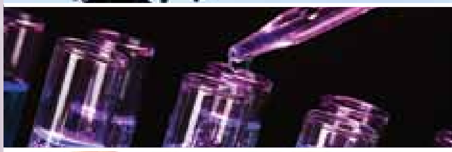
SOPHEON 2012

ANNUAL REPORT

sopheon

Where innovation means business™

Sopheon partners with customers to provide complete Enterprise Innovation Performance solutions including software, expertise, and best practices to achieve exceptional long-term revenue growth and profitability.

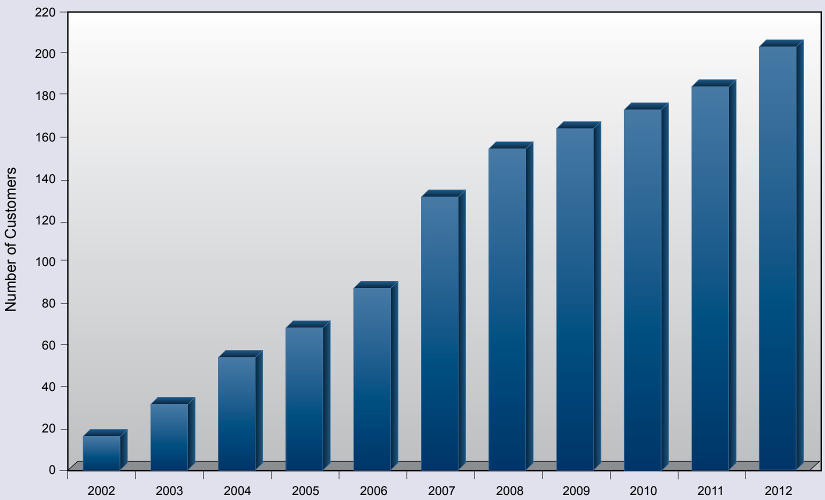
Sopheon's software, expertise, and best practices enables our customers to improve innovation and new product development performance for sustainable, profitable revenue growth.

Summary Results and Trends

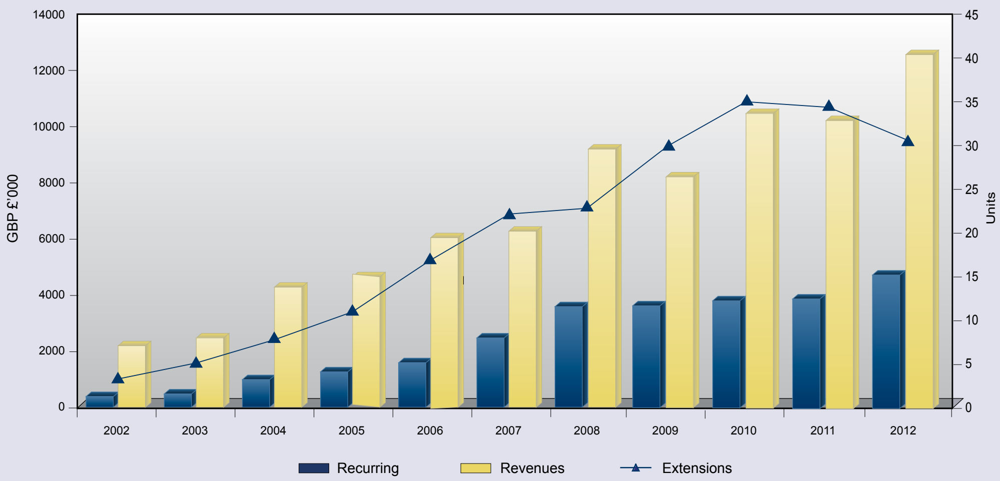
		2012	2011	2010	2009	2008	2007
Revenue	**£'000**	**12, 663**	**10,276**	**10,537**	**8,260**	**9,304**	**6,332**
EBITDA	**£'000**	**1,803**	**1,491**	**1,510**	**(195)**	**1,120**	**113**
Profit before tax	**£'000**	**281**	**104**	**171**	**(1,494)**	**44**	**(443)**
Earnings per share	**pence**	**0.19**	**0.07**	**0.10**	**(1.03)**	**0.02**	**(0.32)**
Pre financing cashflow	**£'000**	**1,070**	**151**	**1,320**	**(1,276)**	**896**	**(551)**
Net assets	**£'000**	**3,264**	**3,082**	**3,008**	**2,685**	**4,268**	**3,310**
Gross cash	**£'000**	**3,880**	**2,941**	**3,358**	**1,624**	**2,586**	**2,053**
Working capital	**£'000**	**4,315**	**3,289**	**4,145**	**2,001**	**3,068**	**2,140**
Long-term liabilities	**£'000**	**(2,121)**	**(1,663)**	**(2,290)**	**(1,222)**	**(1,105)**	**(1,195)**

Working capital is calculated as net current assets after adding back deferred income.

In 2012 we saw a strong return to growth after a relatively flat performance the year before. Business from new customers picked up sharply, amounting to 51% of new orders compared to 21% the year before. Customers headquartered in China and the Middle East made a major contribution to this. The balance sheet was also improved with new funds from long-term investors to underpin ongoing growth strategies.



In 2012, we grew our customer base to 203 licensees.



Annualized average growth since the launch of Accolade remains at 25%. As the business rebalanced towards new customer acquisition, we saw a total of 49 license orders in 2012, of which 31 were extensions. We expect today's new customers to drive further extension business in the future. Average license revenue per transaction was up on 2011, as is the maintenance base.

STATEMENT FROM THE CHAIRMAN AND CHIEF EXECUTIVE OFFICER

Performance

Last year represented solid progress on a number of fronts and this is particularly evident in our financial performance. Revenues were up 23 percent, from £10.3m in 2011 to £12.7m in 2012, and we are also pleased to report improvement in profitability. The EBITDA result was a profit of £1.8m compared to £1.5m in 2011. We are also very pleased to report further improvement to profit after tax, which rose to £0.3m (2011: £0.1m). Since 2010, we have steadily extended our resourcing and investment in key operational areas, as part of our ongoing growth strategy, and it is particularly pleasing to see these measures pay off in the context of improving financial performance.

We entered 2012 with plans to improve our acquisition rate of new clients and are glad to report that revenue from new clients generated 51 percent of our 2012 revenue, as compared to 21 percent in 2011.

Total license transactions including extension orders were 49 in 2012 (2011: 54). License revenues grew by 20 percent and reflected a higher average deal size, validating our expectation that smaller initial orders from the previous year would generate larger extensions in 2012. Growth in consulting and implementation services was even more marked and approached 50 percent.

From a geographical standpoint, customers headquartered in new territories such as China and the Middle East made a major contribution to the year. Our core innovation solution, Accolade® Process Manager™, continued to account for the majority of revenues at 91 percent compared to 84 percent in 2011.

At the date of this report, full-year 2013 revenue visibility incorporating booked revenue, contracted services business and the run rate of recurring contracts stands at £6.4m, compared to £6.0m at the same time last year. Revenue visibility is more fully defined in Note 4.

Strategy and Product

We have previously stated that Sopheon's growth strategies for 2012 and beyond center on three key objectives:

- **Increase our rate of growth by deploying vertical-specific marketing strategies.** Coming into 2012 we realigned sales, product and marketing initiatives around target growth industries. We revised our marketing approach to be a more vertical-specific, integrated mix of tactics including digital, web-based and social media methods as well as more traditional approaches such as conferences and direct mail. Target sectors included consumer goods, food and beverage, chemical, high-tech and aerospace and defense. Although we have seen significant success in the majority of these sectors, aerospace and defense has been held back by well publicized uncertainties around government procurement.

- **Broaden the use of our solutions within existing accounts.** We continue to expand the range of our innovation solutions to enable expansion within our customers. An example is our recent release of Accolade 8.2, which introduces a new module Accolade Innovation Planner™ to assist companies in creating strategic enterprise innovation plans. As reported last year, we also invested in our client growth strategy by focusing account management resources and marketing programs on growing within our customer base.

- **Expand direct and indirect distribution channels to acquire new accounts.** During 2011 we hired new sales people to expand our direct distribution channel. At the start of 2013, we underpinned our position in Germany through the acquisition of our reseller partner. We also continued to build our relationships with consulting partners. Evidence

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Process Manager and Innovation Planner are trademarks of Sopheon plc.

of progress during 2012 included our first sale into China, through a partner, and the announcement of a joint product and service offering with Kalypso, a major consulting firm in the innovation market. In addition we won our second Saudi Arabia based customer and expect to expand into this region going forward.

Our investment in these strategic objectives started in 2011 and as we predicted, commercial results have started to come through in 2012. On the product front, in 2011 we completed a full refresh of the technology platform upon which our core software offerings are built to make them Microsoft® .net based. We also introduced a new Agile development methodology designed to build products faster and do a better job of ensuring that they are in step with real customer needs. In 2012, these changes resulted in a number of customer-focused releases, culminating in the landmark release of Accolade 8.2 at the start of 2013. With this release, Sopheon continues to extend the market leadership of the Accolade solution with expanded functionality for innovation users and business processes.

As Sopheon grows, our solutions and market position also continue to evolve. With the recent expansion of our solution footprint we have also evolved our market position. Sopheon partners with customers to provide complete Enterprise Innovation Performance solutions including software, expertise, and best practices to achieve exceptional long-term revenue growth and profitability. Sopheon's Accolade solution provides unique, fully-integrated coverage for the entire innovation management and new product development lifecycle. For the first time, businesses can access a single source of the truth across strategic innovation planning, roadmapping, idea and concept development, process and project management, and portfolio and in-market management.

Our decision to sustain internal product development investment despite the ongoing economic uncertainty is serving us well in the present and will continue to fortify our business performance and potential in the days ahead.

People

Sopheon is differentiated in the market by its reputation for deep domain expertise in innovation management. That know-how is embodied in our people, whose best-practice understanding and experience have been developed through many years of helping top businesses achieve innovation success. We are very proud of the commitment that our people have shown in lifting Sopheon to a position of leadership in this area.

Sopheon continues to recruit, grow and develop our people. In 2011, as previously communicated, we identified that a key barrier to our ability to scale for growth was a lack of formal onboarding and certification training. During 2012, we recruited a dedicated training specialist to close this gap. We held our first formal training events during the year, which enjoyed excellent feedback. Our goal is to reduce the ramp-up time for new employees, and in turn, improve our ability to scale our organization with growth while maintaining customer satisfaction. This priority continues to have high visibility inside our company. In addition, as part of our Accolade version 8 roll out programs we offered customers packaged training classes at Sopheon facilities for the first time. The feedback and value received from our clients was overwhelmingly positive. We will expand this program in 2013.

Building on steps taken in 2011 to restructure and strengthen Sopheon's executive management team, we were pleased to round out our executive team with the recruitment of Mike Frichol to spearhead global marketing. Mike has a great deal of experience with emerging high-growth software companies, and has held a number of senior positions in the industry at companies such as Great Plains Software, Infor, and Microsoft.

The Sopheon plc board is made up of three executive directors, augmented by three non-executive directors who bring a wealth of knowledge and experience to our business. Details about each board member can be found at the back of this report.

Outlook

We are delighted that revenues and profits for 2012 exceeded market expectations. In parallel with this positive financial performance, Sopheon continued to make strategic advances during the year. We announced major new product releases that further embed our leadership in enterprise innovation management. We started 2013 with the acquisition of a long-standing business partner in Germany, a key regional market. Through 2012 and also coming into 2013, we have continued our steady expansion of resources to keep pace with our growth plans. Nevertheless, market conditions remain hard to predict, and we continue to watch the cost base closely.

On the corporate front, we secured an additional £1.1m of convertible debt finance, giving us the confidence to continue execution of our expansion strategy. We moved our Amsterdam listing to the Alternext exchange, better suited to a company of our size. Separately, we shared our intent to undertake a corporate restructuring to reduce the accumulated deficit on the profit and loss account, and to consolidate shares. Precise details remain under review and we expect to request authorities for these changes at our 2013 annual general meeting.

Sopheon enters 2013 having made substantial progress on financial, operational and corporate fronts. We will continue our efforts in all areas and are excited by the opportunities ahead.

Barry Mence
Executive Chairman

Andy Michuda
Chief Executive Officer

20 March 2013

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FINANCIAL AND OPERATING REVIEW

Trading Performance

Sopheon's consolidated turnover in 2012 was £12.7m, compared to £10.3m in 2011, an increase of 23 percent. Both regions showed good growth. Much of the EMEA region growth is attributable to substantial business sold into new territories in Asia and the Middle East. The overall shape of the business continues to be approximately one-third Europe and two-thirds North America. Currency effects had limited impact in 2012.

Total license transactions including extension orders were 49 in 2012 compared to 54 in 2011, a reduction of 9 percent. However, average revenue per transaction rose, which resulted in higher license revenues overall. Historically, our license performance in the fourth quarter has tended to be very strong and to provide a substantial boost to overall annual revenues. In 2012, for the second year running, this fourth quarter spike did not come through and our strongest license quarter in the year was the second quarter.

Business Mix

The annualized average growth of the business since the launch of Accolade remains at 25 percent. Within this overall picture, maintenance revenues were broadly flat but license and services delivered increases of 20 percent and 50 percent respectively. It is particularly satisfying to see a return to license growth after a pause in 2011. Over the years we have frequently referred to the sensitivity of our license results to individual sales events. In 2011 this was compounded by an evolution of buying patterns whereby customers preferred extended validation phases, pilot projects and phased license orders as opposed to making substantial up-front orders as in the past. We expected this buying behavior to result in better license performance in 2012 and this came through as customers made extension orders. However, 2012 also saw a welcome improvement in the share of revenues from new customers as compared to existing customers, and this is a large part of the growth achieved. In 2012 just over 50 percent of the value of new business (excluding maintenance and hosting renewals) was derived from new customers, compared to 21 percent in 2011, and 38 percent in 2010. This improvement is due in part to rising market interest in our solutions but also to actions taken to reorganize and improve the focus on winning new customers, without compromising our existing customer relationships. We are very conscious that we need to continue to focus on both add-on business from existing customers as well as signing new clients; each customer represents an extended business opportunity for Sopheon to deliver value and grow revenue.

