Sopheon

# 2019 Annual Report


Enterprise Innovation Management
Portfolio Optimization
Innovation Planning
Idea/Concept Development
Process & Project Management

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# Sopheon's mission is to help our customers achieve exceptional long-term growth and profitability through sustainable innovation.

We do this by digitalizing enterprise innovation through **software, services and best practices** that help companies operate with success.

Our solutions **connect people, systems and information,** helping companies better execute on business strategy and improve the return on their investments into initiatives such as transformational change, enterprise innovation, product development, supply chain efficiencies and cost reduction.

These solutions are designed to keep strategy visible and continuously aligned with operational execution throughout the initiative life cycle, ensuring long-term market success. The transparency and insight they provide support **speed, agility and adaptability** – all critical enterprise capabilities in the digital era – and enable decision-making that drives better business outcomes.

| Strategic Innovation Planning & Roadmapping | Strategy Execution | Idea/ Concept Development | Innovation Process & Program Management | Portfolio Optimization & Resource Management |
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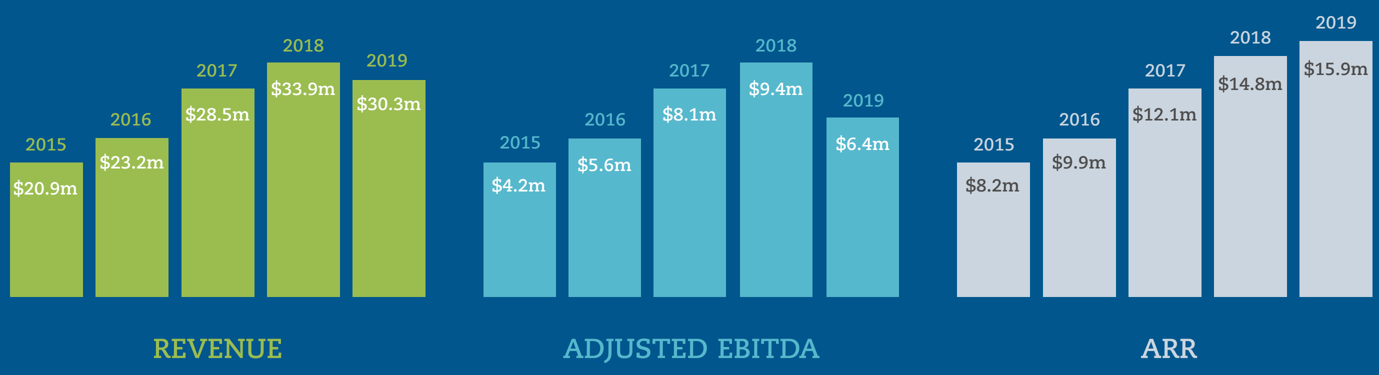
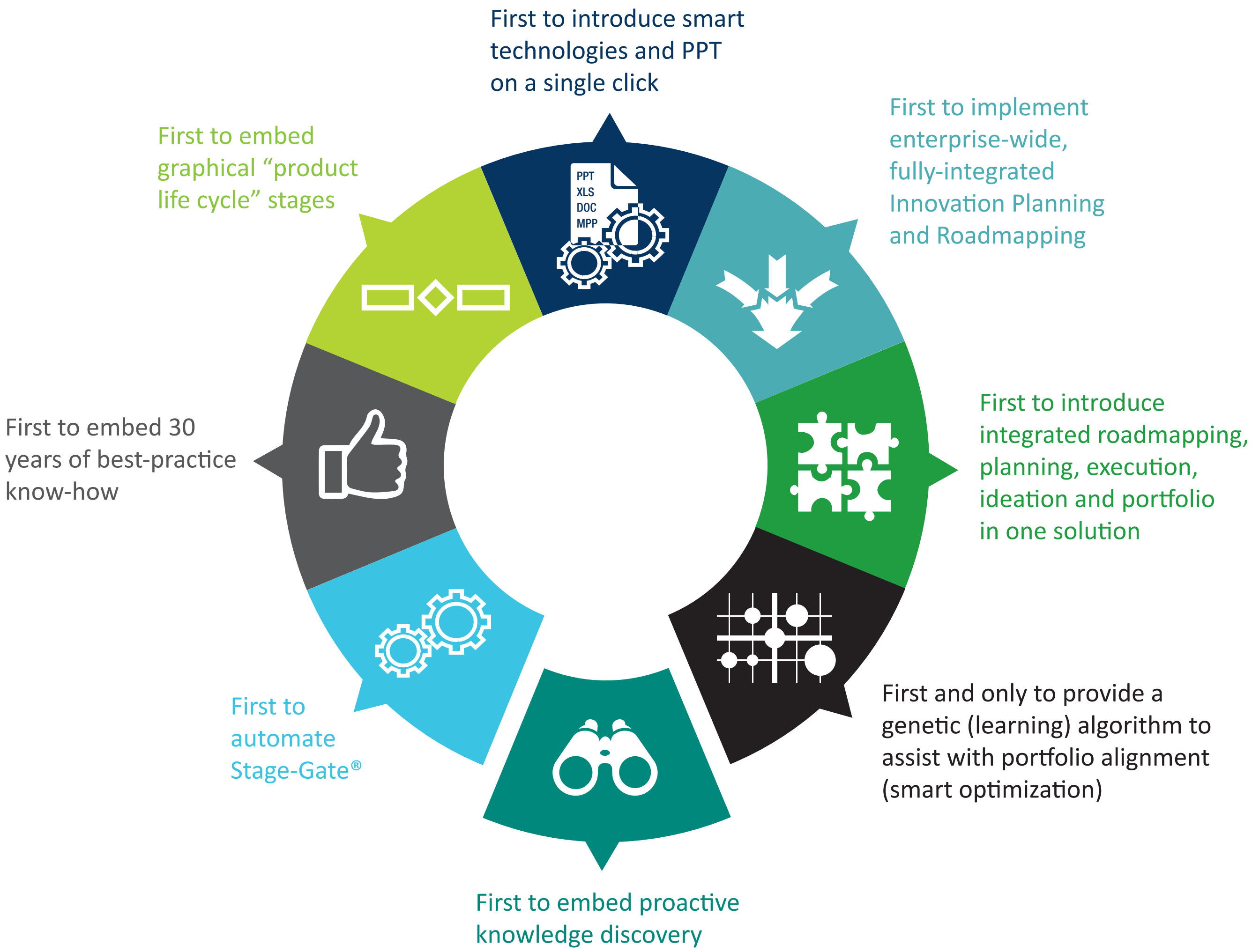



JUNIPER NETWORKS Land O'Lakes, Inc. Leprino Foods Parker PEPSICO P&G سابك sabic

# CHAIRMAN'S STATEMENT

After several years of continuous and strong financial growth, revenues paused somewhat, coming in at just over $30m. In view of this, it was good to see the inherent discipline in our business delivering another profitable and cash generative year, and our closing net asset and cash positions at historic highs. Consistent with our expectation after a slow first half momentum rebounded sharply in the final quarter, which was one of the strongest on record for deal flow.

We have previously communicated our perspective on the underlying reasons behind the pause – unexpected client personnel changes, customer scope expanding from point to enterprise solution and ramp-up time of our newer sales resources. These same circumstances, however, have also contributed to a substantially larger sales pipeline, up 50 percent year on year. On the whole deals have not gone away, but have been deferred. We saw some signs of customer hesitation due to economic factors, but we do not attribute this as a key contributor. Indeed, behind the headline financials, we signed the same number of new customers – 18 – as in the year before.

Our business strategy continued to focus on the same three themes as in the past – leveraging our tremendous roster of blue-chip customers, winning new customers through strict vertical focus and developing a distribution ecosystem. To this we have added a commitment to transition our software revenue and delivery model from one that is predominantly perpetual and on-premise to one that is primarily based on software as a service ("SaaS"). Our goals are to transition to a revenue model that drives higher recurring revenue and brings greater stability to the financial results, while also meeting a growing customer preference that has taken time to filter through to our market. We referred to this shift in our 2018 annual report, and over the course of last year transformation to a cloud business has become a key internal driver of change. We have revised our standard pricing models, service delivery models and commission plans, and a longer-term migration of the software platform is underway. Industry experience tells us that the conversion to SaaS will take a number of years. It also means that, going forward, annual recurring revenue ("ARR") will be a key performance indicator alongside annual revenue. Overall, ARR including maintenance and SaaS stood at $15.9m coming into 2020, compared to $14.8m coming into 2019. Adding closed business since year end and the consulting backlog takes overall revenue visibility[1] for 2020 to $21.2m at the time of this report, compared to $20.6m a year ago. In this regard, in future we expect to focus increasingly on ARR rather than visibility as a metric of progress.

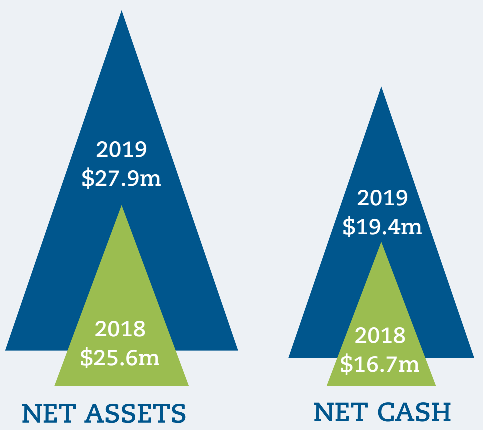
> Our goals are to transition to a revenue model that drives higher recurring revenue and brings greater stability to the financial results, while also meeting a growing customer preference that has taken time to filter through to our market...Overall, ARR including maintenance and SaaS stood at $15.9m coming into 2020.

Companies need solutions to help them deal with the new reality of constant disruption, and to manage it through digital transformation. Last year I described the broadening of our mission from one that helps R&D organizations to improve innovation, to one that helps major enterprises achieve their strategic goals through innovation. I also said that the extension of our vision had the potential to be a third major pillar of the enterprise stack, alongside ERP and CRM, and that this dramatically expands our horizons and potential. This perspective remains entirely consistent with current market realities. As detailed later, we have also taken positive steps to prepare the business to operate virtually and effectively in the new global circumstances presented by the coronavirus crisis.

Sopheon has a strong track record in a market that we believe is set to expand rapidly. Customer satisfaction is high – at the time of our Accolade 13.0 release in November 2019, over 90 percent of our customers were on a supported release of the software; and we achieved a record net promoter score in 2019 of 40, considered high for a B2B business. Broader recognition has been forthcoming from Gartner and others, and we were particularly pleased that Sopheon won the best performing company slot in the enterprise software category of Megabuyte's Quoted25 awards, announced in January 2020. Continued investment will be called for as we look to accelerate progress and solidify our leadership position. Overall, coronavirus unknowns aside, we remain confident of growing commercial traction in the coming year; our very strong balance sheet also gives us the comfort to press on. To underline this confidence, I am pleased to announce that in spite of a challenging year, we are maintaining our dividend at 3.25p per share.

Barry Mence
Executive Chairman

18 March 2020




[1] *Revenue visibility 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.*

# STRATEGY AND MARKET

In this section, our CEO Andy Michuda provides more details on Sopheon's mission, differentiation and principal growth strategies. A summary of the principal risk areas facing the business is set out in the Directors' Report. Further analysis of Sopheon's financial results during the year, including a review of the business, the financial position at the end of the year, key indicators and an overview of key corporate developments are set out in the Financial Review.

### Our Mission

Sopheon was founded with a mission to provide our customers with world-class solutions to aid them in achieving exceptional long-term growth and profitability through sustainable innovation. Our Accolade solution, comprised of software, services and best practices, is designed to keep strategy visible and continuously aligned with operational execution throughout the life cycle of initiatives. By increasing connection of people, transparency to information and surfacing actionable insights, they support speed, agility and adaptability – all critical enterprise capabilities in the digital era – and enable decision-making that drives better business outcomes.

## LEARNINGS FROM 2019

### 1 THE MARKET IS READY FOR CLOUD

The time is right for Sopheon to start making the shift towards becoming a cloud company. During the year we saw unexpectedly strong drive and desire from our customers for adopting cloud technologies and SaaS solutions. This allows us to increase our own innovation velocity and speed to market and lower the overhead cost to develop and maintain our solutions by leveraging best in class cloud technologies and capabilities. Shifting Accolade to the cloud will make ecosystem innovation a reality for our customers.

### 2 ADAPTIVENESS IS A KEY CAPABILITY

In 2018 we shared our success in Accolade's role as an enterprise platform supporting multiple needs relating to product as well as broader business model innovation.
In 2019 we continued to be pulled by clients to introduce even more flexibility and configurability into our product to allow them to meet unique business needs while easing system updates and deployments. As a result, we invested heavily in this area last year and will continue to enhance this area of the product while also simplifying the user experience of our configuration capabilities.

## 3 NEW CLIENT ACQUISITION BEST PRACTICES

In 2019 we matched the record client acquisition of the previous year by signing 18 new clients. We did, however, experience extended client buying cycles at times, in part due to the increasing range of business solutions supported by the Accolade software. A consequence of broadening the scope of the value we offer was the introduction of new business groups and buying personas into the buying decision. This resulted in additional cycles and lengthened the decision-making process. We learned from this experience to phase our selling efforts, limiting the initial sale to a single solution that addresses the client's most urgent need, and then expanding our value proposition following the initial deployment.

## 4 GLOBAL DISRUPTION DRIVERS

Last year many of our clients were disrupted by global economic factors such as trade talks and Brexit. Such unanticipated disruption requires companies to move with speed to reprioritize strategic initiatives, make changes to their supply chain or revisit their product portfolio strategy. Accolade offers visibility and speed to decisions in such times of crisis.

Clearly the world is now being hit by a new, unexpected and massive crisis with the coronavirus. At the time of writing, Sopheon has already taken prompt action to ensure the health and safety of staff, introducing an immediate work from home policy and travel restrictions supported by well-defined virtual working practices, and also to assure continuity of business operations and cloud services through our co-location and Azure based infrastructure.

## 5 INNOVATION ECOSYSTEM EXPANSION

In 2019 we expanded the geographic reach of Accolade solutions with signatures of Akdeniz Kimya in Turkey, Global Chemicals in Thailand, and Nippon Paint in Japan. All these new customers approached us as the result of recommendations within their ecosystem or relationships with industry peers. This was a satisfying expansion beyond our traditional successes from past years in Europe and North America.

*"After an in-depth evaluation of a number of software vendors, we chose the Accolade Express solution. Sopheon has the expertise and a solid number of customer references in the fast moving consumer goods (FMCG) space."*

Abrar Hasan

CEO, National Foods Limited

# GROWTH STRATEGY

Our growth strategy has not wavered, and we continue to be focused on the same four cornerstones that have delivered our recent growth:

1. **Leverage blue-chip references to extend Accolade as the digital platform of choice to digitalize corporate strategy and operational execution.** Sopheon's roster of customer names is a Who's Who of the world's leading companies. Our customers are a key voice directly into our cloud, ecosystem and product roadmap strategies. We will continue to partner closely with our clients and our client ecosystem to gain insights and learnings that drive further advancement and development in the consistently changing Enterprise Innovation Management market. We believe our Accolade platform extension strategy represents a significant growth opportunity. We continued to invest in "enterprise adaptability" last year to meet the needs of some of our forward-thinking customers. Our clients are increasingly using Accolade as the platform to enable these shifts and we believe this trend will continue. We therefore anticipate further enterprise adaptability expansion in the future.

2. **Generate faster Net New logo growth in target industries through deeper specialization and domain-specific expertise.** We will continue to focus our efforts on dominating our chosen core vertical markets of chemicals, aerospace, consumer products, food and beverage, automotive/transportation and high technology. Sopheon's long history and experience in these verticals allows us to operate as an industry connector for our clients, introducing them to one another for mutual learning and to advance their competency and success. We will continue to invest in industry-specific expertise and solutions.

3. **Multiply our growth through developing and monetizing an Accolade ecosystem of distribution partnerships – channel, strategic and geographical.** Our ecosystem has now matured to where it makes sense to invest time in the development of a network of partner relationships to expand the growth rate of the business. Last year we made progress with the signing of new clients in Turkey, Japan and Thailand, most of which was through our reseller channel. In 2020 we expect to expand our consulting partner ecosystem in both the EU and the United States.

4. **Engage in M&A only if it propels the speed and competency for Sopheon to achieve 1, 2 or 3 above.**

To these we have now added a new and fifth strategy:

5. **Transformation to a cloud business.** The benefits of moving our revenue model to one which is subscription based and of focusing our product innovation on solutions that are designed to be run in the cloud are material. This transformation will not happen overnight, yet when completed successfully will allow Sopheon to innovate more quickly, shorten the time it takes to acquire new customers, improve business predictability (through reducing license spikes and troughs, guaranteeing recurring revenue and guaranteeing paid support), further improve the scalability and performance of our software, and reduce the cost of service delivery. In addition, we will also be better meeting our customer preference for greater flexibility and alignment of their investment with consumption of the software.

> *"Given the positive reputation of Accolade among other industry leaders, as well as Sopheon's growing in-market presence here in Asia, we believe that we made a right choice in partnering with the Prodex/Sopheon team to help us bring our new product and process innovations to market more quickly and efficiently than before."*
>
> – Dr. Chaya Chandavasu,
> Senior VP of Science & Innovation, PTT Global Chemical Public Company Ltd.

