Financial Statements
Xtera Communications Ltd.

For the year ended 30 September 2015

Registered number: 04260336

Xtera Communications Ltd.

Company Information

Directors	J Hopper H Fevrier
Registered number	04260336
Registered office	Devonshire House 60 Goswell Road London EC1M 7AD
Independent auditor	Grant Thornton UK LLP Chartered Accountants & Statutory Auditor Grant Thornton House 202 Silbury Boulevard Central Milton Keynes Buckinghamshire MK9 1LW

Xtera Communications Ltd.

Contents

Directors' report

For the year ended 30 September 2015

The directors present their report and the audited financial statements for the year ended 30 September 2015.

Directors' responsibilities statement

The directors are responsible for preparing the Directors' report and the financial statements in accordance with applicable law and regulations.

Company law requires the directors to prepare financial statements for each financial year. Under that law the directors have elected to prepare the financial statements in accordance with United Kingdom Generally Accepted Accounting Practice (United Kingdom Accounting Standards and applicable law). Under company law the directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of Xtera Communications Ltd (the company) and of the profit or loss of the company for that period. In preparing these financial statements, the directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgments and accounting estimates that are reasonable and prudent;
- 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 adequate accounting records that are sufficient to show and explain the company's transactions and disclose with reasonable accuracy at any time the financial position of the company and enable them to ensure that the financial statements comply with the Companies Act 2006. They are also responsible for safeguarding the assets of the company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

Principal activities

The principal activity during the year was the design, manufacture, marketing and sale of optical transmission equipment for telecommunications applications.

Directors

The directors who served during the year were:

J Hopper
H Fevrier

Disclosure of information to auditor

Each of the persons who are directors at the time when this Directors' report is approved has confirmed that:

- so far as that director is aware, there is no relevant audit information of which the company's auditor is unaware, and
- that director has taken all the steps that ought to have been taken as a director in order to be aware of any relevant audit information and to establish that the company's auditor is aware of that information.

Directors' report

For the year ended 30 September 2015

Auditor

The auditor, Grant Thornton UK LLP, will be proposed for reappointment in accordance with section 485 of the Companies Act 2006.

In preparing this report, the directors have taken advantage of the small companies exemptions provided by section 415A of the Companies Act 2006.

This report was approved by the board on 8TH JUNE 2016 and signed on its behalf.

H Fevrier
Director

GrantThornton

Independent auditor's report to the members of Xtera Communications Ltd.

We have audited the financial statements of Xtera Communications Ltd. for the year ended 30 September 2015, which comprise the profit and loss account, the balance sheet and the related notes. The financial reporting framework that has been applied in their preparation is applicable law and the Financial Reporting Standard for Smaller Entities (effective April 2008) (United Kingdom Generally Accepted Accounting Practice applicable to Smaller Entities).

This report is made solely to the company's members, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006. 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 auditor

As explained more fully in the Directors' responsibilities statement, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit and express an opinion on the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

Scope of the audit of the financial statements

A description of the scope of an audit of financial statements is provided on the Financial Reporting Council's website at www.frc.org.uk/auditscopeukprivate.

Opinion on financial statements

In our opinion the financial statements:

- give a true and fair view of the state of the company's affairs as at 30 September 2015 and of its loss for the year then ended;
- have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice applicable to Smaller Entities; and
- have been prepared in accordance with the requirements of the Companies Act 2006.

Opinion on other matter prescribed by the Companies Act 2006

In our opinion the information given in the Directors' report for the financial year for which the financial statements are prepared is consistent with the financial statements.

Grant Thornton

Independent auditor's report to the members of Xtera Communications Ltd.

Matters on which we are required to report by exception

We have nothing to report in respect of the following matters where the Companies Act 2006 requires us to report to you if, in our opinion:

- adequate accounting records have not been kept, or returns adequate for our audit have not been received from branches not visited by us; or
- the financial statements are not in agreement with the accounting records and returns; or
- certain disclosures of directors' remuneration specified by law are not made; or
- we have not received all the information and explanations we require for our audit; or
- the directors were not entitled to prepare the financial statements in accordance with the small companies regime and take advantage of the small companies' exemption from the requirement to prepare a strategic report.

Grant Thornton UK LLP.

