# Chief Executive Officer's review

### Performance

I am pleased that we have made good progress in performance and transformation, consistent with our presentations made at the Capital Markets Day (CMD) back in June 2015. At CMD, we shared with investors the growth strategy underpinned by the five strategic pillars of Winning in the Market (New Customer Acquisition); Customer for Life (C4L); Revolutionise Business; Capacity for Growth and One Sage. FY16 has been a pivotal year in our transformation programme and, most importantly, the business continues to perform. As we have highlighted to investors, FY16 was one of the years of highest potential risk in the transition of the business. At CMD, we clearly outlined our strategy and continue to achieve profitable growth, providing best-in-class support for the Business Builder entrepreneur. We delivered revenue growth of 6% with 27% operating margins in line with guidance provided last year. I am particularly pleased to note that higher quality recurring revenue was double digit – the first time for a decade. The strategy for Business Builders is delivering in line with our expectations and supports the Sage business model of quality organic growth; superior operating margins; strong free cash generation (enabling a progressive dividend) combined with selective acquisitions to accelerate the strategy.

Strong revenue growth of 7% in Europe (10% recurring revenue) and 8% (16% recurring revenue) in International has been balanced by 4% revenue growth (9% recurring revenue) in North America, due mainly to challenges in the Payments business. Growth in Europe and North America has been led through strong performance in our Customer for Life (C4L), whilst growth in the International region has been driven by Winning in the Market (new customer acquisition).

As part of the C4L strategy, within recurring revenue, software subscription revenue grew by 32% and the number of software subscription contracts grew by 46% to just over one million. Our contract renewal rates grew by 2 percentage points from 84% to 86% for the year coupled with continuing improvement in our Net Promoter Scores (NPS).

Organic processing revenue grew by 6% in the year reflecting strong growth in Europe of 12% driven by Sage Pay in the UKI, and International of 50%, driven by payroll processing, balanced by slower growth in North America of 3% that delivered strong payroll processing growth and a flat year-on-year in payments.

Organic SSRS revenue declined by 8% in the year reflecting the planned transition to a subscription model as explained at our 2015 Capital Markets Day.

### Business Transformation

We achieved an operating margin of 27% in FY16 in line with guidance, whilst transforming our business by reducing cost from our back office to reinvest in sales and marketing to support 'Winning in the Market'.

We have reorganised the go-to-market functions and hired a proven leader, Blair Crump, the recently appointed Sage President, to ensure that in FY17 we will see a laser focus on new customer acquisition.

During the year we reduced the general and administrative (G&A) expense as a proportion of revenue to 16% (FY15: 19%). We have secured annualised savings of £51m from G&A and have incurred an exceptional charge of £110m, £76m of which relates to G&A, therefore giving an associated payback period of under two years, in line with our guidance.

The extent of the transformation is substantial. Of our top leadership, 72% has changed in the last two years and half of the new leaders are internal promotions. The overall headcount remained stable during the year and yet 3,000 new colleagues have joined Sage. 32% of the Senior Management Team is now female, up from 25% in the prior year. We will continue to hire people to support our growth plans whilst at the same time driving for productivity, efficiency, high performance and inclusion.

In FY16 as we communicated, there was an exceptional charge of £110m, incurred as part of phase one of the transformation. In FY17 we have identified additional cost saving opportunities of at least £50m which we will reinvest in our go-to-market functions in order to accelerate our ability to acquire new customers. This will create a further exceptional charge, with a targeted payback of under two years.

### Success in our technology strategy

Our suite of cloud accounting solutions continues to drive the 'Winning in the Market' strategy to generate revenue and increase market share:

- Sage One paying subscriptions increased by 81% to 313,000 during the year and revenue increased by 54%. The majority of the increase in customers was driven by Europe and in International, which delivered a triple digit increase in paying customer numbers;
- X3 revenue grew by 18%, with particular success in the International region which achieved revenue growth of 74%. Customer numbers in X3 have increased by 25%;
- Sage Live, launched in USA and UK in February 2016 was awarded 'Best Salesforce Developer Community' innovation award and has now left 'incubation', gaining momentum as a powerful mobile first, real-time accounting engine. We now have over Sage Live 600 customers, with over 400 added in the past 90 days.
- Sage 50 Accounts remains a popular choice with our installed base, with functionality continually increasing as the product enhances its cloud functionality through Sage Drive and Sage 50C. In the year Sage 50 Accounts delivered triple digit subscription revenue growth in the UKI, US and Canada. The overall Sage 50 family of payroll and accounting solutions now accounts for 29% of all revenue.

### Progress in areas targeted to improve performance

As a management team focused on improvements throughout the business, we share our 'watch list' regularly. During FY15 we highlighted areas of the business that were underperforming relative to Sage's overall performance, being Enterprise Europe, Small and Medium Business North America and Payments North America. We continue to believe that progress will be non-linear and that we expect the watch list to vary over time.

*Enterprise Europe*

Enterprise Europe delivered full year growth of 5% compared to a decline in the prior year. The strategic product within this portfolio, X3, grew by 12%, with particular success in the UKI where revenue grew by 17% and customer numbers grew by 41%. We are confident of continued growth of X3 and further progress in the Enterprise segment.

*Small and Medium Businesses North America*

Revenue has grown by 4% for the full year in this segment, compared with 4% in the prior year.

This segment continues to be a focus: some progress is notable with Sage 100 Cloud and Sage 300 Cloud products starting to gain momentum with software subscription revenue growing by 60% and 63% respectively. Sage Construction and Real Estate has also been a success, growing by 7% in the year and adding over 1,000 customers – a record for this part of the business.

*Payments North America*

Payments North America has remained flat year-on-year. Challenges in this segment reflect margin compression in line with industry trends and new account shortfall due to slower progress in marketing and the partner channel. In order to drive growth in FY17 we are now offering the power of the combination of Payments, Accounting and Payroll and therefore differentiating our value proposition by bundling these solutions, and offering new and updated product and process functionality. Payments marketing now has a separately dedicated team and is expected to significantly improve lead generation and referrals.

## Progress of execution

Throughout FY16 we have executed on our transformation by driving improvements through each of our strategic pillars. There is strong evidence that our strategy is working, with continued improvements planned for FY17:

***Customers for Life***

**Progress:**

- We are building higher quality relationships with our customers through subscription. Software subscription revenue has increased by 32% and the number of software subscriptions has increased by 46% to just over one million.
- By providing excellent levels of customer service and the latest technology we continue to build up our contract renewal rates. The contract renewal rate has grown to 86% in the year, compared to 84% in FY15, with the best renewal rates in North America and Europe at 89% and 88% respectively.
- Cross-sell campaigns are starting to gain traction: in the UKI 37% of Sage 50 Accounts customers also have Sage 50 Payroll.
- Our NPS score measures customer satisfaction and has increased by 61% on the prior year.

**Focus:**

- We will continue to focus on the move to subscription, scaling up cross-sell in FY17 to improve the average number of products held by our customers and implementation of our customer journey maps, which highlight how customers from start-up to scale-up to enterprise can choose Sage as their cloud accounting partner for life.

***Winning in the Market***

**Progress:**

- Our suite of cloud accounting products designed to win in the market is showing progress. X3 revenue grew by 18% in the year with 74% growth in the International region. Sage One paying subscriptions grew by 81% to 313,000, of which 61,000 were added in the UKI and 23,000 each in both Brazil and South Africa, representing evidence of Sage's international strength.
- Products continue to develop at pace. Sage One updates are available every two weeks, leading to over 1,500 design improvements and over 150 new or improved features in FY16.
- In July 2016 we hosted Sage Summit, the world's largest gathering of entrepreneurs. We had 15,000 registered attendees, generated one billion social impressions and over 3,000 media articles were written from the conference.

- Our digital marketing strategy is starting to deliver: we increased our social media following by 220%, leapfrogging our competitors, and tripled engagement with our content on social channels, as well as increasing our lead to conversion rate in Q4 – a trend we will continue to build upon.
- We have made significant progress implementing our web domain consolidation strategy seeing 14% growth in web traffic to all Sage properties and 77% growth in organic traffic to Sage.com.

**Focus:**

- FY17 will be a year of focus on execution of the 'Winning in the Market' cloud accounting product roadmaps in each country, for Sage One, Sage Live and X3 Cloud with significant upgrades and distribution planned for the products. Product roadmaps are now updated monthly, outlining country roll-out plans, major releases and key feature updates. In addition, we will scale up the Customer Business Centres (CBCs); take Sage Summit 'on the road' around major cities; and elevate Sage's brand as the popular cloud accounting choice for Business Builders. During FY17, Sage is planning 27 major cloud product launches across our geographies.

***Revolutionise Business***

**Progress:**

- We launched Pegg, the world's first accounting Chatbot at Sage Summit in July 2016 gaining over 9,000 new users to Sage in 125 different countries.
- We continued to build our ecosystem through Sage Marketplace, an online hub to access complementary partner applications. 215 ISV apps have been signed to Sage Marketplace during the year, of which 86 have been fully integrated.
- We have launched the Sage One mobile app and new versions of Sage One for Partners and Accountants as we continue to move our Sage One solutions on to our Global Accounting Core (GAC).
- Sage Live was developed in 26 weeks with early adopter customers contributing to the build of the product. Product updates are released on a bi-monthly basis and we now have over 600 customers, many of whom are 'live' following a rapid period of implementation.
- In Spain, a country that has not launched any new products since 2010, we are launching five major products in six months (Sage One GAC, Sage Live, Sage 50C and Sage 200C), all in local language and locally compliant based on the new, agile model of development.

**Focus:**

- During FY16 we continued to develop our Sage ecosystem with further expansion to be sustained throughout FY17. Partner-driven solutions will be available on Sage Marketplace for six of our growth products and the suite of ISV apps will continue to increase.  Further innovation is planned for Chatbots, artificial intelligence, machine learning and data sciences.

***Capacity for growth***

**Progress:**

- We are measuring the return on our investment in go-to-market functions. Within the marketing department, the people cost to marketing expense ratio has decreased from 46:54 to 39:61, moving in line with IDC benchmarking.
- We have created greater capacity to reach prospects through the consolidation of our digital media strategy and a single worldwide media agency. This has enabled a more consistent approach to media, faster time to market and a 25% reduction in agency fees. The first year of implementation achieved a significant increase in the performance of demand related media investment, reflected in a 37% decrease in cost per enquiry.
- We have made some early changes in other areas of the go to market functions as we start to integrate areas of sales and marketing operations and reduce non quota carrying sales support roles.
- We have streamlined our property portfolio from 139 to 78 premises. Core Sage properties have been upgraded to provide an outstanding workplace for colleagues in Atlanta, Lawrenceville, London and Dublin.
- We are establishing the critical platforms for growth with our CBCs, digital marketing platforms, Sage partnership programme and our updated brand.

**Focus:**
During FY17 we will continue our focus on expanding the platform for sales and marketing to drive new customer acquisition. We will further leverage the power of our CBCs, which provide one touchpoint for the customer so we can coordinate leads from initial contact, selecting a product, through to aftersales success coaching. Our CBCs are currently located in Dublin and Atlanta and the same formula will be applied to other locations as we continue to roll-out this approach.

***One Sage***

**Progress:**
- We have reduced fragmentation and misalignment within our business:
  - We have continued to consolidate the Sage One towards a single code base;
  - The new Operating Design has been rolled out around the world and provides a consistent operating model.
- Colleague engagement has increased with All Hands meetings and Sage TV broadcasting live to all colleagues, and Sage FY17 Kick-Offs, where each major Sage office around the world was visited by management meeting approximately 10,000 colleagues as well as customers, partners and accountants.
- We have increased our colleague engagement through Sage Foundation. 13,000 days were donated by Sage colleagues to volunteer through Sage Foundation in the year and 110 charities and non-profit partners globally benefited from grants awarded by the Foundation.
- To strive towards Excellence in Governance, we have introduced a suite of 56 refreshed policies to ensure our business remains fully committed to good governance throughout the transformation and beyond. In FY16 Sage was recognised in the top four of the FTSE 100 for governance in a study by the Institute of Directors.
- Goal setting has been aligned throughout Sage by Vision, Strategy, Goals, Measures (VSGM), with the CEO’s FY17 objectives now cascaded down through the organisation, aligning colleague objectives to both leadership and the strategic pillars.

