

SDL plc Annual Report 2006

Global Information Management Solutions



Our Mission

“We help corporations drive global brand consistency and accelerate time-to-market by providing software and services to manage the delivery of all corporate information into different languages”

Global Information Management

Faced with increasing competition and a shrinking world, businesses face fresh challenges every day in remaining agile and competitive. The internet, communication advancements and the breaking down of trade barriers all increase the challenge of remaining agile and competitive on a global basis.

In this competitive environment, SDL helps corporations drive global brand consistency and accelerate time-to-market by providing software and services to manage the delivery of all corporate information into different languages.

Through these Global Information Management solutions companies can increase their competitive edge and remain agile by conquering language and ensuring that all information across the corporation is delivered in the language of their customer. This has three significant benefits:

- Allowing companies to ensure that their brand is managed consistently across the world
- Enabling companies to accelerate the time it takes to deliver new products to market, at a lower cost
- Delivering a relevant experience to their customers across the world

The Challenge

Today 90% of the information that is produced by a global organization is relevant to an international audience – yet on average only 10% is delivered in their language. Global Information Management is the essential business strategy for enabling a corporation to manage the massively increasing requirements for language delivery in order to remain agile and competitive on the world stage.

Independent Technology

SDL technology enables all multilingual information to be stored within a centralized repository and shared across an enterprise.

Global Services

SDL provides a network of translation service offices across the world. Connected by SDL technology this network gives global corporations a cost-effective, consistent and transparent process for delivering information into any language.

Knowledge-based Translation

Through a combination of Automated Translation systems and human translators across the SDL office network, multilingual content can be delivered to clients into markets 50% faster than, and at 40% of the cost of, traditional translation services.

We chose SDL because they offer the knowledge, technologies, and services that Garmin needs to serve our worldwide customers more efficiently and consistently. Using SDL to centralize our translation requirements can provide Garmin with the high-quality and timely deliverables that our worldwide customers want and deserve.”

Garmin

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Officers and Professional Advisors

Directors

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Chairman & Chief Executive Officer

Alastair Gordon
Chief Financial Officer

Cristina Lancaster
Chief Operations Officer

Keith Mills
President - Technology

Chris Batterham
Non-executive Director

John Matthews
Non-executive Director

Joe Campbell
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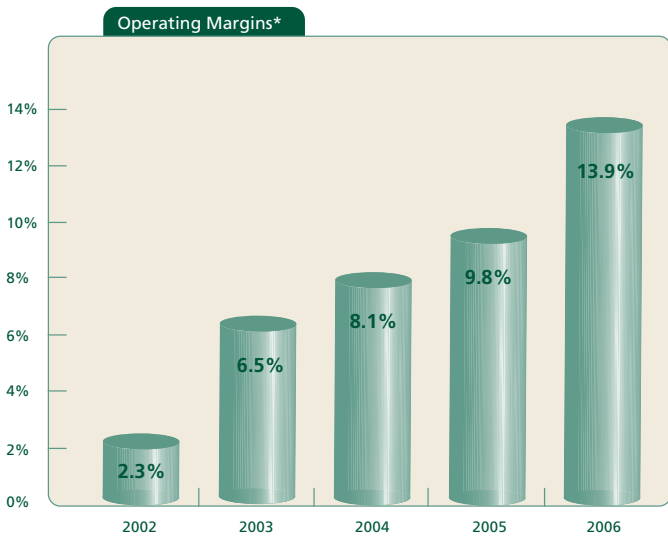
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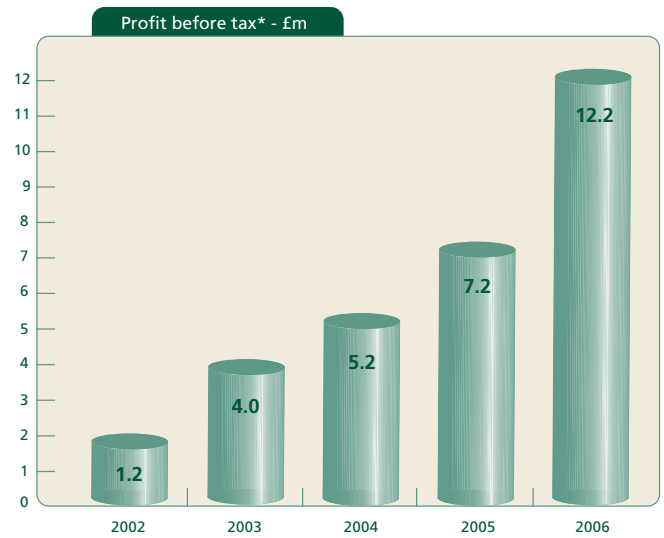
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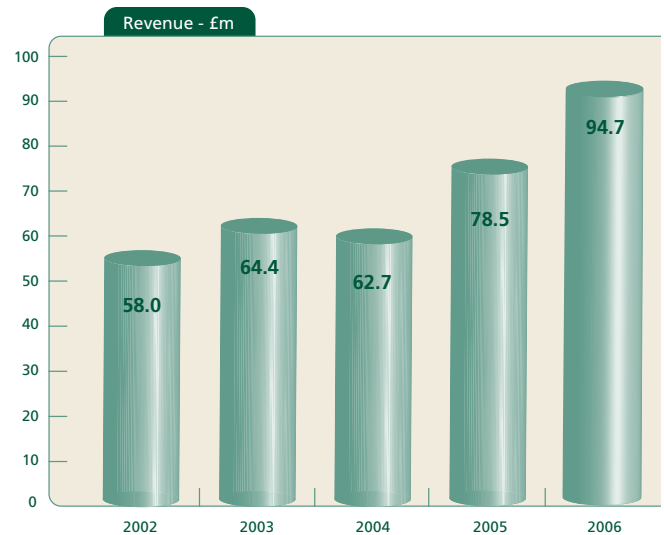
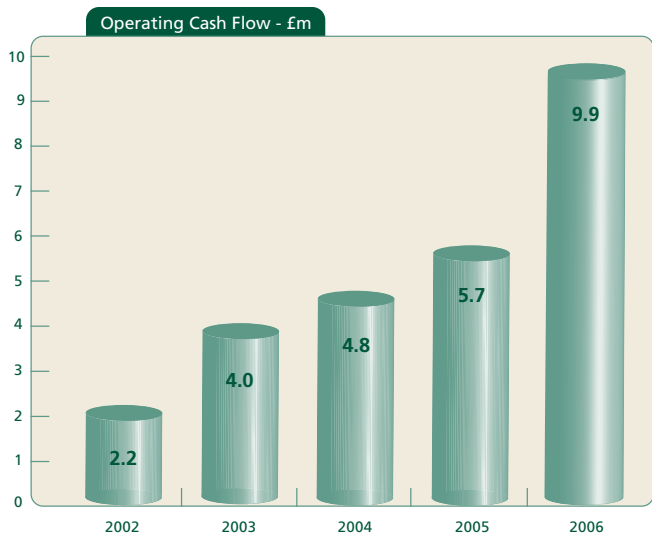
Revenue	£94.7m	21%	
Profit before tax and amortisation	£12.2m	71%	
Basic earnings per share before amortisation	14.52p	77%	
Operating cash flow	£9.9m	73%	



*Before amortisation of intangible assets



*Before amortisation of intangible assets



Summary Performance

The second half of 2006 saw SDL again achieve record operating profits which are significantly ahead of our upgraded market expectations. The prime drivers for the increase over the upgraded expectations were the faster uptake of product released towards the year end and stronger than anticipated sales and related margins from certain service customers in December. Revenues for 2006 were up 21% at £94.7 million (2005: £78.5 million) with approximately half of this revenue growth being organic and half contributed by a year of full trading in Trados which was acquired in July 2005. Profit before tax and amortisation of intangible assets has increased by 71% to £12.2 million (2005: £7.2 million). The major contributors to the over performance in 2006 are SDL continuing to increase its lead in Global Information Management technology, combined with increased utilization of technology to leverage service margins, and an effective hedging strategy to manage currency fluctuations.

Our Technology

The successful integration of Trados into SDL has led to a considerable improvement in gross margins, now at 49%, which has in turn improved the underlying operating performance of the Group. We have seen interest in Global Information Management technology increase considerably in 2006, particularly for our hosted offerings accessed over the internet by our clients. This has resulted in both strong service and software sales. We have experienced solid growth in market share in both the desktop and the enterprise software markets with over 140,000 installed units of desktop products and having added more than 40 installations of enterprise product into the market with such customers as Dell, BMC and Avaya. We launched SDL Trados Synergy at the end of the third quarter of 2006 resulting in a positive impact on our year end result, with the uptake in this product being greater than we had anticipated. This is encouraging feedback from the market as we will be launching major new releases of our new platform technology throughout 2007. These major innovations in technology will provide completely integrated technology across the translation supply chain, enabling all parties, from freelance translators through language service providers to corporations in the supply chain, to benefit from smooth file integration and effective translation logistics management. We believe these advancements in technology will further accelerate the trend for enterprise content to be translated and tailored for local markets. The start of this trend is already evidenced by companies such as Salesforce.com, Linde, Bosch and Intel investing in Global Information



Management technology to speed up the translation of content for local markets.

Services Infrastructure

The services side of the business, which now operates in over 30 countries, continues to benefit from the global reach, scale and leveraging of our technology. The structure and integrated nature of our regional offices allows considerable scaling and resource capacity which, when coupled with our Knowledge-based Translation solutions, have transformed the landscape for translation, speeding up time to market and reducing costs for our clients. We continue to increase the quantity of words that flow through our Knowledge-based Translation systems, for enterprise customers such as HP, Microsoft and Daimler Chrysler. As well as the increased adoption of Knowledge-based Translation, 30% of SDL's major clients have their content flowing through SDL's enterprise translation management technology, driving internal operational efficiencies and bringing scalability to our services offering.

Vision and Strategy for Global Information Management

In a world that is moving closer together through ever more effective and immediate communications infrastructure, trading effectively in global markets is not an option for large corporations, it is a necessity. However, the starting point to allow a business to trade in local markets is to speak to them in their own language. The enormity and complexity of translating and maintaining millions of words of global content into multiple languages in a world where communications needs to be instant is a major challenge for any business. Content is now delivered in multiple formats through many channels from the web to hard copy. Press releases, marketing collateral, support knowledge

bases, not to mention a company's products and documentation, should all share common wording and messaging to support a company's brand. The creation and management of multiple language content is currently not addressed by the content management technology available on the markets today.

SDL's Global Information Management technology accelerates the delivery of global content into local markets, ensures the operational consistency of branding and reduces the costs to translate content into multiple languages. In order to provide comprehensive global content management the complete supply chain of those involved in the creation and maintenance of global content must be included in the solution. SDL's technology automates the delivery of global content in a controlled manner through this supply chain. As we continue to release new vendor independent translation technology onto the market over the next 12 months, we consider that the major advances that we have made in the technology will significantly enhance the productivity of the translation supply chain, stimulating growth in both the technology and the localization services industry as a whole. SDL is also very well placed to take advantage of the consolidation of the content management space, being the world leader in Global Information Management, which is an integral part of content management that has been previously overlooked.

Outlook

We expect to see continued strong financial returns from our investment in Global Information Management, both from the services and the technology sides of the business. The understanding and awareness of Global Information Management continues to be the number one challenge to the growth of our business. We do however expect to see a considerable uplift in awareness of the complexities of creating and managing global content from companies that trade globally. This will in part be driven by our increased investment in marketing during 2007, but increasingly by the realisation of companies that language is now a major competitive differentiator in winning and retaining market-share across the globe. As the investments SDL has made into Knowledge-based Translation continue to give increased returns, we expect to see more content flow through this automated translation technology in 2007, which ultimately brings higher margins to the group. In summary we believe that our efficient services infrastructure and technology systems will offset the increase in investment in marketing and the potential continued dollar weakness to provide another year of growth in 2007.

Mark Lancaster
Chairman & Chief Executive

Global Information Management

Within the enterprise, SDL's Global Information Management solutions allow an organization to author multilingual content for a global audience by using a consistent terminology and an efficient translation service. The goal is to reduce the amount of repetition and ensure that information is authored once, translated once and re-used many times.

So, with SDL enterprise solutions, multilingual assets are centralized into an internet-enabled repository and re-used across the enterprise. An authoring solution allows the author to reference the terminology and access previously translated content that is held in this repository. Through this technology the multilingual assets can be interrogated and reused. Any content that has not been translated is automatically delivered into the translation supply chain where it is translated and returned into the centralized repository for immediate access by authors across the world.

Software for the Translation Supply Chain

The translation supply chain is a network of over 140,000 translators across the world and is used by all global corporations to deliver multilingual content across the world. SDL provides the industry-standard solution that is used by this network of translators.

In a global operating environment, the Internet has become a primary interface between customer and vendor. And the customer expects to see consistent and timely information regardless of where and how it is published.

Hewlett-Packard

Services to deliver multilingual projects

SDL provides a network of offices across 30 countries to enable the delivery of multilingual content for global corporations. Through this network, global corporations are assured of a consistent process utilizing SDL technology to deliver all elements of multilingual

project delivery at high quality in any language within the tight deadlines required.

Corporations across the world can tap into this network to deliver content in any language – thereby providing a service to companies in any country wishing to compete on the global stage.

Through our partnership with SDL, we provide support to our global dealers at 40% lower costs with significantly faster turnaround times. This provides solutions to their technical issues every hour of every day of the year, whilst significantly reducing the workload on support centres.

CNH

Publishable Quality Automated Translation Service

SDL provides a network of translation service offices across the world. Connected by SDL technology this network gives global corporations a cost-effective, consistent and transparent process for delivering information into any language.

Translation solutions for the consumer and small businesses

SDL provides internet based on-demand services for small businesses and consumers requiring fast-turnaround translation services.

FreeTranslation.com delivers over 50 million words a day with over 4,000 translations a minute to 4 million visitors a week. Small businesses can deliver quality translations of key documents by using the online portal Click2Translate.com. This service uses human translators from across the SDL network to deliver high quality response to small businesses across the world.



The Executive Mandate

Electrocomponents plc, the parent company of RS Components, is a dynamic and international business that distributes a wide range of products to development and maintenance engineers in all types of businesses around the world. It is the leading international high service distributor of electronic, electrical and industrial supplies.

RS Components had a new business strategy that required large product ranges to be available in the local language, initially in France, Germany and Italy, but ultimately across the globe. The initial project required translation into 3 languages of on average 60,000 products per catalogue. RS had a 3 month window for work which would have taken 6 months using traditional translation methods.

The existing process involved each country having their own individual product offering which was managed locally. This meant that content was sent for translation with a local supplier who then translated it using

traditional methods. These processes were not scalable to deliver the amount of translation required in the short period of time available to complete the project. The process was also expensive, since large volumes of content were being translated manually.

Building an efficient and cost-effective translation process

RS Components spoke to SDL about the different possibilities for improving efficiencies in the translation process. "Our new business strategy required a much wider offer in the Electronic and Electro-Mechanical area that would be common across all markets. In order to globalize the offer, we had to provide a high volume of multilingual content in a limited period of time," said Rob Fifield, Head of Media Production at RS Components.

“ We have been delighted with SDL Knowledge-based Translation System ”

"Additionally, we had the desire to move from managing multiple processes, with multiple translation providers to a more centralized and efficient solution. SDL suggested the high volumes might best be handled through the use of their automated translation solution, SDL Knowledge-based Translation System."

The SDL Solution at RS Components

SDL Translation Management System was put in place for RS Components so that content could be submitted for translation which would be passed through SDL Knowledge-based Translation System. Once new content is detected, SDL Translation Management System automatically picks it up and passes it through the automated translation process, so that no time is lost in getting the translations under way. RS Components' incountry reviewers are also able to access the system to comment and make changes to the multilingual content. SDL Translation Management System also ensures the content is automatically returned to RS Components once it has been through the process of translation and approval, completing the cycle of managing global information.

Before the content is returned to RS Components' content management system and after automated translation has been applied, SDL's post-editors and reviewers make any necessary changes to the content to ensure it is of the highest quality. This has provided process improvements which have made the translation cycle much faster. Once this has been done, it is then automatically passed back into RS Components' Stibo Step Catalogue system.

RS Components achieved a 25% improvement in productivity and was able to reduce the costs of providing multilingual content by 27%, helping to ensure increased operating margins for the business.

Challenges

- Delivering information relating to over 60,000 products into multiple languages
- Delays in time-to-market on global content
- Existing fragmented, manual processes for managing global information
- Ineffective and costly processes

Benefits

- Ability to simultaneously ship into global markets
- 25% improvement in productivity
- 35% reduction in time-to-market
- Automated centralized process improves efficiency
- 27% cost savings
- Improved consistency for global branding

The results ...

“SDL Knowledge-based Translation System has provided us with a 25% improvement in productivity, as well as a reduction in costs of 27%.”



PHILIPS

The Executive Mandate

Philips Consumer Electronics (PCE) is one of the world's top three consumer electronics companies, and the largest in Europe.

With a growing product range, expansion into new markets and an increasing range of communication channels, Philips Consumer Electronics was faced with hugely complex multilingual content management challenges.

The Complexity Challenge

Over 9,000 communications were required to source content for product catalogues, translation of the same content was happening multiple times and it was taking over 4 months for new content to reach local websites. There were 1,800 different logos and over 50,000 different product specifications, including over 10,000 different feature descriptions. With a requirement for web content in 19 different languages, catalogues in 28 languages and product leaflets in 35 languages, it was clear that a lot of time and money was being wasted.

Increasing Business Demands Increasing Business Demands

New products needed to be launched simultaneously across all markets in order for manufacturing, marketing and sales to operate as efficiently as possible.

“In the world of consumer electronics, time-to-market can be a key competitive advantage and our existing processes were introducing too many delays”

“Quality and consistency were suffering, leading to poor communications with consumers and potentially damaging the Philips’ brand.”

New Content Standards, Systems and Processes

Addressing the increasing complexity and increasing demands from the business needed a fundamentally different approach. “Our goal was to create a transparent and efficient flow of marketing product information with identified responsibilities to make that information available to the relevant people at the right time in the right format. All assets should be created only once, to be used multiple times.”



The SDL Solution at Philips

SDL teamed up with Philips to design and deploy a truly international Global Information Management platform. From a completely decentralized and fragmented translation approach, Philips has utilized SDL's technologies, consulting services and localization services to create a centralized, cost-effective, fast-turnaround translation delivery solution.

Initially geared at streamlining multilingual translation and publication of web content, this Global Information Management platform has been extended and tailored to support any type of content, including helpdesk and FAQ databases, catalogues, user documentation, leaflets, etc. Through a consistent and unified process, the SDL solution is supporting the localization needs of more than 100 order givers within PCE and Philips Domestic Appliances.

At the core of the solution is SDL Translation Management System (SDL TMS), which centralizes and automates processes for the management and deployment of translation memories.

With SDL TMS, Philips and SDL have shortened the complete review turnaround time, reduced translation cost by more than 30% and reduced the workload involved in managing multilingual content by over 85%.

Challenges

- Simultaneous launch of new products across all markets
- Reduce translation management overhead and translation costs
- Reduce 4 month lead time for content to reach the web
- Improve time-to-market for all product communications

Benefits

- Centralized translation memory across 9 divisions giving more than 30% reduction in translation costs
- Centralized terminology management for improved quality and a further 17% reduction in translation costs
- Faster time-to-market
- One process for 35 languages and multiple content types via customizable workflows, reducing management overhead by 85%

The results ...

“ Our partnership with SDL has enabled us to reduce translation costs more than 30% and improve time-to-market for our multilingual product marketing communications. It used to take 4 months for new product information to reach local web sites, now its available for publication within weeks. ”



Executive Directors



① Mark Lancaster

Chairman & Chief Executive Officer, age 45 (Appointed: 31 January 1992)

Mark Lancaster founded the Group in 1992, having identified the need for a high-level and comprehensive service and technology provider for the globalization of company's content and products. Mark was previously employed as a design engineer at Satchwell Control Systems before he progressed his career through Lotus Development Corporation and later as international development director with Ashton-Tate. He is responsible for the strategic development of the Group.

② Alastair Gordon

Chief Financial Officer, age 56 (Appointed: 27 April 1998)

Alastair Gordon is a qualified Chartered Accountant who joined the Group in 1998. From 1974 he spent thirteen years with Arthur Andersen, specialising in corporate finance and venture capital. Subsequently he spent ten years with Berisford plc, the last three of which he was Chief Financial Officer for the USA operations. He is responsible for all financial matters relating to the Group.

③ Cristina Lancaster

Chief Operations Officer, age 43 (Appointed: 4 July 1993)

Cristina Lancaster is an experienced software engineer who previously worked as a senior support analyst at Lotus Development before establishing an IT training consultancy business in 1990. She joined in 1993 and has responsibility for the systems, processes and methodology used throughout the Group coupled with the implementation of training and development plans.

④ Keith Mills

President - Technology, age 45 (Appointed: 1 September 2000)

Keith Mills joined the Group in 1994 as Senior Software Engineer. Previously he had held senior positions with Lotus Corporation, where he specialised in the process of software localization before moving to Ashton-Tate the international software-engineering group. He has overall responsibility for sales and implementations involving technology solutions, as well as all aspects of technical development at each of the Group centres throughout the world.



⑤ Chris Batterham

Senior Independent Director, age 51 (Appointed: 15 October 1999 - Re-appointed 28 April 2005)

Chris Batterham qualified as a Chartered Accountant with Arthur Andersen and has significant experience in the technology based business environment, including the flotation of Unipalm on the London Stock Exchange. Currently working on the boards of Betfair, Iomart plc, DRS Group plc and the Risk Advisory Group as a non-executive director, Chris brings a wealth of experience in the strategic development of companies within the IT sector.

⑥ John Matthews

Non-executive Director, age 62 (Appointed: 12 June 2001 - Re-appointed 1 June 2004)

John Matthews has been Chairman of Crest Nicholson plc since 1996 and of Regus Group plc since July 2002. He also acts as an independent non-executive director on the Boards of other listed companies, providing a valuable range of insights into public company compliance and strategy.

⑦ Joe Campbell

Non-executive Director, age 48 (Appointed 1 July 2005 - Re-appointed 27 April 2006)

Joe Campbell was CEO of Trados, and following its acquisition by SDL in July 2005, joined the board as a non-executive director. He adds a considerable level of expertise in enterprise software sales and brings years of experience of the US financial markets and M&A activity. Most recently, prior to Trados, he was COO of iManage, a publicly traded company on the NASDAQ.

None of the directors have been accused of, or been reported as acting in breach of, professional conduct by any Regulatory or Statutory Authority.

OPERATING REVIEW

Overview

As noted in the Chairman's Statement, the Group has had a positive year, with a full year's contribution from the Trados group acquired in 2005. The increase in the technology activity within the Group and further improvements in the service solutions operations have led to increases in both gross and net margins. The positive cash flow generated by the overall operations has enabled the Group to accelerate the repayments under the credit facilities originally drawn down in 2005 to facilitate the acquisition of the Trados group.

Sales and Marketing

On a like for like basis SDL service solutions revenues were up 17% over 2005, with the majority of the increase continuing to arise from higher volumes as opposed to any underlying increase in the price of services. The increase in volumes is attributed to both the high levels of repeat business sales, particularly with the Group's existing solutions customer base, but also major new client wins. Repeat business remains an important barometer as to the success of the Group's account management processes and the quality of the services provided. The level of repeat business has increased to 86% in the year (2005 – 85%).

