

Micro Focus International Plc
Chief Financial Officer's review

Turnover for the half year ended 31 October 2006 increased to \$79.0 million (2005: \$72.9 million).

Turnover for the half year by geographic region was as follows:

| | 31 October 2006 | | 30 April 2006 | | 31 October 2005 | |
|----------------------------|--------------------|--------------|------------------|--------------|--------------------|--------------|
| | \$'m | % | \$'m | % | \$'m | % |
| North America | 35.7 | 45.2 | 33.8 | 47.7 | 35.1 | 48.1 |
| Europe and the Middle East | 30.2 | 38.2 | 28.3 | 40.0 | 25.7 | 35.3 |
| Rest of the world | 13.1 | 16.6 | 8.7 | 12.3 | 12.1 | 16.6 |
| Total turnover | 79.0 | 100.0 | 70.8 | 100.0 | 72.9 | 100.0 |

Whilst revenue growth was achieved across all areas, as compared to the prior half year period to 31 October 2005, growth was primarily driven from our European operations, notably our smaller territories in Benelux, France and Italy along with our distributor channel. Our UK and North America operations produced results below the performance levels expected from geographic territories with such a high concentration of resource, existing customers and market potential. However, it should be noted that during the six-month period to 31 October 2005, the North American operation closed a licence fee deal for \$3.0 million.

Similarly, it is encouraging to see the improvement in our rest of the world operations, highlighted by a weak third quarter in the prior year to 30 April 2006.

Turnover for the half year by category was as follows:

| | 31 October 2006 | | 30 April 2006 | | 31 October 2005 | |
|-----------------------|--------------------|--------------|------------------|--------------|--------------------|--------------|
| | \$'m | % | \$'m | % | \$'m | % |
| Licence fees | 37.7 | 47.7 | 32.8 | 46.3 | 35.2 | 48.3 |
| Maintenance fees | 39.1 | 49.5 | 36.5 | 51.6 | 35.4 | 48.6 |
| Consultancy fees | 2.2 | 2.8 | 1.5 | 2.1 | 2.3 | 3.1 |
| Total turnover | 79.0 | 100.0 | 70.8 | 100.0 | 72.9 | 100.0 |

It can be seen that the increase in total revenues for the half year related to the improvement in both licence and maintenance revenues. Licence fees increased by \$2.5 million or 7.1% to \$37.7 million for the half year ended 31 October 2006 (2005: \$35.2 million). Encouragingly, the growth in licence fee revenues was achieved by an increased volume of lower value orders. A number of large contracts remain in our pipeline although by their very nature, they are unpredictable.

Maintenance revenues increased by \$3.7 million or 10.5% to \$39.1 million for the half year ended 31 October 2006 (2005: \$35.4 million).

Chief Financial Officer's review

Maintenance revenues are recognised evenly over the life of each contract, which is typically 12 months. As such, the profit and loss recognition of maintenance revenue lags the initial licence fee sale. Thus, it was encouraging to see the increase in maintenance revenues following the disappointing licence fee performance in the second half of the year to 30 April 2006. Whilst the solid first half year of licence fees is encouraging, the major factors driving growth in the six months to 31 October 2006 are as follows:

- An improvement in the renewal rate of existing customers.
- Modest annual price increases to existing customers.
- A focus on closing "contracts in negotiation" and the introduction of an automatic renewal process for our customers.

Consulting revenues showed a modest decline against the comparative first half year but represent only a minor proportion of total revenues.

Costs

It has been pleasing to see the reduction in costs following the restructuring of the business announced on 6 April 2006. A firm control of expenses has been established and will be maintained on an ongoing basis. The cost reduction programme was designed to improve overall returns while maintaining the fabric of the business.

Cost of sales for the half year ended 31 October 2006 reduced by 12.9% to \$8.1 million (2005: \$9.3 million). The costs in this category predominantly relate to our consulting and helpline support operations. Costs within the consulting organisation have been reduced and its performance has improved substantially.

Selling and distribution costs reduced to \$19.9 million for the half year ended 31 October 2006 (2005: \$24.4 million). Headcount levels are broadly consistent year on year and the reduction reflects lower travel and entertainment, marketing expense and commission payments.

