

Corporate governance statement

The Board of Directors is accountable to shareholders for the good corporate governance of the Group. The principles of corporate governance are set out in the Financial Reporting Council's revised Combined Code on corporate governance issued in 2003. Under the rules of the Alternative Investment Market (AIM) the Company is not required to comply with the Code and the Board considers that the size of the Group does not warrant compliance with all of the Code's requirements. This statement sets out how the principles of the Code that the Directors consider are relevant to Flomerics Group PLC are applied.

Board of Directors

The Non-Executive Chairman of the Company is David Mann. Gary Carter was appointed as Chief Executive in 2005. Tom Rowbotham as the Non-Executive Deputy Chairman is the senior independent Non-Executive Director. Wolfgang Biedermann, principal of Pricap (the former majority shareholder of NIKA), was appointed as a Non-Executive Director following the Group's acquisition of NIKA on 6 July 2006. On 31 December 2006 David Tatchell, the Chief Technology Officer and former Chief Executive, stepped down from the Board. For the period under review Tim Morris was the Chairman of the Audit Committee but on 24 January 2007 he stepped down from the Board and was replaced by Peter Teague.

The Board now comprises two Executive Directors (Chief Executive and Finance Director) and four Non-Executive Directors. For the size of the Group, it is considered that this gives the necessary mix of industry specific and broad business experience necessary for the effective governance of the Group. The Board meets regularly, normally on a monthly basis, and is particularly concerned with the Group's strategy.

The group has a senior management team which is responsible for the day to day management of the Group. This is comprised of the Chief Executive, the Finance Director, the Chief Technology Officer, Regional Directors for the US, Europe and Asia Pacific, the Director of Marketing, Director of Software Development UK and India, Director of Software Development Moscow, and the Product Director. Biographies of the Board of Directors are shown on page 20.

The Board met twelve times during the year, excluding ad hoc meetings convened to deal with procedural matters.

Director	Board Meetings		Audit Committee		Remuneration Committee		Nominations Committee		Risk Committee	
	No. of possible attendances	No. Attended	No. of possible attendances	No. Attended	No. of possible attendances	No. Attended	No. of possible attendances	No. Attended	No. of possible attendances	No. Attended
CHAIRMAN										
D. Mann	12	11	3	3	5	5	1	1	n/a	n/a
EXECUTIVE DIRECTORS										
G. Carter	12	12	n/a	n/a	5	5	1	1	n/a	n/a
D. Tatchell	12	12	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a
C. Ogle	12	12	n/a	n/a	n/a	n/a	n/a	n/a	3	3
NON-EXECUTIVE DIRECTORS										
T. Morris	12	12	3	3	5	3	n/a	n/a	n/a	n/a
T. Rowbotham	12	12	3	3	5	5	1	1	3	3
W. Biedermann	5	4	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a

Board Evaluation

As reported in last year's Annual Report, early in 2006 the Board carried out an internal evaluation and an action plan was compiled for the year.

Due to the recent changes in the make-up of the Board it has been decided that it is more appropriate to return to this later in the year.

Audit Committee

For the period under review the Audit Committee comprised Tim Morris (Chairman), David Mann and Tom Rowbotham, with Gary Carter, Chris Ogle and the external auditors generally in attendance. Tim Morris was replaced on 24 January 2007 by Peter Teague and Tom Rowbotham stepped down from the Committee because it is felt that for the size of company two independent Directors is sufficient. The remit of the Committee is to ensure the continued operation of good financial practices throughout the Group; to monitor that controls are in force to ensure the integrity of financial information; to review the interim statement and annual financial statements; and to provide a line of communication between the Board and the external auditors. The Audit Committee normally meets three times a year.

Remuneration Committee

A separate report on remuneration including the composition and remit of the Committee has been included on page 23.

Risk Committee

The Risk Committee is chaired by the Non-Executive Deputy Chairman, Tom Rowbotham, and for the period under review comprised Chris Ogle, the Finance Director, Ian Clark, the Product Manager for the company's major product, FLOTHERM, and Andrew Manning, the Director of Engineering Services for Flomerics, Inc. In 2007 the Committee was rationalised to comprise: Tom Rowbotham as Chairman, Peter Teague and Chris Ogle.

This Committee was set up in 2000 in response to a recommendation of the Turnbull Report, which offered guidance to Directors on complying with the internal control requirements of the Combined Code.

The role of the Committee is to identify the risks facing the business, to quantify their impact, and to ensure that they are managed within acceptable levels.

During 2006 the Committee reviewed the current status of the management of the major risks to the business, and the impact of the actions that the executives had taken.

The highest priority risks were chosen after discussion with all the executives and the Board. The executives then drew up an action plan to address each risk.

