Principal risks and uncertainties

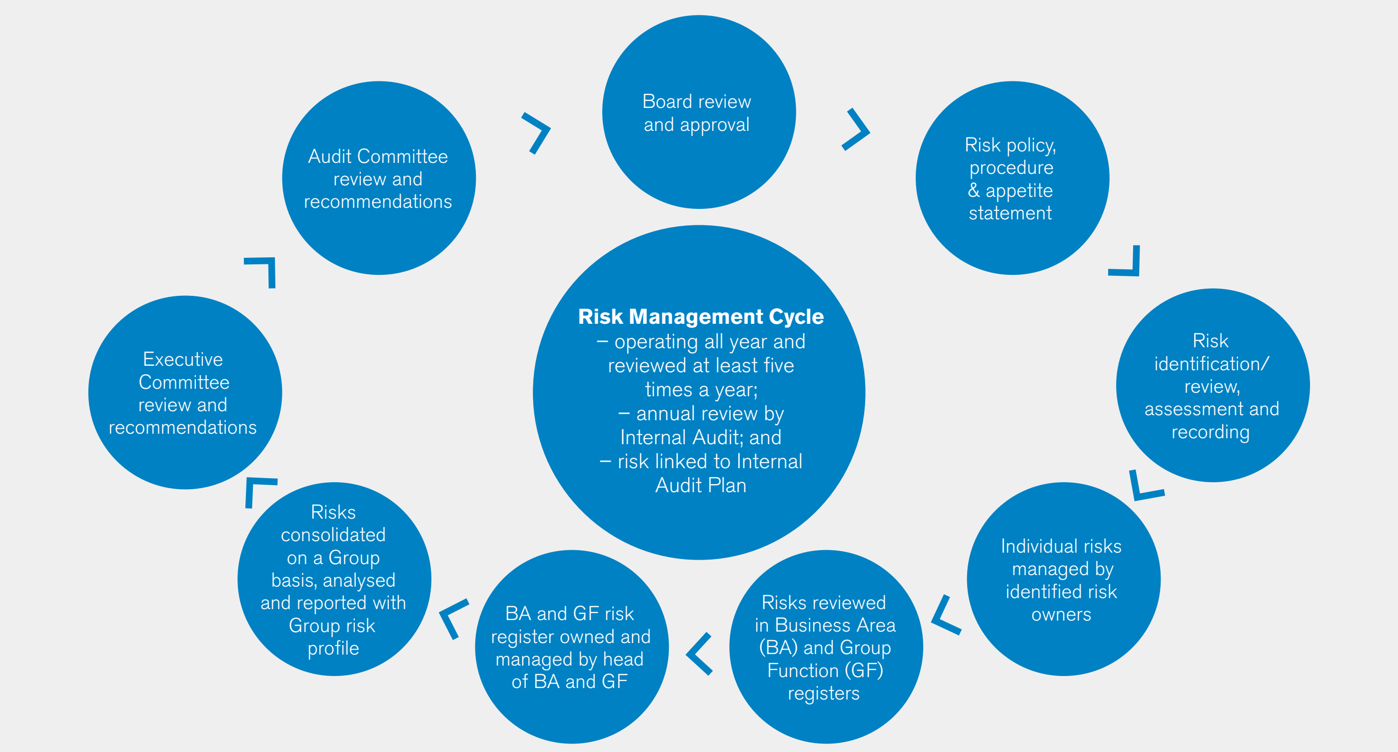
Risk management overview

The board's role is to provide entrepreneurial leadership of the Group within a framework of prudent and effective controls which enables risk to be assessed and managed. During the year the board continued to enhance the risk management process to ensure that it is robust. Underpinning the operation of, and central to, the risk management process is the culture of the Group, led by the board, of openness, transparency, trust and accountability. On behalf of the board the Audit Committee reviews and challenges the effectiveness of the risk management process.

The board manages risk in accordance with the Risk Management Framework ("RMF") under the Group's Risk Management Policy and Procedure. The RMF is aligned to the business objectives and strategy. A key component of the RMF for the board is that, whilst the RMF enables a robust assessment of risk, it is also practical and proportionate. This ensures that the RMF is embedded into the day to day business processes across the Group, to drive risk awareness and risk culture. The board continues to build upon the RMF to respond to any future change in the Group's risk profile. In the year the board developed its risk appetite work and agreed a set of Group level risk appetite statements aligned to the Group's principal risk areas. The statements set out the board's risk taking approach to ensure a balanced view between risk aversion, opportunity and gains, against a background of maintaining reputation, financial stability and compliance. As part of the assurance for the board the operation of the RMF is facilitated by an Internal Risk Management function. Individual risks are also mapped onto the Internal Audit plan for the year (see page 65 for the report on internal control). As part of the risked based internal audit process, the internal audit team assesses the gross and net risk ranking assigned by the risk owners to underpin the robustness of the operation of the RMF. The RMF is also subject to an annual review by Internal Audit. A key area of focus for the forthcoming year is to strengthen the three lines of defence (i) risk ownership (ii) risk management and compliance, and (iii) internal audit.