# IMMEDIATE MARKET OPPORTUNITIES

## 1 TAP INTO DISRUPTION

Today's business climate is characterized by disruption. This is no ordinary business cycle, but rather one that requires a fundamental transformation by businesses of all sizes and across all industries to operate with more agility and responsiveness. Organizations that are unable to master this transition will not survive.

The key driver of this disruption and resulting "digital revolution" is the changing expectation of customers in the way they choose, buy, obtain and use products. Simply put, product innovation is at the heart of digital transformation and is, now more than ever, critical for business survival.

**Companies must create three operational competencies powered through digitalization to win in the digital age**

**Global Digitization**

**Power of the Consumer**

**01**
Annual planning must be **dynamic** and **iterative**

**02**
Strategic initiatives must be **realized** at a higher rate

**03**
Cross-functional teamwork must be **"connected"**

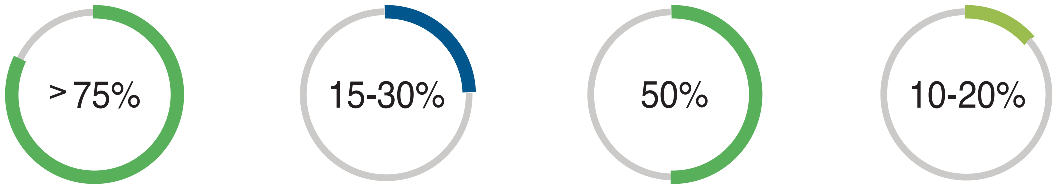
### Product Innovation

Our addressable market is defined as a subset of several distinct product markets including project and portfolio management, strategic planning and innovation management. The overall project and portfolio management market by itself is estimated at $3 billion in 2018 and grew at 14.1% over the prior year.[1]

The broad applicability of our solution is evidenced by the addition in 2019 of new customers in food and beverage, consumer goods, chemicals and industrial manufacturing industries. In addition, our vision and ability to execute is noted by leading analyst group Gartner in their 2019 Magic Quadrant for Project & Portfolio Management, 2019 Market Guide for Strategy and Innovation Roadmapping Tools, 2019 Market Guide for Innovation Management and 2019 Market Guide for Strategy Execution Management Software.

[1] *Gartner, 'Market Share: Enterprise Application Software, Worldwide, 2018'*

Sopheon customers report the following value from digitalizing their innovation processes with Accolade:




**Increase Portfolio Value by 75-100%**

**Reduce Time to Market by 15-30%**

**Increase Product/Initiative Success by up to 50%**

**Reduce Costs by 10-20%**

## Business Innovation and Digital Transformation

As a leader in product innovation solutions, Sopheon is ideally positioned to help organizations deliver the new products and associated business innovation that will achieve digital transformation and the resulting new experiences demanded by their customers.

Executing on digital transformation strategies and initiatives is becoming an imperative for these organizations. This new emerging market represents considerable addressable target market size as a subset of the overall digital transformation market, which is estimated to exceed $2 trillion by 2025.[2]

We see this as a unique opportunity for Sopheon to digitalize corporate strategic initiatives, innovation investments and portfolios in a single platform, creating a digital operating model designed to help organizations meet the challenge of digital disruption. Accolade digitalizes this emerging operating model enabling a CEO to achieve his or her strategic direction with a velocity that cannot be accomplished without the support of an enterprise innovation management platform.

In 2019, we continued to see the role of Accolade expand to support these strategic transformation initiatives spanning supply chain, digital/physical product innovation, and more. Our strengths in this area are also recognized by Gartner in their 2019 Market Guide for Strategy Execution Management Software, 2019 Market Guide for Strategy and Innovation Roadmapping Tools, and 2019 Market Guide for Technologies Supporting DTO (Digital Twin of the Organization).

## 2 INCREASE MARKET SHARE IN CORE VERTICALS

We have continued to concentrate on our core industries with the objective of growing market share where we hold preferred positions due to strong competency in our product, best-practice content and expertise of our people. I am proud to share that all but one of our new sales in 2019 came from these core verticals, proof of our team's dedication to executing on our strategy. Despite the success in this area, we have not fully captured the share of these markets and will therefore be investing efforts to do so. In parallel, we continue to test additional industries for expansion such as the automotive and transportation sectors.

Food & Beverage
Aerospace & Defense High-Tech Electronics
Chemicals Consumer Goods
Automotive Industrial Manufacturing

[2] *Research and Markets, "Digital Transformation Market to 2025"*

# WHAT MAKES SOPHEON DIFFERENT

## Our Culture

As a company and as individuals we value integrity, honesty, openness, personal excellence, continual self-improvement and mutual respect. These core values contribute to a culture that sets us apart. At a time when technology companies are experiencing unprecedented turnover, Sopheon is proud of our employee retention of almost 90 percent. The large number of employees whose tenure is 10 years or longer contributes in a unique and critical way to instilling our cultural values into the mentoring of new Sopheonites as they undergo onboarding. In a recent independent consultant study evaluating Sopheon internal processes and culture, employees shared the following:

*“It’s truly a team, you have a voice and are heard.”*

*“The work is challenging… it doesn’t get dull!”*

*“As long as your work gets done, you have autonomy and flexibility.”*

*“[Sopheon is] the most flexible and open company I’ve worked for.”*

*“We’re always upgrading [technologically] and playing with new tools.”*

*“Good people who are energetic and good to be around.”*

## Our People

### *Innovation Specialists with Deep Experience*

We have long-term partnerships with some of the most admired innovators and domain experts in the world. This has provided us the opportunity to learn, invest and continue to serve the needs of such market leaders. It is this foundational expertise that has differentiated Sopheon from others in the market.

Our clients tell us our people are caring, give them high marks for domain knowledge and commitment to their success.

- “Sopheon set itself apart with the promise of best-practice content embedded in its software to guide us in defining our new processes, and its knowledgeable and highly responsive team.” (Endress+Hauser)
- “We have found in Sopheon a professional, trustworthy and flexible partner who not only meets the regulatory requirements for hosting our sensitive project data but proved to have a deep understanding of our business needs and processes." (innoEnergy)
- “You both have been extremely engaging and proactive in improving our environment.” (Fortune 500 consumer goods firm)

## Commitment to Delivering Value

As we continue to grow our teams, we are taking measures to infuse both our culture and our domain experience into how we work. We are in the second year of introducing our Value Assurance Approach (VAA) program. As this expands, we are leveraging the client-facing aspects of the VAA to upgrade the level of prescriptive solutions we bring to our clients. The VAA structure enables us to incorporate our learned experiences into the experience of the delivery team. This creates operational efficiencies through reuse of content from one client to the next and reduces the risk of overrunning the contractual agreements that we have with our clients. At the same time, it enables us to better assure that the client can achieve value in a shorter timeframe and focus on growing their process with support from Accolade as it matures. Ultimately, this allows us to scale the delivery organization faster to support a growing client base and increase client satisfaction and client retention.

## Our Product

Sopheon's product team continues to move our offerings forward, updating legacy technology while making strategic advancements that will provide market differentiation well into the future. Our solutions are unique in their end-to-end support of the innovation lifecycle, and the configurability that enables support for such a broad range of tangential business processes and applications. We continue to maintain a regular release cadence, with three releases in 2019:

1. Accolade 12.2, released in January, introduced new levels of transparency, flexibility and governance to connect corporate strategic initiatives with operational execution. Accolade 12.2 allowed an organization to connect its strategic initiatives with operational execution activities, giving the company a single version of the truth to:

    - Increase strategy realization rates: Real-time information informs and enables faster responses and adjustments for maximizing success, addressing and mitigating problems and risks, or avoiding challenges and potential risks.
    - Improve financial and organizational performance to strategy.
    - Reduce the latency time for decision making from historical planning cycles of 12 months to three months for revised planning, and from three weeks to one day for real-time portfolio reviews.

> *"Honeywell is excited by Accolade's advances in support of enterprise adaptability, segmentation and product execution. The enhancements in Accolade 12.2 will help us navigate change more effectively as an organization and streamline our daily work on a team and personal level so we can move the business forward more quickly."*
>
> – Richard Heard,
> Director of Program Management Tools, Honeywell

2. Accolade 12.3, released in June, enabled local flexibility to react quickly to markets, eased risk management, and freed up teams for high-value contributions. Accolade 12.3 allowed for more localized flexibility without compromise to corporate governance.

    New automation for known patterns of activity and deliverable dependencies reduced administrative burden and stress for users who are no longer required to create or monitor these critical relationships manually.

> *"We are very pleased with Accolade 12.3 advances in user friendliness that will save our users time in their work, while providing management of the information they need for better decision making."*
>
> – Tristen Branson,
> Product Innovation Manager, Australian Paper

3. Accolade 13.0, released in December, balanced standardization and flexibility to enable acceleration of digital transformation and product innovation, allowed teams to complete their work productively and collaboratively in the same system of record thereby improving strategic alignment and transparency, and increased the speed of decision making to enable the realization of strategic goals. This release enabled faster strategic pivots by providing our customers a competitive advantage that allows them the speed and adaptability to reorganize masses of corporate business data very quickly—within hours instead of weeks or months, and the flexibility that solves the age-old conflict between enforcing corporate governance while enabling business agility with managed independence at the "local" level.

> *"Solvay has used Accolade for close to a decade. Today we are also users of the Google platform and the Google Sheets, Docs and Slides. Sopheon's new Chrome Extension and the G Suite Add-Ons make it very easy for us to continue using both platforms seamlessly together. It couldn't be easier – deliverable templates open in G Suite and we can save these back to Accolade directly with one click. The combination of Accolade 13.0 and Google is a great productivity solution for Solvay."*
>
> – Pieter Ceelen,
> Senior Program Manager, Solvay Business Services

## Our Clients

Sopheon is extremely proud of the quality of our blue-chip customer base. Legendary brands to join the Sopheon fold in 2019 include Rolls Royce, Nouryon, GOJO and Nippon Paint among others. These market leaders provide a strong revenue stream from ongoing maintenance renewals, plus the nature of the relationship offers potential for expanding our user base and application of our software into new areas of their business. Sopheon's solutions have been implemented by over 250 customers with over 60,000 users in over 50 countries. Our client base of global innovation leaders has grown to be an additional differentiator for us as our clients increasingly benefit through collaboration, sharing and learning across this ecosystem. This value is shared by longstanding clients and new clients coming into the Sopheon network alike.

## Client Product Uptake and Satisfaction

**Migration to current releases is strong**

Our clients have become familiar with Sopheon's release cadence and a strong majority upgrade to a supported release of Accolade to take advantage of new functionality and capabilities. At the time of our 13.0 release in November 2019 this number stood over 90 percent.

**Highest NPS score in Sopheon history**

Our net promoter score reached a record high of 40 (up from 36 in 2018). This score reflects our commitment to customer success.

We remain confident in our growth direction and work with passion to achieve the unique market opportunity in front of us.

A summary of the principal risk areas facing the business is set out in the Directors' Report. Approved by the board and signed on its behalf by:

Andy Michuda
CEO

18 March 2020

# FINANCIAL REVIEW

In this report, our CFO Arif Karimjee provides further analysis of Sopheon's financial results during 2019, our financial position at the end of the year, and an overview of key corporate developments.

## Trading Performance

As highlighted by Barry in the Chairman's Statement, financial performance during 2019 showed a pause after many years of solid growth. Consolidated revenue came in at $30.3m compared to $33.9m in 2018. Approximately $0.5m of this can be attributed to a stronger dollar than the year before, but clearly this was not the major factor. For additional context, revenue in 2017 was $28.5m, emphasizing the relatively lumpy revenue profile that is a consequence of our historically perpetual-oriented license model.

In this regard, transactional revenue was the main cause of the gap, with perpetual licenses coming in at $5.4m compared to $8.9m the year before, and consulting services at $9.4m compared to $10.8m the previous year. Revenue recognized from recurring relationships – maintenance, hosting and SaaS – rose to $15.5m from $14.2m in 2018. License order volume (including SaaS deals) was decent at 47 license transactions; although this was below the 57 achieved in 2018, the entire difference in this count was due to the slower first half – and in fact 23 deals were signed in November and December alone. New customer acquisition held steady at 18, the same as 2018 and up from 13 in 2017.

A lower average perpetual deal value also affected the final revenue figure; in the prior year we had five license orders above $0.5m in perpetual license value of which two were over $1m, one considerably so; in 2019 there were three over $0.5m, and none that exceeded $1m, though one came close. As we note elsewhere, the sales funnel does include several larger opportunities; accordingly, we believe the impact on performance is a timing issue largely due to deferred deals. In some cases, Sopheon had already been selected as preferred vendor. As we've noted before, the reasons for the extended buying cycles vary. Several were due to customer specific factors such as M&A, personnel changes or budget consideration impacting decision making. In other cases, extra effort and decision cycles linked to a broader evaluation of Accolade as a platform purchase for the customer may have contributed; we are refining our sales approach to minimize such delays. In addition, we had hired a number of new enterprise tier sales representatives, who while building pipeline have not yet contributed materially to bookings.

Revenue recognized from recurring relationships – maintenance, hosting and SaaS – rose to $15.5m from $14.2m in 2018. License order volume (including SaaS deals) was decent at 47 license transactions; although this was below the 57 achieved in 2018, the entire difference in this count was due to the slower first half – and in fact 23 deals were signed in November and December alone.

*SaaS and ARR*

Although nine of the license orders signed last year were SaaS orders and we are seeing a clear acceleration of SaaS value in our pipeline, the total value of new SaaS business booked was of a similar magnitude in 2019 as in 2018. The value of new SaaS signings was offset in the second half by a major existing SaaS customer converting its license to perpetual, in conjunction with a large expansion of their license footprint. While delighted with their vote of confidence in our platform, we note that this did not assist the overall ARR position. Two other factors affected ARR growth – lower perpetual license revenues resulted in lower incremental maintenance, and recurring revenue attrition was approximately 6 percent compared to 3 percent in 2018, calculated on a gross basis. The combined effect was to limit the rise in recurring revenue to $15.9m, up from $14.8m at the start of the year. We do not believe these factors are symptomatic of a larger trend. For example, attrition is typically due to factors outside our control such as M&A and corporate reorganizations. Our customer base is generally happy, with our net promoter ("NPS") surveys recording an overall NPS score of 40 compared to 36 in 2018, a very creditable score for a business solution. While we have highlighted 18 new customers, it is important to note that 29 existing customers also signed license extension orders during the year.

*Seasonality and Geography*

The overall calendarization pattern broadly held to past experience with the second half of the year accounting for 55 percent of revenues (2018: 53 percent and 2017: 56 percent). As previously noted, the seasonal profile of our consulting business is less predictable as it is linked to timing of preceding license sales and the individual scale of implementation projects, which can vary depending on the maturity of each customer. Maintenance and hosting revenue elements are more evenly spread as would be expected from their accounting treatment.

The geographical footprint of the new customers we signed was balanced and global in nature, with signings in Thailand, Canada, Latin America, Japan and Turkey alongside signings across our more traditional US and European territories. Our activities in Asia continue to be managed through partners while the broader Americas, Europe and Middle East markets are currently addressed by our direct sales teams. Roughly one third of the license orders were in Europe in 2019, compared to around half in 2018. Furthermore, all of the larger transactions were in North America in 2019, whereas the split in 2018 was more balanced across our two regions. As a consequence, most of the revenue reduction was in the European segment. Overall European revenues including recurring revenues were 32 percent of the total compared to 36 percent the year before. However, looking ahead, European opportunities represent around 38 percent of total pipeline value.

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*Gross Margin*

Gross margin was 70 percent, compared to 71 percent in 2018. This remains well within the historical range and reflects the cost of our consulting organization – both payroll and subcontracted; costs and charges associated our hosting activities, some license royalties due to OEM partners and costs and credits relating to certain indirect taxes. We expanded use of subcontractors last year as opposed to rehiring all departing consulting staff, allowing for greater flexibility.

## Pipeline

Revenue visibility for the year now stands at $21.2m compared to $20.6m at this time a year ago. As Barry noted earlier, in future we expect to focus increasingly on ARR rather than visibility as a metric of progress. In addition, the pipeline has matured considerably since the start of 2019, with total value 50 percent higher year on year and one third of the total in advanced stages of the pipeline.

Focusing on the deals where the pipeline already indicates a buying preference, approximately 45 percent of the software-related value represents SaaS opportunity as opposed to perpetual. This shape is reflected in our planning assumptions for 2020. In this respect, our broad expectation is that the majority of new customers will opt for SaaS, and indeed we are now actively encouraging that path through internal “SaaS first” initiatives. We expect the majority of existing customers to continue to opt for perpetual licensing as a natural extension of their existing licensed base. That said, we are also developing a “cloud lift” program to encourage existing perpetual customers to upgrade their license to a hosted and managed service relationship with subscription aspects. Approximately one third of our perpetual customers already host with Sopheon.

