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Due diligence assistance

DRAFT

August 9, 2011

This report is provided to Hewlett-Packard Company (“HP”) pursuant to our statement of work (“SOW”), dated August 3, 2011 and is subject in all respects to the terms and conditions of that SOW and the related Master Service Agreement as amended on January 13, 2011, including restrictions on disclosure of this report to third parties.

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Any tax advice in this document is limited to the conclusions specifically set forth herein and is based on the completeness and accuracy of the stated facts, assumptions and representations. If any of the facts, assumptions or representations herein is not entirely complete or accurate, it is imperative that we be informed immediately, as the inaccuracy or incompleteness could have a material effect on our conclusions. In rendering our advice, we are relying upon the relevant provisions of the Internal Revenue Code of 1986, as amended, state and local tax statutes, the regulations thereunder, and the judicial and administrative interpretations thereof. These authorities are subject to change, retroactively and/or prospectively and any such changes could affect the validity of our advice. We will not update our advice for subsequent changes or modifications to the law and regulations, or to the judicial and administrative interpretations thereof.

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August 9, 2011

PRIVATE

Meeta Sunderwala
Hewlett–Packard Company
3000 Hanover Street
Palo Alto, CA 94304

Dear Meeta;

We have not yet completed our engagement to assist Hewlett-Packard Company ("Client" or "you") in performing due diligence of Autonomy Corporation plc ("Target") in accordance with the terms of our statement of work dated August 3, 2011 and the related Master Service Agreement as amended on January 13, 2011, including its Standard Terms and Conditions. This report reflects our findings to date based on the data provided in the data room and limited telephone meetings with management and it will be updated as further data and access is provided.

Objective

The objective of our engagement was to assist you with your assessment of the risks and opportunities of your proposed investment in Target. Our work was conducted using an electronic data room and telephone discussions with Target management. The primary scope of our engagement was to obtain, read, make inquiries concerning, and comment on information that you and Target provided to us, directed toward those business activities and related financial data that you identified as important to your investment decision.

Basis of information

The statement of work describes the procedures we were to perform; a summary of those procedures is included as an appendix to this report. Those procedures were selected by you and were limited in nature and extent to those that you determined best fit your needs. We make no representation regarding the sufficiency for your purposes of the procedures you selected, and those procedures will not necessarily disclose all significant matters about Target or reveal errors in the underlying information, instances of fraud, or illegal acts, if any. We have indicated in our report any instances in which procedures you requested could not be performed. This report was prepared by us on the basis that you provided us with all relevant information you received concerning Target. You have agreed to review promptly this draft of our report to confirm that the procedures we performed were consistent with those requested by you, and to advise us on a timely basis of any additional procedures you would like us to perform or areas you would like us to address.

The procedures we performed do not constitute an audit, examination or review in accordance with standards established by the American Institute of Certified Public Accountants ("AICPA"), and we have not otherwise verified the information we obtained or presented in this report. Also, any procedures we performed with respect to Target's internal control over financial reporting were substantially less in scope than an examination of internal control conducted in accordance with Statements on Standards for Attestation Engagements issued by the AICPA. Therefore, we express no opinion or any other form of assurance on the Target's internal control over financial reporting or on the information presented in our report, and make no representations concerning its accuracy or completeness. Furthermore, we have not compiled, examined, or applied other procedures in accordance with Statements on Standards for Attestation Engagements issued by the AICPA to prospective information contained in this document and, accordingly, express no opinion or any other form of assurance or representations concerning the accuracy, completeness or presentation format of such prospective information. There will usually be differences between projected and actual results, because events and circumstances frequently do not occur as expected, and those differences may be material.

Our procedures concentrated on the financial, tax, and customer contract information contained in the electronic data room.

Specific Target officers and management interviewed included: Andrew Kanter, Chief Operating Officer and General Counsel, Sushovan Hussain, Chief Financial Officer and Stephen Chamberlain, Vice President of Finance.

The data included in this report was obtained from you and Target on or before August 9, 2011. Since many aspects of the proposed transaction with Target have either not been finalized or are not yet documented, changes may occur that materially affect the financial and other information we received and reported to you. We have no obligation to update our report or to revise the information contained herein to reflect events and transactions occurring subsequent to August 9, 2011. We have not reviewed a draft of this report with Target management for the purpose of confirming the factual accuracy of the information we presented.

We presented our interim findings to you in various phone conversations throughout the course of our work. Because of its special nature, this report is not suited for any purpose other than to assist you in your evaluation of Target and, as such and as agreed in the SOW, is restricted for your internal use only.

Please contact Andy Gersh at 650-404-3025, Richard Hanley at 650-404-4602 or Rusty Thomas at 650-404-5008 if you have any questions or comments on this report. We look forward to continuing to provide service to Hewlett-Packard Company in the future.

Firm signature to be inserted in Final Report

Glossary of terms

$m	U.S. dollars in millions
AEHL	Target Europe Holdings Ltd. (UK)
ANAH	Target NA Holdings, Inc. (U.S.)
APIC	Additional paid-in capital
ASC	Accounting Standards Codification
ASP	Average selling price
CUP	Comparable uncontrolled price
DSO	Days sales outstanding
DTA	Deferred tax assets
DTL	Deferred tax liabilities
E&Y	Ernst & Young
EBITDA	Earnings before interest, taxes, depreciation, and amortization
EBT	Employee Benefit Trust
EITF	Emerging Issues Task Force
ETR	Effective tax rate
FASB	Financial Accounting Standards Board
FIN	FASB Interpretation
FY	Fiscal year ended December 31, 20XX
G&A	General and administrative
GAAP	Generally accepted accounting principles
GM	Gross margin
H1 201X	6 months ended June 30, 20XX
HMRC	Her majesty's revenue and customs
HP	Hewlett-Packard
IAS	International Accounting Standards
IDOL	Intelligent Data Operating Layer
IFRS	International Financial Reporting Standards
IFRIC	IFRS Interpretations Committee Update
Interwoven	Interwoven, Inc.
IP	Intellectual property
IRC	Internal Revenue Code of 1986, as amended
IRM	Iron Mountain
IRS	Internal Revenue Service
LLC	Limited liability company
LLC 1	Target TS1 LLC
LLC 2	Target TS2 LLC

Glossary of terms

Management	Target's management
MFN	Most favored nation
NIC	National Insurance Contributions
NOL	Net operating loss
OEM	Original equipment manufacturer
OM	Operating margin
PAYE	Pay As You Earn
PCS	Post contract support
PP&E	Property, plant and equipment
PPA	Purchase price accounting
PS	Professional services
PSM	Profit Split Method
PwC	Pricewaterhouse Coopers
Q1'XX	3 months ended March 31, 20XX
Q2'XX	3 months ended June 30, 20XX
Q3'XX	3 months ended September 30, 20XX
Q4'XX	3 months ended December 31, 20XX
R&D	Research & development
ROW	Rest of world
S&M	Sales and marketing
SaaS	Software-as-a-service
SOL	Statute of limitations
Target	The Autonomy Group
TNMM	Transactional net margin method
TP	Transfer pricing
U.K.	United Kingdom
U.S.	United States
U.S. Group	U.S. federal consolidated group with common parent, Autonomy NA Holdings, Inc.
U.K. parent	Autonomy plc (U.K.)
U.K. Plan	U.K. discretionary option scheme 1996
VAR	Value-added reseller
VSOE	Vendor-specific objective evidence
WHT	Withholding tax

Contents

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Executive summary

Executive summary

Headlines

Due diligence process	■ Due diligence comprised telephone discussions with management and access to very limited proprietary financial and tax information. The majority of findings and observations are based on oral representations from management and reading published financial information. ■ This acquisition is under the remit of the U.K. City Code on Takeovers and Mergers (“the Code’). The rules in the Code regarding treatment of bidders frequently results in very limited information being provided prior to a transaction closing. The data and access provided to us during due diligence was very limited but was comparable with other acquisitions involving large U.K. publicly traded companies
Historical revenue growth	■ Target reported organic revenue growth 2009 to 2010 and H1 2010 to H1 2011 of 12% for the consolidated business and 17% for the core IDOL business (excluding services and deferred revenue roll-out) in both periods. This is a decline from organic revenue growth of 16% and14% in total revenue and 22% and 24% for IDOL for the periods 2008 to 2009 and H1 2009 to H1 2010, respectively. Immediate future organic revenue growth should be supported by the contribution from the acquired Iron Mountain business.
Revenue recognition	■ Target recognizes revenue in accordance with IFRS. The majority of Target’s revenue recognition policies appear to be consistent with U.S. GAAP and HP policies. However, there are some policy differences related to extended payment terms, sales to VARs, and potentially fair value analysis. ■ The differences could not be quantified but should only have a short term impact on your GAAP model revenue recognition (i.e. through FY13) as you institute the necessary processes and reporting around contracting to be consistent with your revenue recognition model.
Balance sheet and debts	■ Target has almost $900 million of outstanding debt that will need to be repaid at Closing. There is a make whole provision in the debt and the total debt repayment costs (convertible, bank debt, and accrued interest) may be about $1.35 billion. ■ There is a change in control provision in a soccer sponsorship arrangement which extends the sponsorship arrangement through the 2012/2013 season (minimum of $18 million). There is also a cash payment in January 2012 of $9 million for the 2011/2012 season. Target may have employee change in control obligations but these amounts were not disclosed to us. ■ Target has deferred revenue at June 30, 2011 of $193 million. In acquisition accounting this balance will be fair valued. Our preliminary estimate is that the fair value may be about $60 million. About 95% of the balance will be recognized in FY12. Target has $272 million of committed backlog at June 30, 2011. This backlog will be recognized as revenue over three to five years. Our initial estimate is that an amortizable asset will be recorded in connection with this backlog of about $75 million. The intangible asset will be amortized as an operating expense. The net contribution to operating income is estimated to be about $197 million. ■ The fair value of Target’s investment in Blinkx is currently about $25 million less than the book value ($95 million). ■ Target is currently negotiating a net working capital adjustment in connection with the Iron Mountain acquisition. Target may recover up to $20 million of consideration if it prevails in its claim.
Taxation	■ Target’s management represented that the 2011 effective tax rate is projected to approximate 26%, comprised primarily of a mix of U.S. and U.K. income subject to statutory rates, net of R&D credit benefits in both countries and the benefit of an intercompany financing arrangement. ■ Target’s transfer pricing policy relating to its U.S. acquisitions may be challenged by the IRS. In addition, there may be some other miscellaneous tax exposures. The range of exposures appears to be around $30 million. Any transfer pricing assessments sustained by the IRS could conceivably be mitigated through competent authority proceedings between the U.S. and U.K. tax authorities, as contemplated by the U.S.-U.K. Income Tax Treaty. ■ Target acquired or generated approximately $389 million of U.S. NOLs, of which approximately $76 million were subject to permanent limitation under IRC section 382. Management has represented all available losses were to be utilized by 2011.

Executive summary

Overview

Target is a provider of enterprise search and knowledge management software that allows companies to more efficiently manage and process data.

Target was founded in 1996 and has dual headquarters in Cambridge, United Kingdom and San Francisco, California.

Target has acquired four companies from 2009 through H1'11.

Target
Revenue: FY10: $870m
Operating income: FY10: $316m
Employees: as of July 2011: 2,621

Americas	**Rest of World**
Revenue: FY10 $592m	Revenue: FY10 $278m
Operating income: FY10 $196m	Operating income: FY10 $117m
Headcount as of July 2011: 1,812	Headcount as of July 2011: 809

Products

License	Cloud	OEM	Services	Deferred revenue release
FY10: $252m	FY10: $190m	FY10: $133m	FY10: $41m	FY10: $256m

Markets

- **Power:** Provides infrastructure that enables an organization to manage and process its data, independently of where it is stored or created.
- **Protect:** Allows companies to prepare for changes in regulatory environments have implications across all sectors.
- **Promote:** Enables implementation of a meaning-based marketing solution, as well as leveraging a firm's online business model.

Customers

- **Power:** Samsung, Shell, AT&T, Philips, Nissan, U.S. Department of Homeland Security, McDonalds, Verizon Wireless
- **Protect:** New York Stock Exchange, U.S. Securities and Exchange Commission, Citigroup, Chevron, MGM Grand
- **Promote:** Safeway, Allstate, Symantec, Boeing, Proctor and Gamble, FedEx, NBA, GE, Hilton

Note: Target's presentation of operating income by region excludes $3.5 million of restructuring costs and $6.6 million of FX gains ($3.1 million difference).
Source: Annual reports and unaudited management information

Executive summary

Summary income statements

Target has experienced significant growth in the last three years. The growth is a combination of acquisitions (principally Interwoven) and organic growth.

Management stated that it expects the organic growth rate to remain around 15% for the next few years.

Income statements - reported results

$m	2008	2009	2010	H1 2010	H1 2011
Revenue	503.2	739.7	870.4	415.3	476.0
Cost of revenue	(45.0)	(87.7)	(111.5)	(51.9)	(58.6)
Intangible amortization	(19.5)	(49.7)	(57.3)	(29.4)	(29.1)
Gross profit	438.7	602.3	701.6	334.0	388.3
Research and development	(78.4)	(98.8)	(114.8)	(55.5)	(71.8)
Sales and marketing	(135.2)	(170.8)	(204.1)	(93.5)	(111.3)
General and administrative	(42.6)	(60.6)	(69.4)	(34.5)	(37.4)
Other	4.0	0.1	3.1	(0.4)	(0.2)
Operating income	**186.5**	**272.2**	**316.4**	**150.1**	**167.6**
Net interest income/(expense)	1.4	(5.8)	(32.8)	(13.2)	(20.3)
Other	(2.2)	(0.3)	(1.4)	(0.7)	(0.4)
Tax	(54.0)	(74.5)	(64.9)	(34.2)	(37.8)
Net income	**131.7**	**191.6**	**217.3**	**102.1**	**109.1**

Source: Annual reports, unaudited management information

Target has made a number of acquisitions. A significant portion of the revenue growth is due to acquisition. Management estimates the underlying organic growth to be about 15% to 17% 2008 to 2010.

Target capitalizes R&D expenses in accordance with IAS 38. Post-acquisition, it is likely that the majority of this expense will not qualify for capitalization under U,S, GAAP. The net impact of this policy to operating margins is about 2%.

Income statements - adjusted for intangible amortization

$m	2008	2009	2010	H1 2010	H1 2011
Revenue	503.2	739.7	870.4	415.3	476.0
Cost of revenue	(45.0)	(87.7)	(111.5)	(51.9)	(58.6)
Gross profit	458.2	651.9	758.9	363.4	417.4
Gross margin	*91.1%*	*88.1%*	*87.2%*	*87.5%*	*87.7%*
Research and development	(85.0)	(114.6)	(135.9)	(64.8)	(82.0)
Sales and marketing	(135.2)	(170.8)	(204.1)	(93.5)	(111.3)
General and administrative	(42.6)	(60.6)	(69.4)	(34.5)	(37.4)
Other	5.1	0.9	6.6	0.2	6.0
Operating income	**200.6**	**306.8**	**356.0**	**170.8**	**192.8**
Operating margin	*39.9%*	*41.5%*	*40.9%*	*41.1%*	*40.5%*
Net interest income/(expense)	1.4	(5.8)	(32.8)	(13.2)	(20.3)
Other	(2.2)	(0.3)	(1.4)	(0.7)	(0.4)
Tax	(54.0)	(74.5)	(64.9)	(34.2)	(37.8)
Net income	**145.8**	**226.2**	**256.9**	**122.8**	**134.3**

Source: Annual reports, unaudited management information

Target has maintained a consistent gross margin since 2009. Target expects the gross margin to decline slightly in the future with the growth in the hosting business.

Management stated it integrates its acquisitions very soon after each transaction closes and that it is able to secure synergies and maintain its operating margins.

Summary balance sheets and cash flows

Target has convertible debt and bank debt of about $850 million. There is a make-whole provision in the convertible debt and the repayment cost for all the debt is around $1.35 billion.

Target generates approximately $200 million of free cash flow per year.

Balance sheets

$m	Dec 31, 2009	Dec 31, 2010	Jun 30, 2011
Assets			
Cash and equivalents	242.8	1,060.6	736.2
Accounts receivable	230.2	267.6	299.8
Other current assets	45.7	62.6	74.6
Current assets	518.7	1,390.8	1,110.7
PP&E, net	33.9	42.6	84.9
Investments	16.6	68.6	98.1
Goodwill and other intangibles	1,686.3	1,762.3	2,153.5
Deferred tax assets	24.0	16.3	19.2
Total assets	**2,279.6**	**3,280.5**	**3,466.4**
Liabilities			
Bank debt	197.5	145.2	66.1
Convertible debt	-	681.8	715.7
Accounts payable	14.9	23.4	19.7
Other current liabilities	63.4	60.9	92.8
Taxes payable	43.3	33.2	41.3
Deferred revenue	173.5	177.7	192.8
Deferred taxes	85.1	91.1	104.3
Total liabilities	577.8	1,213.3	1,232.6
Net assets	**1,701.8**	**2,067.2**	**2,233.7**

Source: Annual reports, unaudited management information

The majority (about 90%) of the cash is in the U.K. and is unrestricted. Cash is held at banks with no or limited withdrawal notification periods.

Target has a $25 million bad debt reserve against aged receivables greater than one year. Receivables are reserved on a specific basis.

The majority of investments comprises a 14% interest in a public entity, Blinkx Plc. Management stated there are no restrictions around the disposition of this investment. The remaining investments (about $5 million) comprise investments in two private companies.

The convertible debt is repayable upon a change in control. The repayment includes a make-whole provision plus accrued interest.

The initial estimate of fair value of deferred revenue is about $60 million. The majority (95%) of deferred revenue should be recognized within one year.

Cash flow statement

$m	2009	2010	H1 2011
Cash from operating activities	**245.9**	**293.1**	**156.2**
Capitalized software development costs	(24.7)	(38.6)	(21.2)
Capital expenditure	(34.4)	(59.7)	(24.3)
Free cash flows	**186.8**	**194.8**	**110.7**

Source: Annual reports, unaudited management information

Free cash flow after interest and tax is estimated to be slightly more than $200 million in 2011. About 70% of the cash is generated in the U.S.

Summary of acquisitions

Target stated that it rapidly integrates each acquisition and replaces the acquired companies technology platform with its IDOL technology.

Acquisition history

	Year	Net consideration ($m)	Description of acquired business
Iron Mountain Digital	2011	401	Archiving, eDiscovery and online backup
MicroLink	2010	55	Reseller targeting U.S. state and federal government accounts
CA Information Governance	2010	19	Meaning based governance
Interwoven	2009	630	Content management solutions
Meridio	2007	10	Records management
Zantaz	2007	375	E-mail archiving and e-discovery/compliance provider
Verity	2005	500	Business search and process management software

Source: Annual reports, unaudited management information

Target is negotiating a working capital arrangement with Iron Mountain. Target's claim is about $20 million.

Key findings – 1

Item No.	Status	Brief Description of Issue	Potential Actions	Cost Estimate ($m) Financial Implications	Closure Date & Owner
		Status This report reflects our due diligence assistance findings through August 9, 2011. To date, diligence has comprised telephone question and answer meetings with management and access to very limited internal Target finance and tax information. The limited provision of data is not unusual in acquisitions of U.K. public companies. The lack of information has limited the analysis we could perform and consequently our findings and quantification of potential due diligence issues. We will update our analysis and findings to the extent further information and data is provided.			

Key findings – 2

Item No.	Status	Brief Description of Issue	Potential Actions	Cost Estimate ($m) Financial Implications	Closure Date & Owner
		Revenue recognition Target records revenue in accordance with IFRS. Management represented that this is generally consistent with U.S. GAAP. Based on our limited discussions with management and data provided we believe there may be differences which could impact the historical growth rate and the timing of revenue recognition post-closing. The potential differences identified are: ■ Extended payment terms: Target may recognize revenue even if the payment terms extend beyond one year. Under HP policy, for customers with payment terms in excess of 90 days, revenue is deferred until it is collected. ■ Warranties: Target may be offering non-standard warranty arrangements. Target may not have VSOE of fair value to separate this element. ■ Sell in vs. sell through: Target recognizes revenue for license sales upon sell-in to its VARs rather than on a sell-through basis to end customers. ■ Other undelivered elements: Target's contracts can be extremely complex. In many cases there appear to be undelivered elements, e.g. services, training, products. It is unclear how Target has accounted for these elements and whether it has VSOE of fair value for each element. ■ Multi-year PCS: In limited cases, customers have initial PCS terms that are for three years or more with subsequent renewals detailed in the contract for one year. In these cases, as the aggregate renewal term is less than the initial PCS period, the stated PCS rate may not be considered substantive for purposes of establishing fair value. ■ MFN: Management represented it has provided one customer with MFN terms. Management did not indicate whether these terms were retroactive or prospective. ■ Platform transfer rights: Management indicated that one customer has been provided with platform transfer rights. However, it has not evaluated the impact this may have on revenue recognition for this arrangement. Management represented it has VSOE of fair value for PCS, hosting, and services. There is a risk that post-acquisition, Target's VSOE studies are insufficient for your purposes which could result in some elements being recognized on a ratable basis.	When data becomes available, consider the U.S GAAP differences on historical growth rates and the potential impact on revenue recognition in immediate post-acquisition period. Detailed analysis of Target's revenue recognition policies and VSOE studies post-closing.		

