

# Remuneration report

## Introduction

This is the Company's remuneration report in respect of the year to 30 April 2006 and, subject to ongoing review by the remuneration committee (the "committee") as to its appropriateness, sets out the ongoing policy in respect of the following and subsequent years.

The Company seeks to comply with the relevant conditions of the 2003 Combined Code on Corporate Governance relating to directors' remuneration as published by the London Stock Exchange and the directors' remuneration report regulations 2002.

The regulations require the auditors to report to the Company's members on the "auditable part" of the directors' remuneration report and to state whether in their opinion that part of the report has been properly prepared in accordance with the Companies Act 1985 (as amended by the regulations). The report has therefore been divided into separate sections for audited and unaudited information.

In accordance with the Companies Act 1985, a resolution to approve the remuneration report will be proposed at the Company's Annual General Meeting on 27 September 2006. Details of the resolution may be found in the notice of meeting accompanying this annual report. The vote will be advisory and will be considered carefully by the members of the committee in the formulation and approval of the Company's future remuneration policies.

## Unaudited information

### The remuneration committee

The committee has met five times during the financial year since admission. The committee is responsible for reviewing remuneration arrangements for members of the board and for providing general guidance on aspects of remuneration policy throughout the Group. The committee will meet at least twice during the coming financial year.

The terms of reference of the committee include, among other things, the following responsibilities:

- to determine and agree with the board the framework or broad policy for the remuneration of the Company's Chief Executive Officer, Chairman, the executive directors, the Company Secretary and other members of the executive management (as appointed from time to time);
- to determine the total individual remuneration package of each executive director and other senior executives including bonuses, incentive payments and share options or other share awards;
- to determine the policy for, and scope of, pension arrangements for each executive director and other senior executives;
- to approve the design of salaries for senior managers, and determine targets for any performance-related pay schemes operated by the Company, and approve the total annual payments;
- to review the design of all share incentive plans for approval by the board and shareholders;
- to oversee any major changes in employee benefits structures throughout the Company or Group; and
- to review the ongoing appropriateness and relevance of the remuneration policy;

Kevin Loosemore is the Chairman of the committee, with David Maloney and John Browett its other members. The Company is aware that the Chairman is not regarded as independent for the purposes of the Combined Code. It is planned that Kevin Loosemore, the Chairman, will relinquish the chairmanship of the committee in due course when other independent non-executive directors are appointed to it. Where appropriate the committee invites the views of the Chief Executive Officer, the Chief Financial Officer and the Director of Human Resources, as well as that of external remuneration consultants.

The committee has been materially assisted by New Bridge Street Consultants in providing remuneration advice, by Steen and Co in providing legal advice with respect to directors' service agreements, by the Company Secretary and by Linklaters, solicitors. New Bridge Street Consultants were appointed by the committee and provided no other services to the Group. During the year the Chief Executive Officer attended some of the meetings by invitation of the committee on specific items, however he did not participate in discussions relating to his own remuneration.

### **Remuneration policy**

The Company's policy on the remuneration of executive directors and their direct reports is established by the committee and approved by the board. The individual remuneration packages of each executive director is determined by the committee. No executive director or employee participates in discussions relating to the setting of their own remuneration.

The overall budget for the remuneration of employees will continue to be approved by the board as part of the annual budget-setting exercise.

The objective of the Group's remuneration policies is that all employees, including executive directors, should receive appropriate remuneration for their performance, responsibility, skills and experience. Remuneration packages are designed to enable the Group to attract and retain key employees by ensuring they are remunerated appropriately and competitively and that they are motivated to achieve the highest level of Group performance in line with the best interests of shareholders.