Risks are identified, assessed and recorded by the Micro Focus and SUSE Product Portfolios and the Group functions. Each product portfolio director and Group function head is responsible for the identification, assessment and management of risk in their area. Each risk is owned by an individual in that area. The process includes the use of risk registers, one to one interviews with product portfolio directors, Group function heads and board members. Risks are assessed on a gross and net basis against a consistent set of criteria defined by the board. The criteria measures likelihood of occurrence against potential impact to the Group including financial results, strategic plans, operations and reputation. Each risk is allocated a risk appetite category and a risk tolerance; changes in the risk profile are tracked at each reporting point in the year. The assessment includes current and emerging risks, as well as internal and external threats. Existing controls and improvement actions are recorded on the risk register for each risk.

The RMF contains a continuous cycle of review and reporting over the year. No fewer than five times a year, following one to one interviews with the business area directors and Group function heads, the individual risk registers are consolidated to form the Group risk profile. The Group risk profile is reported to the Executive Directors for monitoring, review and challenge. A report is made to every Audit Committee meeting in the year for review and to challenge the effectiveness of the RMF and then approval by the board. As part of the RMF an annual review of risk is also undertaken, this is aligned with the annual review of Internal Audit. These annual reviews focus on areas for improvement in the process, as well as the key emerging areas of risk for the Group in the year ahead. The board and the Audit Committee also received detailed risk assessments as part of reports on material projects. The RMF is set out below.



On 7 September 2016 the Group announced the intention to acquire the software business of HPE. This will be a transformational transaction for the Group and is currently expected to complete on 1 September 2017. The transaction is significantly complex as it involves the carve-out of HPE Software from HPE, as well as the integration with the Group. To assist in managing the risks associated with the transaction the board engaged specialist external resources and has set up a dedicated Integration Management Office ("IMO"). Risks are identified, owned, assessed and reviewed in accordance with the RMF. The IMO runs detailed deep dive integration sessions and risk assessments. The Completion of the acquisition, and integration, of HPE Software is a key area of principal risks in the forthcoming year.

The Group faces a number of risks in this area which may include but is not restricted to;

- Integration of HPE Software with the existing businesses carried on by the Group may be more time consuming and costly than anticipated;
- Closing is subject to a number of conditions which may not be satisfied or waived;
- The Group is obliged to pay a termination payment if the Merger Agreement is terminated under certain circumstances;
- Cost and expenses related to the transaction could exceed amounts currently estimated;
- The Group will not be able to recover damages from HPE for any losses suffered as a result of a breach of warranty by HPE under the Merger Agreement following Completion;
- There can be no guarantee that the Group Return of Value will be executed as planned or at all;
- The development of IT systems for the HPE Software and the integration of the Group's existing IT systems with HPE Software's IT systems could be subject to delays or difficulties;
- The Group may fail to realize the anticipated benefits of the Merger;
- HPE Software may not perform in line with expectations prior to or following the Completion;
- Integration and implementation of the business strategies of the Group and HPE Software could fail or not achieve the objectives of the Group;
- The transaction may result in a loss of customers for the Group;
- Third parties may terminate or seek to modify existing contracts with HPE Software as a result of transaction;
- The Group could incur operational difficulties or losses if HPE were unable to perform under the agreements entered into as part of the separation of HPE software from HPE;
- The Group may be negatively affected if HPE Software is unable to obtain the same types and level of benefits, services and resources that historically have be provided by HPE, or may be unable to obtain them at the same cost;
- The Group will have an ongoing relationship with HPE following the Completion and, as a result, the future state of actions of HPE or any successor of HPE could adversely affect the Group;
- The Group is exposed to funding risks in relation to its pension schemes;
- The Group will be listing ADS's on the NYSE which may result in liquidity in the market being adversely effected by maintaining two exchange listings;
- Any future issue of shares may further dilute the holdings of the Group shareholders and could adversely affect the market price of the Group's shares;
- The Group may in certain circumstances be obliged to indemnify HPE for tax liabilities relating to the separation of HPE Software from HPE, which could be material;
- The Group will be subject to potentially significant restrictions relating to tax issues that could limit the Group's ability to undertake certain corporate actions (such as the issuance of Micro Focus Shares or Micro Focus ADSs or the undertaking of a merger or consolidation) that otherwise could be advantageous to the Group;
- The U.S. tax authorities may seek to treat the Group as a U.S. corporation for U.S. federal income tax purposes following the Merger, which could result in material additional tax costs to the Group;
- Legislative or other governmental action in the U.S. could adversely affect the Group's business; and
- The tax rate that will apply to the Group is uncertain and may vary from expectations.

