivables. An allowance for impairment is made where there is an identified loss event, which is evidence of a reduction in the recoverability of the amount receivable. The group has no significant concentration of credit risk, with exposure spread over a number of customers.

Interest rate risk profile of financial assets and liabilities

The interest rate profile of the financial assets and liabilities of the group as is as follows:

At 31 December 2006	*Within 1 year*	*1 to 2 years*	*2 to 5 years*	*Total*
Floating rate				
Cash	310	-	-	310
Short-term deposits	724	-	-	724
Bank overdrafts and lines of credit	(413)	-	-	(413)
Fixed rate				
Obligations under finance leases	(3)	(3)	(2)	(8)

At 31 December 2005	*Within 1 year*	*1 to 2 years*	*2 to 5 years*	*Total*
Floating rate				
Cash	980	-	-	980
Short-term deposits	991	-	-	991
Bank overdrafts and lines of credit	(370)	-	-	(370)
Fixed rate				
Obligations under finance leases	(3)	(3)	(6)	(12)

Fair values of financial assets and financial liabilities

Set out below is a comparison by category of carrying amounts and fair values of all of the group's financial instruments that are carried in the financial statements.

		Book values		*Fair values*
	2006	*2005*	*2006*	*2005*
	£'000	*£'000*	*£'000*	*£'000*
Financial assets				
Cash	310	980	310	980
Short-term deposits	724	991	724	991
Financial liabilities				
Bank overdrafts and lines of credit	(413)	(370)	(413)	(370)
Obligations under finance leases	(8)	(12)	(8)	(12)

Currency and interest profile of financial assets and liabilities

At 31 December 2006	*Sterling*	*US$*	*Euro*	*Total*
Floating rate				
Cash	51	172	87	310
Short-term deposits	724	-	-	724
Bank overdrafts and lines of credit	(4)	(409)	-	(413)
Fixed rate				
Obligations under finance leases	-	(8)	-	(8)

At 31 December 2005	*Sterling*	*US$*	*Euro*	*Total*
Floating rate				
Cash	264	420	296	980
Short-term deposits	991	-	-	991
Bank overdrafts and lines of credit	(8)	(362)	-	(370)
Fixed rate				
Obligations under finance leases	-	(12)	-	(12)

Interest rate profile

The rates of interest payable on floating rate financial liabilities are disclosed in Note 19. The group has no fixed rate financial liabilities other than its obligations under the finance lease disclosed in Note 21, where the implied interest rate is 3.5% and instalments are due until June 2010.

Interest on the group's short-term bank deposits fluctuates in line with sterling money market rates.

24. SHARE CAPITAL

Authorized	*2006 Number*	*2006 £000*	*2005 Number*	*2005 £000*
Ordinary shares of 5p each	175,000,000	8,750	175,000,000	8,750

Issued and fully paid	*2006 Number*	*2006 £000*	*2005 Number*	*2005 £000*
At 1 January	133,305,139	6,665	115,871,082	5,793
Issued for cash	-	-	4,747,826	237
Issued on conversion of Convertible Loan Stock	-	-	12,572,326	629
Issued on exercise of share options	273,888	14	113,905	6
At 31 December	133,579,027	6,679	133,305,139	6,665

The company has one class of ordinary shares, which carry no right to fixed income.

During 2006 273,888 new ordinary shares were issued pursuant to the exercise of share options for an aggregate subscription price of £43,000.

25. CAPITAL RESERVES

Group

	Share premium £'000	Merger reserve £'000	Capital redemption reserve £'000	Share options reserve £'000	Total £'000
At 1 January 2005	48,949	17,944	2,884	1,405	71,182
Shares issued at a premium	1,707	-	-	-	1,707
Recognition of share-based payments	-	-	-	143	143
Lapsing of share options	-	-	-	(101)	(101)
At 1 January 2006	50,656	17,944	2,884	1,447	72,931
Shares issued at a premium	29	-	-	-	29
Recognition of share-based payments	-	-	-	62	62
Lapsing of share options	-	-	-	(195)	(195)
At 31 December 2006	50,685	17,944	2,884	1,314	72,827

Company

	Share premium £'000	Merger reserve £'000	Capital redemption reserve £'000	Share options reserve £'000	Total £'000
At 1 January 2005	48,949	10,179	2,884	1,405	63,417
Shares issued at a premium	1,707	-	-	-	1,707
Recognition of share-based payments	-	-	-	143	143
Lapsing of share options	-	-	-	(101)	(101)
At 1 January 2006	50,656	10,179	2,884	1,447	65,166
Shares issued at a premium	29	-	-	-	29
Recognition of share-based payments	-	-	-	62	62
Lapsing of share options	-	-	-	(195)	(195)
At 31 December 2006	50,685	10,179	2,884	1,314	65,062

Share premium represents the premium arising on the issue of shares and its use is governed by the provisions of the Companies Act 1985 .

