# microgen plc
annual report

2013

microgen

microgen plc annual report 2013

# ***Directors, Senior Management***
# *and Advisors*

## Directors

**Martyn Ratcliffe**
Executive Chairman
Martyn Ratcliffe was appointed a non-executive director of Microgen plc ("Microgen") on 7 May 1998 and Chairman on 31 July 1998. Mr Ratcliffe is also Executive Chairman of Sagentia Group plc.

**Philip Wood**
Group Finance Director
Philip Wood was appointed Group Finance Director on 2 January 2007. A Chartered Accountant, Mr Wood spent seven years with AttentiV Systems Group plc and its group companies during which time he, as Group Finance Director, oversaw the group's flotation in 2004 and subsequent acquisition in 2005 by Tieto Corporation.

**Peter Bertram**
Senior Independent Non-Executive Director
Peter Bertram was appointed as a non-executive director on 3 October 2006 and Chairman of the Audit Committee on 1 May 2007. On 19 April 2011 Mr Bertram was appointed as the senior independent non-executive director. A Fellow of the Institute of Chartered Accountants in England and Wales, Mr Bertram is also Executive Chairman of Phoenix IT Group plc and Chairman of Ten Alps plc.

**Vanda Murray OBE**
Non-Executive Director
Vanda Murray was appointed as a non-executive director on 1 September 2011 and Chair of the Remuneration Committee on 1 January 2012. Ms Murray was Chief Executive Officer of Blick plc from 2001 to 2004 and is currently non-executive director of Carillion plc, Chemring Group plc, Fenner plc and The Manchester Airports Holdings Limited.

**Peter Whiting**
Non-Executive Director
Peter Whiting was appointed as a non-executive director on 2 February 2012. Mr Whiting has over twenty years' experience as an investment analyst, specialising in the software and IT services sector. He joined UBS in 2000, led the UK small and mid-cap research team and was Chief Operating Officer of UBS European Equity Research from 2007 to 2011.

## Senior Management

**Tom Crawford**
Managing Director, Aptitude Software
Tom Crawford joined Microgen in 2003 and was appointed Head of Aptitude Software USA operations in 2010 before being promoted to Managing Director of Aptitude Software in 2013, a role that divides his time between Boston and London.

**Simon Baines**
Managing Director, Financial Systems
Simon Baines joined Microgen in 2010 as Managing Director of the Financial Systems business, prior to which he worked in private equity covering financial services technology companies.

**Anjum O'Neill**
Company Secretary and Group Legal Counsel
Anjum O'Neill was appointed as Company Secretary on 7 October 2008. Mrs O'Neill joined the Group in 2004 and has held the role of Group Legal Counsel since 1 March 2007. She is a Solicitor of England and Wales.

### Independent Auditors
PricewaterhouseCoopers LLP
Chartered Accountants and
Statutory Auditors
1 Embankment Place
London WC2N 6RH

### Financial Advisors and Stockbroker
Investec Bank plc
2 Gresham Street
London EC2V 7QP

### Financial Public Relations
FTI Consulting LLP
Holborn Gate
26 Southampton Buildings
London WC2A 1PB

### Registrars
Capita Registrars Limited
The Registry
34 Beckenham Road
Beckenham
Kent BR3 4TU

### Registered Office
Old Change House
128 Queen Victoria Street
London EC4V 4BJ

# Contents



## STRATEGIC REPORT



## GOVERNANCE



## FINANCIAL STATEMENTS



## SUPPLEMENTARY INFORMATION

# Chairman's Statement
## and Group Strategy

Microgen maintained a resilient financial performance in 2013. The year was significant due to the Board's extensive review of the strategies of the Group and its businesses ("Strategic Review" or "Review"). The timing of the Review coincided with achieving the milestone of returning in cash the Group's market capitalisation to shareholders over the 5 year period following the completion of the previous review in October 2008. The £10 million tender offer announced as one of the outcomes of the Review brought the total cash returned to shareholders over the 5 year period to 130% of the October 2008 market capitalisation. The detail of the Strategic Review was announced on 29 October 2013 and is incorporated in this statement by reference.

The Strategic Review detailed that the Group strategy is to "Acquire, Enhance and Realise Value" for Microgen shareholders. As a result Microgen plc is now the corporate parent of a series of technology businesses and strategic investments, operated as independent business units. Reflecting the new organisational structure, reports on the Group's existing businesses, Aptitude Software and Financial Systems, are provided by the respective Managing Directors. Pursuant to the Strategic Review, investment is being significantly increased in the Aptitude Software business in order to pursue the developing Big Data opportunity. In parallel, the Financial Systems business is focussing resources on the growing wealth management sector and delivered a substantial increase in return on capital employed following the change in capital structure.

Despite a period of strategic evolution, in aggregate, the Group reports adjusted operating profit in line with expectations and with the prior year (throughout this statement adjusted operating profit and margin excludes exceptional and other items, unless stated to the contrary). Pursuant to this performance the Board is recommending a final dividend of 2.2 pence per share (2012: 2.2 pence), representing a full year dividend of 3.3 pence (2012: 3.3 pence) in addition to the special dividend of 5.2 pence paid in May 2013. Subject to shareholder approval, the proposed final dividend will be payable on 27 May 2014 to shareholders on the register at the close of business on 25 April 2014.

Microgen is continuously identifying and appraising technology businesses and strategic investments which the Board believes, based on the Group's capabilities and technologies, may benefit from being operated as an independent business unit under Microgen's stewardship. Consistent with the scope set out in the Strategic Review announcement, the businesses and investments appraised to date have been predominantly UK based across a broad technology spectrum.

During 2013, Microgen returned £17.0 million of cash to shareholders through dividends and the tender offer which completed in December. The Group's balance sheet, with cash of £40.2 million at 31 December 2013 (2012: £32.1 million) and net funds of £20.9 million (2012: £32.1 million), still provides the Group with the cash resources to be a credible acquirer although the Board would seek additional support from shareholders if appropriate. However, the Board will maintain its prudent approach and there can be no certainty that any material acquisition will be completed.

**Martyn Ratcliffe**
Executive Chairman

25 February 2014

The Aptitude Software business provides enterprise level application products and solutions, typically where customers require very rapid processing of very high volume (often referred to as "Big Data") complex, business event-driven transactions. The Aptitude software and associated applications have been, and continue to be, developed at the Aptitude Technology Centre in Wroclaw, Poland. The cost of this development is expensed as incurred on an annual basis. The business generates revenue from this software through a combination of annual licence fees, software maintenance and support, professional services and, to a lesser extent, initial licence fees.

The Strategic Review reaffirmed the Group's preferred strategy of annual software licencing, producing recurring revenues, as the right approach to value creation. As such, the Board's objective of increasing licence revenue, both in absolute terms and as a proportion of revenue, is the leading performance metric for the business. (Recurring revenue includes annual licence fees, software maintenance and support).

Benefitting from both new business sales and growth from the existing client base, revenue from annual software licences and other recurring revenue grew by 9% to £7.9 million (2012: £7.2 million) and now represents 54% of revenue (2012: 44%). Whilst not materially benefitting 2013 due to the Group's conservative revenue recognition policy, a significant new European client was contracted in December 2013 with a North American opportunity in the final stages of contracting.

The number of consultants deployed during 2013 was broadly flat, although this is a reduction on 2012 particularly in the first half of the year, when customer budgetary constraints had a material impact. However, the future growth of consultancy revenue is not a strategic objective of the business, reflecting the change in emphasis towards software revenues to align with the greater potential for shareholder value-creation. As a result, despite broadly consistent services revenue throughout 2013, the impact of the decline in 2012 has led to services revenue reducing to £6.8 million compared to £8.8 million in the prior year.

Correspondingly, overall reported revenue for the business was £14.7 million (2012: £16.3 million). Nevertheless, strong operating margins of 19% (2012: 18%) delivered an operating profit of £2.8 million (2012: £2.9 million) while maintaining investment in research and development at £3.5 million (2012: £3.5 million) and continuing to expense as incurred all research and development costs.

Following the Strategic Review the Board has approved an increase in investment in order to pursue the potential from the Big Data market opportunity at a level such that the business remains profitable and cash flow positive. Details of the areas of investment were described in the Strategic Review including product development of a Hadoop interface which will expand the multi-platform Aptitude offering. Costs incurred in 2013 related to these investments have not been significant.

In 2014, the Aptitude Software business has commenced a sales partnership with IBM, further developing the indirect sales channel to complement the established direct sales force. In addition, opportunities have been identified in a number of new sectors which will benefit from the capabilities of the Aptitude software. In summary, 2013 realigned the strategy for the Aptitude Software business. While the tangible results from the changes will take time, the significant new European client contracted in December 2013, the launch of the IBM sales partnership and the new product development activities provide an exciting opportunity for the future.

**Tom Crawford**
Managing Director, Aptitude Software

25 February 2014

# Financial Systems
## *Report*

The Financial Systems business has a well-established customer base with an increasing focus on the wealth management sector. Revenues are generated through a combination of annual licence fees, software maintenance and support, professional services and, to a lesser extent, initial licence fees. The Strategic Review concluded that the business should focus on increasing the proportion of revenue derived from the wealth management sector through both organic growth and add-on acquisitions while continuing to explore opportunities in other financial services sectors.

During 2013 revenue from wealth management products grew 7% to £8.0 million (2012: £7.5 million) and now represents 53% (2012: 47%) of revenue. The leading wealth management product, 5Series, continues to be well received by the market with adoption increasing in line with expectations. In 2013, the business contracted with a major US bank and is currently in the process of implementing the largest ever 5Series deployment. The other more mature product categories, and non-financial services offerings in particular, continued to decline, as anticipated, with revenue in 2013 of £7.1 million (2012: £8.5 million).

Overall reported revenue was £15.1 million (2012: £16.0 million), in line with the Board's expectations. Recurring revenues account for 79% (2012: 78%) of the revenue, with 28% of revenue being generated by its top 5 clients (2012: 28%). Benefitting from continued tight cost control, the business reported strong adjusted operating profits of £8.1 million (2012: £8.4 million) representing an adjusted operating margin of 54% in 2013 (2012: 53%). The expenditure on research, development and support activities in 2013 was £2.2 million (2012: £2.2 million) the costs of which have been, and continue to be, expensed on an annual basis with no capitalisation.

The Strategic Review provided the catalyst for the Board to consider the capital structure of the Financial Systems business and the opportunity for Microgen to manage the business using a more efficient capital model. As a result the Review announced the agreement of a £20 million bank loan, secured solely against the Financial Systems business at a very competitive interest rate, reflecting the consistently strong cash flow from the business. £5 million of the received funds were retained by the business to fund add-on acquisitions with £15 million distributed to Microgen plc. The loan is repayable over five years with an annual capital repayment of £3 million and the remainder at the end of the period. The interest rate has been fixed by an appropriate financial instrument at 3.24% over the five year period. Operating covenants are limited to the performance of the Financial Systems business based on net debt leverage, interest cover and a minimum cash balance of £3 million being held within the business. Furthermore, in the event of a default by the Financial Systems business, Microgen plc has the option, but not the obligation, to remedy. Following the agreement of this loan and the capital reorganisation of the business during the year, the Return on Capital Employed ("ROCE") for 2013 is 30% (2012: 18%). (For the purposes of calculating ROCE, capital is defined as being the average of the consolidated net assets of the business at the beginning and end of each year). The interest cost in 2013, representing only the two months since the loan was advanced on 29 October 2013, was £0.1 million. The loan outstanding at 31 December 2013 was £19.3 million (2012: £nil).

In pursuing the major strategic objective of the business, namely to increase the proportion of revenues generated from the wealth management sector, the business has continued to identify and appraise a number of add-on acquisitions. However, the Board remains prudent and there can be no certainty that any acquisitions will be completed in the near future. Meanwhile, the existing Financial Systems business benefits from its high level of recurring revenues and the business is confident the adoption of the 5Series wealth management product will continue to progress in 2014.

**Simon Baines**
Managing Director, Financial Systems

25 February 2014

Value to shareholders is derived from the aggregation of the performance of the operating businesses. The Group results are therefore provided for statutory purposes but in isolation provide minimal additional perspective.

Revenue for the year ended 31 December 2013 was £29.8 million (2012: £32.3 million) producing an adjusted operating profit in line with both expectations and the prior year of £9.1 million (2012: £9.1 million). Operating profit on a statutory basis was £8.7 million (2012: £9.0 million). The Group reported a profit for the year attributable to equity shareholders of £6.4 million (2012: £6.9 million). In accordance with IFRS, the Board has continued to determine that all internal research and development costs are expensed as incurred and therefore the Group has no capitalisation of development expenditure. The overall group expenditure on research, development and support activities in 2013 was £5.7 million (2012: £5.7 million). Despite the reduction in revenue, adjusted operating margins increased to 30% (2012: 28%) due to the Group's conservative operational approach. This has been achieved by the growth in the proportion of the Group's higher margin annual software licences and other recurring revenues together with a reduction in the Group's overheads. Headcount at 31 December 2013 was 228 including contractors and associates (31 December 2012: 238).

Whilst the majority of the Group's revenue is invoiced in Pounds Sterling, £4.1 million of the revenue was invoiced in US Dollars at an average exchange rate of 1.56 (2012: £2.3 million at 1.59) and £1.3 million was invoiced in South African Rand at an average exchange rate of 15.22 (2012: £1.5 million at 13.04). It is Microgen's policy to hedge foreign exchange cash flows once the size and timing of transactions can be predicted with sufficient certainty. To date only the costs in relation to the Aptitude Technology Centre in Poland are hedged but in light of the changes in the business the Board continue to monitor whether it is appropriate to hedge other currencies.

Pursuant to the shareholder approval on 18 November 2013, options in respect of 5.5 million ordinary shares were issued to directors and management. A profit and loss charge of £0.1 million was incurred in the period in respect of these options and is included in the total exceptional and other item costs of £0.4 million together with costs in respect of the arrangement of the £20.0 million loan entered into by the Financial Systems business in the year, details of which are summarised in the Financial Systems Report. The total tax charge of £2.3 million (2012: £2.2 million) represents 26% of the Group's profit before tax (2012: 24%). The Group's tax charge benefitted from the recognition of £0.1 million (2012: £0.2 million) tax losses in the year. The deferred tax asset in relation to taxable trading losses represents only £0.1 million (2012: £0.2 million) of the overall deferred tax asset of £0.8 million (2012: £1.0 million) with short term timing differences representing the principal component at £0.3 million (2012: £0.4 million). Adjusted earnings per share for the year ended 31 December 2013 was 8.3 pence (2012: 8.5 pence).

The Group completed a £10.0 million tender offer in December 2013 purchasing 8,130,075 ordinary shares. In addition, ordinary dividends paid during 2013 totalled £2.7 million with a further £4.3 million returned to shareholders by way of a special dividend. The total returned to shareholders in 2013 was £17.0 million. Following the agreement of the loan for the Financial Systems business of £20.0 million and the above returns to shareholders, the Group continues to have a strong balance sheet with net assets at 31 December 2013 of £54.4 million (2012: £64.7 million), including cash at 31 December 2013 of £40.2 million (2012: £32.1 million), and net funds at 31 December 2013 of £20.9 million (2012: £32.1 million). Continuing to be a focus of the Group, cash conversion (measured by cash generated from operations as a percentage of operating profit) was 93% in the year (2012: 115%).

**Philip Wood**
Group Finance Director

25 February 2014

# Report of the Directors

The directors of Microgen plc (the "Company") present their report and the audited consolidated financial statements of the Company for the year ended 31 December 2013.

## Results and Dividends

The results for the year are set out in the financial statements and notes that appear on pages 46 to 90. As explained in the Chairman's Statement, the directors propose the payment of a final dividend of 2.2 pence per share, making a total of 3.3 pence per share for the year (2012: 3.3 pence) in addition to a special dividend of 5.2 pence which was paid in May 2013. The proposed final dividend will be paid on 27 May 2014, subject to shareholder approval, to shareholders on the register at 25 April 2014.

The ordinary dividends paid in 2013 totalled £2.7 million (2012: £2.7 million) in addition to the special dividend of £4.3 million paid in May 2013.

## Principal Activities

The Company is the corporate parent of a series of technology businesses and strategic investments, operated as independent business units. The Group's services are currently provided through two operating businesses which are detailed within the reports on pages 3 and 4.

## Key Performance Indicators

The Key Performance Indicators are set for each of the Group's two operating businesses and can be found in the reports on pages 3 and 4. The Key Performance Indicators for the Financial Systems business are Adjusted Operating Profit; Return on Capital Employed; Recurring Revenue; and growth in the Wealth Management sector. The Key Performance Indicators for the Aptitude Software business are Revenue Growth and Recurring Software-based Revenue Growth.

## Principal Risks and Uncertainties

The management of the business and the execution of the Group's strategy are subject to a number of risks. As detailed on page 16 risks are formally reviewed by the Board and appropriate processes put in place to monitor and mitigate such risks where feasible. The key business risks for the Group are set out in the table on pages 8 and 9.

## Directors' Responsibilities

The directors are responsible for preparing the Annual Report, the Directors' Remuneration Report and the financial statements in accordance with applicable law and regulations.

Company law requires the directors to prepare financial statements for each financial year. The directors have elected to prepare the Group and Parent company financial statements in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union and applicable law. 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 the 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 judgements and accounting estimates that are reasonable and prudent;

- state whether applicable IFRSs as adopted by the European Union have been followed, subject to any material departures disclosed and explained in the financial statements; and

- prepare the financial statements on a going concern basis unless it is inappropriate to presume that the Company will continue in business.

The directors are responsible for keeping adequate accounting records that are sufficient to show and explain the Company's transactions and disclose with reasonable accuracy at any time the financial position of the Company and the Group and to enable them to ensure that the financial statements and the Directors' Remuneration Report comply with the Companies Act 2006 and, as regards the Group financial statements, Article 4 of the IAS Regulation. They are also responsible for the system of internal control and safeguarding the assets of the Company and the Group and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

The directors are responsible for the maintenance and integrity of the Company's website and the financial information included in the website. Information included on the website is accessible in the United Kingdom as well as many countries with differing legal requirements but only legislation in the United Kingdom governing the preparation and dissemination of financial statements applies to the Company.

Each of the directors, whose names and functions are listed at the front of this report confirm that, to the best of their knowledge:

- the Group financial statements, which have been prepared in accordance with IFRS, as adopted by the EU, give a true and fair view of the assets, liabilities, financial position and profit of the Group; and

- the Annual Report, taken as a whole, is considered to be fair, balanced and understandable and provides the information necessary to assess the Group's performance, business model and strategy. A description of the principal risks and uncertainties of the Group is set out on pages 8 and 9.

## Table detailing Principal Risks and Uncertainties

| Major Risks and Uncertainties | Explanation | Mitigating Action |
|---|---|---|
| Demand for the Group's products may be adversely affected if economic and market conditions are unfavourable | Adverse economic conditions worldwide can contribute to slowdowns in the Information Technology spending environment and may impact the Group's business resulting in reduced demand for its products as a result of decreased spending by customers and increased price competition for the Group's products. The Group's revenues, expenses and operating results could vary significantly from period to period as a result of a variety of factors, some of which are outside the directors' control. | The Group's preferred annual licence fee model and recurring revenue provides some resilience against the full effects of market deterioration. Additionally, the Group operates in multiple geographic regions and, while it has a material exposure to the financial services sector, operates in a number of business sectors. |
| If the Group does not expand or enhance its product offerings or respond effectively to technological change, the business may be negatively affected | The Group's future performance will depend on the successful development, introduction and market acceptance of new and enhanced products that address customer requirements in a cost effective manner. If the Group does not expand or enhance its product offerings or respond effectively to technological change, its business may be negatively affected. Additionally, there is a risk that the Group's technological approach will not achieve broad market acceptance or that other technologies or solutions will supplant the Group's approach. Some of the Group's markets are characterised by rapid technological change, frequent introduction of new products, changes in customer requirements and evolving industry standards. | The development of new products and enhancement of existing ones is overseen by monthly forums which are attended by senior managers from relevant functions of the business. |
| There is substantial competition in the Group's markets which could adversely affect the Group | Some of the markets for the Group's products are competitive, rapidly evolving and subject to rapid technological change. As a result the Group expects competition to persist, intensify and increase in the future. There are no substantial barriers to entry into these markets and some of the Group's competitors are large organisations with far greater financial resources than Microgen. The Group's ability to compete is dependent upon many factors within and beyond the Group's control, including (a) timing and market acceptance of new solutions and enhancements to existing solutions developed by the Group and its competitors (b) performance, ease of use and reliability of the Group's products (c) price (d) customer service and support and (e) sales and marketing efforts. | Where appropriate the Group performs product development and marketing activities to improve the competitiveness of its products. In addition significant proposals are reviewed by senior managers and, if appropriate, the Board. |
| The Group's products have lengthy sales and implementation cycles, which could adversely affect the Group's business | Sales of the Group's software products may require the Group to engage in a lengthy sales effort, and these lengthy periods or delays in customer deployment of a product could materially adversely affect the Group's operating results or financial condition. The Group's sales efforts include significant education of prospective customers regarding the use and benefits of the Group's products. As a result, the sales cycle for the Group's products varies. In addition, the implementation of the Group's products involves a significant commitment of resources by customers over an extended period of time. The Group's sales and customer implementation cycles may be subject to a number of potential delays. These include delays related to product development and implementation as well as delays over which the Group has little or no control, including (a) customers' budgetary constraints (b) internal acceptance reviews (c) customers' purchasing processes (d) the complexity of customers' technical needs and (e) changing customer requirements. | Business processes in support of each stage in the major contract life cycle (bid, in life, renewal and termination) are well established. All significant proposals and contracts are subject to review by senior managers and, if appropriate, the Board. |
| The Group's operating businesses are dependent on a number of major clients and contracts | A significant part of the revenue of the Group's operating businesses may be derived from large contracts. Loss of or reduction in revenue from any one or more of these clients (either as a result of external factors or other factors such as performance on contracts) as well as any expiry without renewal or delay of these contracts could adversely affect the Group's business and results of operations. | Managers of the Group regularly meet with major clients to identify any factors which may, if not addressed, result in loss of revenue. Any significant issues are reported to the senior managers and, if appropriate, the Board. The Group continues to aim to expand its client base to reduce its dependency on any one client. |
| Potential future acquisitions by the Group may have unexpected material adverse consequences | As detailed in the reports on pages 2 and 4 acquisitions are part of the strategy for the Group as a whole and the Financial Systems business in particular. Acquisitions involve numerous risks which may have unexpected adverse material consequences. | Due diligence is performed when potential acquisitions are identified and all acquisitions require Board approval. |

## Table detailing Principal Risks and Uncertainties (continued)

| Other Risks and Uncertainties | Explanations | Mitigating Action |
|---|---|---|
| If the Group loses its key personnel or cannot recruit additional personnel, the Group's business may suffer | The Group's success greatly depends on its ability to hire, train, retain and motivate qualified personnel, particularly in sales, marketing, research and development, consultancy services and support. The Group faces significant competition for individuals with the skills required to perform the services the Group will offer. If the Group is unable to attract and retain qualified personnel it could be prevented from effectively managing and expanding its business. | The Remuneration Committee regularly reviews the Group's compensation policies to endeavour to ensure that it can continue to attract, motivate and retain qualified personnel. |
| Claims by others that the Group's products or brands infringe on their intellectual property rights could be costly to defend and could harm the Group's business | The Group may be subject to claims by others that the Group's products or brands infringe on or misappropriate their intellectual property or other property rights. These claims, whether or not valid, could require the Group to spend significant sums in litigation, distract management attention from the business, pay damages, delay or cancel product shipments, rebrand or re-engineer the Group's products or acquire licences to third party intellectual property. In the event that the Group needs to acquire a third party licence, the Group may not be able to secure it on commercially reasonable terms, or at all. | The Group's legal function regularly reviews methods by which it can protect its own intellectual property rights and avoid infringing the intellectual property rights of third parties. This has resulted in both the registration of trade marks and patent applications where considered appropriate. |
| The Group's reputation as a quality professional service provider may be adversely affected by any failure to meet its contractual obligations, customer expectations or agreed services levels | The Group's ability to attract new customers or retain existing customers is largely dependent on its ability to provide reliable high quality products and services to them and to maintain a good reputation. Because many of the engagements of the Group involve projects that are critical to the business operations and information systems of clients, the failure or inability of the Group to meet a client's expectations could have an adverse effect on the client's operations and could result in damage to the reputation of the Group. Certain contracts may provide for a reduction in fees payable by the client if service levels fall below certain specified thresholds, thus potentially reducing or eliminating the profit margin on any particular contract. If the Group fails to meet its contractual obligations or perform to client expectations, it could be subject to legal liability or damage to its reputation and the client may ultimately be entitled to terminate the contract. | The Group employs highly skilled personnel and has business processes in place to endeavour to ensure that any lapse is quickly identified and addressed. In addition, significant issues are reported to senior managers and, if appropriate, the Board. |
| The Group's software products may contain undetected errors and have dependency upon integration with third party products | The Group's products involve sophisticated technology that perform critical functions to highly demanding standards. Software products as complex as those offered by the Group might contain undetected errors or failures. If flaws in design, production, assembly or testing of the Group's products (by the Group or the Group's suppliers) were to occur, the Group could experience a rate of failure in its products that would result in substantial repair, replacement or service costs and potential liability and damage to the Group's reputation. The Group will not be able to be certain that, despite testing by the Group and by current and prospective customers, flaws will not be found in products or product enhancements. Any flaws found may cause substantial harm to the Group's reputation and result in additional unplanned expenses to remedy any defects, and liability stemming therefrom, as well as a loss in revenue and profit.<br>In addition, third party products and databases have been included in or integrated with the Group's products under licences granted to the Group or its customers. If any such licence was to expire without renewal or be otherwise terminated, the Group or the relevant customer would need to cease use of, and remove or disintegrate, the relevant third party product or database which could be costly, time-consuming and cause significant disruption to the Group's business. Any such removal or disintegration of third party products or databases would necessitate changes to, and/or the re-engineering of, the Group's products which could also be costly, time-consuming and cause significant disruption to the Group's product development strategies and otherwise adversely affect the Group's business. Even if such third party licences are not terminated, the Group's reliance on third party products or databases could limit and/or adversely affect its ability to control the future development of its own products. | Development activities including software quality and integration with third party products and databases are reviewed in regular monthly meetings with senior managers. The Group's software testing processes are also well established. |
| The Financial Systems business may not be able to service its obligations under its loan agreements | The Financial Systems business has a loan secured solely on its assets. The loan agreement has a number of obligations and financial covenants that, if not complied with, may lead to default. | The Board approved the terms of the loan and regularly monitors forecast adherence to financial covenants. Included within the loan agreement is the ability of the Group to cure any financial covenant breaches on a limited number of occasions. To mitigate the interest rate risk associated with the loan the Financial Systems business of the Group has entered into an interest rate swap which effectively fixes the interest payable on the loan to 3.24% per annum. |

## Going Concern

The directors, having made appropriate enquiries, consider that the Company and the Group have adequate resources to continue in operational existence for the foreseeable future and that therefore it is appropriate to adopt the going concern basis in preparing the financial statements.

