SOPHEON 2004

sopheon

The Knowledge To Compete®

ANNUAL REPORT

Sopheon's *mission* *is to give our clients the* *power* *to more effectively create, capture and share* *knowledge* *– and use it to* *compete.*

contents

Sopheon is an international provider of software and services that enable organizations to improve their return on investments in innovation and product development. Sopheon's software applications integrate process and strategic decision support to reduce product development spending

Group Profile

waste and accelerate time to market. The Sopheon group has operating bases in the United Kingdom, the Netherlands and the United States. Its clients are R&D intensive companies in the high-tech manufacturing, chemicals, food and beverage, and healthcare industry sectors.

Statement from the Chairman and Chief Executive Officer

Introduction

Sopheon entered 2004 tightly focused on the market potential of its software solutions, following the successful divestment of information management divisions in the USA and Germany. This left a core business with a substantially reduced cost base, but an international presence geared to build on the promise of our flagship product, the Accolade product portfolio and process management system. During the year we delivered substantial operational, financial and strategic achievements. Revenues for the continuing software business nearly doubled in dollar terms, EBITDA loss was reduced by more than 70% and the balance sheet was strengthened. Our market presence in terms of sales, industry recognition and partnership development continued to gather pace. We are a recognized leader in a new enterprise software sector that is focused on helping organizations improve the business impact of product development.

Results

Sopheon's consolidated turnover from continuing activities grew to £4.3m (2003: £2.7m for the continuing software business and £4.1m from businesses divested in the year) and the consolidated EBITDA loss was reduced to £1.1m (2003: £4.1m). Goodwill charges amounted to £0.4m (2003: £4.6m) for the year, in addition to net interest of £0.3m (2003: £0.2m). After factoring in research and development tax credits amounting to £0.1m (2003 - £0.3m) the retained loss for the year was £1.8m (2003: £5.5m) reducing the loss per ordinary share to 1.6p (2003: 6.3p). This continues the trend of improvement since 2001, when the group recorded a retained loss of £34.6m.

Revenues in Sopheon's core software business almost doubled in US Dollar terms, and grew over 70% in Pound Sterling terms. The weakening dollar had significant effect on reported turnover, but because a large portion of Sopheon's costs are dollar denominated Sopheon's EBITDA performance was in line with broker forecasts.

Viewed broadly, Sopheon's revenue mix in 2004 was 60:20:20 among license, maintenance and consulting services respectively. The management team is very conscious of the importance of building the recurring revenue base of maintenance contracts, and Sopheon enters 2005 with an annualised run rate of more than £1m in such revenue.

Sopheon implemented a controlled expansion in R&D resources in the final weeks of 2004, recruiting into our Denver development center. Other overheads remained stable during the year and our plans for 2005 include limited expansion of sales and services resources, dependent on performance. Incentive payments for staff as a whole also remain tightly linked to achieving financial objectives.

Financing

Cash resources as of 31 December 2004 totaled £1.2m (2003 - £0.9m) and net current assets amounted to £1.1m (2003: £0.1m). The trebling of trade debtors compared to 2003 appears high relative to total turnover, but is due to the substantial license sales achieved in December.

During 2003 Sopheon concluded an agreement for a €10 million equity line of credit facility with GEM Global Yield Fund Limited by securing access to a source of equity-based funding over which the company retains a substantial degree of control. More than 90% of the equity line facility, the term of which extends to 23 December 2005, remains available. The board is considering whether to seek an extension to the instrument.

During 2004 the company raised £2.4m in cash through private equity placement. Of that sum, £0.6m was secured through the equity line. In addition, the board secured a resolution from holders of its £2.6 million 6% Convertible Loan Stock to reconstitute the instrument such that, in return for a one-off payment of 7% and subject to the Sopheon group continuing to meet key solvency tests, the Loan Stock will automatically convert into ordinary shares rather than be repayable on maturity in December 2005. This change also eliminated the annual interest coupon. Due to the modifications of the terms of the instrument it has been reclassified as equity shareholders' funds in the balance sheet. These actions, coupled with the improved trading performance, enabled Sopheon to end 2004 with consolidated net assets of £1.2m compared to a net deficit of £1.9m at the end of 2003.

Market

Overall, we continued to see high rates of adoption of Accolade within our installed base, with the largest single client implementation at 2200 seats. We also signed our first contracts extending the use of Accolade to automate and improve business processes beyond the area of product development. Another priority in 2004 was to generate additional business with existing customers. BASF is an excellent example. Developed as a customer through one of Sopheon's distribution partners, BASF began implementation of Accolade a year ago. Our relationship with this chemicals industry leader has grown rapidly since then, and BASF is now one of four Sopheon clients that have contracted for 2000 or more Accolade seat-licenses. Another market development of note was expansion of the Accolade platform to use by hospitals in the management of clinical trials. We have signed three such contracts in the past twelve months, affording us an important opportunity to learn more about this market segment.

Our recurring maintenance base was reinforced during the year by two new offerings: hosting services for our license customers, and subscriptions for our Monitor system. The former offers a low total-cost-of-ownership model to license customers and attracted attention from both small and large prospects. To date, four Accolade customers have contracted for a hosted environment. The Monitor subscription is underpinned by a business partnership with Siemens. Supported by Airbus and Boeing, this partnership introduces a web-based application to the aviation industry to promote standardization around Radio Frequency Identification (RFID) use.

Sopheon made important progress in 2004 in positioning itself for the longer term by securing distribution partners in geographical areas outside the Company's existing sphere of operations, and strategic alliances in key markets. The first area is a key priority for further expansion in 2005, augmenting existing partner presence in continental Europe and the Asia Pacific. The second bore fruit in the final quarter of 2004, when we announced that we had become part of Microsoft's Collaborative Product Development (CPD) initiative, building significantly on our existing Gold Partnership status. The CPD initiative is designed to help companies leverage investments in Microsoft technology by using it to improve product development success rates. Microsoft and Sopheon are teaming to develop, promote and deliver solutions based on integrated technologies. Other CPD participants include Hewlett Packard, UGS, and Dassault Systems.

Product Development

In conjunction with the launch of the Microsoft CPD initiative, Sopheon announced that it would integrate Microsoft Project Server 2003 and SharePoint Portal Server 2003 into Accolade, to further enhance collaborative, information-sharing and enterprise deployment capabilities. During the first quarter of 2005, with support from Microsoft, resources have been expanded to accelerate these developments. Accolade is built on Microsoft technology and since inception, has leveraged tools such as Office, NetMeeting and Project to facilitate information sharing, ease-of-use and fast implementation. The expanded integration of Microsoft technologies will increase Accolade's capacity to leverage work repositories and will strengthen its ability to scale to enterprise-wide implementation.

At Parker Hannifin Corporation, Sopheon assisted with the rollout of Accolade under an enterprise-wide license agreement concluded in June. Parker reviewed three lifecycle management software solutions and selected Accolade based on such considerations as its ease-of-use, speed of deployment, built-in best-practices content, capacity to scale, and ability to further leverage Microsoft technologies already prevalent in their business - a good example of the combined value proposition of Accolade and Microsoft technology.

Sopheon holds patents relating to presentation of large domain search results, profiling, and the application of IT to language-intensive processes. All three areas benefit from US patent protection. In line with our vision of underpinning complex business processes such as product development with relevant knowledge management tools, we have applied much of this intellectual property in Sopheon's healthcare compliance solutions in the Netherlands, and look to integrate such technologies into our Accolade roadmap where appropiate.

Board of Directors and Management Team

Sopheon's group management and governance structure is divided between a Sopheon plc board of directors and an executive management board responsible for business operations. The Sopheon plc board remains unchanged with four non-executive directors and three executive directors, being the Executive Chairman, the CEO and the CFO. The executive management board is a team of five, which includes the three executive directors. Further details on members of the board and the management team can be found on page 43.

Outlook

The past year was earmarked by steady improvements in the performance of our business and significant progress in key areas of strategy. Revenues in our business do however continue to be sensitive to the timing and value of individual sales events, which are challenging to predict with precision. Accordingly, we continue to exercise balance and caution in our planning approach. Our cost base remains under tight control, and the board continues to believe in the importance of not disrupting the high degree of focus achieved in the business since our divestiture activity in 2003. Accolade is generating strong interest, has an expanding installed client base, and enjoys increased validation by the market. It has demonstrated, consistently, that it is a valuable solution in which clients are prepared to invest, reflected in the fact that four of our customers have each made license investments of US$600,000 or more.

Overall, we are encouraged by the direction, focus and momentum of our business, and look forward to a successful 2005.

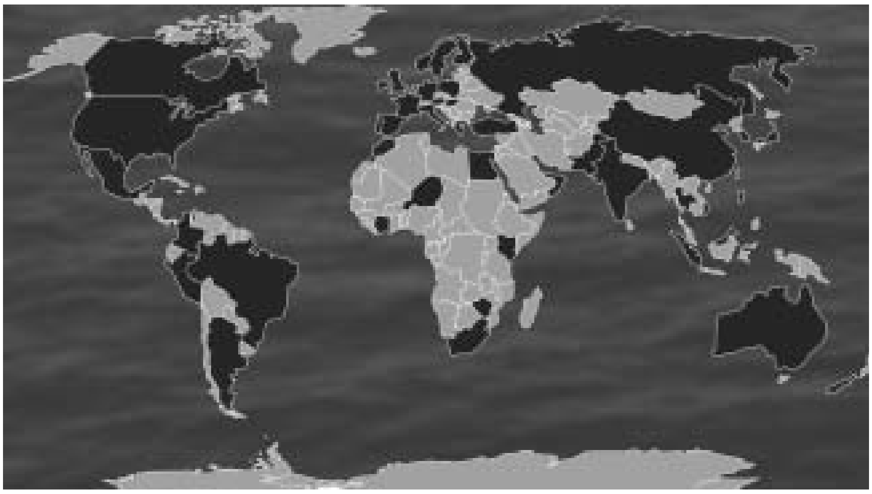
Barry Mence
Executive Chairman

Andy Michuda
Chief Executive Officer

4 April 2005

Market and Product Overview

The need for precisely relevant decision-making and problem-solving support is central to the successful execution of today's business processes. As the quantity of internal and external information and knowledge grows, the ability to quickly organize it, access it, gain insight from it and apply it has become an increasingly critical necessity. This requirement, in turn, is driving more and more demand for high-performance tools and solutions that effectively enable such gathering and use.



Sopheon Accolade® is used by today's largest global companies for process and product portfolio management. Accolade is being used in over 45 countries worldwide as represented by the darker shaded areas on the above map.

Sopheon's products and services are uniquely capable of facilitating information and knowledge access and application. The primary reason is that they integrate technology and human expertise. People can supply answers and context that document-centric software offerings simply cannot. Sopheon's solutions provide cost-effective access to both documented information and human knowledge sources within one application environment, a standard by which future software-based business process solutions are likely to be measured.

The value of Sopheon's products and services is further enhanced by their tight integration with workflow inside critical business processes. From pivotal research and development to product creation and commercialisation, from assessment of business opportunities to management of intellectual property and optimisation of patient care, organisations depend upon Sopheon's solutions to cope with their greatest challenges.

Today, the utility of Sopheon's solutions is redefining the capacity of technical professionals to access and apply needed information and know-how. This is true whether such information resides in the mind of a nearby colleague, or that of a world-class technical authority on the other side of the globe; whether it is to be found in the knowledgebase of another operating unit within the same company, or the document database of a far-off technical publisher. Our solutions empower individuals. In turn, entire teams and organisations are empowered, making them more innovative and productive. Sopheon's capabilities are helping organisations in high-tech manufacturing, chemicals, food and beverage, and healthcare – by enabling them to achieve specific business objectives, and important top- and bottom-line results.