Technology revenues, encompassing licence sales and associated professional services covering consultancy, integration and installation plus ongoing support and maintenance, now represent 18% of the Group's revenue. At the enterprise level, sales have broadened out of the IT sector to include the pharmaceutical (Wyeth) and automotive industries amongst others. Desktop technology sales have grown at 10% year on year, mainly as a result of concerted marketing campaigns over and above the traditional translation memory software campaigns. These campaigns have included small corporate servers marketed to translation service providers and products such as SDL Synergy which allows these same translation providers to better project manage their client base.

The 20 largest customers contributed 38% of revenue (2005: 43%). The proportion of the revenue taken up by the larger customers has fallen as the Group broadens its customer base but also as a result of the growth of the technology business. While there is a repeat element to the technology sales, particularly with support and maintenance, there is not the same potential for growing the account as in the solutions division. In addition the desktop revenues within the technology sales, while growing in the year as noted above, comprise many small sales of less than £10,000. The companies where

service sales have grown considerably in the period (including Microsoft, Hewlett Packard) or where they are significant new customers (such as Derivco, Honda) have adapted technology solutions to their Global Information Management (GIM) requirements and this is what is distinguishing the Group from the rest of the industry. Geographically the USA remains the largest sector for sales, though revenues in this region as a percentage of overall revenues were down from 42% to 39%.

Gross Margin

The Group's gross margin improved from 47% to 49%. This was from a combination of a further increase in the margins of the traditional GIM solutions business as well as the benefit of the technology segment assuming a larger percentage of the overall revenues at 18% of revenues (2005 – 15%).

The margin on the traditional services business has been increasing over the past few years as pricing in the market place has stabilised and SDL's continuing investment in the utilisation of the Group's technology, processes and infrastructure has benefited the Group. Part of this improvement is covered in more detail in the section on the Network Offices below. As a result the gross margin on this aspect of the business has increased in 2006 by 1% to 44%.

The technology division generates higher gross margins as neither the desktop nor the enterprise sales within the division carry any significant direct costs, but benefit from the related development costs which are charged to overheads. The licence sales within the technology division, £10.2m in the year (2005 - £7.4m), generate the highest level of margin, with related professional services and support and maintenance at lower levels. During the year the licence billing element of the technology sales fell from 63% to 60%, due to licences very often being priced as part of a complete solution and not split out from service revenue (being provided as "software as a service") but overall technology contributed 2% to the increase in the overall Group gross margin.

Overheads

Overall administrative expenses, excluding amortisation of intangible assets and foreign exchange, increased by £5.0m in 2006 to £34.9m. A significant element of this increase was due to the inclusion of the Trados group for a full year. The main focus during the year has been on continuing to build the service solutions and technology sales teams along with the associated marketing, including the appointment of a chief marketing officer. This is an important aspect of building the SDL brand

within the Global Information Management market. While the overall average headcount only increased from 1,449 to 1,498, despite the presence of Trados for a full year, the majority of this increase – 34 average heads – was in the non-production divisions, reflecting this emphasis on sales and marketing. Marketing costs, both personnel and external spend are expected to increase further in 2007 with the launch of the combined SDL/Trados product. As a people related business, employee overhead costs constitute 58% of Group overheads (2005 - 58%). The next major cost element is represented by facility costs related to the office infrastructure.

The development expenditure in the year was £4.7m (2005 - £3.9m). SDL's own development expenditure has remained at approximately the same level as prior years with the increase in 2006 being a result of Trados development costs being incurred for a full year. However, there has not been a prorata increase as the enlarged group has sought to reduce the overall spend by less reliance on the outsourced developers engaged by Trados and the benefits accruing from transitioning to a single technology platform. Development spend has remained at approximately 5% of revenues.

Development costs are reviewed regularly as to whether the criteria for capitalisation under IFRS are met. The majority of the development spend in 2006 has related to the evaluation of the combined technologies of the Group, following the acquisition of Trados, and in assessing how the integrated platform that will be released in the latter part of 2007 should operate. It has been a process of establishing the key aspects of each technology, ensuring that legacy issues and inconsistencies are eliminated and that the revised platform will plug in easily to the customers' main IT and technology systems. The new product releases in the period have been built on existing technology within the Group. At the current time the Board do not believe any capitalisation is required and consequently no capitalised development costs are carried on the balance sheet.

Intangible assets, representing intellectual property rights ascribed to certain of the Group's software and certain customer relationships acquired with the Trados acquisition, are written-off between 5 and 15 years and the carrying value is reviewed formally on an annual basis to assess whether any permanent impairment has occurred. The impairment review carried out in the second half of 2006 did not result in any adjustments being required. The intangible amortisation charge in 2006 was £2.9m (2005 - £2.0 m). Under IFRS goodwill is no longer amortised but it is subject to a similar impairment review as the intangible assets. The 2006 review did not result in any impairment.

During the year the Group's overhead figures have benefited from a credit of £1.3m (2005 - £0.6m) in relation to foreign exchange gains. This arises due to the retranslation of the closing balance sheet together with the benefits of certain hedging transactions that the Group has held in relation to the US dollar. The Group has held part of its borrowing in relation to the Trados acquisition in US dollars and hence has benefited from the weakening of the US dollar.

Net Operating Margin

The net operating margin is a key measure for the Group as the Group evolves from a service related business to one with a technology base. The net operating margin has increased from 7.3% to 10.9% during the year. Of equal importance is the profit before tax and amortisation of intangibles (PBTAs) as this measure is closely monitored by the analysts and investor community. The PBTAs increased by 71% from £7.2m to £12.2m with 2006 representing a 12.9% margin (2005: 9.1%) These increases are as a result of the Group's ability to leverage the higher sales and higher gross margin percentage over proportionately lower increases in Group overheads.

Earnings Per Share

The Board monitors the Earnings Per Share (EPS) as a key driver of the share price and also, since 2006, as an important measure in the incentivisation of senior management through the LTIP scheme. Diluted EPS grew by 104% to 9.53p, while the diluted EPS, adjusted for amortisation of intangible assets, increased by 78% to 13.97p.

Financing Costs

Interest costs in 2006 have amounted to £1.1m (2005 - £0.8m). The interest costs arise on the original credit facility of £20m that was taken out by the Group at the time of the Trados acquisition. As at the beginning of the year the outstanding balance stood at £19.1m but has been reduced to £11.7m at December 2006. Despite the fact that the Bank of England has increased interest rates three times over the period the Group has been able to control the effect on its own interest costs by accelerating the repayment of the loans and exceeding covenant requirements to the extent of reducing the premium paid over LIBOR. Interest income on surplus cash has remained constant at £0.2m.

Network Offices

The 2006 financial year has seen a consolidation of the Group's translation services in the in-country Network Offices. This not only enables the resulting translations

to be up to date in the individual language and country context but has also contributed to the improved gross margins on the translation services aspects of the Group's operations. The success of this transfer into the Network Office structure has also been replicated by the transfer of software engineering and desktop publishing functions to low cost centres in China and Thailand. These have benefited from concentrating them in the lower cost centres in the infrastructure. The Group's systems and processes continue to be enhanced and implemented consistently across all network offices. The Board believes that, along with the combined technology and services platform, the Group's multilingual and network office infrastructure remains a key differentiator from its competitors.

Cristina Lancaster
Chief Operating Officer

FINANCIAL REVIEW

The Group's capital structure is as follows:

	2006 £'000	2005 £'000
Net debt (note 18)	3,678	12,116
Total equity attributable to equity holders of the parent	<u>54,506</u>	<u>49,594</u>
Capital employed	<u>58,184</u>	<u>61,710</u>

Throughout 2006 the Group sought to maximise operational cash flow with the intention of reducing the debt owed under the £20m term loan and revolving credit facilities agreement ("the credit facility") with the Royal Bank of Scotland plc (RBS), taken out at the time of the Trados acquisition. This credit facility is discussed in more detail below. The Group has an obligation under the credit facility to repay a minimum of £2m a year but during 2006 repaid £6.6m. During the year the Group has reduced net borrowings from £12.1m at the end of 2005 to £3.7m at the end of 2006.

Derivatives and Other Financial Instruments

The Group holds cash and short-term deposits to fund the Group's operations and has various other financial instruments such as trade debtors and trade creditors arising directly from its operations. It is, and has been throughout the period under review, the Group's policy that no active trading in financial instruments shall be undertaken.

The credit facility draw-down at the time of the Trados acquisition took the form of two loans – a £15m term loan for five and a half years to December 2010 and a revolving credit facility of £5m. The term loan is repayable at £500,000 a quarter, with a bullet payment of £4.5m (or the then balance outstanding) in December 2010, and initially incurred an interest rate of 1.75% above LIBOR. The revolving credit facility is repayable and redrawable at any time through December 2010, when the facility terminates. It incurred an initial interest rate of 1.85% above LIBOR. Both the term loan and the revolving credit facility have a reducing interest rate dependent on the balance outstanding and also reduces over time to 1.25% over LIBOR when the ratio of consolidated borrowings to consolidated EBITDA is less than 1.75 times. Due to the Group's repayment levels in the year and its performance under the financial covenants it has been possible to reduce the interest rates on both the term loan and the revolving credit facility earlier than anticipated to 1.25% above LIBOR.

It remains the Group's intention to make accelerated repayments as and when positive cash flow permits.

In addition to the £20m facility, RBS also provided an overdraft facility of £3m, which was renewable in July 2006. In the light of the positive cash in the Group and in order to reduce facility fees this facility was not renewed.

Under the credit facility agreement, SDL is subject to certain financial covenants relating to cash flow, gearing, interest rate cover and capital expenditure and also the requirement to maintain a certain percentage of cash within those Group companies that are guarantors of the credit facility. Since entering into the facility agreement SDL has fully complied with these covenants.

The main risks arising from the Group's financial instruments are interest rate risk, liquidity risk and foreign currency risk. The Board reviews and agrees policies for managing each of these risks and they are summarised below. The Group also monitors the market price risk arising from all financial instruments. The magnitude of this risk that has arisen over the period is detailed in note 22.

Interest Rate Risk

The loan facilities that the Group holds with RBS expose the Group to interest rate risk. The interest rates that the Group is paying are linked directly to the 3-month LIBOR rate, and the Group is required by the credit facility agreement to hedge 50% of the interest rate exposure on the term loan outstanding at any time. This interest rate hedge is required to extend to June 2009. The Group has met this requirement by entering into a 4 year LIBOR value collar, under which the Group is protected from 3-month LIBOR moving above 6%. In order to obtain this protection there is an interest rate "barrier" of 3.7%. If base rate falls below this level the Group will be charged interest as if the base rate was 6%.

To ensure adequate working capital the Group maintains cash deposits over and above monies required to repay the credit facility, and these deposits are affected by any movement in rates of interest generally. The Group seeks to place all cash surplus to operational requirements in secure money market funds, mainly in overnight funds. To enhance the interest earning capacity of the Group, processes have been put in place to ensure that cash balances held by subsidiary companies are kept as low as operationally possible. The Group also seeks to maintain sufficient deposits in currencies providing higher rates of interest but at the same time ensuring the Group is not exposed to currency movements.

Liquidity Risk

The Group's objective is to optimise the funds currently available to it in order to maintain a net debt position as low as possible and to enable accelerated repayments of the term loan to be made. There has been continued pressure from the larger existing and new customers to extend credit periods. In addition the initial integration of the Trados Group customer base and credit terms into the Group extended the level of credit being taken by certain customers. The Group has worked on bringing the Trados collection processes in line with those of SDL and this is reflected in the fact that the level of day's sales outstanding in debtors has decreased by 5 days to 56 days during the year. The management of working capital continues to be an important objective.

Foreign Currency Risk

A significant amount of business continues to be done with customers in the USA. This gives rise to short-term debtors and cash balances in US Dollars. Consequently, the movements in the US Dollar/Sterling exchange rates, and to a lesser extent the US Dollar/Euro, affect the Balance Sheet. The Group seeks to manage this risk by ensuring that all currency needs in the USA are funded from the settlement of US Dollar denominated debtors. In the light of the significant weakening of the US Dollar in 2004, the Group introduced a policy of taking forward hedged and option positions to cover a proportion of the Group's anticipated US Dollar inflow. Under the RBS credit facility, SDL is required to have in place a foreign exchange hedge against two thirds of its net exposure to US Dollar cash flows. This requirement is similar to the policy that the board had in place prior to the Group entering into the credit facility. The current Forward Plus hedge protects the Group for \$1m a month for the first three months of 2007 at US\$ 1.7650 to the £ and for a further three months at US\$ 1.8999 and enables the Group to participate in a strengthening US Dollar to \$1.650 for the first three months and to \$1.760 for the following three months.

Operational Risk

As with any growing and acquisitive business in the technology sector, the Group faces a number of operational risks. The Board considers that the technology and the integration of acquisitions to be the main risks that they monitor regularly. The technology risks are both internal, in relation to transitioning the two technologies of Trados and SDL to a common platform, and from competitive sources. With regard to the former, the Group is on track to release the combined platform in the second half of 2007 and with regard to the latter the Group monitors competitive offerings and believes it is maintaining its lead in the market place.

The Group has successfully integrated a number of acquisitions in the last 10 years. Prior to all acquisitions, detailed due diligence is carried out and a comprehensive integration plan is agreed and then carefully monitored post acquisition. This process has been maintained throughout the period since the latest acquisition of Trados in July 2005 in order to ensure that any risks to the combined business have been managed and eliminated.

Taxation

An analysis of the taxation charge is set out in note 5 to the accounts.

The effective rate of taxation will, in the first instance, be dependent upon the tax jurisdictions in which the operating profits are earned and the tax rates in those countries. The Group's effective rate is affected by the fact that profit on ordinary activities before tax is reduced by amortisation of intangible assets, which is not fully tax deductible.

The taxation charge as a percentage of profit before tax excluding non tax deductible amortisation of intangibles is 28.3% (2005 – 35.1%).

The adoption of IFRS has also affected the Group's effective tax rate. Due to the requirements of IAS 12 in conjunction with IFRS 2 the schedule 23 tax credit available for share options exercised has primarily been recorded in equity rather than the income statement. In accordance with the provisions of IAS 38 the Group has in prior years recognised a deferred tax liability in respect of non tax deductible amortisation of intangible assets acquired and the movement of this liability in the period has been reflected in the income statement. Overall, the impact of these IFRS adjustments has been to decrease the Group's effective tax rate by 2.1% (2005 – increase by 3.3%).

Cash Flows

The statement of cash flows on page 39 shows that there was an increase in cash in 2006 of £1.3m (2005 – decrease £4.8m). Operating activities created £9.9m (2005 – £5.7m) of cash.

The outflow of cash from capital expenditure was £1.4m compared with an outflow of £1.0m in 2005. The Group continues to maintain a tight control over the operational capital expenditure, the majority of which consists of computer and communications equipment. The increase in expenditure during 2006 relates to the establishment of a central hosting function covering certain customer and Group enterprise installations and the Group's own websites and databases and

the refurbishment of a major subsidiary office on relocation.

Going Concern

After making enquiries, the directors have a reasonable expectation that the Group has adequate resources to continue in operational existence for the foreseeable future. For this reason, they continue to adopt the going concern basis in preparing the accounts.

For and on behalf of the Board

Alastair Gordon
Chief Financial Officer

The Group is required to report under the Combined Code ("the Code") that was formally adopted in July 2003 by the Financial Services Authority. In the preamble to the Code there is a requirement for companies to make disclosure statements falling into two parts: firstly a report on how the company has applied the principles of the Code (both main and supporting); and secondly confirmation that the company complies with the Code provisions and, if it does not, to explain why it does not comply. The preamble goes on to state that smaller listed companies, like SDL, may judge that some of the provisions are disproportionate or less relevant, and the Code itself provides lesser requirements on companies below the FTSE 350 with regard to certain of its provisions. Whilst SDL considers that it is committed to high standards of corporate governance, the strong growth of the company since its flotation requires careful choices to be made in determining which elements of the Code are truly relevant to the needs of SDL, and offer real value to the interests of its shareholders.

SDL acknowledges that it does not comply, as the following disclosure statements show, with all of the Code principles and provisions. However, the directors have considered each aspect carefully and looked to identify where efforts should be focussed in 2007, subject to any conflicting demands that may arise because of the size and complexity of the business and the nature of the risks and challenges that it faces. This does mean that, in some cases, SDL cannot report compliance with the Code in 2006. However, where the intention is to take remedial action, this is highlighted so that shareholders can evaluate fully the approach that the directors are taking and be better placed to make reasoned judgements on the soundness of the strategy being followed.

REPORT ON APPLICATION OF THE PRINCIPLES OF THE COMBINED CODE

The directors are of the opinion that throughout the year ended 31 December 2006 the Group has applied the principles (both main and supporting) of Section 1 of the Code, with the following exceptions:

- Principle A.2 – The role of Chairman and Chief Executive Officer is combined (see later), and for this reason it is not possible to assert that a clear division of responsibilities exists between these two functions.
- Principle A.4 – There is no procedure for the appointment of new directors that is formal, rigorous and transparent. It is felt that should there be a need for a new appointment, the current approach of ensuring that all relevant views and inputs are sought and considered does guarantee

that any appointment is made on merit against clear criteria.

As noted in last year's report and accounts, during 2006 the board has established a formal internally based review process, as required under Principle A.6, to enable the performance of the board as a whole and individually to be assessed and the strengths and weaknesses of the board and the directors to be recognised and addressed. The results of this review were summarised to the board members in early 2007 and the detailed comments and observations will be utilised by the Chairman/Chief Executive Officer to implement recommendations and changes during 2007. As in prior years, the Chairman/Chief Executive Officer together with the non-executive directors evaluate the performance of the other executive board members with regard to annual salary reviews and bonus achievements. The non-executive directors perform the same evaluation with regard to the Chairman/Chief Executive Officer.

The way that the Group has applied the principles of the Code, other than the above, can be seen by the following statements, supplemented as they are in some cases by more detailed disclosures elsewhere in this report:

Principle A.1 – Having an effective board responsible for the success of the company

In an environment of past substantial growth, both organically and through acquisition, there has to be full dialogue between all members of the board. The Chief Executive Officer, Mark Lancaster, continually works to ensure that executive and non-executive directors are fully apprised of the strategic benefits of any planned acquisitions, with full discussions both within and outside of board meetings on the required financial controls and human resources needed to ensure that the overall objectives of the Group are met. Presentations by executive directors and senior management direct to board meetings on aspects of the business that are assigned to them enables non-executives to satisfy themselves that the performance of management at all levels is both effective and in line with Group goals and objectives. At least once a year there is a formal discussion at board level of the risks facing the Group and the suitability of the controls in place. During 2006 the internal controls matrix was reviewed on a number of occasions including evaluating the potential financial effects of these risks. Further information about the role of the board and the various Committees is given later in this report.

Principle A.3 – Having a balanced board

With four executive and three non-executive members,

the board is clearly not large, but is considered appropriate for the Group at its current size. All three non-executive directors are considered independent using the criteria set out in the Code and bring a good balance to the proceedings of the board. Joe Campbell, as the former CEO of Trados, was not considered independent under the Code in last year's report and accounts. However, Mr Campbell was only with the Trados business for a short period of time prior to its acquisition by SDL with the specific mandate to consolidate the business with others or to dispose of the business. Since the acquisition Mr Campbell has not been involved in any operational matters concerning Trados. A significant part of his input to the board is in relation to assisting in the ongoing acquisition strategy and assessing the US public and private equity markets. He is also consulted regularly by the chairman of the various board committees as to matters of policy. Currently two of the independent non-executive directors (Chris Batterham and John Matthews) represent all of the members that make up the Audit and Remuneration Committees, as well as the majority of the members of the Nomination Committee. Under the Terms of Reference for each of the aforementioned Committees, only members are entitled to attend Committee meetings unless the subject of specific invitation. In terms of the Remuneration Committee, the Chairman/Chief Executive Officer, Mark Lancaster, is automatically invited to attend to discuss the performance of executive directors except his own.

Principle A.5 – Having information supplied to the board in a timely and appropriate manner, with skills and knowledge related to the company updated continually

Board papers are circulated, wherever possible, in advance of meetings to allow time for the content to be considered prior to the meeting. This is particularly true in relation to monthly management accounts, other financial reports and where major acquisitions are concerned. Otherwise all aspects are deliberated on and discussed at board meetings or, if urgent decisions are required, through telephone conference calls or e-mail. Regular presentations are made to the board on the development of software products being introduced into the Group, the progress on the integration of the SDL and Trados product platforms and the marketing campaigns in relation to Global Information Management so that the knowledge and capabilities of directors are regularly updated.

Principle A.7 – Having directors re-elected at regular intervals with planned refreshing of the board

All directors are required by SDL's Articles of Association

to be re-elected at regular intervals (one-third, or the number nearest to one-third, being re-elected each year). Any concerns over the performance of a director would be considered annually irrespective of the fact that the director is to be submitted for re-election. Mark Lancaster, the Chairman/Chief Executive Officer, maintains an open dialogue with the non-executives through the medium of the Nomination Committee on the need for any refreshment of board members.

Principle B.1 – Having levels of remuneration sufficient to attract, retain and motivate directors, with a significant proportion linked to achievement of corporate and individual performance

The independent non-executive directors set each year the remuneration levels and targets for the Chairman/Chief Executive Officer, Mark Lancaster, after discussion with him on the issues currently facing the Group and those expected in the current, medium and longer term. Annually, and more frequently should the circumstances merit it, Mark Lancaster reviews the suitability of the remuneration package for other executive directors, taking into account pay elsewhere in the Group and externally, and the corporate and personal targets expected from each person in the following 12-month period. His recommendation to the independent non-executives (in their role as the members of the Remuneration Committee) on potential salary increases and the targets are considered and, if in order, agreed. At the same time, Mark Lancaster and the independent non-executive directors agree the structure of the remuneration package that, in recent years, has included a performance related element that, if achieved, would represent a significant proportion of the remuneration available to the executive directors (approximately 50% of basic salary). Mark Lancaster will periodically discuss with other executive directors the suitability of the remuneration paid to the non-executive directors. Further information relating to remuneration policy is contained in the Directors' Remuneration Report.

Principle B.2 – Having a formal and transparent procedure for developing policy on executive remuneration with no director involved in decisions affecting his/her own remuneration

As indicated in relation to principle B.1, executive remuneration is determined using a procedure that requires the involvement of the Chairman/Chief Executive Officer, Mark Lancaster and the non-executive directors. This is considered appropriate for the Group at this time, with the process, other than in relation to the remuneration of Mark Lancaster himself, taking place formally under the direction of Mark Lancaster and with

the Remuneration Committee (consisting of certain of the independent non-executive directors) reviewing the suitability of the policy being used by Mark Lancaster to determine the proposed level of remuneration. The process described here also ensures that no director is involved in deciding his/her own remuneration (the remuneration of Mark Lancaster, himself, being the exclusive responsibility of certain of the independent non-executive directors). At this time the Remuneration Committee have not felt it necessary to appoint external consultants to provide advice on executive director remuneration but it is intended that advice will be sought from external consultants in 2007 to assess the appropriateness of the current procedures.

