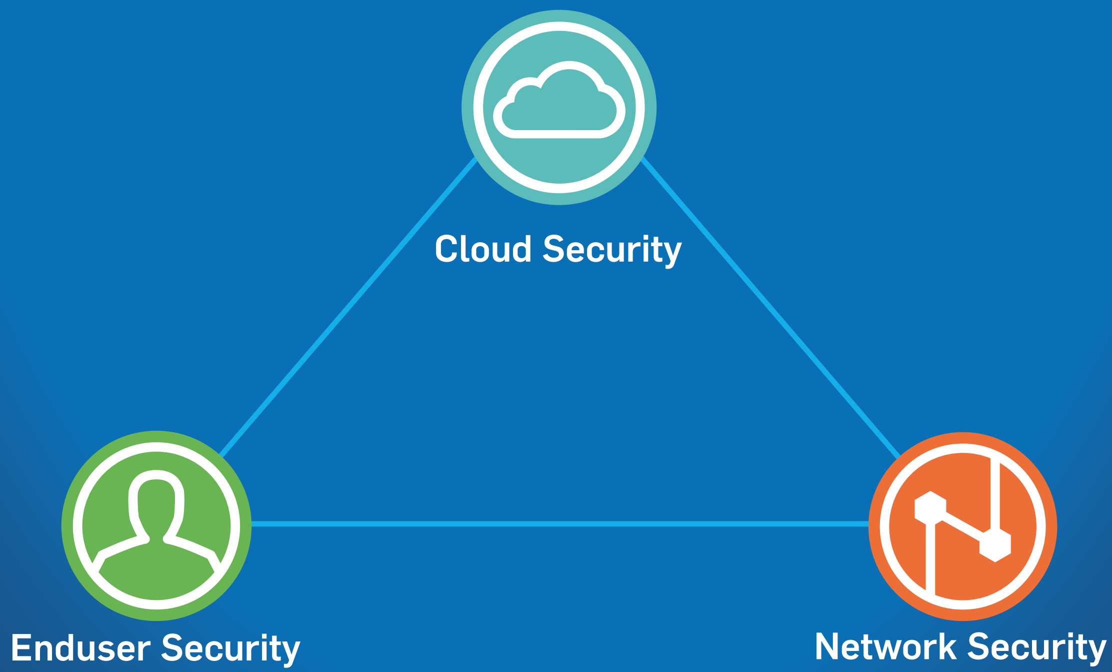
SOPHOS

Security made simple.

# Annual Report 2016

Sophos Group plc



SOPHOS

Security made simple.

# A Proven Global Leader in Delivering Complete IT Security to the Mid-Market

The Sophos Group is a leading global provider of cloud-enabled enduser and network security solutions, offering organisations end-to-end protection against known and unknown IT security threats through products that are easy to install, configure, update and maintain. For further information please visit: www.sophos.com. The Group has over 30 years of experience in enterprise security and has built a portfolio of products that protect over 220,000 organisations and over 100 million endusers in 150 countries across a variety of industries.

## CONTENTS

# HIGHLIGHTS

- Continued market share gains throughout the year to 31 March 2016 ("FY16") as Sophos outperformed industry market growth rates for both network security and enduser security
- Sophos remains the only security vendor with balance and scale in network and enduser security products, supported by a unique cloud management platform
- Sophos was the first company to deliver synchronized security through the launch of its next-generation firewall that actively shares valuable security intelligence directly with the Sophos endpoint via the Sophos Security Heartbeat™ technology
- Granted six US patents in the year for innovative methods in threat detection and remediation
- Sophos continued to be recognised as a leader by independent industry analysts, for both enduser and network products
- Strong FY16 reported financial performance, despite significant currency headwinds, across all products and regions
- Growth driven by retaining existing customers at higher billings levels through up-sell and cross-sell, enhanced by new customers representing a higher proportion of total billings

**+19.7%**
Like-for-like billings growth

**+7.1%**
Revenue growth

**$120.9M**
Cash EBITDA

**$32.7M**
Operating loss

**$46.4M**
Unlevered free cash flow

**$21.3M**
Net cash flow from operating activities

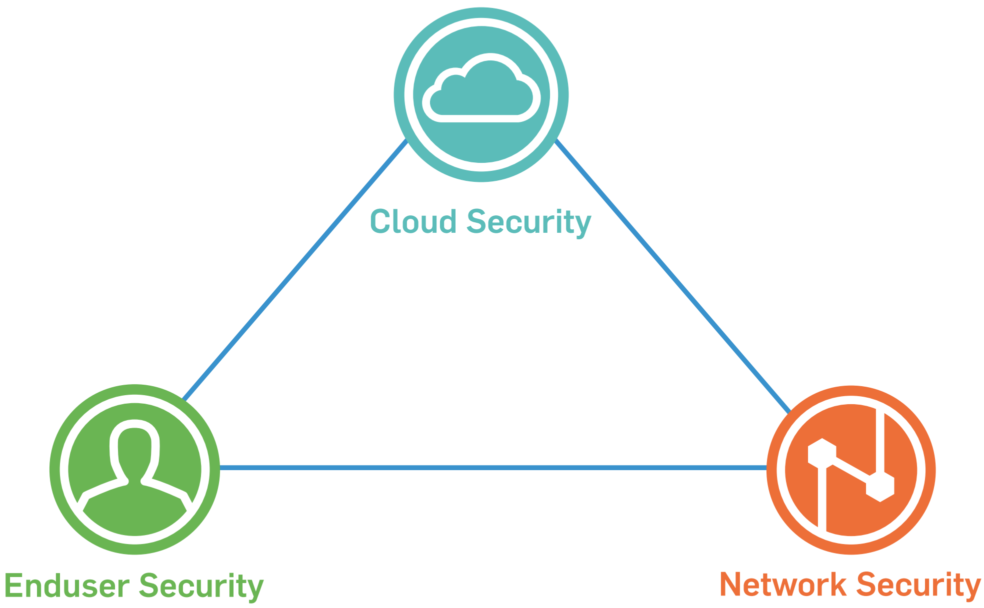
For further Investor information:
investors.sophos.com

p123 Definitions of non-GAAP measures are included in the Glossary.

# AT A GLANCE

## Complete Security. Made Simple.

Our mission is to be the best in the world at delivering complete IT security to mid-market enterprises and the channel that serves them.

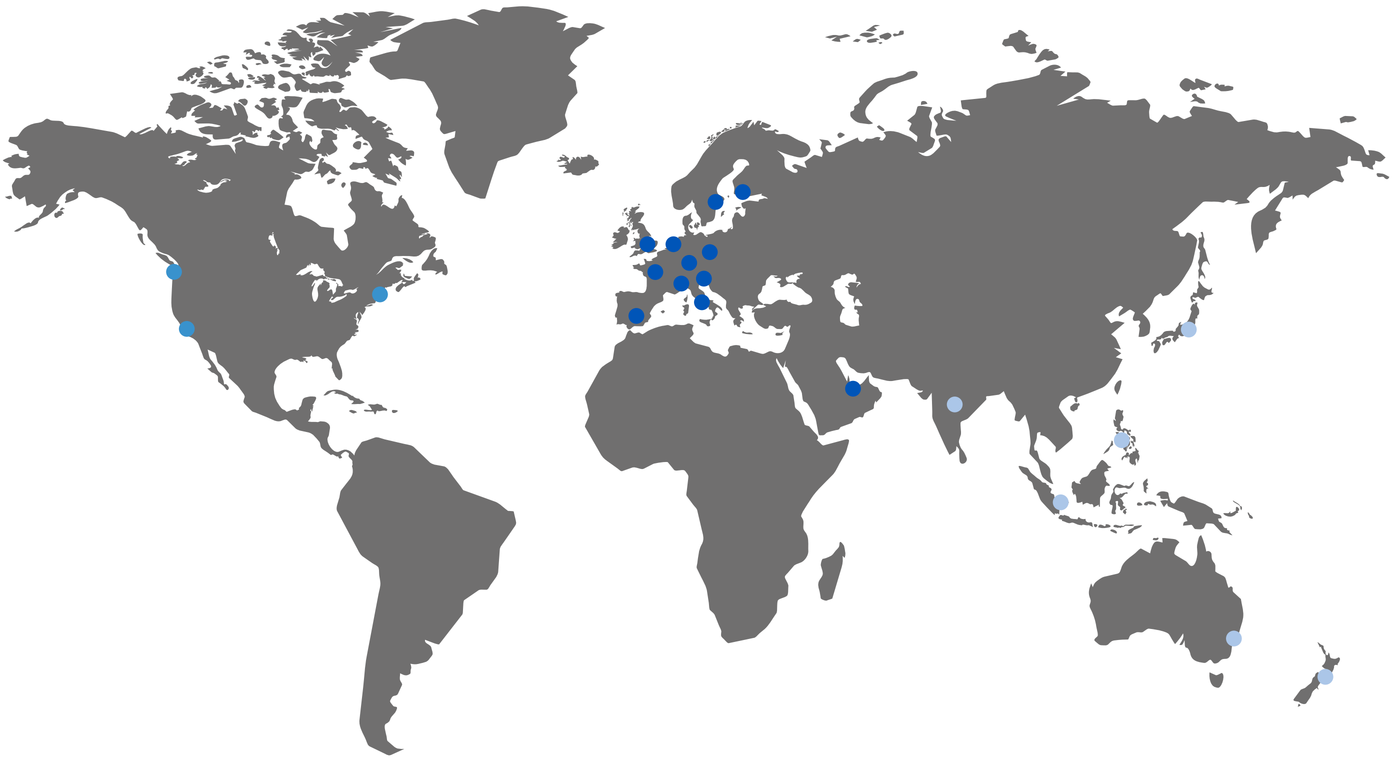



- Endpoint
- Server
- Mobile
- Encryption
- UTM and Next-Gen Firewall
- Web
- Wireless
- Email

| | | | |
|---|---|---|---|
| **$535M** Billings | **$478M** Revenue | **220K** Enterprise customers | **100M+** Endusers |

# Global Reach. Global Success.

Founded in Oxford and headquartered in Abingdon, Oxfordshire, Sophos has over 40 offices across the world. SophosLabs operations are located in Abingdon, Vancouver and Sydney, with product development centres of excellence concentrated in the UK, Germany, India, Canada, Austria, and the United States.



**20,000+**
Channel partners

**2,900**
Employees

**30 year**
Operating history

**$38bn**
Market growing at 7%

# CHAIRMAN'S STATEMENT

FY16 was a momentous year for Sophos. After 30 years of growth and success as a private company, Sophos became the largest software initial public offering on the London Stock Exchange, ever. In its first year as a public company, Sophos has exceeded its key financial and operating targets and has continued to post above-market growth in each of its core markets of network security and enduser security. Underpinning this performance were very healthy customer renewal rates combined with aggressive growth in new customer acquisition.

In addition to delivering strong operating and financial performance for FY16, we continue to build a solid foundation for ongoing market share growth and success.

Cybersecurity remains very high on the agenda for IT departments and, now more than ever, for management teams and boards at organisations of every size. Providing a truly effective, affordable, and manageable solution to protect organisations against cybercrime is a massive and growing need and opportunity. At Sophos, we focus on this opportunity through our mission to be the best in the world at delivering complete IT security to mid-market enterprises and the channel that serves them.

Our strategy to synchronize multiple and previously disparate security disciplines, to deliver complete security made simple, to leverage the cloud to both manage and deliver our security solutions, we believe is highly differentiated and compelling. Together with our rigorous focus on mid-market enterprises and our "Channel First" sales approach, we are strongly positioned to continue delivering superior value to our customers in this large and growing security market, and thereby provide growing long-term value to our shareholders.

The Sophos Board has evolved and developed over the years to support the Company as we seek to take full advantage of the significant market opportunity in cybersecurity. Paul Walker joined the Board in 2015 as our Senior Independent Director, adding considerable knowledge of, and experience in the mid-market customer segment, as well as executive operating experience of a global company publicly listed in the UK. We are confident that we have a balanced, experienced and engaged team with highly relevant background, skills and track record to guide Sophos forward.

Our first year as a listed company has been energising both in terms of accomplishments as well as momentum into FY17. On behalf of our Board, thank you to our Sophos family of employees all around the world for your dedication, innovation, and hard work to make it happen for our customers, partners and shareholders; thank you to our customers and partners for your business and confidence in our offerings and capabilities; thank you to our shareholders for your confidence and support. We appreciate it very much and continue to work hard to keep earning it.

**Peter Gyenes**
**Non-Executive Chairman**

"SOPHOS IS STRONGLY POSITIONED TO TAKE ADVANTAGE OF THE OPPORTUNITY AHEAD WITH DIFFERENTIATED OFFERINGS PROVIDING SUPERIOR VALUE TO CUSTOMERS AND THEREBY BUILDING LONG-TERM SHAREHOLDER VALUE."

# AWARDS

Sophos continued to gain industry recognition from leading publications, industry analysts and testing organisations for its market-leading products. Below is just a small selection of awards and accolades given to Sophos in FY16.

**SC MAGAZINE:**
"Best UTM Solution – Sophos SG Series UTM"

**PC PRO TECH EXCELLENCE:**
"Security Product of the Year for Sophos Cloud"

**AV-TEST:**
"Best Free Android Protection 2015 – Sophos Mobile Control for Android"

**INGRAM MICRO 2016 EXPERIENCE AWARDS:**
"Vendor of the Year – Security"

**VAR INDIA:**
"Best Security Company in India"

**COMPUTER RESELLER NEWS ANNUAL REPORT CARD:**
"Winner – Client Security Software; Winner - Network Security Appliances; Winner – Network Security Software"

**CRN ICT SUMMIT:**
"IT Security Vendor of the Year, as voted by readers"

**COMPUTER RESELLER NEWS:**
"5 Star Rating: Sophos Channel Partner Program"

# Synchronized Security

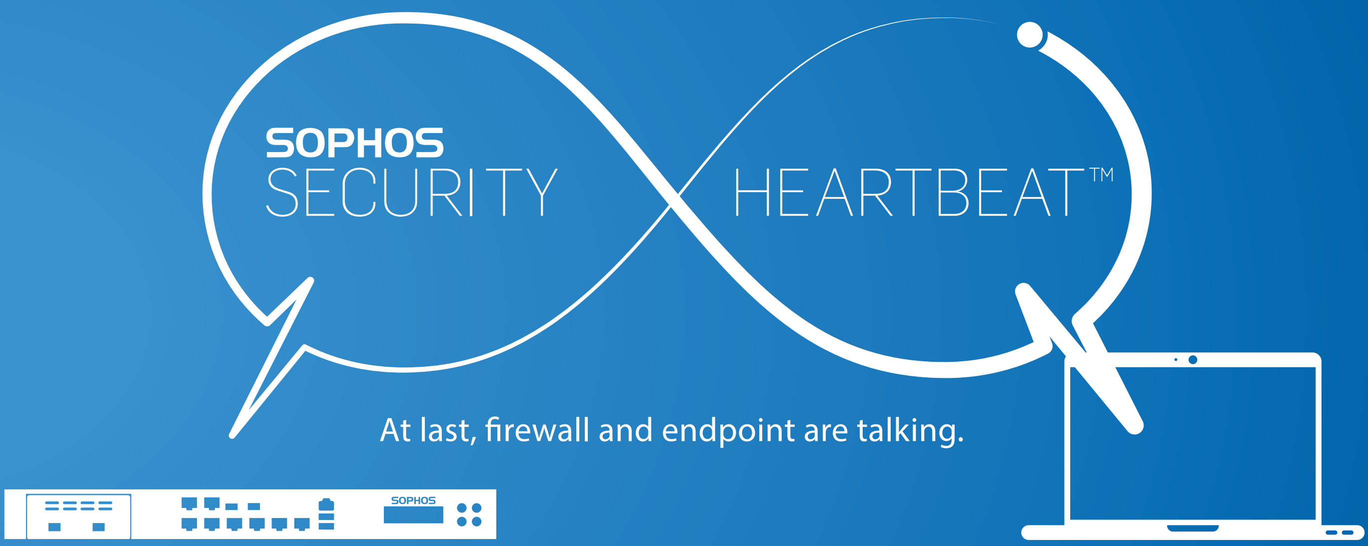
## A revolution for network and endpoint protection and management

### SYNCHRONIZED SECURITY

- Synchronized security automates incident response via instant sharing of threat, security and health information between endpoint and network. It eliminates the manual work of trying to figure out the who, what and when of a compromise
- The Security Heartbeat™ pulses continuous, real-time information about suspicious behaviour or malicious activity between cloud-managed endpoints and the Sophos XG Firewall
- With Security Heartbeat™, organisations of any size can advance their defences against increasingly coordinated and stealthy attacks and drive a dramatic reduction in the time and resources required to investigate and address security incidents
- IT organisations can benefit from advanced threat protection capabilities without requiring additional agents, expense, layers of complex management tools or logging and analysis tools
- The Security Heartbeat is fully enabled and included as part of the Sophos XG Firewall and Sophos cloud-managed endpoint protection

### SECURITY HEARTBEAT – HOW DOES IT WORK?

- When a new Sophos protected endpoint is added to the network, its Security Heartbeat automatically connects to the local Sophos XG Firewall and the endpoint immediately starts sharing health status
- If suspicious traffic is identified by the firewall, or malware is detected on the endpoint, security and threat information is instantly and securely shared via the Security Heartbeat
- The firewall can automatically take action to isolate the endpoint from internal and/or external networks and trigger additional action on the endpoint to mitigate risk and prevent data loss
- After the threat has been removed, the endpoint uses the Security Heartbeat to communicate an updated health status back to the network, which then re-establishes normal service to the endpoint




"ESG has confirmed that Sophos' Security Heartbeat provided nearly instantaneous communication between Sophos' Endpoint Protection and Sophos XG Firewall solutions and enabled them to work together, providing enhanced detection, source identification and automated incident response.

Through our hands-on testing, ESG Lab validated that Sophos' integrated approach — providing bi-directional communication and control between network and endpoint security solutions — enables organisations to implement policies to enable or restrict access to critical resources based on endpoint health. This level of automation can be extremely valuable, enabling already overburdened IT administrators to keep up with the ever-increasing pace of threats and attacks and reducing time to response from hours to seconds."

***ESG Lab Review, January 2016***

"No other company is close to delivering this type of synchronized and integrated communication between endpoint and network security products. For the mid-market, the time and resource savings will be very compelling as their ability to stay ahead of increasingly sophisticated threats with today's products will only become more challenging."

***Christian Christiansen, Vice President, Security Products, IDC***

"There will never be a perfect security solution that stops all the threats. But, with Sophos we are getting close to perfect. This approach to synchronized security from Sophos allows everything to talk to one another and is a game changer for the industry."

***Michelle Drolet, CEO, Towerwall, a Sophos Partner***

"What Sophos is doing to deliver synchronized security with the new XG Firewall is impressive. As a company, we are looking forward to how the network will be integrated fully with the endpoint, saving us the amount of time it typically takes to research threats, act on them, and actively manage security for the entire organisation."

***Timothy Speakman, System Administrator, Contra Costa Health Services, a Sophos customer***

"Adding a Sophos XG appliance to add network security to our endpoint protection made sense. We were looking for the ability to manage multiple sites, now with Sophos UTM and Cloud Endpoint, we can manage every site much more efficiently."

***JD Morecraft, F.C. Tucker Company, Inc.***

# OUR BUSINESS MODEL

Sophos has a unique strategy to pursue a massive and growing market opportunity in IT security.

## What we do and how we offer it:

### INNOVATE

**CONTINUED INVESTMENT IN R&D TO ENSURE ONGOING PRODUCT INNOVATION**

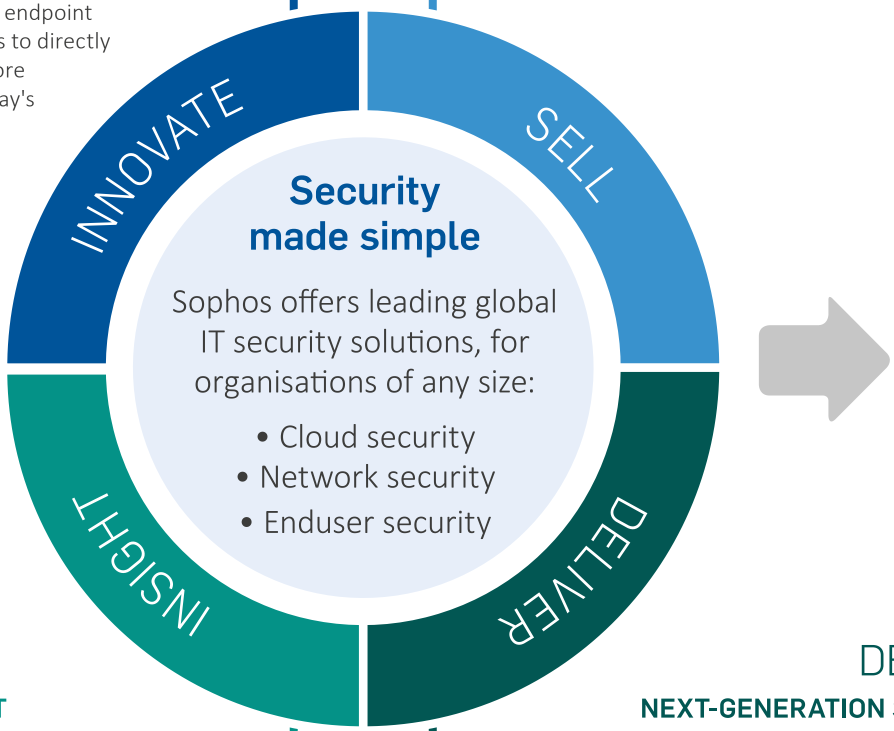
Sophos develops products designed to offer complete security, made simple. This is critical for mid-market enterprises who face many of the same IT security threats as larger organisations, but do not have access to the same level of financial and IT personnel resources.

Sophos is a leading provider of both enduser security and network security, with a proven business at scale in each. Sophos recently introduced its synchronized security strategy which allows endpoint and network security products to directly share threat intelligence to more effectively protect against today's sophisticated threats.

### SELL

**VIA A "CHANNEL FIRST" SALES MODEL**

We operate a "channel first" business model that drives billings through the proactive selling activities of thousands of channel partners worldwide. Other security players sell through multiple channels including their own direct sales organisations, resulting in inevitable conflict and confusion.




### INSIGHT

**WORLD-CLASS THREAT INTELLIGENCE THROUGH SOPHOS LABS**

At the heart of our solutions is SophosLabs, a 24-hour threat research and intelligence centre, providing real-time cloud-enabled security intelligence that updates our products multiple times each day. With a combination of ''big data'' automated analytics and human discovery and analysis of malware, vulnerabilities, intrusion attempts, spam, potentially unwanted applications and compromised or malicious websites, SophosLabs efficiently processes millions of operations on a daily basis and addresses nearly every area of IT security.

### DELIVER

**NEXT-GENERATION SECURITY ENABLED BY THE CLOUD**

Sophos aggressively leverages cloud computing technologies to both manage and deliver security more effectively. Cloud computing is at the heart of SophosLabs, the security intelligence foundation for Sophos. Many Sophos products further leverage the cloud in numerous ways to deliver more effective, real-time security. And Sophos Central is a cloud-based management platform that provides both end user customers and channel partners with a single, integrated console to manage multiple Sophos security products providing a unified view across an organisation's IT security environment.

## What makes us unique:

- Focus on security
- Focus on mid-market enterprises
- Product strategy of delivering complete IT security, made simple
- Broad portfolio of leading, enterprise-grade security technologies
- Leadership in both network and enduser security, allowing synchronized security that shares threat intelligence
- Leveraging the cloud for more effective delivery and management of security
- Channel First sales strategy
- SophosLabs, one of the world's leading IT security threat intelligence centres
- Established brand, built on long-standing relationships with customers and partners developed over 30+ years
- Presence in more than 150 countries
- Global network of more than 20,000 partners
- Experienced leadership team, whose interests are aligned with those of the Group

## How we create value:

### FOR OUR SHAREHOLDERS

- Scale, healthy profitability and cash flow, and above-market growth
- Long-term visibility, predictability and resilience of billings and revenue streams from subscription model

### FOR OUR CUSTOMERS

- Leading, trusted, enterprise grade security solutions engineered for organisations of all sizes to deliver complete security, made simple
- Choice of deployment option, choice of partner, choice of best of breed solutions that work better together

### FOR OUR PARTNERS

- 100% "Channel First" commitment
- Industry-leading channel programs and operational systems designed to help partners grow their revenue and profit margin

# INVESTMENT PROPOSITION

Compelling Industry Fundamentals

## Our market presents a huge opportunity…

- IT Security is a $38 billion market estimated to grow at 7 percent through 2019
- The attack surface for cyber threats is ever expanding
- The vanishing perimeter due to cloud-based services, social media, remote offices, Internet of Things, roaming workers and BYOD brings new security challenges
- Business leaders have a growing awareness of the risk associated with cyber-attacks, the leakage of sensitive data and the implications of increased regulatory compliance
- Attacks are becoming more sophisticated as the 'crimeware-as-a-service' economy grows

## …for which we are uniquely positioned to succeed.

Unique Strategy

## Our clear and compelling strategy…

- Sophos is solely focused on security
- Sophos focuses on mid-market enterprises
- The Group's product strategy delivers complete IT security, made simple
- Sophos is the only security player that is a balanced leader in scale in both network and enduser security, allowing synchronized security that shares threat intelligence
- Leveraging the cloud for more effective delivery and management of security
- A 100% "Channel First" sales strategy

## …resonates with customers and partners.

Attractive Financial Model

## Our strong financial position…

- Strong momentum in billings growth in both Network and Enduser segments across all regions
- Sustainable billings
- Strong new customer growth combined with strong renewal rates
- High revenue visibility and predictability driven by large, diversified pre-paid subscription billings on the balance sheet for deferred recognition
- Strong cash conversion
- Disciplined investment to drive top line growth

## …is underpinned by high renewal rates and recurring revenues.

Established and Recognised Brand

## Our brand promise of 'security made simple'...

- Our ethos of simplicity spans all we do at Sophos, from product development to our go-to-market efforts
- A metrics-driven marketing approach is complemented by highly creative digital marketing, educational in-person events and aggressive social media and PR outreach
- Sophos maintains an intense focus on connecting with our customers using a clear, prescriptive and authentic voice across all media
- Sophos has earned a reputation as a trusted source of IT security information

## ...drives a deep and lasting connection with customers and partners.

Experienced Management Team

## Our experienced management team...

- Extensive experience in running $500 million + technology organisations
- Proven track records, each with more than 20 years of experience in their field
- Committed to our vision and strategy for security made simple

## ...leads our global team to translate our mission and strategy into reality.

Exciting Growth Opportunities

## Our numerous growth opportunities...

- Market share expansion, especially among mid-market enterprises
- Global expansion
- Drive up-sell and cross-sell opportunities
- Recruit additional partners and enhance productivity of existing partners
- Introduce new products, developed organically and acquired through disciplined M&A
- Continue to enhance Sophos' brand visibility and awareness, leading to incremental new sales engagements

## ...provide multiple vectors for Sophos to continue to outperform the IT security market.

# OUR MARKET

Today, commercial cybercrime thrives on many of the same drivers as the legitimate business world it preys upon: innovation, response to market opportunities, operational and commercial optimisation and heavy reinvestment to support future growth. Due to the amounts of money involved, we see everyday cybercriminals with the financial muscle, motivation and sophistication approaching that of state-sponsored or advanced persistent threat actors.

## Today's Threat Environment

When we review today's threat environment, we see four basic intents for cyberattack: nation or state-sponsored disruption, industrial espionage, hacktivism and commercial gain. The first three usually target large organisations or high-profile individuals and get the most attention in the media, but the motivator for the majority of cybercrime is financial gain. The biggest threat today comes from groups of professional, highly organised commercial cybercriminals.

These commercial cybercriminals use sophisticated malware at an industrial scale. The components that make up these attacks come from highly skilled individuals who specialise in creating exploit code or malware. This lowers the barrier to entry for those with little or no technology skill but the desire to become a cybercriminal. The key performance indicators for these cyber-attack businesses is return-on-investment ("ROI") and customer service, whether that be producing malware as a service or providing victims of ransomware with a streamlined and user-friendly experience for paying the ransom-takers. Who the victim is makes no difference beyond what the attackers need to know about them to create and carry out more effective attacks with a higher return.

Commercial cybercriminals relentlessly target the most vulnerable systems, software and companies. Where there is a weakness, the commercial malware authors will exploit it. We have seen a trend to build sophisticated development and delivery processes, e.g. automation and malware testing before release. Also, rather than individual targeting, we are seeing extensive 'market testing' for the purpose of optimising the attack and increasing its likelihood of success.

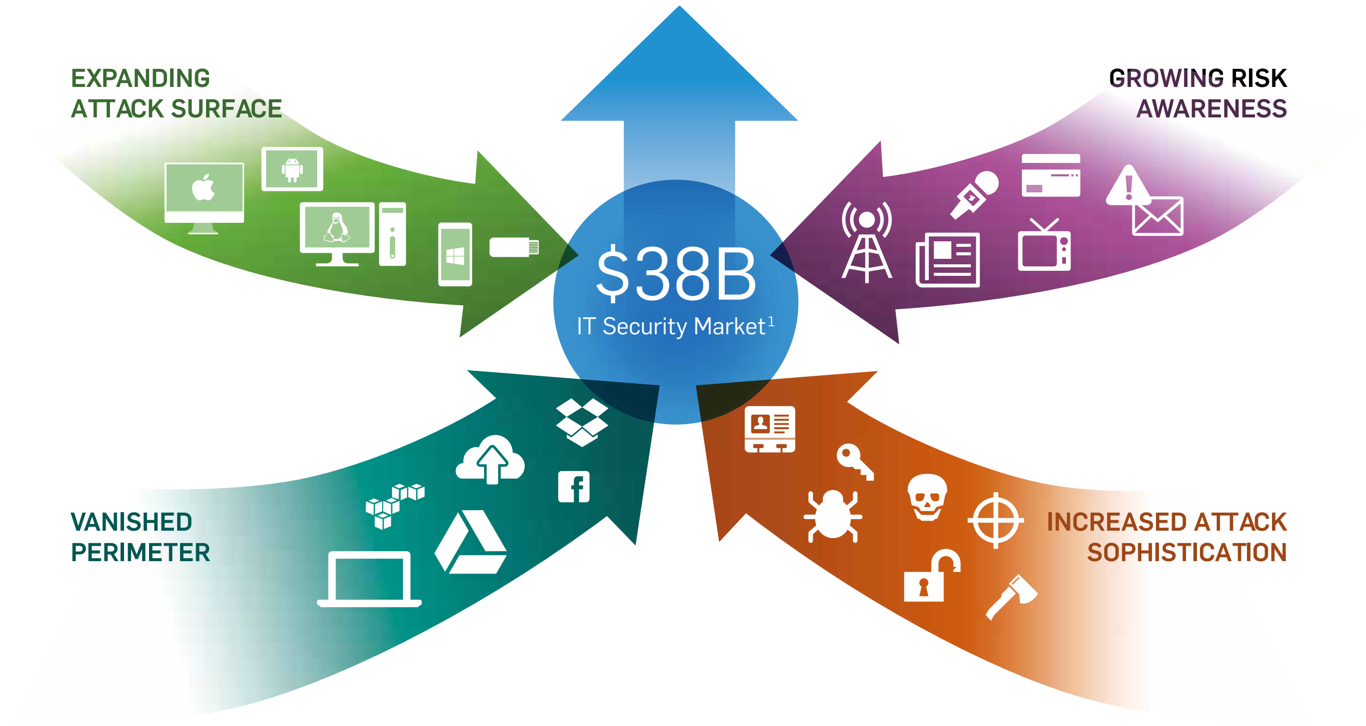
Today we continue to see the majority of attacks carried out against Windows, because that is where the greatest return is for commercial malware. But we see growing evidence of malware authors pushing into other platforms – Mac, Android, Linux and even attempting cross-platform malware such as using the Java platform. We have seen a growing number of ransomware families, such as Locky and Cerber, as commercial malware authors see opportunity in this lucrative "business model". Recently we saw the emergence of the first type of ransomware targeting the Mac. The renowned poor security of web servers used by smaller organisations is leading to an increase in attacks on content management systems with new forms of ransomware that encrypt web server content.

Classic or well-known techniques are becoming more widespread and easier to execute through pre-packaged components or provided as a service. For targeted spear-phishing attacks, cybercriminals have become more skilled with social engineering that is pixel perfect, with many companies falling for scams and sharing valuable data such as employee HR and tax records. Some attackers identify high-value social engineering targets with automated processes, and once a target is acquired, hand it over to a human operator to run the scam.

Despite the best efforts of law enforcement and its industry partners, cybercrime is persistent and difficult to eradicate because the threat actors are widespread and their infrastructure dispersed. The threat is everywhere and indifferent to who you are. As the commercial cybercrime underworld continues to thrive, we expect that these trends will make cyber threats more pervasive and more difficult to contain than ever before, thus making a comprehensive security strategy a necessity for every organisation.

> "DESPITE THE BEST EFFORTS OF LAW ENFORCEMENT AND ITS INDUSTRY PARTNERS, CYBERCRIME IS PERSISTENT AND DIFFICULT TO ERADICATE BECAUSE THE THREAT ACTORS ARE WIDESPREAD AND THEIR INFRASTRUCTURE DISPERSED. THE THREAT IS EVERYWHERE AND INDIFFERENT TO WHOM YOU ARE."

# IT Security a $38B Market Growing at 7%




1 Source for c.$38B IT security market (hardware + software) is IDC WW IT Security Products 2015-2019 Forecast: Comprehensive Security Product Review (December 2015, IDC #US40709015) and represents expected market size in 2016. Growth of 7% represents 2015E-2019E CAGR

## IT Security Market

Analysis from the major industry analysts agrees that the IT security market will continue to grow at a CAGR of approximately 7 percent over the next few years. Industry analysts also agree that IT spending in the small to mid-size enterprise will continue to grow at a rate above that of the enterprise market, particularly on mobile and tablet investment. Achieving data security and compliance with government regulation is seen as key driver for investment by CIOs in Europe and the US in particular.

In 2016, the pressure on businesses to secure customer data and safeguard intellectual property will increase as legislators respond to the rising severity of data breaches. This could have a far-reaching impact on how businesses approach security, including the high-risk and potentially sensitive area of securing corporate data on an employee's personal device. The EU Data Protection regulation will come into force across Europe by the end of 2017, bringing more severe penalties for non-compliance. It has numerous components but one key takeaway is that European businesses will now be held responsible for the protection of the data they process, including cloud providers and other third parties.

The increase in targeted and organised attacks is impacting the way businesses approach security. There is no difference between the security required by an enterprise and that required by a small business other than in the scale and resources to manage it. Small businesses face a significant competitive disadvantage if they cannot respond effectively to incidents, and face the same penalties as the enterprise. The ability for security solutions to directly share information and automate incident response through synchronized security technology, brings the complex and costly Security Incident and Event Management ("SIEM") capabilities utilised by the enterprise, to businesses of all sizes. This ability for security systems that work better together and reduce the need for IT admin intervention can level both the competitive playing field with larger enterprises and improve security against sophisticated attack.

# OUR STRATEGY

The Sophos mission is **to be the best in the world at delivering complete IT security to mid-market enterprises and the channel that serves them**. This mission is built on the following six fundamental strategy pillars which have been and will continue to be key to our success.

| | |
|---|---|
| Focus on security solutions | Sophos remains committed to IT security, and we believe our focus gives us an advantage vs. other players who often try to address multiple and unrelated areas of technology. The Group is the only security vendor who has built a leading and balanced business at scale in enduser and network security. We continue to invest in technology and market leadership to support our security-only strategy, adding depth and breadth to our security portfolio through both organic development and where appropriate by targeted and disciplined acquisitions. |
| Focus on mid-market enterprises | Most security vendors spend the bulk of their resources addressing the large enterprise, the world's 5,000 largest organisations. At Sophos we are explicitly focused on the other 50 million small and mid-market enterprises worldwide. They face many of the same IT security threats as large enterprises, but do not have the same financial resources and access to large numbers of highly experienced IT security professionals to address their security needs. |
| Complete security, made simple | Sophos is committed to delivering industry-leading, enterprise-grade security solutions that are at the same time simple and easy to deploy, manage and use. The Group's view is that "complexity is the enemy of security", and that simple, integrated solutions that work as a system can deliver both better security that is also easier to manage, for organisations of any size. |
| Deliver complete end-to-end capabilities spanning from enduser to network protection | Sophos continues to develop its comprehensive portfolio of security technologies including endpoint, mobile and server security, data encryption, web protection, email protection, unified threat management and next-generation firewall, secure Wi-Fi and VPN technology. Sophos has embarked on a multi-year strategy to bring these different products together to deliver on a strategy of synchronized security. Synchronized security automates incident response by sharing threat, security and health information across multiple individual security components, including endpoints and next-generation firewalls. It eliminates the manual work of trying to figure out the who, what and when of a compromise. |
| Cloud at the core of current and future strategy | Sophos continues to drive its cloud-enabled competitive advantage, adding key capabilities and products to its single, integrated cloud-based management and reporting platform. With new enhancements to our partner-centric management console, channel partners are able to more easily drive up-sell and cross-sell, as well as manage, update and configure their customers' solutions remotely, thereby reducing overhead and business expense and improving their profit margin. |
| Clear "channel first" sales strategy | Sophos continues to drive a channel-only sales model. During 2015, Sophos launched a new and simplified partner program and completely redesigned its partner portal with innovative remote management options and automated digital marketing capabilities. During the development of the synchronized security strategy, Sophos collaborated with partners to support cross-sell and up-sell opportunities that simplify both the partner and customer experience. |

# KEY PERFORMANCE INDICATORS

The Group utilises a number of Key Performance Indicators ("KPIs"), the definitions of which are included in the glossary, to measure performance against our strategy. A description of these KPIs and performance against them during the period is set out below:

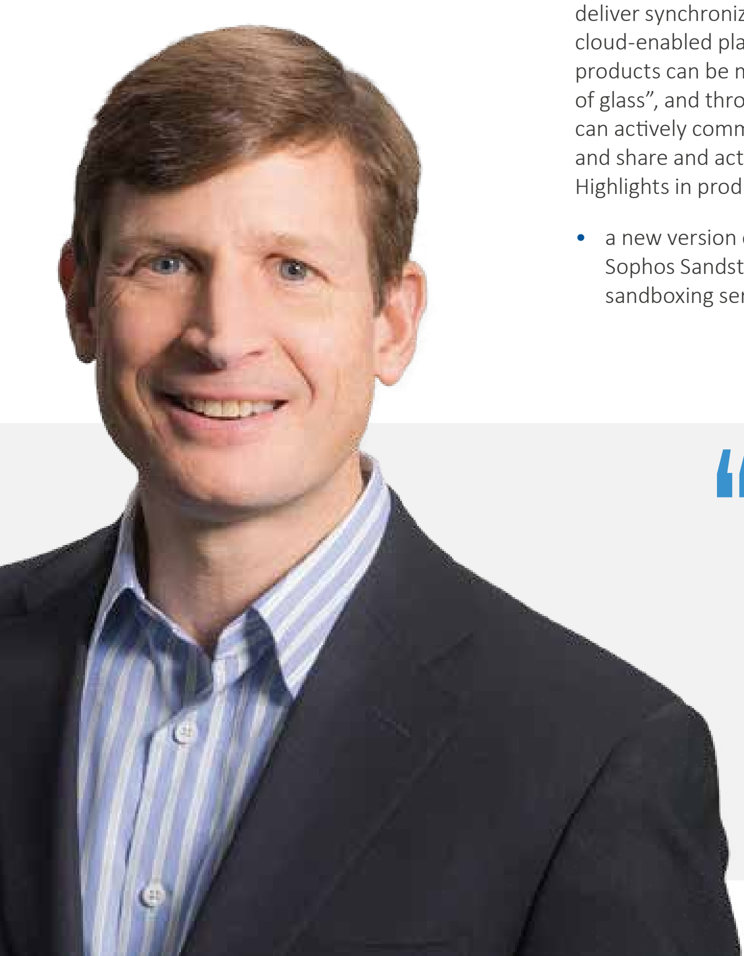
| KPI | Description | Performance 2016 |
|---|---|---|
| **$534.9M** Billings 2015: $476.0M | Billings represents the value of products and services invoiced to customers. Cash is received at the start of a subscription period and consequently billings become our key forward indicator of future performance. | Billings growth has been experienced across all major regions and product categories with particularly strong growth in new customer and UTM billings. Further discussion of billings is included on page 24. |
| **$478.2M** Revenue 2015: $446.7M | Revenue reflects the element of billings recognised in the period including from companies acquired from the date of their acquisition. The majority of billings are for subscription contracts that are recognised rateably over the contract term. | Strong revenue growth has been experienced in the Group's Network products, aided by immediate recognition of associated hardware. Further discussion on revenue is included on page 27. |
| **$120.9M** Cash EBITDA 2015: $101.4M | Cash EBITDA provides visibility on actual cash earned by the Group during the period, even if the associated revenue for that period's billings has not yet been recognised. | Cash EBITDA increased YOY reflecting the strong billings growth and ability of the Group to leverage its cost base to ensure that the cash EBITDA margin (cash EBITDA as a percentage of billings) also increased. |
| **$46.4M** Unlevered free cash flow 2015: $65.3M | Unlevered free cash flow is a measure that provides information about the amount of cash generated by the Group's business. | In line with the Board's expectations, the YOY reduction is due to anticipated one-off, prior-year working capital movements. |
| **28.6 months** Weighted average contract length 2015: 28.0 months | The weighted average contract length, measured over the prior twelve month period, gives the Group an indication of the period over which future revenue will be recognised. | The weighted average contract length increased marginally in the year due to a small number of longer term Japanese deals; excluding these deals, the underlying length remained consistent YOY. |
| **102%** Renewal rate 2015: 100% | Renewal rate (including up-sell and cross-sell) is a measure of long-term value of end user agreements and the Group's ability to retain end users. | There has been continued improvement in renewal rate as the Group successfully leveraged its product portfolio. |
| **7.4%** Endpoint-UTM cross-sell 2015: 5.6% | The continued growth of the business partially depends on successfully selling additional products and services to existing customers. Customers can derive greater value by owning multiple products from the Group as they benefit from synergies in management, support and functionality. | The level of endpoint-UTM cross-ownership has increased consistently through the year reflecting the ability of the Group to demonstrate to its customer the benefits of cross-ownership of products. |

# CHIEF EXECUTIVE OFFICER'S STATEMENT

We are pleased with our strong performance during our first year as a public company. The year has been marked by sustained strength across all major regions and product categories, with our financial and operational performance exceeding the Board's expectations set at the start of the year and at the upper-end of our revised outlook. Our leading product portfolio, innovation to drive our strategy of synchronized security, commitment to "security made simple" and "channel first" sales strategy enabled us to grow our billings and revenue across both new and existing customers.