It is intended that an appropriate and significant proportion of remuneration will continue to be performance related (see details below). Performance conditions for performance-related bonuses and long-term incentives will represent challenging growth targets which are designed to increase shareholder value. The committee will review the performance conditions used to ensure that they remain demanding and appropriate. As an exception the committee determined that it was appropriate when making awards to Stephen Kelly, Nick Bray and the Chief Operating Officer on joining the Company that they be entitled to a conditional amount of matching shares in the event of purchasing shares in the Company during the first year of employment, of up to 100% of salary for Stephen Kelly and the Chief Operating Officer and 50% of salary for Nick Bray, subject to them remaining with the Company for a period of three years.

It is the board's intention to award share incentives to executive directors and selected employees as appropriate to reward and encourage performance. These share incentives will be granted at the discretion of the committee. Share options granted under pre-IPO share option plans will be fully vested by September 2007. Non-executive directors do not participate in the Group's share incentives or otherwise receive performance related pay.

Policies on remuneration take account of the pay structure, employment conditions and relativities within the Group and also the industry sector. To determine the elements and level of remuneration appropriate to each executive director, the committee considered benchmark remuneration data for selected comparable technology companies and seeks to ensure that fixed costs are no higher than market median, that an appropriately significant proportion of potential pay is performance related and that total pay is consistent with appropriately competitive levels of pay for superior performance.

### **Directors' service contracts**

#### **Executive directors**

The Group's policy in entering into service contracts with executive directors is to enable the recruitment of high-quality executives and to obtain protection from their sudden departure whether or not to competitor companies. In addition, service contracts are an important element in maintaining maximum protection for the Group's intellectual property rights and other commercially sensitive information.

The executive directors are employed subject to service contracts. The service contract dated 1 May 2006 with Stephen Kelly provides for a base annual salary of £300,000 and requires the Company to give 12 months' notice of termination. Stephen Kelly is required to give six months' notice of the termination of his employment should he wish to leave. The service contract dated 30 November 2005 with Nick Bray provides for a base annual salary of £170,000 (subsequently increased to £180,000 with effect from 1 May 2006) and requires the Company to give 12 months' notice of termination. Nick Bray is required to give six months' notice of the termination of his employment should he wish to leave.

With respect to executive directors who have resigned during the year, the service contract dated 3 August 2005 with Dr Anthony Hill provided for a base annual salary of £220,000 and required the Company to give six months' notice of termination. Dr Anthony Hill was required to give six months' notice of termination of his employment. The service contract dated 3 August 2005 with Richard Lloyd provided for a base annual salary of £125,000 and required the Company to give six months' notice of termination. Richard Lloyd was required to give six months' notice of termination of his employment.

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If an executive director is guilty of a material breach of his service contract or commits any crime or act of gross misconduct or dishonesty, the Company is entitled summarily to terminate the service contract without notice and without payment in lieu of notice or other compensation. Such a contract term cannot, however, as a rule of law, affect the executive director's statutory rights such as rights in respect of unfair dismissal.

Should an executive director be dismissed other than as described above, the Company may pay him, in lieu of notice, a sum equal to his basic pay over his notice period.

At the discretion of the committee having regard to the Company's performance at the time of dismissal, the committee may in addition pay all or a proportion of the bonus which would, but for the dismissal, have become payable during the notice period. The Company's policy on the duration of such contracts with executive directors is explained above.

Stephen Kelly acts in the capacity of a non-executive director elsewhere, for which he receives remuneration of £40,000 per annum. Nick Bray does not serve as a non-executive director for any company. Neither Stephen Kelly nor Nick Bray may accept non-executive appointments without the consent of the board.

## **Non-executive directors**

Non-executive directors are appointed by letter of appointment for a fixed term of three years subject to earlier termination by either the director or the Company on 90 days notice. They receive fees for services as members of the board and its committees. The level of fees is determined by the board after taking into account appropriate advice.

Kevin Loosemore and David Maloney signed appointment letters with the Company which became effective on 4 April 2005. Prescott Ashe and David Dominik are non-independent directors of the Company and signed appointment letters with the Company on 29 April 2005 which became effective immediately. John Browett signed an appointment letter with effect from 1 July 2005.