Key findings – 3

<table>
<tr><th>Item No.</th><th>Status</th><th>Brief Description of Issue</th><th></th><th>Potential Actions</th><th>Cost Estimate ($m) Financial Implications</th><th>Closure Date & Owner</th></tr>
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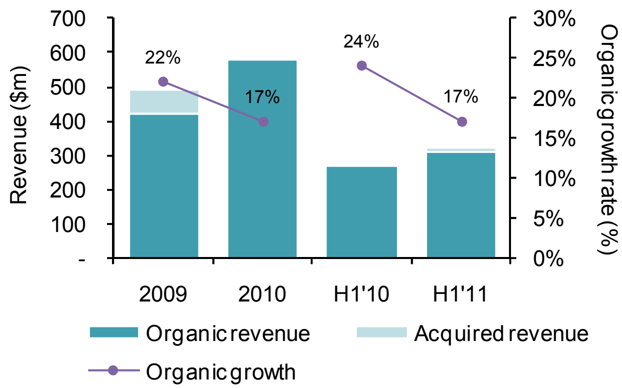
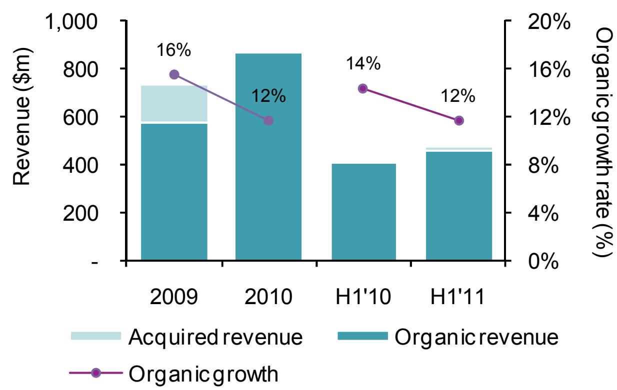
Organic growth rates – core business (IDOL)



Source: Information provided by management

Organic growth rates – overall business



Source: Information provided by management

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- Target's organic growth rate has declined in both its core business and overall business. The recent growth rate for the IDOL business is 17% and for the overall business 12%. The growth rate in H2 2011 and 2012 will benefit from the Iron Mountain acquisition.
- Target includes the results of its acquisitions in its organic growth calculation immediately after acquisition. Target takes this approach since, post-acquisition, it replaces the acquired companies products with Target's core IDOL technology. As such, management represented that it does not track performance by product or class of customer post-acquisition and it is not possible to compare the performance of the acquired companies to the existing business.
- It is possible that the acquired companies has a disproportionate impact on growth rates and that prospectively, Target may need to continue making acquisitions to maintain its growth rate.
- Management stated that growth rates were not impacted by one-time transactions but it was not prepared to provide customer data to validate this statement.

</td><td>Consider the current growth rate and impact of the Iron Mountain acquisition in your financial model.</td><td></td><td></td></tr>
</table>

Key findings – 4

Item No.	Status	Brief Description of Issue	Potential Actions	Cost Estimate ($m) Financial Implications	Closure Date & Owner
		Transactions with HP Target stated that HP is a significant customer. The data provided suggested sales to HP exceeded $10 million in the period 2006 to 2010. Post-acquisition, this revenue will be eliminated in consolidation. Profit is unaffected.			
		Transactions with competitors Target has OEM agreements with various of your competitors (e.g. IBM and Oracle). We have been provided with some of these agreements and we are in the process of reading the terms. The termination rights in these agreements appear to favor the OEM customer. The financial terms of the agreements and revenue associated with each customer are redacted and the loss of one or more of these companies as customers on the results or their ability to compete in the market cannot be quantified.			
		Accounting policy differences We noted potential U.S. GAAP/IFRS accounting differences related to: ■ Acquisition accounting: Target's methodology for valuing intangible assets, particularly deferred revenue is different than under U.S. GAAP. Target does not write-down deferred revenue in purchase accounting but records it at the acquired company's book value. Under U.S. GAAP and HP's accounting policy, deferred revenue is adjusted to fair value in acquisition accounting. This typically results in the book value of the deferred revenue at the date of acquisition being written-down. ■ Capitalization of R&D expenses: Target capitalizes more cost than is permitted under U.S. GAAP. The net impact is $21 million in 2010. ■ Stock compensation expense: Target uses the graded method for valuing stock options. We understand that HP uses the ratable method. The impact on historical results is less than $5 million per year.			

Key findings – 5

Item No.	Status	Brief Description of Issue	Potential Actions	Cost Estimate ($m) Financial Implications	Closure Date & Owner
		Deferred revenue acquisition accounting adjustment			

- Target has $193 million of deferred revenue at June 30, 2011. The balance at closing is estimated to be a similar amount.
- Management did not provide detailed information to support the fair value estimate. As such, we have based the calculation on aggregate data and market comparables.
- The gross margin used in the calculation is 85%. Management did not provide an estimate for the gross margin on PCS and hosting revenue but stated that it may be lower than the aggregate margin of 88%.

Deferred revenue - indicative fair value estimate

$m	June 30, 2011
Deferred revenue	193
Less: deferred license revenue	(5)
Carrying value of deferred revenue	188
Less: Estimated write-down	(127)
Fair value of deferred revenue	**60**
% Write-Down	-66.1%

Source: Information provided by management

Target management's estimate of the portion of deferred revenue related to software licenses that have been delivered.

This comprises both deferred PCS and hosting revenue. Management could not provide an estimate of the margin on each component but stated that it was lower than the aggregate margin. For purposes of this estimate we have assumed an 85% gross margin compared to an aggregate margin of 87%.

Key findings – 6

Item No.	Status	Brief Description of Issue	Potential Actions	Cost Estimate ($m) Financial Implications	Closure Date & Owner
		Commit backlog – indicative fair value estimate ■ Target has $272 million of committed backlog at June 30, 2011 (contracted revenue that has not been delivered and for which cash has not been collected. Under acquisition accounting this intangible asset must be fair valued and amortized as an expense over the period the backlog is recognized as revenue. ■ Management stated that the backlog related to SaaS and hosting sales and would be recognized over three to five years. For purposes of our indicative estimate, we assumed it would be recognized evenly over four years. ■ A significant component of the calculation is the contributory asset charge. Data is required from Target to accurately estimate this charge. We have based our estimate of the charge on comparable software company acquisitions. Depending on the synergy component in your valuation, the contributory asset charge could increase which would reduce the value of your backlog intangible asset.			

Indicative estimate of commit backlog intangible asset

$m	**30-Jun-11**
Reported commit	465
Less deferred revenue	(193)
Backlog	**272**
Estimated intangible asset	**75**

Source: Information provided by management

This intangible asset is recorded on the balance sheet in acquisition accounting and is amortized to expense over the period the backlog is recognized. This is a preliminary estimate and will change once Target provides additional data.

Key findings – 7

Item No.	Status	Brief Description of Issue	Potential Actions	Cost Estimate ($m) Financial Implications	Closure Date & Owner
		Commitments and contingencies ■ Management has identified the following non-customer commitments and contingencies. Where possible, we have tried to estimate the potential amounts: – Tottenham Hotspur soccer sponsorship: Management stated that there is a change in control clause in its soccer sponsorship arrangement with Tottenham Hotspur soccer team. A change in control extends the sponsorship arrangement through the 2012/2013 U.K. soccer season. The minimum cost of extending the arrangement appears to be $18 million. We were not provided with the complete agreement and it is possible the cost could increase depending on the success of the soccer team in international competitions. – Management would not disclose employee bonus, incentive compensation, or other payments that may arise upon a change in control. – Target has a number of outstanding legal cases. Management estimated that the cost for employee litigation may be up to $3 million and commercial litigation around $2.5 million. Management has three outstanding patent litigation claims but it did not quantify the potential exposure for these cases. – Management stated it makes no royalty payments for third party software embedded in its technology. – Based on the 2010 financial statements, Target may have operating lease commitments of approximately $60 million. The leases appear to extend through at least 2018. – Management stated its purchase commitments for IT contracts, trade shows, marketing, and other sponsorship arrangements is minimal. – Target has submitted a claim for a net working capital adjustment arising from the Iron Mountain acquisition. The amount of the claim may be up to $20 million.			

Key findings – 8

Item No.	Status	Brief Description of Issue	Potential Actions	Cost Estimate ($m) Financial Implications	Closure Date & Owner
		Tax due diligence The scope of the diligence performed was severely limited by the inadequate access to information and personnel. Our scope was therefore limited only to publicly available documents and the limited information posted in the data room. The data room information was limited to summaries of TP studies, summary IRC section 382 study reviews by a third party and U.S. and U.K. tax opinions on a specific implemented tax structure. During the course of our diligence, we did not speak to Target's external tax advisors. While numerous requests to speak with the tax advisors were made, as of the date of this report, all requests were denied. Additionally, because we were provided a limited amount of tax information and documentation, we were unable to investigate other tax matters such as state, local, VAT, etc. We recommend that these areas be investigated as part of the next phase of diligence.			
		Recommended next steps In the next phase of diligence we recommend: ■ A call with the U.S. Group tax advisors regarding the current tax profile of the U.S. Group, including audit history, status and any results from the closing of any audits. ■ A call with the U.K. tax advisors regarding the current tax profile of the U.K., including audit history, status, and results of closing audits. ■ Analysis of U.S. and U.K. entity attributes including R&D tax credits and NOLs. ■ Analysis of the PwC IRC section 382 limitation studies to validate the outcomes of the revised studies based on PwC assumptions. ■ Analysis of the tax provision, ETR, and DTA/DTL balances. ■ Analysis of employee taxes, property taxes, unclaimed property, VAT, state and local tax liabilities such as state income, franchise, gross receipts, sales and use tax, etc.			

Key findings – 9

Item No.	Status	Brief Description of Issue	Potential Actions	Cost Estimate ($m) Financial Implications	Closure Date & Owner
		U.S. taxation –U.S. transfer pricing Based on limited information and corresponding assumptions, as of the drafting of this report, we estimate the U.S. transfer pricing tax liability exposure is approximately $30 million including interest and penalties. The potential exposure could be largely mitigated through competent authority proceedings between the I.R.S. and U.K. tax authorities. If such proceedings were successful, then Target's reserve of approximately $7 million for transfer pricing appears reasonable. However, please note, there is always uncertainty regarding a successful competent authority outcome and as such, the uncertainty should be considered in assessing the associated risk.			
		U.K. taxation – ETR The Target's ETR is expected to generally align to the mix of U.K. and U.S. income subject to respective statutory rates. Target has benefitted from a financing structure and R&D tax credits but the associated tax benefit to Target is partially mitigated by the high tax rates in the U.S. While the majority of the Target's sales are invoiced by the U.S. Group, the transfer pricing strategy shifts the majority of profits to the U.K. by reason of the primary IP ownership residing in the U.K. In contrast the Target's ETR for the year ended December 31, 2010 was 23%, which is significantly below the U.K. statutory rate of 28%. This was predominantly due to the utilization of previously unrecognized NOLs (tax effect $(25.5 million)). Management forecast an ETR of approximately 26% for FY11, which is in line with the reduced U.K. statutory rate.			

Supporting analysis – accounting and finance

Supporting analysis

Income statements

Presented are Target's IFRS results. See the next page for a description of potential adjustments you could consider in your cash flow and U.S. GAAP model.

Income statements - IFRS results

$m	2008	2009	2010	H1 2010	H1 2011
Revenue	503.2	739.7	870.4	415.3	476.0
Cost of revenue	(45.0)	(87.7)	(111.5)	(51.9)	(58.6)
Intangible amortization	(19.5)	(49.7)	(57.3)	(29.4)	(29.1)
Gross profit	438.7	602.3	701.6	334.0	388.3
Research and development	(78.4)	(98.8)	(114.8)	(55.5)	(71.8)
Sales and marketing	(135.2)	(170.8)	(204.1)	(93.5)	(111.3)
General and administrative	(42.6)	(60.6)	(69.4)	(34.5)	(37.4)
Other	4.0	0.1	3.1	(0.4)	(0.2)
Operating income	**186.5**	**272.2**	**316.4**	**150.1**	**167.6**
Net interest income/(expense)	1.4	(5.8)	(32.8)	(13.2)	(20.3)
Other	(2.2)	(0.3)	(1.4)	(0.7)	(0.4)
Tax	(54.0)	(74.5)	(64.9)	(34.2)	(37.8)
Net income	**131.7**	**191.6**	**217.3**	**102.1**	**109.1**

Source: Annual reports, unaudited management information

Quality of earnings

Presented are potential quality of earnings adjustments that you could consider in your valuation model.

We have included the capitalized R&D expense and reversed the amortization expense since under U.S. GAAP it is unlikely that much, if any, of these costs could be capitalized.

Quality of earnings

$m	2008	2009	2010	H1 2010	H1 2011
Net income	131.7	191.6	217.3	102.1	109.1
Tax	54.0	74.5	64.9	34.2	37.8
Net interest (income)/expense	(1.4)	5.8	32.8	13.2	20.3
Loss from associates	2.2	0.3	1.8	0.7	0.4
Profit on disposal of investment	-	-	(0.4)	-	-
Depreciation	14.1	16.2	14.0		
Amortization	24.3	64.9	85.6	53.1	54.9
Capitalized R&D expenses	(11.2)	(24.7)	(38.5)	(16.3)	(21.2)
EBITDA	**213.7**	**328.5**	**377.5**	**186.9**	**201.3**
Other potential items for consideration					
Stock compensation	5.5	7.2	6.0	2.8	4.6
Restructuring expenses	1.2	0.8	3.5	0.6	6.3
	220.4	**336.6**	**386.9**	**190.2**	**212.2**

Source: Annual reports, unaudited management information

This QofE analysis includes potential adjustments identified during field work and unusual or non-recurring items. These potential adjustments to EBITDA are not deemed to be all-inclusive and are based on information provided by Management. Further analysis could uncover additional adjustments to EBITDA.

Revenue recognition – delivery models (1)

Target has a variety of revenue arrangements including license, PS, PCS, and hosting. In some case the PS component may be significant and potentially contract accounting could apply. Management stated it has fair value for its PCS, PS, and hosting arrangements and that it is able to separate these elements for revenue recognition purposes. Based on the contracts we read there appear to be multiple variations on the products being offered and there is a risk that under U.S. GAAP Target does not have VSOE of fair value for each element. If this is the case then in some arrangements revenue may have to be deferred until PCS is the remaining undelivered element or recognized under the subscription method.

Delivery models - background

- Target segregated its business into three markets (Power, Protect and Promote). As the products within each market operate from the same software platform (IDOL), Target "virtually" brands and markets the same technology across several vertical markets with the same delivery models across each market .
- For delivery models that include PCS and PS, management represented that it has VSOE of fair value for these elements regardless of sales channel or delivery model.
  - For PCS, management stated it establishes VSOE based on stand-alone renewals using the bell-shaped-curve method. Arrangements with PCS priced at rates below fair value are allocated arrangement consideration to the low end of the fair value range.
  - For PS, management represented that it establishes VSOE based on stated rates in its contracts and that it rarely sells PS on a stand-alone basis. In addition, third party partners such as VARs and resellers can perform these services.

Delivery models

- *On-premise and Appliance:* Target sells its software as a license, which is installed on-premise and runs on hardware owned by its customers. These arrangements include first year PCS and can also include PS (training, implementation or installation and consulting) as well as hardware.
  - Target primarily sells perpetual software licenses for its on-premise solutions However, it has also sold term licenses. Target recognizes license revenue upon delivery of the software.
  - PCS revenue is recognized ratably over the term, which is usually one year but Target has sold multi-year PCS to customers.
  - PS revenue is recognized as services are delivered or when complete depending on whether the arrangement is time and materials or fixed fee.
  - In limited situations, Target will ship its software pre-installed on hardware to its customers. Target recognizes revenue for the hardware in conjunction with the software license, when it is delivered.
- *Hosted :* Target sells its software as a hosted service that can be accessed via the internet and is installed on Target's servers that are dedicated to the specific customer (i.e., single tenant). These arrangements are comprised of a license to use the software via the internet (usage based, pay as you go) over a specific term (usually three to five years). Some customers also have the option to take possession of the software, converting the arrangement into an on-premise solution.
  - These arrangements are priced based on usage (i.e., amount of data, number of searches, number of log-ins, etc.) and will usually include a minimum usage amount. Revenue for these arrangements are recognized on a monthly basis, when invoiced.
  - See the on-premise discussion regarding when the customer has taken possession of the license and the arrangement includes a license fee and PCS.

Revenue recognition – delivery models (2)

Delivery models (continued)

- *Cloud (SaaS):* Target sells its software using the SaaS model, where the product can be accessed via the internet and the data is stored and potentially co-mingled with other customers on Target's servers (i.e., multi-tenant). These arrangements are comprised of a license to use the service via the internet (usage based, pay as you go) over a specific term (usually three to five years). In these cases, the customer does not have the option to take possession of the software license.
  - These arrangements are priced based on usage (i.e., amount of data, number of searches, number of log-ins, etc.) and will usually include a minimum usage amount. Revenue for these arrangements are recognized on a monthly basis, when invoiced.
  - Management indicated that it also charges set-up fees, which it recognizes once customer set-up has been completed. Set-up can include data migration and other tasks in order to bring a customer on-line.
- *OEM:* Target licenses its technology to third parties that embed it into their software. These arrangements are comprised of an upfront licensing fee, PCS and royalties that are paid on a quarterly basis and reported one quarter in arrears. Target recognizes the license fee upfront, PCS over the service term and royalties one quarter in arrears, as reports are received.

Revenue recognition – U.S. GAAP considerations

There is a risk that Target's revenue recognition may differ from U.S. GAAP and HP's policies. At this stage, no data has been provided to validate there are differences and to quantify the differences, if any.

Management represented it establishes VSOE of fair value for PCS on its product sales based on renewal rates for existing customers using the bell-shaped-curve approach. Management performs the analysis on a quarterly basis and it is evaluated annually using the last four quarters of data.

- Management did not provide us with the basis of preparation of its VSOE studies using this approach (i.e., using the median, average or a stated rate as the midpoint for the analysis or what was its acceptable range of deviation from the midpoint).
- Target segments renewals between its two regions (i.e., U.S. and rest of world) and that the midpoint is 15% of license for the U.S. and 18% of license for rest of world. However, it does not segment its population of renewals by sales channel, product or service level.
- Management indicated that it limits the population of renewals included in the analysis to those greater than $100,000 and renewals fall within the range from the midpoint over 90% of the time.
- Management's calculation of fair value may be different from HP's policy. Accordingly, there is a risk that post-acquisition, Target's VSOE studies for PCS would be insufficient for your purposes, which could result in some arrangements being recognized on a ratable basis.
- We understand that your auditors may provide a grace-period post acquisition to allow your revenue recognition team time to perform a more rigorous analysis using the industry accepted calculation methodology (i.e., establishing the median as the midpoint, using the industry standard deviation range of ±15% of the median and further segmentation of the population).

Based on our limited discussions with management and data provided we believe there may be other differences which could impact the historical growth rate and the timing of revenue recognition immediately post-closing. The potential differences identified are:

- *Extended payment terms:* Target may recognize revenue for certain arrangements even if the payment terms extend beyond one year. We understand that you will generally defer revenue related to arrangements with payment terms that extend beyond 90 days.
- *Sell in vs. sell through:* Target recognizes revenue for license sales upon sell-in to its VARs rather than on a sell-through basis to end customers.
- *Other undelivered elements:* Management does not prepare a VSOE analysis for the other undelivered elements in its arrangements, which include hosting, PCS for hosted arrangements and PS. Rather, management bases fair value for PCS using the fair value rates set for its software licenses. Fair value for PS and hosting is based on stated rates in its contracts (per day for PS and by volume or transaction for hosting), which management indicated was priced within a fairly close range.
- *Multi-year PCS:* In limited cases, customers have initial PCS terms that are for three years or more with subsequent renewals detailed in the contract for one year. In these cases, as the aggregate renewal term is less than the initial PCS period, the stated PCS rate may not be considered substantive for purposes of establishing fair value.
- *MFN:* Management represented it has provided one customer with MFN terms. Management did not indicate whether these terms were retroactive or prospective.
- *Platform transfer rights:* Management indicated that one customer has been provided with platform transfer rights. However, it has not evaluated the impact this may have on revenue recognition for this arrangement.

Supporting analysis

Organic growth rates

We have presented management's basis for its organic revenue growth calculation. We do not have some of the minor changes associated with foreign exchange; however, the impact does not change the calculated organic growth rates.

Management stated that it immediately integrates acquisitions into its existing business and that it is not possible to track the organic growth of its products post-acquisition. We have not been provided with revenue by product to validate this statement.

Additionally, we have not been provided with customer data to determine if the organic growth is due to a class of customer or may be more one-time in nature (e.g. revenue from BP).