Similar to prior years certain customers reorganized and rationalized in reaction to the economic conditions, resulting in termination of their maintenance contracts. We did, however, see overall growth in the base of recurring business, which is almost £4.5m coming into 2013 compared to £4.1m coming into 2012, and £3.9m coming into 2011. This is a more substantial rise than in prior years due in part to the additional maintenance revenues brought on with the acquisition of our German business partner in January 2013. The majority of recurring income is represented by maintenance services, but also includes hosting services and license rentals. Overall, in 2012 our business delivered a 28:31:41 ratio of licenses, maintenance, and services respectively compared to 29:38:33 in the previous year.

Overall gross margins have fallen to just over 71 percent (2011: 73 percent), which can be largely attributed to the growth in service compared to license revenues and the associated higher costs. Within this overall picture, we did incur approximately £0.45m of third-party software costs (2011: £0.3m). As we have noted in prior annual reports, we anticipated that license margins will be affected by decisions to embed, rather than build, certain third-party components or methods of working into our software. This is expected to continue going forward. In the services area, the higher revenues resulted in a substantial rise in the overall cost of service resources. While subcontractor costs increased, the majority of this rise was due to actual staffing.

Research and Development Expenditure

We have continued our gradual expansion of investment in product development since 2010. This policy has resulted in actual expenditures in research and development being approximately £0.4m higher in 2012 than in 2011. In addition, this increase was boosted by the effect of providing for bonuses. The headline R&D reported in the income statement adjusts this basic expenditure for the effects of capitalization and amortization of development costs. The amount of 2012 research and development expenditure that met the criteria of IAS38 for capitalization was £1.2m (2011: £1.1m) offset by amortization charges of £1m (2011: £0.8m). These capitalized costs are largely attributable to the group's investment in the Accolade 8.0, 8.1 and 8.2 releases.

As in prior years, the effect of capitalization was not completely offset by amortization, however by only £0.2m in 2012 compared to £0.3m in 2011. Accordingly, headline research and development expenditures reported in the income statement rose to £2.7m, compared to £2.2m in 2011, an overall net increase of £0.5m. A further £0.3m of amortization and impairment charges relating to acquired intangible assets (2011: £0.2m) has been charged to distribution costs. Including these costs, the overall effect of capitalization, amortization and impairment was to increase costs reported in the income statement by £0.1m.

Sopheon remains committed to product leadership, with excellence in research and software development as a critical core competency of the group. Since 2001 Sopheon's reported research and development costs each year have been at least 20 percent of revenues reported in that year. For 2012, this metric was 21 percent (2011: 21 percent).

Operating Costs

Coming into 2012 Sopheon had 95 staff members. As noted elsewhere, during the year we steadily expanded resources in line with revenue growth, and by the end of the year the total staff count stood at 109. In addition to the impact of expanded staffing, all cost areas were affected by the fact that the improved 2012 performance led to a bonus award being made to all members of the company that participate in the corporate bonus scheme. The corporate bonus scheme covers the majority of the group's executives and employees, with the principal exception of the sales teams for whom incentives are tied to individual or territory results. The costs of the bonus have been allocated to the relevant categories of the income statement. The group's 2011 performance did not achieve the benchmarks required for bonus payment under the corporate scheme.

Detailed comments regarding professional services and research and development costs are noted above. Headline sales and marketing costs have risen to £4.2m in 2012 compared to £3.5m in 2011. As noted above, £0.1m of this increase represents higher amortization and impairment of acquired intangible assets, leaving an actual spend increase of £0.6m. Increase in staffing is responsible for a third of this increase, reflecting the recruitment of staff in both Europe and America, and the remaining two thirds from higher commission and bonus costs linked to higher sales.

Headline administration costs have risen by £0.1m. This follows a fall of £0.1m from 2010 to 2011. Underlying administration costs and resourcing have remained broadly constant, as they have since 2007. The increase last year can be attributed to a blend of factors including limited expansion in resources, higher bonus costs and an increase in legal and professional fees. This last area was partly due to the company's move to the Alternext exchange. Although administration costs will continue to be managed tightly as the group expands operational resources, we do anticipate some increase in this area in 2013 as we start to build out the group's infrastructure to handle growth.

Results

The combined effect of the revenue and cost performance discussed above has resulted in Sopheon's EBITDA (Earnings before Interest, Tax, Depreciation and Amortization) performance for 2012 rising to £1.8m, compared to £1.5m 2011.

In common with other technology businesses, the board believes EBITDA provides a useful indicator of the underlying performance of our business by removing the effect on earnings of tax, capital spend and financing. EBITDA is further defined and reconciled to profit before tax in Note 4. Our calculation of EBITDA is stated after charging (i) share-based payments of £38,000 (2011: £39,000); (ii) impairment charges of acquired intangible assets of £175,000 (2011: £66,000); and (iii) exchange losses of £36,000 (2011: gains of £55,000) but excludes depreciation and amortization charges for the year of £1.2m (2011: £1.0m) and net finance costs of £0.3m (2011: £0.4m).

Including the effect of interest, depreciation and amortization, the group reported a profit before tax for the year of £281,000 (2011: £104,000). No tax has been provided. The profit per ordinary share was 0.19p (2011: 0.07p).

Balance Sheet and Corporate

Consolidated net assets at the end of the year stood at £3.3m (2011: £3.1m). Gross cash resources at 31 December 2012 amounted to £3.9m (2011: £2.9m). Approximately £1.7m was held in US Dollars, £1.6m in Euros and £0.6m in Sterling.

Intangible assets stood at £3.5m (2011: £3.7m) at the end of the year. This includes (i) £2.8m being the net book value of capitalized research and development (2011: £2.7m) and (ii) an additional £0.7m (2011: £1.0m) being the net book value of Alignent intangible assets acquired in 2007. The carrying value of the Alignent intangibles has been impacted by both amortization and impairment charges. Further details are set forth in Note 14.

In June 2007, the group entered into a \$3.5m, 48-month mezzanine term loan with BlueCrest Capital Finance ("BlueCrest"), in connection with its acquisition of Alignent Software Inc. This term loan was repayable in equal monthly installments through to July 2011. In December 2010 the company signed an agreement with BlueCrest to refresh the mezzanine term loan back up to \$3.5m, for a new 39-month term, repayable in equal monthly installments of \$90,000 plus interest through March 2014. The loan bears interest at 13 percent per annum. No warrants were issued to BlueCrest in connection with the transaction.

In addition to the term loan, for a number of years the group has had access to a revolving line of credit with BlueCrest, secured against the trade receivables of Sopheon's North American business and with a maximum draw capacity of \$1.25m. The facility is periodically renewable and the next renewal date is 31 May 2013. As announced previously, the group has been advised that a change in ownership of BlueCrest Capital Finance may lead to uncertainty over future renewals of the facility.

To mitigate this risk, and to underpin the group's expansion strategy, in October 2009 the company issued £0.85m of convertible unsecured loan stock (the "Loan Stock") to a group of investors including key members of the board and senior management team. On 15 May 2012, the holders of the existing Loan Stock unanimously agreed to extend the maturity date of the Loan Stock by two years to 31 January 2015. This amendment was coupled with modification of the conversion price of the Loan Stock to 5p per share. On 23 August 2012, the investors subscribed for a further £1.15m of Loan Stock with the same maturity date of 31 January 2015 and conversion price of 5 pence per share. In accordance with the AIM Rules for Companies, Daniel Metzger, having consulted with the company's Nominated Adviser, finnCap Limited, acted as independent director with respect to the amendment to the terms of the Loan Stock and further subscription of Loan Stock and considered that these were fair and reasonable insofar as the company's shareholders are concerned.

Sopheon has an equity line of credit facility with GEM Global Yield Fund Limited ("GEM") was last renewed for a two-year term expiring on 23 December 2013. The facility, which has been renewed on a number of previous occasions, has been used to raise working capital once, in March 2004. This leaves approximately 90 percent of the original €10m facility available under the extended agreement. Drawings under the GEM equity line of credit are subject to conditions relating *inter alia* to trading volumes in Sopheon shares.

The principal risks and uncertainties facing the group are further described in the Directors' Report on pages 21 to 22.

MARKET AND SOLUTION OVERVIEW

How Sopheon Creates Value for Customers

Sopheon partners with customers to provide complete **Enterprise Innovation Performance** solutions including software, expertise, and best practices to achieve exceptional long-term revenue growth and profitability.

Sopheon's Accolade solution provides unique, **fully-integrated coverage for the entire innovation management and new product development lifecycle**. This enables our customers to **improve innovation and new product development performance** for sustainable, profitable revenue growth.

For the first time, businesses can access a single source of the truth across:

- Strategic Innovation Planning and Roadmapping
- Idea and Concept Development
- Process and Project Management
- Portfolio, Resource and In-Market Management

Sopheon's solutions have been implemented by over 200 customers with over 60,000 users in over 50 countries.

Research indicates that on average, **only 50 percent of new products achieve their desired business objectives**. We have helped customers implement effective innovation management processes to dramatically **increase this success rate, with some as high as 85 percent**.

A common innovation and new product development challenge companies face is coordinating resources to bring products to market. We help **improve throughput efficiency, enabling 15-30 percent more products to be brought to market for the same investment**.

Companies can **increase the value of their portfolios by 75-100 percent or more**, by connecting innovation planning to business objectives, developing better initiatives in the innovation funnel, more effectively managing processes, and optimizing portfolios with our Accolade solution.

Market Trends and Conditions

We see a confluence of several business, economic and market trends that play directly into Sopheon's market position, solutions and investments. We believe that Sopheon is uniquely positioned to leverage these trends with our proven solutions, services, expertise and best practices. This unique position and belief was recently confirmed in two separate briefings with different Gartner analysts.

The following are major trends we are seeing with our customers, in the market, and from research sources where businesses are applying innovation beyond traditional product-related initiatives:

- **Business Transformation** – Companies are exploring innovative options to transform their business models for increased competitiveness, disruptive operating models, and greater connectedness with customers, and other strategic initiatives. Sopheon provides these companies with solutions to undertake these high-risk/high-reward initiatives with structured planning, governance and performance measurement that greatly improve success probabilities.

- **Increased Operating Plan Cadence** – Most companies are realizing that the traditional annual operating plan (AOP) done in spreadsheets and presentations is not effective and does not systematically drive relevant action, results and alignment in innovation initiatives. Sopheon's solutions provide companies with the means to increase their operating plan cadence to quarterly, with integration that directly drives and connects monthly and daily operational activities with a feedback and performance loop. This condensed cadence enables the customers to operate with agility in responding to market conditions faster than the competition. Companies face increasing disruptive and unplanned events from their markets which requires an ability to quickly assess a situation, make fact-based informed decisions, and then implement appropriate actions and/or initiatives to respond in a timely or speedy manner to take advantage of market shifts. Sopheon's solutions can be deployed across the enterprise to facilitate agility and manage the action plans for optimal results.

- **Increased Rate of Services Innovation** – Companies are increasingly turning their attention to services innovation for competitive differentiation, product augmentation, additional revenue opportunities and increasing profits. Sopheon's solutions are designed from the ground up for flexibility to equally support product and/or service innovation.

- **Enterprise Innovation** – Customers, prospective buyers and industry analysts see the 'top-down' approach across the enterprise for driving innovation and managing portfolios that Sopheon has promoted for several years, as a key solution requirement to support and connect strategies and initiatives through and across the enterprise. This means that a CEO-level objective can be driven, propagated, managed and tracked through all areas and levels of the enterprise by Sopheon's solutions. This trend calls for the enterprise to improve innovation process to gain productivity, efficiency and performance results. The flexibility with which Sopheon's solutions can be applied uniquely supports this enterprise process need.

"In an increasingly volatile and uncertain world, competitive advantage is proving elusive. Knowing how to manage innovation, where to focus for maximum benefit, and where to develop holistic, forward-looking insight into the complex interactions between trends as they coalesce and mature are essential to success."

— Gartner, 2012

Sopheon's Solutions

Sopheon made significant investments in our products that paid off in 2012 and will continue to generate increasing returns going forward. In 2011 we completed a multi-year effort to replace our core product platform with Microsoft .net technology – a modern software framework with increased design flexibility and an industry standard technology platform that brought new levels of efficiency to the software development process.

In 2011 we also began the journey to transition our product development process to an Agile software development methodology, which enables consistent product delivery cycles to meet customer and market needs faster and more efficiently. Our adoption of Agile also drives greater customer interaction and feedback directly into the development process. Our objective with the Agile methodology at that time was to deliver new product releases every four months. This objective was achieved in 2012. Sopheon, like most business software vendors, used to deliver new releases every 12-18 months on a particular product. Another benefit to our clients is that our Accolade 8 platform (see next paragraph) offers the flexibility to choose the timing of applying their upgrade cadence, which involves an easier and faster upgrade and installation path.

In our 2011 Annual Report we stated "Sopheon expects to introduce three significant new product releases in 2012". We are pleased to report that we achieved our plan:

1. In April 2012 we released Accolade 8.0 – the new .net-based platform with several product enhancements including Innovation Planning, Accolade Mobile, Microsoft SharePoint® integration, and more. We also released FEI Optimizer based on Accolade Idea Lab™ as a joint solution with our partner, Kalypso for the front end of innovation, targeting consumer goods companies.
2. In July 2012 we released Accolade 8.1 with significant enhancements and additions for integrated innovation across all processes in the innovation and new product development lifecycle.
3. In December 2012 we released Accolade 8.2 with a new Accolade Portfolio Center™ that significantly expands our portfolio management, prioritization and optimization capability. The new Accolade Innovation Planner module for strategic enterprise planning and various enhancements to Stage-Gate® automation and other functionality were also included.