## Research and Development Expenditure

Overall expenditure in product development in 2019 increased by approximately $1.0m to $6.5m. These amounts can be compared to the headline research and development reported in the income statement showing an increase from $5.1m to $5.7m; the differences are due to the effects of capitalization and amortization of development costs. The additional spend reflects further recruitment of development resources during the year including design, architecture and coding expertise. These resources have allowed an acceleration in delivery of Accolade capabilities, to meet our twin goals of market leadership from a functional standpoint, but also in terms of being a highly credible enterprise-class solution with the scalability, security and configurability required by global corporations. To this we are now adding the evolution of the platform towards the requirements of SaaS and cloud. Overall, the amount of 2019 research and development expenditure that met the criteria of IAS38 for capitalization was $3.0m (2018: $2.6m) offset by amortization charges of $2.3m (2018: $2.2m). The higher capitalization rate reflects the greater resources referred to above; the consequent impact on amortization will come through over time as the products are released. Capitalized costs in 2019 are largely attributable to the group’s investment in the Accolade 12.3, 13.0 and 13.1 releases, the last of which is scheduled to be released in the first half of 2020.

> The pipeline has matured considerably since the start of 2019, with total value 50 percent higher year on year and one third of the total in advanced stages...approximately 45 percent of the software-related value represents SaaS opportunity as opposed to perpetual.

## Other Operating Costs

As we have noted in previous reports, our greatest asset and our main expenditure is on our people, which is typical of most software businesses. Payroll and related costs represent over three quarters of our cost base. Sopheon has a relatively mature and highly qualified blend of staff, reflecting the professional and intellectual demands of our chosen market. Historically, we made a strategic decision to maintain technical resources onshore in the US, as we believe that until a certain scale is reached, the cost benefits of offshoring to locations like India are outweighed by management and productivity concerns. This is starting to change, and we now have a small team working in India through an outsourcing firm to support both consulting and development efforts. Nevertheless, direct hiring remains our main source of resources and we have steadily expanded staffing since 2016. We ended last year with 162 staff, compared to 147 at the end of 2018 – many of whom were hired early in the year, reflected in an average headcount during the year of 160 (2018: 142). During 2019, our improved hiring practices ensured a better fulfilment of our hiring ambitions than in earlier years, where slow hiring often resulted in lower costs than expected.

The higher average headcount has resulted in higher overall wage costs as reported in Note 7 of the financial statements. Payroll costs also include the cost of our corporate bonus scheme, for which all non-sales staff in the company are eligible. The bonus is primarily linked to the achievement of annual EBITDA goals and is paid in the following year. Bonus costs in a given year are allocated to the relevant categories of the income statement based on department.

Specific comments regarding consulting operations and research and development costs are noted above. Overall costs in the sales and marketing area increased by approximately $0.2m. This reflects an increase attributable to staff growth, offset by lower commission and incentive payments. Several members of our direct sales team have been hired relatively recently and have been actively building pipeline, reflected in the growth described earlier. We expect sales pipe conversion to gather pace in 2020.

Headline administration costs have risen by approximately $0.3m. This area includes all other overheads, office costs, regulatory and compliance costs, and depreciation – several of which expanded to keep pace with our growth. It also includes the impact of the notional charge for share option grants, which is allocated entirely to this caption. Although very limited option grants were made in 2019, the full year effect of grants made in 2018 has fed through. The administration line also reflects the impact of Sopheon's adoption of IFRS 16, as further described in Note 1. This has resulted in a reduction in lease and rental expenses of $0.7m, offset by increases in depreciation and interest of $0.7m and $0.1m respectively.

With regard to foreign exchange, the group aims to incorporate a natural hedge through broadly matching revenues and costs within common currency entities, reducing the need for active currency management. In addition, it is not the group's policy to hedge currency cash holdings, but we do look to keep cash balances in local currency within an entity and to time currency purchases so as to minimize impacts on the individual income statements. As Sterling strengthened during 2019, approximately $0.1m of exchange losses have been recorded and expensed during the year.

## Results and Corporate Tax

Adjusted EBITDA (Adjusted Earnings before Interest, Tax, Depreciation and Amortization) is a key indicator of the underlying performance of our business, commonly used in the technology sector. It is also a key metric for management and the financial analyst community. This measure is further defined and reconciled to profit before tax in Note 5. The combined effect of the revenue and cost performance discussed above has resulted in Sopheon's Adjusted EBITDA performance for 2019 moving to $6.4m, from $9.4m in 2018. Limited influence of working capital movements has resulted in a similar reduction flowing through into cash generated from operating activities. Profit before tax reduced to $2.4m (2018: $6.4m) with the larger movement due mainly to the higher amortization and depreciation flowing from our capitalization of intangibles and the adoption of IFRS 16.

The tax charge of $0.4m (2018: $0.5m credit) reported in the income statement is made up of two main elements. Although Sopheon benefits from accumulated tax losses in a number of jurisdictions including at the US federal level, this is not universal, and accordingly a current tax charges of approximately $0.2m each were incurred in Germany and for state taxes in the US. Both included some element of prior year adjustment, amounting to approximately $0.1m. The credit in 2018 offset similar charges with an increase in recognition of the deferred tax asset owned by the business, and refunds of corporate alternative minimum tax (AMT) in the US. A total of $2.6m deferred tax asset is recognized at both 31 December 2018 and 2019, of a total potential asset of $10.6m (2018: $10.7m).

Altogether this leads to a profit after tax of $2.0m (2018: $6.9m). This has also resulted in profit per ordinary share on a fully diluted basis of 19 cents (2018: 65 cents).

## Statement of Compliance with Section 172 of the Companies Act 2006

Recent legislation requires that directors include a separate statement in the annual report that explains how they have had regard to wider stakeholder needs when performing their duty under Section 172(1) of the Companies Act 2006. This duty requires that a director of a company must act in the way he or she considers, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole, and in doing so have regard (amongst other matters) to:

a) the likely consequences of any decision in the long term;
b) the interests of the company's employees;
c) the need to foster the company's business relationships with suppliers, customers and others;
d) the impact of the company's operations on the community and the environment;
e) the desirability of the company maintaining a reputation for high standards of business conduct; and
f) the need to act fairly as between members of the company.

Guidance recommends that in connection with its statement, the board describe in general terms how key stakeholders, as well as issues relevant to key decisions, are identified, and also the processes for engaging with key stakeholders and understanding those issues. It is the board's view that these requirements are predominantly addressed in the corporate governance disclosures we have made in the directors' report, which are themselves more extensively discussed on the company's website.

Guidance also recommends that more detailed description is limited to matters that are of strategic importance in order to remain meaningful and informative for shareholders. The board believes that two decisions taken during the year fall into this category, and engaged with internal and external stakeholders on this. These are:

- The decision to migrate the group's software licensing model towards one that is more subscription than perpetual based. As described in the Chairman's Statement and the Strategy & Market Review, the benefits of moving our revenue model to one which is subscription based and focusing on solutions that are designed to be run in the cloud will allow Sopheon to innovate more quickly, shorten the time it takes to acquire new customers and improve business predictability through replacing license spikes and troughs with recurring revenue. Though this could in the near term have the impact of reducing revenue, this would be in exchange for increasing recurring revenue in future periods and consequently a greater lifetime revenue from each customer. This will ultimately benefit both customers and shareholders and is fully consistent with trends in the software industry.

- The decision to maintain the staff bonus, albeit substantially reduced for senior management. The remuneration committee revisited bonus objectives after the revision of 2019 performance expectations and concluded that it was in the best interest of the company and of shareholders to recognize solid strategic progress, and maintain a regular award for the majority of staff in order to motivate our people in a competitive market. Bonuses for senior staff, including directors, have been progressively reduced in line with seniority, resulting in a 50-60 percent reduction in bonuses earned at the top of the organization.

> On the back of a very solid balance sheet, coupled with continued cash generation and continued business confidence, the board is pleased to maintain Sopheon's dividend at 3.25 pence per share for the year ended 31 December 2019 (2018: 3.25p).

## Dividend

In spite of a challenging year, on the back of a very solid balance sheet, coupled with continued cash generation and continued business confidence, the board is pleased to maintain Sopheon's dividend at 3.25 pence per share for the year ended 31 December 2019 (2018: 3.25p). Subject to approval by the company's shareholders at the annual general meeting scheduled for 11 June 2020, the dividend will be paid on 10 July 2020 with a record date of 12 June 2020.

## Facilities and Assets

The group's $3m revolving line of credit facility with Silicon Valley Bank was renewed last year through February 2020, with an improved interest rate of 3.75 percent, down from 7.25 percent, with a rolling annual renewal structure. The facility was only used on demand, and there were no funds drawn at year end (31 December 2018: $0.3m). In view of net cash balances approaching $20m, the board has decided that the benefits of extending the facility do not merit the costs, and has therefore decided not to renew it. Our relationship with Silicon Valley Bank remains strong with potential established for funding arrangements in connection with M&A or other corporate activity.

> In view of net cash balances approaching $20m, the board has decided that the benefits of extending the facility do not merit the costs, and has therefore decided not to renew it. Our relationship with Silicon Valley Bank remains strong with potential established for funding arrangements in connection with M&A or other corporate activity.

Intangible assets stood at $6.9m (2018: $6.2m) at the end of the year. This includes (i) $5.9m being the net book value of capitalized research and development (2018: $5.2m) and (ii) an additional $1.0m (2018: $1.0m) being goodwill arising on acquisitions completed in previous years. As indicated above in our discussion of research and development costs, capitalization and amortization have been broadly in balance for a number of years though a relatively small and temporary gap has opened up connected with the recent expansion of development resources. Our spend on tangible fixed assets was held to $0.3m last year (2018: $0.4m) and this broadly equaled depreciation, resulting in net book value staying flat at $0.5m at the end of the year (2018: $0.5m).

As we noted in our interim statement and in more detail in Note 1, the adoption of IFRS 16 requires lessees to recognize a lease liability that reflects future lease payments and a "right-of-use asset" in all lease contracts within scope, with no distinction between financing and operating leases. This has resulted in recognition of total right-of-use assets and corresponding lease liabilities of $1.6m each at 31 December 2019.

Consolidated net assets at the end of the year stood at $27.9m (2018: $25.6m), an increase of $2.3m and including net current assets of $17.2m (2018: $16.1m). Within the net current asset position, cash at 31 December 2019 amounted to $19.4m (2018: $17.1m). Approximately $9.2m was held in US Dollars, $9.0m in Euros and $1.2m in Sterling. Net cash, stated after subtracting debt, rose from $16.7m the previous year to $19.4m at the end of 2019, as all debt (excluding notional debt from the adoption of IFRS 16) has been eliminated.

Approved by the board and signed on its behalf by:

Arif Karimjee
CFO

18 March 2020

# 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 |
| | Daniel Metzger | Non-executive Director |

Please refer to the inside back cover of this report for details of the professional background of each director.

*Secretary*

Arif Karimjee

*Registered Office*

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West End, Surrey GU24 9PW

*Registered Name and Number*

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Registered in England and Wales
No. 03217859

*Auditors*

BDO LLP
55 Baker Street
London W1U 7EU

*Principal Bankers and Financiers*

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Santa Clara, CA 95054
United States

Silicon Valley Bank
Alphabeta
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Van Baerlestraat 102-106
1071 BC Amsterdam
The Netherlands

Commerzbank
Rheinstrasse 14
64283 Darmstadt
Germany

*Solicitors and Attorneys*

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7 Devonshire Square
Cutlers Gardens
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Briggs and Morgan
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United States

Loyens & Loeff
Fred Roeskestraat 100
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The Netherlands

*AIM Nominated Adviser and Broker*

finnCap Limited
60 New Broad Street
London EC2M 1JJ

*Registrars*

Link Asset Services
65 Gresham Street
London EC2V 7NQ

# BOARD COMMITTEE REPORTS

**Remuneration Committee**

The remuneration committee of Sopheon plc is responsible for oversight of the contract terms, remuneration and other benefits for executive directors, including performance-related bonus schemes. The committee comprises two non-executive directors, D. Metzger and S.A. Silcock, together with B.K. Mence, other than in respect of his own remuneration. The committee makes recommendations to the board, within agreed parameters, on an overall remuneration package for executive directors and other senior executives in order to attract, retain and motivate high quality individuals capable of achieving the group's objectives. The package for each director consists of a basic salary, benefits and pension contributions, together with performance-related bonuses and share options on a case-by-case basis. Consideration is given to pay and employment policies elsewhere in the group, especially when considering annual salary increases. From time to time, the remuneration committee may take advice from appropriate remuneration consultants or 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 US Dollars at the average rate for the period. Benefits primarily comprise healthcare insurance and similar expenses. Details of directors' interests in shares and options are set out in the Directors' Report.

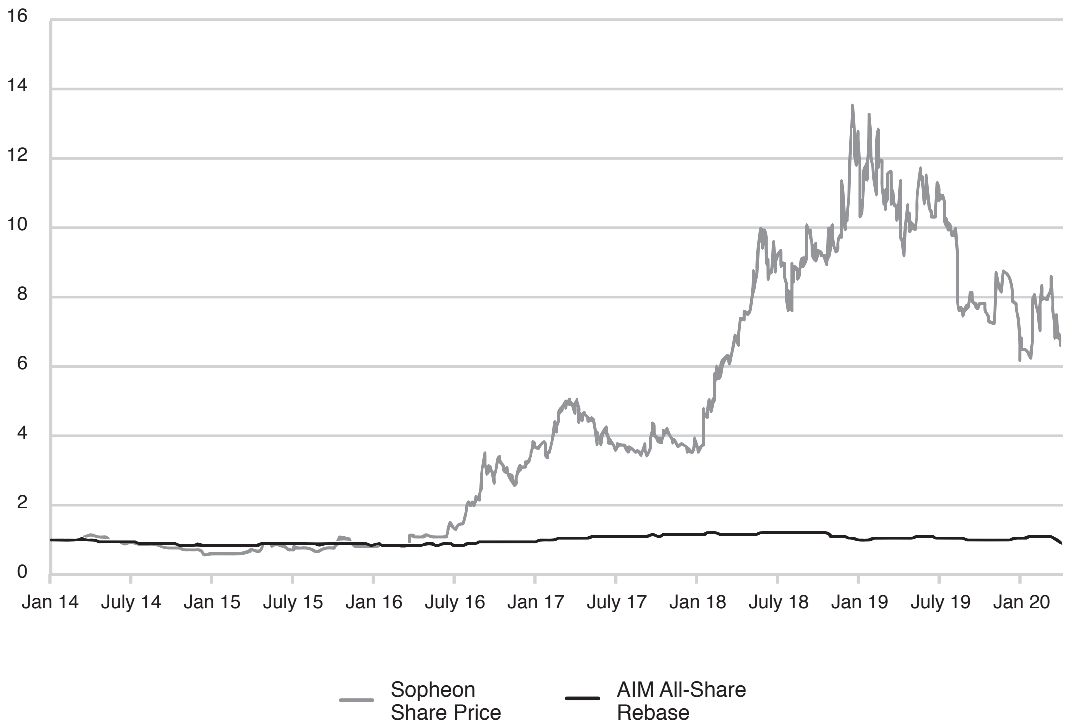
| | *Pay and Fees 2019 $* | *Bonus 2019 $* | *Benefits 2019 $* | *Total 2019 $* | *Pay and Fees 2018 $* | *Bonus 2018 $* | *Benefits 2018 $* | *Total 2018 $* |
|---|---|---|---|---|---|---|---|---|
| *Executive Directors* | | | | | | | | |
| B.K. Mence | 203 | 38 | 12 | 253 | 206 | 97 | 7 | 310 |
| A.L. Michuda | 330 | 63 | 11 | 404 | 320 | 155 | 12 | 487 |
| A. Karimjee | 196 | 37 | 5 | 238 | 196 | 75 | 5 | 276 |
| *Non-executive Directors* | | | | | | | | |
| S.A. Silcock | 33 | - | - | 33 | 34 | - | - | 34 |
| D. Metzger | 33 | - | - | 33 | 34 | - | - | 34 |
| | 795 | 138 | 28 | 961 | 790 | 327 | 24 | 1,141 |

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 2018 and 2019 these objectives were set with regard to EBITDA performance. 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 2019 contributions of $8,963, $3,599 and $9,187 (2018: $9,331, $4,527 and $9,175) 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 2014, in UK pence, 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 group's. Historical share prices have been adjusted to reflect the net 20:1 share consolidation performed by the group during 2013.




**Directors' Interests**

The interests of the directors, who held office at the end of the year, in the share capital of the company were as follows:

| | *Share Options* | | *Ordinary Shares* | |
|---|---|---|---|---|
| At 31 December | *2019* | *2018* | *2019* | *2018* |
| B.K. Mence | 24,250 | 24,250 | 2,228,537 | 2,228,537 |
| A.L. Michuda | 290,000 | 290,000 | 84,155 | 84,155 |
| A. Karimjee | 85,000 | 85,000 | 82,493 | 82,493 |
| S.A. Silcock | - | - | 520,318 | 520,318 |
| D. Metzger | - | - | 5,000 | 5,000 |

With respect to the interests stated above for B.K. Mence, S.A Silcock and A. Karimjee, their respective spouses are the beneficial owners of 15,575, 8,875 and 32,493 ordinary shares each. An additional 11,250 of the ordinary shares disclosed for S. A. Silcock are held as trustee or executor for family members. Accordingly, the personal interest of B.K. Mence is in 2,212,962, S.A. Silcock in 500,193 and A. Karimjee in 50,000 ordinary shares.