**Focus:**

- Further focus on the next phase of Excellence in Governance with the Sage Excellence in Controls programme and integrated business planning for FY17 and cultural change to encourage consistency.

### Outlook

FY17 signals the start of phase two of our transformation to execute the strategy for Business Builders. We will build on the strong foundations built during phase one in FY16 as follows:

- Rigour in implementation of the country customer journey maps for C4L and Winning in the Market.
- Increased focus on new customer acquisition with our award winning cloud accounting products. This includes launching Sage Live in a further five countries with user experience improvements and new services for Sage Live for Accountants with Practice Management; increasing functionality in Sage One with improvements to banking, user experience, reporting and partnering with Accountants and shifting the product focus on X3 towards cloud-first development and subscription pricing. Sage One and Sage Live are both now sold and supported through CBCs.
- We will continue efficient investment in the marketing function to increase the number and conversion rate on marketing qualified leads and improve return on investment.
- Continuing the Capacity for Growth initiative, we will drive further opportunities for cost saving identified to be achieved in FY17 of at least £50m with an associated exceptional cost and payback of less than two years.
- Cost savings to be further reinvested into sales and marketing and product innovation to continue to drive new customer acquisition.

As we progress into Phase two of the transformation programme, our guidance for full-year FY17 is at least 6% revenue growth and at least 27% operating margin. Consistent with FY16 there is a planned strategic investment bias towards the first half of the year and therefore we expect margins to be lower than 27% in H117 and higher margin in H2 to achieve the blended 27% margin for the full year. With the front-load investment in growth in H117, we anticipate stronger H2 growth and accelerating momentum as we exit FY17.

## Chief Financial Officer's review

### Group performance

The Group achieved revenue growth of 6.1% (FY15: 6.0%) and an operating profit margin of 27.2% (FY15: 26.5%).

The quality of growth is demonstrated by recurring revenue growth of 10.4% (FY15: 9.0%) including growth in software subscription revenue of 32% (FY15: 29%).

Organic figures neutralise the impact of foreign currency fluctuations and exclude the contribution from current and prior period acquisitions when relevant. A reconciliation of operating profit to statutory operating profit is shown on page 14.

Statutory performance has been impacted by movements in key exchange rates during the year, particularly in South Africa and Brazil, combined with exchange rate re-alignment following the EU referendum in Sterling against Euro and US Dollar translation. Statutory figures also include the contribution of acquisitions and disposals.

*Revenue*

| | STATUTORY | | | ORGANIC | | |
|---|---|---|---|---|---|---|
| | **FY16** | **FY15** | **Change** | **FY16** | **FY15** | **Change** |
| Europe | £827m | £753m | +10% | £827m | £776m | +7% |
| North America | £535m | £477m | +12% | £535m | £513m | +4% |
| International | £207m | £206m | +1% | £205m | £189m | +8% |
| **Group** | **£1,569m** | **£1,436m** | **+9%** | **£1,567m** | **£1,477m** | **+6%** |

*Operating profit*

| | STATUTORY | | | ORGANIC | | |
|---|---|---|---|---|---|---|
| | **FY16** | **FY15** | **Change** | **FY16** | **FY15** | **Change** |
| **Group** | £300m | £297m | +1% | £427m | £391m | +9.2% |
| **Margin** | 19.1% | 20.7% | -160bps | 27.2% | 26.5% | +70bps |

The Group achieved full year organic operating profit margin of 27.2% (FY15: 26.5%). The current year statutory operating profit is stated after non-recurring costs incurred relating to business transformation and recurring costs relating to amortisation of acquisition related intangible assets and other acquisition related charges.

FY16 has been a key year of transformation with significant progress made in delivering cost savings in G&A. During the year, savings of £51m of G&A were realised, which were fully reinvested in our go-to-market functions of sales and marketing. An associated exceptional cost of £110m has also been recognised in the year, with both the exceptional cost and the associated saving broadly in line with guidance. Of the £110m exceptional charge, £76m relates to G&A and £34m to go-to-market functions. There is a £2m non-recurring credit in relation to the Archer litigation claim.

We have identified further annualised cost saving opportunities of at least £50m for FY17 which will create a further exceptional expense with a target payback period of under two years.

**Revenue mix**

*Segmental reporting*

Consistent with our FY15 results, the business is split into three regions: Europe, North America and International.

| | RECURRING REVENUE | | | PROCESSING REVENUE | | | SSRS REVENUE | | |
|---|---|---|---|---|---|---|---|---|---|
| **ORGANIC** | **FY16** | **FY15** | **Change** | **FY16** | **FY15** | **Change** | **FY16** | **FY15** | **Change** |
| Europe | £642m | £582m | +10% | £36m | £32m | +12% | £149m | £161m | -7% |
| North America | £308m | £284m | +9% | £157m | £153m | +3% | £70m | £76m | -8% |
| International | £142m | £123m | +16% | £11m | £7m | +50% | £52m | £59m | -12% |
| **Group** | £1,092m | £989m | 10% | £204m | £192m | +6% | £271m | £296m | -8% |

| | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| **% of total revenue** | **70%** | **67%** | | **13%** | **13%** | | **17%** | **20%** | |

*Recurring revenue*

The Group delivered recurring revenue growth of 10% (FY15: 9%), driven by the year-on-year increase in subscription revenue of 32% (FY15: 29%). This growth represents the continuing planned transition from licensing to higher quality subscription revenue.

Contract renewal rates have reached 86% (FY15: 84%) with subscription contract renewal rates now over 90%. Recurring revenue now represents 70% of Group revenue (FY15: 67%).

*Processing revenue*

Processing revenue has grown by 6% (FY15: 2%), reflecting strong performance in payroll processing and an increase in Sage Pay revenue in the UKI, offset by flat growth in Payments North America.

*SSRS revenue*

SSRS revenue declined by 8% (FY15: decline of 1%) in line with the continued transition to subscription based revenue, offset slightly by growth in Professional Services of 2% and Training of 7%

**Regional performance - Europe**

| ORGANIC REVENUE GROWTH | FY16 | FY15 |
|---|---|---|
| UK & Ireland | +7% | +7% |
| France | +6% | +5% |
| Spain | +7% | +3% |
| Germany | +7% | +4% |
| Rest of Europe | +3% | +1% |
| **Europe** | **+7%** | **+5%** |

Revenue in Europe grew by 7% in the year (FY15: 5%). Within Europe, there were strong results in UKI, France, Spain and Germany which all delivered growth in excess of the Group growth rate, balanced by modest growth in Poland and flat performance in Switzerland, our smaller European entities.

Europe delivered recurring revenue growth of 10%, of which software subscription revenue grew by 28% with an overall contract renewal rate of 88%. The region continues to deliver on the transition to a recurring revenue model driving growth through the installed base.

Processing revenue grew by 12% in Europe (FY15: 9%) largely due to the growth in Sage Pay in the UKI.

SSRS revenue declined by 7% (FY15: decline of 4%) due to the continued planned decline in licences, offset by growth in upgrades to modernised products and professional services linked to X3 'big deals' in France.

X3 revenue grew by 12% in the region, with double digit growth in UKI, France and Spain and an increase of 22% in X3 customer numbers in the region.

Sage One paying subscriptions in Europe grew by 62% demonstrating further momentum of the product footprint.

The focus in Europe in FY17 will be to drive further revenue growth through new customer acquisition.

*UK & Ireland – strong growth driven by C4L*

UKI revenue grew by 7% (FY15: 7%) in the year, driving growth through the Customer for Life strategy. Retention rates have now risen to 86%. Within recurring revenue, software subscription revenue grew by 39% driven by successes in Sage 50 Payroll and especially in Sage 50 Accounts which delivered triple digit subscription revenue growth as the solution continues to drive revenue growth through ever-increasing functionality.

The UKI also delivered strong performance on X3 with 17% revenue growth in the year, both due to new customer acquisition and migration and implementation of the customer journey map.

Sage One paying subscriptions in the UKI grew by 66% driven mainly by the Accountants channel.

Processing growth of 11% was driven by the increase in Sage Pay due to growth of e-commerce within the UKI and an increase in customers.

SSRS decline of 13% reflects the planned transition to subscription.

*France – Success in i7 upgrades and X3*

In France, revenue grew by 6% (FY15: 5%). Recurring revenue growth of 8% is below Group growth due to the early pace of subscription in the country (recurring revenue represents 85% of revenue), with software subscription growth of 14% in the year.

During FY16, the i7 upgrade delivered revenue increases due to successful customer experience, cross-sell and up-sell campaigns with scope to further increase revenue into FY17.

X3 has also been a success in France: X3 customer numbers grew by 28%, now representing 51% of Group X3 customers. France also had success targeting larger deals, winning 20 with a revenue per contract in excess of £100k.

The decline in SSRS reflects transition to subscription, offset by SRS growth for professional services and training to implement X3.

*Spain – strong subscription revenue growth*

Revenue growth of 7% (FY15: 3%) was driven by a growth in software subscription revenues of 52%. Improvements in retention rates were driven through customer experience campaigns and successful targeting of the existing base with cross-sell and up-sell.

Spanish local growth products, Contaplus and Murano, both remain popular delivering double digit growth.

*Germany – strong subscription revenue growth*

Germany delivered revenue growth of 7% (FY15: 4%). From April 2016, all new contracts signed in Germany are done so on subscription which, combined with bundling propositions, has led to an increase in software subscription revenue of 48%. OfficeLine, the flagship local product in Germany has grown revenue by 15% in the year.

### Regional performance – North America

| ORGANIC REVENUE GROWTH | FY16 | FY15 |
|---|---|---|
| North America | +4% | +4% |

North America delivered revenue growth of 4% (FY15: 4%) with recurring revenue growth of 9% (FY15: 9%) and processing revenue growth of 3% (FY15: decline of 1%) offset by a decline in SSRS of 8% (FY15: decline of 5%).

Growth in North America was below Group growth of 6%, partly due to flat revenue within the payments business. Excluding payments revenues, year-on-year growth in North America was 6%.

Recurring revenue growth of 9% includes an increase in software subscription revenue of 84%. There has been strong performance in the year from Sage 50 US and Sage 50 Canada, both of which achieved triple digit growth in subscription revenue with customers benefiting from functionally-rich products and increased flexibility through cloud-based solutions. Canada also drove growth through success in Sage Drive and mobile invoicing functionality.

The strong growth in subscription in the region shows positive signs that recurring growth rates can continue to increase. Focus for FY17 will be to drive further growth from new customer acquisition to reduce reliance on the installed base.

Sage One subscriptions grew by 65% year-on-year, driven by Accountant referrals.

X3 growth of 7% in the year reflects a modest start to the year, but a strong second half which grew by 18% as the product begins to gain momentum through new leadership, improved sales and marketing alignment, pipeline growth and a focus on larger deals.

Processing revenue growth of 3% reflects strong growth in payroll processing of 25% due to licensee acquisitions and new customer additions. Payments revenue remained flat year-on-year reflecting challenges in margin compression in line with industry trends and new account shortfall due to slower progress in the partner channel and in marketing. In order to drive growth in this segment we are now differentiating our product by bundling payments, payroll and accounting, offering updated functionality and focusing marketing to improve lead generation and referrals.

SSRS revenue fell by 8% in the year as licence based customers continued the planned transition to subscription.