Feedback from customers on these 2012 releases has been very positive and while our new release cycle cadence requires customers to adjust past practices, they view this as a positive change to gain additional value from their investments in Sopheon's solutions.

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

Following is the current Accolade suite of offerings as we enter 2013:

Sopheon's Accolade solution provides integrated support for innovation planning, roadmapping, idea and concept development, process, project, portfolio, resource and in-market management.

"One of Philips central business strategies is to drive profitable growth through meaningful innovation… Accolade's new features have given us the ability to model projects in a very dynamic manner and alter them quickly in response to shifts in market opportunities and needs…. We believe that these capabilities will help shorten our Idea to Market processes."

— Paul de Wit
Director of Idea-to-Market Processes, Consumer Lifestyle Business
Philips

Growth Initiatives

We have previously stated that Sopheon's growth strategies for 2012 and beyond center on three key objectives:

1. Invest in industry-specific vertical solutions
2. Introduce new offerings to grow our existing customer base
3. Expand our direct and indirect distribution channels to grow new customer acquisition

1. Invest in industry-specific vertical solutions

Last year we realigned sales, product and marketing initiatives around target growth industries. We revised our marketing approach to be more vertical-specific, and integrated a mix of tactics including digital, web-based and social media methods as well as more traditional approaches such as conferences and direct mail. Target sectors included consumer goods, food and beverage, chemical, aerospace & defense, and high-tech. During the fourth quarter of 2012 we made significant changes and investments in our global marketing organization to develop our markets and generate demand for our solutions through multiple channels including more focus on digital marketing methods, vertical industry marketing and establishing a greater presence for Sopheon in our target markets.

With Accolade release 8.2 we can now offer buyers multiple points of entry, to start in whichever area is of immediate concern—e.g. planning, portfolio, ideation, process management—and expand the solution footprint and usage as their needs evolve and capabilities mature. Buyers have additional flexible purchase options to buy only what they need to start, and to add user licenses and functionality as the solution usage and adoption expands.

Sopheon offers customers additional purchase and deployment flexibility with software rental options and Accolade Cloud hosting services.

2. Introduce new offerings to grow our existing customer base

We continue to expand the range of our innovation solutions to enable expansion within our customers. With Accolade 8.2 we can now align our solution with the innovation maturity of our customers, supporting everything from beginner to world class innovator. Accolade is designed so that different modules and functionality can be turned on and off depending on the need of the customer. This allows Sopheon to engage in long-term relationships with our customers as we work together to improve their innovation maturity and the corresponding business performance.

An example of our advancement in this regard is our recent introduction of Accolade Innovation Planner which assists companies in creating strategic enterprise innovation plans. This is a new offering never before available to our customer base. We have also started to create 'customer only' marketing programs to inspire cross-learning among our clients. Several such marketing events are scheduled for 2013 expanding on the success of our 2012 experience.

3. Expand our direct and indirect distribution channels to grow new customer acquisition

During 2012 we hired new salespeople to expand our direct distribution channel in the United States and Europe. In addition, at the start of 2013 we expanded our position in Germany through the acquisition of our reseller partner. We also have our first sale into China through a new partner as part of our strategy to expand into Asia. Further, our expansion into Saudi Arabia has resulted in a second direct sale providing for a foundation in that part of the world for us to grow.

"Companies [are] making a conscious effort to pursue innovation. A sense that change is all around drives an orientation toward innovation in strategy and execution. This is a belief that surfaced again and again throughout the survey and interviews."

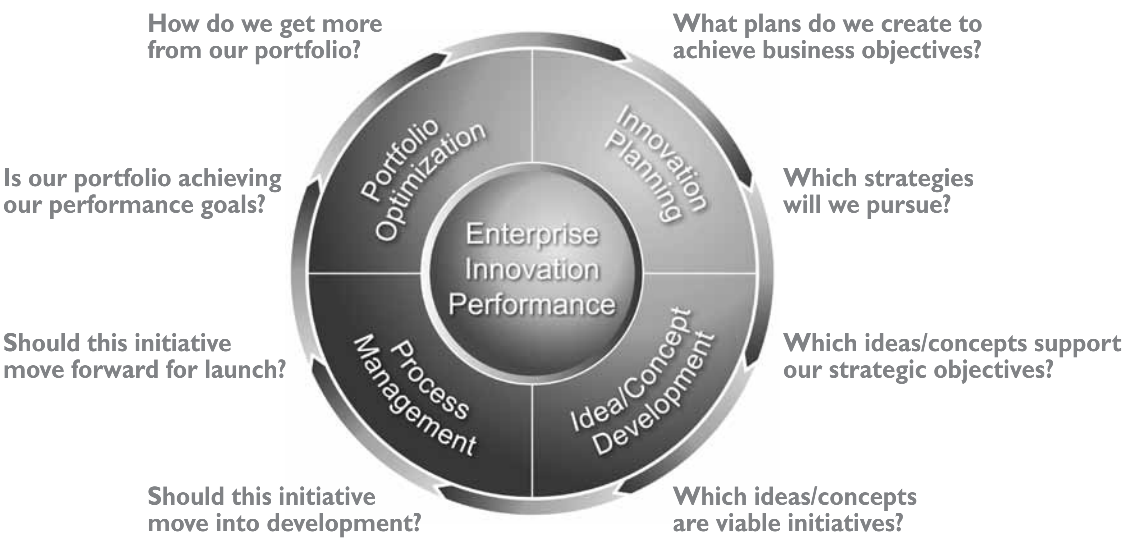
— Research from Forbes Insights and BMO Harris Bank
Harnessing Innovation to Jumpstart Growth
September 2012

Customer and Buyer Business Challenges Addressed by Sopheon Solutions

In September 2011, Sopheon commissioned a research study done by Consumer Goods Technology (CGT) magazine to determine the common challenges companies face with their innovation and new product development initiatives. The results of this research not only validated Sopheon's approach and value proposition, it has also provided insights for constructive consultative engagement with buyers during the sales process and on a continuing basis with customers. Some of the key insights from this study are:

- Only 50 percent of companies report that new product launches meet profit objectives.
- 79 percent of companies launch products too or late to market.
- Only 6 percent of companies report that there is no gap in alignment between short-term product development activities and long-term growth strategies.
- 74 percent indicated that in general their front-end innovation ideas do not support their business strategies.
- Ideas at 82 percent of companies get stuck in development to some moderate or greater degree.
- 85 percent of companies lack data regarding the feasibility and risk associated with innovation and new product development projects.
- 82 percent of companies can't tell whether their portfolio is aligned with strategic targets.
- 85 percent of companies make investment decisions based on politics rather than data.

Several important overriding themes from this study are apparent, primarily that companies lack the processes, functional integration and tools to make decisions and track meaningful performance. Sopheon's Accolade solution is designed to support integrated decision-making throughout the entire innovation and new product development lifecycle.



As illustrated above, Accolade's integrated support for the entire lifecycle enables critical decision-making at every step to help companies achieve significant innovation performance improvements across the enterprise.

"Our goal is to translate market trends and ideas from the scientific community into tangible innovations for our customers. Accolade provides us with a flexible backbone for managing our innovation projects, and it allows our senior management to have complete visibility of the projects in our innovation portfolio. Now we can prioritize our work more effectively and get our best new products to market faster."

— Manfred Hauptreif
Manager, Science Relations & Innovation Management
BASF

Services

2012 was a busy year for our services organizations. We have gone through a major transformation organizationally in preparation for the next 'step change' in operating level required to support our continued growth plans.

Client Services

This organization is responsible for the business alignment between the Accolade solution and our customer needs. They deliver and configure the software, and provide rollout and training services for successful customer usage and adoption of the solutions.

We have transitioned from a regionally-based organization providing support around the world to a single global service delivery organization. Most of our customers operate globally and expect Sopheon to match their operating models. We now have a single global leader of our Customer Services organization supported by a number of global operating teams. These operating teams are customer-facing in their activities, relationships and service delivery. We have invested in the required infrastructure support to speed up the knowledge transfer and develop deep domain knowledge expected by our customers. Onboarding and transfer mentoring/training programs are now in place to expedite this learning process.

Customer Support

This organization provides on-demand customer support under our maintenance program. Similar to our Client Services organization, Customer Support has completed its transition from a regionally-based model with multiple contacts across our support organization, to a single global organization with people located across time zones to support local customer requests. The location and service enablement is transparent to our customers no matter where they are located providing consistent, high-quality service.

With the introduction of the Accolade 8 platform, our Customer Support organization led, facilitated and managed all customer upgrades with customer and Sopheon teams. Great progress was made with this key initiative in 2012 and we expect 2013 to be another very busy year for this team.

Sopheon introduced our first Customer Training Programs in 2012 which offered ongoing live training programs held at Sopheon facilities. With our inaugural year behind us we had a number of customers participate in several sessions and our customer surveys show they have been very pleased with the program. We will take customer suggestions to expand our customer training programs further in 2013.

Partnerships

Reseller Partners

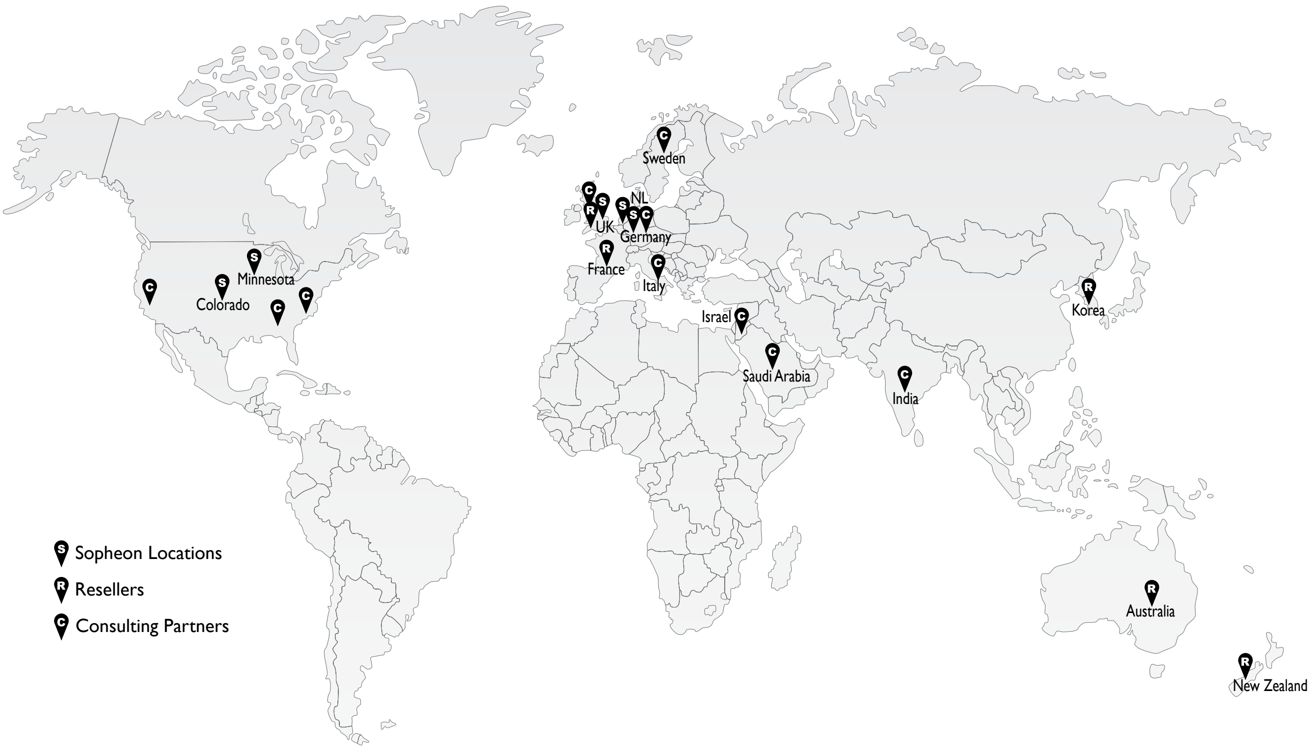
Our resellers made strategic progress in a few areas in 2012:

- New partnerships have opened the Asian market to Sopheon resulting in our first sale into China. We are now working with our partner through the deployment and training process. We expect growth to take time in this region but are excited with the foundation we are laying to grow over time.
- Our partner in Australasia continues to expand the Accolade presence with two new customers signed in 2012.
- Our UK-based roadmapping partner continues to grow their market, signing new license deals during the year and also enjoying strong attendance at their annual conference.

Consulting Partners

2012 was a year in which we focused on growing our existing relationships with a core group of consulting services organizations, including Arthur D. Little, Deloitte, Accenture, Kalypso, and Stage-Gate International. We continue to see our ecosystem grow through relationships with such partners and have seen a good level of introduction activity. Our partners have expanded their Accolade competency and have in some cases already trained their people on Accolade 8. We anticipate we will continue to outsource services work to these partners as part of our scalability and growth plans.

We are also in discussions with a small number of potential new partners with whom we have done some initial work in the market and feel there are opportunities to learn and expand from our initial experience. We expect to sign additional consulting partners in 2013.



Sopheon provides global coverage through our locations and/or certified Valued Industry Alliance partners.

INTEREST DIRECTORS AND ADVISORS

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 LLP 55 Baker Street London W1U 7EU	
Principal Bankers and Financiers	Silicon Valley Bank 3003 Tasman Drive Santa Clara, CA 95054 United States	Lloyds TSB Bank plc. 77 High Street Southend-on-Sea Essex SS1 1HT
	BlueCrest Capital Finance, LLC 225 West Washington, Suite 200 Chicago, IL 60606 United States	
Solicitors and Attorneys	Squire Sanders 7 Devonshire Square Cutlers Gardens London EC2M 4YH	Briggs and Morgan 2200 IDS Center, 80 South Eighth Street Minneapolis, MN 55402 United States
	Loyens & Loeff Fred Roeskestraat 100 1076 ED Amsterdam The Netherlands	
AIM Nominated Adviser and Broker	finnCap Limited 60 New Broad Street London EC2M 1JJ	
Euronext Paying Agent	Kempen & Co. Beethovenstraat 300 1077 WZ Amsterdam The Netherlands	
Registrars	Capita Registrars Northern House Woodsome Park Fenay Bridge Huddersfield HD8 0LA	

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 all three non-executive directors and is chaired by B.P.F. Al. B.K. Mence would typically attend meetings of the committee as a guest by invitation. 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. During 2012, the board granted a 3 percent pay increase to executive directors as of 1 March 2012. This was consistent with the pay increase granted to the majority of the group's employees. From time to time, the remuneration committee may take advice from appropriate remuneration consultants or to consult benchmarking data.