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

| | *Date of Grant* | *Exercise Price* | *At 31 December 2018* | *Granted During Year* | *Expired During Year* | *At 31 December 2019* |
|---|---|---|---|---|---|---|
| B.K. Mence | 29 September 2012 | 105p | 6,125 | - | - | 6,125 |
| B.K. Mence | 5 December 2013 | 85p | 18,125 | - | - | 18,125 |
| A.L. Michuda | 29 September 2012 | 105p | 100,880 | - | - | 100,880 |
| A.L. Michuda | 5 December 2013 | 85p | 49,000 | - | - | 49,000 |
| A.L. Michuda | 8 April 2016 | 87.5p | 15,120 | - | - | 15,120 |
| A.L. Michuda | 15 February 2017 | 467.5p | 25,000 | - | - | 25,000 |
| A.L. Michuda | 11 February 2018 | 565p | 50,000 | - | - | 50,000 |
| A.L. Michuda | 4 July 2018 | 900p | 50,000 | - | - | 50,000 |
| A. Karimjee | 27 August 2010 | 150p | 7,500 | - | - | 7,500 |
| A. Karimjee | 29 September 2012 | 105p | 3,125 | - | - | 3,125 |
| A. Karimjee | 5 December 2013 | 85p | 26,875 | - | - | 26,875 |
| A. Karimjee | 8 April 2016 | 87.5p | 5,850 | - | - | 5,850 |
| A. Karimjee | 15 February 2017 | 467.5p | 11,650 | - | - | 11,650 |
| A. Karimjee | 11 February 2018 | 565p | 15,000 | - | - | 15,000 |
| A. Karimjee | 4 July 2018 | 900p | 15,000 | - | - | 15,000 |

Vesting of all of the above share options which were outstanding at 31 December 2019 is in three equal tranches on the first, second and third anniversaries of the date of grant and all such options expire on the tenth anniversary of the date of grant. The mid-market price of Sopheon ordinary shares at 31 December 2019 was 640p. During the financial year the mid-market price of Sopheon ordinary shares ranged from 615p to 1,345p. 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.

**Audit Committee**

The Audit Committee, which includes all of the non-executive directors and is chaired by Stuart Silcock, considers and determines actions regarding any control or financial reporting issues they have identified, or that have been raised by the auditors. During the year, the Audit Committee met twice, and the external auditor and Executive Directors were invited to attend these meetings. Consideration was given to the external auditor's post-audit reports and these provide opportunities to review the accounting policies, internal control and financial information contained in both the annual and interim reports, as well as the independence of the external auditor. The committee chair is also able to meet with the auditors independently if required.

Approved by the board on 18 March 2020 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 for complete Enterprise Innovation Management solutions. The Chairman's Statement on page 6 includes reference to the group's future prospects. In view of the fact that approximately two-thirds of the group's revenues and staff are based in the United States, the group's financial statements are presented in US Dollars. The board is pleased to recommend a final dividend in respect of the year ended 31 December 2019 of 3.25 pence per share (2018: 3.25 pence per share), amounting to £331,000 (2018: £330,000).

**Directors**

The directors who served during the year are disclosed in the Board Committee Reports.

**Corporate Governance**

The Sopheon board is committed to maintaining high standards of corporate governance. Following recent changes to AIM Rule 26, AIM quoted companies are required to adopt and give details of the corporate governance code which they have adopted and to show how they are following it. In September 2018, the board adopted the Quoted Companies Alliance's (QCA) Corporate Governance Code for small and mid-size quoted companies (the "QCA Code").

Of the recognized codes generally adhered to by AIM companies, the QCA Code has been drafted with smaller businesses in mind, with a pragmatic and principles-based approach. It was therefore deemed by the board to be the most suitable.

In 2017 the board had already established an internal project to update its internal risk management procedures with a new enterprise risk framework based on the provisions proposed by COSO (Committee of Sponsoring Organizations of the Treadway Commission) with a view to incorporating a formal risk review agenda point in each board meeting. The adoption of the QCA Code has reinforced the underpinnings for this project and key principles of the Code have been incorporated into the risk management process. In addition, the adoption of the QCA Code has resulted in the board preparing new terms of reference for its two key board committees (the Audit Committee and the Remuneration and Appointments Committees) as well as a new schedule of matters reserved for the board of directors.

Solid corporate governance is the foundation on which the business is managed, and this is supported by the range of talents of the directors. Biographies of the directors appear inside the back cover and demonstrate a range of experience and caliber to bring the right level of independent judgment to Sopheon's business. Ensuring financial strength alongside growth objectives is a key guiding principle, supported by an effort to ensure solid communication with shareholders.

The chairman is responsible for leading the board and for its overall effectiveness in directing the group, and for ensuring that the board implements, maintains and communicates effective corporate governance processes and for promoting a culture of openness and debate designed to foster a positive governance culture throughout the group.

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 does 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 2019, all directors attended all quarterly meetings either in person or by conference call.

The QCA Code identifies ten principles that focus on the pursuit of medium- to long-term value for shareholders without stifling entrepreneurial spirit. Sopheon's adoption of the QCA principles is summarized in the table below. Further details are made available on our website at www.sopheon.com/board-governance.

| QCA Principle | Sopheon Adoption |
|---|---|
| **1. Establish a strategy and business model which promote long-term value for shareholders** | Sopheon's mission is to help our customers achieve exceptional long-term growth and profitability through sustainable innovation. Our guiding philosophy is to balance aggressive growth strategies with a focus on profitability, while also ensuring long-term financial stability. We believe the combination of these three factors will maximize long-term value for shareholders. Full information on the group's strategy and business model can be found in the Strategic Report on pages 6 to 21. |
| **2. Seek to understand and meet shareholder needs and expectations** | The board engages with shareholders and the broader investment community via a variety of channels and activities including the annual general meeting, updates to shareholders via reporting and the regulatory news service, and institutional presentations. The Chairman and CFO are the primary contacts for investor interaction alongside finnCap, with the CEO ensuring availability to meet investors when visiting Europe from his US base. |
| **3. Take into account wider stakeholder and social responsibilities and their implications for long-term success** | Sopheon's culture is very open and this includes reaching out and seeking feedback and insights from our various stakeholders. In addition to the investor outreach described above, key practical elements of this philosophy for other stakeholders include having a flat organization with few tiers of management, meeting regularly; all-hands communications via web-meetings; customer engagement through account management, satisfaction surveys and user forum events; and broader market engagement through close relationships with sector analysts such as Gartner and Forrester Research. |
| **4. Embed effective risk management, considering both opportunities and threats, throughout the organization** | The board is responsible for identifying the major business risks faced by the group and for determining the appropriate course of action to manage those risks. In 2017 the board adopted a framework for the effective identification, assessment, and management of risks to the achievement of corporate objectives. The risk management process is managed in Accolade and is embedded in our quarterly meeting cycle. The risks that the board consider to be principal risks to the group's business are set out on page 28. |
| **5. Maintain the board as a well-functioning, balanced team led by the chair** | The QCA Code requires that boards have an appropriate balance between executive and non-executive directors and that each board should have at least two independent directors. The board is made up of three executive directors and two non-executive directors. The two non-executive directors are mature, experienced and independent persons who have each succeeded in their own businesses and are not dependent upon income from the group. They have developed a strong and detailed understanding of the business, and are prepared and able to intervene and challenge the executive directors. |
| **6. Ensure that between them the directors have the necessary up-to-date experience, skills and capabilities** | Details of the background and experience of the directors of the company are set out inside the back cover of this report. These demonstrate that our team collectively has the necessary skills and experiences, as well as the required caliber, to carry out the group's strategy and business model effectively. With regard to the non-executive directors, one is a financial specialist and the other is an industry specialist, and both have prior experience of working in a public company environment. Furthermore, one is America based and the other Europe based, reflecting the geographical footprint of the group. |
| **7. Evaluate board performance based on clear and relevant objectives, seeking continuous improvement** | A board self-evaluation process led by the chairman takes place in July each year, using a QCA-sponsored questionnaire and process. Low scoring or divergent scoring responses are discussed, with gaps and actions for improvement identified. The first such formal process was conducted in 2018 and the board has agreed that this should be an annual event. |
| **8. Promote a corporate culture that is based on ethical values and behaviors** | Sopheon' core values statement and guiding principles, developed by the extended management team, support the group's culture with a strong footing in ethical values. These are reinforced in the staff handbook and the staff appraisal and development process, which formally embeds cultural and ethical considerations as part of each employee's self-evaluation. |
| **9. Maintain governance structures and processes that are fit for purpose and support good decision-making by the board** | Formal board meetings are held quarterly to review strategy, management and performance of the group, with additional meetings between those dates convened as necessary. We have two board committees, the Audit Committee and the Remuneration and Appointments Committee. The terms of reference of both these committees of the board have been revised to reflect the principles of the QCA Code and are available online. |
| **10. Communicate how the company is governed and is performing by maintaining a dialog with shareholders and other relevant stakeholders** | The group's approach to investor and shareholder engagement is described under Principle 2 above. Annual reports, Annual General Meeting notices, regulatory announcements, trading updates and other governance-related materials since the year 2000 are available from the group's website. |

## Post Balance Sheet Events

There are no post balance sheet events that warrant disclosure in the financial statements.

## Research and Development

A summary of research and development activities and the key benefits and enhancements to the Sopheon Accolade solution is set out in the Strategic Report. A summary of the expenditure incurred and the accounting treatment thereof is set out in the Financial Review of the Strategic Report.

## 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 are emerging and this means that Sopheon's growth may be erratic.* The broad market for Sopheon's software products continues to emerge and evolve, and the timing and size of individual sales can have a substantial impact on performance in a given period. Sopheon has formalized processes for soliciting input to product strategy from analysts and customers, while also capitalizing on the group's leadership in key market areas. Sopheon also seeks to improve revenue predictability by introducing specific initiatives to balance efforts between new customer acquisition and meeting the needs of existing customers. Sopheon's consistently growing recurring revenue base should also improve revenue predictability.

*Sopheon's prospects for achieving sustained and growing profitability are dependent on correctly aligning investments with sales.* Sopheon's ability to continue to finance its investments at the optimal pace is dependent on the group maintaining profitability and sales growth alongside its investment strategy or having appropriate financial resources in place to invest with confidence. Sopheon has sought to focus its resources on the sub-segments that it believes offer the best opportunities for growth. Sopheon management carefully monitors short- and medium-term financing requirements and has regularly raised additional funding resources to meet requirements.

*Some of Sopheon's competitors and potential competitors have greater resources than Sopheon.* Sopheon remains a relatively small organization by global standards. Its resources are small compared to those of many larger companies that are capable of developing competitive solutions and it can be 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's use of an agile development methodology with deep customer involvement is a key plank in this approach.

*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 remained challenging. 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 modest part of the total.

*Sopheon could be subject to claims for damages in connection with 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, should support and maintenance service level agreements fail to meet agreed criteria, or should the security features of its software or hosting services fail. Sopheon has sought to protect itself from such risks through excellent development methodologies and high-quality operating procedures, its contract terms and insurance policies. Sopheon has never had any such claims.

**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 22 to the financial statements.

**Brexit**

The United Kingdom ('UK') formally left the European Union ('EU') on 31 January 2020. The period of time from when the UK voted to exit the EU on 23 June 2016 and the formal process initiated by the UK government to withdraw from the EU, or Brexit, created volatility in the global financial markets. The UK now enters a transition period, being an intermediary arrangement covering matters like trade and border arrangements, citizens' rights and jurisdiction on matters including dispute resolution, taking account of The EU (Withdrawal Agreement) Act 2020, which ratified the Withdrawal Agreement, as agreed between the UK and the EU. The transition period is currently due to end on 31 December 2020 and ahead of this date, negotiations are ongoing to determine and conclude a formal agreement between the UK and EU on the aforementioned matters.

The directors currently deem that the effects of the UK's current transitional period outside the EU and the impact of ongoing discussions with the EU will not have a significant impact on the group and company's operations due to the global geographical footprint of the business and the nature of is operations. However, the directors and management are constantly monitoring the situation to manage the risk of the return of any volatility in the global financial markets and impact on global economic performance.

**Other Matters**

The directors are continuing to monitor the effects of the outbreak of COVID-19 on the group and have implemented plans related to maintaining effective business continuity, to ensure there is no material impact in the company's operations and working capital.

**Substantial Shareholdings**

The directors are aware of the following persons who as at 18 March 2020 were interested directly or indirectly in 3 percent or more of the company's issued ordinary shares:

| | *No. of Ordinary Shares* | *% Issued Ordinary Shares* |
|---|---|---|
| *Name* | | |
| Rivomore Limited and Myrtledare Corp. | 2,428,711 | 23.9 |
| B.K. Mence (director) | 2,228,537 | 21.9 |
| S.A. Silcock (director) | 520,318 | 5.1 |
| Universal-Investment-GmbH | 516,681 | 5.1 |

S.A. Silcock's and B.K. Mence's interests represent direct beneficial holdings as well as those of their families.

Approved by the board on 18 March 2020 and signed on its behalf by:

A. Karimjee
Director

# STATEMENT OF DIRECTORS' RESPONSIBILITIES IN RESPECT OF THE FINANCIAL STATEMENTS

The directors are responsible for preparing the annual report and financial statements in accordance with applicable law and regulations.

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.

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

**Opinion**

We have audited the financial statements of Sopheon plc (the 'parent company') and its subsidiaries (the 'group') for the year ended 31 December 2019 which comprise the consolidated income statement, consolidated statement of comprehensive income, consolidated and company balance sheets, consolidated and company cash flow statements, consolidated and company statement of changes in equity, and notes to the financial statements, including a summary of significant accounting policies.

The financial reporting framework that has been applied in the preparation of the financial statements 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.

In our opinion:

- the financial statements give a true and fair view of the state of the group's and of the parent company's affairs as at 31 December 2019 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 as applied in accordance with the provisions of the Companies Act 2006; and
- the financial statements have been prepared in accordance with the requirements of the Companies Act 2006.

**Basis for Opinion**

We conducted our audit in accordance with International Standards on Auditing (UK) (ISAs (UK)) and applicable law. Our responsibilities under those standards are further described in the Auditor's responsibilities for the audit of the financial statements section of our report. We are independent of the group in accordance with the ethical requirements that are relevant to our audit of the financial statements in the UK, including the FRC's Ethical Standard as applied to listed entities, and we have fulfilled our other ethical responsibilities in accordance with these requirements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

**Conclusions Relating to Going Concern**

We have nothing to report in respect of the following matters in relation to which the ISAs (UK) require us to report to you where:

- the directors' use of the going concern basis of accounting in the preparation of the financial statements is not appropriate; or
- the directors have not disclosed in the financial statements any identified material uncertainties that may cast significant doubt about the group's or the parent company's ability to continue to adopt the going concern basis of accounting for a period of at least twelve months from the date when the financial statements are authorized for issue.

**Key Audit Matters**

Key audit matters are those matters that, in our professional judgment, were of most significance in our audit of the financial statements of the current period and include the most significant assessed risks of material misstatement (whether or not due to fraud) we identified, including those which had the greatest effect on: the overall audit strategy, the allocation of resources in the audit, and directing the efforts of the engagement team. These matters were addressed in the context of our audit of the financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters.