Merger reserve is a non-statutory reserve representing the premium on the issue of shares pursuant to certain past business combinations which meet specified criteria.

The capital redemption reserve is a non-distributable reserve arising from the cancellation in 2001 of deferred shares.

The share options reserve comprises the deemed value of outstanding share options granted in connection with the acquisitions of Teltech Resource Network Corporation in 2000 and of Orbital Software Holdings plc in 2001, together with the fair value of share-based payments to employees pursuant to the group's share option schemes.

26. STATEMENT OF CHANGES IN EQUITY

Group

	Share capital £'000	*Shares to be issued £'000*	*Capital reserves £'000*	*Translation reserve £'000*	*Retained earnings £'000*	*Total £'000*
At 1 January 2005	5,794	1,509	71,182	(117)	(76,479)	1,889
Shares issued at a premium	871	(1,509)	1,707	-	-	1,069
Recognition of share-based payments	-	-	143	-	-	143
Lapsing of share options	-	-	(101)	-	101	-
Exchange differences on translation of foreign operations	-	-	-	86	-	86
Loss for the year attributable to equity shareholders	-	-	-	-	(1,236)	(1,236)
At 1 January 2006	6,665	-	72,931	(31)	(77,614)	1,951
Shares issued at a premium	14	-	29	-	-	43
Recognition of share-based payments	-	-	62	-	-	62
Lapsing of share options	-	-	(195)	-	195	-
Exchange differences on translation of foreign operations	-	-	-	(133)	-	(133)
Loss for the year attributable to equity shareholders	-	-	-	-	(303)	(303)
At 31 December 2006	6,679	-	72,827	(164)	(77,722)	1,620

Company

	Share capital £'000	*Shares to be issued £'000*	*Capital reserves £'000*	*Retained earnings £'000*	*Total £'000*
At 1 January 2005	5,794	1,509	63,417	(63,999)	6,721
Shares issued at a premium	871	(1,509)	1,707	-	1,069
Recognition of share-based payments	-	-	143	-	143
Lapsing of share options	-	-	(101)	101	-
Loss for the year attributable to equity shareholders	-	-	-	(915)	(915)
At 1 January 2006	6,665	-	65,166	(64,813)	7,018
Shares issued at a premium	14	-	29	-	43
Recognition of share-based payments	-	-	62	-	62
Lapsing of share options	-	-	(195)	195	-
Loss for the year attributable to equity shareholders	-	-	-	(560)	(560)
At 31 December 2006	6,679	-	65,062	(65,178)	6,563

27. RETIREMENT BENEFIT PLANS

The group operates defined contribution retirement benefit plans which employees are entitled to join. The total expense recognized in the income statement of £65,000 (2005: £65,000) represents contributions paid to such plans at rates specified in the rules of the plans.

28. RELATED PARTY TRANSACTIONS

Details of transactions between the group and related parties are disclosed below.

Compensation of key management personnel

Details of directors' remuneration are given in Note 7. The total remuneration of directors and members of the group's management committee during the year was as follows:

	2006	*2005*
	£'000	*£'000*
Emoluments and benefits	649	521
Pension contributions	16	16
	665	537

Transactions with related parties who are subsidiaries of the company

The following is a summary of the transactions of the company with its subsidiaries during the year:

	2006	*2005*
	£'000	*£'000*
Amounts advanced to subsidiaries by way of interest-free loans	19	364
Net management charges to subsidiaries	239	226

During 2006 and 2005 the company granted share options to employees of subsidiary companies, details of which are disclosed in Note 29.

Other related party transactions

There were no other related party transactions during the year under review or the previous year.

29. SHARE-BASED PAYMENTS

Equity settled share option schemes
The group has a number of share option schemes for all employees. Options are exerciseable at a price equal to the market price on the date of grant. The normal vesting periods are as set out below.