Contracts

The service contract between the company and Mr. Michuda is terminable on up to three months' notice, with an additional twelve months' salary in lieu of notice due by the company in the event of termination without cause. Service contracts between the company and the other executive directors are terminable on six to nine 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. Mr. Mence's remuneration is largely fee-based and therefore subject to fluctuations from period to period. Mr. Michuda's remuneration is payable in US Dollars, the average exchange rate for which changes year on year. Benefits primarily comprise healthcare insurance and similar expenses. Details of directors' interests in shares and options are set out in the Directors' Report.

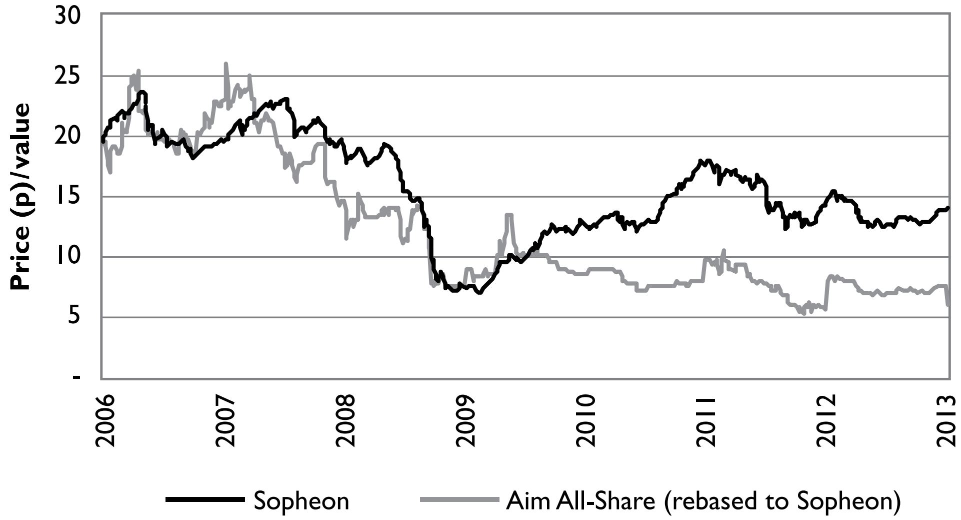
	Pay and Fees 2012 £	*Bonus 2012 £*	*Benefits 2012 £*	*Total 2012 £*	*Total 2011 £*
Executive Directors					
B.K. Mence	132,787	31,500	5,278	169,565	141,816
A.L. Michuda	162,690	40,672	6,040	209,402	164,007
A. Karimjee	110,879	20,676	2,287	133,842	110,150
Non-executive Directors					
S.A. Silcock	20,000	-	-	20,000	18,000
B.P.F. Al	20,000	-	-	20,000	18,000
D. Metzger	20,000	-	-	20,000	18,000
	466,356	92,848	13,605	572,809	469,973

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 2011 and 2012 these objectives were set with regard to EBITDA performance. For 2012, these objectives were set such that incentive started to accrue from EBITDA of £1,600,000, after providing for the costs of the bonus itself. These measures were applied to all members of the executive board and management committee of the group, as well as the majority of the group's employees.

In addition to the amounts disclosed above, pension contributions are made to individual directors' personal pension schemes. During 2012 contributions of £4,875, £2,245 and £4,800 (2011: £4,875, £3,201 and £4,800) were paid respectively to the pension schemes of B.K. Mence, A.L. Michuda and A. Karimjee.

Performance Graph

The following graph shows the company's share price performance on AIM since January 2006, compared with the performance of the FTSE AIM All Share index, which has been selected for this comparison as it is a broad-based index which the directors believe most closely reflects the performance of companies with similar characteristics as the company's.



Directors' 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*		*8% Convertible Loan Stock*	
At 31 December	2012	2011	2012	2011	2012	2011
B.K. Mence	484,500	462,500	14,430,535	14,430,535	£640,000	£200,000
A.L. Michuda	3,997,594	3,942,932	155,188	155,188	£45,000	£20,000
A. Karimjee	1,150,000	1,137,500	87,667	87,667	£27,000	£12,000
S.A. Silcock	-	-	950,000	950,000	£200,000	£100,000
S.A. Silcock*	-	-	76,639	76,639	-	-
B.P.F. Al	25,000	-	650,000	650,000	£60,000	£40,000
D. Metzger	-	-	100,000	100,000	-	-

Of the 14,430,535 ordinary shares mentioned above B.K. Mence beneficially owns and is the registered holder of 10,129,715 ordinary shares. A further 2,300,820 ordinary shares are held by Inkberrow Limited, a company in which B.K. Mence is the majority shareholder and in which S.A. Silcock is a minority shareholder. In addition B.K. Mence is, or his wife or children are, potential beneficiaries under trusts holding an aggregate of 2,000,000 ordinary shares.

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 2011*	*Granted During Year*	*Expired During Year*	*At 31 December 2012*
B.K. Mence (1)	30 April 2002	14.75p	100,000	-	(100,000)	-
B.K. Mence (4)	15 April 2005	25.25p	62,500	-	-	62,500
B.K. Mence (6)	3 May 2006	22p	100,000	-	-	100,000
B.K. Mence (8)	29 June 2007	19p	100,000	-	-	100,000
B.K. Mence (8)	1 April 2008	13.25p	100,000	-	-	100,000
B.K. Mence (9)	29 September 2012	5.25p	-	122,500	-	122,500
A.L. Michuda (2)	30 April 2002	14.75p	487,932	-	(487,932)	-
A.L. Michuda (2)(3)	5 November 2003	16.25p	2,225,000	-	(2,225,000)	-
A.L. Michuda (4)	15 April 2005	25.25p	150,000	-	-	150,000
A.L. Michuda (6)	3 May 2006	22p	100,000	-	-	100,000
A.L. Michuda (7)	29 June 2007	19p	250,000	-	-	250,000
A.L. Michuda (4)(8)	1 April 2008	13.25p	250,000	-	-	250,000
A.L. Michuda (4)	27 June 2008	14p	230,000	-	-	230,000
A.L. Michuda (4)	27 August 2010	7.5p	250,000	-	-	250,000
A.L. Michuda (9)	29 September 2012	5.25p	-	2,767,594	-	2,767,594
A. Karimjee (1)	30 April 2002	14.75p	150,000	-	(150,000)	-
A. Karimjee (3)(5)	5 November 2003	16.25p	300,000	-	(300,000)	-
A. Karimjee (4)	15 April 2005	25.25p	62,500	-	-	62,500
A. Karimjee (6)	3 May 2006	22p	100,000	-	-	100,000
A. Karimjee 7)	29 June 2007	19p	100,000	-	-	100,000
A. Karimjee (4)(8)	1 April 2008	13.25p	175,000	-	-	175,000
A. Karimjee (4)	27 June 2008	14p	100,000	-	-	100,000
A. Karimjee (4)	27 August 2010	7.5p	150,000	-	-	150,000
A. Karimjee (9)	29 September 2012	5.25p	-	462,500	-	462,500

None of the directors exercised any share options during the year.
(1) Exercisable between the third and tenth anniversary of the date of grant.
(2) 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.
(3) Vesting of a proportion of these options was subject to performance conditions relating to the achievement of positive EBITDA in two successive quarters. The conditions were met. These options, which were due to expire in 2013, were cancelled on 30 September 2012.
(4) 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.
(5) 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.
(6) 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.
(7) Vesting of one half of these options was subject to performance conditions based on the achievement of certain financial objectives in 2007. The conditions were met.
(8) Vesting of one half of these options was subject to performance conditions based on the achievement of certain financial objectives in 2008. The conditions were met.
(9) These options are replacement options for options which expired in 2011 and 2012 and options due to expire in 2013 which were cancelled during 2012. They vest evenly over the three year period following grant.

The mid-market price of Sopheon ordinary shares at 31 December 2012 was 7.21p. During the financial year the mid-market price of Sopheon ordinary shares ranged from 5.5p to 8.45p.

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

Approved by the board on 20 March 2013 and signed on its behalf by:
A. Karimjee
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 xx and the subsequent Financial and Operating 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 6. The group's result for the year ended 31 December 2012 is a profit after tax of £281,000 (2011: profit after tax of £104,000). The directors do not intend to declare a dividend.

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 Alternext the company is not subject to the requirements of the UK Corporate Governance Code or the Netherlands Tabaksblat Committee. The board currently comprises three executive directors and three independent non-executive directors. Their biographies appear at the back of this annual report, and demonstrate a range of experience and caliber to bring the right level of independent judgment 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 satisfied that the scale of the group's activities do not warrant the establishment of an internal audit function. 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. During 2012, all directors attended all meetings either in person or by conference call. 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 18.

Principal Risk Areas

As with any business at its stage of development, Sopheon faces a number of risks and uncertainties. The board monitors 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. This risk has become particularly relevant in view of the economic turmoil that has affected the global economy. Sopheon continues to monitor market needs carefully, and has formalized processes for soliciting input to product strategy from analysts and customers.

Sopheon's prospects of achieving sustained 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 but also due to the fact that the timing and size of individual sales can have a substantial impact on performance in a given period. 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 alongside its investment strategy, or in the absence of such growth, its ability to secure funding through the company's facilities or other sources. Sopheon management carefully monitors short- and medium-term financing requirements and has regularly raised additional funding resources to meet requirements. 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 maximized.

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 the competition for qualified employees continues to be difficult and retaining key employees has become accordingly more challenging and expensive. As a relatively small business, Sopheon is more exposed to this risk than some of its larger competitors. Sopheon management checks staff remuneration against recognized benchmarks and other industry sources, and seeks to maintain pay at competitive levels appropriate to its business.

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. Over the years Sopheon has built up a network of both resellers and consulting partners, however this has yet to mature and the revenues delivered through these relationships remain a relatively small part of the total.

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 policies, and is not aware of any such claims at this time.

Share Option Schemes

Details of options granted are shown in Note 28 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 2012 the company had approximately 35 days' purchases outstanding (2011: 21 days).

Charitable and Political Donations

The group has made no charitable or political donations during the year.

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 LLP 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

Substantial Shareholdings

The directors are aware of the following persons who as at 20 March 2013 were interested directly or indirectly in 3 percent or more of the company's issued ordinary shares:

Name	*No. of Ordinary Shares*	*% Issued Ordinary Shares*
B.K. Mence (director)	14,430,535	9.9
Rivomore Limited	16,191,260	11.1

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

Approved by the board on 20 March 2013 and signed on its behalf by:

A. Karimjee
Director

STATEMENT OF DIRECTORS' RESPONSIBILITIES IN RESPECT OF THE FINANCIAL STATEMENTS

Company law requires the directors to prepare financial statements for each financial year. Under that law the directors have elected to prepare the group and company financial statements in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union. Under company law the directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the group and company and of the profit or loss of the group for that period. The directors are also required to prepare financial statements in accordance with the rules of the London Stock Exchange for companies trading securities on the Alternative Investment Market and the rules of the NYSE Alternext Amsterdam Stock Exchange.

In preparing these financial statements, the directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgments and accounting estimates that are reasonable and prudent;
- state whether they have been prepared in accordance with IFRSs as adopted by the European Union, subject to any material departures disclosed and explained in the financial statements; and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the company will continue in business.

The directors are responsible for keeping adequate accounting records that are sufficient to show and explain the company's transactions and disclose with reasonable accuracy at any time the financial position of the company and enable them to ensure that the financial statements comply with the requirements of the Companies Act 2006. 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.

Website Publication

The directors are responsible for ensuring the annual report is made available on a website. Annual reports are published on the company's website in accordance with legislation in the United Kingdom governing the preparation and dissemination of financial statements, which may vary from legislation in other jurisdictions. The maintenance and integrity of the company's website is the responsibility of the directors. The directors' responsibility also extends to the ongoing integrity of the annual reports contained therein.

INDEPENDENT AUDITORS' REPORT TO THE MEMBERS OF SOPHEON PLC

We have audited the financial statements of Sopheon plc for the year ended 31 December 2012 which comprise the consolidated income statement, the consolidated statement of comprehensive income, the consolidated and company balance sheets, the consolidated and company cash flow statements, the consolidated and company statements of changes in equity, and the related notes. The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union and, as regards the parent company financial statements, as applied in accordance with the provisions of the Companies Act 2006.

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

Respective Responsibilities of Directors and Auditors

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

Scope of the Audit of the Financial Statements

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

Opinion on Financial Statements

In our opinion:

- the financial statements give a true and fair view of the state of the group's and the parent company's affairs as at 31 December 2012 and of the group's profit for the year then ended;
- the group financial statements have been properly prepared in accordance with IFRSs as adopted by the European Union;
- the parent company financial statements have been properly prepared in accordance with IFRSs as adopted by the European Union; and
- the financial statements have been prepared in accordance with the requirements of the Companies Act 2006.

Opinion on Other Matters Prescribed by the Companies Act 2006

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

Matters on Which We are Required to Report by Exception

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

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

Julian Frost (senior statutory auditor)
For and on behalf of BDO LLP, statutory auditor
55 Baker Street
London W1U 7EU
United Kingdom

20 March 2013

BDO LLP is a limited liability partnership registered in England and Wales (with registered number OC305127).