| *Key audit matter* | *How the key audit matter was addressed in our audit* |
|---|---|
| ***Revenue Recognition***<br><br>See accounting policy in Note 2 on page 42 and Revenue from contracts with customers in Note 4 on page 48.<br><br>The group, as a software business, generates revenue primarily from the sale of licenses, related maintenance/support contracts and service income.<br><br>We considered there to be a significant audit risk arising from inappropriate or incorrect recognition of revenue.<br><br>The risk of material misstatement in relation to revenue recognition concerns the recognition around the year end, particularly in relation to license sales. License sales require a key code to be provided to the customer, which enables access to the Accolade software. This in turn provides evidence of delivery to the customer in relation to the contractual performance obligation.<br><br>Further in line with IFRS 15 there is a risk that accounts receivable and deferred income are shown gross in the financial statements where there is not an unconditional right to consideration.<br><br>For these reasons revenue recognition is considered to be a key audit matter. | Revenue recognition is one of the primary focuses of the engagement team. During the planning phase, discussions are held in relation to the revenue approach, and the senior members of the audit team are responsible for procedures that are performed around revenue.<br><br>In order to assess the appropriateness of the processes and controls in place that impact upon revenue recognition, we performed walkthroughs involving understanding the design of the controls over the group's revenue cycle and checking that those controls appear to have been implemented.<br><br>Our audit procedures included assessing the adequacy of the revenue recognition policy, in line with IFRS as adopted by the European Union, with particular consideration given to IFRS 15.<br><br>For each of the revenue streams, licenses, maintenance and service revenues, we selected a sample of contracts entered in to during the year for testing, ensuring that all material contracts were captured in the selection process. We assessed whether the revenue recognized was in line with the contractual terms, the group's revenue recognition policy and the relevant accounting standards.<br><br>To address the risk of revenue being recognized in the incorrect financial year, in relation to license contract revenue, we obtained support for a sample of binding contracts that were entered into and confirmed that the delivery of the Accolade license key was before the year-end, and therefore recognized in the appropriate period.<br><br>For the maintenance and service contracts that we selected we ensured the methodology applied in accounting for accrued and deferred revenue on these contracts was in line with the contractual terms and stage of completion of the project, where appropriate.<br><br>We ensured that for the growing number of software as a service (SaaS) contracts supplied by the group where Sopheon hosts the offering, a sample of contracts were obtained, and the revenue recognition, to recognize the revenue over the lifetime of the contract, was confirmed as appropriate.<br><br>Finally, our procedures, in relation to IFRS 15, also considered the presentation of trade receivable and contract liabilities to ensure that both balances reflect the required presentation position. This being the earlier of either, the date the payment becomes due (i.e. when the 'receivable' is recognized), or the date the goods or services are delivered (i.e. when a 'contract asset' is recognized).<br><br>**Key observations:**<br><br>Based on the procedures performed, we noted no instances of material misstatements in the year. |

| Key audit matter | How the key audit matter was addressed in our audit |
|---|---|
| ***Intangible Assets: Development Costs, Amortization and Impairment***<br><br>See accounting policy in Note 2 and intangible assets Note 14 on pages 44 and 54 respectively.<br><br>The group capitalizes costs in relation to the development of the software provided to its clients, being the Accolade platform as defined on page 8.<br><br>In accordance with IAS 38, management's policy is to capitalize development expenditure on internally developed software products if the costs can be measured reliably and the resulting asset meets the criteria per the standard.<br><br>Development costs not satisfying the above criteria and expenditure on the research phase of internal projects are recognized in the income statement as incurred.<br><br>Capitalized development costs are amortized over the period within which the group expects to benefit from selling the product developed. This is deemed to be four years.<br><br>There is a risk that the criteria outlined under IAS 38 are not met and therefore development costs are incorrectly capitalized. Further, a risk exists that assets not available for use have not been impaired as required.<br><br>Both of these factors indicate that this is a key audit matter due to the focus of resources and the time apportioned to this area of the audit. | The senior members of the audit team are responsible for completing the work in relation to capitalized development costs. The testing strategy involves engaging with individuals working out of different components within the group.<br><br>We considered whether the development costs capitalized met the criteria for capitalization under IAS 38 and subsequently whether the mechanics over capturing time spent and translating that cost into an accounting entry operated accurately. Utilizing the underlying timecard information for a sample of items, the underlying hours and cost were agreed back through to the timecard system.<br><br>Any capitalized projects with a material net book value ("NBV") on the balance sheet were selected for testing. An understanding was gained over the stage of development of the product by reviewing the underlying timecard information. In addition the ability for the asset to generate future economic benefits for the business was assessed by analyzing future expected cashflows and the percentage of customers who upgrade to the latest version on release.<br><br>For each intangible asset all inputs were agreed back to supporting documentation for each of the samples selected for testing, ensuring the existence and accuracy of the intangible asset created.<br><br>As an extension of the above, we revisited management's estimate of the amortization period applied to the asset, establishing whether any requirements of impairment exist in relation to older versions of Accolade.<br><br>Finally, in line with IAS 36 we ensured that assets that were not yet available for use (such as projects in development) had undertaken an impairment review as required. There were no instances where this was an issue in the year.<br><br>**Key observations:**<br><br>Based on the procedures performed, we noted no instances of material misstatements in the year. |

**Our Application of Materiality**

We apply the concept of materiality both in planning and performing our audit, and in evaluating the effect of misstatements. At the planning stage we set an overall level of materiality for the financial statements as a whole based on our understanding of the elements of the financial statements that are likely to be of greatest significance to users. In order to reduce to an appropriately low level the probability that any misstatements exceed materiality, we use a lower materiality level, performance materiality, to determine the extent of testing needed. Importantly, misstatements below these levels will not necessarily be evaluated as immaterial as we also take account of the nature of identified misstatements, and the particular circumstances of their occurrence, when evaluating their effect on the financial statements as a whole.

We determined materiality for the group financial statements as a whole to be $302,000 (2018: $341,000) which represents 1 percent of revenue (2018: 1 percent of revenue). We used revenue as a benchmark as this is the primary KPI which is used to address the performance of the business by the board, and is consistently referenced within the RNS announcements released by the group, in addition to new contract wins, both of which feed into the revenue figure.

Performance materiality was set at 70 percent (2018: 70 percent) due to the fact that there are multiple components within the group. Additionally there are a select number of areas included in the accounts which are subject to estimates. Materiality for the parent company was set at 65 percent of group materiality paying due consideration to aggregation risk in relation to group materiality, being $196,000 (2018: 65 percent of group materiality, being $220,000).

We agreed with the audit committee that we would report all individual audit differences in excess of $12,000 (2018: $17,000) as well as differences below that threshold that, in our view, warranted reporting on qualitative grounds.

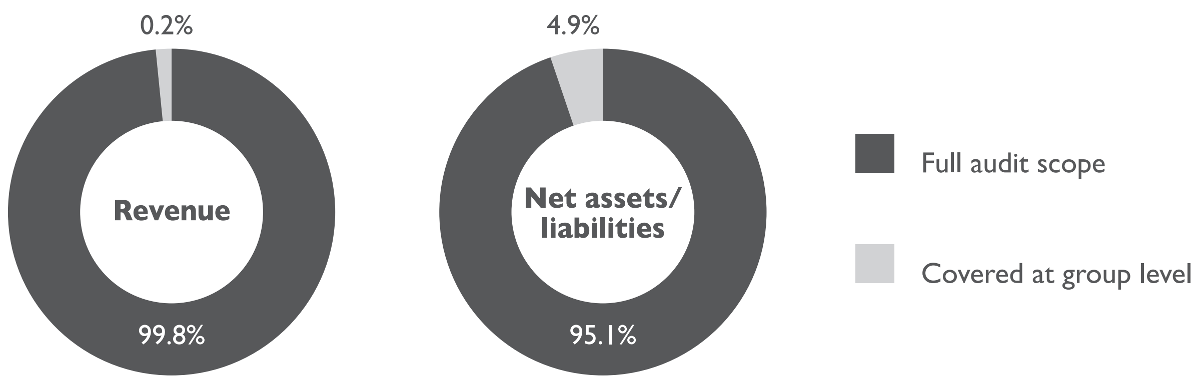
**An Overview of the Scope of Our Audit**

Our group audit was scoped by obtaining an understanding of the group and its environment and assessing the risks of material misstatement at the group level. The group consists of seven entities based in Europe and North America. There are two entities based in the UK, one being the holding company. Further to this there are two trading entities incorporated in Europe based in Germany and the Netherlands, with the remaining three trading entities incorporated in the USA.

Based on our assessment of the group and consistent with the prior year, we focused our group audit scope primarily over the significant components, being Sopheon plc, Sopheon UK Limited, Sopheon NV and Sopheon Corporation, Minnesota. For these significant components BDO LLP completed detailed audit testing, and performed desktop reviews for the remaining group entities.

At the parent entity level we also tested the consolidation process including consolidation adjustments and journals, performed our work on all key judgements areas and carried out analytical procedures to confirm our conclusion that there were no significant risks of material misstatement of the aggregated financial information of the remaining components not subject to audit.

The graphs below demonstrate the coverage of our audit work over the components within the group. Revenue has been tested in detail across each entity within the group, regardless of the level of review performed in relation to that entity. The full scope audit work performed has therefore provided coverage over 99 percent of the group from a revenue perspective, and also covers 95 percent of the total assets of the group. The elements of the group that were not covered by full scope work were reviewed to group materiality.



**Other Information**

The directors are responsible for the other information. The other information comprises the information included in the annual report, other than the financial statements and our auditors' report thereon. Our opinion on the financial statements does not cover the other information and, except to the extent otherwise explicitly stated in our report, we do not express any form of assurance conclusion thereon.

In connection with our audit of the financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit or otherwise appears to be materially misstated. If we identify such material inconsistencies or apparent material misstatements, we are required to determine whether there is a material misstatement in the financial statements or a material misstatement of the other information. If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report in this regard.

**Opinions on Other Matters Prescribed by the Companies Act 2006**

In our opinion, based on the work undertaken in the course of the audit:

- the information given in the strategic report and the directors' report for the financial year for which the financial statements are prepared is consistent with the financial statements; and
- the strategic report and the directors' report have been prepared in accordance with applicable legal requirements.

**Matters on Which We are Required to Report by Exception**

In the light of the knowledge and understanding of the group and the parent company and its environment obtained in the course of the audit, we have not identified material misstatements in the strategic report or the directors' report.

We have nothing to report in respect of the following matters in relation to which 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.

**Responsibilities of Directors**

As explained more fully in the statement of directors' responsibilities in respect of the financial statements set out on page 30, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view, and for such internal control as the directors determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, the directors are responsible for assessing the group's and the parent company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless the directors either intend to liquidate the group or the parent company or to cease operations, or have no realistic alternative but to do so.

**Auditor's Responsibilities for the Audit of the Financial Statements**

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs (UK) will always detect a material misstatement when it exists.

Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

A further description of our responsibilities for the audit of the financial statements is located on the Financial Reporting Council's website at: www.frc.org.uk/auditorsresponsibilities. This description forms part of our auditor's report.

**Use of Our Report**

This report is made solely to the Parent 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 Parent 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 Parent Company and the Parent Company's members as a body, for our audit work, for this report, or for the opinions we have formed.

Iain Henderson (Senior Statutory Auditor)
For and on behalf of BDO LLP, Statutory Auditor
London
United Kingdom

18 March 2020

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 2019

| | Notes | *2019 $'000* | *2018 $'000* |
|---|---|---|---|
| Revenue | 3, 4 | 30,254 | 33,922 |
| Cost of sales | | (9,043) | (9,916) |
| Gross profit | | 21,211 | 24,006 |
| Sales and marketing expense | | (8,806) | (8,552) |
| Research and development expense | | (5,682) | (5,078) |
| Administrative expense | | (4,305) | (3,995) |
| Operating profit | | 2,418 | 6,381 |
| Finance income | 8 | 166 | 102 |
| Finance expense | 9 | (127) | (77) |
| Profit before tax | 5 | 2,457 | 6,406 |
| Income tax (charge)/credit | 10 | (409) | 514 |
| Profit for the year | | 2,048 | 6,920 |
| **Earnings per share** | | | |
| Basic (US cents) | 12 | 20.16c | 68.60c |
| Fully diluted (US cents) | 12 | 19.20c | 64.98c |

# CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME
# FOR THE YEAR ENDED 31 DECEMBER 2019

| | *2019 $'000* | *2018 $'000* |
|---|---|---|
| **Profit for the year** | 2,048 | 6,920 |
| **Other comprehensive expense** | | |
| *Items that may be reclassified to profit or loss:* | | |
| Exchange differences on translation of foreign operations | (41) | (314) |
| **Total comprehensive income for the year** | 2,007 | 6,606 |

# CONSOLIDATED AND COMPANY BALANCE SHEETS AT 31 DECEMBER 2019

| | | Group | | Company | |
|---|---|---|---|---|---|
| | *Notes* | *2019 $'000* | *2018 $'000* | *2019 $'000* | *2018 $'000* |
| **Assets** | | | | | |
| *Non-current Assets* | | | | | |
| Property, plant and equipment | 13 | 510 | 532 | - | - |
| Right-of-use assets | 21 | 1,553 | - | - | - |
| Intangible assets | 14 | 6,874 | 6,206 | - | - |
| Investments in subsidiaries | 15 | - | - | 8,084 | 7,814 |
| Deferred tax asset | 10 | 2,557 | 2,557 | - | - |
| Other receivables | 16 | 123 | 227 | 14,793 | 5,793 |
| Total non-current assets | | 11,617 | 9,522 | 22,877 | 13,607 |
| *Current Assets* | | | | | |
| Trade and other receivables | 17 | 13,000 | 13,997 | 105 | 96 |
| Cash and cash equivalents | 18 | 19,433 | 17,086 | 2,636 | 3,076 |
| Total current assets | | 32,433 | 31,083 | 2,741 | 3,172 |
| Total assets | | 44,050 | 40,605 | 25,618 | 16,779 |
| **Liabilities** | | | | | |
| *Current Liabilities* | | | | | |
| Trade and other payables | 19 | 4,238 | 5,621 | 382 | 518 |
| Borrowings | 20 | - | 355 | - | - |
| Lease liabilities | 21 | 643 | - | - | - |
| Contract liabilities | 4 | 10,337 | 9,035 | - | - |
| Total current liabilities | | 15,218 | 15,011 | 382 | 518 |
| *Non-current Liabilities* | | | | | |
| Borrowings | 20 | - | - | - | - |
| Lease liabilities | 21 | 936 | - | - | - |
| Total non-current liabilities | | 936 | - | - | - |
| Total liabilities | | 16,154 | 15,011 | 382 | 518 |
| Net assets | | 27,896 | 25,594 | 25,236 | 16,261 |
| **Equity** | | | | | |
| Share capital | 23 | 3,126 | 3,118 | 3,126 | 3,118 |
| Capital reserves | 24 | 8,942 | 8,277 | 8,942 | 8,277 |
| Translation reserve | | 9 | 50 | (1,802) | (2,159) |
| Retained profits | | 15,819 | 14,149 | 14,970 | 7,025 |
| Total equity | | 27,896 | 25,594 | 25,236 | 16,261 |

As permitted by Section 408 of the Companies Act 2006, the income statement of the parent company is not presented as part of these financial statements. The profit dealt with in the financial statements of the parent company for the year ended 31 December 2019 was $8,323,000 (2018: profit of $2,994,000).

Approved by the board and authorized for issue on 18 March 2020.

Barry K. Mence
Director

Arif Karimjee
Director

# CONSOLIDATED AND COMPANY CASH FLOW STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2019

| | Notes | Group 2019 $'000 | Group 2018 $'000 | Company 2019 $'000 | Company 2018 $'000 |
|---|---|---|---|---|---|
| **Operating Activities** | | | | | |
| Profit for the year | | 2,048 | 6,920 | 8,323 | 2,994 |
| *Adjustments for:* | | | | | |
| Finance income | 8 | (166) | (102) | - | - |
| Finance costs | 9 | 127 | 77 | 4 | 4 |
| Depreciation of property, plant and equipment | 13 | 364 | 297 | - | - |
| Depreciation of right-of-use assets | 21 | 698 | - | - | - |
| Amortization of intangible assets | 14 | 2,342 | 2,230 | - | - |
| Share-based payment expense | | 620 | 512 | 620 | 512 |
| Deferred tax credit | | - | (547) | - | - |
| Tax refundable in future years | | - | (208) | - | - |
| Operating cash flows before movements in working capital | | 6,033 | 9,179 | 8,947 | 3,510 |
| Intra-group credits and charges | | - | - | (634) | (713) |
| Decrease in provisions against intra-group loans | | - | - | (9,359) | (3,775) |
| Decrease/(increase) in receivables | | 1,071 | 1,175 | (9) | - |
| (Decrease)/increase in payables | | (50) | 318 | (135) | 344 |
| Net cash generated from/(used in) operating activities | | 7,054 | 10,672 | (1,190) | (634) |
| **Investing Activities** | | | | | |
| Finance income | 8 | 166 | 102 | - | - |
| Purchases of property, plant and equipment | 13 | (345) | (420) | - | - |
| Development costs capitalized | 14 | (3,010) | (2,615) | - | - |
| Advance of loans to group companies | | - | - | (1,940) | (1,484) |
| Repayment of loans by group companies | | - | - | 3,107 | 3,866 |
| Net cash (used in)/generated from investing activities | | (3,189) | (2,933) | 1,167 | 2,382 |
| **Financing Activities** | | | | | |
| Issues of shares | | 105 | 213 | 105 | 213 |
| Repayment of borrowings | 20 | (29) | (170) | - | - |
| Repayment of line of credit | 20 | (325) | (2,674) | - | - |
| Lease payments | 21 | (739) | - | - | - |
| Interest paid | | (60) | (77) | (4) | (4) |
| Dividends paid | 25 | (430) | (337) | (430) | (337) |
| Net cash used in financing activities | | (1,478) | (3,045) | (329) | (128) |
| Net increase/(decrease) in cash and cash equivalents | | 2,387 | 4,694 | (352) | 1,620 |
| Cash and cash equivalents at the beginning of the year | | 17,086 | 12,729 | 3,076 | 1,492 |
| Effect of foreign exchange rate changes | | (40) | (337) | (88) | (36) |
| Cash and cash equivalents at the end of the year | 18 | 19,433 | 17,086 | 2,636 | 3,076 |

# CONSOLIDATED AND COMPANY STATEMENTS OF CHANGES IN EQUITY FOR THE YEAR ENDED 31 DECEMBER 2019

*Group*

| | *Share Capital $'000* | *Capital Reserves $'000* | *Translation Reserve $'000* | *Retained Profits $'000* | *Total $'000* |
|---|---|---|---|---|---|
| At 1 January 2018 | 3,079 | 7,720 | 364 | 7,437 | 18,600 |
| Profit for the year | - | - | - | 6,920 | 6,920 |
| Exchange differences on translation of foreign operations | - | - | (314) | - | (314) |
| Total comprehensive income for the year | - | - | (314) | 6,920 | 6,606 |
| Issues of shares | 39 | 174 | - | - | 213 |
| Recognition of share-based payments | - | 512 | - | - | 512 |
| Lapse or exercise of share options and warrants | - | (129) | - | 129 | - |
| Dividends paid in year | - | - | - | (337) | (337) |
| At 1 January 2019 | 3,118 | 8,277 | 50 | 14,149 | 25,594 |
| Profit for the year | - | - | - | 2,048 | 2,048 |
| Exchange differences on translation of foreign operations | - | - | (41) | - | (41) |
| Total comprehensive income for the year | - | - | (41) | 2,048 | 2,007 |
| Issues of shares | 8 | 97 | - | - | 105 |
| Recognition of share-based payments | - | 620 | - | - | 620 |
| Lapse or exercise of share options and warrants | - | (52) | - | 52 | - |
| Dividends paid in year | - | - | - | (430) | (430) |
| At 31 December 2019 | 3,126 | 8,942 | 9 | 15,819 | 27,896 |

The translation reserve represents accumulated differences on the translation of assets and liabilities of foreign operations. Full details of capital reserves are set out in Note 24.