Following Completion of the acquisition of HPE Software, the Group intends to change its financial year end to 31 October and will report an 18 month financial period ending 31 October 2018.

As a consequence of Completion the Group will also be listed on the NYSE and, subject to Completion and the proposed change in financial year end to 31 October, the Group will need to put in place a system of internal controls which is compliant with the Sarbanes Oxley Act 2002 (SOX) by 31 October 2019. The Group has engaged specialist external resource to assist with the planning and implementation of SOX compliant internal controls. Preliminary work on SOX compliant internal controls has commenced as mentioned on page 66 in the report on internal controls. There may be other risks which emerge in the future.

The risks above may result in an adverse impact on the principal risks and uncertainties for the Group set out below.

Principal risks and uncertainties

The Group, in common with all businesses, could be affected by risks and uncertainties that may have a material effect on its business operations and achieving its strategic objectives including its business model, future performance, solvency or liquidity. These risks could cause actual results to differ materially from forecasts or historic results. The board is mindful of the interdependencies of some risks. Where possible, the Group seeks to mitigate these risks through its RMF and internal controls, but this can only provide reasonable assurance and not absolute assurance against material losses.

Principal risks and uncertainties
continued

The following are the principal risks and uncertainties, potential impacts and mitigations that are relevant to the Group as a provider of software products and associated services at this time. The risk movement from the prior year has been assessed and noted against each risk as has the alignment with the business, in accordance with the key below. There may be other risks which could emerge in the future.

Please also refer to the section on internal controls within the corporate governance report on pages 65 to 66.

Risk movement from the prior year

↑ Risk increased ↓ Risk decreased ↔ Risk remained the same

Products ↔

Risk

To remain successful the Group must ensure that its products continue to meet the requirements of customers. Investment in research and innovation in product development is essential to meet customer and partner requirements in order to maximize revenues and corporate performance. The Group has a large number of products, at differing stages of their life cycle. The extent of investment in each product set needs to be managed and prioritized considering the expected future prospects, to ensure an effective balance between growth and legacy products.

Potential impact

If products do not meet the requirements of customers they will seek alternative solutions, resulting in the loss of new revenue opportunities and the cancellation of existing contracts. Insufficient focus on key research and development projects may damage the long-term growth prospects of the Group.

Mitigation

The Group continued to improve the interaction between Product Management, Product Development, Sales and Marketing. The Group's structured approach to managing its products was further enhanced during the year to ensure alignment to the Four Box Model.

The Group operates as two product portfolios Micro Focus and SUSE. All of Micro Focus's products are managed through the global product management and development organization, with a geographic GTM organization. To capitalize on the growth potential of the SUSE Product Portfolio these are managed separately and dedicated resources concentrate on the development, customer care and sales, marketing and engineering.

At Micro Focus on 2 May 2016 we completed the acquisition of Serena, a leading provider of Application Lifecycle Management products. On 30 September 2016 we completed the acquisition of GWAVA a leading company in email security and enterprise information archiving based in the US, Canada and Germany.

At SUSE on 1 November 2016 we acquired OpenATTIC storage management and engineering talent from the company it-novum. On 7 September 2016 it was announced that SUSE was to become HPE's preferred Linux partner and explore additional collaboration. On 30 November 2016 it was announced that it had reached agreement with HPE on the acquisition of technology and talent to expand SUSE's OpenStack Infrastructure-as-a-service solution and accelerate SUSE's entry to the Cloud Foundry Platform-as-a-service market. The acquisition was completed on 8 March 2017. SUSE also appointed a dedicated Chief Technology Officer in the year.

Go to Market ("GTM") models

Risk

For the Group to succeed in meeting revenue and growth targets it requires successful GTM models across the full product portfolio, with effective strategies and plans to exploit channel opportunities and focus the sales force on all types of customer categories. In addition, effective GTM models may be more successful if accompanied by compelling Micro Focus and SUSE brand awareness programmes.

Potential impact

Poor execution of GTM plans may limit the success of the Group by targeting the wrong customers through the wrong channels and using the wrong product offerings.