"To maintain our market-leading position, we have outlined an organic growth strategy that relies upon our ability to innovate well and achieve high levels of return on our innovation investments. Sopheon's Accolade will give us the process uniformity and performance consistency we need to enable the sharing of knowledge and expertise across a common process and system platform, ensuring faster time-to-market and winning products."

Christine Connelly, Chief Information Officer, Cadbury Schweppes

Our History

Sopheon began in 1993 as Netherlands-based PolyDoc. Building on unique competencies in linguistics and language management, the company created software applications that allowed organizations to capture, organize and access knowledge through structured authoring tools, terminology management and thesauri. Use of this technology was focused on specific processes such as hospital protocol management and the sharing of quality standards within manufacturing environments.

In the mid and late 90's PolyDoc continued to grow its knowledge management and implementation capabilities, while extending its market presence to the U.K. In 1999 the company changed its name to Sopheon. In 2000, Sopheon followed an acquisition strategy to establish a foothold in U.S. markets. That same year, the company began to focus on the development of software and service solutions that could help technology-driven organizations strengthen innovation and improve the business results from new products. In 2001 Sopheon introduced its flagship solution, the Accolade product development system.

Business Process Solutions – Helping Organizations Move from Strategy to Results

Sopheon's solutions blend the richness of human expertise and specialized content with the efficiencies of technology to support strategic, knowledge-intensive business processes. Sopheon's solutions model and automate the steps of these processes, enabling collaboration and integrating best-practices with access to market, technical and competitive intelligence to support and inform process decisions.

Innovation and Product Development To achieve and sustain success in today's economic order, many companies are striving to generate more revenue from new products. Sopheon's flagship offering, Sopheon Accolade®, is a software system that automates the product development process and strengthens it with strategic decision-making support. Sopheon developed Accolade in partnership with Dr. Robert Cooper, founder of the Product Development Institute (PDI) and creator of the Stage-Gate® product development methodology used by more than 70 percent of the technology-driven companies in the US.

SEVENTY-THREE PERCENT OF COMPANIES WORLDWIDE WILL INCREASE SPENDING ON INNOVATION IN 2005, UP FROM 64 PERCENT IN 2004.

– The Boston Consulting Group (BCG)

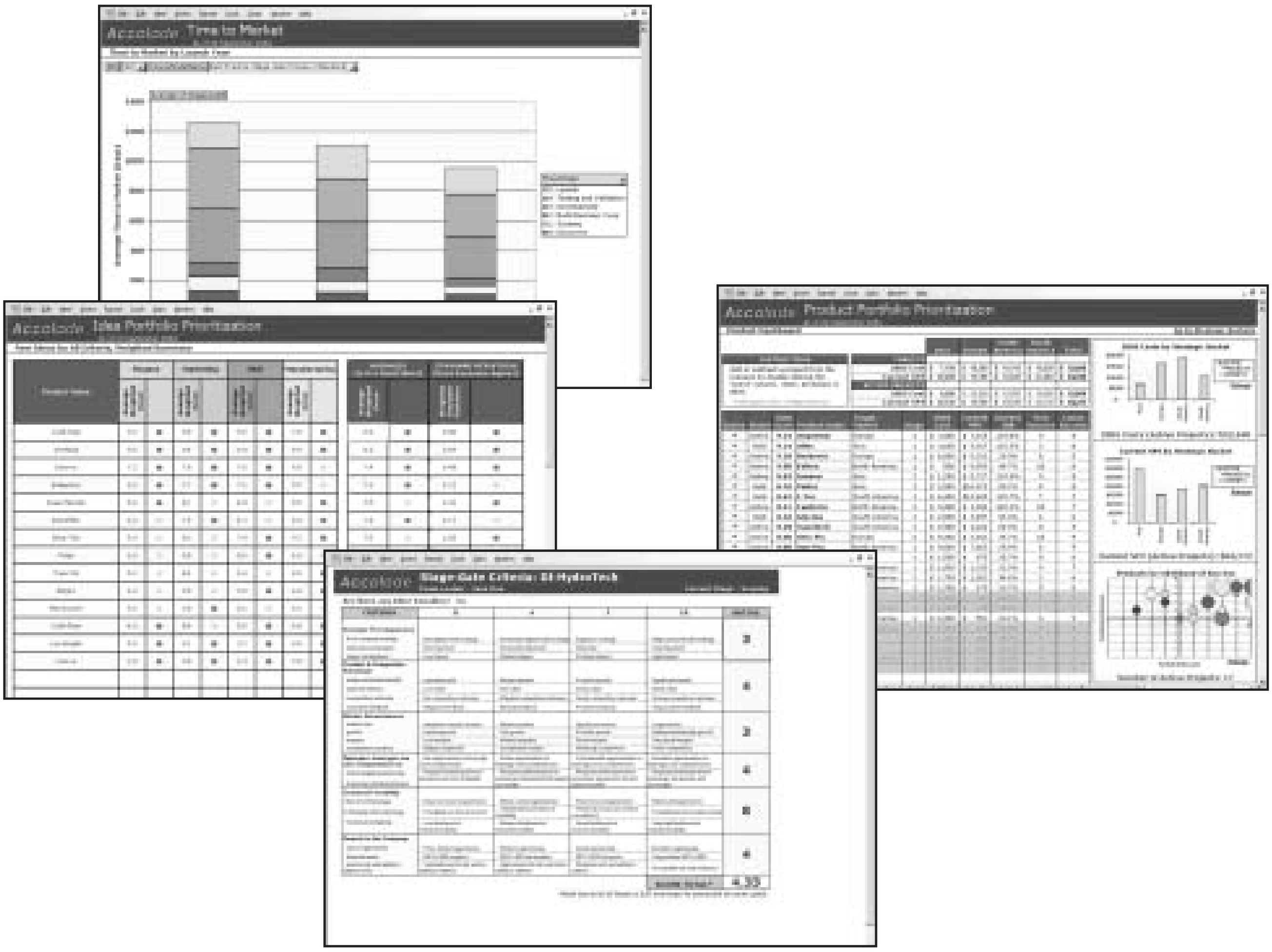
"Raising the Return on Innovation: Innovation-to-Cash Survey 2004," December 2004

Accolade's principal components organise documents, resources and metrics, facilitate communication and provide access to the internal and external information and human expertise necessary to inform decision-making throughout the product conception-to-commercialisation-to-retirement cycle. The software system provides a process backbone and embedded best-practice manuals that guide users and help to ensure that each step of the process is successfully executed. Available modules include an idea management system, a portfolio management tool, a benchmarking module that identifies product-development process strengths and weaknesses, a research center that enables access to external market and technology intelligence and a module that supports cross-functional collaboration. By applying Accolade's capabilities, adopting organizations are able to more efficiently and cost-effectively bring products to market. Leading IT research and advisory regard Sopheon's product development solution as best-of-breed within its class.

Advanced technology developed by Sopheon prior to the creation of Accolade is now being brought into the Accolade suite to enhance its capacity to support specific aspects of product development and expand its use in healthcare applications.

"Sopheon's Accolade gives us a best-practices communication network with a common, business-driven language for design-engineering. For the first time, we have the ability to collaborate simultaneously across all eight Parker operating groups, located throughout 46 countries and in multiple time zones. We're confident that this tool will help leverage our ability to provide customers with higher-value systems solutions."

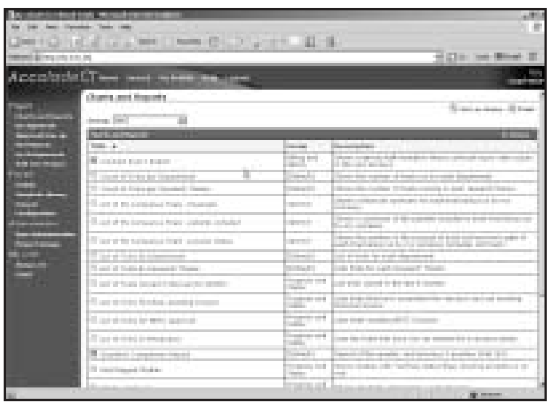
Craig Maxwell, Vice President of Technology and Innovation, Parker Hannifin



Compliance Management. For a growing number of companies, one of the central challenges of successful innovation is to ensure that new products comply with ever-changing federal, state and local regulatory directives, legal requirements and industry technical standards. The Accolade suite is being expanded to include monitoring technology that supports compliance by proactively alerting engineers and other professionals in product development to changes in relevant standards and to new regulatory directives. These new Accolade capabilities have been incorporated, for example, into a service supported by Airbus and Boeing that supports compliance with standards for the use of radio frequency identification (RFID) technology in the development of new commercial aircraft.

"Boeing and Airbus recognize that continuous conformity assessment is of critical importance to their industry. The service that we have developed in partnership with Sopheon greatly reduces the complexity of staying up-to-date with the multitude of current and evolving RFID standards and regulations. It will allow Airbus and Boeing to extend their best practices in compliance throughout their supply chain."

Winfried Holz, Director of Global IT Solutions, Siemens Business Services



Clinical Trials Management. Clinical trial management is a critical step in the cycle that moves new pharmaceutical products from conception and development to safe adoption in the marketplace. It is estimated that, in the United States alone, approximately 80,000 clinical trials are being conducted at any one time. In Europe, clinical trial regulations recently enacted by the European Union (EU) have escalated the importance of optimizing organization and execution of trial activities. Sopheon Accolade is being used today by some of the largest teaching and general hospitals in the Netherlands to enhance the structure of their clinical-trials processes and improve the quality and efficiency of trial management. The software is also being used by healthcare institutions to prioritize and manage innovation projects such as the installation of new processes for treating patients and the updating of research and care facilities.

"Sopheon's software will integrate our processes for managing clinical trials and innovation projects, making these processes more stable, predictable and efficient. As a consequence, we will be able to deliver high-quality results to our pharmaceutical clients more rapidly and with reduced paperwork, while making certain that the innovation projects we choose to support and implement are the ones that will most greatly benefit those who turn to us with their healthcare needs."

Dr. Graham Ramsay, Atrium Medical Center, Board of Directors

Healthcare Provision. Hospitals and clinics are increasingly turning to software-based systems for the management of both medical and non-medical processes. Sopheon's evidence monitoring technology enables healthcare providers to comply with the demanding requirements of evidence-based medicine by providing tailored procedural instructions at the point of care and by helping doctors, nurses and other medical practitioners keep up-to-date with the latest medical news and best practices.

FROM 2004 TO 2010, GLOBAL 1000 MANUFACTURERS WILL INCREASE THEIR INVESTMENT IN PORTFOLIO MANAGEMENT BY AT LEAST A FACTOR OF FIVE TO IMPROVE R&D PERFORMANCE.

– Gartner, Inc.

– Portfolio Management Adds Strategy and Process to PLM," M. Halpern, 23 June 2004

Partnership Strategy

Partnerships are a central aspect of Sopheon's plans for continued growth. During 2004, the Company made important progress in developing relationships with strategic partners who can assist Sopheon both in enhancing the capabilities of its core Accolade solution and in accelerating business expansion within targeted accounts and markets. A principal example of our progress in this area is our emerging relationship with Microsoft. Late last year we announced that we had become part of Microsoft's Collaborative Product Development (CPD) go-to-market strategy. The CPD initiative is designed to help companies leverage investments in Microsoft technology by using it to improve product development success rates. Microsoft and Sopheon are teaming to develop, promote and deliver solutions based on integrated technologies. This relationship was instrumental, for instance, to our recent sales success at Parker Hannifin, where Accolade's ability to further leverage Microsoft technologies already in prevalent use within the client environment was a significant factor in Parker's choice of our solution. In another example of strategic partnering, we established a relationship with Siemens that will allow us to test the viability of our compliance management technology in new markets.