## Regional performance - International

| ORGANIC REVENUE GROWTH | FY16 | FY15 |
|---|---|---|
| Africa | +19% | +16% |
| Brazil | +12% | +8% |
| Australia | +3% | +5% |
| Middle East and Asia | -18% | +33% |
| **International** | **+8%** | **+14%** |

Organic revenue in the International region grew by 8% year-on-year (FY15: 14%), with recurring revenue growth of 16% (FY15: 14%) and processing revenue growth of 50% (FY15: 18%), offset by a decline in SSRS of 12% (FY15: growth of 13%).

Growth in the region has been driven by strong performance in Brazil and South Africa, both of which have had success in new customer acquisition through Sage One and X3, balanced by a decline in revenue in Asia.

*Africa – winning in the market with X3 and Sage One*

Organic revenue growth of 19% reflects double digit growth across recurring, processing and SSRS revenue streams. Africa's revenue growth is driven by new customer acquisition with a 77% growth in X3 revenue and 71% growth in Sage One revenue, with Sage One paying subscriptions increasing by 23,000 in the year.

Recurring revenue growth is driven by a 32% increase in software subscription revenue with triple digit software subscription revenue growth in X3 and its two local growth products, Sage Evolution ERP and Sage VIP People HRIS.

Organic processing revenue growth of 27% reflects strong performance in payroll processing.

Organic SSRS revenue grew by 12% due to X3 licence revenue growth.

*Brazil – resilient software growth despite tough economic conditions*

Brazil's revenue grew by 12% reflecting a 14% increase in recurring revenue and a 1% increase in SSRS, achieving high revenue growth despite recession in the country where GDP declined by 4%. This highlights the indispensable nature of Sage to support Business Builders during challenging economic times. New customer acquisition has driven the growth in recurring revenue: focus has been successfully shifted during the year to drive sales internally rather than through the Accountant network, with the product gaining pace and 10,000 units added in October alone.

As we introduced X3 into the Brazilian market and signed up business partners during the year, we have now secured 41 customers (FY15: 4).

The slight growth in SSRS reflects X3 licence sales offset by the trend to transition customers to subscription.

*Australia, Middle East and Asia*

In Australia, revenue growth of 3% was slow, but this does not reflect success in Sage One which grew by 12,000 units in the year mainly through the Accountants channel, and in professional services which grew by 22% due to X3 implementations.

Middle East and Asia revenue declined by 18% reflecting 17% growth in the Middle East, offset by decline in Malaysia and Singapore. Declining revenue in Asia represents a one-off revenue gain in FY15 due to legislative change in Malaysia in the prior year and a lack of new product introductions which will be addressed in FY17. Following the introduction of Blair Crump as Sage President and the reorganisation of regional management, we are confident we have the leadership in place to drive growth in Asia.

## Financial review

| | FY16 | | | FY15 | | |
|---|---|---|---|---|---|---|
| **ORGANIC TO STATUTORY RECONCILIATIONS** | **Revenue** | **Operating profit** | **Margin** | **Revenue** | **Operating profit** | **Margin** |
| **Organic** | £1,567m | £427m | 27.2% | £1,477m | £391m | 26.5% |
| Organic adjustments[1] | £2m | - | | £3m | £1m | |
| Underlying | £1,569m | £427m | 27.2% | £1,480m | £392m | 26.5% |
| Impact of foreign exchange[2] | - | - | | (£44m) | (£12m) | |
| **Underlying (as reported)** | £1,569m | £427m | 27.2% | £1,436m | £380m | 26.5% |
| Recurring items[3] | - | (£19m) | | - | (£21m) | |
| Non-recurring items[4] | - | (£108m) | | - | (£62m) | |
| **Statutory** | £1,569m | £300m | 19.1% | £1,436m | £297m | 20.7% |

*[1]Organic adjustments comprise contributions from acquisitions, disposals and assets held for sale of standalone businesses.*
*[2]Impact of retranslating FY15 results at FY16 average rates.*
*[3]Recurring items comprise amortisation of acquired intangible assets, acquisition-related items and fair value adjustments.*
*[4]Non-recurring items comprise items that management judge to be one-off or non-operational including business transformation costs.*

### Revenue

Statutory revenue grew by 9% to £1,569m, reflecting organic growth, combined with foreign exchange movements experienced throughout the year. The impact of foreign exchange of £44m in FY15 reflects a currency tailwind following the EU referendum. The average exchange rates used to translate the consolidated income statement for the year are set out on page 16.

### Operating profit

Organic operating profit increased by 9% to £427m (FY15: £392m) in line with revenue and the organic operating profit margin increased by 0.7% to 27.2% in line with guidance issued in FY15. Statutory operating profit increased by £3m, although the operating profit margin fell by 1.6%.

*Adjustments between underlying and statutory operating profit*

Non-recurring items separated from underlying operating profit of £427m include £110m of non-recurring costs in relation to the Business Transformation comprised of people organisation charges of £51m, net property exit costs of £40m and other directly attributable costs of £19m, offset by a £2m credit in relation to the Archer litigation claim. Recurring items of £19m represents amortisation of acquisition related intangible assets and other acquisition related charges.

### Net finance cost

The statutory net finance cost for the year was £25m (2015: £21m) and the underlying net finance cost was £22m (2015: £21m). The difference between underlying and statutory net finance costs for the year reflects a fair value adjustment to a debt related instrument and FX movements on intercompany balances.

### Taxation

The statutory income tax expense was £67m (FY15: £82m). The effective tax rate on statutory profit before tax was 24% (FY15: 30%). The FY15 statutory tax rate included exceptional impairment charges which were not deductible for tax purposes. As there are no similar items in the current year, the FY16 statutory tax rate has reduced.

The effective tax rate on underlying profit before tax was 26% (FY15: 25%). The underlying tax rate has increased in the period as the FY15 rate included one-off credits which are not recurring in FY16.

### Earnings per share

Underlying basic earnings per share increased by 9% to 27.84p (FY15: 25.54p) and statutory basic earnings per share increased to 19.28p (FY15: 18.11p) due to increased operating profit and a lower effective tax rate.

### Cash flow and net debt

| CASH FLOW | FY16 | FY15 |
|---|---:|---:|
| **Underlying operating profit** | **£427m** | **£392m** |
| Exchange rate translation movements | **-** | (12m) |
| **Underlying operating profit (as reported)** | **£427m** | **£380m** |
| Non-recurring items | (£58m) | - |
| Depreciation/amortisation/profit on disposal | £30m | £29m |
| Share-based payments | £8m | £9m |
| Working capital and balance sheet movements | (£10m) | £5m |
| Exchange rate translation movements | £1m | (£5m) |
| **Statutory cash flow from operating activities** | **£398m** | **£419m** |
| Net interest paid | (£20m) | (£18m) |
| Tax paid | (£92m) | (£85m) |
| Net capital expenditure | (£32m) | (£20m) |
| **Free cash flow** | **£254m** | **£296m** |

| | | |
|---|---:|---:|
| **Statutory cash flow from operating activities** | £398m | £419m |
| Non-recurring cash items | £58m | - |
| Net capital expenditure | (£32m) | (£20m) |
| Eliminate exchange rate translation movements | £1m | £5m |

| | | |
|---|---|---|
| **Underlying cash flow from operating activities** | £425m | £403m |
| **Underlying cash conversion[1]** | **100%** | **106%** |

[1] *Refer to Appendix II on page 18 for information on Non-GAAP measures.*

The Group remains cash generative with underlying cash flows from operating activities of £425m, which represents strong underlying cash conversion of 100%.

A total of £145m was returned to shareholders through ordinary dividends paid. Net debt stood at £397m at 30 September 2016 (30 September 2015: £425m).

### Treasury management

The Group continues to be able to borrow at competitive rates and currently deems this to be the most effective means of raising finance. The current Group's syndicated bank multi-currency Revolving Credit Facility (RCF), expires in June 2019 with facility levels of £614m (US$551m and €218m tranches). There were no drawings on the RCF at 30 September 2016 (FY15: £82m).

Total USPP loan notes at 30 September 2016 were £575m (US$650m and EUR€85m), (2015: £525.4m, US$700m and EUR€85m). Approximately £35m (US$50m) of USPP borrowings were repaid in March 2016. This repayment was funded by free cash flow.

### Foreign exchange

The Group does not hedge foreign currency profit and loss translation exposures and the statutory results are therefore impacted by movements in exchange rates.

The average rates used to translate the consolidated income statement and to neutralise foreign exchange in prior year underlying and organic figures are as follows:

| AVERAGE EXCHANGE RATES (EQUAL TO GBP) | FY16 | FY15 | Change |
|---|---|---|---|
| Euro (€) | 1.28 | 1.35 | -5% |
| US Dollar ($) | 1.42 | 1.54 | -8% |
| South African Rand (ZAR) | 21.05 | 18.55 | +13% |
| Australian Dollar (A$) | 1.94 | 1.97 | -2% |
| Brazilian Real (R$) | 5.18 | 4.64 | +12% |

### Capital structure and dividend

With consistent and strong cash flows, the Group retains considerable financial flexibility going forward. The Board's main strategic policy remains an acceleration of growth, both organically and through targeted acquisitions. The growth underpins the Board's sustainable, progressive dividend policy with surplus cash being returned to shareholders from time to time. Consistent with this policy, the Board is proposing an 8% increase in the total ordinary dividend per share for the year to 14.15p per share (FY15: 13.10p per share). The ordinary dividend for the year is covered two times by underlying earnings per share.

# Appendix I – Key Performance Indicators ("KPIs") and other measures

| | | FY16 | FY15 |
|---|---|---|---|
| STRATEGIC KPIs | KPI DESCRIPTION | | |

| | | | |
|---|---|---|---|
| **Customers for life:**<br>Contract renewal rate | As we focus on providing exceptional customer experiences, we track the response of our customers by measuring the number of contracts successfully renewed for the last twelve months as a percentage of those that were due for renewal. | 86% | 84% |
| **Winning in the market:**<br>Adoption of Sage One | The number of paying subscriptions for our portfolio of Sage One products. | 313,000 | 173,000 |
| **Winning in the market:**<br>Adoption of Sage X3 | The percentage increase in underlying revenue derived from Sage X3. | 18% | 11% |
| **Revolutionise business:**<br>Annualised software subscription base ("ASB") | Our latest technologies are delivered to customers via software subscription relationships which drives growth in the ASB, calculated as the amount of organic software subscription revenue recorded in the last month of the period multiplied by 12. | £511m | £381m |
| **Capacity for growth:**<br>G&A% | Investing for growth is enabled by releasing efficiencies in General and Administrative ("G&A") expenses. We track progress by expressing G&A as a percentage of revenue (both on an organic basis). | 16.5% | 18.7% |
| **One Sage:**<br>Foundation Days | Doing business the right way is important at Sage. Giving back to the community through Sage Foundation allows our colleagues to volunteer to work with charitable causes. This is the first year we have had a quantitative measure of One Sage which recognises the importance of Sage Foundation within our organisation | 13,000 | N/A |

| FINANCIAL DRIVERS | KPI DESCRIPTION | FY16 | FY15 |
|---|---|---|---|
| Organic revenue growth | Organic revenue neutralises the impact of foreign exchange in prior period figures and excludes the contribution of current and prior period acquisitions, disposals and assets held for sale of standalone businesses. | 6.1% | 6.0% |
| Organic operating profit margin | Organic operating profit excludes:<br>– Recurring items including amortisation of acquired intangible assets, acquisition-related items and fair value adjustments;<br>– Non-recurring items that management judge to be one-off or non-operational; and<br>– The contribution of current and prior period acquisitions, disposals and assets held for sale of standalone businesses.<br>The impact of foreign exchange is neutralised in prior period figures. | 27.2% | 26.5% |
| Underlying basic EPS growth | Underlying basic EPS is defined as underlying profit after tax divided by the weighted average number of ordinary shares in issue during the period, excluding those held as treasury shares.<br>Underlying profit after tax is defined as profit attributable to owners of the parent excluding:<br>– Recurring items including amortisation of acquired intangible assets, acquisition-related items, fair value adjustments and imputed interest; and<br>– Non-recurring items that management judge to be one-off or non-operational.<br>All of these adjustments are net of tax. The impact of foreign exchange is neutralised in prior period figures. | 9.0% | 12.6% |
| Underlying cash conversion | Underlying cash conversion is underlying cash flow from operating activities divided by underlying operating profit. Underlying cash flow from operating activities is statutory cash flow from operating activities less net capital expenditure and adjusted for movements on foreign exchange rates and non-recurring cash items. | 100% | 106% |
| Net debt leverage | The net value of cash less borrowings expressed as a multiple of rolling 12-month EBITDA. EBITDA is defined as earnings before interest, tax, depreciation, amortisation of acquired intangible assets, acquisition-related items, fair value adjustments and non-recurring items that management judge to be one-off or non-operational. | 0.9:1 | 1.0:1 |
| Interest cover | Statutory operating profit for the last twelve months excluding non-recurring items that management judge to be one-off or non-operational, expressed as a multiple of finance costs excluding imputed interest for the same period. | 20x | 17x |
| Dividend cover | Underlying earnings per share (as reported) divided by the full year dividend per share. | 2.0 | 1.9x |