Organic growth rate - overall business

$m	2009	2010	H1'10	H1'11
Reported revenue	740	870	415	476
Foreign exchange	-	4	-	(2)
Acquired revenue	(158)	(8)	(3)	(11)
Organic revenue	**581**	**866**	**412**	**464**
Prior period adjustment	-	36	36	-
Organic growth	*16%*	*12%*	*14%*	*12%*

Source: Information provided by management

Organic growth rate - core business

$m	2009	2010	H1'10	H1'11
Reported revenue	490	574	267	324
Foreign exchange	-	4	-	(2)
Acquired revenue	(68)	-	-	(10)
Organic revenue	**422**	**578**	**267**	**313**
Prior period adjustment	-	4	4	-
Organic growth	*22%*	*17%*	*24%*	*17%*

Source: Information provided by management

The tables above presents management's calculation of its organic growth rates. The calculation of these growth figures are based on the organic revenue less the total revenue from the prior period (which includes other adjustments depending on the timing of an acquisition). Details of these adjustments include:

2009

- Management's calculation of its organic growth rate excludes revenue attributed to the Interwoven acquisition. For the overall business, this is all of Interwoven's pre-acquisition revenue (license, PCS and services). For Target's core business, it only includes Interwoven's license sales.

2010 and H1'10

- Target acquired MicroLink and CA's Information Governance division in Q1 and Q2 2010, respectively. Management represented that neither of these acquisitions generated IDOL product sales (services and deferred revenue only). Management adjusted sales related to services ($8 million and $3 million in 2010 and H1'10, respectively) for these acquisitions.
- Management recorded an adjustment to the 2009 base results in order to add back Interwoven revenue for the pre-acquisition stub period from January 1, 2009 to March 16, 2009 ($36 million for the overall business and $4 million for Target's core business).

H1'11

- This adjustment pertains to the Iron Mountain Digital assets acquisition, which contributed approximately $9.6 million of revenue during the period as well as a foreign exchange loss of $1.6 million. As Iron Mountain Digital sales are largely SaaS related, the adjustment was applicable to both the overall business as well as the core IDOL business.
  - The overall business also includes a $1 million adjustment related to deferred revenue releases related to the CA acquisition.

Revenue

Cloud revenue is growing at a significantly faster rate than the historical license business.

It appears that many customers are purchasing licenses with a hosting arrangement, although, the fee for the license component may be decreasing.

Revenue by category

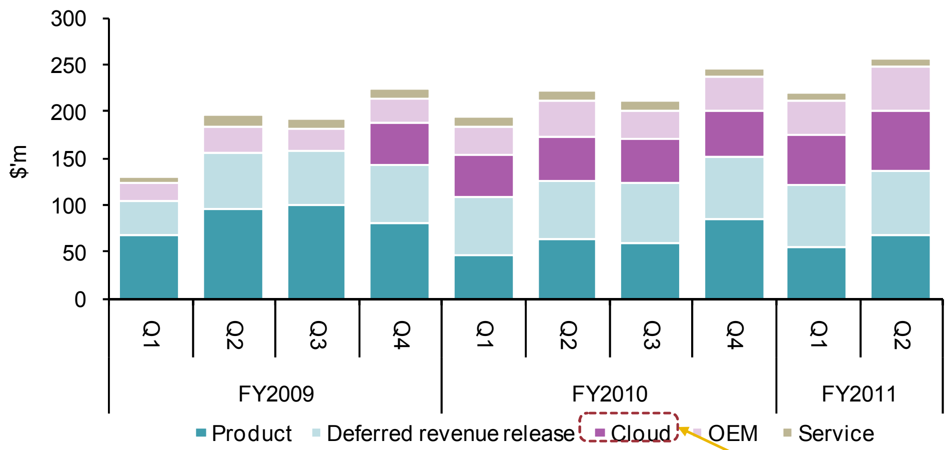
$m	2009	2010	H1 2010	H1 2011
Product	390	252	109	123
Deferred revenue release	214	256	126	134
Cloud	-	190	92	117
OEM	100	133	67	84
Service	36	40	22	18
Total	**740**	**870**	**415**	**476**

Source: Annual reports, unaudited management information

Cloud revenue is growing at 25% compared to the prior period. This is a significantly faster rate than the deferred revenue release, reflecting with switch away from the perpetual license model with associated PCS revenue.

We have not been provided with the composition of deferred revenue to assess the renewal/attach rate. Management represented that it is in the 90% range.

Revenue by type



Source: Annual reports, unaudited management information

Target did not identify cloud revenue prior to Q4 2009.

Expenses

Cost of goods sold as a percentage of revenue has increased over the period reflecting a shift in revenue mix to hosting.

Operating expenses as a percentage of revenue have been approximately flat after taking into account the Interwoven acquisition.

We have no information regarding the composition of expenses. Management stated that it was not aware of any significant one-time items that need to be considered in evaluating revenue and expense trends.

Expenses

$m	2008	2009	2010	H1 2010	H1 2011
Cost of good sold	**45.0**	**87.7**	**111.5**	**51.9**	**58.6**
% of revenue	*8.9%*	*11.9%*	*12.8%*	*12.5%*	*12.3%*
Research and development					
Reported expense	78.4	98.8	114.8	55.5	71.8
Less amortization	(4.6)	(8.9)	(17.4)	(7.0)	(11.0)
Add amounts capitalized	11.2	24.7	38.5	16.3	21.2
Net expense	**85.0**	**114.6**	**135.9**	**64.8**	**82.0**
% of revenue	*16.9%*	*15.5%*	*15.6%*	*15.6%*	*17.2%*
Sales and marketing	**135.2**	**170.8**	**204.1**	**93.5**	**111.3**
% of revenue	*26.9%*	*23.1%*	*23.5%*	*22.5%*	*23.4%*
General and administrative	**42.6**	**60.6**	**69.4**	**34.5**	**37.4**
% of revenue	*8.5%*	*8.2%*	*8.0%*	*8.3%*	*7.9%*

Target capitalizes certain research and development costs under IAS 38. Under U.S. GAAP the majority of these costs would not qualify for capitalization and would be expensed as incurred.

Supporting analysis

Summary balance sheet

See following slides for a description of balance sheet components.

Balance sheets

$'m	Dec 31, 2009	Dec 31, 2010	Jun 30, 2011
Assets			
Cash and equivalents	242.8	1,060.6	736.2
Accounts receivable	230.2	267.6	299.8
Other receivables	45.7	62.6	74.6
Current assets	518.7	1,390.8	1,110.7
Property, plant, and equipment	33.9	42.6	84.9
Long-term investments	16.6	68.6	98.1
Goodwill and other intangibles	1,686.3	1,762.3	2,153.5
Deferred tax assets	24.0	16.3	19.2
Total assets	**2,279.6**	**3,280.5**	**3,466.4**
Liabilities and equity			
Current debt	52.4	78.7	66.1
Accounts payable	14.9	23.4	19.7
Other current liabilities	57.2	53.6	77.8
Taxes payable	43.3	33.2	41.3
Deferred revenue, current	164.9	170.3	186.6
Current liabilities	332.8	359.3	391.4
Long-term debt	145.2	748.2	715.7
Deferred revenue, non-current	8.6	7.4	6.2
Deferred taxes	85.1	91.1	104.3
Other non-current liabilities	6.1	7.3	15.1
Total liabilities	577.8	1,213.3	1,232.6
Shareholders' equity	1,701.8	2,067.2	2,233.7
Total liabilities and equity	**2,279.6**	**3,280.5**	**3,466.4**

Source: Unaudited management information

Other receivables comprise deposits for real estate leases and prepayments. No further detail of this balance is available.

Investments mainly comprise Blinkx (95%) of the asset. Blinkx share price has declined since the balance sheet date and the fair value of this asset is now approximately $70 million rather than $95 million.

Current debt is a term loan from Barclays and is repayable at Closing.

Long-term debt at June 30, 2011 comprises the convertible debt. The expected cost of repayment including accrued interest and the make-whole components is about $1.35 billion.

Supporting analysis

Accounts receivable

Target's DSOs are in the range of 90 to 100 days (after adjustment for the impact of Iron Mountain).

Target stated its bad debt write-off is typically less than 1% of its receivable balance.

At December 31, 2010 $5 million of receivables were due after one year.

Approximately 5% of accounts receivable are unbilled. Management did not specify the reasons why the receivables were unbilled and whether this represented milestone or extended payment terms with a potential revenue recognition impact.

Accounts receivable

$m	Dec 31, 2009	Dec 31, 2010	Jun 30, 2011
Gross accounts receivable	251.6	293.6	
Bad debt reserve	(21.4)	(26.0)	
	230.2	**267.6**	**299.8**

The bad debt reserve is computed on a specific invoice by invoice basis. The reserve covers invoices that could be significantly more than one year old. Management's policy is to keep the receivables and reserve in its general ledger unless there is no realistic opportunity to collect the debt.

There is a difference in revenue recognition policy between Target and HP around payment terms. Under HP policy, for customers with payment terms in excess of 90 days, revenue is deferred until it is collected. This will result in less revenue being recognized than under Target's policies; however, we do not have sufficient data to determine the impact on an annual or quarterly basis.

Current liabilities

Target has not provided details of its accrued expenses and provisions beyond the data contained in the financial statements.

Management represented that it had no provisions or reserves for unprofitable customer contracts or other long-term non-lease contracts.

Liabilities

$m	Dec 31, 2009	Dec 31, 2010	Jun 30, 2011
Accrued expenses and other current liabilities	54.5	52.0	67.6
Acquisition and other provisions	7.9	5.3	22.0
	62.4	**57.2**	**89.5**

Source: Annual reports, unaudited management information

The provision prior to June 30, 2011 related to onerous lease obligations. The $17 million increase in provisions at June 30, 2011 relates to the Iron Mountain acquisition. The increase represents provisions for onerous leases and patent litigation.

Deferred revenue

Presented is the calculation to estimate the fair value of deferred revenue. We were not provided with the estimated roll-out of deferred revenue. As such, we assumed that for deferred revenue recognized within one year the roll-out is 35%, 28%, 22%, and 15% for each of the first four quarters. We assumed that deferred revenue greater than one year is recognized in the fifth quarter after closing.

This estimate was based on consolidated data. Once Target provides detailed fulfillment cost information we will be able to provide a more detailed analysis.

Valuation of deferred revenue

$'000		Q4 FY2011 31-Oct-11	Q1 FY2012 31-Jan-12	Q2 FY2012 30-Apr-12	Q3 FY2012 31-Jul-12	Q4 2012 31-Oct-12
Deferred revenue		63,543	50,834	39,941	27,233	6,211
Cost of sales	15.0%	9,531	7,625	5,991	4,085	932
Profit mark-up @	10.0%	953	763	599	408	93
		10,485	8,388	6,590	4,493	1,025
R&D Expense	10.0%	6,354	5,083	3,994	2,723	621
Profit mark-up @	10.0%	635	508	399	272	62
		6,990	5,592	4,394	2,996	683
G&A Expense	5.0%	3,177	2,542	1,997	1,362	311
Profit mark-up @	10.0%	318	254	200	136	31
		3,495	2,796	2,197	1,498	342
Total cost obligation and mark-up		20,969	16,775	13,181	8,987	2,050
Discount factor						
Discount period		0.1260	0.3771	0.6271	0.8771	1.1271
Present value factor @	6.21%	0.9924	0.9775	0.9629	0.9485	0.9344
Present value		**20,810**	**16,398**	**12,692**	**8,524**	**1,915**
Fair value		**60,340**				

Source: Information provided by management

Notes:

1) Cost of fulfilling deferred revenue is based on an analysis of historical and projected cost margins. Deferred revenue primarily relates to maintenance support for technology and hosting. Service costs include customer service personnel costs and costs related to technical phone support. Management, stated the cost margin should be representative of future cost to fulfill deferred service revenue obligations.

2) The profit mark-up is based on comparable public companies.

3) R&D expenses was based on analysis of historical and projected maintenance R&D fulfillment costs. Maintenance R&D activities includes bug fixes, escalation of cases and technology updates.

4) G&A expenses was based on an analysis of historical and projected G&A margins

5) The discount factor is based on the yield of Moody's Baa / S&P BBB corporate bonds as of August 3, 2011.

Supporting analysis

Commit backlog

Presented is the calculation to estimate the intangible asset associated with the commit backlog asset. We were not provided with the estimated roll-out the commit backlog. As such, we assumed that it is recognized over four years in the following proportion - 35%, 28%, 22%, and 15%.

This estimate was based on consolidated data. Once Target provides detailed fulfillment cost information we will be able to provide a more detailed analysis.

Indicative estimate of commit backlog intangible asset

$m		Year 1	Year 2	Year 3	Year 4
Revenue		95.3	76.2	59.9	40.8
Cost of sales	15%	14.3	11.4	9.0	6.1
Research and development	13%	12.4	9.9	7.8	5.3
General and administrative	5%	4.8	3.8	3.0	2.0
Depreciation	1%	1.0	0.8	0.6	0.4
Operating income		62.9	50.3	39.5	27.0
Taxes	28%	17.6	14.1	11.1	7.5
Profit after tax		45.3	36.2	28.5	19.4
Contributory asset charge	20%	19.1	15.2	12.0	8.2
Excess earnings		26.2	21.0	16.5	11.2
Discount factor	10%	0.953	0.867	0.788	0.716
Present value		**25.0**	**18.2**	**13.0**	**8.1**
Sum of present value		64.2			
Tax amortization benefit		11.2			
Fair value of intangible backlog asset		**75.5**			

Source: Information provided by management

Notes:

1) Assumed mid-period cash flow receipt.

2) Calculated using an income tax rate of 25.0% and based on the U.S. tax amortization benefit factor.

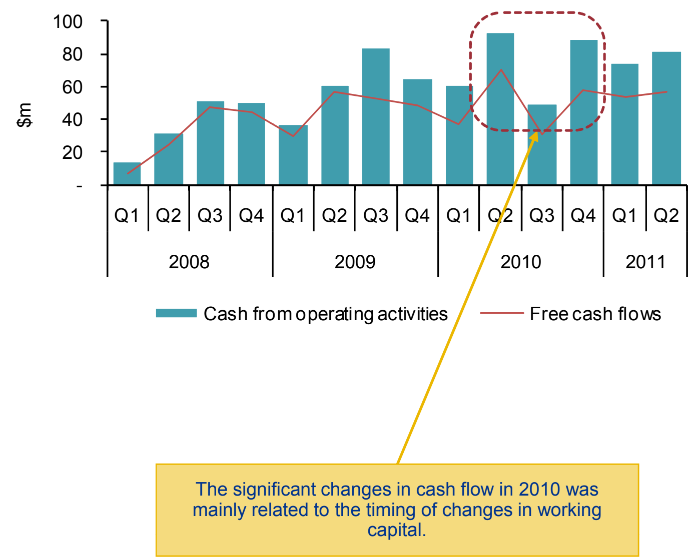
Supporting analysis
Summary cash flow

Target generates approximately $250 million of operating cash flow after capitalized R&D costs and around $200 million of free cash flow.

Cash flow statement

$m	2009	2010	H1 2011
Operating activities			
Net income	191.6	217.3	109.1
Depreciation	37.2	38.8	25.8
Amortization of goodwill and intangibles	35.0	43.5	29.1
Capitalized software amortization	8.9	17.4	-
Asset writedown & restructuring costs	0.8	0.7	-
Stock-based compensation	7.2	6.0	4.6
Non-cash changes in tax and interest	43.2	31.7	25.0
Interest income	1.1	7.8	5.9
Interest expense	(5.3)	(17.1)	(14.9)
Changes in working capital			
Accounts receivable	(78.3)	(60.9)	(3.6)
Inventory	0.2	0.3	0.0
Accounts payable	4.3	7.8	(24.9)
Cash from operating activities	**245.9**	**293.1**	**156.2**
Capitalized software development costs	(24.7)	(38.6)	(21.2)
Capital expenditure	(34.4)	(59.7)	(24.3)
Free cash flows	**186.8**	**194.8**	**110.7**
Cash acquisitions	(630.1)	(79.6)	(401.6)
Investments in associates	(6.5)	(10.2)	-
Change in net debt	158.7	707.9	(79.6)
Issuance of common stock	333.2	18.7	10.1
Foreign exchange differences	1.5	(14.2)	36.1
Net change in cash	**43.6**	**817.5**	**(324.3)**

Quarterly cash flows



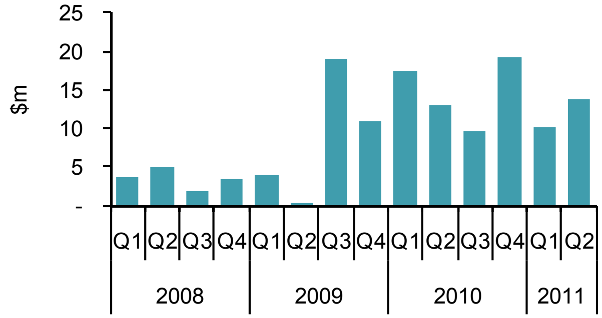
Supporting analysis

Capital expenditure

Capital expenditure was $60 million in 2010 as Target built out its hosting and data storage business. Capital expenditure is forecast to be about $55 million in 2011. The majority of the expense is related to further expansion of the hosting business including investments for some specific customer contracts.

Capital expenditure represents a combination of both hardware and software. Management stated it makes relatively few purchases from HP.

Capital expenditure



Source: Annual reports, unaudited management information

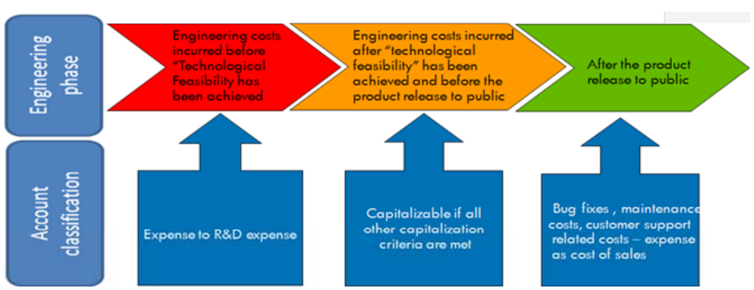
IFRS and U.S. GAAP differences – 1

<table>
<tr><th>Issue</th><th>Description</th><th>Potential Implications</th></tr>
<tr>
<td>Capitalized research and development – software

U.S. GAAP: ASC 985-20

IFRS: IAS 38</td>
<td>

- Target recognizes an internally-generated intangible asset arising from product development if all of the following conditions are met:
  - an asset is created that can be identified (such as software and new processes);
  - it is probable that the asset created will generate future economic benefits;
  - the development cost of the asset can be measured reliably; and
  - the product from which the asset arises meets the group's criteria for technical feasibility.
- Target amortizes internally-generated intangible on a straight-line basis over the three year useful life.
- Prior to converting to IFRS in 2005, Target previously recognized U.S. GAAP internally generated intangibles under legacy FAS 86 (now ASC 985-20: Accounting for the Costs of Computer Software to Be Sold, Leased, or Otherwise Marketed).
  - Note: Target's policy under U.S. GAAP included general overheads, which are not allowed under IFRS; FAS 86 left the capitalization of these costs up to professional judgment.
- HP typically expenses software development as R&D expense. However, HP has a policy for capitalizing certain software development costs under limited situations (AFM Topic 6345-Software For Resale).
  - Costs must be incurred after "technological feasibility" and before the software is ready for general release (generally a very short period of time – refer to visual below).
  - Target's internally-generated intangible asset might not qualify for capitalization under HP's U.S. GAAP policy - this would require detailed technology reviews to ensure compliance with HP's detailed criteria.



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- **EBITDA impact:** potentially up to a $21 million impact in 2010.

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IFRS and U.S. GAAP differences – 2

Issue	Description	Potential Implications
Share-based payments U.S. GAAP: ASC 718 IFRS: IFRS 2	**Awards vesting:** ▪ Under U.S. GAAP, awards vesting in difference tranches (graded vesting) may be accounted for as separate share-based payment arrangements, or ratably over the longest vesting tranche if the award vests based on service only. Our experience suggests that HP chooses to utilize the ratable method. Target has confirmed that it applies graded vesting, which is required under IFRS. Target essentially accounts for award tranches as separate share-based payment arrangements. **Deferred taxes:** ▪ IFRS also requires deferred taxes related to share-based payments to be remeasured based on the tax deduction attributable to the stock option price (intrinsic value) at the end of each reporting period. ▪ Based on price fluctuations, there could be a change in deferred tax asset and expense as well as potential APIC movements. There is also no "APIC pool" or "mezzanine equity" concept under IFRS.	▪ **EBITDA impact:** Timing and amount of compensation recognized over the term of the plan may differ under U.S. GAAP. IFRS typically shows more volatility in the P&L and balance sheet for share-based payments.
Deferred taxes U.S. GAAP: ASC 740 IFRS: IAS 12	**Tax measurement:** ▪ Deferred tax is measured based on rates and tax laws that are enacted or substantively enacted at the reporting date. ▪ There is no specific IFRS guidance (similar to U.S. GAAP / legacy FIN 48) on the recognition of deferred tax liabilities in respect of income tax exposures and on the classification of interest and penalties related to income tax exposures.	▪ **EBITDA impact:** Potential for additional deferred tax liabilities under U.S. GAAP. ▪ Target might apply different measurement of deferred tax assets and liabilities, in either direction.

