

(24)

Masergy Communications UK Limited

**Directors' report and financial
statements**

Registered number 4170863

30 June 2004



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Directors' report

The directors present their annual report and the audited financial statements for the year ended 30 June 2004.

Principal activities

The company was incorporated on the 1 March 2001, and is a subsidiary undertaking of Masergy Communications, Inc., a company incorporated in the United States of America. The principle activity of the company is the sale of network services, providing businesses with customer-controlled network services for enhanced application performance.

Business review

The profit and loss account for the year is set out on page 4.

As discussed in note 1 to the financial statements, the company is dependent for its working capital on funds provided to it by Masergy Communications Inc., the company's ultimate parent undertaking.

Proposed dividend

The directors do not recommend the payment of a dividend (2003: £nil).

Political and charitable contributions

The company made no political contributions during the year. Donations to UK charities amounted to £Nil.

Directors and directors' interests

The directors who held office during or since year end were as follows:

B Nalls

J Tankersley Jr.

M Beaton (resigned 16 September 2003)

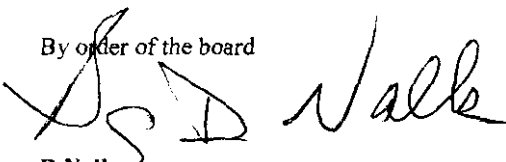
None of the directors who held office at the end of the financial year had any disclosable interest in the shares of the company. According to the register of directors' interests, no rights to subscribe for shares in or debentures of the company were granted to any of the directors or their immediate families, or exercised by them, during the financial year.

As the company is wholly owned subsidiary of a company incorporated outside Great Britain, the company is exempt from the requirement to record the directors' interests in the ultimate parent company.

Auditors

Pursuant to a shareholders' resolution, the company is not obliged to reappoint its auditors annually and KPMG LLP will therefore continue in office.

By order of the board



B Nalls
Director

Alder Castle
10 Noble Street
London
EC2V 7QJ

26 October 2005

Statement of directors' responsibilities

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 of the profit or loss 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;
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the company will continue in business.

The directors are responsible for keeping proper accounting records 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 have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the company and to prevent and detect fraud and other irregularities.



KPMG LLP

8 Salisbury Square
London
EC4Y 8BB
United Kingdom

Report of the independent auditors to the members of Masergy Communications UK Limited

We have audited the financial statements on pages 4 to 16.

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

Respective responsibilities of directors and auditors

The directors are responsible for preparing the directors' report and, as described on page 2, the financial statements in accordance with applicable United Kingdom law and accounting standards. Our responsibilities, as independent auditors, are established in the United Kingdom by statute, the Auditing Practices Board and by our profession's ethical guidance.

We report to you our opinion as to whether the financial statements give a true and fair view and are properly prepared in accordance with the Companies Act 1985. We also report to you if, in our opinion, the directors' report is not consistent with the financial statements, if 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 transactions with the company is not disclosed.

Basis of audit opinion

We conducted our audit in accordance with Auditing Standards 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 judgements made by the directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the company's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the 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.

Going Concern

In forming our opinion, we have considered the adequacy of the disclosures made in note 1 to the financial statements concerning the reliance on the company's ultimate parent, Masergy Communications Inc. for continued financial support and the ability of that company to provide this support. In view of the significance of this matter, we consider that it should be drawn to your attention but our opinion is not qualified in this respect.

Opinion

In our opinion the financial statements give a true and fair view of the state of the company's affairs at 30 June 2004 and of its loss for the year then ended and have been properly prepared in accordance with the Companies Act 1985.