One senior executive was assigned responsibility for each risk in order to assure its continuous relevance, that actions were carried out to plan, and that quarterly progress reports were produced. The Risk Committee reviewed these reports and informed the Board about progress, while feeding back comments to the Executives.

The Committee is satisfied that in every case the Executives have taken the task of managing the risk programme very seriously and the Risk Committee concludes that the actions taken during 2006 have resulted in significantly reduced risks for the business.

Of special note is the acquisition of NIKA, which addressed a number of the competitive and product portfolio risks.

The principal risks facing the Group and discussed by the Board relate to the Group's technology, the competitive environment and managing a diverse range of products.

Nomination Committee

The Nomination Committee comprises David Mann, Tom Rowbotham and Gary Carter as members. It is chaired by David Mann, except when matters concerning the Chairmanship are being discussed.

The Committee is responsible for reviewing the structure, size and composition of the Board, identifying suitable candidates for the approval of the Board when vacancies arise and ensuring effective Board succession planning.

During 2006 the Committee conducted a search for the replacement of Tim Morris as Chairman of the Audit Committee and Peter Teague was appointed in January 2007.

Internal financial control

The Board is ultimately responsible for the Group's system of internal financial control and for reviewing its effectiveness. This is achieved through the following means:

The Group maintains a comprehensive process of financial reporting. The annual budget is reviewed and approved by the Board before being formally adopted. The Board receives financial reports of the Group's performance compared to the budget and prior years with explanations of significant variances. In addition, monthly reforecasts and cash flow forecasts are presented to the Board.

A thorough recruitment process ensures, as far as possible, that its employees hold principles of the highest integrity. This is an essential part of the Group's culture.

The effectiveness of the Group's internal financial controls is the responsibility of the Audit Committee and, to the extent that they are perceived to be a risk, of the Risk Committee. The maintenance and constant improvement of these controls is the responsibility of the Finance Director. The external auditors review the internal financial controls relevant to expressing their audit opinion and report to the Audit Committee on their findings where appropriate.

The existence of internal controls cannot entirely eliminate risk and no absolute assurance against loss to the Group can be made.

Going concern

The Board reports as to whether it is appropriate for the financial statements to be prepared on a going concern basis.

The Group's finances are currently sound and the net funding position is positive. Looking beyond the annual budget, the product roadmap and financial plans for the Group are reviewed and updated annually. On this basis, the Board continues to adopt the going concern basis in preparing the financial statements.

Report on Remuneration

for the year ended 31 December 2006

Remuneration Policy

The Remuneration Committee ("the Committee") is chaired by David Mann and during the period comprised the Non-Executive Directors excluding Wolfgang Biedermann. On 24 January 2007 Tim Morris resigned as a Director and has not been replaced on the Committee. So the Committee now comprises David Mann (as Chairman) and Tom Rowbotham. The Chief Executive is normally in attendance, except when his own remuneration is being discussed.

The principal function of the Committee is to set the remuneration and other benefits of the Executive Directors and senior managers including pension contributions, share options and bonus payments. The Committee also approves the overall salary increase made across the Group as recommended by the Chief Executive and it oversees all bonus and share option schemes.

The policy of the Committee is to pay remuneration comparable to other peer companies, within the limits of what can be afforded. During 2006 the Committee has commissioned an independent survey by PricewaterhouseCoopers of the remuneration of Executive Directors of comparable public software companies.

Bonus Payments

The Committee oversees a bonus scheme for the senior management team which is reviewed annually. The intention behind the scheme is to ensure that the Executive Directors are strongly incentivised to exceed budget performance. 50% of the potential bonus payment is directly related to the financial performance of either the entire Group or, where relevant, the area under their responsibility. The other 50% is paid at the discretion of the Committee and is based on their individual performance.

During 2006 the Executive Directors and other senior managers, excluding the Chief Executive could earn up to a maximum of 50% of their basic salary as a bonus. The Chief Executive could earn up to a maximum of 60% of his basic salary as a bonus. For 2006 the profit for the Group was at a level whereby any bonuses to the senior management were entirely discretionary.

The Group also runs a scheme for employees whereby a portion of the Group's pre-tax profit is set aside to be distributed amongst the Group's employees. For the year ended 31 December 2006 approximately 9% of the Group's profits before tax and amortisation of goodwill have been set aside in this way.

Share Options

The Committee recognises that share options can play an important part in aligning the interests of shareholders, Directors and staff. Share options that are granted have performance conditions attached, which ensure that the options only vest if the Group's earnings per share, as shown in the financial statements, exceed the percentage increase in the Retail Price Index plus 3% over a three year reference period.

Directors' Service Contracts

Executive Directors have "rolling" service contracts. The Chief Executive's contract is terminable by either party giving twelve months' notice. In the case of all other Executive Directors the notice period is six months.