*Company*

| | *Share Capital $'000* | *Capital Reserve $'000* | *Translation Reserve $'000* | *Retained Profits $'000* | *Total $'000* |
|---|---|---|---|---|---|
| At 1 January 2018 | 3,079 | 7,720 | (1,380) | 4,239 | 13,658 |
| Profit and total comprehensive income for the year | - | - | (779) | 2,994 | 2,215 |
| Issues of shares | 39 | 174 | - | - | 213 |
| Recognition of share-based payments | - | 512 | - | - | 512 |
| Lapse or exercise of share options and warrants | - | (129) | - | 129 | - |
| Dividends paid in year | - | - | - | (337) | (337) |
| At 1 January 2019 | 3,118 | 8,277 | (2,159) | 7,025 | 16,261 |
| Profit and total comprehensive income for the year | - | - | 357 | 8,323 | 8,680 |
| Issues of shares | 8 | 97 | - | - | 105 |
| Recognition of share-based payments | - | 620 | - | - | 620 |
| Lapse or exercise of share options and warrants | - | (52) | - | 52 | - |
| Dividends paid in year | - | - | - | (430) | (430) |
| At 31 December 2019 | 3,126 | 8,942 | (1,802) | 14,970 | 25,236 |

## 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 22. The principal activities of the company and its subsidiaries are described in Note 3. The financial statements have been presented in US Dollars 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.

The impact of the adoption of IFRS 16 Leases is described under the relevant heading below. A number of other 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 other new standards, amendments and interpretations in issue but not yet effective are expected to have a material effect on the financial statements.

While the functional currency of the parent company is Sterling, the group’s financial statements have been presented in US Dollars. The directors believe this better reflects the underlying nature of the business. Approximately two-thirds of the group’s revenue and operating costs are denominated in US Dollars. The exchange rates used for translation of Sterling amounts are 1.3210 US Dollars to British Pounds Sterling as at 31 December 2019 and 1.2804 US Dollars to British Pounds Sterling as the average rate prevailing during 2019.

### 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 and the cash and financing facilities available to the group.

### Basis of Preparation

The consolidated financial statements incorporate the financial statements of the parent company Sopheon plc and the financial statements of the subsidiaries controlled by the group as defined by IFRS 10 Consolidated Financial Statements, as shown in Note 15. Where the company has control over an investee, it is classified as a subsidiary. The company controls an investee if all three of the following elements are present: power over the investee, exposure to variable returns from the investee, and the ability of the investor to use its power to affect those variable returns. The financial statements of all the group companies are prepared using uniform accounting policies. 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. 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 on 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.

There have been no business combinations in the period covered by this report.

**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 perpetual software licenses are recognized once no significant obligations remain owing to the customer in connection with such license sale. Such significant obligations could include giving a customer a right to return the software product without any preconditions, or if the group is unable to deliver a material element of the software product by the balance sheet date. Revenues relating to software subscription, maintenance, and hosting agreements are deferred creating a contract liability at the period end, and recognized evenly over the term of the agreements, due to the customer simultaneously receiving and consuming the benefits of the contractual performance obligation over that term.

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. Based on stage of completion and billing arrangement, either a contract asset or a contract liability is created at the period end. Where the group is acting as a principal, other income includes recoverable costs that have been incurred in the course of business including travel expenses of employees and contractors.

Where a sales contract involves multiple service obligations, the allocation of the transaction price is performed proportionally based on the standalone selling price for each obligation. The way in which management assigns the selling price to each separate performance obligation is based on the cost of satisfying the performance obligation plus an appropriate margin based on experience of standalone sales.

**Leases**

The implementation of IFRS 16 replaced the existing guidance in IAS 17: Leases. The standard sets out the principles for the recognition, measurement, presentation and disclosure of leases and the group adopted the new standard with effect from 1 January 2019.

Prior to the 2019 financial year, the group classified its leases either as finance leases or operating leases. Payments made under operating leases were charged to profit or loss on a straight-line basis over the period of the lease.

IFRS 16 changes the previous guidance in IAS 17 and requires lessees to recognize a lease liability that reflects the net present value of future lease payments and a corresponding "right-of-use asset" in all lease contracts, although lessees may elect not to recognize lease liabilities and right-of-use assets in respect of short-term leases or leases of assets of low value.

The company has elected not to recognize right-of-use assets and lease liabilities in respect of certain leases of office equipment of low value or of short term. The lease payments associated with these leases is recognized as an expense on a straight-line basis over the lease term.

IFRS 16 also changes the definition of a "lease" and the manner of assessing whether a contract contains a lease. At inception of a contract, the group assesses whether a contract is, or contains, a lease based on whether the contract conveys the right to control the use of an identified asset for a period of time in exchange for consideration.

The group recognizes a right-of-use asset and a corresponding lease liability at the lease commencement date. The lease liability is initially measured at the present value of the following lease payments:

- fixed payments;
- variable payments that are based on index or rate;
- the exercise price of any extension or purchase option if reasonably certain to be exercised; and
- penalties for terminating the lease, if relevant.

The lease payments are discounted using the interest rate implicit in the lease or, if that rate cannot be readily determined, the group's incremental borrowing rate. The group has used its incremental borrowing rate as the discount rate.

The right-of-use assets are initially measured based on the initial amount of the lease liability adjusted for any lease payments made at or before the commencement date, plus any initial direct costs. The right-of-use assets are depreciated over the period of the lease term, or, if earlier, the useful life of the asset, using the straight-line method. The lease term includes periods covered by an option to extend, if the group is reasonably certain to exercise that option. In addition, the right-of-use assets may during the lease term be reduced by impairment losses, if any, or adjusted for certain remeasurements of the lease liability.

*Impact of IFRS 16*

Under IAS 17 the group did not recognize related assets or liabilities, but instead disclosed the total amount of commitments under operating leases calculated on a straight-line basis over the respective lease terms. The new standard requires the group to recognize interest on its lease liabilities and amortization of its right-of-use assets, instead of recognizing lease payments as part of operating costs. Accordingly, this change has increased adjusted EBITDA in the year to 31 December 2019 by $734,000 but has not had a material effect on the group's profit for the year.

Further details of the practical expedients used by the group in adopting IFRS 16 Leases are set out in Note 21.

**Interest on Borrowings**

All interest on borrowings is recognized in the income statement using the effective interest rate method.

**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 plans.

**Foreign Currencies**

The individual financial statements of each group entity are prepared 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 US Dollars 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. The same approach is used to translate the financial statements of the company on a stand-alone basis from Sterling to US Dollars. The equity of the company and group is retranslated into the presentational currency at its historic rate.

**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. Deferred tax assets are recognized only to the extent that the level and timing of taxable profits can be measured, and it is probable that these 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.

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.

**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.

Development costs not satisfying the above criteria and expenditure on the research phase of internal projects are recognized in the income statement as incurred. Capitalization of a particular activity commences after proof of concept, requirements and functional concept stages are complete.

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.

**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.

**Segmental Reporting**

Operating segments are reported in a manner consistent with the internal reporting provided to the chief operating decision maker of the group, which has been identified as the board of directors.

**Share-based Payments**

The group awards share options in the company, being the parent entity, to certain employees. These are treated as equity-settled share-based payments and are measured at fair value (excluding the effect of non-market-based vesting conditions) at the date of grant. This fair value 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. Where an option vests in multiple instalments, each instalment is treated as a separate grant with its own vesting period. In the consolidated financial statements, the entire expense is recognized within administrative expenses. At the individual entity level, the expense is transferred to the employing subsidiary and in the company, the benefit transferred is recognized as an increase in investment in subsidiaries, and this increase is then assessed for impairment in accordance with the company's accounting policy.

**Financial Instruments**

**1. Financial Assets**

Financial assets do not include prepayments. Management determines the classification of financial assets at initial recognition.

*Amortized Costs*

These assets arise principally from the provision of goods and services to customers (e.g. trade receivables), but also incorporate other types of financial assets where the objective is to hold these assets in order to collect contractual cash flows and the contractual cash flows are solely payments of principal and interest. They are initially recognized at fair value plus transaction costs that are directly attributable to their acquisition or issue, and are subsequently carried at amortized cost using the effective interest rate method, less provision for impairment.

Impairment provisions for current and non-current trade receivables are recognized based on the simplified approach within IFRS 9 using the lifetime expected credit losses. During this process the probability of the non-payment of the trade receivables is assessed. This probability is then multiplied by the amount of the expected loss arising from default to determine the lifetime expected credit loss for the trade receivables. For trade receivables, which are reported net, such provisions are recorded in a separate provision account with the loss being recognized within cost of sales in the consolidated statement of comprehensive income. On confirmation that the trade receivable will not be collectable, the gross carrying value of the asset is written off against the associated provision.

Financial assets held at amortized cost comprise trade and other receivables, contract assets, and cash and cash equivalents in the consolidated statements of financial position.

**2. Financial Liabilities**

The group classifies its financial liabilities in the category of financial liabilities at amortized cost. All financial liabilities are recognized in the statement of financial position when the company becomes a party to the contractual provision or the instrument.

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, and lease liabilities 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. 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, the group considers its capital to comprise its ordinary share capital, its capital reserves (as set out in Note 24), and its retained earnings.

**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. 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.

Estimates have been adopted for the depreciation and amortization periods relating to property, plant and equipment, externally acquired intangible assets and internally generated intangible assets. These are dealt with in the accounting policy notes set forth above that relate to these areas.

Judgement has been used to determine the assumed discount rate of 9 percent used for recoverability assessment relating to intangible assets referred to in Note 14, and the discount rate of 3.75 percent used in respect of the application of IFRS 16 further described in Note 21. The difference in rate selected reflects assessment of the differing risk profile of the underlying assets. Judgement has also been used in determining that no provision is required for credit losses on trade receivables, based on the quality of the group's customers and historic loss experience as further described in Note 17.

Where the sales contract involves multiple service obligations the allocation of the transaction price is performed proportionally based on the standalone selling price for each obligation. The way in which management assigns the selling price to each separate performance obligation is based on the cost of satisfying the performance obligation plus an appropriate margin.

## 3. SEGMENTAL ANALYSIS

All of the group's revenue in respect of the years ended 31 December 2019 and 2018 was derived from the design, development and marketing of software products with associated implementation and consultancy services, as more particularly described in the Strategic Report. The business is seen as one cash-generating unit and operates as a single operating segment. For management purposes, the group is organized geographically across two principal territories, North America and Europe. Information relating to this geographical split is outlined below.

The information in the following table provides analysis by location of operations. Inter-segment revenues are priced on an arm's length basis.

| *Year ended 31 December 2019* | *North America $'000* | *Europe $'000* | *Total $'000* |
|---|---|---|---|
| *Income Statement* | | | |
| External revenues | 20,690 | 9,564 | 30,254 |
| Operating profit before interest and tax | 3,887 | (1,469) | 2,418 |
| Profit before tax* | 3,962 | (1,505) | 2,457 |
| Finance income | 166 | - | 166 |
| Finance expense | (91) | (36) | (127) |
| Depreciation and amortization | (2,991) | (413) | (3,404) |
| Adjusted EBITDA* | 6,879 | (437) | 6,442 |
| *Balance Sheet* | | | |
| Fixed asset additions | 243 | 102 | 345 |
| Capitalization of internally generated development costs | 3,010 | - | 3,010 |
| Total assets | 29,052 | 14,998 | 44,050 |
| Total liabilities | (11,123) | (5,031) | (16,154) |

| *Year ended 31 December 2018* | *North America $'000* | *Europe $'000* | *Total $'000* |
|---|---|---|---|
| *Income Statement* | | | |
| External revenues | 21,614 | 12,308 | 33,922 |
| Operating profit before interest and tax | 6,068 | 313 | 6,381 |
| Profit before tax* | 6,100 | 306 | 6,406 |
| Finance income | 102 | - | 102 |
| Finance expense | (70) | (7) | (77) |
| Depreciation and amortization | (2,464) | (63) | (2,527) |
| Adjusted EBITDA* | 5,273 | 4,112 | 9,385 |
| *Balance Sheet* | | | |
| Fixed asset additions | 272 | 148 | 420 |
| Capitalization of internally generated development costs | 2,615 | - | 2,615 |
| Total assets | 26,246 | 14,359 | 40,605 |
| Total liabilities | (10,041) | (4,970) | (15,011) |

*Reconciliation from profit before tax to adjusted EBITDA is detailed in Note 5.

Revenues attributable to customers in North America in 2019 amounted to $20,003,000 (2018: $20,985,000). Revenues attributable to customers in the rest of the world amounted to $10,245,000 (2018: $12,937,000) of which $8,762,000 (2018: $11,555,000) was attributable to customers in Europe.

No individual customer accounted for more than 10 percent of the group's revenues in 2019. One customer, located in North America, accounted for approximately 11 percent of the group's revenues in 2018.

## 4. REVENUE FROM CONTRACTS WITH CUSTOMERS

*Disaggregation of Revenue*

Revenue attributable to each of the group's primary geographic markets is analyzed in Note 3 above. The following table provides further disaggregation of revenue in accordance with the IFRS 15 requirement to depict how the nature, amount, timing and uncertainty of revenue and cash flows are affected by economic factors.

| | *2019 $'000* | *2018 $'000* |
|---|---|---|
| Perpetual software licenses | 5,401 | 8,921 |
| Consulting and implementation services | 9,355 | 10,771 |
| Maintenance, software subscriptions and hosting | 15,498 | 14,230 |
| | 30,254 | 33,922 |

Perpetual licenses are recognized at a point in time. Consulting and implementation services, and maintenance, subscription and hosting services, are recognized over time. Further details of the revenue recognition approaches are described in Note 2.

*Contract Balances*

Contract assets and contract liabilities arise because cumulative billings to customers at each balance sheet date does not necessarily equal the amount of revenue recognized on the contracts. Contract assets, historically described as accrued income, represent performance obligations that have been satisfied but not yet billed at the end of the reporting period. Contract liabilities, historically described as deferred revenue, represent transaction price allocated to the performance obligations that are unsatisfied (or partially unsatisfied) as of the end of the reporting period. The group does not have any instances where payment is received in advance for multi-year contracts; all invoicing is annual as per contract terms.

| | *Contract Assets* | | *Contract Liabilities* | |
|---|---|---|---|---|
| | *2019 $'000* | *2018 $'000* | *2019 $'000* | *2018 $'000* |
| At 1 January | 1,109 | 382 | 9,035 | 8,345 |
| Transfers in the period from contract assets to trade receivables | (1,109) | (382) | - | - |
| Revenue recognized ahead of cash (or rights to cash) | 397 | 1,109 | - | - |
| Transfers in the period from contract liabilities to revenue | - | - | (9,035) | (8,345) |
| Cash (or rights to cash) received in advance of revenue recognition | - | - | 10,337 | 9,035 |
| At 31 December | 397 | 1,109 | 10,337 | 9,035 |

## 5. PROFIT FOR THE YEAR

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

| | *2019 $'000* | *2018 $'000* |
|---|---|---|
| Net foreign exchange losses/(gains) | 100 | (31) |
| Research and development costs (excluding amortization) | 3,340 | 2,848 |
| Amortization of intangible assets | 2,342 | 2,230 |
| Depreciation of property, plant and equipment | 364 | 297 |
| Depreciation of right-of-use assets | 698 | - |
| Employee share-based payments | 620 | 512 |

Net foreign exchange gains or losses arise on the translation of cash and trade balances held in currencies other than the functional currency of the entity concerned and are accordingly included in administration expense.

Adjusted EBITDA, which is a company specific measure, defined as earnings before interest, tax, depreciation, amortization, and employee share-based payment charges, is considered to be an important profit measure, since it is widely used by the investment community. See page 19 for further information on the use of this measure. It is calculated as follows:

| | *2019 $'000* | *2018 $'000* |
|---|---|---|
| Profit for the year before tax | 2,457 | 6,406 |
| Interest payable | 127 | 77 |
| Interest receivable | (166) | (102) |
| Write-back of investment provision | - | (35) |
| Amortization of intangible assets | 2,342 | 2,230 |
| Depreciation of property, plant and equipment | 364 | 297 |
| Depreciation of right-of-use assets | 698 | - |
| Employee share-based payments | 620 | 512 |
| Adjusted EBITDA | 6,442 | 9,385 |

## 6. AUDITORS' REMUNERATION

During the year the group obtained the following services from its auditors and associated firms.

| | *2019 $'000* | *2018 $'000* |
|---|---|---|
| Audit of the financial statements of the group | 72 | 68 |
| Audit of the financial statements of the UK subsidiary | 5 | 5 |
| Review of interim financial information | 17 | 16 |
| Tax compliance services | 31 | 22 |

## 7. STAFF COSTS

| | *2019 $'000* | *2018 $'000* |
|---|---|---|
| Wages and salaries | 17,959 | 17,181 |
| Social security costs | 1,529 | 1,388 |
| Pension contributions | 442 | 419 |
| Employee benefits expense | 1,049 | 942 |
| | 20,979 | 19,930 |

Included within the above are staff costs capitalized as development expenditure amounting to $3,010,000 (2018: $2,615,000). Included within wages and salaries are bonus and sales commission costs amounting to $2,108,000 (2018: $3,027,000).