KPMG LLP

KPMG LLP
Chartered Accountants
Registered Auditor

27 October 2005

Profit and loss account
for the year ended 30 June 2004

	<i>Note</i>	2004 £	2003 £
Turnover		897,354	767,216
Cost of sales		(945,268)	(1,042,492)
Gross loss		(47,914)	(275,276)
Administrative expenses		(955,175)	(2,374,835)
Operating loss		(1,003,089)	(2,650,111)
Other interest receivable and similar income	4	592,020	389,441
Interest payable and similar charges	5	(18,650)	(7,765)
Loss on ordinary activities before taxation	2	(429,719)	(2,268,435)
Tax on profit on ordinary activities	6	-	-
Retained loss for the year		(429,719)	(2,268,435)

A note on historical cost profits and losses has not been included as part of these accounts as the results as disclosed in the profit and loss account are prepared on an unmodified historical cost basis.

All results are derived from continuing operations.

There are no recognised gains or losses during the year other than those shown in the profit and loss account.

Balance sheet
at 30 June 2004

	Note	2004		2003	
		£	£	£	£
Fixed assets					
Tangible assets	7		622,507		626,589
Investments	8		7,483		7,483
			<u>629,990</u>		<u>634,072</u>
Current assets					
Debtors	9	297,356		555,792	
Cash at bank and in hand		262,083		26,290	
		<u>559,439</u>		<u>582,082</u>	
Creditors: amounts falling due within one year	10	(7,084,567)		(6,680,180)	
Net current assets			<u>(6,525,128)</u>		<u>(6,098,098)</u>
Total assets less current liabilities			<u>(5,895,138)</u>		<u>(5,464,026)</u>
Creditors: amounts falling due after more than one year	11		-		(1,393)
Net liabilities			<u>(5,895,138)</u>		<u>(5,465,419)</u>
Capital and reserves					
Called up share capital	12		1,000		1,000
Profit and loss account	13		(5,896,138)		(5,466,419)
Equity shareholders' deficit			<u>(5,895,138)</u>		<u>(5,465,419)</u>

These financial statements were approved by the board of directors on 26 October 2005 and were signed on its behalf by:



B Nalls
Director

Cash flow statement
for the year ended 30 June 2004

	<i>Note</i>	2004	2003
		£	£
Cash flow from operating activities	<i>15</i>	365,969	152,131
Returns on investments and servicing of finance	<i>16</i>	(10,326)	(7,038)
Capital expenditure and financial investment	<i>16</i>	(116,271)	(126,934)
		<hr/>	<hr/>
Cash inflow before management of liquid resources and financing		239,371	18,159
Financing	<i>16</i>	(3,579)	(2,821)
		<hr/>	<hr/>
Increase in cash in the year		235,793	15,338
		<hr/>	<hr/>
Reconciliation of net cash flow to movement in net funds	<i>17</i>		
Increase in cash in the year		235,793	15,338
Cash used to repay finance leases		3,579	2,821
		<hr/>	<hr/>
Change in net funds resulting from cash flows		239,372	18,159
		<hr/>	<hr/>
Movement in net funds in the year		239,372	18,159
Net funds at the start of the year		21,318	3,159
		<hr/>	<hr/>
Net funds at the end of the year		260,670	21,318
		<hr/>	<hr/>

Reconciliation of movements in shareholders' funds
for the year ended 30 June 2004

	2004 £	2003 £
Loss for the financial year	(429,719)	(2,268,435)
Net increase in shareholders' deficit	(429,719)	(2,268,435)
Opening shareholders' deficit	(5,465,419)	(3,196,984)
Closing shareholders' deficit	(5,895,138)	(5,465,419)

Notes

(forming part of the financial statements)

1 Accounting policies

The following accounting policies have been applied consistently in dealing with items which are considered material in relation to the company's financial statements except as noted below.

Basis of preparation

The financial statements have been prepared in accordance with applicable accounting standards and under the historical cost accounting rules.

The company is exempt by virtue of s248 of the Companies Act 1985 from the requirement to prepare group accounts. These financial statements present information about the company as an individual undertaking and not about its group.

The financial statements have been prepared on the going concern basis, notwithstanding net liabilities of £5,895,138 which the directors believe to be appropriate for the following reasons.