Supporting analysis

IFRS and U.S. GAAP differences – 3

Issue	Description	Potential Implications
Other IFRS considerations Provisions U.S. GAAP: ASC 450, ASC 715, IFRS: IAS 37, IFRIC 1, IFRIC 5, IFRIC 6	**Provisions (liabilities):** ■ Under IFRS, "probable" is defined as "more likely than not", generally interpreted as more than 50%. Under U.S. GAAP, "probable" is defined as "likely to occur", generally interpreted as 70% to 75%, which is a higher threshold than the IFRS approach. ■ Provisions may also be measured differently under IFRS, as a result of mandatory discounting for material, long-term provisions. IFRS also measures a provision at the midpoint of a range as opposed to the U.S. GAAP requirement to measure at the low end of a range.	■ **EBITDA impact –** ■ **Provisions:** The timing of recognition of a provision may be earlier and at a higher amount under IFRS.
Impairment U.S. GAAP: ASC 350, 360 IFRS: IAS 36, IAS 38	**Impairment:** ■ Under IFRS, impairment testing of goodwill and long-lived assets is a single-step process in which an impairment loss is recognized to the extent that the carrying amount of a cash generating unit exceeds its 'recoverable amount' (measured at the higher of fair value less cost to sell and value in use, which is a discounted cash flow valuation using discounted entity-specific future cash flows). ■ Impairment write-downs, other than for goodwill, must be reversed under IFRS if the recoverable amount improves subsequently. ■ U.S. GAAP does not have an equivalent concept of cash generating unit and impairment write-downs cannot be reversed.	■ **Impairment:** It is generally believed that IFRS leads to earlier recognition of impairments than under U.S. GAAP.

Supporting analysis – taxation

Target taxation - background

HP is contemplating the acquisition of all the common stock of Target, which includes the U.K. parent and the U.S. Group, in a taxable transaction.

Scope

In connection with our tax due diligence of Target as detailed in the engagement scope (see Appendix 1), we read the tax documentation provided in Target's online data room from July 31, 2011 through August 8, 2011. We were provided a limited amount of documentation from which we base this report. These documents included, but were not limited to, U.S. and U.K. tax opinions, the transfer pricing study covering the period beginning with the acquisition of eTalk and ending with the acquisition of Zantaz, and TP addendum covering the acquisition of Interwoven. Additionally, we read publicly available documents including financial statements and U.K. filed statutory accounts. We also had discussions with management on August 2, 2011.

During the course of our diligence, we did not speak to Target's external tax advisors. While numerous requests to speak with the tax advisors were made, as of the date of this report, all requests were denied.

Additionally, as noted above, we were provided a limited amount of tax information and documentation. As such, during the course of the current diligence, we were unable to investigate other tax matters such as state and local taxes, VAT, etc.

Background

Target was founded in 1996 and has dual headquarters in Cambridge, U.K. and San Francisco, CA.

Target is a U.K. company, which wholly owns the stock of AEHL, a U.K. subsidiary of Target. AEHL wholly owns ANAH, a U.S. subsidiary, which is also the common parent of the U.S. consolidated group. Please see Appendix 2 for the detailed organizational chart.

In March 1996, Target, Inc. was formed in the U.S. as a wholly owned subsidiary of Target. In October 2005, Target formed ANAH as a wholly owned subsidiary and contributed the stock of Target, Inc. in exchange for the stock of ANAH. ANAH subsequently made a number of stock and asset acquisitions including Verity in December 2005, Zantaz in July 2007, and Interwoven in March 2009. Please see the detailed acquisition discussion on the next slide.

Target's economic and tax beneficial rights to Target's primary self-developed as well as acquired IP is located primarily in Cambridge, U.K. Management represented that customer support operations are based in Cambridge, U.K., Calgary, Canada and Bangalore, India. We are unsure to what extent, if any, IP development also occurs in these jurisdictions.

- Acquired IP: "Wither on the vine" strategy - With respect to acquired IP, the IP is typically transferred to the U.K. in a five year process, during which a residual profit split between the acquired company and U.K. occurs representing the contribution of acquired IP versus U.K. based IP. Please see the Transfer Pricing section for additional detail.

Supporting analysis

Target taxation - acquisition timeline

Key acquisitions:

1) Iron Mountain Digital

2) Interwoven

3) Zantaz

4) Verity

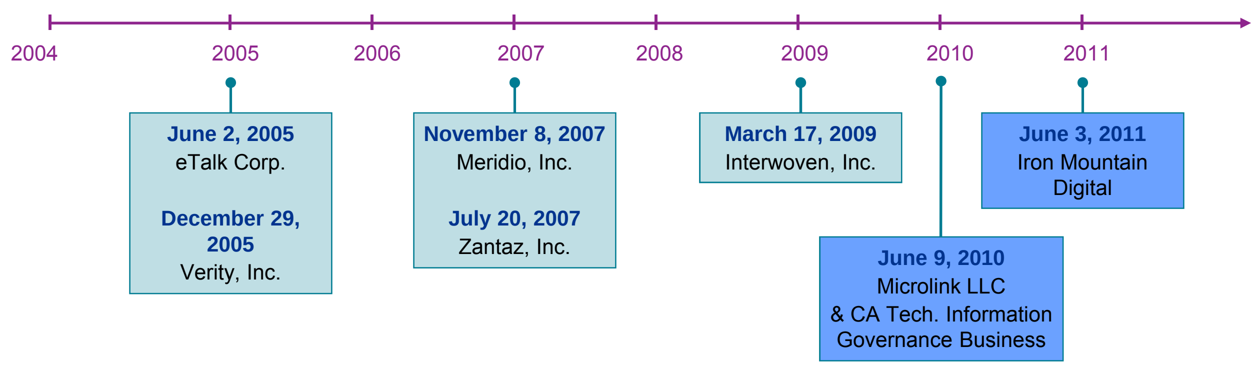
Recent acquisition history

Please see Acquisition timeline below.

- Key acquisitions included Iron Mountain Digital, Interwoven, Zantaz and Verity.
- According to Target's 2010 filed financial statements, the fully integrated acquisitions of Interwoven, Zantaz and Verity represent approximately 20% of the market capitalization as of the end of 2010.

Acquisitions (in reverse chronological order)

- **Iron Mountain Digital**: On June 3, 2011, Target purchased certain stock (Mimosa Systems, Inc., Stratify, Inc., and four foreign subsidiaries) and the assets of Iron Mountain Digital, based in Southborough, Massachusetts, for approximately $380 million plus preliminary working capital adjustments of $21 million (as of June 30, 2011). The selected purchased assets from IRM's Digital division included archiving, eDiscovery and online backup (the final PPA is anticipated in the second half of 2011).
- **Microlink LLC and CA Technologies Information Governance Business**: On June 9, 2010, Target announced the purchase of assets from CA Technologies, a company based in Islandia, New York, to strengthen Target's leadership position in Meaning Based Governance for $19.4M. Additionally, Target purchased 100% of the interests in Microlink LLC (which should be treated as an asset purchase for U.S. federal income tax purposes), based in Vienna, Virginia, from one of Target's resellers with the intent to accelerate the adoption of Target's technology in U.S. state and federal government accounts for $56.9 million.
- **Interwoven**: On March 17, 2009, Autonomy acquired 100% of the stock of Interwoven, Inc., based in San Jose, California, and a leader in content management software, for $804.2 million.
- **Zantaz**: On July 20, 2007, Target acquired 100% of the stock of Zantaz, Inc. for $378.0 million. Zantaz, Inc., a company based in Pleasanton, California, is a leader in archiving, eDiscovery, and proactive Information Risk Management.



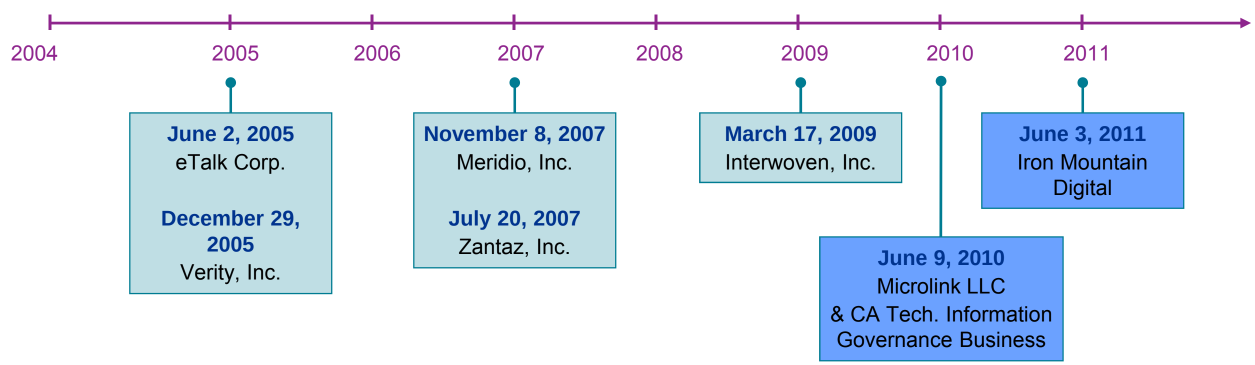
Source: Public documents including: Investor Forum 29 November 2010; Press release Iron Mountain Digital Acquisition 16 May 2011; Target's 2005 through 2010 Annual Report & Accounts.

Target taxation - acquisition timeline

- **Meridio**: On November 8, 2007, Target acquired 100% of the stock of Meridio Holdings Limited, a company based in Belfast, Northern Ireland, and a provider of records management software and licenses, for $61.0 million.
- **Verity**: On December 29, 2005, Target acquired 100% of the stock of Verity, Inc. for $501.9 million. Verity, based in Sunnyvale, California, is a provider of software solutions for the enterprise search market and the business process management market.
- **eTalk Corporation**: On June 2, 2005, Target acquired 100% of the stock of eTalk Corporation, a company based in Dallas, TX, for $72.7 million. In the purchase, Target acquired an audio search and a call center.

Of the stock acquisitions, Interwoven, Verity, Zantaz, Meridio, eTalk, and stock acquired from Iron Mountain, currently remain legal entities represented on the organizational chart. With the exception of Meridio, all are part of the U.S. Group. Management represented the foreign subsidiaries acquired in U.S. acquisitions are largely dormant. These foreign operations have been integrated with legacy Target local country operations, and none operate autonomously.

Management represented that they recently contemplated a legal entity rationalization project, but to date no action or implementation has been pursued. We have not been provided with a definitive list of active U.S. or foreign entities.



Source: Public documents including: Investor Forum 29 November 2010; Press release Iron Mountain Digital Acquisition 16 May 2011; Target's 2005 through 2010 Annual Report & Accounts.

Supporting analysis

Target taxation - tax overview

Management represented that Target has no internal tax function.

Current status of tax function

Sushovan Hussain, Target's CFO, has the overall responsibility for Target's tax affairs.

During discussions with management, management represented that Target has no internal tax function, instead using one to two individuals from the finance group as "tax processors." The tax processors primary function is to gather source materials for Target's external tax advisors. Any other staff providing source material and source reports from Target's enterprise software are extensions of the finance group and are not performing any tax analysis or planning.

Reliance on external tax advisors

Target relies on external tax advisors for U.S., U.K., and international compliance, as well as for any tax planning.

With respect to U.S. compliance, management represented that PwC has provided all U.S. compliance for the U.S. Group since 2001.

With respect to U.K. compliance and planning, management represented that E&Y Cambridge has provided all U.K. compliance and planning since 2001. Namely, Cathy Taylor has been instrumental in providing services and has helped implement the "Tower Structure" used by Target to finance the most recent U.S. acquisitions.

With respect to international compliance, management represented that E&Y as well as local firms provide compliance for all non-U.K. and non-U.S. subsidiaries.

Deloitte served as Target's auditors since 2001, and in addition prepared TP documentation. Management represented that with respect to TP documentation, they have worked closely with Richard Blackwell.

Tax control environment

Historically, Target focused on ensuring that it met U.S. and U.K. compliance obligations rather than implement tax strategies to reduce the consolidated ETR.

Although in recent years Target has implemented a financing structure, the "Tower Structure," which enables the U.K. Parent to benefit from tax relief on financing costs without a corresponding credit being subject to tax in the jurisdiction lending the funds, the U.K. Provided this structure has been implemented correctly, the tax risks associated with this planning are manageable. Please see the slide on the Tower Structure for further detail.

In addition, the U.K. business has benefited from R&D tax credits with respect to qualifying R&D expenditure/activity. We understand that HMRC reviewed and agreed with the assumptions used to identify qualifying expenditure.

The planning adopted has had the effect of reducing Target's ETR by approximately 3% annually.

Target has adopted sophisticated transfer pricing methodologies to ensure that material profits are recognized in the U.K. business, as this is where Target's core IP is located.

Target taxation – FY10 tax provision, ETR, deferred taxes

No financial statements were provided for the U.S. Group (i.e., no U.S. Group specific tax provision, ETR or DTA/DTL breakout).

Tax provision

Target's financial statements are prepared under IFRS.

The provision for income taxes is based on the U.K. corporate tax rate of 28%. The table presented below represents Target's global tax provision.

Tax provision

$'000	2009	2010
Current tax		
Current year	75,147	81,130
Prior year	(2,912)	(7,795)
Subtotal	72,235	73,335
Deferred tax		
Origination and reversal of timing differences	2,280	(8,434)
Total	**74,515**	**64,901**

Source: Target Annual Report and Accounts for the year ended 31 December 2010.

ETR

The ETR reconciled to profit before tax is outlined below and represents Target's global ETR. The ETR as of December 31, 2010 was 23%.

According to management, ETR is managed primarily through transfer pricing policy and the R&D tax credit. Management represented that they forecast the 2011 ETR to be approximately 26%.

Effective tax rate

		2009		2010
$m		%		%
Profit before tax	266		282	
Tax at UK corporate rate (28%)	75	28.0%	79	28.0%
Tax effect of non-deductible expenses	2	0.7%	1	0.4%
Tax effect of non-taxable income	(1)	-0.5%	(4)	-1.2%
R&D tax credits	(2)	-0.7%	(4)	-1.2%
Utilization of tax losses no previously recognized	(1)	-0.2%	(24)	-8.4%
Other differences	(5)	-1.7%	4	1.5%
Effect of different tax rates	9	3.5%	7	2.3%
Prior year adjustment	(3)	-1.1%	5	1.6%
Tax expense & ETR for the	**74**	**28.0%**	**65**	**23.0%**

Source: Target Annual Report and Accounts for the year ended 31 December 2010.

Target taxation – FY10 tax provision, ETR, deferred taxes

The consolidated gross ETR of 23.0% for FY10 was substantially below the U.K. statutory rate of 28%.

This was predominantly due to the utilization of previously unrecognized tax losses, R&D tax credits in the U.K. and U.S. and the tax benefit arising from the Tower Structure.

Management expects an ETR of approximately 26% for 2011 which is in line with the U.K. statutory rate.

The gradual reduction in U.K. tax rates from 26% as of April 1, 2011 to 23% beginning April 1, 2014, is likely to reduce the ETR in future periods.

FY10 - The consolidated gross ETR of 23.0% for the period is lower than the U.K. statutory rate of 28% predominantly due to:

- The utilization of previously unrecognized brought forward losses (tax effect $(23.5) million).
- An enhanced deduction with respect to R&D tax credits in the U.K. and U.S. (tax effect $(3.5) million).
- Tax effect of non-deductible income (tax effect $(3.5) million). We understand that this predominantly relates to the tax benefits arising from the Tower Structure.

These are partly offset by the following:

- Effect of different tax rates (tax effect $6.5 million). We assume this arises due to higher U.S. tax rates compared to U.K. tax rates. However, we have not received sufficient information to verify this.
- Tax effect of non-deductible expenditures (tax effect $1.2 million). We have insufficient information to verify what contributes to this amount.
- Other differences (tax effect $4.3 million). We have insufficient information to verify what contributes to this amount.
- Prior year adjustment (tax effect $4.5 million). We do not have sufficient information to verify what contributes to this amount.

FY09 - The consolidated gross ETR of 28.0% for the period is in line with the statutory rate of 28%.

Given the tax benefit obtained from the Tower Structure and the R&D tax credits, we would have expected the ETR to have been lower than the statutory rate.

Based on the tax reconciliation, it would appear that Target has been adversely effected by higher tax rates in overseas jurisdictions (tax effect $9.2 million). Given the geographical analysis of Target's turnover, we assumed that the majority relates to the taxes in the U.S. However, this is not in line with Target's transfer pricing model.

Non-deductible expenditures (tax effect $1.9 million) also increased the ETR for Target.

The above items were offset against an enhanced deduction with respect to R&D tax credits in the U.K. and U.S. (tax effect $(1.9) million), and the tax effect of non-deductible income (tax effect $(1.3) million). We understand that this predominantly relates to the tax benefits arising from the Tower Structure.

Target has also benefited from "other differences" (tax effect $(4.6) million) and a "prior year adjustment" (tax effect $(2.9) million).

Future ETR

Management represented that they forecast an ETR of approximately 26% for FY11, which is in line with the U.K. statutory rate.

This is based on approximately 80% of profits arising in the U.K. and 20% in the U.S.

It is expected that both the Tower Structure and R&D tax credits will both contribute in reducing the ETR by 1.5% each (total of 3%) for the period.

U.K. tax rate

As of April 1, 2011 the U.K. statutory corporation tax rate decreased from 28% to 26%. Furthermore, the rate will continue to decrease by one percentage point annually from April 1, 2012 until it reaches 23% (for the year ended March 31, 2015). At this point only the first reduction from 28% to 26% as from April 1, 2011 and to 25% from April 1, 2012 have been substantively enacted.

Target taxation – FY10 tax provision, ETR, deferred taxes

Target has a DTL of $91.1 million which predominantly relates to purchased intangibles.

Target has a DTA of $16.3 million which primarily relates to future tax deductions on the exercise of share options.

Deferred taxes

The DTA and DTL balances outlined in the chart represents Target's global balances. The DTA and DTL balances as of December 31, 2010, respectively, was $16.3 million and $91.1 million. The U.S. Group specific DTA and DTL balances were not provided.

Deferred tax assets		
$'000	**2009**	**2010**
Tax losses	234	234
Stock option losses	19,362	9,667
Accelerated tax depreciation	4,419	-
Other timing differences	-	6,362
Total	**24,015**	**16,263**

Deferred tax liabilities		
$'000	**2009**	**2010**
Purchased Intangibles	85,087	84,906
Accelerated tax depreciation	-	6,166
Total	**85,087**	**91,072**

Source: Target Annual Report and Accounts for the year ended 31 December 2010.

DTA

Under IFRS, DTA should only be recognized to the extent that it is probable that taxable profits will be available in the future against which the deductible temporary differences can be utilized.

Management represented that the reported DTA balance is largely related to future tax deductions related to the intrinsic value of the stock options.

The deferred tax asset relates to the following items:

- Stock option losses ($9.7 million). This relates to the potential tax deductions available on the exercise of stock options currently issued. The DTA does not take into account the situation where the option is not fully vested (i.e. where an option is only one-year through a three-year vesting period only 1/3 of the potential deferred tax asset is recognized). Therefore, if all options vest on a change in control, the tax benefit received by Target could be significantly different from the $9.7 million.
- Other timing differences ($6.3 million). We were not provided with sufficient information regarding the nature of these timing differences.
- Tax losses ($0.2 million).

According to management and the financials, in 2010, Target utilized all of its tax losses and thus, has no unrecognized DTA related to those losses.

DTL

Management represented that the reported DTL balance is largely related to purchased intangibles where the value of the intangible for book purposes is in excess of the tax basis. As the intangible is amortized, the DTL will reverse over time.

The remaining DTL relates to accelerated tax depreciation which arose as Target receives a tax deduction which is in excess of the depreciation in the financial statements in previous periods.

Target taxation - tax reserves

Management booked a $7 million tax contingency reserve related to its transfer pricing policy.

Tax reserves

In total, the current tax credit in the accounts as of December 31, 2010 was approximately $33.2 million.

Management represented that Target has booked a $7 million tax contingency reserve, representing a reserve for the last four years at approximately 5%. The reserve was set up due to the TP policy employed with respect to the U.S.

Management represented that there is an expectation that the TP policy will eventually be scrutinized under an IRS audit of the U.S. Group with respect to the value driver methodology and residual profit split between the U.K. and U.S.

As we have not been made aware of any other contingencies, we assume that the balance of $26.2 million relates to actual amounts payable to the revenue authorities.

Target taxation – audit history

We were not provided information regarding the recently applicable U.K. Senior Accounting Office rules.

Target HMRC risk rating

The HMRC issues risk ratings based on the tax profile of U.K. companies based on the historic background, business and activities of the companies. The U.K. parent was initially awarded a high risk rating by HMRC due to the Inspector not understanding the business. However management represented upon further dialogue, the rating was lowered to "low risk."