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

| | *2019 Number* | *2018 Number* |
|---|---|---|
| Development and operations | 107 | 97 |
| Sales and management | 53 | 45 |
| | 160 | 142 |

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

The remuneration of all directors was as follows:

| | *2019 $'000* | *2018 $'000* |
|---|---|---|
| Fees and emoluments | 961 | 1,141 |
| Pension contributions | 22 | 23 |
| | 983 | 1,164 |

During the year no share options (2018: 70,000) were exercised by directors. Pension contributions are to personal defined contribution schemes and have been made for three directors (2018: three) who served during the year.

Full details of directors' remuneration are disclosed in the Board Committee Reports on page 23.

Staff costs in the parent company amounted to $513,000 including bonuses (2018: $602,000). The average monthly number of staff of the parent company during the year included one full time and two part time (2018: one and two).

## 8. FINANCE INCOME

| | *2019 $'000* | *2018 $'000* |
|---|---|---|
| Income on financial assets measured at amortized cost | | |
| Interest income on bank deposits | 166 | 102 |

## 9. FINANCE EXPENSE

| | *2019 $'000* | *2018 $'000* |
|---|---|---|
| Interest expense on financial liabilities measured at amortized cost | | |
| Interest on borrowings | (60) | (77) |
| Interest on lease liabilities | (67) | - |
| | (127) | (77) |

## 10. INCOME TAX CREDIT

| | *2019 $'000* | *2018 $'000* |
|---|---|---|
| Income tax (charge)/credit for the year – current tax | (409) | 514 |

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

| | 2019 $'000 | 2018 $'000 |
|---|---|---|
| Profit before tax | 2,457 | 6,406 |
| Tax charge at the UK corporation tax rate of 19% (2018: 19%) | (467) | (1,217) |
| Adjustment for differing rates of corporate taxation in overseas jurisdictions | (139) | (401) |
| Tax effect of expenses that are not deductible in determining taxable profits | (192) | (154) |
| Temporary differences arising from the capitalization and transfer of development investments | 127 | 56 |
| Utilization of prior year losses | 262 | 1,476 |
| Current tax expense for the year | (409) | (240) |
| US Alternative Minimum Tax refundable | - | 208 |
| Recognition of deferred tax asset | - | 547 |
| Total income tax credit for the year | (409) | 514 |

The current tax expense represents German corporation tax payable by Sopheon GmbH and US state taxes payable by the group's US subsidiaries.

US corporate Alternative Minimum Tax (AMT) has been repealed in respect of tax years beginning on or after 1 January 2018. AMT paid by US corporations in respect of periods prior to that date is refundable over a four-year period to December 2021. Of the $208,000 of refundable AMT credited in 2018, Sopheon's US subsidiaries received $104,000 during the year, with the balance refundable in future years.

The deferred tax income represents the recognition of a deferred tax asset arising from historic trading losses of the group's US and UK subsidiaries.

There is no tax arising on other comprehensive income.

**Deferred Tax Asset**

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

The deferred tax asset which has been recognized in the financial statements is as follows:

| | 2019 $'000 | 2018 $'000 |
|---|---|---|
| Deferred tax asset at 1 January | 2,557 | 2,010 |
| Amount recognized during the year | - | 547 |
| Deferred tax asset at 31 December | 2,557 | 2,557 |

The unrecognized deferred tax asset is made up as follows:

| | 2019 $'000 | 2018 $'000 |
|---|---|---|
| Shortfall of tax depreciation compared to book depreciation | 156 | 144 |
| Effect of timing differences arising from capitalization of internally generated development costs | (1,212) | (1,072) |
| Unrelieved trading losses | 8,027 | 8,189 |
| Unrecognized deferred tax asset at 31 December 2019 | 6,971 | 7,261 |

At 31 December 2019, tax losses estimated at $52m (2018: $53m) were available to carry forward by the Sopheon group, arising from historic losses incurred. These losses have given rise to a deferred tax asset of $2.6m (2018: $2.6m) and a further potential deferred tax asset of $8.0m (2018: $8.2m), based on the tax rates currently applicable in the relevant tax jurisdictions.

Of these tax losses, an aggregate amount of $8.8m, representing $1.9m of the potential deferred tax asset (2018: $8.8m and $1.9m respectively) represents pre-acquisition tax losses of 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. PROFIT DEALT WITH IN THE FINANCIAL STATEMENTS OF THE PARENT COMPANY

The profit dealt with in the financial statements of the parent company for the year ended 31 December 2019 was $8,323,000 (2018: profit of $2,994,000). The parent company's result includes an increase in the amount recognized in respect of loans to subsidiaries amounting to $9,359,000 (2018: $1,130,000). Further details of parent company loans to subsidiaries appear in Note 16.

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

| | *2019 $'000* | *2018 $'000* |
|---|---|---|
| **Basic earnings per share** | | |
| Profit after tax | 2,048 | 6,920 |
| | *'000s* | *'000s* |
| Weighted average number of ordinary shares for the purpose of basic earnings per share | 10,156 | 10,088 |
| Earnings per share | 20.16c | 68.60c |
| | *'000s* | *'000s* |
| **Diluted earnings per share** | | |
| Profit after tax | 2,048 | 6,920 |
| Diluted profit after tax | 2,048 | 6,920 |
| | *'000s* | *'000s* |
| Weighted average number of ordinary shares for the purpose of basic earnings per share | 10,667 | 10,649 |
| Diluted earnings per share | 19.20c | 64.98c |

For the purpose of calculating the diluted earnings per ordinary share in 2019 and 2018, in respect of the outstanding 868,394 share options (details of which are set out in Note 28), the treasury stock method is used. This assumes that options to subscribe for Sopheon shares at prices below the average share price prevailing during the year are exercised on 1st January of the relevant year (or, if later, on the date of grant) and that the proceeds from exercise of such options are reinvested in treasury shares at the average price prevailing during the year.

## 13. PROPERTY, PLANT AND EQUIPMENT

| *Group* | *Computer Equipment $'000* | *Furniture & Fittings $'000* | *Total $'000* |
|---|---|---|---|
| **Cost** | | | |
| At 1 January 2018 | 2,424 | 463 | 2,887 |
| Additions | 299 | 121 | 420 |
| Exchange differences | (17) | (7) | (24) |
| At 1 January 2019 | 2,706 | 577 | 3,283 |
| Additions | 333 | 12 | 345 |
| Exchange differences | (4) | (3) | (7) |
| At 31 December 2019 | 3,035 | 586 | 3,621 |
| **Accumulated Depreciation** | | | |
| At 1 January 2018 | 2,084 | 386 | 2,470 |
| Depreciation charge for the year | 264 | 33 | 297 |
| Exchange differences | (13) | (3) | (16) |
| At 1 January 2019 | 2,335 | 416 | 2,751 |
| Depreciation charge for the year | 304 | 60 | 364 |
| Exchange differences | (2) | (2) | (4) |
| At 31 December 2019 | 2,637 | 474 | 3,111 |
| **Carrying Amount** | | | |
| At 31 December 2019 | 398 | 112 | 510 |
| At 31 December 2018 | 371 | 161 | 532 |

*Company*

The company has no property, plant and equipment.

## 14. INTANGIBLE ASSETS

| | *Development Costs (Internally Generated) $'000* | *Goodwill $'000* | *Total $'000* |
|---|---|---|---|
| **Cost** | | | |
| At 1 January 2018 | 24,165 | 1,022 | 25,187 |
| Additions (internally generated) | 2,615 | - | 2,615 |
| At 1 January 2019 | 26,780 | 1,022 | 27,802 |
| Additions (internally generated) | 3,010 | - | 3,010 |
| At 31 December 2019 | 29,790 | 1,022 | 30,812 |
| **Amortization** | | | |
| At 1 January 2018 | 19,366 | - | 19,366 |
| Charge for the year | 2,230 | - | 2,230 |
| At 1 January 2019 | 21,596 | - | 21,596 |
| Charge for the year | 2,342 | - | 2,342 |
| At 31 December 2019 | 23,938 | - | 23,938 |
| **Carrying Amount** | | | |
| At 31 December 2019 | 5,852 | 1,022 | 6,874 |
| At 31 December 2018 | 5,184 | 1,022 | 6,206 |

The amortization period for the internally generated development costs relating to the group's software products is four years. Goodwill that arose in prior periods is not amortized. The residual goodwill arising on the acquisition of Alignent is attributable to the enhanced market position of the group, due to the completeness of the solution that Sopheon can offer the market. The recoverable amount of the goodwill can be underpinned on a value in use basis by the expected performance of the group, which is seen as a single cash-generating unit.

The valuation used for this purpose is based on cash flow projections for the next five years, and thereafter for an indefinite period at a growth assumption of 3 percent (2018: 3 percent). The discount rate used was 9 percent (2018: 9 percent). Sensitivity analysis has been performed on these projections, specifically changes in assumed annual revenue growth, profit margin growth and terminal growth rate. This demonstrates significant valuation headroom above the carrying value of goodwill.

*Company*
The company has no intangible assets.

## 15. INVESTMENT IN SUBSIDIARIES

| | *Company* *$'000* |
|---|---|
| **At cost less amounts provided** | |
| At 31 December 2018 | 7,814 |
| Exchange difference | 230 |
| At 31 December 2019 | 8,084 |

Details of the company's subsidiaries at 31 December 2019 are set out below. Companies marked with an asterisk (*) are held via Sopheon UK Ltd. The common stock of Alignent Software, Inc. and Sopheon Corporation, Minnesota, USA are held by Sopheon Corporation, Delaware, USA. The share capital of Sopheon Corporation, Delaware, USA and Sopheon GmbH are held by Sopheon NV.

| *Name of Company Place of Incorporation* | *Nature of Ownership* | *Proportion of Voting Rights Held* | *Nature of Business* |
|---|---|---|---|
| Sopheon Corporation<br>3001 Metro Drive<br>Bloomington, MN 55425, USA | Common Stock | 100% | Software sales and services |
| Sopheon Corporation<br>6870 W 52nd Avenue<br>Arvada, CO 80002, USA | Common Stock | 100% | Software development and sales |
| Alignent Software, Inc.<br>3001 Metro Drive<br>Bloomington, MN 55425, USA | Common Stock | 100% | Software sales and services |
| Sopheon NV<br>Kantoorgebouw Officia 1<br>De Boelelaan 7, 1083 HJ<br>Amsterdam, The Netherlands | Ordinary Shares | 100% | Software sales and services |
| Sopheon UK Ltd<br>Dorna House One, 50 Guildford Road<br>West End GU24 9PW, UK | Ordinary Shares | 100% | Software sales and services |
| Sopheon GmbH<br>Lise-Meitner-Str. 10, D-64293<br>Darmstadt, Germany | Ordinary Shares | 100% | Software sales and services |
| Applied Network Technology Ltd*<br>Dorna House One, 50 Guildford Road<br>West End GU24 9PW, UK | Ordinary Shares | 100% | Employee Share Ownership Trust |

During 2019 the group wound up and dissolved several dormant subsidiaries.

## 16. OTHER RECEIVABLES

| | Group | | Company | |
|---|---|---|---|---|
| | 2019 $'000 | 2018 $'000 | 2019 $'000 | 2018 $'000 |
| Other receivables | 19 | 19 | - | - |
| Tax refundable in future years | 104 | 208 | - | - |
| Amounts due from subsidiary undertakings (net of provisions) | - | - | 14,793 | 5,793 |
| | 123 | 227 | 14,793 | 5,793 |

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

The tax refundable represents US Alternative Minimum Tax, further details of which appear in Note 10.

A partial credit loss provision of $33,622,000 (2018: $41,315,000) has been made against amounts totaling $48,415,000 (2018: $47,108,000) owed to the parent company by subsidiary undertakings, which are due after more than one year and are subordinated to the claims of all other creditors. The reduction in the credit loss provision during 2019 includes an additional amount of $9,359,000 which has been recognized in the parent company balance sheet, based upon an assessment of the expected performance of the group and its subsidiaries.

The expected credit loss provision against amounts due to the parent company from subsidiary undertakings has been assessed using a Stage 3 approach as detailed below.

| | 2019 $'000 | 2018 $'000 |
|---|---|---|
| At 1 January | 41,315 | 47,681 |
| Net repayments | (1,167) | (2,382) |
| Net management charges | 634 | 713 |
| Release of provision | (9,359) | (1,129) |
| Exchange adjustments | 2,199 | (3,568) |
| At 31 December | 33,622 | 41,315 |

## 17. TRADE AND OTHER RECEIVABLES

| | Group | | Company | |
|---|---|---|---|---|
| | 2019 $'000 | 2018 $'000 | 2019 $'000 | 2018 $'000 |
| Trade receivables | 11,722 | 12,014 | - | - |
| Other receivables | 55 | 56 | 79 | 77 |
| Total receivables | 11,777 | 12,070 | 79 | 77 |
| Prepayments | 826 | 818 | 26 | 19 |
| Contract assets | 397 | 1,109 | - | - |
| | 13,000 | 13,997 | 105 | 96 |

The carrying value of trade and other receivables classified at amortized cost approximates fair value.

The group has adopted the IFRS 9 simplified approach to measuring expected credit losses using a lifetime expected credit loss provision for trade receivables and contract assets. As further detailed in Note 22, the group's customers almost exclusively comprise major international corporations of good credit standing mostly based in the USA and the EU, and the group's historical credit loss experience is negligible. Accordingly, the trade receivables and contract assets are assessed as homogenous for the purposes of grouping for credit risk, and expected loss rate is expected to be nil leading to no provision for impairment being recorded.

## 18. CASH AND CASH EQUIVALENTS

| | Group | | Company | |
|---|---|---|---|---|
| | *2019 $'000* | *2018 $'000* | *2019 $'000* | *2018 $'000* |
| Cash at bank | 9,163 | 7,878 | 2,636 | 3,076 |
| Short-term bank deposits | 10,270 | 9,208 | - | - |
| | 19,433 | 17,086 | 2,636 | 3,076 |

Cash and cash equivalents 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 $66,000 (2018: $64,000) held by the group's employee share ownership trust.

## 19. TRADE AND OTHER PAYABLES

| | Group | | Company | |
|---|---|---|---|---|
| | *2019 $'000* | *2018 $'000* | *2019 $'000* | *2018 $'000* |
| Trade payables | 821 | 636 | 44 | 51 |
| Other payables | 124 | 471 | 132 | 120 |
| Tax and social security costs | 597 | 1,104 | - | - |
| Accruals | 2,696 | 3,410 | 206 | 347 |
| | 4,238 | 5,621 | 382 | 518 |

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 | |
|---|---|---|---|---|
| | *2019 $'000* | *2018 $'000* | *2019 $'000* | *2018 $'000* |
| *Current Loans and Borrowings* | | | | |
| Line of credit | - | 326 | - | - |
| Loan notes (current portion) | - | 29 | - | - |
| Total current loans and borrowings | - | 355 | - | - |
| *Non-current Loans and Borrowings* | | | | |
| Loan notes (non-current portion) | - | - | - | - |
| Total non-current loans and borrowings | - | - | - | - |
| Total loans and borrowings | - | 355 | - | - |

The following is an analysis of the group's movements in loans and borrowings, analyzed between cash and non-cash changes:

| | *2018* *$'000* | *Cash Flows* *$'000* | *Settled Through Equity* *$'000* | *2019* *$'000* |
|---|---|---|---|---|
| Line of credit | 326 | (326) | - | - |
| Loan notes | 29 | (29) | - | - |
| Total loans and borrowings | 355 | (355) | - | - |

The group's line of credit facility and all loan notes due to Silicon Valley Bank were fully repaid during the year.

## 21. LEASES

With effect from January 1, 2019, the company has adopted IFRS 16 Leases, which specifies how to recognize, measure, present and disclose leases. The company has not restated comparatives for the 2018 reporting period, as permitted under the specific transitional provisions in the standard. The reclassifications and the adjustments arising from the new leasing rules are therefore recognized in the opening balance sheet on 1 January 2019.

On initial application, the group recognized lease liabilities in relation to leases which had previously been classified as 'operating leases' under the principles of IAS 17: Leases. These liabilities were measured at the present value of the remaining lease payments, discounted using the lessee's weighted average incremental borrowing rate as at 1 January 2019 of 3.75 percent. The company has elected to record right-of-use assets as equal to the corresponding lease liabilities as the impact of potential additional costs or deductions to the assets are immaterial.

In applying IFRS 16 for the first time, the group has used the following practical expedients permitted by the standard:

- the use of a single discount rate to a portfolio of leases with reasonably similar characteristics;
- reliance on previous assessments on whether leases are onerous;
- the exclusion of initial direct costs for the measurement of the right-of-use asset at the date of initial application; and
- the use of hindsight in determining the lease term where the contract contains options to extend or terminate the lease.

The group has also elected not to reassess whether a contract is or contains a lease at the date of initial application. Instead, for contracts entered into before the application date, the group has relied on its assessment made applying IAS 17 and IFRIC 4 in determining whether an arrangement is or contains a lease.