The company is dependent for its working capital on funds provided to it by Masergy Communications Inc., the company's ultimate parent undertaking.

On March 1, 2005, Masergy Communications, Inc., the company's ultimate parent company, closed a third round of funding for US\$45 million, comprising equity investment of US\$ 30 million and a debt facility of US\$ 15 million. Masergy Communications, Inc. will be using the funds for sales, marketing and customer support activities, and to fund group operations to cash flow breakeven which is expected to occur in 2006.

Masergy Communications Inc. has indicated to the company that for at least 12 months from the date of approval of these financial statements, it will continue to make available such funds as are needed by the company and in particular will not seek repayment of the amounts currently made available. The directors believe this will enable the company to continue in operational existence for the foreseeable future by meeting its liabilities as they fall due for payment.

Further, as with any company placing reliance on other group entities for financial support, the directors acknowledge that there can be no certainty that this support will continue although, at the date of approval of these financial statements, they have no reason to believe that it will not do so.

Based on this undertaking the directors believe that it remains appropriate to prepare the financial statements on a going concern basis. The financial statements do not include any adjustments that would result from the basis of preparation being inappropriate.

Notes (continued)

1 Accounting policies (continued)

Fixed assets and depreciation

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

Leasehold improvements	over the remaining life of the lease
Computers and Equipment	3 to 5 years
Fixtures and fittings	3 to 5 years
Network Equipment	10 years

Starting 1 July 2003, the Company revised the useful life of network equipment from 3 to 10 years to more closely match the economic life of those assets. This change in estimate is accounted for on a prospective basis.

Foreign currencies

Transactions in foreign currencies are recorded using the rate of exchange ruling at the date of the transaction or, if hedged forward, at the rate of exchange under the related forward currency contract. Monetary assets and liabilities denominated in foreign currencies are translated using the contracted rate or the rate of exchange ruling at the balance sheet date and the gains or losses on translation are included in the profit and loss account.

Leases

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

Taxation

The charge for taxation is based on the loss for the year and takes into account taxation deferred because of timing differences between the treatment of certain items for taxation and accounting purposes.

Deferred tax is recognised, without discounting, in respect of all timing differences between the treatment of certain items for taxation and accounting purposes which have arisen but not reversed by the balance sheet date, except as otherwise required by FRS 19.

Turnover

Service revenues are recognised based on usage of its telecommunications network and facilities and contract fees. The company recognises product and other service revenues when services are provided in accordance with the contract terms and when products are delivered and accepted by the customers. Cost of service revenues includes fees paid to wholesale telecommunications carriers for connectivity and collocation services provided to the company.

Where contracts are signed and invoiced by the company but include services provided by Masergy Communications Inc., turnover is recognised gross and charges are recognised in cost of sales in respect of these services provided.

Notes (continued)

2 Loss on ordinary activities before taxation

	2004 £	2003 £
<i>Loss on ordinary activities before taxation is stated</i>		
<i>after charging</i>		
Auditors' remuneration:		
Audit	15,000	20,000
Other services - fees paid to the auditor and its associates	-	-
Depreciation and other amounts written off tangible fixed assets:		
Owned	98,353	383,564
Leased	2,000	2,973
Hire of other assets - operating leases	49,800	241,695
<i>after crediting</i>		
Exchange gains arising on amounts owed to group undertakings	(583,696)	(388,714)
	<u> </u>	<u> </u>

3 Staff numbers and costs

The average number of persons employed by the company (including directors) during the year, analysed by category, was as follows:

	Number of employees	
	2004	2003
Administration	-	5
Network operations	2	3
Sales	2	4
	<u> </u>	<u> </u>
	4	12
	<u> </u>	<u> </u>

The aggregate payroll costs of these persons were as follows:

	2004 £	2003 £
Wages and salaries	388,245	1,089,177
Social security costs	46,115	78,013
	<u> </u>	<u> </u>
	434,360	1,167,190
	<u> </u>	<u> </u>