Sophos had a successful inaugural year as a public company, as we continued to benefit from strong underlying fundamentals in the cybersecurity market, a unique and compelling strategy and consistent, solid operational execution.

In FY16 we outperformed the Board's expectations for both top-line billings and profitability, and produced a result at the upper end of our revised expectations, which we increased at the time of our interim results in November 2015. We grew billings 19.7 percent year-over-year ("YOY") on a like-for-like basis and we grew cash EBITDA by 31.6 percent at constant currency, resulting in a cash EBITDA margin of 22.6 percent. We remain confident that we will continue to deliver strong FY17 growth in billings, strong profitability with a modest cash EBITDA margin expansion and an approximate doubling in unlevered free cash flow.



We continue to make steady, consistent progress in fulfilling our mission to be the best in the world at delivering complete IT security to mid-market enterprises and the channel that serves them. IT security continues to be the top priority for IT administrators at organisations of every size, as threats continue to grow in both volume and sophistication, driving a $38 billion market growing at 7 percent. Meanwhile, the vendor community continues to be complex and fragmented, with numerous overlapping products, mostly designed for large enterprises, and conflicting claims about which proven and new techniques are most effective; it is against this backdrop that Sophos' vision of "complete security made simple" is proving both differentiated and highly effective.

At the heart of any technology company's success is product delivery and in FY16 Sophos delivered a robust set of new and enhanced offerings. We also made substantial progress in our strategy to deliver synchronized security and establish a cloud-enabled platform through which all our products can be managed in a single "pane of glass", and through which all our products can actively communicate with each other and share and act on security intelligence. Highlights in product delivery included:

- a new version of our SG UTM featuring Sophos Sandstorm, a cloud-based sandboxing service;
- the new XG Firewall, our future direction in UTM and next-generation firewalls, featuring synchronized security through the Sophos Security Heartbeat™ technology;
- next-generation endpoint capabilities such as malicious traffic detection and download reputation;
- one-click server lockdown, providing advanced and integrated application whitelisting and anti-malware, with unprecedented ease of deployment;
- the launch of a new cloud-based email security offering, through the acquisition of Reflexion Networks; and
- the introduction of a new cloud-based web security offering, integrated into Sophos Central, our cloud-based management console.

In addition to organic development, Sophos continues to take advantage of focused, disciplined M&A activity to enhance and deepen our existing offerings, or to enter new markets that we feel fit well with our mission, our strategy, and our product portfolio.

Sophos is the only IT security vendor in the world that is a proven, balanced leader in both the enduser and network security markets. We are also driving a new wave of security innovation through our strategy of synchronized security.

> "OUR DIFFERENTIATED MISSION AND STRATEGY CONTINUE TO RESONATE WITH OUR CUSTOMERS AND PARTNERS AND ARE AT THE CORE OF OUR GROWING MOMENTUM. WE CONTINUE TO GAIN SHARE, AS WE OUTPERFORM MARKET GROWTH RATES IN BOTH OF OUR CORE SEGMENTS, NETWORK SECURITY AND ENDUSER SECURITY. WE BELIEVE WE ALSO HAVE PLENTY OF ADDITIONAL "RUNNING ROOM", AS WE ONLY HAVE ABOUT 5% SHARE IN EACH OF THESE MARKETS."

We began by linking our Endpoint and next-generation firewall products. But our vision extends far beyond that as, over time, we look to integrate our entire product portfolio into a single platform, all managed in a single console, available either in the cloud or on-premise.

We believe this approach has numerous benefits to our customers, to our partners and to our business model, including:

- differentiation versus other security vendors;
- enhanced and more proactive security, by generating actionable, detailed intelligence and addressing the vulnerable "white spaces" that exist between isolated products from multiple vendors that do not communicate with each other;
- easier deployment, management, and use;
- enhanced ability for partners to cross-sell and up-sell, to grow their top-line billings; and
- improvement in partner profitability as they can manage across multiple customers, remotely, providing more effective utilisation of their valuable technical staff.

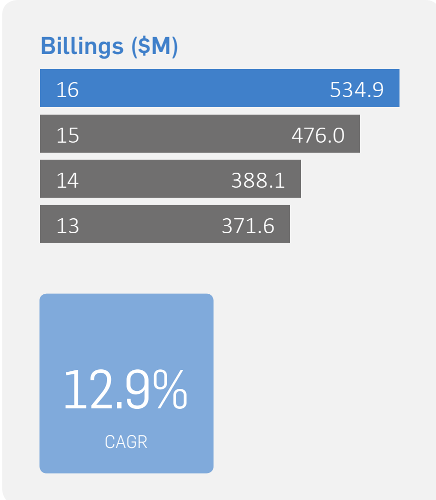
Our differentiated mission and strategy continue to resonate with our customers and partners and are at the core of our growing momentum. We continue to gain share, as we outperform market growth rates in both of our core segments, network security and enduser security. We believe we also have plenty of additional "running room", as we only have about 5 percent share in each of these markets.

We posted significant growth in both existing customer billings and new customer billings in each of our major regions. Our retention rate for our existing customers also improved, as they responded positively to the enhancements we made across our product portfolio. We added over 5,000 new partners and our total is now in excess of 20,000. Within our partner base we have grown our strongest and most active "Blue Chip" partners, those who conduct more than five transactions in the prior six-month period, by 38 percent to approximately 4,700. The number of our Blue Chip partners that sell both Enduser and Network products increased by 37 percent YOY. We will continue to develop our partner base to deliver sustainable billings and growth at an efficient sales expense.

We are driving greater brand awareness in our key markets and will remain focused on this effort during FY17 with creative and innovative marketing such as IT-centric social media campaigns, an expansion of our free tools and a continued focus on providing clear and practical IT security advice for businesses. One notable advance in our free tools during the year was the introduction of Sophos Home, a cloud-managed, easy-to-use anti-malware and web filtering solution for PCs and Macs in the home. Although there are many free antivirus tools for home users available on the market, ours is designed for the modern household, supports both the Microsoft Windows and Apple Mac operating environments, is completely cloud-enabled and is differentiated in its simplicity, ease of use and un-annoying user design. Sophos Home is now generating thousands of new users every day for Sophos, providing a positive introduction to Sophos and enhancing our brand visibility and awareness, which in turn makes it easier for our sales teams and channel partners to sell our products to enterprises of all sizes.

During FY16 Sophos continued to receive positive recognition and endorsement from industry analysts, such as Gartner and Forrester for key products in our network and enduser portfolio. Sophos has also continued to be recognised during the financial year as a leader by industry publications such as SC Magazine and Channel Reseller News ("CRN").

We are particularly pleased that Sophos continued to gain recognition in the industry as a great place to work, which supports our ability to attract and retain world-class talent. Sophos was rated as one of the "Top 30 medium sized businesses to work for undergraduates" in the UK by ratemyplacement.com and in the "Top 100 Places to Work for Graduates" in the UK by The Job Crowd. Sophos was also named as a "Dream Company to Work For" by World HRD Congress in India. Our people drive our success and as we continue to grow our business we constantly look for new ways to enhance our work environment, so our team members can do the very best work of their careers here at Sophos and feel excited and fulfilled about doing so.




Security remains a top priority for organisations of all sizes and continues to be a truly mission critical investment area. I continue to hear from our customers that they struggle to find the personnel and budget resources to effectively protect their organisations. They are looking for vendors who can help them stay secure, cost effectively, and also who can help them simplify their infrastructure, rather than make it more complex and more difficult to manage.

We believe we are uniquely positioned in the industry to meet this demand and I remain extremely confident in our future prospects.

I would like to add my personal thanks to every Sophos employee, partner and supporter whose hard work and commitment are so pivotal to our success, and whose actions help protect hundreds of thousands of organisations all over the world, every day.

**Kris Hagerman**
**Chief Executive Officer**
25 May 2016

# GEOGRAPHICAL REVIEW

As predicted, operations in the Americas and APJ continue to grow at higher rates than in EMEA, even though operations in EMEA are expected to continue to grow at rates that exceed those of the market.

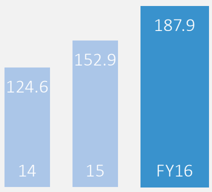
In the year-ended 31 March 2016, the Group generated 35 percent, 49 percent and 16 percent of its billings from end customers in the Americas, EMEA and APJ, respectively.

The Directors believe that the Group's strong history and footprint in Europe as well as its global operational improvements and its network of more than 20,000 channel partners, provide it with a significant opportunity to grow billings across all of its key geographical regions.

As a result, the Group intends to continue to invest in marketing to improve brand awareness as well as its sales teams and channel partner relationships to improve end customer reach in regions that are currently under-represented in the Group's billings, largely because the Group entered those markets later as it expanded outward from its U.K. headquarters.

## AMERICAS

Americas saw new customer growth across both Network and Enduser portfolios and a reported billings growth of 22.9 percent. Cloud platform adoption was a significant contributor.



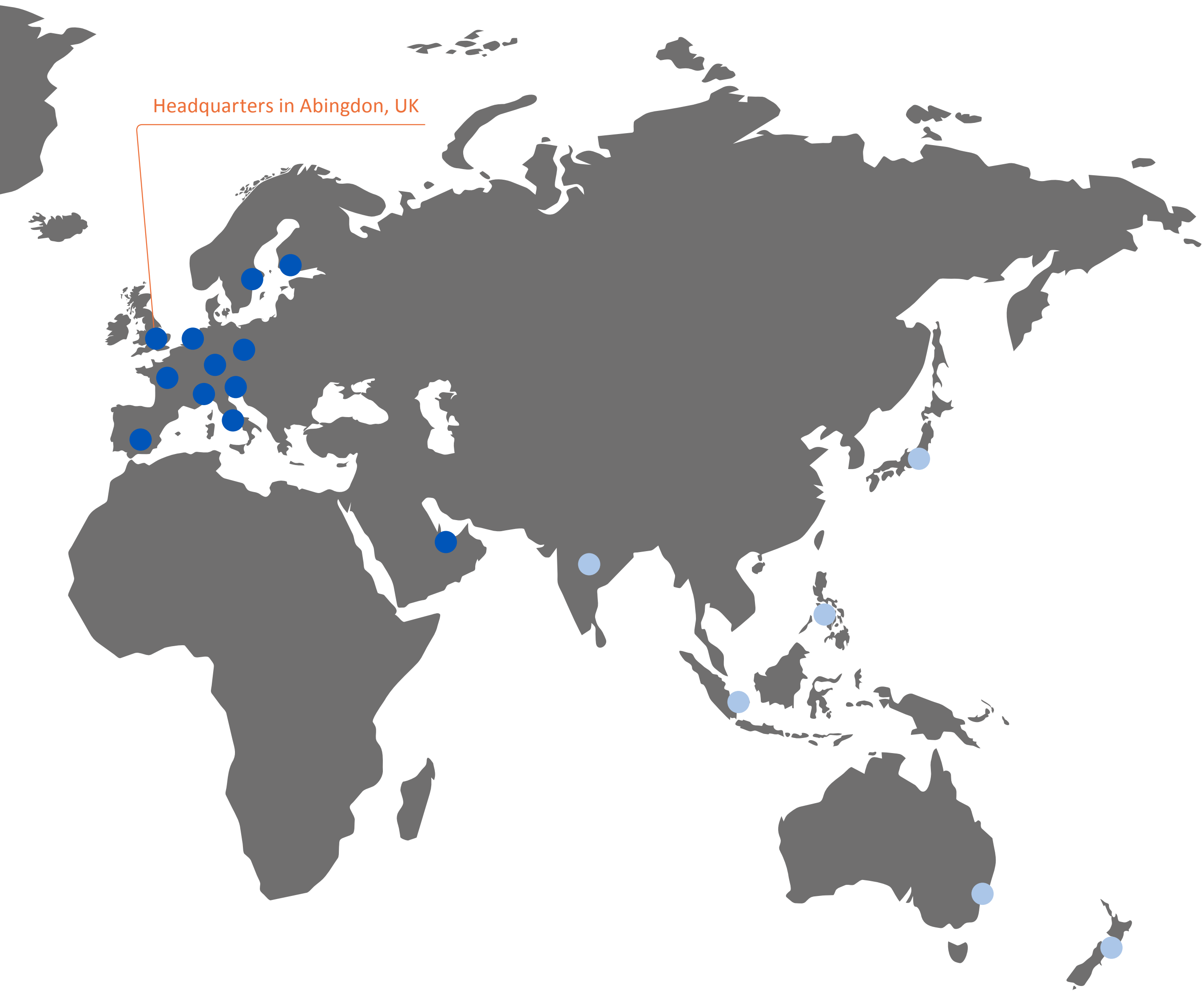

### THREE-YEAR BILLINGS $M

Like-for-like Billings grew YOY 20.5 percent

576
EMPLOYEES

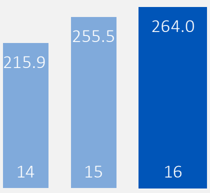
35%
OF TOTAL BILLINGS

35%
OF TOTAL REVENUE




## EMEA

Billings in EMEA were driven by a strong Network business primarily due to sales to new customers. Enduser grew more modestly with the cloud-based management platform beginning to gain momentum. Total reported billings growth was 3.3 percent YOY; significantly impacted by currency headwinds.




### THREE-YEAR BILLINGS $M

Like-for-like Billings grew YOY 15.5 percent

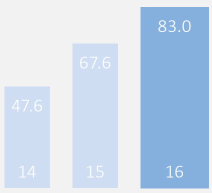
1,168 EMPLOYEES

49% OF TOTAL BILLINGS

50% OF TOTAL REVENUE

## APJ

Similar to EMEA, but to a lesser extent, currency headwinds affected reported billings growth which was 22.8 percent on a reported basis. Network billings were particularly strong in Japan.




### THREE-YEAR BILLINGS $M

Like-for-like Billings grew YOY 33.1 percent

955 EMPLOYEES

16% OF TOTAL BILLINGS

15% OF TOTAL REVENUE

# PRODUCT REVIEW

**Sophos is the only security vendor at scale with a leading and balanced product portfolio across endpoint and network security. Sophos continues to expand all its product capabilities, most notably the integration of enduser and network security and Sophos Central, our strategic cloud-based management platform used both by end customers and channel partners.**

Sophos further enhanced its cloud-enabled security management strategy with the evolution of Sophos Cloud from a cloud-based administration console for several enduser security products to a fully integrated endpoint and network security management platform that will be available in the cloud and on-premise, Sophos Central. This new management platform includes role-based interfaces for partners, IT administrators and end users. The platform is designed to simplify the sales, service and support that our partners can deliver to customers and will also improve the levels of protection for these customers. In late 2015, Sophos opened a new Frankfurt data centre which allows customers in Germany to keep their data in-country, and customers in the rest of continental Europe will also benefit from having a centrally-located data centre with data staying within the EU. Our priority for FY16 was delivering the first phase of our synchronized security strategy, with the release of the Sophos Cloud endpoint and Sophos XG Firewall featuring innovative Security Heartbeat™ technology. Synchronized security offers deep, meaningful and intelligent integration between enduser and network security and with our Sophos Central management platform, dramatically simplifies the ability for an end customer or channel partner to purchase and deploy additional products, and will help channel partners and end customers manage overall IT security through a single unified interface.

## Enduser Security

**Billings**


45%
OF TOTAL BILLINGS

**Revenue**


44%
OF TOTAL REVENUE

The underlying trends driving growth in the Enduser segment include the adoption of advanced threat protection features, the increased use of anomaly-based malware detection, the expansion of bring your own device (''BYOD'') computing environments, the proliferation of mobile computing devices, the growing importance of encryption and data protection, the increased adoption of cloud-based security offerings and the integration of enduser and network security technologies to address next-generation threats.

Sophos continues to enhance and expand next-generation capabilities in enduser products as sophisticated threats evolve:

Anti-malware technologies

- Behaviour analytics
- Reputation management
- Malicious traffic detection

Incident Response technologies

- Security Heartbeat™
- Encryption key shredding
- Malware removal
- Root cause analytics (currently in beta)

The acquisition of SurfRight B.V. adds the following capabilities:

- Exploit prevention
- Anti-ransomware
- Memory/process protection

Key product enhancements and launches:

### SOPHOS MOBILE CONTROL 6

Developed to include Sophos Secure Email, a personal information management (PIM) container solution for email, calendar and contacts. Personal and corporate data can be separated, allowing organisations to manage business data security while enhancing user privacy. IT administrators can remotely provision email to employee mobile devices across popular platforms, including iOS and Android.

### SOPHOS SERVER PROTECTION ADVANCED

Integrates server application whitelisting with anti-malware to deliver single-click server lockdown, using the simple, intuitive Sophos Central management console that makes it easy to deploy, manage and maintain. By locking a known-good server configuration and building in automatic trust of known-good updaters and linked DLLs, Sophos Server Protection Advanced reduces the administrative time needed to lock down multiple servers from weeks to just minutes, by simplifying configuration and only allowing approved or whitelisted applications to run.

# Network Security

**Billings**


50%
OF TOTAL BILLINGS

**Revenue**


50%
OF TOTAL REVENUE

Research and development for the Network product portfolio continues to be focused on enhancing next-generation firewall and advanced protection technology to address the increase in web-based infection, browser-based exploits and threats embedded in email; the increased adoption of cloud-based security offerings; and the integration of enduser and network security technologies to address next-generation threats.

Key product developments and launches include:

## SOPHOS XG FIREWALL

In late 2015, Sophos introduced the new Sophos XG Firewall that combined the best of our Cyberoam and Sophos firewall technology into an innovative next-generation firewall platform. XG Firewall introduced a number of advances, including Sophos Security Heartbeat™ which links Sophos Endpoint Protection with the XG Firewall to share important context and status information to improve protection and enable new types of firewall policies based on Endpoint status and health. Other innovations included a new intuitive user-interface, broad Layer-8 user identity awareness, unified policy model, user and application risk reporting, and FastPath packet optimization. In March 2016, the XG 135w model was awarded a 5-star A-List rating in the UK's PC Pro Magazine.

## SOPHOS UTM

Our trusted Sophos UTM running on SG Series appliances remains a critical part of our network security portfolio, offering a great mix of simplicity, performance, protection and value. The latest version, UTM 9.4, was released in March 2016 with the addition of Sophos Sandstorm next-generation threat protection for targeted and evasive threats, and support for the latest RED 15w and AP 15C hardware. We also added Auto Scaling technology to the Sophos UTM solution designed for Amazon Web Services ("AWS").

## SOPHOS SANDSTORM

To complement our existing malware protection capabilities, Sophos introduced a new advanced persistent threat and zero day malware security technology that provides signatureless protection. Sophos Sandstorm determines potential threat behaviour across multiple operating systems including Windows, Mac and Android on either physical or virtual hosts, on networks, web mail, Word, PDF and more than 20 file types and mobile applications. Sophos Sandstorm is available as a subscription option in Sophos Email Appliance 4.0 and Sophos UTM 9.4.

## SOPHOS WEB GATEWAY

The updated Sophos Web Gateway provides advanced cloud-delivered protection for users, devices and data across multiple operating systems regardless of their location, and is managed by Sophos Central. The latest version of the Sophos Web Appliance includes a new proxy engine with up to 7 times the scanning performance on the same hardware and improved granular controls over features like chat, games and comments to manage the use of popular social media apps.

## SOPHOS EMAIL APPLIANCE

Sophos Sandstorm protection has been added to the Sophos Email Appliance (SEA) along with new Sophos Delay Queue technology. This sophisticated enhancement is designed to address the problem of Snowshoe Spam and further advances threat prevention, along with Sophos Time-of-Click protection to block malicious email URLs, protecting against stealthy, delayed, spear phishing attacks.

# Technology acquisitions that accelerate leadership in endpoint and network

## Astute acquisitions drive customer, partner and shareholder value

The IT and cyber-crime landscape is ever-evolving, so consistent innovation is required to keep customers protected from the latest threats. Sophos has a rich heritage of internal innovation as well as an exceptional track record for acquiring and integrating technology from other companies. In FY16 Sophos made two acquisitions to accelerate the delivery of advanced security solutions.

### EMAIL PROTECTION IN THE CLOUD

In June 2015, Sophos acquired Reflexion Networks Inc. ("Reflexion") for a cash consideration of $15 million to accelerate the delivery of advanced email protection in the cloud. The solution from Reflexion had been developed for the needs of the mid-market and was designed to be offered as a managed service through channel partners. As Sophos integrates this technology as part of Sophos Central, it will complement the existing Sophos Secure Email Appliance by giving customers the choice of a cloud-based email security solution or an on-site appliance solution.

Reflexion developed its products to address the same target market, sales model and integrated solution strategy that Sophos has established. For our partners, this acquisition also strengthens our managed service provider ("MSP") portfolio. The ability to sell managed services offers an additional and predictable revenue stream to partners who have the capacity to manage security for their customers on an ongoing basis.

The acquisition of Reflexion strengthens the Sophos product set by adding a rich cloud-based email security, continuity and archiving solution. Reflexion's innovative, easy-to-deploy and easy-to-manage security platform provides:

- A cloud-based email filtering engine enabling full protection for email interactions without requiring additional on-site technology
- Near instantaneous protection from emerging threats by supplying real-time threat intelligence from the cloud
- A simple and intuitive management experience designed for small and mid-market enterprises or pragmatic enterprises of any size

At the time of acquisition, Reflexion had over 17,000 customers worldwide. More than 2,000 MSPs sell its cloud services every month.

## NEXT-GENERATION ENDPOINT TECHNOLOGY

Sophos is recognised as a leader in endpoint protection today, with a growing set of next-generation technologies such as behaviour-based analytics, Malicious Traffic Detection, Sophos System Protector, crowd sourced application reputation and many other technologies. Sophos acquired SurfRight B.V. ("SurfRight") in December 2015 for a cash consideration of $31.8 million to further strengthen Sophos' leading endpoint protection technology with next-generation defence tactics that can be delivered either on premise or in the cloud.

SurfRight is recognised as an innovator in signature-less next-generation endpoint threat detection and response ("ETDR") and advanced threat prevention. SurfRight has developed a portfolio of technologies that prevent, detect and remediate zero-day and sophisticated attacks by interrupting malware and advanced persistent threat ("APT") vectors. SurfRight's real-time anti-exploit technology focuses on detecting and preventing the memory manipulations and abuses that allow malicious code to run in the first place. Generic prevention of exploits at this early stage in the attack chain is a key enhancement to endpoint security mechanisms and can help thwart malicious code in the processor and memory. The portfolio also includes anti-espionage technology and enhanced protection against ransomware attacks such as CryptoLocker.

SurfRight's technology will also further enhance the effectiveness of Sophos' synchronized security strategy, in which multiple components of security protection actively and continuously communicate with each other.

This innovative approach leads to faster threat detection and a dramatic reduction in the time and resources required to investigate and remediate security incidents.

# FINANCIAL REVIEW

Trading for the year closed at the upper end of the Board's expectations with like-for-like billings growth of 19.7 percent as the Group experienced strong growth across all regions and products. Revenue grew 15.6 percent on a constant currency basis, or 7.1 percent on a reported basis.

**The table below presents the Group's financial highlights (in reported currency):**

| | FY16 $M | FY15 $M | Growth Reported % | Growth Like-for-like % |
|---|---|---|---|---|
| Billings | 534.9 | 476.0 | 12.4 | 19.7 |
| Revenue* | 478.2 | 446.7 | 7.1 | 15.6 |
| Cash EBITDA* | 120.9 | 101.4 | 19.2 | 31.6 |
| Operating loss | (32.7) | (0.5) | n/m | n/a |
| Unlevered free cash flow | 46.4 | 65.3 | (28.9) | n/a |
| Net cash flow from operating activities | 21.3 | 59.9 | (64.4) | n/a |

* Like-for-like growth rates for revenue and cash EBITDA are presented on a constant currency basis but do not adjust for pre-acquisition revenues and profits.

Definitions of non-GAAP measures are included in the glossary.

The strong billings performance in the year resulted in an increase in the deferred revenue balance of $65.4 million to $498.7 million as at the end of March 2016; of which $286.5 million which will be recognised as revenue in FY17, up 14 percent YOY, highlighting the visibility and sustainability of the Sophos subscription based business model. The Group targets investment to drive subscription billings growth and hence much of the positive impact of the year's billing activity will be seen in the profit and loss account of future years.

Billings to new customers grew 33.0 percent YOY. In addition, the renewal rates and cross-sell rates to existing customers, of which there are now in excess of 220,000, continue to improve. This combination of new customer growth combined with improving retention and cross-sell metrics across an expanding customer base underpins the Group's confidence for future billings growth.

Cash EBITDA increased to $120.9 million and margins improved to 22.6 percent as the Group grew billings and leveraged its operating expense base. Research and development and marketing investments are anticipated to increase in line with billings growth going forward. The Group expects to continue to leverage other functions to support margin expansion.

The operating loss widened YOY in line with the Board's expectations as a result of exceptional items, predominantly associated with the cost of the IPO. Before exceptional items the Group made an operating profit of $9.2 million.

Unlevered free cash flow was also in line with the Board's expectations and below the prior year due to one-time nonrecurring items. It is expected that unlevered free cash flow will approximately double in FY17 as working capital normalises and the level of anticipated profit improves, driven by continued billings growth and modest margin expansion. Net cash flow from operating activities was predominantly impacted by $41.9 million of exceptional items and is expected to significantly increase in the year ahead.

## BILLINGS

The Group's reported billings increased by $58.9 million from $476.0 million in the year-ended 31 March 2015 to $534.9 million in the year-ended 31 March 2016, with growth in all regions, products and types as detailed below. This represented 12.4 percent reported growth or 19.7 percent growth on a like-for-like basis. The variance between the reported and like-for-like billing growth rates represents the impact of both currency and acquisitions. This significant variance was predominantly due to the devaluation in the average Euro rate which impacted the reported growth rate in the EMEA region.

The Group's billings are primarily comprised of subscription agreements, which represented 79 percent of the Group's billings in FY16. Subscription agreements are paid in full upfront with revenue being recognised on a deferred basis in accordance with accounting standards over the life of the agreements, which can vary from one to five years, resulting in a highly visible and predictable future revenue stream. There was an immaterial billings contribution from Reflexion and SurfRight in the respective periods post-acquisition.

"BILLINGS GREW 19.7 PERCENT YEAR-ON-YEAR, WELL ABOVE THE GROWTH IN THE MARKET OF 7 PERCENT CAGR, WITH STRONG GROWTH ACROSS ALL REGIONS AND PRODUCTS IN BOTH CUSTOMER RENEWALS AND NEW CUSTOMERS, SUPPORTING GROWTH IN BOTH CURRENT YEAR AND DEFERRED REVENUE."

| | | | Growth | |
|---|---|---|---|---|
| | FY16 $M | FY15 $M | Reported % | Like-for-like % |
| Billings by Region: | | | | |
| – Americas | 187.9 | 152.9 | 22.9 | 20.5 |
| – EMEA | 264.0 | 255.5 | 3.3 | 15.5 |
| – APJ | 83.0 | 67.6 | 22.8 | 33.1 |
| | 534.9 | 476.0 | 12.4 | 19.7 |
| Billings by Product: | | | | |
| – Network | 266.7 | 223.7 | 19.2 | 27.5 |
| – Enduser | 238.2 | 224.1 | 6.3 | 13.4 |
| – Other | 30.0 | 28.2 | 6.4 | 9.1 |
| | 534.9 | 476.0 | 12.4 | 19.7 |
| Billings by Type: | | | | |
| – Subscription | 422.8 | 384.9 | 9.8 | 16.5 |
| – Hardware | 99.0 | 78.4 | 26.3 | 37.7 |
| – Other | 13.1 | 12.7 | 3.1 | 10.2 |
| | 534.9 | 476.0 | 12.4 | 19.7 |

## Billings by region

### Americas

Billings attributable to the Americas increased by $35.0 million to $187.9 million in the year-ended 31 March 2016, representing 22.9 percent growth on a reported basis and 20.5 percent on a like-for-like basis. This increase was driven by new customer growth across both Enduser and Network, and an increase in the existing customer retention rate.

Enduser new customer growth was positively impacted by significant adoption of the Sophos Central platform. Reported growth includes the impact of billings from Reflexion, a cloud-based Email security company acquired in June 2015; like-for-like billings growth adjusts for the acquisition and currency.

### EMEA

Billings attributable to EMEA increased by $8.5 million to $264.0 million in the year-ended 31 March 2016, representing 3.3 percent growth on a reported basis and 15.5 percent growth on a like-for-like basis. This increase was primarily due to Network growth in new customer business. Enduser billings also continued to grow, albeit more modestly, with adoption of the Sophos Central platform now starting to gain momentum, a few quarters behind the Americas. As anticipated, EMEA's reported billings for the year were negatively impacted by the strengthening US Dollar, the impact of which moderated over the second-half of the year.

### APJ

Billings attributable to APJ increased by $15.4 million to $83.0 million in the year-ended 31 March 2016, representing 22.8 percent growth on a reported basis and 33.1 percent growth on a like-for-like basis. Network billings growth was particularly strong in Japan in the year, assisted by a number of larger one-time deals, but similar to EMEA, currency headwinds from the strengthening US Dollar impacted on reported billings growth.

# FINANCIAL REVIEW CONTINUED

## Billings by product

### Network products

The Group's billings attributable to Network products increased by $43.0 million to $266.7 million in the year-ended 31 March 2016, representing 19.2 percent growth on a reported basis and 27.5 percent growth on a like-for-like basis. This was primarily due to 31.2 percent like-for-like growth in UTM sales that grew strongly in all regions and across both new and existing customers. The Network like-for-like three-year CAGR was 19.8 percent.

### Enduser products

The Group's billings attributable to Enduser products increased by $14.1 million to $238.2 million in the year-ended 31 March 2016, representing 6.3 percent growth on a reported basis and 13.4 percent growth on a like-for-like basis. Enduser YOY billings growth was primarily driven by the cloud platform. The like-for-like three-year CAGR was 8.8 percent.

### Billings by type

The percentage of hardware billings increased to 18.5 percent in the year (2015: 16.5 percent), reflecting the higher proportion of Network billings, which increased from 47.0 percent of billings to 49.9 percent, and growth in UTM billings in particular.

## Key billings metrics

### Billings from new customers

Billings from new customers grew at an even faster rate than billings from existing customers. Total billings from new customers grew faster than in FY15, increasing 33.0 percent YOY and as a percentage of billings increased to 25 percent from 23 percent in the prior year. Sophos Network billings from new customers grew 36.2 percent YOY and increased as a percentage of Network billings to 32 percent from 31 percent in the prior year. Enduser billings from new customers grew 28.3 percent YOY and have increased as a percentage of Enduser billings to 19 percent from 17 percent in the prior year.

### Retention rates

The Group's results are largely driven by revenue generated from subscriptions for its products and services, including professional services and enhanced support services. The Group's net retention rates include the impact of cross-selling and up-selling, which helps the Group evaluate its success in fully leveraging its broad product portfolio throughout its installed customer base. The Group's net retention rate, excluding Cyberoam, improved in the year from 100.2 percent in the year-ended 31 March 2015 to 101.9 percent in the year-ended 31 March 2016.

### Billings by size

Sophos products are designed for the Group's target market, mid-market enterprises (defined as enterprises with between 100 and 5,000 employees), but are frequently also bought by both smaller and larger enterprises. In FY16, the proportion of billings to each of the customer size groups remained largely consistent YOY.

### Billings by length of contract

The Group sells subscription agreements covering a range of durations, most typically being one to three years in length. The average contract length for the year-ended 31 March 2016 was 28.6 months, a small increase on the 28.0 months for the year-ended 31 March 2015 due to a small number of longer-term deals in Japan. Excluding these longer-term deals in Japan, average contract length would have remained stable.

The billings analysis of contracts by subscription length was as follows:

| (Like-for-like billings, excluding Cyberoam, Reflexion and SurfRight) | FY16 % | FY15 % |
|---|---|---|
| Under one year | 32.8 | 33.5 |
| One to two years | 8.2 | 8.3 |
| Two to three years | 46.7 | 45.3 |
| Greater than three years | 12.3 | 12.9 |

### Cross-sell and up-sell opportunities

As the IT needs of the Group's existing customers evolve and as customers realise the benefits of the products and services they previously purchased, the Group's product portfolio provides an opportunity to cross-sell additional products and services or to up-sell enhanced versions of products, or additional enduser licences, or longer subscription periods.

Following the launch during the year of the Group's synchronized security strategy, and the introduction of new products incorporating Sophos Security Heartbeat™ technology, the percentage of customers who own both a Sophos Endpoint and UTM has continued to improve. At 31 March 2016, approximately 7.4 percent of customers had both a UTM product and an Endpoint product compared to 5.6 percent of customers at 31 March 2015. The Group expects this metric to steadily improve over future periods as more customers take advantage of the benefits of synchronized security. The cloud platform also facilitates easier cross-sell of other products beyond endpoint, such as server, mobile and web security; and over time the Group expects to extend this platform to incorporate the Group's entire product portfolio, including encryption, email security, web security, Wi-Fi, and UTM/NGFW. Many of the Group's customers do not yet deploy all of these essential security components from any vendor and as such this represents further cross-sell opportunities over and above the Group's core Endpoint and UTM products.

## Revenue

The Group's revenue increased by $31.5 million, or 7.1 percent, to $478.2 million in the year-ended 31 March 2016. On a constant currency basis, revenue growth for the year was 15.6 percent. This growth was due to a combination of continuing growth in subscription billings across all major product groups and an improvement in UTM hardware billings, which are recognised as revenue in the same period as the billing.

As the majority of the Group's revenue relates to subscriptions (FY16: 76.3 percent; FY15: 79.4 percent), the benefit from increased billings is spread over a number of years on the subsequent recognition of deferred revenue. Reported revenue in the year of $478.2 million comprised $251.4 million from recognition of prior year deferred revenues and $226.8 million from new billings. The deferred revenue balance at the end of the year of $498.7 million increased $65.4 million YOY, $286.5 million of which will be recognised as revenue in FY17, an increase of 14 percent YOY.

| | FY16 $M | FY15 $M | Growth % |
|---|---|---|---|
| Revenue by Region: | | | |
| – Americas | 166.1 | 150.6 | 10.3 |
| – EMEA | 239.5 | 233.5 | 2.6 |
| – APJ | 72.6 | 62.6 | 16.0 |
| | 478.2 | 446.7 | 7.1 |
| Revenue by Product: | | | |
| – Network | 239.0 | 206.5 | 15.7 |
| – Enduser | 211.9 | 210.0 | 0.9 |
| – Other | 27.3 | 30.2 | (9.6) |
| | 478.2 | 446.7 | 7.1 |
| Revenue by Type: | | | |
| – Subscription | 364.7 | 354.8 | 2.8 |
| – Hardware | 100.9 | 80.0 | 26.1 |
| – Other | 12.6 | 11.9 | 5.9 |
| | 478.2 | 446.7 | 7.1 |

Revenue in the Americas increased by 10.3 percent to $166.1 million in the year-ended 31 March 2016 due to growth both in Network sales, including the UTM hardware component, and growth in Enduser revenue which is predominantly made up of subscription based products.

Though impacted by foreign exchange headwinds for much of the year, EMEA revenue increased by 2.6 percent to $239.5 million in the year-ended 31 March 2016, primarily due to growth in UTM billings.

APJ revenue increased by 16.0 percent to $72.6 million in the year-ended 31 March 2016, also predominantly due to strong growth in UTM billings.

The impact of currency headwinds in both EMEA and APJ meant that despite reporting strong like-for-like subscription billings growth of 16.5 percent, EMEA and APJ both reported headline reductions in subscription revenues.

A further analysis of subscription revenue by region is set out below to illustrate the impact of changes in exchange rates:

| | FY16 $M | FY15 $M | Growth % |
|---|---|---|---|
| Americas | 141.7 | 130.4 | 8.7 |
| EMEA | 176.0 | 177.3 | (0.7) |
| APJ | 47.0 | 47.1 | (0.2) |
| Total subscription | 364.7 | 354.8 | 2.8 |

## Cost of Sales

The Group's cost of sales increased by $15.1 million, or 16.9 percent, to $104.4 million in the year-ended 31 March 2016, primarily due to the growth of Network product billings, which have a larger hardware component.

## Sales and Marketing

The Group's sales and marketing expenses increased by $8.6 million or 4.9 percent, to $184.0 million in the year-ended 31 March 2016. Marketing expenses are increasing to broadly match the investment with billings growth. Sales expenses are increasing more slowly as the Group starts to leverage its strong channel model.

## Research and Development

The Group's research and development expenses increased by $17.8 million, or 21.8 percent, to $99.6 million in the year-ended 31 March 2016. This reflected the continued investment in the development of new products and enhancements of existing products, including higher headcount as a consequence of the acquisition of Reflexion and SurfRight in the year. As with marketing investment, research and development investment is targeted to now broadly grow in line with billings.

# FINANCIAL REVIEW CONTINUED

### General Finance and Administration

The Group's underlying general finance and administration expenses increased by $13.6 million, or 35.4 percent, to $52.0 million in the year-ended 31 March 2016. The increase was almost entirely attributable to the share-based payment expense, which is higher following the issue of new equity awards at the time of the Company's IPO. Excluding share-based payments and exceptional items, the underlying general finance and administration expenses decreased YOY, and now represent 6.7 percent of billings (FY15: 7.8 percent) as the Group leverages its strong back office function.

The Group's exceptional items included within general finance and administration expenses increased by $24.6 million to $41.9 million in the year-ended 31 March 2016. The increase was mainly due to costs of $17.8 million incurred during the Company's IPO, as well as acquisition costs and expenses incurred in relation to the defence or settlement of claims brought against a number of our employees by their former employer and certain intellectual property litigation cases.

### Amortisation of Intangible Assets

The Group's amortisation of intangible assets decreased by $18.4 million, or 38.7 percent, to $29.2 million in the year-ended 31 March 2016. This decrease was due to the reduction in amortisation charges associated with acquisitions in prior years exceeding the charge in the year from the FY16 acquisitions of Reflexion and SurfRight.

### Currency Movements and Impact

The weakening of the Euro as compared to the US Dollar negatively impacted the Group's reported billings and profit growth rate in the year-ended 31 March 2016.

The Group's foreign exchange gain was $0.2 million in the year-ended 31 March 2016, compared with a gain of $2.6 million in the year-ended 31 March 2015. This change was primarily due to the moderate weakening of the US Dollar compared to Sterling and the Euro having strengthened throughout the prior year.

### Cash EBITDA

Whilst subscription billings are recognised in the profit and loss account as revenue over the length of the contract, substantially all of the costs in connection with the contract have been incurred and are recognised in the profit and loss account upfront. The Directors believe that cash EBITDA is a useful supplemental measure of earnings that provides visibility on actual cash earned in the period and is a better reflection of the profitability of the contract signed, as it matches cash inflows with nearly all of the cash costs of delivering the relevant service to the customer.