U.K. audit history

Management confirmed that there are currently no open inquiries in the U.K. and that no significant adjustments were made with respect to recently closed inquiries into the U.K. R&D claim.

Additionally, Target is subject to the Senior Accounting Officer rules in the U.K. which apply for periods starting on or after January 1, 2010. These rules require the Senior Accounting Officer, typically the CFO, to certify that appropriate tax accounting arrangements have been established and are maintained.

If the Senior Accounting Officer fails to take reasonable steps to ensure that the company has established and maintained appropriate tax accounting arrangements, they could be subject to a personal penalty. Furthermore, this is also likely to result in an increased HMRC's risk grading.

We were not provided with any information to verify the steps taken by Target to satisfy this new requirement.

U.S. Group audit history

In general, the statute of limitations for federal and most state income tax purposes is three years from the filing of the applicable tax return. However, some states have a four-year statute of limitations. Generally, the U.S. Group's 2008 through current tax filings remain open to IRS and state examination.

Management represented that the U.S. Group is not currently subject to any federal income tax audits. Management further represented that the U.S. Group was last audited "probably three years ago." However, no documentation regarding the nature or conclusion of the last audit cycle was provided.

With respect to state income and non-income taxes, management represented that while many audits are currently ongoing, there have been no significant changes or results from these audits. We have not received any documentation regarding the status or conclusion of any of these audits.

U.K. transfer pricing - profit split report

Target has adopted the PSM for transfer pricing. From a U.K. taxing perspective, Target appears to have complied with the requirements for preparation of its study and the risk of HMRC successfully challenging the methodology appears low. The conclusions in the profit split report appear reasonable.

However, there remains a significant risk that IRS could successfully challenge aspects of the analysis. Please refer to the discussion in the U.S. taxation section below regarding transfer pricing.

With respect to the value contribution analysis used to perform the residual profit split, the determination of the percentage value of the parties' respective contributions has been made by management. Depending on the available evidence, there may be a risk that reasonable alternative conclusions as to the parties' respective contributions could be drawn. If sustainable, such alternative conclusions would lead to a different allocation of profit to the parties.

If a transfer pricing adjustment is required, the U.K.-U.S. Double Taxation Convention provides that a disadvantaged taxpayer may seek relief from double taxation by presentation of a case to the taxpayer's competent authority. If necessary, the competent authority shall then endeavour to remedy the double taxation by mutual agreement with the competent authority of the other state.

The mutual agreement procedure may take some time and there is no legal obligation on the competent authorities to reach an agreement, only to endeavour to do so. In our experience U.S.-U.K. competent authority claims are usually resolved, but there may be some delay in this resolution. Even if relief from double taxation is achieved, the adjusted position may still result in increased overall taxation for the group (e.g., due to a tax rate differential and potential interest and penalties).

U.K. taxation – compliance

The U.K. tax computations up to FY09 were filed on time and HMRC have until December 31, 2011 to inquire into the FY09 return.

We understand that there are currently no open HMRC inquiries.

Corporation tax compliance - U.K.

The filing deadline for submission of the U.K. corporation tax returns is 12 months after the end of the relevant accounting period.

Assuming the tax return is filed on or before the statutory filing date, HMRC will have up to twelve months from that date of submission to open an inquiry into the tax return (the "inquiry window").

If no inquiry is opened within the inquiry window the return can be regarded as closed. However, the inquiry window can be extended to four years when "discovery" of new facts is made by HMRC or extended up to 20 years where there has been fraudulent or negligent conduct.

We understand that all corporation tax computations and returns have been submitted on time. The FY10 return needs to be submitted by December 31, 2011.

Therefore, all periods up to FY08 should be closed to "normal" inquiry.

The "normal" inquiry window for FY09 will close on December 31, 2010.

HMRC inquiries

Management confirmed that there are currently no open inquiries into the U.K. corporation tax returns.

The R&D claims for Target have historically been inquired into, as noted on the previous slide.

U.K. taxation – Tower Structure (1)

The tax opinion issued by E&Y appears reasonable, however, we recommend confirming that the structure was implemented as described in the opinion to assess whether there are any potential exposures.

We were not provided with the Treasury consents and the clearance to pay interest without applying WHT.

Background

Following the Interwoven transaction in FY09, Target reviewed the funding structure of the U.S. Group.

Management decided to implement a long term financing structure which maintained the characteristics of an equity funding structure.

The Tower Structure was chosen as the overall result reflected an equity equivalent funding structure from a U.K. perspective but had the added benefit of a potential U.S. federal tax deduction for finance costs.

Summary

The key elements to the structure are the receipt of a U.K. interest deduction for LLC 1 (under Loan B), which is to be group relieved against the interest receipt that AEHL will receive under Loan A. This should result in no net U.K. tax, though importantly, this should only result if the non-trading deficit in LLC 1 can be group relieved.

We understand from a U.S. tax perspective, there is an interest payment by ANAH to AEHL, under Loan A. The interest payment by LLC 1 will be disregarded by ANAH as LLC 1 is treated as a disregarded entity.

A swap has been introduced between LLC 1 and LLC 2 with the intention of ensuring that the group is not exposed to a net foreign exchange position.

The intention is for these transactions to together result in a net interest deduction in the U.S., and a tax neutral position in the U.K.

U.K. tax issues

The significant U.K. tax issues are considered below. In addition to those issues, in analyzing the structure we have not been provided with the Treasury consents, and the clearance to pay interest without applying WHT.

For these purposes we have assumed that these were all obtained and remain in force.

Interest deduction

In our experience the key U.K. tax issue is the deductibility of the interest payment made by LLC 1 for tax purposes. Certain U.K. tax rules may prevent a deduction from being claimed on the interest payment.

Avoidance involving tax arbitrage

The arbitrage rules in Sections 24 and 25 F(No.2)A 2005 can deny a corporation a tax deduction for interest payable on a loan by a company in certain circumstances.

These rules apply where a company is a party to a transaction that forms part of a scheme that contains a hybrid entity, where one of the main purposes of the scheme is to obtain a U.K. tax deduction.

It is possible the tax authorities could argue that LLC 1 comes within these rules unless it shows that the scheme (i.e., this financing structure) was not entered into with a main purpose of obtaining a U.K. tax deduction.

An application was made to HMRC for clearance, whereby HMRC would not seek to apply the rules and deny an interest deduction, on the basis that the scheme/structure was not entered into with a main purpose of obtaining a U.K. tax deduction.

U.K. taxation – Tower Structure (2)

The thin capitalization position of LLC 1 will need to be reviewed regularly to ensure that the tax deduction is not denied.

The constitutional documentation of LLC 1 and LLC 2 will need to be reviewed to confirm that these entities are in a group relief group with the other U.K. entities.

We note that clearance has been obtained from HMRC that those rules should not apply to this structure, as there is no U.K. tax advantage.

However, clearance is granted based on the information supplied in the application to HMRC, and so if the structure was implemented in a different manner, the clearance may not be valid.

Unallowable purpose (Section 441 Corporation Tax Act 2009)

Under Section 441 CTA 2009 (previously Paragraph 13 Schedule 9 FA 1996), where in any accounting period a company is a party to a loan relationship which has an unallowable purpose, relief for any debits and credits (which would otherwise be taken into account) is denied to the extent that is just and reasonable.

Under Section 442 CTA 2009 (previously Paragraph 13(2) Schedule 9 FA 1996), a loan relationship has an "unallowable purpose" if the purposes for which the company is a party to the loan include one which is not amongst its business or other commercial purposes.

It is stated that LLC 1 entered into the loan in order to acquire the Interwoven Group from ANAH. E&Y's conclusion is that this is a prima facie business purpose. Further, E&Y state that where HMRC have granted clearance under the arbitrage rules (as is the case), it is unusual for them to challenge a structure under as an unallowable purpose.

We do not consider E&Y's conclusions unreasonable, but again have not seen all of the documentation surrounding the design and implementation of the structure to ensure that the risk of an unallowable purpose challenge is remote.

Transfer pricing and thin capitalization

The transfer pricing rules deny a tax deduction for interest payable on a loan where a U.K. resident company is thinly capitalized. Interest may be disallowed because the amount of the loan exceeds the amount a third party would have lent or because the rate of interest exceeds arm's-length terms.

Of concern is Loan B from ANAH to LLC 1. E&Y states: "It is possible that LLC 1 will not have sufficient balance sheet equity in relation to its debt as it is a newly incorporated entity that is likely to have been set up with minimal share capital and prima facie is likely to be considered to be thinly capitalized."

E&Y's opinion provides support for the contention that LLC 1 is not thinly capitalized, however, if its borrowing capacity takes account of the assets that it controls as direct or indirect investments i.e., the Interwoven Group. This would result in assets of approximately $790 million supporting a debt of $175 million. Moreover, E&Y state that LLC 1 should have interest cover of 11.29:1.

E&Y's conclusion that LLC 1 is not thinly capitalized and should be able to deduct interest payments, with no restriction, appears reasonable to us.

U.K. taxation – Tower Structure (3)

Treatment of swap

In the absence of the swap, the structure leaves the group with a foreign exchange position that should roughly net off. However, there is a risk that the Disregard Regulations could apply to LLC 1, such that the foreign exchange exposure of LLC 1 under Loan B would be considered to hedge its exposure to exchange movements through true ownership of U.S. subsidiaries. If this were the case, Target would have a net foreign exchange exposure on Loans A and B.

It appears that the intention of entering into a swap with LLC 2, is that LLC 1 largely removes its foreign exchange risk, and reduces the risk of the Disregard Regulations applying. The result is that LLC 2 has the foreign exchange exposure.

The structure is designed so that the exposure of LLC 2 should correspond to and cancel the foreign exchange exposure of AEHL. However, for this to be the case, the two companies must be grouped for foreign exchange purposes.

Group relief

Even if the interest payment by LLC 1 under Loan B is accepted as deductible (as appears to be the case), it is also necessary that the non-trading debit that this would create in LLC 1 may be surrendered to AEHL to offset against the corresponding interest receipt of AEHL.

Further, for the foreign exchange position of Loans A and B to be largely neutral, LLC 2 will also need to be grouped with AEHL.

For the non-trading deficit and any exchange losses to be relieved, LLC 1, LLC 2 and AEHL must be considered to be part of the same group for U.K. group relief purposes. E&Y's memorandum states that ANAH holds all of the entire share capital of LLC 1 and LLC 2, and AEHL holds the share capital of ANAH. LLC 1 and LLC 2 have issued member's interest certificates to ANAH, which HMRC state they accept as being "ordinary share capital." On this basis, LLC 1 and LLC 2 should fall within the definition of a "75% subsidiary" for group relief purposes.

U.K. taxation – Research and Development allowances and WHT

Under U.K. tax rules a large company can claim a deduction equal to 130% of the qualifying R&D costs.

Target incurs a significant amount of qualifying R&D expenditure in the U.K. and due to the size of the claims HMRC has historically inquired into these claims every two to three years.

Management represented no significant adjustments were made as a result of historic inquiries and in each case HMRC agreed with the underlying methodology used to calculate the claim.

R&D claims

Corporation tax rules

Under U.K. corporation tax rules a company which undertakes R&D activities and incurs qualifying revenue expenditure (which may potentially be reflected in the statutory accounts under intangible fixed assets) is entitled to an enhanced deduction in calculating its chargeable profits.

A large company can claim a deduction equal to 130% of the qualifying costs (125% for claims made prior to April 1, 2008).

Qualifying R&D expenditures would potentially include staff costs, software, consumables, externally provided workers and subcontracted R&D (both of which are usually restricted to 65% of the costs incurred).

A U.K. company which incurs qualifying capital expenditure relating to R&D activities is entitled to a 100% first year allowance. However, no enhancement is available for capital expenditures.

Applicability to Target

We understand Target incurs a significant amount of qualifying R&D expenditure in the U.K.

Due to the size of the claims, HMRC has historically inquired into the claims every two to three years.

Management confirmed that no inquiries are currently open and previous inquiries were closed without any significant adjustments. In each case HMRC agreed with the underlying methodology used to calculate the claim. We understand that Target has not changed the methodology since the last HMRC inquiry.

Withholding tax on royalty payments

From our discussions with management, we understand that the majority of the royalty payments are between the EU and the U.K. and the U.S. and the U.K. No withholding tax is applied to these royalties.

Target has experienced some withholding tax issues in Latin America. However, we understand that the amounts involved are insignificant.

U.K. taxation - Share incentives – U.K. awards (1)

Target operates two unapproved share plans.

Unapproved share options have been granted to U.K. employees.

Options are exercisable on a change in control.

U.K. PAYE and NIC will be due on the exercise of the unapproved share options on the difference between the value of the shares on exercise and the exercise price.

The rules of the U.K. Plan provide for the transfer of the employer's NIC liability to the employee.

Background

Target operates two unapproved share option plans, the U.K. Plan and the 2008 U.S. Share Option Plan.

U.K. Plan

The options schedule in the data room provides that there are a total of 9,586,994 active options granted under all of Target's share plans, and of this total, there are 3,275,068 active options granted under the U.K. Plan.

However, while this appears to be the number of active options, the schedule provides that the total number of options deemed to be outstanding under the U.K. Plan is 7,619,244. We have been unable to reconcile these numbers.

Further, share options have been granted under other share plans, and confirmation is required that no such options have been granted to U.K. employees.

In 2010 the Board introduced a new share policy, the Deferred Shares Bonus, under which shares are granted which vest depending on the extent to which the business meets targets over a three year period. The maximum award level for executive directors for 2010 and 2011 is 100% of base salary. Shares will normally be released to participants after the third anniversary of the award. Any ordinary shares granted under this policy will be satisfied from the EBT rather than a new issue of shares.

The accounts also refer to deferred bonuses to executive directors in 2010 being made in the form of share options.

Impact of change in control

The unapproved options granted under the U.K. Plan vest over a vesting period, with the initial vesting taking place after six or 12 months and the remainder vesting over a period of 2.5 to 3.5 years.

The rules of the U.K. Plan provide that options become exercisable during the following periods in connection with a change in control (and then lapse on the expiry of the earliest applicable period):

- within six months of a change in control;
- conditionally from the date on which the court orders a shareholders' meeting to sanction a proposed comprise or arrangement until noon on the day immediately preceding the shareholders meeting, or such other period and on such terms as the Board shall determine acting fairly and reasonably; and
- any time during which a person is bound or entitled to acquire the company's shares under sections 428 to 430F Companies Act 1985 (now sections 979 to 982 Companies Act 2006, i.e. the squeeze out provisions once 90% have been offered).

The rules of the U.K. Plan also provide that on a change in control, employees may exchange their options for equivalent options over shares in the acquiring company where the acquiring company consents to such an exchange of options.

PAYE and NIC

PAYE and employer's and employee's NIC will be due on the exercise of the unapproved options held by U.K. employees on the difference between the market value of the shares at the date of exercise and the exercise price.

U.K. taxation - Share incentives – U.K. awards (2)

A statutory corporation tax deduction may be due on the exercise of the unapproved options by U.K. employees.

Target operates an EBT which is used to hold shares to satisfy options. Further information is required with respect to EBT.

The rules of the U.K. Plan provide that in order to exercise their options, the employees must deliver payment for the PAYE liability arising to Target or enter into arrangements satisfactory to Target for the satisfaction of the tax liability. Further, unless the Board determines otherwise at the date of grant, the PAYE liability includes the employer's NIC liability. Where the employer's NIC liability has been transferred to the employee, this will be an employee cost as well as the employee's NIC. Target must withhold these amounts and account for them to HMRC.

It is necessary to obtain confirmation that the employer's NIC liability has been transferred to the employees with respect to all existing share options.

Corporation tax deduction

A statutory corporation tax deduction may be available under Part 12, CTA 2009 on the exercise of the unapproved share options provided that the relevant conditions of the legislation are met.

The main conditions for the relief on the exercise of options are that:

- The shares are ordinary share capital, fully paid up and not redeemable;
- The shares are in a company not under the control of another company, unless that company is listed on a recognized stock exchange;
- The grant must be for the purpose of the business of the employing company, which must be within the charge to U.K. corporation tax;
- Shares acquired must be shares in the employing company or a company which at the time of the grant is a parent company of the employing company; and
- The employee is subject to U.K. income tax on the shares (or would be if he were both resident and ordinarily resident in the U.K. and carried out his employment duties in the U.K.).

The purchaser is listed on a recognized stock exchange, and therefore the exercise of the options should qualify for a corporation tax deduction both pre and post change in control, assuming the other conditions are met.

EBT

According to documents provided, Target operates an EBT which is used to satisfy share options granted to U.K. employees. On December 31, 2010, the EBT held 389,699 shares. We have not been provided with any further details in respect of the EBT but note the comment above about the Deferred Shares Bonus awards being satisfied using EBT shares. These shares could therefore be fully allocated to that arrangement or there could be surplus EBT shares which could be used to satisfy some of the outstanding options under the U.K. Plan.

Supporting analysis

U.S. transfer pricing

Based on our high-level calculations with limited data, we believe there is a potential taxable income exposure of approximately $50 million to $75 million for the four acquisitions previously cited through the extension of the life of the U.S. IP.

Legacy transfer pricing

Between 2005 and 2009, Target made several acquisitions. For the purpose of this report, we will discuss only four acquisitions, those of the following U.S. companies:

- eTalk;
- Verity Cardiff;
- Zantaz; and
- Interwoven.

The acquired companies had developed technology IP, strategic business know-how, customer relationships, and business reputation/brand image. Target also developed similar IPs and subsequent to the acquisitions, Target combined its own IP with those of the acquired entities. The combined IP was used to develop "post-acquisition" products.

As a result of combining the IPs specifically:

- (i) ownership of valuable product R&D;
- (ii) access to strategic business know-how;
- (iii) access to new customers; and
- (iv) business reputation/ brand image, the U.S. Group made a payment to the U.K. parent in the form of a royalty for Target's share of the contributed IPs, which was calculated using the PSM. The royalty was calculated using sales as the base.

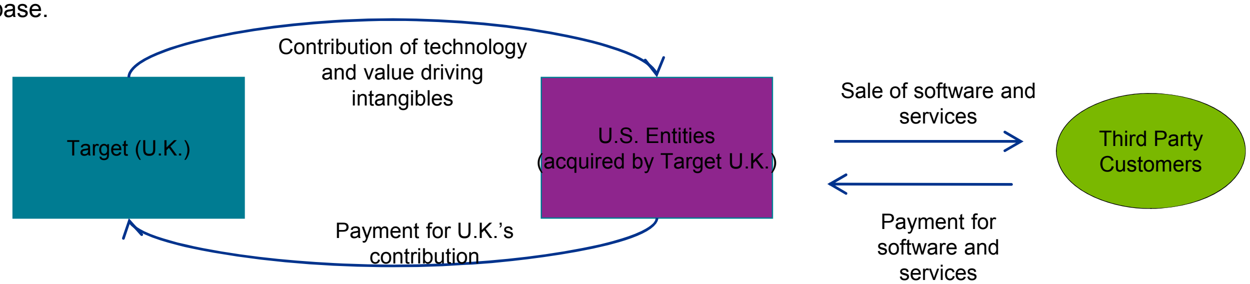
As outlined in the U.K. transfer pricing section, the RPM was applied as follows:

- The U.S. Group was paid a routine return of 3.5% OM on sales. The 3.5% margin was determined based on a benchmarking analysis using the Comparable Profits Method, which generated an inter-quartile range of 1.39% to 3.5%.
- The remaining profit (referred to as "super-profits") earned by each U.S. company was split between the U.K. parent and the U.S. company based on the U.K. parent's and the U.S. entity's contribution of IP. The weight of the IPs contributed by the U.S. Group versus the U.K. parent was developed through discussions with management from both the U.S. Group and the U.K. parent.

To arrive at the contribution split, a weight was first assigned to each of the value drivers:

- (i) ownership of valuable product R&D;
- (ii) access to strategic business know-how;
- (iii) access to new customers; and
- (iv) business reputation/ brand image.

The value drivers were split between U.S. and U.K. for each year over a five year period.



U.S. transfer pricing

- Then the percentages for each value driver was summed to arrive at a total IP contribution split for the U.S. entity and the U.K. parent. The total weight was then applied to split the residual profit for each year. The amount attributable to the U.K. parent was paid by the U.S. entity to the U.K. parent as a royalty.
- This analysis was done over a five-year period and in each of the years, the value drivers were shifted in favor of the newly developed IPs and away from the U.S. entities' IPs such that the weight of the newly developed IPs' contribution comprised of the majority of the weight at the end of the five year period.

In applying the RPM, there are several areas of uncertainties from a U.S. tax perspective:

- We note that the "super profits" were divided between U.K. and U.S. entities based on a qualitative analysis of four value drivers, discussed above. Even though weights were assigned to each of the drivers and the weights were then split between U.K. and U.S. entities, a clear rationale was not provided in the memo for allocating X% to one entity and Y% to another. The IRS could question the profit allocation that is based solely on discussions with management.
- The application of RPM results in what would appear to be a one-way royalty from the U.S. to the U.K. It is not clear whether the RPM model used in the transfer pricing memo takes into consideration a situation where the combined IP of the U.S. Group and the U.K. Parent were exploited by Target in selling products in the non-U.S. market. In the event the U.K. parent also makes a sale, then a routine distribution return would be given to the U.K. parent and accordingly, Target would make a royalty payment to the U.S. Group for their IP contribution.
- The value drivers were gradually shifted in favor of the newly developed IPs and away from the IP developed by the U.S. Group over a period of five years. It is not clear why the value drivers were shifted within a period of five years, indicating that the life of the IP owned by the U.S. Group was only five years. The IRS could contend that the life of the IP was longer than five years, potentially extending the period to ten years.