Mitigation

The business operates under a global product group with geographic GTM sales organizations. Revenue plans are supported by a range of measures to monitor and drive improvements in GTM operating models in both Micro Focus and SUSE. The dedicated sales teams operate by portfolio but management are targeted on the sales of both Micro Focus and SUSE Product Portfolios. Operationally there are quarterly business reviews with all geographies and monthly reviews with regional presidents, the President of Sales for Micro Focus and SUSE participate in their respective weekly management team meetings to review sales performance and GTM priorities.

Customer sales cycles are reviewed regularly and a bid review process is in place to monitor and maximize customer revenue opportunities. In addition to sales performance reviews, marketing and product development programmes are assessed regularly to optimize levels of qualified pipeline and ensure that marketing programmes are supported by appropriate product offerings.

A series of measures are in place to focus the direction of the sales force towards a broad range of customer categories. These measures include detailed bid management, tailored quota targets and robust pre-sales management.

In addition, brand awareness programmes are in place and reviewed on an on-going basis to draw on differentiated and consistent PR plans across key geographies. These are supported by targeted industry analyst relations to reach and raise Micro Focus and SUSE brand awareness through key marketplace influencers. Brand building is also supported by growing a customer reference programme and online programmes such as effective search engine optimization, use of social media and improved corporate websites.

The Product to Market process is standardized so that execution is on a consistent basis. Micro Focus continued to run the internal sales certification programme, to improve the level of expertise across the sales force and the Micro Focus Sales Academy, the initiative through which it hires graduate sales representatives to enhance the sales capability and train up new talent with the potential to progress within the sales organization.

At SUSE a President of Global Sales was appointed in the year. A new Partner Programme strategy was also implemented across the business.

Principal risks and uncertainties
continued

Competition

Risk
Comprehensive information about the markets in which Micro Focus and SUSE operate is required for the Group to assess competitive risks effectively and to perform successfully.

Potential impact	Mitigation
Failure to understand the competitive landscape adequately and thereby identify where competitive threats exist may damage the successful sales of the Group's products.	Group product plans contain analysis of competitive threats and subscriptions to industry analyst firms are leveraged to better understand market dynamics and competitor strategies. In addition, customer contact programmes are analyzed for competitive intelligence. Micro Focus and SUSE continue to monitor and review intelligence on market threats to focus on offering best in class service to customers.

Employees

Risk
The retention and recruitment of highly skilled and motivated employees, at all levels of the Group, is critical to the success and future growth of the Group in all countries in which it operates. Employees require clear business objectives, and a well communicated vision and values, for the Group to achieve alignment and a common sense of corporate purpose among the workforce.

Potential impact	Mitigation
Failure to retain and develop skill sets, particularly in sales and research and development may hinder the Group's sales and development plans. Weak organizational alignment and inadequate incentivization may lead to poor performance and instability. It could also have an adverse impact on the realization of strategic plans.	The Group has policies in place to help ensure that it is able to attract and retain employees of a high calibre with the required skills. These policies include training, career development and long-term financial incentives. Leadership training schemes are in place to support management development and succession plans. The Group also has in place a performance management and appraisal system. The measures for talent management will continue to be enhanced to ensure a rigorous recruitment and retention process which is aligned to business as usual as well as the strategic plans for the Group. Succession plans have been developed and are in place for key leadership positions within the Company. In the year the Group took significant action to develop its management capability both internally, by training and promotions, and through external hires. In the year the Group appointed a dedicated HR Talent Manager.

Business strategy and change management

Risk

The Group is engaged in a number of major change projects including acquisitions to grow the business by strengthening the portfolio of products and capabilities, IT projects and projects to standardize systems and processes. The successful integration of businesses will build a solid base for further expansion. These projects expose the Group to transformation risks. The acquisition of HPE Software is a complex transaction with a range of integration risks.

Potential impact

Failure to analyze, execute and co-ordinate the various projects successfully may result in the disruption of the ongoing business without delivering the benefits of the operational efficiencies and/or commensurate increase in revenues. In addition this may affect the ability to execute strategic plans for growth.

The risk increased in the year to reflect the risks associated with the acquisition of HPE Software.

Mitigation

The Group has an established acquisition strategy and focus on efficient execution in the mature infrastructure software products. The Group announced the acquisition of HPE Software on 7 September 2016 and Completion is currently expected to be 1 September 2017.

The project is run in the dedicated IMO by an appropriately experienced team, utilizing external resources as required. There are detailed and robust governance disciplines around each project. The board monitors and reviews progress. The Group has a dedicated Group Business Operations and Integration Director to ensure that execution of the various projects are successfully aligned so as to minimize any disruption to business as usual.