On a reported basis, cash EBITDA increased by 19.2 percent to $120.9 million in the year-ended 31 March 2016. On a constant currency basis, cash EBITDA growth was 31.6 percent as a result of a combination of strong billings and operational leverage, particularly within the back office and sales functions. Cash EBITDA margins improved year over year to 22.6 percent from 21.3 percent.

### Operating Loss

The Group's operating loss was $32.7 million in the year-ended 31 March 2016 compared to a loss of $0.5 million in the prior year. After adding back exceptional items, as explained above, gains on group asset disposals and foreign exchange gains and losses, the operating profit was $9.0 million in the year-ended 31 March 2016 compared to $14.2 million in the prior year. The YOY reduction was a consequence of investment in FY16, the positive impact of which will be reflected as revenue in the profit and loss account of future years.

### Net Finance Costs

The Group's net finance costs decreased by $18.1 million to $35.7 million in the year due to the impact of the IPO, the proceeds of which enabled the repayment of both the amounts due to the previous parent company and $87.7 million of bank debt. These underlying improvements were offset by a $27.1 million variance in foreign exchange gain on borrowings and a $5.9 million expense relating to the write-off of un-amortised capitalised finance fees that originally arose on the repaid external debt facility.

### Income Tax

The Group's tax charge for the year was $3.5 million (FY15: $5.7 million) with an effective tax rate of -5 percent (FY15: -11 percent). The charge is driven by both the profit mix amongst the key jurisdictions in which the Group operates and by a number of one-time events.

Following the IPO, the Group has increased the proportion of employee remuneration associated with share-based compensation, the cost of which can be claimed as a statutory deduction in at least two of the key jurisdictions in which the Group operates, including the UK and the US. This resulted in the recognition of a deferred tax asset in FY16 of $13.7 million, of which $3.5 million has been recognised through the income statement.

During FY16 the Group has also elected to adopt the new Research & Development (R&D) Expenditure Credit regime introduced by the UK Government with effect from 1 April 2013 and has benefitted from a $5.3 million credit to the tax charge in respect of the three years to 31 March 2016.

### Loss for the Year

The Group's loss for the year increased by $11.9 million, from a loss of $60.0 million in the year-ended 31 March 2015 to a loss of $71.9 million in the year-ended 31 March 2016 predominantly reflecting exceptional expense items.

## Unlevered Free Cash Flow

Unlevered free cash flow represents cash EBITDA less purchases of property, plant and equipment and intangibles, plus cash flows in relation to changes in working capital and taxation. Unlevered free cash flow is presented to enhance understanding of the Group's cash generation capability.

| | FY16 $M | FY15 $M |
|---|---|---|
| Cash EBITDA | 120.9 | 101.4 |
| Net capital expenditure | (16.8) | (11.9) |
| **Operating cash flow** | 104.1 | 89.5 |
| Change in working capital | (32.5) | 1.5 |
| Corporation tax paid | (25.2) | (25.7) |
| **Unlevered free cash flow** | 46.4 | 65.3 |

In line with the Board's expectations, unlevered free cash flow reduced to $46.4 million predominantly due to anticipated one-time working capital movements.

Unlevered free cash flow can be reconciled to the statutory measure of net cash from operating activities as follows:

| | FY16 $M | FY15 $M |
|---|---|---|
| **Net cash flow from operating activities** | 21.3 | 59.9 |
| Exceptional items | 41.9 | 17.3 |
| Net capital expenditure | (16.8) | (11.9) |
| **Unlevered free cash flow** | 46.4 | 65.3 |

Net cash from operations reduced to $21.3 million mainly as a result of the increased exceptional items related to the IPO and expenses incurred in the defence or settlement of claims brought against a number of our employees by their former employer and certain intellectual property litigation cases.

## Changes in Working Capital

Working capital changes YOY were largely due to the FY15 balance sheet including accrued and payable amounts in relation to closure of one office, the "Cloudburst" brand awareness marketing program and extraordinary bonus and commission payments arising from FY15 over-performance. Working capital at the end of the current year reflects an increased volume of trade occurring as well as prepayments for FY17 partner conferences that are being held earlier than in the prior year. Despite trade receivables increasing due to billings growth, DSO has decreased marginally to 44 days (FY15: 45 days).

## Capital Expenditure

The Group's capital expenditure primarily comprises property, plant and equipment as well as intangible assets. In the year-ended 31 March 2016, net cash capital expenditure increased by $4.9 million YOY. The prior year comparative included the disposal of property that was surplus to requirements for $3.0 million; the underlying capital expenditure outflow was $14.9 million. The increased YOY capital expenditure is a result of expanding facilities in the Group's India operation as well as operational system improvements that enhance the Group's ability to transact business with its partners and customers.

## Cash Taxation

Corporation tax amounts paid in FY16 were slightly lower than in FY15 largely due to a number of catch-up payments made in FY15 in relation to earlier years. Cash tax is driven by the profits mix amongst the key jurisdictions in which the Group operates and by acquisitions in recent years. A cash tax payment of $2.8 million also arose in FY16 due to the distribution of dividends from India.

## Financing

In connection with the IPO process that was completed in July 2015, the Group refinanced its external borrowings. In the third quarter of FY16 the Group drew down a portion of the associated revolving credit facility to partially finance the acquisition of SurfRight. At 31 March 2016, the ratio of net debt to cash EBITDA was 2.1 times, which in the absence of future acquisitions will improve as a consequence of the cash generative nature of the Group.

## Dividends

At the time of the IPO, the Directors indicated an intention to adopt a progressive dividend policy, reflecting the cash generative nature and long-term earnings potential of the Group. The Directors propose to pay a final dividend for the year-ended 31 March 2016 of 1.1 US Cents per share, giving a total dividend for the year of 1.8 US Cents per share. The final dividend, subject to shareholder approval, will be paid on 14 October 2016 to all shareholders on the register on 16 September 2016.

**Nick Bray**

**Chief Financial Officer**

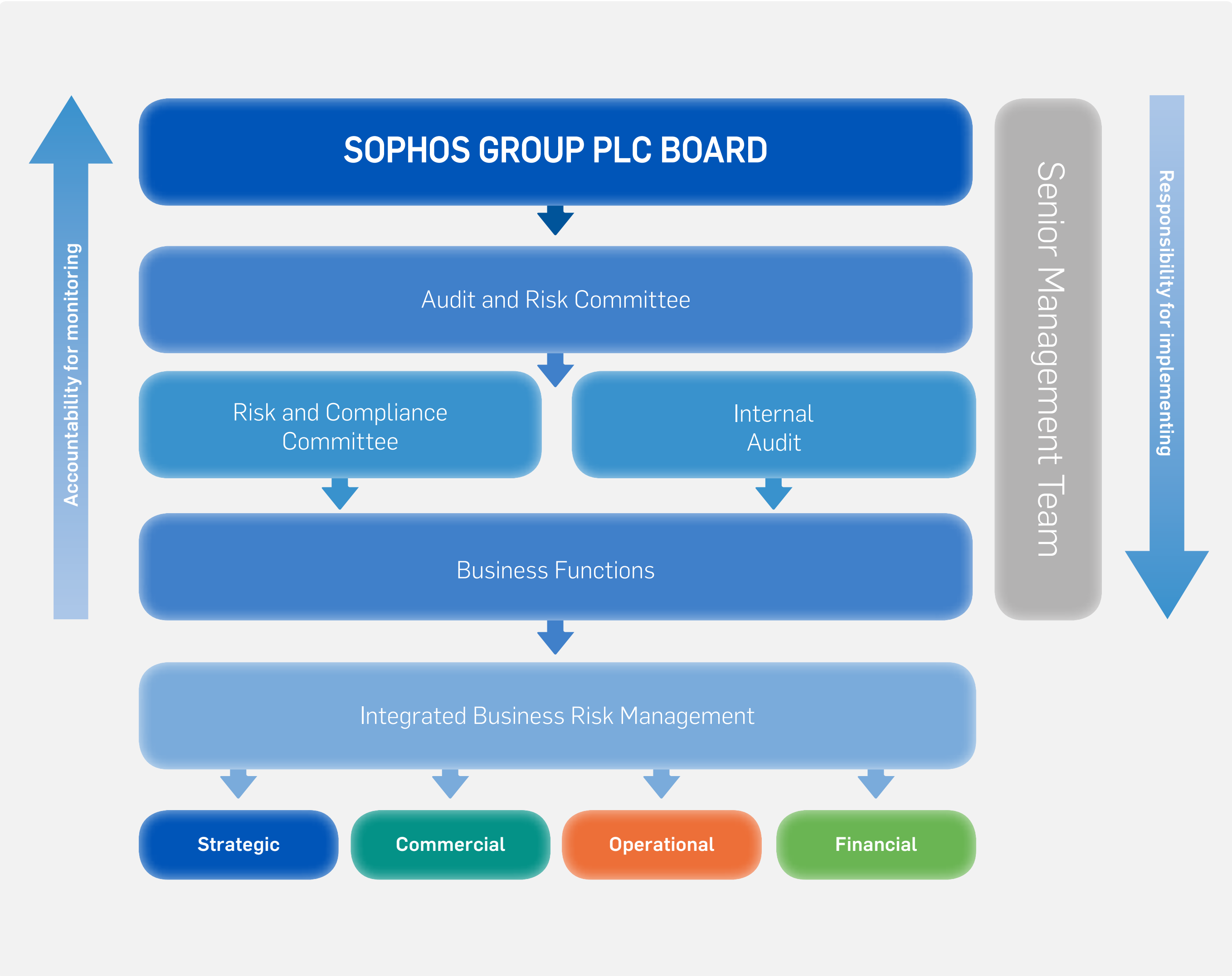
25 May 2016

# PRINCIPAL RISKS AND RISK MANAGEMENT

Principal risks are identified through a business-wide risk assessment process, along with an evaluation of the strategy and operating environment of the Group. The risk review process encompasses the identification, management and monitoring of risks in each business area. This process includes an assessment of the risks to determine the likelihood of occurrence, the potential impact and the adequacy of mitigation or controls already in place.

A full review is then undertaken by the Risk and Compliance Committee, who evaluate the principal risks of the Group with reference to its strategy and operating environment. The Audit and Risk Committee monitors these processes, reviewing the Group's Consolidated Risk Register and reporting material risks to the Board.

## STRUCTURE OF RISK MANAGEMENT




Read more about the Group's risk environment and internal controls on page 48.

The Directors consider the following matters to be the principal risks and uncertainties (in no specific order) affecting the Group:

| | HOW IT IMPACTS US | WHAT WE ARE DOING | RISK MOVEMENT |
|---|---|---|---|
| **RECRUITMENT AND RETENTION OF KEY PERSONNEL** | The ongoing success of the Group is dependent on attracting and retaining high quality employees at all levels in the business who can effectively implement the Group's strategy.<br><br>Failure to attract, retain or develop high quality employees across the business could limit the Group's ability to deliver its business plan commitments. | Making Sophos a great place to work is central to the Group's strategy.<br><br>Sophos is committed to a strong recruitment process supported by robust remuneration programs which are benchmarked appropriately. Additionally, Sophos has a commitment to all levels of training throughout the organisation.<br><br>Reward schemes are continuously evaluated to drive and reward performance and ensure the retention of key talent.<br><br>Annual employee engagement surveys enable progress of our people actions to be monitored, areas of improvement identified and necessary actions performed. | ↔ |
| **DEFECTS OR VULNERABILITIES IN PRODUCTS OR SERVICES** | The Group's products and services are complex, and as such they have contained and may in the future contain design or manufacturing defects or errors that are not detected until after their commercial release and deployment by end customers. These defects could cause the Group's products or services to be vulnerable to security attacks, cause them to fail to help security networks, temporarily interrupt end customers' networking traffic, fail to prevent or detect viruses or similar threats. Further, due to the evolving nature of threats and the continual emergence of new threats, the Group may fail to identify and update its threat intelligence or other virus databases in time to protect end customers' networks and devices.<br><br>As a result, actual or perceived defects or vulnerabilities in the Group's products or services, the failure of the Group's products or services to prevent a security threat, could harm the Group's reputation and divert the Group's resources. | The Group is committed to extensive test cycles and quality procedures, which are subject to continuous improvement.<br><br>Sophos employs a combination of internal and external quality reviews and testing of products, including source code reviews, public and private third party efficacy testing, and various forms of penetration testing. We encourage a healthy collaboration with the security research community, as described in our Responsible Disclosure Policy: https://www.sophos.com/security.<br><br>Further, we protect the privacy and security of our customers worldwide through our pledge to never engineer backdoors into our products as described here: https://www.sophos.com/nobackdoors | ↔ |

# PRINCIPAL RISKS AND RISK MANAGEMENT CONTINUED

| | HOW IT IMPACTS US | WHAT WE ARE DOING | RISK MOVEMENT |
|---|---|---|---|
| **FALSE DETECTION OF THREATS** | The Group's products may falsely detect threats or malware that do not actually exist in applications or content based on the Group's classification of application type, virus, malware, vulnerability exploits, data or URL categories (known as "false positives"). These false positives, while inherent in the Group's industry, may impair the perceived reliability of the Group's products and may therefore adversely impact market acceptance of the Group's products.<br><br>If the Group's products restrict important files or applications based on falsely identifying them as malware (or some other item that could be restricted), this could adversely affect end customers' systems and cause material system failures. Any such false identification of important files or applications could result in negative publicity, damage to the Group's reputation, loss of end customers and sales, increased costs to remedy any problem and risk of litigation, any of which could have a material adverse effect on the Group's financial condition and operating results. | Sophos is committed to investment in its world class security research labs facility with emphasis placed on staff training, testing and quality procedures.<br><br>Moreover, there is a continuous proactive focus on improvement of processes to enable early detection of a false positive event, as well as applying a 'lessons learnt' approach through root cause analysis.<br><br>Sophos acknowledges the inherent risk associated with a false positive incident within the industry and is committed to ensuring there are mitigating processes in place to manage any incident, large or small, in order to minimise the impact on our customers. | |
| **IT SECURITY AND CYBER RISK** | As a provider of IT security products, the Group is a high profile target and the Group's networks and products may have vulnerabilities that have from time to time been, and may in the future be, targeted by attacks specifically designed to disrupt the Group's business and harm the Group's reputation.<br><br>If an actual or perceived breach of security occurs in the Group's internal systems, it could adversely affect the market perception of the Group's products. In addition, a security breach could affect the Group's ability to operate its business, including the Group's ability to provide support services to end customers. | Sophos has a dedicated Cyber Security Team which is focused on investigation and mitigation of risks related to cyber-attack. The Group is focused on day-to-day active monitoring processes to identify and deal with IT security incidents, and also implements continual improvements in the IT security technology, education and awareness and policies that combine in the overall security posture of Sophos. | |

| | HOW IT IMPACTS US | WHAT WE ARE DOING | RISK MOVEMENT |
|---|---|---|---|
| **PRODUCT PORTFOLIO MANAGEMENT** | Sophos has an extensive number of products, enhanced further by acquired technologies. The extent of investment in each product needs to be managed and prioritised, taking into account the expected future prospects. Additionally, consideration must be given to the ability to adequately support the entire product range.<br><br>Failure to manage the product portfolio adequately could result in inappropriate investment focus in relation to research and innovation in product development. This could result in products that do not meet the requirements of customers or partners and the risk they will look to alternative solutions, leading to the potential loss of both new and existing revenue streams.<br><br>Additionally, insufficient focus on key research and development projects may damage the long-term growth prospects of the Group. | Sophos continues to focus on and improve the interaction between Product Management, Product Development, Sales and Marketing and all Support functions in an integrated product development approach.<br><br>Internal processes are run to identify opportunities for standardisation and consistency across products lines. This helps to eliminate redundancy, reduce development and support cost and improve partner and customer experience through a more predictable and coherent product portfolio.<br><br>Additionally, Sophos customers and the partner community continue to be an invaluable resource in guiding portfolio management decisions. They provide immediate and constant feedback on how well Sophos is meeting their requirements and what improvements Sophos can make to its current offering, as well as opportunities for portfolio consolidation or expansion.<br><br>During the year-ended 31 March 2016, the Group strengthened its product portfolio through the acquisition of Reflexion Networks Inc and SurfRight BV. | |
| **DISRUPTION TO DAY TO DAY GROUP OPERATIONS** | Sophos is at risk of disruption to its day to day operations from a disaster incident, which may seriously impact IT systems or access to office space.<br><br>A failure in the operation of the Group's key systems or infrastructure on which the Group relies could cause a failure of service to our customers and negatively impact the Sophos brand. | Sophos has made significant investments in the technology and infrastructure of the Group to ensure it continues to support the growth of the organisation.<br><br>Additionally, incident management procedures and escalation processes are in place as well as maintaining security, business continuity and disaster recovery plans. Ongoing updates and testing of these plans is underway. | |

# CORPORATE RESPONSIBILITY REPORT

## EMPLOYEES

The Group promotes a culture where people can achieve and be recognised for their achievements, where people have the support they need to develop themselves and where people are valued and treated with respect. The Group continues to operate by its core values: simplicity, empowerment, passion, innovation, and authenticity. To aid with the development of all of the Group's employees, unlimited access has been made available to one of the largest independent online libraries of e-learning courses in the world for technical, personal and leadership skills development, in addition to role specific training and access to Instructor-Led Training ("ILT") aligned to their development and career aspirations. The Group is committed to providing equal opportunities and recruits and promotes staff on the basis of their experience, qualifications, skills and attitude.

At the end of the financial year the gender breakdown of employees and Directors was:

| | Executive & Non-Executive Directors | Senior Managers* | Employees |
|---|---|---|---|
| Female | 1 | 13 | 600 |
| Male | 8 | 70 | 2,194 |

* The Group has defined Senior Managers as members of the Senior Management Team and their direct reports (excluding Executive Directors separately reported).

The Group conducts a global Employee Opinion Survey on an annual basis to gain feedback from employees and help identify and deliver actions that will increase employee engagement and company performance. Sophos will continue to identify and drive actions on a global, location and functional basis.

The Group actively engages with local universities in our key locations and offers internships and working student opportunities in Canada, the US, UK, Germany and Austria. In the UK, the Group has established an intern and graduate program, supporting students through a full-year paid internship and provide support, expertise and guidance for their final year projects. Many of the interns receive permanent offers to join Sophos post-graduation, as well as financial assistance for their final year of study.

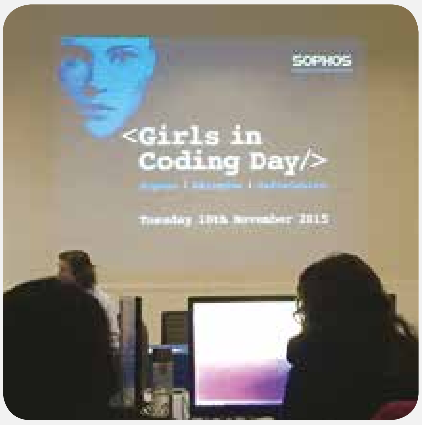
## COMMUNITY & CHARITIES

Sophos employees come from many countries and walks of life, but all share the same core values, including a commitment to help others and make a positive impact in the communities where they live and work. From the global headquarters in the UK, to the offices in India, Hungary, the Philippines and many other places, Sophos' corporate social responsibility efforts stretch across the world.

In the UK the Group continued its long-term support for the Prince's Trust; based in the UK the Trust supports 13 to 30 year olds who are unemployed, struggling at school or at risk of exclusion. Amongst other activities, during the year, a team from the UK office completed the three-peaks challenge, raising £6,000 for the charity.

Around the world the Group has supported a number of charities and community projects including:

- The Polio Foundation
- Association de Damas de Fillipinas
- Télévie
- DELTA
- Global Jet Watch Project




## CASE STUDY: GIRLS IN CODING DAY

In November 2015, Sophos hosted its first ever 'Girls in Coding' event at the Groups' headquarters in Abingdon. The event was designed to engage, motivate and challenge the brightest aspiring young female programmers in Oxfordshire; boosting confidence and encouraging girls to compete in what has traditionally been a male-orientated field.

Forty two students battled against each other in eight teams as they undertook four DEFCON-style coding challenges and participated in presentations from a number of women in senior technical roles within the Group as well as Simon Reed, VP of Sophos Labs.

One of the students said "It was challenging in a way that I really like – you know you can do it but it takes a lot of effort and that's something that I really like as I like problem solving… I was already thinking about a career in coding but I didn't know quite yet. Today has really helped me decide."

## ENVIRONMENT

The Group is committed to effectively managing and improving its environmental performance and minimising the impacts of the business on the environment, by driving continual environmental improvement.

The Group accepts that it bears a responsibility for ensuring that a continuing contribution is made to improve the quality of the environment and aims to continue to achieve this through management of its premises, control of its operations and encouraging its staff to act and work in an environmentally friendly manner.

Practical means of complying with this policy include existing, ongoing and planned procedures:

### Premises

- Continual efforts to minimise energy loss
- Continual efforts to improve the efficient use of energy
- Continual reduction in energy wastage
- When procuring new equipment, ensuring it not only meets the business needs long-term but is also energy efficient
- The premises will continue to be kept in a good state of repair
- The grounds will continue to be cultivated in an environmentally friendly manner

### Employees

- Employees being encouraged to share transportation
- Employees being encouraged to use alternative means of more environmentally friendly transport and facilities to accommodate that will be provided
- Employees are encouraged to minimise waste and recycle wherever possible

### Operations

- Wherever possible recyclable materials will continue to be used in packaging operations
- Suppliers being asked to pursue a policy of supplying goods in recyclable materials
- The use of non-recyclable materials reduced to a minimum
- The policy of using the minimum quantity of packaging consistent with ensuring the maintenance of product protection, quality and safety will be further developed
- Wherever possible materials will continue to be recycled, or collected for recycling

## STRATEGIC REPORT APPROVAL

The Strategic report on pages 6 to 37 was approved by the Board on 25 May 2016 and signed on its behalf by:

**Kris Hagerman**
**Chief Executive Officer**

## CASE STUDY: ADOPTING A VILLAGE

A Sophos group company has adopted a rural village in India to uplift the lives of 350 families living in the village. The aim is to improve education, health care, family welfare, infrastructure, sanitation and sustainable livelihood patterns in the village. More than 100 employees have volunteered to work a few hours every week at the village to teach over 200 students.

The initiatives taken, and continue to take, for uplifting the lives of the rural and urban poor are an important part of who we are. Sophos believes there is a long way to go before a better future is delivered to the underprivileged and until we achieve this objective, we will continue our efforts to better their lives.

# Dance like no o encrypt like eve

# Building the Sophos brand

## GROWING AWARENESS OF SOPHOS BRAND DRIVES MOMENTUM FOR CHANNEL PARTNERS




To sustain a clear voice and connection to our partners and customers Sophos adheres to the "simple" philosophy in marketing. It is authentic in voice, genuine in sentiment and the voice of reason in a scary world. We have a maniacal focus on what's important to our customers and we try to do it with a bit more personality than what is "typical" for the industry. This makes our marketing seem somewhat unconventional. But it works, and our customers and partners appreciate it.

### FREE TOOLS

Nothing helps connect a technology brand with IT professionals more than the technology itself. Although Sophos is focused on mid-market enterprises, we realise that everyone, whether at work or at home, needs effective, simple security that "just works". To expand the number of people who are familiar with the Sophos brand and to enable our enterprise customers to protect their employees at home, we have developed a range of free tools to protect home computing users. These include a free home version of our UTM, anti-virus for Mac, virus removal tools, free Android security, free Linux

# ne's watching, ryone is.


server security and most recently Sophos Home, a cloud-managed PC and Mac home protection solution.

## SOCKS

IT professionals like socks. Last year Sophos gave out free IT themed socks for Sys Admin Appreciation Day as a gesture of gratitude to all the unsung IT heroes across the globe. The socks became so popular that we made them available year-round. We now have hundreds of thousands of IT sock-wearing devotees and more than a few potential sales leads that may need an updated IT security solution now or in the future.

And it's not just socks. Sophos has become so popular that we've starting offering Sophos-branded lunchboxes, hiking gear and even surfboards.

## NAKED SECURITY

Naked Security is a highly respected security industry news source that Sophos publishes five days a week. With more than 600,000 unique visitors per month and more than 40,000 subscribers to the daily newsletter, it reaches more individuals than many commercial security news services. The award-winning "Chet Chat" podcast garners about 4,000 listens per episode. The editorial explains security-related news and events in plain language. It is often quoted in the industry media as a trusted source of information. The regular article contributors are security experts and researchers at Sophos with more than 20 years of front-line experience.

## OUT OF HOME ADVERTISING

In 2015 Sophos started testing some out of home advertising concepts to enhance brand awareness in certain key markets. The results exceeded our expectations with web traffic in those markets increasing by 221 percent during the test period. Like with our other marketing efforts, our aim is to connect with our target audience, show a bit of personality and let the market know that Sophos understands what it takes to keep organisations secure.

## VIDEOS

Video content is the most effective and compelling online communication method today. Sophos has a dual strategy of educational content and quirky engaging videos that are designed to connect with our customer and partner audiences, often with humour. Many of these are shared across social media and support our global marketing campaigns. In recent years, we have marked occasions such as Christmas, Mother's Day, Sys Admin Day and other holidays with special videos that connect directly with our audiences and help Sophos to stand out in the marketplace with a unique voice.

## MARKETING METRICS

Sophos marketing is a metrics-driven organisation with detailed ROI and marketing influence metrics. Throughout FY16 we've continued to see steady improvement of our marketing metrics across all geographies and product lines. With our "channel first" approach, we dedicate a large percentage of our marketing budget to partner recruitment, partner enablement and partner co-marketing activities. As with our sales strategy, we seek to get channel leverage by focusing time, effort and resources on our most productive partners in each country.

# BOARD OF DIRECTORS

### Peter Gyenes

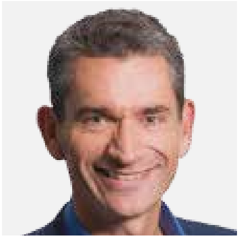
**Non-Executive Chairman**

Peter Gyenes joined the Sophos Board in 2006, bringing experience with corporate growth and value creation to our vision for integrated threat management leadership. Peter was most recently the Chairman and Chief Executive Officer of Ascential Software Corporation, until its acquisition by IBM in April 2005. He brings to Sophos four decades of experience in technical, sales, marketing and general management positions within the computer systems and software industry in the Americas, Europe and Asia/Pacific. Peter has a bachelor's degree in mathematics and an MBA from Columbia University in New York. He serves on the Boards of Intralinks Holdings Inc., Pegasystems Inc., RealPage Inc., Carbonite Inc., Epicor Software Corporation and the Massachusetts Technology Leadership Council (Trustee Emeritus).

### Kris Hagerman

**Chief Executive Officer**

Kris Hagerman joined Sophos in 2012 as CEO; he is responsible for all aspects of Sophos' strategic direction and business operations. Prior to Sophos, Kris was CEO of Corel Corporation. Previously, Kris served as group president, data centre management at Symantec, where he led a business of more than $1.5 billion that represented nearly 30 percent of Symantec's global revenue. Prior to Symantec, Kris was executive vice president and GM, storage and server management at Veritas Software where during his tenure, the company grew from $1 billion in revenue to more than $2 billion, prior to its acquisition by Symantec. Earlier in his career, Kris was founder and CEO of BigBook, an online yellow pages service and founder and CEO of Affinia, an online contextual advertising network. Kris also held positions at Silicon Graphics and McKinsey & Company. Kris has a bachelor's degree in Russian and economics from Dartmouth College, an M.Phil. in international relations from Cambridge University, and an MBA from the Stanford Graduate School of Business.



### Nick Bray

**Chief Financial Officer**

Nick Bray joined Sophos as Chief Financial Officer in 2010 having worked in the technology sector for over 20 years. Nick has extensive international operational skills combined with significant public company experience, having previously been the CFO of listed companies on both the London Stock Exchange and Nasdaq. He has successfully accelerated organic growth both at Sophos and prior organisations through acquisition, having now acquired and integrated in excess of ten companies, funding for these transactions being raised in both the UK and US debt markets. Before joining Sophos, Nick was Group CFO at Micro Focus International plc, where he was instrumental in the company tripling revenue and increasing market capitalisation from circa £200 million to in excess of £1 billion. Nick has also held Group CFO roles at Fibernet Group plc and Gentia Software plc, as well as senior financial positions at Comshare Inc. and Lotus Software. Nick has a first class bachelor's degree in civil engineering from Aston University, UK, and is a qualified chartered accountant having trained with PwC.

### Sandra Bergeron

**Independent Non-Executive Director**

Sandra Bergeron joined in 2010. She has previously served as a Director of Tipping Point, Netegrity, Nuance Communications, TriCipher, and ArcSight, until their acquisitions. During a ten-year career at McAfee, Inc Sandra held a number of key executive positions, including head of research and development, head of corporate strategy, and president of PGP Security. Sandra holds an MBA from Xavier University in Cincinnati, Ohio and a bachelor's in business administration (Cum Laude) from Georgia State University. Sandra serves as a Director of F5 Networks, Inc. and Qualys Inc.

### Edwin Gillis

**Independent Non-Executive Director**

Edwin Gillis joined in 2009. He is currently a Director and Chairman of the Audit Committee of AppNexus, LogMeIn, Sprinklr, and Teradyne Corporation. He has held senior roles at Symantec Corporation, Veritas Software, Parametric Technology and Lotus Development Corporation, and spent 15 years with Coopers & Lybrand as a CPA and general practice partner. Edwin has a bachelor's degree in government from Clark University in Massachusetts, a master's degree in international relations from the University of Southern California and an MBA from Harvard Business School.

### Roy Mackenzie

**Non-Executive Director**

Roy Mackenzie joined in 2010. He joined Apax Partners in 2003 and is a partner in the technology and telecom team. Previously, Roy worked at McKinsey & Company, Inc., focusing on consulting clients in the high technology sector and also held product management positions at Psion Computers. While at Apax, Roy worked on a number of investments including NXP Semiconductors, and King.com. He holds an MBA from Stanford Graduate School of Business and a master's degree in engineering from Imperial College, London. Roy is currently also a Director of Epicor Software Corporation and Exact Holdings NV.

### Steve Munford

**Non-Executive Director**

Steve Munford served as Sophos' CEO from 2006 to 2012, he led the company through a period of dramatic growth, more than tripling billings. Prior to his role as CEO, Steve was President of Sophos for North America and then became COO, responsible for the day-to-day running of the company and its senior management team. Previously, he was President of ActiveState before its acquisition by Sophos. Under his leadership, ActiveState established itself as a global leader in email security software. Steve has a bachelor's degree in economics from the University of Western Ontario and has an MBA from Queen's University, Ontario. Steve is also a Director of Actenum, Alert Logic, Carbonite Inc., Teradici, Elastic Path, Quick Mobile and Utimaco Inc.

### Salim Nathoo

**Non-Executive Director**

Salim Nathoo joined in 2010. He is a partner and co-head of Apax Partners' technology and telecom team. He joined Apax Partners in 1999 and has been involved in a variety of technology focussed investments including Evry, Global Logic, Orange Switzerland, iGATE, Weather Investments, Tim Hellas, and SMART Technologies. Before he joined Apax Partners, Salim worked at McKinsey & Company, Inc., where he focused extensively on telecommunications. Salim also held sales, marketing and technical positions at NYNEX CableComms Ltd. and IBM. He earned a master's degree in mathematics from St. John's College, Cambridge and an MBA from INSEAD. Salim currently serves on the Boards of Evry ASA and Global Logic.

### Paul Walker

**Senior Independent Director**

Paul Walker joined in 2015. Paul brings more than 30 years of technology and senior leadership experience to the Board of Sophos, having served for 16 years as Chief Executive Officer of Sage Group plc., a leader in business solutions for small and medium businesses. Paul has previously served on the Boards of Diageo plc., My Travel Group plc. and Ernst & Young. Paul qualified as a Chartered Accountant with Ernst & Young, having graduated from York University with a degree in economics. Paul is currently Non-Executive Chairman of Perform Group Ltd and Non-Executive Chairman of Halma plc. He is also a Non-Executive Director for WANdisco plc. and Experian plc and serves on the Boards of Epicor Software Corporation and Newcastle Science City Partnership.

# CORPORATE GOVERNANCE STATEMENT

## Dear Shareholder

At Sophos, all our stakeholders are important to us. The design and operation of a robust governance structure appropriate for a group of Sophos' scale and ambition is critical to meeting their needs. Our approach to governance is based on the concept that good corporate governance enhances long-term shareholder value and sets the culture, ethics and values for the rest of the Group.

The Board has ultimate responsibility for reviewing and approving the Annual Report and Accounts and it has considered and endorsed the arrangements for their preparation. The Directors confirm the Annual Report and Accounts, taken as a whole, is fair, balanced and understandable and provides the information necessary for shareholders to assess the Group's position and performance, business model and strategy.

**Peter Gyenes**
**Non-Executive Chairman**

## UK CORPORATE GOVERNANCE CODE

This report, which is available on the Company's website, explains the key features of the Company's governance structure to provide a greater understanding of how the main principles of the UK Corporate Governance Code ("Code"), published in September 2014 by the Financial Reporting Council ("FRC"), have been applied and to highlight areas of focus during the period. The Code can be found on the FRC's website at at www.frc.org.uk.

The Company was incorporated on 26 May 2015 and achieved premium listing on the London Stock Exchange on 1 July 2015. In the one month period prior to listing work was done by the Company to ensure it had appropriate governance structures and policies in place so as to comply with the Code before the Company's shares were admitted to trading. Accordingly, the corporate governance statement and the reports of the Audit and Risk, Remuneration, and Nomination Committees explain how the provisions and principles of the FCA Listing Rules, Disclosure and Transparency Rules and the Code have been applied in the period from listing to 31 March 2016.

## GOVERNANCE CHANGES IN PREPARATION FOR LISTED STATUS

In preparation for the Company's listing, it was recognised that although the internal governance processes were fit for purpose, additional work was required to enhance these processes to meet the obligations of being a company listed on the London Stock Exchange. Accordingly, a number of work streams were put in place to ensure that the Company's operations as a listed company complied with relevant regulation and guidance. Work undertaken included the creation and embedding of the necessary policies and procedures to meet the various corporate governance and regulatory requirements applicable to the Company post-listing.

## COMPLIANCE WITH THE CODE

In the period from listing to 31 March 2016 the Company complied with all the principles and provisions of the Code, except as set out below:

Code provision B.1.2 recommends that at least half the Board of Directors of a UK-listed company, excluding the Chairman, should comprise Non-Executive Directors determined by the Board to be independent. The Board considers that the Company does not comply with the requirements of the Code in this respect, however the Company intends to move towards compliance with this requirement within a reasonable period of time. In furtherance of this goal, the Board recently commenced a process to identify and recruit one or more potential candidates to serve as Non-Executive Directors. The Board currently expects to have at least one new Independent Non-Executive Director appointed to the Board before 31 December 2016; although, there can be no assurance that suitable candidates will be identified, that they will accept the appointment, or that the appointment can be completed within the Board's desired timeline.

The Directors who are not considered independent are:

Peter Gyenes – in accordance with the Code the test of independence is not appropriate for a Chairman following their appointment.

Kris Hagerman and Nick Bray – due to the executive nature of their roles they are not considered to be independent.

Steve Munford – was CEO of the Group between 2006 and 2012 and accordingly is not considered to be independent.

Salim Nathoo and Roy Mackenzie – are shareholder appointed Directors and accordingly are not considered to be independent.

## THE BOARD AND ITS COMMITTEES

The Board is responsible for the effective oversight of the Company. It also agrees the strategic direction and governance structure that will help achieve the long-term success of the Company and deliver shareholder value. The Board takes the lead in areas such as strategy, financial policy and making sure a sound system of internal control is maintained. The Board's full responsibilities are set out in the schedule of matters reserved for the Board described below. The Board delegates authority to its Committees to carry out certain tasks on its behalf, so that it can operate efficiently and give the right level of attention and consideration to relevant matters.

### Responsibilities of the Board

The Board has approved a schedule of matters reserved for its decision; specifically, the Board is responsible for:

- Guiding the Group's long-term strategic aims, leading to its approval of the Group's strategy and its budgetary and business plans
- Approval of significant investments and capital expenditure
- Approval of annual and half-year results
- Approval of the dividend policy, payment of the interim dividend and the recommendation of final dividends
- Ensuring maintenance of a sound system of internal control and risk management
- Ensuring adequate succession planning for the Board and senior management (taking into account the recommendations of the Nomination Committee)
- Determining the remuneration policy for the Directors and the senior management team (taking into account the recommendations of the Remuneration Committee)

### Board Focus During the Year

- Strategy: During FY16, the Board worked with management to identify and anticipate industry trends to ensure that the Company's strategy is designed to address these trends as well as other industry dynamics, such as the competitive landscape. The Board also considered acquisition opportunities to advance the Company's strategy. During FY16, the Board approved two acquisitions.
- Financials: During FY16, the Board reviewed the Company's operating results and financial statements with management and the Company's external auditors. The Board also reviewed and approved the operating plan for the fiscal year.
- The Company's listing on the London Stock Exchange: In anticipation of the Company's listing on the London Stock Exchange in FY16, the Board undertook a review of the Company's governance structure, internal controls, compliance requirements, compensation arrangements and other aspects of the Company's operations that are relevant for a listed company.
- Governance: As noted above, the Board undertook a comprehensive review of its governance structure in FY16. As a result of this review, the Board considered and approved governance policies designed to ensure its compliance with the requirements applicable to a publicly listed company, including the Code.
- Business performance: In FY16, the Board received and reviewed reports from management on the performance of the Company's business. The Board engaged in discussions with management on various aspects of business performance, including business drivers, industry trends, risks, opportunities and the competitive landscape.

### Board Committees

In June 2015 the Board established the Audit and Risk Committee (Chaired by Edwin Gillis) to oversee financial reporting, internal control and the management of the risks the Company faces. The Board also established a Nomination Committee (chaired by Peter Gyenes) to lead the process for appointments to the Board and a Remuneration Committee (chaired by Paul Walker) which has the responsibility of helping to develop and manage the Company's Remuneration Policy.

The various committee reports can be found on pages 45 to 65 and each committees' full terms of reference are available on our website.

# CORPORATE GOVERNANCE STATEMENT CONTINUED

## Table of Attendance

The table below summarises the attendance of the Directors and committee members at the scheduled Board and committee meetings held during the year:

| | Board | | Audit and Risk Committee | | Remuneration Committee | | Nomination Committee | |
|---|---|---|---|---|---|---|---|---|
| **Director** | **Held** | **Attended** | **Held** | **Attended** | **Held** | **Attended** | **Held** | **Attended** |
| Peter Gyenes* | 6 | 5 | – | – | 3 | 3 | 1 | 1 |
| Kris Hagerman | 6 | 6 | – | – | – | – | – | – |
| Nick Bray | 6 | 6 | – | – | – | – | – | – |
| Sandra Bergeron | 6 | 6 | 4 | 4 | 3 | 3 | 1 | 1 |
| Edwin Gillis** | 6 | 6 | 4 | 4 | 3 | 3 | 1 | 1 |
| Salim Nathoo | 6 | 5 | – | – | – | – | – | – |
| Roy Mackenzie | 6 | 6 | – | – | – | – | 1 | – |
| Steve Munford | 6 | 6 | – | – | – | – | – | – |
| Paul Walker*** | 6 | 6 | 4 | 4 | 3 | 3 | 1 | 1 |

The figures in the "held" column represent the number of meetings a Director was eligible to attend and the "attended" column represents the number of meetings attended by that Director.

* Peter Gyenes is Chairman of the Board and Chairman of the Nomination Committee.

** Edwin Gillis is Chairman of the Audit and Risk Committee.

*** Paul Walker is Chairman of the Remuneration Committee.

## Board Composition, Qualification and Experience

The composition, experience and balance of skills on the Board are periodically reviewed to ensure that there is the right mix on the Board and its Committees and they are working effectively. There are currently nine Directors on the Board, which comprises a Non-Executive Chairman (who, for the purposes of the Code was independent on appointment), two Executive Directors, three Independent Non-Executive Directors and three Non-Executive Directors who are considered by the Board not to be independent for the purpose of the Code. The current members of the Board have a wide range of skills and experience. The Board believes that a membership that combines detailed knowledge of the Group's operations, the technology industry and leading a company listed on the London Stock Exchange are crucial to the Board's ability to lead the Company successfully.

## Key Board Roles

| Chairman | Chief Executive Officer |
|---|---|
| • Leads the Board | • Leads the management team |
| • Promotes a high standard of corporate governance | • Develops proposals for the Board to consider |
| • Facilitates effective contributions by the Non-Executive Directors | • Oversees implementation of all Board-approved actions |
| • Promotes a culture of openness and debate | • Supports the Chairman to ensure that appropriate governance standards spread through the organisation |
| • Encourages constructive relations between Executive and Non-Executive Directors | • Ensures that the Board is made aware of the employees' views on relevant issues |

## Interaction between the Chairman and Chief-Executive

The division of responsibilities between the Chairman, Chief Executive Officer and Senior Independent Director is set out in writing and agreed by the Board.