John Corbishley (Senior statutory auditor)
for and on behalf of
Grant Thornton UK LLP
Statutory Auditor
Chartered Accountants
Central Milton Keynes
Date: 16 June 2016

Profit and loss account

For the year ended 30 September 2015

	Note	2015 £	2014 £
Turnover	1,2	**6,954,560**	963,305
Cost of sales		**(6,247,938)**	(817,880)
Gross profit		**706,622**	145,425
Administrative expenses		**(3,822,071)**	(3,343,381)
Operating loss	4	**(3,115,449)**	(3,197,956)
Interest receivable and similar income		**72**	2,341
Loss on ordinary activities before taxation		**(3,115,377)**	(3,195,615)
Tax on loss on ordinary activities		**-**	-
Loss for the financial year	12	**(3,115,377)**	(3,195,615)

The notes on pages 7 to 14 form part of these financial statements.

Balance sheet

As at 30 September 2015

	Note	£	2015 £	£	2014 £
Fixed assets					
Tangible assets	5		**284,256**		186,648
Current assets					
Debtors	6	**623,276**		273,055	
Cash at bank		**350,955**		281,452	
		974,231		554,507	
Creditors: amounts falling due within one year	7	**(1,448,693)**		(581,792)	
Net current liabilities			**(474,462)**		(27,285)
Total assets less current liabilities			**(190,206)**		159,363
Creditors: amounts falling due after more than one year	8		**(5,894,808)**		(3,196,864)
Provisions for liabilities					
Other provisions	9		**(263,855)**		(195,990)
Net liabilities			**(6,348,869)**		(3,233,491)
Capital and reserves					
Called up share capital	11		**5,109**		5,109
Share premium account	12		**20,344,529**		20,344,530
Other reserves	12		**10,287,160**		10,287,160
Profit and loss account	12		**(36,985,667)**		(33,870,290)
Shareholders' deficit			**(6,348,869)**		(3,233,491)

The financial statements have been prepared in accordance with the provisions applicable to small companies within Part 15 of the Companies Act 2006 and in accordance with the Financial Reporting Standard for Smaller Entities (effective April 2008).

The financial statements were approved and authorised for issue by the board and were signed on its behalf by:

J Hopper
Director

Date: 8TH JUNE 2016

The notes on pages 7 to 14 form part of these financial statements.

Notes to the financial statements

For the year ended 30 September 2015

1. Accounting policies

1.1 Basis of preparation of financial statements

The financial statements have been prepared under the historical cost convention and in accordance with the Financial Reporting Standard for Smaller Entities (effective April 2008).

The financial statements have been prepared on a going concern basis, which assumes that the company will continue to trade for the foreseeable future. During the year the company generated a loss after tax of £3.1m (2014 - loss £3.2m) and had an accumulated profit and loss account deficit of £37m at 30 September 2015 (2014 - £33.9m).

The directors have obtained confirmation that the parent company, Xtera Communications Inc., will continue, as far as they are able, to provide financial support for the company which will enable it to continue its activities for the foreseeable future. As a result, the directors believe that the company will remain financially viable and therefore that it is appropriate that these financial statements are prepared on the going concern basis. This basis of preparation assumes that the company will continue in operational existence for a period of at least twelve months from the date of approval of these financial statements, the validity of which depends on Xtera Communications Inc being able to provide ongoing support to Xtera Communications Ltd. as required. The financial statements do not include any adjustments that might arise if the going concern basis is not appropriate.

1.2 Turnover

Turnover comprises revenue recognised by the company in respect of goods and services supplied during the year, exclusive of Value Added Tax and trade discounts.

The company recognises its revenue in accordance with the Revenue Recognition of the FASB ASC and UK GAAP. Revenue is recognised when persuasive evidence of an arrangement exists, delivery has occurred, the sales price is fixed or determinable and collection is reasonably assured. Delivery does not occur until products have been shipped or services have been provided to the customer and title and risk of loss have transferred to the customer. The company also provides for estimated costs that may be incurred for product warranties and for sales returns. When other significant obligations or acceptance terms remain after products are delivered, revenue is recognised only after such obligations are fulfilled. Revenue is recognised net of cash discounts and sales tax.

Contracts for optical network solutions often involve multiple deliverables which may include any combination of products, solutions, installation or other services. Revenue under multiple element arrangements is recognised in accordance with the Accounting for Revenue Arrangements with Multiple Deliverables of the FASB ASC. A multiple-element arrangement is separated into more than one unit of accounting if all of the following criteria are met:

• The delivered item(s) has value to the client on a stand-alone basis;
• If the arrangement includes a general right of return relative to the delivered item(s), delivery or performance of the undelivered item(s) is considered probable and substantially in the control of the company.