# Appendix II – Non-GAAP measures

| MEASURE | DESCRIPTION | WHY WE USE IT |
|---|---|---|
| Underlying | Prior period underlying measures are retranslated at the current year exchange rates to neutralise the effect of currency fluctuations.<br><br>Underlying operating profit excludes: | Underlying measures allow management and investors to compare performance without the potentially distorting effects of foreign exchange movements, one-off items or non-operational items. |

| | | |
|---|---|---|
| | – Recurring items:<br>· Amortisation of acquired intangible assets;<br>· Acquisition-related items;<br>· Fair value adjustments on non-debt-related financial instruments and foreign currency movements on intercompany debt balances; and<br><br>– Non-recurring items that management judge are one-off or non-operational<br><br>Underlying profit before tax excludes:<br>– All the items above; and<br>– Imputed interest; and<br>– Fair value adjustments on debt-related financial instruments.<br><br>Underlying profit after tax and earnings per share excludes:<br>– All the items above net of tax. | By including part-period contributions from acquisitions, disposals and assets held for sale of standalone businesses in the current and/or prior periods, the impact of M&A decisions on earnings per share growth can be evaluated. |
| Organic | In addition to the adjustments made for underlying measures, organic measures exclude the contribution from acquisitions, disposals and assets held for sale of standalone businesses in the current and prior period. Acquisitions and disposals which occurred close to the start of the opening comparative period where the contribution impact would be immaterial are not adjusted. | Organic measures allow management and investors to understand the like-for-like performance of the business. |
| Underlying cash conversion | Underlying cash conversion is underlying cash flow from operating activities divided by underlying operating profit. Underlying cash flow from operating activities is statutory cash flow from operating activities less net capital expenditure and adjusted for movements on foreign exchange rates and non-recurring cash items. | Underlying cash conversion informs management and investors about the cash operating cycle of the business and how efficiently operating profit is converted into cash. |
| Underlying (as reported) | Where prior period underlying measures are included without retranslation at current period exchange rates, they are labelled as underlying (as reported). | This measure is used to report comparative figures for external reporting purposes where it would not be appropriate to retranslate. For instance, on the face of primary financial statements. |

| Revenue Type | DESCRIPTION |
|---|---|
| Recurring revenue | Recurring revenue is revenue earned from customers for the provision of a good or service, where risks and rewards are transferred to the customer over the term of a contract, with the customer being unable to continue to benefit from the full functionality of the good or service without ongoing payments. Recurring revenue includes both software subscription revenue and maintenance and service revenue. |
| Software subscription revenue | Subscription revenue is revenue earned from customers for the provision of a good or service, where the risk and rewards are transferred to the customer over the term of a contract. In the event that the customer stops paying, they lose the legal right to use the software and the Company has the ability to restrict the use of the product or service. (Also known as 'Pay to play'). |
| Software and software related services ("SSRS") | SSRS revenue is for goods or services where the entire benefit is passed to the customer at the point of delivery. It comprises revenue for software or upgrades sold on a perpetual license basis and software related services, including hardware sales, professional services and training. |
| Processing revenue | Processing revenue is revenue earned from customers for the processing of payments or where Sage colleagues process our customers' payroll. |

# Consolidated income statement
## For the year ended 30 September 2016

| | Note | **Underlying 2016 £m** | **Adjustments 2016 £m** | **Statutory 2016 £m** | Underlying as reported 2015 £m | Adjustments 2015 £m | Statutory 2015 £m |
|---|---|---|---|---|---|---|---|
| Revenue | 2 | **1,569.1** | **–** | **1,569.1** | 1,435.5 | – | 1,435.5 |
| Cost of sales | | **(103.0)** | **–** | **(103.0)** | (86.7) | – | (86.7) |

| | | | | | | | |
|---|---|---|---|---|---|---|---|
| Gross profit | | **1,466.1** | **–** | **1,466.1** | 1,348.8 | – | 1,348.8 |
| Selling and administrative expenses | | **(1,039.1)** | **(126.6)** | **(1,165.7)** | (968.9) | (82.7) | (1,051.6) |
| Operating profit | 2 | **427.0** | **(126.6)** | **300.4** | 379.9 | (82.7) | 297.2 |
| Share of loss of an associate | | **(0.4)** | **(0.6)** | **(1.0)** | – | – | – |
| Finance income | | **2.4** | **2.7** | **5.1** | 2.2 | – | 2.2 |
| Finance costs | | **(24.1)** | **(5.9)** | **(30.0)** | (23.6) | – | (23.6) |
| Profit before income tax | | **404.9** | **(130.4)** | **274.5** | 358.5 | (82.7) | 275.8 |
| Income tax expense | 4 | **(105.1)** | **38.2** | **(66.9)** | (90.3) | 8.8 | (81.5) |
| Profit for the period | | **299.8** | **(92.2)** | **207.6** | 268.2 | (73.9) | 194.3 |
| | | | | | | | |
| Profit attributable to: | | | | | | | |
| Owners of the parent | | **299.8** | **(92.2)** | **207.6** | 268.2 | (73.9) | 194.3 |
| | | | | | | | |
| Earnings per share attributable to the owners of the parent (pence) | | | | | | | |
| Basic | 6 | **27.84p** | | **19.28p** | 25.00p | | 18.11p |
| Diluted | 6 | **27.67p** | | **19.16p** | 24.85p | | 18.00p |

# Consolidated statement of comprehensive income
## For the year ended 30 September 2016

| | 2016 £m | 2015 £m |
|---|---|---|
| Profit for the period | **207.6** | 194.3 |
| Other comprehensive income/(expense) for the period: | | |
| Items that will not be reclassified to profit or loss: | | |
| Actuarial loss on post-employment benefit obligations | **(2.2)** | (4.8) |

| | | |
|---|---|---|
| Deferred tax credit on actuarial loss on post-employment benefit obligations | **0.8** | 0.6 |
| | **(1.4)** | (4.2) |
| Items that may be reclassified to profit or loss: | | |
| Deferred tax credit on foreign currency movements | **2.6** | – |
| Exchange differences on translating foreign operations | **117.1** | (23.2) |
| | **119.7** | (23.2) |
| Other comprehensive income/(expense) for the period, net of tax | **118.3** | (27.4) |
| Total comprehensive income for the period | **325.9** | 166.9 |
| Total comprehensive income for the period attributable to: | | |
| Owners of the parent | **325.9** | 166.9 |

The notes on pages 25 to 36 form an integral part of this condensed consolidated report.

# Consolidated balance sheet
## As at 30 September 2016

| | Note | **2016 £m** | 2015 £m |
|---|---|---|---|
| Non-current assets | | | |
| Goodwill | 7 | **1,658.5** | 1,446.0 |
| Other intangible assets | 7 | **109.3** | 105.5 |
| Property, plant and equipment | 7 | **123.4** | 122.7 |
| Investment in an associate | | **9.0** | – |

| | | | |
|---|---|---|---|
| Other financial assets | | **2.7** | – |
| Deferred income tax assets | | **58.4** | 34.2 |
| | | **1,961.3** | 1,708.4 |
| Current assets | | | |
| Inventories | | **2.1** | 2.0 |
| Trade and other receivables | | **419.5** | 320.9 |
| Current income tax asset | | **7.9** | – |
| Cash and cash equivalents (excluding bank overdrafts) | 10 | **264.5** | 263.4 |
| Assets classified as held for sale | | **1.0** | – |
| | | **695.0** | 586.3 |
| Total assets | | **2,656.3** | 2,294.7 |
| Current liabilities | | | |
| Trade and other payables | | **(350.5)** | (311.2) |
| Current income tax liabilities | | **(20.7)** | (31.4) |
| Borrowings | | **(43.3)** | (33.6) |
| Provisions | | **(37.6)** | (9.9) |
| Deferred income | | **(535.8)** | (436.5) |
| Liabilities classified as held for sale | | **(0.4)** | – |
| | | **(988.3)** | (822.6) |
| Non-current liabilities | | | |
| Borrowings | | **(534.4)** | (571.4) |
| Post-employment benefits | | **(25.3)** | (18.7) |
| Deferred income tax liabilities | | **(13.2)** | (7.3) |
| Provisions | | **(29.4)** | (10.4) |
| Trade and other payables | | **(7.5)** | – |
| Deferred income | | **(4.9)** | (2.2) |
| | | **(614.7)** | (610.0) |
| Total liabilities | | **(1,603.0)** | (1,432.6) |
| Net assets | | **1,053.3** | 862.1 |
| Equity attributable to owners of the parent | | | |
| Ordinary shares | 9 | **11.8** | 11.8 |
| Share premium | 9 | **544.4** | 541.2 |
| Other reserves | | **186.6** | 66.9 |
| Retained earnings | | **310.5** | 242.2 |
| Total equity | | **1,053.3** | 862.1 |

# Consolidated statement of changes in equity
## For the year ended 30 September 2016

| | Attributable to owners of the parent | | | | |
|---|---|---|---|---|---|
| | **Ordinary shares £m** | **Share premium £m** | **Other reserves £m** | **Retained earnings £m** | **Total £m** |
| At 1 October 2015 | **11.8** | **541.2** | **66.9** | **242.2** | **862.1** |
| Profit for the year | **–** | **–** | **–** | **207.6** | **207.6** |
| Other comprehensive income/(expense): | | | | | |
| Exchange differences on translating foreign operations | **–** | **–** | **117.1** | **–** | **117.1** |

| | | | | | |
|---|---|---|---|---|---|
| Deferred tax credit on foreign currency movements | **–** | **–** | **2.6** | **–** | **2.6** |
| Actuarial loss on post-employment benefit obligations | **–** | **–** | **–** | **(2.2)** | **(2.2)** |
| Deferred tax credit on actuarial gain on post-employment obligations | **–** | **–** | **–** | **0.8** | **0.8** |
| Total comprehensive income for the period ended 30 September 2016 | **–** | **–** | **119.7** | **206.2** | **325.9** |
| Transactions with owners: | | | | | |
| Employee share option scheme: | | | | | |
| - Proceeds from shares issued | **–** | **3.2** | **–** | **–** | **3.2** |
| - Value of employee services, net of deferred tax | **–** | **–** | **–** | **9.3** | **9.3** |
| Purchase of treasury shares | **–** | **–** | **–** | **(2.4)** | **(2.4)** |
| Dividends paid to owners of the parent | **–** | **–** | **–** | **(144.8)** | **(144.8)** |
| Total transactions with owners for the period ended 30 September 2016 | **–** | **3.2** | **–** | **(137.9)** | **(134.7)** |
| At 30 September 2016 | **11.8** | **544.4** | **186.6** | **310.5** | **1,053.3** |

| | Attributable to owners of the parent | | | | |
|---|---|---|---|---|---|
| | Ordinary shares £m | Share premium £m | Other reserves £m | Retained earnings £m | Total £m |
| At 1 October 2014 | 11.7 | 535.9 | 90.1 | 130.2 | 767.9 |
| Profit for the year | – | – | – | 194.3 | 194.3 |
| Other comprehensive (expense)/income: | | | | | |
| Exchange differences on translating foreign operations | – | – | (23.2) | – | (23.2) |
| Actuarial loss on post-employment benefit obligations | – | – | – | (4.8) | (4.8) |
| Deferred tax credit on actuarial gain on post-employment obligations | – | – | – | 0.6 | 0.6 |
| Total comprehensive (expense)/income for the period ended 30 September 2015 | – | – | (23.2) | 190.1 | 166.9 |
| Transactions with owners: | | | | | |
| Employee share option scheme: | | | | | |
| - Proceeds from shares issued | 0.1 | 5.3 | – | – | 5.4 |
| - Value of employee services, net of deferred tax | – | – | – | 10.1 | 10.1 |
| Purchase of treasury shares | – | – | – | (14.6) | (14.6) |
| Expenses related to the purchase of treasury shares | – | – | – | (0.1) | (0.1) |
| Close period share buyback programme | – | – | – | 60.0 | 60.0 |
| Dividends paid to owners of the parent | – | – | – | (133.5) | (133.5) |
| Total transactions with owners for the period ended 30 September 2015 | 0.1 | 5.3 | – | (78.1) | (72.7) |
| At 30 September 2015 | 11.8 | 541.2 | 66.9 | 242.2 | 862.1 |