The roles of the Chairman and the Chief Executive Officer are separate with a distinct division of responsibilities. The partnership between Kris Hagerman and Peter Gyenes is based on mutual trust and facilitated by regular contact between the two. The separation of authority enhances independent oversight of the executive management by the Board and helps to ensure that no one individual on the Board has unfettered authority.

## The Role of Non-Executive Directors

| Senior Independent Director | Non-Executive Directors |
| --- | --- |
| • Acts as intermediary between Directors when required<br>• Works closely with the Chairman, acting as a sounding board and providing support<br>• Is available to shareholders and other Non-Executives to address any concerns or issues they feel have not been adequately dealt with through the usual channels of communication | • Constructively challenges management proposals<br>• Help develop proposals on strategy<br>• Have a prime role in appointing and, where necessary, removing Executive Directors<br>• Have an integral role in succession planning |

## Non-Executive Director Independence

The Board considers and reviews the independence of each Non-Executive Director on an annual basis as part of the Directors' performance evaluation. In carrying out the review, consideration is given to factors such as their character, judgement, commitment and performance on the Board and relevant committees and their ability to provide objective challenge to management.

The Board considers its Independent Non-Executive Directors bring strong judgement and considerable knowledge and experience to the Board's deliberations. The Code requires a company to state its reasons if it determines that a Director is independent in certain circumstances, including where a Director holds cross-directorships or participates in the Company's share option or performance related pay scheme. As noted in the Annual Report on Remuneration on page 65, Paul Walker participates in a restricted share arrangement. Paul is also a Director of Epicor Software Corporation of which Peter Gyenes and Roy Mackenzie are also Directors. Notwithstanding these arrangements, the Board considers Paul to be independent in character and judgement. This is evidenced by the valuable contributions he makes at Board and Committee meetings, and in particular, the knowledge and experience he brings to his role as Chairman of the Remuneration Committee.

Additionally, Peter Gyenes is a Director of Carbonite Inc., of which Steve Munford is also a Director. The Code provides that the Chairman of a company should be independent on appointment. The Board considers that Peter Gyenes, the Chairman, was independent upon appointment and that he continues to be independent notwithstanding the cross-directorships described above.

## Appointment and Tenure

All Non-Executive Directors serve on the basis of letters of appointment which are available for inspection upon request. The letters of appointment set out the expected time commitment of Non-Executive Directors who, on appointment, undertake that they will have sufficient time to meet what is expected of them. Non-Executive Directors are appointed for an initial three year term and the continuation of their appointment is conditional on satisfactory performance and subject to annual re-election at the Company's Annual General Meetings.

Executive Directors serve on the basis of service agreements which are also available for inspection upon request. Further details on the Executive Directors' service agreements are included in the Annual Report on Remuneration, on page 58.

## Director Induction and Training

The Chairman, with the support of the Company Secretary, is responsible for the induction of new Directors and ongoing development of all Directors. As part of its preparation for the Company's listing on the London Stock Exchange, the Board received full, formal and tailored training to prepare the Board for service on a listed company Board. New Directors will receive a full, formal and tailored induction on joining the Board designed to provide an understanding of the Group's business, governance and key stakeholders. The induction process may include provision of an induction pack, operational site visits, meetings with key individuals and the Company's advisors, and briefings on key business, legal and regulatory issues facing the Group.

As the business environment changes, it is important to ensure the Directors' skills and knowledge are refreshed and updated regularly. Accordingly, the Company Secretary ensures that updates on corporate governance, regulatory and technical matters are provided to Directors at Board meetings and by means of communications or special sessions in between formal Board meetings. In this way, Directors keep their skills and knowledge relevant so as to enable them to continue to fulfil their duties effectively.

## Information and Support Available to Directors

All Board Directors have access to the Company Secretary, who advises them on Board and governance matters. The Chief Executive Officer and the Company Secretary work together to ensure that Board papers are clear, accurate, delivered in a timely manner to Directors, and of sufficient quality to enable the Board to discharge its duties. As well as the support of the Company Secretary, there is a procedure in place for any Director to take independent professional advice at the Company's expense in the furtherance of their duties, where considered necessary or advisable.

## Director Election

Following recommendations from the Nomination Committee, taking into account the results of the Board's performance evaluation process, the Board considers that all Directors continue to be effective, committed to their roles and have sufficient time available to perform their duties. In accordance with the Company's Articles of Association and provision B.7.1 of the Code all Directors will be subject to annual re-election. All Directors will seek election at the Company's first AGM in 2016 as set out in the Notice of AGM.

# CORPORATE GOVERNANCE STATEMENT CONTINUED

### Directors' Conflicts of Interest

Directors have a statutory duty to avoid situations in which they have, or may have, interests that conflict with those of the Company, unless that conflict is first authorised by the Directors. This includes potential conflicts that may arise when a Director takes up a position with another company. The Company's Articles of Association allow the Board to authorise such potential conflicts, and there is in place a procedure to deal with any actual or potential conflict of interest. The Board deals with each appointment on its individual merit and takes into consideration all the circumstances.

Salim Nathoo is a partner at Apax Partners LLP and Roy Mackenzie is a partner at Apax Partners, LP. Apax Partners, LP is a wholly-owned subsidiary of Apax Partners LLP. Both Apax Partners, LP and Apax Partners LLP are advisors of the Apax Funds, which wholly own Pentagon Lock Sarl, Pentagon Lock 6-A Sarl, Pentagon Lock 7-A Sarl and Pentagon Lock US Sarl (collectively "Apax"). Following the admission of the Company's shares to the London Stock Exchange Apax controlled 35.2 percent of the voting rights in the Company and at 31 March 2016 controlled 22.3 percent of the voting rights in the Company.

In April 2016 the Board was notified that Steve Munford had been appointed a Director at Utimaco Inc, a subsidiary of Utimaco GmbH which supplies professional cybersecurity solutions. This appointment has been authorised by the Board and has been included in the conflicts register.

### Board Evaluation and Effectiveness

The Board and its Committee were formed upon IPO in June 2015 and in January 2016 an internal evaluation commenced and was conducted by the Company Secretary under the direction of the Senior Independent Director. The Company Secretary had distributed a tailored, high level questionnaire for the Directors completion. The questionnaire was structured to provide Directors with an opportunity to express their views about:

- the performance of the Board and its Committees, including how Directors work together as a whole;
- the balance of skills, experience, independence and knowledge of the Directors;
- individual performance, particularly considering whether each Director continues to make an effective contribution.

## SHAREHOLDER ENGAGEMENT

Responsibility for shareholder relations rests with Nick Bray, the Group's Chief Financial Officer. He ensures that there is effective communication with shareholders and is responsible for ensuring that the Board understands the views of shareholders. Mr Bray is supported by the Group's corporate brokers with whom he is in regular dialogue. As a part of a comprehensive investor relations programme, formal meetings with investors are scheduled to discuss the Group's interim and final results. In the intervening periods, the Company continues its dialogue with the investor community by meeting key investor representatives and holding investor roadshows.

## ANNUAL GENERAL MEETING

The Company's first Annual General Meeting ("AGM") will take place at 15:00 on 14 September 2016 at The Pentagon, Abingdon Science Park, Abingdon, OX14 3YP. All shareholders have the opportunity to attend and vote, in person or by proxy, at the AGM. The notice of the AGM can be found on our website and in a booklet which is being mailed out at the same time as this Report. The Notice of AGM sets out the business of the meeting and an explanatory note on all proposed resolutions. Separate resolutions are proposed in respect of each substantive issue. The AGM is the Company's principal forum for communication with private shareholders.

## RISK MANAGEMENT AND INTERNAL CONTROLS

The Audit and Risk Committee report explains the process carried out for the assessment of the effectiveness of the Company's risk management and internal control systems on page 50.

## EXTERNAL AUDITOR

KPMG have expressed their willingness to continue as the Company's auditor. As outlined in the Audit and Risk Committee report on page 51, resolutions proposing their reappointment and to authorise the Audit and Risk Committee to determine their remuneration will be proposed at the 2016 AGM.

By order of the Board

**D Ari Buchler**

**Company Secretary**

25 May 2016

# NOMINATION COMMITTEE REPORT

The Nomination Committee is chaired by Peter Gyenes, and its other members are Paul Walker, Sandra Bergeron and Edwin Gillis, who are independent Non-Executive Directors, and Roy Mackenzie, who is a Non-Executive Director.

## ROLE AND RESPONSIBILITIES

The Committee assists the Board in discharging its responsibilities relating to the composition and make-up of the Board and any Committees of the Board. It is also responsible for periodically reviewing the Board's structure and identifying potential candidates to be appointed as Directors or Committee members as the need may arise. The Committee is responsible for evaluating the balance of skills, knowledge and experience as well as the size, structure and composition of the Board and Committees of the Board, retirements and appointments of additional and replacement Directors and Committee members and makes appropriate recommendations to the Board on such matters.

A copy of the Committee terms of reference is available on the Company's website.

## MEETINGS DURING THE YEAR

The Committee met once in the period from listing to the financial year end. At that meeting the Committee:

- reviewed the terms of reference;
- requested a review of the succession plans for senior management be undertaken to ensure a pipeline of talent was maintained for the continued success of the Company;
- considered the annual time requirement of Non-Executive Directors;
- reviewed the composition of the Board and its Committees, including the Chairmanship of each Committee; and
- recommended a draft Diversity Policy to the Board for approval.

## PROCESS FOR BOARD APPOINTMENTS

When the Company decides to appoint a Non-Executive Director:

- The Committee Chairman, or search consultants if engaged, will submit a short-list of candidates to members of the Committee and the Chief Executive Officer for them to review and enable them to suggest other candidates.
- The Committee Chairman, one other Committee member and the Chief Executive Officer will then meet short-listed candidates selected by the Committee. If the Chairman wishes to proceed with the selection process, the candidate will then be invited to meet all members of the Committee.
- After meeting the candidate the Committee will decide whether to recommend the candidate to the Board for appointment.

When the Company decides to appoint an Executive Director:

- The Committee Chairman and the Chief Executive Officer or, if engaged, search consultants, will submit a short-list of one or more candidates to the Committee.
- Some or all of the Committee members will then meet the candidates selected for interview.
- The Committee's assessments will be reviewed with the Chairman of the Board and the Chief Executive Officer, following which a candidate may be recommended to the Board for appointment.

## DIVERSITY

At the meeting held in November 2015 the Committee requested that the Company's Diversity Policy be formally codified, and it was subsequently approved by the Board in February 2016. The policy acknowledges the importance of diversity, including gender diversity, for the Group and the role the Committee will perform in increasing diversity throughout the Group.

The Board has established the following measurable objectives for achieving diversity on the Board:

- All Board appointments will be made on merit, in the context of the skills, knowledge and experience that are needed for the Board to be effective.
- Ensure long lists of potential Non-Executive Directors include diverse candidates of appropriate merit.
- Encourage the emergence of female candidates and candidates of diverse backgrounds among the non-board senior management talent pool.
- Only engage executive search firms who have signed up to the voluntary Code of Conduct on gender diversity and best practice.

Progress against all of these objectives is ongoing and the Committee will report more fully in the next Annual Report.

**Peter Gyenes**
**Nomination Committee Chairman**
25 May 2016

# AUDIT AND RISK COMMITTEE REPORT

I am pleased to present our first report on the role and activities of the Audit and Risk Committee following its formation in June 2015 in preparation for Initial Public Offering of the Company's shares.

## MEMBERSHIP OF THE COMMITTEE

The Committee was chaired by me throughout the year, with Sandra Bergeron and Paul Walker being the other members of the Committee. All members and the Chair are Independent Non-Executive Directors. All of the members of the Committee have extensive experience of the technology industry and I am the Independent Non-Executive Director with recent, relevant, financial experience. During the year-ended 31 March 2016, the Committee met four times. The table below summarises the attendance of members at committee meetings:

| | Eligible to attend | Attended |
|---|---|---|
| Edwin Gillis | 4 | 4 |
| Sandra Bergeron | 4 | 4 |
| Paul Walker | 4 | 4 |

Only members of the Committee have the right to attend meetings, though the Committee may invite others to attend if it is considered appropriate or necessary. The external auditors are invited to attend meetings of the Committee on a regular basis.

## ROLES AND ACTIVITIES

The Committee is responsible for monitoring the integrity of the Group's financial statements, including its annual and half-yearly reports, interim management statements, preliminary result announcements and any other formal announcements relating to its financial performance prior to release. The Committee oversees the relationship between the Group and its external auditors and makes recommendations to the Board on their appointment. In addition, the Committee monitors and reviews the external auditor's independence and objectivity and the effectiveness of the audit process, taking into account relevant legal, professional and regulatory requirements.

The terms of reference of the Committee also includes the following responsibilities:

- to review and challenge significant accounting and treasury policies, the clarity and completeness of disclosures in financial reports and significant estimates and judgements;
- review the findings of the audit with the external auditors;
- where requested by the Board, to review the content of the annual report and accounts and advise the Board on whether, taken as a whole, it is fair, balanced and understandable and provides the information necessary for shareholders to assess the Group's position and performance, business model and strategy;
- monitoring and reviewing the effectiveness of the Group's internal audit function and review and assess the annual internal audit plan;
- to monitor and keep under review the adequacy and effectiveness of the Group's internal financial controls and internal control and risk management systems, including a review of the Group's risk management framework; and
- to review the Group's policies and procedures for preventing and detecting fraud, its systems and controls for preventing bribery, its Code of Conduct and its policies for ensuring that the Group complies with relevant regulatory and legal requirements.

The full terms of reference of the Committee can be found on the Company's website at investors.sophos.com.

During the year-ended 31 March 2016 the Committee:

- reviewed and approved the year-end and interim results and accounts;
- reviewed and approved the quarterly trading statements issued during the year;
- met with the external auditors to review and approve the annual audit plan and receive their findings and reports of the annual audit and interim review;
- approved the appointment of Ernst & Young LLP ("EY") as outsourced internal audit providers and the manner in which they would operate with the Group, including a direct reporting line to the Committee to ensure their independence is maintained;
- reviewed and approved the internal audit plan for the year as well as longer-term objectives and received the results of the work performed by internal audit; and
- received, reviewed and challenged the half-year and year-end accounting papers prepared by management covering significant accounting policies, significant transactions, judgemental areas, estimates, disclosures and going concern.

## SIGNIFICANT ISSUES

The issues considered by the Committee that are deemed to be significant to the Group are set out below.

| | |
|---|---|
| **Revenue recognition** | The Group generates revenue from sales of subscriptions, hardware and the rendering of enhanced support or professional services in connection with the Group's Network, Enduser and Cloud-based products. There is a risk therefore that revenue is inappropriately recognised if revenue is incorrectly apportioned to a product or service.<br><br>A detailed revenue recognition policy is in place and includes rules for applying fair value to components of multiple element arrangements and timing of recognition dependent upon the individual nature of the goods or services sold. Management also provide to the Committee at half-year and year-end an accounting paper on revenue recognition and a commentary on the revenue recognised. The Group's external auditors have reported to the Committee that they have reviewed the revenue recognition policy and processes as well as performing detailed testing of revenue recognition across the year and found revenue to be appropriately accounted for.<br><br>As a result of the above and after providing appropriate challenge the Committee has concluded that the revenue recognition for the Group is appropriate. |
| **Goodwill and intangibles carrying value** | At 31 March 2016, the Group had on its balance sheet goodwill of $716.1 million and intangibles of $40.5 million that has primarily arisen as a consequence of acquisitions. Management perform impairment reviews annually, or more frequently if there is an indication of impairment, based on the Group's Cash-Generating Units ("CGUs"). The cash flow forecasts used for each CGU are based on the latest Board-approved long-term forecasts with an assumed long-term growth rate after the five year period. Management prepare an accounting paper for review by the Committee that details the methodology applied, key assumptions used and the impact of sensitivity analysis.<br><br>Having considered the impairment reviews performed, the Committee is satisfied that the carrying value of goodwill and intangibles at 31 March 2016 is appropriate. |
| **Reporting requirements and presentation** | Following the Initial Public Offering of the Company's shares in July 2015, a number of disclosure and regulatory requirements became relevant for the first time in this Annual Report as the Company transitioned into life as a public company. In addition the Group makes use of certain non-GAAP measures and discloses certain items separately within the consolidated statement of profit or loss as exceptional items which, in the opinion of the Directors, enables a better understanding of the performance of the Group. The use of these measures and disclosures is judgemental in nature<br><br>The Committee has received papers during the year from management and advisors highlighting key new disclosure requirements and has discussed with both management and advisors the use of non-GAAP measures and the classification of certain income statement items as exceptional or underlying. The Committee has also reviewed the disclosures made in this annual report and has discussed them with the external auditors; so as to ensure that it is comfortable with the content and presentation made in the annual report. |

# AUDIT AND RISK COMMITTEE REPORT CONTINUED

## INTERNAL CONTROLS AND RISK ENVIRONMENT

Whilst the Board is ultimately responsible for the establishment, monitoring and review of effectiveness of internal control systems throughout the Group, each of the individual functional leaders drive the process through which risks and uncertainties are identified. The Board recognises that rigorous internal control systems are critical to managing the risks in achieving its strategic objectives. The Board further acknowledges that these systems are designed to manage rather than eliminate risk in the Group.

The formal process for identifying, evaluating and managing significant risks faced by the Group is overseen by the Risk and Compliance Committee, in association with the work performed by the Internal Audit function. The Risk and Compliance Committee have designed the risk framework in order to capture and evaluate control weaknesses and risks facing the business. Where the Board defines an identified risk as significant, procedures exist to ensure that necessary action is taken to rectify or mitigate as appropriate.

The aforementioned functions provide additional assurance to the Audit and Risk Committee who have ultimate responsibility for the oversight and review of the adequacy and effectiveness of the Group's systems of internal controls.

The external auditors provide a supplementary, independent and autonomous perspective on those areas of the internal control system which they assess in the course of their work. Their findings are regularly reported to both the Audit and Risk Committee and the Board.

Key elements of the control environment are:

- annual budgets and strategic plans prepared for all business units;
- monitoring of performance against budget and forecast with reporting to the Board on a regular basis;
- monthly review of detailed key performance indicators;
- all contracts are reviewed at a level of detail appropriate to the size and complexity of the contract;
- timely reconciliations are performed for all significant balance sheet accounts;
- clearly defined organisational structure and authorisation lines;
- a Risk and Compliance Committee (formed during the financial year), reviews key business processes, controls and their effectiveness, as well as identifying, assessing and managing significant control issues; and
- the Audit and Risk Committee, which approves audit plans and assesses the overall appropriateness of the Group's internal control environment.

The preparation and issue of financial reports is managed by the Group Finance department, as delegated by the Board. The Group's financial reporting process is controlled using the Group accounting policies and reporting systems. The Group Finance department supports all reporting entities with guidance on the preparation of financial information. In the current year, this process was supported by the Financial Control and Group & Commercial Finance functions. Each legal entity has a Finance Director or Controller who has responsibility and accountability for providing information which is in accordance with agreed policies. The financial information for each entity is subject to a review at reporting entity and Group level by the Chief Financial Officer alongside the Vice Presidents of both Financial Control and Group & Commercial Finance. The Annual Report is reviewed by the Audit and Risk Committee in advance of presentation to the Board for approval. Additionally, during the current year, the Finance Director or Controller of each reporting entity completed a quarterly Financial Reporting Review Questionnaire, which was used to identify control strengths and weaknesses across all financial areas with any weaknesses being subsequently addressed.

The Group also maintains a Consolidated Risk Register which sets out the nature and extent of the significant risks facing the Group. Each of the risks is prioritised according to likelihood and impact and the register ensures that all risks identified are either mitigated or managed by an appropriate owner.

The Directors, through the use of appropriate procedures, systems and the employment of competent personnel, have ensured that measures are in place to secure compliance with the Company's obligation to keep adequate accounting records. The accounting records are kept at the registered office of the Company.

## HOW WE MANAGE RISK

To enhance effective governance and risk management oversight, the Group has, in this financial year, established an additional layer of risk management in a Risk and Compliance Committee. This Committee of senior leaders is authorised by the Board to provide an additional level of assurance to the Audit and Risk Committee in overseeing risk management and internal control activities. It also provides the business with a framework for risk management, upward reporting of significant risks and policies and procedures.

On a quarterly basis, the Risk and Compliance Committee reviews the status on risk exposures and risk management throughout the business within the pre-agreed risk management framework. The risk management framework is designed to identify, evaluate, analyse and mitigate or manage risks appropriate to the achievement of the business strategy.


The Group takes a two-pronged approach to identifying risks:

1) a bottom-up approach at the business function level; where risks are managed at the operational level with an appropriately defined escalation process in place for those risks rated as high; and

2) a top-down approach at the senior leadership team level; where the principal risks and uncertainties are identified and managed.

A series of risk identification approaches are used such as risk identification and horizon scanning workshops, interviews and inclusion of risk discussions into team meetings.

All identified risks are assessed against a pre-defined scoring matrix and prioritised accordingly. Any risks identified in the bottom-up approach deemed to be rated as higher risk are escalated in line with pre-defined escalation procedures for further evaluation. The Group's risk appetite is considered by the Board and evaluated to ensure appropriateness of risk management and mitigation.

# AUDIT AND RISK COMMITTEE REPORT CONTINUED

Following the identification of risks, a risk management plan is developed and implemented; this is managed by the assigned risk owner with regular feedback to the Risk and Compliance Committee.

Regular reporting of risk management ensures each risk is re-evaluated on a timely basis to ensure that all relevant risks are identified and managed appropriately and that the Board is focused on the principal risks identified.

Additionally, during the current year subsequent to the Initial Public Offering of the Company's shares, the Group has assessed the need for an Internal Audit function and has concluded that the size and complexity of the Group deems this to be necessary. Accordingly, the Group has employed an externally appointed Internal Audit team. They are responsible for the review and audit of controls within the business and report to management on the appropriateness and effectiveness of those controls.

The current year Internal Audit plan was developed through a review of formal risk assessments together with consideration of the Group's key business processes and functions that could be subject to audit. A similar approach will be employed in relation to the Internal Audit plan for the coming year. The principal objectives of the Internal Audit plan for both years are:

- to provide confidence that existing and emerging key risks are being managed effectively; and
- to confirm that controls over core business functions and processes are operating as intended.

During the current year, an audit report was issued by the Internal Audit function and reviewed by the Audit and Risk Committee and the Board. Internal Audit recommendations are closely monitored and a summary of the status of the implementation of Internal Audit recommendations is made quarterly to the Audit and Risk Committee.

## WHISTLE-BLOWING

A whistleblowing policy is in place in the Group enabling employees to confidentially report matters of concern directly to Non-Executive Directors. The Audit and Risk Committee receives details of any matters raised.

## INTERNAL AUDIT

During the financial year, the Group appointed an outsourced Internal Audit function. This function is provided by EY. The Group's Chief Financial Officer provides oversight and co-ordination of Internal Audit with support from the Risk and Compliance Committee. In order to ensure independence, the Internal Audit function has a direct reporting line to the Audit and Risk Committee and its Chairman.

The nature and scope of the Internal Audit plan, developed by EY, was approved by the Audit and Risk Committee, with any subsequent changes to the plan requiring further approval. The results of the audits were assessed alongside responses from management. Any outcomes graded as requiring improvement were considered in detail by the Audit and Risk Committee along with the appropriateness of mitigation plans to resolve the issues identified.

At each meeting, the Audit and Risk Committee received audit reports and updates from the Internal Auditors, in order to ascertain progress in completing the internal audit plan and to review results of the audits.

The Audit and Risk Committee monitored and reviewed the scope and results of the Internal Auditor's activities as well as its effectiveness during the financial year.

## REVIEW OF EFFECTIVENESS

The Board, through the Audit and Risk Committee, has reviewed and considered the effectiveness of the risk management and system of internal controls in operation across the Group.

The main objectives of the Group's internal control systems are:

- to ensure its aims and objectives are met;
- to ensure adherence to management policies;
- to ensure compliance with statutory requirements;
- to safeguard assets; and
- to ensure the relevance, reliability and integrity of information, so ensuring as far as possible the completeness and accuracy of records.

Any system of control can only ever provide reasonable and not absolute assurance that control weaknesses or irregularities do not exist, or that there is no risk of material errors, losses, fraud, or breaches of laws or regulations. Accordingly, the Group is continually seeking to improve the effectiveness of its systems of internal control.

The Audit and Risk Committee has concluded that the Group's risk management and system of internal controls is deemed effective. This is informed by a number of sources:

- the audit work undertaken by the Internal Audit function during this financial year;
- reports issued by the Group's external auditors; and
- risk management procedures managed and overseen by the Risk and Compliance Committee.

A detailed review of the Group's management of each principal risk or uncertainty is explained on pages 30 to 33.

## EXTERNAL AUDITOR

The Audit and Risk Committee reviews and makes recommendations with regard to the appointment and reappointment of the external auditors. In making these recommendations, consideration is given to auditor effectiveness and independence, partner rotation and any other factors that may impact the reappointment of the external auditors. There are no contractual restrictions on the choice of external auditors.

The Group's auditors, KPMG LLP, were appointed for the year-ended 31 March 2001 with the audit engagement partner rotation last occurring for the year-ended 31 March 2011. As the Group listed during the current financial year, in accordance with Ethical Standard 3, the audit engagement partner may continue to serve for not more than two years after the listing occurred with a maximum term of seven years in total.

The Audit and Risk Committee is confident that the effectiveness and independence of the external auditors is not impaired in any way. The Committee will continue to assess the effectiveness and independence of the external auditors. In doing so, they will consider a formal tender process in accordance with the provisions of the UK Corporate Governance Code.

The external auditors may perform certain non-audit services for the Group, any such non-audit services require pre-approval by the Audit and Risk Committee and are only permitted to the extent allowed by relevant laws and regulations.

During the year-ended 31 March 2016 the non-audit services provided by KPMG primarily related to their role as reporting accountant for the Initial Public Offering of the Group's shares and as a result their non-audit fees exceeded their audit fees for the year. Excluding fees associated with the Initial Public Offering, the non-audit fees were 47 percent of the audit and audit-related fees for the year compared to 27 percent for the year-ended 31 March 2015. Except for services related to the Initial Public Offering the non-audit services provided primarily related to tax compliance activities. Full details of auditor's remuneration is shown in note 9 to the Financial Statements.

## REVIEW OF EFFECTIVENESS OF EXTERNAL AUDITORS

An important role of the Committee is to assess the effectiveness of the external audit process. In performing this assessment the Committee:

- reviewed the annual audit plan and considered the auditors performance against that plan along with any variations to it;
- met with the audit engagement partner to review the audit findings and responses received to questions raised by the Committee;
- held regular meetings with the audit engagement partner, including with the absence of executive management;
- considered their length of tenure;
- reviewed the nature and magnitude of non-audit services provided; and
- reviewed the external auditors own independence confirmation presented to the Committee.

Based on the assessment performed, the Committee has recommended to the Board that a resolution to reappoint KPMG LLP be proposed at the next Annual General Meeting.

**Edwin Gillis**

**Chairman of the Audit and Risk Committee**

25 May 2016

# ANNUAL STATEMENT OF THE REMUNERATION COMMITTEE CHAIRMAN

As Chairman of Sophos' Remuneration Committee, I am pleased to present the Directors' Remuneration Report for the year-ended 31 March 2016, our first as a UK-listed company, which has been prepared by the Committee and approved by the Board. In line with the UK reporting regulations, this report is divided into three sections:

- The Annual Statement by the Remuneration Committee Chairman;
- The Directors' Remuneration Policy, which details Sophos' remuneration policies and their link to Group strategy, as well as projected pay outcomes under various performance scenarios; and
- The Annual Report on Remuneration, which focuses on our remuneration arrangements and incentive outcomes for the year under review and how the Committee intends to implement the Remuneration Policy in FY17

We will be seeking shareholder approval for both our Remuneration Policy and the remuneration report at the Annual General Meeting ("AGM") on 14 September 2016.

## REMUNERATION POLICY FOR FY17 AND FUTURE YEARS

Sophos was listed on the London Stock Exchange in July 2015. In advance of its listing, the Sophos Remuneration Committee reviewed the Company's remuneration structure to ensure it aligns with the forward looking strategy, is able to motivate and retain the executive team over the next key phase in the Company's development, and to ensure it takes into account market practice and best practice for a listed company. The remuneration structure for Executive Directors, which applies from the date of the AGM, being 14 September 2016, is set out in the Remuneration Policy on pages 53 to 59.

Our policy is broadly unchanged from that outlined in our IPO prospectus, and our remuneration arrangements reflect that we compete for talent in a competitive market against other high-technology US West Coast companies. The Committee has also carefully considered the expectations of UK institutional shareholders in formulating our policy and has included malus and clawback provisions in our incentive schemes to align with developing best practice. The overarching principles of our Remuneration Policy are to provide a competitive package of fixed and variable pay that will enable the Group to ensure it can attract and retain executives with the right skills and experience to drive the long-term success of the Company. The Committee believes that our remuneration arrangements can achieve these goals through the application of stretching performance targets and strong shareholder alignment through our equity incentives. Information on the implementation of the policy for FY17 is included in the Annual Report on Remuneration on pages 59 to 65.

## REMUNERATION DECISIONS IN FY16

Sophos achieved strong results in the year-ended 31 March 2016, with billings of $534.9 million and cash EBITDA of $120.9 million. The activities of the Committee and key decisions in FY16 are set out on page 59.

As a result, Kris Hagerman and Nick Bray will receive bonuses of 116 percent and 92 percent of salary, respectively. Following a review of Group performance and their personal contribution the salaries of the Executive Directors will be increased by 3 percent, effective from 1 July 2016. This is in line with the average increase expected for the wider employee population (c.3 percent).

As foreshadowed in the future remuneration policy in our prospectus, in August 2015, Kris Hagerman and Nick Bray were granted awards under the Sophos Group Long-Term Incentive Plan 2015 ("LTIP") in the form of restricted share units vesting over four years subject to continued employment only and in the form of performance share units vesting over three years subject to achievement of annual billings and cash EBITDA targets. They also received awards related to the IPO in the form of restricted share units vesting over five years subject to continued employment only, as detailed in the prospectus issued as part of the IPO.

The Committee will continue to monitor market trends and developments over the next year in order to assess ongoing relevance for the Company's remuneration practices. The Committee welcomes feedback from our shareholders as we remain committed to an open and transparent dialogue, and hope to receive your support at the forthcoming AGM.

On behalf of the Remuneration Committee

**Paul Walker**

**Chairman of the Remuneration Committee**

25 May 2016

This report, prepared by the Remuneration Committee ('the Committee') on behalf of the Board, takes account of the UK Corporate Governance Code and the latest Investment Association, ISS and PLSA guidelines, and has been prepared in accordance with the provisions of the Act, the Listing Rules of the Financial Conduct Authority and the Large and Medium-Sized Companies and Groups (Accounts and Reports) (Amendment) Regulations 2013. The Act requires the Auditor to report to the Company's Shareholders on the audited information within this report and to state whether in their opinion those parts of the report have been prepared in accordance with the Act. The Auditor's opinion is set out on pages 71 to 74 and those aspects of the report that have been subject to audit are clearly marked.

# DIRECTORS' REMUNERATION POLICY

This section describes the Group's proposed remuneration policy for Directors which, if approved, will apply for up to three years from the date of the Annual General Meeting.

The overarching principles of our remuneration policy are to provide a competitive package of fixed and variable pay that will enable the Group to ensure it has executives with the right skills and experience to drive the success of the Company, and that their remuneration is linked to shareholder interests and the Company's long-term success. Our remuneration philosophy is:

- to promote the long-term success of the Company, with stretching performance targets which are rigorously applied
- to provide appropriate alignment between the Company's strategic goals, shareholder returns and executive reward
- to have a competitive mix of base salary and short and long-term incentives, with an appropriate proportion of the package determined by stretching targets linked to the Company's performance

Executive Directors' fixed and variable remuneration arrangements have been determined taking into account:

- the role, experience in the role, and performance of the Executive Director
- the location in which the Executive Director is working
- remuneration arrangements at UK listed companies of a similar size and complexity
- remuneration arrangements at US high-technology companies of a similar size and complexity, including companies with which the Company competes for talent
- best practice guidelines for UK listed companies set by institutional investor bodies

## FUTURE POLICY TABLE

The key components of Executive Directors' remuneration are as follows:

| Purpose and link to strategy | Operation | Maximum opportunity | Performance metrics |
|---|---|---|---|
| **Fixed pay** | | | |
| **Base salary** | | | |
| To attract and retain talent of the right calibre and with the ability to contribute to strategy, by ensuring base salaries are competitive in the relevant talent market. | Base salaries are reviewed annually, with reference to individual performance, Group performance, market competitiveness, salary increases across the Group and the position holder's experience, competence and criticality to the business.<br>Any increases are generally effective from 1 July. | Executive Directors' salary increases will normally be in line with those for the wider employee population. However, higher salary increases may be made where there is a change in role or responsibilities or a significant market misalignment. | Individual and Group performance is taken into account when determining appropriate salary levels. |

# DIRECTORS' REMUNERATION POLICY CONTINUED

| Purpose and link to strategy | Operation | Maximum opportunity | Performance metrics |
|---|---|---|---|
| **Pension** | | | |
| Provide post-retirement benefits for participants in a cost-efficient manner. | Pension contributions are provided, with a choice of funding vehicles: US 401(k) savings plan for all US employees or group personal pension scheme. | The CEO currently receives a matching contribution of up to 3 percent of salary under his US 401(k) savings plan, subject to the applicable maximum contribution (US$24,000 for FY16).<br>The CFO receives up to 5 percent of salary as a contribution to a group personal pension scheme.<br>Other than in exceptional cases (such as to replace existing arrangements for new recruits) the Committee does not anticipate pension benefits as being at a cost to the Company that would exceed 20 percent of base salary. | None. |
| **Benefits** | | | |
| To provide competitive benefits for each role. | Benefits currently include the provision of medical and dental insurance, life and disability insurance, travel insurance, personal tax return preparation, and car allowance.<br>Reasonable relocation, travel and subsistence allowances (and, in certain circumstances, cash allowances in respect of the associated tax charge) and other benefits may be provided based on individual circumstances. | There is no overall maximum value set out for benefits. They are set at a level that is comparable to market practice and appropriate for individual and Company circumstances.<br>The Committee retains the discretion to amend benefits in exceptional circumstances or in circumstances where factors outside of the Group's control have materially changed (e.g. increases in insurance premiums). | None. |
| **Variable pay** | | | |
| **Annual bonus** | | | |
| Aims to focus executives on achieving stretching financial targets relevant to the business priorities for the financial period. | Performance measures and targets are set prior to or shortly after the start of the relevant financial period.<br>At the end of the financial period, the Remuneration Committee will determine the extent to which the targets have been achieved.<br>Awards are typically delivered in cash, however the Committee has discretion to defer awards in cash or in shares.<br>The Committee has discretion to reduce the bonus in the event of serious financial misstatement or misconduct. In extreme cases of misconduct, the Committee may claw back annual bonus payments previously made. | The maximum bonus opportunity for Executive Directors will be up to 200 percent of salary.<br>Up to 50 percent of maximum will vest for target performance. The Committee may award up to 12.5 percent of maximum for threshold performance. | The annual bonus will be based on achievement of stretching financial targets (e.g. billings, cash EBITDA) and personal performance. Personal performance will have a weighting of no more than a third.<br>Details of the measures used during the period under review are set out on page 60.<br>The Committee has discretion to adjust the formulaic bonus outcome downwards (or upwards with shareholder consultation) within the limits of the plan, to ensure alignment of pay with the underlying performance of the business. |

| Purpose and link to strategy | Operation | Maximum opportunity | Performance metrics |
|---|---|---|---|
| **Long-term incentive plan ('LTIP')** | | | |
| Aligns the interests of executives with shareholders in growing the value of the business over the long-term. | The plan provides for annual awards of restricted shares, options and performance shares to eligible participants. Other than for restricted shares, vesting is based on three-year performance.<br>The Committee has discretion to reduce any unvested long-term incentive awards, or to vary the opportunities for future awards, in the case of serious financial misstatement or misconduct. In extreme cases of misconduct, the Committee may claw back vested long-term incentive awards.<br>Participants are eligible to receive cash or shares equal to the value of dividends that would have been paid over the vesting period on shares that vest. | Awards may be made up to a maximum of 500 percent of salary in normal circumstances and up to 750 percent in exceptional circumstances (including, but not limited to, recruiting an individual). The award size is reviewed in advance of grant.<br>No performance-based awards will vest below threshold. Up to 25 percent of each element will vest for achievement of threshold performance under each metric, then increase on a straight-line basis to full vesting for achieving stretch performance.<br>It is anticipated that no more than 25 percent of aggregate awards in any one year will be over restricted shares or options. | Performance-based awards will vest on achievement of financial performance measures, measured over a three-year performance period, which may include profit measures and billings.<br>Performance-based awards: profit will receive a weighting of at least 50%. Other measures may be considered in future years to help capture the strategic goals of the business and may be used in conjunction with these metrics.<br>Time-based awards: restricted shares will begin vesting after one year, and thereafter vest in equal instalments on a quarterly basis until the fourth anniversary of grant based on continued employment only.<br>The Committee has discretion to adjust the formulaic LTIP award downwards (or upwards with shareholder consultation), within the limits of the plan, to ensure alignment of pay with the underlying performance of the business. |
| **Other Arrangements** | | | |
| **Shareholding guidelines** | | | |
| To align directors' interests with the long-term interests of shareholders. | Executive Directors are required to retain a minimum shareholding in the Company, and are required to retain at least 50 percent of shares vesting (after tax) under the LTIP until the shareholding guideline has been met.<br>Further details of the level of shareholding guideline currently in operation are set out on page 64. | n/a | n/a |
| **All-employee schemes** | | | |
| To encourage share ownership across the workforce. | SAYE and ESPP schemes are operated by the Company for eligible employees, in which Executive Directors may participate on the same terms. | Participation is capped at the prevailing approved limit at the time eligible employees are invited to participate, or such lower limit as determined by the Remuneration Committee. | None |
| **Non-Executive Directors' fees** | | | |
| To reflect the time commitment in preparing for and attending meetings, the duties and responsibilities of the role and the contribution expected from the Non-Executive Directors. | Annual fee for Chairman.<br>Annual base fee for Non-Executive Directors.<br>Additional fees paid to the Chairmen of Board Committees. Additional fees may be paid if there is a material increase in time commitment required.<br>Non-Executive Directors do not participate in any incentive schemes, nor do they receive any pension or benefits (other than nominal travel expenses and, in certain circumstances, cash allowances in respect of the associated tax charge). | Any increases to Non-Executive Director fees will be considered as a result of the outcome of a review process and taking into account wider market factors, e.g. inflation. There is no prescribed individual maximum fee.<br>Further details are set out on page 62. | None |

# DIRECTORS' REMUNERATION POLICY CONTINUED

## NOTES TO THE POLICY TABLE

### Performance measure selection and approach to target setting

Cash EBITDA and billings are considered to be the best measures of the Group's annual performance given our current size and stage of growth, and will continue to determine annual bonus vesting. The Committee will keep this under review, and may select alternative measures as the Group evolves and strategic priorities change.

Annual bonus targets will be selected prior to, or shortly after, the start of the financial period. Financial targets will be calibrated with reference to the Group's budget for the upcoming financial period and the Group's performance over the prior financial period.

Threshold and stretch performance levels for performance-based awards under the LTIP will be set at the start of the three-year performance period. The Committee aims to set stretching but achievable targets, taking account of a range of reference points, including market consensus and the Group's strategic plan.

### Differences in remuneration policy operated for other employees

Other employee remuneration has the same components as set out in the policy, being base salary, annual bonus, long-term incentive participation, pension, life assurance and benefit provision. Annual bonus and long-term incentive arrangements share a similar structure and pay-out arrangement, although the mix between performance-based and time-based awards, and the maximum award, varies by seniority and role.

