

Sophos Plc

Directors' report and consolidated
financial statements

Registered number 2096520

31 March 2006

Contents

Directors' report	1
Statement of directors' responsibilities	4
Independent auditors' report to the members of Sophos Plc	5
Consolidated profit and loss account	7
Consolidated statement of total recognised gains and losses	8
Consolidated balance sheet	9
Company balance sheet	10
Consolidated cash flow statement	11
Reconciliations of movements in shareholders' funds	12
Notes	13

Directors' report

The directors present their annual report and the audited financial statements for the year ended 31 March 2006.

Principal activities

The group is principally engaged in the business of developing, selling and supporting software for computer security. Towards the end of the financial year the group introduced a hardware appliance into its product range.

Business review and future plans

Sophos achieved its seventeenth year of growth in turnover in the fiscal year ended 31 March 2006. Turnover grew by 13.5% from £60.0 million (as restated) to £68.1 million with increases across all major geographic territories. At 20% year on year, growth was particularly strong in Europe and the Asia Pacific region.

Cash flow from operating activities in the year remained strong at £16.9 million compared with £16.7 million in the prior year. Cash holdings at the year end grew from £21.2 million to £38.2 million.

Administrative expenses (which include sales and engineering costs) grew by £10.5 million. The growth in administrative expenses is primarily accounted for by investment in product development and engineering. This investment is already bearing fruit in the form of new product releases with two major product releases in the last quarter of the year. This included the launch of the group's first hardware appliance-based security solution, which has been well received by end users and channel sales partners. New products were launched for the Linux and Mac markets, which evidence the group's support for non-Windows environments. In the same quarter the group also released a beta version of its flagship enterprise endpoint security product, which was followed by the full launch of the product itself in May 2006.

During the year, Sophos has also made major investments in IT systems and infrastructure, which are expected to generate efficiencies and support the future growth objectives of the group.

During the year the group has made several senior management appointments to strengthen its strategic leadership. In January 2006 Stephen Munford was promoted to Chief Executive Officer from his prior role of Chief Operating Officer and Peter Gyenes was appointed Non-Executive Chairman in March 2006. The company's founders, Peter Lammer and Jan Hruska have adopted non-executive director roles from January 2006.

In February 2006, Sophos sold the business assets and liabilities of its ActiveState division for proceeds of £1.0 million and a gain of £0.7 million. The sale included the transfer of 20 employees who were exclusively involved in the operations of the division. The sale was undertaken as the division's business, which focused on building dynamic programming tools and services for scripting languages, was not core to the group's primary business of developing, selling and supporting software for computer security.

Employee numbers increased from 852 at 31 March 2005 to 946 at 31 March 2006. Most of the net growth took place in the engineering and technical departments.

Whilst it does not affect operating cash flow, the directors' decision to change the group's revenue recognition policy has had a material impact upon the trend in profitability. Under the new revenue recognition policy, all software licence revenue is recognised rateably over the licence term, and therefore has the effect of deferring a higher proportion of bookings to future periods. Previously the licence element of the software was recognised at the start of a software licence and only the services revenue was recognised rateably over the licence term. The change in revenue recognition policy is in line with developing industry practice in the UK and remains in accordance with UK GAAP. The new policy aligns closely with US GAAP and reflects the increasing importance to the group of the North American market.

This accounting policy change has necessitated a prior year adjustment to the previously stated results for the year ended 31 March 2005 and the balance sheet at that date. The reduction in the group's revenue for this and prior years has resulted in a corresponding increase in the group's deferred revenue creditor. The amount originally reported at 31 March 2005 was £37.1 million, which has been restated to £70.8 million. At 31 March 2006 the deferred revenue creditor in the balance sheet was £80.7 million, which represents an increase over the previous year of 14%.

Directors' report *(continued)*

Principal risks and uncertainties

Competitive pressure in all markets is a continuing risk for the group. This risk is managed by maintaining strong relationships with and providing added value services to customers. Investment in research and development also contributes to this end. The group actively promotes its brand which is underpinned by the group's strategy.

As the group operates in a number of markets in different currencies, there is an inherent exposure to exchange risk.

The group has no third party debt and therefore has no interest exposure.

Proposed dividend

The directors do not recommend the payment of a dividend (2005: *£nil*).

Market value of land and buildings

The company has as its global headquarters a building that was designed and constructed for Sophos. The building's open market value, based on typical rental yields of non-specialist commercial properties, would be substantially below the cost and net book value recorded in the group's accounts. However, in the opinion of the directors, this difference is not significant since the group intends to occupy the building as its headquarters for the foreseeable future.

Research and development

The group continues to undertake research and development relating to the principal activity.

Directors and directors' interests

The directors who held office during the year and their interests in the issued ordinary shares of Sophos Plc according to the register of directors' interests were:

Name	Title	Interest at end of year £0.0002 shares	Interest at start of year £0.0002 shares
Peter Gyenes (appointed 1 March 2006)	Non-Executive Chairman	-	-
Jan Hruska	Founder & Non-Executive Director	111,499,200	111,499,200
Richard Jacobs	Chief Technology Officer	2,525,000	2,525,000
Peter Lammer	Founder & Non-Executive Director	111,499,200	111,499,200
Stephen Munford	Chief Executive Officer	-	-
Ajit Nedungadi	Non-Executive Director	-	-
Peter Norman	VP of Marketing and Product Management	200,000	200,000

According to the register of directors' interests no rights to subscribe for ordinary shares in the Company were granted to any of the directors or their immediate families, or exercised by them, during the financial year except as indicated below:

	Number of options granted over £0.0002 shares
Peter Gyenes	3,195,610
Richard Jacobs	500,000
Stephen Munford	5,585,571
Peter Norman	1,500,000

In addition to the above, Stephen Munford was awarded 2,396,708 options over £0.0002 shares during the financial year with a grant date of 25 May 2006.