Sopheon also continues to expand its global network of distribution and implementation partners with a goal of maximizing market coverage and providing local support to multinational clients wherever they may be operating. These efforts have recently resulted in the establishment of new partnerships in such areas as Northern Europe, Portugal, Australia, New Zealand, and Southeast Asia

"Sopheon has developed a reputation as a domain expert in product portfolio and product development process management. By combining their advanced software solution and industry-specific knowledge with Microsoft's proven, easy-to-use technology solutions, Sopheon has responded to the industry's demand for tools that provide the collaboration and communication capabilities needed to help manufacturers deliver products to market faster."

Don Richardson, Director, Manufacturing Industry Unit, Microsoft

Directors and Advisers

Directors	Barry K. Mence	Executive Chairman
	Andrew L. Michuda	Chief Executive Officer
	Arif Karimjee ACA	Finance Director
	Stuart A. Silcock FCA	Non-executive Director
	Bernard P. F. Al	Non-executive Director
	Andrew B. Davis	Non-executive Director
	Daniel Metzger	Non-executive Director
Secretary	Arif Karimjee	
Registered office	Surrey Technology Centre 40 Occam Road, Surrey Research Park Guildford, Surrey GU2 7YG	
Registered name and number	Sopheon plc Registered in England and Wales No. 3217859	
Auditors	Ernst & Young LLP Apex Plaza Reading RG1 1YE	
Principal bankers	Silicon Valley Bank 3003 Tasman Drive Santa Clara California CA 95054 United States	Lloyds TSB Bank plc 77 High Street Southend-on-Sea Essex SS1 1HT
Solicitors	Hammonds 7 Devonshire Square Cutlers Gardens London EC2M 4YH	Briggs and Morgan 2400 IDS Center, 80 South Eighth Street Minneapolis Minnesota 55402 United States
	Nauta Dutilh Prinses Irenestraat 59 1077 WV Amsterdam The Netherlands	
AIM Nominated Adviser and Broker	Seymour Pierce Limited Bucklersbury House 3 Queen Victoria Street London EC4N 8EL	
Euronext Paying Agent	Kempen & Co. Beethovenstraat 300 1077 WZ Amsterdam The Netherlands	
Registrars	Capita Registrars The Registry, 34 Beckenham Road Beckenham, Kent BR3 4TV	
Financial PR Consultants	Hansard Communications Limited 14 Kinnerton Place South London SWIX 8EH	Citigate First Financial BV Assumburg 152A 1081 GC Amsterdam The Netherlands

Report On Directors' Remuneration

The remuneration committee of Sopheon Plc is responsible for oversight of the contract terms, remuneration and other benefits for executive directors, including performance related bonus schemes. The committee comprises two non-executive directors, B.P.F. Al, as chairman, and S.A. Silcock, together with B.K. Mence, an executive director, other than in respect of his own remuneration. The committee makes recommendations to the board, within agreed parameters, on an overall remuneration package for executive directors and other senior executives in order to attract, retain and motivate high quality individuals capable of achieving the group's objectives. The package for each director consists of a basic salary, benefits and pension contributions, together with performance related bonuses and share options for certain directors on a case by case basis. Consideration is given to pay and employment policies elsewhere in the group, especially when considering annual salary increases. From time to time, the remuneration committee may take advice from appropriate remuneration consultants.

Contracts

Service contracts between the company and the executive directors are terminable on 6 months' notice for B. K. Mence and A. Karimjee, and 9 months' notice for A. L. Michuda.

Fees for non-executive directors

The fees for non-executive directors are determined by the board. The non-executive directors are not involved in any discussions or decisions about their own remuneration.

Directors' remuneration

Set out below is a summary of the fees and emoluments received by all directors during the year. Details of directors' interests in shares and options are set out in the Directors' Report.

	Pay and fees 2004 £	*Benefits 2004 £*	*Total 2004 £*	*Total 2003 £*	*Contributions to Pension 2004 £*	*Contributions to Pension 2003 £*
Executive directors						
B. K. Mence	112,824	5,374	118,198	115,759	4,875	4,875
A. L. Michuda	98,722	5,295	104,017	113,480	1,921	2,145
A. Karimjee	79,246	842	80,088	83,443	3,655	3,556
Non-executive directors						
S. A. Silcock	18,000	-	18,000	18,000	-	-
B. P. F. Al	18,000	-	18,000	18,000	-	-
A. M. Davis	18,000	-	18,000	18,000	-	-
D. Metzger	18,000	-	18,000	18,000	-	-
	362,792	11,511	374,303	384,682	10,451	10,576

Pension contributions are made to individual directors' personal pension schemes.

The emoluments of S. A. Silcock are paid to Lawfords Limited, of which Mr. Silcock is a director. Lawfords Limited also received fees of £2,695 in respect of advisory services to the Company.

Directors' Report

Financial Results

The loss for the year ended 31 December 2004 before interest, tax, depreciation and amortisation (LBITDA) was £1,140,000 (2003 - £4,066,000) on a turnover of £4,323,000 (2003 - £6,734,000). The retained loss after tax for the year is £1,821,000 (2003 - £5,501,000). The directors do not propose to declare a dividend.

Principal Activities

The group's principal activities during the year continued to focus on the provision of software and services that improve the return on investment of product development, within the rapidly emerging product lifecycle management (PLM) market.

Review of the Business

Sopheon's consolidated revenues from continuing activities grew to £4.3m (2003: £2.7m for the continuing software business and £4.1m from information management businesses divested in the year) and the consolidated EBITDA loss was reduced to £1.1m (2003: £4.1m). Goodwill charges amounted to £0.4m (2003: £4.6m) for the year, in addition to net interest of £0.3m (2003: £0.2m). The resultant retained loss for the year was £1.8m (2003: £5.5m) reducing the loss per ordinary share to 1.6p (2003: 6.3p). This continues the trend of improvement since 2001, which recorded a retained loss of £34.6m.

In its continuing activity, sales growth over the prior year achieved in Sopheon's core software business was almost 100% in US Dollar terms, and almost 75% in Pound Sterling terms. Notwithstanding the significant effect of the weakening dollar on reported revenues, due to the fact that a large portion of Sopheon's costs are dollar denominated Sopheon's EBITDA performance did not suffer.

In broad terms, revenue mix recorded in 2004 was 60:20:20 between license, maintenance and consulting services. The management team is very conscious of the importance of building the recurring revenue base of maintenance contracts, and Sopheon enters 2005 with an annualised run rate of over £1m of such revenue.

Cash resources at 31 December 2004 were £1.2m (2003 - £0.9m) and net current assets £1.1m (2003: £0.1m). Trade receivables have nearly trebled compared with the prior year and appear high relative to total revenues, due to the substantial license sales achieved in December.

At the end of 2003 Sopheon concluded an agreement for a €10 million equity line of credit facility with GEM Global Yield Fund Limited by securing access to a source of equity based funding over which the company retains a substantial degree of control. Approximately 90% of the equity line facility, the term of which extends to 23 December 2005, remains available. The board is considering whether to seek an extension to the instrument.

During the first half of 2004 the company raised £2.4m in cash by way of private equity placing, of which £0.6m was secured through the equity line. In addition, the board secured a resolution from holders of its £2.6 million Convertible Loan Stock to reconstitute the instrument such that, in return for a one off payment of 7% and subject to the Sopheon group continuing to meet key solvency tests, the Loan Stock will automatically convert into ordinary shares rather than be repayable on maturity in December 2005. The change also eliminated the annual interest coupon. The modifications of the terms of the instrument enable it to be reclassified as equity shareholders' funds in the group balance sheet. As a consequence of these actions and the improved trading performance, Sopheon ended 2004 with consolidated net assets of £1.2m compared to a net deficit of £1.9m at the end of 2003.

Research and Development

In October 2004, Sopheon announced that it would integrate Microsoft Project Server 2003 and SharePoint Portal Server 2003 into Accolade, to further enhance collaborative, information-sharing and enterprise deployment capabilities. With support from Microsoft, external resources have been brought in to accelerate these developments during the first quarter of 2005. Accolade is built on Microsoft technology and since inception, has leveraged tools such as Office, NetMeeting and Project to facilitate information sharing, ease-of-use and fast implementation.

Sopheon's development team, based in Denver, continues to apply high quality standards, designed to deliver world class, enterprise strength software, resulting in the high customer satisfaction ratings that Accolade enjoys. Sopheon implemented a controlled expansion in R&D resources in the final weeks of 2004, in order to ensure delivery of our product development roadmap.

The group holds patents relating to presentation of large domain search results, profiling, and the application of IT to language-intensive processes. All three areas benefit from US patent protection.

Future Developments

The past year was earmarked by steady improvements in the performance of our business and significant progress in key areas of strategy. We continue to exercise balance and caution in our planning approach. Accordingly our cost base remains under tight control, and the board continues to believe in the importance of not disrupting the high degree of focus achieved in the business since our divestiture activity in 2003. Accolade is generating strong interest, has an expanding installed client base, and enjoys increased validation by the market. It has demonstrated, consistently, that it is a valuable solution in which clients are prepared to invest. Overall, we are encouraged by the direction, focus and momentum of our business, and look forward to a successful 2005.

International Financial Reporting Standards

As an AIM listed UK group Sopheon is not required to adopt IFRS until the financial statements for the year 2007 and would expect to continue to report under UK GAAP for 2005 and 2006. At this stage the group has performed a preliminary review of the key areas where Sopheon's financial statements are likely to be affected. These are expected to be share based compensation, accounting for research and development costs, and financial instruments.

The board has considered the merits of early adoption of IFRS and has concluded that for the time being, the costs of early conversion outweigh the benefits. In any event, Sopheon will be required under UK GAAP to recognise as an expense in its financial statements the fair value of share-based payments (FRS 20) from 2006, and to provide additional presentation and disclosure regarding the financial instruments it has issued (FRS 25) from 2005.

Directors and their interests

The interests of the directors, who held office at the end of the year, in the share capital of the company (all beneficially held except those marked with an asterisk (*), which are held as trustee), were as follows:

	Share Options		*Ordinary Shares*	
Director	*2004*	*2003*	*2004*	*2003*
B. K. Mence	122,500	122,500	11,173,847	10,997,277
A. L. Michuda	2,998,607	2,998,607	41,855	41,855
A. Karimjee	562,500	562,500	-	-
S. A. Silcock	-	-	181,383	181,383
S. A. Silcock*	-	-	98,077	98,077
B. P. F. Al	25,000	25,000	650,000	393,000
A. B. Davis	-	-	494,520	494,520
D. Metzger	-	-	-	-

Of the 11,173,847 ordinary shares mentioned above B. K. Mence beneficially owns and is the registered holder of 5,025,227 ordinary shares. A further 2,300,820 ordinary shares are held by Inkberrow Limited, a company in which his family trust is the major shareholder. In addition he is, or his wife or children are, potential beneficiaries under trusts holding an aggregate of 3,847,800 ordinary shares, of which trusts directors of Lawfords Ltd., in the Isle of Man, are trustees and are registered as the holders of such shares. S.A. Silcock is a shareholder in Lawfords Ltd and is a minority shareholder in Inkberrow Limited.

Listed below are the holdings of the directors of Sopheon Convertible Loan Stock (the "Stock"). Details of the terms of the Stock, which is now classified as part of equity shareholders' funds, are given in Note 15.