The IRS may extend the life of the IP developed by the U.S. Group and argue that the royalty payable by the U.S. Group to Target in the first five years was much lower than that calculated in the transfer pricing memo. Based on our high-level calculations with limited data, we believe there is a potential taxable income exposure of approximately $50 million to $75 million for the four acquisitions previously cited through the extension of the life of the U.S. IP.

Even under the existing transfer pricing methodology, it would be important for Target to compare the forecasted financials used in the RPM with the final financial statements of the U.S. Group to analyze the potential profit or loss earned by the U.S. Group. Further, in the event the U.S. Group is earning losses, it would be relevant to analyze whether Target would share in these losses.

There is a potential that the IRS could apply other methods of calculating the value of IP owned by the U.S. Group, which was eventually combined with that of the U.K. Possible methods are the Income Method, Market Capitalization, and the Acquisition Price Method. Since there was limited data, we could not calculate the potential exposure with respect to the value of IP transferred by the U.S. to U.K. under these methods.

To the extent the IRS makes an adjustment to the profitability of the U.S. Group, there would be potential for competent authority involvement.

U.S. taxation - current tax profile

We have not been provided with any U.S. federal income tax returns during the course of our diligence.

Federal filings

We have not been provided with any U.S. federal income tax returns during the course of our diligence.

Based on discussions with management and the provided organizational chart, ANAH is the parent of the U.S. federal consolidated group and files on the behalf of all U.S. entities. Based on Target financials, the U.S. Group likely has a December 31 year end and files on a calendar year basis. As the common parent of the U.S. Group, ANAH would file Form 1120 *U.S. Consolidated Corporation Income Tax Return* annually.

Tax attributes

Based on the information provided and discussions with management, we understand that there are a number of important tax attributes that should carryover in the proposed acquisition of Target.

- **NOLs** - the U.S. Group has had a number of losses that have been self-generated as well as acquired. However, based on provided IRC section 382 studies and third party reviews of these IRC section 382 studies, use of the acquired losses have been limited.
- **R&D tax credit** – Management represented that the R&D tax credit plays a key role in managing the ETR for the U.S. Group. However, management also represented that Target's R&D is primarily conducted in the U.K. For U.S. federal income tax purposes, R&D expenditures in these foreign jurisdictions would not be included in the U.S. R&D tax credit calculation.
- **Other attributes** – We have not been apprised of any other attributes. They will be considered when further data is provided.

U.S. taxation – net operating losses

The U.S. Group has historically both self-generated as well as acquired NOLs. Based on documents provided, both acquired and generated NOLs were subject to IRC section 382 limitations on utilization.

We are unable to validate management's representations that the majority of losses were to be fully utilized by 2011 based on the information provided.

Net operating losses, generally

The U.S. Group has both generated and acquired losses since 1996. Based on a third party review of Target's IRC section 382 limitations, as of the year ended December 31, 2009, the U.S. Group had acquired or generated NOL carryovers of approximately $389.8 million. The report also indicated that approximately $75.8 million of the NOLs were to be subject to permanent limitation by reason of IRC section 382, and thus are to expire unutilized. Management represented that all available losses were substantially utilized in 2010 and prior years, and any remaining residual losses were to be utilized by 2011. However, based on the documents provided, we were unable to confirm these representations. Please see the summary of PwC-revised NOLs and limitations on the following pages.

Generally, in a stock acquisition, the target company retains its historical U.S. tax attributes; however, some of these attributes are subject to an annual limitation. IRC sections 382 and 383 impose limitations on a corporation's ability to use its NOL and credit carryforwards (and certain other tax attributes), following an "ownership change." States generally impose similar limitations following an "ownership change."

An "ownership change" is a cumulative increase by "5% shareholders" of more than 50 percentage points (by value), within a rolling three-year period. Such a change in the equity of a company having tax attributes will generally cause an ownership change for purposes of IRC section 382 and results in the application of an annual limitation on the utilization of NOLs, credits and certain other tax attributes subsequent to the ownership change.

The annual limitation is generally calculated by multiplying the long-term tax exempt rate in effect at the time of the ownership change (e.g. 4.17% for ownership changes in August 2011, see Rev. Rul. 2011-16) by the fair market value of the loss company's equity on the ownership change date. The fair market value of the shares must be adjusted for various special rules under IRC section 382. Under IRS Notice 2003-65, the annual limitation may generally be increased by the additional hypothetical depreciation/amortization that would have been generated had an asset purchase occurred upon the ownership change date. The annual limitation may also be increased by any additional built-in gain recognized within the initial five years after the acquisition. All such increases to the limitations are limited to the NUBIG at the date of the ownership change.

Alternatively, if the target corporation has a NUBIL immediately prior to the ownership change date, any portion of such NUBIL recognized during the five-year recognition period is subject to the annual limitation. Such recognized built-in losses can include depreciation and amortization with respect to built-in loss assets.

U.S. taxation – net operating losses

Net operating losses, documents provided

The U.S. Group has conducted a number of IRC section 382 limitation studies on its self-generated and acquired NOLs (through the Zantaz acquisition). Specifically, IRC section 382 studies were conducted on ANAH, Target, Inc., Verity, and Zantaz. We were provided a review of these IRC section 382 studies, conducted by the U.S. Group's external tax advisor, PwC. In addition, PwC also conducted IRC section 382 studies on the Virage and Interwoven acquisitions.

The PwC review of the U.S. Group's IRC section 382 studies makes several observations about the initial starting testing dates of some of the studies, conclusions reached about presumed 5% and non-5% shareholders and their effects on whether an ownership change occurred on the specified dates and subsequently, conclusions reached about the level of limitation on the ownership change dates.

- PwC found in certain cases, initial testing dates were incorrect.
- PwC questioned the inclusion of certain 5% shareholders which affected the calculation of the ownership date.
- PwC applied Notice 2003-65 to increase the limitations.

Based on these findings, PwC substantially revised the IRC section 382 studies and limitation calculations. Please see the next page for a summary of revised ownership dates and calculated limitations.

The PwC review did not include adequate equity rollforward documentation, thus, we were unable to attempt to corroborate the findings of the PwC review. However, with respect to the procedures and assumptions used to review the U.S. Group IRC section 382 studies, we find the approach and general application of the IRC section 382 rules (i.e., cash issuance exception, small issuance exception, 5% shareholder vs. investment adviser presumptions, etc.) to be reasonable.

With respect to the PwC studies of Virage and Interwoven, we similarly find that the procedures and assumptions used and general application of the IRC section 382 rules to be reasonable.

Net operating losses, previously unutilized

Management represented that approximately $23.5 million of losses previously unutilized were recognized in 2010. Management represented that these losses were related to Interwoven and that there were doubts as to whether or not the losses could be utilized. While management represented that a recent IRC section 382 study confirmed appropriate use of the losses, it is not immediately clear which losses were disputed and how management confirmed the use of the losses based on material provided.

Supporting analysis

U.S. taxation – net operating losses

Based on the PwC review and revisions of the U.S. Group IRC section 382 limitations, the U.S. Group had generated or acquired approximately $389.8 million NOL carryovers, $75.8 million of which in future years will expire before being utilized.

Ownership changes & section 382 Limitations (per PwC review and studies)

Entity	Ownership change dates	Section 382 limitation	Notice 2003-65 NUBIG	Total limitation		NOL C/F subj. to 382 analysis	NOLs permanently limited	
ANAH	none	-	-	-		1,206,387		
	July 15, 1998	1,525,589	2,371,571	3,897,160				
Autonomy, Inc.	December 31, 2000	98,433,107	122,315,341	220,748,448		66,784,112	-	
	December 19, 2005	13,731,437	20,935,009	34,666,446				
	February 17, 1998	2,765,105	-	2,765,105				
Verity, Inc.	September 3, 2005	10,706,877	3,256,055	13,962,932		62,044,530	-	
	December 31, 2005	21,302,457	-	21,302,457				
	May 1, 1998	3,322	-	3,322				
	June 23, 1998	4,212	-	4,212				
Zantaz, Inc.	October 8, 1999	2,102,883	-	2,102,883	(1)	75,975,745	1,361,242	
	August 18, 2004	3,926,298	6,215,226	10,141,524				
	July 20, 2007	15,925,867	21,580,322	37,506,189				
	April 3, 1995	12,482	192,085	204,567				
	April 27, 1998	164,986	535,868	700,854				
	December 17, 1998	2,500,606	2,983,688	5,484,294				
Virage, Inc.	February 14, 2002	-	-	-	(2)	88,834,814	71,213,109	(4)
	July 9, 2003	541,602	625,759	1,167,361				
	September 2, 2003	570,734	633,506	1,204,240				
	December 19, 2005	-	-	-	(3)			
	April 1, 1996	770	-	770				
	May 9, 1997	3,821	139,250	143,071				
	March 31, 1998	2,346	227,849	230,195				
Interwoven	December 31, 1999	153,943,915	180,434,345	334,378,260		94,965,070	3,198,002	(5)
	December 29, 2002	5,609,956	-	5,609,956				
	March 27, 2009	41,749,276	18,724,827	60,474,103				
Total						**389,810,658**	**75,772,353**	

Note:
(1) Mistakenly transcribed as August in summary NOL schedules. The accompanying memo notes ownership change date as October.
(2) $62 million in capital contributions removed per anti-stuffing rules, thus limitation is $0.
(3) Value of Virage increased dramatically, between 2003 to December 2005, the IRC section 382 limitation on this ownership change date was determined to be generally irrelevant by PwC.
(4) The accompanying memo cites the NOLs lost to expiration as $59 million. The Virage work papers indicate $71.2 million.
(5) The calculation of NOLs permanently limited by the IRC section 382 limitation is overstated by approximately $650,000. The calculation does not account for the prior year permanently limited amount from what is a cumulative account of NOLs subject to the !RC section 382 limitation in the following year.

Source: PwC Review.

U.S. taxation – Tower Structure

Target implemented the Tower financing structure to finance its U.S. acquisitions. Key areas of concern are the ability of the U.S. Group to continue to service intercompany debt and not become too thinly capitalized which could unfavorably recharacterize intercompany debt as equity under IRC section 385. The affirmative conclusions of the tax opinion obtained by Target addressing these and other issues appear reasonable.

Tower structure

Management has represented that it implemented a tax – favorable financing structure, the "Tower Structure," to finance its U.S. acquisitions, while also repatriating earnings from the U.S. by increasing the level of debt funding provided to the U.S. Group. Management represented that the Zantaz acquisition was the first acquisition financed in such a manner, however, we were only provided with the U.S. and U.K. opinions regarding the structure as it relates to the Interwoven acquisition.

Generally, based on the provided tax opinions, through the use of a U.S. organized/U.K. resident entity (i.e., treated as a corporation for U.K. tax purposes, but a disregarded entity for U.S. federal tax purposes), the Tower Structure allows for ANAH to recognize U.S. deductions for interest paid, yet allows for AEHL interest income to be offset by an interest expense incurred by the U.S. organized/U.K. resident entity. Please see Appendix 4 for the implemented steps, and a schematic of the transaction with key tax concerns typically identified when using these type of structures.

Management represented that currently the U.S. has outstanding intercompany debt of approximately $470 million. The CFO approximates that Target has received approximately $15 million in tax benefits from the implementation.

The U.S. tax opinion reached the following conclusions regarding the following U.S. tax issues identified in the Tower Structure as implemented:

- Debt v. equity: the proper characterization of the loan from AEHL to ANAH ("Loan A") should be debt for U.S. federal tax purposes;
- Deductibility of interest payments: Interest payments made on Loan A by ANAH should be deductible when paid and potentially limited by IRC section 163(j);
- Reduced rate on withholding taxes: AEHL is a beneficial owner of interest payments received from ANAH on Loan A pursuant to the U.S.-U.K. Treaty and thus, no U.S. withholding tax on the interest payments received by AEHL from ANAH should apply;
- Entity classification: LLC 1 and LLC 2 should be treated as single member LLCs, disregarded for U.S. federal income tax purposes;
- Dual consolidated losses: the dual consolidated loss rules do not apply to limit or disallow the deduction of interest payments made by ANAH to AEHL;
- Reportable transaction: the transaction is not treated as a reportable transaction requiring disclosure.

Based on our reading of the U.S. tax opinion, which addresses potential tax issues with respect to the Tower Structure, we find the conclusions of the tax opinion reasonable.

Debt-equity characterization

Typically, one of the general concerns regarding the use of Tower Structure is the ability of the U.S. entity to service debt and not run afoul of IRC section 385. IRC section 385(b) outlines several factors taken into account to classify payments between two entities as either debt or equity. Such a classification of such advances for U.S. tax purposes (either as debt or equity) is important because it determines whether the U.S. Group can claim interest deductions for payments made with respect to any advances.

The five factors outlined in IRC section 385(b) are: (1) whether the advance is formalized as a loan; (2) whether there is a subordination to or preference over any indebtedness of the corporation; (3) the ratio of debt to equity of a corporation;

U.S. taxation – Tower Structure

(4) whether there is convertibility into the stock of the corporation; and (5) the relationship between holdings of stock in the corporation and holdings of the interest in question. However, a debt-equity analysis is not limited to the factors listed in IRC section 385, and a thorough analysis depends on a number of other factors outlined by the courts to determine the economic reality.

IRC section 163(j) earnings stripping

Generally, IRC section 163(j) limits the deductibility of interest paid or accrued by a U.S. corporation if the debt is borrowed from or guaranteed by a related non-U.S. party. IRC section 163(j) applies if the U.S. corporation's debt-to-equity ratio (as of the end of the taxable year) exceeds 1.5:1. Therefore, the earnings stripping provisions of IRC section 163(j) apply to corporations that are relatively thinly capitalized. Assuming a corporation's debt exceeds the 1.5:1 ratio test as of the end of its taxable year, IRC section 163(j) would prohibit the U.S. Group from deducting interest due on debt guaranteed by a related non-U.S. party, to the extent that the total interest deduction (including interest due unrelated persons) would otherwise exceed 50% of the corporation's "adjusted taxable income" as defined by IRS regulations. Interest in excess of this 50% limit ("excess interest expense") can be carried forward indefinitely.

In this case, based on the tax opinions provided, it does not appear that IRC section 163(j) caused a limitation on the U.S. Group's interest deduction prior to 2010. However, this limitation is tested annually, and continued unbounded use of the Tower financing structure through ANAH could eventually limit ANAH's interest deduction in future years.

Appendices

Appendix 1

SOW procedures

Procedures that could not be performed appear in bold.

Procedures that could not be performed appear in bold.

Unless otherwise noted, our work will concentrate on the last two fiscal years and the most recent available year-to-date financial information, together with Target's forecast for the remainder of FY2011.

Our comments will depend on the extent to which we can carry out the procedures below, the level of information made available, and the level of access we have to Target management. We anticipate that fieldwork may also be performed in U.K. depending on where financial information is located.

Financial due diligence assistance – general

1. Attend management presentations offered by Target.
2. Read information provided in the data room.
3. Participate in interviews of Target management who can address matters you have indicated are of concern to you.
4. Read Target's financial statements and inquire about Target's accounting policies and practices, including:
   - Reporting methodology and consistency with HP's policies and procedures;
   - Differences between U.S. GAAP and IFRS;
   - Basis for cost allocations;
   - Significant accounting policies and estimates, including revenue recognition;
   - Recent or contemplated changes in accounting principles, procedures, or estimates;
   - Intercompany accounts and related party transactions; and
   - Internal control environment including controls at foreign subsidiaries
5. **Read Target's auditors' work papers, management letter, and reports to the audit committee for the most recently completed audit and quarterly reviews for this fiscal year.**

Financial due diligence assistance – Revenues and revenue recognition; expenses

6. Obtain and read materials outlining Target's historical revenues and inquire about:
   - Revenue recognition policies and procedures;
   - **Target's methodology for establishing fair value for undelivered elements in multiple-element transactions;**
   - **Revenue composition (e.g., license, professional services, hosting, maintenance) by significant products/offerings;**
   - **Historical trends in revenue and key metrics including customers (direct, OEM, resellers), products, geography, sales channel, customer type, new vs. existing customers, renewal rates, attrition, volumes and pricing;**
   - **Target's pricing model (including implementation) and professional services;**
   - **Discounts and allowances;**
   - **Revenue vs. cash collection;**
   - **Acquisition vs. organic growth;**
   - **Seasonality;**
   - **Foreign exchange;**
   - **Deferred revenue and the expected timing of revenue recognition;**
   - **Non recurring revenue, including discontinued offerings and one-time items;**
   - **Cut-off; and**
   - **Order backlog, historical conversion rates and pipeline.**

Appendix 1
SOW procedures

Procedures that could not be performed appear in bold.

7. At your request, read the financial terms of the 20 largest customer contracts and 20 largest partner and VAR contracts by value in each of 2010 and 2011 and comment on standard and non–standard contract terms and issues having a potential revenue recognition impact.
8. Hold discussions with you and your internal accounting team to discuss our findings with respect to Target's revenue recognition. Assist your team in considering the post-close implications, if any, on your own revenue recognition.
9. Summarize the potential identified adjustments regarding the profit and loss performance of Target in the form of a quality of earnings analysis, summarizing the risks that may impact earnings.
10. **Obtain and read an analysis of Target's expenses and inquire about:**
    - **Historical trends in costs and key cost metrics, gross margins and operating margins;**
    - **Cost of revenues;**
    - **Royalty costs and license fees to support intellectual property;**
    - **Capitalized costs including commissions and software development expenses**
    - **Overhead;**
    - **Consulting labor costs (including billing and utilization rates) and the extent to which subcontractors are utilized to perform consulting services;**
    - **Selling, general, and administrative expenses;**
    - **Research and development;**
    - **Trends in key metrics, including headcount and average salaries;**
    - **Fixed salaries, profit sharing, commissions and bonuses;**
    - **Restructuring charges;**
    - **Unusual and extraordinary items; and**
    - **Cut-off.**

Financial due diligence assistance – Balance sheet, working capital, cash flow

11. **Obtain and read an analysis of Target's accounts receivable and inquire about:**
    - **Credit terms;**
    - **Aging analysis;**
    - **Trade and non-trade balances; and**
    - **Allowance for uncollectible accounts and write-offs.**
12. **Obtain and read an analysis of Target's fixed assets, capital expenditures, and other significant assets and inquire about:**
    - **Equity and other investments;**
    - **The components of other assets and intangible assets;**
    - **Historical, deferred, and planned capital expenditures; and**
    - **Impairment write-downs and issues.**
13. **Obtain and read an analysis of Target's accounts payable, accrued liabilities, deferred revenue, and other significant liabilities and inquire about:**
    - **Accounts payable and accrued liabilities;**
    - **Restructuring provisions;**
    - **Deferred revenue and the timing of future revenue recognitions; and**
    - **Other current and non-current liabilities.**

Appendix 1

SOW procedures

Procedures that could not be performed appear in bold.

14. Inquire into Target's banking relationships, including its:
    - Outstanding indebtedness;
    - Banking agreements;
    - Change in control and repayment penalties
    - Borrowing terms and debt covenants; and
    - Credit facilities.
15. Obtain and read an analysis of Target's historical cash flows and working capital and comment on historical working capital and cash flow trends and cash flows by entity.

Financial due diligence assistance – Commitments and contingencies

16. In conjunction with your attorneys, inquire about significant commitments and contingent liabilities including:
    - Customer commitments (specified technology, support commitments, etc.);
    - Pending or threatened litigation or investigations by regulatory or other authorities;
    - Commitments related to historical and pending acquisitions;
    - Self-insurance;
    - Post-retirement benefits and pension arrangements;
    - Warranty obligations;
    - Incentive compensation; and
    - Committed or contractual capital expenditures.
17. In conjunction with your attorneys, inquire about change-in-control provisions in significant contracts, including employment contracts; supply agreements; debt agreements; and option, warrant, stockholder, preferred stock, and other equity-related agreements.

Financial due diligence assistance – Internal control infrastructure

18. **Hold a discussion with Target's independent accountants about their approach to testing and relying on Target's internal control infrastructure as part of their financial statement audits.**

Management's forecasts/projections

19. **Obtain historical and latest interim financial information available and compare actual results to budget. Interview management about the reasons for significant fluctuations between periods and with budget.**
20. **Based on the results of our other procedures comment on key financial, accounting and tax issues that may have an impact on your valuation model.**

Financial due diligence assistance – Preliminary (indicative) purchase price

21. Read Target's public filings, interview Target management, and read Target management's financial projections to assist in a preliminary (indicative) "top-level" purchase price allocation for the purpose of providing inputs to your financial model regarding deferred revenue and key intangible assets prior to announcing the potential transaction.