Notes to the financial statements

For the year ended 30 September 2015

1. Accounting policies (continued)

The guidance establishes a selling price hierarchy for determining the selling price of a deliverable in a sale arrangement. The selling price for each deliverable is based on vendor-specific objective evidence (VSOE) if available, third-party evidence (TPE) if VSOE is not available, or the Company's best estimated selling price (BESP) if neither VSOE nor TPE are available. This method allocates any discount in the arrangement proportionately to each deliverable on the basis of the deliverable's estimated fair value.

VSOE of selling price is used in the selling price allocation where it exists. However, in most instances, VSOE is unavailable for the Company's products because the product solution delivered differs for each customer. Further, substantial majority of the selling prices of each deliverable in our product solution offerings has not been consistent, and do not fall within a reasonable narrow pricing range.

Xtera's product solutions contain significant elements of proprietary technology and the solution offered differs substantially from that of the competitors. Also, the Company's product offerings contain a significant level of configuration unique to a specific customer installation and network which will not generally be interchangeable with a third party product solution. Furthermore, the Company is unable to legally and reliably determine what similar competitor products' selling prices are on a standalone basis. Therefore, it is typically difficult to obtain the reliable standalone competitive pricing necessary to establish TPE.

Instances where established VSOE or reliable TPE is unavailable for the Company products, the Company uses BESP in its allocation of arrangement consideration. VSOE is unavailable for the Company products because the product solution delivered differs for each customer. In addition, reliable TPE does not exist because our product solution is configured to comply with a pre-defined set of customer specific criteria which largely will not be interchangeable with a third party product solution. The objective of BESP is to determine the price at which the Company would transact a sale if the product or service were sold on a stand-alone basis. The Company determines BESP for a product or service by considering multiple factors including, but not limited to, cost of production, market conditions, competitive landscape, gross margin objectives, pricing practices, geographies, customer classes and distribution channels.

Deferred revenue is recorded when cash has been received from the customer and the arrangement does not qualify for revenue recognition under the revenue recognition policies described above. Costs incurred for projects not completed are deferred and recorded as a cost upon recognition of the related revenue.

1.3 Tangible fixed assets and depreciation

Tangible fixed assets are stated at cost less depreciation. Depreciation is provided at rates calculated to write off the cost of fixed assets, less their estimated residual value, over their expected useful lives on the following bases:

Test equipment	-	over 2 - 3 years
Office equipment and fittings	-	over 10 years
Computer equipment	-	over 2 -3 years

Notes to the financial statements
For the year ended 30 September 2015

1. Accounting policies (continued)

1.4 Deferred taxation

Full provision is made for deferred tax assets and liabilities arising from all timing differences between the recognition of gains and losses in the financial statements and recognition in the tax computation.

A net deferred tax asset is recognised only if it can be regarded as more likely than not that there will be suitable taxable profits from which the future reversal of the underlying timing differences can be deducted.

Deferred tax assets and liabilities are calculated at the tax rates expected to be effective at the time the timing differences are expected to reverse.

Deferred tax assets and liabilities are not discounted.

1.5 Research and development

Research and development expenditure is written off in the year in which it is incurred.

1.6 Financial instruments

Financial liabilities and equity instruments are classified according to the substance of the contractual arrangements entered into. An equity instrument is any contract that evidences a residual interest in the assets of the entity after deducting all of its financial liabilities.

Where the contractual obligations of financial instruments (including share capital) are equivalent to a similar debt instrument, those financial instruments are classed as financial liabilities. Financial liabilities are presented as such in the balance sheet. Finance costs and gains or losses relating to financial liabilities are included in the profit and loss account. Finance costs are calculated so as to produce a constant rate of return on the outstanding liability.

Where the contractual terms of share capital do not have any terms meeting the definition of a financial liability then this is classed as an equity instrument. Dividends and distributions relating to equity instruments are debited direct to equity.

Notes to the financial statements
For the year ended 30 September 2015

2. Turnover

91.9% of the company's turnover (2014 - 43.5%) is attributable to geographical markets outside the United Kingdom.

3. Other operating charges

	2015	2014
	£	£
Distribution costs	**552,885**	449,016
Administrative expenses	**3,329,186**	2,894,364
	3,882,071	3,343,380

4. Operating loss

The operating loss is stated after charging/(crediting):

	2015	2014
	£	£
Depreciation of tangible fixed assets:		
- owned by the company	**176,222**	116,366
Auditor's remuneration	**17,200**	18,385
Pension costs	**54,517**	53,973
Research and development expenditure	**2,578,466**	2,459,431
Difference on foreign exchange	**(282,337)**	87,242

During the year, no director received any emoluments (2014 - £NIL).