	Nominal amount of Stock		*Number of Sopheon shares issuable on full coversion*	
Director	*2004*	*2003*	*2004*	*2003*
B. K. Mence	£390,000	£390,000	3,250,000	3,250,000
A. L. Michuda	£28,000	£28,000	233,333	233,333
A. Karimjee	£17,000	£17,000	141,667	141,667
S. A. Silcock	£100,000	£100,000	833,333	833,333
B. P. F. Al	Nil	£25,000	Nil	208,333

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

	Date of Grant	*Exercise price*	*At 31 December 2003*	*Granted during year*	*Exercised during year*	*At 31 December 2004*
B. K. Mence (1)	2 May 2001	77.5p	22,500	-	-	22,500
B. K. Mence (1)	30 April 2002	14.75p	100,000	-	-	100,000
A. L. Michuda (2)	15 September 2000	184p	187,600	-	-	187,600
A. L. Michuda (2)	15 September 2000	230p	7,846	-	-	7,846
A. L. Michuda (2)	15 September 2000	322p	12,501	-	-	12,501
A. L. Michuda (2)	15 September 2000	368p	1,756	-	-	1,756
A. L. Michuda (3)	2 October 2000	427.5p	16,280	-	-	16,280
A. L. Michuda (3)	1 January 2001	160p	5,030	-	-	5,030
A. L. Michuda (3)	2 May 2001	77.5p	54,662	-	-	54,662
A. L. Michuda (4)	30 April 2002	14.75p	487,932	-	-	487,932
A. L. Michuda (4)(5)	5 November 2003	16.25p	2,225,000	-	-	2,225,000
A. Karimjee (1)	22 November 1999	150p	100,000	-	-	100,000
A. Karimjee (1)	2 May 2001	77.5p	12,500	-	-	12,500
A. Karimjee (1)	30 April 2002	14.75p	150,000	-	-	150,000
A. Karimjee (5)(6)	5 November 2003	16.25p	300,000	-	-	300,000
B. P. F. Al (1)	2 May 2001	77.5p	25,000	-	-	25,000

(1) Exercisable between the third and tenth anniversary of the date of grant.
(2) Fully vested options, which were granted as part of the acquisition of Teltech Resource Network Corporation.
(3) One fourth of these options becomes exercisable on each of the first four anniversaries of the date of grant and they expire on the tenth anniversary of the date of grant.
(4) One third of these options are exercisable from the date of grant, one third from the first anniversary of the date of grant and one third from the second anniversary of the date of grant.
(5) Vesting of a proportion of these options is subject to performance conditions relating to the achievement of positive EBITDA in two successive quarters.
(6) 93,846 of these options are exercisable between the third and tenth anniversary of grant and 206,154 options are exercisable as to one third immediately and one third on each of the first and second anniversaries of grant.

The mid-market price of Sopheon ordinary shares at 31 December 2004 was 23.75p. During the financial year the mid-market price of Sopheon ordinary shares ranged from 39.5p to 15.5p.

Save as disclosed above, no director (or member of his family) or connected persons within the meaning of Section 346 of the Companies Act 1985 has any interest, beneficial or non-beneficial, in the share capital of the company.

Substantial Shareholdings

The Directors are aware of the following persons at 31 March 2005 that were interested directly or indirectly in three per cent or more of the company's issued ordinary shares:

Name	*No. of Ordinary Shares*	*% issued Ordinary Shares*
B. K. Mence (director)	11,173,847	9.6
Norman Nominees Limited	4,474,595	3.9
P.J. Korpershoek	4,000,000	3.5
Aventis Research & Technologies GmbH & Co KG	3,471,191	3.0

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

In addition, Norman Nominees Limited has a holding of £650,000 nominal value of Convertible Loan Stock, which on conversion would result in the issue of 5,416,666 ordinary shares.

Share Option Schemes

Details of options granted are shown in note 17.

Supplier payment policy and practice
It is the company's policy that payments to suppliers are made in accordance with those terms and conditions agreed between the company and its suppliers, provided that all trading terms and conditions have been complied with. At 31 December 2004 the company had approximately 47 days' purchases outstanding.

Financial instruments
The group's principal financial instruments comprise bank loans, cash and short-term deposits. The main purpose of these financial instruments is to secure funds and manage cash flow for the group's operations. The group has various other financial instruments such as trade debtors and trade creditors that arise directly from its operations.

It is, and has been throughout the period under review, the group's policy that no trading in derivatives and other financial instruments shall be undertaken. However, the group is considering the use of forward exchange contracts to assist with management of foreign exchange exposures.

The main risks arising from the group's financial instruments are interest rate risk, liquidity risk and foreign currency risk as summarized below. The board reviews and agrees policies for managing each of these risks. These policies have remained unchanged during 2003 and 2004.

Interest rate risk
The group has lines of credit denominated in US Dollars bearing interest at floating rates.

Where the group has significant cash resources available that are in excess of the short term needs of the business, such funds are maintained in Sterling, US Dollars or Euros and are placed on short and medium term bank deposit at the best interest rate available.

Liquidity risk
The group's objective is to maintain a balance between continuity of funding and flexibility through the use of overdrafts and bank loans. Short term flexibility is achieved by overdraft facilities and lines of credit.

Foreign currency risk
As a result of having significant operating units in the USA and the Netherlands, which give rise to short term creditors, debtors and cash balances in US Dollars and Euros, the group's balance sheet can be affected by movements in the US Dollar/Sterling and Euro/Sterling exchange rates.

Corporate Governance
The Sopheon board is committed to high standards of corporate governance and aims to follow appropriate governance practice, although as a company incorporated in the UK and listed on AIM and Euronext, the Company is not subject to the requirements of the UK Combined Code issued in 2003 and the Netherlands Tabaksblat Committee. The board currently comprises three executive directors and four independent non-executive directors. Their biographies appear on the inside back cover of this annual report, and demonstrate a range of experience and calibre to bring the right level of independent judgement to the board.

The board as a whole is responsible for identifying the major business risks faced by the group and for determining the appropriate course of action to manage those risks. Formal meetings are held quarterly to review strategy, management and performance of the group, with additional meetings between those dates convened as necessary. The audit committee, which comprises all of the non-executive directors and is chaired by Stuart Silcock, considers and determines actions in respect of any control or financial reporting issues they have identified or that are raised by the auditors. The board has a formal schedule of matters specifically reserved to it for decision. Details of the constitution of the remuneration committee are provided in the Report on Directors' Remuneration on page 13.

Auditors
A resolution to reappoint Ernst & Young LLP as auditors will be put to the members at the Annual General Meeting.

Approved by the Board on 4 April 2005 and signed on its behalf by

A. Karimjee
Director

Statement of Directors' Responsibilities In Respect Of The Financial Statements

Company law requires the directors to prepare financial statements for each financial year, which give a true and fair view of the state of affairs of the company and of the group and of the profit or loss of the group for that period. In preparing those financial statements, the directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and estimates that are reasonable and prudent;
- state whether applicable accounting standards have been followed, subject to any material departures disclosed and explained in the financial statements;
- 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 proper accounting records which disclose with reasonable accuracy at any time the financial position of the company and to enable them to ensure that the financial statements comply with the Companies Act 1985. They are also responsible for safeguarding the assets of the company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

Independent Auditors' Report To The Members Of Sopheon plc

We have audited the group's financial statements for the year ended 31 December 2004, which comprise the Group Profit and Loss Account, Group Balance Sheet, Company Balance Sheet, Group Statement of Cash Flows, Group Statement of Total Recognized Gains and Losses and the related notes 1 to 20. These financial statements have been prepared on the basis of the accounting policies set out therein.

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

Respective responsibilities of directors and auditors

The directors are responsible for preparing the Annual Report, including the financial statements which are required to be prepared in accordance with United Kingdom law and accounting standards as set out in the Statement of Directors' Responsibilities in relation to the financial statements.

Our responsibility is to audit the financial statements in accordance with relevant legal and regulatory requirements and United Kingdom Auditing Standards.

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

We read other information contained in the Annual Report and consider whether it is consistent with the audited financial statements. This other information comprises the Directors' Report, Chairman's and Chief Executive Officer's Statement, Market and Product Overview, Report on Directors' Remuneration, and Directors and Senior Management. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the financial statements. Our responsibilities do not extend to any other information.

Basis of audit opinion

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

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

Emphasis of matter – going concern

In forming our opinion we have considered the adequacy of the disclosures made in note 1 to the financial statements concerning the uncertainties associated with the preparation of the accounts on a going concern basis. The financial statements have been prepared on a going concern basis, the validity of which depends on continued growth in the business, or, in the absence of such growth, the ability to secure funding through the company's facilities or other sources. In view of the significance of these uncertainties we consider they should be drawn to your attention but our opinion is not qualified in this respect.

Opinion

In our opinion the financial statements give a true and fair view of the state of affairs of the company and of the group as at 31 December 2004 and of the loss of the group for the year then ended and have been properly prepared in accordance with the Companies Act 1985.

Ernst & Young LLP
Registered Auditor
Reading

4 April 2005

Group Profit And Loss Account For The Year Ended 31 December 2004

	Notes	2004 £'000	2003 £'000	2002 £'000
TURNOVER	2	4,323	6,734	12,353
Cost of sales		(993)	(4,117)	(9,002)
GROSS PROFIT		3,330	2,617	3,351
Sales and marketing expenses		(2,588)	(3,442)	(5,437)
Research and development expenditure		(890)	(1,237)	(2,331)
Amortisation and impairment charges in respect of goodwill		(440)	(4,586)	(5,922)
Other administrative expenses		(1,111)	(2,577)	(5,727)
Total administrative expenses		(2,441)	(8,400)	(13,980)
GROUP OPERATING LOSS	3	(1,699)	(9,225)	(16,066)
Share of operating loss of associated undertaking		-	-	(46)
TOTAL OPERATING LOSS	3	(1,699)	(9,225)	(16,112)
Profit on disposal of operations discontinued activities	11	-	3,568	-
LOSS ON ORDINARY ACTIVITIES BEFORE INTEREST AND TAXATION		(1,699)	(5,657)	(16,112)
Interest receivable		83	76	260
Interest payable and similar charges	5	(348)	(225)	(327)
LOSS ON ORDINARY ACTIVITIES BEFORE TAXATION		(1,964)	(5,806)	(16,179)
Tax on ordinary activities	6	143	305	126
RETAINED LOSS FOR THE YEAR		(1,821)	(5,501)	(16,053)
Loss per share basic and diluted (pence)	8	(1.6p)	(6.3p)	(19.4p)
LOSS ON AN EBITDA BASIS (LBITDA)	1	(1,140)	(4,066)	(8,910)

GROUP STATEMENT OF TOTAL RECOGNISED GAINS AND LOSSES FOR THE YEAR ENDED 31 DECEMBER 2004

	2004 £'000	2003 £'000	2002 £'000
Loss on ordinary activities after taxation	(1,821)	(5,501)	(16,053)
Exchange difference on retranslation of net assets of subsidiary undertakings	(61)	88	75
Total recognised losses relating to the year	(1,882)	(5,413)	(15,978)