## Employment Policies and Gender Diversity

The Group is committed to offering equal employment opportunities and its policies are designed to attract, retain and motivate the best staff regardless of gender, race, colour, religion, ethnic or national origin, age, marital status, disability, sexual orientation or any other conditions not relevant to the performance of the job, who can demonstrate that they have the necessary skills and abilities. The Group gives proper consideration to applications for employment when these are received from disabled persons and will employ them in posts whenever suitable vacancies arise. Staff who become disabled will be retained whenever possible through retraining, use of appropriate technology and making available suitable alternative employment.

The following table reports on the gender diversity within the Group's workforce at 31 December 2013:

| | **Board diversity** | | **Top leadership diversity** | | **Total workforce diversity** | |
|---|---|---|---|---|---|---|
| | **2013** | 2012 | **2013** | 2012 | **2013** | 2012 |
| Men | **4** | 5 | **11** | 12 | **173** | 183 |
| Women | **1** | 1 | **3** | 3 | **55** | 55 |
| Men % | **80%** | 83% | **79%** | 80% | **76%** | 77% |
| Women % | **20%** | 17% | **21%** | 20% | **24%** | 23% |

The Group encourages the participation of all employees in the operation and development of the business and has a policy of regular communications including overviews of the Group's financial performance. The Group incentivises employees and senior management through the payment of bonuses linked to performance objectives, together with the other components of remuneration detailed in the Directors' Remuneration Report.

## Environmental Policy

As a supplier of software solutions the Group's operations do not have a significant impact on the environment. The Group has no manufacturing facilities and its premises exclusively comprise offices. Any obsolete office equipment and computers are resold or recycled to the extent practicable. The Group has recycling facilities in all of its offices and use of waste paper is minimised by promoting a paperless process and downloadable software products. However the Group recognises that its activities should be carried out in an environmentally friendly manner and therefore aims to:

- comply with relevant environmental legislation;
- reduce waste and, where practicable, re-use and recycle consumables;
- dispose of non-recyclable items in an environmentally friendly manner;
- minimise the consumption of energy and resources in the Group's operations; and
- reduce the environmental impact of the Group's activities and where possible increase the procurement of environmentally friendly products.

## Greenhouse Gas Emissions

The Company complies with the greenhouse gas ("GHG") emissions reporting requirements of The Companies Act 2006 (Strategic and Directors' Reports) Regulations 2013. The Company reports all material GHG emissions, wherever possible using 'tonnes of $CO_2$-equivalent' ("$tCO_2e$") as the unit, to account for all GHGs which are attributable to human activity, as defined in section 92 of the Climate Change Act 2008(a). Emissions data is reported for the Group's operations in the UK, Poland, Guernsey, the USA and South Africa. The methodology used to compile this data is in accordance with the requirements of the following standards: the World Resources Institute's Greenhouse Gas Protocol (revised version); Defra's Environmental Reporting Guidelines: Including mandatory greenhouse gas emissions reporting guidance (June 2013) and ISO 14064 – part 1.

Material GHG emissions from business activities in 2013 totalled 1,009 $tCO_2e$, consisting of:

- 246 $tCO_2e$ from the combustion of fuel and the operation of any facilities; and
- 763 $tCO_2e$ from the purchase of electricity, heat, steam or cooling by the Group for its own use.

| | Emissions source | $tCO_2e$ |
|---|---|---|
| $CO_2e$ from the combustion of fuel and the operation of any facilities | Natural gas | 126 |
| | Refrigerant | 118 |
| | Owned vehicles | 2 |
| $CO_2e$ from the purchase of electricity, heat, steam or cooling by the company for its own use | Purchased electricity | 763 |
| | **Total** | **1,009** |

Carbon intensity ratio for this reporting period was 33.8 tCO2e per £1,000,000 turnover.

This is the first year that carbon footprint data has been gathered so there is no previous year to compare performance against. Where it has not been practical to gather data on energy use for the Group's smaller offices typical energy consumption figures have been used. In addition, a $CO_2$ equivalent conversion factor is not available for all locations so a $CO_2$ only factor is used for those affected locations.

The Group's financial reporting year is the calendar year, however the Group has set its greenhouse gas emissions reporting period back by a quarter to facilitate data collection. Therefore, the reporting period for greenhouse gas emissions is 1 October 2012 to 30 September 2013. The Company reports on sources of GHG over which operational control is held and which are associated with the business activities covered in this Report of the Directors.

## Donations

The charitable donations made in the period by the Company and its subsidiaries total £1,000 (2012: £250).

## Substantial Shareholdings

In accordance with the Disclosure and Transparency Rules of the Financial Conduct Authority, as at 25 February 2014, the Company had been advised of the following notifiable interests in its voting rights:

| | Number of shares | % Issued Share Capital |
|---|---|---|
| Aberforth Partners LLP* | 15,777,814 | 21.18 |
| Schroders plc** | 15,210,297 | 20.42 |
| P F and C C M Barbour*** | 6,805,327 | 9.13 |
| M R Ratcliffe | 5,294,524 | 7.11 |
| Standard Life Investments Limited | 4,120,841 | 5.53 |
| The Welcome Trust Limited | 4,038,979 | 5.42 |
| Invesco Limited | 3,981,876 | 5.34 |
| Hargreave Hale Limited | 3,604,050 | 4.84 |
| L G Crisp and Mrs H Crisp | 2,726,602 | 3.66 |
| FIL Limited | 2,488,624 | 3.34 |

* Included within Aberforth Partners LLP's interest are 6,972,536 shares (9.36 per cent.) held by Aberforth Smaller Companies Trust plc; 1,623,000 shares (2.18 per cent) held by Aberforth Geared Income Trust LLP; 956,072 shares (1.28 per cent.) held by Aberforth UK Small Companies Fund and a further 6,226,206 shares (8.36 per cent.) for which it does not have access to the voting rights.

** Included within Schroders plc's interest are 3,806,692 shares (5.11 per cent.) held by Mineworkers Pension Scheme and 2,788,605 shares (3.74 per cent.) held by British Coal Staff Superannuation Scheme.

*** CCM Barbour holds 2,764,531 of the voting rights of these shares and PF Barbour holds 1,250,000 of the voting rights of these shares. Both CCM Barbour and PF Barbour are interested in a further 2,790,796 shares however neither have any voting rights in these shares.

## The Takeovers Directive

The Company has one class of share capital, ordinary shares. All the shares rank pari passu. There are no special control rights in relation to the Company's shares.

Under the Company's share option schemes, a change of control of the Company following a takeover bid would be considered a vesting event. This would allow the exercise of awards subject to the relevant performance conditions being satisfied. There are a small number of customer contracts which include a change of control clause. Three senior managers have change of control agreements which increase the notice receivable by one individual from 3 to 6 months and the other two individuals from 6 to 12 months in the event of a change of control.

## Repurchase of Own Shares

On 29 October 2013 the Company announced its intention to return up to £10 million to shareholders by way of a tender offer. The tender offer completed on 2 December 2013 with the Company purchasing 8,130,075 ordinary shares at 123 pence per share for a total cash consideration, excluding expenses, of £10 million.

At the General Meeting held on 18 November 2013 members renewed the authority under section 701 of the Companies Act 2006 to make market purchases on the London Stock Exchange of up to 7,446,183 ordinary shares of 5p each. Such purchases could be made at no more than 5% above the average of the middle market quotations derived from the London Stock Exchange daily official list on the five business days prior to the date of purchase, nor less than 5p each. No shares have been purchased under this renewed authority. A resolution to give the Directors further authority for the Company to purchase its own shares is to be proposed at the forthcoming Annual General Meeting.

## Significant Contracts

There did not exist at any time during the year any contract involving the Company or any of its subsidiaries in which a director of the Company was or is materially interested or any contract which was either a contract of significance with a controlling shareholder or a contract for the provision of service by a controlling shareholder. Related party transactions are disclosed on page 90.

## Directors

Details of directors who have held office during the period and up to the date of signing these financial statements are given below:

M R Ratcliffe
P B Wood
P M Bertram
V Murray
P Whiting
D J Sherriff (resigned 29 October 2013)

Biographical details of the current directors are given on the inside front cover of this Annual Report. At the forthcoming Annual General Meeting Ms Vanda Murray OBE and Mr Peter Whiting, who retire by rotation, will stand for re-election.

The Company has purchased and maintained throughout the year directors' and officers' liability insurance in respect of itself and its directors. The directors also have the benefit of the indemnity provision contained at article 138 of the Company's articles of association. Pursuant to this article 138, the Company has granted indemnities for the benefit of current and future directors of, and the Company Secretary of, the Company in respect of liabilities which may attach to them in their capacity as directors of, or Company Secretary of, the Company to the extent permitted by law and also committing to maintain directors' and officers' insurance cover. Qualifying third party indemnity provisions ( as defined by section 234 of the Companies Act 2006 ) were in force during the year ended 31 December 2013 and continue in force, in relation to certain losses and liabilities which the directors (or Company Secretary) may incur to third parties in the course of acting as directors (or Company Secretary).

## Treasury and Foreign Exchange

The Group has in place appropriate treasury policies and procedures, which are approved by the Board. The treasury function manages interest rates for both borrowings and cash deposits for the Group and is also responsible for ensuring there is sufficient headroom against any banking covenants contained within its credit facilities, and for ensuring there are appropriate facilities available to meet the Group's strategic plans.

In order to mitigate and manage exchange rate risk, the Group routinely enters into forward contracts in respect of monthly transactions with the Group's Polish development organisation. The Group continues to monitor exchange rate risk in respect of other foreign currency exposures.

In order to mitigate and manage interest rate risk the Group has in place an effective interest rate hedge to manage exposure on borrowings. Interest rate swaps are used as cash flow hedges of future interest payments, which have the effect of increasing the proportion of fixed interest debt.

These treasury policies and procedures are regularly monitored and reviewed. It is the Group's policy not to undertake speculative transactions which create additional exposures over and above those arising from normal trading activity.

See page 60 for further information on the Group's management of financial risk.

## Creditor Payment Policy

The Group agrees terms and conditions for its business transactions with suppliers. Payment is then made in line with these terms, subject to the terms and conditions being met by suppliers.

The Company has trade creditors of £265,000 at 31 December 2013 (2012: £91,000).

At 31 December 2013, for the Group the average number of days of annual purchases represented by year end creditors was 37 days (31 December 2012: 21 days).

## Auditors and Disclosure of Information to Auditors

As far as the directors are aware, there is no relevant audit information (as defined by section 418(3) of the Companies Act 2006) of which the Company's auditors are unaware and each of the directors have taken the steps that they ought to have taken as directors in order to make themselves aware of any relevant audit information and to establish that the Company's auditors are aware of that information.

The auditors, PricewaterhouseCoopers LLP, have indicated their willingness to continue in office, and a resolution that they be re-appointed will be proposed at the Annual General Meeting.

## Corporate Governance

The Group's statement on corporate governance is included in the Corporate Governance Statement on pages 16 to 22, and is incorporated into this Report of the Directors by reference.

## Annual General Meeting

The forthcoming Annual General Meeting will be held at 9.00 am on 28 April 2014 at Old Change House, 128 Queen Victoria Street, London EC4V 4BJ. The notice of the Annual General Meeting contains the full text of resolutions to be proposed.

By Order of the Board

**Anjum O'Neill**
Company Secretary

25 February 2014

# Corporate Governance
## Statement

### Statement of Compliance

The Group has applied the main principles set out in the UK Corporate Governance Code ("Code"). A full statement of compliance with the Code's main principles of the Code of Best Practice is on pages 21 to 22.

The Company has complied with the Code throughout the year ended 31 December 2013, other than the exception stated as follows:

A.2.1 – Chairman and Chief Executive – The Corporate Governance Code requires that the roles of Chairman and Chief Executive should not be exercised by the same individual. Mr Ratcliffe was appointed to the role of Executive Chairman following the resignation of David Sherriff (Chief Executive Officer) on 29 October 2013. The Board considered that the combined role is in the interest of shareholders following the Strategic Review which concluded that the Group's operating businesses should be managed by the Managing Directors and associated management teams of each business with the Group roles providing a holding company function, including corporate governance, corporate/strategic direction and operational oversight. The Board will maintain a majority of independent non-executive directors ensuring continued robust corporate governance.

### Board of Directors

The Board of Directors meets regularly to review strategic, operational and financial matters, including proposed acquisitions and divestments, and has a formal schedule of matters reserved to it for decision. It approves the interim and preliminary financial statements, the annual financial plan, significant contracts and capital investment in addition to reviewing the effectiveness of the internal control systems and business risks faced by the Group. Where appropriate, it has delegated authority to committees of directors. Information is supplied to the Board in advance of meetings and the Chairman ensures that all directors are properly briefed on the matters being discussed. The Board Meetings are also attended by the Managing Directors of each of the operating businesses who provide detailed presentations and updates on the performance of their business.

The Chairman is primarily responsible for management of the Board, corporate strategy and development and ensuring effective communication with shareholders. The Managing Directors of each operating business are responsible for managing their respective businesses.

Non-executive directors are appointed for specified terms, up to a maximum of three years, and reappointment is not automatic. There is a formal selection process to appoint non-executive directors and a separate Nomination Committee was formed in 2001. Mr Bertram is the senior independent non-executive director.

The Board considers that all of the non-executive directors are independent in character and judgement from the management of the Company and free from any business or other relationship which could materially interfere with the exercise of their independent judgement. All of the non-executive directors have extensive business experience.

All directors have access to the advice and services of the Company Secretary or a suitably qualified alternative, and all the directors are able to take independent professional advice, if necessary, at the Company's expense. Directors offer themselves for re-election at the Annual General Meeting following their appointment and thereafter in accordance with the Company's current Articles of Association which requires directors to retire from office and offer themselves for reappointment by the members if they were not appointed or reappointed at one of the preceding two Annual General Meetings.

## Board Committees

Each of Mr Bertram, Ms Murray and Mr Whiting serve on the Nomination, Remuneration and Audit Committees and Mr Ratcliffe serves on the Nomination Committee. The Committees have written terms of reference which clearly specify their authority and duties and those terms of reference are available upon written request to the Company.

Nomination Committee

Mr Ratcliffe is chairman of the Nomination Committee which also comprises Mr Bertram, Ms Murray and Mr Whiting. The Nomination Committee meets at least once a year and recommends to the Board candidates for appointment as directors and reappointment.

The Board and the Board Committees recognise the importance of promoting all aspects of diversity, including gender, throughout the Group. When making an appointment to the Board, candidates are chosen against criteria, specified by the Nomination Committee in 2011, such as balance of skills, business experience, independence, qualifications, knowledge, diversity and other factors relevant to the Board operating effectively. Successful candidates are chosen on merit against these criteria, regardless of race, gender or religious beliefs.

Remuneration Committee

Ms Murray is chair of the Remuneration Committee and the Committee also comprises Mr Bertram and Mr Whiting. The Directors' Remuneration Report appears on pages 23 to 40.

Audit Committee

Mr Bertram, a Fellow of the Institute of Chartered Accountants in England and Wales, is chairman of the Audit Committee and the Committee also comprises Ms Murray and Mr Whiting. The Audit Committee monitors the integrity of the financial statements of the Company and meets regularly with management and the external auditors to review and monitor the financial reporting process, the statutory audit of the consolidated financial statements, audit procedures, internal controls and financial matters.

The external auditors present in advance of the year end its approach to the forthcoming audit together with its findings from the audit following the completion of its work. The Audit Committee assesses the performance of the external auditors on an annual basis and based on this review the Audit Committee recommends the appointment, reappointment or removal of the Company's external auditors to the Board. PricewaterhouseCoopers LLP, the Group's current external auditor, was originally appointed in 1997 with the latest review held in 2013 following the change in partner in the year. This review resulted in the Audit Committee determining to retain PricewaterhouseCoopers LLP as auditors for the Group's 2013 financial statements.

The Chairman and Group Finance Director attend the Audit Committee meetings by invitation, however, the Audit Committee meets at least annually with the Company's external auditors without the other directors present. The external auditors have unrestricted access to the Audit Committee.

The Audit Committee considers that, in some circumstances, the external auditors' understanding of the business can be beneficial in improving the efficiency and effectiveness of advisory work and, therefore, it has been considered appropriate that the external auditors be engaged for non-audit services related to financial and tax matters. The Audit Committee has reviewed the nature of the work and level of fees for non-audit services and considers that this has not affected the auditors' objectivity and independence. The expenditure on non-audit services is set out on page 68.

The Audit Committee reports to the Board on how it has discharged its responsibilities. This includes identifying the significant issues that it has considered in relation to the financial statements and how these issues were addressed, its assessment of the effectiveness of the external audit process and its recommendation on the reappointment of the Company's external auditors together with any other issues on which the Board has asked the Audit Committee's opinion.

The significant judgements considered by the Audit Committee were:-

**Revenue Recognition**

A key area of judgement in respect of recognising revenue is the timing of recognition where management assumptions and estimates are necessary. The Audit Committee were provided with an overview of significant balances, together with the movement on those balances since the previous year end. In addition, the Audit Committee receives an overview of significant contracts entered into during the course of the year which provides the opportunity to discuss the impact of contractual terms on revenue recognition. External audit performed detailed audit procedures on revenue recognition and reported their findings to the Audit Committee. The Audit Committee concluded that the timing of recognition continues to be in line with the Group's accounting policy on revenue recognition.

**Annual Goodwill Impairment Review**

Goodwill is a material asset on the Group's balance sheet and it is the Group's policy to annually test the asset for impairment. The judgements in relation to goodwill impairment testing relate to the assumptions applied in calculating the value in use of the operating businesses. The key assumptions applied in the calculation relate to the future performance expectations of the businesses. Plans prepared by senior management supporting the future performance expectations used in the calculation were reviewed and approved by the Board. The Audit Committee received a presentation on the outcome of the impairment review performed by senior management. The impairment review was also an area of focus for the external auditor, who reported their findings to the Audit Committee. The Audit Committee concluded that there was no requirement to impair the carrying value of goodwill at the year end.

**Tax**

The operating businesses operate in a number of territories which increases the complexity of the Group's tax affairs. A presentation was prepared by senior management for the Board and Audit Committee to consider. The presentation provided an overview of the Group's tax affairs together with the proposed accounting treatment of any judgemental items. Tax matters were also an area of focus for the external auditor, who reported their findings to the Audit Committee. The Audit Committee concluded that they were satisfied with the accounting treatment.

**Share Based Payments Charge**

The grant of 5.5 million share options in November 2013 results in a share based payments charge in the Group's financial statements. The share based payments charge is principally determined by the fair value of the options awarded. In conjunction with the Group's independent adviser on executive remuneration, senior management provided the Audit Committee with a presentation of the assumptions supporting the fair value calculation in respect of the 5.5 million share options. The fair value of share options was also an area of focus for the external auditor, who reported their findings to the Audit Committee. The Audit Committee concluded that they were satisfied with the accounting treatment.

## Board Attendance

Details of the number of meetings of the Board (including sub-committees at which only certain directors are required to attend) and committees and individual attendances by directors are set out in the table below.

| | Board Meetings | Audit Committee | Remuneration Committee | Nomination Committee |
|---|---|---|---|---|
| **Number of Meetings held in 2013** | 11 | 5 | 10 | 1 |
| M R Ratcliffe | 11 | 5* | 10* | 1 |
| P B Wood | 11 | 5* | 9* | 1* |
| P M Bertram | 11 | 5 | 10 | 1 |
| V Murray | 11 | 5 | 10 | 1 |
| P Whiting | 11 | 5 | 10 | 1 |
| D J Sherriff (resigned 29 October 2013) | 8 | 3* | 4* | 1* |

* attendance by invitation.

The above table details attendance at scheduled meetings. In addition 13 ad hoc meetings were held, of these meetings, 5 meetings were held by a sub-committee relating to the exercise of share options.

## Management Meetings of the Operating Businesses

Each of the Group's two operating businesses hold management meetings on a monthly basis chaired by the Managing Director responsible for that business. The Chairman and Group Finance Director regularly attend these meetings and all Non-Executive Directors are invited to attend these meetings.

## Relations with Shareholders

In order to maintain dialogue with institutional shareholders the Chairman and Group Finance Director meet with them following interim and final results announcements, or as appropriate, with other directors available to meet institutional shareholders on request. Where practicable the Annual Report is sent to shareholders at least 20 working days before the Annual General Meeting and each issue for consideration at the Annual General Meeting is proposed as a separate resolution. All continuing directors generally attend the Annual General Meeting.

## Capital Structure

The information required pursuant to the Disclosure and Transparency Rules is detailed on page 12.

## Social, Ethical and Environmental Risks

The Board takes regular account of the significance of social, environmental and ethical ("SEE") matters to the Group's business of providing IT services and solutions (including software, managed services and consultancy) to the business community.

The Board considers that it has received adequate information to enable it to assess any significant risks to the Company's short-term and long-term value arising from SEE matters and has concluded that the risks associated with SEE matters are minimal. The Board will continue to monitor those risks on an ongoing basis and will implement appropriate policies and procedures if those risks become significant.

## Internal Control

The Group maintains an ongoing process in respect of internal control to safeguard shareholders' investments and the Group's assets and to facilitate the effective and efficient operation of the Group.

These processes enable the Group to respond appropriately, and in a timely fashion, to significant business, operational, financial, compliance and other risks, (in accordance with the Code), which may otherwise prevent the achievement of the Group's objectives.

The Group recognises that it operates in a competitive market that can be affected by factors and events outside its control. Details of the major risks identified by the Group are set out in the table on pages 8 and 9. The Group is committed to mitigating risks arising wherever possible and accepts that internal controls, rigorously applied and monitored, are an essential tool in achieving this objective.

The key elements of Group internal control, which have been effective during 2013 and up to the date of approval of these financial statements, are set out below:

- The existence of a clear organisational structure with defined lines of responsibility and delegation of authority from the Board to its executive directors and operating divisions;
- A procedure for the regular review of reporting business issues and risks by the operating businesses;
- Regular review meetings with the operating management;
- A planning and management reporting system operated by each operating business and the executive directors; and
- The establishment of prudent operating and financial policies.

The directors have overall responsibility for establishing financial and other reporting procedures to provide them with a reasonable basis on which to make proper judgements as to the financial position and prospects of the Group, and have responsibility for establishing the Group's system of internal control and for monitoring its effectiveness. The Group's systems are designed to provide directors with reasonable assurance that physical and financial assets are safeguarded, transactions are authorised and properly recorded and material errors and irregularities are either prevented or detected with the minimum delay. However, systems of internal financial control can provide only reasonable and not absolute assurance against material misstatement or loss.

The key features of the systems of internal financial control include:

- Financial planning process with an annual financial plan approved by the Board. The plan is regularly updated providing an updated forecast for the year;
- Monthly comparison of actual results against plan;
- Written procedures detailing operational and financial internal control policies which are reviewed on a regular basis;
- Regular reporting to the Board on treasury and legal matters;
- Defined investment control guidelines and procedures; and
- Periodic reviews by the Audit Committee of the Group's systems and procedures.

The majority of the Group's financial and management information is processed and stored on computer systems. The Group is dependent on systems that require sophisticated computer networks. The Group has established controls and procedures over the security of data held on such systems, including business continuity arrangements.

On behalf of the Board, the Audit Committee has reviewed the operation and effectiveness of this framework of internal control for the year ended 31 December 2013, and up to the date of approval of the Annual Report.

