

Company Registration No. 04441386 (England and Wales)

LEVEL 5 NETWORKS LIMITED
DIRECTORS' REPORT AND FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2005



LEVEL 5 NETWORKS LIMITED

COMPANY INFORMATION

Directors	C W A Cotton A Hopper J Golden H Hauser D Karr (resigned 25 October 2005) B Carano (appointed 1 February 2005)
Secretary	D E Roberts
Company Number	04441386
Registered Office	25 Greville Road Cambridge Cambs CB1 3QJ
Auditors	PricewaterhouseCoopers LLP Abacus House Castle Park Cambridge CB3 0AN
Accountants	Haslers Chartered Accountants and Registered Auditors Johnston House 8 Johnstone Road Woodford Green Essex IG8 0XA
Bankers	Barclays Bank plc 28 Chesterton Road Cambridge CB4 3AZ

LEVEL 5 NETWORKS LIMITED

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LEVEL 5 NETWORKS LIMITED

DIRECTORS' REPORT FOR THE YEAR ENDED 31 DECEMBER 2005

The Directors present their report and the audited financial statements of the company for the year ended 31 December 2005.

Principal activities and review of business

The principal activity of the company is the research and development of ethernet based network technology.

The company is the wholly owned subsidiary of Level 5 Networks, Inc. Level 5 Networks, Inc. is a developer of semi-conductors and software providing application acceleration through high-performance Ethernet network adapters. Level 5 Networks Inc. develops products which include multi-gigabit Ethernet Network Interface Cards which improve server and network efficiency for data centres.

The Directors of the parent company secured a round of Venture Capital funding in February 2005 totalling \$30m in 2 tranches of \$17m and \$13m respectively.

In April 2006 Level 5 Networks Inc, the parent company, merged with Solarflare Communications Inc in a merger of equals. Both companies raised additional funds to set the capitalisation substantially equal, with the combined entity holding a cash balance of over \$50m.

The company receives commissions from Level 5 Networks Inc., equal to its operating costs plus a percentage of net revenues generated by Level 5 Networks Inc. through the research and development and administrative support provided by the company.

The company continues to be dependent on the support of its ultimate parent company, Level 5 Networks Inc., to be able to continue in operation for the foreseeable future. Level 5 Networks Inc has committed to provide such financial support as is necessary for the company to meet its obligations on an ongoing basis, and at least for the next 12 months, and accordingly the directors believe that it is appropriate to prepare the financial statements on a going concern basis.

The company will continue to undertake Research and Development exclusively for the Parent Company.

The results for the year to 31 December 2005 are set out in the profit and loss account on page 6.

Research and development

The company incurred research and development costs of £1,741,787 during the year (year ended 31 December 2004: £816,373), all of which has been written off to the profit and loss account during the year.

LEVEL 5 NETWORKS LIMITED

DIRECTORS' REPORT (CONTINUED) FOR THE YEAR ENDED 31 DECEMBER 2005

Dividends

The directors do not recommend payment of a dividend (year ended 31 December 2004: £nil).

Directors and their interests

The following directors have held office during the period:

C W A Cotton
A Hopper
D Karr (resigned 25 October 2005)
J Golden
H Hauser
B Carano (appointed 1 February 2005)

The directors had no interests in the shares of the company or any other body corporate in the group that are required to be disclosed under Schedule 7 of the Companies Act 1985.

LEVEL 5 NETWORKS LIMITED

DIRECTORS' REPORT (CONTINUED) FOR THE YEAR ENDED 31 DECEMBER 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 of the company for that period. In preparing those financial statements, the directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and estimates that are reasonable and prudent;
- state whether applicable 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 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.

Auditors

The auditors, PricewaterhouseCoopers LLP, have indicated their willingness to continue in office, and a resolution concerning their reappointment will be proposed at the next Annual General Meeting.

This report was approved by the board on 30 Oct 06 and signed on its behalf.



Director

LEVEL 5 NETWORKS LIMITED

INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF Level 5 Networks Limited

We have audited the financial statements of Level 5 Networks Limited for the year ended 31st December 2005 which comprise the Profit and Loss Account, the Balance Sheet, 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 the 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). This report, including the opinion, has been prepared for and only for the company's members as a body in accordance with Section 235 of the Companies Act 1985 and for no other purpose. We do not, in giving this opinion, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

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 other transactions is not disclosed.

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 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.

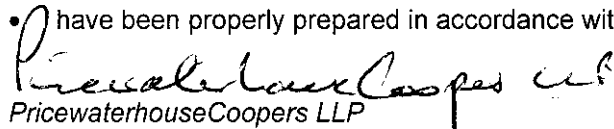
LEVEL 5 NETWORKS LIMITED

Independent auditors' report to the members of Level 5 Networks Limited (continued)

Opinion

In our opinion the financial statements:

- give a true and fair view, in accordance with United Kingdom Generally Accepted Accounting Practice, of the state of the company's affairs as at 31st December 2005 and of its profit for the year then ended; and
- have been properly prepared in accordance with the Companies Act 1985.