On 17 January 2017 Chris Hsu was announced as the CEO of the Enlarged Group (following Completion of the acquisition of HPE Software) at the same time Stephen Murdoch will become COO of the Enlarged Group, part of a strong and fully aligned leadership team to deliver the full potential of the transaction.

IT systems and information

Risk

The Group's operations, as most businesses, are dependent on maintaining and protecting the integrity and security of the IT systems and management of information. The Group may experience a major breach of system security or cyber-attack. The external threat profile is generally increasing as are the regulations around data protection.

Potential impact

Disruption to the IT systems could adversely affect business and Group operations in a variety of ways, which may result in an adverse impact on revenues and reputational damage.

The risk increased in the year to reflect the increase in the general external cyber risk environment.

Mitigation

The Group has in place a highly skilled technology team which constantly monitors and reviews the performance and availability of the Group IT systems including any risk of cyber-attack. Policies and processes are in place for the protection of business and personal information. The Group has in place well established and tested business continuity plans. The Group seeks to mitigate cyber risks with a range of measures including monitoring of threats and testing of cyber response procedures and equipment.

Principal risks and uncertainties
continued

Legal and regulatory compliance

Risk
The Group operates across a number of jurisdictions. Compliance with national and regional laws and regulations is essential to successful business operations.

Potential impact

Failure to comply could result in civil or criminal sanctions as well as possible fines and reputational damage.

Mitigation

The Group has in place policies and procedures to mitigate these risks. The Group's legal and regulatory team, enhanced by specialist external advisors as required, monitor and review compliance. There is a Compliance Committee and a Market Abuse and Insider Dealing Committee which report into the board. All staff are subject to mandatory compliance training. During the year the Group established an executive Financial Reporting Group (FRG) to monitor, review and manage the risks associated with financial reporting across the Group. The FRG reports to the audit committee.

Intellectual property

Risk
Failure to adequately protect the Group's Intellectual Property and brands. Some of the Group's products utilize Open Source technology which is dependent upon third party developers.

Potential impact

Failure could adversely affect the ability of the Group to compete in the market place and affect the Group's revenue and reputation.

Mitigation

There are procedures in place across the Group to ensure the appropriate protection and use of the Group's brands and intellectual property, which are monitored by the IP Panel and Legal team.

Treasury

Risk
The Group operates across a number of jurisdictions and so is exposed to currency fluctuations.

The risk of foreign exchange fluctuations may be increased as a result of Brexit.

The Group targets a Net Debt to Facility EBITDA ratio of 2.5 times and may require additional debt funding in order to execute its acquisition strategy.

Potential impact

The relative values of currencies can fluctuate and may have a significant impact on business results.

Insufficient access to funding could limit the Group's ability to achieve its desired capital structure or to complete acquisitions.

Mitigation

The Group's operations are diversified across a number of currencies. Changes in foreign exchange rates are monitored and exposures regularly reviewed and actions taken to reduce exposures where necessary. The Group provides extensive constant currency reporting to enable investors to better understand the underlying business performance.

The Group has significant committed facilities in place, the earliest of which matures in November 2021 and sufficient headroom to meet its operational requirements.

The Group seeks to maintain strong relationships with its key banking partners and lenders and to proactively monitor the loan markets.

The Group also has strong engagement with the providers of equity capital, which represents an alternative source of capital.

Tax

Risk

The tax treatment of the Group's cross-border operations is subject to the risk of challenge under tax rules and initiatives targeting multinationals' tax arrangements, including the OECD's Base Erosion and Profit Shifting project and EU state aid rules.

Potential impact	Mitigation
Tax liabilities in various territories in which the Group operates could be significantly higher than expected.	Tax laws, regulations and interpretations are kept under ongoing review by the Group and its advisors. The Group reviews its operations, including the structuring of intra-group arrangements, on a periodic basis to ensure that risks are identified and mitigated accordingly. External professional advice is obtained to support positions taken in financial statements and local tax returns where there is significant uncertainty or risk of challenge.

Macro-economic environment

Risk

The Group operates a global business and is exposed to a variety of external economic and political risks which may affect the Group's business operations and execution of the strategy.

Potential impact	Mitigation
Adverse economic conditions could affect sales, and other external economic or political matters, such as price controls, could affect the business and revenues. The risk increased in the year to reflect Brexit and the potential general external political environment.	The spread of jurisdictions allows the Group to be flexible to adapt to changing localized risk to a certain extent. The Group has business continuity plans and crisis management procedures in place in the event of political events or natural disasters. The Group have a Brexit Working Group with processes in place to assess, respond, monitor and track the impact of Brexit on our businesses, and associated risks, as matters progress and how the business can seek to mitigate these risks.