### Internal Audit

The need for an internal audit function is reviewed on an annual basis by the Audit Committee taking into account the size and complexity of the Group. At present there is no intention to establish an internal audit function.

| COMPLIANCE WITH THE UK CORPORATE GOVERNANCE CODE | | |
|---|---|---|
| | **Code of Best Practice – Principles** | **Microgen Compliance Statement** |
| **A** | **LEADERSHIP** | |
| **1** | **The Role of the Board**<br>Every company should be headed by an effective board, which is collectively responsible for the success of the company. | The directors' responsibilities are outlined in the Report of the Directors. The Board meets regularly on a formal basis plus additional ad hoc meetings as necessary. |
| **2** | **Division of Responsibilities**<br>There should be a clear division of responsibilities at the head of the company between the running of the board and the executive responsibility for the running of the company's business. No one individual should have unfettered powers of decision. | Mr Ratcliffe was appointed Executive Chairman on 29 October 2013. The Board retains a majority of non-executive directors ensuring continued robust corporate governance. Each operating business is the responsibility of an executive who is invited to attend Board meetings. |
| **3** | **The Chairman**<br>The Chairman is responsible for leadership of the board and ensuring its effectiveness on all aspects of its role. | The Chairman is responsible for setting the Board's agenda and ensuring that adequate time is available for discussion of all agenda items, in particular strategic issues. He promotes a culture of openness and debate by facilitating the effective contribution of non-executive directors in particular and ensuring constructive relations between executive and non-executive directors. In addition, he ensures that the directors receive accurate, timely and clear information. |
| **4** | **Non-Executive Directors**<br>As part of their role as members of a unitary board, non-executive directors should constructively challenge and help develop proposals on strategy. | The Board appoints one of the independent non-executive directors to be the senior independent non-executive director to provide a sounding board for the Chairman and to serve as an intermediary for the other directors if necessary. The senior independent non-executive director is available to shareholders if they have concerns which contact through the normal channels of the Chairman or Group Finance Director fails to resolve or for which such contact is inappropriate. The Chairman holds meetings with the non-executive directors without the other executives being present. Led by the senior independent non-executive director, the non-executive directors meet without the Chairman at least annually to appraise the Chairman's performance and on such other occasions as are deemed appropriate.<br>If the directors have concerns which cannot be resolved about the running of the company or a proposed action, it is Company policy that their concerns must be recorded in the Board minutes. On their resignation, a non-executive director has to provide a written statement to the Chairman, for circulation to the Board, if they have any such concerns. |
| **B** | **EFFECTIVENESS** | |
| **1** | **The Composition of the Board**<br>The board and its committees should have the appropriate balance of skills, experience, independence and knowledge of the company to enable them to discharge their respective duties and responsibilities effectively. | The Board consists of the Chairman and Group Finance Director plus a majority of non-executive directors. All of the non-executive directors (including those detailed in the Statement of Compliance) are considered by the Board to be independent of the management of the Company and free from any business or other relationship which could materially interfere with the exercise of their independent judgement. |
| **2** | **Appointments to the Board**<br>There should be a formal, rigorous and transparent procedure for the appointment of new directors to the board. | A separate Nomination Committee, comprising all the non-executive directors together with the Chairman, is responsible for identifying and nominating candidates to fill Board vacancies. |
| **3** | **Commitment**<br>All directors should be able to allocate sufficient time to the company to discharge their responsibilities effectively. | The Chairman's other significant commitments are disclosed in the Annual Report. Any changes to such commitments are reported to the Board as they arise and their impact explained in the next Annual Report. Other executive directors will not be given permission by the Board to take on more than one directorship in a company nor chairman of such a company.<br>The terms and conditions of appointment of non-executive directors are made available for inspection. The letter of appointment sets out the expected time commitment. The appointed non-executive directors have undertaken that they will have sufficient time to meet what is expected of them. |
| **4** | **Development**<br>All directors should receive induction on joining the board and should regularly update and refresh their skills and knowledge. | The Chairman ensures that new directors receive an induction on joining the Board. Any training needs required by the directors will be discussed with the Chairman. |
| **5** | **Information and Support**<br>The board should be supplied in a timely manner with information in a form and of a quality appropriate to enable it to discharge its duties. | The Board is supplied with management accounts and operational reviews prior to each meeting. All non-executive directors have extensive business experience and possess relevant and updated skills and knowledge to perform their duties.<br>The Board ensures that directors, especially non-executive directors, have access to independent professional advice at the Company's expense where they judge it necessary to discharge their responsibility as directors.<br>All directors have access to the advice and services of the Company Secretary, who is responsible to the Board for ensuring that Board procedures are complied with. The appointment and removal of the Company Secretary is a matter for the Board as a whole. |

| COMPLIANCE WITH THE UK CORPORATE GOVERNANCE CODE (continued) | | |
|---|---|---|
| | **Code of Best Practice - Principles** | **Microgen Compliance Statement** |
| **B** | **EFFECTIVENESS** | |
| **6** | **Evaluation**<br>The board should undertake a formal and rigorous annual evaluation of its own performance and that of its committees and individual directors. | Given Microgen's size and Board structure, performance evaluation is an ongoing process. A performance evaluation is undertaken for all directors at the time of their proposed reappointment. The Group Finance Director receives an annual performance appraisal as part of the Management Bonus Scheme. The performance of each Board Committee is reviewed on an annual basis. |
| **7** | **Re-election**<br>All directors should be submitted for re-election at regular intervals, subject to continued satisfactory performance. | Non-executive directors are appointed for specific terms, up to a maximum of three years and re-appointment is not automatic. All directors offer themselves for election at the Annual General Meeting following their appointment and for re-election thereafter in accordance with the Company's articles, which require one-third of directors to retire in rotation at each Annual General Meeting. The Board sets out to shareholders in papers accompanying a resolution to elect a non-executive director why they believe an individual should be elected. The Chairman confirms to shareholders when proposing re-election that the non-executive director's performance remains effective. |
| **C** | **ACCOUNTABILITY** | |
| **1** | **Financial and Business Reporting**<br>The board should present a balanced and understandable assessment of the company's position and prospects. | The Board considers it is in compliance with this requirement. |
| **2** | **Risk Management and Internal Control**<br>The board is responsible for determining the nature and extent of the significant risks it is willing to take in achieving its strategic objectives. The board should maintain a sound risk management and internal control systems. | The Company operates a detailed internal control process which is reviewed at least on an annual basis by the Audit Committee and endorsed by the Board. Further information is provided in the Corporate Governance Statement. |
| **3** | **Audit Committee and Auditors**<br>The board should establish formal and transparent arrangements for considering how they should apply the financial reporting and risk management and internal control principles and for maintaining an appropriate relationship with the company's auditors. | The Audit Committee consists of all non-executive directors and meets at least three times a year. The Chairman and Group Finance Director are invited to attend but the Audit Committee meets at least annually with the Company's auditors without the other directors present.<br>The Board ensures that at least one member of the Audit Committee has recent and relevant financial experience. |
| **D** | **REMUNERATION** | |
| **1** | **The Level and Make-up of Remuneration**<br>Levels of remuneration should be sufficient to attract, retain and motivate directors of the quality required to run the company successfully, but a company should avoid paying more than is necessary for this purpose. A significant proportion of executive directors' remuneration should be structured so as to link rewards to corporate and individual performance. | The Directors' Remuneration Report provides details of the executive directors' remuneration. |
| **2** | **Procedure**<br>There should be a formal and transparent procedure for developing policy on executive remuneration and for fixing the remuneration packages of individual directors. No director should be involved in deciding his or her own remuneration. | Remuneration packages for individual directors are set by the Remuneration Committee after receiving information from independent sources and if required the Company's Human Resources function. The Chairman and Group Finance Director may be invited to attend the Committee's meetings. |
| **E** | **RELATIONS WITH SHAREHOLDERS** | |
| **1** | **Dialogue with Shareholders**<br>There should be a dialogue with shareholders based on the mutual understanding of objectives. The board as a whole has responsibility for ensuring that a satisfactory dialogue with shareholders takes place. | The Chairman and Group Finance Director meet on a regular basis with the Company's major shareholders. Non-executive directors are available to meet institutional shareholders if requested. |
| **2** | **Constructive Use of the Annual General Meeting**<br>The board should use the Annual General Meeting to communicate with investors and to encourage their participation. | The Company arranges for the Notice of the Annual General Meeting and related papers to be sent to shareholders at least 20 working days before the meeting.<br>All continuing directors make themselves available at the Annual General Meeting to respond to any questions raised by the investors in attendance. |

## Introduction

On behalf of the Board, I am pleased to present the Remuneration Committee's ("Committee") report of the directors' remuneration for the year ended 31 December 2013.

This is the first report that we have prepared in accordance with The Large and Medium sized Companies and Groups (Accounts and Reports) (Amendment) Regulations 2013 that came into force on 1 October 2013 and to reflect the requirements set out in these Regulations this Report is set out in two sections: the Directors' Remuneration Policy and the Annual Report on Remuneration. We believe the revised format and approach of the Directors' Remuneration Report provides shareholders with a comprehensive, clear and informative report.

This year shareholders will be asked to vote separately on the Directors' Remuneration Policy and the Annual Report on Remuneration at the Annual General Meeting on 28 April 2014. Outlined below are the key changes to remuneration policy and the Committee's key decisions during the year, some of which were set out in the Circular of the Company dated 1 November 2013 and were approved by shareholders at the General Meeting of the Company on 18 November 2013.

## Cancellation of the Microgen Value Enhancement and Realisation Bonus Scheme ("VERBS")

On 29 October 2013, the Board of Microgen plc announced the outcome of the Strategic Review. As part of the Strategic Review, the Committee reviewed whether or not VERBS as an incentive scheme should continue. Whilst the Board had returned in excess of 100% of its October 2008 market capitalisation (£37 million) to shareholders, which affirmed the effectiveness of VERBS in aligning management and shareholder interests since its introduction in November 2008, the Strategic Review highlighted the potential of VERBS to cause divergence between management and shareholder interests and to deter new investors. Therefore, the Committee put forward a resolution to cancel VERBS and shareholders passed this resolution at the General Meeting on 18 November 2013.

## Awards under the Company's Performance Share Plan ("PSP")

The Committee has recognised the continued need to incentivise and retain key staff, particularly since the inception of VERBS there have been minimal long term incentives awarded. As a result, share options under the PSP were granted to Martyn Ratcliffe, Executive Chairman and Philip Wood, Group Finance Director (in addition to a number of other senior employees) following shareholder approval at the General Meeting on 18 November 2013. Further details of these awards can be found in the Annual Report on Remuneration on page 34.

In addition to the above awards, shareholders approved the reintroduction of a regular programme of PSP share awards, subject to performance conditions aligned with shareholders' interest. Under this programme, which was approved by shareholders at the General Meeting on 18 November 2013, options in respect of a maximum of 750,000 ordinary shares will be granted per annum starting from 1 January 2014 for a period of 3 years after which the Committee will review. Executive Directors and senior employees will be entitled to receive grants under this programme, however, Mr Ratcliffe will not participate.

Further details of the above PSP awards and on-going programme of awards can be found under the Annual Report on Remuneration in Part B below.

## Management Bonus Scheme

It is the Committee's policy that exceptional performance only will result in payments under the Group's Management Bonus Scheme. The Committee has determined that payments will not be made to the Executive Directors under the Management Bonus Scheme for the year ended 31 December 2013 as performance targets have not been met.

## Board Structure

During the year ended 31 December 2013 there have been a number of changes to the Board. David Sherriff, Chief Executive Officer, retired from the Board on 31 October 2013. Mr Sherriff received a compensation payment in line with his service contract of £121,000. Following the decision not to replace the role of Chief Executive Officer, Martyn Ratcliffe, who has been Chairman of Microgen since 1998, was appointed Executive Chairman with Mr Ratcliffe agreeing to increase his time commitment to a minimum of 100 days per annum. As a result of this increased commitment Mr Ratcliffe's basic salary was increased from £205,000 to £275,000 per annum with effect from 1 November 2013. Mr Ratcliffe does not participate in the Company's pension, private medical insurance, permanent health insurance or life assurance schemes and does not receive any other fees (other than his basic salary) or benefits in kind from the Group. Details of Mr Ratcliffe's long-term incentive awards can be found on page 39 of this report.

## Reporting and policy requirements

There follows below Part A being the Directors' Remuneration Policy and Part B being the Annual Report on Remuneration both of which will be voted upon separately at the Annual General Meeting on 28 April 2014.

## Compliance

This report (comprising this introduction and Parts A and B) has been prepared in accordance with the Companies Act 2006 and The Large and Medium sized Companies and Groups (Accounts and Reports) (Amendment) Regulations 2013. It also meets the requirements of the UK Authority's Listing Rules and the Disclosure and Transparency Rules. The Committee further adopts the principles of good governance as set out in the UK Corporate Governance Code.

## A. DIRECTORS' REMUNERATION POLICY ("POLICY")

This section of the report sets out the Policy which will be put forward for shareholder approval at the 2014 Annual General Meeting. The Committee intends that, subject to shareholder approval, all elements of the Policy will be observed by the Committee from 28 April 2014 (the date of the Company's Annual General Meeting) and will formally come into effect on 1 January 2015 and shall apply for the period of three years thereafter.

Details relating to how the remuneration policy was implemented during the year ended 31 December 2013 are set out below in Part B as this Part A sets out the remuneration policy of the Company going forward.

## Remuneration policy for Executive Directors

The Policy for the Executive Directors and other senior executives is based on the following principles, and takes into account prevailing best practice, shareholder expectations, and the remuneration of the wider employee population:

- Determine remuneration by reference to individual performance, experience and prevailing market conditions, with a view to providing a package appropriate to the responsibilities involved;
- Align interests of directors and senior executives with those of the shareholders;
- Ensure remuneration arrangements support the Group's business strategy;
- Encourage the right behaviours, drive performance and reward results; and
- Deliver median/upper quartile pay for median/upper quartile performance.

## Ongoing policy commitments

At the General Meeting held on 18 November 2013 shareholders approved a regular programme of PSP share awards which shall continue to apply during the period to which this Directors' Remuneration Policy applies up to 31 December 2016, such programme being described in the Introduction above.

### *Executive Directors' Policy Table*

The following will apply to any remuneration and loss of office payments made to the Executive Directors on or after the Company's Annual General Meeting on 28 April 2014 up to and including 31 December 2017.

| Purpose and link to strategy | Operation | Maximum opportunity | Performance metrics |
|---|---|---|---|
| **Basic salary**<br>To pay competitive basic salary to attract, retain and motivate the talent required to operate and develop the Group's businesses and to develop and deliver the Group's strategy | Basic salaries are reviewed on an annual basis with reference to (i) scope of the role, (ii) performance and experience of the individual, (iii) pay levels at comparable companies, and (iv) pay and conditions elsewhere in the Group.<br>Basic salaries are also reviewed when an individual changes roles or responsibilities. | Salary increases will typically be in line with the increases awarded to other employees in the Group. In exceptional circumstances at the Committee's discretion, increases of a higher amount may be made taking into account individual circumstances such as:<br>• a material increase in scope or responsibility of the individual's role;<br>• development of the individual within the role (including enhanced performance);<br>• alignment to market level and/or<br>• necessary for the retention of an Executive Director. | None, although overall performance of the individual will be taken into consideration by the Committee when setting and reviewing salary levels. |
| **Pension**<br>To provide an opportunity for executives to build up income on retirement | All Executive Directors (excluding the Executive Chairman) are eligible to participate in the Group Personal Pension Scheme or receive a contribution to self-invested personal pension schemes. | The Group matches employee contributions on a 2:1 basis with employer contributions not exceeding 6% of basic salary. No element other than basic salary is pensionable. | None. Not performance related. |
| **Benefits**<br>To provide market-competitive non-cash benefits | Executive Directors (excluding the Executive Chairman) receive benefits which consist primarily of income protection in the event of long-term ill health, private healthcare insurance, death-in-service benefits and car fuel benefits. | Benefits may vary by role and are set at levels which the Committee considers to be sufficient based on the role and individual circumstances. | None. Not performance related. |
| **Management Bonus Scheme**<br>To incentivise and reward strong performance against financial and non-financial annual targets, thus delivering value to shareholders | Performance targets are set in the first quarter of the financial year.<br>The Committee then assess actual performance compared to those performance targets following the completion of the financial year and determine the bonus payable to each individual.<br>Bonus payments are delivered in cash and clawback provisions exist which entitle the Committee, at its discretion, to seek repayment of up to 25% of net bonus payment for a period of 18 months after the end of the relevant bonus year. | For Executive Directors (excluding the Executive Chairman) on-target performance shall not exceed 50% of salary and maximum performance shall not exceed 100% of salary.<br>The Executive Chairman does not participate in the Management Bonus Scheme and any bonus paid to him is separately and solely determined by the Committee and will be put forward for approval by shareholders at a General Meeting. The maximum bonus amount that the Committee can recommend to shareholders is up to 100% of basic salary. | Performance is determined by the Committee on an annual basis by reference to the following metrics:<br>• 50% of the award is based on financial measures; and<br>• 50% of the award is based on strategic measures (all subject to financial under-pin).<br>Previously 100% of the award was based on financial measures, however following the Strategic Review, the Committee believes that it is appropriate to adjust the metrics as above. The Committee anticipates that the metrics will be adjusted to a 75% / 25% split within the next three years. |

*Executive Directors' Policy Table (continued)*

| Purpose and link to strategy | Operation | Maximum opportunity | Performance metrics |
|---|---|---|---|
| **Performance Share Plan (PSP)**<br>To drive sustained long-term performance that supports the creation of shareholder value | The PSP is used to provide a meaningful reward to senior executives linked to the long-term success of the business, by delivering annual awards of nominal-cost options. | Other than in respect of awards specifically approved by shareholders, the PSP provides for awards of up to a maximum limit of 100% of basic salary for Executive Directors in the 12 calendar months immediately preceding the date of grant, with a limit of 200% in exceptional circumstances.<br>The 2013 awards, approved by shareholders at the General Meeting held on 18 November 2013, are excluded in calculating the maximum limits detailed above. | Other than in respect of awards specifically approved by shareholders, vesting of PSP awards is subject to continued employment and performance against demanding performance measures.<br>Awards made under the PSP will have a performance and vesting period of at least three years. If no entitlement has been earned at the end of the relevant performance period, awards will lapse. |
| **Company Share Option Plan (CSOP)**<br>To align management and shareholder interests and to recognise significant achievement | Option grants are made from time to time at the Committee's discretion. | Under the Company Share Option Plan – Part A which was approved by HMRC and introduced in 2006, any aggregate outstanding CSOP awards made to a participant may not exceed £30,000.<br>The Company Share Option Plan – Part B, also introduced in 2006, is an unapproved plan and except in exceptional circumstances to be determined by the Committee, the CSOP provides for awards of up to a maximum limit of 100% or 200% of basic salary for Executive Directors in the 12 calendar months immediately preceding the date of grant. | Vesting of options awards is subject to continued employment and performance.<br>The measures weightings applying to each performance measure may vary year-on-year to reflect strategic priorities.<br>Awards made under the options plans will have a performance and vesting period of at least three years. If no entitlement has been earned at the end of the relevant performance period, awards will lapse. |

## Exceptional circumstances exception

The Committee shall be entitled to have the discretion to award remuneration to an individual outside of the scope of the Executive Directors Policy table whose appointment to the Company as an Executive Director is being contemplated by the Committee in exceptional circumstances and where the interests of the Group require an exception to be made in order to secure the recruitment successfully.

## Notes to the Policy Table

***Selection of performance measures – Management Bonus Scheme***

The performance measures under the Management Bonus Scheme are selected annually to reflect the main KPIs and strategic priorities for the Group and operating businesses.

***Selection of performance measures – Performance Share Plan***

The Committee's policy is to set performance targets which are both stretching and achievable and that the maximum outcomes are only available for outstanding performance.

***Shareholding guidelines***

The Company expects Directors and senior employees when exercising PSP share options to enter into an undertaking with the Company not to dispose of more than fifty per cent (50%) of the shares until the day on which his or her holding has a market value equal to that of his or her basis salary. Any PSP share options that are sold to discharge the option holder's fiscal obligations are not treated as having been acquired by the option holder.

## Remuneration policy for Non-Executive Directors

The remuneration policy for Non-Executive Directors is set by the Board having taken account of the fees in other companies of similar size and the limits set in the Company's Articles of Association. When recruiting Non-Executive Directors, the remuneration offered will be in line with the policy table below.

### *Non-Executive Directors' Policy Table*

The following will apply to any remuneration and loss of office payments made to the Non-Executive Directors on or after the Company's Annual General Meeting on 28 April 2014 up to and including 31 December 2017.

| Purpose and link to strategy | Operation | Maximum opportunity | Performance measures |
|---|---|---|---|
| To attract and retain Non-Executive Directors of the highest calibre with broad commercial and other experience relevant to the Company | Each Non-Executive Director is paid a basic fee. Additional fees are payable for acting as Senior Independent Director and as Chairman of any of the Board's Committees (Audit and Remuneration) excluding the Nomination Committee.<br>The fees paid to the Non-Executive Directors are determined by the Board.<br>The Non-Executive Directors are not eligible to participate in the Company's performance-related incentive plans or pension arrangements.<br>Fee levels are benchmarked against FTSE-listed SmallCap companies of similar size and complexity. Time commitment and responsibility are taken into account when reviewing fee levels. | Non-Executive Director fees are reviewed by the Board once every three years with any adjustments effective 1 January of the following financial year.<br>However, in the event that there is a material change in the complexity, responsibility or time commitment required to fulfil a Non-Executive Director role, the Board shall seek shareholder approval to make the appropriate adjustment to the fee level.<br>The maximum aggregate fees for all Non-Executive Directors permitted by the Company's Articles of Association is £1 million (excluding bonus arrangement and incentive schemes) and the overall fees paid to the Non-Executive Directors will remain within this limit. | None |

## Remuneration policy for other employees across the Group

The Committee's approach to annual salary reviews is consistent across the Group, with consideration given to the scope of the role, level of experience, responsibility, individual performance and pay levels in comparable companies. Interim salary reviews are typically only proposed where an employee has a change in role or the scope of their role increases.

The Group offers three variable pay schemes to permanent employees of the Group who do not participate in the Management Bonus Scheme. These are the Sales Commission Plan, the Consultants' Bonus Scheme and the Annual Profit Share Bonus Plan. Employees participate in one of these schemes only.

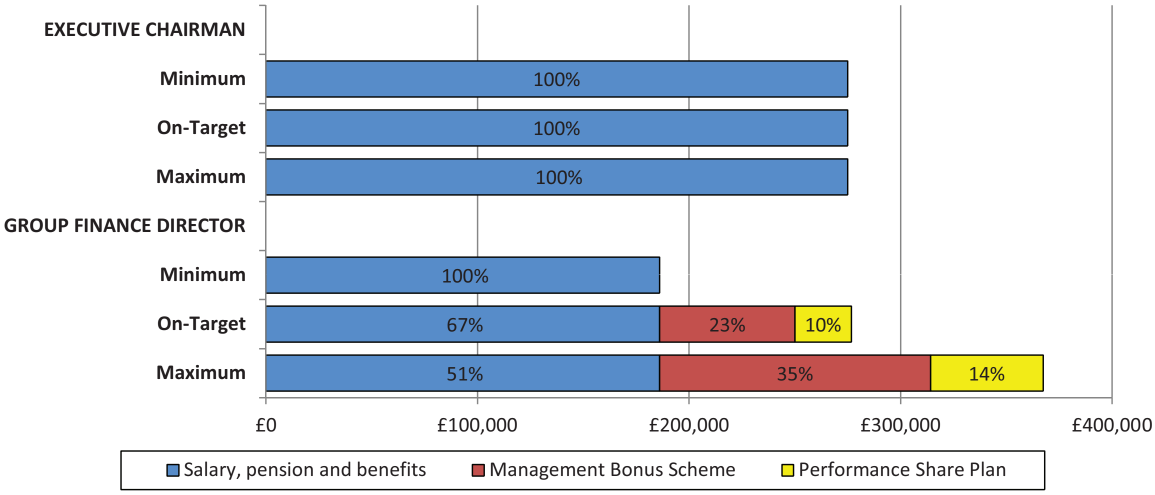
Under the Sales Commission Plan, commission is calculated and paid on a monthly basis for all commission earning sales people in the Microgen Group. Employees who are consultants and are targeted to generate fee income are eligible to participate in the Consultants' Bonus Scheme. Employees who do not participate in the Sales Commission Plan or the Consultants' Bonus Scheme are eligible to participate in an Annual Profit Share Bonus Plan where the quantum is set by the Committee in relation to Group and operating business performance. Opportunities and specific performance conditions vary by organisational level with business area-specific metrics incorporated where appropriate.

All employees are eligible to participate in the PSP and the CSOP and are eligible to receive option grants. Under normal conditions, performance conditions are consistent for all participants, while award sizes vary by organisational level.

### Illustrations of the application of the Executive Directors' Remuneration Policy

The chart below sets out an illustration in line with the Policy for the Executive Directors set out above and provides an estimate of the potential future reward opportunities for the Executive Directors, and the potential split between the different elements of remuneration under three different performance scenarios: 'minimum', 'on-target' and 'maximum'.

Potential reward opportunities are based on the Policy, applied to basic salaries as at 31 December 2013. Note that the projected values exclude the impact of share price movement and actual outcomes may differ from those shown.




The 'minimum' scenario shows basic salary, pension and benefits (i.e. fixed remuneration) which are the only elements of the Executive Directors' remuneration packages which are not at risk.

The 'on-target' scenario reflects fixed remuneration as above, plus for the Group Finance Director a target payout of 40% of salary from the Management Bonus Scheme. In this scenario it is assumed that the Group Finance Director is granted PSP awards of a value equivalent to 33.33% of his basic salary with 50% ultimately vesting.

The 'maximum' scenario reflects fixed remuneration as above plus for the Group Finance Director a payout of 80% of salary from the Management Bonus Scheme. In this scenario it is assumed that the Group Finance Director is granted PSP awards of a value equivalent to 33.33% of his basic salary with 100% ultimately vesting.

The Executive Chairman does not participate in the Management Bonus Scheme and any bonus paid to him is separately and solely determined by the Committee and will be put forward for approval by shareholders at a General Meeting. The maximum bonus amount that the Committee can recommend to shareholders is up to 100% of basic salary.

## Approach to Recruitment of Directors

### *Executive Directors*

When hiring a new Executive Director, or promoting to the Board from within the Group, the Committee may make use of any of the existing components of remuneration as detailed in the table below. Where an individual has contractual commitments made prior to their promotion to the Board, the Company will continue to honour these remuneration arrangements.

| Component | Approach | Maximum annual grant value |
|---|---|---|
| Basic salary | The basic salaries of new appointees will be determined by reference to relevant market data, experience and skills of the individual, internal relativities and their current basic salary. Where new appointees have initial basic salaries set below market, any shortfall may be managed with phased increases over a period of two to three years subject to their development in the role | |
| Pension | New appointees will be eligible to participate in the Group Personal Pension Scheme or receive a contribution to self-invested personal pension schemes in line with existing executives | |
| Benefits | New appointees will be eligible to receive benefits which may include (but are not limited to) income protection in the event of long-term ill health, private healthcare insurance, death-in-service benefits and car fuel benefits | |
| Management Bonus Scheme | The scheme 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. Targets for the individual element will be tailored towards the executive | 100% of salary |
| Performance Share Plan | New appointees who have been invited to participate in the PSP will be granted awards under the PSP on the same terms as other executives, as described in the policy table | 200% of salary |

In determining appropriate remuneration package for new Executive Directors, the Committee will take into consideration all relevant factors (including quantum, the nature of remuneration and where the candidate was recruited from) to ensure that arrangements are in the best interests of the Company and its shareholders. In addition, the Committee reserves the right to make an award in respect of a new appointment to 'buy out' incentive arrangements forfeited on leaving a previous employer. In doing so, the Committee will consider relevant factors including any performance conditions attached to these awards and the likelihood of those conditions being met.