Notes (continued)

4 Other interest receivable and similar income

	2004 £	2003 £
Net exchange gains on amounts owed to group undertakings	583,696	388,714
Other	8,324	727
	<u>592,020</u>	<u>389,441</u>

5 Interest payable and similar charges

	2004 £	2003 £
On third party bank loans and overdrafts	18,097	6,454
Finance charges payable in respect of finance leases and hire purchase contracts	553	1,311
	<u>18,650</u>	<u>7,765</u>

6 Taxation

There is no charge to corporation tax due to the losses incurred in the year.

The current tax charge for the year is different than the standard rate of corporation tax in the UK (30%). The differences are explained below.

	2004 £	2003 £
<i>Current tax reconciliation</i>		
Loss on ordinary activities before tax	(429,719)	(2,268,435)
Current tax at 30%	<u>(128,916)</u>	<u>(680,531)</u>
<i>Effects of:</i>		
Expenses not deductible for tax purposes (primarily legal and professional fees)	764	31,399
Depreciation for the year in excess of capital allowances	29,506	115,069
Losses not utilised in the year	98,646	534,063
Total current tax charge	<u>-</u>	<u>-</u>

At 30 June 2004, the company had potential deferred tax assets of £1,633,497 (2003: £1,505,345) in relation to allowable tax losses and the difference between depreciation on qualifying assets and accelerated capital allowances. These assets have not been recognised in the financial statements, as, in the opinion of the directors, there is insufficient evidence that they will be recoverable.

Notes (continued)

7 Tangible fixed assets

	Leasehold improvements £	Plant and machinery £	Fixtures, fittings, tools and equipment £	Total £
<i>Cost or valuation</i>				
At beginning of year	72,188	1,183,375	39,407	1,294,970
Additions	-	116,271	-	116,271
Disposals	(20,000)	-	-	(20,000)
	<hr/>	<hr/>	<hr/>	<hr/>
At end of year	52,188	1,299,646	39,407	1,391,241
	<hr/>	<hr/>	<hr/>	<hr/>
<i>Depreciation</i>				
At beginning of year	7,180	648,124	13,077	668,381
Charge for year	16,012	77,511	6,830	100,353
Disposals	-	-	-	-
	<hr/>	<hr/>	<hr/>	<hr/>
At end of year	23,192	725,635	19,907	768,734
	<hr/>	<hr/>	<hr/>	<hr/>
<i>Net book value</i>				
At 30 June 2004	28,996	574,011	19,500	622,507
	<hr/>	<hr/>	<hr/>	<hr/>
At 30 June 2003	65,008	535,251	26,329	626,589
	<hr/>	<hr/>	<hr/>	<hr/>

Included in the total net book value of fixtures, fittings, tools and equipment is £nil (2003: £2,000) in respect of assets held under finance leases. Depreciation for the year on these assets was £2,000 (2003: £2,000).

Notes (continued)

8 Fixed asset investments

	Shares in group undertakings £
<i>Cost</i>	
At beginning and end of year	7,483
<i>Net book value</i>	
At 30 June 2004	7,483
At 30 June 2003	7,483

The companies in which the company's interest at the year end is more than 20% are as follows:

	Country of Incorporation	Principal activity	Class and percentage of shares held
<i>Subsidiary undertakings</i>			
Masergy Licensing Limited	England and Wales	Dormant	Ordinary 100%
Masergy SARL	France	Dormant	Ordinary 100%

9 Debtors

	2004 £	2003 £
Trade debtors	196,835	137,957
Prepayments and accrued income	30,093	246,317
Other debtors	70,428	171,518
	<u>297,356</u>	<u>555,792</u>

Other Debtors includes an amount of £37,350 (2003: £37,350) due after more than one year.