All appointments are subject to the directors being re-elected under the rotation provisions in the Company's Articles of Association, and subject to Companies Act provisions. As the non-executive directors were all elected to the board at the last Annual General Meeting of the Company, the directors have agreed to offer themselves for re-election on a rotation basis and accordingly Kevin Loosemore will be retiring voluntarily and submitting himself for re-election by the shareholders at the Annual General Meeting of the Company on 27 September 2006. Each non-executive director still serving at the end of his term will have his appointment reviewed by the board and a further term of office may be agreed. Where a non-executive director does not serve until the end of his term, the policy is to pay the fees due pro rata to the date of cessation.

## **Remuneration package**

Executive directors' remuneration currently comprises annual salary, a performance-related bonus, a long-term incentive in the form of share incentives, pension contributions and other benefits.

## **Annual salary**

The board approves the overall budget for employee salary increases and the committee agrees the specific increases for executive directors and certain other senior members of the management team. In determining appropriate salary levels for each executive director and senior employee, the committee considers both the nature and the status of the Company's operations and the responsibilities, skills, experience and performance of the executive director or employee. The committee compares the Group's remuneration packages for its directors and employees with those for directors and employees of similar seniority in companies whose activities are comparable with the Group and with which it competes for staff. The committee has used New Bridge Street Consultants in making these comparisons.

## **Performance-related bonus**

The executive directors and all other employees, except for sales staff, participate in a performance-related bonus scheme. The level of commission for sales staff is based on a percentage of revenue generated, with the percentages increasing as revenue exceeds target levels. The level of bonus for non-sales staff is based on overall Group performance in meeting its primary financial objectives in worldwide earnings before interest, tax, depreciation and amortisation ("EBITDA") and revenue goals. The percentages increase as revenue and profit exceed target.

The remuneration committee will continue to place a significant proportion of executive pay "at risk", so that it is closely linked to the interests of shareholders. The committee will ensure that challenging and clearly-assessable targets are set for executive directors.

Details of bonuses paid to executive directors in the year to 30 April 2006 are detailed in the remuneration tables below. Bonuses are awarded wholly in cash.

In respect of the year 2006-07 there will be a cap on bonuses payable to executive directors of 150% of base salary.

### Long-term incentives

The board believes that long-term incentive schemes are important in retaining and recruiting high-calibre individuals and ensuring that the performance of executives is focused on creating long-term shareholder value whilst allowing the Group's cash reserves to be conserved. Further awards of options or free shares will be considered by the committee on an ongoing basis.

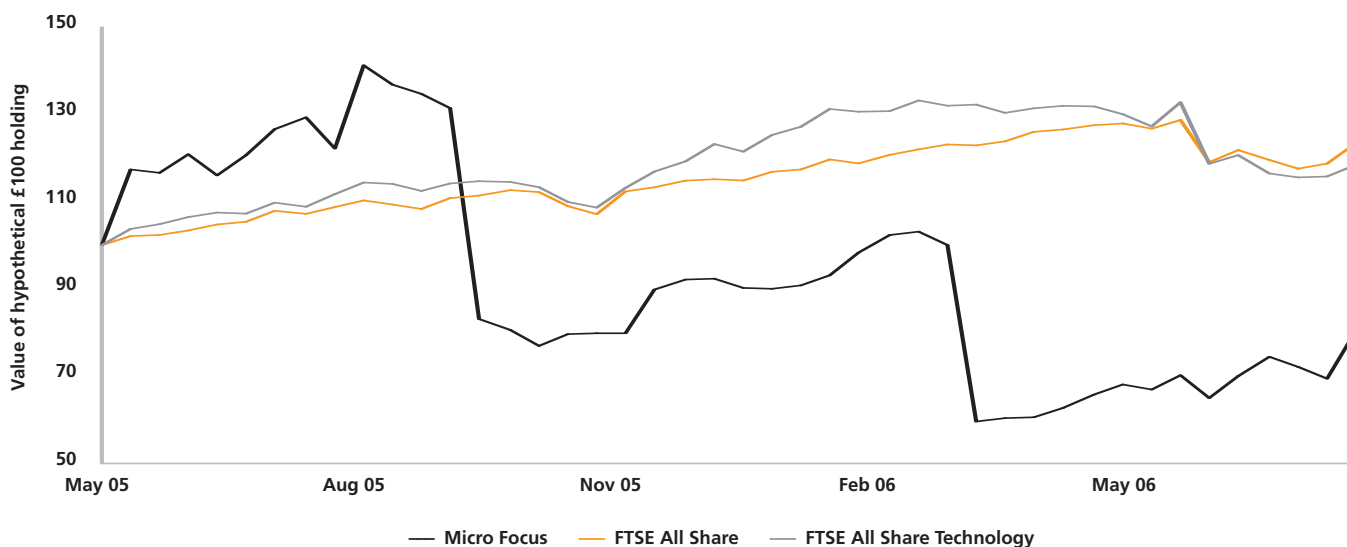
The Company adopted the Micro Focus International Plc Incentive Plan 2005 (the "Plan") prior to admission. This is intended to provide a flexible framework to allow the Company to make awards of free shares in the form of nil-cost options, conditional awards or forfeitable shares, or to grant market value options ("awards").