# Consolidated statement of cash flows
## For the year ended 30 September 2016

| | Notes | **2016 £m** | 2015 £m |
|---|---|---|---|
| Cash flows from operating activities | | | |
| Cash generated from continuing operations | 10 | **397.9** | 418.6 |
| Interest paid | | **(21.1)** | (19.2) |
| Income tax paid | | **(92.1)** | (84.6) |
| Net cash generated from operating activities | | **284.7** | 314.8 |

| | | | |
|---|---|---|---|
| Cash flows from investing activities | | | |
| Acquisitions of subsidiaries, net of cash acquired | 11 | **(6.4)** | (47.3) |
| Purchases of intangible assets | 7 | **(7.7)** | (6.0) |
| Purchases of property, plant and equipment | 7 | **(23.5)** | (16.4) |
| Purchase of investment in an associate | | **(10.0)** | – |
| Proceeds from sale of property, plant and equipment | | **0.1** | 2.1 |
| Interest received | | **2.4** | 2.2 |
| Net cash generated from investing activities | | **(45.1)** | (65.4) |
| Cash flows from financing activities | | | |
| Proceeds from issuance of ordinary shares | 9 | **3.2** | 5.4 |
| Purchase of treasury shares | | **(2.4)** | (17.7) |
| Finance lease principal payments | | **(0.6)** | (1.4) |
| Proceeds from borrowings | | **69.2** | 481.2 |
| Repayments of borrowings | | **(188.8)** | (474.5) |
| Movements in cash held on behalf of customers | | **(13.0)** | 12.5 |
| Borrowing costs | | **(1.5)** | (1.3) |
| Dividends paid to owners of the parent | 5 | **(144.8)** | (133.5) |
| Net cash used in financing activities | | **(278.7)** | (129.3) |
| Net (decrease)/increase in cash, cash equivalents and bank overdrafts (before exchange rate movement) | 10 | **(39.1)** | 120.1 |
| Effects of exchange rate movement | 10 | **35.9** | (0.4) |
| Net (decrease)/increase in cash, cash equivalents and bank overdrafts | | **(3.2)** | 119.7 |
| Cash, cash equivalents and bank overdrafts at 1 October | 10 | **263.4** | 143.7 |
| Cash, cash equivalents and bank overdrafts at period end | 10 | **260.2** | 263.4 |

# Notes to the financial information
## For the year ended 30 September 2016

### 1 Group accounting policies

#### General information

The Sage Group plc ("the Company") and its subsidiaries (together "the Group") is a leading global supplier of business management software to Small & Medium Businesses.

The financial information set out above does not constitute the Company's Statutory Accounts for the year ended 30 September 2016 or 2015, but is derived from those accounts. Statutory Accounts for the year ended 30 September 2015 have been delivered to the Registrar of Companies and those for 2016 will be delivered in December 2016. The auditors have reported on both sets of accounts; their reports were unqualified and did not contain statements under section 498 (2), (3) or (4) of the Companies Act 2006.

Whilst the financial information included in this announcement has been computed in accordance with International Financial Reporting Standards ("IFRSs") as adopted by the European Union ("EU"), this announcement does not in itself contain sufficient information to comply with IFRSs. The financial information has been prepared on the basis of the accounting policies as set out in the Annual Report & Accounts for 2015.

The Company is a limited liability company incorporated and domiciled in the UK. The address of its registered office is North Park, Newcastle upon Tyne, NE13 9AA. The Company is listed on the London Stock Exchange.

### Basis of preparation

The consolidated financial statements of The Sage Group plc have been prepared in accordance with International Financial Reporting Standards ("IFRS") as adopted by the European Union ("EU"). The consolidated financial statements have been prepared under the historical cost convention, except where adopted IFRS require an alternative treatment. The principal variations from the historical cost convention relate to derivative financial instruments which are measured at fair value through profit or loss.

The financial statements of the Group comprise the financial statements of the Company and entities controlled by the Company (its subsidiaries) prepared at the end of the reporting period. The accounting policies have been consistently applied across the Group. Control is achieved where the Company has the power to govern the financial and operating policies of an entity so as to benefit from its activities which is usually from date of acquisition.

### Adoption of new and revised IFRSs

There are no IFRS, IAS amendments or IFRIC interpretations effective for the first time this financial year that have had a material impact on the Group.

### Critical accounting estimates and judgements

The preparation of financial statements requires the use of accounting estimates and assumptions by management. It also requires management to exercise its judgement in the process of applying the accounting policies. We continually evaluate our estimates, assumptions and judgements based on available information. The areas involving a higher degree of judgement or complexity are described below.

The judgements and management's rationale in relation to these accounting estimates and judgements are assessed and, where material in value or in risk, are discussed with the Audit and Risk Committee.

### Revenue recognition

Approximately 30% of the company's revenue is generated from sales to partners rather than to end users. The key judgement in accounting for the three principal ways in which our business partners are remunerated is determining whether the business partner is a customer of the Group in respect of the initial product sale. The key criteria in this determination is whether the business partner has paid for and taken on the risks and rewards of ownership of the software product from Sage. At this point the business partner is able to sell on the licence to the end user at a price of its determination and consequently bears the credit risk of the onward sale.

Where the business partner is a customer of Sage, there are two ways in which they can be remunerated. Firstly, there are discounts granted as a discount from the list price. These discounts are negotiated between the Company and the business partner prior to the sale and invoices are raised, and revenue booked is based on the discounted price. Secondly, there are further discounts given to business partners for subsequent renewals or increased sales to the end user. These discounts are recognised as a deduction from the incremental revenue earned.

Where the business partner is not a customer of Sage and their part in the sale has simply been in the form of a referral, they are remunerated in the form of a commission payment. These payments are treated as a cost within selling and administrative costs.

An additional area of judgement is the recognition and deferral of revenue on bundled products, for example the sale of a perpetual licence with an annual maintenance and support contract. When products are bundled together for the purpose of sale, the associated revenue, net of all applicable discounts, is allocated between the constituent parts of the bundle on a relative fair value basis. The Group has a systematic basis for allocating relative fair values in these situations, based upon published list prices.

### Goodwill impairment

There are two key judgements in relation to goodwill impairment.

The first is the ongoing appropriateness of the cash-generating units ("CGUs") for the purpose of impairment testing. In the current year CGUs were assessed in the context of the Group's evolving business model, the Sage strategy and the shift to global product development. As management continues to monitor goodwill at a country level and product cash flows are still predominantly generated by the existing product base within each country, it was determined that the existing CGUs remain appropriate.

The other key judgement area relates to the assumptions applied in calculating the value in use of the CGUs being tested for impairment. The key assumptions applied in the calculation relate to the future performance expectations of the business – average medium-term revenue growth and long term growth rate – as well as the discount rate to be applied in the calculation.

### Tax provisions

The Group recognises certain provisions and accruals in respect of tax which involve a degree of estimation and uncertainty where the tax treatment cannot finally be determined until a resolution has been reached by the relevant tax authority. This approach resulted in providing £18.7m as at 30 September 2016 (2015: £32.8m).

The carrying amount is sensitive to the resolution of issues which is not always within the control of the Group and it is often dependent on the efficiency of the legal processes in the relevant taxing jurisdictions in which the Group operates. Issues can take many years to resolve and assumptions on the likely outcome have therefore been made by management.

The nature of the assumptions made by management when calculating the carrying amounts relates to the estimated tax which could be payable as a result of decisions by tax authorities in respect of transactions and events whose treatment for tax purposes is uncertain. In making the estimates, management's judgement was based on various factors, including:

- the status of recent and current tax audits and enquiries;
- the results of previous claims; and
- any changes to the relevant tax environments.

When making this assessment, we utilise our specialist in-house tax knowledge and experience of similar situations elsewhere to confirm these provisions. These judgements also take into consideration specialist tax advice provided by third party advisors on specific items.

### Website

This condensed consolidated annual financial report for the year ended 30 September 2016 can also be found on our website: www.sage.com/investors/investor-downloads

## 2 Segment information

In accordance with IFRS 8, "Operating Segments", information for the Group's operating segments has been derived using the information used by the chief operating decision maker. The Group's Executive Committee has been identified as the chief operating decision maker in accordance with their designated responsibility for the allocation of resources to operating segments and assessing their performance, through the Quarterly Business Reviews ("QBRs") chaired by the Chief Executive Officer and Chief Financial Officer. The Executive Committee use organic and underlying data to monitor business performance. Operating segments are reported in a manner which is consistent with the operating segments produced for internal management reporting.

The Group is organised into four key operating segments, with Brazil being aggregated with AAMEA with which there are similar economic characteristics to form the International reporting segment. The UK is the home country of the parent. The reporting segments and their main operating territories are as follows:

– Europe (France, UK & Ireland, Spain, Germany, Switzerland, Poland, Portugal and Sage Pay)
– North America (US and Canada)
– International (Brazil, Africa, Australia, Middle East and Asia)

The Africa operations are principally based in South Africa; the Middle East and Asia operations are principally based in Singapore, Malaysia and UAE.

The revenue analysis in the table below is based on the location of the customer which is not materially different from the location where the order is received and where the assets are located.