Principle C.1 – Ensuring that public reports and other information generally released present a balanced and understandable assessment of the company's position and prospects

The board always presents its financial and other data in a way that meets statutory and other requirements, including those standards set by Financial and Accounting Regulatory bodies.

Principle C.2 – Ensuring there is a sound system of internal control to safeguard shareholders' investments and the company's assets

Mark Lancaster, the Chairman/Chief Executive Officer, and Alastair Gordon, the Chief Financial Officer continually monitor the suitability of internal controls based on the changing demands, risks and opportunities facing the Group, and discuss them with other executive directors and senior management. Formally, on an annual basis or more often if necessary, the board considers what financial, operational and compliance controls and risk management systems should be in place. This is based on a risk matrix, and forms an agenda item for the board each year. The board's approach is to review those risks that are significant in terms of their likelihood of occurrence within and financial effect on the Group, and to ensure that suitable controls exist for those risks considered to be "high" or "medium". Further information on this topic is given below in a separate section of this report (see page 21, Internal Control).

Principle C.3 – Ensuring that formal and transparent arrangements are established to apply the financial reporting and internal control principles and for maintaining an appropriate relationship with the company's auditors

The Audit Committee receives regular verbal and written reports from the Group auditors and Chief Financial

Officer, Alastair Gordon, before and at the end of each full audit or interim review. These arrangements are both formal and transparent and include a consideration of the financial controls in place. The Audit Committee also meets with the Group auditors at the conclusion of each full audit or interim and more frequently when required. Under the Terms of Reference for the Audit Committee senior members of the Finance team are required to report direct to the Committee on the outcome of financial and operational reviews carried out within different parts of the Group.

Principle D.1 – Having regular and satisfactory dialogue with shareholders

Mark Lancaster, the Chairman/Chief Executive Officer, and Alastair Gordon, the Chief Financial Officer, meet with existing and potential institutional investors regularly during the financial year and explain the objectives that the Group are currently pursuing, together with the financial results. This is considered the best way to ensure that those representing the shareholders with the majority of the shares in SDL are able to make their issues and concerns known. Further information relating to the way in which dialogue with shareholders takes place is given later in this report (see page 21, Relations with Shareholders).

Principle D.2 – Using the AGM to communicate with investors and encourage participation

The board ensures that full information is provided to shareholders on the business to be covered at annual meetings of the Group, and the Chairman/Chief Executive Officer, Mark Lancaster, will seek to answer any questions that might be raised by those in attendance. Clearly, as indicated by the disclosure in the preceding section relating to principle D.1, the main communication takes place, because of the shareholder structure within the Group, directly with investors, and this is not restricted to the AGM.

STATEMENT OF COMPLIANCE WITH COMBINED CODE PROVISIONS

Following the statements made at the beginning of this part of the statutory accounts, there are some areas where SDL is not technically in compliance with Code provisions, but where it has a clear mandate to address them. Accordingly, the following statement does not focus on only whether there is non-compliance with Code provisions. Instead it includes where there is "Technical Non-Compliance", meaning that continuing steps were taken in 2006 to address them, and sets out what those steps were. It is considered that this would be of most use to shareholders.

Provision A.2.1 – Non-Compliance

- As described in the previous section (principle A.2), the role of the Chairman and Chief Executive are combined and therefore exercised by the same individual. The board are of the view that this remains appropriate in the current market climate, and with the challenges facing the Group. The strategic goals of the Group are very closely aligned to the operational activities and all the executive directors are closely involved in both these aspects. The board further considers that this does not work to the disadvantage of the Group because of the existence of three strong and independent non-executive directors, all with considerable strategic planning experience, that restrict the chances of any possible situation arising that might be considered a potential abuse of the combined powers. The position is kept under continual review and is discussed with the Group's major shareholders and advisors where the matter is raised.

Provision A.4.2 – Technical Non-Compliance

- The Nomination Committee have been tasked with evaluating the balance of skills, knowledge and experience on the board, and preparing a description of the role and capabilities required for a particular appointment. During 2006 it has not been considered necessary to replace any board member or add to the board or add to the functions represented. The Nomination Committee has met during the year to consider the position and will establish a more formal process in 2007 for appointment of directors to enable the Group to be in full compliance with the Code when board changes are required.

THE BOARD AND ITS COMMITTEES

The Board

The Board currently comprises the Chief Executive Officer (combining the role of Chairman), three other executive directors and three independent non-executive directors. Individual biographies, appearing elsewhere in this annual report, demonstrate a range of experience and calibre of expertise needed to bring independent judgement on issues of strategy, performance, resources and standards of conduct that are vital to the success of the Group. The Board is responsible to shareholders for the proper management of the business. A statement of the directors' responsibilities in respect of the accounts is set out on page 32, a further statement on the directors responsibilities to the auditors is set up on page 33 and a statement on going concern is given on page 15. Chris Batterham has served on the Board

since flotation, and is the senior independent director to whom any concerns, whether shareholder or other, can be conveyed.

The Board has a formal schedule of matters specifically reserved to it for decision. A copy of this schedule is available from the Company Secretary. All directors have access to the advice and services of the Company Secretary, who is responsible to the Board for ensuring that procedures are followed and that applicable rules and regulations are complied with. In addition, the Company Secretary ensures that the directors receive appropriate training covering such things as their legal obligations as directors and compliance with Stock Exchange Rules. The appointment and removal of the Company Secretary is a matter for the Board as a whole.

On average the Board meets at least every other month, reviewing strategic issues, acquisition possibilities, funding requirements, trading performance and the responsibility of reporting to shareholders. The non-executive directors are fully involved in the consideration of the strategies proposed by the executive directors. To enable the Board to discharge its duties, all directors receive appropriate and timely information with briefing papers distributed, wherever possible prior to the meeting. The Chairman ensures that, as and when required, the executive and non-executive directors are able to take independent professional advice at the Group's expense.

All executive directors of the Board are subject to contracts in which notice periods are of no more than one year's duration.

The following committees deal with specific aspects of the Group's affairs:

Remuneration Committee

The Group's Remuneration Committee is chaired by John Matthews and its other member is Chris Batterham. It is responsible for making recommendations to the Board, within agreed terms of reference, on the Group's framework of executive remuneration and its cost. As and when needed the committee reviews the contract terms, remuneration and other benefits for each of the executive directors, including pension rights and compensation payments. The Board itself determines the remuneration of the non-executive directors, and also has responsibility for electing persons to the Board. The committee does not have authority to employ or dismiss directors. During 2006 the committee met four times. Its major activity was the investigation, review and establishment of a long-term incentive plan for executive directors and other senior management

which was approved by the shareholders in April 2006. This plan is covered in more detail in Directors' Remuneration Report.

Copies of the Terms of Reference are available, on request, from the Company Secretary.

Further details of the Group's policies on remuneration, service contracts and compensation payments are given in the Directors' Remuneration Report on pages 24 to 28.

Audit Committee

The Audit Committee comprises two of the non-executive directors, Chris Batterham, who chairs the Committee and John Matthews. The committee provides a forum for reporting by the Group's external auditors and to assess the Group's internal finance function.

The Audit Committee is responsible for reviewing a wide range of matters including the half-year and annual accounts, and monitoring the controls that are in force to ensure the integrity of the information reported to shareholders. The Audit Committee considers the nature, scope and results of the audit. The Audit Committee keeps under review the cost effectiveness, independence and objectivity of the external auditors.

The Audit Committee met four times during the year. Matters consider by the Committee included the internal

Copies of the Terms of Reference are available, on request, from the Company Secretary.

controls matrix with recommendations on changes to the Board, changes to the scopes of the external audit focus in the light of the integration of Trados into the Group's finance function, overall approach to fees and independence and an assessment of the Group's internal operational reviews in the current absence of a formal internal audit function. This latter point is kept under annual review by the Audit Committee.

Copies of the Terms of Reference are available, on request, from the Company Secretary.

Nomination Committee

The Nomination Committee is chaired by Mark Lancaster, with its other members being Chris Batterham and John Matthews, both of whom are non-executive directors as required by the Combined Code. The Terms of Reference of the Committee require that they meet at least once a year in order to review the current structure of the Board, its ongoing relevance to the nature of the business, and consider potential new Board appointments, including any proposed by the executive directors and the matter of succession planning. Recommendations from the Committee are made to the Board. The Committee met once during the year and concluded that the current broad structure is appropriate for the Group's needs but that this should be kept under regular review.

Date	ML	CL	AG	KM	JM	CB	JC
BOARD							
31 January	X	X	X	X	X	X	X
22 March	X	X	X	X	X	X	X
27 April	X	X	X	X	X	X	
27 June	X	X	X	X	X	X	X*
25 July	X	X	X	X	X	X	X
3 October	X	X	X	X	X	X	X
23 November	X	X	X	X	X	X	
18 December	X	X	X	X	X	X	X*

Date	JM	CB	Also Attended	
			ML	AG
AUDIT COMMITTEE				
21 February	X	X	X	X
1 September	X	X	X	X
27 October	X	X	X	X
23 November	X	X	X	X

* = attendance by phone

Date	JM	CB	Also Attended	
			ML	AG
REMUNERATION COMMITTEE				
22 March	X	X	X	X
27 April	X	X	X	X
13 July	X*	X*	X	X
1 September	X	X	X	

Date	ML	JM	CB	Also Attended
				AG
NOMINATION COMMITTEE				
18 December	X	X	X	X

The following tables show the meetings during 2006 and the attendance of individual directors (represented by an "X") for each of them:

RELATIONS WITH SHAREHOLDERS

The operating and financial review on pages 11 to 15 includes a detailed review of the business and future developments. There is regular dialogue with shareholders, financial and industry analysts and the press, most specifically at the announcement of the half and full year results and on the occasion of acquisitions, but also as requested by interested parties. The outcome of any dialogue is communicated to the board in order to enable there to be a broad understanding of the views of major shareholders about the Group. The Board looks to use the Annual General Meeting to communicate with private as well as institutional investors, welcoming their participation. The Group also has a website (www.sdl.com) containing up-to-date information, financial reports, product news and a share club that entitles shareholders and interested investors to register for notification of important SDL financial events and news releases.

The Chairman/Chief Executive, Mark Lancaster, aims to ensure the availability of the chairman of the Audit and Remuneration Committees at Annual General Meetings to answer questions. Details of resolutions to be proposed at the Annual General Meeting can be found in the Notice of Meeting on pages 84 - 85. Separate resolutions are proposed on each substantially separate issue with a specific resolution relating to the report and accounts.

To the directors' knowledge there are no shareholders holding more than 30% of voting rights in the Group. No provision exists in the Articles of Association that empowers a shareholder to designate directors to the Board.

INTERNAL CONTROL

The responsibility for reviewing the system of internal control vests in the Board through, in the first instance, its executive directors. The executive directors take seriously the responsibilities enshrined in principle C.2 of the Combined Code to maintain a sound system of internal control that, amongst other things, safeguards the Group's assets and the investment of shareholders in the Group.

During the year ended 31 December 2006 the Board continued the process of identifying, evaluating and managing the significant risks faced by the Group. A risk matrix has been established to meet the requirements of the Combined Code that identifies, with a view to monitoring, the effectiveness of significant financial, operational and compliance controls as well as risk management. The content of the risk matrix is reviewed regularly through the year and revised in full in January each year. The main focus of the latest reviews has been to ensure that any and all risks arising from the acquisition of the Trados group and the evolution of the Group as a software rather than services company have been addressed. At the same time the Board review the systems of internal control and consider whether they are effective in managing those risks considered to have high importance. The system currently employed is designed to manage rather than eliminate the risk of failure to achieve business objectives and, as such, can only provide reasonable and not absolute assurances against material misstatement or loss. The steps that have been and are being taken by the Board are aimed at embedding internal control and risk management into the operations of the business and to deal with areas of improvement that come to the attention of management and the Board.

The following sets out the reasons for the Board's confidence in maintaining that it meets principle C.2 of the Combined Code.

Management Structure

The Board has overall responsibility for the Group and there is a formal schedule of matters specifically reserved for decision by the Board. Each executive director has been given responsibility for specific aspects of the Group's affairs. The executive directors together with key senior management constitute the Senior Executive Committee, which meets monthly to discuss day-to-day operational matters.

Identification and Control of Risk

The executive directors are directly involved in all aspects of the business and manage the risks in what is a dynamic and rapidly changing environment.

Having regard to the nature and extent of the risks facing the Group, the executive directors exercise control through the following:

- Strict adherence to a policy that expenditure above a set amount (singularly or as a group of transactions) and all capital expenditure is approved by the Chief Executive Officer ("CEO") and/or Chief Financial Officer ("CFO"). Such approval is required before the creation of any financial commitment on the Group
- Limiting authorities for cheques and other payment instructions such that the CFO and/or the CEO must be signatories to any transaction that exceeds a set amount
- Direct control by the CEO and CFO, in conjunction with the non-executive directors and senior management team as appropriate, in the identification and full evaluation of potential acquisitions
- Maintaining an open dialogue with and briefing employees of the Group on strategic initiatives and the way those strategies are expected to crystallise
- Allocation of all projects to the operational divisions by the CEO or Chief Operating Officer ("COO") and a weekly review of all project budgets by the Group Divisional Directors
- Direct involvement of the CFO in any leasehold property initiatives or renewals
- Direct involvement of the CEO and the President

- Technology ("PT") in product development strategies and programmes

- Requests for hiring of personnel and authorisation for salary increases requiring the approval of the responsible executive director
- Direct control by the CEO of marketing and advertisement commitments
- Formal review of material legal agreements and contracts by the CFO/Company Secretary and a detailed process of escalation from the Group Director – Commercial Contracts to the CEO and CFO for such matters as warranties, indemnities and protection of intellectual property rights outside approved limits
- Establishment of internal control site visits by a senior member of the central Finance Department to each local office in order to identify first hand any potential risks
- Implementation of a standard accounting software solution across the Group with capacity for centralised monitoring and analysis

All of the Chief Officers and the President - Technology referred to above act as executive directors of the Group.

It is believed the existence of the above mechanisms provides a system of internal control that is relevant to the current needs of the business and offers adequate protection to shareholders as envisaged by the requirements of the current Code.

Establishment of Formal Risk Control Procedures

During 2006 the Board continued to review and redefine those risks that need to be the subject of regular formal controls, whether through the application of existing procedures or through the creation of new ones, backed up by appropriate and adequate reports. By continually reviewing and adjusting the content of the areas of risk needing to be covered, the Board and the Audit Committee are able to review the degree of control being exercised, determine the cost effectiveness of those controls, and use it as a reference point for the annual review process.

Quality and Integrity of Personnel

The integrity and competence of personnel is ensured through the application of high recruitment standards

and subsequent training courses identified through the Group's CDA system (Continuous Development Analysis). High quality personnel are seen as an essential part of the control environment and the ethical standards expected are fully and openly communicated.

Budgetary Process

Each year the Board approves the annual budget. Key risk areas are identified. Performance is monitored and relevant action taken to rectify any underperformance against budget. Monthly reports are submitted to the Board identifying variances from the budget and outlining steps taken or to be taken in order to bring about rectification. Re-forecasts for the remainder of the year are produced where material changes are anticipated. Sales forecasts are updated monthly, and are supplemented by weekly spot projections based on actual and expected sales in the month.

Investment Appraisal

Due diligence work is carried out if a business is to be acquired. Full investigations into all legal, financial, taxation and operational aspects are undertaken (using external advisers if the size or complexity of the acquisition merits it) and the results of these investigations are communicated to all members of the Board as part of the review and decision making process, and prior to the completion of the acquisition.

Integration of Acquisitions

A detailed integration plan is drawn up and approved during the process of assessing and negotiating all acquisitions. Regular reports are then made to the Board on against this plan issues that arise during the integration of acquired businesses.

Information not subject to audit

Remuneration Committee and Advisors

The Remuneration Committee is chaired by John Matthews and its other member is Chris Batterham. Both are non-executive directors having no financial interest other than as shareholders in the matters to be decided, no conflicts of interest arising from cross-directorships and no day-to-day involvement in running the business of the Group. The committee makes recommendations, within agreed terms of reference, on an overall remuneration package for executive directors and other senior executives.

With the exception of advice taken on the formation of the long term incentive plan ("LTIP"), where the Remuneration Committee appointed Halliwell Consultants to advise, the Remuneration Committee has not formally appointed any other external advisers to assist them in the performance of their duties. However reliance is placed on external published material that is considered relevant to the consideration of executive remuneration packages together with the committee members experience in the other businesses with which they are involved.

Remuneration Policy

The overall and ongoing policy on directors' remuneration is that the package should be sufficiently competitive to attract, retain and motivate high quality executives capable of achieving the Group's objectives and thereby enhancing shareholder value. The package now consists of basic salary, benefits, long-term incentive plan, performance related bonuses and pensions. Consideration is given to pay and employment policies elsewhere in the Group, especially when determining annual salary increases. Executive directors, excluding the Chairman/Chief Executive Officer, are not allowed under their contract to be directly or indirectly engaged or concerned in any other trade or business without the specific written consent of the Chairman/Chief Executive Officer. Mark Lancaster, the Chairman/Chief Executive Officer is required to obtain the prior written approval of the Company, through the Board, if he wishes to be engaged, concerned or interested in the management or conduct of any other business that would conflict with or affect his contractual duties. No such external interests existed during the year.

Executive Remuneration Package: During 2006 the Group has amended its strategy towards the remuneration packages of executive directors, with the introduction of a long-term incentive plan to ensure that rewards remain market competitive and in line with best practice. The long-term incentive plan is discussed in more detail

below. As in previous years, added to the basic salary are performance related bonuses with, the actual level of reward being factored to offer sums that vary with the achievement or non-achievement of predefined, set targets. The bonus scheme is discussed in more detail below.

Share options have not been a formal part of the remuneration package, the Board, on the recommendation of the Remuneration Committee, deciding when and if options were to be granted under the rules of the share option scheme. The share option scheme will remain open to other employees as appropriate but will not be used as part of the executive directors' remuneration package going forward. Those executive directors holding previously issued options will be able to retain them on the terms and performance conditions that were set at the time of the option grant.

The details of current individual components of the remuneration package and service contracts are discussed below.

Basic Salary and Benefits: The salary and benefits are reviewed annually. Mark Lancaster, the Chairman/Chief Executive Officer, did not receive an increase in basic salary during the year. Cristina Lancaster and Alastair Gordon received an increase in basic salary during the year of 10% to £110,000 and Keith Mills received an increase of 20% to £120,000. None of the executive directors receiving a salary increase in 2006 received an increase in the previous financial year. Benefits principally comprise a car or car allowance, car fuel benefits and private healthcare.

Share Options: The Group has a share option scheme, with one element approved by the Inland Revenue, the other unapproved. Share options are awarded within the period of 42 days commencing on the date on which the annual or half-yearly results are announced to the London Stock Exchange. However, no grant can be made on or before the third dealing day. The rules allow for the imposition of performance conditions and the majority of options are granted subject to achievement of Group targets, although none of the current performance conditions involve any comparison with factors external to the company. The approved scheme limits the market value of granted options to that set by the Inland Revenue, currently £30,000, provided that in any 12-month period options granted or proposed do not exceed two times the annual salary of the employee. The unapproved scheme limits options to two times the annual salary in any 12-month period. Salary excludes benefits-in-kind. No options are offered at a discount, and both schemes contain provisions limiting the total number of options that can be granted in any 10-year

period to not more than 10% of issued share capital (this dilution limit is in line with the recommendations of the Association of British Insurers). As noted above the share option scheme is to no longer be used as part of the executive directors' remuneration package, being replaced by the long-term incentive plan noted below. However, the Directors will continue to hold the share options previously granted to them but not yet exercised or lapsed.

Performance Related Bonuses: A performance related bonus scheme is currently in place based upon two elements - the achievement of specified personal objectives and responsibilities appropriate to each executive director and the achievement of Group revenues and earnings before amortisation and taxation ("EBITA") against the consensus of analyst market expectations. The formula for the revenue and earnings targets is set by the Remuneration Committee, with 100% of the theoretical bonus being achievable if both consensus revenue and EBITA targets are met. Additional percentage is achieved if the consensus targets are exceeded. However, the theoretical bonus calculated in this manner is then adjusted for the level of the personal objectives achieved as assessed by the Chairman/CEO. The achievement of consensus revenue and EBITA targets and 100% attainment of the Directors personal objectives mean that the Director will be entitled to a bonus of approximately 60% of base salary.

Long-Term Incentive Plan: In the light of discussions with individual shareholders and representatives of shareholder groups, the Remuneration Committee proposed the introduction of a long-term incentive plan ("LTIP") that the Committee considered better aligned the executive director's remuneration package to the interests of the shareholders themselves. The Remuneration Committee was keen that directors and senior executives should be encouraged to focus on ensuring that the Company's return to shareholders be competitive compared to comparable companies in its sector and that the comparative total shareholder return be a measure operated in conjunction with the majority of the whole share plans in the sector.

The proposed LTIP was formally approved by the shareholders at an EGM on 27 April 2006, having previously been informally reviewed in consultation with a group of senior shareholders. The LTIP allows for the executive directors to be issued with shares up to the value of 100% of basic salary in any one financial year over a period of 5 years. Lower percentage of salary threshold levels are in place for other senior management and technical employees considered important to the long term development of the Group. The award of the LTIP shares will be made to the relevant director or employee at nil cost to the director or employee at the

end of a three year holding period provided stringent performance targets have been met as set out below.

The performance conditions are as follows:

- The initial performance hurdle is a total shareholder return underpin based on the Company's comparative performance against the companies constituting the FTSE Software and Computer Services Index (the "Comparator Group"). This requires the company's comparative performance to be at least the median compared to the Comparator Group at the end of the initial three year period from the granting of the LTIP reward. If this median position is not achieved then no shares can be released regardless of the rest of the performance of the Company, including the Earnings Per Share ("EPS") performance below.
- Providing the total shareholder underpin as required above has been achieved, the LTIP shares will be released by the Remuneration Committee dependent on the Company achieving an absolute level of earnings growth at the end of the three year performance period as follows:
 - 100% of the LTIP shares will be released providing the annual growth of EPS over the three year performance period exceeds 25%
 - 25% of the LTIP share will be released providing the annual growth of EPS over the three years performance period exceeds 10%
 - And there will be straight line vesting of the LTIP shares on EPS growth between these two points

On 25 May 2006, 298,153 LTIP shares were granted to the executive directors at a market price of £1.895, with a performance period of three years from date of grant, and 202,075 to certain senior management employees. The grants to the individual executive directors are set out in more detail below. A further 428,574 and 40,000 LTIP shares were issued on 18 July 2006 and 1 September 2006, at market prices of £1.955 and £2.050 respectively, to managers and technical staff considered important to the future of the SDL Group.

Mark Lancaster - 118,734 shares

Keith Mills – 63,325 shares

Alastair Gordon – 58,047 shares

Cristina Lancaster – 58,047 shares

Pensions: The executive directors are members of the SDL Pension Scheme. The scheme operates as a personal

pension plan into which the Group pays an annual sum equal to 9% of remuneration for Mark Lancaster, the Chairman/Chief Executive Officer, and 7% for all other executive directors. Remuneration for the purpose of pension contributions means basic salary excluding bonuses and benefits-in-kind.