Directors' report *(continued)*

Employee involvement

A key objective for 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 in-house newsletters, the group intranet, individual development reviews and team or company briefings. Employees are encouraged to promote and participate in the progress and profitability of the group through the employee share purchase plan, profit bonus and other incentive schemes. During the year the group introduced share option plans for its employees.

Disabled employees

The group gives full consideration to applications for employment from disabled persons where the requirements of the job can be adequately fulfilled by a handicapped or 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 and promotion to disabled employees wherever appropriate.

Environment

Sophos recognises the importance of its environmental responsibilities. The group aims to reduce any damage that might be caused by the group's activities. Initiatives intended to minimise the group's impact on the environment include recycling and reducing energy consumption.

Political and charitable donations

The group made no political donations during the year. Contributions to local charities totalled £500 (2005: £500).

Policy and practice on payment of creditors

It is the group's policy to pay its suppliers on a timely basis and in accordance with agreed terms.

Trade creditors of the group at 31 March 2006 were equivalent to 21 days (2005: 19 days) purchases, based on the average daily amount invoiced by suppliers during the year.

Disclosure of relevant information to auditors

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

Auditors

In accordance with Section 384 of the Companies Act 1985, a resolution for the re-appointment of KPMG LLP as auditors of the company is to be proposed at the forthcoming Annual General Meeting.

On behalf of the board

Stephen Munford
Director

The Pentagon
Abingdon Science Park
Abingdon
Oxon
OX14 3YP

19 July 2006

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

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

Company law requires the directors to prepare group and parent company financial statements for each financial year. Under that law they have elected to prepare the group and parent company financial statements in accordance with UK Accounting Standards.

The group and the parent company financial statements are required by law to give a true and fair view of the state of affairs of the group and parent company and of the profit or loss of the group for that period.

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

- select suitable accounting policies and then apply them consistently;
- make judgments and estimates that are reasonable and prudent;
- state whether applicable UK Accounting Standards have been followed, subject to any material departures disclosed and explained in the financial statements; and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the group and the parent company will continue in business.

The directors are responsible for keeping proper accounting records that disclose with reasonable accuracy at any time the financial position of the company and enable them to ensure that its financial statements comply with the Companies Act 1985. They have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the group and to prevent and detect fraud and other irregularities.

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



KPMG LLP

Arlington Business Park

Theale

Reading

RG7 4SD

Independent auditors' report to the members of Sophos Plc

We have audited the group and parent company financial statements (the "financial statements") of Sophos Plc for the year ended 31 March 2006 which comprise the Consolidated Profit and Loss Account, the Consolidated and Company Balance Sheets, the Consolidated Cash Flow Statement, the Consolidated Statement of Total Recognised Gains and Losses and the related notes. These financial statements have been prepared under the accounting policies set out therein.

This report is made solely to the company's members, as a body, in accordance with section 235 of the Companies Act 1985. Our audit work has been undertaken so that we might state to the company's members those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the company and the company's members as a body, for our audit work, for this report, or for the opinions we have formed.

Respective responsibilities of directors and auditors

As described in the Statement of Directors' Responsibilities on page 4, the company's directors are responsible for the preparation of the financial statements in accordance with applicable law and UK Accounting Standards (UK Generally Accepted Accounting Practice).

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

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

We read the Directors' Report and consider the implications for our report if we become aware of any apparent misstatements within it.

Basis of audit opinion

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

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

Independent auditors' report to the members of Sophos Plc *(continued)*

Opinion

In our opinion:

- the financial statements give a true and fair view, in accordance with UK Generally Accepted Accounting Practice, of the state of affairs of the company and the group as at 31 March 2006 and of the loss of the group for the year then ended;
- the financial statements have been properly prepared in accordance with the Companies Act 1985; and
- the information given in the Directors' Report is consistent with the financial statements.

KPMG LLP
Chartered Accountants
Registered Auditor

19 July 2006

Consolidated profit and loss account
for the year ended 31 March 2006

	<i>Note</i>	2006 £000	2005 £000 (restated)
Turnover	3	68,103	60,004
Cost of sales		(875)	(1,761)
Gross profit		67,228	58,243
Administrative expenses		(69,561)	(59,153)
Other operating income		165	202
Operating loss		(2,168)	(708)
EBITDA*		5,884	6,972
Profit on sale of a business unit	7	701	-
Interest receivable and similar income	8	1,307	589
Loss on ordinary activities before taxation		(160)	(119)
Tax on loss on ordinary activities	9	(1,203)	(953)
Loss for the financial year	19	(1,363)	(1,072)

The accounts have been prepared on an unmodified historical cost basis.

* EBITDA is "Earnings before interest, tax, depreciation and amortisation" and is calculated as operating loss excluding depreciation of tangible fixed assets and amortisation of goodwill.