Group Balance Sheet At 31 December 2004

	Notes	2004 £'000	2003 £'000
FIXED ASSETS			
Intangible assets			
Goodwill	9	-	440
Tangible fixed assets	10	110	195
CURRENT ASSETS			
Debtors	12	1,901	1,159
Cash at bank and in hand	13	1,211	878
		3,112	2,037
CREDITORS: amounts falling due within one year	14	(1,978)	(1,996)
NET CURRENT ASSETS		1,134	41
TOTAL ASSETS LESS CURRENT LIABILITIES		1,244	676
CREDITORS: amounts falling due after more than one year			
Convertible Unsecured Loan Stock 2005	15	-	(2,561)
		1,244	(1,885)
CAPITAL AND RESERVES			
Called up share capital	17	5,794	4,821
Share premium account	18	48,949	46,420
Shares to be issued	18	1,509	-
Merger reserve	18	17,944	17,944
Other reserves	18	4,157	4,164
Profit and loss account	18	(77,109)	(75,234)
Shareholders' funds/(deficit) (all equity interests)		1,244	(1,885)

Approved by the Board on 4 April 2005

Barry K. Mence
Director

Arif Karimjee
Director

Company Balance Sheet At 31 December 2004

	Notes	2004 £'000	2003 £'000
FIXED ASSETS			
Investments	11	6,119	6,119
CURRENT ASSETS			
Debtors	12	73	116
Cash at bank and in hand		934	670
		1,007	786
CREDITORS: amounts falling due within one year	14	(405)	(441)
NET CURRENT ASSETS		602	345
TOTAL ASSETS LESS CURRENT LIABILITIES		6,721	6,464
CREDITORS: amounts falling due after more than one year			
Convertible Unsecured Loan Stock 2005	15	-	(2,561)
		6,721	3,903
CAPITAL AND RESERVES			
Called up share capital	17	5,794	4,821
Share premium account	18	48,949	46,420
Shares to be issued	18	1,509	-
Merger reserve	18	10,179	10,179
Other reserves	18	4,157	4,164
Profit and loss account	18	(63,867)	(61,681)
Shareholders' funds (all equity interests)		6,721	3,903

Approved by the Board on 4 April 2005

Barry K. Mence
Director

Arif Karimjee
Director

Group Statement Of Cash Flows For The Year Ended 31 December 2004

	Notes	2004 £'000	2003 £'000	2002 £'000
NET CASH OUTFLOW FROM OPERATING ACTIVITIES	3	(1,813)	(4,332)	(10,268)
RETURN ON INVESTMENTS AND SERVICING OF FINANCE				
Interest received		83	76	260
Interest paid		(348)	(225)	(327)
		(265)	(149)	(67)
TAXATION				
Research and development tax credit		62	305	126
CAPITAL EXPENDITURE & FINANCIAL INVESTMENT				
Payments to acquire tangible fixed assets		(42)	(27)	(104)
Receipts from sales of tangible fixed assets		-	-	18
		(42)	(27)	(86)
ACQUISITIONS AND DISPOSALS				
Net proceeds from disposal of operations		-	1,680	-
Net cash disposed of on disposal of operations		-	(649)	-
		-	1,031	-
MANAGEMENT OF LIQUID RESOURCES				
(Increase)/decrease in short term deposits	13	(271)	1,934	8,186
NET CASH OUTFLOW BEFORE FINANCING		(2,329)	(1,238)	(2,109)
FINANCING				
Issues of ordinary share capital		2,437	1,480	39
Repayment of long-term loans		(11)	-	(51)
		2,426	1,480	(12)
INCREASE/(DECREASE) IN CASH	13	97	242	(2,121)

1. ACCOUNTING POLICIES

Accounting convention and basis of preparation

The financial statements are prepared under the historical cost convention and in accordance with applicable accounting standards, and on the going concern basis.

During 2004 the group's revenues from continuing operations grew by 60%, which together with the cost restructuring and divestments completed in 2003 reduced its total losses on an EBITDA (earnings before interest, tax, depreciation and amortisation) basis by over 70%.

At the year end the group reported consolidated net current assets of £1,134,000 and gross cash resources of £1,211,000. The group has access to a $1,000,000 (£522,000) bank line of credit with Silicon Valley Bank, which is secured against the trade debtors of Sopheon Corporation Minnesota. At 31 December 2004, $207,000 (£108,000) was drawn against this facility. The facilities with Silicon Valley Bank have been in place since 1999, and are renewable annually in October.

The directors are encouraged by the direction, focus and momentum of the business and believe that this, together with the group's resources provide it with adequate funding to support its activities through to the point at which they anticipate that trading will become cash generative on a sustained basis. This is in turn dependent on the group maintaining the substantial sales growth achieved in 2004.

Should this not be the case, or should the group require additional funding for other operational or investment purposes, Sopheon continues to have access to its equity line of credit facility from GEM Global Yield Fund Limited ("GEM") for an aggregate of €10 million over the two year life of the instrument, which comes to an end on 22 December 2005. GEM's obligation to subscribe for shares is subject to certain conditions linked to the prevailing trading volumes and prices of Sopheon shares on the Euronext stock exchange. In March 2004, Sopheon made a first call on the equity line of credit facility, raising just under €1 million before expenses and accordingly, leaving €9 million available under the instrument. The directors are considering whether it is appropriate to seek an extension to the life in order to provide continued access to the facility for the foreseeable future.

The directors believe that together, the points above will enable the group to continue as a going concern. However, uncertainties remain as to the achievement of the expected sales growth and the continued availability of facilities to the group. The financial statements do not reflect any adjustments which would be required if the going concern assumption was not appropriate. The precise extent and quantification of such adjustments has not been determined but these could include the reclassification of any unconverted element of the group's convertible unsecured loan stock to creditors falling due within one year, and provision for additional liabilities.

Basis of consolidation

The consolidated financial statements include the results of the company and its subsidiary undertakings. The results of Sopheon's former IM division (comprising the information and research services business of Sopheon Corporation Minnesota and Sopheon GmbH, formerly the Technology and Information Services Division of Aventis Research & Technologies) have been included up to the dates of disposal, which were respectively 1 July 2003 and 15 August 2003.

Turnover

Turnover comprises amounts derived from the sale of goods and services and is stated net of value added tax.
Sales of software products are recognised on delivery, and when no significant vendor obligations remain. Revenues from implementation and consultancy services are recognised as the services are performed. Revenues relating to maintenance and post contract support agreements are deferred and recognised over the period of the agreements.
Revenues and associated costs under long term contracts are recognised on a percentage basis as the work is completed and any relevant milestones are met, using latest estimates to determine the expected duration and cost of the project.

Tangible fixed assets

Tangible fixed assets are stated at historical cost, less accumulated depreciation. Tangible fixed assets are depreciated on a straight line basis over their expected useful lives over the following periods:

Computer equipment	3 years
Fixtures and fittings	4 to 5 years
Internet portals	3 years

Research and development

Research and development expenditure is written off as incurred. The costs of registering patents and trademarks are written off as incurred. Subsidies received from the European Union and other state agencies are credited to the profit and loss account over the period to which they relate.

Goodwill

Goodwill arising on consolidation is capitalised and amortised on a straight line basis over its estimated useful economic life, which in all cases is 3 years. Goodwill is reviewed for impairment at the end of the first full financial year after acquisition and in other periods if events or changes in circumstances indicate that carrying values may not be recoverable. If a subsidiary, associate or business is subsequently sold or closed, any goodwill arising on acquisition that has not been amortised is taken into account in determining the profit or loss on sale or closure.

Deferred Taxation

Deferred tax is recognised in respect of all timing differences that have originated but not reversed at the balance sheet date where transactions or events that result in an obligation to pay more, or a right to pay less, tax in the future have occurred at the balance sheet date, with the following exception. Deferred tax assets are recognised only to the extent that the directors consider that it is more likely than not that there will be suitable taxable profits from which the future reversal of the underlying timing differences can be deducted. Deferred tax is measured on a non-discounted basis at the tax rates that are expected to apply in the periods in which timing differences reverse, based on tax rates and laws enacted or substantively enacted at the balance sheet date.

Foreign currencies

Company

Transactions in foreign currencies are recorded at the rate ruling at the date of the transaction or at the contracted rate if the transaction is covered by a forward exchange contract. Monetary assets and liabilities denominated in foreign currencies are retranslated at the rate of exchange ruling at the balance sheet date or if appropriate at the forward contract rate. All differences are taken to the profit and loss account.

Group

The assets and liabilities of the subsidiary undertakings are translated at the rate of exchange ruling at the balance sheet date. The profit and loss account is translated at the average rate of exchange. The exchange differences arising on the retranslation of subsidiary undertakings are, together with differences arising on the translation of long term intra-group funding loans which are not intended to be repaid in the foreseeable future, taken directly to reserves. All other differences are taken to the profit and loss account.

Pensions

Sopheon contributes to the personal pension arrangements of employees, the costs of which are charged in the profit and loss account as incurred.

Leasing

Rentals payable under operating leases are charged in the profit and loss account on a straight line basis over the lease term.

LBITDA

LBITDA represents loss before interest, tax, depreciation and amortisation and also excludes non-recurring equity-based costs incurred in connection with acquisitions and profits on disposal of operations.

2. TURNOVER AND SEGMENTAL INFORMATION

Turnover (excluding valued added tax) represents the amounts derived from the group's principal activity which comprises the design, development, marketing of software products with associated implementation and consultancy services and, decreasingly, the provision of bespoke software solutions. Discontinued activities primarily comprise the provision of research services by the IM division of Sopheon Corporation Minnesota and by Sopheon GmbH, up to the relevant dates of disposal. The group results are analysed between three geographical markets, the United States, the United Kingdom and the rest of Europe.

Analysis of turnover by area of activity

	2004 *£'000*	*2003* *£'000*	*2002* *£'000*
Software and consultancy services - continuing	4,323	2,669	2,854
Software and consultancy services - discontinued	-	252	453
Information and research services - discontinued	-	3,813	9,046
	4,323	6,734	12,353

Analysis of operating loss by area of activity

	2004 *£'000*	*2003* *£'000*	*2002* *£'000*
Continuing operations - software and consultancy	3,330	2,042	1,135
Discontinued operations	-	575	2,216
Gross margin	3,330	2,617	3,351
Sales and marketing expenses	(2,588)	(3,442)	(5,437)
Administrative expenses (including goodwill amortisation)	(2,441)	(8,400)	(13,980)
Operating loss	(1,699)	(9,225)	(16,066)

Sales and marketing expenses in 2003 include £574,000 in respect of discontinued operations. Administration expenses in 2003 include £4,957,000 in respect of discontinued operations.