### Other

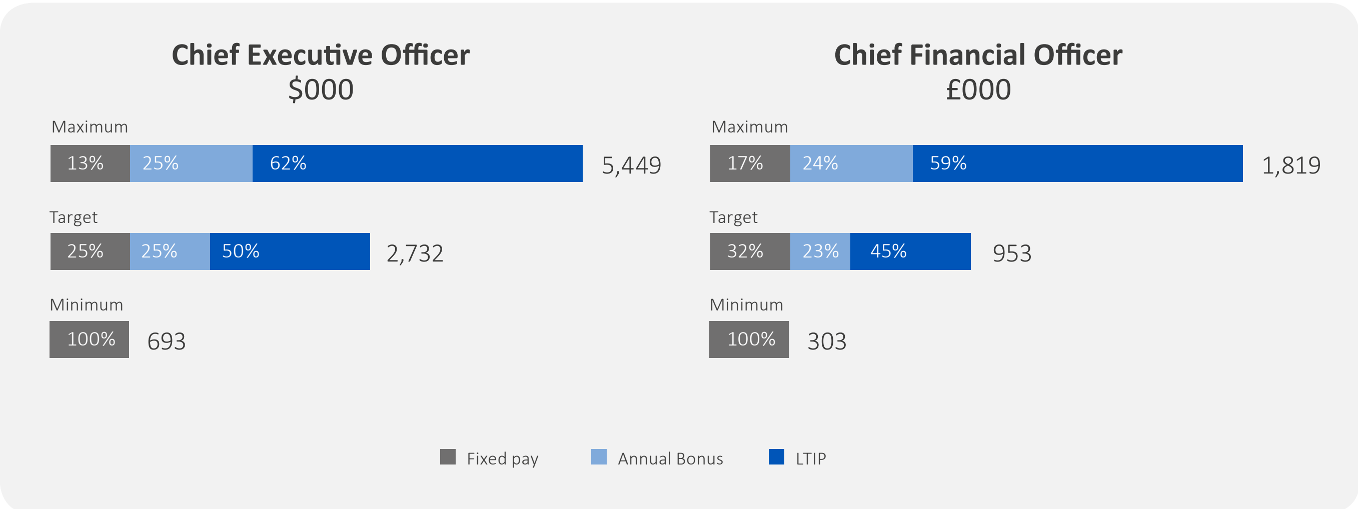
In addition to the above elements of remuneration, any commitment made prior to, but due to be fulfilled after, the approval and implementation of the policy detailed in this report will be honoured, this includes awards made to Directors (both Executive and Non-Executive) prior to IPO.

## PERFORMANCE SCENARIOS

The graphs below provide estimates of the potential future reward opportunities for Executive Directors, and the potential split between the different elements of remuneration under three different performance scenarios; 'Minimum', 'Target' and 'Maximum'.

The potential reward opportunities illustrated are based on the policy which will apply, if approved, from the AGM on 14 September 2016, applied to the base salaries in force at 1 April 2016. The projected value of LTIP amounts excludes the impact of share price movement or dividend accrual. The assumptions made in illustrating potential reward opportunities are shown in the table below:

| Performance scenario | Fixed pay | Annual bonus | LTIP (performance-based awards) | LTIP (time-based awards) |
|---|---|---|---|---|
| Minimum | Salary as at most recent review date.<br><br>Benefits and pension value as for the most recent financial period. | No annual bonus payable. | Threshold not achieved | Full vesting |
| Target | | On target annual bonus payable | Performance warrants threshold vesting | |
| Maximum | | Maximum annual bonus payable | Performance warrants full vesting | |



## APPROACH TO REMUNERATION FOR NEW EXECUTIVE DIRECTOR APPOINTMENTS

In the cases of hiring or appointing a new Executive Director, the Remuneration Committee may make use of all the existing components of remuneration, as follows:

| Component | Approach | Maximum opportunity |
|---|---|---|
| **Base salary** | The base salaries of new appointees will be determined based on the experience and skills of the individual, relevant market data and their current basic salary. | n/a |
| **Pension** | Membership of pension scheme or salary supplement on a similar basis to other executives, as described in the policy table. Other than in exceptional cases (such as to replace existing arrangements for new recruits) the Committee does not anticipate pension benefits as being at a cost to the Company that would exceed 20 percent of base salary. | In line with Policy Table. |
| **Benefits** | New appointees will be eligible to receive benefits in line with the policy which may include (but are not limited to) car allowance, medical insurance and life insurance. | n/a |
| **Annual bonus** | The structure described in the policy table will apply to new appointees with the relevant maximum being pro-rated to reflect the proportion of employment over the year. | 200 percent of base salary. |
| **LTIP** | New appointees will be granted awards under the LTIP on similar terms as other executives, as described in the policy table. | Up to 750 percent of base salary. |
| **All-employee schemes** | New appointees may be eligible to participate in all-employee schemes on the same basis as other employees. | In line with Policy Table. |

In determining appropriate remuneration for a new Executive Director, the Committee will take into consideration all relevant factors to ensure that arrangements are in the best interests of the Group and its shareholders. In addition to the remuneration arrangements set out above, the Committee may make an award in respect of a new appointment to 'buy out' incentive arrangements forfeited on leaving a previous employer, using Listing Rule 9.4.2 R if necessary. In doing so, the Committee will take account of relevant factors including any performance conditions attached to these awards, the likelihood of those conditions being met and the proportion of the vesting period remaining. The fair value of any buyout will not exceed that of the award being foregone.

In cases of appointing a new Executive Director by way of internal promotion, the approach will be consistent with the policy for external appointees detailed above. Where an individual has contractual commitments made prior to their promotion to Board level, the Group will continue to honour these arrangements. Incentive opportunities for below Board employees are no higher than for Executive Directors, but measures may vary.

In recruiting a new Non-Executive Director, the Committee will use the policy as set out in the table on page 55.

## SERVICE CONTRACTS AND EXIT PAYMENT POLICY

### Non-Executive Directors

The appointments of each of the Chairman and the Non-Executive Directors are for a fixed term of three years, commencing on 11 June 2015 and subject to annual re-election by the Company at the AGM. Their letters of appointment set out the terms of their appointment and are available for inspection upon request. They are not eligible to participate in the annual bonus, nor do they receive any additional pension or benefits (other than nominal travel expenses) on top of the fees disclosed on page 62. Non-Executive Directors appointment may be terminated at any time upon written notice or in accordance with the articles and receive no compensation on termination.

| Non-Executive Director | Role | Appointment date | Term of appointment |
|---|---|---|---|
| Peter Gyenes | Chairman | 11 June 2015 | Three years |
| Paul Walker | Senior Independent Director | 11 June 2015 | Three years |
| Steve Munford | Non-Executive Director | 11 June 2015 | Three years |
| Sandra Bergeron | Independent Non-Executive Director | 11 June 2015 | Three years |
| Edwin Gillis | Independent Non-Executive Director | 11 June 2015 | Three years |
| Salim Nathoo | Non-Executive Director | 11 June 2015 | Three years |
| Roy Mackenzie | Non-Executive Director | 11 June 2015 | Three years |

# DIRECTORS' REMUNERATION POLICY CONTINUED

### Executive Directors

On 11 June 2015, each of the Executive Directors entered into a service agreement with the Company.

| Executive Director | Role | Contract date | Notice period |
|---|---|---|---|
| Kris Hagerman | Chief Executive Officer | 11 June 2015 | 12 months |
| Nick Bray | Chief Financial Officer | 11 June 2015 | 12 months |

The Employer is entitled to terminate an Executive Director's employment by payment of a cash sum in lieu of notice, equal to (i) the basic salary that would have been payable, and (ii) the cost that would have been incurred in providing the Executive Director with medical insurance benefits for any unexpired portion of the notice period (the ''Payment in Lieu''). The Company can alternatively choose to continue providing the medical insurance benefits under item (ii) instead of paying a cash sum representing their cost. The Payment in Lieu will be paid in monthly instalments over the notice period.

In specified circumstances (not involving a change of control, in which case the severance payment applicable is as described below), each Executive Director is entitled to terminate his employment without notice and receive a severance payment. The severance payment will be equal to the Payment in Lieu and paid in a single lump sum. The specified circumstances are where either: (a) the Employer terminates or gives notice to terminate the Executive Director's employment without cause; or (b) the Executive Director terminates his employment in response to: a material diminution of his authority, duties, responsibilities or status in a manner inconsistent with his service agreement; a breach of a fundamental term of his service agreement; a material reduction in his annual basic salary or target bonus opportunity; or being required to relocate his place of work beyond a specified distance (each a ''Good Leaver Reason'').

Each Executive Director is entitled to a severance payment, paid in a single lump sum, in the event of a termination of his employment by his Employer without cause or by the Executive Director for a Good Leaver Reason at any time during a period ending 18 months after any change of control of the Company (whether by way of a general offer or a scheme of arrangement or compromise) and beginning three months prior to the announcement of such general offer or scheme of arrangement or compromise. The severance payment will be equal to the sum of: (i) 150 percent of the Executive Director's annual basic salary; (ii) 150 percent of the Executive Director's target bonus for the Company's financial year in which the termination occurs; and (iii) the total cost of providing the Executive Director with the benefits (including pension contributions) to which he is entitled under his service agreement for a period of 12 months.

The Company's policy on termination payments is to consider the circumstances on a case-by-case basis, taking into account the executive's contractual terms, the circumstances of termination and any duty to mitigate. The table below summarises how incentives are typically treated in different circumstances:

| Reason for leaving | Treatment |
|---|---|
| **Bonus** | |
| Summary dismissal, resignation | Awards lapse. |
| Good leaver | Eligible for an award to the extent that performance conditions have been satisfied, pro-rated for the proportion of the financial year served, with Committee discretion to treat otherwise. |
| Change of control | Eligible for an award to the extent that performance conditions have been satisfied up to the change of control, pro-rated for the proportion of the financial year served, with Committee discretion to treat otherwise. Executives may be eligible for an enhanced bonus payment in the case of termination of employment within 18 months of a change of control, as described above. |
| **Long-term incentives** | |
| Summary dismissal, resignation | Awards lapse. |
| Good leaver | Outstanding awards will normally be pro-rated to the date of leaving, with Committee discretion to treat otherwise and with discretion to either test at end of relevant performance periods, or immediately assess, whether or not relevant performance criteria have been met. |
| Change of control | Outstanding awards will normally vest and be tested for performance over the period to change-of-control, and be pro-rated for time based on the proportion of the period served, with Committee discretion to treat otherwise. Executives may be eligible for additional vesting in the case of termination of employment within 18 months of a change of control. |
| **All-employee schemes** | |
| Treated in line with applicable scheme rules | |

### EXTERNAL APPOINTMENTS OF EXECUTIVE DIRECTORS

Executive Directors may accept external appointments with the prior approval of the Chairman, provided that such appointments do not prejudice the executive's ability to fulfil their duties for the Group. Any fees for outside appointments would normally be retained by the Director.

### CONSIDERATION OF EMPLOYMENT CONDITIONS ELSEWHERE IN GROUP

The Committee takes into account the general basic salary increase being offered to employees elsewhere in the Group when annually reviewing the salary increases and remuneration for the Executive Directors. Employees have not been consulted in respect of the design of the Group's senior executive remuneration policy.

### CONSIDERATION OF SHAREHOLDER VIEWS

The Committee takes shareholder feedback into careful consideration when reviewing remuneration and regularly reviews the Remuneration policy in the context of key institutional shareholder guidelines and best practice. It is the Committee's policy to consult with major shareholders prior to making any major changes to its executive remuneration structure.

# ANNUAL REPORT ON REMUNERATION

### THE REMUNERATION COMMITTEE

The following section provides details of remuneration outcomes for the financial year-ended 31 March 2016 for Executive Directors who served at Sophos during the year, and how the Remuneration policy will be implemented in FY17. The key responsibilities of the Committee include:

- determine and monitor the Remuneration policy for the Chairman, Executive Directors and other senior executives it is designated to consider;
- ensure that the Remuneration policy and reward decisions that support business strategy and sustainable long-term performance;
- set specific remuneration packages which include salary, annual bonus, share incentives, pension and benefits;
- review the Executive Directors' service contracts;
- review remuneration trends across the Group; and
- approve employee share-based incentive plans and associated performance conditions and targets.

The Committee's Terms of Reference, which are reviewed regularly, are set out on the Company's website. During the year, the Remuneration Committee comprised the following Non-Executive Directors: Paul Walker (Committee Chairman), Peter Gyenes, Sandra Bergeron, Edwin Gillis.

In FY16, the Committee met three times. Attendance by individual Committee members is reported in the Corporate Governance Statement on page 42. Only Committee members have the right to attend Committee meetings. The Chairman of the Board (if he is not a member of the Committee), CEO, HR Director, and Company Secretary (who acts as Committee secretary) attend the Committee's meetings by invitation, but are not present when their own remuneration is discussed.

### EXTERNAL ADVISERS

Kepler (a brand of Mercer) ("Kepler"), independent remuneration consultants appointed by the Committee in FY16, after consultation with the Board, continued to act as the remuneration adviser to the Committee during the year. Kepler reports directly to the Committee Chairman, and is a signatory to and abides by the Code of Conduct for Remuneration Consultants (which can be found at www.remunerationconsultantsgroup.com). The fees paid to Kepler in respect of work carried out for the Remuneration Committee in FY16 totalled £30,625. Other than advice on remuneration, no other services were provided by Kepler (or any other part of the MMC Group of companies) to the Company. The Committee undertakes due diligence periodically to ensure that Kepler remains independent of the Company and that the advice provided is impartial and objective. The Committee is satisfied that the advice provided by Kepler is independent.

# ANNUAL REPORT ON REMUNERATION CONTINUED

## SINGLE TOTAL FIGURE OF REMUNERATION FOR EXECUTIVE DIRECTORS (AUDITED)

The table below sets out the total single figure remuneration received by each Executive Director who served during the year-ended 31 March 2016 and the prior year:

| | Kris Hagerman ($000) | | Nick Bray (£000) | |
|---|---|---|---|---|
| | 2015 | 2016 | 2015 | 2016 |
| Salary[1] | 665 | 676 | 276 | 276 |
| Taxable benefits[2] | 16 | 8 | 10 | 13 |
| Pension[3] | 8 | 9 | 14 | 14 |
| Single-year variable[4] | 1,015 | 788 | 336 | 255 |
| Restricted Stock Units[5] | – | 9,173 | – | 2,531 |
| Multi-year variable[5] | – | 7,973 | – | 1,473 |
| Total | 1,704 | 18,627 | 636 | 4,562 |

1. Amount earned in respect of the year
2. Taxable benefits include: Kris Hagerman: Car allowance (FY16: $3K, 2015: $16K) and health insurance; Nick Bray: Health insurance, critical illness and car allowance (FY16 and FY15: £10K)
3. The Company's pension contributions during the year of up to 3 percent and 5 percent of salary for Kris Hagerman and Nick Bray, respectively
4. Bonus payment for performance during the year
5. RSUs: The face value at grant of time-based RSU; Multi-year: The embedded value on date of vesting of performance-based options that vested on IPO

## BASE SALARY

During the year the Remuneration Committee reviewed the salaries of Kris Hagerman and Nick Bray, who were each awarded an increase of 3 percent, effective 1 July 2016. The salaries of the Executive Directors are as follows:

| Executive Director | 1 July 2015 | 1 July 2016 | Increase % |
|---|---|---|---|
| Kris Hagerman | $679,000 | $700,000 | 3 |
| Nick Bray | £275,785 | £284,000 | 3 |

## PENSION AND BENEFITS

Kris Hagerman receives medical and dental insurance, travel insurance, life and disability insurance, a reimbursement of up to US$10,000 per annum for the preparation of his tax returns and, under his Employer's standard US 401(k) savings plan for all US employees, is entitled to receive a matching contribution of up to three percent of his salary, subject to any annual maximum contribution applicable to US 401(k) savings plans from time to time. For 2016, this annual maximum is US$24,000.

Nick Bray is entitled to receive up to five percent of his base salary as a contribution to a group personal pension scheme. He also receives an annual car allowance of £10,000 (paid monthly), life insurance, private medical and critical illness insurance, travel insurance, personal accident insurance, and employee assistance programme arrangements.

## ANNUAL BONUS FOR FY16

The Group operates an annual performance-related bonus scheme for a number of senior executives including Executive Directors. Bonus opportunities for FY16 were 196 percent of salary for Kris Hagerman and 156 percent of salary for Nick Bray. Target bonus was 50% of the maximum opportunity.

The level of annual bonus earned in any one year is based on Group performance against predetermined financial targets for the year and personal performance. In FY16, the bonus was based 80 percent on billings and cash EBITDA, with 12.5 percent of maximum vesting for threshold performance and 50 percent for target performance, and 20 percent on personal performance. No bonus is awarded for performance below the threshold. The financial element payout is based on the lower of the implied payouts for billings and cash EBITDA.

The Company exceeded the targets for both financial measures, and the bonus outcome was therefore 58 percent of maximum for the financial element. After taking into account personal performance, Kris Hagerman and Nick Bray will receive bonuses of 116 percent and 92 percent of salary, respectively. All of the bonus in respect of FY16 will be paid in cash.

The Committee believes that disclosing financial performance targets in respect of the annual bonus for FY16 in the report would put the Company at a competitive disadvantage to its international and privately held competitors, which are not subject to similar disclosure requirements. Given the close link between financial performance targets and the Company's longer term strategy, targets are not disclosed in this report but will be disclosed in the annual report for the year-ending 31 March 2017.

## LONG-TERM INCENTIVE PLAN

As included in the IPO prospectus, on 7 August 2015, Kris Hagerman and Nick Bray were granted awards in connection with the IPO under the Sophos Group Long-term Incentive Plan 2015 ("LTIP") in the form of restricted share units ("RSU"); details are provided in the table below.

| Executive Director | Date of award | Awards made during the year | Reference price of award[1] | Face value of award (£000) |
|---|---|---|---|---|
| Kris Hagerman | 7 August 2015 | 1,966,292 | 225p | 4,424 |
| Nick Bray | 7 August 2015 | 842,697 | 225p | 1,896 |

1. As disclosed in the IPO prospectus, the one-off IPO awards were granted with reference to the IPO price of 225p

The awards are not subject to future performance conditions, and will vest over five years, with 20 percent of the awards vesting on 7 August 2016 and the remainder vesting on a quarterly basis thereafter until 7 August 2020. On 7 August 2015, Kris Hagerman and Nick Bray were granted further awards under the LTIP in the form of restricted share units and performance share units ("PSU"); details are provided in the table below.

| Executive Director | Date of award | Type of award | Awards made during the year | Reference price of award[1] | Face value of award (£000) | Face value of award (% of salary) |
|---|---|---|---|---|---|---|
| Kris Hagerman | 7 August 2015 | RSU | 238,764 | 225p | 537 | 124 |
| | | PSU | 716,292 | 225p | 1,612 | 373 |
| Nick Bray | | RSU | 112,359 | 225p | 253 | 92 |
| | | PSU | 337,079 | 225p | 758 | 275 |

1. The first annual awards under the LTIP were granted with reference to the IPO price of 225p

The RSU awards are not subject to future performance conditions, and will vest over four years, with 25 percent of the awards vesting on 7 August 2016 and the remainder vesting on a quarterly basis thereafter until 7 August 2019. The PSU awards vest subject to the average vesting outcome implied by performance against annual targets over the three years to the financial year-ended 31 March 2018. Targets for the three years are set at the start of the performance period. For FY16 awards, vesting was based on the lower of the implied payouts for billings and cash EBITDA, with 25 percent vesting for threshold performance, 100 percent for stretch performance, with up to an additional 25 percent vesting for performance between a super stretch target and maximum target. No awards will vest for performance below the threshold.

The Committee believes that disclosing annual financial performance targets for FY16, FY17 and FY18 in this report would put the Company at a competitive disadvantage to its international and privately held competitors, which are not subject to similar disclosure requirements. Given the close link between financial performance targets and the Company's longer term strategy targets are not disclosed in this report but will be disclosed retrospectively in the Annual Report on Remuneration following the end of the performance period. LTIP awards are subject to malus and clawback provisions.

## SINGLE TOTAL FIGURE OF REMUNERATION FOR NON-EXECUTIVE DIRECTORS (AUDITED)

The table below sets out the total single figure remuneration received by each Non-Executive Director who served during the year-ended 31 March 2016 and the prior year:

| | Base fee ($000) | | Additional fees[1] ($000) | | Other[2] ($000) | | Total ($000) | |
|---|---|---|---|---|---|---|---|---|
| | 2015 | 2016 | 2015 | 2016 | 2015 | 2016 | 2015 | 2016 |
| Peter Gyenes | 150 | 230 | – | 4 | – | – | 150 | 234 |
| Sandra Bergeron | 45 | 129 | – | – | – | – | 45 | 129 |
| Edwin Gillis | – | 120 | – | 12 | – | – | – | 132 |
| Roy Mackenzie | – | – | – | – | – | – | – | – |
| Steve Munford | 154 | 147 | – | – | – | 4,642 | 154 | 4,789 |
| Salim Nathoo | – | – | – | – | – | – | – | – |
| Paul Walker | – | 120 | – | 21 | 290 | – | 290 | 141 |

1. Additional fees relate to fees for chairing Board Committees
2. Paul Walker: Restricted share agreement entered into in advance of the IPO over 190,694 restricted shares that vest in three equal tranches on the first, second and third anniversaries of 27 March 2015; they are valued at face value on the date of grant. Steve Munford: The embedded value on date of vesting of performance-based options.

# ANNUAL REPORT ON REMUNERATION CONTINUED

## EXIT PAYMENTS MADE IN YEAR (AUDITED)

No exit payments were made to Directors in FY16.

## PAYMENTS TO PAST DIRECTORS (AUDITED)

No payments were made to past Directors in FY16.

## REMUNERATION FOR FY17

### Base salary

Salaries for Kris Hagerman and Nick Bray, effective from 1 July 2016, will be $700,000 and £284,000 respectively. This equates to an increase of 3 percent, which is in line with average increase awarded to the broader employee population of c.3 percent.

### Pension and benefits

In line with the Remuneration Policy, the Executive Directors will receive pension contributions of 3-5 percent of salary. They will also receive benefits in line with the policy.

### Annual bonus

For the year-ending 31 March 2017, the Committee will operate the annual bonus using the same framework and measures as used in FY16. Billings and cash EBITDA targets have been set by the Committee and will require Executive Directors to deliver significant stretch performance to achieve full payout. Given the close link between these targets and Sophos' competitive strategy, these financial targets are considered commercially sensitive and will not be disclosed in advance, but will be disclosed on a retrospective basis in next year's Annual Report on Remuneration to the extent that the Committee determines that the targets are no longer commercially sensitive.

100 percent of the bonus will be paid in cash. Bonus payments are subject to malus and clawback provisions.

### Long-term incentive plan

In FY17, the Committee intends to grant long-term incentive awards to Executive Directors in line with the stated remuneration policy and using the same measures as were used in FY16 (see above). Awards will be made over performance share units (at least 75 percent of the total award) and restricted shares, within the normal policy limits. Full details of the awards will be set out in the Annual Report for the year-ended 31 March 2017. LTIP awards are subject to malus and clawback provisions.

### Non-Executive Director fees (including the Chairman)

With effect from admission, the fees payable to the Chairman of the Board and other Non-Executive Directors ('NEDs') are as follows:

| | | Fee p.a. |
|---|---|---|
| Chairman of the Board | | $250,000 |
| NED base fee | | $150,000 |
| Additional fees: | Audit & Risk Committee Chairman | $15,000 |
| | Remuneration Committee Chairman | $10,000 |
| | Nominations Committee Chairman | $5,000 |
| | Senior Independent Director | $15,000 |

### Percentage change in CEO remuneration

The table below shows the percentage change in the CEO's remuneration from the prior year compared to the average percentage change in remuneration for all other employees. To provide a meaningful comparison, the analysis is based on a consistent set of employees, i.e. the same individuals appear in the FY16 and FY15 populations. Kris Hagerman entered into a service agreement with the Company on 11 June 2015, in which his car allowance, previously included in taxable benefits, became part of his base salary. The net impact of this change on the total fixed element of his remuneration was nil.

| | % change FY15 to FY16 | |
|---|---|---|
| | CEO | Other employees |
| Base salary | 2 | 4 |
| Taxable benefits | -50 | – |
| Single-year variable | -22 | -16 |

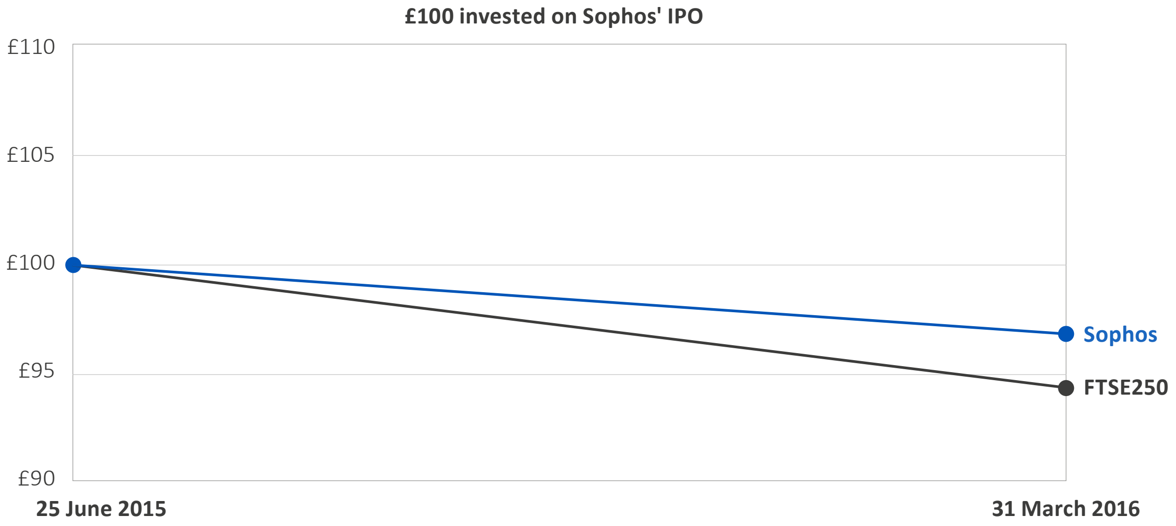
## Relative importance of spend on pay

The Company completed its IPO in July 2015 and announced its first dividend in the year-ended 31 March 2016. As a result a table showing annual percentage change in total employee pay expenditure and shareholder distributions (i.e. dividends, share buybacks and return of capital) will not be presented until the annual report for the year-ending 31 March 2017. As detailed in note 10 to the Financial Statements the total employee costs for FY16 were $250.3 million (FY15: 216.9 million) an increase of 15.4 percent.

## Pay for performance

Under remuneration reporting regulations, companies are required to provide a graph showing the Company's Total Shareholder Return ("TSR") performance (share price plus dividends paid) compared with the performance of a relevant comparator group since IPO, assuming a nominal £100 investment in both the Company and the comparator group at the start of the timeframe. Companies are also required to show the CEO's single figure of remuneration and actual variable pay outcomes over the same period.

Sophos has chosen to compare its performance against the FTSE250 Index, as the Company became a constituent of the index after IPO. The table below details the Chief Executive's single figure of remuneration and actual variable pay outcomes over the same period. As Sophos completed its IPO in July 2015, TSR data and pay disclosure is available only for the financial year-ending 31 March 2016. Pay disclosure and TSR is provided below.




| | 2016 |
|---|---|
| Incumbent | Kris Hagerman |
| CEO single figure of remuneration ($000) | $18,627 |
| Annual bonus outcome (% of salary) | 116 |
| PSU vesting outcome (% of max) | n/a |

# ANNUAL REPORT ON REMUNERATION CONTINUED

## Directors' share ownership (audited)

The table below shows the shareholding of each Director against their respective shareholding requirement as at 31 March 2016.

| | | Share and option awards | | | | | |
|---|---|---|---|---|---|---|---|
| | Beneficially owned | Subject to performance | Subject to continued employment only | Vested but not yet exercised | Shareholding required (% of salary) | Current shareholding (% of salary) | Requirement met |
| Kris Hagerman | 2,134,719 | 716,292 | 3,581,860 | 3,355,655 | 200 | 985 | Yes |
| Nick Bray | 1,100,013 | 337,079 | 955,056 | – | 200 | 870 | Yes |
| Peter Gyenes | 286,631 | – | – | – | | | |
| Paul Walker | 63,565 | – | 127,129 | – | | | |
| Steve Munford | 1,498,656 | – | – | 2,660,884 | | | |
| Sandra Bergeron | 214,974 | – | – | – | | n/a | |
| Edwin Gillis | 286,631 | – | – | – | | | |
| Salim Nathoo | – | – | – | – | | | |
| Roy Mackenzie | – | – | – | – | | | |

There have been no changes to shareholdings between 1 April 2016 and 25 May 2016. None of the Directors had an interest in the shares of any subsidiary undertaking of the Company or in any significant contracts of the Group.

## Summary of outstanding share awards

The interests of the Directors in the Company's share schemes as at 31 March 2016 are summarised in the table below.

| Director | Date of award | Awards held at 1 Apr 15 | Granted during the year | Exercised during the year | Forfeited during the year[1] | Awards held at 31 Mar 16 | Exercise price | Market price at grant date | Performance period | Vesting period/date | Expiry date |
|---|---|---|---|---|---|---|---|---|---|---|---|
| **Kris Hagerman** | | | | | | | | | | | |
| Pre-IPO Options | 10 Oct 12 | 1,997,000 | – | – | 315,285 | 2,312,285 | $0.598 | $0.598 | n/a | 1 Aug 13 –1 Aug 17 | 10 Oct 22 |
| Pre-IPO Options | 10 Oct 12 | 4,131,725 | – | – | (1,711,551) | 2,420,174 | $0.598 | $0.598 | Exit event | 1 Jul 15 | 10 Oct 22 |
| LTIP – RSU | 7 Aug 15 | – | 1,966,292 | – | – | 1,966,292 | – | 265p | n/a | 7 Aug 16 –7 Aug 20 | 6 Aug 25 |
| LTIP – RSU | 7 Aug 15 | – | 238,764 | – | – | 238,764 | – | 265p | n/a | 7 Aug 16 –7 Aug 19 | 6 Aug 25 |
| LTIP – PSU | 7 Aug 15 | – | 716,292 | – | – | 716,292 | – | 265p | 1 Apr 15 –31 Mar 18 | 1 Apr 18 | 6 Aug 25 |
| **Nick Bray** | | | | | | | | | | | |
| Pre-IPO Options | 1 Feb 11 | 1,144,170 | – | (1,151,792) | 7,622 | – | $0.476 | $0.476 | n/a | 1 Sep 11 –1 Sep 15 | 1 Feb 21 |
| Pre-IPO Options | 1 Feb 11 | 1,144,170 | – | (749,885) | (394,285) | – | $0.476 | $0.476 | Exit event | 1 Jul 15 | 1 Feb 21 |
| LTIP – RSU | 7 Aug 15 | – | 842,697 | – | – | 842,697 | – | 265p | n/a | 7 Aug 16 –7 Aug 20 | 6 Aug 25 |
| LTIP – RSU | 7 Aug 15 | – | 112,359 | – | – | 112,359 | – | 265p | n/a | 7 Aug 16 –7 Aug 19 | 6 Aug 25 |
| LTIP – PSU | 7 Aug 15 | – | 337,079 | – | – | 337,079 | – | 265p | 1 Apr 15 –31 Mar 18 | 1 Apr 18 | 6 Aug 25 |
| **Steve Munford** | | | | | | | | | | | |
| Pre-IPO Options | 22 Oct 10 | 204,610 | – | (51,153) | – | 153,457 | $0.019 | $0.476 | n/a | 22 Oct 10 | 22 Oct 20 |
| Pre-IPO Options | 22 Oct 10 | 2,065,863 | – | – | – | 2,065,863 | $0.119 | $0.476 | n/a | 16 Jun 11 –16 Jun 15 | 22 Oct 20 |
| Pre-IPO Options | 22 Oct 10 | 2,065,863 | – | (926,156) | (698,143) | 441,564 | $0.119 | $0.476 | Exit event | 1 Jul 15 | 22 Oct 20 |

1. Kris Hagerman/Nick Bray: Pre-IPO Options forfeited during the year includes performance awards converted to time vesting awards (315,285 and 7,622 respectively).

As outlined in the prospectus, Kris Hagerman and Steve Munford continue to hold share options granted under the Pentagon Holdings Management Equity Plan ("MEP") that were issued prior to IPO. Nick Bray's (until exercised during FY16) and Steve Munford's MEP options (a "Linked Option") were / are linked to a parallel award under a JOE Agreement. Awards under a JOE agreement entitle the participant to call for the transfer to him by the Trustee of the JOE agreement of that part of the beneficial interest in any jointly owned shares which vest, upon payment by the participant of a price specified in the JOE Agreement. Rights under a JOE Agreement may only be exercised to the extent that a Linked Option has not been exercised and vice versa.

The rules of the MEP provide that 50 percent of a MEP option is subject to time vesting and 50 percent is subject to performance vesting. On Admission, 66.2 per cent of the awards subject to performance vested. Depending on the length of service of a MEP participant, the Company may require that a portion of an option which is vested as to performance may only be exercised at a later date.

Steve Munford additionally holds vested share options granted under an option deed with Pentagon Holdings SARL on 22 October 2010.

All share options over shares in Pentagon Holdings SARL were exchanged for new options over shares in Sophos Group plc as part of the reorganisation of the Group immediately prior to the IPO.

The interests of the Directors in pre-IPO restricted shares as at 31 March 2016 are summarised in the table below.

| Director | Date of award | Restricted Awards held at 1 April 2015 | Restriction lifted during year | Restricted Awards held at 31 March 2016 | Exercise price | Market price at grant date | Performance period | Vesting period/ date | Expiry date |
|---|---|---|---|---|---|---|---|---|---|
| **Paul Walker** | | | | | | | | | |
| Pre-IPO Restricted Shares | 27 Mar 15 | 190,694 | (63,565) | 127,129 | – | $1.5575 | n/a | 27 Mar 16 –27 Mar 18 | n/a |
| **Sandra Bergeron** | | | | | | | | | |
| Pre-IPO Restricted Shares | 19 Jan 11 | 42,995 | (42,995) | – | – | $0.476 | n/a | 19 Feb 11 – 1 Jul 15 | n/a |
| **Edwin Gillis** | | | | | | | | | |
| Pre-IPO Restricted Shares | 19 Jan 11 | 57,326 | (57,326) | – | – | $0.476 | n/a | 19 Feb 11 – 1 Jul 15 | n/a |
| **Peter Gyenes** | | | | | | | | | |
| Pre-IPO Restricted Shares | 19 Jan 11 | 57,326 | (57,326) | – | – | $0.476 | n/a | 19 Feb 11 – 1 Jul 15 | n/a |

As outlined in the prospectus certain of the Non-Executive Directors held Restricted Shares, details of them are set out below.

Paul Walker entered into a restricted share agreement on 27 March 2015 (the "Acquisition Date") pursuant to which he acquired 300,000 A shares in Pentagon Holdings SARL. Provided Paul Walker continues as a Director of Sophos, the Restricted Shares shall vest in three equal tranches on the first, second and third anniversaries of the Acquisition Date.

Sandra Bergeron entered into a restricted share agreement on 19 January 2011 (the "Acquisition Date") pursuant to which she acquired 450,927 A shares in Pentagon Holdings SARL. The Restricted Shares vested monthly over 5 years from the expiry of one month of the Acquisition date. On Admission, the vesting of remaining unvested shares was accelerated such that all shares were vested on Admission.

Peter Gyenes and Edwin Gillis entered into restricted share agreements on 19 January 2011 (the "Acquisition Date") pursuant to which they each acquired 601,235 A shares in Pentagon Holdings SARL. The Restricted Shares vested monthly over 5 years from the expiry of one month of the Acquisition date. On Admission, the vesting of remaining unvested shares was accelerated such that all shares were vested at the IPO.

All Restricted Shares in Pentagon Holdings SARL were exchanged for new shares in Sophos Group plc as part of the reorganisation of the Group immediately prior to the IPO.

On behalf of the Board

**Paul Walker**

**Chairman of the Remuneration Committee**

25 May 2016

# DIRECTORS' REPORT

The Directors of Sophos Group plc (the "Company") present their Annual Report on the affairs of the Group, together with the Consolidated Financial Statements and auditor's report on the Group for the year-ended 31 March 2016.

## STRATEGIC REPORT

The Companies Act 2006 requires the Company to prepare a strategic report which is presented on pages 6 to 37 of the Annual Report and includes a fair review of the business, a description of the principal risks and uncertainties facing the Group and an indication of likely future developments.

## CORPORATE GOVERNANCE

In accordance with the Disclosure and Transparency Rules ("DTR") the Group is required to produce a corporate governance statement. The information to fulfil this requirement is included in the Corporate Governance Statement on pages 40 to 44 and Committee Reports on pages 45 to 65, which have been incorporated into the Directors' Report by cross-reference.

## DIRECTORS AND DIRECTORS' INTERESTS

The Directors who held office during the year and up to the date of the signing of this report:

| | |
|---|---|
| Peter Gyenes | Non-Executive Director and Chairman |
| Kris Hagerman | Chief Executive Officer |
| Nick Bray | Chief Financial Officer |
| Sandra Bergeron | Non-Executive Director |
| Edwin Gillis | Non-Executive Director |
| Roy Mackenzie | Non-Executive Director |
| Steve Munford | Non-Executive Director |
| Salim Nathoo | Non-Executive Director |
| Paul Walker | Non-Executive Director |

A summary of the Directors' remuneration, employment contracts and interests in the shares of the Company are disclosed within the Remuneration Report.

Related party disclosures are included in note 32 of the Financial Statements. None of the Directors had an interest in any significant contracts of the Group or its subsidiaries.

Throughout the year the Company has purchased and maintained Directors' and Officers' liability insurance in respect of itself and its Directors. The Directors also have the benefit of the indemnity provision contained in the Company's Articles of Association. The Company has entered into qualifying third-party indemnity arrangements for the benefit of all its Directors in a form and scope which comply with the requirements of the Companies Act 2006 and which were in force throughout the year and remain in force.

## RELATIONSHIP AGREEMENT

From the date of listing to 9 December 2015, Pentagon Lock Sarl, Pentagon Lock 6-A Sarl, Pentagon Lock 7-A Sarl and Pentagon Lock US Sarl (collectively "Apax") held more than 30 percent of the shares in the Company. On 26 June 2015, the Company and Apax entered into a Relationship Agreement which regulates the ongoing relationship between the Company and the controlling shareholder in accordance with the Listing Rules. The Board can confirm that throughout the period:

- the Company has complied with the agreement's independence provisions;
- as far as the Company is aware, the controlling shareholder and its associates have complied with the agreement's independence provisions; and
- as far as the Company is aware, the controlling shareholder has procured the compliance of non-signing controlling shareholders with the agreement's independence provisions.

## SIGNIFICANT AGREEMENTS

The following significant agreements are in place as of 31 March 2016 that include provisions which would enable the counterparties to alter or terminate the agreements upon a change of control of the Company following a takeover bid:

- A syndicated secured term loan ("Facility A") of $235.0 million with an interest rate of LIBOR + 2.25 percent entered into on 1 July 2015, repayable in full on maturity after five years;
- A syndicated secured term loan ("Facility B") of €60.0 million with an interest rate of EURIBOR + 2.25 percent entered into on 1 July 2015, repayable in full on maturity after five years; and
- A revolving credit facility agreement ("RCF") of $30.0 million with an interest rate of LIBOR + 2.00 percent entered into on 1 July 2015.

## SHARE CAPITAL AND SUBSTANTIAL SHAREHOLDERS

The share capital of the Company is disclosed in note 28 of the Financial Statements; ordinary shares of 3p each are the only class of share in issue. As at 31 March 2016 and 20 May 2016 the Company had been notified under DTR5 of the following significant holdings of voting rights in its shares. It should be noted that these holdings may have changed since notified to the Company, however notification of any change is not required until the next applicable threshold is crossed:

| | As at 31 March 2016 | | As at 20 May 2016 | |
|---|---|---|---|---|
| **Name** | **Shares held** | **Percentage of total ordinary shares** | **Shares held** | **Percentage of total ordinary shares** |
| Apax | 100,722,776 | 22.3 | 100,722,776 | 22.3 |
| Jan Hruska | 42,543,360 | 9.41 | 42,543,360 | 9.41 |
| Peter Lammer | 42,543,360 | 9.41 | 42,543,360 | 9.41 |
| Standard Life Investments (Holdings) Limited | 22,735,577 | 5.0 | 22,735,577 | 5.0 |
| Oddo Asset Management | N/A | N/A | 13,633,922 | 3.02 |

## VOTING RIGHTS

The Articles of Association of the Company allow, subject to any rights or restrictions attached to any shares, on a vote on a resolution on a show of hands, every member or proxy who is present shall have one vote. Subject to any rights or restrictions attached to any shares, on a vote on a resolution on a poll, every member present in person or by proxy shall have one vote for every share of which they are the holder.

## TRANSFER OF SHARES

The transfer of shares is governed by the Company's Articles of Association which allows any member to transfer certificated shares in any usual form or in any other form for which the Board may approve. The Board may, in its absolute discretion, refuse to register a transfer of a certificated share which is not fully paid, provided that the refusal does not prevent dealings in the Company form taking place on an open and proper basis. The Board may also refuse to register the transfer of a certificated share unless the instrument of transfer is (i) lodged, duly stamped (if stampable), at the office or at another place appointed by the Board, accompanied by the certificate for the shares to which it relates and such other evidence as the Board may reasonably require to show the right of the transfer to make the transfer; (ii) in respect of only one class of shares; and (iii) in favour of not more than four transferees.