Fees: The fees for non-executive directors are determined by the Board within the limits stipulated in the Articles of Association. In deciding an appropriate level of fees for each non-executive director, the Board consider the responsibility and time commitments taking into account the number of Board meetings, the giving of strategic and general advice plus the membership of the Audit Committee, the Remuneration Committee and the Nomination Committee. The non-executive directors are not involved in any discussions or decision about their own remuneration.

Service contracts

The service contracts and letters of appointment of the directors include the following terms:

<i>Executive Directors</i>	<i>Date of Contract</i>	<i>Unexpired Term (months)</i>	<i>Notice Period (months)</i>
Mark Lancaster	1 December 1999	N/A	12
Cristina Lancaster	1 December 1999	N/A	12
Alastair Gordon	1 December 1999	N/A	6
Keith Mills	1 September 2000	N/A	6
<i>Non-executive Directors</i>			
Chris Batterham	15 October 2002	16	3
John Matthews	27 May 2004	5	3
Joe Campbell	1 July 2005	18	3

Mark Lancaster and John Matthews retire by rotation and, being eligible, offer themselves for re-election.

Biographical details of all directors can be found on page 10.

Performance Graph

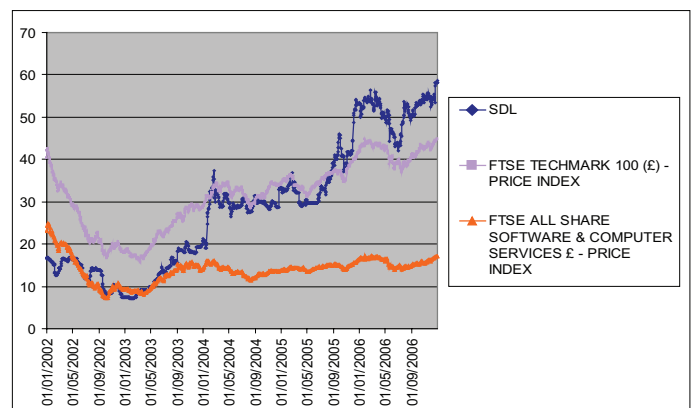
The graph shows the percentage change in the total shareholder return for each of the years from 2000 of a holding of the company's shares against the corresponding change in a hypothetical holding of shares in the FTSE Computer Software and Services Index.

The FTSE Computer Software and Services Index was selected by the Remuneration Committee as the most appropriate equity market index relative to the sector in which the Group operates for the purposes of evaluating

Non-Group Directorships: No executive director holds any executive directorship or appointment outside the Group.

Service Contracts: The policy of the company is to have service contracts for all the executive directors that continue indefinitely unless determined by notice. The non-executive directors have contracts that run for three-year terms, commencing from their date of appointment, subject to three months notice from either side. There are no special provisions for executive or non-executive directors with regard to compensation in the event of loss of office. Whilst it has not been necessary to date, the Remuneration Committee would consider the circumstances of individual cases in the event of early termination and determine compensation payments accordingly.

the Group's management against external sources for the purpose of the LTIP. Previously the Group had used the FTSE Techmark 100 Index as its bench mark and this is also included as a transitional phase to the FTSE Computer Software and Services Index.



Information subject to audit

Directors' Remuneration

The remuneration of the directors is as follows:

	Basic Salary and Fees £	Benefits (*) £	Bonuses £	Total 2006 £	Total 2005 £
Executive Directors					
Mark Lancaster	225,000	24,854	200,000	449,854	443,608
Cristina Lancaster	108,333	12,000	70,000	190,333	157,406
Alastair Gordon	108,333	10,920	60,000	179,253	144,483
Keith Mills	116,667	8,718	125,000	250,385	171,937
Non-executive Directors					
Chris Batterham	28,000	-	-	28,000	26,000
John Matthews	28,000	-	-	28,000	26,000
Joe Campbell	27,342	-	-	27,342	14,156
Total all Directors	641,675	56,492	455,000	1,153,167	983,590

*The remuneration package of each executive director includes non-cash benefits comprising the provision of a company car, when a car allowance is not taken, and private health insurance.

Pension Entitlements: No contributions were made by the Group in respect of non-executive directors. The contributions made by the Group in respect of money purchase schemes for each executive director are as follows:

	Total 2006 £	Total 2005 £
Mark Lancaster	19,786	19,348
Cristina Lancaster	7,583	7,000
Alastair Gordon	7,583	7,000
Keith Mills	8,167	7,000
Total all Directors	43,119	40,348

Interests in Options: Historically, the Group has maintained a share option scheme by which executive directors and other senior executives are able to subscribe for and acquire ordinary shares in the company. This scheme has an approved element and an unapproved element, and was formally adopted by special resolution on 1 December 1999. The approved element has been accepted by the Inland Revenue under the terms of the Income and Corporation Taxes Act 1988 with effect from 23 February 2000. Prior to December 1999 options were granted under unapproved schemes previously adopted by the Group. The executive directors continue to hold share options as outlined below but the share option scheme has been replaced going forward by the long-term incentive plan noted above.

The interests of the directors in share options are as follows:

	Exercise Price	At 1 January 2006	Awarded during the year	Exercised during the year	Expired unexercised during the year	At 31 December 2006
		No.	No.	No.	No.	No.
Cristina Lancaster (a)	1p	315,716	-	-	-	315,716
Cristina Lancaster (a)	17.56p	90,000	-	-	-	90,000
Cristina Lancaster (d)	33.5p	100,000	-	-	-	100,000
Cristina Lancaster (e)	119.33p	100,000	-	-	-	100,000
Alastair Gordon (a)	20.11p	448,000	-	200,000	-	248,000
Alastair Gordon (d)	33.5p	100,000	-	-	-	100,000
Keith Mills (a)	1p	80,000	-	80,000	-	-
Keith Mills (a)	20.11p	45,000	-	45,000	-	-
Keith Mills (b)	58.89p	45,000	-	45,000	-	-
Keith Mills (c)	60p	90,000	-	-	-	90,000
Keith Mills (d)	33.5p	100,000	-	10,000	-	90,000
Keith Mills (e)	119.33p	100,000	-	-	-	100,000
Mark Lancaster (e)	119.33p	200,000	-	-	-	200,000

The options are exercisable between the following dates:

- (a) 7 December 1999 to 1 February 2009
- (b) 2 November 2001 to 2 November 2009
- (c) 26 September 2002 to 26 September 2011
- (d) 28 February 2004 to 28 February 2013
- (e) 4 April 2006 to 4 April 2015

During the period 1 January 2006 through to 31 December 2006 the market price of ordinary shares has ranged between 171p and 238p. The market price of the ordinary shares at 31 December 2006 was 235.75p.

Interests in Long-Term Incentive Plan Shares

The interests of the directors in long-term incentive plan shares are as follows:

	Issue Price	At 1 January 2006	Awarded during the year	Achieved during the year	Expired unachieved during the year	At 31 December 2006
		No.	No.	No.	No.	No.
Mark Lancaster	189.5p	-	118,734	-	-	118,734
Keith Mills	189.5p	-	63,325	-	-	63,325
Alastair Gordon	189.5p	-	58,047	-	-	58,047
Cristina Lancaster	189.5p	-	58,047	-	-	58,047

On behalf of the Board
Alastair Gordon
Director

5 March 2007

The directors present their report and the Group accounts for the year ended 31 December 2006.

RESULTS AND DIVIDENDS

The Group profit for the year, after taxation, amounted to £6.2 million (2005: £2.9 million).

The directors do not recommend the payment of a dividend.

PRINCIPAL ACTIVITIES

The Group's activities during the year continued to be the provision of Global Information Management solutions and related software applications to a wide variety of multinational businesses.

REVIEW OF THE BUSINESS

Group revenue of £94.7 million increased by 21% compared to last year (2005: £78.5 million). The increase represents 11% organic growth within the existing SDL translation solutions business and the balance from the technology segment, including the contribution of the Trados group for a full year. Operating profit before taxation and amortisation of intangibles increased by 71% to £ 13.2 million (2005: £7.7 million), while profit before tax increased to £9.4 million (2005: £5.2 million). The increase in profitability was primarily due to the leverage of the higher sales in the year, and the gross margin thereby generated (up 2% to 49%), over the Group's underlying costs. The Group had net borrowings of £3.7 million as at 31 December 2006 (2005: net borrowings £12.1 million). The Group originally entered into a £20m loan facility to assist in the acquisition of Trados but has sought to reduce the level of borrowing from the Group's cash flow. Further details on the results for the year are given in the Operating and Financial Review section of these accounts.

POSITION, FUTURE PROSPECTS AND BUSINESS RISKS

The Group expects to see continued strong financial returns from our investment in Global Information Management, both from the services and the technology sides of the business. The understanding and awareness of Global Information Management continues to be the number one challenge to the growth of the business. The Group however expects to see a considerable uplift in awareness of the complexities of creating and managing global content from companies that trade globally. This will in part be driven by increased investment in marketing during 2007, but increasingly by the realisation of companies that language is now a

major competitive differentiator in winning and retaining market-share across the globe. As the investments SDL has made into Knowledge-based Translation continue to give increased returns, the Group expects to see more content flow though this automated translation technology in 2007, which ultimately brings higher margins to the group. In summary the Group believes that our efficient services infrastructure and technology systems will offset the increase in investment in marketing and the potential continued dollar weakness to provide another year of growth in 2007.

Details on the risks associated with the business are given in the Operating and Financial Review.

EVENTS SINCE THE BALANCE SHEET DATE

There were no significant events since the financial year-end affecting the business of the Group.

DISABLED EMPLOYEES

The Group gives full consideration to applications for employment from disabled persons where a handicapped or disabled person can adequately fulfil the requirements of the job.

Where existing employees become disabled, it is the Group's policy wherever practicable to provide continuing employment under normal terms and conditions.

Training and career development to disabled employees is made available wherever appropriate, as are opportunities for promotion and personal growth.

EMPLOYEE INVOLVEMENT

During the year, the policy of providing employees with information about the Group has been continued primarily through the production of a monthly in-house magazine and group-wide mailings. Employees are provided with opportunities to invest in the Group through participation in the share option scheme.

Divisional Directors are regularly briefed using face-to-face or conference call meetings by the Chief Executive on matters affecting their operations, and contributions are encouraged on those issues facing the Group. Annually, senior management from all the multilingual and network offices meet in order to exchange ideas and information. Directors of all multilingual and network offices are required to ensure that information is passed down to their managers and regular meetings held with employees to facilitate full consultation and generate employee feedback.

DIRECTORS AND THEIR INTERESTS

The directors at 31 December 2006 and their interests in the share capital of the Group (all beneficially held) according to the register of directors' interests are detailed as follows:

<i>Executive Directors</i>	<i>Class</i>	<i>2006 Number</i>	<i>2005 Number</i>
Mark Lancaster	Ordinary	1,852,584	3,352,588
Cristina Lancaster	Ordinary	220,537	220,537
Alastair Gordon	Ordinary	-	-
Chris Batterham	Ordinary	86,895	86,895
Keith Mills	Ordinary	71,231	71,231
John Matthews	Ordinary	15,000	15,000
Joe Campbell	Ordinary	-	-

The above list represents all persons who were directors at any time during the year.

Details of options and long-term incentive plan shares held by directors at the year-end are given in the Directors' Remuneration Report on page 24.

There have been no changes to any directors' interests in shares (including options) since the end of the financial year up to a date that is not more than one month before the date of the notice of general meeting.

The company has granted an indemnity to one or more of its directors against liability in respect of proceedings brought by third parties, subject to the conditions set out in the Companies Act 1985. Such qualifying third party indemnity provision remains in force as at the date of approving the directors' report.

MAJOR INTERESTS IN SHARES

Excluding directors (see disclosure above), the most recent notifications of an interest in the 1p ordinary shares of SDL plc required to be disclosed in accordance with sections 198 to 208 of the Companies Act 1985 have been as follows (percentage of ordinary shares in issue as at 31 December 2006 shown in brackets):

24 August 2006 - BriTel Fund Trustees Limited held 2,037,159 shares (3.3%)

18 October 2006 – Herald Investment Trust plc held 5,025,000 shares (8.1%)

21 December 2006 – AXA S.A. held 12,556,831 shares (20.0%)

CREDITOR PAYMENT POLICY AND PRACTICE

It is the Group's policy for the current and future years that payments to suppliers are made in accordance with those terms and conditions agreed between the Group and its suppliers, provided that all trading terms and conditions have been complied with.

At 31 December 2006, the Company had an average of 39 days purchases outstanding in trade creditors (2005: 59 days).

RESEARCH AND DEVELOPMENT ACTIVITIES

The Group conducts research and development activities in a number of locations. These activities are concentrated on maintaining the Group's software products in providing Global Information Management solutions, encompassing translation memory, automated real time translation and workflow. During 2006, the development division has concentrated on evaluating the technology acquired with the Trados group and planning and progressing the integration of the combined technologies. As a consequence the resources utilised have remained relatively constant throughout the year. This will be reviewed as the Group moves towards the release of a fully integrated platform in the latter half of 2007.

FINANCIAL INSTRUMENTS

An explanation of the Group's financial instrument risk management objectives, policies and strategies are set out in the Operating and Financial Review on pages 11 to 15.

POLITICAL AND CHARITABLE DONATIONS

During the year no political donations were made. Charitable donations amounting to £5,372 were made.

AUDITORS

A resolution to re-appoint Ernst & Young LLP as auditors will be put to the members at the Annual General Meeting.

Directors' statement as to disclosure of information to auditors

The directors who were members of the board at the time of approving the directors' report are listed on page 10. Having made enquiries of fellow directors and of the company's auditors, each of these directors confirms that:

- to the best of each director's knowledge and belief, there is no information relevant to the preparation of their report of which the company's auditors are unaware; and
- each director has taken all the steps a director might reasonably be expected to have taken to be aware of relevant audit information and to establish that the company's auditors are aware of that information.

SPECIAL BUSINESS AT THE ANNUAL GENERAL MEETING

At the Annual General Meeting, items 1 to 6 are termed ordinary business, while item 7 will be special business. The special business covers the directors' authority to allot shares and the partial disapplication of pre-emption rights all as detailed below. The resolutions are set out in the Notice of Annual General Meeting on page 84.

Resolution 7.1 gives authority to the directors for the purposes of Section 80 of the Companies Act 1985 to allot shares up to a total nominal amount of £125,560, being the nominal value of the authorised ordinary share capital (£750,000) less the nominal value of the issued share capital as at 31 December 2006 (£624,740). This represents 20.0% of the equity share capital in issue. The authority will expire at the conclusion of the next Annual General Meeting unless previously varied, revoked or renewed by the company in general meeting, and replaces a similar authority granted on 27 April 2006. Save for any shares issued following the exercise of share options, or related to deferred consideration for the acquisition of Lingua Franca in 2005, there is no present intention on the part of the directors to allot any equity securities.

Resolution 7.2 will permit the directors, pursuant to Section 95 of the Companies Act 1985, to issue equity securities for cash either by way of a rights issue or in any other way up to a total nominal value of £125,260 (being the nominal value of the authorised ordinary share capital less the nominal value of the issued share capital as at 31 December 2006), provided the shares issued other than by way of rights issue do not have a nominal value exceeding £31,237, being the equivalent of 5% of the equity share capital in issue as at 31 December 2005. The maximum number of shares in respect of which statutory pre-emption rights will be disappplied (other than in connection with a rights issue) will therefore be 3,123,700. The power will replace the similar power last conferred on the directors on 27 April 2006 and will expire at the conclusion of the next Annual General Meeting or, if earlier, not more than 15 months from the date of the passing of the relevant resolution unless previously varied, revoked or renewed by the Company in general meeting.

The directors consider the resolutions that constitute the special business to be in the best interests of the Company and its Shareholders as a whole. Where Shareholders are in any doubt as to what action to take in this matter they should consult appropriate independent advisers. Where all securities have been sold or transferred by the person receiving this document, it should be passed to the person for whom the sale or transfer was affected for transmission to the purchaser or transferee.

By order of the Board

Alastair Gordon
Director

5 March 2007

The directors are responsible for preparing the Annual Report and the Group financial statements in accordance with applicable United Kingdom law and those International Financial Reporting Standards as adopted by the European Union.

The directors are required to prepare Group financial statements for each financial year which present fairly the financial position of the Group and the financial performance and cash flows of the Group for that period. In preparing those Group financial statements the directors are required to:

- select suitable accounting policies in accordance with IAS 8: 'Accounting Policies, Changes in Accounting Estimates and Errors' and then apply them consistently;
- present information, including accounting policies, in a manner that provides relevant, reliable, comparable and understandable information;
- provide additional disclosures when compliance with the specific requirements in IFRSs is insufficient to enable users to understand the impact of particular transactions, other events and conditions on the Group's financial position and financial performance; and
- state that the Group has complied with IFRSs, subject to any material departures disclosed and explained in the financial statements.

The directors are responsible for keeping proper accounting records which disclose with reasonable accuracy at any time the financial position of the Group and enable them to ensure that the Group financial statements comply with the Companies Act 1985 and Article 4 of the IAS Regulation. They are also responsible for safeguarding the assets of the Group and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF SDL PLC

We have audited the Group financial statements of SDL plc for the year ended 31 December 2006 which comprise the Consolidated Income Statement, Consolidated Statement of Changes in Equity, Consolidated Balance Sheet, Consolidated Cash Flow Statement and the related notes 1 to 23. These Group financial statements have been prepared under the accounting policies set out therein.

We have reported separately on the parent company financial statements of SDL plc for the year ended 31 December 2006 and on the information in the Directors' Remuneration Report that is described as having been audited.

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

Respective responsibilities of directors and auditors

The directors' responsibilities for preparing the Annual Report and the Group financial statements in accordance with applicable United Kingdom law and International Financial Reporting Standards (IFRSs) as adopted by the European Union are set out in the Statement of Directors' Responsibilities.

Our responsibility is to audit the Group financial statements in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland).

We report to you our opinion as to whether the Group financial statements give a true and fair view and whether the Group financial statements have been properly prepared in accordance with the Companies Act 1985 and Article 4 of the IAS Regulation. We also report to you whether, in our opinion, the information given in Directors' Report is consistent with the Group financial statements. The information given in the Directors' Report includes that specific information presented in the Operating and Financial Review that is cross referred from the Review of the Business section of the Directors' Report.

In addition we report to you if, in our opinion we have not received all the information and explanations we require for our audit, or if information specified by law regarding directors' remuneration and other transactions is not disclosed.

We review whether the Corporate Governance Report reflects the company's compliance with the nine provisions of the 2003 Combined Code specified for our review by the Listing Rules of the Financial Services Authority, and we report if it does not. We are not required to consider whether the board's statements on internal control cover all risks and controls, or form an opinion on the effectiveness of the group's corporate governance procedures or its risk and control procedures.

We read other information contained in the Annual Report and consider whether it is consistent with the audited Group financial statements. The other information comprises only the Chairman's Statement, Directors, Operating and Financial Review, Corporate Governance Report, Directors' Remuneration Report, Directors' Report and Notice of Annual General Meeting. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the Group financial statements. Our responsibilities do not extend to any other information.

Basis of audit opinion

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

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

Opinion

In our opinion:

- the Group financial statements give a true and fair view, in accordance with IFRSs as adopted by the European Union, of the state of the Group's affairs as at 31 December 2006 and of its profit for the year then ended;
- the Group financial statements have been properly prepared in accordance with the Companies Act 1985 and Article 4 of the IAS Regulation; and
- the information given in the Directors' Report is consistent with the Group financial statements.

Ernst & Young LLP
Registered auditor
Reading
6 March 2007

	Notes	2006 £'000	2005 £'000
Sale of goods		10,190	7,425
Rendering of services		84,521	71,054
REVENUE	3	94,711	78,479
Cost of sales		(47,947)	(41,475)
GROSS PROFIT		46,764	37,004
Administrative expenses	4	(33,610)	(29,288)
OPERATING PROFIT BEFORE AMORTISATION OF INTANGIBLE ASSETS		13,154	7,716
Amortisation of intangible assets	4	(2,865)	(1,952)
OPERATING PROFIT	4	10,289	5,764
Finance costs	4	(1,143)	(761)
Finance revenue	4	230	214
PROFIT BEFORE TAX		9,376	5,217
Tax expense	5	(3,213)	(2,358)
PROFIT FOR THE PERIOD ATTRIBUTABLE TO EQUITY HOLDERS OF THE PARENT		6,163	2,859
Earnings per ordinary share – basic (pence)	6	9.91	4.87
Earnings per ordinary share – diluted (pence)	6	9.53	4.68
Adjusted earnings per ordinary share – basic (pence)	6	14.52	8.20
Adjusted earnings per ordinary share – diluted (pence)	6	13.97	7.87

	Notes	2006 £'000	2005 £'000
ASSETS			
NON CURRENT ASSETS			
Property, plant and equipment	7	3,104	2,746
Intangible assets	8	58,381	63,583
Deferred tax asset	5	2,005	1,640
Rent deposits		313	353
		63,803	68,322
CURRENT ASSETS			
Trade and other receivables	11	20,739	18,995
Financial assets	22	474	-
Cash and cash equivalents	12	7,978	6,976
		29,191	25,971
TOTAL ASSETS		92,994	94,293
CURRENT LIABILITIES			
Trade and other payables	13	(18,524)	(17,925)
Interest bearing loans and borrowings	14	(2,000)	(2,000)
Financial liabilities	22	-	(120)
Current tax liabilities		(4,361)	(4,068)
Provisions	15	(125)	(500)
		(25,010)	(24,613)
NON CURRENT LIABILITIES			
Interest bearing loans and borrowings	14	(9,656)	(17,092)
Other payables		(456)	-
Deferred tax liability	5	(2,981)	(2,596)
Provisions	15	(385)	(398)
		(13,478)	(20,086)
TOTAL LIABILITIES		(38,488)	(44,699)
NET ASSETS		54,506	49,594
EQUITY			
Share capital	16	625	615
Share premium account		51,096	50,629
Shares to be issued		66	238
Retained earnings		4,334	(2,893)
Foreign exchange differences		(1,615)	1,005
TOTAL EQUITY ATTRIBUTABLE TO EQUITY HOLDERS OF THE PARENT		54,506	49,594

Approved by the Board of directors on 5 March 2007

M Lancaster
Director

A Gordon
Director

	Share Capital £'000	Share Premium Account £'000	Shares to be Issued £'000	Retained Earnings £'000	Foreign Exchange Differences £'000	Total £'000
1 January 2005	561	44,165	213	(6,909)	532	38,562
Currency translation differences on foreign currency net investments and intangibles	-	-	-	-	(33)	(33)
Currency translation differences on foreign currency equity loans to foreign subsidiaries	-	-	-	-	506	506
Deferred income taxation on share based payments (Note 5)	-	-	-	418	-	418
Tax credit for share options (Note 5)	-	-	-	464	-	464
Total income and expense for the year recognised directly in equity	-	-	-	882	473	1,355
Net profit for the year	-	-	-	2,859	-	2,859
Total income and expense for the year	-	-	-	3,741	473	4,214
Arising on share issues	9	376	(108)	-	-	277
Arising on acquisition of Trados	45	6,088	-	-	-	6,133
Lingua Franca deferred purchase consideration	-	-	133	-	-	133
Share-based payments (Note 17)	-	-	-	275	-	275
At 31 December 2005	615	50,629	238	(2,893)	1,005	49,594

	Share Capital £'000	Share Premium Account £'000	Shares to be Issued £'000	Retained Earnings £'000	Foreign Exchange Differences £'000	Total £'000
At 1 January 2006	615	50,629	238	(2,893)	1,005	49,594
Currency translation differences on foreign currency intangibles and net investments	-	-	-	-	(1,485)	(1,485)
Currency translation differences on foreign currency equity loans to foreign subsidiaries	-	-	-	-	(1,135)	(1,135)
Deferred income taxation on share based payments (Note 5)	-	-	-	179	-	179
Tax credit for share options (Note 5)	-	-	-	283	-	283
Total income and expense for the year recognised directly in equity	-	-	-	462	(2,620)	(2,158)
Net profit for the year	-	-	-	6,163	-	6,163
Total income and expense for the year	-	-	-	6,625	(2,620)	4,005
Arising on share options	6	299	-	-	-	305
Arising on acquisition of Lomac	3	103	(106)	-	-	-
Arising on acquisition of Lingua Franca	1	65	(66)	-	-	-
Share-based payments (Note 17)	-	-	-	602	-	602
At 31 December 2006	625	51,096	66	4,334	1,615	54,506

All amounts are attributable to equity holders of the parent.