Research and development expenses for the half year were broadly consistent at \$10.8 million (2005: \$11.2 million).

Underlying administrative expenses, excluding exceptional items of \$0.4 million (2005: \$6.0 million), increased to \$9.7 million (2005: \$8.3 million). This cost category contains \$0.8 million in relation to exchange losses in the period to 31 October 2006. In the prior period, costs were reduced by exchange gains of \$0.3 million. As such, underlying administrative expenses have increased by \$0.3 million or 3%.

Operating profit

Operating profit for the period was \$30.0 million (2005: \$13.7 million). Operating profit before exceptional items was \$30.4 million (2005: \$19.6 million), the improvement being driven by the combination of improved revenues and reduced costs.

EBITDA

EBITDA before exceptional items increased by 52.7% to \$31.3 million (2005: \$20.5 million) for the half year ended 31 October 2006.

Net interest income

The IPO proceeds in May 2005 allowed the Company to repay all its outstanding loan balances. Since this time, interest has been generated on the available net cash balance. Interest income of \$1.4 million was achieved in the half year to 31 October 2006 as compared to a net interest expense of \$0.8 million in the first half of the prior period. During the prior first half year, \$0.7 million of the expense related to penalties on the early repayment of debt which the Company deemed appropriate to avoid higher interest charges.

Taxation

Tax for the half year ended 31 October 2006 was \$7.4 million (2005: \$3.9 million) based on increased profits. The Group's effective tax rate is 23.5% (2005: 30%). As a result of the significant increase in the share price in the six-month period to 31 October 2006, a tax deduction has arisen on the stock options in issue. Excluding the effects of this beneficial tax deduction, the underlying effective tax rate was 26.8%.

Profit for the period

Profit after tax for the period ended 31 October 2006 increased by 167% to \$24.0 million (2005: \$9.0 million) driven by a significant improvement in operating performance combined with lower exceptional charges.

Cash flow

For the half year ended 31 October 2006, the Company generated a net cash inflow from operating activities of \$22.2 million (2005: \$10.3 million). At 31 October 2006, the Company's net cash balance was \$68.1 million (2005: \$38.6 million). Dividends of \$8.0 million were paid in the period.

Dividend

The board continues to adopt a progressive dividend policy reflecting the long-term earnings and cash flow potential of Micro Focus whilst targeting a level of dividend cover for the financial year ending 30 April 2007 of approximately 2.5 times on a pre-exceptional earnings basis. In line with the above policy, the directors recommend payment of an interim dividend in respect of the half year to 31 October 2007 of 3 cents per share, an increase of 50% above the interim dividend of 2 cents per share for the half year to 31 October 2005. The interim dividend will be paid on 31 January 2007 to shareholders on the register on 5 January 2007.

Chief Financial Officer's review

Whilst the Group as a whole has a deficit in its profit and loss reserve, the directors of Micro Focus International Plc have concluded that the Company has sufficient reserves to enable the payment of the interim dividend.

Dividends will be paid in sterling based on an exchange rate of £ = \$1.96, equivalent to approximately 1.53 pence per share, being the rate applicable on 7 December 2006, the date of recommendation of the dividend by the board.

Acquisition of HAL Knowledge Solutions SPA

On 2 November 2006, Micro Focus announced that it had agreed to acquire HAL Knowledge Solutions SPA ("HAL KS"), a leading provider of Application Portfolio Management software in order to enhance the Company's enterprise application modernisation capabilities. The transaction successfully closed on 10 November 2006. HAL KS has been acquired by Micro Focus for a total consideration of \$3.5 million in cash, subject to a net asset adjustment.

In the year to 31 December 2005, HAL KS reported a net loss before tax of \$4.5 million and its gross assets as at 31 December 2005 were \$9.5 million. Following the acquisition, we are now restructuring the business to reduce costs, with an expected restructuring charge of approximately \$4.0 million, falling in the current financial year. HAL KS was acquired with net balance sheet liabilities of approximately \$4.5 million.

For the six-month period to 30 April 2007, revenues are expected to be in the range of \$4.0 million to \$5.0 million. Excluding the associated restructuring charge, the business is expected to break even in the six-month period to April 2007.

Nick Bray *Chief Financial Officer*