**Right-of-Use Assets**

| | *Leased Buildings* *$'000* | *Leased Vehicles* *$'000* | *Total* *$'000* |
|---|---|---|---|
| At 1 January 2019 | 1,911 | 187 | 2,098 |
| Additions in year | - | 170 | 170 |
| Amortization | (590) | (108) | (698) |
| Exchange differences | (13) | (4) | (17) |
| At 31 December 2019 | 1,308 | 245 | 1,553 |

**Lease Liabilities**

| | *Leased Buildings $'000* | *Leased Vehicles $'000* | *Total $'000* |
|---|---|---|---|
| At 1 January 2019 | 1,911 | 187 | 2,098 |
| Additions in year | - | 170 | 170 |
| Interest expense | 61 | 6 | 67 |
| Lease payments | (627) | (112) | (739) |
| Exchange differences | (13) | (4) | (17) |
| At 31 December 2019 | 1,332 | 247 | 1,579 |

The maturity of the lease liabilities is as follows:

| | *Carrying amount $'000* | *Contractual cash-flow $'000* | *Less than one year $'000* | *One to two years $'000* | *Two to five years $'000* |
|---|---|---|---|---|---|
| At 31 December 2019 | | | | | |
| Leased buildings | 1,332 | 1,406 | 587 | 426 | 393 |
| Leased vehicles | 247 | 264 | 103 | 54 | 107 |
| Total | 1,579 | 1,670 | 690 | 480 | 500 |

The following table sets out the impact of adopting IFRS 16 on the financial position of the group at 1 January 2019:

| | *As presented at 31 December 2018 $'000* | *IFRS 16 Adjustments $'000* | *At 1 January 2019 $'000* |
|---|---|---|---|
| **Assets** | | | |
| Right-of-use assets - buildings | - | 1,911 | 1,911 |
| Right-of-use assets - vehicles | - | 187 | 187 |
| **Liabilities** | | | |
| Lease liabilities - buildings | - | 1,911 | 1,911 |
| Lease liabilities - vehicles | - | 187 | 187 |
| **Equity** | | | |
| Retained earnings | 14,149 | - | 14,149 |

The following table sets out the impact of adopting IFRS 16 on the financial position of the group at 1 January 2019:

| | *Land & Buildings $'000* | *Other $'000* | *Total $'000* |
|---|---|---|---|
| Minimum operating lease commitment at 31 December 2018 | 1,377 | 159 | 1,536 |
| Effect of extension options reasonably likely to be exercised | 670 | 47 | 717 |
| Low value or short-term leases not recognized under IFRS 16 | - | (11) | (11) |
| Undiscounted lease payments | 2,047 | 195 | 2,242 |
| Effect of discounting at the group's incremental borrowing rate | (136) | (8) | (144) |
| Lease liabilities recognized at 1 January 2019 | 1,911 | 187 | 2,098 |

*Leased Buildings*

Buildings are leased for office space under leases which typically run for a period of 1-5 years and lease payments are at fixed amounts. Some leases for office buildings include extension options exercisable up to one year before the end of the cancellable lease term.

*Leased Vehicles*

The group leases vehicles for qualifying employees with a standard lease term of 4 years with fixed lease payments. The group does not purchase or guarantee the future value of leased vehicles.

*Leased Equipment*

The group has a small number of leases of office equipment. The group considers these leases to be of low value or short term in nature and therefore no right-of-use assets or lease liabilities are recognized for these leases.

## 22. 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 financial assets measured at amortized cost, and all of its financial liabilities are in the category of financial liabilities measured at amortized cost.

**1. Financial Assets**

| | | *Group* | | *Company* | |
|---|---|---|---|---|---|
| | *Notes* | *2019 $'000* | *2018 $'000* | *2019 $'000* | *2018 $'000* |
| *Current Financial Assets* | | | | | |
| Trade receivables | 17 | 11,722 | 12,014 | - | - |
| Other receivables | 17 | 55 | 56 | 79 | 77 |
| Amounts due from subsidiary companies | 16 | - | - | 14,793 | 5,793 |
| Contract assets | 17 | 397 | 1,109 | - | - |
| Cash and cash equivalents | 18 | 19,433 | 17,086 | 2,636 | 3,076 |
| | | 31,607 | 30,265 | 17,508 | 8,946 |
| *Non-current Financial Assets* | | | | | |
| Other receivables | 16 | 123 | 227 | - | - |

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

## 2. Financial Liabilities

| | | Group | | Company | |
|---|---|---|---|---|---|
| | Notes | *2019 $'000* | *2018 $'000* | *2019 $'000* | *2018 $'000* |
| *Current Financial Liabilities* | | | | | |
| Trade payables | 19 | 821 | 636 | 44 | 51 |
| Other payables | 19 | 124 | 471 | 132 | 120 |
| Accruals | 19 | 2,696 | 3,410 | 206 | 347 |
| Loans and borrowings | 20 | - | 355 | - | - |
| Lease liabilities | 21 | 643 | - | - | - |
| | | 4,284 | 4,872 | 382 | 518 |
| *Non-current Financial Liabilities* | | | | | |
| Loans and borrowings | 20 | - | - | - | - |
| Lease liabilities | 21 | 936 | - | - | - |
| | | 936 | - | - | - |
| | | 5,220 | 4,872 | 382 | 518 |

**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
- Loans and borrowings
- Lease liabilities

*General Objectives, Policies and Processes*

The board has overall responsibility for the determination of the group's risk management objectives and policies and, while 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 contract assets. 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 negligible. 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 2019 no individual customer accounted for more than 10 percent of group revenues (2018: 11 percent of group revenues in respect of one customer).

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, Rabobank Amsterdam, and Silicon Valley Bank.

A feature of recent years is that major corporations have slowed down payments or insist on long credit terms, and this is reflected in the ageing profile of the group's receivables. However, as noted above the group's bad debts experience is negligible. Impairments that do arise are not 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 where invoiced and contractually enforceable, but to derecognize revenue if collection is uncertain.

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

| | *Total $'000* | *Current $'000* | *Past Due +30 Days $'000* | *Past Due +60 Days $'000* |
|---|---|---|---|---|
| At 31 December 2019 | 11,722 | 10,653 | 195 | 874 |
| At 31 December 2018 | 12,014 | 10,004 | 1,568 | 443 |

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:

| | | *2019* | | | *2018* | |
|---|---|---|---|---|---|---|
| | *$'000 Gross Value* | *$'000 Provision* | *$'000 Carrying Value* | *$'000 Gross Value* | *$'000 Provision* | *$'000 Carrying Value* |
| Trade receivables | | | | | | |
| North America | 8,918 | - | 8,918 | 8,544 | - | 8,544 |
| Europe | 2,809 | - | 2,809 | 3,470 | - | 3,470 |
| | 11,727 | - | 11,727 | 12,014 | - | 12,014 |

The group records impairment losses on its trade receivables separately from the gross amounts receivable. No impairment losses were recorded during 2019 or 2018. 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 has recognized a proportion of the amounts due to it from its US subsidiaries, taking into account their current profitability and cash holdings. Full details are set out in Note 16 and 27. The company has provided in full for the remaining 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 and deposit accounts 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 be consistently cash generative after 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.

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 2019* | *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 | 945 | - | - | - | 945 |
| Line of credit | - | - | - | - | - |
| Loan notes | - | - | - | - | - |
| Future interest – loan notes | - | - | - | - | - |
| Lease liabilities – contractual cash-flow | 370 | 320 | 480 | 500 | 1,670 |
| Total financial liabilities | 1,315 | 320 | 480 | 500 | 2,615 |

| *At 31 December 2018* | *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 | 1,107 | - | - | - | 1,107 |
| Line of credit | 326 | - | - | - | 326 |
| Loan notes | 29 | - | - | - | 29 |
| Future interest – loan notes | - | - | - | - | - |
| Total financial liabilities | 1,462 | - | - | - | 1,462 |

*Company*

| *At 31 December 2019* | *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 | 176 | - | - | - | 176 |
| Total financial liabilities | 176 | - | - | - | 176 |

| *At 31 December 2018* | *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 | 171 | - | - | - | 171 |
| Total financial liabilities | 171 | - | - | - | 171 |

*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 has no borrowings, other than lease liabilities, in respect of which lease payments are fixed and do not carry 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 2019 was $10,270,000. During 2019 interest rates on money market deposits averaged at or below 0.5 percent in respect of Euro and Sterling deposits and at around 2 percent in respect of US Dollar deposits. The annualized effect of an increase 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 in the group's and the company's interest income of $51,000.

The company had no interest-bearing bank deposits at the balance sheet date.

*e) Currency Risk*

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 that 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, while 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 that is recognized directly in equity. It illustrates the effects if the exchange rates for Sterling and the Euro against the US Dollar had been higher or lower than those that actually applied during the year and at the year-end.

| | *2019* | *2018* | *2019* | *2018* |
|---|---|---|---|---|
| | *Increase/ (Decrease) in Profit After Tax $'000* | *Increase/ (Decrease) in Profit After Tax $'000* | *Effect on Exchange Differences on Translation of Assets and Liabilities of Foreign Operations $'000* | *$'000* |
| Strengthening of Sterling in US Dollar terms by 10c | (75) | 9 | 258 | 194 |
| Weakening of Sterling in US Dollar terms by 10c | 75 | (10) | (260) | (194) |
| Strengthening of Euro in US Dollar terms by 10c | 170 | 275 | 493 | 268 |
| Weakening of Euro in US Dollar terms by 10c | (170) | (275) | (495) | (270) |

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.

| | *2019* | *2018* |
|---|---|---|
| | *Increase/(Decrease) in Profit After Tax* | |
| | *$'000* | *$'000* |
| Strengthening of Sterling in US Dollar terms by 10c | 86 | 123 |
| Weakening of Sterling in US Dollar terms by 10c | (86) | (123) |
| Strengthening of Euro in US Dollar terms by 10c | 95 | 103 |
| Weakening of Euro in US Dollar terms by 10c | (95) | (103) |

*f) Capital*

The group considers its capital to comprise its share capital, its capital reserves (as set out in Note 24) and its retained earnings. 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 share capital is all equity capital and is summarized in Note 23.

## 23. SHARE CAPITAL

| *Issued and Fully Paid* | *2019 Number* | *2019 $'000* | *2018 Number* | *2018 $'000* |
|---|---|---|---|---|
| Ordinary shares of 20 pence each | 10,174,038 | 3,126 | 10,143,766 | 3,118 |

Throughout the year, the company has had in issue one class of ordinary shares, which have at no time carried any right to fixed income. During the year, 30,272 ordinary shares were issued in connection with the exercise of options at exercise prices ranging from 85p to 900p.

## 24. CAPITAL RESERVES

*Group*

| | *Share Premium $'000* | *Equity Reserve $'000* | *Special Reserve $'000* | *Total $'000* |
|---|---|---|---|---|
| At 1 January 2018 | 2,084 | 563 | 5,073 | 7,720 |
| Issues of shares | 174 | - | - | 174 |
| Recognition of share-based payments | - | 512 | - | 512 |
| Lapsing or expiry of share options | - | (129) | - | (129) |
| At 1 January 2019 | 2,258 | 946 | 5,073 | 8,277 |
| Issues of shares | 97 | - | - | 97 |
| Recognition of share-based payments | - | 620 | - | 620 |
| Lapsing or expiry of share options | - | (52) | - | (52) |
| At 31 December 2019 | 2,355 | 1,514 | 5,073 | 8,942 |

*Company*

| | *Share Premium $'000* | *Equity Reserve $'000* | *Special Reserve $'000* | *Total $'000* |
|---|---|---|---|---|
| At 1 January 2018 | 2,084 | 563 | 5,073 | 7,720 |
| Issues of shares | 174 | - | - | 174 |
| Recognition of share-based payments | - | 512 | - | 512 |
| Lapsing or expiry of share options | - | (129) | - | (129) |
| At 1 January 2019 | 2,258 | 946 | 5,073 | 8,277 |
| Issues of shares | 97 | - | - | 97 |
| Recognition of share-based payments | - | 620 | - | 620 |
| Lapsing or expiry of share options | - | (52) | - | (52) |
| At 31 December 2019 | 2,355 | 1,514 | 5,073 | 8,942 |

The equity reserve comprises the fair value of share-based payments made to employees pursuant to the group's share option schemes, offset by credits arising from lapses due to the expiry of the option.

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 2019, the Esot held 36,472 ordinary shares of 20p each in the company (2018: 36,472) which represents 0.4 percent (2018: 0.4 percent) of the company's ordinary share capital. The equity reserve includes a deduction of $46,000 (2018: $46,000) which represents the cost of the shares held by the Esot at 31 December 2019.

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 2019 and at 31 December 2018, 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.

The special reserve is a non-distributable reserve arising from a capital reorganization in 2013, which may be used, amongst other purposes as approved by the court, for the same purposes as if it were a share premium reserve.

## 25. DIVIDENDS

| | *2019* *$'000* | *2018* *$'000* |
|---|---|---|
| Dividends paid in year | | |
| Final dividend for 2018 of 3.25p per share paid in July 2019 | 430 | 337 |

The directors are proposing a final dividend of 3.25 pence per share in respect of the year ended 31 December 2019 amounting to £331,000 ($437,000).

## 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 $442,000 (2018: $419,000) 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:

| | *2019* *$'000* | *2018* *$'000* |
|---|---|---|
| Emoluments and benefits | 2,541 | 2,957 |
| Pension contributions | 67 | 62 |
| Share-based payments | 478 | 369 |
| | 3,086 | 3,388 |

**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:

| | *2019* *$'000* | *2018* *$'000* |
|---|---|---|
| Net amounts repaid by subsidiaries | (1,167) | (2,382) |
| Net management charges to subsidiaries | 634 | 713 |

The amounts owed by subsidiary companies to the parent company at 31 December 2019 totaled $48,415,000 (2018: $47,108,000). An amount of $14,793,000 (2018: $5,793,000), due from the group's US and Dutch subsidiary companies, has been recognized in the parent company balance sheet, the balance of amounts due from subsidiaries remaining subject to full provision. Amounts owed by subsidiary companies to the parent company are unsecured and are subordinated to the claims of all other creditors.

During 2019 and 2018, 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 2019 and 2018 are as follows:

| | *Number of Share Options* | *Weighted Average Exercise Price £* |
|---|---|---|
| Outstanding at 1 January 2018 | 745,589 | 1.76 |
| Options granted in 2018 | 288,278 | 7.03 |
| Options exercised in 2018 | (144,388) | 1.09 |
| Options lapsed in 2018 | (13,658) | 3.69 |
| Outstanding at 1 January 2019 | 875,821 | 3.57 |
| Options granted in 2019 | 30,000 | 7.20 |
| Options exercised in 2019 | (30,272) | 2.68 |
| Options lapsed in 2019 | (7,155) | 5.07 |
| Outstanding at 31 December 2019 | 868,394 | 3.72 |
| Exercisable at 31 December 2019 | 712,583 | 2.97 |
| Exercisable at 31 December 2018 | 585,264 | 2.19 |

During 2019, share options were exercised over 30,272 ordinary shares at exercise prices ranging from 85p to 900p. During 2018, options were exercised over 144,388 ordinary shares at exercise prices ranging from 55p to 565p. The options outstanding at the end of the year have a weighted average contractual life of 5.9 years (2018: 6.8 years).

During the year share options were granted on 14 October 2019, when the exercise price of options granted was 720p and the estimated fair value was 426p. During the preceding year share options were granted on 11 February 2018, when the exercise price of options granted was 565p and the estimated fair value was 335p and on 4 July 2018, when the exercise price of options granted was 900p and the estimated fair value was 533p.

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

| *Date of Grant* | *October 2019* | *July 2018* | *February 2018* |
|---|---|---|---|
| Share price at time of grant | 720p | 900p | 565p |
| Exercise price | 720p | 900p | 565p |
| Expected volatility | 40% | 40% | 40% |
| Risk-free rate | 5% | 5% | 5% |
| Expected dividend yield | 0.5% | 0.3% | 0.4% |

The expected contractual life of the options used was ten years. Expected volatility was determined by reference to the historic volatility of the company's share price in the period before the date of grant.

# DIRECTORS

*Barry Mence*, 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, Barry was the major shareholder and group managing director of the Rendeck Group of Companies, a software and services group based in the Netherlands.

*Andrew Michuda*, Chief Executive Officer. Andrew (Andy) Michuda was appointed chief executive officer of Sopheon in 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. Prior to joining Sopheon, Andy held senior leadership positions at Control Data.

*Arif Karimjee*, ACA, Chief Financial Officer. Arif Karimjee joined Sopheon as chief financial officer in 2000. Arif served as an auditor and consultant with Ernst & Young in the United Kingdom and Belgium from 1988 until joining Sopheon.

*Stuart Silcock*, FCA, Non-Executive Director. Stuart Silcock has served as a director of Sopheon since its inception in 1993 when he was one of the founding members of the company. Since 1982 Stuart has been a principal Partner in Lawford & Co chartered accountants. Stuart was a non-executive director of Brown and Jackson plc for four years from 2001 and has held a number of other directorships in the United Kingdom.

*Daniel Metzger*, Non-Executive Director. Dan Metzger was until 1998 Lawson Software's EVP Marketing, where he helped the company grow its revenues from $13m to $400m. Since then he has held similar roles at Parametric Technologies, and also at auxilium and nQuire, subsequently sold to Parametric and Siebel respectively. As a strategy consultant, Dan has helped numerous technology companies reach and exceed their growth objectives.

Sopheon

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