## Exceptional circumstances exception

The Committee shall be entitled to have the discretion to award remuneration to an individual outside of the ambit of the Executive Directors Policy table whose appointment to the Company as an Executive Director is being contemplated by the Committee in exceptional circumstances and where the interests of the Group require an exception to be made in order to successfully secure the recruitment.

### *Non-Executive Directors*

In recruiting a new Non-Executive Director, the Committee will use the policy as set out in the table on page 27. A basic fee in line with the prevailing fee schedule would be payable for Board membership, with additional fees payable for acting as Senior Independent Director or Chairman of the Audit or Remuneration Committees as appropriate.

## Directors' Service Contracts and Exit Payment Policy

Executive Director service contracts, including arrangements for early termination, are carefully considered by the Committee. Each Executive Director has a rolling service contract with the Group which can be terminated with written notice in accordance with the table below. Such contracts provide for an obligation to pay salary plus pension and benefits for any portion of the notice period waived by the Group. Executive Director service contracts are available to view at the Company's registered office.

| Executive Director | Date of service contract | Notice period from the individual | Notice period from the employer |
|---|---|---|---|
| M R Ratcliffe | 30 July 1998 | 6 months | 6 months |
| P B Wood | 21 October 2006 | 6 months | 6 months |

The table below summarises how the awards under the Management Bonus Scheme and long-term incentives are typically treated in specific circumstances:

| Reason for leaving | Treatment |
|---|---|
| **Management Bonus Scheme** | |
| Resignation | Awards lapse on the date of notice of termination. |
| Retirement, ill-health, disability, death, change of control or redundancy | The Committee may consider it appropriate to award bonus depending on the relevant termination scenario. If a bonus is paid then cash bonuses will typically only be paid to the extent that the relevant performance targets set at the beginning of the plan year have been met or are expected to be met in the reasonable opinion of the Committee, however, the Committee reserves the right to award full or partial bonus for the year of cessation depending on the circumstances. |
| **Performance Share Plan and Share Option Plans** | |
| Resignation | Awards lapse. |
| Retirement, ill-health, disability, death or redundancy | The Committee determines whether and to what extent outstanding awards vest based on the extent to which performance conditions have been achieved. The determination of vesting will be made as soon as reasonably practical following the end of the performance period or such earlier date as the Committee may agree. |
| Change of Control | Microgen awards may alternatively be exchanged for new equivalent awards in the acquirer where appropriate. |

## Non-Executive Directors' Terms of Appointment

Subject to annual re-election by shareholders, Non-Executive Directors are appointed for an initial term of approximately three years. Subsequent terms of three years may be awarded. Details of the Non-Executive Directors' terms of appointment are shown in the table below and copies of the Non-Executive Directors' terms of appointment are available to view at the Company's registered office. The appointment, re-appointment and the remuneration of Non-Executive Directors are matters reserved for the full Board.

| | Initial agreement date | Expiry date of current agreement |
|---|---|---|
| PM Bertram | 3 October 2006 | 14 April 2015 |
| V Murray | 1 September 2011 | 31 August 2014 |
| P Whiting | 2 February 2012 | 1 February 2015 |

## Executive Directors – External appointments

The Executive Directors may accept external appointments of Non-Executive Directorship in order to broaden their experience for the benefit of the Company. Such appointments are subject to approval by the Board in each case, and the Executive Director may retain any fees paid in respect of such a directorship.

Mr Ratcliffe was appointed Chairman of Sagentia Group plc on 15 April 2010 and Executive Chairman on 18 October 2012. Mr Ratcliffe has agreed not to accept any other external appointments for a period of 3 years from 1 November 2013 without the Board's prior consent.

## Consideration of conditions elsewhere in the Company

Although the Committee does not consult directly with employees on executive remuneration policy, the Committee does consider general basic salary increases across the Company, remuneration arrangements and employment conditions for the broader employee population when determining remuneration policy for the Executive Directors.

## Consideration of shareholder views

The Committee is committed to an open and transparent dialogue with shareholders on matters relating to remuneration. When determining remuneration, the Committee takes into account views of shareholders and investor guidelines. The Committee is always open to feedback from shareholders on remuneration policy and arrangements, and commits to undergoing shareholder consultation in advance of any significant changes to remuneration policy.

During the year a number of the Company's largest shareholders were consulted on the proposed changes to the Company's remuneration policy which were approved by shareholders at the General Meeting in November 2013.

## B ANNUAL REPORT ON REMUNERATION

The following section provides details of how Microgen's remuneration policy was implemented during the year ended 31 December 2013.

### Role of the Remuneration Committee

The Committee's primary function is to support the Company's strategy by ensuring its delivery is supported by the Company's remuneration policy. The Committee's responsibilities include:

- determining the Company's remuneration policy and monitoring its implementation;
- approving remuneration packages for each of the Executive Directors and the Executive Chairman;
- recommending the remuneration of the Non-Executive Directors for determination by the Board;
- determining the terms on which Performance Share Plan and Company Share Option Plan awards are made; and
- reviewing and setting performance targets for incentive plans.

The Committee's full terms of reference provide further details of the roles and responsibilities of the Committee and are available on the Company's website.

### Remuneration Committee membership in 2013

The membership of the Remuneration Committee as at 31 December 2013 comprises Ms Murray, Mr Bertram and Mr Whiting and is chaired by Ms Murray.

Only Committee members have the right to attend Committee meetings, though other individuals such as the Executive Chairman and the Group Finance Director may attend by invitation. External consultants provide advice to the Committee from time to time. No individuals are involved in decisions relating to their own remuneration.

The Committee held ten meetings during the financial year and details of members' attendance at meetings are provided in the Corporate Governance section on page 19.

## Single total figure of remuneration (audited)

### *Executive Directors*

The table below sets out a single figure for the total remuneration received by each Executive Director for the year ended 31 December 2013 and the prior year:

| | M R Ratcliffe | | P B Wood | | D J Sherriff | |
|---|---|---|---|---|---|---|
| | **2013** | 2012 | **2013** | 2012 | **2013** | 2012 |
| | **£** | £ | **£** | £ | **£** | £ |
| Basic salary | **216,667** | 205,000 | **171,760** | 174,700 | **203,500** | 225,000 |
| Taxable benefits* | **–** | – | **2,760** | 2,655 | **4,748** | 5,158 |
| Pension** | **–** | – | **9,600** | 9,600 | **10,500** | 12,600 |
| Management Bonus*** | **–** | – | **–** | – | **–** | – |
| Long Term Incentives**** | **–** | – | **–** | – | **–** | – |
| Other***** | **–** | – | **–** | – | **121,000** | – |
| Total | **216,667** | 205,000 | **184,120** | 186,955 | **339,748** | 242,758 |

* Taxable benefits consist primarily of private healthcare insurance and car fuel benefits.

** During the year Mr Sherriff participated in the Group Personal Pension Scheme, a defined contribution scheme, in relation to whom the Company contributed £10,500 up to his resignation date of 31 October 2013 (2012: £12,600). The Company paid £9,600 on behalf of Mr Wood into a self-invested personal pension scheme (2012: £9,600).

*** Payment for performance during the year under the Management Bonus Scheme. See following sections for further details.

**** Includes any PSP, option or VERBS awards based on the value at vesting of shares or options vesting on performance in the year ending 31 December 2013. No shares or options were due to vest on performance during the year ended 31 December 2013.

***** Mr Sherriff (resigned 31 October 2013) received a compensation payment in line with his service contract of £121,000.

### *Non-Executive Directors*

The table below sets out a single figure for the total remuneration received by each Non-Executive Director for the year ended 31 December 2013 and the prior year:

| | P M Bertram* | | V Murray | | P Whiting** | |
|---|---|---|---|---|---|---|
| | **2013** | 2012 | **2013** | 2012 | **2013** | 2012 |
| | **£** | £ | **£** | £ | **£** | £ |
| Basic salary | **37,000** | 37,000 | **37,000** | 37,000 | **37,000** | 33,680 |
| Committee fees | **7,500** | 7,500 | **5,000** | 5,000 | **–** | – |
| Senior Independent Director fees | **5,000** | – | **–** | – | **–** | – |
| Total | **49,500** | 44,500 | **42,000** | 42,000 | **37,000** | 33,680 |

* The Senior Independent Director fee paid to Mr Bertram was a one-off fee paid in relation to Mr Bertram's role as sub-committee Chairman to the Board.

** The basic fee paid to Mr Whiting for 2012 relates to the period 2 February 2012 (when he joined the Board) to 31 December 2012.

## Incentive outcomes for the year ended 31 December 2013

***Management Bonus Scheme in respect of 2013 performance***

The 2013 Management Bonus Scheme for Executive Directors (except for the Executive Chairman who does not participate in the Scheme) is determined by the Committee by reference to the Group's financial and the Executive Director's personal performance during 2013. When assessing performance the Committee compares reported operating profit to target in addition to the consideration of other indicators of performance including customer retention, recurring revenue growth, cash flow management and achievement of other objectives. Annual bonus targets for the participants for 2013 were set up to a maximum of 50% with an overall cap of 100% of salary. Bonuses under the scheme can only be paid up to the total value of the bonus fund as approved by the Committee.

The individual performance targets set and performance against each of the metrics are deemed by the Committee to be commercially sensitive and will therefore not be disclosed.

***Outcome***

It is the Committee's policy that exceptional performance only will result in payment under the Group's Management Bonus Scheme. No bonuses for Executive Directors were awarded in respect of 2013 due to the operating profit of the Group being reported at a level below the level at which bonuses became payable.

***Performance Share Plan vesting***

No Performance Share Plan awards for Executive Directors were due to vest in the year.

## Scheme interests awarded in 2013 (audited)

On 18 November 2013, share options over 2,500,000 ordinary shares were issued to Mr Ratcliffe and share options over 500,000 ordinary shares options were issued to Mr Wood under the Performance Share Plan. The exercise price for the share options is 5 pence per share. The grant of these share options were approved by shareholders at the General Meeting held on 18 November 2013.

***Awards in 2013 to Mr Ratcliffe***

In respect of Mr Ratcliffe's share options, the performance conditions of the grant are as follows:

- 500,000 share options with a performance condition that the Company's share price reaches £2.00 per share;

- A further 1,000,000 share options with a performance condition that the Company's share price reaches £2.50 per share; and

- A further 1,000,000 share options with a performance condition that the Company's share price reaches £3.00 per share.

For assessing whether the share price performance conditions have been achieved, the Company's share price must be sustained for a period of 20 consecutive business days at or above the specified level. The above performance conditions must be achieved within five years from the date of grant.

As a condition of exercise Mr Ratcliffe is required to hold a minimum of 5,500,000 ordinary shares in the Company at the point of exercise. Share options are capable of being exercised three years from the date of grant with the last date of exercise ten years from the date of grant. In the event of the termination of Mr Ratcliffe's service contract (except due to voluntary resignation or gross misconduct) those share options which have satisfied the above performance conditions at that time will immediately vest even if the point of termination is within three years from the date of grant.

***Awards in 2013 to Mr Wood***

In respect of Mr Wood's share options, 50% of share options do not have performance conditions attached (other than continued employment) and 50% have a Total Shareholder Return ("TSR") performance condition under which:

- one-third will vest if (i) the Company's TSR at least matches the performance of the FTSE Fledgling Index over the performance period; and (ii) the Company's TSR over the performance period is not negative;
- a further third will vest if (i) the Company's TSR outperforms the FTSE Fledgling Index by at least 25% over the performance period; and (ii) the Company's TSR over the performance period is at least 10%; and
- a further third will vest if (i) the Company's TSR outperforms the FTSE Fledgling Index by at least 50% over the performance period; and (ii) the Company's TSR over the performance period is at least 20%.

The relevant performance period for assessing the Company's TSR will be 3 years commencing on 20 November 2013. The reference point for the Company's TSR at the start of the performance period will be 123 pence whilst the closing reference point for the Company's TSR will be the average closing share price over the 30 calendar days ending on the last day of the performance period.

65% of the share options will be capable of exercise after three years and 35% after five years from the date of grant respectively.

## Termination payments made in the year (audited)

Mr Sherriff (resigned 31 October 2013) received a compensation payment in line with his employment contract of £121,000.

## Payments to past Directors (audited)

No payments were made to past Directors in the year.

## Implementation of remuneration policy for 2014 (audited)

***Basic salary***

Market positioning of basic salary is reviewed on an individual basis, by reference to individual performance, experience and market conditions with a view to providing a package which is appropriate for the responsibilities involved.

The Committee did not propose that salary increases be made for the Executives save for Mr Ratcliffe, who received a salary increase due to his time commitment increasing from 75 days to 100 days per annum from 1 November 2013:

| Executive Directors | Basic salary from 1 January 2013 | Basic salary from 1 January 2014 | Percentage increase |
|---|---|---|---|
| M R Ratcliffe* | £205,000 | £275,000 | 34.1% |
| P B Wood | £174,700 | £174,700 | – |

* Mr Ratcliffe does not participate in the Company's pension, private medical insurance, permanent health insurance or life assurance schemes and does not receive any other fees (other than his basic salary) or benefits in kind from the Company.

***Pension***

Mr Wood will continue to participate in the Group Personal Pension Scheme or receive a contribution to self-invested personal pension schemes. Mr Ratcliffe does not participate in the Group Personal Pension Scheme.

***Management Bonus Scheme***

The maximum bonus opportunity for Executive Directors in 2014 will remain unchanged from the opportunity in 2013, and will be a maximum on-target of 50% with an overall cap of 100% of salary, however, the on-target bonus for Mr Wood is 40% of basic salary with a maximum bonus of 80% of basic salary. The Executive Chairman does not participate in the Management Bonus Scheme and any bonus paid to him is separately determined by the Committee and will be put forward for approval by shareholders at a General Meeting. The maximum bonus amount that the Committee can recommend to shareholders is up to 100% of basic salary.

Bonuses will be based on performance compared to a number of financial metrics and the individual and strategic goals set for the year. The financial metrics include group operating profit and a number of the KPIs of each operating business. The individual and strategic goals will be subject to financial underpin. Bonuses under the scheme can only be paid up to the total value of the bonus fund as approved by the Committee.

***Long-term incentives***

Shareholder approval was received at the General Meeting held on 18 November 2013 to grant, under the Performance Share Plan, options in respect of up to 750,000 ordinary shares in each of 2014, 2015 and 2016. The exercise price of such options will be 5 pence per ordinary share. Performance conditions will be attached to these share options and the vesting period will be three years. Approval for any awards for Mr Ratcliffe will be sought from shareholders.

***Non-Executive Director fees***

With effect from 1 January 2014, the basic fee payable to each Non-Executive Director is £40,000 per annum. The fees payable for chairing the Audit and Remuneration Committees are £7,500 and £6,500 per annum respectively.

## Percentage change in Executive Chairman's remuneration (audited)

The table below shows the percentage change in Executive Chairman remuneration from the prior year compared to the average percentage change in remuneration for all other employees. Note, for the purposes of this disclosure, remuneration comprises salary, benefits (excluding pension) and annual bonus only.

| | **Change in remuneration from 2012 to 2013** | |
|---|---|---|
| | **Executive Chairman**** | **Other employees*** |
| Salary | 6% | 3% |
| Taxable benefits | 0% | (6%) |
| Single-year variable | 0% | (56%) |
| Total | 6% | (12%) |

* Based on UK employees only as the most appropriate comparator group.
** On 1 November 2013 Mr Ratcliffe's basic salary increased from £205,000 per annum to £275,000 to reflect the increased time commitment from 75 days to 100 days per annum.

## Relative importance of spend on pay (audited)

The table below shows the percentage change in spend on pay and shareholder distributions (i.e. dividends and share buybacks) from the financial year ended 31 December 2012 to the financial year ended 31 December 2013.

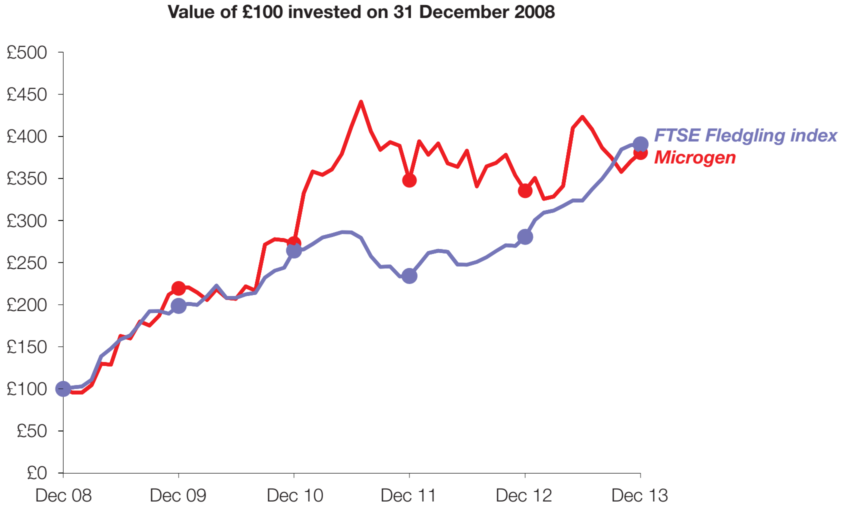
| | % increase (decrease) | **2013 £000** | 2012 £000 |
|---|---|---|---|
| Return to shareholders in year | 500% | **17,016** | 2,837 |
| Employee remuneration | (9%) | **15,649** | 17,139 |

Ordinary dividends have increased 1% from 2012 to 2013.

## Comparison of Company performance

The following graph shows the Company's performance, measured by total shareholder return, compared with the performance of the FTSE Fledgling Index for the five years ended 31 December 2013. The Committee consider that the FTSE Fledgling Index is the most appropriate comparison given the similarities between the Company and the companies forming this index.

The total shareholder return performance (as shown in the graph below) for the Company includes the impact of the dividends paid to its Shareholders across the period; however, it does not reflect either the £6.2m or £10.0m returned to shareholders via Tender Offer in 2010 and 2013 respectively.




The table below details Mr Sherriff's single figure remuneration over the same period together with Mr Ratcliffe's single figure remuneration as he was appointed Executive Chairman on 31 October 2013 having previously been Chairman. The audited single figures of remuneration below are prepared on the same basis as the single total figure of remuneration on page 33.

| | 2009 | 2010 | 2011 | 2012 | 2013 |
|---|---|---|---|---|---|
| **Martyn Ratcliffe** | | | | | |
| Executive Chairman single figure of remuneration (£000) | £350,931 | £252,296 | £224,798 | £205,000** | **£216,667*** ** |
| Bonus award as % of maximum opportunity | n/a* | n/a | n/a | n/a | **n/a** |
| Share Option award vesting as % of maximum opportunity | n/a | n/a | 100%**** | n/a | **n/a** |
| **David Sherriff***** ** | | | | | |
| CEO single figure of remuneration (£000) | £395,755 | £345,716 | £344,924 | £242,758 | **£339,748** |
| Bonus as % of maximum opportunity | 89% | 55% | 50% | 0% | **0%** |
| Share Option award vesting as % of maximum opportunity | 67.09% | 93.34% | 91.67% | n/a | **n/a** |

* Mr Ratcliffe does not participate in the Management Bonus Scheme but was awarded a one-off bonus of £100,000 in respect of the year ended 31 December 2009.

** The reduction in Mr Ratcliffe's basic salary from 1 June 2011 was to reflect the reduction in the number of days per annum that he was required to work reducing from 120 days to 75 days.

*** Mr Ratcliffe's basic salary was increased from 1 November 2013 from £205,000 to £275,000 to reflect the increase in the number of days that he is required to work from 75 days to 100 days per annum.

**** Mr Ratcliffe was awarded 1,000,000 share options under the Company Share Option Plan 2006 on 2 May 2008, these share options vested on 2 May 2011.

***** Mr Sherriff resigned on 31 October 2013.

## Directors' shareholdings (audited)

The interests of the directors and their families in the ordinary shares of the Company as at 31 December 2013 were as follows:

| | **Ordinary shares at 31 December 2013** | Ordinary shares at 31 December 2012 |
|---|---|---|
| M R Ratcliffe | **5,294,524** | 5,294,524 |
| P B Wood | **142,246** | 60,000 |
| P M Bertram | **46,022** | 46,022 |
| V Murray | **2,000** | 2,000 |
| P Whiting | **24,000** | 24,000 |
| D J Sherriff* | **N/A** | 189,000 |

* Resigned on 31 October 2013

There have been no changes to directors' shareholdings since 31 December 2013. 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. Details of directors' interests in shares and options under Microgen long-term incentives are set out in the sections below.

## Directors' other share interests (audited)

The table below shows the other share interests of each director as at 31 December 2013:

| | **Share options unvested and subject to performance conditions & continued employment** | **Share options vested but not exercised** |
|---|---|---|
| M R Ratcliffe | 2,500,000* | 1,000,000 |
| P B Wood | 500,000** | – |
| P M Bertram | – | – |
| V Murray | – | – |
| P Whiting | – | – |

* For these share options to vest, Mr Ratcliffe is required to hold a minimum of 5.5 million shares in the Company in addition to the remaining performance conditions being achieved as documented in the 'Scheme interests awarded in 2013' above.

** Under the rules of the PSP, Mr Wood is not entitled to dispose of more than 50% of the shares that he may acquire on exercise of these share options until the day on which his total holding of shares in the Company has a market value equal to his basic salary. For the purposes of this rule, shares sold to discharge Mr Wood's fiscal obligations shall be treated as not having been acquired by him. Mr Wood's current minimum holding according to these rules is 41,423 shares in the Company.

## Directors' interests in shares options and shares in Microgen long-term incentive plans and all-employee plans

There have been no share options awarded to the Executive Directors since November 2008 other than the share option grants made to the Executive Directors in November 2013. No other share option awards have been made since 31 December 2013.

***Microgen Value Enhancement and Realisation Bonus Scheme***

As part of the Strategic Review, the Committee reviewed the appropriateness of Microgen Value Enhancement and Realisation Bonus Scheme (VERBS) as an incentive scheme. Whilst VERBS had been effective in aligning management and shareholder interests since its introduction in November 2008, the Strategic Review highlighted the potential of VERBS to cause divergence between management and shareholder interests and to deter new investors. Therefore, the Committee put forward a resolution to cancel VERBS and shareholders passed this resolution at the General Meeting on 18 November 2013.

## Advisers

In fulfilling its role the Committee seeks professional advice when considered appropriate to do so. The services of Kepler Associates, an independent adviser on executive remuneration, were made available to the Committee during the year. This included providing assistance with preparation of the Directors' Remuneration Report.

Kepler is a founder member of the Remuneration Consultants Group and is a signatory to the Code of Conduct for consultants to Remuneration Committees of UK-listed companies, details of which can be found at www.remunerationconsultantsgroup.com. Their total fees for the provision of remuneration services to Committee in 2013 were £9,000 which related to advice on reporting requirements. The Committee is satisfied that the advice provided by Kepler is independent.

## Statement of Shareholder voting

At the Annual General Meeting of the Company on 13 May 2013 the results regarding Resolution 2 (to approve the Directors' Remuneration Report for the year ended 31 December 2012) were as follows:

| | **Total number of votes** | **% of votes cast** |
|---|---|---|
| For (including discretionary) | 62,249,446 | ~100% |
| Against | 2,845 | <0.01% |
| **Total votes cast (excluding withheld votes)** | **62,252,291** | **100%** |
| Votes withheld | 4,049 | <0.01% |
| **Total votes cast (including withheld votes)** | **62,256,340** | |

Note: Abstained votes are not included in the final proxy figures as they are not recognised as a vote in law.

The Remuneration Report was approved by a duly authorised Committee of the Board of Directors on 25 February 2014 and signed on its behalf by:

**Vanda Murray OBE**

Chair of the Remuneration Committee

25 February 2014

## Report on the financial statements

**Our opinion**

In our opinion:

- The financial statements, defined below, give a true and fair view of the state of the Microgen plc Group's and of the Company's affairs as at 31 December 2013 and of the Group's profit and of the Group's and Company cash flows for the year then ended;
- The Group financial statements have been properly prepared in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union;
- The Company financial statements have been properly prepared in accordance with IFRSs as adopted by the European Union and as applied in accordance with the provisions of the Companies Act 2006; and
- The financial statements have been prepared in accordance with the requirements of the Companies Act 2006 and, as regards the Group financial statements, Article 4 of the IAS Regulation.

This opinion is to be read in the context of what we say in the remainder of this report.

**What we have audited**

The Group financial statements and Company financial statements (the "financial statements"), which are prepared by Microgen plc, comprise:

- the Group and Company statements of financial position as at 31 December 2013;
- the Group income statement and statement of comprehensive income for the year then ended;
- the Group and Company statements of changes in equity and statements of cash flows for the year then ended; and
- the notes to the financial statements, which include a summary of significant accounting policies and other explanatory information.

The financial reporting framework that has been applied in their preparation comprises applicable law and IFRSs as adopted by the European Union and, as regards the Company, as applied in accordance with the provisions of the Companies Act 2006.

**What an audit of financial statements involves**

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) (ISAs (UK & Ireland)). An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of:

- whether the accounting policies are appropriate to the Group's and Company's circumstances and have been consistently applied and adequately disclosed;
- the reasonableness of significant accounting estimates made by the directors; and
- the overall presentation of the financial statements.

In addition, we read all the financial and non-financial information in the Annual Report to identify material inconsistencies with the audited financial statements and to identify any information that is apparently materially incorrect based on, or materially inconsistent with, the knowledge acquired by us in the course of performing the audit. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report.