Analysis of turnover by geographical destination

	2004 *£'000*	*2003* *£'000*	*2002* *£'000*
United Kingdom	811	551	820
Rest of Europe	1,535	942	835
North America	1,977	1,069	1,095
Rest of World	-	107	104
Continuing operations	4,323	2,669	2,854
United Kingdom	-	-	9
Rest of Europe	-	1,712	3,177
North America	-	2,349	6,296
Rest of World	-	4	17
Discontinued operations	-	4,065	9,499
Total	4,323	6,734	12,353

Analysis of turnover and operating loss by geographical origin

	Operating loss			Turnover		
	2004 £'000	2003 £'000	2002 £'000	2004 £'000	2003 £'000	2002 £'000
United Kingdom	(845)	(1,755)	(4,687)	811	550	994
Rest of Europe	(16)	(270)	(273)	1,111	789	815
United States of America	(838)	(2,244)	(2,608)	2,401	1,330	1,045
Continuing operations	(1,699)	(4,269)	(7,568)	4,323	2,669	2,854
Rest of Europe	-	(456)	(872)	-	1,712	3,217
United States of America	-	(4,500)	(7,626)	-	2,353	6,282
Discontinued operations	-	(4,956)	(8,498)	-	4,065	9,499
	(1,699)	(9,225)	(16,066)	4,323	6,734	12,353

Analysis of net assets/(liabilities) by geographical origin

	2004 £'000	2003 £'000	2002 £'000
United Kingdom	(67)	(87)	162
Rest of Europe	66	6	76
United States of America	265	94	(170)
Unallocated cash and loans at group level	980	(1,898)	(721)
Continuing operations	1,244	(1,885)	(653)
Rest of Europe	-	-	16
United States of America	-	-	3,063
Discontinued operations	-	-	3,079
Total	1,244	(1,885)	2,426

3. OPERATING LOSS

(a) This is stated after charging/(crediting):

	2004 £'000	2003 £'000	2002 £'000
Auditors' remuneration - audit services			
Audit services to UK group companies	75	69	66
Audit services to non-UK group companies	10	6	29
Auditors' remuneration – non-audit services			
Taxation advisory services to UK group companies	25	31	46
Taxation advisory services to non-UK group companies	11	10	6
Transaction support relating to corporate disposals	-	24	-
Research and development expenditure	890	1,237	2,331
Grants and subsidies	-	-	(69)
Foreign exchange (gains)/losses	(24)	23	15
Amortisation of goodwill	440	4,586	5,922
Depreciation of owned tangible fixed assets	119	573	1,280
Operating lease rentals - land and buildings	292	537	1,015
Operating lease rentals - equipment and vehicles	96	116	135

(b) Reconciliation of operating loss to net cash outflow from operating activities

	2004 £'000	2003 £'000	2002 £'000
Operating loss	(1,699)	(9,225)	(16,066)
Depreciation	119	573	1,280
Amortisation of goodwill	440	4,586	5,922
(Increase)/decrease in debtors	(659)	36	948
Decrease in creditors and provisions	(14)	(302)	(2,352)
Net cash outflow from operating activities	(1,813)	(4,332)	(10,268)

4. STAFF COSTS

	2004 £'000	2003 £'000	2002 £'000
Wages and salaries	2,717	5,632	10,580
Social security costs	221	557	960
Other pension costs	66	96	231
	3,004	6,285	11,771

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

	2004 £'000	2003 £'000	2002 £'000
Development and operations	28	75	151
Sales and management	30	48	81
	58	123	232

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

The fees and emoluments of all directors were as follows:

	2004 £'000	2003 £'000	2002 £'000
Fees and emoluments	374	385	388
Pension contributions	11	11	16
	385	396	404

Pension contributions are to personal defined contribution schemes and have been made for three directors who served during the year. The emoluments of the highest paid director were as follows:

	2004 £'000	2003 £'000	2002 £'000
Emoluments	113	111	118
Benefits	5	5	6
Pension contributions to defined contribution schemes	5	5	2
	123	121	126

5. INTEREST PAYABLE AND SIMILAR CHARGES

	2004 £'000	2003 £'000	2002 £'000
Bank loans and overdrafts	54	54	155
Convertible loan stock	294	171	172
	348	225	327

The interest payable in respect of the convertible loan stock includes a compensation payment of 7% of its nominal amount made pursuant to the reconstitution of the stock as referred to in Note 15.

6. TAXATION

(a) Tax on loss on ordinary activities

The tax credit is made up as follows:

	2004 £'000	2003 £'000	2002 £'000
Research and development tax credits in respect of prior years	143	305	126

(b) Factors affecting current tax credit

The differences between the group's expected tax credit, using the group's standard corporation tax rate of 38% (2003: 39% and 2002: 38%), comprising the weighted average rates of tax payable across the group, and the group's current tax credit in each year are as follows:

	2004 £'000	2003 £'000	2002 £'000
Loss on ordinary activities before tax	(1,964)	(5,806)	(16,179)
Expected tax credit on loss on ordinary activities before tax	746	2,264	6,148
Amortisation and impairment charges in respect of goodwill	(167)	(1,789)	(2,250)
Shortfall of tax depreciation compared to book depreciation	(6)	(52)	(102)
Utilisation of tax losses against profit on disposal of operations	-	1,339	-
Losses in year not relievable against current tax	(573)	(1,762)	(3,796)
Research & development tax credits in respect of prior year	143	305	126
Actual current tax credit (see Note 6(a))	143	305	126

(c) Deferred taxation

The group has an unrecognised deferred tax asset arising from its unrelieved trading losses, which has not been recognised owing to uncertainty as to the level and timing of taxable profits in the future.

The unrecognised deferred tax asset is made up as follows:

	2004 £'000	2003 £'000	2002 £'000
Shortfall of tax depreciation compared to book depreciation	162	156	104
Unrelieved trading losses	20,072	20,311	20,888
Unrecognised deferred tax asset	20,234	20,467	20,992

At 31 December 2004, tax losses estimated at £53 million were available to carry forward by the Sopheon plc group, arising from historic losses incurred. These losses represent a potential deferred tax asset of £20.2 million. £12.4 million of the tax losses, and £5.4 million of the potential deferred tax asset, relate to pre-acquisition tax losses of Sopheon Corporation (Minnesota) and of Orbital Software Inc. The future utilisation of these losses may be restricted under section 382 of the US Internal Revenue Code, whereby the ability to utilise net operating losses arising prior to a change of ownership is limited to a percentage of the entity value of the corporation at the date of change of ownership.

Under Financial Reporting Standard 19, the unrecognised deferred tax asset in respect of trading losses can only be recognised if future taxable profits can be foreseen with a greater degree of certainty.

7. LOSS ATTRIBUTABLE TO MEMBERS OF THE PARENT COMPANY

The loss dealt with in the financial statements of the parent company for the year ended 31 December 2004 was £2,193,000 (2003 - loss £2,013,000 and 2002 - loss £15,509,000). The loss in 2004 included a net provision of £1,789,000 (2003 - £1,181,000 and 2002 - £15,245,000) against the company's investment in and loans to subsidiary companies. Advantage has been taken of Section 230 of the Companies Act 1985 not to present a profit and loss account for the parent company.

8. LOSS PER ORDINARY SHARE

The calculation of basic loss per ordinary share is based on a loss of £1,821,000 (2003 - £5,501,000 and 2002 - £16,053,000), and on 114,882,751 (2003 - 87,274,941 and 2002 - 82,669,430) ordinary shares, being the weighted average number of ordinary shares in issue during the year, including 8,085,249 ordinary shares representing the weighted average effect of the reconstitution of the group's convertible loan note (see Note 15).

The loss attributable to ordinary shareholders and the weighted average number of ordinary shares for the purpose of calculating the diluted loss per ordinary share are identical to those used for calculating the basic loss per ordinary share. This is because the exercise of share options would have the effect of reducing the loss per ordinary share and is therefore not dilutive under the terms of Financial Reporting Standard 14.

9. INTANGIBLE FIXED ASSETS

Group only

	Goodwill £'000
Cost	
At 1 January 2004	17,546
Amortisation	
At 1 January 2004	17,106
Provided during the year	440
At 31 December 2004	17,546
Net book value	
At 31 December 2004	Nil
At 31 December 2003	440

10. TANGIBLE FIXED ASSETS

Group only

	Computer Equipment £'000	*Furniture & fittings £'000*	*Total £'000*
Cost			
At 1 January 2004	1,557	333	1,890
Additions	39	3	42
Exchange adjustments	(27)	(6)	(33)
At 31 December 2004	1,569	330	1,899
Depreciation			
At 1 January 2004	1,401	294	1,695
Provided during the year	113	6	119
Exchange adjustments	(19)	(6)	(25)
At 31 December 2004	1,495	294	1,789
Net book value			
At 31 December 2004	74	36	110
At 31 December 2003	156	39	195

11. INVESTMENTS

Company

Investment in subsidiary undertakings

	£'000
Cost	
At 1 January 2004 and 31 December 2004	52,519
Amounts provided	
At 1 January 2004 and 31 December 2004	35,441
Net book value of equity investments at 31 December 2004 and 31 December 2003	17,078
Amounts due to subsidiary undertakings	(10,959)
	6,119

Disposals of operations

a) On 1 July 2003 the group completed the disposal of the IM division of Sopheon Corporation Minnesota. The disposal is analysed as follows:

Net liabilities disposed of:	*£'000*
Fixed assets	50
Debtors	857
Creditors and accruals	(832)
Deferred revenue	(1,117)
	(1,042)
Profit on disposal	3,042
	2,000

Satisfied by:

Cash	1,750
Further amounts due from purchaser	250
	2,000

In the period to 1 July 2003, the IM division of Sopheon Corporation Minnesota contributed £265,000 to the group's operating loss and £145,000 to the group's net operating cash outflow. The tax effect of disposals is set out in note 6.

The further amounts due from the purchaser are subject to final agreement of terms reached in principle regarding payment of earn-outs and escrow balances that comprise securities subject to fluctuations in market value, including 388,350 Sopheon shares, which were issued to the purchaser, FIND/SVP Inc., on 4 July 2003 as referred to in note 18.

b) On 15 August 2003 the group completed the disposal of Sopheon GmbH. The disposal is analysed as follows:

Net liabilities disposed of:	*£'000*
Fixed assets	110
Debtors	956
Cash	649
Creditors and accruals	(859)
Pension provision	(497)
Deferred revenue	(389)
	(30)
Profit on disposal	526
	496

Satisfied by:	
Release of contingent deferred consideration	465
Release of unamortised negative goodwill	101
Cash contribution on disposal	(70)
	496

In the period to 15 August 2003, Sopheon GmbH contributed £521,000 to the group's operating loss and £195,000 to the group's net operating cash outflow. The tax effect of disposals is set out in note 6.

Details of the investments in which the group or company holds more than 20% of the nominal value of any class of share capital are set out below. Companies marked with an asterisk* are held via Sopheon UK Limited and those marked with an obelus† are held via Orbital Software Holdings plc.

Name of Company *Country of incorporation*	*Holding*	*Proportion of voting rights*	*Nature of Business*
Sopheon Corporation Minnesota, USA	Common Stock	100%	Software sales and services
Sopheon Corporation Delaware, USA	Common Stock	100%	Software development
Sopheon NV The Netherlands	Ordinary Shares	100%	Software sales and services
Lessenger BV The Netherlands	Ordinary Shares	100%	Software sales and services
Sopheon UK Ltd United Kingdom	Ordinary Shares	100%	Software sales and services
Orbital Software Holdings plc United Kingdom	Ordinary Shares	100%	Holding company
Orbital Software Inc.† Delaware, USA	Common Stock	100%	Dormant
Sopheon Edinburgh Ltd† United Kingdom	Ordinary Shares	100%	Dormant
Orbital Software Europe Ltd† United Kingdom	Ordinary Shares	100%	Dormant
Network Managers (UK) Ltd* United Kingdom	Ordinary Shares	100%	Dormant
AppliedNet Ltd* United Kingdom	Ordinary Shares	100%	Dormant
Future Tense Ltd* United Kingdom	Ordinary Shares	100%	Dormant
Polydoc Ltd United Kingdom	Ordinary Shares	100%	Dormant
Applied Network Technology Ltd* United Kingdom	Ordinary Shares	100%	Employee Share Ownership Trust

12. DEBTORS

Group

	2004 £'000	2003 £'000
Trade debtors	1,594	589
Other debtors	153	320
Prepayments and accrued income	154	250
	1,901	1,159

Company

	2003 £'000	2002 £'000
Other debtors	20	-
Prepayments	53	116
	73	116

A full provision has been made against amounts totalling £37,444,000 (2003: £35,655,000) owed to the company by subsidiary undertakings, which are due after more than one year, and are subordinated to the claims of all other creditors.

13. NOTES TO STATEMENT OF CASH FLOWS

(a) Reconciliation of net cash flow to movement in net funds/(debt).