Consolidated statement of total recognised gains and losses

for the year ended 31 March 2006

	2006	2005
	£000	£000
		(restated)
Loss for the financial year	(1,363)	(1,072)
Translation differences on foreign currency investments - net	10	279
	<hr/>	<hr/>
Total recognised losses relating to the year	(1,353)	(793)
		<hr/> <hr/>
Prior year adjustment (as explained in note 2)	(23,781)	
	<hr/>	
Total losses recognised since last annual report	(25,134)	
	<hr/> <hr/>	

Consolidated balance sheet

at 31 March 2006

	<i>Note</i>	2006 £000	2006 £000	2005 £000 (restated)	2005 £000 (restated)
Fixed assets					
Intangible assets	<i>10</i>		2,053		6,716
Tangible assets	<i>11</i>		35,395		36,655
			<hr/>		<hr/>
			37,448		43,371
Current assets					
Stocks	<i>13</i>	82		55	
Debtors	<i>14</i>	27,480		25,364	
Cash at bank and in hand	<i>24</i>	38,159		21,235	
			<hr/>		<hr/>
			65,721	46,654	
Creditors: amounts falling due within one year	<i>15</i>	(60,405)		(53,113)	
			<hr/>	<hr/>	
Net current assets / (liabilities)			5,316		(6,459)
			<hr/>	<hr/>	
Total assets less current liabilities			42,764		36,912
Creditors: amounts falling due after more than one year	<i>16</i>		(31,013)		(24,329)
Provisions for liabilities and charges	<i>17</i>		(3,966)		(3,591)
			<hr/>	<hr/>	
Net assets			7,785		8,992
			<hr/> <hr/>	<hr/> <hr/>	
Capital and reserves					
Called up share capital	<i>18</i>		64		64
Share premium account	<i>19</i>		757		611
Profit and loss account	<i>19</i>		6,964		8,317
			<hr/>	<hr/>	
Shareholders' funds			7,785		8,992
			<hr/> <hr/>	<hr/> <hr/>	

These financial statements were approved by the board of directors on 19 July 2006 and were signed on its behalf by:

Stephen Munford
Director

Company balance sheet

at 31 March 2006

	<i>Note</i>	2006 £000	2006 £000	2005 £000 (restated)	2005 £000 (restated)
Fixed assets					
Intangible assets	<i>10</i>		7,166		-
Tangible assets	<i>11</i>		33,808		35,250
Investments	<i>12</i>		142		142
			<hr/>		<hr/>
			41,116		35,392
Current assets					
Stocks	<i>13</i>	82		55	
Debtors	<i>14</i>	26,305		30,677	
Cash at bank and in hand		33,462		18,086	
			<hr/>	<hr/>	
			59,849	48,818	
Creditors: amounts falling due within one year	<i>15</i>	(40,567)		(41,438)	
			<hr/>	<hr/>	
Net current assets			19,282		7,380
			<hr/>	<hr/>	
Total assets less current liabilities			60,398		42,772
Creditors: amounts falling due after more than one year	<i>16</i>		(21,744)		(11,406)
Provisions for liabilities and charges	<i>17</i>		(4,389)		(3,428)
			<hr/>	<hr/>	
Net assets			34,265		27,938
			<hr/>	<hr/>	
Capital and reserves					
Called up share capital	<i>18</i>		64		64
Share premium account	<i>19</i>		757		611
Profit and loss account	<i>19</i>		33,444		27,263
			<hr/>	<hr/>	
Shareholders' funds			34,265		27,938
			<hr/>	<hr/>	

These financial statements were approved by the board of directors on 19 July 2006 and were signed on its behalf by:

Stephen Munford
Director

Consolidated cash flow statement

for the year ended 31 March 2006

	<i>Note</i>	2006 £000	2005 £000 (restated)
Cash flow statement			
Cash flow from operating activities	22	16,893	16,749
Returns on investments and servicing of finance	23	1,307	589
Taxation		(587)	(3,825)
Capital expenditure and financial investment	23	(2,014)	(2,629)
Acquisitions and disposals	23	1,021	-
		<hr/>	<hr/>
Cash inflow before management of liquid resources and financing		16,620	10,884
Management of liquid resources	23	(15,613)	(12,398)
Financing	23	146	-
		<hr/>	<hr/>
Increase/(decrease) in cash in the period		1,153	(1,514)
		<hr/> <hr/>	<hr/> <hr/>
Reconciliation of net cash flow to movement in net funds			
Increase/(decrease) in cash in the period	24	1,153	(1,514)
Cash outflow to liquid resources	24	15,613	12,398
		<hr/>	<hr/>
Change in net funds resulting from cash flows		16,766	10,884
Exchange differences	24	158	44
		<hr/>	<hr/>
Movement in net funds in the period		16,924	10,928
Net funds at the start of the period		21,235	10,307
		<hr/>	<hr/>
Net funds at the end of the period		38,159	21,235
		<hr/> <hr/>	<hr/> <hr/>

Reconciliations of movements in shareholders' funds

for the year ended 31 March 2006

	Group		Company	
	2006 £000	2005 £000 (restated)	2006 £000	2005 £000 (restated)
Profit/(loss) for the financial year	(1,363)	(1,072)	6,181	7,062
New share capital subscribed (net of issue costs)	146	-	146	-
Exchange differences on foreign currency investments – net	10	279	-	-
Net addition/(reduction) to shareholders' funds	(1,207)	(793)	6,327	7,062
Opening shareholders' funds (restated)*	8,992	9,785	27,938	20,876
Closing shareholders' funds	7,785	8,992	34,265	27,938

* Opening shareholders' funds at 1 April 2005 as previously stated were £32,773,000 for the group and £40,285,000 for the company.

Notes

(forming part of the financial statements)

1 Accounting policies

The following accounting policies have been applied consistently in dealing with items which are considered material in relation to the group's and parent company's financial statements, except as noted below.

In these financial statements the following new standards have been adopted for the first time:

- FRS 21 'Events after the balance sheet date';
- The presentation requirements of FRS 25 'Financial instruments: presentation and disclosure'; and
- FRS 28 'Corresponding amounts'.