Tax due diligence – U.S.

22. Hold a discussion with Target's tax director, CFO, CEO, **and/or tax preparers and advisors to and discuss significant tax issues.**
23. Obtain details of and inquire about Target's legal and tax structure.
24. Obtain and read tax returns for recent open tax years and inquire about historical positions taken with respect to state (including income, sales/use, property, payroll, etc.) and federal tax issues.
25. **Inquire about and comment on tax sharing agreements, if any.**

Appendix 1

SOW procedures

Procedures that could not be performed appear in bold.

26. Inquire about structuring of significant transactions in open tax years (including acquisitions, dispositions, joint ventures, and intercompany transactions) and the tax treatment thereof.

27. **Inquire about historical positions taken and compliance with respect to significant sales and use, property, payroll, unclaimed property, gross receipts, and employment.**

28. Obtain and read a summary of the components of current and deferred tax accounts and reserve analyses (including tax reserve analyses), and inquire about historical positions taken.

29. Inquire about completed and ongoing tax examinations, administrative proceedings, or tax litigation, **and comment on the potential resulting cash flow and financial statement implications with respect to future open years.**

30. **Inquire and discuss with Target personnel (and tax advisors if appropriate) about tax attributes, including net operating loss and credit carryforwards. Inquire about limitations on the use of the tax attributes.**

31. Inquire about the established processes and internal controls around the tax process.

32. Inquire about international affiliates and services provided outside the U.S., as well as Target's transfer pricing.

33. **Inquire about IRC section 409A compliance (deferred compensation arrangements).**

34. **In conjunction with your attorneys, inquire about change-in-control provisions, in employment contracts including IRC section 280G exposure, to assess severity of exposures to golden parachute payments or issues. Our work does not include preparation of the final calculations of the actual disallowed deduction or the specific amount of excise tax due once (and if) the transaction is consummated. Our work also does not include assistance with developing, designing or implementing steps to mitigate potential IRC section 280G exposures. We recommend that you engage a benefits consulting firm to provide any services that are beyond the scope of this engagement.**

Tax due diligence – U.K.

35. Read tax returns prepared for the relevant period and inquire about potential tax implications and exposures.

36. With regard to corporate tax matters:

   – **Obtain and read corporate income tax returns and underlying working papers for open tax years and understand historical positions taken with respect to such tax returns.**

   – Understand structuring of significant transactions in open tax years (including acquisitions, dispositions, joint ventures, and intercompany transactions) and the tax treatment thereof.

   – **Read reports issued regarding completed and ongoing tax examinations, administrative proceedings, or tax litigation, and consider the resulting cash flow and financial statement implications with respect to future open years.**

   – Comment on the corporate tax provision in the statutory accounts. In addition, obtain and read a summary of the components of current and deferred tax accounts and reserve analyses, as well as understand significant historical positions taken.

   – Comment on the effective tax rate and reconcile to the relevant statutory tax rates.

   – Summarize details of identified significant tax attributes such as trading and capital losses and comment on their availability for use in future periods including restrictions arising on a change of ownership or time limitations for future use.

   – Inquire about tax planning or optimization strategies which have been undertaken including copies of clearance applications submitted and the responses from the tax authorities.

SOW procedures

Procedures that could not be performed appear in bold.

37. With regard to employee taxes:
    - **Inquire about whether Target has been subject to a recent wage/payroll audit and, if so summarize the results identified.**
    - **Discuss with management whether Target has submitted payroll tax/social security returns within the statutory time limits and whether payroll/social security remittances have been made to date.**
    - **Summarize identified potential payroll and/or social security issues relating to the engagement of self employed contractors.**
    - Read rules of share incentive plans and summarize the identified potential impact of the transaction on such plans, specifically in terms of the payroll and social security exposures for employing companies on vesting and lapsing of awards.
38. **With regard to value added taxes:**
    - **Obtain details of VAT registration status and discuss with Management whether registration obligations have been complied with.**
    - **Discuss with Management whether Target has complied with its VAT/sales tax accounting obligations, and comment on identified areas of non-compliance**
    - **Discuss with Management whether any Revenue authority has conducted inspections or made inquiries into Target's VAT/sales tax affairs during the last three years and comment on the outcome.**
39. **With regard to transfer taxes:**
    - **Comment on significant transfer taxes or capital taxes which may be payable on the sale/purchase of the companies.**

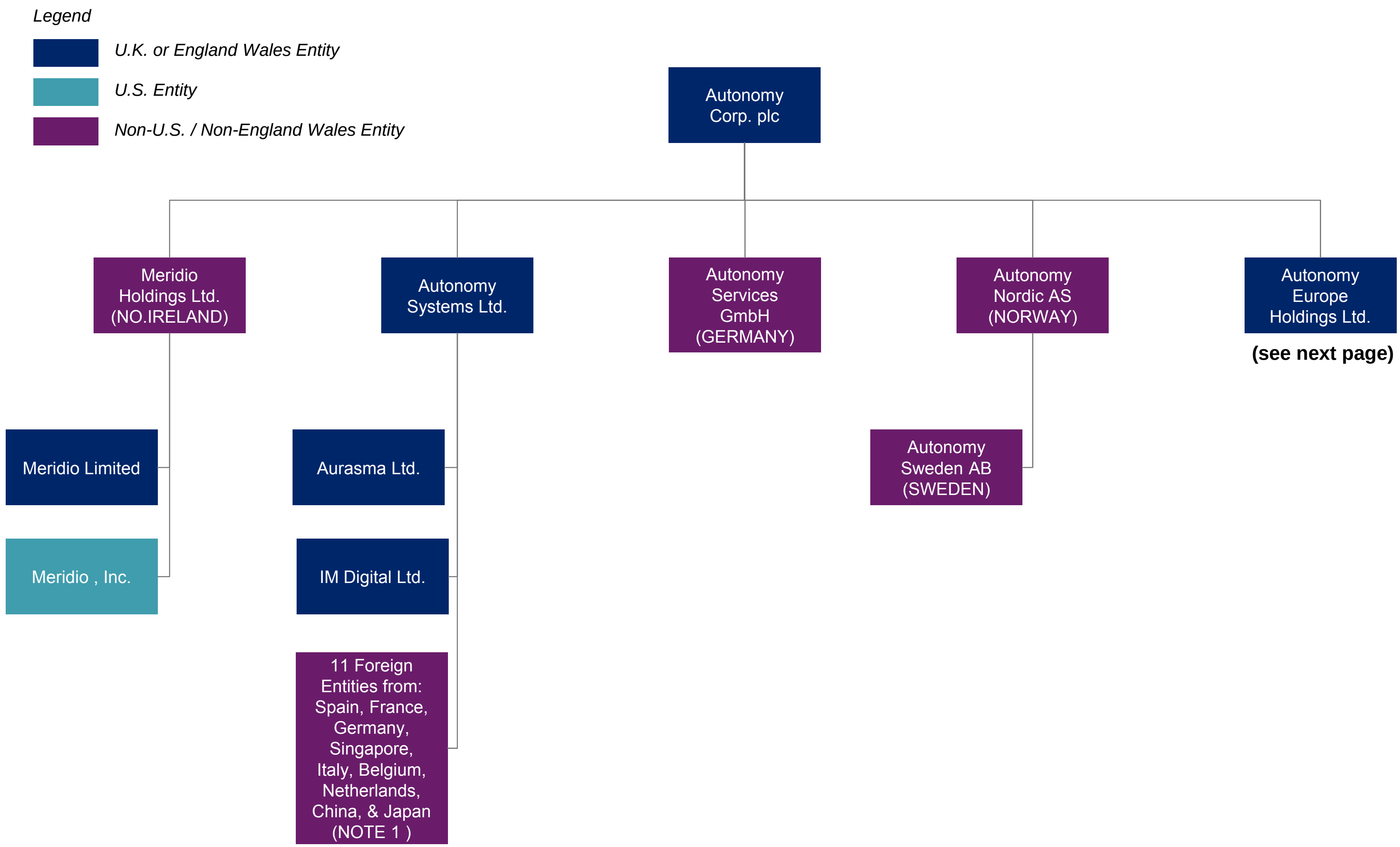
37. Obtain and read intercompany agreements (i.e. transfer pricing analysis).
38. Inquire about location of significant intellectual property including inquiry into: (1) any IP migration structures and buy-in/out arrangements, including territories covered and royalty payment terms; and (2) cost sharing arrangements, including whether stock option compensation was included in the cost sharing pool, when required.

Financial due diligence assistant - Deal structuring and financial reporting

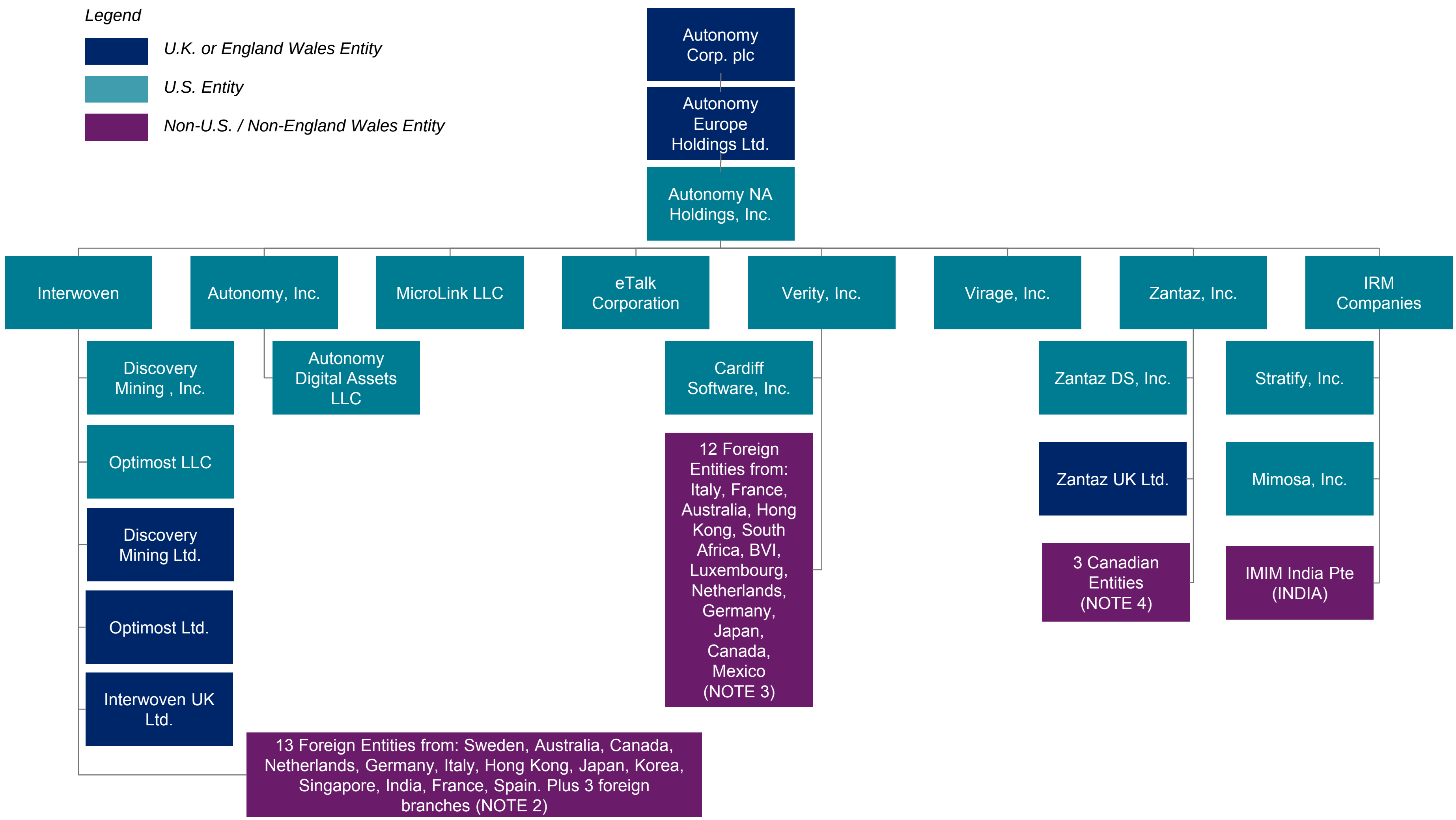
42. **Read the latest available draft of the purchase and sale Agreement and offer commentary to you and your attorneys primarily concerning sections relating to accounting and tax matters, based on the results of the due diligence assistance we provided. You agree to review with your attorney all our comments and suggestions concerning the purchase and sale agreement before acting on any of our suggestions.**
43. **Meet with you and your advisors to discuss possible accounting and tax structuring alternatives relating to matters you and your advisors have identified.**
44. **Meet with you and your advisors to discuss SEC reporting requirements and assistance with financial reporting.**

Appendix 2

Organizational chart (1)



Appendix 2
Organizational chart (2)



Organizational chart (NOTES) (3)

NOTES:

(1) The 11 foreign entities not shown under Autonomy Systems Limited are:
Autonomy Spain SL (SPAIN)
Autonomy France Sarl (FRANCE)
Autonomy Germany GmbH (GERMANY)
Autonomy Systems Singapore Pte Ltd. (SINGAPORE)
IM Digital Sarl (FRANCE)
Autonomy Italy Srl (ITALY)
Autonomy Belgium BVBA (BELGIUM)
Autonomy Netherlands BV (NETHERLANDS)
Autonomy Systems (Beijing) Ltd. Co. (BEIJING)
IM Digital KK (JAPAN)
IM Digital GmbH (GERMANY)

(2) The 13 foreign entities not shown under Interwoven are:
Interwoven AB (SWEDEN)
Interwoven Canada Ltd. (CANADA)
Interwoven GmbH (GERMANY)
Interwoven Hong Kong Ltd. (HONG KONG)
Interwoven Korea, Inc. (KOREA)
Interwoven Software Services India Pvt Ltd. (INDIA)
Interwoven SAS (FRANCE)
Interwoven Australia Pty Ltd. (AUSTRALIA)
Interwoven BV (NETHERLANDS)
Interwoven Srl (ITALY)
Interwoven Japan KK (JAPAN)
Interwoven Software Pte Ltd. (SINGAPORE)
Interwoven Software SL (SPAIN)

The 3 branches not shown under Interwoven are:
Mumbai
PRC
Taiwan

(3) The 12 foreign entities not shown under Verity, Inc. are:
Verity Italy Srl (ITALY)
Autonomy Systems Australia Pty Ltd. (AUSTRALIA)
Autonomy Systems South Africa (SOUTH AFRICA)
Autonomy Systems Canada Ltd. (CANADA)
Verity Mexico S. de R.L.de C.V. (MEXICO)
Verity France Sarl (FRANCE)
Verity Hong Kong Ltd. (HONG KONG)
Autonomy Japan KK (JAPAN)
Verity BVI (BRITISH VIRGIN ISLANDS)
    owns Verity Luxembourg Sarl (LUXEMBOURG)
        owns Verity Benelux BV (NETHERLANDS)
            Verity Deutchland GmbH (GERMANY)

(4) The 3 Canadian entities not shown under Zantaz, Inc. are:
3086025 Nova Scotia Co. (CANADA)
2040523 Ontario, Inc. (CANADA)
Zantaz Canada, Inc. (CANADA)

(5) Other DORMANT entities listed on Target Organizational Chart:
Dremedia Ltd. (UK)
Neurodynamics Ltd. (UK)
Nholdings Ltd. (UK)
Ncorp Ltd. (UK)
Softsound Ltd. (UK)
Virage Europe Ltd. (UK)
Longsand Ltd. (UK)
Meridio Management Ltd. (NORTHERN IRELAND)
Meridio Trustees Ltd. (NORTHERN IRELAND)
Blinkx, Inc. (US)
Inktomi, Inc. (US)
Cardiff, Inc. (US)
Mediabin, Inc. (US)
iManage, Inc. (US)
Srittura, Inc. (US)
Virage GmbH (GERMANY)
Interwoven AS (NORWAY)

U.K. transfer pricing - profit split report

Transfer pricing rules broadly require that, for tax purposes, transactions between related parties are priced on terms that satisfy the arm's length standard.

Where transactions are very interrelated, with each party making unique and valuable contributions, it may be that they cannot be evaluated on a separate basis. The PSM may be appropriate in such cases.

Target has adopted the PSM for transfer pricing. Target appears to have complied with the requirements for preparation of its study and the risk of HMRC successfully challenging the methodology appears low.

Overview

U.K. transfer pricing rules broadly require that, for tax purposes, transactions between related parties are priced on terms that satisfy the arm's length standard. Where the actual terms of related party transactions depart from this standard, with the result that a party's liability to tax is reduced, an adjustment may be required to increase that party's tax liability to that which would have applied under the arm's length standard. There is not necessarily any corresponding downward adjustment to the profits of the other party, or a delay in claiming such an adjustment may be required.

In essence, transactions between related parties satisfy the arm's length standard when the conditions made or imposed do not differ from those that would be made between independent parties. Where this is the case, the profits accruing from the transactions between related parties are considered arm's length.

The OECD's *Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations (*"the OECD Guidelines"), which member states are encouraged to follow (and which are effectively incorporated into U.K. tax legislation) provide detailed descriptions of pricing methods that can be used to establish whether the arrangements are consistent with the arm's length principle.

We have conducted a high level analysis of the transfer pricing report, *Target – Transfer Pricing Study – Acquisitions of eTalk, Cardiff and Zantaz (*"the profit split report"). The profit split report was prepared by Deloitte in 2008. Under the version of the OECD Guidelines then published, there was a distinct hierarchy of methods – traditional transaction methods (particularly the CUP method) should be used, if possible, in preference to transactional profits methods (such as PSM). Parts of the OECD Guidelines were substantially revised in July 2010.

In selecting a transfer pricing method, it is important to find the most appropriate method for each individual case. The 2010 OECD Guidelines acknowledge there is no one method suitable for every case and therefore a number of factors must be considered when selecting the most appropriate method. It is not necessary to prove that a specific method is not suitable.

In particular, consideration should be given to the strengths and weaknesses of each method, the appropriateness of the method in light of the functional analysis, and the availability of reliable information needed to apply the method, among other factors.

Notwithstanding the 2010 revisions to the OECD Guidelines, it is still recognized that traditional transaction methods are generally the most direct means of establishing whether conditions in the commercial and financial relations between associated enterprises are at arm's length. As a result, the OECD Guidelines continue to advise that the traditional transaction methods should be used in preference to the other methods wherever possible.

The profit split report has applied the OECD Guidelines (using, of course, the version that was published at the time). In our view it is likely that the approach adopted would also be reasonable under the 2010 version of the OECD Guidelines.

Use of the PSM

Where transactions are very interrelated, with each party making unique and valuable contributions, it may be that they cannot be evaluated on a separate basis. Under similar circumstances, independent enterprises might decide to set up a form of partnership and agree to a form of profit split. Accordingly, PSM seeks to eliminate the effect on profits of special conditions made or imposed in a controlled transaction by determining the division of profits that independent enterprises would have expected to realize by engaging in the transaction or transactions.

Appendix 3

U.K. transfer pricing - profit split report (2)

This is the approach that has been adopted in the profit split report.

The PSM splits the combined profit resulting from an integrated activity between the two companies based on the relative value of each company's contribution to the combined profit. This method is most applicable where transactions are very interrelated and cannot be evaluated on a separate basis, with each party making unique and valuable contributions.

One recognized approach to the PSM is the residual PSM. This approach has been adopted in the Deloitte transfer pricing report.

The residual PSM divides the combined profits or losses in two stages. The first ensures the participants are given a sufficient allocation to provide them with a basic return relating to their routine functions performed (if any), but which would generally not account for the return that would be generated by any unique and valuable assets of the participants. The second stage allocates any residual profit or loss in accordance with how this would have been allocated between independent enterprises based on an analysis of the facts and circumstances.

The residual profit represents the profit that cannot readily be assigned to routine functions, such as the profit arising from high-value, sometimes unique, intangibles.

Strengths of the PSM

One strength of the PSM is that it generally does not rely directly on closely comparable transactions, and it can therefore be used in cases when no such transactions between independent enterprises can be identified (for example, when valuable and unique IP is provided by both parties, as is the case here). The allocation of profit is based on the division of functions between the associated enterprises themselves.

External data from independent enterprises is relevant in the profit split analysis primarily to assess the value of the contributions that each associated enterprise makes to the transactions, and not to determine directly the division of profit. As a consequence, the PSM offers flexibility by taking into account specific, possibly unique, facts and circumstances of the associated enterprises that are not present in independent enterprises, while still constituting an arm's length approach to the extent that it reflects what independent enterprises reasonably would have done if faced with the same circumstances.

Another strength is that under the PSM it is less likely that either party to the controlled transaction will be left with an extreme and improbable profit result, since both parties to the transaction are evaluated.

Weakness of the PSM

There are a number of weaknesses with the model, of which it the most significant in this case is that the implementation of the PSM is necessarily reliant on a number of data sources and/or assumptions. It may be more difficult to support the data and assumptions by reference to comparable independent data. Tax authorities may therefore identify more opportunities for challenging the conclusions drawn under the method's implementation in a particular case, even where the methodology itself is accepted.