	Vesting
Sopheon plc (USA) stock option plan	In three equal tranches between the first and third anniversary of grant
Sopheon UK approved share option scheme	On third anniversary of grant
Sopheon UK unapproved share option scheme	Immediate or as per USA plan
Sopheon NV share option scheme	Immediate or as per USA plan

Details of the share options outstanding during the year are as follows:

	Number of share options 2006	*Weighted average exercise price 2006 £*	*Number of share options 2005*	*Weighted average exercise price 2005 £*
Outstanding at the beginning of the year	8,530,716	0.36	7,527,302	0.38
Granted during the year	1,602,500	0.22	1,382,500	0.25
Exercised during the year	(273,888)	0.16	(113,905)	0.15
Lapsed during the year	(419,663)	0.57	(265,181)	0.49
Outstanding at the end of the year	9,439,665	0.33	8,530,716	0.36
Exerciseable at the end of the year	7,147,165	0.37	6,650,153	0.41

The weighted average share price at the date of exercise for share options exercised during the year was 21p (2005 25p). The options outstanding at the end of the year have a weighted average remaining life of 7.5 years (2005: 7.3 years).

In 2006, share options were granted on 15 April 2006 and on 11 October 2006. The exercise prices of the options granted on those dates was 22p and 18.75p respectively, and the estimated fair values were 9.6p and 7.4p respectively. In 2005 share options were granted on 15 April 2005 and 13 October 2005. The exercise prices of the options granted on those dates were 25.25p and 21.75p respectively, and the estimated fair values were 14.9p and 12.9p respectively.

The fair values were calculated using the binomial option-pricing model. The principal assumptions used were:

	15 April 2006	*11 October 2006*	*15 April 2005*	*13 October 2005*
Share price at time of grant	22p	18.75p	25.25p	21.75p
Exercise price	22p	18.75p	25.25p	21.75p
Expected volatility	40%	40%	40%	40%
Risk-free rate	5%	5%	5%	5%
Expected dividend yield	Nil	Nil	Nil	Nil

The expected life of the options used was either 5 or 10 years depending on the particular scheme rules.

Expected volatility was determined by reference to the historic volatility of the company's share price in the period before the date of grant.

The group recognized total expenses of £62,000 (2005: £143,000) relating to equity-settled share based payments during the year.

There were no other related party transactions during the year under review or the previous year.

30. APPROVAL OF FINANCIAL STATEMENTS

The financial statements were approved by the board of directors and authorized for issue on 28 March 2007.

Directors and Senior Management

Barry Mence, Executive Chairman. Barry Mence has served as executive chairman, and as a director and substantial shareholder of Sopheon, since its inception in 1993 when he was one of the founding members. From 1976 to 1990, Mr. Mence was the major shareholder and group managing director of the Rendeck Group of Companies, a software and services group based in the Netherlands.

Andrew Michuda, Executive Director. Andrew Michuda was appointed chief executive officer of Sopheon in September 2000. From 1997 to 2000 he served as chief executive officer and an executive director of Teltech Resource Network Corporation, which was acquired by Sopheon. He earlier held senior leadership positions at Control Data, including general manager of the business that evolved into Decision Data, the world's largest independent computer services provider.

Arif Karimjee, ACA, Executive Director. Arif Karimjee has served as chief financial officer of Sopheon since February 2000. Mr. Karimjee was previously an auditor and consultant with Ernst & Young in London, Brussels and Reading, from August 1988 until joining Sopheon.

Stuart Silcock, FCA, Non-executive Director. Stuart Silcock has served as a director of Sopheon from its inception in 1993. Since 1982, Mr. Silcock has been a principal partner of Lawfords & Co. and a director of Lawfords Ltd., chartered accountants. Mr. Silcock was a non-executive Director of Brown & Jackson Plc for 4 years from June 2001 to July 2005 and also holds a number of other UK Directorships.

Bernard Al, Non-executive Director. Bernard Al was appointed as director of Sopheon in January 2001. He is a former chief executive officer of Wolters Kluwer in the Netherlands and has a background in science and linguistics.

Daniel Metzger, Non-executive Director. Daniel Metzger was until 1998 an executive vice president of Lawson Software, a leading ERP provider, where he was responsible for corporate strategy and marketing. Since then he has held similar roles at Parametric Technologies, where he led the business strategy and marketing around collaborative product development technologies and at nQuire Software, which was subsequently sold to Siebel.

Ronald Helgeson, Vice President of Corporate Communications. Ronald Helgeson has served as vice president of corporate communications for Sopheon since 2000. He previously held senior marketing-management roles with Teltech Resource Network Corporation and 3M Company.

Paul Heller, Chief Technology Officer. Paul Heller was appointed chief technology officer in June 1999. He was previously vice president of product management for Baan Company.

Huub Rutten, Vice President of Product Research and Design. Huub Rutten is responsible for Sopheon's healthcare business in the Netherlands and also has responsibility for product research. A founder of Sopheon, he was a director until September 2000 when he assumed a more operational role.

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