There was no impact from the adoption of FRS 21 or FRS 25. FRS 28 'Corresponding amounts' has had no material effect as it imposes the same requirements for comparatives as hitherto required by the Companies Act 1985.

The group has revised its accounting policy for revenue recognition. Details are set out in the turnover accounting policy and in note 2.

Basis of preparation

The financial statements have been prepared in accordance with applicable accounting standards and under the historical cost accounting rules.

Basis of consolidation

The consolidated financial statements include the financial statements of the company and its subsidiary undertakings made up to 31 March 2006. The acquisition method of accounting has been adopted. Under this method, the results of subsidiary undertakings acquired or disposed of in the year are included in the consolidated profit and loss account from the date of acquisition or up to the date of disposal.

Under section 230(4) of the Companies Act 1985 the company is exempt from the requirement to present its own profit and loss account.

In the company's separate financial statements, investments in subsidiary undertakings are stated at cost, less any provision for impairment.

Under the exemption within Financial Reporting Standard 8, the group has elected not to disclose transactions made between companies within the group.

Turnover

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

Customers generally enter into annual or longer term contracts with the group. Most commonly, customers receive software products at the start of the contract under a fixed term licence and are also entitled to receive regular updates or other services for the duration of the licence term. During the year to 31 March 2006 the group also began to sell hardware appliances. Revenue attributable to hardware, software products, updates or other services is recognised rateably over the duration of the contract.

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

Goodwill

Purchased goodwill (representing the excess of the fair value of the consideration given over the fair value of the separable net assets acquired) arising on consolidation is capitalised. Goodwill is amortised to nil by equal annual instalments over its estimated useful life. On the subsequent disposal of a business acquired, the profit or loss on disposal is calculated after charging the unamortised amount of any related goodwill.

Notes (continued)

1 Accounting policies (continued)

Intangible fixed assets and amortisation

Purchased intangible fixed assets are capitalised at their cost and amortised by equal annual instalments over their estimated economic lives.

Tangible fixed assets and depreciation

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

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

From 1 April 2005 depreciation has been calculated on a monthly basis. Previously an annual basis was used. The effect of this change was to reduce the depreciation charge for the current year. This amounted to a reduction of £147,000 for the company and £391,000 for the group

No depreciation is provided on freehold land.

Foreign currencies

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

The assets and liabilities of overseas subsidiary undertakings and related goodwill are translated at the closing exchange rates. Profit and loss accounts of such undertakings are consolidated at the average rates of exchange during the year. Gains and losses arising on these translations are taken to reserves, net of exchange differences arising on related foreign currency borrowings.

Leases

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

Post retirement benefits

The group operates defined contribution pension schemes. The assets of the schemes are held separately from those of the group in independently administered funds. The amount charged against profits represents the contributions payable to the schemes in respect of the accounting period.

Research and development expenditure

Expenditure on research and development is written off against profits in the year in which it is incurred.

Stocks

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

Notes (continued)

1 Accounting policies (continued)

Taxation

The charge for taxation is based on the profit for the year and takes into account taxation deferred because of timing differences between the treatment of certain items for taxation and accounting purposes. Deferred tax is recognised, without discounting, in respect of all timing differences between the treatment of certain items for taxation and accounting purposes which have arisen but not reversed by the balance sheet date, except as otherwise required by FRS 19.

Cash and liquid resources

Cash, for the purpose of the cash flow statement, comprises cash in hand and deposits with banks repayable on demand, less overdrafts payable on demand.

Liquid resources are current asset investments which are disposable without curtailing or disrupting the business and are either readily convertible into known amounts of cash at or close to their carrying values or traded in an active market. Liquid resources comprise term deposits of less than one year (other than cash) and investments in money market managed funds.

2 Prior year adjustment

During the year ended 31 March 2006 the Board has reviewed the group's accounting policy for revenue recognition. Previously the group unbundled its revenue into licence and service elements. Licence revenue was recognised at the start of the contract period and services revenue was recognised rateably over the contract term. The revised policy is detailed in note 1. The Board considers the new policy more appropriate since it is in line with developing industry practice in the UK and also aligns closely with US GAAP.

The revision has resulted in the restatement of the corresponding amounts for the year ended 31 March 2005 and the balance sheet at that date. The effect of the change in accounting policy on the results of the group for the year ended 31 March 2005 is to revise the profit on ordinary activities before taxation from £6,107,000 to a loss of £119,000, an adjustment of £6,226,000.

The change in revenue recognition policy has also had an impact on the deferred tax position within the group. The effect of this timing difference on the year ended 31 March 2005 is to create a deferred tax asset of £1,962,000. The tax charge as previously stated was £2,915,000 and therefore is revised to a charge of £953,000. The group's opening profit and loss reserve at 1 April 2004 has been revised from £28,604,000 to £9,110,000, an adjustment of £19,494,000. The currency translation differences accounted for within reserves for the year ended 31 March 2005 have been revised from £302,000 to £279,000.

If there had been no change in accounting policy the profit on ordinary activities before taxation for the year ended 31 March 2006 would have been £3,367,000. The corresponding deferred tax asset at 31 March 2006 would have been £3,149,000 and the tax charge to the profit and loss account would have been £2,589,000.

Notes (continued)

3 Segmental information

	2006	2005 (restated)
Turnover	£000	£000
United Kingdom	22,861	19,336
Americas	21,495	21,072
Continental Europe	15,921	13,164
Rest of the World	7,826	6,432
	<u>68,103</u>	<u>60,004</u>

In the opinion of the directors the disclosure of profit before interest and tax and net assets by geographical segment as required by SSAP 25 'Segmental analysis' would be seriously prejudicial to the interests of the company and therefore this information has not been disclosed.