Except for conditional awards over 200,000 shares granted to staff on 29 June 2005 in respect of additional duties undertaken during the IPO and for which no performance conditions were set, the awards granted in the year ending 30 April 2006 are subject to an earnings per share ("EPS") performance condition designed to drive growth over three financial years. Such awards comprised both market value options and nil cost options (at par value). The targets for awards to be made during the year ended 30 April 2007 have been set by the remuneration committee and comprise challenging and stretching targets for earnings per share and revenue growth. Such awards are in the form of market value options and will only vest at the end of the three year performance period if the annual compound EPS growth has achieved at least 15%; such awards will then only vest as to a percentage of the shares subject to a minimum of 6% annual compound revenue growth over the performance period and a maximum of 15% annual compound revenue growth over such period.

The maximum aggregate value of awards that can be granted to any individual in any financial year will not exceed two-times his or her basic salary. For these purposes, the value of the awards is equal to the market value of free shares at the time of award or, in the case of market value options, 50% of the market value of the shares under option at the time of award. This limit may be exceeded only where the committee determines that there are exceptional circumstances. The committee determined that it was appropriate to exceed these limits when making awards to Stephen Kelly and the new Chief Operating Officer (COO) on joining the Company. Stephen Kelly was awarded options equivalent to four times annual basic salary and the COO was awarded options equivalent to three times annual basic salary. In addition both Stephen Kelly and the new COO are entitled to a conditional amount of matching shares in the event of purchasing shares in the Company during the first year of employment, of up to 100% of salary.

The board is proposing to introduce a Sharesave scheme and an Employee Share Purchase Plan (ESPP) open respectively to all UK-based and US-based employees, including executive directors, during the year ended 30 April 2007.

### Performance chart



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The preceding chart shows the performance of the Company relative to the FTSE All Share index and the FTSE All Share Technology index which are the most relevant indices for the Company.

## Pension contributions

All employees including executive directors are invited to participate in a Group Personal Pension Plan. All major schemes are money purchase in nature and have no defined benefits. A defined benefit scheme is operated in Japan, but given the number of members is insignificant for group purposes. The Group has no obligation to the pension scheme beyond the payment of contributions. The Company was not, therefore, impacted by the new pensions regime which came into force on 6 April 2006.

Pension benefits include death in service.

## Other benefits

Benefits in kind for executive directors can include the provision of a company car allowance or service, fuel, life insurance and medical benefits.

## Audited information

Detailed emoluments of the directors of the Group (audited).