Non-Executive Directors do not have service contracts. Letters of agreement are in place dated 7 November 1995 for David Mann, 28 July 1999 for Tom Rowbotham and 6 February 2007 for Peter Teague. In each case the arrangement is terminable with three months' notice.

Remuneration to Non-Executive Directors

Fees paid to Non-Executive Directors are detailed on page 24. The intention is to pay fees that are comparable with those paid by companies of similar size and complexity. The remuneration of the Non-Executive Directors is proposed by the Chief Executive and the Finance Director and approved by the Board.

Report on Remuneration
for the year ended 31 December 2006

Directors' Remuneration

Emoluments paid to Directors in the year comprised:

	Salaries/ fees £'000	Bonus £'000	Benefits £'000	Total 2006 £'000	Total 2005 £'000
D W Mann	28	–	–	28	26
G C Carter	129	12	72	213	167
C J R Ogle	117	9	1	127	142
D G Tatchell	109	7	1	117	163
T R Rowbotham	19	–	–	19	18
T R T Morris	13	–	–	13	12
	415	28	74	517	528

Pension Contributions

The Group made contributions under the Company Group Personal Pension Plan, a defined contribution scheme, as follows:

	2006 £'000	2005 £'000
G C Carter	10	10
C J R Ogle	9	9
D G Tatchell	9	10
	28	29

Directors' Interests in Share Options

Share options have been granted to the following Directors under the Company's Share option scheme:

Director	No. of shares under option			At 31 December 2006	Exercise Price	Exercise Date
	At 31 December 2005	Issued in year	Lapsed in year			
G C Carter	100,000	–	–	100,000	70.0	2008–2015
G C Carter	100,000	–	–	100,000	87.5	2008–2015
C J R Ogle	100,000	–	–	100,000	54.5	2002–2009
C J R Ogle	8,750	–	–	8,750	84.0	2005–2012
C J R Ogle	12,500	–	–	12,500	51.0	2006–2013
C J R Ogle	45,000	–	–	45,000	61.5	2007–2014
C J R Ogle	35,000	–	–	35,000	70.0	2008–2015
C J R Ogle	–	50,000	–	50,000	98.5	2009–2016
D G Tatchell*	8,750	–	–	8,750	84.0	2005–2012
D G Tatchell	12,500	–	–	12,500	51.0	2006–2013
D G Tatchell	80,000	–	–	80,000	61.5	2007–2014
D G Tatchell	60,000	–	–	60,000	70.0	2008–2015

* David Tatchell resigned as a Director on 31 December 2006 and has retained 161,250 share options.

Report of the Directors

for the year ended 31 December 2006

The Directors present their report together with the audited financial statements for the year ended 31 December 2006.

Results and dividends

The profit and loss account is set out on page 29 and shows the profit for the year.

The Directors recommend the payment of a dividend of 1.4p (2005: 1.3p) per ordinary share.

The consolidated profit for the year amounted to £338,000 (2005: £863,000).

Principal activities, trading review and future developments

The principal activities of the Group are the provision of virtual prototyping software and other related activities. A review of the development of the business during the year, that fulfils the requirements of the 'Enhanced Business Review', is given in the Chairman's Statement on page 3 in paragraphs headed 'Results' and 'Lines of Business and regional performance'; the risks are reviewed on page 22 within the Report of the Risk Committee and the KPIs are outlined in the OFR on page 18. The Chairman's Statement also includes reference to the Group's future prospects. An indication of the Group's activities in research and development is given in the Chief Executive's review on pages 4 to 5.

Areas of operation

The Group's headquarters and primary centre for research and development is in the United Kingdom. The Group also has research and development centres in India and Hungary and, following the acquisition of NIKA, in Moscow. The Group also has sales and support offices in the United States of America, France, Germany, Italy, China, Singapore, Sweden, Japan and India.

Political and charitable contributions

During 2006, the Group contributed a total of £1,864 (2005: £4,051) to support local charities. The Group made no political donations.

Directors and their interests

The Directors of the Company during the year were:

D W Mann	Non-Executive Chairman
G C Carter	Chief Executive
C J R Ogle	Finance Director
D G Tatchell	Chief Technology Officer (resigned 31 December 2006)
T R Rowbotham	Non-Executive Deputy Chairman
T R T Morris	Non-Executive Director (resigned 24 January 2007)
W Biedermann	Executive Director (appointed 06 July 2006)

Subsequent to the year end Peter Teague was appointed to the Board as Audit Committee Chairman.

Details of Directors' remuneration and Directors' share options are given in the Report on Remuneration on pages 23 to 24.