U.K. transfer pricing - profit split report (3)

Selection of the profit split method

Based on our reading of the profit split report, it appears that the profits under consideration are generated from a combination of the following sources:

- distribution activity conducted by the U.S. Group (a routine function);
- IP developed and owned by the U.S. Group; and
- IP developed and owned by the U.K. parent.

The purpose of the profit split analysis is to identify an arm's length royalty to be granted to the U.K. parent with respect to the value it has contributed to U.S. sales – namely, the value of its IP.

The main factors leading to the selection of the PSM in the profit split report were as follows:

- The introduction to Section 6 states that :
  - "*U.K. parent provides eTalk, Verity Cardiff and Zantaz with IDOL technology, benefits from the association with Target's name and reputation and business expertise. This has enabled the U.S. Group [to] provide new customers with a more sophisticated product, benefit from reduced costs and enhance their reputation by having access to Target's brand name.*"
- The report does note, at 7.2, that
  - *"transaction based methods are favoured by tax authorities so a profit based method such as the profit split should only be used where the traditional transaction methods cannot be reliably applied."*
  - In our view this caveat is appropriate. Nevertheless, based on the information in the functional analysis, the conclusion that the interlinked contributions of the parties means that the PSM is the most appropriate method seems reasonable.

The key issue in selection of the PSM is the combination of IP which was developed individually by the U.K. parent and the U.S. Group. The implications of this for transfer pricing methodology selection are set out in Appendix 2 of the profit split report. In summary, the contribution of valuable IP by both the U.S. and U.K. parties, and the absence of publicly available comparable data, leads to the rejection of traditional transaction methods and the selection of the PSM as the most appropriate method.

The PSM operates to grant a routine return for the U.S. distribution function, and an allocation of residual profit with respect to U.S. IP, to the respective the U.S. Group. The remainder of the residual profit is granted to the U.K. parent as a royalty for the IP it has contributed to U.S. sales.

The absence of a routine return to the U.K. parent implies that the profit split report does not cover any U.K. sales of products involving the combined U.S. and U.K. IP. If there are any such sales, the transfer pricing treatment of these, which may affect the proportions of total profit allocated to each of the entities, should also be considered.

Again, in our view the rejection of alternative methods in Appendix 2 appears reasonable based on the information contained in the profit split report.

Further, in our view the conclusions drawn in the report would also be reasonable if it had been made under the revised version of the OECD Guidelines published in 2010.

However, there is no guarantee that the tax authorities would agree with the conclusion in the profit split report that the PSM is the most appropriate method. However, based on our experience it seems unlikely, on the basis of the facts as stated in the report, that a tax authority would successfully substitute a different transfer pricing methodology in this case.

U.K. transfer pricing - profit split report (4)

The 2010 OECD Guidelines expressly state (at para 2.4):

> "*cases where each of the parties makes valuable and unique contributions in relation to the controlled transaction . . . may make a transactional profit split more appropriate than a one-sided method.*"

The above conclusion is dependent on the determination that both the U.K. parent and the U.S. parties have indeed contributed valuable and unique IP. A contrary determination (e.g., that the value in practice of one party's contribution is not material) could lead to the conclusion that a different methodology is more appropriate. The information in the profit split report indicates that both the U.K. parent and the U.S. Group have contributed valuable IP.

Alternatively, or in addition, the identification of a suitable CUP could affect the method selection. This is particularly relevant in light of the fact that only the U.S. Group appear to be selling the products that arise from the application of the jointly provided IP (discussed further below). It is theoretically possible, therefore, that the provision of IP from the U.K. parent to the U.S. Group could be priced by an application of the CUP method (e.g., to identify an arm's length royalty rate for comparable IP licences). Appendix 2 to the profit split report states that no such CUPs were identified.

We have not independently considered whether any CUPs are available, but in our experience it is difficult and often impossible to identify external CUPs for transactions involving valuable and unique IP. On the understanding that there are no internal CUPs, therefore (which is also stated in Appendix 2), it seems that in practice the PSM is the most appropriate method in this case.

Based on the information in the report, our view is therefore that the risk of a successful tax authority challenge to the selection of the PSM in this case is relatively low.

Application of the profit split method

Application of third party data

- As noted above, a strength of the PSM is that it can be applied where the nature of the transaction is such that little comparable third party information can be found to identify arm's length pricing. The corresponding weakness of the method is that its application can depend, at least in part, on interpretations that are supported by little independent third party data.
- The OECD Guidelines indicate that the PSM should be supported by independent data to the extent possible, but in our experience this is difficult to achieve in practice – especially since one of the reasons for selecting the PSM in the first place is that the transaction is not amenable to support from direct comparable data.
- The profit split report makes most notable reference to third party data in identifying the routine return to be allocated to the U.S. Group for their distribution activities. This return has been benchmarked using the TNNM with OM as the most appropriate profit level indicator. Based on a U.S. comparable search, the profit split report concludes that an OM of 3.5% is a reasonable arm's length return to the U.S. Group for their routine distribution activities.
- In our experience the use of the TNMM is often appropriate in benchmarking distribution returns, and the OM is a suitable profit level indicator in such cases. An OM of 3.5% is broadly consistent with our experience for routine distributors in the business software industry.

U.K. transfer pricing - profit split report (5)

Our view is therefore that the transfer pricing risk arising from the application of a 3.5% OM for routine distribution activities is relatively low.

We understand that the 3.5% return only applies to acquired the U.S. Group entities, and that a separate U.S. Group entity within the group receives a 2% OM return for its routine distribution activities. While this is also broadly consistent with our experience for the industry, the reason(s) for the different returns within the group should be clearly documented.

Allocation of the routine return

- The profit split report allocates the 3.5% OM return for routine distribution activities only to the U.S. Group.
- The return to the U.K. parent under the tested transactions is determined solely by the allocation of residual profit.
- In our experience, application of the residual PSM involving distribution is typically done by granting a routine distribution return to all parties making sales of the products resulting from the jointly provided IP.
- The implication from the one-sided allocation of the routine return is that only the U.S. Group is selling products resulting from the jointly-provided IP. The conclusion is that at arm's length the U.K. parent would require a royalty for the value of its IP that it provides to the U.S. parties; the arm's length amount of that royalty is calculated by the PSM.
- Provided the above summary of facts is accurate, our view is that the risk arising from the allocation of a routine return to the U.S. Group only is relatively low.

Value driver analyses

- Again in connection with the use of interpretations (potentially subject to challenge) under the PSM, we have considered the value contribution analyses used to split the residual profit between the U.K. parent and the entities within the U.S. Group.

The value drivers identified in the report are:

- the ownership of product technology resulting from R&D activity;
- access to strategic business know-how;
- access to new customers; and
- business reputation and brand image.

The analyses are set out for each of three U.S. entities and each value driver individually. Percentage contributions to each value driver from the U.K. parent and each U.S. entity are provided for the years 2006 to 2010.

The consistent picture for each U.S. entity is that the weighting of the percentage contributions shifts from the U.S. entity to the U.K. parent over the five year period shown. This is said to reflect the increasing contribution of the U.K. parent to the overall value over time, as new centralized IP development activity (product enhancement, business development ,etc.) progressively erodes the percentage contribution provided by U.S. entities.

The value contribution data was provided by management and we have not sought to independently verify the data or underlying assumptions, although they appear reasonable based on our experience. However, it is clear that different assumptions (e.g., different value drivers, a different weighting to the parties' respective contributions, or a different timescale for the shift in percentage contribution to the U.K.) could result in a change to the residual profit allocation.

U.K. transfer pricing - profit split report – Interwoven addendum

We have conducted a high level analysis of the addendum to the profit split report prepared in 2009 to cover the acquisition of Interwoven.

It appears likely and has been assumed, though it does not appear to be explicitly stated, that this addendum has been prepared for the purpose only of splitting the residual profits between the U.K. parent and Interwoven, and that it should be read in conjunction with the main transfer pricing report.

On this assumption, the comments in relation to the main report should also apply to the Interwoven addendum.

In our experience, it would be difficult for tax authorities to produce stronger evidence than that provided by management as to the most appropriate data and/or interpretations to be used in performing the value contribution analysis. However, this should nevertheless still be regarded as an area of transfer pricing risk.

Interwoven

The report sets out a value driver analysis demonstrating the relative contributions of the U.K. parent and Interwoven to the value of the combined products.

As in the primary report, the percentage contributions of each of the parties shifts over time as the U.K. performs ongoing IP development activities.

It appears likely and has been assumed, though it does not appear to be explicitly stated, that this addendum has been prepared for the purpose only of splitting the residual profits between Tesla and Interwoven, and that it should be read in conjunction with the main transfer pricing report.

Thus, for instance, it is assumed that prior to the residual profit split Interwoven would also receive a routine return for its distribution functions, and that the 3.5% OM that was benchmarked in the profit split report is also appropriate for Interwoven.

The comments above with respect to the risks involved in the (necessarily subjective) value driver analysis contained in the main report apply also to the analysis contained in the Interwoven addendum to the report. On the assumption that the remainder of the profit split report applies to transactions with Interwoven in the same way as it applies to the transactions involving the other U.S. entities in the U.S. Group, the comments with respect to the profit split report should also apply to the Interwoven addendum.

Target Tower Structure – steps in U.S. & U.K. tax opinions (1)

Steps outlined in provided U.S. and U.K. tax opinions

The following steps were undertaken to set up the Tower structure.

Step 1

U.K. parent contributed the temporary intercompany funding balance with ANAH to AEHL in exchange for an issuance of one share.

Step 2

AEHL formalized the temporary intercompany funding balance with ANAH ("Loan A"), so that it is an interest-bearing loan to be denominated in U.S. dollars for $175 million. The remainder of the intercompany balance ($135 million) was capitalized for the issuance of one share.

Step 3

ANAH created two new U.S. LLCs, which are managed and controlled in the U.K. Therefore, both LLCs should be treated as a U.K. tax resident. ANAH made an initial capital contribution of $10,000 to both LLCs with the balance left outstanding through an intercompany balances.

Step 4

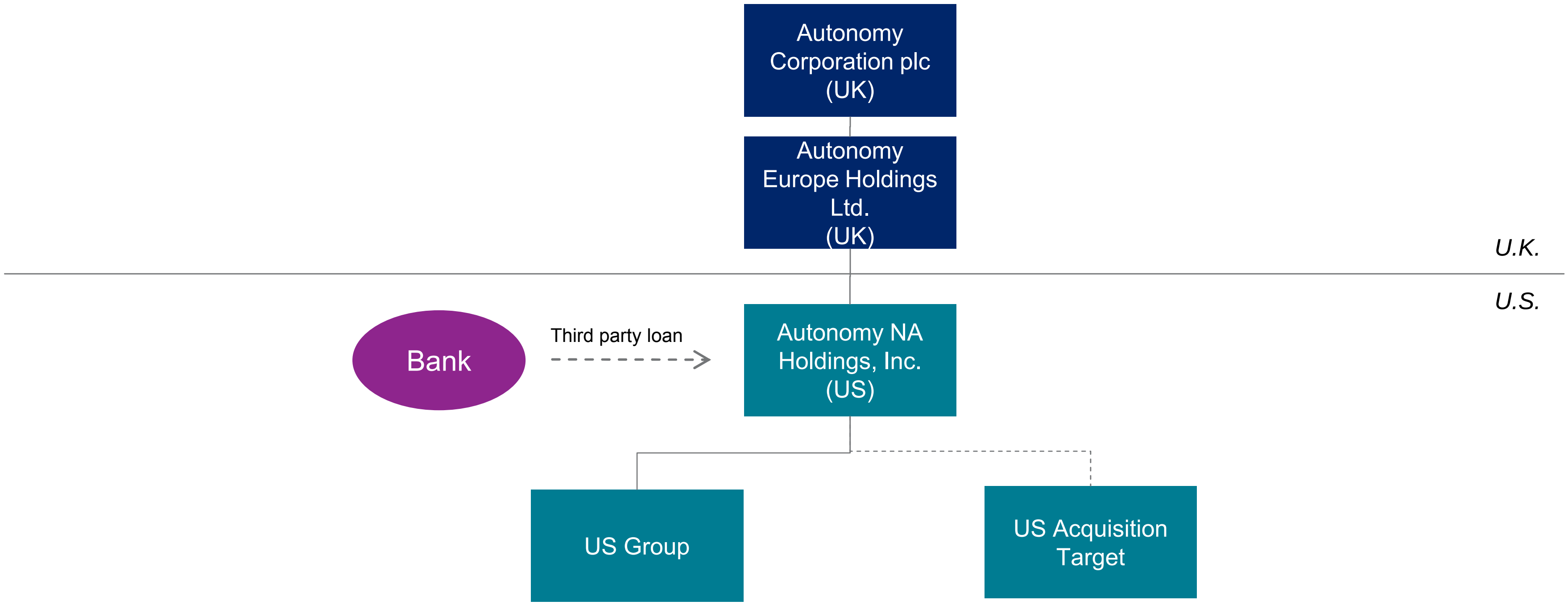
ANAH transferred Interwoven to LLC 1 for market value, $794 million. The consideration was in the form of a $619 million capital contribution and LLC 1 issuing a loan note for $175 million ("Loan B").

Step 5

LLC 2 entered into a swap with LLC 1. The swap required LLC 1 to receive dollar amounts of interest from LLC 2 which will mirror the terms of the loan from ANAH to LLC 1. As both LLC 1 and LLC 2 have a sterling functional currency, this creates a dollar liability in LLC 2 which offsets the dollar asset held by AEHL which also has a sterling functional currency. The overall result is that Target is not exposed to a net foreign exchange position with respect to this transaction.

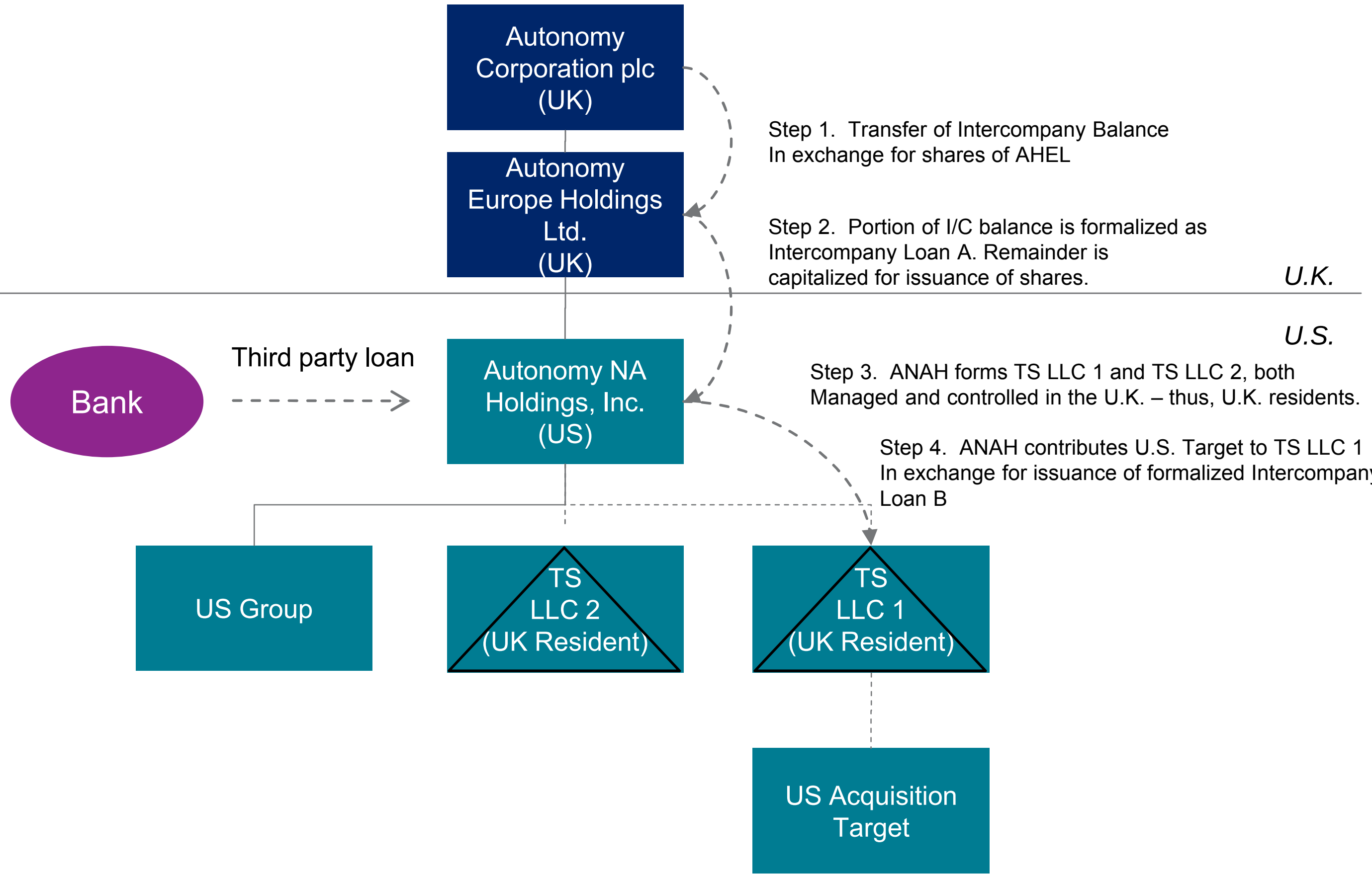
Appendix 4

Target Tower Structure – prior to implementation (2)



Appendix 4

Target Tower Structure – after implementation (3)

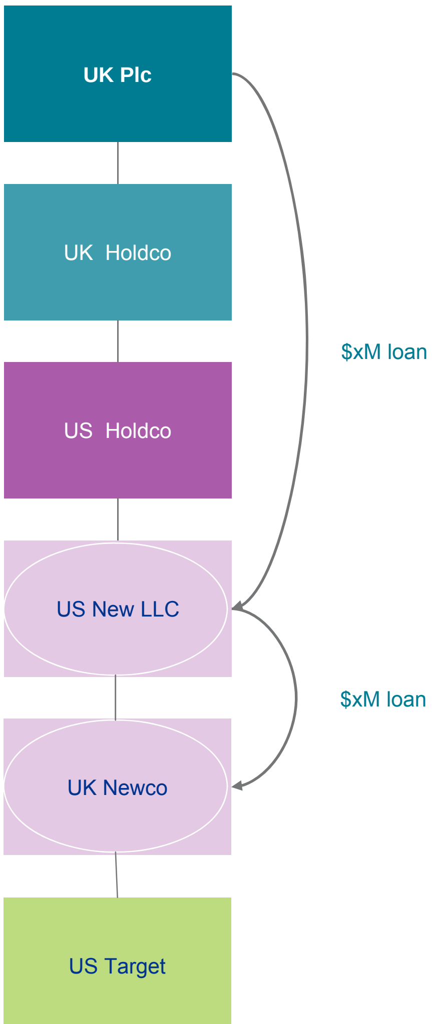


Note: Interest Payment by ANAH on Loan A is deductible for U.S. federal tax purposes. Any interest expense payment by TS LLC 1 on Loan B is disregarded for U.S. federal tax purposes. However. the interest expense payment by TS LLC 1 is deductible as interest expense for U.K. tax purposes. As such, the interest payment by TS LLC 1 offsets U.K. interest income received by AEHL paid by ANAH on Loan A.

Source: E&Y U.S. tax opinion

Appendix 4

Typical Tower Structure – typical general observations



Outline of idea – structure for acquisition of U.S. target

- U.S. Holdco forms U.S. New LLC.
- U.S. New LLC incorporates U.K. Newco and U.K. Newco makes a U.S. tax election to be disregarded.
- U.K. plc advances a loan to U.S. New LLC.
- U.S. New LLC makes a loan to U.K. Newco and subscribes for equity.
- U.K. Newco acquires U.S. Target and using the proceeds from the above loan.

Benefits of the structure

- U.S. tax deduction for the interest when paid by U.S. New LLC, subject to any applicable limitations (e.g. IRC sections 163(j) and 267, etc).
- Tax deduction in U.K. Newco to offset the interest income of U.K. plc.
- The interest paid by U.K. Newco to U.S. New LLC is disregarded for U.S. tax purposes; thus there is no U.S. interest recognition .

U.K. Points to consider

- U.K. Tax arbitrage rules – clearance unlikely hence inclusion of U.S. New LLC;
- Worldwide debt cap rules – unlikely to be any adverse implications;
- CFC status of U.S. Holdco, and U.S. New LLC to be managed;
- Application of the U.K. disguised interest – unlikely to apply;
- Application of the 'group mismatch' rules - unlikely to apply; and
- WHT on interest payments by U.K. Newco – unlikely to be able to pay gross under the U.K.-U.S. double tax treaty, however this could be overcome by issuing debt as a listed Eurobond in the Channel Islands.

U.S. points to consider

- Earnings stripping;
- Transfer pricing;
- Dual consolidated loss;
- Conduit financing;
- Application of U.S./U.K. Treaty; and
- Impact of new economic substance rules.

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