**Overview of our audit approach**

Materiality

We set certain thresholds for materiality. These helped us to determine the nature, timing and extent of our audit procedures and to evaluate the effect of misstatements, both individually and on the financial statements as a whole.

Based on our professional judgement, we determined materiality for the Group financial statements as a whole to be £432,000, which represents 5% of profit before tax.

We agreed with the Audit Committee that we would report to them misstatements identified during our audit above £22,000 as well as misstatements below that amount that, in our view, warranted reporting for qualitative reasons.

Overview of the scope of our audit

The Group is structured such that the significant majority of the business is comprised of two operating businesses being Aptitude Software and Financial Systems. The Group financial statements are a consolidation of 13 reporting units, comprising the Group's operating subsidiaries and overseas branches, and centralised Group functions.

In establishing the overall approach to the Group audit, we determined the type of work that needed to be performed at the reporting units. We also determined the level of involvement we needed to have in the audit work at those reporting units to be able to conclude whether sufficient appropriate audit evidence had been obtained as a basis for our opinion on the Group financial statements as a whole.

Accordingly, of the Group's 13 reporting units, we identified four which, in our view, required an audit of their complete financial information, either due to their size or their risk characteristics. Specific audit procedures were performed on four further reporting units and selected consolidation adjustments in relation to individually significant balances. These included procedures on revenue and deferred income, goodwill, taxation, trade payables, receivables and other payables. This, together with additional procedures performed at the Group level, gave us the evidence we needed for our opinion on the Group financial statements as a whole.

Areas of particular audit focus

In preparing the financial statements, the directors made a number of subjective judgements, for example in respect of significant accounting estimates that involved making assumptions and considering future events that are inherently uncertain. We primarily focused our work in these areas by assessing the directors' judgements against available evidence, forming our own judgements, and evaluating the disclosures in the financial statements.

In our audit, we tested and examined information, using sampling and other auditing techniques, to the extent we considered necessary to provide a reasonable basis for us to draw conclusions. We obtained audit evidence through testing the effectiveness of controls, substantive procedures or a combination of both.

We considered the following areas to be those that required particular focus in the current year. This is not a complete list of all risks or areas of focus identified by our audit. We discussed these areas of focus with the Audit Committee.

Their report on those matters that they considered to be significant issues in relation to the financial statements is set out on page 18.

| Area of focus | How the scope of our audit addressed the area of focus |
|---|---|
| **Fraud in revenue recognition**<br>ISAs (UK & Ireland) presume there is a risk of fraud in revenue recognition because of the pressure management may feel to achieve the planned results. We focused on the timing of the recognition of revenue and its presentation in the income statement, because this is dependent on the fulfilment of contractual obligations, which can be complex. | We tested the timing of revenue recognition, taking into account contractual obligations, and in particular considered with operational and Group management whether judgemental revenue deferral provisions associated with complex contracts were appropriately and consistently calculated.<br>We read extracts of the relevant customer agreements and tested the accounting for contractual milestones against the analysis of the position of each contract that management maintains. Our work included evaluating customer acceptance of the work done, any ongoing disputes, and the directors' estimates of costs to complete the contract. We also tested journal entries posted to revenue accounts to identify unusual or irregular items. |
| **Risk of management override of internal controls**<br>ISAs (UK & Ireland) require that we consider this. | We assessed the overall control environment of the Group, including the arrangements for staff to "whistle-blow" inappropriate actions, and interviewed senior management. We examined the significant accounting estimates and judgements relevant to the financial statements for evidence of bias by the directors that may represent a risk of material misstatement due to fraud. We also tested journal entries. |

**Going Concern**

Under the Listing Rules we are required to review the directors' statement, set out on page 10, in relation to going concern. We have nothing to report having performed our review.

As noted in the directors' statement, the directors have concluded that it is appropriate to prepare the Group's and Company's financial statements using the going concern basis of accounting. The going concern basis presumes that the Group and Company have adequate resources to remain in operation, and that the directors intend them to do so, for at least one year from the date the financial statements were signed. As part of our audit we have concluded that the directors' use of the going concern basis is appropriate.

However, because not all future events or conditions can be predicted, these statements are not a guarantee as to the Group's and the Company's ability to continue as a going concern.

## Opinions on matters prescribed by the Companies Act 2006

In our opinion:

- the information given in the Strategic Report and the Report of the Directors for the financial year for which the financial statements are prepared is consistent with the financial statements;
- 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 Corporate Governance Statement set out on pages 16 to 22 in the Annual Report with respect to internal control and risk management systems and about share capital structures is consistent with the financial statements.

## Other matters on which we are required to report by exception

**Adequacy of accounting records and information and explanations received**

Under the Companies Act 2006 we are required to report to you if, in our opinion:

- we have not received all the information and explanations we require for our audit; or
- adequate accounting records have not been kept by the Company, or returns adequate for our audit have not been received from branches not visited by us; or
- the Company financial statements and the part of the Directors' Remuneration Report to be audited are not in agreement with the accounting records and returns.

We have no exceptions to report arising from this responsibility.

**Directors' remuneration**

Under the Companies Act 2006 we are required to report to you if, in our opinion, certain disclosures of directors' remuneration specified by law have not been made. We have no exceptions to report arising from these responsibilities.

**Corporate Governance Statement**

Under the Companies Act 2006, we are required to report to you if, in our opinion a corporate governance statement has not been prepared by the Company. We have no exceptions to report arising from this responsibility.

Under the Listing Rules we are required to review the part of the Corporate Governance Statement relating to the Company's compliance with nine provisions of the UK Corporate Governance Code ('the Code'). We have nothing to report having performed our review.

On page 7 of the Annual Report, as required by the Code Provision C.1.1, the directors state that they consider the Annual Report taken as a whole to be fair, balanced and understandable and provides the information necessary for members to assess the Group's performance, business model and strategy. On page 18, as required by C.3.8 of the Code, the Audit Committee has set out the significant issues that it considered in relation to the financial statements, and how they were addressed. Under ISAs (UK & Ireland) we are required to report to you if, in our opinion:

- the statement given by the directors is materially inconsistent with our knowledge of the Group acquired in the course of performing our audit; or

- the section of the Annual Report describing the work of the Audit Committee does not appropriately address matters communicated by us to the Audit Committee.

We have no exceptions to report arising from this responsibility.

**Other information in the Annual Report**
Under ISAs (UK & Ireland), we are required to report to you if, in our opinion, information in the Annual Report is:

- materially inconsistent with the information in the audited financial statements; or
- apparently materially incorrect based on, or materially inconsistent with, our knowledge of the Group and Company acquired in the course of performing our audit; or
- is otherwise misleading.

We have no exceptions to report arising from this responsibility.

## Responsibilities for the financial statements and the audit

**Our responsibilities and those of the directors**
As explained more fully in the Directors' Responsibilities Statement set out on page 6, the directors are responsible for the preparation of the Group and Company financial statements and for being satisfied that they give a true and fair view.

Our responsibility is to audit and express an opinion on the Group and Company financial statements in accordance with applicable law and ISAs (UK & Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

This report, including the opinions, has been prepared for and only for the Company's members as a body in accordance with Chapter 3 of Part 16 of the Companies Act 2006 and for no other purpose. We do not, in giving these opinions, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

**John Maitland (Senior Statutory Auditor)**
for and on behalf of PricewaterhouseCoopers LLP
Chartered Accountants and Statutory Auditors
London
25 February 2014

# Consolidated

## Income Statement *for the year ended 31 December 2013*

| | Note | Year ended 31 Dec 2013 Before exceptional and other items | Exceptional and other items | Total | Year ended 31 Dec 2012 Before exceptional and other items | Exceptional and other items | Total |
|---|---|---|---|---|---|---|---|
| | | £000 | £000 | **£000** | £000 | £000 | **£000** |
| **Revenue** | 1 | 29,824 | – | **29,824** | 32,318 | – | 32,318 |
| Operating costs | 1, 2 | (20,755) | (381) | **(21,136)** | (23,187) | (118) | (23,305) |
| **Operating profit** | 2 | 9,069 | (381) | **8,688** | 9,131 | (118) | 9,013 |
| Finance income | 4 | 119 | – | **119** | 174 | – | 174 |
| Finance costs | 4 | (119) | – | **(119)** | – | – | – |
| Net finance income | | – | – | **–** | 174 | – | 174 |
| **Profit before income tax** | | 9,069 | (381) | **8,688** | 9,305 | (118) | 9,187 |
| Income tax expense | 5 | | | **(2,250)** | | | (2,238) |
| **Profit for the year** | | | | **6,438** | | | 6,949 |
| **Earnings per share** | | | | | | | |
| Basic | 6 | | | **7.9p** | | | 8.5p |
| Diluted | 6 | | | **7.7p** | | | 8.3p |

The accounting policies and notes on pages 52 to 90 are an integral part of these consolidated financial statements.

# Consolidated Statement
## Of Comprehensive Income *for the year ended 31 December 2013*

| | Note | Group Year ended 31 Dec 2013 £000 | Group Year ended 31 Dec 2012 £000 |
|---|---|---|---|
| **Profit for the year** | | **6,438** | 6,949 |
| **Other comprehensive income** | | | |
| Items that will or may be reclassifed to profit or loss: | | | |
| Fair value (loss)/gain on hedged financial instruments | 22 | **(7)** | 409 |
| Currency translation difference | 23 | **75** | 80 |
| **Other comprehensive income for the year, net of tax** | | **68** | 489 |
| **Total comprehensive income for the year** | | **6,506** | 7,438 |

The accounting policies and notes on pages 52 to 90 are an integral part of these consolidated financial statements.

# Balance Sheets at 31 December 2013

| | Note | Group As at 31 Dec 2013 £000 | Group As at 31 Dec 2012 £000 | Company As at 31 Dec 2013 £000 | Company As at 31 Dec 2012 £000 |
|---|---|---|---|---|---|
| **ASSETS** | | | | | |
| **Non-current assets** | | | | | |
| Property, plant and equipment | 10 | **5,022** | 5,391 | **–** | – |
| Goodwill | 8 | **41,774** | 41,774 | **–** | – |
| Investments in subsidiaries | 11 | **–** | – | **40,909** | 40,752 |
| Deferred income tax assets | 12 | **752** | 1,041 | **–** | – |
| | | **47,548** | 48,206 | **40,909** | 40,752 |
| **Current assets** | | | | | |
| Trade and other receivables | 13 | **5,049** | 3,163 | **154** | 8,722 |
| Financial assets – derivative financial instruments | 18 | **94** | 69 | **–** | – |
| Cash and cash equivalents | 14 | **40,200** | 32,134 | **29,642** | 22,592 |
| | | **45,343** | 35,366 | **29,796** | 31,314 |
| **Total assets** | | **92,891** | 83,572 | **70,705** | 72,066 |
| **LIABILITIES** | | | | | |
| **Current liabilities** | | | | | |
| Financial liabilities | | | | | |
| – borrowings | 16 | **(3,000)** | – | **–** | – |
| – derivative financial instruments | 18 | **(47)** | (15) | **–** | – |
| Trade and other payables | 15 | **(18,186)** | (17,845) | **(9,334)** | (20,733) |
| Current income tax liabilities | | **(701)** | (742) | **–** | (10) |
| Provisions for other liabilities and charges | 17 | **(33)** | (42) | **–** | – |
| | | **(21,967)** | (18,644) | **(9,334)** | (20,743) |
| **Net current assets** | | **23,376** | 16,722 | **20,462** | 10,571 |
| **Non-current liabilities** | | | | | |
| Financial liabilities – borrowings | 16 | **(16,250)** | – | **–** | – |
| Provisions for other liabilities and charges | 17 | **(269)** | (256) | **–** | – |
| | | **(16,519)** | (256) | **–** | – |
| **NET ASSETS** | | **54,405** | 64,672 | **61,371** | 51,323 |
| **SHAREHOLDERS' EQUITY** | | | | | |
| Share capital | 19 | **3,724** | 4,078 | **3,724** | 4,078 |
| Share premium account | 20 | **12,037** | 11,885 | **12,037** | 11,885 |
| Capital redemption reserve | 21 | **1,558** | 1,152 | **1,558** | 1,152 |
| Other reserves | 22 | **37,021** | 37,028 | **20,177** | 20,177 |
| Retained earnings | 23 | **65** | 10,529 | **23,875** | 14,031 |
| **TOTAL EQUITY** | | **54,405** | 64,672 | **61,371** | 51,323 |

The accounting policies and notes on pages 52 to 90 are an integral part of these consolidated financial statements.

The financial statements on pages 46 to 90 were authorised for issue by the Board of Directors on 25 February 2014 and were signed on its behalf by:

**M R Ratcliffe**
Director

**P B Wood**
Director

# Consolidated Statement

## Of Changes in Shareholders' Equity

microgen

*for the year ended 31 December 2013*

| | Note | Share capital £000 | Share premium £000 | Retained earnings £000 | Capital redemption reserve £000 | Other reserves £000 | Total equity £000 |
|---|---|---|---|---|---|---|---|
| | | Attributable to owners of the parent | | | | | |
| **Group** | | | | | | | |
| **Balance at 1 January 2012** | | **4,069** | **11,842** | **6,299** | **1,146** | **36,619** | **59,975** |
| Profit for the year | | – | – | 6,949 | – | – | **6,949** |
| Cash flow hedges | | | | | | | |
| – net fair value gains in the year | 22 | – | – | – | – | 409 | **409** |
| Exchange rate adjustments | 23 | – | – | 80 | – | – | **80** |
| **Total comprehensive income for the year** | | – | – | 7,029 | – | 409 | **7,438** |
| Shares issued under share option schemes | 19-20 | 15 | 43 | – | – | – | **58** |
| Own shares purchased and cancelled | 19-23 | (6) | – | (146) | 6 | – | **(146)** |
| Share options – value of employee service | 23 | – | – | 61 | – | – | **61** |
| Deferred tax on financial instruments | 23 | – | – | (89) | – | – | **(89)** |
| Deferred tax on share options | 23 | – | – | 25 | – | – | **25** |
| Corporation tax on share options | 23 | – | – | 41 | – | – | **41** |
| Dividends to equity holders of the company | 7 | – | – | (2,691) | – | – | **(2,691)** |
| **Total Contributions by and distributions to owners of the company recognised directly in equity** | | 9 | 43 | (2,799) | 6 | – | **(2,741)** |
| **Balance at 31 December 2012** | | **4,078** | **11,885** | **10,529** | **1,152** | **37,028** | **64,672** |
| Profit for the year | | – | – | 6,438 | – | – | **6,438** |
| Cash flow hedges | | | | | | | |
| – net fair value losses in the year | 22 | – | – | – | – | (7) | **(7)** |
| Exchange rate adjustments | 23 | – | – | 75 | – | – | **75** |
| **Total comprehensive income for the year** | | – | – | 6,513 | – | (7) | **6,506** |
| Shares issued under share option schemes | 19-20 | 52 | 152 | – | – | – | **204** |
| Own shares purchased and cancelled | 19-23 | (406) | – | (10,269) | 406 | – | **(10,269)** |
| Share options – value of employee service | 23 | – | – | 157 | – | – | **157** |
| Deferred tax on financial instruments | 23 | – | – | 9 | – | – | **9** |
| Deferred tax on share options | 23 | – | – | 7 | – | – | **7** |
| Corporation tax on share options | 23 | – | – | 135 | – | – | **135** |
| Dividends to equity holders of the company | 7 | – | – | (7,016) | – | – | **(7,016)** |
| **Total Contributions by and distributions to owners of the company recognised directly in equity** | | (354) | 152 | (16,977) | 406 | – | **(16,773)** |
| **Balance at 31 December 2013** | | **3,724** | **12,037** | **65** | **1,558** | **37,021** | **54,405** |

The accounting policies and notes on pages 52 to 90 are an integral part of these consolidated financial statements.

# Company Statement

## Of Changes in Shareholders' Equity

*for the year ended 31 December 2013*

| | Note | Share capital £000 | Share premium £000 | Retained earnings £000 | Capital redemption reserve £000 | Other reserves £000 | Total equity £000 |
|---|---|---|---|---|---|---|---|
| | | Attributable to owners of the Company | | | | | |
| **Company** | | | | | | | |
| **Balance at 1 January 2012** | | **4,069** | **11,842** | **16,663** | **1,146** | **20,177** | **53,897** |
| Profit for the year | 23 | – | – | 144 | – | – | **144** |
| **Total comprehensive income for the year** | | – | – | 144 | – | – | **144** |
| Shares issued under share option schemes | 19-20 | 15 | 43 | – | – | – | **58** |
| Own shares purchased and cancelled | 19-23 | (6) | – | (146) | 6 | – | **(146)** |
| Share options – value of employee service | 23 | – | – | 61 | – | – | **61** |
| Dividends to equity holders of the company | 7 | – | – | (2,691) | – | – | **(2,691)** |
| **Total Contributions by and distributions to owners of the company recognised directly in equity** | | 9 | 43 | (2,776) | 6 | – | **(2,718)** |
| **Balance at 31 December 2012** | | **4,078** | **11,885** | **14,031** | **1,152** | **20,177** | **51,323** |
| Profit for the year | 23 | – | – | 26,972 | – | – | **26,972** |
| **Total comprehensive income for the year** | | – | – | 26,972 | – | – | **26,972** |
| Shares issued under share option schemes | 19-20 | 52 | 152 | – | – | – | **204** |
| Own shares purchased and cancelled | 19-23 | (406) | – | (10,269) | 406 | – | **(10,269)** |
| Share options – value of employee service | 23 | – | – | 157 | – | – | **157** |
| Dividends to equity holders of the company | 7 | – | – | (7,016) | – | – | **(7,016)** |
| **Total Contributions by and distributions to owners of the company recognised directly in equity** | | (354) | 152 | (17,128) | 406 | – | **(16,924)** |
| **Balance at 31 December 2013** | | **3,724** | **12,037** | **23,875** | **1,558** | **20,177** | **61,371** |

The accounting policies and notes on pages 52 to 90 are an integral part of these consolidated financial statements.

# Statements
## Of Cash Flows *for the year ended 31 December 2013*

| | Note | Group As at 31 Dec 2013 £000 | Group As at 31 Dec 2012 £000 | Company As at 31 Dec 2013 £000 | Company As at 31 Dec 2012 £000 |
|---|---|---|---|---|---|
| **Cash flows from operating activities** | | | | | |
| Cash generated from/(used in) operations | 24 | **8,103** | 10,348 | **(1,597)** | 92 |
| Interest paid | | **(119)** | – | **–** | – |
| Income tax paid | | **(1,728)** | (2,023) | **(2)** | (32) |
| **Net cash flows generated from operating activities** | | **6,256** | 8,325 | **(1,599)** | 60 |
| **Cash flows from investing activities** | | | | | |
| Dividends received | | **–** | – | **28,673** | – |
| Purchase of property, plant and equipment | 10 | **(427)** | (624) | **–** | – |
| Interest received | | **119** | 174 | **73** | 143 |
| **Net cash (used in)/ generated from investing activities** | | **(308)** | (450) | **28,746** | 143 |
| **Cash flows from financing activities** | | | | | |
| Proceeds from bank loan | | **20,000** | – | **–** | – |
| Net proceeds from issuance of ordinary shares | | **204** | 59 | **204** | 59 |
| Dividends paid to company's shareholders | 7 | **(7,016)** | (2,691) | **(7,016)** | (2,691) |
| Repayments of loan | | **(750)** | – | **–** | – |
| Amounts (borrowed)/received from group undertakings | | **–** | – | **(3,016)** | 1,510 |
| Purchase of own shares | 23 | **(10,269)** | (146) | **(10,269)** | (146) |
| **Net cash generated from/(used in) financing activities** | | **2,169** | (2,778) | **(20,097)** | (1,268) |
| **Net increase/(decrease) in cash and cash equivalents** | | **8,117** | 5,097 | **7,050** | (1,065) |
| Cash, cash equivalents and bank overdrafts at beginning of year | 14 | **32,134** | 26,971 | **22,592** | 23,657 |
| Exchange rate (losses)/gains on cash and cash equivalents | | **(51)** | 66 | **–** | – |
| **Cash and cash equivalents at end of year** | 14 | **40,200** | 32,134 | **29,642** | 22,592 |

The accounting policies and notes on pages 52 to 90 are an integral part of these consolidated financial statements.

## Accounting Policies

### General Information

The Company is a public limited company incorporated and domiciled in England and Wales.

The Group consolidated financial statements were authorised for issue by the Board of Directors on 25 February 2014.

### Summary of significant accounting policies

The principal accounting policies applied in the preparation of these consolidated financial statements are set out below. These policies have been consistently applied to all the years presented, unless otherwise stated.

### Basis of preparation

The consolidated financial statements of Microgen plc have been prepared in accordance with International Financial Reporting Standards ("IFRS") as adopted by the European Union (IFRSs as adopted by the EU) and IFRS Interpretations Committee (formerly IFRIC) interpretations and the Companies Act 2006 applicable to companies reporting under IFRS. The consolidated financial statements have been prepared under the historical cost basis, as modified by the revaluation of financial assets and financial liabilities (including derivatives) which are recognised at fair value.

The presentation of financial statements in conformity with IFRS requires the use of certain critical accounting estimates. It also requires management to exercise its judgement in the process of applying the Group's accounting policies. The areas involving a higher degree of judgement or complexity, or where assumptions and estimates are significant to the consolidated financial statements are disclosed on page 64.

### Going Concern

After making enquiries, the Directors have a reasonable expectation that the Group has adequate resources to continue in operational existence for the foreseeable future. The Group therefore continues to adopt the going concern basis in preparing its consolidated financial statements.

### Changes in Accounting policy and disclosures

**(a) New standards, interpretations and amendments effective from 1 January 2013**

A number of new standards and amendments to standards and interpretations which are effective for annual periods beginning after 1 January 2013, have been adopted in these financial statements. The nature and effect of each new standard, interpretation and amendment adopted by the Group is detailed below. Note that not all new standards and amendments to standards and interpretations effective for the first time for periods beginning on or after 1 January 2013 effect the Group's annual consolidated financial statements.

*IAS 1 – Presentation of Items of Other Comprehensive Income – Amendments to IAS 1*

The amendment required that items of other comprehensive income must be grouped together into two sections:

– Those that will or may be classified into profit or loss

– Those that will not.

As the amendment only affects presentation, there is no effect on the Group's financial position or performance.

The following new standards, amendments and interpretations are also effective for the first time in these financial statements. However, none have a material effect on the Group.

IFRS 10 Consolidated Financial Statements

IFRS 11 Joint Arrangements

IFRS 12 Disclosure of Interests in Other Entities

IFRS 13 Fair Value Measurement

IFRS 7 Financial Instruments: Dislcosures (Amendments – Offsetting Financial Assets and Financial Liabilities)

Consolidated Financial Statements, Joint Arrangements and Disclosures of Interests in Other Entities: Transition Guidance (amendments to IFRS 10m IFRS 11 and IFRS 12).

IAS 1 Presentation of Financial Statements – (improvements to IFRSs (2009 to 2011 Cycle))

IAS 16 Property, Plant and Equipment – (Improvements to IFRSs (2009 to 2011 Cycle))

IAS 27 Separate Financial Statements (Amendments)

IAS 28 Investments in Associates and Joint Ventures (Amendments)

IAS 32 Financial Instruments: Presentation IFRS (2009 – 2011 Cycle)

**(b) New standards and interpretations that have not been early adopted.**

None of the other new standards, amendments and interpretations, which are effective for periods beginning after 1 January 2013 and which have not been adopted early, are expected to have a significant effect on the consolidated financial statements of the Group.

**Basis of consolidation**

The financial statements consolidate the results of Microgen plc and its subsidiary undertakings ("subsidiaries"). The results of the subsidiaries acquired are included within the income statement from the date that control passes to the Group. They are de-consolidated from the date on which control ceases.

Subsidiaries are all entities over which the Group has the power to govern the financial and operating policies generally accompanying a shareholding of more than one half of the voting rights. The existence and effect of potential voting rights that are currently exercisable or convertible are considered when assessing whether the Group controls another entity. The Group also assesses existence of control where it does not have more than 50% of the voting power but is able to govern the financial and operating policies by virtue of de-facto control. De-Facto control may arise in circumstances where the size and dispersion of holdings of other shareholders give the Group the power to govern the financial and operating activities.

The purchase method of accounting is used to account for the acquisition of subsidiaries by the Group. The cost of an acquisition is measured as the fair value of the assets given, equity instruments issued and liabilities incurred or assumed at the date of exchange, plus costs directly attributable to the acquisition. Identifiable assets and liabilities and contingent liabilities assumed in a business combination are measured initially at their fair values at acquisition date, irrespective of the extent of any minority interest.

The excess of cost of acquisition over the fair value of the Group's share of the identifiable net assets is recorded as goodwill.

Inter-company transactions, balances, income and expenses on transactions between group companies are eliminated. Profit and losses resulting from inter-company transactions that are recognised in assets are also eliminated. Accounting policies of the subsidiaries have been changed where necessary to ensure consistency with the policies adopted by the Group.

**Revenue recognition**
Revenue compromises the fair value of the consideration received or receivable for the sale of goods and services in the ordinary course of the Group's activities. Revenue is shown net of value-added tax, returns, rebates and discounts and after eliminating sales within the Group. The Group's two operating businesses derive their revenues from some or all of the following categories of revenue:-

– software based activity relating to the Group's intellectual property (comprising software licences, maintenance, support, funded development and related consultancy);

– managed services (comprising principally of application management services); and

– general consultancy services.

The Group recognises revenue from each of these categories as follows:-

<u>Software based activity</u>
*Software licences*
The Group licences its software on an Initial Licence Fee, Perpetual Licence Fee or Annual Licence Fee basis. Licence Fees are first recognised when all of the following criteria are met:-

– a signed contract or customer purchase order is in place;

– licence fee is fixed and determinable;

– evidence of software delivery has been received;

– collection of the debt is likely; and

– no vendor specific obligations relating to the delivered software are outstanding.