## ARTICLES OF ASSOCIATION

The Articles of Association of the Company can be amended only by special resolution.

# DIRECTORS' REPORT CONTINUED

## APPOINTMENT AND RETIREMENT OF DIRECTORS

Unless otherwise determined by ordinary resolution, the number of Directors shall be no less than three but is not subject to any maximum number. The Board may appoint a person who is willing to act to be a Director, either to fill a vacancy or as an additional Director.

At every Annual General Meeting ("AGM") all the Directors at the date of the notice convening the AGM shall retire from office, if the Company does not fill the vacancy at the meeting the retiring Director shall, if willing to act, be deemed to have been re-appointed unless at the meeting it is resolved not to fill the vacancy or unless a resolution for the re-appointment of the Director is put to the meeting and lost.

A person ceases to be a Director as soon as:

(i) notification is received by the Company from the Director that they are resigning or retiring from office;

(ii) that person has been absent for more than six consecutive months without permission of the Board and the Board resolves that their office be vacated;

(iii) the person has become physically or mentally incapable of acting as a Director and may remain so for more than three months;

(iv) a bankruptcy order is made against that person;

(v) a composition is made with that person's creditors generally in satisfaction of that person's debts;

(vi) that person ceases to be a Director by virtue of any provision of the Act or is prohibited from being a Director by law; or

(vii) that person is removed from office pursuant to the Articles of Association.

## POWERS OF THE BOARD

Subject to provisions of the Companies Act 2006 and the Articles of Association and to any directions given by special resolution, the business of the Company shall be managed by the Board who may exercise all the powers of the Company.

## DIVIDENDS

At the time of the IPO, the Directors indicated an intention to adopt a progressive dividend policy, reflecting the cash-generative nature and long-term earnings potential of the Group. The Directors have recommended that the Company pay a final dividend in relation to the year-ended 31 March 2016 of 1.1 US Cents per share. Subject to shareholder approval, combined with the interim dividend announced of 0.7 US Cents per share, this gives a total dividend for the year of 1.8 US Cents per share.

## ANNUAL GENERAL MEETING

The notice of the AGM which sets out the resolutions to be proposed at the AGM accompanies this annual report. The AGM will be held at 15:00 on 14 September 2016 at The Pentagon, Abingdon Science Park, Abingdon, OX14 3YP.

## EMPLOYEES

The Group continues to invest to drive future growth. A key objective of the Group is to achieve a shared commitment by all employees to the success of the business. Throughout the Group there is consultation between employees and management on matters of mutual interest and information is disseminated through team and Company briefings, an intranet and individual development reviews. Employees are encouraged to promote and participate in the progress and profitability of the Group through the share option plans and other incentive schemes.

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

## RESEARCH AND DEVELOPMENT

The Group continues to undertake research and development activity relating to its principal activities. In the year-ended 31 March 2016, the Group spent 18.6 percent of its billings on research and development (2015: 17.2 percent).

## POLITICAL DONATIONS

The Group's policy is not to make any political donations. Accordingly, no political donations have been made in the year-ended 31 March 2016 or the year-ended 31 March 2015.

## SHARE OPTION PLANS

The Group operates a number of share option plans to motivate and retain staff and align their interests with shareholders. Details of these schemes are set out in note 30 to the Financial Statements.

## FINANCIAL INSTRUMENTS

Details of the Group's financial risk management policies and risks are set out in note 27 to the Financial Statements.

## AUTHORITY TO ALLOT SHARES AND AUTHORITY TO PURCHASE OWN SHARES

At a general meeting held on 28 June 2015 the Company was authorised to make market purchases (within the meaning of section 693(4)) of the Companies Act 2006) up to 45,000,000 shares. The Company was given authority by way of written resolution of the shareholders of the Company on 26 June 2015 to issue up to an aggregate nominal amount of £1,500,000,000.

## SHARES HELD IN THE EMPLOYEE BENEFIT TRUST

The Trustees of the Employee Benefit Trust will abstain from voting or exercising any other rights in respect of any shares held by them and in which no beneficial interest is held by any beneficiary unless otherwise directed by the Company.

## GREENHOUSE GAS EMISSIONS

The Greenhouse Gas Emissions ("GHG") disclosures for the Group have been shown for the year-ended 31 March 2016, consistent with the Group's financial year. As this is the first year that the Group is required to disclose the GHG data, no comparatives have been shown. The calculation of the disclosures has been performed in accordance with Greenhouse Gas Protocol Corporate Standard and using the UK government's DEFRA conversion factor guidance for the year reported.

The operations of the Group that primarily release GHG includes usage of electricity and gas of our owned and leased offices, business travel and usage of vehicles. The current year reporting covers all of our material operations and locations which includes over 75 percent of our year-end employees. Where information has not been directly available for the offices, estimates based on size and headcount have been applied. The Group is developing its GHG data gathering capabilities that will, in the coming year, increase the breadth of data captured as well as the number of offices for which direct information is available.

The Group's chosen intensity ratio is tonnes of $CO_2$ equivalent per million US Dollars of billings as it reflects the impact of the growth of the business with emissions and with the strategy of the Group.

| Year-ended 31 March 2016 | $tCO_2e$ |
|---|---|
| Usage of fuel and operation of buildings | 2,099.3 |
| Electricity purchased for own use | 3,024.7 |
| Business travel (air and car) | 4,039.4 |
| **Total** | 9,163.4 |
| Intensity ratio – $tCO_2e$ per $M of billings | 17.1 |

## GOING CONCERN

Having made appropriate enquiries and considered the Group's forecasts, the Directors consider that the Group has sufficient resources to continue for the foreseeable future. Accordingly, they continue to adopt the going concern basis in preparing the Financial Statements. Further details regarding the adoption of the going concern basis can be found in the viability statement below.

## VIABILITY STATEMENT

The Directors have assessed the viability of the Group over a three-year period, taking into account the Group's current position and the potential impacts of the principal risks documented on pages 30 to 33 of the Annual Report. Based on this assessment, the Directors confirm that they have a reasonable expectation that the Company will be able to continue to operate and to meet its liabilities as they fall due over the three years to 31 March 2019.

The Group prepares annually, and on a rolling basis, a strategic plan, which is predicated on a detailed year one budget and higher level forecasts thereafter. The output of this plan is used to perform debt and associated covenant headroom profile analysis, which includes sensitivity to business as usual risks such as billings and EBITDA impacts. A bottom-up operating plan is prepared on an annual basis for presentation to the Board.

Following assessment of the planning process, the Directors have determined that a three-year period is an appropriate period over which to assess the Group's viability. Whilst the Directors have no reason to believe that the Group will not be viable over a longer period; the period of three years has been chosen to provide a greater degree of certainty and, in the view of the Directors, provides an appropriate long-term outlook.

In making this viability statement, the Board carried out a robust assessment of the principal risks facing the Group, including those that would threaten its business model, future performance, solvency or liquidity. Where individual principal risks did not impact the future viability of the Group, consideration was given to potential principal risk combinations. The process of identifying, assessing and managing our principal risks is described in the Audit and Risk Committee Report on pages 46 to 51.

# DIRECTORS' REPORT CONTINUED

## POST BALANCE SHEET EVENTS

There have been no material events from 31 March 2016 to the date of this report.

## AUDITORS

KPMG LLP has expressed their willingness to continue in office as auditors of the Company and accordingly a resolution for the re-appointment of KPMG LLP as auditors of the Company is to be proposed to the shareholders at the AGM.

## DISCLOSURE OF INFORMATION TO AUDITORS

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

## STATEMENT OF DIRECTORS' RESPONSIBILITIES IN RESPECT OF THE ANNUAL REPORT AND THE FINANCIAL STATEMENTS

The Directors are responsible for preparing the Annual Report and the group and parent company financial statements in accordance with applicable law and regulations.

Company law requires the Directors to prepare group and parent company financial statements for each financial year. Under that law they are required to prepare the group financial statements in accordance with IFRSs as adopted by the EU and applicable law and have elected to prepare the parent company financial statements in accordance with UK Accounting Standards, including FRS 102, the Financial Reporting Standard applicable in the UK and Republic of Ireland.

Under company law the Directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the group and parent company and of their profit or loss for that period. In preparing each of the group and parent company financial statements, the Directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and estimates that are reasonable and prudent;
- for the group financial statements, state whether they have been prepared in accordance with IFRSs as adopted by the EU; and
- for the parent company financial statements, state whether applicable UK Accounting Standards have been followed, subject to any material departures disclosed and explained in the financial statements.

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

Under applicable law and regulations, the Directors are also responsible for preparing a Strategic Report, Directors' Report, Directors' Remuneration Report and Corporate Governance Statement that complies with that law and those regulations.

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

## RESPONSIBILITY STATEMENT OF THE DIRECTORS IN RESPECT OF THE ANNUAL FINANCIAL REPORT

We confirm that to the best of our knowledge:

- the financial statements, prepared in accordance with the applicable set of accounting standards, give a true and fair view of the assets, liabilities, financial position and profit or loss of the company and the undertakings included in the consolidation taken as a whole; and
- the strategic report includes a fair review of the development and performance of the business and the position of the issuer and the undertakings included in the consolidation taken as a whole, together with a description of the principal risks and uncertainties that they face.

By order of the Board

**D Ari Buchler**
**Company Secretary**
25 May 2016

# INDEPENDENT AUDITOR'S REPORT

## INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF SOPHOS GROUP PLC ONLY

### Opinions and conclusions arising from our audit

### 1. Our opinion on the financial statements is unmodified

We have audited the financial statements of Sophos Group plc for the year-ended 31 March 2016 set out on pages 75 to 122. In our opinion:

- the financial statements give a true and fair view of the state of the Group's and of the Parent Company's affairs as at 31 March 2016 and of the Group's loss for the year then ended;
- the group financial statements have been properly prepared in accordance with International Financial Reporting Standards as adopted by the European Union;
- the parent company financial statements have been properly prepared in accordance with UK Accounting Standards FRS 102 The Financial Reporting Standard applicable in the UK and Republic of Ireland; and
- the financial statements have been prepared in accordance with the requirements of the Companies Act 2006; and, as regards the group financial statements, Article 4 of the IAS Regulation.

### 2. Our assessment of risks of material misstatement

In arriving at our audit opinion above on the financial statements the risks of material misstatement that had the greatest effect on our audit, in decreasing order of audit significance, were as follows:

**Revenue ($478.2m)**
Refer to the Audit and Risk Committee Report on pages 46 to 51 and note 5 on page 91 (notes to the consolidated financial statements).

*The Risk:*
As the Group expands and product portfolios evolve, there can be considerable risk associated with recognising revenue on contracts containing multiple elements. A significant audit risk has been recognised with regards to such multiple element arrangements as judgement is required in allocating the consideration receivable to each element of the arrangement. This requires the fair value for each separable element of the arrangement to be estimated. In estimating the relative fair values of each element, management make reference to list prices of individual elements and discounts given on the total contract. This judgement could materially affect the timing and quantum of revenue and profit recognised in each period.

*Our Response:*
Our procedures included evaluating the operating effectiveness of revenue allocation controls, including IT system controls and assessing the appropriateness of the Group's principles in determining the relative fair value of each separable element of the arrangement against applicable accounting standards. We selected a sample of Group billings from throughout the year and recalculated the relative fair values of each element to assess if the determination of relative fair values of each separable element was in in line with Group Policy. We also assessed the adequacy of the Group's disclosure about estimation uncertainty regarding the determination of fair values of multiple element arrangements.

**Carrying Value of Intangible Assets and Goodwill ($756.6m)**
Refer to the Audit and Risk Committee Report on pages 46 to 51 and note 17 on pages 98 (notes to the consolidated financial statements).

*The Risk:*
The Group carries significant goodwill and intangible assets, resulting from business acquisitions across several geographic locations. There is a risk that the carrying value of goodwill and intangible assets is not supported by the performance of the Group in geographies where global and local economic conditions have negatively affected profitability, or where there are poor trading conditions. Management tests the Group's goodwill and indefinite life intangible assets for impairment annually, and definite life intangible assets whenever there is an indication of an impairment. Due to the inherent uncertainty involved in forecasting and discounting future cash flows which forms the basis of the recoverability assessment and the subjectivity of key assumptions in impairment models, this is one of the key judgmental areas on which our audit is focused.

# INDEPENDENT AUDITOR'S REPORT CONTINUED

*Our Response:*
Our audit procedures included evaluating through examination of trading performance, consideration of economic and market data, and queries of management, whether indicators of impairment such as significant changes in business environment have been identified and assessing whether these have been appropriately evaluated in the Group's impairment evaluation process and models.

We assessed the rigour of the Group's budget and discounted cash flow forecast impairment models used to support the carrying value of intangible assets and goodwill. We challenged the assumptions for key inputs used by management in their forecasts such as projected market growth, future capital expenditure levels, revenue growth rates, inflation, and cost projections, and compared them to externally derived data where relevant, as well as our expectations based on our knowledge and experience of the Group. We evaluated the historical accuracy of the Group's forecasts by comparing actual to budgeted results. We applied specialist impairment tools to perform a sensitivity analysis over key assumptions and discount rates used to assess the impact on recoverability of the assets.

We compared the results of the discounted cash flows against the Group's market capitalisation to determine if there were any significant differences that required further examination

We also considered the adequacy of the Group's disclosures in respect of the sensitivities and key risks inherent in those calculations and if they have met the requirements of relevant accounting standards.

**Classification of Exceptional Expenses ($41.9m) and Presentation of Non-GAAP Measures**
Refer to the Audit and Risk Committee Report on pages 46 to 51 and note 7 on page 91 (notes to the consolidated financial statements).

*The Risk:*
The Group presents alternative income statement measures to operating loss for the period within the consolidated income statement and throughout the Annual Report. The Directors believe that the separate identification of exceptional items and the presentation of the following Non-GAAP measures of Billings ($534.9m), Cash EBITDA ($120.9m), and Unlevered Free Cash Flow ($46.4m), provides clear and useful information on the Group's underlying trading performance. However, when improperly used and presented, these kind of measures might prevent the Annual Report from being fair, balanced and understandable by focusing on only part of the performance. The determination of whether an item should be separately disclosed as an exceptional item or other adjustments requires judgement on its nature and incidence, as well as whether it provides a better understanding of the Group's underlying trading performance. Therefore, this is one of the key judgement areas on which our audit is concentrated.

Exceptional items in the current year comprised of Initial Public Offering Costs ($17.8m), acquisition related expenses ($1.7m), restructuring and integration costs ($2.6m) and litigation costs ($19.8m).

*Our Response:*
Our audit procedures included assessing and challenging the judgements made by Directors of the Group regarding their determination of exceptional items and other adjustments in the presentation of Non-GAAP measures. We evaluated the presentation and completeness of material or unusual transactions for appropriate classification within the financial statements by assessing whether these items fulfil the criteria to require separate disclosure in accordance with IAS 1 "Presentation of financial statements". We also assessed whether, in judging what to include in exceptional items, the Directors took appropriate regard to guidance issued by the Financial Reporting Council on the reporting of exceptional items. We then assessed the application of these principles by assessing whether the approach taken to identify exceptional items was consistent between gains and losses; assessing whether the same category of material items are treated consistently each year; assessing whether the tax effects of exceptional items are explained; by agreeing amounts incurred in the year to underlying documentation and supporting information; and by using our knowledge of the Group's transactions throughout the audit to consider the completeness of exceptional items.

We assessed whether the separate disclosure and related commentary of exceptional items and alternative Non-GAAP measures of Billings, Cash EBITDA and Unlevered Cash Flow throughout the Annual Report and Accounts placed disproportionate emphasis on those component of performance; whether the alternative measures provided meaningful measures of trading performance; whether adjusted results and alternate measures were adequately reconciled to IFRS numbers with sufficient prominence given to that reconciliation; and whether the underlying financial information is not otherwise misleading.

## 3. Our application of materiality and an overview of the scope of our audit

Materiality for the Group financial statements as a whole was set at $4.78m (2015: $6.5m), determined with reference to a benchmark of Group revenue, of which it represents 1% (2015: 1.5%). We consider revenue to be the most appropriate benchmark as it provides a more stable measure year on year than Group Loss before tax. We note as indicated above, that with the increased risks associated as a listed entity, materiality has decreased year on year.

We reported to the Audit Committee all corrected or uncorrected identified misstatements exceeding $0.235m (2015: $0.3m), in addition to other identified misstatements that warranted reporting on qualitative grounds.

Of the Group's 28 (2015: 25) reporting components, we subjected 10 (2015: 10) to audits for group reporting purposes and 2 (2015: 2) to specified risk-focused audit procedures. The latter were not individually significant enough to require an audit for group reporting purposes, but did present specific individual risks that needed to be addressed.

The components within the scope of our work accounted for the following percentages of the group's results:


The Group team instructed component auditors as to the significant areas to be covered, including the relevant risks detailed above and the information to be reported back. The Group team approved the component materialities, which ranged from $2.75m to $3.9m (2015: $3m to $4.2m), having regard to the mix of size and risk profile of the Group across the components. The work on 6 of the 12 components (2015: 6 of the 12 components) was performed by component auditors and the rest by the Group team.

The Group team visited 2 (2015: 1) component locations in Germany and India (2015: Germany). Telephone conference meetings were also held with these component auditors and all others that were not physically visited. At these visits and meetings, the findings reported to the Group team were discussed in more detail, and any further work required by the Group team was then performed by the component auditor.

# INDEPENDENT AUDITOR'S REPORT CONTINUED

### 4. Our opinion on other matters prescribed by the Companies Act 2006 is unmodified

In our opinion:

- the part of the Directors' Remuneration Report to be audited has been properly prepared in accordance with the Companies Act 2006; and
- 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.

### 5. We have nothing to report on the disclosures of principal risks

Based on the knowledge we acquired during our audit, we have nothing material to add or draw attention to in relation to:

- the Directors' Viability Statement on page 69, concerning the principal risks, their management, and, based on that, the Directors' assessment and expectations of the Group's continuing in operation over the 3 years to 31 March 2019; or
- the disclosures in note 3.2 of the financial statements concerning the use of the going concern basis of accounting.

### 6. We have nothing to report in respect of the matters on which we are required to report by exception

Under ISAs (UK and Ireland) we are required to report to you if, based on the knowledge we acquired during our audit, we have identified other information in the annual report that contains a material inconsistency with either that knowledge or the financial statements, a material misstatement of fact, or that is otherwise misleading.

In particular, we are required to report to you if:

- we have identified material inconsistencies between the knowledge we acquired during our audit and the Directors' statement that they consider that the annual report and financial statements taken as a whole is fair, balanced and understandable and provides the information necessary for shareholders to assess the group's position and performance, business model and strategy; or
- the Audit Committee Report does not appropriately address matters communicated by us to the Audit Committee.

Under the Companies Act 2006 we are required 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 and the part of the Directors' Remuneration Report to be audited 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.

Under the Listing Rules we are required to review:

- the Directors' statements, set out on page 69, in relation to going concern and longer-term viability; and
- the part of the Corporate Governance Statement on pages 40 to 44 relating to the company's compliance with the eleven provisions of the 2014 UK Corporate Governance Code specified for our review.

We have nothing to report in respect of the above responsibilities.

## SCOPE AND RESPONSIBILITIES

As explained more fully in the Directors' Responsibilities Statement set out on page 70, the Directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view. A description of the scope of an audit of financial statements is provided on the Financial Reporting Council's website at *www.frc.org.uk/auditscopeukprivate*. This report is made solely to the company's members as a body and is subject to important explanations and disclaimers regarding our responsibilities, published on our website at *www.kpmg.com/uk/auditscopeukco2014a*, which are incorporated into this report as if set out in full and should be read to provide an understanding of the purpose of this report, the work we have undertaken and the basis of our opinions.

**Tudor Aw (Senior Statutory Auditor)**
**for and on behalf of KPMG LLP, Statutory Auditor**
Chartered Accountants
15 Canada Square
London
E14 5GL
25 May 2016

# CONSOLIDATED STATEMENT OF PROFIT OR LOSS

For the year-ended 31 March 2016

| | Note | Year-ended 31 March 2016 $M | Year-ended 31 March 2015 $M |
|---|---|---|---|
| **Revenue** | 5 | 478.2 | 446.7 |
| Cost of sales | | (104.4) | (89.3) |
| **Gross profit** | | 373.8 | 357.4 |
| Sales and marketing | | (184.0) | (175.4) |
| Research and development | | (99.6) | (81.8) |
| General finance and administration: | | (122.9) | (100.7) |
| – Underlying | | (35.7) | (36.9) |
| – Share-based payments | | (16.3) | (1.5) |
| – Exceptional items | 7 | (41.9) | (17.3) |
| – Amortisation of intangible assets | | (29.2) | (47.6) |
| – Foreign exchange gain | | 0.2 | 2.6 |
| **Operating loss** | | (32.7) | (0.5) |
| Finance income | 12 | 0.7 | 1.1 |
| Finance expense | 12 | (36.4) | (54.9) |
| **Loss before taxation** | | (68.4) | (54.3) |
| Income tax charge | 13 | (3.5) | (5.7) |
| **Loss for the period** | | (71.9) | (60.0) |
| Earnings per Share ($ cents) | | | |
| Basic and diluted EPS | 14 | (16.4) | (14.7) |
| Adjusted EPS | 14 | 27.5 | 24.8 |

All of the loss for the year is attributable to equity shareholders of the parent company.

The notes on pages 80 to 118 form an integral part of these financial statements.

# CONSOLIDATED STATEMENT OF OTHER COMPREHENSIVE INCOME

For the year-ended 31 March 2016

| | Year-ended 31 March 2016 $M | Year-ended 31 March 2015 $M |
|---|---|---|
| Loss for the period | (71.9) | (60.0) |
| **Other comprehensive losses:** | | |
| **Items that will not be reclassified subsequently to profit or loss:** | – | – |
| **Items that may be reclassified subsequently to profit or loss:** | | |
| – Exchange differences arising on translation of foreign operations | (2.9) | (7.1) |
| **Total other comprehensive losses** | (2.9) | (7.1) |
| **Comprehensive loss for the year** | (74.8) | (67.1) |

All of the comprehensive loss for the year is attributable to equity shareholders of the parent company.

The notes on pages 80 to 118 form an integral part of these financial statements.

# CONSOLIDATED STATEMENT OF FINANCIAL POSITION

At 31 March 2016

Registered number 9608658

| | Note | 31 March 2016 $M | 31 March 2015 $M |
|---|---|---|---|
| **Non-current assets** | | | |
| Intangible assets | 15 | 756.6 | 719.3 |
| Property, plant and equipment | 16 | 24.9 | 25.1 |
| Deferred tax asset | 18 | 73.9 | 47.2 |
| Other receivables | 19 | 0.8 | 0.4 |
| | | 856.2 | 792.0 |
| **Current assets** | | | |
| Investments | 22 | – | 0.6 |
| Inventories | 20 | 18.7 | 12.5 |
| Trade and other receivables | 19 | 129.8 | 110.5 |
| Cash and cash equivalents | 21 | 66.8 | 72.6 |
| | | 215.3 | 196.2 |
| **Total assets** | | 1,071.5 | 988.2 |
| **Current liabilities** | | | |
| Trade and other payables | 23 | 76.4 | 557.0 |
| Deferred revenue | 24 | 286.5 | 251.4 |
| Income tax payable | | 11.2 | 10.7 |
| Financial liabilities | 25 | 26.2 | 2.9 |
| Provisions | 26 | 0.3 | 0.7 |
| | | 400.6 | 822.7 |
| **Non-current liabilities** | | | |
| Trade and other payables | 23 | 0.8 | 0.7 |
| Deferred revenue | 24 | 212.2 | 181.9 |
| Financial liabilities | 25 | 300.9 | 377.8 |
| Provisions | 26 | 1.0 | 0.3 |
| Deferred tax liabilities | 18 | 10.1 | 10.6 |
| | | 525.0 | 571.3 |
| **Total liabilities** | | 925.6 | 1,394.0 |
| | | | |
| **Net assets/(liabilities)** | | 145.9 | (405.8) |
| **Represented by:** | | | |
| Share capital | 28 | 21.3 | 552.6 |
| Share premium | | 115.9 | – |
| Merger reserve | | (200.9) | (200.9) |
| Other reserves | | (0.1) | 10.4 |
| Retained earnings/(deficit) | | 205.7 | (750.0) |
| Share-based payment reserve | | 36.2 | 11.4 |
| Translation reserve | | (32.2) | (29.3) |
| **Total equity** | | 145.9 | (405.8) |

These financial statements were approved by the Board of Directors on 25 May 2016, and were signed on its behalf by:

**Nick Bray**

**Chief Financial Officer**

The notes on pages 80 to 118 form an integral part of these financial statements.

# CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

For the year-ended 31 March 2016

| | Share Capital $M | Share Premium $M | Merger Reserve $M | Other Reserves[1] $M | Retained Earnings $M | Share-Based Payment Reserve $M | Translation Reserve $M | Total $M |
|---|---|---|---|---|---|---|---|---|
| At 1 April 2014[2] | 552.6 | – | (200.9) | 10.4 | (690.0) | 10.0 | (22.2) | (340.1) |
| Loss for the period: | – | – | – | – | (60.0) | – | – | (60.0) |
| Other comprehensive profit or loss: | – | – | – | – | – | – | (7.1) | (7.1) |
| Total comprehensive loss | – | – | – | – | (60.0) | – | (7.1) | (67.1) |
| Share-based payments expense | – | – | – | – | – | 1.4 | – | 1.4 |
| At 31 March 2015 | 552.6 | – | (200.9) | 10.4 | (750.0) | 11.4 | (29.3) | (405.8) |
| Loss for the period: | – | – | – | – | (71.9) | – | – | (71.9) |
| Other comprehensive profit or loss: | – | – | – | – | – | – | (2.9) | (2.9) |
| Total comprehensive loss | – | – | – | – | (71.9) | – | (2.9) | (74.8) |
| Reserve transfer | – | – | – | (10.4) | 10.4 | – | – | – |
| Shares issued[3] | – | 485.3 | – | – | – | – | – | 485.3 |
| Capital reduction[4] | (533.1) | (485.2) | – | – | 1,020.4 | – | – | 2.1 |
| EBT treasury shares | – | – | – | (0.2) | – | – | – | (0.2) |
| Primary proceeds | 1.7 | 123.3 | – | – | – | – | – | 125.0 |
| Share issue expenses | – | (8.6) | – | – | – | – | – | (8.6) |
| Share options exercised | 0.1 | 1.1 | – | – | – | – | – | 1.2 |
| Disposal of EBT treasury shares | – | – | – | 0.1 | (0.1) | – | – | – |
| Share-based payments expense | – | – | – | – | – | 15.0 | – | 15.0 |
| Share-based payments deferred tax | – | – | – | – | – | 9.8 | – | 9.8 |
| Cash dividend (note 29) | – | – | – | – | (3.1) | – | – | (3.1) |
| **At 31 March 2016** | 21.3 | 115.9 | (200.9) | (0.1) | 205.7 | 36.2 | (32.2) | 145.9 |

1 At 31 March 2016 other reserves comprise own shares held in an Employment Benefit Trust.

2 Sophos Group plc listed its shares on the London Stock Exchange on 1 July 2015. The Group has applied the principles of reverse acquisition accounting under IFRS 3 – Business Combinations in preparing the consolidated financial statements. By applying the principles of reverse acquisition accounting, the Group is presented as if Sophos Group plc has always owned Shield Midco Limited, the largest company for which consolidated financial statements were previously produced under IFRS. On 26 June 2015 Sophos Group issued 333,037 Ordinary, A-Class and C shares of £0.75 each together with 1,009,869 Preference shares of £0.10 each in consideration for the purchase of the issued share capital of Pentagon Holdings SARL.

3 On 26 June 2015 Sophos Group plc issued 14 shares at nominal £0.001 in consideration for the purchase of $485.3m of Preferred Equity Certificates issued by Pentagon Holdings SARL.

4 On 1 July 2015 Sophos Group plc reorganised its share capital and share premium to comprise 414,654,813 Ordinary shares of £0.03 each creating distributable reserves.

The notes on pages 80 to 118 form an integral part of these financial statements.

# CONSOLIDATED STATEMENT OF CASH FLOWS

For the year-ended 31 March 2016

| | Note | Year-ended 31 March 2016 $M | Year-ended 31 March 2015 $M |
|---|---|---|---|
| Loss for the year | | (71.9) | (60.0) |
| Adjusted for: | | | |
| Depreciation | | 8.4 | 8.3 |
| Amortisation of intangible assets | | 29.2 | 47.6 |
| Amortisation of fair value adjustment on deferred income | | (1.8) | (3.5) |
| Foreign exchange | | 2.4 | (2.0) |
| Share-based payments | 30 | 15.0 | 1.4 |
| Finance income | 12 | (0.7) | (1.1) |
| Finance costs | 12 | 36.4 | 54.9 |
| Income tax charge | | 3.5 | 5.7 |
| | | 20.5 | 51.3 |
| Increase in inventories | | (6.7) | (8.1) |
| increase in trade and other receivables | | (16.1) | (15.8) |
| (Decrease)/increase in trade and other payables | | (10.9) | 27.0 |
| Increase in deferred revenue | | 59.4 | 32.7 |
| Increase/(decrease) in provisions | | 0.3 | (1.5) |
| **Cash generated from continuing operations** | | 46.5 | 85.6 |
| Income taxes paid | | (25.2) | (25.7) |
| **Net cash flow from operating activities** | | 21.3 | 59.9 |
| **Investing activities** | | | |
| Disposal of subsidiary undertakings | 34 | – | 4.5 |
| Purchase of property, plant and equipment | | (8.5) | (7.3) |
| Acquisition of subsidiaries net of cash acquired | 34 | (46.0) | (10.2) |
| Purchase of intangible assets – software | | (8.3) | (7.6) |
| Proceeds on sale of assets | | – | 3.0 |
| Finance income | 12 | 0.7 | 1.1 |
| **Net cash flow from investing activities** | | (62.1) | (16.5) |
| **Financing activities** | | | |
| Proceeds from issue of shares | | 126.2 | – |
| Transaction costs related to the issue of shares | | (8.6) | – |
| Dividends paid | | (3.1) | – |
| Proceeds from borrowings | 34 | 326.9 | – |
| Repayment of borrowings | 34 | (389.6) | (4.0) |
| Transaction costs related to borrowings | 34 | (4.4) | (0.2) |
| Finance lease payments | | (0.1) | (0.1) |
| Finance costs | | (12.9) | (21.8) |
| **Net cash flow from financing activities** | | 34.4 | (26.1) |
| **(Decrease)/increase in cash and cash equivalents** | | (6.4) | 17.3 |
| Net foreign exchange differences | | 0.6 | (8.8) |
| Cash and cash equivalents at the start of period | | 72.6 | 64.1 |
| **Cash and cash equivalents at the end of period** | 21 | 66.8 | 72.6 |

The notes on pages 80 to 118 form an integral part of these financial statements.

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year-ended 31 March 2016

## 1 GENERAL INFORMATION

### Reporting entity

Sophos Group plc ("the Company") is a company domiciled in the United Kingdom. The Company's registered office is Sophos Group plc, The Pentagon, Abingdon Science Park, Abingdon, Oxfordshire, OX14 3YP, United Kingdom. The consolidated financial statements of the Company as at and for the year-ended 31 March 2016 comprise the Company and its subsidiaries (together referred to as "the Group"). The Group is a leading provider of cloud enabled enduser and network security solutions.

Prior to the Initial Public Offering of the Company's shares, Shield Midco Limited was the largest Company for which consolidated financial statements were produced. Statutory accounts for that company for the year-ended 31 March 2015 were approved by the Board of Directors on 1 June 2015 and were delivered to the Registrar of Companies. The report of the auditors on those accounts was unqualified, did not contain an emphasis of matter paragraph and did not contain any statement under Section 498 of the Companies Act 2006.

## 2 APPLICATION OF NEW AND REVISED INTERNATIONAL FINANCIAL REPORTING STANDARDS ("IFRSs")

The Group has not applied the following new and revised IFRSs that have been issued but are not yet effective. The Directors are still evaluating the impact on the Group of IFRS 16 – Leases, which was issued in January 2016 and becomes effective for annual periods beginning on or after January 2019. The Directors do not anticipate that the following IFRSs will have a significant effect on the Group's consolidated financial information:

Effective for annual periods beginning on or after January 2016:

Amendments to IFRS 10 – "Consolidated Financial Statements"

Amendments to IFRS 11 – "Joint Arrangements"

Amendments to IFRS 12 – "Disclosure of Interests in Other Entities"

Amendments to IAS 16 – "Property, Plant and Equipment"

Amendments to IAS 27 – "Separate Financial Statements"

Amendments to IAS 28 – "Investments in Associates and Joint Ventures"

Amendments to IAS 38 – "Intangible Assets"

Effective for annual periods beginning on or after January 2017:

Amendments to IAS 7 – Statement of Cash Flows

Amendment to IAS12 – Income Taxes

Effective for annual periods beginning on or after January 2018:

IFRS 9 (2014) – "Financial Instruments"

Based on the latest available guidance, the Directors have made an initial assessment of the impact of IFRS 15 "Revenue from contracts with customers", which is effective for annual periods beginning on or after 1 January 2018, and have concluded that there may be a material impact on the Group's consolidated financial information as a result of the deferral of commissions and rebates in line with the recognition of revenue, and the accelerated recognition of certain software revenue where the Group has no remaining vendor obligations. The provisional estimate of this impact on results, had it been effective for the reported periods, is summarised as follows:

| | 2016 $M | 2015 $M |
|---|---|---|
| Increase in revenue | 3.4 | 5.0 |
| Decrease/(increase) in expenses | 0.2 | 3.4 |
| Increase in operating profit | 3.6 | 8.4 |
| Increase/(decrease) in cash EBITDA | 0.2 | 3.4 |
| Increase in other receivables | 20.5 | 20.8 |
| Decrease in deferred revenue | 25.2 | 21.3 |

# 3 SIGNIFICANT ACCOUNTING POLICIES

## 3.1 Statement of compliance

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

## 3.2 Going Concern

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

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

Further information regarding the Group's business activities, together with the factors likely to affect its future development, performance and position is set out in the Strategic Report on pages 6 to 37. Further information regarding the financial position of the Group, its cash flows, liquidity position and borrowing facilities are described in the Strategic Report and the notes to the financial statements. In addition, note 27 to the financial statements includes the Group's objectives, policies and processes for managing its capital, its financial risk management objectives, and its exposures to credit risk and liquidity risk.

## 3.3 Basis of consolidation

The consolidated historical financial information has been prepared under the historical cost convention and is presented in US Dollars. All values are rounded to the nearest 0.1 million ($M) unless otherwise indicated. The functional currency of Sophos Group plc is US Dollars. The Group uses US Dollars as its presentation currency to aid comparability of its financial information with that of its peers; whose information is generally presented in US Dollars.

The accounting policies used in preparing the consolidated historical financial information for the year-ended 31 March 2016 have been consistently applied to all years presented and are set out below.

The historical financial information consolidates the financial information of Sophos Group plc and the entities it controls (its subsidiaries) at 31 March 2016. Control is achieved where the Company has the power to govern the financial and operating policies of an investee entity so as to obtain benefits from its activities.

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

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

All intra-Group balances, transactions, income and expenses and profits and losses resulting from intra-Group transactions that are recognised in the statement of financial position of the individual reporting entities, are eliminated in full on consolidation.

## 3.4 Foreign currency translation

The individual historical financial information of each Group company is prepared in the currency of the primary economic environment in which it operates (its functional currency). Each entity in the Group determines its own functional currency and items included in the historical financial information of each entity are measured using that functional currency.

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

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

On disposal of a foreign entity, the deferred accumulated amount recognised in equity relating to that particular foreign operation is recognised in the consolidated statement of profit or loss.

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS CONTINUED

For the year-ended 31 March 2016

## 3 SIGNIFICANT ACCOUNTING POLICIES CONTINUED

### 3.5 Critical accounting judgments and key sources of estimation uncertainty

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

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

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

#### Revenue

The Group sells software products under fixed term contracts and perpetual licences. Where there is a multi-element arrangement, the consideration receivable is allocated to each element of the arrangement and this is done on the basis of an estimate of their respective fair values. In determining the relative fair values of each element, management make reference to current prices of individual elements and adjust this by its relative share of discounts applied to the entire sale.

#### Deferred taxation

Deferred tax assets are recognised for all unused tax losses to the extent that it is probable that taxable profit will be available against which the losses can be utilised. Management judgment is required to determine the amount of deferred tax assets that can be recognised, based upon the likely timing and level of future taxable profits, together with future tax planning strategies. Further details are contained in note 18.

#### Impairment of goodwill and intangibles

The Group determines whether goodwill and intangible assets are impaired on at least an annual basis. This requires an estimation of the "value in use" of the cash-generating units to which the goodwill and intangible assets are allocated. Estimating a value in use amount requires management to make an estimate of the expected future cash flows from the cash-generating unit and also to choose a suitable discount rate in order to calculate the present value of those cash flows.

#### Share-based payments transactions

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

The fair value of Restricted share units and Performance share units is equal to the market price of the underlying shares on the day of the grant.

#### Research and development costs

Development costs are capitalised in accordance with the accounting policy in this note. Determining the amounts to be capitalised requires management to make assumptions regarding the capitalisation criteria requirements of IAS 38 – Intangible assets.

#### Business combinations

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

#### Provisions

The Group measures provisions at management's best estimate of the amount required to settle the obligation at the balance sheet date, discounted where the time value of money is considered material. These estimates take account of available information, historical experience and the likelihood of different possible outcomes. Both the amount and the maturity of these liabilities could be different from those estimated.

### 3.6 Revenue recognition

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

#### Revenue from software licenses and service contracts

The Group sells software products under fixed term contracts and perpetual licenses. Where there is multi-element arrangement revenue is allocated to each element on a fair value basis, based on the price at which the respective elements are usually sold separately, regardless of any separate prices stated within the contract. The portion of the revenue allocated to an element is recognised when the revenue recognition criteria for that element has been met.

#### Fixed term contracts

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

Revenue for these fixed rate contracts is recognised rateably over the period that the contractual obligation exists.

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

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

#### Perpetual licenses

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

#### Sale of goods

Where software licenses and hardware and are sold together, if the software is not essential to the functionality of the tangible product, then the revenue from the sale of goods is recognised immediately. However, where the software is essential to the functionality of the tangible product and the hardware cannot function without the software, revenue from the sale of goods is recognised rateably over the period of the associated software license contract.

#### Interest income

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

### 3.7 Property, plant and equipment

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

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

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

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

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

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

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS CONTINUED

For the year-ended 31 March 2016

## 3 SIGNIFICANT ACCOUNTING POLICIES CONTINUED

### 3.8 Business combinations and goodwill

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

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

After initial recognition, goodwill is stated at cost less any accumulated impairment losses, with the carrying value being reviewed for impairment, at least annually and whenever events or changes in circumstances indicate that the carrying value may be impaired. Goodwill assets considered significant in comparison to the Company's total carrying amount of such assets have been allocated to cash-generating units or groups of cash-generating units. Where the recoverable amount of the cash-generating unit is less than its carrying amount including goodwill, an impairment loss is recognised in the consolidated statement of profit or loss.

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

### 3.9 Intangible assets

Intangible assets are carried at cost less accumulated amortisation and accumulated impairment losses.

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

Where computer software is not an integral part of a related item of computer hardware, the software is classified as an intangible asset. The capitalised costs of software for internal use include external direct costs of materials and services consumed in developing or obtaining the software, and incremental payroll and payroll-related costs arising from the assignment of employees to implementation projects. Capitalisation of these costs ceases no later than the point at which the software is substantially complete and ready for its intended internal use.

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

*Intangible assets arising on acquisition of subsidiaries*

| | | |
|---|---|---|
| Intellectual property relating to Unified Threat Management technology | – | 65% reducing balance basis |
| Other intellectual property | – | 35% reducing balance basis |
| Brand names | – | 35% reducing balance basis |
| Customer base | – | 45% – 49% reducing balance basis |
| *Other purchased intangible assets* | | |
| All other intangibles | – | 3 years (straight-line basis) |

The amortisation expense on intangible assets with finite lives is recognised in the consolidated statement of profit or loss as a general finance and administration cost. The amortisation period and the amortisation method for an intangible asset with a finite useful life are reviewed at least annually.

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

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

### 3.10 Research and development costs

Expenditure on research activities is expensed as incurred.

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

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

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

### 3.11 Impairment of assets

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

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

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

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

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

### 3.12 Inventories

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

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

### 3.13 Financial instruments

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

#### Trade receivables

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

#### Cash and cash equivalents

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

#### Trade payables

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

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS CONTINUED

For the year-ended 31 March 2016

## 3 SIGNIFICANT ACCOUNTING POLICIES CONTINUED

### Classification of shares as debt or equity

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

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

Equity instruments issued by the Company are recorded as the proceeds received, net of direct issue costs. Equity instruments are classified according to the substance of the contractual arrangements entered into.