### Revenue by segment

| | **Year ended 30 September 2016** | | | Change | | |
|---|---|---|---|---|---|---|
| | **Statutory and underlying £m** | **Organic adjustments £m** | **Organic £m** | Statutory | Underlying | Organic |

| | | | | | | |
|---|---|---|---|---|---|---|
| Recurring revenue by segment | | | | | | |
| Europe | **641.7** | **–** | **641.7** | 13.5% | 10.2% | 10.2% |
| North America | **307.9** | **–** | **307.9** | 16.3% | 8.5% | 8.5% |
| International | **143.3** | **(1.1)** | **142.2** | 7.7% | 15.8% | 16.0% |
| Recurring revenue | **1,092.9** | **(1.1)** | **1,091.8** | 13.5% | 10.4% | 10.4% |
| Software and software related services (“SSRS”) revenue by segment | | | | | | |
| Europe | **149.1** | **–** | **149.1** | (4.0%) | (7.4%) | (7.4%) |
| North America | **70.5** | **–** | **70.5** | (0.8%) | (7.6%) | (7.6%) |
| International | **52.6** | **(0.8)** | **51.8** | (18.2%) | (13.5%) | (12.4%) |
| SSRS revenue | **272.2** | **(0.8)** | **271.4** | (6.4%) | (8.7%) | (8.5%) |
| Processing revenue by segment | | | | | | |
| Europe | **36.2** | **–** | **36.2** | 11.7% | 11.5% | 11.5% |
| North America | **157.1** | **–** | **157.1** | 11.3% | 2.9% | 2.9% |
| International | **10.7** | **–** | **10.7** | 32.1% | 49.8% | 49.8% |
| Processing revenue | **204.0** | **–** | **204.0** | 12.3% | 6.1% | 6.1% |
| Total revenue by segment | | | | | | |
| Europe | **827.0** | **–** | **827.0** | 9.8% | 6.6% | 6.6% |
| North America | **535.5** | **–** | **535.5** | 12.3% | 4.4% | 4.4% |
| International | **206.6** | **(1.9)** | **204.7** | 0.6% | 7.8% | 8.4% |
| Total revenue | **1,569.1** | **(1.9)** | **1,567.2** | 9.3% | 6.0% | 6.1% |

## Revenue by segment (continued)

| | Year ended 30 September 2015 | | | | |
|---|---|---|---|---|---|
| | Statutory and Underlying as | Impact of foreign exchange | Underlying £m | Organic adjustments £m | Organic £m |

| | Reported £m | £m | | | |
|---|---|---|---|---|---|
| Recurring revenue by segment | | | | | |
| Europe | 565.3 | 17.1 | 582.4 | – | 582.4 |
| North America | 264.7 | 19.0 | 283.7 | – | 283.7 |
| International | 133.1 | (9.3) | 123.8 | (1.2) | 122.6 |
| Recurring revenue | 963.1 | 26.8 | 989.9 | (1.2) | 988.7 |
| Software and software related services ("SSRS") revenue by segment | | | | | |
| Europe | 155.3 | 5.7 | 161.0 | – | 161.0 |
| North America | 71.1 | 5.2 | 76.3 | – | 76.3 |
| International | 64.3 | (3.5) | 60.8 | (1.7) | 59.1 |
| SSRS revenue | 290.7 | 7.4 | 298.1 | (1.7) | 296.4 |
| Processing revenue by segment | | | | | |
| Europe | 32.4 | 0.2 | 32.6 | – | 32.6 |
| North America | 141.2 | 11.5 | 152.7 | – | 152.7 |
| International | 8.1 | (1.0) | 7.1 | – | 7.1 |
| Processing revenue | 181.7 | 10.7 | 192.4 | – | 192.4 |
| Total revenue by segment | | | | | |
| Europe | 753.0 | 23.0 | 776.0 | – | 776.0 |
| North America | 477.0 | 35.7 | 512.7 | – | 512.7 |
| International | 205.5 | (13.8) | 191.7 | (2.9) | 188.8 |
| Total revenue | 1,435.5 | 44.9 | 1,480.4 | (2.9) | 1,477.5 |

## Operating profit by segment

| | **Year ended 30 September 2016** | | | | | Change | | |
|---|---|---|---|---|---|---|---|---|
| | **Statutory £m** | **Underlying adjustments £m** | **Underlying £m** | **Organic adjustments £m** | **Organic £m** | Statutory % | Underlying % | Organic % |
| Operating profit by segment | | | | | | | | |
| Europe | **167.6** | **88.1** | **255.7** | **–** | **255.7** | (22.6%) | 12.7% | 12.7% |
| North America | **106.0** | **28.3** | **134.3** | **–** | **134.3** | 11.7% | 15.9% | 15.9% |
| International | **26.8** | **10.2** | **37.0** | **(0.1)** | **36.9** | – | (25.5%) | (23.4%) |
| Total operating profit | **300.4** | **126.6** | **427.0** | **(0.1)** | **426.9** | 1.1% | 8.8% | 9.2% |

| | Year ended 30 September 2015 | | | | | | |
|---|---|---|---|---|---|---|---|
| | Statutory £m | Underlying adjustments £m | Underlying as reported £m | Impact of foreign exchange £m | Underlying £m | Organic adjustments £m | Organic £m |
| Operating profit by segment | | | | | | | |
| Europe | 216.6 | 6.4 | 223.0 | 3.9 | 226.9 | – | 226.9 |
| Americas | 94.9 | 7.5 | 102.4 | 13.5 | 115.9 | – | 115.9 |
| International | (14.3) | 68.8 | 54.5 | (5.0) | 49.5 | (1.3) | 48.2 |
| Total operating profit | 297.2 | 82.7 | 379.9 | 12.4 | 392.3 | (1.3) | 391.0 |

## Reconciliation of underlying operating profit to statutory operating profit

| | **Year ended 30 September 2016 £m** | Year ended 30 September 2015 £m |
|---|---|---|
| Underlying operating profit | **427.0** | 379.9 |

| | | |
|---|---|---|
| Amortisation of acquired intangible assets | **(18.2)** | (18.2) |
| Other acquisition-related items | **(0.7)** | – |
| Goodwill impairment and fair value adjustments | **–** | (64.5) |
| Non-recurring items | **(107.7)** | – |
| Statutory operating profit | **300.4** | 297.2 |

### 3 Adjustments between underlying profit and statutory profit

| | **Year ended 30 September 2016 Recurring £m** | **Year ended 30 September 2016 Non-recurring £m** | **Year ended 30 September 2016 Total £m** | Year ended 30 September 2015 Recurring £m | Year ended 30 September 2015 Non-recurring £m | Year ended 30 September 2015 Total £m |
|---|---|---|---|---|---|---|
| Amortisation of acquired intangibles | **18.2** | **–** | **18.2** | 18.2 | – | 18.2 |
| Fair value adjustments | **–** | **–** | **–** | 2.2 | – | 2.2 |
| Other acquisition-related items | **0.7** | **–** | **0.7** | – | – | – |
| Litigation related items | **–** | **(2.2)** | **(2.2)** | – | – | – |
| Transformation costs | **–** | **109.9** | **109.9** | – | – | – |
| Goodwill impairment | **–** | **–** | **–** | – | 62.3 | 62.3 |
| Total adjustments made to operating profit | **18.9** | **107.7** | **126.6** | 20.4 | 62.3 | 82.7 |
| Fair value adjustments | **(2.7)** | **–** | **(2.7)** | – | – | – |
| Amortisation of acquired intangibles | **0.6** | **–** | **0.6** | – | – | – |
| Foreign currency movements on intercompany balances | **5.9** | **–** | **5.9** | – | – | – |
| Total adjustments made to profit before income tax | **22.7** | **107.7** | **130.4** | 20.4 | 62.3 | 82.7 |

#### Recurring items

Acquired intangibles are assets which have previously been recognised as part of business combinations. These assets are predominantly brands, customer relationships and technology rights.

Other acquisition-related items relate to completed transaction costs and include advisory, legal, accounting, valuation and other professional or consulting services.

The fair value adjustment relates to an embedded derivative asset which relates to contractual terms agreed as part of the US private placement debt.

Amortisation of acquired intangibles below operating profit relates to the Group's share of the amortisation of intangible assets arising on the acquisition of an investment in an associate accounted for under the equity method.

Foreign currency movements on intercompany balances of £5.9m occurs due to retranslation of intercompany balances other than those where settlement is not planned or likely in the foreseeable future. The balance arises in the current year due to fluctuation in exchange rates, predominately the movement in Euro and US Dollar compared to sterling.

The prior year fair value adjustment of £2.2m relates to an accounting loss on fair valuation of the call option in relation to the possible acquisition of Mastermaq.

### Non-recurring items

Net charges in respect of non-recurring items amounted to £107.7m (2015: £62.3m).

Charges of £109.9m have been incurred in the current year as a result of the implementation of the business transformation strategy. This is comprised of people reorganisation charges of £51.5m, net property exit costs of £39.7m and other directly attributable costs, mainly relating to consultancy, contractor and asset write downs, of £18.7m.

The people reorganisation charges comprise severance costs of £43.8m with the remaining cost largely arising from retention payments, transition and overlap costs whilst implementing the new operating model. The property exit costs consist of net lease exit costs following consolidation of office space used and impairment and accelerated depreciation of leasehold improvement assets and other related assets that are no longer in use due to the property exits. The other costs include expenditure that is directly attributable to the implementation of the new operating model under the business transformation strategy, including advisory, legal, accounting, valuation and other professional or consulting services.

These charges are one-off in nature and directly linked to the business transformation that is under way. Given the scale of the change, further non-recurring costs will be incurred in the next financial year.

Total cash paid in relation to the business transformation strategy totalled £57.9m in the year.

In addition, there has been income of £2.2m in the year arising from recovery of costs relating to the Archer Capital litigation case following its conclusion in 2015. All other litigation costs which may be incurred through the normal course of business are charged through operating expenses.

As a result of the prior year annual goodwill impairment review, an impairment of the goodwill held in the Brazilian business was recognised in 2015, totalling £62.3m.

## 4 Income tax expense

The statutory effective income tax rate for the year ended 30 September 2016 is 24% (2015: 30%), whilst the effective tax rate on underlying profit before tax was 26% (2015: 25%). The difference between the statutory effective tax rate and the underlying tax rate relates to non-recurring items which are deductible in countries with a tax rate higher than the UK.

The underlying effective tax rate is higher than the UK corporation tax rate applicable to the Group due to the geographic profile of the Group. In addition, there is an obligation to account for local business taxes in the corporate tax expense. These additional tax expenses are offset by research and development tax credits which are a government incentive in a number of operating territories.

## 5 Dividends

| | **Year ended 30 September 2016 £m** | Year ended 30 September 2015 £m |
|---|---|---|
| Final dividend paid for the year ended 30 September 2015 of 8.65p per share | **93.0** | – |

| | | |
|---|---|---|
| Final dividend paid for the year ended 30 September 2014 of 8.00p per share | **–** | 85.7 |
| Interim dividend paid for the year ended 30 September 2016 of 4.80p per share | **51.8** | – |
| Interim dividend paid for the year ended 30 September 2015 of 4.45p per share | **–** | 47.8 |
| | **144.8** | 133.5 |

In addition, the directors are proposing a final dividend in respect of the financial year ended 30 September 2016 of 9.35p per share which will absorb an estimated £101m of shareholders' funds. It will be paid on 3 March 2017 to shareholders who are on the register of members on 10 February 2017. These financial statements do not reflect this dividend payable.

## 6 Earnings per share

Basic earnings per share is calculated by dividing the profit for the year attributable to owners of the parent by the weighted average number of ordinary shares in issue during the year, excluding those held as treasury shares, which are treated as cancelled.