	<i>Notes</i>	2006 <i>£'000</i>	2005 <i>£'000</i>
PROFIT BEFORE TAX		9,376	5,217
Depreciation of property, plant and equipment	7	1,272	1,122
Amortisation of intangible assets	8	2,865	1,952
Finance costs		1,143	761
Finance revenue		(230)	(214)
Share-based payments		602	275
(Gains)/losses on disposal of property, plant & equipment		(7)	24
Increase in trade and other receivables		(1,825)	(2,640)
Increase in trade and other payables		215	(1,289)
Exchange differences		(1,032)	(123)
Income tax paid		(2,515)	(1,956)
NET CASH FLOWS FROM OPERATING ACTIVITIES		9,864	5,707
CASH FLOWS FROM INVESTING ACTIVITIES			
Payments to acquire property, plant & equipment		(1,433)	(1,010)
Receipts from sale of property, plant & equipment		49	201
Payments to acquire subsidiaries		-	(30,328)
Net cash acquired with subsidiaries		-	3,216
Interest received		230	214
NET CASH FLOWS FROM INVESTING ACTIVITIES		(1,154)	(27,707)
CASH FLOWS FROM FINANCING ACTIVITIES			
Net proceeds from issue of ordinary share capital		305	277
Repayment of interest bearing loans and borrowings	18	(6,596)	(2,385)
Proceeds from new loans		-	20,092
Interest paid		(1,143)	(761)
NET CASH FLOWS FROM FINANCING ACTIVITIES		7,434	17,223
INCREASE /(DECREASE) IN CASH AND CASH EQUIVALENTS		1,276	(4,777)
MOVEMENT IN CASH AND CASH EQUIVALENTS			
Cash and cash equivalents at the start of year		6,976	11,452
Increase/(decrease) in cash and cash equivalents	18	1,276	(4,777)
Effect of exchange rates on cash and cash equivalents	18	(274)	301
NET CASH AND CASH EQUIVALENTS AT END OF YEAR	18	7,978	6,976

1 CORPORATE INFORMATION

The consolidated financial information of SDL plc (the 'Group') for the year ended 31 December 2006 was authorised for issue in accordance with a resolution of the directors on 5 March 2007. SDL plc is a public limited company incorporated and domiciled in England whose shares are publicly traded on the London Stock Exchange. The consolidated financial statements of SDL plc and its subsidiaries have been prepared in accordance with International Financial Reporting Standards.

The principal activities of the Group are described in Note 3.

2 ACCOUNTING POLICIES

Basis of accounting

The consolidated financial statements of SDL plc and its subsidiaries have been prepared in accordance with International Financial Reporting Standards as adopted by the EU as relevant to the financial statements of SDL plc. The Company has elected to prepare its parent company financial statements in accordance with UK GAAP and these are presented on pages 72 to 82.

The consolidated financial statements are presented in UK sterling and all values are rounded to the nearest thousand except where otherwise indicated.

Basis of preparation of consolidated financial statements

The consolidated financial statements include the results of the Company and all its subsidiaries for the full year or from the date of acquisition if later. Subsidiaries are all entities over which the Group has the power to govern the financial and operating policies. Subsidiaries are fully consolidated from the date on which control is transferred to the Group. The Group has elected not to apply IFRS 3 retrospectively to business combinations that took place before the date of 1 January 2004. As a result, goodwill recognised as an asset at 31 December 2003 is recorded at its carrying amount under UK GAAP and is not amortised. The purchase method of accounting is used to account for the acquisition of subsidiaries by the Group. The cost of an acquisition is measured as the fair value of the assets, equity instruments issued and liabilities incurred or assumed at the date of exchange, plus costs directly attributable to the acquisition. Identifiable assets and liabilities acquired and contingent liabilities assumed in a business combination are measured initially at their fair values at the acquisition date, irrespective of the extent of any minority interest. The excess of the cost of acquisition over the fair value of the Group's share of the identifiable

net assets acquired is recorded as goodwill. If the cost of acquisition is less than the fair value of the net assets of the subsidiary acquired, the difference is recognised directly in the income statement.

Intangible assets: Goodwill

Following initial recognition, goodwill is measured at cost less any accumulated impairment losses. Goodwill is reviewed for impairment annually or more frequently if events or changes in circumstances indicate that the carrying value may be impaired. As at the acquisition date, any goodwill acquired is allocated to each of the cash generating units expected to benefit from the combination's synergies. A cash-generating unit is the smallest identifiable group of assets that generate cash inflows that are largely independent of the cash inflows from other assets. This is usually at business segment level or statutory company level as the case may be. Impairment is determined by assessing the recoverable amount of the cash-generating unit, to which the goodwill relates. Where the recoverable amount of the cash-generating unit is less than the carrying amount, an impairment loss is recognised. Goodwill arising on acquisitions pre 1 January 2004 was capitalised and amortised over its useful economic life, which was presumed to be 8 years. Any goodwill remaining on the balance sheet at 1 January 2004 is not amortised after 1 January 2004, but is also subject to annual impairment reviews.

Intangible assets: Other

Intangible assets acquired separately are capitalised at cost and from a business acquisition are capitalised at fair value as at the date of acquisition. Following initial recognition, intangible assets are held at cost less accumulated amortisation. Intangible assets are amortised on a straight-line basis over their useful economic lives, which are reassessed annually together with any assessment of residual value. The useful lives of these intangible assets are assessed over the expected period that benefits accrue to the group. Amortisation is charged as a separate line item on the income statement.

Intellectual property is amortised on a straight-line basis over its estimated useful life of between 5 and 15 years.

Research and development costs

Research costs are expensed as incurred. Development expenditure incurred on an individual project is carried forward when its future recoverability can reasonably be regarded as assured and technical feasibility and commercial viability can be demonstrated. Where these

criteria are not met the expenditure is expensed to the income statement. Following the initial recognition of the development expenditure the cost model is applied requiring the asset to be carried at cost less any accumulated amortisation and accumulated impairment losses. Any expenditure carried forward is amortised over the period of expected future sales from the related project. The carrying value of development costs is reviewed for impairment annually when the asset is not yet in use, or more frequently when an indicator of impairment arises during the reporting year indicating that the carrying value may not be recoverable.

Development costs that are subject to amortisation are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable.

Intangible assets: Impairment of assets

An impairment loss is recognised for the amount by which the asset's carrying amount exceeds its recoverable amount. The recoverable amount is the higher of an asset's fair value less costs to sell and its value in use, where value in use is calculated as the present value of the future cash flows expected to be derived from the asset. For the purpose of assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash flows (cash generating units).

Property, plant and equipment

Property, plant and equipment is stated at historical cost less depreciation and any impairment in value. Historical cost includes the expenditure that is directly attributable to the acquisition of the assets. All other repairs and maintenance are charged to the income statement during the financial period in which they are incurred. Depreciation is provided to write off the cost less the estimated residual value based on prices at the balance sheet date of property, plant and equipment over their estimated useful economic lives as follows:

Leasehold improvements	-	The lower of ten years or the lease term straight line
Equipment	-	4 years straight line
Fixtures & fittings	-	20% reducing balance
Motor vehicles	-	20% reducing balance

Useful economic lives and residual values are assessed annually.

An item of property, plant and equipment is derecognised upon disposal or when no future economic benefits are expected to arise from the continued use of the asset. Any gain or loss arising on derecognising of the asset (calculated as the difference between the net disposal proceeds and the carrying amount of the item) is

included in the income statement in the year the item is derecognised.

Revenue

Revenue is recognised to the extent that it is probable that the economic benefits will flow to the group and the revenue can be measured reliably. The following specific recognition criteria must also be met before revenue is recognised:

Rendering of services

Revenue on service contracts is recognised only when their outcomes can be foreseen with reasonable certainty and is based on the percentage stage of completion of the contracts, calculated on the basis of costs incurred. Accrued and deferred revenue arising on long-term contracts is included in debtors as accrued income and creditors as deferred income as appropriate.

Support and maintenance contracts are invoiced in advance and normally run for periods of 12 months with automatic renewal on the anniversary date. Revenue in respect of support and maintenance contracts is recognised evenly over the 12 months commencing from the date of the contract period.

Managed services (hosting) fees are recognised over the term of the hosting contract on a straight-line basis.

Professional services and consulting revenue, which is provided on a 'time and expense' basis, is recognised as the service is performed.

For multiple element arrangements revenue is allocated to each element on fair value regardless of any separate prices stated within the contract. The portion of the revenue allocated to an element is recognised when the revenue recognition criteria for that element have been met.

Sale of goods

Revenue from the sale of goods is recognised when the significant risks and rewards of ownership of the goods have passed to the buyer, usually on despatch of the goods.

Revenue on software licenses and upgrades is recognised on despatch, when there are no significant vendor obligations remaining and the collection of the resulting receivable is considered probable. In circumstances where a considerable future vendor obligation exists as part of a software licence and related services' contract, revenue is recognised over the period that the obligation exists per the contract.

Interest

Revenue is recognised as the interest accrues to the net carrying amount of the financial asset.

Foreign currencies

Transactions in foreign currencies are recorded using the rate of exchange ruling at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are translated using the rate of exchange ruling at the balance sheet date and the gains or losses on translation are included in the income statement with the exception of differences on foreign currency borrowing that provide a hedge against a net investment in a foreign entity. These are taken directly to equity until the date of disposal of the net investment, at which time they are recognised in the consolidated income statement. The assets and liabilities of overseas subsidiaries and branches are translated at the closing exchange rate. Income statements of such undertakings are translated at the average rate of exchange during the year. Gains and losses arising on these translations are taken to reserves. As permitted by IFRS 1, SDL has elected to deem the cumulative amount of exchange differences arising on translation of the net investments in subsidiaries at 1 January 2004 to be nil.

Hedge accounting

The Group uses derivative financial instruments such as foreign currency and interest rate contracts to hedge its risks associated with interest rate and foreign currency fluctuations. Such derivative financial instruments are stated at fair value. The fair value of forward exchange contracts is calculated by reference to current forward exchange rates for contracts with similar maturity profiles. The fair value of interest rate contracts is determined by reference to market values for similar instruments.

The derivatives entered into do not qualify for hedge accounting and therefore any gains or losses arising from changes in fair value are taken directly to net profit or loss for the period.

Cash and cash equivalents

Cash and cash equivalents include cash in hand and deposits held at call with banks. For the purpose of the Consolidated Cash Flow Statement, cash and cash equivalents consist of cash and cash equivalents as defined above.

Borrowing costs

Borrowing costs are recognised as an expense in the

period in which they are incurred.

Leases

Finance leases, which transfer to the group substantially all the risks and benefits incidental to ownership of the leased item, are capitalised at the inception of the lease at the fair value of the leased property or, if lower, at the present value of the minimum lease payments. Lease payments are apportioned between the finance charges and reduction of the lease liability so as to achieve a constant rate of interest on the remaining balance of the liability. Finance charges are charged directly against income.

Leases where the lessor retains substantially all the risks and benefits of ownership of the asset are classified as operating leases. Operating lease payments are recognised as an expense in the income statement on a straight-line basis over the lease term.

Incentives received from landlord

In accordance with SIC 15, the aggregate benefit of incentives is recognised as a credit to the income statement. The benefits of the incentives are allocated over the life of the lease on a straight-line basis.

Pension cost

The Company contributes to a group personal pension scheme for qualifying employees whereby it makes defined contributions to independently administered personal pension schemes. The Company does not control any of the assets or have any ongoing liabilities with regard to the performance of and payments from these individual personal schemes. SDL Global Solutions (Ireland) Limited operates a separate defined contribution scheme whose assets are held separately from the Company. The pension cost charge for both schemes represents contributions payable during the period.

Taxation

The charge for current taxation is based on the results for the year as adjusted for items, which are non-assessable of disallowed, based on tax rates that are enacted at the balance sheet date.

Deferred income tax is provided, using the liability method, on temporary differences at the balance sheet date between the tax bases of assets and liabilities and their carrying amounts for financial reporting purposes.

Deferred income tax liabilities are recognised for all taxable temporary differences except:

- where the deferred income tax liability arises from the initial recognition of an asset or liability in a transaction that is not a business combination and, at the time of the transaction, affects neither the accounting profit nor taxable profit or loss; and
- in respect of taxable temporary differences associated with investments in subsidiaries, except where the timing of the reversal of the temporary differences can be controlled and it is probable that the temporary differences will not reverse in the foreseeable future.

Deferred income tax assets are recognised for all deductible temporary differences, carry-forward of unused tax assets and unused tax losses, to the extent that it is probable that taxable profit will be available against which the deductible temporary differences, and the carry-forward of unused tax assets and unused tax losses can be utilised, except:

- where the deferred income tax asset relating to the deductible temporary difference arises from the initial recognition of an asset or liability in a transaction that is not a business combination and, at the time of the transaction, affects neither the accounting profit nor taxable profit or loss; and
- in respect of deductible temporary differences associated with investments in subsidiaries, deferred tax assets are only recognised to the extent that it is probable that the temporary differences will reverse in the foreseeable future and taxable profit will be available against which the temporary differences can be utilised.

The carrying amount of deferred income tax assets is reviewed at each balance sheet date and reduced to the extent that it is no longer probable that sufficient taxable profit will be available to allow all or part of the deferred income tax asset to be utilised.

In the United Kingdom, the Group is entitled to a tax deduction for amounts treated as remuneration on exercise of certain employee share options. As explained under "Share based payment" below, a remuneration expense is recorded in the consolidated income statement over the period from the grant date to the vesting date of the relevant options. As there is a temporary difference between the accounting and tax bases, a deferred tax asset may be recorded. The deferred tax asset arising on share option awards is calculated as the estimated amount of tax deduction to be obtained in the future (based on the Group's share price at the balance sheet date) pro-rated to the extent that the services of the employee have been rendered over the vesting period. If this amount exceeds the cumulative amount of the remuneration expense at the statutory rate, the excess is recorded directly in equity,

against retained earnings. Similarly, current tax relief in excess of the cumulative amount of the remuneration expense at the statutory rate is also recorded in retained earnings. No remuneration charge is recorded in respect of options granted before 7 November 2002 which have not vested by 1 January 2005. Nevertheless, tax deductions have arisen and will continue to arise on these options. The tax effects arising in relation to these options are recorded directly in equity against retained earnings. No deferred tax asset is recognised with respect to this where there is no certainty of taxable profits being generated in appropriate locations that the deferred tax asset could be utilised against.

Deferred income tax assets and liabilities are measured at the tax rates that are expected to apply to the year when the asset is realised or the liability is settled, based on tax rates (and tax laws) that have been enacted or substantively enacted at the balance sheet date.

Income tax relating to items recognised directly in equity are recognised in equity and not in the income statement.

Revenues, expenses and assets are recognised net of the amount of VAT except:

- where the VAT incurred on a purchase of goods and services is not recoverable from the taxation authority, in which case the VAT is recognised as part of the cost of acquisition of the asset or as part of the expense item as applicable; and
- trade receivables and payables are stated with the amount of VAT included.

The net amount of VAT recoverable from, or payable to, the taxation authority is included as part of receivables or payables in the balance sheet.

Share-based payments

Employees (including directors) of the Group receive remuneration in the form of share-based payment transactions, whereby employees render services in exchange for shares or rights over shares ('equity-settled transactions').

Equity-settled transactions

The cost of equity-settled transactions with employees is measured by reference to the fair value at the date at which they are granted. The fair value is determined by using the Black Scholes model.

The cost of equity-settled transactions is recognised, together with a corresponding increase in equity, ending on the date on which the relevant employees become

entitled to the award ('vesting date'). The cumulative expense recognised for equity settled transactions at each reporting date until the vesting date reflects the extent to which the vesting period has expired and the number of awards that, in the opinion of the directors of the Group at that date, based on the best available estimate of the number of equity instruments that will ultimately vest. The expense is recognised in the income statement over the vesting period.

No expense is recognised for awards that do not ultimately vest.

Where the terms of an equity-settled award are modified, as a minimum an expense is recognised as if the terms had not been modified. In addition, an expense is recognised over the remainder of the vesting period for any increase in the value of the transaction

as a result of the modification, as measured at the date of modification.

Where an equity-settled award is cancelled, it is treated as if it had vested on the date of cancellation, and any expense not yet recognised for the award is recognised immediately. However, if a new award is substituted for the cancelled award, and designated as a replacement award on the date that it is granted, the cancelled and new awards are treated as if they were a modification of the original award, as described in the previous paragraph.

The Group has taken advantage of the transitional provisions of IFRS 2 in respect of equity-settled awards and has applied IFRS 2 only to equity-settled awards granted after 7 November 2002 that had not vested at 1 January 2005.

New standards and interpretations not applied

IASB and IFRIC have issued the following standards and interpretations with an effective date after the date of these financial statements:

International Accounting Standards (IAS/IFRSs)		Effective date
IFRS 7	Financial Instruments: Disclosures	1 January 2007
IFRS 8	Operating Segments	1 January 2009
IAS 1	Amendment – Presentation of Financial Statements: Capital Disclosures	1 January 2007

International Financial Reporting Interpretations Committee (IFRIC)	Effective date
IFRIC 7 Applying the Restatement Approach under IAS 29 Financial Reporting in Hyperinflationary Economies	1 March 2006
IFRIC 8 Scope of IFRS 2	1 May 2006
IFRIC 9 Reassessment of Embedded Derivatives	1 June 2006
IFRIC 10 Interim Financial Reporting and Impairment	1 November 2006
IFRIC 11 IFRS 2 – Group and Treasury Share Transactions	1 March 2007
IFRIC 12 Service Concession Arrangements	1 January 2008

The Directors do not anticipate that the adoption of these standards and interpretations will have a material impact on the Group's financial statements in the period of initial application. Upon adoption of IFRS 7, the Group will have to disclose additional information about its financial instruments, their significance and the nature and extent of risks that they give rise to. More specifically the Group will need to disclose the fair value of its financial instruments and its risk exposure in greater detail. There will be no effect on reported income or net assets.

3 SEGMENT INFORMATION

The Group operates in the translation and localisation industry.

The primary reporting format is determined to be business segments, being Translation Services and Technology.

The Translation Services segment is the provision of a translation service to the customer's software products, documents, manuals and websites. As well as translation of words, this incorporates desktop publishing, software engineering and project management.

The Technology segment is the sale of desktop and enterprise technology developed and owned by the Group to freelance translators, translation service providers and to corporate translation end users who may perform the service themselves. This includes both the sale of software licences and associated support, maintenance and training services and more tailor made enterprise solutions.

The Group's geographical segments are based upon the geographical destination of sales.

Year ended 31 December 2006

	<i>Translation Services</i> £'000	<i>Technology</i> £'000	<i>Total</i> £'000
Revenue			
Sales to external customers	77,852	16,859	94,711
Segment results	11,332	(1,043)	10,289
Net finance costs			(913)
Profit before tax			9,376
Tax expense			(3,213)
Net profit for the year			6,163
Assets and liabilities			
Segment assets	42,977	39,314	82,291
Unallocated assets			10,703
Total assets			92,994
Segment liabilities	15,860	2,397	18,257
Unallocated liabilities			20,231
Total liabilities			38,488
Other segment information			
Capital expenditure	1,418	351	1,769
Share based payments	494	108	602
Depreciation	1,089	183	1,272
Amortisation	770	2,095	2,865

Year ended 31 December 2005

	<i>Translation Services</i> £'000	<i>Technology</i> £'000	<i>Total</i> £'000
Revenue			
Sales to external customers	66,657	11,822	78,479
Segment results	8,107	(2,343)	5,764
Net finance costs			(547)
Profit before tax			5,217
Tax expense			(2,358)
Net profit for the year			<u>2,859</u>
Assets and liabilities			
Segment assets	44,087	39,158	83,245
Unallocated assets			11,048
Total assets			<u>94,293</u>
Segment liabilities	11,467	2,955	14,422
Unallocated liabilities			30,277
Total liabilities			<u>44,699</u>
Other segment information			
Capital expenditure	962	48	1,010
Share based payments	234	41	275
Depreciation	1,025	97	1,122
Amortisation	770	1,182	1,952

Year ended 31 December 2006

	<i>United Kingdom £'000</i>	<i>Rest of Europe £'000</i>	<i>USA £'000</i>	<i>Rest of North America £'000</i>	<i>Rest of the World £'000</i>	<i>Total £'000</i>
Revenue						
Revenue from continuing operations	7,307	34,121	36,823	9,704	6,756	94,711
Other segment information						
Segment assets	25,823	33,747	17,728	2,884	2,109	82,291
Unallocated assets						10,703
Total assets						<u>92,994</u>
Capital expenditure						
Property, plant and equipment	742	390	113	336	188	1,769

Year ended 31 December 2005

	<i>United Kingdom £'000</i>	<i>Rest of Europe £'000</i>	<i>USA £'000</i>	<i>Rest of North America £'000</i>	<i>Rest of the World £'000</i>	<i>Total £'000</i>
Revenue						
Revenue from continuing operations	5,896	26,884	33,102	8,044	4,553	78,479
Other segment information						
Segment assets	28,803	31,685	18,333	2,824	1,600	83,245
Unallocated assets						11,048
Total assets						<u>94,293</u>
Capital expenditure						
Property, plant and equipment	355	414	45	63	133	1,010

4 OTHER REVENUE AND EXPENSES

Group operating profit is stated after charging/(crediting):

	2006 £'000	2005 £'000
Included in administrative expenses:		
Research and development expenditure	4,724	3,877
Bad debt expense	11	13
Depreciation of property, plant and equipment	1,272	1,122
Amortisation of intangible fixed assets	2,865	1,952
Operating lease rentals for plant and machinery	67	194
Operating lease rentals for land and buildings	3,252	3,229
Operating lease rentals received for land and buildings	(150)	(150)
Net foreign exchange gains	(1,256)	(551)

The net foreign exchange gains above arose due to movements in foreign currencies between the time of the original transaction and the realisation of the cash collection or spend, the benefits of foreign currency instruments on certain transactions during the year, the valuation of foreign currency instruments at the end of the year and the retranslation of US Dollar denominated loans.