CONSOLIDATED INCOME STATEMENT FOR THE YEAR ENDED 31 DECEMBER 2012

	Notes	2012 £'000	2011 £'000
Revenue	3	12,663	10,276
Cost of sales		(3,612)	(2,731)
Gross profit		9,051	7,545
Sales and marketing expense		(4,238)	(3,533)
Research and development expense		(2,696)	(2,173)
Administrative expense		(1,510)	(1,377)
Operating profit		607	462
Finance income	8	9	8
Finance expense	9	(335)	(366)
Profit before tax		281	104
Income tax expense	10	-	-
Profit for the year		281	104
Earnings per share			
Basic and fully diluted (pence)	12	0.19p	0.07p

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME FOR THE YEAR ENDED 31 DECEMBER 2012

	2012 £'000	2011 £'000
Profit for the year	281	104
Other comprehensive income		
Exchange differences on translation of foreign operations	(187)	(58)
Total comprehensive income for the year	94	46

CONSOLIDATED AND COMPANY BALANCE SHEETS AT 31 DECEMBER 2012

	Notes	Group 2012 £'000	Group 2011 £'000	Company 2012 £'000	Company 2011 £'000
Assets					
Non-current Assets					
Property, plant and equipment	13	197	166	-	-
Intangible assets	14	3,522	3,748	-	-
Investments in subsidiaries	15	-	-	6,119	6,119
Other receivable	16	12	12	-	-
Total non-current assets		3,731	3,926	6,119	6,119
Current Assets					
Trade and other receivables	17	3,959	3,265	-	-
Cash and cash equivalents	18	3,880	2,941	1,455	703
Total current assets		7,838	6,206	1,455	703
Total assets		11,570	10,132	7,574	6,822
Liabilities					
Current Liabilities					
Trade and other payables	19	2,386	1,467	363	301
Borrowings	20	1,136	1,448	-	-
Obligations under finance leases	21	1	2	-	-
Deferred revenue		2,662	2,470	-	-
Total current liabilities		6,185	5,387	363	301
Non-current Liabilities					
Borrowings	20	2,121	1,663	1,959	823
Total non-current liabilities		2,121	1,663	1,959	823
Total liabilities		8,306	7,050	2,322	1,124
Net assets		3,264	3,082	5,252	5,698
Equity					
Share capital	24	7,279	7,279	7,279	7,279
Capital reserves	25	55,619	55,803	55,619	55,803
Translation reserve		175	362	-	-
Retained losses		(59,809)	(60,362)	(57,646)	(57,384)
Total equity		3,264	3,082	5,252	5,698

Approved by the board and authorized for issue on 20 March 2013.

Barry K. Mence
Director

Arif Karimjee
Director

CONSOLIDATED AND COMPANY CASH FLOW STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2012

	Notes	Group 2012 £'000	Group 2011 £'000	Company 2012 £'000	Company 2011 £'000
Operating Activities					
Profit for the year		281	104	(534)	42
Adjustments for:					
Finance income		(9)	(8)	-	(1)
Finance costs		335	366	132	83
Depreciation of property, plant and equipment		98	101	-	-
Amortization and impairment of intangible assets		1,273	994	-	-
Share-based payment expense		38	39	38	39
Intra-group credits and charges		-	-	(290)	(250)
Provisions against intra-group loans		-	-	115	(270)
Operating cash flows before movements in working capital		2,016	1,596	(539)	(357)
Decrease/(increase) in receivables		(744)	855	-	(2)
Increase/(decrease) in payables		1,135	(1,123)	62	(134)
Net cash generated from/(used in) operating activities		2,407	1,328	(477)	(493)
Investing Activities					
Finance income		9	8	-	1
Purchases of property, plant and equipment		(136)	(125)	-	-
Development costs capitalized		(1,210)	(1,060)	-	-
Intra-group loans		-	-	(1,915)	(803)
Repayment of intra-group loans		-	-	2,091	1,323
Net cash from/(used in) investing activities		(1,337)	(1,177)	176	521
Financing Activities					
Issue of convertible loan stock		1,150	-	1,150	-
Repayment of borrowings		(681)	(673)	-	-
(Decrease)/increase in lines of credit		(252)	442	-	-
Interest paid		(301)	(342)	(97)	(59)
Net cash from financing activities		(84)	(573)	1,053	(59)
Net increase/(decrease) in cash and cash equivalents		986	(422)	752	(31)
Cash and cash equivalents at the beginning of the year		2,941	3,358	703	734
Effect of foreign exchange rate changes		(47)	5	-	-
Cash and cash equivalents at the end of the year	18	3,880	2,941	1,455	703

CONSOLIDATED AND COMPANY STATEMENTS OF CHANGES IN EQUITY FOR THE YEAR ENDED 31 DECEMBER 2012

Group

	Share Capital £'000	*Capital Reserves £'000*	*Translation Reserve £'000*	*Retained Losses £'000*	*Total £'000*
At 1 January 2011	7,279	73,719	420	(78,410)	3,008
Profit for the year	-	-	-	104	104
Exchange differences on translation of foreign operations	-	-	(58)	-	(58)
Total comprehensive income for the year	-	-	(58)	104	46
Recognition of share-based payments	-	39	-	-	39
Purchase of shares by Esot (Note 25)	-	(11)	-	-	(11)
Transfer of merger reserve to profit and loss reserve (see Note 25)	-	(17,944)	-	17,944	-
At 1 January 2012	7,279	55,803	362	(60,362)	3,082
Profit for the year	-	-	-	281	281
Exchange differences on translation of foreign operations	-	-	(187)	-	(187)
Total comprehensive income for the year	-	-	(187)	281	94
Recognition of share-based payments	-	38	-	-	38
Lapsing or expiry of share options	-	(272)	-	272	-
Equity element of convertible loan stock issued	-	50	-	-	50
At 31 December 2012	7,279	55,619	175	(59,801)	3,264

The translation reserve represents accumulated differences on the translation of assets and liabilities of foreign operations. Retained losses represent accumulated trading losses, including amortization and impairment charges in respect of goodwill and intangible assets arising from past acquisitions. Details and description of the capital reserves are set out in Note 25.

Company

	Share Capital £'000	*Capital Reserves £'000*	*Retained Losses £'000*	*Total £'000*
At 1 January 2011	7,279	65,954	(67,605)	5,628
Profit and total comprehensive income for the year	-	-	42	42
Recognition of share-based payments	-	39	-	39
Purchase of shares by Esot (Note 25)	-	(11)	-	(11)
Transfer of merger reserve to profit and loss reserve (see Note 25)	-	(10,179)	10,179	-
At 1 January 2012	7,279	55,803	(57,384)	5,698
Profit and total comprehensive income for the year	-	-	(534)	(534)
Recognition of share-based payments	-	38	-	38
Lapsing or expiry of share options	-	(272)	272	-
Equity element of convertible loan stock issued	-	50	-	50
At 31 December 2012	7,279	55,619	(57,646)	5,252

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 17. The principal activities of the company and its subsidiaries are described in Note 3. The financial statements have been prepared in Pounds Sterling and rounded to the nearest thousand.

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 2006 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.

A number of new standards, amendments and interpretations to existing standards have been adopted by the group, but have not been listed, since they have no material impact on the financial statements. None of the new standards, amendments and interpretations in issue but not yet effective are expected to have a material effect on the financial statements.

Going Concern

The financial statements have been prepared on a going concern basis. In reaching their assessment, the directors have considered a period extending at least 12 months from the date of approval of these financial statements. This assessment has included consideration of the forecast performance of the business for the foreseeable future, the cash and financing facilities available to the group, and the repayment terms in respect of the group's borrowings, including the potential of having to repay convertible loan stock in January 2015.

During 2012, the group achieved revenues of £12.7m and a profit before tax of £281,000. This represents an improvement compared to the previous year. The performance in 2011 was flat over 2010. Coming into 2013, the group's sales pipeline remains very active, and accordingly, the directors remain positive about the prospects for the business.

In December 2010 the group renegotiated its loan note from BlueCrest Capital Finance ("BlueCrest") for a new principal value of $3.5m, which brought in new working capital of approximately $2.7m. The principal is repayable in equal monthly installments of $90,000, plus interest, through March 2014. The group also has access to a revolving line of credit with BlueCrest which is secured against the trade receivables of Sopheon's North American business. This facility is periodically renewable, and the current term is to 31 May 2013. The facility limit is $1,250,000. At 31 December 2012, $800,000 (£495,000) was drawn against this revolving facility. In addition, during 2012 the group extended a convertible loan to key investors from £850,000 to £2,000,000. The loan is repayable or convertible by 31 January 2015.

Notwithstanding the group's stable funding and trading position, the time-to-close and the order value of individual sales continues to vary considerably. When combined with the relatively low-volume and high-value nature of the group's business, these are factors which constrain the ability to accurately predict revenue performance. In addition, to meet its strategic objectives, the group has expanded its staff levels. If sales fall short of expectations, there is a risk that the group's facilities may prove insufficient to cover both operating activities and the repayment of its debt facilities, which latter point could be due to the regular repayment of the BlueCrest term loan, the possibility of non-renewal of the BlueCrest revolving line of credit, or the possibility of having to repay in cash £2,000,000 of convertible loan stock on 31 January 2015. In such circumstances, the group would be obliged to seek additional funding.

The directors have concluded that the circumstances set forth above represent uncertainties, however they believe that taken as a whole, the factors described above 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 within the consolidated financial statements using the purchase method, as set out within IFRS 3 Business Combinations for acquisitions made on or before 1 January 2010. 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 are recognized at their fair values of the date of acquisition.

Identifiable intangible assets are capitalized at fair value as at the date of acquisition. The useful lives of these intangible assets are assessed and amortization is charged on a straight-line basis, with the expense taken to the income statement within sales and marketing expense (in respect of customer relationships) and research and development expense (in respect of IPR and technology). Intangible assets are tested for impairment when a trigger event occurs. Useful lives are also examined on an annual basis and adjustments, where applicable, are made on a prospective basis.

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. 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, provided that no significant obligations remain owing to the customer in connection with such product sale. Such significant obligations could include giving a customer a right to return the software product without any preconditions, or if the group has failed to deliver an element of the software product by the balance sheet date. 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 fixed price or milestone-based projects, 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 the income statement.

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

Interest on Borrowings

All interest on borrowings is recognized in the income statement in the period in which it is 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). 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. Exchange differences arising on the settlement of monetary items, and on the retranslation of monetary items, are included in the income statement for the period.

For the purpose of presenting consolidated financial statements, the assets and liabilities of the group's foreign operations 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 where there is no intention that these should be settled) are classified as equity and transferred to the group's translation reserve. Such translation differences are recognized in the income statement 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 utilized.

Deferred tax is calculated at tax rates that have been enacted or substantively enacted at the balance sheet date, and that are expected to apply in the period when the liability is settled or the asset realized. 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 the income statement.

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

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

Investments

Investments in subsidiaries within the company balance sheet are stated at cost less impairment. Impairment tests are undertaken whenever events or changes in circumstances indicate that their carrying amount may not be recoverable. Where the carrying value of an investment exceeds its recoverable amount, the investment is written down accordingly.

Externally Acquired Intangible Assets

Externally acquired intangible assets are initially recognized at their fair values at the date of acquisition and are subsequently amortized on a straight-line basis over their useful economic lives. The amortization expense in respect of externally acquired technology and intellectual property ("IPR") is included in research and development costs in the income statement, and the amortization expense in respect of externally acquired customer relationships is included in sales and marketing expense.

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. This has been estimated to be four years from the date of code-finalization of the applicable software release. The amortization expense in respect of internally generated intangible assets is included in research and development costs.

Development costs not satisfying the above criteria and expenditure on the research phase of internal projects are recognized in the income statement 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.

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.

Financial Instruments

1. Financial Assets

The group's financial assets fall into the category of loans and receivables. The group does not have any financial assets in the categories of fair value through profit and loss or available for sale. The group has not classified any of its financial assets as held to maturity.

Unless otherwise indicated, the carrying values of the group's financial assets are a reasonable approximation of their fair values.

Loans and Receivables

These assets are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. They arise principally through the provision of goods and services (e.g. trade receivables) but also include cash and cash equivalents and other types of contractual monetary asset. They are initially recognized at fair value plus transaction costs that are directly attributable to the acquisition or issue and subsequently carried at amortized cost using the effective interest rate method, less provision for impairment. The effect of discounting on these financial instruments is not considered material.

Impairment provisions are recognized when there is objective evidence (such as significant financial difficulties, default or significant delay in payment on the part of the counter-party) that the group will be unable to collect all the amounts due under the terms of the receivable, the amount of such provision being the difference between the net carrying amount and the present value of the future expected cash flows associated with the receivable. For trade receivables, such provisions are recorded in a separate allowance account with the loss being recognized within administrative expenses in the income statement. On confirmation that the trade receivable will not be collectable, the gross carrying value of the asset is written off against the associated provision.

2. Financial Liabilities

The group classifies its financial liabilities in the category of financial liabilities at amortized cost.

Financial liabilities measured at amortized cost include:

- Trade payables and other short-dated monetary liabilities, which are initially recognized at fair value and subsequently carried at amortized cost using the effective interest rate method.

- Bank and other borrowings (including the host debt element of the convertible loan noted above), which are initially recognized at fair value net of any transaction costs directly attributable to the acquisition of the instrument. Such interest-bearing liabilities are subsequently measured at amortized cost using the effective interest rate method, which ensures that the interest expense over the period to repayment is at a constant rate on the balance of the liability carried in the balance sheet. Interest expense in this context includes initial transaction costs and premiums payable on redemption, as well as any interest payable while the liability is outstanding.

Unless otherwise indicated, the carrying values of the group's financial liabilities measured at amortized cost represent a reasonable approximation of their fair values.

3. Convertible Loan Stock

The host debt element of convertible loan stock is treated as a financial liability measured at amortized cost as further described above. The equity component of convertible loan stock arising on issue is reclassified from debt to capital reserves.