The directors consider there to be a single class of business.

4 Profit on ordinary activities before taxation

	2006	2005
<i>Profit on ordinary activities before taxation is stated after charging/(crediting):</i>	<i>£000</i>	<i>£000</i>
Auditor's remuneration:		
- audit (including in respect of the company £30,900 (2005: £27,500))	70	40
- fees paid to the auditor and its associates in respect of other services	124	120
Depreciation and other amounts written off tangible fixed assets	3,350	3,284
Hire of plant and machinery - rentals payable under operating leases	15	7
Hire of other assets - operating leases	139	137
Research and development expenditure	13,637	10,138
Amortisation of goodwill	4,702	4,396
Profit on sale of tangible fixed assets	(36)	(4)
	<u> </u>	<u> </u>

5 Remuneration of directors

	2006	2005
	£000	£000
Directors' emoluments	952	861
Compensation for loss of office	-	42
Company contributions to money purchase pension schemes	3	7
	<u>955</u>	<u>910</u>

The aggregate of emoluments of the highest paid director was £357,000 (2005: £218,000), and no company pension contributions were made to a money purchase scheme on his behalf (2005: £nil).

Retirement benefits are accruing to the following number of directors under:

	Number of directors	
	2006	2005
Money purchase schemes	<u>1</u>	<u>2</u>

Notes (continued)

5 Remuneration of directors (continued)

There were no directors (2005: no directors) in respect of whose services shares were received or receivable under long term incentive schemes and no directors (2005: no directors) who exercised share options.

Directors' rights to subscribe for shares in or debentures of the company and its subsidiaries are indicated below:

Director	Number of options granted over £0.0002 shares		
	At start of year	At end of year	Exercise price (pence)
Peter Gyenes	-	3,195,610	28.2
Jan Hruska	-	-	-
Richard Jacobs	-	500,000	28.2
Peter Lammer	-	-	-
Stephen Munford	-	5,585,571	28.2
Ajit Nedungadi	-	-	-
Peter Norman	-	1,500,000	28.2

In addition to the above, Stephen Munford was awarded 2,396,708 options over £0.0002 shares during the financial year with a grant date of 25 May 2006.

6 Staff numbers and costs

The average number of persons employed by the group (including directors) during the year, analysed by category, was as follows:

	Number of employees	
	2006	2005
Technical	489	400
Sales and marketing	332	337
Administration	125	115
	946	852
	946	852

The aggregate payroll costs of these persons were as follows:

	2006	2005
	£000	£000
Wages and salaries	38,724	33,407
Social security costs	4,332	3,272
Other pension costs	827	641
	43,883	37,320
	43,883	37,320

7 Profit on sale of a business unit

The profit on sale of a business unit relates to the group's disposal of the net assets of the ActiveState division of a wholly owned subsidiary, Sophos Inc, Canada on 21 February 2006.

	£000
Sale proceeds	1,021
Net liabilities disposed of	196
Net book value of goodwill disposed of	(516)
	701
Profit on disposal	701

Notes (continued)

8 Interest receivable

	2006	2005
	£000	£000
Bank interest receivable	1,161	589
Other interest receivable	146	-
	<hr/>	<hr/>
	1,307	589
	<hr/> <hr/>	<hr/> <hr/>

9 Taxation

	2006	2005
	£000	£000
<i>UK corporation tax</i>		(restated)
Current tax on income for the period at 30% (2005: 30%)	2,192	3,281
Credit in respect of prior year adjustment	(5,290)	-
Adjustments in respect of prior periods	-	(82)
	<hr/>	<hr/>
	(3,098)	3,199
<i>Foreign tax</i>		
Current tax on income for the period	612	519
Adjustments in respect of prior periods	(260)	(2)
	<hr/>	<hr/>
Total current tax (credit)/charge	(2,746)	3,716
Deferred tax charge/(credit) (see note below)	3,949	(2,763)
	<hr/>	<hr/>
	1,203	953
	<hr/> <hr/>	<hr/> <hr/>

<i>Deferred tax</i>	Assets	Provision	Net
	(note 14)	(note 17)	
	£000	£000	£000
At 1 April 2005 (as restated)	(11,902)	2,703	(9,199)
Charge for the year	3,525	424	3,949
Foreign currency translation gain taken to reserves	(305)	-	(305)
	<hr/>	<hr/>	<hr/>
At 31 March 2006	(8,682)	3,127	(5,555)
	<hr/> <hr/>	<hr/> <hr/>	<hr/> <hr/>

Notes *(continued)*

9 Taxation *(continued)*

Factors affecting the tax charge for the current period

The current tax charge for the period is lower (*2005: higher*) than the standard rate of corporation tax in the UK of 30% (*2005: 30%*). The differences are explained below.

	2006	2005
	£000	£000
<i>Current tax reconciliation</i>		
Loss on ordinary activities before tax	(160)	(119)
	<hr style="width: 100%;"/>	<hr style="width: 100%;"/>
Current tax at 30% (<i>2005: 30%</i>)	(48)	(36)
<i>Effects of:</i>		
Expenses not deductible for tax purposes	500	140
Goodwill amortisation not deductible for tax purposes	1,410	1,319
Capital allowances for period (in excess of)/less than depreciation	(724)	12
Tax losses carried forward	-	635
Utilised tax losses from group companies	(690)	(85)
Higher tax rates on overseas earnings	182	81
R&D and other tax credits	(120)	(374)
Other timing differences	1,016	2,108
Credit in respect of prior year adjustment	(5,290)	-
Permanent difference on account of capital gains	1,278	-
Adjustments to tax charge in respect of prior periods	(260)	(84)
	<hr style="width: 100%;"/>	<hr style="width: 100%;"/>
Total current tax (credit)/charge (see above)	(2,746)	3,716
	<hr style="width: 100%;"/>	<hr style="width: 100%;"/>

Factors affecting the tax charge for future periods

As set out in note 14, the group has significant deferred tax assets. If the group is able to utilise these assets, it will reduce future current tax charges.