Auditors' Remuneration

Audit of the Group financial statements	154	133
Other fees to auditors:		
Local statutory audits for subsidiaries	73	89
Other taxation services	102	76
Other services	24	21

In 2005 Ernst and Young received £291,000 as reporting accountants and advisors in respect of the Group's acquisition of Trados in July 2005.

Staff costs

	2006 £'000	2005 £'000
Wages and salaries	35,572	34,507
Social security costs	5,013	4,887
Pension costs (included in administrative expenses)	1,171	1,011
Expense of share based payments	602	275
	<u>42,358</u>	<u>40,680</u>

The Company operates a personal pension scheme for qualifying employees. Other companies acquired have similar schemes for their qualifying members although SDL Global Solutions (Ireland) Limited operates a defined contribution scheme with contributions made by the company placed in a separately administered pension fund. The pension cost charge for the year represents contributions payable by the Group to these schemes and amounted to £1,170,716 (2005 - £1,011,713).

The average number of employees during the year, including executive directors, was made up as follows:

	2006 Number	2005 Number
Administration and sales	352	318
Production	1,146	1,131
	<u>1,498</u>	<u>1,449</u>

Finance costs

	2006 £'000	2005 £'000
Bank loans	<u>1,143</u>	<u>761</u>

Finance revenue

	2006 £'000	2005 £'000
Bank interest receivable	<u>230</u>	<u>214</u>

5 INCOME TAX

(a) Income tax on profit:

	2006 £'000	2005 £'000
<i>Current taxation</i>		
<i>UK Income tax charge/(credit)</i>		
Current tax on income for the period	670	1,255
Adjustments in respect of prior periods	(242)	(200)
Tax credit for share options taken to equity	283	464
	<u>711</u>	<u>1,519</u>
<i>Foreign tax</i>		
Current tax on income for the period	2,201	1,260
Adjustments in respect of prior periods	(72)	(87)
	<u>2,129</u>	<u>1,173</u>
Total current taxation	<u>2,840</u>	<u>2,692</u>
<i>Deferred income taxation</i>		
Origination and reversal of temporary differences	(277)	(752)
Adjustments in respect of prior periods	471	-
Deferred tax credit for share options taken to equity	179	418
Total deferred income tax	<u>373</u>	<u>(334)</u>
Tax expense (see (b) below)	<u>3,213</u>	<u>2,358</u>

An aggregate tax credit in respect of share based compensation for current and deferred taxation of £462,000 (2005: £882,000) has been recognised in equity in the year.

(b) Factors affecting current tax charge:

The tax assessed on the profit on ordinary activities for the year is higher than the standard rate of income tax in the UK of 30% (2005: 30%). The differences are reconciled below:

	<i>2006</i> <i>£'000</i>	<i>2005</i> <i>£'000</i>
Profit on ordinary activities before tax	<u>9,376</u>	<u>5,217</u>
Profit on ordinary activities at standard rate of tax in the UK 30% (2005: 30%)	2,813	1,565
Expenses not deductible for tax purposes	235	216
Non deductible amortisation of intangibles	550	365
Non taxable income	-	(91)
Adjustments in respect of previous years	157	(287)
Utilisation of tax losses brought forward	(424)	(304)
Current tax losses not available for offset	55	1,157
Effect of overseas tax rates	(378)	(249)
Other	205	(14)
	<u>3,213</u>	<u>2,358</u>
Tax expense (see (a) above)	<u>3,213</u>	<u>2,358</u>

(c) Factors that may affect future tax charges:

The Group may claim a Schedule 23 tax credit in respect of certain share based compensation benefits. Due to the requirements of IAS 12, in conjunction with IFRS 2, the amount of benefit that can be recognised in the income statement has been restricted in the current year and may also be restricted in future periods. Any surplus tax credit will be recorded in equity.

There are temporary differences which arise in relation to unremitted earnings of overseas subsidiaries. Since the Group is able to control dividend distributions from these companies it is unlikely that further UK tax on repatriation of these earnings will be payable in the foreseeable future. Consequently no deferred tax liability has been provided.

(d) Deferred income tax

The amounts recognised and unrecognised for deferred income tax are set out below:

	<i>Recognised</i> <i>2006</i> <i>£'000</i>	<i>Unrecognised</i> <i>2006</i> <i>£'000</i>	<i>Recognised</i> <i>2005</i> <i>£'000</i>	<i>Unrecognised</i> <i>2005</i> <i>£'000</i>
Depreciation in advance of capital allowances	319	-	334	-
Other short-term temporary differences	(1,295)	-	(1,290)	-
Tax losses	-	3,388	-	1,751
Net deferred income tax (liability)/asset	<u>(976)</u>	<u>3,388</u>	<u>(956)</u>	<u>1,751</u>

The Group has tax losses in net terms of £3,388,000 (2005: £1,751,000) that may be available for use by offset against future taxable profits in the companies in which the losses arose. Deferred tax assets have not been recognised in respect of these losses as the Group cannot foresee profitability in the companies where the losses arose with sufficient certainty.

Included within other short term temporary differences are deferred tax assets in respect of potential Schedule 23 tax benefits of £1,462,000 (2005: £1,103,000) and a deferred tax liability in respect of the amortisation of certain intangible assets acquired in 2005, recognised in accordance with IAS 38, of £2,163,000 (2005: £2,523,000).

At 31 December 2006 the net deferred income tax position is represented by a deferred income tax asset of £2,005,000 (2005: £1,640,000) and a deferred income tax liability of £2,981,000 (2005: £2,596,000).

(e) Reconciliation of movement on deferred tax liability

	2006 £'000	2005 £'000
At 1 January	2,596	78
Deferred tax liability arising on intangible assets acquired	-	2,743
Reversal of temporary differences arising on the amortisation of intangibles	(360)	(220)
Other temporary differences arising in the period	745	(5)
Deferred tax liability at 31 December	2,981	2,596

(f) Reconciliation of movement on deferred tax asset

	2006 £'000	2005 £'000
At 1 January	1,640	1,113
Temporary differences arising in the period	6	27
Deferred income tax asset arising on share based payments recorded in income statement	180	82
Deferred income tax asset arising on share based payments recorded in statement of changes in equity	179	418
Deferred tax asset at 31 December	2,005	1,640

6 EARNINGS PER SHARE

The calculation of basic earnings per ordinary share is based on a profit after tax of £6,163,000 (2005: £2,859,000) and 62,159,156 (2005: 58,674,412) ordinary shares, being the weighted average number of ordinary shares in issue during the period.

The diluted earnings per ordinary share is calculated by including in the weighted average number of shares the dilutive effect of potential ordinary shares related to committed share options as described in note 17. For 2006 the diluted ordinary shares were based on 64,641,295 ordinary shares that included 2,482,139 potential weighted number of options.

The following reflects the income and share data used in the basic, diluted and adjusted earnings per share computations:

	2006	2005
	£'000	£'000
Profit for the period attributable to equity holders of the parent	6,163	2,859
Amortisation of intangible fixed assets	2,865	1,952
Adjusted profit for the period attributable to equity holders of the parent	9,028	4,811

	2006	2005
	No.	No.
Weighted average number of ordinary shares for basic earnings per share	62,159,156	58,674,412
Effect of dilution resulting from share options	2,482,139	2,473,434
Weighted average number of ordinary shares adjusted for the effect of dilution	64,641,295	61,147,846

	2006	2005
Adjusted earnings per ordinary share – basic (pence)	14.52	8.20
Adjusted earnings per ordinary share – diluted (pence)	13.97	7.87

There have been no other transactions involving ordinary shares or potential ordinary shares between the reporting date and the date of completion of the financial statements.

7 PROPERTY, PLANT AND EQUIPMENT

	<i>Leasehold Improvements £'000</i>	<i>Computer Equipment £'000</i>	<i>Fixtures & Fittings £'000</i>	<i>Motor Vehicles £'000</i>	<i>Total £'000</i>
<i>Cost:</i>					
At 1 January 2005	1,066	6,426	1,449	182	9,123
Additions	77	812	121	-	1,010
Acquisition of subsidiaries	100	251	55	12	418
Disposals	(7)	(982)	(43)	(43)	(1,075)
Currency adjustment	4	41	39	2	86
At 1 January 2006	1,240	6,548	1,621	153	9,562
Additions	285	1,308	176	-	1,769
Disposals	(48)	(726)	(264)	(30)	(1,068)
Currency adjustment	(59)	(377)	(59)	(4)	(499)
At 31 December 2006	1,418	6,753	1,474	119	9,764
<i>Accumulated depreciation:</i>					
At 1 January 2005	(381)	(5,078)	(923)	(110)	(6,492)
Provided during the year	(153)	(806)	(150)	(13)	(1,122)
Disposals	7	811	-	32	850
Currency adjustment	2	(19)	(34)	(1)	(52)
At 1 January 2006	(525)	(5,092)	(1,107)	(92)	(6,816)
Provided during the year	(192)	(945)	(123)	(12)	(1,272)
Disposals	35	701	265	25	1,026
Currency adjustment	38	315	48	1	402
At 31 December 2006	(644)	(5,021)	(917)	(78)	(6,660)
<i>Net book value:</i>					
At 31 December 2006	774	1,732	557	41	3,104
At 1 January 2006	715	1,456	514	61	2,746

The net book value of assets held under finance leases is £nil as 31 December 2006 (2005 £nil).

8 INTANGIBLE ASSETS

	<i>Intellectual Property</i> £'000	<i>Goodwill</i> £'000	<i>Total</i> £'000
<i>Cost:</i>			
At 1 January 2005	6,270	32,758	39,028
Acquisition of subsidiaries	13,615	28,038	41,653
Currency adjustment	63	157	220
At 1 January 2006	19,948	60,953	80,901
Currency adjustment	(858)	(1,616)	(2,474)
At 31 December 2006	19,090	59,337	78,427
<i>Amortisation:</i>			
At 1 January 2005	(3,163)	(12,203)	(15,366)
Provided during the year	(1,952)	-	(1,952)
At 1 January 2006	(5,115)	(12,203)	(17,318)
Provided during the year	(2,865)	-	(2,865)
Currency adjustment	137	-	137
At 31 December 2006	(7,843)	(12,203)	(20,046)
<i>Net book value:</i>			
At 31 December 2006	11,247	47,134	58,381
At 1 January 2006	14,833	48,750	63,583

Intellectual property is written off on a straight-line basis over its estimated useful life of between 5 and 15 years. As from 1 January 2004, the date of transition to IFRS, goodwill was no longer amortised but is now subject to annual impairment testing (see note 10). The group has not capitalised any development costs in the year (2005: £nil). The reasons for the non capitalisation of development costs in the year are outlined in Operating and Financial Review – Overheads.

9 INVESTMENTS IN SUBSIDIARIES

Details of the investments in which the Group or Company holds more than 20% of the nominal value of ordinary share capital are as follows:

<i>Name of Company</i>	<i>Country of Incorporation</i>	<i>Holding</i>	<i>Proportion of Voting Rights</i>	<i>Nature of Business</i>
Held Directly:				
SDL Sheffield Limited	England & Wales	Ordinary	100%	Globalisation services
Software & Documentation Localisations France SARL	France	Ordinary	100%	Globalisation services
SDL Sweden AB	Sweden	Ordinary	100%	Globalisation services
SDL Global Solutions (Ireland) Limited	Ireland	Ordinary	100%	Globalisation services Engineering, Testing and Product
SDL International Belgium NV	Belgium	Ordinary	100%	Globalisation services
SDL Software Technology (Shenzhen) Co. Ltd	China	Ordinary	100%	Globalisation services
SDL Inc.	United States of America	Ordinary	100%	Globalisation services
SDL Poland Sp z.o.o	Poland	Ordinary	100%	Globalisation services
SDL International America Inc.	United States of America	Ordinary	100%	Product
SDL Japan KK	Japan	Ordinary	100%	Globalisation services
Held Indirectly:				
SDL Italia Srl	Italy	Ordinary	100%	Globalisation services
SDL Spain SL	Spain	Ordinary	100%	Globalisation services
SDL International Nederland BV	The Netherlands	Ordinary	100%	Globalisation services
SDL International (Canada) Inc.	Canada	Ordinary	100%	Globalisation services
SDL Multilingual Services GmbH & Co KG	Germany	Ordinary	100%	Globalisation services
SDL Multi-Lingual Solutions (Singapore) PTE Ltd	Singapore	Ordinary	100%	Globalisation services
SDL Magyaror szaj szolgaltato Kft	Hungary	Ordinary	100%	Globalisation services
SDL CZ s.r.o	Czech Republic	Ordinary	100%	Globalisation services
SDL Traduceri S.R.L.	Romania	Ordinary	100%	Globalisation services
SDL Zagreb LLC	Croatia	Ordinary	100%	Globalisation services
SDL d.o.o Ljubljana	Slovenia	Ordinary	100%	Globalisation services
Trados GmbH	Germany	Ordinary	100%	Product

The proportion of voting rights held as at 31 December 2005 is as shown above. There have been no changes during 2006.

Acquisition of Trados

In 2005 the Group acquired 100% of the share capital of Trados, based in the US.

The fair value of the identifiable assets and liabilities of Trados as at the date of acquisition were:

	<i>Bookvalue</i>	<i>Fair value</i>
	<i>£'000</i>	<i>to Group</i>
		<i>£'000</i>
Intangible assets	2,375	13,615
Property, plant and equipment	494	402
Cash and cash equivalents	3,203	3,203
Trade receivables	2,909	2,820
Other receivables	313	324
Trade payables	(899)	(899)
Loans	(1,318)	(1,385)
Other payables	(5,537)	(6,735)
Deferred tax	-	(2,743)
Net assets	<u>1,540</u>	<u>8,602</u>
Goodwill arising on acquisition		<u>27,646</u>
		<u>36,248</u>

Acquisition of Lingua Franca

In 2005 the Group acquired the business of Lingua Franca, based in Dubai.

The fair value of the identifiable assets and liabilities of Lingua Franca as at the date of acquisition were:

	<i>Book value</i>	<i>Fair value</i>
	<i>£'000</i>	<i>to Group</i>
		<i>£'000</i>
Property, plant and equipment	16	16
Cash and cash equivalents	13	13
Trade receivables	13	13
Other receivables	21	21
Trade payables	(3)	(3)
Other payables	(62)	(62)
Loans	(44)	(44)
Net assets	<u>(46)</u>	<u>(46)</u>
Goodwill arising on acquisition		<u>392</u>
		<u>346</u>

10 IMPAIRMENT TESTING OF GOODWILL AND INTANGIBLES WITH INDEFINITE LIVES

The Group has goodwill that has been acquired through business combinations but does not hold any intangible assets that have indefinite lives ascribed to them. Where possible the goodwill has been allocated for impairment testing purposes to the individual companies acquired, on the basis that these are the lowest level cash-generating units at which the Group is able to monitor the resulting goodwill. However, with regard to the Alpnet Group acquisition it is not possible to segregate out a separate cash-generating unit relating to the acquisition. This is because the original Alpnet group underwent significant restructuring and integration with the rest of the SDL Group at the time and management does not maintain or manage the ex-Alpnet businesses in a manner that allows for the identification of a separate unit.

In addition the Trados group that was acquired during 2005 is currently viewed by management as a separate cash-generating unit. It currently represents the majority of the products division of the enlarged group and while it is geographically dispersed and has an enterprise and desktop product division it is viewed by management as a single overall unit.

For the purposes of evaluating the recoverable amounts relating to the cash-generating units the following should be noted.

Individual company entities – the recoverable amount for these individual companies has been determined using the cash flow projections from the 2007 budget and a discount rate of 13%. The valuation is on a value in-use basis and assumes that the growth rate in extrapolating the cash flows will be 5%. While the rates of growth will vary between the individual cash-generating units, the units are linked to the overall growth of the group in that a number of the companies are supplying translation services to other members of the group. The rate of growth is less than that predicted by external industry analysts. The individual company entities are represented by SDL Sheffield Limited, SDL Sweden AB, SDL Global Solutions (Ireland) Limited and SDL Poland Sp z.o.o (and its subsidiary companies).

Alpnet Inc – The operations acquired as part of the acquisition of Alpnet Inc have been restructured and/or subsumed into the overall Group business to such an extent that they can no longer be viewed as a separate entity. In addition the management reporting is on a segmental basis as disclosed in Note 3 and hence the Alpnet Inc group is not reported on separately. In order to assess whether any impairment has occurred in relation to the goodwill arising on the Alpnet Inc acquisition, the Group cash flows have been adjusted for

the cash flows in relation to the entities with their own related goodwill. The resulting net cash flow has been discounted at a discount rate of 13% and compared with the carrying value if the Alpnet Inc goodwill.

Trados Inc group (Products division) – The recoverable amount of the Trados Inc group has been determined on a value in use basis using cash flow projections based on a growth rate in the cash flows of 10% and a discount rate of 13%.

Carrying amount of goodwill allocated to cash-generating units

	2006 £'000	2005 £'000
Individual company entities	10,473	10,473
Alpnet Inc	10,474	10,474
Trados Inc group	<u>26,187</u>	<u>27,803</u>
	<u>47,134</u>	<u>48,750</u>

Key assumptions used in value in-use calculations

Management believe that the calculations of the value in use are most sensitive to the following:

1. Gross margins – these have been based on the gross margins from the 2007 budget which took into account gross margins in the immediately preceding years as adjusted for operational changes. No benefit has been taken for anticipated improvements in utilisation.
2. Discount rates – individual companies or divisions are assessed on similar target performance levels and management has used the weighted average cost of capital to reflect its best estimate of returns in the businesses.
3. Growth rates – growth rates have been determined at a discounted level to those anticipated by industry analysts, adjusted for management's objectives to improve on these industry levels.

Sensitivity to changes in assumptions

Management believe that no reasonably possible change in any of the above key assumptions would cause the carrying value of the relevant units to exceed their recoverable amounts.

11 TRADE AND OTHER RECEIVABLES (CURRENT)

	2006 £'000	2005 £'000
Trade debtors	15,661	14,864
Corporation tax	721	368
Prepayments and accrued income	4,357	3,763
	<u>20,739</u>	<u>18,995</u>

All amounts are due within one year. Trade receivables are non-interest bearing and on average have thirty to sixty day settlement terms.

12 CASH AND CASH EQUIVALENTS

	2006 £'000	2005 £'000
Cash at bank and in hand	<u>7,978</u>	<u>6,976</u>

Cash at bank and in hand earns interest at floating rates based on daily bank deposit rates. The fair value of cash and cash equivalents is £7,978,000 (2005: £6,976,000).

At 31 December 2006, the Group had available £nil (2005: £3.0 million) of undrawn committed borrowing facilities in respect of which all conditions precedent had been met.

For the purposes of the cash flow statement cash and cash equivalents comprise the amounts shown above.

13 TRADE AND OTHER PAYABLES (CURRENT)

	2006 £'000	2005 £'000
Trade creditors	3,430	3,161
Other taxes and social security costs	742	627
Other payables	1,046	1,523
Accruals and deferred income	13,306	12,614
	<u>18,524</u>	<u>17,925</u>

The terms and conditions of the above financial liabilities are as follows:

Trade payables are non-interest bearing and are normally settled within 45 days.

Other taxes and social security costs are non-interest bearing and have an average term of 1 month.

Other payables are non-interest bearing and have an average term of 2 months.

14 INTEREST BEARING LOANS AND BORROWINGS

	2006 £'000	2005 £'000
Current		
Current instalments due on bank loans	2,000	2,000
Non-current		
Non-current instalments due on bank loans	9,656	17,092
Bank loans comprise the following:		
	2006 £'000	2005 £'000
US \$3,006,926 variable rate secured term loan	1,534	3,122
£6,400,000 variable rate secured term loan	6,400	10,900
US \$7,294,000 variable rate secured revolving credit facility	3,722	5,070
	<u>11,656</u>	<u>19,092</u>
Less current instalments due on bank loans	<u>(2,000)</u>	<u>(2,000)</u>
	<u>9,656</u>	<u>17,092</u>

US \$3,006,926 variable rate secured term loan and £6,400,00 variable rate secured term loan

These loans are secured and combined are repayable in quarterly instalments of £500,000 with the final balance being repaid in 2010. The loans bear interest at LIBOR + 1.25%.

US \$7,294,000 variable rate secured revolving credit facility

This loan is secured and is drawn down under an available 5-year term revolving credit facility. Interest is charged at LIBOR + 1.25%. The loan is repayable within 1 month of the balance sheet date but has been classified as long term because the group expects to draw down under the 5 year revolving credit facility available to it. This facility is unconditional.

Under the credit facility agreement, the Group is subject to certain financial covenants relating to cash flow, gearing, interest rate cover and capital expenditure. The Group is also required to maintain a certain percentage of cash within those Group companies that are guarantors of the facility. Since entering into the facility agreement the Group has fully complied with these covenants.

15 PROVISIONS

	<i>Property Leases</i> <i>£'000</i>	<i>NIC on Options</i> <i>£'000</i>	<i>Restructuring</i> <i>£'000</i>	<i>Total</i> <i>£'000</i>
At 1 January 2006	613	23	262	898
Arising during the year	31	-	-	31
Utilised	(177)	-	(242)	(419)
At 31 December 2006	467	23	20	510
Current 2006	105	-	20	125
Non-current 2006	362	23	-	385
	467	23	20	510
Current 2005	238	-	262	500
Non-current 2005	375	23	-	398
	613	23	262	898

Property Leases

The provision for property leases is in respect of closed leasehold premises, from which the Group no longer trades, but is liable to fulfil rent and other property commitments up to the lease expiry dates. Obligations are payable within a range of one to 15 years. Amounts have been provided on current rentals and are management's best estimate of the likely future cash outflows and opportunities to sub-let the properties.

NIC on Options

A provision of £23,000 (2005 - £23,000) was held this year for National Insurance Contributions (NIC) arising on unapproved share option schemes. The provision is based on the difference between the price at which the options were granted and the year-end share price.

Restructuring

The restructuring provision of £20,000 is the remainder of a £900,000 provision that was set up to cover the costs of the restructuring of Trados following its acquisition in July 2005. The balance of the provision is expected to be used in 2007.

16 SHARE CAPITAL

	2006 £	2005 £		
Authorised 75,000,000 Ordinary shares of 1p each	750,000	750,000		
Allotted, called up and fully paid				
	2006 thousands	2005 thousands	2006 £	2005 £
Ordinary shares of 1p each				
At 1 January	61,451	56,118	614,512	561,183
Issued on exercise of share options	679	502	6,792	5,024
Issued on acquisition of subsidiaries	344	4,831	3,436	48,305
At 31 December	<u>62,474</u>	<u>61,451</u>	<u>624,740</u>	<u>614,512</u>

The following movements in the ordinary share capital of the company occurred during the year:

- 679,227 ordinary shares of 1p each were allotted under the SDL Share Option Scheme (1999) and earlier Unapproved Option Schemes at a price range of 1 pence to 220.75 pence per share for an aggregate consideration of £305,188.
- On 18 April 2006, 270,302 and 17,254 ordinary shares of 1p each were allotted to Marek Piorkowski and Marius Kordas respectively. This represented a proportion of the deferred consideration for the purchase of Lomac SP z.o.o. and its subsidiary companies that took place in April 2003.
- On 18 April 2006 56,043 ordinary shares of 1p each were allotted to Najwa Arnouk. This represented a proportion of the deferred consideration for the purchase of Lingua Franca Computer System Design that took place in April 2005.