4. Share Capital

Financial instruments issued by the group are treated as equity only to the extent that they do not meet the definition of a financial liability. The group's ordinary shares are classified as equity. For the purpose of the disclosures given in Note 23(f) the group considers its capital to comprise its ordinary share capital, share premium and other capital reserves less its accumulated retained loss.

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 behavioral considerations.

As set out in Note 24, the group has also issued warrants to certain financing institutions which are also treated as equity-settled share-based payments.

Significant Accounting Estimates and Judgments

Management is required to make judgments, 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. Estimates and judgments adopted for property plant and equipment, externally acquired intangible assets and internally generated intangible assets are dealt with in the accounting policy notes set forth above that relate to these areas. 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.

3. SEGMENTAL ANALYSIS

All of the group's revenue in respect of the years ended 31 December 2012 and 2011 is derived from the design, development and marketing of software products with associated implementation and consultancy services, as more particularly described in the Directors' Report. For management purposes, the group is organized geographically across two principal operating segments, which can be expressed geographically. The first segment is North America, and the second Europe, Middle East and Africa (EMEA). Information relating to these two segments is given below.

The information in the following table relating to external revenues includes analysis both by location of customer and by location of operations. The information relating to other items provides analysis by location of operations only. Inter-segment revenues are priced on an arm's length basis.

Year ended 31 December 2012	*North America £'000*	*EMEA £'000*	*Total £'000*
Income Statement			
External revenues – by location of operations	7,792	4,871	12,663
Operating profit before interest and tax	139	469	607
Finance income	-	9	9
Finance expense	(202)	(134)	(336)
Profit before tax	(64)	345	281
Depreciation, amortization and impairment charges	(1,191)	(5)	(1,196)
EBITDA	1,330	473	1,803
Balance Sheet			
Fixed asset additions	117	19	136
Capitalization of internally generated development costs	1,211	-	1,211
Total assets	7,665	3,799	11,464
Total liabilities	(4,804)	(3,437)	(8,241)

Year ended 31 December 2011	*North America £'000*	*EMEA £'000*	*Total £'000*
Income Statement			
External revenues – by location of operations	7,189	3,087	10,276
Operating profit before interest and tax	(139)	601	462
Finance income	-	8	8
Finance expense	(281)	(85)	(366)
Profit before tax	(420)	524	104
Depreciation, amortization and impairment charges	(1,090)	(5)	(1,095)
EBITDA	884	607	1,491
Balance Sheet			
Fixed asset additions	100	25	125
Capitalization of internally generated development costs	1,060	-	1,060
Total assets	7,701	2,431	10,132
Total liabilities	(4,924)	(2,126)	(7,050)

One customer accounted for approximately 16 percent of the group's revenues in 2012. A different customer accounted for approximately 10 percent or more of the group's sales in 2011.

External revenues in 2012 exclude inter-segmental revenues which amounted to £1,245,000 (2011: £793,000) for North America and £215,000 (2011: £192,000) for EMEA.

Revenues attributable to customers in North America in 2012 amounted to £7,084,000 (2011: £6,565,000). Revenue attributable to customers in the Rest of the World amounted to £5,579,000 (2011: £3,711,000) of which £2,920,000 (2011: £3,546,000) was attributable to customers in the EU. The segmental analysis above has been presented using information that is readily available to management.

4. EBITDA AND REVENUE VISIBILITY

EBITDA

The directors consider that EBITDA, which is defined as earnings/(loss) before interest, tax, depreciation and amortization, is an important measure, since it is widely used by the investment community. It is calculated as follows:

	2012 *£'000*	*2011* *£'000*
Profit for the year after tax	281	104
Interest payable	335	366
Interest receivable	(9)	(8)
Amortization of intangible assets	1,098	928
Depreciation of property, plant and equipment	98	101
Income tax expense	-	-
EBITDA	1,803	1,491

Revenue Visibility

Another performance indicator used by the group and referred to in narrative descriptions of the group's performance is revenue visibility. At any point in time it comprises revenue expected from (i) closed license orders, including those which are contracted but conditional on acceptance decisions scheduled later in the year; (ii) contracted services business delivered or expected to be delivered in the year; and (iii) recurring maintenance, hosting and rental streams. The visibility calculation does not include revenues from new sales opportunities expected to close during the remainder of the year.

5. PROFIT FOR THE YEAR

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

	2012 *£'000*	*2011* *£'000*
Continuing Operations		
Net foreign exchange (gains)	36	(55)
Research and development costs (excluding amortization)	1,698	1,363
Amortization of intangible assets	1,098	928
Impairment of intangible assets	175	66
Depreciation of property, plant and equipment	98	101
Operating lease rentals – land and buildings	319	328
Operating lease rentals – other	74	80

Net foreign exchange losses or gains arise on the translation of certain cash and trade balances held in Euros and US Dollars and are accordingly included in administration expense.

6. AUDITORS' REMUNERATION

During the year the group obtained the following services from its auditors and associated firms. Fees for the audit of subsidiaries pursuant to legislation are not segregated from those for the group and are included in the amounts disclosed.

	2012 *£'000*	*2011* *£'000*
Audit of the financial statements of the group	50	50
Review of interim financial information	10	10
Audit of US pension plan	5	5
Tax services	24	35

7. STAFF COSTS

	2012	*2011*
	£'000	*£'000*
Wages and salaries	6,784	5,662
Social security costs	539	453
Pension contributions	134	123
Employee benefits expense	439	509
	7,896	6,747

Included within the above are staff costs capitalized as development expenditure amounting to £1,210,000 (2011: £1,060,000). Included within wages and salaries are bonus and sales commission costs amounting to £833,000 (2011: £311,000).

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

	2012	*2011*
	Number	*Number*
Development and operations	70	61
Sales and management	32	31
	102	92

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

The remuneration of all directors was as follows:

	2012	*2011*
	£'000	*£'000*
Fees and emoluments	573	470
Pension contributions	12	13
	585	483

No director exercised share options during the year (2011: None). Pension contributions are to personal defined contribution schemes and have been made for three directors (2011: three) who served during the year.

Full details of directors' remuneration are disclosed in the Report on Directors' Remuneration on page 18.

8. FINANCE INCOME

	2012	*2011*
	£'000	*£'000*
Income on financial assets measured at amortized cost		
Interest income on bank deposits	9	8

9. FINANCE EXPENSE

	2012	*2011*
	£'000	*£'000*
Interest expense on financial liabilities measured at amortized cost		
Interest on borrowings	(335)	(366)

10. INCOME TAX EXPENSE

	2012 £'000	2011 £'000
Income tax expense for the year – current tax	-	-

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

	2012 £'000	2011 £'000
Profit before tax	281	104
Tax (charge) at the UK corporation tax rate of 24.5% (2011: 26.5%)	(69)	(28)
Adjustment for differing rates of corporate taxation in overseas jurisdictions	(12)	(22)
Tax effect of expenses that are not deductible in determining taxable losses	(99)	(98)
Temporary differences arising from the capitalization and amortization of internally generated development costs	52	79
Utilization of prior year losses	128	69
Income tax expense for the year	-	-

There is no tax arising on other comprehensive income.

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:

	2012 £'000	2011 £'000
Shortfall of tax depreciation compared to book depreciation	165	165
Effect of timing differences arising from capitalization of internally generated development costs	(994)	(1,100)
Unrelieved trading losses	13,448	14,457
Unrecognized deferred tax asset	12,619	13,522

At 31 December 2012, tax losses estimated at £44m were available to carry forward by the Sopheon group, arising from historic losses incurred. These losses represent a potential deferred tax asset of £13.4m, based on the tax rates currently applicable in the relevant tax jurisdictions.

Of these tax losses, an aggregate amount of £8.5m (representing £3.0m of the potential deferred tax asset) represents pre-acquisition tax losses of Sopheon Corporation (Minnesota) and Alignent Software, Inc. The future utilization of these losses may be restricted under Section 382 of the US Internal Revenue Code, whereby the ability to utilize 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 2012 was £534,000 (2011: profit of £42,000). Advantage has been taken of Section 408 of the Companies Act 2006 not to present an income statement for the parent company.

12. EARNINGS PER SHARE

	2012 *£'000*	*2011* *£'000*
Profit after tax	281	104
	'000s	*'000s*
Weighted average number of ordinary shares for the purpose of basic earnings per share	145,579	145,579

The profit attributable to ordinary shareholders and the weighted average number of ordinary shares for the purpose of calculating the diluted earnings per ordinary share are the same as those used for calculating the basic earnings per ordinary share in both 2012 and 2011. This is (i) because the exercise of conversion rights attaching to the convertible loan stock (details of which are set out in Note 20), would have the effect in each year of increasing earnings per ordinary share (by virtue of the saving of loan stock interest, which would otherwise be payable, and of interest receivable on subscription proceeds), and are therefore not dilutive; and (ii) because the warrants to subscribe for 502,790 ordinary shares and the 12,739,930 share options to subscribe for ordinary shares (details of which are set out in Notes 24 and 28), either have a strike price above the average market price for the year, or have an immaterial impact.

13. PROPERTY, PLANT AND EQUIPMENT

Group	*Computer Equipment £'000*	*Furniture & Fittings £'000*	*Total £'000*
Cost			
At 1 January 2011	2,260	434	2,694
Additions	97	28	125
Exchange differences	10	3	13
Amounts written off	(1,559)	(279)	(1,838)
At 1 January 2012	808	186	994
Additions	127	9	136
Exchange differences	(35)	(8)	(43)
At 31 December 2012	900	187	1,087
Accumulated Depreciation			
At 1 January 2011	2,129	424	2,553
Depreciation charge for the year	95	6	101
Exchange differences	9	3	12
Amounts written off	(1,559)	(279)	(1,838)
At 1 January 2012	674	154	828
Depreciation charge for the year	91	7	98
Exchange differences	(29)	(7)	(36)
At 31 December 2012	736	154	890
Carrying Amount			
At 31 December 2012	164	33	197
At 31 December 2011	134	32	166

The net carrying amount of property, plant and equipment includes £1,000 (2011: £2,000) in respect of assets held under finance leases.

Company
The company has no property, plant and equipment.

14. INTANGIBLE ASSETS

	Development Costs (Internally Generated) £'000	Technology and IPR £'000	Customer Relationships £'000	Goodwill £'000	Total £'000
Cost					
At 1 January 2011	6,307	891	1,670	627	9,495
Additions (internally generated)	1,060	-	-	-	1,060
Exchange differences	121	11	21	8	161
At 1 January 2012	7,488	902	1,691	635	10,716
Additions (internally generated)	1,210	-	-	-	1,210
Exchange differences	(348)	(40)	(74)	(27)	(489)
At 31 December 2012	8,350	862	1,617	608	11,437
Amortization					
At 1 January 2011	3,894	575	652	-	5,121
Charge for the year	764	46	118	-	928
Exchange differences	78	10	13	-	101
At 1 January 2012	4,736	631	783	-	6,150
Charge for the year	998	-	100	-	1,098
Exchange differences	(224)	(28)	(35)	-	(287)
At 31 December 2012	5,510	603	848	-	6,961
At 1 January 2011	-	268	473	-	741
Impairment losses in year	-	-	66	-	66
Exchange differences	-	3	8	-	11
At 1 January 2012	-	271	547	-	818
Impairment losses in year	-	-	175	-	175
Exchange differences	-	(12)	(27)	-	(39)
At 31 December 2012	-	259	695	-	954
Carrying Amount					
At 31 December 2012	2,840	-	74	608	3,522
At 31 December 2011	2,752	-	361	635	3,748

The amortization period for the internally generated development costs relating to the group's software products is four years. The amortization periods for (a) technology & IPR and (b) customer relationships, arising from the acquisition of Alignent Software, Inc. in June 2007, are four years and eight years respectively. Goodwill is not amortized. The residual goodwill arising on the acquisition of Alignent is attributable to the enhanced market position of each of the group's operating segments, due to the completeness of the solution that Sopheon can offer the market, in addition to the ability to penetrate wholly new markets such as aerospace and defense for the overall product set. The recoverable amount of the goodwill can be underpinned on a value in use basis by the expected performance of each of the group's operating segments.

The valuation used for this purpose is based on cash-flow projections for the next two years, then extrapolated using a pre-tax discount rate of 14.6 percent and an annual growth assumption of 20 percent for four years, and thereafter for an indefinite period at a growth assumption of 3 percent. Sensitivity analysis performed on these projections demonstrates significant valuation headroom above the carrying value of goodwill even if the growth rate for the four year period is reduced to 5 percent. The annualized average growth of the business since the launch of the group's core Accolade solution is approximately 25 percent.

The initial valuation of the intangible assets acquired with Alignent relating to technology and IPR, and to customer relationships, used an income-based approach. The recurring income from certain acquired Alignent customer base has or is expected to fall, due to a mix of factors including the conversion of certain rental licenses to perpetual, changes in rental levels, and cancellations. The overall reduction exceeds the rate of attrition of such recurring income estimated in the original valuation exercise, leading to impairments in the carrying value of the acquired Alignent customer relationships of £175,000 (2011: £66,000).

All other assumptions of the original valuation have been retained in the impairment review. The valuation exercise, and the recoverable amount of the intangible assets and goodwill, are based on value in use with a pre-tax discount rate of 14.6 percent. The remaining amortization period for the acquired Alignent customer relationships is 3.5 years.

Company
The company has no intangible assets.

15. INVESTMENT IN SUBSIDIARIES

At 31 December 2011 and at 31 December 2012

	Company *£'000*
Cost	41,560
Less: Amounts provided	(35,441)
Carrying amount	6,119

Details of the company's subsidiaries at 31 December 2012 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. The common stock of Alignent Software, Inc. is held by Sopheon Corporation, Delaware, USA.

Name of Company *Place of Incorporation*	*Nature 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 and sales
Alignent Software, Inc. California, USA	Common Stock	100%	Software sales and services
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

16. OTHER RECEIVABLE

	Group		Company	
	2012 £'000	2011 £'000	2012 £'000	2011 £'000
Other receivable	12	12	-	-

The other receivable represents a deposit paid in respect of a property leased by the group.