Notes to the financial statements

For the year ended 30 September 2015

5. Tangible fixed assets

	Test equipment	Office equipment and fittings	Computer equipment	Total
	£	£	£	£
Cost				
At 1 October 2014	**2,446,344**	**152,532**	**296,798**	**2,895,674**
Additions	**245,865**	**-**	**27,965**	**273,830**
At 30 September 2015	**2,692,209**	**152,532**	**324,763**	**3,169,504**
Depreciation				
At 1 October 2014	**2,278,535**	**141,354**	**289,137**	**2,709,026**
Charge for the year	**159,803**	**1,499**	**14,920**	**176,222**
At 30 September 2015	**2,438,338**	**142,853**	**304,057**	**2,885,248**
Net book value				
At 30 September 2015	**253,871**	**9,679**	**20,706**	**284,256**
At 30 September 2014	167,809	11,178	7,661	186,648

6. Debtors

	2015	2014
	£	£
Trade debtors	**508,955**	176,811
Other debtors	**114,321**	96,244
	623,276	273,055

7. Creditors: Amounts falling due within one year

	2015	2014
	£	£
Trade creditors	**862,438**	141,851
Other taxation and social security	**78,517**	70,984
Other creditors	**507,738**	368,957
	1,448,693	581,792

Notes to the financial statements
For the year ended 30 September 2015

8. Creditors: Amounts falling due after more than one year

	2015	2014
	£	£
Amounts owed to group undertakings	**5,894,808**	3,196,864

9. Provisions

	Warranty provision
	£
At 1 October 2014	**195,990**
Created	**67,865**
At 30 September 2015	**263,855**

Warranty provision

The warranty provision is calculated on 2.5% of manufacturing costs for each contract which remains unchanged from prior periods. The majority of the warranty expense will be incurred in years two through to five on a five year warranty.

10. Deferred taxation

The company's provision for deferred taxation consists of the tax effect of timing differences in respect of:

	2015 Provided	2015 Unprovided	2014 Provided	2014 Unprovided
	£	£	£	£
Accelerated capital allowances	-	**39,626**	-	85,945
Short term timing differences	-	**5,656**	-	21,296
Tax losses carried forward	-	**5,875,847**	-	5,846,285
Net deferred tax asset	-	**5,921,129**	-	5,953,526

11. Share capital

	2015	2014
	£	£
Authorised		
13,192 Ordinary shares of £1 each	**13,192**	13,192
Allotted, called up and fully paid		
5,109 Ordinary shares of £1 each	**5,109**	5,109

Notes to the financial statements

For the year ended 30 September 2015

12. Reserves

	Share premium account	Other reserves	Profit and loss account
	£	£	£
At 1 October 2014	20,344,529	10,287,160	(33,870,290)
Loss for the financial year	-	-	(3,115,377)
At 30 September 2015	20,344,529	10,287,160	(36,985,667)

13. Pension commitments

The company operates a defined contribution scheme for its directors and employees. The assets of the scheme are held separately from those of the company in an independently administered fund. The pension charge for the year was £54,517 (2014 - £53,973) and £Nil (2014 - £11,369) was included in creditors at the year end.

14. Operating lease commitments

At 30 September 2015 the company had annual commitments under non-cancellable operating leases as follows:

	Land and buildings 2015	Land and buildings 2014
	£	£
Expiry date:		
Between 2 and 5 years	136,516	117,556

15. Other financial commitments

Xtera Communications Ltd have provided the following foreign guarantees as at the 30th September 2015 - US$51,465 in favour of Telecom Egypt (2014 - US$51,465) and €99,992 in favour of PT Cam, Portugal (2014 - €99,992).

16. Related party transactions

As a subsidiary undertaking, 100% of whose voting rights are controlled within the group, the company has taken advantage of the exemption not to disclose transactions with entitites that are part of the group, in accordance with FRS8.

Notes to the financial statements

For the year ended 30 September 2015

17. Ultimate parent undertaking and controlling party

The company's immediate parent undertaking is Azea Networks Inc, which is incorporated in the State of Delaware, USA and its ultimate parent undertaking and controlling party is Xtera Communications Inc, which is incorporated in the State of Delaware, USA, and this is the largest and smallest group of which the company is a member and for which group financial statements are prepared. Copies of these group financial statements may be obtained from the company secretary.