Once all of these criteria have been met, all of the Initial or Perpetual Licence Fee is recognised and recognition of the Annual Licence Fee commences. Annual Licence Fees are recognised in the period the services are provided, using a straight-line basis over the term of the licence. In assessing whether the collection of the debt is likely, any deferred payments for Licence Fees are recognised only if they are to be invoiced within 90 days of the period end and such invoice is payable within 30 days of the invoice date.

*Software Maintenance*
Fees relating to the maintenance of the Group's software are recognised in the period the services are provided, using a straight-line basis over the term of the maintenance agreement.

*Support fees*
Support fees are billed to customers where the Group's software is used by a customer as part of an IT solution and that customer contracts with the Group for support relating to that IT solution. The customer will commit to a minimum monthly, quarterly or annual fee that covers an agreed level of support and then agrees additional fees for support used over and above the minimum commitment. Revenue from support contracts is recognised as the fees are earned.

*Funded development*

Where a customer seeks enhancement to the core functionality of a Group product such enhancements will be considered for inclusion in the product road map. Where customers wish to accelerate the product development the Group may undertake funded development work. Revenue for funded development work is recognised on a percentage completed basis after deferring a proportion of the revenue to cover the resolution of any issues arising after the enhancement has been delivered to the customer. Once the enhancement has been accepted by the customer the deferred portion of the revenue is recognised.

*IPR consultancy*

The majority of consultancy services which relate to a project which includes the Group's software is contracted for on a time and materials basis and is recognised as such. Occasionally, fixed priced or shared risk work is undertaken and this is recognised on a percentage completion basis after deferring a proportion of the overall revenue until the end of the relevant stage of the project. The percentage completed is determined with reference to effort incurred to date and effort required to complete the development.

Managed Services

Where the Group provides application management services to a customer for a third party software product or solution then revenue from these services is recognised as the services are performed.

General Consultancy

The majority of general consultancy services are contracted for on a time and materials basis, with revenue and costs recognised as incurred. Revenue and costs on fixed price and shared risk contracts are recognised on a percentage completion basis after deferring a proportion of the overall revenue until the end of the relevant stage of the project.

**Segmental reporting**

Operating segments are reported in a manner consistent with the internal reporting provided to key decision makers. These decision makers are responsible for allocating resources and assessing performance of the operating segments.

The primary segmental reporting is by operating businesses being Aptitude Software and Financial Systems.

The operating businesses are allocated central function costs in arriving at operating profit. Group overhead costs are not allocated into the operating businesses as the Board believes that these relate to Group activities as opposed to the operating businesses.

**Exceptional and other items**

Items that are both material in size and unusual and infrequent in nature are presented as exceptional and other items in the income statement. The directors are of the opinion that the separate recording of exceptional and other items provides helpful information about the Group's underlying business performance.

**Leasing**

Leases where the lessor retains substantially all the risks and rewards of ownership are classified as operating leases. Operating lease rentals are charged to the income statement on a straight line basis over the life of the lease.

**Property, plant and equipment**

Property, plant and equipment is shown at historic purchase cost less accumulated depreciation and adjusted for any impairment. Land is not depreciated. Costs include expenditure that is directly attributable to the acquisition of the items.

Depreciation is provided on assets so as to write off the cost of property, plant and equipment less their residual value over their estimated useful economic lives by equal annual instalments at the following rates.

| | |
|---|---|
| Freehold land and buildings | 2 per cent |
| Leasehold improvements | 10 – 20 per cent (or the life of the lease if shorter) |
| Plant and machinery | 20 – 50 per cent |
| Fixtures and fittings | 20 per cent |

Estimation of the useful economic life includes an assessment of the expected rate of technological developments and the intensity at which the assets are expected to be used.

The assets' residual values and useful economic lives are reviewed, and adjusted if appropriate, at each balance sheet date.

**Goodwill**

Goodwill arising on consolidation represents the excess of the fair value of the consideration given over the fair value of the identifiable net assets acquired. Goodwill is capitalised on the balance sheet and subject to an annual impairment test. The carrying value of goodwill is cost less accumulated impairment. Goodwill is allocated to cash generating units for the purpose of impairment testing. The allocation is made to those cash generating units that are expected to benefit from the business combinations in which the goodwill arose. Impairment reviews are carried out by the Board at least annually. Impairments to goodwill are charged to the income statement in the period in which they arise.

**Intangible assets**

*Research and Development ("R&D")*

Research expenditure is expensed to the income statement as incurred. Costs incurred on internal development projects relating to new or substantially improved products are recognised as intangible assets from the date upon which all IAS 38 criteria have been satisfied.

In assessing the IAS 38 criteria it is considered that the technical feasibility of development has only been satisfied once the product is deployed into a live customer environment and thereafter development expenditure is minimal, therefore all research and development costs have been expensed when incurred.

*Externally acquired software intellectual property rights*

Rights in externally acquired software assets are capitalised at cost and amortised over their estimated useful economic life. Useful economic life is assessed on an individual basis.

*In process R&D*

In process R&D is recognised only on acquisition. The fair value is derived based on time spent on the project at an average daily cost rate. The carrying value is stated at fair value at acquisition less accumulated amortisation and impairment losses. The useful economic life is assessed on an individual basis. Amortisation is charged on a straight line basis over the estimated useful economic life of the assets.

*Customer relationships*

Customer relationships are recognised only on acquisition. The fair value is derived based on discounted cash flows from estimated recurring revenue streams. The carrying value is stated at fair value at acquisition less accumulated amortisation and impairment losses. The useful economic life is assessed on an individual basis. Amortisation is charged on a straight line basis over the estimated economic useful life of the assets.

### Interest income

Interest income is recognised on a time-proportion basis using the effective interest method.

### Interest costs

Interest costs are recognised on a time-proportion basis using the effective interest method.

### Impairment of non-financial assets

Assets that have an indefinite useful economic life are not subject to amortisation and are tested annually for impairment and whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. Assets that are subject to amortisation are tested for impairment whenever events or changes in circumstances indicate that the carrying value may not be recoverable. An impairment loss is recognised for the amount by which the asset's carrying amount exceeds its recoverable amount. The recoverable amount is the higher of an asset's fair value less costs to sell and value in use. For the purposes of assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash flows. Non-financial assets other than goodwill that suffered an impairment are reviewed for possible reversal of the impairment at each reporting date. Any impairment of goodwill is not reversed.

### Investments

Investments in subsidiaries are stated in the financial statements of the Company at cost less any provision for impairment.

### Cash and cash equivalents

Cash is defined as cash in hand and on demand deposits. Cash equivalents are defined as short term, highly liquid investments with original maturities of three months or less.

### Share-based payments

The Group operates share-based compensation plans that are equity settled. The fair value of the employee services received in exchange for the grant of the options is recognised as an expense in the Group income statement over the vesting period with a corresponding adjustment to equity. The expense in relation to options granted on 18 November 2013 (details can be found on page 67) is shown within Exceptional and Other Items.

No charge is taken to the Company income statement as share options are treated in a similar manner to capital contributions with an addition to investments as all employees are employed by subsidiary companies.

The total amount to be expensed over the vesting period is determined by reference to the fair value of the options granted, excluding the impact of any non-market vesting conditions.

Non-market vesting conditions are included in assumptions about the number of options that are expected to become exercisable. At each balance sheet date, the entity revises its estimates of the number of options that are expected to become exercisable. It recognises the impact of the revision of original estimates, if any, in the income statement, with a corresponding adjustment to equity.

The proceeds received net of any directly attributable transaction costs are credited to share capital (nominal value) and share premium when the options are exercised.

The option pricing model used is the Monte Carlo pricing model.

**Foreign currency**
Items included within the financial statements of each of the Group's entities are measured using the currency of the primary economic environment in which the entity operates. The consolidated financial statements are presented in sterling, which is the Group's functional and presentation currency.

Foreign transactions are translated into the functional currency at the exchange rate ruling when the transaction is entered into. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation at year-end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognised in the income statement.

On consolidation, the balance sheet of each overseas subsidiary is translated at the closing rate at the date of the balance sheet, and the income and expenses for each income statement are translated at the average exchange rate for the period. Exchange gains and losses arising thereon are recognised as a separate component of equity.

Exchange differences arising from the translation of the net investment in foreign subsidiaries are taken to shareholders' equity on consolidation. When a foreign operation is sold, such exchange differences are recognised in the income statement as part of the gain or loss on sale.

**Pensions**
The Group operates defined contribution retirement benefit plans in respect of its UK employees. Employee and employer contributions are based on basic earnings for the current year. The schemes are funded by payments to a trustee-administered fund completely independent of the Group's finances. The expense is recognised on a monthly basis as accrued. The Group has no further payment obligations once the contributions have been paid.

**Current and deferred income tax**
The charge for current tax is based on the results for the year as adjusted for items which are non-assessable or disallowed. It is calculated using tax rates that have been enacted or substantively enacted by the balance sheet date.

Deferred income tax is provided in full, using the liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the consolidated financial statements. However, the deferred income tax is not accounted for, if it arises from initial recognition of an asset or liability in a transaction other than a business combination that at the time of the transaction affects neither accounting nor taxable profit and loss.

Deferred income tax is determined using tax rates (and laws) that have been enacted or substantially enacted by the balance sheet date and are expected to apply when the related deferred income tax asset is realised or the deferred income tax liability is settled.

Deferred tax assets are recognised to the extent that it is probable that future taxable profit will be available against which the temporary differences can be utilised.

Deferred income tax is provided on temporary differences arising on investments in subsidiaries and associates, except where the timing of the reversal of the temporary difference is controlled by the Group and it is probable that the temporary difference will not reverse in the foreseeable future.

**Trade receivables**
Trade receivables are recognised initially at fair value and to the extent that it is deemed necessary are subsequently measured at amortised cost using the effective interest method, less provision for impairment. A provision for impairment

of trade receivables is established when there is objective evidence that the Group will not be able to collect all amounts due according to the original terms of the receivables.

The amount of the provision is the difference between the asset's carrying amount and the present value of estimated future cash flows, discounted at the effective interest rate. The amount of the provision is recognised in the income statement within other operating costs.

**Trade payables**

Trade payables are recognised initially at fair value and subsequently measured at amortised cost using the effective interest method.

**Share capital**

Ordinary shares are classified as equity. Incremental costs directly attributable to the issue of new ordinary shares or options are shown in equity as a deduction, net of tax, from the proceeds.

**Provisions for other liabilities and charges**

Provisions are created for vacant or sublet properties when the Group has a legal obligation for future expenditure in relation to onerous leases. The provision is measured at the present value of management's best estimate of the expenditure required to settle the present obligation at the balance sheet date. The discount rate used to determine the present value reflects current market assessments of the time value of money and the risks specific to the liability.

**Borrowings**

Borrowings are initially stated at the amount of the net proceeds after deduction.

**Dividend distribution**

Dividend distribution to the Company's shareholders is recognised as a liability in the Group's financial statements in the period in which the dividends are approved by the Company's shareholders or in respect of interim dividends when they are paid.

**Dividend income**

Dividend income to the Company received from subsidiary investments is recognised in the Company's income statement in the period in which it is paid.

**Derivative financial instruments and hedging activities**

The Group holds derivative financial instruments to hedge its foreign currency and interst rate risk exposures.

Derivatives are initially recognised and measured at fair value on the date a derivative contract is entered into and subsequently measured at fair value. The gain or loss on re-measurement is taken to the income statement except where the derivative is a designated hedging instrument. The accounting treatment of derivatives classified as hedges depends on their designation, which occurs on the date that the derivative contract is committed to. At the year-end the Group has designated its derivatives as a hedge of the cost of a highly probable forecasted transaction commitment ('cash flow hedge'). Gains or losses on cash flow hedges that are regarded as highly effective are recognised in equity. If the forecasted transaction or commitment results in future income or expenditure, gains or losses deferred in equity are transferred to the income statement in the same period as the underlying income or expenditure. The ineffective portions of the gain or loss on the hedging instrument are not recognised in equity, rather they are recognised immediately in profit or loss.

For the portion of hedges deemed ineffective or transactions that do not qualify for hedge accounting under IAS 39, any change in assets or liabilities is recognised immediately in the income statement. When a hedging instrument expires or is sold, any cumulative gain or loss existing in equity at that time remains in equity and is recognised when the forecasted transaction is ultimately recognised in the income statement.

**Financial Risk Management**

The Group's trading, multi-national operations and debt financing expose it to financial risks that include the effects of changes in foreign currency exchange rates, credit risk, liquidity and interest rates.

The Group manages these risks so as to limit any adverse effects on the financial performance of the Group.

**(a) Market risk – Foreign exchange**

The Group's major foreign exchange exposures are to the Polish Zloty, South African Rand and US Dollar, arising from its trading subsidiaries in Europe, South Africa and the USA. Group policy in this area is to eliminate foreign currency cash flows between Group companies once the size and timing of transactions can be predicted with sufficient certainty. Since April 2007 this has been achieved by hedging Polish Zloty cash outflows 12 months in advance by using forward foreign currency contracts. These have the effect of fixing the sterling amount of Polish Zlotys to be paid in the future. The average remaining life of the forward exchange contracts at 31 December 2013 was 6 months (2012: 6 months).

Given the above policy, the table below approximates the impact on the Group's profit before tax of a 5% exchange rate movement (strengthening of sterling against the specified currency) of the Group's major non sterling trading currencies during the year.

| | **2013 £000** | 2012 £000 |
|---|---|---|
| Polish Zloty gain | **11** | 5 |
| South African Rand loss | **(53)** | (66) |
| US Dollar loss | **(125)** | (55) |
| | **(167)** | (116) |

For a 5% weakening of sterling against the relevant currency, there would be a comparable but opposite impact on the profit.

In management's opinion, the sensitivity analysis is unrepresentative of the inherent foreign exchange risk as the analysis does not reflect management's proactive monitary measures for exchange risk.

### (b) Market risk – Interest rate

The Group's major interest rate exposures arise from interest earned on its cash balances.

The Group's policy in this area is to maximise the interest return on cash balances (subject to the constraints imposed by the need to limit credit and liquidity risk as detailed below). In respect of interest payable on borrowings, it is the Group's policy to enter into an interest rate swap so that there is no change in interest payable pursuant to changes in interest rates.

Given the above policies the table below approximates the impact on the Group's profit before tax of a increase of 100 basis points in interest rates during the year.

| | 2013<br>£000 | 2012<br>£000 |
|---|---|---|
| Increase in interest receivable on cash balances | 314 | 273 |

For a decrease of 100 basis points in interest rates, there would be a comparable but opposite impact on profit.

### (c) Credit risk

The Group's major credit risk exposures arise from its cash and trade receivable balances. The Group's policies in this area are:

– in respect of cash balances to ensure that deposits are always held across at least 2 financial institutions; and

– in respect of trade receivables, the client or prospective client's credit risk is assessed at the commencement of any new project with payment terms agreed which are appropriate. Regular receivable reports are provided to senior management.

The table below shows the credit rating and balance of the six major counterparties at the balance sheet date:

| Counterparty | Current Rating (Moody's) | 31 December 2013 Balance £000 | 31 December 2012 Balance £000 |
|---|---|---|---|
| Bank A | A3 | 35,068 | 16,087 |
| Bank B | A2 | 1,550 | 6,511 |
| Bank C | A2 | 1,529 | 6,505 |
| | | 38,147 | 29,103 |
| Customer A | Ba1 | 970 | 443 |
| Customer B | Aa3 | 859 | 227 |
| Customer C | Aa3 | 158 | 223 |
| | | 1,987 | 893 |

**(d) Liquidity risk**

The Group's major liquidity exposures arise from the need to settle its trade, employee and taxation liabilities as they fall due.

Whilst the Group is comfortably able to finance all of these payments out of operating cash flows, policies are in place to further limit exposure to liquidity risk:

– surplus cash is never deposited for maturities of longer than 110 days; and

– uncommitted facilities will be entered into to support any specific expansion opportunities that arise.

Management monitors forecasts of the Group's liquidity reserve on the basis of expected cash flow. The Group's liquidity management policy involves projecting cash flows in major currencies and considering the level of liquid assets necessary to meet these.

The table below analyses the Group's financial liabilities and net-settled derivative financial liabilities into relevant maturity groupings based on the remaining period at the balance sheet to the contractual maturity date. The amounts disclosed in the table are the contractual undiscounted cash flows.

| **At 31 December 2013** | **Less than 1 year £000** | **Between 1 and 2 years £000** | **Between 2 and 5 years £000** |
|---|---|---|---|
| Borrowings | 3,000 | 3,000 | 13,250 |
| Derivative financial instruments | 47 | – | – |
| Trade and other payables | 17,195 | – | – |
| | 20,242 | 3,000 | 13,250 |

| At 31 December 2012 | Less than 1 year £000 |
|---|---|
| Derivative financial instruments | 15 |
| Trade and other payables | 17,187 |
| | 17,202 |

The table below analyses the Group's derivative financial instruments which will be settled on a gross basis into the relevant maturity groups based on the remaining period at the balance sheet to the contractual maturity date. The amounts disclosed in the table are the contractual undiscounted cash flows.

| **At 31 December 2013** | **Less than 1 year £000** | **Between 1 and 2 years £000** | **Between 2 and 5 years £000** |
|---|---|---|---|
| Forward foreign exchange contracts – cash flow hedges | | | |
| Outflow | (3,259) | – | – |
| Inflow | 3,263 | – | – |
| Interest rate swap – cash flow hedges | | | |
| Outflow | (587) | (490) | (846) |
| Inflow | 587 | 490 | 846 |
| | 4 | – | – |

| At 31 December 2012 | Less than 1 year £000 |
|---|---|
| Forward foreign exchange contracts – cash flow hedges | |
| Outflow | (3,126) |
| Inflow | 3,260 |
| | 134 |

**Fair value estimation**

**Financial instruments not measured at fair value**

Financial instruments not measured at fair value includes cash and cash equivalents, trade and other receivables, trade and other payables, and loans and borrowings.

Due to their short term nature, the carrying value of cash and cash equivalents, trade and other receivables, trade and other payables approximates their fair value.

**Financial instruments measured at fair value**

The fair value hierachy of the financial instruments measures at fair value is provided below.

| | **As at 31 Dec 2013 £'000** | As at 31 Dec 2012 £'000 |
|---|---|---|
| Financial Assets | | |
| Derivative financial assets (designated hedge instruments) | **94** | 69 |
| | **94** | 69 |
| Financial Liabilities | | |
| Derivative financial liabitities (designated hedge instruments) | **47** | 15 |
| | **47** | 15 |

The derivative financial assets and liabilites have been valued using the market approach and are considered to be Level 2 inputs. There were no changes to the valuation techniques used in the period. There were no transfers between levels during the period.

**Capital risk management**

The Group's objectives when managing capital are to safeguard the Group's ability to continue as a going concern in order to provide returns for shareholders and benefits for other stakeholders and to maintain an optimal capital structure to reduce the cost of capital. In order to maintain or adjust the capital structure, the Group may adjust the amount of dividends paid to shareholders, return capital to shareholders, issue new shares or sell assets to reduce debt.

We manage the capital structure based on the economic conditions and the risk characteristics of the Group. The Board reviews the capital structure regularly. No changes were made to our objectives and processes during 2013.

Our general funding policy is to raise long term debt when required to meet the anticipated requirements of the Group.

A loan was entered into by Microgen Financial Systems Limited, a wholly owned subsidiary of Microgen plc for £20,000,000. Details of the loan, the loan securities and operating covenants are given in note 16. Microgen Financial

Systems Limited has complied with the externally imposed capital requirements to which it is subject. There are no further capital covenants to which the Group or the Company are subject.

The Group completed a £10,000,000 share tender offer in 2013, details of which are provided in note 19.

**Critical Accounting Estimates and Judgements**

**(a) Impairment of freehold land and buildings**

The Group has carried out an impairment review on the carrying value of its freehold land and buildings. Following the review performed in 2009, which resulted in an impairment of £896,000, the directors have not received any market information either in 2012 or 2013 to require an adjustment to the impairment provision established in 2009.

**(b) Impairment of goodwill**

Determining whether goodwill is impaired requires an estimation of the value in use of the cash generating units to which goodwill has been allocated. The value in use calculation requires the Group to estimate the future cash flows expected to arise from the cash generating unit and a suitable discount rate in order to calculate present value. The discount rate applied in the value in use calculation approximates to the Group's Weighted Average Cost of Capital.

The Group annually reviews the goodwill valuation based on various scenarios and each of these scenarios have different growth rate assumptions. The growth rate assumptions are in relation to periods covered by Board approved plans.

Impairments recognised during the year are performed against the carrying value of goodwill. The impairment is recognised in the income statements in the period which it is deemed to arise.

**(c) Impairment of investments**

The Group has also carried out an impairment review on the value of investments held in the Company. Where the investment is held in a company which has an ongoing trade, the value is derived by a value in use calculation of the cash generating units. This is done on a similar basis to that used in the impairment of goodwill calculation as detailed above and is therefore subject to the same estimates by management. Where the investment is held in a company which is no longer trading, the value is derived from the carrying value of the net assets on the balance sheet of that entity.

**(d) Taxation**

The actual tax the Group pays on its profits is determined according to complex tax laws and regulations. Where the effect of these laws and regulations is unclear, estimates are used in determining the liability for the tax to be paid on past profits which are then recognised in financial statements. The Group believes the estimates, assumptions and judgements are reasonable but this can involve complex issues which may take a number of years to resolve. The final determination of prior year tax liabilities could be different from the estimates reflected in the financial statements and may result in the recognition of an additional tax expense or tax credit in the income statement.

Deferred tax assets and liabilities require management judgement in determining the amount to be recognised. In particular, judgement is used when assessing the extent to which deferred tax assets should be recognised with consideration given to the timing and level of future taxable income.

1. **Segmental Information**

**Business segments**

The Board has determined the operating segments based on the reports it receives from management to make strategic decisions.

The segmental analysis is split into the Aptitude Software and Financial Systems operating businesses.

The principal activity of the Group throughout 2012 and 2013 was the provision of IT services and solutions, including software based activity generating the majority of its revenue from software licences, maintenance, support, funded development and related consultancy.

The operating businesses are allocated central function costs in arriving at operating profit/(loss). Group overhead costs are not allocated into the operating businesses as the Board believes that these relate to Group activities as opposed to the operating businesses.

**(a) Revenue and operating profit by operating business**

| **Year ended 31 December 2013** | **Aptitude Software £000** | **Financial Systems £000** | **Group £000** | **Total £000** |
|---|---|---|---|---|
| Revenue | 14,676 | 15,148 | – | **29,824** |
| Operating costs | (11,839) | (7,042) | – | **(18,881)** |
| Operating profit before Group overheads | 2,837 | 8,106 | – | **10,943** |
| Unallocated Group overheads | | | (1,874) | **(1,874)** |
| Operating profit before exceptional and other items | | | | **9,069** |
| Exceptional and other items | – | (285) | (96) | **(381)** |
| **Operating profit/(loss)** | **2,837** | **7,821** | **(1,970)** | **8,688** |
| Net finance income | | | | **–** |
| **Profit before tax** | | | | **8,688** |
| Income tax expense | | | | **(2,250)** |
| **Profit for the year** | | | | **6,438** |

| **Year ended 31 December 2012** | **Aptitude Software £000** | **Financial Systems £000** | **Group £000** | **Total £000** |
|---|---|---|---|---|
| Revenue | 16,316 | 16,002 | – | **32,318** |
| Operating costs | (13,388) | (7,588) | – | **(20,976)** |
| Operating profit before Group overheads | 2,928 | 8,414 | – | **11,342** |
| Unallocated Group overheads | | | (2,211) | **(2,211)** |
| Operating profit before exceptional and other items | | | | **9,131** |
| Exceptional and other items | – | (118) | – | **(118)** |
| **Operating profit/(loss)** | **2,928** | **8,296** | **(2,211)** | **9,013** |
| Net finance income | | | | **174** |
| **Profit before tax** | | | | **9,187** |
| Income tax expense | | | | **(2,238)** |
| **Profit for the year** | | | | **6,949** |

1. **Segmental Information (continued)**

**(b) Other information**

| | Aptitude Software £000 | Financial Systems £000 | Group £000 | Total £000 |
|---|---|---|---|---|
| **Year ended 31 December 2013** | | | | |
| Capital expenditure | | | | |
| – property, plant and equipment (note 10) | **311** | **47** | **69** | **427** |
| Depreciation (note 10) | **(442)** | **(87)** | **(261)** | **(790)** |

| | Aptitude Software £000 | Financial Systems £000 | Group £000 | Total £000 |
|---|---|---|---|---|
| **Year ended 31 December 2012** | | | | |
| Capital expenditure | | | | |
| – property, plant and equipment (note 10) | 317 | 83 | 224 | 624 |
| Depreciation (note 10) | (387) | (87) | (314) | (788) |
| Amortisation of intangible assets (note 9) | – | (118) | – | (118) |

**(c) Balance sheet**

| | Aptitude Software £000 | Financial Systems £000 | Group £000 | Total £000 |
|---|---|---|---|---|
| **Year ended 31 December 2013** | | | | |
| Consolidated total assets | **21,510** | **39,662** | **31,719** | **92,891** |
| Consolidated total liabilities | **(7,248)** | **(30,421)** | **(817)** | **(38,486)** |
| | **14,262** | **9,241** | **30,902** | **54,405** |

| | Aptitude Software £000 | Financial Systems £000 | Group £000 | Total £000 |
|---|---|---|---|---|
| **Year ended 31 December 2012** | | | | |
| Consolidated total assets | 23,897 | 41,481 | 18,194 | 83,572 |
| Consolidated total liabilities | (7,221) | (10,867) | (812) | (18,900) |
| | 16,676 | 30,614 | 17,382 | 64,672 |

Capital expenditure comprises additions to property, plant and equipment and intangible assets, including additions resulting from acquisitions through business combinations.

### (d) Geographical segments

The Group has two geographical segments for reporting purposes, the United Kingdom and Ireland and the Rest of the World.