The Directors who held office at the end of the financial year had the following interests in the ordinary shares of the Company as recorded in the register of Directors' share and debenture interests:

	At 31 December 2006 Ordinary shares Number	At 1 January 2006 Ordinary shares Number
D W Mann	167,195	138,500
D W Mann – non beneficial	45,000	45,000
G C Carter	30,000	8,000
C J R Ogle	22,500	12,500
D G Tatchell (resigned 31 December 2006)	1,332,800	1,332,800
T R Rowbotham	361,326	361,326
T R T Morris (resigned 24 January 2007)*	40,000	40,000
W Biedermann (appointed 06 July 2006)**	–	–

* TRT Morris held 40,000 ordinary shares at the date of his resignation.

** W Biedermann is a principal of Pricap Venture Partners AG, which has a shareholding in the company as set out on page 26 under Significant Shareholdings.

There were no changes in the Directors' shareholdings between 31 December 2006 and 23 March 2007.

Financial Instruments

The Group's policy in respect of financial instruments is set out in note 25.

Significant shareholdings

As at 23 March 2007 notification had been received that the following were interested in more than 3% of the Company's ordinary share capital:

	Number of ordinary shares	Percentage of issued ordinary share capital
Pricap Venture Partners AG*	3,812,785	17.87
Bluehone Investors LLP (formerly F & C Asset Management)	1,380,000	6.47
Fidelity Investments	1,338,088	6.27

* There is a further 666,930 shares due to Pricap, that are held in the Shares to be Issued Account, which will be issued to Pricap at the expiry of the warranty period.

Creditor payment policy and practice

The Group policy for all suppliers is to fix terms of payment when agreeing the terms of each business transaction, to ensure the supplier is aware of those terms and to abide by the agreed terms of payment. The creditor payment days outstanding for the Group at 31 December 2006 was 39 days (2005: 16 days). The Company has no trade creditors.

Auditors

All of the current Directors have taken all the steps that they ought to have taken to make themselves aware of any information needed by the company's auditors for the purposes of their audit and to establish that the auditors are aware of that information. The Directors are not aware of any relevant audit information of which the auditors are unaware.

BDO Stoy Hayward LLP have expressed their willingness to continue in office and a resolution to re-appoint them will be proposed at the annual general meeting.

By order of the Board

C J R Ogle
Secretary
26 March 2007

Statement of Directors' responsibilities

The Directors are responsible for preparing the Annual Report and the financial statements in accordance with applicable law and United Kingdom Generally Accepted Accounting Practice.

Company law requires the Directors to prepare financial statements for each financial year which give a true and fair view of the state of affairs of the Company and Group and of the profit or loss of the Group for that period. In preparing those financial statements, the Directors are required to:

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

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

Financial statements are published on the Group's website in accordance with legislation in the United Kingdom governing the preparation and dissemination of financial statements, which may vary from legislation in other jurisdictions. The maintenance and integrity of the Group's website is the responsibility of the Directors. The Directors' responsibility also extends to the ongoing integrity of the financial statements contained therein.

Report of the independent auditors

To the shareholders of Flomerics Group PLC

We have audited the group and parent company financial statements (the "financial statements") of Flomerics Group PLC for the year ended 31 December 2006 which comprise the consolidated profit and loss account, the consolidated statement of total recognised gains and losses, the consolidated and company balance sheets, the consolidated cash flow statement and the related notes. These financial statements have been prepared under the accounting policies set out therein.

Respective responsibilities of Directors and auditors

The Directors' responsibilities for preparing the Annual Report and Group financial statements in accordance with applicable law and United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice) are set out in the statement of Directors' responsibilities.

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

We report to you our opinion as to whether the financial statements give a true and fair view and have been properly prepared in accordance with the Companies Act 1985 and whether the information given in the Directors' Report is consistent with those financial statements. We also report to you if, in our opinion, the company has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law regarding Directors' remuneration and other transactions is not disclosed.

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

Our Report has been prepared pursuant to the requirements of the Companies Act 1985 and for no other purpose. No person is entitled to rely on this Report unless such a person is a person entitled to rely upon this Report by virtue of and for the purpose of the Companies Act 1985 or has been expressly authorised to do so by our prior written consent. Save as above, we do not accept responsibility for this Report to any other person or for any other purpose and we hereby expressly disclaim any and all such liability.

Basis of audit opinion

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

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

Opinion

In our opinion:

- the group financial statements give a true and fair view, in accordance with United Kingdom Generally Accepted Accounting Practice, of the state of the group's affairs as at 31 December 2006 and of its profit for the year then ended;
- the parent company financial statements give a true and fair view, in accordance with United Kingdom Generally Accepted Accounting Practice, of the state of the parent company's affairs as at 31 December 2006;
- the financial statements have been properly prepared in accordance with the Companies Act 1985; and
- the information given in the Directors' Report is consistent with the financial statements.

BDO STOY HAYWARD LLP
Chartered Accountants and Registered Auditors
London
26 March 2007