17. TRADE AND OTHER RECEIVABLES

	Group		Company	
	2012 £'000	2011 £'000	2012 £'000	2011 £'000
Trade receivables	3,547	3,103	-	-
Other receivables	4	5	-	-
Total receivables	3,551	3,108	-	-
Prepayments	290	145	-	9
Accrued income	118	12	-	-
	3,959	3,265	-	9

Trade and other receivables are stated net of allowances totaling £24,000 (2011: £30,000) for estimated irrecoverable amounts. The directors consider that the carrying amount of trade and other receivables approximates to their fair value.

A full provision has been made against amounts totaling £40,015,000 (2011: £40,191,000) 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		Company	
	2012 £'000	2011 £'000	2012 £'000	2011 £'000
Cash at bank	3,129	1,824	1,398	133
Short-term bank deposits	751	1,117	57	570
	3,880	2,941	1,455	703

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 and bearing interest at variable rates. The carrying amount of these assets represents a reasonable approximation to their fair value.

Included in cash at bank of the group is an amount of £23,000 (2011: £23,000) held by the group's employee share ownership trust.

19. TRADE AND OTHER PAYABLES

	Group		*Company*	
	2012	*2011*	*2012*	*2011*
	£'000	*£'000*	*£'000*	*£'000*
Trade payables	717	344	29	24
Other payables	113	114	107	103
Tax and social security costs	231	221	-	-
Accruals	1,325	788	227	174
	2,386	1,467	363	301

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

The directors consider that the carrying amounts of trade and other payables represent a reasonable approximation to their fair values.

20. BORROWINGS

	Group		*Company*	
	2012	*2011*	*2012*	*2011*
	£'000	*£'000*	*£'000*	*£'000*
Current Loans and Borrowings				
Line of credit	495	776	-	-
Loan notes (current portion)	641	672	-	-
Total current loans and borrowings	1,136	1,448	-	-
Non-current Loans and Borrowings				
Loan notes	162	840	-	-
8% convertible loan stock 2015	1,959	823	1,959	823
Total non-current loans and borrowings	2,121	1,663	1,959	823
Total loans and borrowings	3,257	3,111	1,959	823

a) Line of Credit

The line of credit is denominated in US Dollars and bears interest at a variable rate currently 10.95 percent. The line of credit is a revolving facility limited to the lesser of $1,250,000 and 75 percent of the eligible trade receivables of the group's US subsidiaries, which at 31 December 2012 amounted to $3,865,000 (£2,391,000) (2011: $3,483,000 (£2,252,000)). At 31 December 2012 $800,000 (£495,000) was drawn down under the line of credit facility (2011: $1,200,000 (£776,000)).

b) Loan Notes

The loan notes are denominated in US Dollars and represent mezzanine loan finance provided by BlueCrest Capital Finance LLC ("BlueCrest"). The loan notes were issued in June 2007 for an initial principal amount of $3,500,000 repayable in equal installments over the four-year period to July 2011 bearing interest at a fixed rate of 11.03 percent.

On 8 December 2010 the group entered into a new mezzanine loan with BlueCrest, for an amount of $3,500,000, equal to the principal amount of the original loan. Part of the proceeds after expenses were applied in repayment of the remaining balance outstanding on the original mezzanine loan, with the balance to provide additional working capital of approximately $2.7m for the group. The new mezzanine loan is repayable in 39 monthly installments of $90,000, together with interest at a fixed rate of 13 percent per annum, over the period to March 2014.

The mezzanine loan and the line of credit, which is also provided by BlueCrest, are secured by a debenture and guarantee provided by Sopheon plc. The company has estimated the risk of this guarantee being called at 5 percent of the carrying value of the loan, and in its financial statements has included a provision for this amount within other payables.

The directors consider that the carrying amounts for loan notes, and the line of credit, represent a reasonable approximation of the financial instruments' fair values.

c) 8 Percent Convertible Loan Stock 2015

The convertible loan stock is denominated in Sterling and bears interest at a fixed rate of 8 percent per annum. The loan stock was issued at par in a nominal amount of £850,000 on 1 October 2009 with a maturity date of 30 September 2011. The original terms provided that the loan stock was convertible into Sopheon ordinary shares at a conversion price of 10p per share, and contained provisions for the amendment of the conversion price in the case of any subsequent equity issues by the company at a price per share lower than the conversion price.

On 8 December 2010, the holders of the loan stock unanimously agreed to extend the maturity date by a further sixteen months to 31 January 2013 and to amend the conversion price to 7.75p. At the same time, the provisions for future amendment of the conversion price were removed, and the carrying value of the equity component represented by the conversion rights attaching to the loan stock, which amounted at that date to £51,000, was reclassified from debt to equity in the financial statements. On 15 May 2012 the maturity of the loan stock was extended by a further two years to 31 January 2015 and the conversion price was amended to 5p per share (representing a premium of 0.25p over the closing mid-market price of 4.75p for Sopheon shares on 14 May 2012).

On 23 August 2012 the company made a further issue of loan stock in a nominal amount of £1,150,000 bearing the same interest rate, and with the same maturity date and conversion price, as the existing loan stock. The closing mid-market price of Sopheon shares on 22 August 2012 was 5p. Following this issue, the aggregate liability at maturity of the loan stock increased from £850,000 to £2,000,000. This transaction has resulted in an increase of £50,000 in the carrying value of the equity component represented by the conversion rights attaching to the loan stock, and this amount has been transferred from debt to equity in the financial statements. As set out below, of the total investment in further issue of £1,150,000, members of the board and management or their families subscribed for £665,000.

	Initial *£'000*	*Further* *£'000*	*Total* *£'000*
Barry Mence, Chairman	200	440	640
Stuart Silcock, Non-executive Director	100	100	200
Bernard Al, Non-executive Director	40	20	60
Andrew Michuda, Chief Executive Officer	20	25	45
Arif Karimjee, Chief Financial Officer	12	15	27
Other Members of Sopheon Management	43	65	98
External Investors	435	485	930
Total	850	1,150	2,000

Of the £485,000 of Further Loan Stock being subscribed by external investors, £440,000 was subscribed by Rivomore Limited, an existing Significant Shareholder that was also interested in £200,000 of Initial Loan Stock. Holders may convert the loan stock into Sopheon ordinary shares at any time up to the extended maturity date of 31 January 2015, and any loan stock not converted will be repaid at par on that date.

21. OBLIGATIONS UNDER FINANCE LEASES

The present value of future lease payments is analyzed as:

	Group		*Company*	
	2012 *£'000*	*2011* *£'000*	*2012* *£'000*	*2011* *£'000*
Current liabilities	1	2	-	-
Non-current liabilities	-	-	-	-
	1	2	-	-

The group leases a telephone system with a net carrying value at 31 December 2012 of £1,000 (2011: £2,000).

Future lease payments are due as follows:

At 31 December 2012	*Minimum Lease Payments £'000*	*Interest £'000*	*Present Value £'000*
Within one year	1	-	1
Due in one to five years	-	-	-
	1	-	1

At 31 December 2011	*Minimum Lease Payments £'000*	*Interest £'000*	*Present Value £'000*
Within one year	2	-	2
Due in one to five years	-	-	-
	2	-	2

22. OPERATING LEASE ARRANGEMENTS

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

	Land & Buildings 2012 £'000	*Other 2012 £'000*	*Land & Buildings 2011 £'000*	*Other 2011 £'000*
Due within one year	337	54	345	52
Due after one year and within five years	74	76	279	18
	411	130	624	70

The group leases its office accommodation in the US, UK and the Netherlands and has operating leases for office equipment and vehicles.

Company
The company has no operating leases.

23. FINANCIAL INSTRUMENTS

Categories of Financial Assets and Liabilities

The following table sets out the categories of financial instruments held by the group. All of the group's financial assets are in the category of loans and receivables, and all of its financial liabilities are in the category of financial liabilities measured at amortized cost.

1. Financial Assets

	Notes	Group 2012 £'000	Group 2011 £'000	Company 2012 £'000	Company 2011 £'000
Current Financial Assets					
Trade receivables	17	3,547	3,103	-	-
Other receivables	17	4	5	-	-
Accrued income	17	118	12	-	-
Cash and cash equivalents	18	3,880	2,941	1,455	703
		7,549	6,061	1,455	703
Non-current Financial Assets					
Other receivable	16	12	12	-	-

The group does not have any financial assets in any other categories.

2. Financial Liabilities

	Notes	Group 2012 £'000	Group 2011 £'000	Company 2012 £'000	Company 2011 £'000
Current Financial Liabilities					
Trade payables	19	717	344	29	24
Other payables	19	113	114	107	103
Accruals	19	1,325	788	227	174
Loans and borrowings	20	1,136	1,448	-	-
Obligations under finance lease	21	1	2	-	-
		3,292	2,696	363	301
Non-current Financial Liabilities					
Loans and borrowings	20	162	840	-	-
8% convertible loan stock 2015	20	2,000	823	2,000	823
		2,162	1,663	2,000	823
		5,454	4,359	2,363	1,124

The amounts shown in respect of the 8% convertible loan stock 2015 represent the nominal value of the instrument. As set out in Note 20 the carrying value of the instrument at the balance sheet date reflects a deduction for the reclassification of the fair value of conversion rights into equity.

Financial Instrument Risk Exposure and Management

The group is exposed to risks that arise from its use of financial instruments. This note describes the group's objectives, policies and processes for managing those risks and the methods used to measure them.

There have been no changes in the group's exposure to financial instrument risks, its objectives, policies and processes for managing those risks or the methods used to measure them from previous periods, unless otherwise disclosed in this note.

Principal Financial Instruments

The principal financial instruments used by the group, from which financial instrument risk arises, are as follows:

- Trade and other receivables
- Cash and cash equivalents
- Trade and other payables
- Loan notes
- Bank line of credit
- Convertible loan stock

General Objectives, Policies and Processes

The board has overall responsibility for the determination of the group's risk management objectives and policies and, whilst retaining ultimate responsibility for them, it has delegated the authority for designing and operating processes that ensure the effective implementation of the objectives and policies to the group's finance function. The board receives quarterly reports from the group finance director through which it reviews the effectiveness of the processes put in place and the appropriateness of the objectives and policies it sets. The group's risk management procedures are also reviewed periodically by the audit committee.

The overall objective of the board is to set policies that seek to reduce risk as far as possible without unduly affecting the group's competitiveness and flexibility. Further details regarding these policies are set out below:

a) Credit Risk

Credit risk arises principally from the group's trade receivables, other receivables and accrued income. It is the risk that the counterparty fails to discharge its obligations in respect of the instrument.

The group's software is principally marketed at major international corporations of good credit standing, and the group's historical bad debt experience is very low. Due to the potentially large size of certain individual sales, in a particular year one customer can account for a substantial proportion of revenues recorded. However, such concentrations rarely persist for multiple years and therefore the directors do not believe that the group is systematically exposed to credit risk concentration in respect of particular customers. In 2012, the largest single customer accounted for 16 percent of group revenues (2011:10 percent).

Credit risk also arises from cash and cash equivalents and deposits with banks and financial institutions. At the year end the group was holding a proportion of its deposits and bank balances with each of Lloyds Banking Group plc, Royal Bank of Scotland plc, and Silicon Valley Bank.

The group does not enter into derivatives to manage credit risk.

The group's customers are major international corporations of high credit standing and therefore the group does not typically obtain credit ratings for individual customers. Nevertheless, current economic conditions have resulted in such major corporations slowing down payments and this is reflected in the ageing profile of the group's receivables. However, impairment of trade receivables is very rare, and in the three years ending 31 December 2012 provisions or write offs against customer receivables amounted in total to less than 0.5 percent of revenues. Such impairments do not arise from credit defaults, but principally from disagreements with a very small number of former customers over their responsibility for renewal fees for maintenance or hosting contracts. Sopheon's policy is to pursue collection of such fees but to make provision against the applicable receivable if collection is uncertain.

The following is an analysis of the group's trade receivables identifying the totals of trade receivables which are current and those which are past due but not impaired:

	Total £'000	Current £'000	Past Due +30 Days £'000	Past Due +60 Days £'000
At 31 December 2012	3,547	2,843	382	322
At 31 December 2011	3,103	2,726	167	210

The following is an analysis of the group's provisions against trade receivables, analyzed between the geographical segments in which the group's operations are located:

	2012			2011		
	£'000 Gross Value	£'000 Provision	£'000 Carrying Value	£'000 Gross Value	£'000 Provision	£'000 Carrying Value
Trade receivables						
North America	2,391	-	2,391	2,282	30	2,252
United Kingdom	264	24	240	463	-	463
Rest of Europe	916	-	916	388	-	388
	3,571	24	3,547	3,133	30	3,103

The group records impairment losses on its trade receivables separately from the gross amounts receivable. The movements on this allowance during the year are summarized below:

	2012 £'000	2011 £'000
Opening balance	30	28
Utilization of provisions	(30)	(28)
New provisions	24	30
Closing balance	24	30

The main factors used in assessing the impairment of the group's trade receivables are the age of the balances and the circumstances of the individual customer.

The company provides in full for amounts due from subsidiaries. The company is exposed to credit risk in respect of its cash and cash equivalents, which are held in the form of current account and money market balances with leading UK, US and European banking institutions.

b) Liquidity Risk

Liquidity risk arises from the group's management of working capital, and more particularly its ability to reach a point where its trading is cash generative, together with the finance charges and principal repayments on its debt instruments. It is the risk that the group will encounter difficulties in meeting its financial obligations as they fall due.

The group's policy is to maintain significant cash balances, short-term bank deposits and facilities with a view to having sufficient cash to meet its liabilities when they become due. The board annually approves budgets including cash flow projections for each of the operating companies within the group and receives regular information as to cash balances held and progress against budget. Attention is particularly drawn to the detailed discussion of the factors which enable the group to continue as a going concern for the foreseeable future in the section headed "Going Concern" in Note 2 to the financial statements.