### Interest bearing loans and borrowings

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

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

Gains and losses arising on the re-purchase, settlement or other cancellation of liabilities are recognised respectively in finance income and finance expense.

### Derivative financial instruments

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

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

### 3.14 Leases

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

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

### 3.15 Provisions

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

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

The expense relating to any provision is presented in the consolidated statement of profit or loss net of any reimbursement.

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

### 3.16 Taxation

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

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

As explained under 'Share-based payments' below, a remuneration expense is recorded in the consolidated statement of profit or loss over the period from the award date to the vesting date of the relevant options. Where there is a temporary difference between the accounting and tax bases, a deferred tax asset may be recorded. Any deferred tax asset arising on share option awards is calculated as the estimated amount of tax deduction to be obtained in the future (based on the Group's share price at the reporting date) pro-rated to the extent that the services of the employee have been rendered over the vesting period. If this amount exceeds the cumulative amount of the remuneration expense at the statutory rate, the excess is recorded directly in equity, against retained earnings. Similarly, current tax relief in excess of the cumulative amount of the remuneration expense at the statutory rate is also recorded in retained earnings. Deferred tax assets have only been recognised in jurisdictions in which future tax deductions are expected.

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

Deferred tax is calculated at the tax rates that are expected to apply in the period when the liability is settled or the asset is realised. Deferred tax is charged or credited in the consolidated statement of 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. Deferred tax assets and deferred tax liabilities are offset if a legally enforceable right exists to set off current tax assets against current tax liabilities and the deferred taxes relate to the same taxation authority.

### 3.17 Pensions and other post-retirement benefits

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

### 3.18 Share-based payments

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

The cost of equity-settled transactions with employees is measured by reference to the fair value at the date on which they are granted. The fair value is determined by using an appropriate pricing model, further details of which are given in note 30.

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

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

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

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

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS CONTINUED

For the year-ended 31 March 2016

## 3 SIGNIFICANT ACCOUNTING POLICIES CONTINUED

### 3.19 Exceptional items

Exceptional items are those that in the judgment of the Directors need to be disclosed by virtue of their size, nature or incidence, in order to draw the attention of the reader and to show the underlying business performance of the Group more accurately. Such items are included within the income statement caption to which they relate, and are separately disclosed either in the notes to the consolidated financial statements or on the face of the consolidated income statement.

### 3.20 Events after reporting date

Events between the reporting date and the date the financial statements are approved, favourable and unfavourable, providing evidence of conditions that existed at the reporting date, adjust the amounts recognised in the financial statements. Those that indicate conditions arising after the reporting date are disclosed but are not recognised within the financial statements.

## 4 SEGMENT INFORMATION

For internal management reporting purposes, the primary segment reporting format is determined to be geographic segments as the Group's risks and rates of return are affected predominantly by the different economic environments. This is consistent with the information provided to the Chief Operating Decision Maker. The Group has only one secondary business segment on the basis that the products and services offered to external customers are very similar and therefore do not result in different risks and rates of return for the Group.

The Group's geographical segments are based on the location of the Group's operations consisting of Europe, Middle East and Africa ("EMEA"), The Americas and Asia Pacific and Japan ("APJ").

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

Billings are classified by the geographic location of direct customers, OEMs and the distributors which purchase our products. The geographic location of OEMs or distributors may be different from that of the end customers. A disclosure of revenue by region is included in the Financial Review on page 27.

The accounting policies of the reportable segments are the same as the Group's accounting policies described in note 3. Segment profits represent the profit earned by each segment without allocation of central administration costs including Directors' salaries, finance costs and income tax expense. This is the measure reported to the Chief Operating Decision Maker, the Chief Executive Officer, and Senior Management Team for the purposes of resource allocation and assessment of segment performance.

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

## Geographical segments

The following tables present Billings, expenditure and certain asset information regarding the Group's geographical segments for the year-ended 31 March 2016 and 31 March 2015.

| Year-ended 31 March 2016 | Americas $M | EMEA $M | APJ $M | Total $M |
|---|---|---|---|---|
| Billings | 187.9 | 264.0 | 83.0 | 534.9 |
| Regional cost of sales | (13.3) | (34.6) | (15.8) | (63.7) |
| Regional gross margin | 174.6 | 229.4 | 67.2 | 471.2 |
| Regional sales and marketing expense | (55.4) | (60.2) | (28.1) | (143.7) |
| Regional operating profit | 119.2 | 169.2 | 39.1 | 327.5 |
| Revenue deferral | | | | (56.7) |
| Central costs | | | | (265.9) |
| Amortisation | | | | (29.2) |
| Depreciation | | | | (8.4) |
| Operating loss | | | | (32.7) |

| Year-ended 31 March 2015 | Americas $M | EMEA $M | APJ $M | Total $M |
|---|---|---|---|---|
| Billings | 152.9 | 255.5 | 67.6 | 476.0 |
| Regional cost of sales | (11.1) | (27.7) | (11.3) | (50.1) |
| Regional gross margin | 141.8 | 227.8 | 56.3 | 425.9 |
| Regional sales and marketing expense | (48.0) | (58.1) | (25.9) | (132.0) |
| Regional operating profit | 93.8 | 169.7 | 30.4 | 293.9 |
| Revenue deferral | | | | (29.3) |
| Central costs | | | | (209.2) |
| Amortisation | | | | (47.6) |
| Depreciation | | | | (8.3) |
| Operating loss | | | | (0.5) |

## Other Segment information

| Segment Assets | 31 March 2016 $M | 31 March 2015 $M |
|---|---|---|
| Americas | 311.8 | 290.4 |
| EMEA | 568.1 | 522.7 |
| APJ | 117.7 | 127.3 |
| Total segment assets | 997.6 | 940.4 |
| Unallocated assets | 73.9 | 47.8 |
| Consolidated total assets | 1,071.5 | 988.2 |

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS CONTINUED

For the year-ended 31 March 2016

## 4 SEGMENT INFORMATION CONTINUED

Unallocated assets relate to financial instruments and corporation and deferred tax.

| Depreciation and amortisation | Year-ended 31 March 2016 $M | Year-ended 31 March 2015 $M |
|---|---|---|
| Americas | 7.1 | 12.1 |
| EMEA | 27.8 | 38.6 |
| APJ | 2.7 | 5.2 |
| Total depreciation and amortisation | 37.6 | 55.9 |

| Additions to non-current assets | Year-ended 31 March 2016 $M | Year-ended 31 March 2015 $M |
|---|---|---|
| Americas | 1.8 | 1.4 |
| EMEA | 11.9 | 11.2 |
| APJ | 3.1 | 2.2 |
| Total additions to non-current assets | 16.8 | 14.8 |

Additions to non-current assets exclude financial instruments and deferred tax assets.

| Non-current assets by country | 31 March 2016 $M | 31 March 2015 $M |
|---|---|---|
| UK | 27.5 | 28.3 |
| USA | 2.9 | 2.3 |
| Germany | 2.5 | 2.1 |
| Other countries | 8.1 | 6.4 |
| Total non-current assets by country | 41.0 | 39.1 |

Non-current assets by country exclude financial instruments, goodwill, IP, other intangibles and deferred income taxes.

| Revenue from external customers by country | Year-ended 31 March 2016 $M | Year-ended 31 March 2015 $M |
|---|---|---|
| UK | 58.9 | 59.0 |
| USA | 151.3 | 136.5 |
| Germany | 89.3 | 91.1 |
| Other countries | 178.7 | 160.1 |
| Total revenue from continuing operations | 478.2 | 446.7 |

The Group’s revenue is diversified across its entire end customer base and no single end customer or channel partner accounted for greater than 10% of the Group’s billings; in 2016 two distributors accounted for 17% and 12% each of Group billings which were attributable to all segments of the Group (2015: two distributors at 14% and 13% each).

## 5 REVENUE

Revenue recognised in the Consolidated Statement of profit or loss is analysed as follows:

| | Year-ended 31 March 2016 $M | Year-ended 31 March 2015 $M |
|---|---|---|
| Subscription | 364.7 | 354.8 |
| Hardware | 100.9 | 80.0 |
| Other | 12.6 | 11.9 |
| **Total** | 478.2 | 446.7 |

## 6 RECONCILIATION OF OPERATING LOSS TO CASH EBITDA

Cash EBITDA is defined as the Group's operating loss adjusted for depreciation and amortisation charges, any gains or losses on the sale of tangible and intangible assets, share option charges, unrealised foreign exchange differences and exceptional items with billings replacing revenue.

The Directors believe this measure is a more appropriate earnings and cash flow measure than EBITDA.

| | Year-ended 31 March 2016 $M | Year-ended 31 March 2015 $M |
|---|---|---|
| Operating loss | (32.7) | (0.5) |
| Depreciation | 8.4 | 8.3 |
| Loss on group asset disposal | – | – |
| Amortisation of intangible purchased assets | 29.2 | 47.6 |
| Share-based payments expense | 15.0 | 1.4 |
| Exceptional items and other adjustments | 41.9 | 17.3 |
| Foreign exchange loss/(gain) | 2.4 | (2.0) |
| Adjusted EBITDA | 64.2 | 72.1 |
| Net deferral of revenue | 56.7 | 29.3 |
| **Cash EBITDA** | 120.9 | 101.4 |
| Billings | 534.9 | 476.0 |
| Revenue | (478.2) | (446.7) |
| Net deferral of revenue | 56.7 | 29.3 |

## 7 EXCEPTIONAL ITEMS

Exceptional items are those that in the Directors judgment need to be disclosed by virtue of their size, nature or incidence, in order to draw the attention of the reader and to show the underlying business performance of the Group more accurately. Such items are included within the income statement caption to which they relate and are separately disclosed on the face of the consolidated income statement within General finance and administration expenses.

During the year-ended 31 March 2016, Initial Public Offering ("IPO") costs of $17.8M (2015: $Nil), acquisition related expenses of $1.7M (2015: $3.3M), restructuring and integration costs of $2.6M (2015: $6.5M) and costs incurred in relation to the defence and settlement of certain intellectual property litigation of $19.8M (2015: $7.5M). The IP litigation costs includes a one-time payment to Fortinet Inc. on 9 December 2015 in respect of the settlement of all outstanding litigation, including various claims asserted by Fortinet Inc. against the Group and a number of former Fortinet Inc. employees employed by the Group and the respective patent claims the parties had asserted against each other. This resulted in total Exceptional items of $41.9M (2015: $17.3M). Tax credits on these exceptional items amounted to $5.3M (2015: $6.2M).

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS CONTINUED

For the year-ended 31 March 2016

## 8 LOSS ON ORDINARY ACTIVITIES

The loss on ordinary activities before taxation is stated after charging:

| | Year-ended 31 March 2016 $M | Year-ended 31 March 2015 $M |
|---|---|---|
| Depreciation of property, plant and equipment | 8.4 | 8.3 |
| Amortisation of intangible assets | 29.2 | 47.6 |
| Research and development expenditure | 99.6 | 81.8 |
| Operating lease rentals: | | |
| Property | 8.9 | 9.3 |
| Other | 1.4 | 1.4 |
| Pension scheme contributions | 6.7 | 5.1 |
| Impairment of trade receivables | 0.5 | 0.8 |
| Net foreign currency differences | (0.2) | (2.6) |

## 9 AUDITOR'S REMUNERATION

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

| | Year-ended 31 March 2016 $M | Year-ended 31 March 2015 $M |
|---|---|---|
| Audit of the financial statements | 0.3 | – |
| Subsidiary local statutory audits | 0.2 | 0.5 |
| Total audit fees | 0.5 | 0.5 |
| Taxation compliance services | 0.2 | 0.1 |
| Other assurance services[1] | 1.1 | 0.1 |
| Total non-audit fees | 1.3 | 0.2 |

1 Other assurance servises relate to the Company's Initial Public Offering.

## 10 EMPLOYEE COSTS

| | Year-ended 31 March 2016 $M | Year-ended 31 March 2015 $M |
|---|---|---|
| Wages and salaries | 200.5 | 185.3 |
| Social Security costs | 19.1 | 19.2 |
| Pension costs | 6.7 | 5.1 |
| Other costs | 7.7 | 5.8 |
| | 234.0 | 215.4 |
| Share-based payments (note 30) | 16.3 | 1.5 |
| Total employee costs | 250.3 | 216.9 |

The average number of employees during the period, analysed by category, was as follows:

| | Year-ended 31 March 2016 | Year-ended 31 March 2015 |
|---|---|---|
| Technical | 1,487 | 1,229 |
| Sales and marketing | 934 | 797 |
| Administration | 278 | 214 |
| Total average number of employees | 2,699 | 2,240 |

## 11 DIRECTORS' REMUNERATION

| | Year-ended 31 March 2016 $M | Year-ended 31 March 2015 $M |
|---|---|---|
| Directors' emoluments | 3.0 | 3.3 |
| Share-based payment – equity-settled | 5.2 | 0.3 |
| Total Directors' emoluments | 8.2 | 3.6 |

Directors' remuneration represents all emoluments and aggregate contributions to pension schemes earned during the year as a Director of Sophos Group plc and its subsidiaries. Further details can be found in the Group's Remuneration Report on pages 58 to 65.

## 12 FINANCE INCOME AND EXPENSE

| **Finance income** | Year-ended 31 March 2016 $M | Year-ended 31 March 2015 $M |
|---|---|---|
| Interest on bank deposits | 0.7 | 1.1 |

| **Finance expense** | Year-ended 31 March 2016 $M | Year-ended 31 March 2015 $M |
|---|---|---|
| Interest expense on loans and borrowings | 11.0 | 20.8 |
| Other interest, bank charges and swap settlements | 0.5 | 0.9 |
| | 11.5 | 21.7 |
| Accretion on Subordinated Preference Certificates | 13.5 | 54.8 |
| Accretion on contingent consideration | 0.2 | – |
| Foreign exchange loss/(gain) on borrowings[1] | 4.4 | (22.7) |
| Amortisation of facility fees | 0.9 | 1.1 |
| Facility fees expensed on settlement of debt | 5.9 | – |
| Total finance expense | 36.4 | 54.9 |

1 Prior to the Initial Public Offering of the Company's shares, Shield Midco Limited was the largest Company for which consolidated financial statements were produced. Statutory accounts for that company for the year-ended 31 March 2015 included foreign exchange losses and gains on borrowings within the operating result rather than as part of interest expense.

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS CONTINUED

For the year-ended 31 March 2016

## 13 TAXATION

UK corporation tax for the year-ended 31 March 2016 is calculated at 20% (2015:21%) of the estimated assessable loss for the period.

| | Year-ended 31 March 2016 $M | Year-ended 31 March 2015 $M |
|---|---|---|
| **Current income tax:** | | |
| UK corporation tax | (2.0) | – |
| Adjustments in respect of previous years UK corporation tax | (2.7) | – |
| Overseas tax before exceptional items | 30.4 | 29.5 |
| Overseas tax on exceptional items | (1.0) | (6.2) |
| Adjustment in respect of previous years | 0.6 | 1.5 |
| Total current tax charge | 25.3 | 24.8 |
| **Deferred tax:** | | |
| Origination and reversal of temporary differences | (15.9) | (13.9) |
| Origination and reversal of temporary differences on exceptional items | (4.2) | – |
| Adjustment in respect of previous years | (1.7) | (5.2) |
| Total deferred tax credit | (21.8) | (19.1) |
| Total income tax charge | 3.5 | 5.7 |

An election was made in the period for Sophos Limited to be included within the new UK Research & Development (R&D) Expenditure Credit regime for the FY14 and FY15 tax periods, this has resulted in the UK prior year current tax adjustment shown above.

The charge for the year-ended can be reconciled to the loss for the period before taxation per the Consolidated Statement of profit or loss as follows:

| | Year-ended 31 March 2016 $M | Year-ended 31 March 2015 $M |
|---|---|---|
| Loss for the year before taxation | (68.4) | (54.3) |
| Loss for the year before taxation multiplied by the standard rate of corporation tax in the UK of 20% (2015: 21%) | (13.7) | (11.4) |
| Effects of: | | |
| Adjustments in respect of previous years | (4.2) | (3.7) |
| Change in tax rate during the year | 1.1 | 1.6 |
| Expenses not deductible for tax purposes | 7.0 | 6.0 |
| Losses not recognised | 6.8 | 8.0 |
| Higher tax rates on overseas earnings | 8.7 | 7.3 |
| Research and development and other tax credits | (3.2) | (1.7) |
| Other movements | 1.0 | (0.4) |
| Charge for taxation on loss for the year | 3.5 | 5.7 |

The Group's taxation strategy is closely aligned to its business strategy operational needs. Oversight of taxation is within the remit of the Audit and Risk Committee composed of Independent Non-Executive Directors. The Chief Financial Officer is responsible for tax strategy supported by a global team of tax professionals.

There is an ongoing risk, with changes to taxation law or perceptions on tax planning strategies in multiple territories where the Group operates, that could lead to a higher effective tax rate. Legislative change in key territories is being monitored and acted upon. Sophos strives for an open and transparent relationship with all revenue authorities. A tax authority may seek adjustment to the filing position adopted by a Group company and it is accepted that interpretation of complex regulations may lead to additional tax being assessed. Uncertain tax positions are monitored regularly and the provision made in the accounts was appropriate.

## 14 EARNINGS PER SHARE

Basic earnings per share ("EPS") is calculated by dividing the profit for the period attributable to equity holders of the parent by the weighted average number of ordinary shares outstanding during the period.

Diluted EPS is calculated by dividing the profit for the period attributable to equity holders of the parent by the weighted average number of ordinary shares outstanding during the period plus the weighted average number of shares that would be issued if all dilutive potential ordinary shares were converted into ordinary shares. In accordance with IAS 33, the dilutive earnings per share are without reference to adjustments in respect of outstanding shares when the impact would be anti-dilutive.

Adjusted EPS is calculated by dividing the cash EBITDA for the period attributable to equity holders of the parent by the weighted average number of ordinary shares outstanding during the period.

In each case, the weighted average number of shares take into account the weighted average number of own shares held during the period.

The following reflects the income and share data used in calculating EPS:

| | Year-ended 31 March 2016 $'M | Year-ended 31 March 2015 $'M |
|---|---|---|
| Loss for the period attributable to the equity holders of the Company | (71.9) | (60.0) |
| Cash EBITDA for the period attributable to the equity holders of the Company (see note 6) | 120.9 | 101.4 |

| | Year-ended 31 March 2016 | Year-ended 31 March 2015 |
|---|---|---|
| Weighted average number of shares (000's): | 438,640 | 408,207 |

| | Year-ended 31 March 2016 $ Cents | Year-ended 31 March 2015 $ Cents |
|---|---|---|
| Basic and diluted EPS | (16.4) | (14.7) |
| Adjusted EPS | 27.5 | 24.8 |

The weighted average number of shares used in the calculation for the current and comparative periods reflects the shares in issue after adjusting for the capital restructuring.

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS CONTINUED

For the year-ended 31 March 2016

## 15 INTANGIBLE ASSETS

| Cost | Goodwill $M | Intellectual property $M | Software $M | Others $M | Total $M |
|---|---|---|---|---|---|
| At 31 March 2014 | 694.1 | 360.4 | 25.7 | 274.2 | 1,354.4 |
| Additions | – | – | 7.6 | – | 7.6 |
| Acquired through business combinations | 1.4 | 9.9 | – | – | 11.3 |
| Disposals | – | – | (1.1) | – | (1.1) |
| Effect of movements in exchange rates | (25.7) | (8.9) | (3.2) | (15.5) | (53.3) |
| At 31 March 2015 | 669.8 | 361.4 | 29.0 | 258.7 | 1,318.9 |
| Additions | – | – | 8.3 | – | 8.3 |
| Acquired through business combinations | 41.6 | 5.6 | – | 6.2 | 53.4 |
| Disposals | – | – | (0.1) | – | (0.1) |
| Effect of movements in exchange rates | 4.9 | 1.9 | (1.0) | 2.3 | 8.1 |
| **At 31 March 2016** | 716.3 | 368.9 | 36.2 | 267.2 | 1,388.6 |
| **Amortisation/Impairment loss** | | | | | |
| At 31 March 2014 | – | 330.0 | 12.5 | 234.3 | 576.8 |
| Charge for the period | 0.2 | 20.6 | 5.4 | 21.4 | 47.6 |
| Disposals | – | – | (0.7) | – | (0.7) |
| Effect of movements in exchange rates | – | (8.7) | (1.8) | (13.6) | (24.1) |
| At 31 March 2015 | 0.2 | 341.9 | 15.4 | 242.1 | 599.6 |
| Charge for the period | – | 12.7 | 6.2 | 10.3 | 29.2 |
| Disposals | – | – | (0.1) | – | (0.1) |
| Effect of movements in exchange rates | – | 1.7 | (0.6) | 2.2 | 3.3 |
| **At 31 March 2016** | 0.2 | 356.3 | 20.9 | 254.6 | 632.0 |
| **Net book value** | | | | | |
| At 31 March 2015 | 669.6 | 19.5 | 13.6 | 16.6 | 719.3 |
| **At 31 March 2016** | 716.1 | 12.6 | 15.3 | 12.6 | 756.6 |

Intellectual property is written off on a reducing balance basis over its estimated useful life of up to fifteen years.

Software is amortised on a straight line basis over 36 months.

Within Other intangibles, brand names are amortised on a reducing balance basis over a period of up to twenty years, and the customer base on a reducing balance basis over a period of up to fourteen years.

The Group has not capitalised development costs in the year-ended 31 March 2016 (2015: $Nil).

The Group does not have any intangible assets with indefinite useful lives.

## 16 PROPERTY, PLANT AND EQUIPMENT

| Cost | Land and Buildings $M | Plant and Machinery $M | Fixtures and Fittings $M | Total $M |
|---|---|---|---|---|
| As at 31 March 2014 | 34.7 | 21.9 | 3.2 | 59.8 |
| Additions | 0.2 | 5.9 | 1.1 | 7.2 |
| Acquired through business combinations | – | 0.2 | – | 0.2 |
| Disposals | (7.8) | (0.7) | (0.2) | (8.7) |
| Effect of movements in exchange rates | (6.6) | (4.5) | (0.7) | (11.8) |
| As at 31 March 2015 | 20.5 | 22.8 | 3.4 | 46.7 |
| Additions | 1.6 | 5.9 | 1.0 | 8.5 |
| Acquired through business combinations | – | 1.5 | 0.1 | 1.6 |
| Disposals | (0.1) | (0.6) | (0.1) | (0.8) |
| Effect of movements in exchange rates | (1.5) | (0.2) | – | (1.7) |
| **As at 31 March 2016** | 20.5 | 29.4 | 4.4 | 54.3 |
| **Depreciation** | | | | |
| As at 31 March 2014 | 12.7 | 12.2 | 0.9 | 25.8 |
| Charge for the year | 2.6 | 5.2 | 0.5 | 8.3 |
| Acquired through business combinations | – | 0.2 | – | 0.2 |
| Disposals | (5.0) | (0.7) | (0.1) | (5.8) |
| Effect of movements in exchange rates | (3.2) | (3.3) | (0.4) | (6.9) |
| As at 31 March 2015 | 7.1 | 13.6 | 0.9 | 21.6 |
| Charge for the year | 2.5 | 5.1 | 0.8 | 8.4 |
| Acquired through business combinations | – | 0.9 | – | 0.9 |
| Disposals | (0.1) | (0.6) | (0.1) | (0.8) |
| Effect of movements in exchange rates | (0.7) | (0.1) | 0.1 | (0.7) |
| **As at 31 March 2016** | 8.8 | 18.9 | 1.7 | 29.4 |
| **Net book value** | | | | |
| At 31 March 2015 | 13.4 | 9.2 | 2.5 | 25.1 |
| **At 31 March 2016** | 11.7 | 10.5 | 2.7 | 24.9 |

Included in the net book value of property, plant and equipment are assets under finance lease of $0.2M (2015: $0.1M).

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

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS CONTINUED

For the year-ended 31 March 2016

## 17 IMPAIRMENT OF GOODWILL AND INTANGIBLES

Before recognition of impairment losses, the carrying amount of goodwill had been allocated as follows:

| | 31 March 2016 $M | 31 March 2015 $M |
|---|---|---|
| Americas | 253.5 | 241.7 |
| EMEA | 379.3 | 344.4 |
| APJ | 83.3 | 83.5 |
| | 716.1 | 669.6 |

Impairment of goodwill and intangible assets is tested annually or more frequently where there is indication of impairment.

Where the asset does not generate cash flows that are independent from other assets, the Group estimates the recoverable amount of the cash-generating unit to which the asset belongs. 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 recognised as an expense immediately in the Consolidated Statement of profit or loss.

Goodwill is considered impaired if the carrying value of the cash-generating unit to which it relates is greater than the higher of fair value less costs of disposal and the value in use.

For the year-ended 31 March 2016, the Directors have reviewed the value of goodwill based on internal value in use calculations. The key assumptions for these calculations are discount rates, growth rates and expected changes to billings and direct costs during the period.

The Group prepares cash flow forecasts derived from the Directors' most recent financial forecasts for the following five years. The growth rates for the five year period are based on management's expectations of the medium-term operating performance of the cash-generating unit, planned growth in market share, industry forecasts, growth in the market and specific regional considerations. Discount rates have been estimated based on rates that reflect current market assessments of the Group's weighted average cost of capital.

The key assumptions used in the assessments in the year-ended 31 March 2016 are as follows:

| | Americas % | EMEA % | APJ % |
|---|---|---|---|
| Long-term regional growth rate beyond 5 years | 2.50% | 1.50% | 2.00% |
| Discount rate | 11.00% | 10.00% | 12.00% |

The key assumptions used in the assessments in the year-ended 31 March 2015 were as follows:

| | Americas % | EMEA % | APJ % |
|---|---|---|---|
| Long-term regional growth rate beyond 5 years | 2.50% | 3.00% | 3.50% |
| Discount rate | 12.00% | 12.50% | 13.00% |

As at 31 March 2016, there were no indicators of impairment that suggested the carrying amounts of the Group's long-lived assets are not recoverable.

## 18 DEFERRED TAX

Deferred tax assets and liabilities are attributable to the following:

| | 31 March 2016 $M | 31 March 2015 $M |
|---|---|---|
| **Deferred income tax assets in relation to:** | | |
| Deferred revenue | 35.1 | 29.9 |
| Tax value of carry forward losses of UK subsidiaries | 9.3 | 1.7 |
| Tax value of carry forward losses of overseas sunsidiaries | 2.3 | 3.7 |
| Advanced capital allowances of overseas subsidiaries | 6.7 | 5.7 |
| Share-based payments | 13.7 | 0.4 |
| Other timing differences | 6.8 | 5.8 |
| Total | 73.9 | 47.2 |
| **Deferred income tax liabilities in relation to:** | | |
| Intangible assets | 9.6 | 10.2 |
| Other timing differences | 0.5 | 0.4 |
| Total | 10.1 | 10.6 |

At the balance sheet date the Group has unused tax losses of $248.5M (2015: 201.7M) available for offset against future profits. A deferred tax asset has been recognised in respect of $54.6M (2015: $23.5M) of such losses. No deferred tax asset has been recognised in respect of the remaining $193.9M (2015:$178.1M unutilised) as it is not considered probable that there will be the required type of future trading or non-trading profits available in the correct entities necessary to permit offset and recognition.

The Group's tax charge is driven by the profit mix amongst the key jurisdictions in which the Group operates. A deferred tax asset has been recognised in respect of losses where current forecasts indicate profits will arise in the foreseeable future against which the losses recognised will be offset.

As at 31 March 2016 the aggregate amount of temporary differences associated with undistributed earnings of subsidiaries for which deferred tax liabilities have been recognised was $Nil (2015: $Nil). No liability has been recognised because the Group is in a position to control the reversal of temporary differences and it is probable that such differences will not reverse in the foreseeable future.

Deferred tax assets and liabilities are measured at the tax rates that are expected to apply in the period when the asset is realised or the liability settled, based on tax rates that have been enacted or substantially enacted at the reporting date. The Finance (No. 2) Act 2015 determined that the main rate of corporation tax would reduce from 20% to 19% with effect from 1 April 2017 and reduced from 19% to 18% with effect from 1 April 2020.

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS CONTINUED

For the year-ended 31 March 2016

## 19 TRADE AND OTHER RECEIVABLES

| | 31 March 2016 $M | 31 March 2015 $M |
|---|---|---|
| **Current** | | |
| Trade receivables | 103.7 | 88.0 |
| Prepayments | 19.0 | 13.2 |
| Amounts due from parent | – | 0.8 |
| Other receivables | 7.1 | 8.5 |
| Total current trade and other receivables | 129.8 | 110.5 |
| **Non-current** | | |
| Other receivables | 0.8 | 0.4 |
| Total non-current trade and other receivables | 0.8 | 0.4 |

Trade receivables are non interest-bearing and are generally on 30-90 day terms depending on the geographical territory in which sales are generated. The carrying value of trade and other receivables also represents their fair value. During the period ended 31 March 2016 a provision for impairment of $0.3M (2015: $0.8M) was recognised in operating expenses against receivables.

At 31 March 2016, trade receivables at a nominal value of $0.7M (2015: $0.7M) were impaired and fully provided for. Movements in the provision for impairment of receivables were as follows:

| | 31 March 2016 $M | 31 March 2015 $M |
|---|---|---|
| At 1 April | 0.7 | 0.9 |
| Charge for the year | 0.3 | 0.8 |
| Amounts written off | (0.1) | (0.2) |
| Unused amounts reversed | (0.2) | (0.8) |
| At 31 March | 0.7 | 0.7 |
| The analysis of trade receivables that were past due, | | |
| but not impaired is as follows: | | |
| Up to 3 months | 4.1 | 3.1 |
| 3 to 6 months | 0.2 | 0.1 |
| Greater than 6 months | – | 0.2 |
| Total | 4.3 | 3.4 |

## 20 INVENTORIES

| | 31 March 2016 $M | 31 March 2015 $M |
|---|---|---|
| Finished goods and goods for resale | 18.7 | 12.5 |

The amount of write-down of inventories included within cost of sales was $1.0M (2015: $3.2M).

## 21 CASH AND CASH EQUIVALENTS

| | 31 March 2016 $M | 31 March 2015 $M |
|---|---|---|
| Cash at bank and in hand | 49.7 | 59.0 |
| Short-term deposits | 17.1 | 13.6 |
| Total cash and cash equivalent | 66.8 | 72.6 |

Cash at bank earns interest at floating rates based on daily bank deposit rates. Short-term deposits are made for varying periods of between one day and three months, depending on the immediate cash requirements of the Group, and earn interest at the respective short-term deposit rates.

## 22 INVESTMENTS

| Employee benefit Trust | 31 March 2016 $M | 31 March 2015 $M |
|---|---|---|
| Brought forward | 0.6 | 0.6 |
| Shares cancelled on pre-admission restructuring | (0.4) | – |
| Own shares transferred to equity | (0.2) | – |
| Carried forward | – | 0.6 |

## 23 TRADE AND OTHER PAYABLES

| | 31 March 2016 $M | 31 March 2015 $M |
|---|---|---|
| **Current** | | |
| Trade payables | 21.8 | 25.8 |
| Accruals | 46.5 | 51.3 |
| Social security and other taxes | 5.2 | 5.6 |
| Other payables | 2.9 | 2.4 |
| Amounts due to parent – loans and accumulated interest | – | 471.9 |
| Total current trade and other payables | 76.4 | 557.0 |
| **Non-current** | | |
| Other payables | 0.8 | 0.7 |
| Total non-current trade and other payables | 0.8 | 0.7 |

Trade payables are non-interest bearing and are normally settled on 30-day terms or as otherwise agreed with suppliers.

Loans and accumulated interest due to parent with a value of $485.3M were capitalised on 26 June 2015 as part of the Group reorganisation leading up to the Initial Public Offering of the Company's shares. Prior to capitalisation, the Loans were disclosed within Trade and other payables.

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS CONTINUED

For the year-ended 31 March 2016

## 24 DEFERRED REVENUE

| | 31 March 2016 $M | 31 March 2015 $M |
|---|---|---|
| Current | 251.4 | 265.9 |
| Non-current | 181.9 | 181.9 |
| At 1 April | 433.3 | 447.8 |
| Billings deferred during the year | 534.9 | 476.0 |
| Revenue released to the statement of profit or loss | (478.2) | (446.7) |
| Translation and other adjustments | 8.7 | (43.8) |
| Current | 286.5 | 251.4 |
| Non-current | 212.2 | 181.9 |
| At 31 March | 498.7 | 433.3 |

On acquisition of SurfRight B.V. on 3 December 2015, deferred revenue was increased by $1.3M representing the fair value of future support costs acquired. $0.9M remains unamortised at 31 March 2016.

On acquisition of Cyberoam Technologies Pvt Ltd on 6 February 2014, deferred revenue was increased by $7.1M representing the fair value of future support costs acquired. $0.4M (2015 : $2.0M) remains unamortised at 31 March 2016.

On acquisition of the Astaro group on 30 June 2011, deferred revenue was reduced by $17.6M representing the fair value of original selling cost and associated profit. $.0.0 (2015 : $0.3M) remains unamortised at 31 March 2016.

## 25 FINANCIAL LIABILITIES

The fair values of financial assets and liabilities are included at the price that would be received to sell an asset, or paid to transfer a liability, in an orderly transaction between market participants at the end of the reporting period. The following methods and assumptions were used to estimate the fair values:

- Cash and cash equivalents – approximates to the carrying amount
- Finance leases – approximates to the carrying amount
- Bank loans – approximates to the carrying amount
- Interest rate swaps, caps and floors – based on the net present value of discounted cash flows
- Receivables and payables – approximates to carrying amount

Where financial assets and liabilities are measured at fair values their measurement should be classified into the following hierarchy:

- Level 1 – quoted prices (unadjusted) in active markets from identical assets or liabilities
- Level 2 – inputs other than quoted prices included within level 1 that are observable for the asset or liability, either directly (i.e. as prices) or indirectly (i.e. derived from prices)
- Level 3 – inputs for the asset or liability that are not based on observable market data

The Group had a Level 3 financial liability of $2.1M of contingent consideration measured at fair value through profit and loss at 31 March 2016 (2015 : $Nil).

Total financial liabilities at the end of the reporting period were as follows:

| | 31 March 2016 $M | 31 March 2015 $M |
|---|---|---|
| Current instalments due on finance leases | 0.1 | – |
| Current instalments due on bank loans | 25.0 | 3.9 |
| Contingent consideration | 1.1 | – |
| Unamortised facility fees | – | (1.0) |
| Total current financial liabilities | 26.2 | 2.9 |
| Non-current instalments due on finance leases within 5 years | 0.1 | – |
| Non-current instalments due on bank loans | 303.4 | 382.7 |
| Contingent consideration | 1.0 | – |
| Unamortised facility fees | (3.6) | (4.9) |
| Total non-current financial liabilities | 300.9 | 377.8 |
| Total financial liabilities | 327.1 | 380.7 |

### Finance leases

The Group has acquired lease obligations on certain of its fixtures and fittings under finance leases with terms of 3 to 5 ½ years and underlying interest rates ranging from 5.2% – 6.3% per annum as part of the acquisition of Reflexion Inc. At 31 March 2016, the present value of future lease payments was $0.2M (2015: $0.0).

### Contingent Consideration

As part of the purchase agreement with the previous owners of Reflexion Inc., a contingent consideration has been agreed. The consideration is dependent on the billings of the Reflexion Inc. product range for the calendar years ended 31 December 2015 and ending 31 December 2016 with a maximum payout of $6.5M. The fair value of the contingent consideration at the acquisition date was estimated at $2.0M. The contingent consideration is due for final measurement and payment to the former shareholders on 5 June 2016 in respect of billings for the calendar year ended 31 December 2015, and no later than 31 March 2017 in respect of the billings for the calendar year ending 31 December 2016.

### Loans and Borrowings

Included in borrowings are bank loans of $328.4M (2015: $386.6M) as analysed below. This note provides information about the contractual terms of the Group's interest-bearing loans and borrowings, which are measured at amortised cost. For more information about the Group's exposure to interest rate, foreign currency and liquidity risk, see note 27.

| | 31 March 2016 $M | 31 March 2015 $M |
|---|---|---|
| Current instalments due on bank loans | 25.0 | 3.9 |
| Non-current instalments due on bank loans | 303.4 | 382.7 |
| Total bank loans | 328.4 | 386.6 |

The bank loans are repayable as follows:

| | 31 March 2016 $M | 31 March 2015 $M |
|---|---|---|
| Due within one year | 25.0 | 3.9 |
| Due between one and two years | – | 3.9 |
| Due between two and five years | 303.4 | 11.7 |
| Due after more than five years | – | 367.1 |
| Total bank loans | 328.4 | 386.6 |

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS CONTINUED

For the year-ended 31 March 2016

## 25 FINANCIAL LIABILITIES CONTINUED

The Group re-financed its bank loans from primary proceeds arising on the IPO on 1 July 2015, reducing the US Dollar borrowing by $71.1M to $235.0M and reducing the Euro borrowing by €14.1M to €60.0M. Following the re-financing, the following terms apply to the bank loans outstanding at 31 March 2016:

| Facility | Interest | Margin | Principal M | Principal $M |
|---|---|---|---|---|
| Facility – A | Libor | 2.25% | $235.0 | 235.0 |
| Facility – B | Euribor | 2.25% | €60.0 | 68.4 |
| Revolving Credit Facility | Libor | 2.00% | $25.0 | 25.0 |
| | | | | 328.4 |

Repayment and maturity:

Facility A ($235.0M), Facility B (€60.0M) and the Revolving Credit Facility (multicurrency up to $30.0M) are repayable in full on the termination date at the end of the 60-month term on 1 July 2020.

Any utilisation of the Revolving Credit facility is repayable on the last day of its interest period, any amount repaid may be re-borrowed.

The margin payable on the facilities is dependent upon the ratio of the Group's net debt to cash EBITDA as defined in the facility agreement.

The bank loans are secured by fixed and floating charges over the trade and assets of certain Group companies.

## 26 PROVISIONS

| | Restructuring $M | Other $M | Total $M |
|---|---|---|---|
| At 31 March 2014 | 1.9 | 0.4 | 2.3 |
| Arising during the year | 0.5 | – | 0.5 |
| Utilised | (1.7) | – | (1.7) |
| Released during the year | – | – | – |
| Disposal of a business | – | – | – |
| Exchange differences | – | (0.1) | (0.1) |
| At 31 March 2015 | 0.7 | 0.3 | 1.0 |
| Arising during the year | 0.1 | 0.6 | 0.7 |
| Utilised | (0.5) | – | (0.5) |
| Released during the year | – | – | – |
| Disposal of a business | – | – | – |
| Exchange differences | – | 0.1 | 0.1 |
| **At 31 March 2016** | 0.3 | 1.0 | 1.3 |
| **31 March 2016** | | | |
| **Current** | 0.3 | – | 0.3 |
| **Non-current** | – | 1.0 | 1.0 |
| **Total provisions** | 0.3 | 1.0 | 1.3 |
| 31 March 2015 | | | |
| Current | 0.7 | – | 0.7 |
| Non-current | – | 0.3 | 0.3 |
| Total provisions | 0.7 | 0.3 | 1.0 |

### Restructuring provision

The opening provision relates to vacant properties which are surplus to the Group's requirements and are due to be disposed of. This provision has either been utilised or released during the year. The provision arising in the year-ended 31 March 2016 relates to expenditure in relation to vacant properties which are surplus to the Group's requirements and are due to be disposed of, and to the integration of Cyberoam into the wider Sophos Group.

### Other provisions

The opening and closing provisions relate to the Group's obligations to make good the dilapidations of various leasehold premises at the end of the lease periods. In France, the Group operates a unfunded, compulsory retirement indemnity plan, payable only if the employees are working for the Group when they retire. The provision arising in the year-ended 31 March 2016 relates to this retirement indemnity plan.

## 27 FINANCIAL RISK MANAGEMENT

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

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

### Liquidity risk

The Group prepares budgets annually in advance. This enables the Group's operating cash flow requirements to be anticipated and to ensure sufficient liquidity is available to meet foreseeable needs, financial obligations and to invest any surplus cash assets safely and profitably. Quarterly covenant tests are performed and monitored by the Directors at quarterly board meetings.

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

### Capital management

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

The capital structure of the Group consists of cash and cash equivalents as disclosed in note 21, borrowings as disclosed in note 25 and equity attributable to equity holders of the parent, comprising issued capital, reserves and retained earnings, as disclosed in the Consolidated Statement of Changes in Equity.

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

### Credit risk

The Group's principal financial assets are cash and bank deposits and trade and other receivables.

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

The amounts presented in the Consolidated Statement of Financial Position are net of allowance for doubtful debts. An allowance for impairment is made where there is an identified loss event which, based on previous experience, is evidence of a reduction in the recoverability of cash flows. The expense recognised in the Consolidated Statement of profit or loss in respect of doubtful debts during the period was $0.3M, as disclosed in note 19.