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

| | **Underlying 2016** | Underlying as reported 2015 | Underlying 2015 | **Statutory 2016** | Statutory 2015 |
|---|---|---|---|---|---|
| Earnings attributable to owners of the parent (£m) | | | | | |
| Profit for the period | **299.8** | 268.2 | 274.0 | **207.6** | 194.3 |
| Number of shares (millions) | | | | | |
| Weighted average number of shares | **1,077.0** | 1,073.0 | 1,073.0 | **1,077.0** | 1,073.0 |
| Dilutive effects of shares | **6.3** | 6.5 | 6.5 | **6.3** | 6.5 |
| | **1,083.3** | 1,079.5 | 1,079.5 | **1,083.3** | 1,079.5 |
| Earnings per share attributable to owners of the parent (pence) | | | | | |
| Basic earnings per share | **27.84** | 25.00 | 25.54 | **19.28** | 18.11 |
| Diluted earnings per share | **27.67** | 24.85 | 25.38 | **19.16** | 18.00 |

| **Reconciliation of earnings** | **Year ended 30 September 2016 £m** | Year ended 30 September 2015 £m |
|---|---|---|
| Underlying earnings attributable to owners of the parent | **299.8** | 274.0 |
| Impact of movement in foreign currency exchange rates | **–** | (5.8) |
| Underlying earnings attributable to owners of the parent (as previously reported) | **299.8** | 268.2 |

| | | |
|---|---|---|
| Amortisation of acquired intangible assets | **(18.8)** | (18.2) |
| Goodwill impairment and fair value adjustments | **2.7** | (64.5) |
| Foreign currency movements on intercompany balances | **(5.9)** | – |
| Other acquisition-related items | **(0.7)** | – |
| Transformation costs and litigation related items | **(107.7)** | – |
| Taxation on adjustments | **38.2** | 8.8 |
| Net adjustments | **(92.2)** | (73.9) |
| Earnings statutory profit for the year | **207.6** | 194.3 |

## 7 Non-current assets

| | **Goodwill £m** | **Other intangible assets £m** | **Property, plant and equipment £m** | **Total £m** |
|---|---|---|---|---|
| Opening net book amount at 1 October 2015 | **1,446.0** | **105.5** | **122.7** | **1,674.2** |
| Additions | **–** | **7.7** | **23.5** | **31.2** |
| Acquisition | **–** | **6.4** | **–** | **6.4** |
| Disposals | **–** | **(0.2)** | **(0.1)** | **(0.3)** |
| Depreciation, amortisation and other movements | **–** | **(29.6)** | **(22.2)** | **(51.8)** |
| Impairment | **–** | **–** | **(6.6)** | **(6.6)** |
| Exchange movement | **212.5** | **19.5** | **6.1** | **238.1** |
| Closing net book amount at 30 September 2016 | **1,658.5** | **109.3** | **123.4** | **1,891.2** |

| | Goodwill £m | Other intangible assets £m | Property, plant and equipment £m | Total £m |
|---|---|---|---|---|
| Opening net book amount at 1 October 2014 | 1,433.0 | 98.1 | 126.7 | 1,657.8 |
| Additions | – | 6.0 | 16.4 | 22.4 |
| Acquisition | 61.9 | 34.2 | 1.0 | 97.1 |
| Disposals | – | (0.2) | (2.1) | (2.3) |
| Depreciation, amortisation and other movements | – | (29.1) | (18.2) | (47.3) |
| Impairment | (62.3) | – | – | (62.3) |
| Exchange movement | 13.4 | (3.5) | (1.1) | 8.8 |
| Closing net book amount at 30 September 2015 | 1,446.0 | 105.5 | 122.7 | 1,674.2 |

Goodwill is not subject to amortisation, but is tested for impairment annually at the year-end or whenever there is any indication of impairment. The Group performed its annual test for impairment in the third quarter of 2016. The recoverable amount exceeded the carrying value for all CGUs. In the prior year an impairment of £62.3m was recognised, driven by economic uncertainty in Brazil.

Detail of the current period acquisition has been provided in note 11.

## 8 Financial instruments

For financial assets and liabilities other than borrowings, the carrying amount of the financial instrument approximates the fair value of the instruments. At 30 September 2016, USPP borrowings with a carrying value of £577.7m had a fair value of £602.9m due to bearing interest at fixed rates which are currently higher than equivalent current market fixed rates.

## 9 Ordinary shares and share premium

| | Number of shares | Ordinary shares £m | Share premium £m | Total £m |
|---|---|---|---|---|
| At 1 October 2015 | **1,118,298,748** | **11.8** | **541.2** | **553.0** |
| Shares issued/proceeds | **1,181,615** | **–** | **3.2** | **3.2** |
| At 30 September 2016 | **1,119,480,363** | **11.8** | **544.4** | **556.2** |

| | Number of shares | Ordinary Shares £m | Share premium £m | Total £m |
|---|---|---|---|---|
| At 1 October 2014 | 1,115,892,047 | 11.7 | 535.9 | 547.6 |
| Shares issued/proceeds | 2,406,701 | 0.1 | 5.3 | 5.4 |
| At 30 September 2015 | 1,118,298,748 | 11.8 | 541.2 | 553.0 |

During the year, under the Executive Share Option Scheme, 500,489 $1^{4/77}$p ordinary shares were issued during the year for aggregate proceeds of £0.9m. Under the Savings-related Share Option Scheme, 675,608 $1^{4/77}$p ordinary shares were issued for aggregate proceeds of £2.3m.

## 10 Cash flow and net debt

| Reconciliation of profit for the year to cash generated from continuing operations | Year ended 30 September 2016 £m | Year ended 30 September 2015 £m |
|---|---|---|
| Profit for the year | **207.6** | 194.3 |
| Adjustments for: | | |
| Income tax | **66.9** | 81.5 |
| Finance income | **(5.1)** | (2.2) |
| Finance costs | **30.0** | 23.6 |
| Share of loss of an associate | **1.0** | – |
| Amortisation and impairment of intangible assets | **29.6** | 29.1 |
| Depreciation and impairment of property, plant and equipment | **28.8** | 18.2 |
| R&D tax credits | **(2.0)** | (2.3) |
| Equity-settled share-based transactions | **7.9** | 9.1 |
| Fair value adjustments and goodwill impairment | **–** | 64.5 |
| Exchange movement | **(0.4)** | (4.7) |
| Changes in working capital (excluding effects of acquisitions and disposals of subsidiaries): | | |
| - Decrease/(increase) in inventories | **0.2** | (0.2) |
| - Increase in trade and other receivables | **(53.8)** | (8.4) |
| - Increase/(decrease) in trade and other payables | **50.8** | (6.8) |
| - Increase in deferred income | **36.4** | 22.9 |
| Cash generated from continuing operations | **397.9** | 418.6 |

| Reconciliation of net cash flow to movement in net debt (inclusive of finance leases) | 2016 £m | 2015 £m |
|---|---|---|
| (Decrease)/increase in cash in the year (pre-exchange movements) | **(22.7)** | 90.5 |
| Cash inflow/(outflow) from movement in loans, finance leases and cash held on behalf of customers | **133.2** | (17.8) |
| Change in net debt resulting from cash flows | **110.5** | 72.7 |
| Acquisitions | **(16.4)** | (21.3) |
| Non-cash movements | **(1.0)** | – |

| | | |
|---|---|---|
| Exchange movement | **(64.7)** | (39.6) |
| Movement in net debt in the year | **28.4** | 11.8 |
| Net debt at 1 October | **(425.4)** | (437.2) |
| Net debt at 30 September | **(397.0)** | (425.4) |

| **Analysis of change in net debt (inclusive of finance leases)** | At 1 October 2015 £m | **Cash flow £m** | **Acquisitions £m** | **Non-cash movements £m** | **Exchange movement £m** | **At 30 September 2016 £m** |
|---|---|---|---|---|---|---|
| Cash and cash equivalents | 263.4 | **(18.4)** | **(16.4)** | **–** | **35.9** | **264.5** |
| Bank overdrafts | – | **(4.3)** | **–** | **–** | **–** | **(4.3)** |
| Cash, cash equivalents and bank overdrafts | 263.4 | **(22.7)** | **(16.4)** | **–** | **35.9** | **260.2** |
| Finance leases due within one year | (0.6) | **0.5** | **–** | **(0.2)** | **(0.1)** | **(0.4)** |
| Loans due within one year | (33.0) | **34.7** | **–** | **(34.7)** | **(5.6)** | **(38.6)** |
| Loans due after more than one year | (571.0) | **84.9** | **–** | **33.7** | **(81.8)** | **(534.2)** |
| Finance leases due after more than one year | (0.4) | **0.1** | **–** | **0.2** | **(0.1)** | **(0.2)** |
| Cash held on behalf of customers | (83.8) | **13.0** | **–** | **–** | **(13.0)** | **(83.8)** |
| Total | (425.4) | **110.5** | **(16.4)** | **(1.0)** | **(64.7)** | **(397.0)** |

Included in cash above is £83.8m (2015: £83.8m) relating to cash collected from customers. This arises as a consequence of providing payment processing and electronic fund transfer services. The balance represents cash in transit from third parties to Sage Customers. Accordingly, a liability for the same amount is included in trade and other payables on the balance sheet and is classified within net debt.

The Group continues to be able to borrow at competitive rates and currently deems this to be the most effective means of raising finance. The current Group's syndicated bank multi-currency revolving credit facility expires in June 2019 with facility levels of £613.5m (£525.2m) which consists both of US$551.0m (£424.8m, 2015: £364.1m) and €218.0m (£188.7m, 2015: £161.1m) tranches.

At 30 September 2016, £nil (2015: £81.6m) of the multi-currency revolving debt facility was drawn.

Total US private placement ("USPP") loan notes at 30 September 2016 were £575.0m (2015: £525.2m) consisting of US$650m and EUR€85m (2015: US$700m and EUR€85m). Approximately £35m (US$50m) of USPP borrowings were repaid in March 2016.

## 11 Acquisitions and disposals

### *Acquisitions made during the period*

On 2 November 2015 the Group acquired trade and business from People's United Bank, a provider of payroll services for small and medium sized business in North America, for a total consideration of £6.4m. The transaction price included deferred consideration of £2.0m, which was fully paid in the year. The acquisition strengthens Sage's position in the large and growing US payroll market.

The acquisition resulted in the recognition of intangible assets of £6.4m, consisting of customer lists. No goodwill was recognised.

### 12 Related party transactions

The Group's related parties are its subsidiary undertakings and Executive Committee members. The Group has taken advantage of the exemption available under IAS 24, "Related Party Disclosures", not to disclose details of transactions with its subsidiary undertakings.

| Key management compensation | **2016 £m** | 2015 £m |
|---|---|---|
| Salaries and short-term employee benefits | **7.3** | 10.0 |
| Post-employment benefits | **0.5** | 0.4 |
| Share-based payments | **2.7** | 2.4 |
| | **10.5** | 12.8 |

The key management figures given above include Directors. Key management personnel are deemed to be members of the Executive Committee.

Supplier transactions occurred during the year between Sage South Africa (Pty) Ltd, one of the Group's subsidiary companies, and Ivan Epstein, President, International and Executive Committee member. These transactions relate to the lease of four properties in which Ivan Epstein has a minority and indirect shareholding. During the year £4.0m (2015: £4.3m) relating to these transactions was charged through selling and administrative expenses. There were no outstanding amounts payable for the year ended 2016 (2015: £nil).

Supplier transactions occurred during the year between Sage SP, S.L., one of the Group's subsidiary companies, and Álvaro Ramírez, who held the role of President, Europe and Executive Committee member during the year. These transactions relate to the lease of a property in which Álvaro Ramírez has a minority shareholding. During the year £0.9m (2015: £1.0m) relating to these transactions was charged through selling and administrative expenses. There were no outstanding amounts payable for the year ended 2016 (2015: £nil).

These arrangements are subject to independent review using external advisers to ensure all transactions are at arm's length.

## Managing Risk

Risk is inherent within our business activities, and we continue to prioritise and develop our risk management strategy and capability in recognition of this. Timely identification of risks, combined with their appropriate management and escalation, enables us to successfully run our business and deliver strategic change, while ensuring that the likelihood and / or potential impact associated with such risks is understood and managed within our defined risk appetite.

The Board continues to monitor the risk environment, and reviews the appropriateness of the principal risks to the business.