The aggregate remuneration paid to directors during the year ending 30 April 2006 was as follows:

	Base salary 2006 £'000	Bonus 2006 £'000	Compensation for loss of office 2006 £'000	Benefits in kind 2006 £'000	Pensions 2006 £'000	Total 2006 £'000	Total 2005 £'000
<b>Executive directors</b>							
Anthony Hill (resigned 23 February 2006)	220	5	–	15	11	251	425
Richard Lloyd (resigned 3 January 2006)	125	38	18†	11	7	199	159
Nick Bray	56	98*	–	4	3	161	–
<b>Total</b>	<b>401</b>	<b>141</b>	<b>18</b>	<b>30</b>	<b>21</b>	<b>611</b>	<b>584</b>
<b>Non-executive directors</b>							
Kevin Loosemore	179**	–	–	–	–	179	10
David Maloney	60	–	–	–	–	60	5
John Browett	25	–	–	–	–	25	–
<b>Total</b>	<b>264</b>	<b>–</b>	<b>–</b>	<b>–</b>	<b>–</b>	<b>264</b>	<b>15</b>

\* Includes £58,000 that was paid in consideration of Mr Bray forfeiting benefits from his former employer and negotiated as part of the terms of his recruitment (there are no guarantees regarding bonus entitlement in respect of future years) and performance related bonus of £40,000.

\*\* Includes £54,000 additional remuneration paid in respect of the period when acting as interim Chief Executive Officer.

† Ex gratia payment on termination of employment.

Neither of the non-independent non-executive directors of the Company (David Dominik and Prescott Ashe) received any emoluments during the year ended 30 April 2006 (2005: nil). David Dominik and Prescott Ashe are directors of Golden Gate Capital. Details of transactions with related parties are set out in note 28 of the financial statements of the Operating Company.

### Directors' interests in share capital

At the date of approval of the annual report the directors owned the following shares in the Company. These interests were all beneficially held.

Director	At 31 July 2006	At 30 April 2006
Kevin Loosemore	406,640	406,640
Stephen Kelly	–	–
Nick Bray	20,000	20,000
David Maloney	30,000	25,000
David Dominik	–	–
Prescott Ashe	–	–
John Browett	18,377	10,000
Dr Anthony Hill*	5,924,000	7,524,000
Richard Lloyd**	600,000	600,000

\* resigned 23 February 2006

\*\* resigned 3 January 2006

### Long-Term Incentive Plan

	Date of grant	Number			30 April 2006	Exercise price	Dates of exercise
		Number granted	Exercised	Waived			
Nick Bray	11 January 2006	412,955	–	–	412,955	123.5p	11 January 2009 to 10 January 2016
<b>Total</b>		412,955	–	–	412,955		

During the period up to 30 April 2006, Nick Bray was granted 412,955 market value options with a market price of 123.5 pence per share. No other director owned or was granted awards during this period. The performance condition was based on growth in EPS over a three-year performance period with a minimum average annual EPS growth of RPI + 3% and 100% vesting at an average annual EPS growth of RPI + 7%.

During the period between 1 May 2006 and the date of approval of the annual report, Nick Bray was granted 100,000 market value options with a market price of 104 pence per share and 20,000 conditional matching shares. The conditional award is subject to Nick Bray retaining his original purchase of 20,000 shares for a three-year period. Stephen Kelly joined the Company on 1 May 2006. During the period up to the date of approval of the annual report, Stephen Kelly was granted 1,153,846 market value options with a market price of 104 pence per share. No other director owned or was granted awards during this period. The market value options will only vest at the end of the three-year performance period if the annual compound EPS growth has achieved at least 15%; such awards will then only vest as to a percentage of the shares subject to a minimum of 6% annual compound revenue growth over the performance period and a maximum of 15% annual compound revenue growth over such period.

### Share option schemes

Details of share option schemes of the Company are given in note 24 of the financial statements.

The mid-market price of the shares at 30 April 2006 was 87 pence and during the period since admission the price varied between 72 pence and 184 pence.

On behalf of the board,



Kevin Loosemore *Chairman of the remuneration committee*  
31 July 2006