The following table sets out an analysis of the contractual maturity of the group's and the company's financial liabilities that must be settled gross, based on exchange rates prevailing at the relevant balance sheet date.

Group

At 31 December 2012	*On Demand or Within Six Months £'000*	*Within One Year £'000*	*Within Two Years £'000*	*Within Five Years £'000*	*Total £'000*
Trade and other payables	2,386	-	-		2,386
Line of credit	495	-	-	-	495
Loan notes	333	333	166	-	832
Future interest – loan notes	45	23	4	-	72
Convertible loan stock	-	-	-	2,000	2,000
Future interest – convertible loan stock	80	80	160	14	334
Finance lease	1	-	-	-	1
Total financial liabilities	3,340	436	330	2,014	6,120

At 31 December 2011	*On Demand or Within Six Months £'000*	*Within One Year £'000*	*Within Two Years £'000*	*Within Five Years £'000*	*Total £'000*
Trade and other payables	1,444	-	-	23	1,467
Line of credit	776	-	-	-	776
Loan notes	336	336	672	168	1,512
Future interest – loan notes	92	70	72	3	237
Convertible loan stock	-	-	850	-	850
Future interest – convertible loan stock	34	34	6	-	74
Finance lease	1	1	-	-	2
Total financial liabilities	2,683	441	1,600	194	4,918

Company

At 31 December 2012	*On Demand or Within Six Months £'000*	*Within One Year £'000*	*Within Two Years £'000*	*Within Five Years £'000*	*Total £'000*
Trade and other payables	363	-	-	-	363
Convertible loan stock	-	-	-	2,000	2,000
Future interest – convertible loan stock	80	80	160	14	334
Total financial liabilities	443	80	160	2,014	2,697

At 31 December 2011	*On Demand or Within Six Months £'000*	*Within One Year £'000*	*Within Two Years £'000*	*Within Five Years £'000*	*Total £'000*
Trade and other payables	301	-	-	-	301
Convertible loan stock	-	-	850	-	850
Future interest – convertible loan stock	34	34	6	-	74
Total financial liabilities	335	34	856	-	1,225

c) Market Risk

Market risk arises from the group's use of interest-bearing and foreign currency financial instruments. It is the risk that the future cash flows of a financial instrument will fluctuate because of changes in interest rates (interest rate risk) or foreign exchange rates (currency risk). The group does not have any financial instruments that are publicly traded securities and is not exposed to other price risk associated with changes in the market prices of such securities.

d) Interest Rate Risk

The group's fixed rate interest bearing liabilities comprise loan notes with a carrying value at 31 December 2012 of £803,000, which bear a fixed interest rate of 13 percent, and convertible loan stock with a carrying value of £2,000,000, which bears a fixed interest rate of 8 percent. These liabilities do not give rise to interest rate risk. The group also has a line of credit, on which £495,000 was outstanding at 31 December 2012, and which bears a variable interest rate based on a margin of 1.25 percent above the lender's Prime Rate. Should this rate vary by 1 percent the annualized effect would be to increase or reduce finance costs by £5,000.

The company's interest bearing liabilities consist of its convertible loan stock which bears a fixed rate of interest of 8 percent, which does not give rise to interest rate risk.

The group invests its surplus cash in bank deposits denominated in US Dollars, Euros or Sterling, which bear interest based on short-term money market rates, and in doing so exposes itself to fluctuations in money market interest rates. The group's surplus cash held in the form of bank deposits at 31 December 2012 was £737,000. During 2012 interest rates on money market deposits averaged around 0.5 percent in respect of Sterling and US Dollar deposits and 0.75 percent in respect of Euro deposits. The annualized effect of a movement of 0.5 percent in the average interest rate received on the group's bank deposits at the balance sheet date would result in an increase or decrease in the group's and the company's interest income of £4,000.

The company's interest bearing deposits at the balance sheet date amounted to £57,000. The effect of a 0.5 percent changes in the rate of interest would be immaterial

e) Currency Risk

The following is an analysis of the group's financial assets and liabilities, analyzed by the currency in which they are denominated:

At 31 December 2012	*US Dollars*	*Sterling*	*Euro*	*Total*
	£'000	*£'000*	*£'000*	*£'000*
Financial Assets				
Receivables and accrued income	2,402	356	923	3681
Cash and cash equivalents	1,640	1,638	602	3,880
Total financial assets	4,042	1,994	1,525	7,561
Financial Liabilities				
Trade and other payables	1,283	337	535	2,155
Borrowings	1,299	2,000	-	3,299
Total financial liabilities	2,582	2,337	535	5,454

At 31 December 2011	*US Dollars*	*Sterling*	*Euro*	*Total*
	£'000	*£'000*	*£'000*	*£'000*
Financial Assets				
Receivables and accrued income	2,264	473	394	3,132
Cash and cash equivalents	1,777	219	945	2,941
Total financial assets	4,041	692	1,339	6,073
Financial Liabilities				
Trade and other payables	693	237	316	1,246
Borrowings	2,290	823	-	3,113
Total financial liabilities	2,983	1,060	316	4,359

The amount shown in respect of Sterling borrowings at December 31, 2012 represents the nominal value of the instrument. As set out in Note 20 the carrying value of the instrument at the balance sheet date reflects a deduction for the reclassification of the fair value of conversion rights into equity.

The group's policy is, where possible, to allow group entities to settle liabilities denominated in the functional currency with cash generated from their own operations in that currency. The group also maintains cash and bank deposits in the currencies which are the functional currencies of its operating entities, which are the US Dollar, the Euro and Sterling.

The group is exposed to currency risk in respect of foreign currency denominated bank deposits and bank loans. Taking into account the fact that a large proportion of the group's income and expenditure arise in US Dollars and, to a lesser extent, in Euros, the group's policy is not to seek to hedge such currency risk.

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 and, whilst this would be an economic hedge of the cash-flow risk, the group does not employ hedge accounting.

The following table shows the effects, all other things being equal, of changes to exchange rates on the group's profit after tax and on the exchange differences on retranslation of the assets and liabilities of foreign operations which is recognized directly in equity. It illustrates the effects if the exchange rates for the US Dollar and the Euro had been higher or lower than those which actually applied during the year and at the year end.

	2012	*2011*	*2012*	*2011*
	Increase/ (Decrease) in Profit After Tax	*Increase/ (Decrease in Profit After Tax*	*Effect of Exchange Differences on Translation of Assets and Liabilities of Foreign Operations*	
	£'000	*£'000*	*£'000*	*£'000*
Weakening of US Dollar by 10c	167	(10)	(193)	(118)
Strengthening of US Dollar by 10c	(76)	3	214	134
Weakening of Euro by 10c	(77)	-	(5)	(57)
Strengthening of Euro by 10c	91	(26)	7	67

The company holds certain assets, mainly bank deposits, and liabilities denominated in the functional currencies of its principal operating subsidiaries, which are the US Dollar, the Euro and Sterling. The following table shows the effects, all other things being equal, of changes to exchange rates at the year end on the profit after tax of the company. It is based on the company's assets and liabilities at the relevant balance sheet date.

	2012	*2011*
	(Increase)/Decrease in Profit After Tax	
	£'000	*£'000*
Weakening of US Dollar by 10c	(18)	(19)
Strengthening of US Dollar by 10c	21	22
Weakening of Euro by 10c	(46)	(22)
Strengthening of Euro by 10c	54	25

f) Capital

The group considers its capital to comprise its share capital and share premium and other capital reserves less the accumulated retained losses. The group is not subject to any externally imposed capital requirements. In managing its capital, the group's primary objective is to support the development of the group's activities through to the point where they are cash generative on a sustained basis.

The group's capital is all equity capital and is summarized in Note 24.

24. SHARE CAPITAL

Issued and Fully Paid	*2012 Number*	*2012 £'000*	*2011 Number*	*2011 £'000*
Ordinary shares of 5p each	145,579,027	7,279	145,579,027	7,279

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

At 31 December 2012 the company had outstanding 502,790 warrants to subscribe for ordinary shares at a price of 20p per share, which were issued in June 2007 to BlueCrest Capital Finance LLC in connection with the financing of the acquisition of Alignent Software, Inc. The warrants have a 10 year life.

25. CAPITAL RESERVES

Group	*Share Premium £'000*	*Merger Reserve £'000*	*Capital Redemption Reserve £'000*	*Equity Reserve £'000*	*Total £'000*
At 1 January 2011	52,096	17,944	2,884	795	73,719
Recognition of share-based payments	-	-	-	39	39
Purchase of shares by Esot	-	-	-	(11)	(11)
Transfer of merger reserve to profit and loss reserve	-	(17,944)	-	-	(17,944)
At 1 January 2012	52,096	-	2,884	823	55,803
Recognition of share-based payments	-	-	-	38	38
Lapsing or expiry of share options	-	-	-	(272)	(272)
Equity component of convertible loan stock	-	-	-	50	50
At 31 December 2012	52,096	-	2,884	639	55,619

Company	*Share Premium £'000*	*Merger Reserve £'000*	*Capital Redemption Reserve £'000*	*Equity Reserve £'000*	*Total £'000*
At 1 January 2011	52,096	10,179	2,884	795	65,954
Recognition of share-based payments	-	-	-	39	39
Purchase of shares by Esot	-	-	-	(11)	(11)
Transfer of merger reserve to profit and loss reserve	-	(10,179)	-	-	(10,179)
At 1 January 2012	52,096	-	2,884	823	55,803
Recognition of share-based payments	-	-	-	38	38
Lapsing or expiry of share options	-	-	-	(272)	(272)
Equity component of convertible loan stock	-	-	-	50	50
At 31 December 2012	52,096	-	2,884	639	55,619

Share premium represents the premium arising on the issue of shares and its use is governed by the provisions of the Companies Act 2006.

The 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 carrying values of such investments have since been subject to impairment charges exceeding the amount of the merger reserve, and accordingly the full amount of the merger reserve has been transferred to profit and loss reserve.

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

The equity reserve comprises the deemed value of outstanding share options granted in connection with the acquisition 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, the fair value of warrants to subscribe for Sopheon shares issued to BlueCrest Capital Finance LLC, and the equity component of the group's 8 percent convertible loan stock 2015.

In addition, investment by the group's employee share ownership trust (the "Esot") in the company's shares is deducted from equity in the consolidated balance sheet as if they were treasury shares, by way of deduction from the equity reserve. At 31 December 2012, the Esot held 185,244 (2011: 185,244) ordinary shares in the company, which represents 0.1 percent (2011: 0.1 percent) of the company's ordinary share capital. The reserve of £11,000 (2011: £11,000) represents the cost of these shares held by the Esot at 31 December 2012.

The purpose of the Esot is to facilitate the company's policy of offering participation in the ownership of its shares to employees for reward and incentive purposes. At 31 December 2012 and at 31 December 2011, no shares held by the Esot were under option or had been gifted to any employees. Arrangements for the distribution of benefits to employees will be made at the Esot's discretion in such manner as the Esot considers appropriate. Administration costs of the Esot are accounted for in the profit and loss account of the company as they are incurred.

26. 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 £134,000 (2011: £123,000) represents contributions paid to such plans at rates specified in the rules of the plans.

27. 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 executive directors and members of the group's operating and executive management committees during the year was as follows:

	2012 *£'000*	*2011* *£'000*
Emoluments and benefits	1,111	1,006
Pension contributions	30	30
Share-based payments	27	24
	1,168	1,060

Subscriptions by members of the board and management to convertible loan stock are disclosed in Note 20.

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:

	2012 *£'000*	*2011* *£'000*
Net amounts repaid by subsidiaries by way of interest-free loans	176	521
Net management charges to subsidiaries	290	250

The amounts owed by subsidiary companies to the parent company at 31 December 2012 totaled £40,015,000 (2011: £40,191,000). A full provision has been made against these amounts, which are unsecured and are subordinated to the claims of all other creditors.

During 2012 and 2011 the company granted share options to employees of subsidiary companies. Details of grants of share options are disclosed in Note 28.

Other Related Party Transactions

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

28. SHARE-BASED PAYMENTS

Equity-settled Share Option Schemes

The group has a number of share option schemes for all employees. Options are exercisable 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 2012	*Weighted Average Exercise Price 2012 £*	*Number of Share Options 2011*	*Weighted Average Exercise Price 2011 £*
Outstanding at the beginning of the year	13,193,054	0.16	12,504,924	0.17
Granted during the year	5,465,598	0.05	880,000	0.09
Lapsed, expired or cancelled during the year	(6,478,972)	0.17	(191,870)	0.63
Outstanding at the end of the year	12,179,680	0.10	13,193,054	0.16
Exercisable at the end of the year	5,815,545	0.15	10,801,432	0.17

No share options were exercised during the year (2011: Nil). The options outstanding at the end of the year have a weighted average contractual life of 6.8 years (2011: 4.6 years).

During the year share options were granted on 20 April 2012, when the exercise price of options granted was 5p and the estimated fair value was 2.96p, and on 29 September 2012, when the exercise price of options granted was 5.25p and the estimated fair value was 3.11p. During 2011, share options were granted on 26 April 2011 and on 28 September 2011, on both of which dates the exercise price was 8.75p and the estimated fair value was 5.2p.

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

Date of Grant	*September 2012*	*April 2012*	*April & September 2011*
Share price at time of grant	5.25p	5p	8.75p
Exercise price	5.25p	5p	8.75p
Expected volatility	40%	40%	40%
Risk-free rate	5%	5%	5%
Expected dividend yield	Nil	Nil	Nil

The expected contractual life of the options used was either five or ten 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 and company recognized total expenses of £38,000 (2011: £39,000) relating to equity-settled share-based payments during the year.

DIRECTORS

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 a 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 Lawford & Co, chartered accountants and until 2010 a director of Lawfords Ltd. also chartered accountants. Mr. Silcock was a non-executive director of Brown & Jackson plc. for four years from June 2001 to July 2005 and currently holds a number of other directorships in the United Kingdom.

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.

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