Currently there are ten principal risks which we monitor and report against. These risks are aligned to successful delivery of our Strategy and mapped against the strategic pillars to which they relate. A range of measures are in place to manage and mitigate these risks, while other activities are in the process of being developed or deployed

Other risks are analysed and mitigated via the normal embedded risk management process.

| Risk | Risk Background | Management and Mitigation |
|---|---|---|
| **Licensing Model Transition**<br><br>Sage does not successfully manage its transition to subscription licensing against defined timelines and targets or appropriately adapt its customer approach.<br><br>*Strategic alignment:*<br><br>***Customers for Life*** | Sage is transitioning from a perpetual to a subscription-based licensing model.<br><br>In addition to providing additional value for customers, this transition assists with cash flow; offers a platform for cross-selling; and lowers attrition rates, which in turn aids revenue forecasting.<br><br>It also provides regular customer engagement and enhanced opportunities to develop these relationships.<br><br>The speed of transition needs to be balanced against any reduction in short-term revenues. | • An approved licensing model transition strategy is in place<br>• A series of approved subscription revenue targets are defined, which span multiple years and support successful and balanced delivery of our strategy<br>• Ongoing monitoring and review of the approved targets takes place at country, regional and Group levels to proactively manage the licence transition, and revenue targets<br>• New products are being offered on a subscription only basis, to support achievement of overall revenue targets<br>• Customer Business Centres (CBCs) are established in North America and Europe to integrate digital marketing, sales and service operations for customers using Software as a Service (SaaS), and support planned growth ambitions<br><br>In progress:<br><br>• Additional CBCs are being created, to better manage ongoing customer relationships and the sales cycle |

| Risk | Risk Background | Management and Mitigation |
|---|---|---|
| **Market Intelligence**<br><br>Sage fails to understand and anticipate changes in the external environment, including customer needs, emerging market trends, competitor strategies and regulatory / legal requirements.<br><br>*Strategic alignment:*<br><br>***Customers for Life***<br>***Winning in the Market*** | Sage has previously operated as a federated set of operating companies, using local definitions and methodologies to capture market data.<br><br>The alignment of federated activities allows consolidation of data across geographies and product to provide a single Sage view, enabling trends and white space opportunities to be identified.<br><br>In order to develop a consolidated understanding of its market and customer needs, Sage is developing its market intelligence capability, and aligning this with competitive positioning and product development activities. | • A Market and Competitive Intelligence team is established, which has group responsibility for Market Intelligence<br>• Market intelligence surveys are undertaken, to identify market opportunities<br>• Brand health surveys are undertaken in order to understand customer perception of the Sage brand and its products<br>• An approved internal communications plan is delivered, to share market intelligence to build brand awareness<br>• Market data is provided through a Market Data portal, allowing ease of access and improved analysis<br><br>In progress:<br>• Action to support the increasing awareness and quality of the Market Data portal<br>• Ongoing refinement and improvement of market data through feedback from the business |
| **Competitive Positioning and Product Development**<br><br>Sage is unable to clearly identify the approach to market, or deploy competitive advantage, including product development<br><br>*Strategic alignment:*<br><br>***Winning in the Market***<br>***Capacity for Growth*** | The competitive environment in which Sage operates continues to see significant development.<br><br>Sage must translate market intelligence into effective strategies targeting attractive market segments with appropriate products and continually work to reinforce competitive superiority.<br><br>During the transition to 'One Sage' products, we continue to manage the local product base and plan and evolve these in line with longer-term aspirations. | • A Product Marketing team is established to oversee competitive positioning and product development<br>• A Product Delivery team is established to develop and deliver products<br>• Battlecards are in place for key products in all countries, setting out the strengths and weaknesses of competitors and their products<br>• Defined 'customer for life' roadmaps are in place, detailing how products fit together, and any interdependencies<br>• A BattleApp has been released to provide timely information to sales channels<br><br>In progress:<br><br>• Prioritised product development based on 'Customer for life' roadmaps<br>• Sage wide standard templates are to be launched for Battlecards to ensure consistent information is provided<br>• Analysis of product investments is being enhanced to further consider anticipated return on investment |

| Risk | Risk Background | Management and Mitigation |
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| **Business Model Transition**<br><br>Sage does not successfully manage its transition to a 'One Sage' operating model against defined timeframes.<br><br>Strategic alignment:<br><br>***Capacity for Growth*** | Sage has operated as a federated set of operating companies.<br><br>The move to a 'One Sage' model provides enhanced governance, process harmonisation, efficiencies and scalability. | • An approved Business Model Transition Strategy is in place, supported by an overarching plan detailing the goal, overall time plan, and scheduled adoption by countries and functions<br>• A programme authority lead is managing transition activity<br>• Clear governance is in place to support the strategy and overarching plan through the Executive Committee and programme steering group<br>• Consolidated operational reporting is in place and provides oversight of progress and supports consistency of direction, and management of potential conflicts<br><br>In progress:<br><br>• Country / function transitions are progressing in line with overarching plan<br>• On-going monitoring and management of implementation through the Transformation Forum, including monitoring of success factors against defined transition activities |
| **Supporting Control Environment**<br><br>Sage's control environment, business processes and technology infrastructure do not support the efficient and effective operation of the business<br><br>Strategic alignment:<br><br>***One Sage***<br>***Capacity for Growth*** | Sage's footprint has developed often through acquisition. Aligning and rationalising these systems and processes, is required to support the 'One Sage' operating model. | • Established Global and Regional Risk Committees oversee the risk and internal control environment, and sets the tone-from-the-top<br>• Shared Service Centres are established in Newcastle and Johannesburg, enabling the creation of consistent and consolidated systems and processes<br>• The Excellence in Governance initiative has developed a Sage-wide policy suite, alongside colleague training and revision to management structures<br>• Customer Business Centres (CBCs) are built around core systems to underpin operational consistency and expansion, including Salesforce CRM and Sage's own X3 for General Ledger activity. As volumes scale, all new customers for CBC supported products are being entered directly into these systems<br><br>In progress:<br><br>• Shared Service Centres in Newcastle and Johannesburg are in the stabilisation phase following installation of X3 General Ledger<br>• Post stabilisation plans for migration of other country General Ledgers is on-track with plans<br>• Following the success of the 'Excellence in Governance' initiative, an 'Excellence in Controls' initiative to enhance the supporting control environment has commenced<br>• Selection and deployment of a Governance, Risk and Compliance technology solution is underway |

| Risk | Risk Background | Management and Mitigation |
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| **Information Management and Protection (including cyber)**<br><br>Sage fails to adequately understand, manage and protect information<br><br>*Strategic alignment:*<br><br>***One Sage*** | Sage's footprint has developed through a process of acquisition, each arriving with its own processes and activities appropriate to a smaller business, but which did not develop in line with Sage's growth.<br><br>Harmonising and rationalising these, as necessary, is required to support the 'One Sage' operating model and to allow a business view on all data being held and processed, including management and protection.<br><br>During 2016, we have broadened the risk to include all data, both internal Sage related information, and external customer related information. | • Accountability is established within both OneIT and Product for all internal and external data being processed by Sage. OneIT and Product Services report to the Chief Information Officer and Chief Product Delivery Officer respectively<br>• A network of Information Security Officers supports the business<br>• Formal certification schemes are maintained, across appropriate parts of the business, and include internal and external validation of compliance<br>• Structured and ad-hoc IT internal audit activity is undertaken by Sage Assurance against an agreed plan, and reported to management and the Audit and Risk Committee<br>• A revised Sage information security policy suite has been launched<br>• The Incident Management framework was revised and updated, to include the rating of incidents and requirements for escalation<br><br>In progress:<br><br>• Information Security is being aligned with the existing Governance structures (Global and Regional Risk Committees), to establish clear accountability<br>• Awareness training for Information Management and protection is being rolled out |

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| **Regulatory and Legal Framework**<br><br>Sage does not understand and operate within the applicable regulatory and legal framework<br><br>*Strategic alignment:*<br><br>***One Sage*** | Sage's services operate within a complex regulatory and legal environment. Monitoring this evolving regulatory and legal environment enables timely and appropriate steps to ensure ongoing compliance. | • All legal resources across Sage report directly to the General Counsel and Company Secretary<br>• Legal services use internal and external resources to monitor planned and realised changes in legislation<br>• All product contracts are reviewed and approved through Legal services<br>• An agreed suite of policies is in place as defined through the Excellence in Governance initiative, and has been revised, to support key legislation, including data protection and anti-bribery<br>• A Code of Conduct is in place across the business which provides clarity over how colleagues are expected to behave. Completion of Code of Conduct training is mandatory for colleagues, and confirmation of understanding is recorded and monitored<br>• Whistleblowing and Incident Management Policies and procedures are in place. These have been updated and processes enhanced in 2016, to ensure appropriate treatment of identified events, and management visibility<br><br>In progress:<br><br>• The appointment of a Sage Head of Compliance and creation of a Sage Compliance function to reinforce the drive towards a 100% compliance culture |

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| **Sage Brand**<br><br>Sage does not deliver clear and consistent branding to the market<br><br>Strategic alignment:<br><br>***One Sage*** | Following several years of acquisition, work continues to develop and harmonise the Sage brand. Whilst it is well-recognised and trusted by customers in many core markets, brand awareness remains inconsistent.<br><br>A clear and consistent brand enables customers to understand Sage values. | • A Brand team is in place which has overall responsibility for developing the Sage Brand<br>• All countries must comply with Sage's Brand Governance and Brand Guidelines, which are designed to execute the Sage Masterbrand Strategy. The timeframes for compliance of all products are defined, and any exceptions must be approved through the Brand team<br>• A Digital Asset Management (DAM) tool is in place which workflows requests and approvals, and acts as a single information repository<br>• Ongoing reviews of customer experience are performed (Net Promoter Scores), and output is reviewed across both countries and products to identify variance, and develop improvement plans<br>• Sage Summit 2016 took place in Chicago<br>• The Sage Foundation was expanded across Sage during FY16, aligned with our values and behaviours.<br><br>In progress:<br><br>• All branded assets must be uploaded to the Brand Library, and any exceptions from brand guidelines reported to the Chief Marketing Officer<br>• Compliance Programme to be rolled out, to assess and educate on compliance with Brand Governance and Brand Guidelines<br>• Brand awareness campaign to be launched to improve Brand recognition<br>• Sage Summit will take place across eight cities in 2017 |
| **Strategic Partnerships**<br><br>Sage fails to identify, build and maintain strategic partnerships.<br><br>Strategic alignment:<br><br>***Revolutionise Business*** | There are increasing instances where developing strategic partnerships will benefit Sage.<br><br>The governance and control around engagement and use must be defined, as well as management of the ecosystem.<br><br>During 2016, we have broadened the risk to include our extended distribution network (Sage Partner Programme). | • A Partner and Alliances team is established to oversee the selection and management of Sage's strategic alliances and partners, including accountability for active management of relationships<br>• Definitions are in place to ensure clarity and consistency over strategic alliances and partners, to enable appropriate and consistent management of these arrangements<br>• All contracts for strategic alliances require approval through legal services<br>• Defined legal provisions are required for inclusion in contracts. Any variance in provisions must be recorded as part of the formal contract approval process<br><br>In progress:<br><br>• Ongoing review and development of the Sage Partner Programme<br>• A financial model for the Sage Partner Programme is being developed |

| Risk | Risk Background | Management and Mitigation |
|---|---|---|
| **Third Party Reliance**<br><br>Sage does not understand and manage its third party ecosystem<br><br>Strategic alignment:<br><br>***Revolutionise Business*** | Several Sage customer service offerings are delivered or supported using third parties, whilst Sage remains accountable for quality of performance.<br><br>The third party ecosystem must be understood and effectively managed, in order to limit Sage's exposure. | • A Procurement function ensures key controls are applied in the selection and on-boarding of third parties<br>• The Procurement function supports the business with the selection of third parties and negotiation of contracts<br>• Legal resources are used in contract negotiation<br>• A Procurement Lifecycle Policy and procedures are defined, agreed and published. These contain clear roles and responsibilities for colleagues and align with existing processes, including investment approval<br><br>In progress:<br><br>• Implementation of the Procurement Lifecycle Procedures is underway, including classifying third parties for business criticality, and associated actions<br>• Rationalisation of the third party ecosystem is continuing |

## Statement of Directors' Responsibilities

### Responsibility statement of the Directors on the Annual Report & Accounts

The Annual Report & Accounts for the year ended 30 September 2016 includes the following responsibility statement.

The Directors as at the date of this report, whose names and functions are listed in the Board of Directors section of the Annual Report and Accounts, confirm that:

- To the best of their knowledge, the Group's financial statements, which have been prepared in accordance with IFRSs as adopted by the EU, give a true and fair view of the assets, liabilities, financial position and profit of the Group;
- To the best of their knowledge, the Directors' report and the Strategic report include a fair review of the development and performance of the business and the position of the Group, together with a description of the principal risks and uncertainties that it faces.

On behalf of the Board

**S Hare**
Chief Financial Officer
29 November 2016