Notes *(continued)*

10 Intangible fixed assets

Group	Goodwill
	£000
<i>Cost</i>	
At beginning of year	13,630
Disposed of	(2,401)
Foreign currency translation difference taken to reserves	1,504
	12,733
At end of year	12,733
<i>Amortisation</i>	
At beginning of year	6,914
Charge for year	4,702
Disposed of	(1,885)
Foreign currency translation difference taken to reserves	949
	10,680
At end of year	10,680
<i>Net book value</i>	
At 31 March 2006	2,053
	6,716
At 31 March 2005	6,716
	6,716

Goodwill is in respect of the acquisition of ActiveState Corporation. The goodwill is being amortised over a period of 3 years.

Company	Software
	£000
<i>Cost</i>	
At beginning of year	-
Additions	7,166
	7,166
At end of year	7,166
<i>Amortisation</i>	
At beginning of year	-
Charge for year	-
	-
At end of year	-
<i>Net book value</i>	
At 31 March 2006	7,166
	-
At 31 March 2005	-
	-

The software asset represents intellectual property acquired on 31 March 2006 from a wholly owned subsidiary, Sophos Inc (formerly ActiveState Corporation, Canada). It is being amortised over a period of 3 years.

Notes *(continued)*

11 Tangible fixed assets

Group	Freehold land and buildings £000	Plant and machinery £000	Motor vehicles £000	Fixtures and fittings £000	Total £000
<i>Cost</i>					
At beginning of year	37,531	8,975	263	1,651	48,420
Additions	47	1,788	5	144	1,984
Disposals	-	(62)	(76)	(14)	(152)
Exchange movement	-	257	2	73	332
	<hr/>	<hr/>	<hr/>	<hr/>	<hr/>
At end of year	37,578	10,958	194	1,854	50,584
	<hr/>	<hr/>	<hr/>	<hr/>	<hr/>
<i>Depreciation</i>					
At beginning of year	3,926	6,684	208	947	11,765
Charge for year	1,445	1,620	40	245	3,350
On disposals	-	(60)	(65)	(14)	(139)
Exchange movement	-	170	1	42	213
	<hr/>	<hr/>	<hr/>	<hr/>	<hr/>
At end of year	5,371	8,414	184	1,220	15,189
	<hr/>	<hr/>	<hr/>	<hr/>	<hr/>
<i>Net book value</i>					
At 31 March 2006	32,207	2,544	10	634	35,395
	<hr/> <hr/>	<hr/> <hr/>	<hr/> <hr/>	<hr/> <hr/>	<hr/> <hr/>
At 31 March 2005	33,605	2,291	55	704	36,655
	<hr/> <hr/>	<hr/> <hr/>	<hr/> <hr/>	<hr/> <hr/>	<hr/> <hr/>

Within freehold land and buildings the gross cost which is depreciable is £36,139,000 (2005: £36,092,000).

Notes *(continued)*

11 Tangible fixed assets *(continued)*

Company	Freehold land and buildings	Plant and machinery	Motor vehicles	Fixtures and fittings	Total
	£000	£000	£000	£000	£000
<i>Cost</i>					
At beginning of year	37,531	5,929	138	573	44,171
Additions	47	940	-	35	1,022
Disposals	-	(1)	(28)	-	(29)
	<hr/>	<hr/>	<hr/>	<hr/>	<hr/>
At end of year	37,578	6,868	110	608	45,164
	<hr/>	<hr/>	<hr/>	<hr/>	<hr/>
<i>Depreciation</i>					
At beginning of year	3,926	4,591	110	294	8,921
Charge for year	1,445	937	16	66	2,464
On disposals	-	(1)	(28)	-	(29)
	<hr/>	<hr/>	<hr/>	<hr/>	<hr/>
At end of year	5,371	5,527	98	360	11,356
	<hr/>	<hr/>	<hr/>	<hr/>	<hr/>
<i>Net book value</i>					
At 31 March 2006	32,207	1,341	12	248	33,808
	<hr/> <hr/>	<hr/> <hr/>	<hr/> <hr/>	<hr/> <hr/>	<hr/> <hr/>
At 31 March 2005	33,605	1,338	28	279	35,250
	<hr/> <hr/>	<hr/> <hr/>	<hr/> <hr/>	<hr/> <hr/>	<hr/> <hr/>

Within freehold land and buildings the gross cost which is depreciable is £36,139,000 (2005: £36,092,000).

Notes (continued)

12 Fixed asset investments

Company	Shares in group undertakings £000
<i>Cost</i>	
At beginning and end of the year	142

The principal undertakings in which the company's interest at the year-end is more than 20% are set out below. All investments are held directly by the company.