The following table provides an analysis of the Group's sales by origin and by destination.

| | Sales revenue by origin | | Sales revenue by destination | |
|---|---|---|---|---|
| | **Year ended 31 Dec 2013 £000** | Year ended 31 Dec 2012 £000 | **Year ended 31 Dec 2013 £000** | Year ended 31 Dec 2012 £000 |
| United Kingdom and Ireland | **19,686** | 23,696 | **11,666** | 16,157 |
| Rest of World | **10,138** | 8,622 | **18,158** | 16,161 |
| | **29,824** | 32,318 | **29,824** | 32,318 |

The following is an analysis of the carrying amount of segment assets, and additions to property, plant and equipment and intangible assets, analysed by the geographical area in which the assets are located.

| | Carrying amount of segment assets | | Capital expenditure | |
|---|---|---|---|---|
| | **Year ended 31 Dec 2013 £000** | Year ended 31 Dec 2012 £000 | **Year ended 31 Dec 2013 £000** | Year ended 31 Dec 2012 £000 |
| United Kingdom and Ireland | **87,009** | 77,762 | **127** | 313 |
| Rest of World | **5,882** | 5,810 | **300** | 311 |
| | **92,891** | 83,572 | **427** | 624 |

The Company's business is to invest in its subsidiaries and, therefore, it operates in a single segment.

## 2 Operating profit

The following items are included in operating costs:

| | **Year ended 31 Dec 2013 £000** | Year ended 31 Dec 2012 £000 |
|---|---|---|
| Employee benefit expense (note 3) | **15,649** | 17,139 |
| Depreciation (note 10) | **790** | 788 |
| Research and development expenditure credit | **(129)** | – |
| Other operating costs | **4,445** | 5,260 |
| Exceptional and other costs | | |
| Intangible amortisation (note 9) | **–** | 118 |
| Share based payments on share options issued in 2013 | **96** | – |
| Costs relating to the new loan arrangements | **285** | – |
| | **21,136** | 23,305 |

The UK government in the Finance Act 2013 introduced a new research and development expenditure credit scheme with effect from 1 April 2013. The credit is calculated at 10% of qualifying research and development expenditure.

## 2 Operating profit (continued)

Profit from operations has been arrived at after charging/(crediting):

| | Year ended 31 Dec 2013 £000 | Year ended 31 Dec 2012 £000 |
|---|---|---|
| Net foreign exchange (gains)/losses | **(69)** | 274 |
| Research, development and support costs – Aptitude Software | **3,539** | 3,514 |
| Research, development and support costs – Financial Systems | **2,156** | 2,172 |
| Depreciation of property, plant and equipment (note 10) | **790** | 788 |
| Amortisation of intangible assets (note 9) | **–** | 118 |
| Operating lease rentals payable: | | |
| – plant and machinery | **30** | 26 |
| – other | **629** | 599 |
| Repairs and maintenance expenditure on property, plant and equipment | **198** | 205 |

During the year the group obtained the following services from the Company's auditors at costs as detailed below:

| | Year ended 31 Dec 2013 £000 | Year ended 31 Dec 2012 £000 |
|---|---|---|
| Fees payable to Company's auditors for the audit of the Parent Company and consolidated financial statements | **95** | 110 |
| Fees payable to the Company's auditors and its associates for other services: | | |
| – the audit of Company's subsidiaries pursuant to legislation | **37** | 41 |
| – corporation and sales tax services | **84** | 106 |
| – overseas secondment services | **129** | 132 |
| | **345** | 389 |

The Company's auditors perform tax return services for the Group's employees in circumstances where the employer has overseas tax filing requirements pursuant to working on overseas projects. These costs are included in the row entitled 'overseas secondment services'.

A description of the work of the Audit Committee is included in the corporate governance statement on pages 17 to 18 and includes an explanation of how auditor objectivity and independence is safeguarded when non-audit services are provided by the auditors.

## 3 Employees and directors

| | Group Year ended 31 Dec 2013 £000 | Group Year ended 31 Dec 2012 £000 |
|---|---|---|
| **Employee benefit expense during the year including contractors** | | |
| Wages and salaries | **13,970** | 15,375 |
| Social security costs | **1,181** | 1,261 |
| Other pension costs (note 28) | **437** | 442 |
| Share based payments (note 27) | **61** | 61 |
| | **15,649** | 17,139 |

There is an additional share-based payment of £96,000 included within exceptional and other items (see note 2).

Average monthly number of employees (including directors and external contractors) for the Group:

| | Group Year ended 31 Dec 2013 Number | Group Year ended 31 Dec 2012 Number |
|---|---|---|
| **By location:** | | |
| United Kingdom and Ireland | **122** | 142 |
| Rest of World | **111** | 114 |
| | **233** | 256 |

Headcount at 31 December 2013 was 228 (2012: 238) including contractors.

| | Year ended 31 Dec 2013 £000 | Year ended 31 Dec 2012 £000 |
|---|---|---|
| **Key management compensation:** | | |
| Salaries and short-term employee benefits | **2,129** | 2,200 |
| Post employment benefits | **82** | 116 |
| Share based payments | **124** | 45 |
| | **2,335** | 2,361 |

Key management compensation for the Group includes the Board of the Company and senior executives within the Group.

| | Year ended 31 Dec 2013 £000 | Year ended 31 Dec 2012 £000 |
|---|---|---|
| **Directors** | | |
| Aggregate emoluments | **849** | 756 |
| Company contributions to money purchase pension scheme | **20** | 22 |
| | **869** | 778 |

Average monthly number of directors and senior executives were 15 (2012: 16).

The key management figures given above include the directors of Microgen plc.

The information on directors' remuneration required by the Companies Act and the Listing Rules of the Financial Conduct Authority is contained in the Directors' Remuneration Report on pages 23 to 40.

## 4 Net finance income

| | Year ended 31 Dec 2013 £000 | Year ended 31 Dec 2012 £000 |
|---|---|---|
| **Finance income** | | |
| Interest on bank deposits | **119** | 169 |
| Interest on Corporation Tax | **–** | 5 |
| | **119** | 174 |
| **Finance cost** | | |
| Interest payable on bank borrowings | **(119)** | – |
| | **(119)** | – |
| **Net finance income** | **–** | 174 |

## 5 Income tax expense

| Analysis of charge in the year | Year ended 31 Dec 2013 £000 | Year ended 31 Dec 2012 £000 |
|---|---|---|
| Current tax: | | |
| – current year charge | **(1,860)** | (1,973) |
| – prior year charge | **(143)** | (71) |
| Total current tax | **(2,003)** | (2,044) |
| Deferred tax (note 12): | | |
| – current year charge | **(327)** | (139) |
| – prior year credit/(charge) | **80** | (55) |
| Total deferred tax | **(247)** | (194) |
| **Income tax expense** | **(2,250)** | (2,238) |

UK corporation tax is calculated at 23.25% (2012: 24.5%) of the estimated assessable profit for the year. Taxation for other jurisdictions is calculated at the rates prevailing in the respective jurisdictions.

Finance Act 2012, which was enacted on 17 July 2012, includes legislation reducing the main UK corporation tax rate from 26% to 24%, with effect from 1 April 2012. A further reduction to 23% was also enacted on this date and was effective from 1 April 2013. The financial statements reflect these changes.

Finance Act 2013, which was enacted on 17 July 2013, includes legislation reducing the main UK corporation tax rate from 23% to 21%, with effect from 1 April 2014. A further reduction to 20% was also enacted on this date and will be effective from 1 April 2015.The deferred tax balances have been re-measured to reflect the reduction in tax rate to 20%. Consequently, within the analysis of the deferred income tax rate asset in note 12, there is a separate line item disclosing the impact of the change in tax rate on the opening deferred tax balance.

## 5 Income tax expense (continued)

As disclosed in note 2, legislation has been introduced in Finance Act 2013 to allow large companies to claim Research and Development ("R&D") relief as a credit of 10% per cent of their qualifying R&D expenditure. The R&D Expenditure Credit ("RDEC") is taxable at the corporation tax rate, and is included in the Group's taxable trading profits for the accounting period in which the R&D expenditure is incurred. The RDEC is available for qualifying R&D expenditure incurred on or after 1 April 2013. The RDEC scheme will initially be optional and will run in parallel with the existing super-deduction scheme until 31 March 2016. The RDEC will become mandatory on 1 April 2016. These financial statements include a claim under the existing super-deduction scheme for qualifying R&D expenditure incurred in the period 1 January to 31 March 2013, and an RDEC for qualifying expenditure incurred in the period 1 April to 31 December 2013.

The tax for the year is higher (2012: lower) than the standard rate of corporation tax in the UK of 23.25% (2012: 24.5%). The differences are explained below:

| | **Year ended 31 Dec 2013** | Year ended 31 Dec 2012 |
|---|---|---|
| Profit on ordinary activities before tax | **8,688** | 9,187 |
| Tax at the UK corporation tax rate of 23.25% (2012: 24.5%) | **(2,020)** | (2,251) |
| Effects of: | | |
| Adjustment to tax in respect of prior period | **(63)** | (126) |
| Adjustment in respect of foreign tax rates | **(63)** | 7 |
| Foreign exchange gains on intercompany balances | **(111)** | (42) |
| Research and development tax credit | **10** | 135 |
| Expenses not deductible for tax purposes | | |
| Share based payment expenses | **(51)** | (89) |
| Other | **(18)** | (58) |
| Changes in UK Corporation Tax Rates | **(55)** | (20) |
| Recognition of tax losses | **121** | 206 |
| Total taxation | **(2,250)** | (2,238) |

The total tax charge of £2,250,000 (2012: £2,238,000) represents 25.9% (2012: 24.4%) of the Group profit before tax of £8,688,000 (2012: £9,187,000).

After adjusting for the change in tax rates, prior year tax charges and exceptional and other items, the tax charge for the year of £2,286,000 (2012: £2,319,000) represents 25.21% (2012: 25.23%) of the adjusted profit, which is the tax rate used for calculating the adjusted earnings per share.

## 6 Earnings per share

Basic earnings per share is calculated by dividing the earnings attributable to ordinary shareholders by the weighted average number of ordinary shares outstanding during the year.

For diluted earnings per share, the weighted average number of ordinary shares in issue is adjusted to assume conversion of all dilutive potential ordinary shares. The Group has dilutive potential ordinary shares in the form of share options granted to employees where the exercise price is less than the average market price of the Company's ordinary shares during the year.

6 **Earnings per share (continued)**

The calculation of the basic and diluted earnings per share is based on the following data:

| | **Year ended 31 Dec 2013** | | | Year ended 31 Dec 2012 | | |
|---|---|---|---|---|---|---|
| | **Earnings £000** | **Weighted average number of shares (in thousands)** | **Per-share amount pence** | Earnings £000 | Weighted average number of shares (in thousands) | Per-share amount pence |
| **Basic EPS** | | | | | | |
| Earnings attributable to ordinary shareholders | **6,438** | **81,649** | **7.9** | 6,949 | 81,572 | 8.5 |
| Effect of dilutive securities: | | | | | | |
| – share options | **–** | **1,535** | **(0.2)** | – | 1,873 | (0.2) |
| **Diluted EPS** | **6,438** | **83,184** | **7.7** | 6,949 | 83,445 | 8.3 |

To provide an indication of the underlying operating performance per share the adjusted profit after tax figure shown below excludes exceptional and other items and has a tax charge using the effective rate of 25.21% (2012: 25.23%).

| | **Year ended 31 Dec 2013** | | Year ended 31 Dec 2012 | |
|---|---|---|---|---|
| | **Basic EPS pence** | **Diluted EPS pence** | Basic EPS pence | Diluted EPS pence |
| Earnings per share | **7.9** | **7.7** | 8.5 | 8.3 |
| Exceptional and other items net of tax | **0.3** | **0.3** | 0.1 | 0.1 |
| Prior years' tax charge | **0.1** | **0.1** | 0.2 | 0.2 |
| Foreign exchange gains on intercompany balances tax charge | **0.1** | **0.1** | – | – |
| Tax losses recognised | **(0.1)** | **(0.1)** | (0.3) | (0.3) |
| Adjusted earnings per share | **8.3** | **8.1** | 8.5 | 8.3 |

| | **Year ended 31 Dec 2013 £000** | Year ended 31 Dec 2012 £000 |
|---|---|---|
| Profit on ordinary activities before tax, exceptional and other items | **9,069** | 9,305 |
| Tax charge at a rate of 25.21% (2012: 25.23%) | **(2,286)** | (2,348) |
| Adjusted profit on ordinary activities after tax | **6,783** | 6,957 |
| Prior years' tax charge | **(63)** | (126) |
| Exceptional and other items net of tax | **(292)** | (88) |
| Foreign exchange gains on intercompany balances tax charge | **(111)** | – |
| Recognition of tax losses | **121** | 206 |
| Profit on ordinary activities after tax | **6,438** | 6,949 |

## 7 Dividends

| | 2013 pence per share | 2012 pence per share | 2013 £000 | 2012 £000 |
|---|---|---|---|---|
| **Dividends paid:** | | | | |
| Interim dividend | **1.1** | 1.1 | **908** | 897 |
| Final dividend (prior year) | **2.2** | 2.2 | **1,816** | 1,794 |
| Special dividend (prior year) | **5.2** | – | **4,292** | – |
| | **8.5** | 3.3 | **7,016** | 2,691 |
| **Proposed but not recognised as a liability:** | | | | |
| Final dividend (current year) | **2.2** | 2.2 | **1,639** | 1,816 |
| Special dividend (current year) | **–** | 5.2 | **–** | 4,292 |
| | **2.2** | 7.4 | **1,639** | 6,108 |

The proposed final dividend was approved by the Board on 25 February 2014 but was not included as a liability as at 31 December 2013, in accordance with IAS 10 'Events after the Balance Sheet date'. If approved by the shareholders at the Annual General Meeting this final dividend will be payable on 27 May 2014 to shareholders on the register at the close of business on 25 April 2014.

## 8 Goodwill

| | 31 Dec 2013 £000 | 31 Dec 2012 £000 |
|---|---|---|
| **Cost** | | |
| At 1 January and 31 December | **59,709** | 59,709 |
| **Accumulated impairment** | | |
| At 1 January and 31 December | **(17,935)** | (17,935) |
| **Net book amount** | **41,774** | 41,774 |

Goodwill acquired in a business combination is allocated, at acquisition, to the cash generating units (CGUs) that are expected to benefit from that business combination. The carrying amount of goodwill has been allocated as follows:

| | Aptitude Software £000 | Financial Systems £000 | Total £000 |
|---|---|---|---|
| At 1 January and 31 December 2013 | 15,347 | 26,427 | 41,774 |

The Group tests goodwill annually for impairment, or more frequently if there are indications that goodwill might be impaired.

Determining whether goodwill is impaired requires an estimation of the value in use of the CGUs to which goodwill has been allocated. The value in use calculation requires the Group to estimate the future cash flows expected to arise from the CGUs and a suitable discount rate in order to calculate present value.

## 8 Goodwill (continued)

The Board-approved plans, prepared for the Financial Systems operating business, project a reduction in operating income of 5% per annum for the next 4 years following the approved 2014 plan. Whilst part of the strategy for Financial Systems is to increase the proportion of the business derived from the Wealth Management sector through both organic growth and add-on acquisitions, no benefit of any potential acquisitions is included in the value in use calculation for Financial Systems.

Following the strategic review announced on 29 October 2013, a decision was made to increase investment significantly in the Aptitude Software operating business to focus the business on the growth of its recurring software-based revenues and not short-term profitability. The Board approved plans for Aptitude Software reflect in 2014 this increased investment and lower operating profit. Benefitting from the increase in investment the plan for the years 2015 to 2018 show a growth in operating income of 50% per annum. The Board considers this to be an achievable growth rate given the increased investment in the business.

The terminal growth rates for the period after 2018 are no greater than 2.25% per annum for either business. The conversion to cash ratio is assumed to be 79% based on the UK corporation tax rate effective from 1 April 2014. The utilisation of deferred tax losses to offset the tax payable has not been considered. The discount rate applied to the CGUs was 9.8% (2012: 9.8%).

A movement of 5% in any of the assumptions would not result in an impairment. It is possible that outcomes within the forthcoming financial years different from the key assumptions, could require a material adjustment to the carrying value of the Group's goodwill.

## 9 Other intangible assets

| | Software IPR and in process R&D £000 | Customer relationships £000 | Total £000 |
|---|---|---|---|
| **Group** | | | |
| **Cost** | | | |
| At 1 January 2013 | **876** | **876** | **1,752** |
| **At 31 December 2013** | **876** | **876** | **1,752** |
| **Accumulated amortisation and impairment** | | | |
| At 1 January 2013 | 876 | 876 | 1,752 |
| **At 31 December 2013** | **876** | **876** | **1,752** |
| **Net book amount** | | | |
| **At 31 December 2013** | **–** | **–** | **–** |

## 9 Other intangible assets (continued)

| | Software IPR and in process R&D £000 | Customer relationships £000 | Total £000 |
|---|---|---|---|
| **Group** | | | |
| **Net book value** | | | |
| **At 1 January 2012** | **118** | **–** | **118** |
| **Cost** | | | |
| At 1 January 2012 | 876 | 1,329 | 2,205 |
| Disposals | – | (453) | (453) |
| At 31 December 2012 | 876 | 876 | 1,752 |
| **Accumulated amortisation and impairment** | | | |
| At 1 January 2012 | 758 | 1,329 | 2,087 |
| Charge for the year (note 2) | 118 | – | 118 |
| Disposals | – | (453) | (453) |
| **At 31 December 2012** | **876** | **876** | **1,752** |
| **Net book amount** | | | |
| **At 31 December 2012** | **–** | **–** | **–** |

The Company held no intangible assets during the year (2012: nil).

The externally acquired software IPR and in process R&D relates to expected future benefits of development projects in progress at the date of acquisition. As at 31 December 2013 no internal research and development costs have been capitalised.

The customer relationships relate to expected benefits obtained from recurring level of business from customers obtained as a result of acquisitions.

Amortisation in the year is shown in operating costs.

## 10 Property, plant and equipment

| | Freehold land and buildings £000 | Leasehold improv-ements £000 | Plant & machinery £000 | Fixtures & fittings £000 | Total £000 |
|---|---|---|---|---|---|
| **Group** | | | | | |
| **Cost** | | | | | |
| At 1 January 2013 | 4,579 | 848 | 2,890 | 203 | 8,520 |
| Additions | – | 9 | 418 | – | 427 |
| Disposals | – | (4) | (109) | (14) | (127) |
| Exchange movements | – | – | (16) | (9) | (25) |
| **At 31 December 2013** | **4,579** | **853** | **3,183** | **180** | **8,795** |
| **Accumulated depreciation** | | | | | |
| At 1 January 2013 | 515 | 587 | 1,887 | 140 | 3,129 |
| Charge for the year (note 2) | 57 | 103 | 607 | 23 | 790 |
| Disposals | – | (4) | (101) | (13) | (118) |
| Exchange movements | – | – | (19) | (9) | (28) |
| **At 31 December 2013** | **572** | **686** | **2,374** | **141** | **3,773** |
| **Net book amount** | | | | | |
| **At 31 December 2013** | **4,007** | **167** | **809** | **39** | **5,022** |

**10 Property, plant and equipment (continued)**

| | Freehold land and buildings £000 | Leasehold improv-ements £000 | Plant & machinery £000 | Fixtures & fittings £000 | Total £000 |
|---|---|---|---|---|---|
| **Group** | | | | | |
| **Net book value** | | | | | |
| **At 1 January 2012** | **4,126** | **293** | **1,023** | **79** | **5,521** |
| **Cost** | | | | | |
| At 1 January 2012 | 4,579 | 1,015 | 2,317 | 196 | 8,107 |
| Additions | – | 115 | 508 | 1 | 624 |
| Disposals | – | (280) | (76) | – | (356) |
| Reclassification | – | (6) | – | 6 | – |
| Exchange movements | – | 4 | 141 | – | 145 |
| **At 31 December 2012** | **4,579** | **848** | **2,890** | **203** | **8,520** |
| **Accumulated depreciation** | | | | | |
| At 1 January 2012 | 453 | 722 | 1,294 | 117 | 2,586 |
| Charge for the year (note 2) | 62 | 141 | 561 | 24 | 788 |
| Disposals | – | (280) | (76) | – | (356) |
| Exchange movements | – | 4 | 108 | (1) | 111 |
| **At 31 December 2012** | **515** | **587** | **1,887** | **140** | **3,129** |
| **Net book amount** | | | | | |
| **At 31 December 2012** | **4,064** | **261** | **1,003** | **63** | **5,391** |

The Company held no property, plant and equipment in the year (2012 nil).

## 11 Investments in subsidiaries

The Group did not hold any investments in 2013 (2012: nil).

| | 2013 £000 | 2012 £000 |
|---|---|---|
| **Company** | | |
| **Cost** | | |
| At 1 January | **53,907** | 53,846 |
| Share based payments – share options granted to employees of subsidiaries | **157** | 61 |
| **At 31 December** | **54,064** | 53,907 |
| **Impairment** | | |
| **At 31 December** | **13,155** | 13,155 |
| **Net book amount** | | |
| **At 31 December** | **40,909** | 40,752 |

The recoverable amounts of the investments are determined by calculating a value in use for the appropriate subsidiary investment. Management estimates discount rates using pre-tax rates that reflect current market assessments of the time value of money and the risks specific to the subsidiary investments.

Where the investment is held in a company which is no longer trading, the value is derived from the carrying value of the net assets on the balance sheet of that entity.

The Directors consider the value of the investments to be supported by their underlying assets.

| Principal subsidiaries | Country | Activity |
|---|---|---|
| Aptitude Software Limited (formerly Microgen Aptitude Limited) | England & Wales | Software and Services |
| Microgen (Channel Islands) Limited * | Guernsey | Software and Services |
| Microgen Wealth Management Systems Limited * | England & Wales | Software and Services |
| Microgen Banking Systems Limited * | England & Wales | Software and Services |
| Microgen Solutions Limited * | England & Wales | Software and Services |
| Microgen Asset Management Solutions Limited * | England & Wales | Software and Services |
| Aptitude Software Inc.* (formerly Microgen Solutions Inc.)* | USA | Software and Services |
| Microgen (South Africa) Limited * | South Africa | Software and Services |
| Microgen Poland Sp. Z.o.o.* | Poland | Development |
| Microgen Management Services Limited | England & Wales | Employment and Group Services |
| Microgen Financial Systems Limited | England & Wales | Software and Services |

* Indirectly held by Microgen plc

The Company owns 100% of the ordinary share capital and share premium in the above subsidiaries.

## 12 Deferred income tax assets

Deferred tax is calculated in full on temporary differences under the liability method using a tax rate of 20% (2012: 23.0%).

The following are major deferred tax assets and liabilities recognised by the Group, and the movements thereon, during the current and prior reporting periods.

| | Accelerated capital allowances £000 | Short term timing differences £000 | Share-based payments £000 | Taxable trading losses £000 | Total £000 |
|---|---|---|---|---|---|
| **Group** | | | | | |
| At 1 January 2012 | **329** | **463** | **326** | **206** | **1,324** |
| (Charge)/credit to income statement for the year for temporary differences | (54) | 53 | (80) | (8) | (89) |
| Charge to the income statement for reduction in tax rate | (26) | (37) | (26) | (16) | (105) |
| Total (charge)/credit to income statement for the year (note 5) | (80) | 16 | (106) | (24) | (194) |
| (Charge)/credit to equity (note 23) | – | (89) | 25 | – | (64) |
| Exchange differences | – | (25) | – | – | (25) |
| At 31 December 2012 | **249** | **365** | **245** | **182** | **1,041** |
| (Charge)/credit to income statement for the year for temporary differences | (3) | 35 | (81) | (61) | (110) |
| Charge to the income statement for reduction in tax rate | (32) | (48) | (33) | (24) | (137) |
| Total charge to income statement for the year (note 5) | (35) | (13) | (114) | (85) | (247) |
| Credit to equity (note 23) | – | 9 | 7 | – | 16 |
| Exchange differences | – | (58) | – | – | (58) |
| **At 31 December 2013** | **214** | **303** | **138** | **97** | **752** |

Deferred tax assets have been recognised in respect of taxable losses and other temporary differences giving rise to deferred tax assets where it is probable that these assets will be recovered.

At the balance sheet date, the Group has unused tax losses of £6,797,000 (2012: £7,606,000) available for offset against future profits. A deferred tax asset has been recognised in respect of £484,000 (2012: £790,000) of such losses which is the maximum the Group anticipates being able to utilise in the year ending 31 December 2014. No deferred tax has been recognised in respect of the remaining £6,313,000 (2012: £6,816,000) due to the unpredictability of future profit streams.

Deferred tax assets and liabilities are only offset where there is a legally enforceable right of offset and there is an intention to settle the balances net.

There are no deferred tax liabilities at 31 December 2013 (2012: £nil).

Included in the deferred tax asset above is an amount of £432,000 which is expected to be utilised in the next twelve months.

## 13 Trade and other receivables

| | Group 31 Dec 2013 £000 | Group 31 Dec 2012 £000 | Company 31 Dec 2013 £000 | Company 31 Dec 2012 £000 |
|---|---|---|---|---|
| Trade receivables | **4,286** | 2,411 | **–** | – |
| Less: provision for impairment of receivables | **(60)** | (61) | **–** | – |
| Trade receivables – net | **4,226** | 2,350 | **–** | – |
| Amounts owed by group undertakings | **–** | – | **20** | 8,609 |
| Other receivables | **101** | 139 | **47** | 26 |
| Prepayments and accrued income | **722** | 674 | **87** | 87 |
| | **5,049** | 3,163 | **154** | 8,722 |

Amounts due from group undertakings are unsecured and repayable on demand.

An impairment provision for all past due trade receivables is maintained as the Group's experience is that a proportion of all such receivables may not ultimately be collectable.