	2004 £'000	2003 £'000	2002 £'000
Increase/(decrease) in cash	62	(543)	(1,803)
Decrease/(increase) in overdrafts and lines of credit	35	785	(318)
Net increase/(decrease) in cash and cash equivalents	97	242	(2,121)
Repayment of term loans	11	-	51
Cash inflow/(outflow) from change in liquid resources	271	(1,934)	(8,186)
Change in net funds/(debt) resulting from cash flows	379	(1,692)	(10,256)
Conversion of convertible loan stock	1,065	26	-
Reclassification of convertible loan stock as equity	1,509	-	-
Exchange difference	10	5	80
Allocation of convertible loan stock issue costs	(13)	(18)	(16)
Movement in net funds/(debt)	2,950	(1,679)	(10,192)
Net funds at 1 January	(1,868)	(189)	10,003
Net funds/(debt)/ at 31 December	1,082	(1,868)	(189)

(b) Analysis of changes in net funds

	Cash at Bank	*Short Term Deposits/ Liquid Resources*	*Overdrafts and Lines of Credit*	*Convertible Loan Stock*	*Term Loans*	*Total*
	£'000	*£'000*	*£'000*	*£'000*	*£'000*	*£'000*
At 1 January 2003	758	2,597	(947)	(2,569)	(28)	(189)
Cashflow	(543)	(1,934)	785	-	-	(1,692)
Conversion of loan stock	-	-	-	26	-	26
Exchange difference	-	-	5	-	-	5
Allocation of issue costs	-	-	-	(18)	-	(18)
At 31 December 2003	215	663	(157)	(2,561)	(28)	(1,868)
Cashflow	62	271	35	-	11	379
Conversion of loan stock	-	-	-	1,065	-	1,065
Reclassification of loan stock as shareholders' funds	-	-	-	1,509	-	1,509
Exchange difference	-	-	10	-	-	10
Allocation of issue costs	-	-	-	(13)	-	(13)
At 31 December 2004	277	934	(112)	-	(17)	1,082

14. CREDITORS: amounts falling due within one year

Group

	2004	*2003*
	£'000	*£'000*
Overdrafts and bank lines of credit	112	157
Current instalments due on bank loan	17	28
Trade creditors	234	404
Other taxes and social security costs	176	94
Accruals and deferred income	1,325	1,147
Other creditors	114	166
	1,978	1,996

The bank line of credit is secured against the trade debtors of Sopheon Corporation Minnesota and bears interest at a rate of 2% above US prime rate.

The bank loan comprises a sterling loan made under the Small Companies Loan Guarantee Scheme, bearing interest at 3% over bank base rate, in respect of which the lender holds a guarantee for 85% of the loan facility from the Department of Trade and Industry.

Company

	2004	*2003*
	£'000	*£'000*
Bank overdraft	2	2
Trade creditors	46	101
Other creditors	77	78
Accruals	280	260
	405	441

15. CREDITORS: amounts falling due after more than one year

Group and company

	2004 *£'000*	*2003* *£'000*
Convertible Unsecured Loan Stock 2005	Nil	2,561

£2.6 million nominal of 6% Convertible Unsecured Loan Stock 2005 ("the Stock"), with 557,143 detachable warrants to subscribe for Sopheon shares, was issued at par on 20 June 2001. The detachable warrants expired unexercised on 19 June 2003. During 2004 the holders of £1,065,000 nominal of the Stock exercised rights of conversion into Sopheon ordinary shares. The nominal amount outstanding at 31 December 2003 is shown net of issue costs of £13,000 allocated to future periods.

On 14 July 2004 the holders of the Stock approved a resolution to reconstitute the Stock such that, subject to the Sopheon group continuing to meet key solvency tests, the Stock is no longer repayable at par at maturity on 19 June 2005, but will automatically convert on 31 December 2005 into Sopheon ordinary shares at the conversion rate of 12p nominal of the Stock per Sopheon share. The resolution also provided that the Stock is no longer interest bearing. On reconstitution, the Stock was renamed "Interest Free Mandatory Convertible Loan Stock". The solvency tests include the Company being unable, for the purposes of Section 123 of the Insolvency Act 1986, to pay its debts as they fall due; the appointment of an administrator, receiver, liquidator, trustee or similar officer; or the Company ceasing to carry on business as a going concern. As consideration for the forgoing of interest and repayment rights, stockholders received a compensation payment of 7% of the nominal value of the Stock on 2 August 2004. Following the modifications to the Stock, the instrument has been reclassified as part of equity shareholders' funds in Sopheon's balance sheet. Accordingly, an amount of £1,509,000, representing the nominal amount of the Stock outstanding at 31 December 2004, has been reclassified as equity shareholders' funds as shown in Note 18.

In the event that prior to the date of conversion of the stock the company makes an offer of shares by way of rights issue, placing, open offer or similar issue at a price less than its conversion rate of 12p per share, the conversion rate shall be adjusted to the offer price or to the par value of 5p per share, whichever is the greater.

16. OBLIGATIONS UNDER LEASES

The company and group had no amounts due under finance leases and hire purchase contracts.

At 31 December 2003 and 2004 the group had annual commitments under operating leases as set out below.

Group only

	Land & Buildings 2004 £'000	*Other 2004 £'000*	*Land & Buildings 2003 £'000*	*Other 2003 £'000*
Operating leases which expire:				
within one year	210	17	102	45
in two to five years	120	81	261	36
Totals	330	98	363	81

17. SHARE CAPITAL

Authorised	*2004 Number*	*2004 £*	*2003 Number*	*2003 £*
Ordinary shares of 5p each	175,000,000	8,750,000	125,000,000	6,250,000

Allotted, called up and fully paid	*2004 Number*	*2004 £*	*2003 Number*	*2003 £*
Ordinary shares of 5p each	115,871,082	5,793,554	96,410,019	4,820,501

On 5 March 2003 15,344 ordinary shares were issued for cash at 6.193p per share pursuant to the exercise of a share option.

On 17 March 2003 7,672 ordinary shares were issued for cash at 6.193p per share pursuant to the exercise of a share option.

On 16 June 2003 4,500,000 ordinary shares were issued for cash at 12p per share by way of a share placing to raise £520,000 net of expenses.

On 4 July 2003 388,350 ordinary shares were issued to FIND/SVP Inc pursuant to the agreement for the sale of Sopheon's North American IM business, representing an amount of $100,000 (£59,880) satisfied by the issue of Sopheon shares.

On 11 August 2003 15,344 ordinary shares were issued for cash at 6.193p per share pursuant to the exercise of a share option.

On 3 September 2003 116,666 ordinary shares were issued on conversion of £14,000 nominal of Convertible Loan Stock 2005.

On 22 October 2003 8,333,334 ordinary shares were issued for cash at 12p per share by way of a share placing to raise £960,000 net of expenses.

On 20 November 2003 100,000 ordinary shares were issued on conversion of £12,000 nominal of Convertible Loan Stock 2005.

On 23rd December 2003 the Company announced that it had entered into a definitive agreement with GEM Global Yield Fund Limited ("GEM Global") for a Euro 10 million equity line of credit facility. The agreement takes the form of a subscription and share lending agreement ("the Agreement") such that the Company may, at its option within the terms of the Agreement, require GEM Global to subscribe for Sopheon shares at a 10% discount to the average market bid price for the 15 days preceding the issue, up to an aggregate of Euro 10 million over the two year life of the Agreement. GEM Global's obligation to subscribe for shares is subject to certain restrictions including the prevailing trading volumes of Sopheon shares on the Euronext stock exchange. In all other respects the Company will remain in control of the amount and timing of any subscription under the equity line and is under no obligation to use the facility at any point during the term.

On 23 January 2004 70,000 ordinary shares were issued on conversion of £8,400 nominal of Convertible Loan Stock 2005.

On 26 January 2004 3,600,000 ordinary shares were issued for cash at 23p per share by way of a share placing to raise £810,000 (net of expenses).

On 18 February 2004 17,440 ordinary shares were issued for cash at 8.6p per share pursuant to the exercise of share options and 130,000 ordinary shares were issued on conversion of £15,600 nominal of Convertible Loan Stock 2005.

On 3 March 2004 2,000,000 ordinary shares were issued for cash at 31p per share under the equity line of credit arrangement with GEM Global Yield Fund Limited to raise £578,000 (net of expenses).

On 10 March 2004 4,360 ordinary shares were issued for cash at 8.6p per share pursuant to the exercise of a share option.

On 30 April 2004 125,820 ordinary shares were issued for cash at 14.75p per share and 66,500 at 16.25p per share pursuant to the exercise of share options and 136,006 ordinary shares were issued on conversion of £16,321 nominal of 6% Convertible Loan Stock 2005.

On 25 June 2004 4,651,163 ordinary shares were issued for cash to Norman Nominees at 21.5p per share by way of a share placing to raise £1,000,000 in working capital. On the same day at the Annual General Meeting of the company shareholders approved a resolution to increase the authorised share of capital of the company to £8,750,000 by the creation of 50,000,000 new ordinary shares of 5p each.

On 22 July 2004 4,166,667 ordinary shares were issued on conversion of £500,000 nominal of Convertible Loan Stock 2005.

On 3 September 2004 208,333 ordinary shares were issued on conversion of £25,000 nominal of Convertible Loan Stock 2005.and 45,941 ordinary shares were issued for cash at 14.75p per share and 33,000 at 16.25p per share pursuant to the exercise of share options.

On 8 October 2004 17,500 ordinary shares were issued for cash at 14.75p per share and 21,666 at 16.25p per share pursuant to the exercise of share options.

On 11 November 2004 4,166,667 ordinary shares were issued on conversion of £500,000 nominal of Convertible Loan Stock 2005.

Contingent rights to subscribe for Sopheon shares

On 19 June 2001 Sopheon issued £2.6 million of Convertible Unsecured Loan Stock with 557,143 detachable warrants to subscribe for Sopheon shares. Details of the terms of the Stock, which have been modified, are given in Note 15. At 31 December 2004 £1,509,000 nominal value of the stock remained outstanding, which on full conversion would result in the issue of 12,572,326 Sopheon ordinary shares.

Employee share option schemes

On 28 August 1996 the directors adopted, and the company in general meeting approved, the Sopheon Executive Share Option Scheme in a form approved by the Inland Revenue. Subsequently an unapproved executive share option scheme was established with terms similar to the approved scheme.

On the same date the directors adopted, and the company in general meeting approved, a share option scheme to provide for the grant to certain directors and employees of PolyDoc NV (renamed Sopheon NV) of options over Sopheon ordinary shares in exchange for the surrender by such directors and employees of their existing options over shares in PolyDoc NV, and to provide for further grants of share options to employees of the Sopheon group subject to Dutch tax.

On 29 September 2000, following the acquisition of Teltech Resource Network Corporation, the directors adopted the Sopheon plc (USA) Stock Option Plan, under which share options can be granted either as qualifying Incentive Stock Options (ISOs) or as Non-Qualifying Options (NQOs).

Pursuant to the acquisition of Orbital Software Holdings plc in November 2001, share options granted under the Orbital Software Group Limited Share Option Scheme were released in exchange for the grant of new options over Sopheon ordinary shares. These options remain subject to the rules of the Orbital Software Group Limited Share Option Scheme.

At the Annual General Meeting held on 25 June 2004 shareholders approved a maximum of 10,000,000 Sopheon ordinary shares over which options could be granted under any employee share option scheme.

A summary of options granted under the share option schemes at 31 December 2004 is set out below.