<i>Subsidiary undertakings</i>	Country of incorporation	Principal activity	Class of shares held	Percentage of shares held
Sophos Inc	United States of America	Selling software for computer security	Ordinary	100%
Sophos GmbH	Germany	Selling software for computer security	Ordinary	100%
Sophos Pty Ltd	Australia	Selling software for computer security	Ordinary	100%
Sophos Sarl	France	Selling software for computer security	Ordinary	100%
Sophos KK	Japan	Selling software for computer security	Ordinary	100%
Sophos Srl	Italy	Selling software for computer security	Ordinary	100%
Sophos Anti-Virus (Asia) Pte Ltd	Singapore	Selling software for computer security	Ordinary	100%
Sophos Nominees Limited	UK	Share nominee company	Ordinary	100%
Sophos Inc (formerly ActiveState Corporation)	Canada	Selling software for computer security	Common	100%

All the above investments have been included in the consolidated financial statements.

13 Stocks

	Group		Company	
	2006 £000	2005 £000	2006 £000	2005 £000
Finished goods and goods for resale	82	55	82	55

Notes (continued)

14 Debtors

	Group		Company	
	2006 £000	2005 £000 (restated)	2006 £000	2005 £000 (restated)
Trade debtors	13,027	11,888	6,529	5,573
Amounts owed by group undertakings	-	-	15,885	19,266
Other debtors	1,769	765	295	192
Prepayments	908	623	502	189
Corporation / corporate taxes	3,094	186	3,094	166
Deferred tax asset	8,682	11,902	-	5,291
	27,480	25,364	26,305	30,677

The elements of the group deferred tax asset are as follows:

	2006 £000	2005 £000 (restated)
Tax losses of overseas subsidiaries	1,536	1,124
Tax effect of revenue deferral	5,533	4,901
Tax effect of the purchase of the software asset from Sophos Inc	1,613	-
In respect of prior year adjustment	-	5,291
Other items in respect of overseas subsidiaries	-	586
	8,682	11,902

The company's deferred tax asset as at 31 March 2005 of £5,291,000, as restated, is in respect of the prior year adjustment.

Deferred tax assets are recognised where, in the opinion of the directors, there is persuasive and reliable evidence that the assets will be recovered from relevant future taxable profits. The group has unrecognised deferred tax assets, mainly in respect of tax losses of overseas subsidiaries, of £65,000 (2005: £34,000).

Within Group other debtors are deposits amounting to £409,000 (2005: £292,000) that are due after one year. These include a deposit of £121,000 with a bank against which a guarantee is provided by the bank to a third party.

15 Creditors: amounts falling due within one year

	Group		Company	
	2006 £000	2005 £000 (restated)	2006 £000	2005 £000 (restated)
Trade creditors	1,453	1,144	851	631
Corporation / corporate taxes	345	292	-	-
Social security and other taxes	2,145	1,909	1,460	1,313
Other creditors	459	424	114	97
Accruals	6,335	2,877	3,282	985
Deferred revenue	49,668	46,467	34,860	38,412
	60,405	53,113	40,567	41,438

Notes *(continued)*

16 Creditors: amounts falling due after more than one year

	Group		Company	
	2006 £000	2005 £000 (restated)	2006 £000	2005 £000 (restated)
Deferred revenue	31,013	24,329	21,744	11,406

17 Provisions for liabilities and charges

Group	Deferred tax £000	Other £000	Total £000
At beginning of year	2,703	888	3,591
Amounts provided during the year	424	-	424
Amounts utilised during the year	-	(49)	(49)
At end of year	3,127	839	3,966

Company	Deferred tax £000	Other £000	Total £000
At beginning of year	2,703	725	3,428
Amounts provided during the year	961	-	961
At end of year	3,664	725	4,389

The provision for deferred tax relates to the difference between accumulated depreciation and capital allowances.

Other provisions relate to customer, supplier and legal matters. Generally such matters are resolved within one or two years.

Notes (continued)

18 Called up share capital

	2006		2005	
	Number	£000	Number	£000
<i>Authorised</i>				
Ordinary shares of £0.0002 each	45,000,000,000	9,000	45,000,000,000	9,000
Convertible preferred ordinary shares of £0.0002 each	5,000,000,000	1,000	5,000,000,000	1,000
		<hr style="width: 100%; border: 0.5px solid black;"/>		<hr style="width: 100%; border: 0.5px solid black;"/>
		10,000		10,000
		<hr style="width: 100%; border: 0.5px solid black;"/>		<hr style="width: 100%; border: 0.5px solid black;"/>
<i>Allotted, called up and fully paid</i>				
Ordinary shares of £0.0002 each	249,449,400	50	249,063,900	50
Convertible preferred ordinary shares of £0.0002 each	70,111,600	14	70,111,600	14
		<hr style="width: 100%; border: 0.5px solid black;"/>		<hr style="width: 100%; border: 0.5px solid black;"/>
		64		64
		<hr style="width: 100%; border: 0.5px solid black;"/>		<hr style="width: 100%; border: 0.5px solid black;"/>

All classes of share rank pari passu for any dividend declared by the company. On a qualifying listing or at the election of the holders, the convertible preferred ordinary shares convert into ordinary shares on a one-for-one basis. The convertible preferred ordinary shares also carry priority over the assets of the company available for distribution in a winding up or other return of capital.

During the year 385,500 ordinary shares with an aggregate nominal value of £77 and at a premium of £146,000 were purchased by employees under the company's share purchase plan.

Share option plan

During the year the company introduced an employee share option plan. At 31 March 2006 the following options granted to employees over ordinary shares of the company were outstanding:

Number	Exercise Period	Exercise price (pence)
4,291,755	16 September 2005 - 15 September 2015	28.2
2,393,816	7 March 2006 – 15 September 2015	28.2
5,549,500	1 April 2006 – 15 September 2015	28.2
300,300	16 September 2006 – 15 September 2015	28.2
3,195,610	24 March 2007 – 23 March 2016	28.2
15,730,981		

The following options have been granted to employees between 31 March 2006 and the date of approval of these financial statements, where the options were awarded to those employees during the year ended 31 March 2006.