Within the trade receivables balance of £4,286,000 (2012: £2,411,000) there are balances totalling £791,000 (2012: £567,000) which, at 31 December 2013, were overdue for payment. Of this balance £778,000 (2012: £535,000) has been collected at 25 February 2014 (2012: 22 February 2013).

| | Trade receivables | |
|---|---|---|
| The ageing of the trade receivables is as follows: | 31 Dec 2013 £000 | 31 Dec 2012 £000 |
| **Not past due** | **3,495** | 1,844 |
| **Past due** | | |
| Less than one month overdue | **759** | 244 |
| One to two months overdue | **20** | 296 |
| Two to three months overdue | **–** | 1 |
| More than three months overdue | **12** | 26 |
| At 31 December | **4,286** | 2,411 |

The Company had no trade receivables in either year.

Trade and other receivables are denominated in the following currencies:

| | Group 31 Dec 2013 £000 | Group 31 Dec 2012 £000 | Company 31 Dec 2013 £000 | Company 31 Dec 2012 £000 |
|---|---|---|---|---|
| Sterling | **3,932** | 2,397 | **154** | 8,722 |
| South African Rand | **14** | 14 | **–** | – |
| United States Dollars | **970** | 604 | **–** | – |
| Other | **133** | 148 | **–** | – |
| | **5,049** | 3,163 | **154** | 8,722 |

### 13 Trade and other receivables (continued)

Movements on the provision for impairment of trade receivables are as follows:

| | Group 31 Dec 2013 £000 | Group 31 Dec 2012 £000 |
|---|---|---|
| At 1 January | **61** | 64 |
| Receivables written off as uncollectable | **(4)** | (3) |
| Unused provisions reversed | **3** | – |
| At 31 December | **60** | 61 |

Creation and reversals of the provision for impaired trade receivables have been included in the income statement under other operating costs. Non-trade receivables do not contain any impaired assets.

The maximum exposure to credit risk at the reporting date is the fair value of each receivable class mentioned above. No collateral is held as security against these assets.

The Company does not have any provisions for impairments of trade receivables (2012: nil).

### 14 Cash and cash equivalents

Cash and cash equivalents are denominated in the following currencies:

| | Group 31 Dec 2013 £000 | Group 31 Dec 2012 £000 | Company 31 Dec 2013 £000 | Company 31 Dec 2012 £000 |
|---|---|---|---|---|
| Sterling | **39,155** | 31,106 | **29,642** | 22,592 |
| South African Rand | **560** | 667 | **–** | – |
| United States Dollar | **242** | 98 | **–** | – |
| Polish Zloty | **243** | 263 | **–** | – |
| **Cash at bank and in hand** | **40,200** | 32,134 | **29,642** | 22,592 |

The effective interest rate on short term deposits was 0.38% (2012: 0.46%).

### 15 Trade and other payables

| | Group 31 Dec 2013 £000 | Group 31 Dec 2012 £000 | Company 31 Dec 2013 £000 | Company 31 Dec 2012 £000 |
|---|---|---|---|---|
| Trade payables | **532** | 368 | **265** | 91 |
| Amounts owed to group undertakings | **–** | – | **9,012** | 20,617 |
| Other tax and social security payable | **991** | 658 | **–** | – |
| Other payables | **55** | 657 | **25** | 25 |
| Accruals | **1,259** | 1,877 | **32** | – |
| Deferred income | **15,349** | 14,285 | **–** | – |
| | **18,186** | 17,845 | **9,334** | 20,733 |

The amounts owed to group undertakings are unsecured, interest free and repayable upon demand.

## 16 Financial liabilities

| | Group 31 Dec 2013 £000 |
|---|---|
| Bank loan | **19,250** |
| The borrowings are repayable as follows: | |
| Within one year | **3,000** |
| In the second year | **3,000** |
| In the third to fifth years inclusive | **13,250** |
| | **19,250** |
| Less: Amount due for settlement within 12 months (shown under current liabilities) | **(3,000)** |
| Amount due for settlement after 12 months | **16,250** |

On 28 October 2013 Microgen Financial Systems Limited, a wholly owned subsidiary of Microgen plc, entered into a loan agreement with Royal Bank of Scotland plc for £20,000,000. The loan is secured solely against the assets of the Financial Systems operating business of the Group. Operating covenants are limited to the performance of the Financial Systems business only and are based on net debt leverage, interest cover and a minimum cash balance of £3,000,000 held within the Financial Systems business. In the event of a default of the loan, Microgen plc has the option, but not the obligation, to remedy. The loan is repayable over five years with an annual capital repayment of £3,000,000 and a final repayment of £5,000,000 on the fifth anniversary of the loan agreement. The loan is denominated in Pound Sterling and carries interest at LIBOR plus 1.75%. The Group entered into an interest swap on 28 October 2013, effectively fixing the interest rate at 3.24% over the five year period.

The Company has nil borrowings at 31 December 2013 (2012: nil).

## 17 Provisions for other liabilities and charges

| | Provisions | |
|---|---|---|
| | **31 Dec 2013 £000** | 31 Dec 2012 £000 |
| **Group** | | |
| At 1 January | **298** | 242 |
| Charged/(credited) to income statement | **13** | (45) |
| Charged to property, plant and equipment | **–** | 100 |
| Foreign exchange | **(9)** | 1 |
| **At 31 December** | **302** | 298 |

Provisions have been analysed between current and non-current as follows:

| | Provisions | |
|---|---|---|
| | **31 Dec 2013 £000** | 31 Dec 2012 £000 |
| Current | **33** | 42 |
| Non-current | **269** | 256 |
| | **302** | 298 |

**17 Provisions for other liabilities and charges (continued)**

£281,000 of the total provision at 31 December 2013 of £302,000 relates to the cost of dilapidations in respect of its occupied leasehold premises. Of the non-current provision, £269,000 is expected to unwind within 2 to 5 years (2012: £256,000).

**18 Financial instruments**

At the balance sheet date, the total notional amount of outstanding forward foreign exchange and the interest rate swap are:

| | **31 Dec 2013** | | 31 Dec 2012 | |
|---|---|---|---|---|
| | **Assets £000** | **Liabilities £000** | Assets £000 | Liabilities £000 |
| Interest rate swaps – cash flow hedges | **89** | **–** | – | – |
| Forward foreign exchange contracts – cash flow hedges | **5** | **47** | 69 | 15 |
| | **94** | **47** | 69 | 15 |

**Total derivatives designated as heding instruments**

The company has no derivative financial instruments (2012: none).

The maximum exposure to credit risk at the reporting date is the fair value of the derivative assets in the consolidated statement of financial position.

**Currency derivatives**

The forward foreign exchange contracts are used to hedge the Group's forecasted Polish Zloty denominated costs over the next 12 months.

The notional principal amounts outstanding at the balance sheet date are as follows:

| | **31 Dec 2013 £000** | 31 Dec 2012 £000 |
|---|---|---|
| Forward foreign exchange contracts – Polish Zloty | **3,259** | 3,126 |

The forward exchange contracts mature evenly across the year on a monthly basis.

At 31 December 2013, the fair value of the Group's currency derivatives is estimated to be a liability of approximately £42,000 (2012: asset £54,000), comprising £5,000 assets (2012: £69,000) and £47,000 liabilities (2012: £15,000), based on quoted market values.

The forward contracts are designated as effective as cash flow hedges in accordance with IAS 39 Financial Instruments: Recognition and Measurement. The fair value has been recognised in other comprehensive income and presented in the hedging reserve in equity. These will be transferred to the income statement over the next 12 months (2012: 12 months).

A profit of £155,000 (2012: £199,000) has been transferred to the income statement in respect of contracts which have matured during the period.

## 18 Financial instruments (continued)

### Fair Value interest rate swaps

The Group enters into floating-to-fixed interest rate swaps to hedge the fair value interest rate risk arising where it has borrowed at floating rates.

The notional principal amounts of the outstanding interest rate swap contracts designated as hedging instruments in fair value interest rate debt at 31 December 2013 amounts to £19,250,000.

The fair value gain recognised in the consolidated statement of comprehensive income is £89,000.

Additional disclosures are set out in the accounting policies relating to risk management.

### Fair values of non-derivative financial assets and financial liabilities

Where market values are not available, fair values of financial assets and financial liabilities have been calculated by discounting expected future cash flows at prevailing interest rates and by applying year-end exchange rates.

| | | **31 Dec 2013** | | 31 Dec 2012 | |
|---|---|---|---|---|---|
| | Note | **Book value £000** | **Fair value £000** | Book value £000 | Fair value £000 |
| **Group** | | | | | |
| Cash at bank and in hand | 14 | **40,200** | **40,200** | 32,134 | 32,134 |

| | | **31 Dec 2013** | | 31 Dec 2012 | |
|---|---|---|---|---|---|
| | Note | **Book value £000** | **Fair value £000** | Book value £000 | Fair value £000 |
| **Company** | | | | | |
| Cash at bank and in hand | 14 | **29,642** | **29,642** | 22,592 | 22,592 |

The carrying amount of short term payables and receivables is equal to their fair value.

Neither the Group or Company defaulted on any loans during the period. In addition the Group or Company did not breach the terms of any loan agreements during the year.

### Credit quality of financial assets

The credit quality of financial assets that are neither past due or impaired can be assessed by reference to the customer type.

| **Group** | **2013 £000** | 2012 £000 |
|---|---|---|
| **Trade receivables** | | |
| Banks and financial institutions | **3,256** | 1,578 |
| Other corporates | **239** | 266 |
| Total current trade receivables | **3,495** | 1,844 |
| Overdue trade receivables | **791** | 567 |
| Total trade receivables | **4,286** | 2,411 |

## 18 Financial instruments (continued)

| Cash at bank and short-term bank deposits | Current Rating (Moody's) | 2013 £000 | 2012 £000 |
|---|---|---|---|
| | A2 | **3,565** | 13,016 |
| | A3 | **35,068** | 17,116 |
| | Aa3 | **1,007** | 2,002 |
| | Baa1 | **560** | – |
| | | **40,200** | 32,134 |

None of the financial assets that are fully performing have been renegotiated in the last year.

## 19 Share capital

| | 31 Dec 2013 | | 31 Dec 2012 | |
|---|---|---|---|---|
| **Group and company** | **Number** | **£000** | Number | £000 |
| **Authorised ordinary shares of 5p each** | **145,000,000** | **7,250** | 145,000,000 | 7,250 |
| **Issued and fully paid:** | | | | |
| At 1 January | **81,581,850** | **4,078** | 81,395,677 | 4,069 |
| Issued under share option schemes | **1,046,727** | **52** | 307,173 | 15 |
| Share buyback | **–** | **–** | (121,000) | (6) |
| Share tender offer | **(8,130,075)** | **(406)** | – | – |
| **At 31 December** | **74,498,502** | **3,724** | 81,581,850 | 4,078 |

In the year the Company repurchased 8,130,075 ordinary shares for a consideration of £10,000,000 via a tender offer. In 2012, 121,000 ordinary shares were purchased for consideration of £145,200. The shares in both years were then cancelled.

## 19 Share capital (continued)

The number of ordinary shares for which Microgen employees hold options and the period to which the options are exercisable are as follows:

| Period | Year of grant | Exercise price | 2013 Number | 2012 Number |
|---|---|---|---|---|
| Between 18 February 2006 and 18 February 2013 | 2003 | 20.33p | – | 6,000 |
| Between 24 February 2006 and 24 February 2013 | 2003 | 24.5p | – | 50,000 |
| Between 28 July 2006 and 28 July 2013 | 2003 | 42.5p | – | 25,000 |
| Between 7 November 2006 and 7 November 2013 | 2003 | 42.5p | – | 75,000 |
| Between 28 April 2007 and 28 April 2014 | 2004 | 60p | 12,500 | 25,000 |
| Between 22 September 2008 and 22 September 2015 | 2005 | 70.50p | 32,500 | 167,500 |
| Between 24 May 2009 and 24 May 2016 | 2006 | 5p | – | 397,991 |
| Between 15 June 2009 and 15 June 2016 | 2006 | 59.33p | 9,999 | 16,666 |
| Between 5 March 2010 and 5 March 2017 | 2007 | 5p | – | 93,340 |
| Between 6 August 2010 and 6 August 2017 | 2007 | 5p | 46,670 | 210,015 |
| Between 6 August 2010 and 6 August 2017 | 2007 | 46.83p | 43,336 | 51,336 |
| Between 28 February 2011 and 28 February 2018 | 2008 | 48.17p | 33,331 | 33,331 |
| Between 2 May 2011 and 2 May 2018 | 2008 | 52.33p | 1,000,000 | 1,000,000 |
| Between 2 December 2011 and 2 December 2018 | 2008 | 43.50p | 60,415 | 92,414 |
| Between 2 December 2011 and 2 December 2018 | 2008 | 5p | 18,334 | 116,219 |
| Between 13 December 2013 and 13 December 2020 | 2010 | 5p | 130,000 | 130,000 |
| Between 3 March 2014 and 3 March 2021 | 2011 | 140p | 70,000 | 70,000 |
| Between 20 September 2014 and 20 September 2021 | 2011 | 5p | 15,000 | 15,000 |
| Between 18 November 2016 and 18 November 2023 | 2013 | 5p | 4,433,750 | – |
| Between 18 November 2018 and 18 November 2023 | 2013 | 5p | 1,041,250 | – |
| | | | **6,947,085** | 2,574,812 |

## 20 Share premium account

| | £000 |
|---|---|
| **Group and Company** | |
| At 1 January 2012 | 11,842 |
| Premium on shares issued during the year under the share option schemes | 43 |
| At 31 December 2012 | 11,885 |
| Premium on shares issued during the year under the share option schemes | 152 |
| **At 31 December 2013** | **12,037** |

## 21 Capital Redemption Reserve

| | £000 |
|---|---|
| **Group and Company** | |
| At 1 January 2012 | 1,146 |
| On shares purchased and cancelled in 2012 | 6 |
| At 31 December 2012 | 1,152 |
| On shares purchased and cancelled in 2013 | 406 |
| **At 31 December 2013** | **1,558** |

## 22 Other reserves

| | Derivatives hedge reserve £000 | Merger reserve £000 | Total £000 |
|---|---|---|---|
| **Group** | | | |
| At 1 January 2012 | (355) | 36,974 | 36,619 |
| Cash flow hedges | | | |
| – net fair value gains in the period net of tax | 409 | – | 409 |
| At 31 December 2012 | 54 | 36,974 | 37,028 |
| Cash flow hedges | | | |
| – net fair value losses in the period net of tax | (7) | – | (7) |
| **At 31 December 2013** | **47** | **36,974** | **37,021** |

| | Merger reserve £000 | Total £000 |
|---|---|---|
| **Company** | | |
| **At 1 January 2012, 31 December 2012 and 31 December 2013** | **20,177** | **20,177** |

## 23 Retained earnings

| | Group £000 | Company £000 |
|---|---|---|
| At 1 January 2012 | 6,299 | 16,663 |
| Profit for the year | 6,949 | 144 |
| Share options – value of employee service (note 27) | 61 | 61 |
| Shares repurchased and cancelled | (146) | (146) |
| Deferred tax on financial instruments (note 12) | (89) | – |
| Deferred tax on share options (note 12) | 25 | – |
| Corporation tax on share options | 41 | – |
| Exchange rate adjustments | 80 | – |
| Dividends paid (note 7) | (2,691) | (2,691) |
| At 31 December 2012 | 10,529 | 14,031 |
| Profit for the year | 6,438 | 26,972 |
| Share options – value of employee service (note 27) | 157 | 157 |
| Shares repurchased and cancelled | (10,269) | (10,269) |
| Deferred tax on financial instruments (note 12) | 9 | – |
| Deferred tax on share options (note 12) | 7 | – |
| Corporation tax on share options | 135 | – |
| Exchange rate adjustments | 75 | – |
| Dividends paid (note 7) | (7,016) | (7,016) |
| **At 31 December 2013** | **65** | **23,875** |

The profit for the financial year dealt with in the financial statements of the Company was £26,972,000 (2012: £144,000). As permitted by Section 408 of the Companies Act 2006, no separate income statement or statement of comprehensive income is presented in respect of the Company.

## 24 Cash flows from operating activities

Reconciliation of profit before tax to net cash generated from/(used in) operations:

| | Group Year ended 31 Dec 2013 £000 | Group Year ended 31 Dec 2012 £000 | Company Year ended 31 Dec 2013 £000 | Company Year ended 31 Dec 2012 £000 |
|---|---|---|---|---|
| **Profit before tax** | **8,688** | 9,187 | **26,964** | 143 |
| Adjustments for: | | | | |
| Depreciation | **790** | 788 | **–** | – |
| Loss on disposal of fixed assets | **9** | – | **–** | – |
| Amortisation of intangible assets | **–** | 118 | **–** | – |
| Share-based payment expense | **157** | 61 | **–** | – |
| Finance income | **(119)** | (174) | **(73)** | (143) |
| Finance costs | **119** | – | **–** | – |
| Dividend income | **–** | – | **(28,673)** | – |
| **Changes in working capital:** | | | | |
| (Increase)/decrease in receivables | **(1,886)** | 2,448 | **(21)** | 22 |
| Increase/(decrease) in payables | **341** | (2,136) | **206** | 70 |
| Increase in provisions | **4** | 56 | **–** | – |
| **Cash generated from/(used in) operations** | **8,103** | 10,348 | **(1,597)** | 92 |

## 25 Commitments

| | 31 Dec 2013 £000 | 31 Dec 2012 £000 |
|---|---|---|
| **Group** | | |
| Contracts placed for future capital expenditure not provided in the financial statements | **108** | – |

The Company has no unprovided financial commitments (2012: £nil).

## 26 Operating leases – minimum lease payments

The Group leases various offices under non-cancellable operating lease agreements. The leases have various terms and renewal rights. The Group also leases plant and machines under non-cancellable operating lease agreements.

At the balance sheet date, the Group had outstanding commitments for future minimum lease payments under non-cancellable operating leases, which fall due as follows:

| | **31 Dec 2013** | | 31 Dec 2012 | |
|---|---|---|---|---|
| | **Properties £000** | **Other £000** | Properties £000 | Other £000 |
| Within one year | **491** | **9** | 539 | 22 |
| In the second to fifth year inclusive | **1,035** | **5** | 623 | 11 |
| | **1,526** | **14** | 1,162 | 33 |

The Company had no operating lease commitments during the year (2012: £nil)

## 27 Share based payments

### Performance Share Plan (PSP)

Under the 2006 Performance Share Plan (PSP), the Remuneration Committee is allowed to grant conditional allocations of par value options in the Company to key executives. The contractual life of an option is 10 years.

The PSP is considered a Long Term Incentive Plan (LTIP) award.

Awards granted prior to 18 November 2013 become exercisable from the third anniversary of the date of grant, subject to specific criteria being met. These performance conditions were structured so that 50% of awards were subject to an adjusted earnings per share target and 50% were subject to a total shareholder return target.

5,475,000 awards were granted on 18 November 2013. The performance conditions in respect of 3,000,000 of the awards for the directors are detailed on pages 34 and 35 of the Directors' Remuneration Report. The balance of 2,475,000 awards have performance conditions in line with those described for Mr Wood on page 35. Shareholder approval in respect of these awards was received on 18 November 2013 together with approval for a further 750,000 awards for each of the three years 2014 to 2016.

Following the granting of awards on 18 November 2013, at the year end there were 30 (2012: 7) employees currently participating in the scheme.

Exercise of an option is subject to continued employment.

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

| | **2013** | | 2012 | |
|---|---|---|---|---|
| | **Number** | **Weighted average exercise price** | Number | Weighted average exercise price |
| Outstanding at 1 January | **962,565** | **5p** | 1,168,824 | 5p |
| Granted | **5,475,000** | **5p** | – | 5p |
| Exercised | **(752,561)** | **5p** | (206,259) | 5p |
| Outstanding at 31 December | **5,685,004** | **5p** | 962,565 | 5p |
| Exercisable at 31 December | **195,004** | **5p** | 817,565 | 5p |

The weighted average share price at the date of exercise for share options exercised during the year under the Share Option Plans was 118.0p (2012: 144.4p).

The options outstanding at the end of the year have an expected weighted average remaining contractual life of 9.75 years (2012: 4.74 years).

### Share Option Plans

The Group has set up several Share Option Plans, under which the Remuneration Committee can grant options over shares in the Company to employees of the Group. Options are granted with a fixed exercise price equal to the market price of the shares under option at the date of grant. The contractual life of an option is 10 years. 17 employees (2012: 24) currently participate in these Plans.

### 27 Share based payments (continued)

Options granted under the Share Option Plans will become exercisable on the third anniversary of the date of grant, subject to specific criteria being met. The present criteria are based on a combination of factors including adjusted earnings per share and share price growth over a minimum period of three years.

Exercise of an option is subject to continued employment.

Details of the share options outstanding under the Share Option Plans during the year are as follows:

| | 2013 | | 2012 | |
|---|---|---|---|---|
| | Number | Weighted average exercise price | Number | Weighted average exercise price |
| Outstanding at 1 January | **1,612,247** | **55.86p** | 1,754,828 | 55.64p |
| Lapsed | **(56,000)** | **24.05p** | (41,667) | 66.49p |
| Exercised | **(294,166)** | **56.70p** | (100,914) | 47.78p |
| Outstanding at 31 December | **1,262,081** | **57.07p** | 1,612,247 | 55.86p |
| Exercisable at 31 December | **1,192,081** | **52.22p** | 1,542,247 | 52.04p |

The weighted average share price at the date of exercise for share options exercised during the year under the Share Option Plans was 121.9p (2012: 137.27p).

The options outstanding at the end of the year have an expected weighted average remaining contractual life of 4.37 years (2012: 4.65 years).

Included within the outstanding share options at 31 December 2013 under Share Option Plans and the PSP were outstanding share options of 6,475,000 (2012: 1,397,991) which whilst outside of the Association of British Insurers recommended limits, have been approved by the Company's shareholders.

The Group recognised total expenses of £157,000 (2012: £61,000) related to equity-settled share-based payment transactions during the year. After deferred tax, the total credit in the income statement was £44,000 (2012: £90,000). There was a deferred tax credit of £7,000 (2012: £25,000) and a corporation tax credit of £135,000 (2012: £41,000) taken directly to equity.

### 28 Retirement benefit schemes

The Group operates defined contribution retirement benefit plans for qualifying employees in the UK. The assets of the plans are held separately from those of the Group in funds under the control of trustees.

The Group also operates defined contribution retirement benefit plans for its overseas employees with contributions up to 9.76% of basic salary.

The total expense recognised in the income statement of £437,000 (2012: £442,000) represents contributions payable to these plans by the Group at rates specified in the rules of the plans. As at 31 December 2013, contributions of £22,000 (2012: £76,000) due in respect of the 2013 reporting period had not been paid over to the plans and were included within accruals. The amounts were paid over subsequent to the balance sheet date.

## 29 Related party transactions

**Group**

The following transactions were carried out with related parties:

Microgen's Chairman, Mr Ratcliffe was chairman of RM plc from 1 June 2011 to 30 April 2013. During the year, the amounts invoiced to RM Education Ltd, a subsidiary of RM plc, were £342,000 (2012: £364,000). At 31 December 2013 £nil was owed by RM Education Ltd (2012: £23,000). During 2013 Microgen entered into two contracts with RM Education Ltd to provide software and services. Mr Ratcliffe did not participate in the negotiations in respect of these contracts.

The Company acts as the Group's treasury vehicle and during the year borrowed a net £8,992,000 (2012: £12,008,000) from its subsidiary companies.

There were no further related party transactions in the year ended 31 December 2013 (2012: nil), as defined by International Accounting Standard No 24 "Related Party Disclosures" other than key management compensation as disclosed in note 3.

| Shareholder Analysis Range | Number of Shareholders | Percentage of overall total | Number of shares | Percentage of overall total |
|---|---|---|---|---|
| 1-1,000 | 620 | 56.2% | 228,357 | 0.3% |
| 1,001-5,000 | 263 | 23.8% | 640,543 | 0.9% |
| 5,001-50,000 | 149 | 13.5% | 2,254,440 | 3.0% |
| 50,001-500,000 | 46 | 4.2% | 6,556,148 | 8.8% |
| 500,001 and above | 25 | 2.3% | 64,819,014 | 87.0% |
| **Totals** | **1,103** | **100%** | **74,498,502** | **100%** |

| Investor Type | Number of shares | Percentage of overall total |
|---|---|---|
| Nominee Companies | 53,577,257 | 71.9% |
| Private Shareholders | 12,682,979 | 17.0% |
| Bank & Bank Nominees | 4,398,451 | 5.9% |
| Pension Funds | 3,558,121 | 4.8% |
| Limited Companies | 167,747 | 0.2% |
| Other Institutions | 106,003 | 0.2% |
| Deceased Shareholders | 7,944 | 0.0% |
| | **74,498,502** | **100%** |

**Registered Office and Group Head Office**

Microgen plc
Old Change House
128 Queen Victoria Street
London
EC4V 4BJ

Telephone: 020 7496 8100
e-mail: investors@microgen.com

**Registrar**

Capita Asset Services
The Registry
34 Beckenham Road
Beckenham
Kent
BR3 4TU

Telephone: 0871 664 0300
e-mail ssd@capita.co.uk

Microgen plc ordinary shares are listed on the main market of the London Stock Exchange.

**Shareholders' enquiries**

Enquiries regarding shareholdings or dividends should in the first instance be addressed to Capita Asset Services.

Please note that calls will cost 10p per minute plus network extras. Lines are open 9.00 am – 5.30 pm Monday to Friday.

**Annual General Meeting**

The forthcoming Annual General Meeting will be held at 9.00 a.m. on 28 April 2014 at Old Change House, 128 Queen Victoria Street, London, EC4V 4BJ. Details are given in a separate notice to shareholders enclosed with this Annual Report. A copy of the Notice of Annual General Meeting together with this Annual Report is posted on the Company's website www.microgen.com.

microgen

Old Change House, 128 Queen Victoria Street, London, EC4V 4BJ
Telephone: 020 7496 8100 investors@microgen.com
Web: www.microgen.com
Company Registered Number: 1602662

For Microgen patent information please refer to www.microgen.com