10 Creditors: amounts falling due within one year

	2004 £	2003 £
Net obligations under finance leases and hire purchase contracts	1,393	3,579
Trade creditors	59,691	102,969
Amounts owed to group undertakings	6,559,426	6,156,358
Taxation and social security	13,763	21,726
Accruals and deferred income	450,294	395,548
	<u>7,084,567</u>	<u>6,680,180</u>

Notes (continued)

11 Creditors: amounts falling due after more than one year

	2004 £	2003 £
Net obligations under finance leases and hire purchase contracts	-	1,393

The maturity of net obligations under finance leases and hire purchase contracts is as follows:

	2004 £	2003 £
Within one year	1,393	3,579
In the second to fifth years	-	1,393
	<u>1,393</u>	<u>4,972</u>

12 Called up share capital

	2004 £	2003 £
<i>Authorised</i>		
Equity: 1,000 Ordinary shares of £1 each	1,000	1,000
<i>Allotted, called up and fully paid</i>		
Equity: 1,000 Ordinary shares of £1 each	1,000	1,000

13 Movement in reserves

	Profit and loss account £
At beginning of year	(5,466,419)
Retained loss for the year	(429,719)
At end of year	<u>(5,896,138)</u>

Notes (continued)

14 Commitments

(a) Annual commitments under non-cancellable operating leases are as follows:

	2004 Land and buildings £	2003 Land and buildings £
Operating leases which expire:		
Within one year	-	-
In the second to fifth years inclusive	49,800	49,800
	<u> </u>	<u> </u>

15 Reconciliation of operating loss to net cash flow from operating activities

	2004 £	2003 £
Operating loss	(1,003,089)	(2,650,111)
Depreciation charges	100,353	386,537
Decrease/increase in debtors	258,436	(87,041)
Increase in creditors	1,010,269	2,502,746
	<u> </u>	<u> </u>
Net cash inflow from operating activities	365,969	152,131
	<u> </u>	<u> </u>

16 Analysis of cash flows

	2004 £	2004 £	2003 £	2003 £
Returns on investment and servicing of finance				
Interest received	8,324		727	
Interest paid	(18,650)		(7,765)	
	<u> </u>		<u> </u>	
		(10,326)		(7,038)
Capital expenditure and financial investment				
Purchase of tangible fixed assets	(116,271)		(120,451)	
Investment in French share capital	-		(6,483)	
	<u> </u>		<u> </u>	
		(116,271)		(126,934)
Financing				
Repayment of capital finance lease	(3,579)		(2,821)	
	<u> </u>		<u> </u>	
		(3,579)		(2,821)
		<u> </u>		<u> </u>

Notes (continued)

17 Analysis of net funds

	At beginning of year £	Cash flow £	At end of year £
Cash in hand, at bank	26,290	235,793	262,083
Debt due after one year	(1,393)	1,393	-
Debt due within one year	(3,579)	2,186	(1,393)
	(4,972)	3,579	(1,393)
Total	21,318	239,372	260,670

18 Post balance sheet events

On March 1, 2005, Masergy Communications, Inc., the company's ultimate parent company, closed a third round of funding for \$30 Million (USD). See note 1 for further details.

19 Related party disclosures

During the financial year, Masergy Communications UK Limited purchased fixed assets totalling £116,271 (2003: £74,259) from Masergy Communications Inc., the company's immediate and ultimate parent company.

Masergy Communications Inc. funds the working capital requirements for Masergy Communications UK Limited.

At 30 June 2004, Masergy Communications Inc. is owed £6,559,427 (2003: £6,156,358), by Masergy Communications UK Limited. This amount is currently non-interest bearing with no fixed repayment date.

20 Ultimate parent company and parent undertaking of larger group of which the company is a member

The company is a subsidiary undertaking of Masergy Communications Inc. incorporated in the USA.

The largest group in which the results of the company are consolidated is that headed by Masergy Communications Inc. The consolidated accounts of this company are not available to the public.