Number	Exercise Period	Exercise price (pence)
2,396,708	1 January 2007 - 31 December 2015	28.2

Notes *(continued)*

19 Reserves

Group	Share premium	Profit and loss account	Total reserves
	£000	£000	£000
At 1 April 2005 (as previously reported)	611	32,098	32,709
Prior year adjustment	-	(23,781)	(23,781)
	<hr/>	<hr/>	<hr/>
At 1 April 2005 (as restated)	611	8,317	8,928
Loss for the year	-	(1,363)	(1,363)
Premium on shares issued	146	-	146
Exchange differences	-	10	10
	<hr/>	<hr/>	<hr/>
At 31 March 2006	757	6,964	7,721
	<hr/> <hr/>	<hr/> <hr/>	<hr/> <hr/>

Company	Share premium	Profit and loss account	Total reserves
	£000	£000	£000
At 1 April 2005 (as previously reported)	611	39,610	40,221
Prior year adjustment	-	(12,347)	(12,347)
	<hr/>	<hr/>	<hr/>
At 1 April 2005 (as restated)	611	27,263	27,874
Profit for the year	-	6,181	6,181
Premium on shares issued	146	-	146
	<hr/>	<hr/>	<hr/>
At 31 March 2006	757	33,444	34,201
	<hr/> <hr/>	<hr/> <hr/>	<hr/> <hr/>

Notes (continued)

20 Commitments and contingencies

(a) Capital commitments at the end of the financial year, for which no provision has been made, are as follows:

	Group		Company	
	2006	2005	2006	2005
	£000	£000	£000	£000
Contracted but not provided for	163	52	72	-
	<u> </u>	<u> </u>	<u> </u>	<u> </u>

(b) At the end of the financial year the group had entered into no commitments in respect of finance leases or hire purchase contracts, the inception of which occurs after the year-end.

(c) Annual commitments under non-cancellable operating leases are as follows:

Group	2006		2005	
	Land and buildings	Other	Land and buildings	Other
	£000	£000	£000	£000
Operating leases which expire:				
Within one year	286	24	199	20
In the second to fifth years inclusive	897	124	950	107
Over five years	10	-	-	-
	<u> </u>	<u> </u>	<u> </u>	<u> </u>
	1,193	148	1,149	127
	<u> </u>	<u> </u>	<u> </u>	<u> </u>
Company	2006		2005	
	Land and Buildings	Other	Land and buildings	Other
	£000	£000	£000	£000
Operating leases which expire:				
Within one year	-	-	-	3
In the second to fifth years inclusive	-	4	-	4
	<u> </u>	<u> </u>	<u> </u>	<u> </u>
	-	4	-	7
	<u> </u>	<u> </u>	<u> </u>	<u> </u>

(d) Forward foreign exchange contracts:

The group enters into derivative transactions such as forward foreign exchange contracts, all of which have a duration of less than one year, the purpose of which is to manage the currency risks arising from the group's operations. At the year end there were no outstanding commitments to sell foreign currency (2005: USD 2.0 million and EUR 1.2 million).

Notes (continued)

21 Pension scheme

The group contributes to money purchase personal pension schemes in the UK and to similar or state pension schemes overseas for the benefit of the employees and directors. The assets of the schemes are administered by trusts or by 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 £827,000 (2005: £641,000).

There were no outstanding or prepaid contributions at either the beginning or end of the financial year.

22 Reconciliation of operating loss to operating cash flows

	2006 £000	2005 £000 (restated)
Operating loss	(2,168)	(708)
Depreciation	3,350	3,284
Amortisation of goodwill	4,702	4,396
Profit on sale of fixed assets	(36)	(4)
Increase in stocks	(27)	(11)
Increase in debtors	(1,971)	(1,579)
Increase in creditors	13,091	10,951
(Decrease)/increase in provisions	(48)	420
Net cash inflow from operating activities	16,893	16,749

23 Analysis of cash flows

	<i>Notes</i>	2006 £000	2006 £000	2005 £000	2005 £000
Returns on investments and servicing of finance					
Interest received	8		1,307		589
Capital expenditure and financial investment					
Purchase of tangible fixed assets		(2,032)		(2,646)	
Sale of tangible fixed assets		17		17	
			(2,015)		(2,629)
Acquisitions and disposals					
Sale of assets in subsidiary undertaking	7	1,021		-	
			1,021		-
Management of liquid resources					
Cash transferred to short-term deposits with banks	24		(15,613)		(12,398)
Financing					
Issue of ordinary share capital		146		-	
			146		-

Notes *(continued)*

24 Analysis of net funds

	At beginning of year £000	Cash flow £000	Exchange movement £000	At end of year £000
Bank current accounts	2,326	1,153	158	3,637
Short term deposits with banks	18,909	15,613	-	34,522
	<u>21,235</u>	<u>16,766</u>	<u>158</u>	<u>38,159</u>

25 Related party disclosures

The company shares premises, management and administrative services with Virus Bulletin Limited, a company in which Peter Lammer and Jan Hruska have interests. A contribution of £165,000 (2005: £162,000) to the costs of such services was receivable by the company in the year. In addition Virus Bulletin Limited invoiced Sophos group companies £37,000 (2005: £40,000) for subscriptions and conference fees.

At 31 March 2006 an amount of £165,000 (2005: £109,000) was due to the company from Virus Bulletin Limited. Trade creditors include £10,000 (2005: £nil) due to Virus Bulletin Limited from Sophos group companies.