The following movements in the ordinary share capital of the company occurred during 2005:

- 502,377 ordinary shares of 1p each were allotted under the SDL Share Option Scheme (1999) and earlier Unapproved Option Schemes at a price range of 1 pence to 117 pence per share for an aggregate consideration of £277,845.
- On 18 April 2005, 270,301 and 17,253 ordinary shares of 1p each were allotted to Marek Piorkowski and Marius Kordas respectively. This represented a proportion of the deferred consideration for the purchase of Lomac SP z.o.o. and its subsidiary companies that took place in April 2003. As at 31 December 2005 287,554 shares remained to be issued.
- During July 2005 4,542,957 ordinary shares were issued in part consideration for the acquisition of Trados.

17 SHARE-BASED PAYMENT PLANS

On 1 December 1999 the company adopted the SDL Share Option Scheme (1999). It comprises two parts, namely the SDL Approved Share Option Scheme (1999) ("Approved Part") and the SDL Unapproved Share Option Scheme (1999) ("Unapproved Part"). The Approved Part has been approved by the Board of the Inland Revenue under the provisions of the Income and Corporation Taxes Act 1988. The Unapproved Part has not been approved by the Inland Revenue and it is not intended to apply for approval in respect of it.

On 27 April 2006 a long term incentive plan (LTIP) was formally approved by the shareholders at an EGM. The award of any LTIP shares is made at nil costs to the directors or employees at the end of a three year holding period provided stringent performance targets have been met. These performance targets are detailed in the Directors' Remuneration Report on page 24.

On 25 May 2006 500,228 LTIP shares were granted to the executive directors and certain senior management employees at a market price of £1.895 with a performance period of three years from date of grant. A further 428,574 and 40,000 LTIP shares were issued on 18 July 2006 and 1 September 2006, at market prices of £1.955 and £2.050 respectively, to managers and technical staff considered important to the future of the SDL Group.

The expense recognised for all share-based payments in respect of employee services received during the year to 31 December 2006 is £602,000 (2005: £275,000).

SDL Share Option Scheme

The table below sets out the number and weighted average exercise prices (WAEP) of, and movements in, the SDL Share Options Scheme during the year:

	2006	2006	2005	2005
	No.	WAEP	No.	WAEP
Outstanding at the beginning of the year	3,846,729	£0.70	3,786,433	£0.68
Granted during the year	371,667	£2.18	702,000	£1.19
Forfeited during the year	(33,001)	£1.17	(20,417)	£1.11
Exercised during the year	(679,227)	£0.45	(502,377)	£0.53
Expired during the year	(83,750)	£1.79	(118,910)	£3.90
Outstanding at the end of the year	<u>3,422,418</u>	<u>£0.87</u>	<u>3,846,729</u>	<u>£0.70</u>
Exercisable at 31 December	2,061,418	£0.56	2,400,891	£0.56

The weighted average share price at the date of exercise for the options exercised is £2.10 (2005: £1.57).

For the share options outstanding as at 31 December 2006, the weighted average remaining contractual life is 6.57 years (2005: 6.88 years).

The fair value of equity settled share options granted under the SDL Share Option Scheme is estimated as at the date of grant using the Black Scholes model. The following table lists the inputs to the model:

	2006	2005
Weighted average share price (pence)	218	119
Expected volatility	35%	55%
Option life	5 years	5 years
Expected dividends	1%	1%
Risk-free interest rate	5%	5%

The range of exercise prices for options outstanding at the end of the year was £0.01-£3.60 (2005: £0.01-£3.60).

Date of Grant		Exercise Period	2006 Number	2005 Number
£0.01 - £0.50	01/01/92-16/04/03	10 years after grant date	1,134,244	1,549,367
£0.51 - £1.00	15/10/99-12/12/03	10 years after grant date	636,531	771,862
£1.01 - £1.50	02/04/04-04/04/05	10 years after grant date	1,290,276	1,471,750
£1.51 - £2.00	07/04/01	10 years after grant date	9,250	14,750
£2.01 - £2.50	22/03/06-03/10/06	10 years after grant date	321,117	-
£3.01 - £3.60	12/05/00	10 years after grant date	31,000	39,000
Total			3,422,418	3,846,729

SDL Long Term Incentive Plan

The fair value of equity-settled shares granted under the SDL Long Term Incentive Plan is estimated as at the date of grant using a Monte-Carlo model, taking into account the terms and conditions upon which the options were granted. The following table lists the inputs to the model used for the years ended 31 December 2006.

	2006
Expected volatility	35%
Expected life	3 years
Expected dividends	0%
Risk-free interest rate	5%

	2006	2006
	No.	WAEP
Outstanding at the beginning of the year	-	-
Granted during the year	968,802	-
Forfeited during the year	(33,167)	-
Exercised during the year	-	-
Expired during the year	-	-
Outstanding at the end of the year	<u>935,635</u>	-
Exercisable at 31 December	Nil	-

All LTIPs are exercisable at nil cost to the individual.

18 ADDITIONAL CASH FLOW INFORMATION

Analysis of group net debt:

	<i>January 2006 £'000</i>	<i>Cash flow £'000</i>	<i>Exchange differences £'000</i>	<i>31 December 2006 £'000</i>
Cash and cash equivalents	6,976	1,276	(274)	7,978
Loans	(19,092)	6,596	840	(11,656)
	(12,116)	7,872	566	(3,678)

	<i>1 January 2005 £'000</i>	<i>Cash flow £'000</i>	<i>Exchange differences £'000</i>	<i>Non cash movement £'000</i>	<i>31 December 2005 £'000</i>
Cash and cash equivalents	11,452	(4,777)	301	-	6,976
Loans	-	(17,707)	-	(1,385)	(19,092)
	11,452	(22,484)	301	(1,385)	(12,116)

The non cash movement in 2005 is the debt acquired with Trados in July 2005.

19 COMMITMENTS AND CONTINGENCIES

The Group has entered into commercial leases on certain properties used as offices. The future minimum rentals payable under non-cancellable operating leases as at 31 December are as follows:

	<i>2006 £'000</i>	<i>2005 £'000</i>
Within one year	2,745	2,956
After one year but not more than five years	7,689	7,585
More than five years	9,670	11,743
	20,104	22,284

There is sublease rental of £150,000 per annum for a minimum term of 8 years to 2014.

20 RELATED PARTY DISCLOSURES

Compensation of key management personnel of the Group

	<i>2006 £'000</i>	<i>2005 £'000</i>
Short term employee benefits	1,153	984
Post employment and medical benefits	43	40
Share based payments	734	91
Total compensation paid to key management personnel	1,930	1,115

21 FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES

An explanation of the Group's financial instrument risk management objectives, policies and strategies are set out in the Operating and Financial Review on pages 11 to 15.

Interest Rate Risk: The loan facilities that the Group holds with RBS expose the Group to interest rate risk when drawn in foreign currencies. The interest rates that the group is paying are linked directly to the 3 month LIBOR rate, and the Group is required by the credit facility agreement to hedge the interest rate exposure on 50% of the term loan outstanding at any time. This interest rate hedge is required to extend to June 2009. The Group has met this requirement by entering into a 4 year LIBOR value collar, under which the Group is protected from 3 month LIBOR moving above 6%. In order to obtain this protection there is an interest rate 'barrier' of 3.7%. If the base rate falls below this level the Group will be charged interest as if the base rate was 6%.

To ensure adequate working capital the Group maintains cash deposits over and above monies required to repay the credit facility, and these deposits are affected by any movements in rates of interest generally. The Group seeks to place all cash surplus to operational requirements in secure money market funds, mainly in overnight funds. To enhance the interest earning capacity of the Group, processes have been put in place to ensure that cash balances held by subsidiary companies are kept as low as operationally possible. The Group also seeks to maintain sufficient deposits in currencies providing higher rates of interest but at the same time ensuring that the Group is not exposed to currency movements.

Liquidity Risk: The Group's objective is to optimise the funds currently available to it in order to maintain a net debt position as low as possible and to enable accelerated repayments of the term loan to be made.

Foreign Currency Risk: A significant amount of business continues to be done with customers in the USA. This gives rise to short-term debtors and cash balances in US Dollars. Consequently, the movements in the US Dollar/Sterling exchange rates, and to a lesser extent the US Dollar/Euro, affect the Balance Sheet. The Group seeks to manage this risk by ensuring that all currency needs in the USA are funded from the settlement of US Dollar denominated debtors. In the light of the significant weakening of the US Dollar in 2004, the Group introduced a policy of taking forward hedged and option positions to cover a proportion of the Group's anticipated US Dollar inflow. Under the RBS credit facility, SDL is required to have in place a foreign exchange hedge against two thirds of its net

exposure to US Dollar cash flows. This requirement is similar to the policy that the board had in place prior to the Group entering into the credit facility. The current Forward Plus hedge protects the Group for \$1 million a month for the first three months of 2007 at US\$ 1.7650 to the £ and for a further three months at US\$ 1.8999 and enables the Group to participate in a strengthening US Dollar to \$1.650 for the first three months and to \$1.760 for the following three months.

22 DERIVATIVES AND OTHER FINANCIAL INSTRUMENTS

Interest rate risk profile of financial assets and liabilities

The interest rate profile of the financial assets and liabilities of the group as at 31 December is as follows:

Year ended 31 December 2006

<i>Floating rate</i>	<i>Within 1 year £'000</i>	<i>1-2 years £'000</i>	<i>2-3 years £'000</i>	<i>3-4 years £'000</i>	<i>4-5 years £'000</i>	<i>More than 5 years £'000</i>	<i>Total £'000</i>
Cash	7,978	-	-	-	-	-	7,978
US\$3,006,926 variable rate secured loan	(387)	(387)	(387)	(373)	-	-	(1,534)
£6,400,000 variable rate secured loan	(1,613)	(1,613)	(1,613)	(1,561)	-	-	(6,400)
US\$7,294,000 variable rate secured loan	-	(3,722)	-	-	-	-	(3,722)

Year ended 31 December 2005

<i>Floating rate</i>	<i>Within 1 year £'000</i>	<i>1-2 years £'000</i>	<i>2-3 years £'000</i>	<i>3-4 years £'000</i>	<i>4-5 years £'000</i>	<i>More than 5 years £'000</i>	<i>Total £'000</i>
Cash	6,976	-	-	-	-	-	6,976
US\$5,388,650 variable rate secured loan	(455)	(455)	(455)	(455)	(455)	(847)	(3,122)
£10,900,000 variable rate secured loan	(1,555)	(1,555)	(1,555)	(1,555)	(1,555)	(3,125)	(10,900)
US\$8,750,000 variable rate secured loan	-	(5,070)	-	-	-	-	(5,070)

Maturity of financial liabilities

The maturity profile of the Group's financial liabilities at each relevant year-end is set out in note 14.

Borrowing facilities

The Group has one borrowing facility available to it. The undrawn committed facilities available at each year end were as follows:

	<i>2006 £'000</i>	<i>2005 £'000</i>
Expiring in one year or less	-	3,000

Credit risk

There are no significant concentrations of credit risk within the Group. The maximum credit risk exposure relating to financial assets is represented by carrying value as at the balance sheet date.

Fair values of financial assets and liabilities

The fair values of financial assets and liabilities are set out below. The directors consider that there were no material differences between the book values and fair values of all the Group's financial assets and liabilities at each year-end. The fair value of loan notes and financial assets has been calculated using the market interest rates.

Financial assets	<i>Book Value</i>		<i>Fair Value</i>	
	<i>2006</i>	<i>2005</i>	<i>2006</i>	<i>2005</i>
	<i>£'000</i>	<i>£'000</i>	<i>£'000</i>	<i>£'000</i>
Cash and short term deposits	7,978	6,976	7,978	6,976
Foreign currency contracts	469	-	469	-
Interest rate swaps	5	-	5	-
<hr/>				
Financial liabilities	<i>Book Value</i>		<i>Fair Value</i>	
	<i>2006</i>	<i>2005</i>	<i>2006</i>	<i>2005</i>
	<i>£'000</i>	<i>£'000</i>	<i>£'000</i>	<i>£'000</i>
Loan notes	11,656	19,092	11,656	19,092
Foreign currency contracts	-	67	-	67
Interest rate swaps	-	53	-	53

At 31 December 2006 the Group has a 3 month Forward contract to sell \$1 million at \$1.7350 to the £ and a Forward Plus hedge arrangement commencing January 2007 under which it is able to sell \$1 million each month at US\$ 1.7650 to the £. The Group has net US\$ inflows from customer sales and this Forward Plus hedge arrangement protects the Group with respect to up to US\$1 million each month on movements in the US\$:£ exchange rate above \$1.7650, whilst enabling the Group to benefit from exchange rate movements below this. To enable the Group to acquire this Forward Plus hedge there is a floor of \$1.6500 below which the Group would be requested to sell the \$1 million at \$1.7350 for the month in which the rate was below \$1.6500 at the time of expiry. In addition the Group has a consecutive 3 month Forward contract to sell \$1 million at \$1.8999 to the £ and a Forward Plus hedge arrangement, also running consecutively, under which it is able to sell \$1 million each month at US\$ 1.8999 to the £. This hedge arrangement protects the Group with respect to net cash inflows of up to US\$1 million each month to movements in the US\$:£ exchange rate above \$1.8999, whilst enabling the Group to benefit from exchange rate movements below this. To enable the Group to acquire this Forward Plus hedge there is a floor of \$1.7600 which the Group would be requested to sell the US\$1 million at \$1.8600 for the month in which the rate was below \$1.7600 at the time of expiry.

Forward Plus contracts to hedge future cash inflows:

US\$ 1 million	17 January 2007	1.7650
US\$ 1 million	20 February 2007	1.7650
US\$ 1 million	16 March 2007	1.7650
US\$ 1 million	17 April 2007	1.8999
US\$ 1 million	17 May 2007	1.8999
US\$ 1 million	15 June 2007	1.8999

The hedge protects the Group from movements above \$1.765 and \$1.899 on the Forward Plus contracts and \$1.7350 and \$1.899 on the forward contracts as at 31 December 2006. The exchange rate at the year end of US\$1.9599 compared to the prevailing rate at the time the hedge was entered into means that the Group has recognised an unrealised gain of £536,000 (2005: loss £67,000) in the income statement. As at 31 December 2006 the Group's foreign currency contract was valued at £469,000 (2005: loss (£67,000)).

The loan facilities that the Group holds with RBS expose the Group to interest rate risk when drawn in foreign currencies. The interest rates that the Group is paying are linked directly to the 3-month LIBOR rate, and the Group is required by the credit facility agreement to hedge the interest rate exposure on 50% of the term loan outstanding at any time. This interest rate hedge is required to extend to June 2009. The Group has met this requirement by entering into a 4 year LIBOR value collar, under which the Group is protected from 3-month LIBOR moving above 6%. In order to obtain this protection there is an interest rate "barrier" of 3.0%. If base rate falls below this level the Group will be charged interest as if the base rate was 6%.

As at 31 December the Group's interest rate contract was valued at £5,000 (2005: loss (£53,000)), with a gain of £58,000 (2005: loss (£53,000)) being recognised in the income statement in 2006, reflecting the movement in interest rates during the year.

These financial instruments do not qualify for hedge accounting and therefore any gains and losses arising are taken directly to the profit and loss for the period.

A summary of amounts included within financial assets and financial liabilities is given below:

Financial assets

	2006 £'000	2005 £'000
Other financial assets – current		
Forward currency contracts	469	-
Interest rate contract	5	-
	474	-

Financial liabilities

	2006 £'000	2005 £'000
Other financial liabilities – current		
Forward currency contracts	-	67
Interest rate contract	-	53
	-	120

23 POST BALANCE SHEET EVENTS

There are no known post balance sheet events requiring disclosure at the date of this report.

The directors are responsible for preparing the Annual Report and the financial statements in accordance with applicable law and regulations.

Company law requires the directors to prepare financial statements for each financial year. Under that law the directors have elected to prepare the financial statements in accordance with United Kingdom Generally Accepted Accounting Practice (United Kingdom Accounting Standards and applicable law).

The financial statements are required by law to give a true and fair view of the state of affairs of the Company and of the profit or loss of the Company for that period. In preparing those financial statements, the directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and estimates that are reasonable and prudent;
- state whether applicable UK Accounting Standards have been followed, subject to any material departures disclosed and explained in the financial statements; and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the Company will continue in business.

The directors are responsible for keeping proper accounting records that disclose with reasonable accuracy at any time the financial position of the Company and enable them to ensure that the financial statements comply with the Companies Act 1985. They are also responsible for safeguarding the assets of the Company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

We have audited the parent company financial statements of SDL plc for the year ended 31 December 2006 which comprise the Company Balance Sheet and the related notes 1 to 15. These parent company financial statements have been prepared under the accounting policies set out therein. We have also audited the information in the Directors' Remuneration Report that is described as having been audited.

We have reported separately on the Group financial statements of SDL plc for the year ended 31 December 2006.

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

Respective responsibilities of directors and auditors

The director's responsibilities for preparing the Annual Report, the Directors Remuneration Report and the parent company financial statements in accordance with applicable United Kingdom law and Accounting Standards (United Kingdom Generally Accepted Accounting Practice) are set out in the Statement of Directors' Responsibilities.

Our responsibility is to audit the parent company financial statements and the part of the Directors' Remuneration Report to be audited in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland).

We report to you our opinion as to whether the parent company financial statements give a true and fair view and whether the parent company financial statements and the part of the Directors' Remuneration Report to be audited have been properly prepared in accordance with the Companies Act 1985. We also report to you whether in our opinion the information given in the Directors' Report is consistent with the financial statements. The information given in the Directors' Report includes that specific information presented in the Operating and Financial Review that is cross referred from the Review of the Business section of the Directors' Report.

We review whether the Corporate Governance Report reflects the company's compliance with the nine

provisions of the 2003 Combined Code specified for our review by the Listing Rules of the Financial Services Authority, and we report if it does not. We are not required to consider whether the board's statements on internal control cover all risks and controls, or form an opinion on the effectiveness of the group's corporate governance procedures or its risk and control procedures.

We read other information contained in the Annual Report and consider whether it is consistent with the audited Group financial statements. The other information comprises only the Chairman's Statement, Directors, Operating and Financial Review, Corporate Governance Report, Directors' Remuneration Report, Directors' Report and Notice of Annual General Meeting. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the Group financial statements. Our responsibilities do not extend to any other information.

Basis of audit opinion

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements and the part of the Directors' Remuneration Report to be audited. It also includes an assessment of the significant estimates and judgements made by the directors in the preparation of the parent company financial statements, and of whether the accounting policies are appropriate to the Company's circumstances, consistently applied and adequately disclosed.

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

Opinion

In our opinion:

- the parent company financial statements give a true and fair view, in accordance with United Kingdom Generally Accepted Accounting Practice, of the state of Company's affairs as at 31 December 2006;
- the parent company financial statements and the part of the Directors' Remuneration Report to be audited have been properly prepared in accordance with the Companies Act 1985; and
- the information given in the Directors' Report is consistent with the parent company financial statements.

Ernst and Young LLP
Registered Auditor
Reading

6 March 2007

	<i>Notes</i>	2006	2005
		£'000	£'000
FIXED ASSETS			
Intangible assets	2	4,692	6,357
Tangible assets	3	1,142	1,047
Investments	4	55,408	55,408
		<u>61,242</u>	62,812
CURRENT ASSETS			
Debtors	5	19,975	16,109
Cash at bank and in hand		5,221	3,697
		<u>25,196</u>	19,806
CREDITORS: amounts falling due within one year			
Loans due within one year	7	(2,000)	(2,000)
		<u>(941)</u>	4,659
NET CURRENT ASSETS			
		<u>60,301</u>	67,471
TOTAL ASSETS LESS CURRENT LIABILITIES			
CREDITORS: amounts falling due after one year			
	7	(9,656)	(17,092)
PROVISIONS FOR LIABILITIES AND CHARGES			
	8	(426)	(436)
		<u>50,219</u>	49,943
CAPITAL AND RESERVES			
Called up share capital	10	625	615
Share premium account	10	51,096	50,629
Shares to be issued	10	66	238
Profit and loss account	10	(1,568)	(1,539)
TOTAL EQUITY		<u>50,219</u>	49,943

Approved by the Board of directors on 5 March 2007

M Lancaster
Director

A Gordon
Director

1 ACCOUNTING POLICIES

The principal accounting policies that have been consistently applied in arriving at the financial information set out in this report are:

Accounting convention

The financial statements are prepared under the historical cost convention as modified for certain items which have been measured at fair value, namely financial instruments. The financial statements are presented in accordance with applicable accounting standards in the United Kingdom.

Basis of preparation of consolidated financial statements

No profit and loss account is presented for the Company as permitted by Section 230 of the Companies Act 1985. The Company's result for the year is shown in note 14.

Fixed assets and depreciation

Depreciation is provided to write off the cost less the estimated residual value of intangible and tangible fixed assets over their estimated useful economic lives as follows:

Intangible fixed assets	-	5 - 8 years straight line
Leasehold improvements	-	The lower of ten years or the lease term straight line
Equipment	-	4 years straight line
Fixtures & fittings	-	20% reducing balance
Motor vehicles	-	20% reducing balance
Software	-	3 years straight line

Foreign currencies

Transactions in foreign currencies are recorded using the rate of exchange ruling at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are translated using the rate of exchange ruling at the balance sheet date and the gains or losses on translation are included in the profit and loss account.

Financial instruments

The company uses forward foreign currency contracts and options to reduce exposure to foreign exchange rates. The Company also uses interest rate swaps to adjust interest rate exposures. Such instruments are stated at fair value. Gains and losses arising from

changes in fair value are taken to the profit and loss account in the period.

The company has taken advantage of the exemption in paragraph 3C of FRS 25 Financial Instruments: Disclosure and Presentation and has not disclosed information required by paragraphs 51 to 95 of that standard, as the Group's consolidated financial statements, in which the company is included, provide equivalent disclosures for the Group under IAS 32 Financial Instruments: Presentation and Disclosure.

Leases

Assets acquired under finance leases and hire purchase contracts are capitalised and the outstanding future obligations are shown in creditors. Operating lease rentals are charged to the profit and loss account on a straight-line basis over the period of the lease. Operating lease income is credited to the profit and loss account on a straight-line basis over the period of the lease.

Incentives received from landlord

In accordance with UITF 28, the aggregate benefit of incentives are recognised as a credit to the profit and loss account. The benefits of the incentives are allocated over the period to the first rent review in December 2007, commencing from the date of occupation, or the life of the underlying assets. These allocations are on a straight-line basis.

Pension cost

The company contributes to a group personal pension scheme for qualifying employees whereby it makes defined contributions to independently administered personal pension schemes. The company does not control any of the assets or have any ongoing liabilities with regard to the performance of and payments from these individual personal schemes.

Research and development

Research and development costs are written off as incurred in the year of expenditure.

Revenue

Revenue is recognised to the extent that it is probable that the economic benefits will flow to the group and the revenue can be measured reliably. The following specific recognition criteria must also be met before revenue is recognised:

Rendering of services

Revenue on service contracts is recognised only when their outcomes can be foreseen with reasonable certainty and is based on the percentage stage of completion of the contracts, calculated on the basis of costs incurred.

Accrued and deferred revenue arising on long-term contracts is included in debtors as accrued income and creditors as deferred income as appropriate.