Year of grant	Number	Exercise Price (£)	Exercise Period From	To
1996	40,000	0.2000	28-08-96	21-07-06
1999	10,000	1.4150	20-01-02	20-01-09
1999 (1)	42,500	1.5000	28-04-00	28-04-09
1999 (1)	52,500	1.5000	03-11-00	03-11-09
1999	10,000	1.5000	03-11-02	03-11-09
1999	100,000	1.5000	22-11-02	22-11-09
2000 (1)	7,000	5.7900	24-01-01	24-01-10
2000	3,000	6.0725	25-01-01	25-01-10
2000 (1)	10,000	9.6000	08-02-01	08-02-10
2000 (1)	8,500	4.9500	28-06-01	28-06-10
2000 (1)	25,000	5.0000	26-06-01	26-06-10
2000	14,000	4.9500	28-06-03	28-06-10
2000 (1)	30,196	4.2750	02-10-01	02-10-10
2000 (1)	5,000	3.7250	15-11-01	15-11-10
2000	5,000	1.6000	31-12-03	31-12-10
2000 (1)	8,996	1.6000	31-12-01	31-12-10
2001	72,500	0.7750	02-05-04	02-05-11
2001 (1)	92,604	0.7750	02-05-02	02-05-11
2001 (4)	11,508	0.0619	14-09-01	14-09-08
2002	320,000	0.1475	30-04-05	30-04-12
2002	239,750	0.1475	30-04-02	30-04-07
2002 (2)	1,032,110	0.1475	30-04-02	30-04-12
2003 (2)	20,000	0.1475	07-07-03	07-07-13
2003 (3)	585,000	0.1625	05-11-03	05-11-08
2003 (2) (3)	3,630,000	0.1625	05-11-03	05-11-13
2003 (3)	440,000	0.1625	05-11-06	05-11-13
2004 (2) (3)	180,000	0.2150	16-09-04	16-09-14
2004	100,000	0.2150	16-09-07	16-09-14
	7,095,164			

(1) One fourth of these options become exercisable each year starting on the date indicated. All other options become exercisable in full from the date indicated.

(2) One third of these options are exercisable from the date of grant, one third from the first anniversary of the date of grant and one third from the second anniversary of the date of grant

(3) Includes options which are contingent upon performance conditions related to the achievement of positive EBITDA in two successive quarters, or to the achievement of individual targets.

(4) Arising from options held by employees of Orbital Software Holdings plc and rolled over into Sopheon options.

Other share options

Fully vested options to subscribe for 718,292 Sopheon ordinary shares at prices between £1.84 and £5.15 were granted on 15 September 2000 as part of the consideration payable in respect of the acquisition of Teltech Resource Network Corporation. These options, with exercise dates between 7 June 2001 and 31 July 2010, are held by the vendors of Teltech. At 31 December 2004, 349,654 of such options had lapsed, 1,500 had been exercised, and 367,138 remained outstanding, in respect of which the aggregate exercise price was £0.8 million.

18. SHAREHOLDERS' FUNDS

Group

	Shares Share Capital £'000	*Share to be Issued £'000*	*Premium Account £'000*	*Merger Reserve £'000*	*Profit & Other Reserves £'000*	*Loss Account £'000*	*Total £'000*
At 1 January 2002	4,116	465	45,372	18,384	5,455	(55,427)	18,365
Arising on share issues	31	-	8	-	-	-	39
Lapsing of share options	-	-	-	-	(1,010)	1,010	-
Retained loss for the year	-	-	-	-	-	(16,053)	(16,053)
Exchange differences	-	-	-	-	-	75	75
At 31 December 2002	4,147	465	45,380	18,384	4,445	(70,395)	2,426
Arising on share issues	661	-	878	-	-	-	1,539
Exercise of share options and conversion of loan stock	13	-	162	-	(147)	-	28
Lapsing of share options	-	-	-	-	(134)	134	-
Disposal of subsidiary	-	(465)	-	(440)	-	440	(465)
Retained loss for the year	-	-	-	-	-	(5,501)	(5,501)
Exchange differences	-	-	-	-	-	88	88
At 31 December 2003	4,821	-	46,420	17,944	4,164	(75,234)	(1,885)
Arising on share issues	512	-	1,875	-	-	-	2,387
Exercise of share options and conversion of loan stock	461	-	654	-	-	-	1,115
Lapsing of share options	-	-	-	-	(7)	7	-
Reclassification of convertible loan stock as equity	-	1,509	-	-	-	-	1,509
Retained loss for the year	-	-	-	-	-	(1,821)	(1,821)
Exchange differences	-	-	-	-	-	(61)	(61)
At 31 December 2004	5,794	1,509	48,949	17,944	4,157	(77,109)	1,244

Company

	Share Capital £'000	*Shares to be Issued £'000*	*Share Premium Account £'000*	*Merger Reserve £'000*	*Other Reserve £'000*	*Profit & Loss Account £'000*	*Total £'000*
At 1 January 2003	4,147	465	45,380	10,619	4,445	(60,242)	4,814
Arising on share issues	661	-	878	-	-	-	1,539
Exercise of share options and conversion of loan stock	13	-	162	-	(147)	-	28
Lapsing of share options	-	-	-	-	(134)	134	-
Disposal of subsidiary	-	(465)	--	(440)	-	440	(465)
Retained loss for the year	-	-	-	-	-	(2,013)	(2,013)
At 31 December 2003	4,821	-	46,420	10,179	4,164	(61,681)	3,903
Arising on share issues	512	-	1,875	-	-	-	2,387
Exercise of share options and conversion of loan stock	461	-	654	-	-	-	1,115
Lapsing of share options	-	-	-	-	(7)	7	-
Reclassification of convertible loan stock as equity	-	1,509	-	-	-	-	1,509
Retained loss for the year	-	-	-	-	-	(2,193)	(2,193)
At 31 December 2004	5,794	1,509	48,949	10,179	4,157	(63,867)	6,721

Other reserves comprise (for both Group and Company):

	2004 £'000	2003 £'000
Capital redemption reserve	2,884	2,884
Reserve arising from issues of share options in connection with acquisitions	1,273	1,280
	4,157	4,164

The reserve arising from issue of share options in connection with acquisitions has reduced during 2004 by £7,000 as a result of the lapsing of share options.

19. FINANCIAL INSTRUMENTS

The group's approach to managing financial risk is described in the Directors' Report. Disclosures made in this note, other than currency disclosures, exclude short-term debtors and creditors.

Interest rate risk profile of financial liabilities

The financial liabilities of the group at each year-end are set out below.

	2004 £'000	2003 £'000
Floating rate line of credit – US Dollar	108	155
Floating rate overdraft – Sterling	4	2
Floating rate loans – Sterling	17	28
Fixed rate 6% convertible unsecured loan stock 2005	-	2,561
	129	2,746

Other than the Convertible Loan Stock 2005, these financial liabilities bear interest rates that are based on local bank rates.

Interest rate risk profile of financial assets

The financial assets of the group at each year-end comprise cash or cash deposits on money market deposit at call and monthly rates. The amounts were as follows:

	2004 £'000	2003 £'000
Floating rate		
Sterling	638	663
Euro	342	-
	980	663
Non-interest bearing		
Sterling	1	38
US Dollar	186	150
Euro	44	27
	231	215
Total financial assets	1,211	878

Currency exposures

The table below shows the group's transactional currency exposures that give rise to the net currency gains and losses recognised in the profit and loss account. Such exposures comprise the monetary assets and monetary liabilities of the group that are not denominated in the operating currency of the operating unit involved, and have arisen only in operating units with a functional currency of Sterling.

	Net foreign currency monetary assets		
	US dollar	*Euro*	*Total*
	£'000	*£'000*	*£'000*
2003 Sterling	9	-	9
2004 Sterling	-	342	342

Maturity of financial liabilities
The maturity profile and interest rates of the group's financial liabilities at each relevant year-end is as set out in Notes 14 and 15.

Borrowing facilities
The group had no undrawn committed borrowing facilities available at each relevant year-end, apart from the bank line of credit referred to in Note 14.

Fair values of financial assets and liabilities
The fair values of financial assets and liabilities are set out below. The directors consider that there were no material differences between the book values and fair values of all the group's financial assets and liabilities at each year end.

	Book value and fair value	
	2004	*2003*
	£'000	*£'000*
Cash and short term deposits	1,211	878
Bank overdrafts and lines of credit	(112)	(157)
Current instalments on bank loans	(17)	(28)
Convertible Unsecured Loan Stock 2005	-	(2,561)

20. CONTINGENT LIABILITIES

In accordance with Article 403, Paragraph 1, Subsection b, Book 2 of the Dutch Civil Code (B.W.), Sopheon plc guarantees the liabilities of Sopheon NV and agrees with the departure from the regulations in Title 9 Book 2 of the Dutch Civil Code (B.W.), that prescribes the submission of the financial statements of Sopheon NV to the Trade Register in the Netherlands.

Directors and Senior Management

Barry Mence, Executive Chairman. Barry Mence has served as executive chairman, and as a director and substantial shareholder of Sopheon, since its inception in 1993 when he was one of the founding members. From 1976 to 1990, Mr. Mence was the major shareholder and group managing director of the Rendeck Group of Companies, a software and services group based in the Netherlands.

Andrew Michuda, Executive Director. Andrew Michuda was appointed chief executive officer of Sopheon in September 2000. From 1997 to 2000 he served as chief executive officer and an executive director of Teltech Resource Network Corporation, which was acquired by Sopheon. He earlier held senior leadership positions at Control Data, including general manager of the business that evolved into Decision Data, the world's largest independent computer services provider.

Arif Karimjee, ACA, Executive Director. Arif Karimjee has served as chief financial officer of Sopheon since February 2000. Mr. Karimjee was previously an auditor and consultant with Ernst & Young in London, Brussels and Reading, from August 1988 until joining Sopheon.

Stuart Silcock, FCA, Non-executive Director. Stuart Silcock has served as a director of Sopheon from its inception in 1993. Since 1982, Mr. Silcock has been a principal partner of Lawfords & Co. and a director of Lawfords Ltd., chartered accountants. Mr. Silcock has been a non-executive director of Brown & Jackson plc since June 2001, and also holds a number of other UK directorships.

Bernard Al, Non-executive Director. Bernard Al was appointed as director of Sopheon in January 2001. He is a former chief executive officer of Wolters Kluwer in the Netherlands and has a background in science and linguistics.

Andrew Davis, Non-executive Director. Andrew Davis was a founder of Spider Systems Limited in 1983 and held the post of chief technology officer for 12 years. He left Spider Systems Limited in 1995 when it was sold to Shiva Corporation. Since then he has been an investor and director in a number of companies, including Orbital Software Holdings plc.

Daniel Metzger, Non-executive Director. Daniel Metzger was until 1998 an executive vice president of Lawson Software, a leading ERP provider, where he was responsible for corporate strategy and marketing. Since then he has held similar roles at Parametric Technologies, where he led the business strategy and marketing around collaborative product development technologies and at nQuire Software, which was subsequently sold to Siebel.

Ronald Helgeson, Vice President of Corporate Communications. Ronald Helgeson has served as vice president of corporate communications for Sopheon since 2000. He previously held senior marketing-management roles with Teltech Resource Network Corporation and 3M Company.

Paul Heller, Chief Technology Officer. Paul Heller was appointed chief technology officer in June 1999. He was previously vice president of product management for Baan Company.

Huub Rutten, Vice President of Product Research and Design. Huub Rutten is responsible for Sopheon's healthcare business in the Netherlands and also has responsibility for product research. A founder of Sopheon, he was a director until September 2000 when he assumed a more operational role.

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