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

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

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS CONTINUED

For the year-ended 31 March 2016

## 27 FINANCIAL RISK MANAGEMENT CONTINUED

### Interest rate risk

The Group is exposed to interest rate risk primarily due to the long-term debt obligations with floating rates of interest.

### Interest rate sensitivity

A change of 100 basis points in market interest rates would have increased/(decreased) equity and profit and loss by the amounts shown below.

| | Year-ended 31 March 2016 $M | Year-ended 31 March 2015 $M |
|---|---|---|
| Increase in interest rates | (2.3) | (1.2) |
| Decrease in interest rates | 2.3 | – |

### Foreign currency risk

The Group is exposed to translation and transaction foreign exchange risk. Several other currencies in addition to the reporting currency of US Dollar are used, including Sterling and the Euro. The Group experiences currency exchange differences arising upon retranslation of monetary items (primarily short-term inter-company balances and long-term borrowings), which are recognised as an expense in the period the retranslation occurs. The Group endeavours to match the cash inflows and outflows in the various currencies; the Group typically invoices its customers in their local currency, and pays its local expenses in local currency as a means to mitigate this risk.

The Group is also exposed to exchange differences arising from the translation of its subsidiaries' financial statements into the Group's reporting currency of US Dollar with the corresponding exchange differences taken directly to equity.

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

| | Year-ended 31 March 2016 $M | Year-ended 31 March 2015 $M |
|---|---|---|
| 10% movement in Sterling to US Dollar value | | |
| Profit or loss | 1.9 | 1.9 |
| Equity | 25.1 | 22.5 |
| 10% movement in Euro to US Dollar value | | |
| Profit or loss | 6.9 | 7.2 |
| Equity | (7.2) | (4.5) |

Any foreign exchange variance would be recognised as unrealised foreign exchange in the Consolidated Statement of profit or loss and have no impact on cash flows.

## 28 SHARE CAPITAL

| Shares issued and fully paid | 000's | Year-ended 31 March 2016 $M | 000's | Year-ended 31 March 2015 $M |
|---|---|---|---|---|
| At 1 April of £0.75 each[1] | 333,037 | 393.5 | 333,037 | 393.5 |
| At 1 April of £0.10 each[1] | 1,009,869 | 159.1 | 1,009,869 | 159.1 |
| Pre-admission capital restructuring shares[2] | (928,251) | (533.1) | – | – |
| Initial Public Offering | 35,345 | 1.7 | – | – |
| Issued for cash on exercise of options | 2,172 | 0.1 | – | – |
| At 31 March 2016, Ordinary shares of £0.03 each | 452,172 | 21.3 | 1,342,906 | 552.6 |

1 On 26 June 2015, Sophos Group issued 333,037 Ordinary, A-Class and C shares of £0.75 each together with 1,009,869 Preference shares of £0.10 each in consideration for the purchase of issued share capital of Pentagon Holdings SARL.

2 On 1 July 2015, Sophos Group plc reorganised its share capital and share premium to comprise 414,654,813 Ordinary shares of £0.03 each creating distributable reserves.

## 29 DISTRIBUTIONS MADE AND PROPOSED

| Cash dividends on ordinary shares declared and paid | Year-ended 31 March 2016 $M | Year-ended 31 March 2015 $M |
|---|---|---|
| Interim dividend for year ending 31 March 2016 at 0.7 US Cents per share (FY15: nil) | 3.1 | – |
| **Total Cash dividends paid** | 3.1 | – |

The Directors have proposed that the Company will pay a full-year dividend for the year-ending 31 March 2016 amounting to 1.1 US Cents per share.

Proposed final dividends on ordinary shares are subject to approval at the annual general meeting and are not recognised as a liability at 31 March 2016.

## 30 SHARE-BASED PAYMENTS

On 25 June 2015, and in connection with the reorganisation of the Group immediately prior to admission of the Company's shares for trading on the London Stock Exchange, participants with existing options outstanding under the Pentagon Holdings SARL approved share plans were offered to exchange their options for new options over shares in Sophos Group plc.

On 11 June 2015, and in connection with the admission of the Company's shares for trading on the London Stock Exchange, the Company's Board of Directors approved the following share-based payment plans:

### The Sophos Group Long-term Incentive Plan 2015, ("2015 LTIP")

The 2015 LTIP plan aims to motivate and retain employees and align their interest with shareholders. Under the plan the remuneration committee of the Board can award the following types of awards: Performance Share Units, Restricted Share Units, Share Options, Conditional Share Awards, Cash-Based Awards or Forfeitable Shares.

### Sophos Group SAYE option scheme 2015 ("SAYE")

The SAYE plan aims to encourage wider share ownership amongst UK employees of the Group by offering an HMRC approved share save scheme, whereby employees are offered options to buy shares at a discount following a pre-set savings period.

### Sophos Group 2015 Employee Share Purchase Plan ("ESPP")

The ESPP plan aims to encourage wider share ownership amongst US employees of the Group by offering options compliant with Section 423 of the Internal Revenue Code. Employees are offered options to buy shares at a discount following a pre-set savings period.

### Sophos Group International SAYE option scheme 2015 "(International SAYE")

The International SAYE plan aims to encourage wider share ownership amongst the Group's employees outside of the UK and US by offering options to buy shares at a discount following a pre-set savings period.

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS CONTINUED

For the year-ended 31 March 2016

## 30 SHARE-BASED PAYMENTS CONTINUED

### Share-based payment expense

The expense recognised for employee services received during the year is as follows:

| | Year-ended 31 March 2016 $M | Year-ended 31 March 2015 $M |
|---|---|---|
| Cash-settled transactions | 1.3 | 0.1 |
| Equity-settled transactions | 15.0 | 1.4 |
| Total share-based payment expense | 16.3 | 1.5 |

The cash-settled expense comprises cash-based awards together with certain social security taxes. The carrying value of the liability as at 31 March 2016 was $1.1M (2015: $0.1M).

### Share Options

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

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

| | Year-ended 31 March 2016 | Year-ended 31 March 2015 |
|---|---|---|
| Weighted average share price ($ cents) | 130.63 | 79.55 |
| Weighted average exercise price ($ cents) | 130.63 | 75.81 |
| Expected volatility | 0.3266 | 0.5147 |
| Expected life of options (years) | 2.28 | 0.65 |
| Risk free rate | 0.0057 | 0.0054 |
| Expected dividends | Nil | Nil |

The weighted average fair value of options granted during the year was $ cents 24.4 (2015 $ cents 13.1).

Expected volatility was determined by calculating the historical share price volatility of comparable listed companies over the expected life of the options. The expected volatility reflects the assumption that the historical volatility is indicative of future trends, which may not necessarily be the actual outcome. An increase in the expected volatility will increase the estimated fair value.

The expected life of the options is based on historical data and is not necessarily indicative of exercise patterns that may occur. The expected life used in the model has been adjusted, based on management's best estimate, taking into account the effects of exercise restrictions, non-transferability and behavioural considerations. An increase in the expected life will increase the estimated fair value.

The fair value of awards with a market condition has been discounted to reflect the probability of meeting the market condition attached to the options.

The number and weighted average exercise prices ("WAEP") of, and movements in, share options in the year is set out below:

| | Number 000's | Year-ended 31 March 2016 WAEP $ cents | Number 000's | Year-ended 31 March 2015 WAEP $ cents |
|---|---|---|---|---|
| Outstanding at the start of the year | 54,951 | 39.7 | 55,097 | 30.2 |
| Awarded | 989 | 130.5 | 11,875 | 78.9 |
| Forfeited | (9,851) | 30.7 | (3,445) | 35.1 |
| Exercised | (5,216) | 25.2 | (8,576) | 35.1 |
| Outstanding on Admission | 40,873 | 46.0 | – | – |
| Converted on Admission | 26,087 | 71.9 | – | – |
| Awarded | – | – | – | – |
| Forfeited | (1,191) | 76.0 | – | – |
| Exercised | (2,219) | 42.3 | – | – |
| Outstanding at the end of the year | 22,677 | 74.5 | 54,951 | 39.7 |
| Exercisable at the end of the year | 13,918 | 56.0 | 11,884 | 25.2 |

The weighted average share price for options exercised during the year was £ pence 228 (2015: $ cents 75.81).

Options outstanding at the end of the year had the following range of exercise prices and weighted average remaining contractual terms ("WARCT"):

| | Exercise price ($ cents) | Number 000's | 31 March 2016 WARCT Years | Number 000's | 31 March 2015 WARCT Years |
|---|---|---|---|---|---|
| | 2.5000 | – | – | 2,343 | 5.2 |
| | 7.5625 | – | – | 8,006 | 5.2 |
| | 30.250 | – | – | 8,351 | 5.2 |
| | 38.000 | – | – | 25,578 | 7.7 |
| | 45.000 | – | – | 2,360 | 9.2 |
| | 58.000 | – | – | 963 | 9.5 |
| | 99.000 | – | – | 7,350 | 9.9 |
| | 1.8598 | 153 | 4.2 | | |
| | 2.5000 | 446 | 0.9 | | |
| | 11.897 | 2,507 | 4.2 | | |
| | 47.589 | 1,286 | 4.2 | | |
| | 51.915 | 43 | 6.7 | | |
| | 59.781 | 12,133 | 6.7 | | |
| | 70.794 | 1,144 | 8.2 | | |
| | 91.245 | 276 | 8.2 | | |
| | 155.746 | 4,199 | 8.5 | | |
| | 210.808 | 490 | 8.9 | | |
| Outstanding at the end of the year | | 22,677 | 6.8 | 54,951 | 7.3 |

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS CONTINUED

For the year-ended 31 March 2016

## 30 SHARE-BASED PAYMENTS CONTINUED

### Restricted Shares

The following table illustrates the number and weighted average share price ("WASP") on date of award of, and movements in, non-vested restricted shares in the year:

| Restricted shares | Number 000's | Year-ended 31 March 2016 WASP $ cents | Number 000's | Year-ended 31 March 2015 WASP $ cents |
|---|---|---|---|---|
| Outstanding at the start of the year | 548 | 67.94 | 568 | 30.25 |
| Awarded | – | – | 300 | 99.00 |
| Forfeited | – | – | – | – |
| Vested | (248) | 30.25 | (320) | 30.25 |
| Outstanding on Admission | 300 | 99.00 | | |
| Converted on Admission | 191 | 155.75 | | |
| Awarded | – | – | | |
| Forfeited | – | – | | |
| Vested | (64) | 155.75 | | |
| Outstanding at the end of the year | 127 | 155.75 | 548 | 67.94 |

### Restricted Share units

The following table illustrates the number and weighted average share price ("WASP") on date of award, and movements in, restricted share units ("RSU's") and cash based awards granted under the 2015 LTIP:

| Restricted share units | Number 000's | Year-ended 31 March 2016 WASP £ pence | Number 000's | Year-ended 31 March 2015 WASP £ pence |
|---|---|---|---|---|
| Outstanding at the start of the year | – | – | – | – |
| Awarded | 9,630 | 264.75 | – | – |
| Forfeited | (241) | 265.00 | – | – |
| Vested | – | – | – | – |
| Outstanding at the end of the year | 9,389 | 264.74 | – | – |

RSU's and cash-based awards vest as to 25% (20% in the case of RSU's with a 5 year vesting period) on the anniversary of the award and the remaining 75% (or 80% in the case of RSU's with a 5 year vesting period) quarterly thereafter.

### Performance share units

The following table illustrates the number and weighted average share price ("WASP") on date of award, and movements in, performance share units ("PSU's") granted under the 2015 LTIP:

| Performance share units | Number 000's | Year-ended 31 March 2016 WASP £ pence | Number 000's | Year-ended 31 March 2015 WASP £ pence |
|---|---|---|---|---|
| Outstanding at the start of the year | – | – | – | – |
| Awarded | 2,879 | 265.00 | – | – |
| Forfeited | (94) | 265.00 | – | – |
| Vested | – | – | – | – |
| Outstanding at the end of the year | 2,785 | 265.00 | – | – |

PSU's vest on one vesting date following a three year vesting period which will comprise three financial years. The awards are divided into three equal parts which will each be subject to an individual annual performance condition linked to the financial performance of the Group.

## 31 PENSION SCHEMES

The Group contributes to money defined contribution pension schemes in the UK and to similar or state pension schemes overseas for the benefit of the employees and Directors. The assets of the schemes are administered by trusts or other bodies in funds independent from the Group.

The pension cost charge for the period represents contributions payable by the Group to the funds and amounted to $6.7M (2015: $5.1M).

Contributions of $1.2M (2015: $0.9M) to the defined contribution pension scheme were outstanding, but not overdue, at 31 March 2016.

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS CONTINUED

For the year-ended 31 March 2016

## 32 RELATED PARTY TRANSACTIONS

### Subsidiaries

The consolidated financial information includes the financial information of Sophos Group plc and the subsidiaries listed in the following table:

| Subsidiary undertaking | Country of incorporation | Principal activity | Class of shares held | Percentage of shares held |
|---|---|---|---|---|
| Pentagon Holding Sarl[1] | Luxembourg | In liquidation | Ordinary | 100% |
| Shield 1 Ltd[1] | UK | Pre liquidation/strike off | Ordinary | 100% |
| Shield 1A Ltd[1] | UK | Pre liquidation/strike off | Ordinary | 100% |
| Shield Holdco Ltd[1] | UK | Pre liquidation/strike off | Ordinary | 100% |
| Shield Midco Ltd[1] | UK | Pre liquidation/strike off | Ordinary | 100% |
| Sophos Holdings Ltd[1] | UK | Holding Company | Ordinary | 100% |
| Sophos Treasury Ltd[2] | UK | Financing Company | Ordinary | 100% |
| Shield Finance Co Sarl[2] | Luxembourg | In liquidation | Ordinary | 100% |
| Aspen Finance Co Sarl[2] | Luxembourg | Financing Company | Ordinary | 100% |
| Sophos Limited[2] | UK | Selling IT security solutions | Ordinary | 100% |
| Sophos Inc[3] | USA | Selling IT security solutions | Ordinary | 100% |
| Cyberoam Inc[6] | USA | Services Company | Ordinary | 100% |
| Reflexion Networks Inc[7] | USA | Selling IT security solutions | Ordinary | 100% |
| Sophos Pty Ltd[3] | Australia | Selling IT security solutions | Ordinary | 100% |
| Sophos Sarl[3] | France | Selling IT security solutions | Ordinary | 100% |
| Sophos KK[3] | Japan | Selling IT security solutions | Ordinary | 100% |
| Sophos Italia Srl[3] | Italy | Selling IT security solutions | Ordinary | 100% |
| Sophos Computer Security Pte Ltd[3] | Singapore | Selling IT security solutions | Ordinary | 100% |
| Sophos Inc[3] | Canada | Selling IT security solutions | Common | 100% |
| Sophos Nominees Limited[3] | UK | Share nominee company | Ordinary | 100% |
| Sophos AB[3] | Sweden | Selling IT security solutions | Ordinary | 100% |
| Sophos BV[3] | Netherlands | Selling IT security solutions | Ordinary | 100% |
| Threatstar Holding BV[8] | Netherlands | Holding Company | Ordinary | 100% |
| Threatstar BV[9] | Netherlands | Research and Development | Ordinary | 100% |
| SurfRight BV[8] | Netherlands | Selling IT security solutions | Ordinary | 100% |
| Sophos Schweiz AG[3] | Switzerland | Selling IT security solutions | Ordinary | 100% |
| Sophos Iberia Srl[3] | Spain | Selling IT security solutions | Ordinary | 100% |
| Sophos Technology Solutions India Private Ltd[10] | India | Services Company | Ordinary | 100% |
| Sophos Technology Pvt Ltd (formerly Cyberoam Technologies Pvt Ltd)[11] | India | Selling IT security solutions | Ordinary | 100% |
| Sophos Hong Kong Co Ltd[3] | Hong Kong | Selling IT security solutions | Ordinary | 100% |
| Sophos Holdings GmbH[3] | Germany | Holding Company | Ordinary | 100% |
| Sophos Hungary Kft[3] | Hungary | Research and Development | Ordinary | 100% |
| Sophos GmbH[4] | Germany | Selling IT security solutions | Ordinary | 100% |
| Sophos Technology GmbH[4] | Germany | Research and Development | Ordinary | 100% |
| Astaro Trading AG[5] | Switzerland | Historical purchasing entity | Ordinary | 100% |
| Sophos Taiwan Ltd[3] | Taiwan | Services Company | Ordinary | 100% |

1 Shares held by Sophos Group Plc
2 Shares held by Sophos Holdings Ltd
3 Shares held by Sophos Limited
4 Shares held by Sophos Holdings GmbH
5 Shares held by Sophos Technology GmbH
6 Shares held by Sophos Technology Pvt Ltd (formerly Cyberoam Technologies Pvt Ltd)
7 Shares held by Sophos Inc
8 Shares held by Sophos BV
9 Shares held by Threatstar Holding BV
10 Shares held by Sophos Limited and Sophos Nominees Limited
11 Shares held by Sophos Limited and Sophos Technology Solutions India Private Ltd

### Other related parties

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

Apligo GmbH, an entity related through a minority equity investment, manufactured and shipped hardware for the Group's European operations prior to a restructuring of the supply chain during the year-ended 31 March 2015. During the year-ended 31 March 2016 the Group made purchases from Apligo GmbH of $0.4M (2015: $1.8M). At 31 March 2016, the Group had amounts owing to Apligo GmbH of $Nil (2015: $Nil).

Virus Bulletin Limited, an entity related through common Director's interest up until the admission of the Company's shares for trading on the London Stock Exchange, is a security information portal, testing and certification body .

During the year-ended 31 March 2016, sales to, and purchases from Virus Bulletin Limited were $0.0M (2015: $0.1M) and $0.0M (2015: 0.0M) respectively. At 31 March 2016, Amounts owed by Virus Bulletin were $0.0M (2015: $0.1M), No amounts were due to Virus Bulletin Limited.

During the year-ended 31 March 2016, no provisions were made for doubtful debts relating to amounts owed by related parties (2015: $Nil).

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

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

The Company and certain subsidiaries have provided unsecured guarantees to certain third parties within the normal course of business, the majority of which were in favour of certain lenders in respect of some of the Group's borrowing facilities. As at 31 March 2016, these guarantees totaled $328.4M (2015: $386.6M) relating to the Group's financing facilities.

### Compensation of key management personnel (including Directors)

| | Year-ended 31 March 2016 $M | Year-ended 31 March 2015 $M |
|---|---|---|
| Short-term employee benefits | 8.6 | 10.2 |
| Post-employment benefits | 0.1 | 0.1 |
| Share-based payments – equity-settled | 8.7 | 0.7 |
| Total | 17.4 | 11.0 |

As of 31 March 2016, the Group had a receivable of $Nil (2015: $0.2M from two Directors), and $Nil (2015: $0.1M from one senior manager). All amounts receivable had been received by 22 April 2015.

Short-term employee benefits comprise fees, salaries, benefits and bonuses earned during the year as well as non-monetary benefits.

Post-employment benefits comprise the cost of providing defined contribution pensions to senior management in respect of the current period.

Share-based payments comprise the cost of senior management's participation in share-based payment plans for the period as measured by the fair value of awards in accordance with IFRS2.

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS CONTINUED

For the year-ended 31 March 2016

## 33 BUSINESS COMBINATIONS

On 5 June 2015, Sophos Inc. acquired 100% of the share capital of Reflexion Networks Inc., a leader in e-mail security, archiving and encryption. Reflexion Networks Inc. was acquired to further enhance the Group's Cloud product offering.

Acquisition related expenses of $0.8M have been excluded from the consideration transferred and have been recognised as an expense within General finance and administration – exceptional items.

Assets acquired and liabilities assumed on the day of acquisition were as follows:

| | Book value $M | Adjustment $M | Fair value $M |
|---|---|---|---|
| **Non-current assets:** | | | |
| Intangible assets | | | |
| Intellectual Property | – | 1.9 | 1.9 |
| Customer relationships | – | 5.8 | 5.8 |
| Other non-current assets | 0.4 | – | 0.4 |
| **Current Assets:** | | | |
| Trade and other receivables | 0.5 | – | 0.5 |
| Deferred tax asset | – | – | – |
| Cash and cash equivalents | – | – | – |
| **Non-Current Liabilities:** | | | |
| Deferred tax liability | – | 3.1 | 3.1 |
| **Current liabilities:** | | | |
| Deferred revenues | 0.2 | – | 0.2 |
| Trade and other payables | 0.7 | – | 0.7 |
| Lease obligations | 0.2 | – | 0.2 |
| **Net assets recognised at the date of acquisition** | (0.2) | 4.6 | 4.4 |
| Cash paid | | | 15.0 |
| Contingent consideration (note 25) | | | 2.0 |
| **Goodwill arising on acquisition – Reflexion Networks Inc.** | | | 12.6 |

Prior to the acquisition, Reflexion Networks Inc. operated in a complimentary market sector to the Group and, accordingly, the results of Reflexion Networks Inc. are incremental to those of the Group. Revenue of $478.2M for the twelve-months to 31 March 2016 includes $5.1M in respect of Reflexion Networks Inc. The impact of Reflexion Networks Inc. on the operating loss of the Group for the period is insignificant. Had Reflexion Networks Inc. been owned since 1 April 2015, revenue for the year-ended 31 March 2016 would have increased over the reported revenue by approximately $1.0M. The impact on the operating loss of the Group would have been insignificant.

On 3 December 2015, Sophos B.V. completed the acquisition from common shareholders of 100% of the share capital of SurfRight B.V. and Threatstar Holdings B.V. to enhance the Group's next generation endpoint security offering.

Acquisition-related expenses of $0.4M have been excluded from the consideration transferred and have been recognised as an expense within General finance and administration – exceptional items.

Assets acquired and liabilities assumed on the day of acquisition were as follows:

| | Book value $M | Adjustment $M | Fair value $M |
|---|---|---|---|
| **Non-current assets:** | | | |
| Intangible assets | | | |
| Intellectual Property | – | 3.7 | 3.7 |
| Customer relationships | – | 0.3 | 0.3 |
| Brand | – | 0.1 | 0.1 |
| Other non-current assets | 0.3 | – | 0.3 |
| **Current Assets:** | | | |
| Trade and other receivables | 0.6 | – | 0.6 |
| Deferred tax asset | – | 0.3 | 0.3 |
| Cash and cash equivalents | 0.7 | – | 0.7 |
| **Non-Current Liabilities:** | | | |
| Deferred tax liability | – | 0.9 | 0.9 |
| **Current liabilities:** | | | |
| Deferred revenues | – | 1.3 | 1.3 |
| Trade and other payables | 1.0 | – | 1.0 |
| **Net assets recognised at the date of acquisition** | 0.6 | 2.2 | 2.8 |
| Cash paid | | | 31.8 |
| **Goodwill arising on acquisition – Threatstar Holdings B.V. and Surfright B.V.** | | | 29.0 |

Prior to the acquisition, Threatstar Holdings B.V. and Surfright B.V. operated in a complimentary market sector to the Group and accordingly the results of the companies are incremental to the Group. Revenue of 478.2M for the twelve months to 31 March 2016 includes $1.1M in respect of Surfright B.V. The impact of Surfright B.V. and Threatstar Holdings B.V. on the operating loss of the Group is insignificant. Had both companies been owned since 1 April 2015, revenue for the year-ended 31 March 2016 would have increased over the reported revenue by approximately $2.2M. The impact on the operating loss would have been insignificant.

In the prior year, on 6 October 2014, Sophos Inc. acquired 100% of the share capital of Mojave Networks Inc. a developer of cloud based network security technology. Mojave Networks Inc. was acquired to enhance the Group's Cloud product line.

Acquisition-related expenses of $0.6M have been excluded from the consideration transferred and has been recognised as an expense within General finance and administration – exceptional items.

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS CONTINUED

For the year-ended 31 March 2016

## 33 BUSINESS COMBINATIONS CONTINUED

Assets acquired and liabilities assumed on the day of acquisition were as follows:

| | Book value $M | Adjustment $M | Fair value $M |
|---|---|---|---|
| Non-current assets: | | | |
| Intangible assets | | | |
| Intellectual Property | – | 9.9 | 9.9 |
| Current Assets: | | | |
| Trade and other receivables | 0.3 | | 0.3 |
| Deferred tax asset | | | – |
| Cash and cash equivalents | 0.3 | – | 0.3 |
| Current liabilities: | | | |
| Deferred revenues | – | – | – |
| Trade and other payables | 0.4 | – | 0.4 |
| **Net assets recognised at the date of acquisition** | 0.2 | 9.9 | 10.1 |
| Cash paid | | | 10.3 |
| Cash payable | | | – |
| Goodwill arising on acquisition – Mojave Networks Inc. | – | – | 0.2 |
| Additions to goodwill in respect of Cyberoam Technologies Pvt Ltd. | | | |
| Fair value adjustment to fixed assets | – | – | 0.4 |
| Fair value adjustment to Inventories | – | – | 0.7 |
| Final working capital adjustment | – | – | 0.1 |
| **Goodwill arising on business acquisitions - Mojave Networks Inc.** | | | 1.4 |

Prior to the acquisition, Mojave Networks Inc. was a start-up technology company pioneering a cloud based approach to mobile and web security, as a result, the company's trading result would be insignificant to the Group. Had the company been owned by the Group since 1 April 2014, additional research and development costs of $1.3M would have been incurred.

Goodwill arose in all the above business combinations because the cost of the combination included amounts in relation to the benefit of expected synergies, future market development and the assembled workforce. These benefits are not recognised separately from Goodwill because they do not meet the recognition criteria for identifiable intangible assets. None of the goodwill recognised is expected to be deductible for income tax purposes.

## 34 NOTES TO THE CONSOLIDATED STATEMENT OF CASH FLOWS

| Disposal of subsidiary undertakings | Year-ended 31 March 2016 $M | Year-ended 31 March 2015 $M |
|---|---|---|
| Consideration received, satisfied in cash – Utimaco safeware AG | – | 4.5 |
| **Disposal of subsidiaries net of cash** | – | 4.5 |

| Acquisition of subsidiaries net of cash acquired | Year-ended 31 March 2016 $M | Year-ended 31 March 2015 $M |
|---|---|---|
| Consideration paid, satisfied in cash: | | |
| – Surfright B.V. and Threatstar Holdings B.V. | 31.8 | – |
| – Reflexion Networks Inc. | 15.0 | – |
| – Mojave Inc. | – | 10.3 |
| – Cyberoam Technologies Pvt Ltd | – | 0.2 |
| Net cash purchased | (0.8) | (0.3) |
| **Acquisition of subsidiaries net of cash** | 46.0 | 10.2 |

| Movement in net debt | 31 March 2015 $M | Cash flow $M | Non-cash movements $M | Effect of movements in exchange Rates $M | 31 March 2016 $M |
|---|---|---|---|---|---|
| Cash at bank and in hand | (59.0) | 10.5 | – | (1.2) | (49.7) |
| Short-term deposits | (13.6) | (4.1) | – | 0.6 | (17.1) |
| Cash and cash equivalents | (72.6) | 6.4 | – | (0.6) | (66.8) |
| Obligations under finance leases | 0.1 | (0.1) | 0.2 | – | 0.2 |
| Bank loans | 380.6 | (67.2) | 6.8 | 4.5 | 324.7 |
| Gross debt | 380.7 | (67.3) | 7.0 | 4.5 | 324.9 |
| Net debt | 308.1 | (60.9) | 7.0 | 3.9 | 258.1 |

| Movement in net debt | 31 March 2014 $M | Cash flow $M | Non-cash movements $M | Effect of movements in exchange Rates $M | 31 March 2015 $M |
|---|---|---|---|---|---|
| Cash at bank and in hand | (61.9) | (5.3) | – | 8.2 | (59.0) |
| Short-term deposits | (2.2) | (12.0) | – | 0.6 | (13.6) |
| Cash and cash equivalents | (64.1) | (17.3) | – | 8.8 | (72.6) |
| Obligations under finance leases | 0.2 | (0.1) | – | – | 0.1 |
| Bank loans | 406.4 | (4.2) | 1.1 | (22.7) | 380.6 |
| Gross Debt | 406.6 | (4.3) | 1.1 | (22.7) | 380.7 |
| Net debt | 342.5 | (21.6) | 1.1 | (13.9) | 308.1 |

## 35 COMMITMENTS AND CONTINGENT LIABILITIES

| Operating lease arrangements | Year-ended 31 March 2016 $M | Year-ended 31 March 2015 $M |
|---|---|---|
| Amount recognised for the year: | | |
| Property | 8.9 | 9.3 |
| Other | 1.4 | 1.4 |
| Total | 10.3 | 10.7 |

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

| | 31 March 2016 $M | 31 March 2015 $M |
|---|---|---|
| Within one year | 10.8 | 8.6 |
| In the second to fifth years inclusive | 28.0 | 22.7 |
| After five years | 10.8 | 9.1 |
| Total | 49.6 | 40.4 |

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS CONTINUED

For the year-ended 31 March 2016

## 35 COMMITMENTS AND CONTINGENT LIABILITIES CONTINUED

### Commitments for the acquisition of property, plant and equipment

At 31 March 2016 the Group had entered into contractual commitments for the acquisition of property, plant and equipment amounting to $0.8M (2015: $2.2M).

### Guarantees

At 31 March 2016 the Group had outstanding guarantees provided to third parties of $1.3M (2015:$1.1M).

### Legal proceedings

The Group is involved in a number of legal proceedings that are incidental to our business. Although it is possible that adverse decisions (or settlements) may occur in one or more of the cases, it is not currently possible to estimate the potential loss or losses. The final outcome of these proceedings, individually or in the aggregate, is not expected to have a material impact on the business.

Litigation is currently in process against an entity within the Group by RPost Holdings Inc. and Finjan Inc. Both companies allege patent infringements and claim unspecified damages. In accordance with IAS 37.92, the Group does not provide further information on the grounds that this could seriously prejudice the outcome of the litigation. The Directors are of the opinion that the claims can be successfully resisted by the Group.

## 36 PRINCIPAL EXCHANGE RATES

| Principal exchange rates | Year-ended 31 March 2016 | Year-ended 31 March 2015 |
|---|---|---|
| Translation of Sterling into US Dollar ($:£1.00) | | |
| Average | 1.5057 | $1.6238 |
| Closing | 1.4373 | $1.4845 |
| Translation of Euro into US Dollar ($:€1.00) | | |
| Average | 1.0969 | $1.2749 |
| Closing | 1.1395 | $1.0740 |

## 37 EVENTS AFTER THE REPORTING PERIOD

There are no material events after the reporting period which require disclosure under IAS 10.

# COMPANY ONLY STATEMENT OF FINANCIAL POSITION

At 31 March 2016

Registered number 9608658

| | Note | 31 March 2016 $M |
|---|---|---|
| **Non-current assets** | | |
| Deferred tax asset | | 5.9 |
| Investments | 3 | 1,045.3 |
| Loan due from subsidiary | 4 | 93.5 |
| | | 1,144.7 |
| **Current assets** | | |
| Trade and other receivables | | 0.3 |
| Amounts due from subsidiaries | | 22.3 |
| **Total current assets** | | 22.6 |
| **Total assets** | | 1,167.3 |
| **Current liabilities** | | |
| Trade and other payables | | 0.7 |
| Amounts due to subsidiaries | | 16.7 |
| **Total Liabilities** | | 17.4 |
| **Net assets** | | 1,149.9 |
| **Represented by:** | | |
| Share capital | 5 | 21.3 |
| Share Premium | | 115.9 |
| Retained earnings | | 993.7 |
| Share-based payment reserve | | 19.0 |
| **Total equity** | | 1,149.9 |

Sophos Group plc was incorporated on 26 May 2015 and as such does not present comparatives of its statement of financial position.

These financial statements were approved by the Board of Directors on 25 May 2016 and were signed on its behalf by:

**Nick Bray**
**Chief Financial Officer**

The notes on pages 121 to 122 form an integral part of these financial statements.

# COMPANY ONLY STATEMENT OF CHANGES IN EQUITY

For the year-ended 31 March 2016

| | Share Capital $M | Share Premium $M | Retained Earnings $M | Share Based Payment Reserve $M | Total $M |
|---|---|---|---|---|---|
| **On Incorporation 26 May 2015** | – | – | – | – | – |
| Loss for the period: | – | – | (21.4) | – | (21.4) |
| Total comprehensive loss | – | – | (21.4) | – | (21.4) |
| Issue Shares | 552.6 | 483.1 | – | – | 1,035.7 |
| Capital reduction | (533.1) | (483.0) | 1,018.2 | – | 2.1 |
| Primary proceeds | 1.7 | 123.3 | – | – | 125.0 |
| Share issue expenses | – | (8.6) | – | – | (8.6) |
| Share options exercised | 0.1 | 1.1 | – | – | 1.2 |
| Share-based payments – expense | – | – | – | 15.0 | 15.0 |
| Share-based payments – deferred tax | – | – | – | 4.0 | 4.0 |
| Cash Dividend | – | – | (3.1) | – | (3.1) |
| **At 31 March 2016** | 21.3 | 115.9 | 993.7 | 19.0 | 1,149.9 |

The notes on pages 121 to 122 form an integral part of these financial statements.

# NOTES TO THE COMPANY FINANCIAL STATEMENTS

## 1 PRINCIPAL ACCOUNTING POLICIES

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

### Basis of preparation

The Company and its trading subsidiaries have considerable financial resources and a large number of customer contracts across different geographic areas and industries. As a consequence, the Directors believe the Company is well placed to manage its business risks successfully.

The Company operates as an investment company for the Sophos Group, holding investments in subsidiaries financed by Group companies. As the Company is an intrinsic part of the Group's structure, the Directors have a reasonable expectation that Group companies will continue to support the Company through trading and cash generated from trading for the foreseeable future. Thus they continue to adopt the going concern basis in preparing the financial statements.

The financial statements have been prepared in accordance with Financial Reporting Standard 102 ("FRS 102") and under the historical cost accounting rules.

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

The company is considered to be a qualifying entity for the purposes of FRS 102 and has applied the exemptions available under FRS 102 in respect of the cash flow statement and key management personnel compensation.

As the consolidated financial statements of the Company include the equivalent disclosures, the Company has also taken the exemptions available under FRS 102 in respect of disclosures in respect of share-based payments, financial instruments and the requirements of Section 33 Related Party Disclosures paragraph 33.7.

### Investments

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

### Foreign currencies

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

### Interest bearing loans and borrowings

Obligations for loans and borrowings are recognised when the Company becomes party to the related contracts and are measured initially at fair value less directly attributable transactions costs. After initial recognition, interest bearing loans and borrowings are subsequently measured at amortised cost using the effective interest method. Gains and losses arising on the repurchase, settlement or otherwise cancellation of liabilities are recognised respectively in finance income and finance expense.

### Going Concern basis

The Company operates as an investment company for the Sophos Group, holding investments in subsidiaries financed by Group companies. As the Company is an intrinsic part of the Group's structure, the Directors have a reasonable expectation that Group companies will continue to support the Company through trading and cash generated from trading for the foreseeable future. Thus they continue to adopt the going concern basis in preparing the financial statements.

# NOTES TO THE COMPANY FINANCIAL STATEMENTS CONTINUED

For the year-ended 31 March 2016

## 2 PROFIT AND LOSS ACCOUNT

The loss after tax dealt with in the books of the Company was $21.4M. Under section 408 of the Companies Act 2006 the Company is exempt from the requirement to present its own profit and loss account.

## 3 INVESTMENTS

| | 31 March 2016 $M |
|---|---|
| At 26 May 2015 | – |
| Investment in Sophos Holdings Limited | 1,035.8 |
| Investment in Sophos Limited | 9.4 |
| Investment in employee benefit trust | 0.1 |
| **Total** | 1,045.3 |

The investment in Sophos Holdings Limited, a holding company for the Sophos Group, comprises 100% of the ordinary share capital.

The investment in Sophos Limited comprises share-based payment expenses for equity awards granted to participants employed by Sophos Limited and its subsidiaries.

## 4 LOAN DUE FROM SUBSIDIARY

As part of the re-financing of the Group on 1 July 2015, The Company lent $93.5M to Sophos Holdings Limited, a 100% owned subsidiary.

The loan carries a variable interest rate based on the Group's Senior Facility A loan plus a margin of 0.1% and is repayable in full at the end of a 60-month term on 1 July 2020.

## 5 SHARE CAPITAL

| Allotted, called up and fully paid shares of £0.03 each | 000's | Year-ended 31 March 2016 $M |
|---|---|---|
| On incorporation 26 May 2015 | – | – |
| Share issuance | 414,655 | 19.5 |
| Initial Public Offering | 35,345 | 1.7 |
| Issued on exercise of share options | 2,172 | 0.1 |
| **At 31 March 2016** | 452,172 | 21.3 |

## 6 FUNCTIONAL CURRENCY

Sophos Group plc is registered in England and Wales and has a functional currency of US Dollars, as this is the currency of the primary economic environment in which the entity operates.

# GLOSSARY

| | |
|---|---|
| **AES** | Advanced Encryption Standard |
| **Americas** | North and South America |
| **APJ** | Asia-Pacific & Japan |
| **Billings** | Billings represents the value of products and services invoiced to customers after receiving a purchase order from the customer and delivering products and services to them, or for which there is no right to a refund for undelivered items |
| **Blue chip** | Channel partners who transact five or more deals in a trailing six-month period |
| **Board** | The Board of Directors of Sophos Group plc |
| **BYOD** | Bring Your Own Device |
| **Cash EBITDA** | Cash EBITDA is defined as the Group's operating profit adjusted for depreciation and amortisation charges, any gains or losses on the sale of tangible and intangible assets, share option charges, unrealised foreign exchange differences and exceptional items with billings replacing revenue |
| **Cash EBITDA margin** | Cash EBITDA margin is calculated as cash EBITDA as a percentage of billings |
| **Channel first** | The distribution model used by the Group, where products are sold to end customers through a network of channel partners and distributors |
| **Company** | Sophos Group plc |
| **CAGR** | Compound annual growth rate |
| **Directors** | The Executive and Non-Executive Directors of the Company |
| **DPI** | Deep Packet Inspection |
| **DMR** | Direct Market Reseller |
| **EBITDA** | Earnings before interest, taxation, depreciation and amortisation |
| **EMEA** | Europe, Middle East and Africa |
| **FDE** | Full Disk Encryption |
| **FIPS** | U.S. Federal Information Processing Standards |
| **GHG** | Greenhouse gas |
| **Group** | The group of companies owned by Sophos Group plc |
| **HTML5** | The fifth revision of the HyperText Markup Language of the internet used for structuring and presenting content for the world wide web |
| **IASB** | International Accounting Standards Board |
| **IDP** | Intrusion Detection and Prevention |
| **IFRS** | International Financial Reporting Standards as adopted by the European Union |
| **IoT** | Internet of Things |
| **IPO** | Initial public offering of the Company's shares completed in July 2015 |
| **KPI** | Key Performance Indicator |
| **Like-for-like billings** | Like-for-like billings represent billings on a constant currency basis excluding disposals and including acquisitions from the point of acquisition plus the pre-acquisition billings of any acquired companies on a reported basis. |
| **MSP** | Managed Service Provider |
| **OEM** | Original Equipment Manufacturer |
| **RED** | Remote Ethernet Device |
| **Renewal rate** | Renewal rates are calculated by comparing the actual US Dollar amount of contracts renewed in a period (including instances of cross-sell and up-sell) to the US Dollar amount of total contracts available to be renewed in that period |
| **Secure SSL** | Secure Sockets Layer, a standard security technology for establishing an encrypted link between a server and a client |
| **SIEM** | Security Incident and Event Management |
| **SI** | System Integrator |
| **Unlevered free cash flow** | Unlevered free cash flow represents cash EBITDA less purchases of property, plant and equipment and intangibles, plus cash flows in relation to changes in working capital and taxation |
| **UTM/NGFW** | Unified Threat Management/Next-Generation Firewall |
| **VAR** | Value-Added Reseller |
| **VPN** | Virtual Private Network |

# COMPANY INFORMATION

## DIRECTORS

Peter Gyenes

Kris Hagerman

Nick Bray

Sandra Bergeron

Edwin Gillis

Salim Nathoo

Roy Mackenzie

Steve Munford

Paul Walker

## REGISTERED OFFICE

Sophos Group plc
The Pentagon, Abingdon Science Park
Abingdon
OX14 3YP

Registered number: 09608658

www.sophos.com

## REGISTRAR SERVICES

Capita Asset Services

The Registry
34 Beckenham Road
Beckenham
BR3 4TU

## PUBLIC RELATIONS

Brunswick Group
16 Lincoln's Inn Field
London
WC2A 3ED

## INVESTOR RELATIONS

investors.sophos.com

investor.relations@sophos.com

## AUDITOR

KPMG LLP
15 Canada Square
London
E14 5GL

Designed and produced by
ACCRUE FULTON
www.accruefulton.com

SOPHOS

Security made simple.