Support and maintenance contracts are invoiced in advance and normally run for periods of 12 months with automatic renewal on the anniversary date. Revenue in respect of support and maintenance contracts is recognised evenly over the 12 months commencing from the date of the contract period.

Managed services (hosting) fees are recognised over the term of the hosting contract on a straight-line basis.

Professional services and consulting revenue, which is provided on a 'time and expense' basis, is recognised as the service is performed.

For multiple element arrangements revenue is allocated to each element on fair value regardless of any separate prices stated within the contract. The portion of the revenue allocated to an element is recognised when the revenue recognition criteria for that element have been met.

Sale of goods

Revenue from the sale of goods is recognised when the significant risks and rewards of ownership of the goods have passed to the buyer, usually on despatch of the goods.

Revenue on software licenses and upgrades is recognised on despatch, when there are no significant vendor obligations remaining and the collection of the resulting receivable is considered probable. In circumstances where a considerable future vendor obligation exists as part of a software licence and related services' contract, revenue is recognised over the period that the obligation exists per the contract.

Interest

Revenue is recognised as the interest accrues to the net carrying amount of the financial asset.

Taxation

The charge for taxation is based on the profit for the year and takes into account taxation deferred arising from timing differences between the treatment of certain items for taxation and accounting purposes. The effective tax rate for current taxation is higher than the UK statutory rate, reflecting a high proportion of disallowable items such as the amortisation of goodwill.

Deferred tax is recognised in respect of all timing differences that have originated but not reversed at the balance sheet date where transactions or events have occurred at that date that will result in an obligation to pay more, or a right to pay less or to receive more, tax, with the following exceptions:

- provision is made for tax on gains arising from fair value adjustments of fixed assets, and gains on disposal of fixed assets that have been rolled over into replacement assets, only to the extent that, at the balance sheet date, there is a binding agreement to dispose of the assets concerned. However no provision is made where, on the basis of all available evidence at the balance sheet date, it is more likely than not that the taxable gain will be rolled over into replacement assets and charged to tax only where the replacement assets are sold;
- provision is made for deferred tax that would arise on remittance of the retained earnings of overseas subsidiaries, only to the extent that, at the balance sheet date, dividends have been accrued as receivable;
- deferred tax assets are recognised only to the extent that the directors consider that it is more likely than not that there will be suitable taxable profits from which the future reversal of the underlying timing differences can be deducted.

Deferred tax is measured on an undiscounted basis at the tax rates that are expected to apply in the periods in which timing differences reverse, based on tax rates and laws enacted or substantively enacted at the balance sheet date.

National Insurance Liabilities on Share Option Gains

Following the issuance of UITF abstract 25 "National Insurance contributions on share option gains" the Group makes provision for the National Insurance contributions on a straight-line basis over the vesting period of the options and as remeasured each period thereafter until the options are exercised. The remeasurement is based upon the share price at the year-end.

Cash flow statement

The Company has taken advantage of the exemption granted by Financial Reporting Standard 1 to not present a cash flow statement.

Related party transactions

The Company has taken advantage of the exemption granted by Financial Reporting Standard 8 from disclosing related party transactions with entities that are part of the SDL plc group.

Investment

Investments are recorded at cost.

Investments denominated in foreign currency are recorded using the rate of exchange at the date of acquisition and reviewed annually for evidence of impairment.

Share based payments

Employees (including directors) of the Company receive remuneration in the form of share-based payment transactions, whereby employees render services in exchange for shares or rights over shares ('equity-settled transactions').

Equity-settled transactions

The cost of equity-settled transactions with employees is measured by reference to the fair value at the date at which they are granted. The fair value is determined by using the Black Scholes model.

The cost of equity-settled transactions is recognised, together with a corresponding increase in equity, ending on the date on which the relevant employees become entitled to the award ('vesting date'). The cumulative expense recognised for equity settled transactions at each reporting date until the vesting date reflects the extent to which the vesting period has expired and the number of awards that, in the opinion of the directors of the Company at that date, based on the best available estimate of the number of equity instruments that will ultimately vest.

No expense is recognised for awards that do not ultimately vest.

Where the terms of an equity-settled award are modified, as a minimum an expense is recognised as if the terms had not been modified. In addition, an expense is recognised for any increase in the value of the transaction as a result of the modification, as measured at the date of modification.

Where an equity-settled award is cancelled, it is treated as if it had vested on the date of cancellation, and any expense not yet recognised for the award is recognised immediately. However, if a new award is substituted for the cancelled award, and designated as a replacement award on the date that it is granted, the cancelled and new awards are treated as if they were a modification of the original award, as described in the previous paragraph.

The Company has taken advantage of the transitional provisions of FRS 20 in respect of equity-settled awards and has applied FRS 20 only to equity-settled awards granted after 7 November 2002 that had not vested at 1 January 2005.

2 INTANGIBLE FIXED ASSETS

*Intellectual
Property
£'000*

Cost

**At 1 January 2006 and
31 December 2006**

10,691

Amortisation

At 1 January 2006

4,334

Provided during the year

1,665

At 31 December 2006

5,999

Net book value

At 31 December 2006

4,692

At 31 December 2005

6,357

Intellectual property is written off on a straight-line basis over its estimated useful life of over 5 to 8 years.

3 TANGIBLE FIXED ASSETS

	<i>Leasehold Improvements £'000</i>	<i>Equipment £'000</i>	<i>Fixtures & Fittings £'000</i>	<i>Motor Vehicles £'000</i>	<i>Software £'000</i>	<i>Total £'000</i>
Cost						
At 1 January 2006	532	3,172	797	117	796	5,414
Currency adjustment	(4)	(49)	(3)	(1)	(6)	(63)
Additions	5	631	27	-	51	714
Transfer to fellow subsidiary	(18)	(445)	(28)	-	(63)	(554)
Disposals	-	(21)	(12)	(25)	-	(58)
At 31 December 2006	515	3,288	781	91	778	5,453
Depreciation						
At 1 January 2006	167	2,786	584	73	757	4,367
Currency adjustment	(2)	(39)	(3)	-	(6)	(50)
Provided during the year	56	332	45	8	39	480
Transfer to fellow subsidiary	(8)	(368)	(22)	-	(60)	(458)
Disposals	-	-	(7)	(21)	-	(28)
At 31 December 2006	213	2,711	597	60	730	4,311
Net book value						
At 31 December 2006	302	577	184	31	48	1,142
At 31 December 2005	365	386	213	44	39	1,047

The net book value of assets held under finance leases is £nil as at 31 December 2006 (2005 - £nil).

4 FIXED ASSET INVESTMENTS

Details of the investments in which the Company holds more than 20% of the nominal value of ordinary share capital are given in Note 9 of the Group financial statements.

Cost	
	<i>£'000</i>
At 1 January 2005	23,457
Additions during the year	32,170
Disposals during the year	(219)
Cost and Net Book Value as at 31 December 2005	55,408
At 1 January 2006	55,408
Cost and Net Book Value as at 31 December 2006	55,408

5 DEBTORS

	2006 £'000	2005 £'000
Trade debtors	3,485	3,275
Amounts owed by Group undertakings	14,053	11,616
Corporation tax	746	-
Deferred income tax asset	174	357
Prepayments and accrued income	1,517	861
	<u>19,975</u>	<u>16,109</u>

6 CREDITORS: amounts falling due within one year

	2006 £'000	2005 £'000
Trade creditors	1,024	1,359
Amounts owed to Group undertakings	17,758	6,827
Corporation tax	445	368
Other taxes and social security costs	616	152
Other creditors	14	433
Accruals and deferred income	4,280	4,008
	<u>24,137</u>	<u>13,147</u>

7 INTEREST BEARING LOANS AND BORROWINGS

	2006 £'000	2005 £'000
Current		
Current instalments due on bank loans	2,000	2,000
Non-current		
Non-current instalments due on bank loans	9,656	17,092

Bank loans comprise the following:

	2006 £'000	2005 £'000
US \$3,006,926 variable rate secured term loan	1,534	3,122
£6,400,000 variable rate secured term loan	6,400	10,900
US \$7,294,000 variable rate secured revolving credit facility	3,722	5,070
	<u>11,656</u>	<u>19,092</u>
Less current instalments due on bank loans	<u>(2,000)</u>	<u>(2,000)</u>
	<u>9,656</u>	<u>17,092</u>

US \$3,006,926 variable rate secured term loan and £6,400,000 variable rate secured term loan

These loans are secured and combined are repayable in quarterly instalments of £500,000 with the final payment due in 2010. The loans bear interest at LIBOR + 1.25%.

US \$7,294,000 variable rate secured revolving credit facility

This loan is secured and is drawn down under an available 5-year term revolving credit facility. Interest is charged at LIBOR + 1.25%. The loan is repayable within 12 months of the balance sheet date but has been classified as long term because the group expects to draw down under the 5 year revolving credit facility available to it.

8 PROVISIONS FOR LIABILITIES AND CHARGES

	2006 £'000	2005 £'000
NIC arising on options	23	23
Property leases	403	413
	426	436

Movement in provisions:

	<i>Provision 1 January 2006 £'000</i>	<i>Arising during the year £'000</i>	<i>Utilised £'000</i>	<i>Provision 31 December 2006 £'000</i>
NIC	23	-	-	23
Property leases	413	31	(41)	403
	436	31	(41)	426

NIC on Options

A provision of £23,000 (2005 - £23,000) was held this year for National Insurance Contributions (NIC) arising on unapproved share option schemes. The provision is based on the difference between the price at which the options were granted and the year-end share price.

Property Leases

The provision for Property Leases is in respect of closed leasehold premises, from which the company no longer trades, but is liable to fulfil rent and other property commitments up to the lease expiry dates. Obligations are payable within a range of one to 15 years. Amounts have been provided on current rentals and are management's best estimate of the likely future cash outflows and opportunities to sub-let the properties.

9 SHARE CAPITAL

	2006 £	2005 £
Authorised 75,000,000 Ordinary shares of 1p each	750,000	750,000

Allotted, called up and fully paid

	2006 thousands	2005 thousands	2006 £	2005 £
Ordinary shares of 1p each				
At 1 January	61,451	56,118	614,512	561,183
Issued on exercise of share options	679	502	6,792	5,024
Issued on acquisition of subsidiaries	344	4,831	3,436	48,305
At 31 December	62,474	61,451	624,740	614,512

The following movements in the ordinary share capital of the company occurred during the year:

4. 679,227 ordinary shares of 1p each were allotted under the SDL Share Option Scheme (1999) and earlier Unapproved Option Schemes at a price range of 1 pence to 220.75 pence per share for an aggregate consideration of £305,188.
5. On 18 April 2006, 270,302 and 17,254 ordinary shares of 1p each were allotted to Marek Piorkowski and Marius Kordas respectively. This represented a proportion of the deferred consideration for the purchase of Lomac SP z.o.o. and its subsidiary companies that took place in April 2003.
6. On 18 April 2006 56,043 ordinary shares of 1p each were allotted to Najwa Arnouk. This represented a proportion of the deferred consideration for the purchase of Lingua Franca Computer System Design that took place in April 2005.

The following movements in the ordinary share capital of the company occurred during 2005:

4. 502,377 ordinary shares of 1p each were allotted under the SDL Share Option Scheme (1999) and earlier Unapproved Option Schemes at a price range of 1 pence to 117 pence per share for an aggregate consideration of £277,845.
5. On 18 April 2005, 270,301 and 17,253 ordinary shares of 1p each were allotted to Marek Piorkowski and Marius Kordas respectively. This represented a proportion of the deferred consideration for the purchase of Lomac SP z.o.o. and its subsidiary companies that took place in April 2003. As at 31 December 2005 287,554 shares remained to be issued.
6. During July 2005 4,542,957 ordinary shares were issued in part consideration for the acquisition of Trados.

10 SHARE PREMIUM AND RESERVES

	<i>Share Capital £'000</i>	<i>Share Premium Account £'000</i>	<i>Shares to be Issued £'000</i>	<i>Profit & Loss Account £'000</i>	<i>Total £'000</i>
At 1 January 2005	561	44,165	213	(3,062)	41,877
Profit for the period	-	-	-	829	829
Currency translation differences on net investments in overseas branches	-	-	-	527	527
Arising on share issues	54	6,464	25	-	6,543
Share based payments	-	-	-	167	167
At 1 January 2006	615	50,629	238	(1,539)	49,943
Loss for the period	-	-	-	(1,407)	(1,407)
Currency translation differences on net investments in overseas branches	-	-	-	1,066	1,066
Arising on share issues	10	467	(172)	-	305
Share based payments	-	-	-	312	312
At 31 December 2006	625	51,096	66	(1,568)	50,219

All amounts are attributable to equity holders of the parent.

11 COMMITMENTS AND CONTINGENCIES

The Company had annual commitments under operating leases as set out below:

	<i>Land and Buildings 2006 £'000</i>	<i>Land and Buildings 2005 £'000</i>
Within one year	2	53
After one year but not more than five years	195	186
More than five years	953	915
	<u>1,150</u>	<u>1,154</u>

12 SHARE-BASED PAYMENT PLANS

On 1 December 1999 the company adopted the SDL Share Option Scheme (1999). It comprises two parts, namely the SDL Approved Share Option Scheme (1999) ("Approved Part") and the SDL Unapproved Share Option Scheme (1999) ("Unapproved Part"). The Approved Part has been approved by the Board of the Inland Revenue under the provisions of the Income and Corporation Taxes Act 1988. The Unapproved Part has not been approved by the Inland Revenue and it is not intended to apply for approval in respect of it.

On 27 April 2006 a long term incentive plan (LTIP) was formally approved by the shareholders at an EGM. The award of any LTIP shares is made at nil costs to the directors or employees at the end of a three year holding period provided stringent performance targets have been met. These performance targets are detailed in the Directors' Remuneration Report on page 24.

On 25 May 2006 500,228 LTIP shares were granted to the executive directors and certain senior management employees at a market price of £1.895 with a performance period of three years from date of grant. A further 428,574 and 40,000 LTIP shares were issued on 18 July 2006 and 1 September 2006, at market prices of £1.955 and £2.050 respectively, to managers and technical staff considered important to the future of the SDL Group.

The expense recognised for all share-based payments in respect of employee services received during the year to 31 December 2006 is £602,000 (2005: £275,000).

	<i>2006 No.</i>	<i>2006 WAEP</i>	<i>2005 No.</i>	<i>2005 WAEP</i>
Outstanding at the beginning of the year	3,846,729	£0.70	3,786,433	£0.68
Granted during the year	371,667	£2.18	702,000	£1.19
Forfeited during the year	(33,001)	£1.17	(20,417)	£1.11
Exercised during the year	(679,227)	£0.45	(502,377)	£0.53
Expired during the year	<u>(83,750)</u>	£1.79	<u>(118,910)</u>	£3.90
Outstanding at the end of the year	<u>3,422,418</u>	£0.87	<u>3,846,729</u>	£0.70
Exercisable at 31 December	2,061,418	£0.56	2,400,891	£0.56

The weighted average share price at the date of exercise for the options exercised is £2.10 (2005: £1.57).

For the share options outstanding as at 31 December 2006, the weighted average remaining contractual life is 6.57 years (2005: 6.88 years).

The fair value of equity settled share options granted under the SDL Share Option Scheme is estimated as at the date of grant using the Black Scholes model. The following table lists the inputs to the model:

	2006	<i>2005</i>
Weighted average share price (pence)	218	119
Expected volatility	35%	55%
Option life	5 years	5 years
Expected dividends	1%	1%
Risk-free interest rate	5%	5%

The range of exercise prices for options outstanding at the end of the year was £0.01-£3.60 (2005: £0.01-£3.60).

Date of Grant		Exercise Period	2006 Number	2005 Number
£0.01 - £0.50	01/01/92-16/04/03	10 years after grant date	1,134,244	1,549,367
£0.51 - £1.00	15/10/99-12/12/03	10 years after grant date	636,531	771,862
£1.01 - £1.50	02/04/04-04/04/05	10 years after grant date	1,290,276	1,471,750
£1.51 - £2.00	07/04/01	10 years after grant date	9,250	14,750
£2.01 - £2.50	22/03/06-03/10/06	10 years after grant date	321,117	-
£3.01 - £3.60	12/05/00	10 years after grant date	31,000	39,000
Total			3,422,418	3,846,729

SDL Long Term Incentive Plan

The fair value of equity-settled shares granted under the SDL Long Term Incentive Plan is estimated as at the date of grant using a Monte-Carlo model, taking into account the terms and conditions upon which the options were granted. The following table lists the inputs to the model used for the years ended 31 December 2006.

	2006
	£'000
Expected volatility	35%
Expected life	3 years
Expected dividends	0%
Risk-free interest rate	5%

	2006	2006
	No.	WAEP
Outstanding at the beginning of the year	-	-
Granted during the year	968,802	-
Forfeited during the year	(33,167)	-
Exercised during the year	-	-
Expired during the year	-	-
Outstanding at the end of the year	935,635	-
Exercisable at 31 December	Nil	-

All LTIPs are exercisable at nil cost to the individual.

13 FINANCIAL INSTRUMENTS

Fair values of financial assets and liabilities

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

	<i>2006</i> <i>£'000</i>	<i>2005</i> <i>£'000</i>
Cash and short term deposits	5,221	3,697
Loan notes	11,656	19,092

14 PROFIT ATTRIBUTABLE TO MEMBERS OF THE PARENT COMPANY

The loss dealt with in the financial statements of the parent company is £1,407,000 (2005: Profit £829,000). No profit and loss account is presented for the Company as permitted by Section 230 of the Companies Act 1985.

15 POST BALANCE SHEET EVENTS

There are no known post balance sheet events requiring disclosure at the date of this report.

<i>Year Ended 31 December:</i>	IFRS 2006 £'000	<i>IFRS 2005 £'000</i>	<i>IFRS 2004 £'000</i>	<i>UK GAAP 2004 £'000</i>	<i>UK GAAP 2003 £'000</i>	<i>UK GAAP 2002 £'000</i>
Turnover (notes 1, 2 and 3)	94,711	78,479	62,690	62,690	64,378	58,002
Growth/(fall) in turnover	<u>21%</u>	<u>25%</u>	<u>(3)%</u>	<u>(3)%</u>	<u>11%</u>	<u>72%</u>
Profit before interest, depreciation, amortisation and tax	14,426	8,838	6,189	6,300	5,676	2,993
Profit/(loss) before interest and tax	10,289	5,764	4,334	359	(648)	(3,339)
Profit/(loss) before tax	9,376	5,217	4,432	457	(804)	(3,518)
Profit/(loss) after tax	<u>6,163</u>	<u>2,859</u>	<u>2,989</u>	<u>(978)</u>	<u>(1,788)</u>	<u>(3,811)</u>
Fixed assets	61,485	66,329	26,293	22,207	26,983	31,859
Net current assets	4,181	1,358	11,453	11,709	8,036	4,456
Total assets less current liabilities	67,984	69,680	39,076	34,426	35,019	36,315
Equity interests	54,506	49,594	38,562	33,912	33,836	35,019
Average number of employees	1,498	1,449	1,270	1,270	1,174	1,105
Earnings/(loss) per share – basic (adjusted for movements in capital) (notes 1, 2, and 3)	9.91p	4.87p	5.42p	(1.77p)	(3.30p)	(7.10p)

Notes:

- (1) 2002 – 11m share placing and open offer and the acquisition of Alpnet Inc.
- (2) 2003 – Acquisition of Lomac SP z.o.o and its subsidiaries.
- (3) 2005 – Acquisition of Trados group and Lingua Franca

NOTICE IS HEREBY GIVEN that the Annual General Meeting of the Company will be held at Globe House, Clivemont Road, Maidenhead, Berkshire, SL6 7DY on 26 April 2007 at 2.00 p.m. for the following purposes:

1. To receive the directors' report and accounts for the financial year ended 31 December 2006 and the auditors' report thereon.
2. To approve the Directors' Remuneration Report for the financial year ended 31 December 2006.
3. To re-elect Mark Lancaster, who is retiring by rotation, as a director.
4. To re-elect John Matthews, who is retiring by rotation, as a director.
5. To re-appoint Ernst & Young LLP as auditors.
6. To authorise the directors to fix the remuneration of the auditors.

As special business to consider and, if thought fit, to pass the following resolutions which will be proposed as special resolutions:

- 7.1 IT IS RESOLVED THAT the directors be generally and unconditionally authorised pursuant to section 80 of the Companies Act 1985 ("Act") to allot any relevant securities (as defined in section 80 (2) of the Act) of the Company up to a maximum aggregate nominal amount of £125,260 provided that:
- I. This authority shall expire at the conclusion of the next annual general meeting of the Company after the passing of this resolution unless previously varied, revoked or renewed by the Company in general meeting; and
 - II. The Company shall be entitled to make, prior to the expiry of such authority, any offer or agreement which would or might require relevant securities to be allotted after the expiry of such authority and the directors may allot any relevant securities pursuant to such offer or agreement as if such authority had not expired; and
 - III. All prior authorities to allot relevant securities be revoked but without prejudice to the allotment of any relevant securities already made or to be made pursuant to such authorities.
- 7.2 IT IS RESOLVED THAT the directors be granted power pursuant to section 95 of the Act to allot equity securities (within the meaning of section 94 of the Act) wholly for cash as if section 89 (1) of the Act did not apply to any such allotment provided that this power shall be limited to:
- I the allotment of equity securities in connection with a rights issue, subject to such exclusions or other arrangements as the directors may deem necessary or expedient to deal with fractional entitlements or legal or practical problems under the laws of, or the requirements of, any regulatory body or any stock exchange or otherwise in any territory; and for the purposes of this resolution "rights issue" means an offer of equity securities to holders of ordinary shares in proportion to their respective holdings (as nearly as may be);
 - II the allotment (otherwise than pursuant to the preceding paragraph) of equity securities up to an aggregate nominal value of £31,237;

and shall expire at the conclusion of the next annual general meeting of the Company or, if earlier, not more than 15 months from the date of the passing of this resolution unless previously varied, revoked or renewed by the Company in general meeting provided that the Company may, before such expiry, make any offer or agreement which would or might require equity securities to be allotted after such expiry and the directors may allot equity securities pursuant to any such offer or agreement as if the power hereby conferred had not expired.

All prior powers granted under section 95 of the Act be revoked provided that such revocation shall not have retrospective effect.

By order of the Board

Alastair Gordon
 Director
 5 March 2007

Registered Office:

Globe House
Clivemont Road
Maidenhead
Berkshire SL6 7DY

Registered No: 2675207

A member entitled to attend and vote at the meeting is entitled to appoint one or more proxies to attend and vote instead of him/her. A proxy need not also be a member of the Company.

Forms of proxy must be deposited at the Company's registrars, Proxy Processing Centre, Telford Road, Bicester, OX26 4LD, not less than 48 hours before the time fixed for the meeting.

Details of proxy votes lodged on all resolutions will be disclosed at the meeting prior to any vote to be taken on a show of hands, or following completion of a validly requested poll.

A statement or summary of transactions of directors (and their family interests) in the share capital of the company and copies of their service contracts will be available for inspection at the Company's registered office during normal business hours on each business day from the date of this notice up to the close of the Annual General Meeting and will be available for inspection at the place of the Annual General Meeting for at least 15 minutes prior to and during the meeting.

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