PricewaterhouseCoopers LLP
Chartered Accountants and Registered Auditors
Cambridge

30 October 2006

LEVEL 5 NETWORKS LIMITED

PROFIT AND LOSS ACCOUNT FOR THE YEAR ENDED 31 DECEMBER 2005

		2005	2004
	Notes	£	£
Turnover		2,437,661	1,373,888
Cost of sales		-	-
Gross profit		2,437,661	1,373,888
Net operating expenses	2	(2,231,930)	(1,264,059)
Other operating income		-	-
Operating profit	5	205,731	109,829
Other interest receivable and similar income		6,733	3,668
Profit on ordinary activities before taxation		212,464	113,497
Taxation	10	(63,578)	8
Profit/(Loss) on ordinary activities after taxation	12,13	148,885	113,505

The above results relate to continuing operations of the company.

The company had no gains or losses other than those included in the results above. Therefore no separate statement of total recognised gains and loss has been presented.

There is no material difference between the profit on ordinary activities before taxation and the profit for the year stated above and their historical cost equivalents.

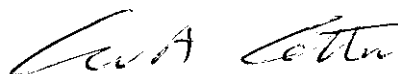
The notes on pages 8 to 16 form part of these financial statements.

LEVEL 5 NETWORKS LIMITED

BALANCE SHEET AS AT 31 DECEMBER 2005

			2005	2004
	Notes	£	£	£
Fixed assets				
Tangible assets	7		156,113	92,509
			<u>156,113</u>	<u>92,509</u>
Current assets				
Debtors	8	194,165	90,601	
Cash at bank and in hand		156,385	146,615	
		<u>350,550</u>	<u>237,216</u>	
Creditors - Amounts falling due within one year	9	(235,803)	(254,585)	
Provisions for liabilities and charges	6	(46,834)	0	
Net current asset/(liabilities)			<u>67,913</u>	<u>(17,369)</u>
Net asset			<u>224,025</u>	<u>75,140</u>
Capital and reserves				
Called up share capital	10	10,500	10,500	
Share premium account	11	147,370	147,370	
Profit and loss account	11	66,155	(82,730)	
Total shareholders' funds	12		<u>224,025</u>	<u>75,140</u>

The financial statements on pages 6 to 16 were approved by the Board of Directors on 30 Oct 06 and signed on its behalf by:



C Cotton
Director

LEVEL 5 NETWORKS LIMITED

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2005

1 Accounting policies

1.1 Basis of preparation of financial statements

These financial statements are prepared on the going concern basis, under the historical cost convention, and in accordance with the Companies Act 1985 and applicable accounting standards in the United Kingdom. The principal accounting policies, which are set out below, have been applied consistently throughout the year.

1.2 Going concern

Level 5 Networks Limited is a private company, which became a wholly owned subsidiary of Level 5 Networks Inc on 26 November 2003.

In April 2006 the Level 5 Networks Inc merged with Solarflare Communications Inc in a merger of equals. Both companies raised additional funds to set the capitalisation substantially equal, with the combined entity holding a cash balance in excess of over \$50m.

The company receives commissions from Level 5 Networks Inc., equal to its operating costs plus a percentage of net revenues generated by Level 5 Networks Inc. through the research and development and administrative support provided by the company.

The company continues to be dependent on the support of its ultimate parent company, Level 5 Networks Inc.(Solarflare Communications Inc), to be able to continue in operation for the foreseeable future. Level 5 Networks Inc (Solarflare Communications Inc) has committed to provide such financial support as is necessary for the company to meet its obligations on an ongoing basis, and at least for the next 12 months, and accordingly the directors believe that it is appropriate to prepare the financial statements on a going concern basis.

The Directors of the parent company secured a round of Venture Capital funding in February 2005 totalling \$30m in 2 tranches of \$17m and \$13m respectively.

1.3 Turnover

Turnover, represents amounts recharged to Level 5 Networks Inc. in respect of operating costs and commissions earned on net revenues generated by Level 5 Networks Inc. through the efforts of the company.

LEVEL 5 NETWORKS LIMITED

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2005

1.4 Tangible fixed assets and depreciation

The cost of tangible fixed assets is their purchase cost, together with any incidental costs of acquisition.

Depreciation is calculated so as to write off the cost of tangible fixed assets, less their estimated residual values, on a straight line basis over the expected useful economic lives of the assets concerned. The principle annual rates used for this purpose are:

Computer and laboratory equipment	33.33%
Equipment	25.00%
Leasehold Improvements	over the term of the lease

1.5 Foreign currencies

Assets and liabilities denominated in foreign currencies are expressed in sterling at the rates of exchange ruling at the balance sheet date. Exchange differences are dealt with in the profit and loss account.

1.6 Finance and operating leases

Costs in respect of operating leases are charged on a straight line basis over the lease term. Leasing agreements which transfer to the company substantially all the benefits and risks of ownership of an asset are treated as if the asset had been purchased outright.

1.7 Deferred taxation

Provision is made for deferred taxation, in accordance with FRS 19 "Deferred tax", on all material timing differences. Deferred tax assets are recognised to the extent that they are regarded as recoverable. Deferred tax assets and liabilities are not discounted.

1.8 Cash flow statement

The company has taken advantage of the exemption in Financial Reporting Standard No. 1 from the requirement to produce a cash flow statement on the grounds that it is a small company.

1.9 Research and development

Research and development costs are written off in the period in which they are incurred.

LEVEL 5 NETWORKS LIMITED

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED) FOR THE YEAR ENDED 31 DECEMBER 2005

1.10 Financial instruments

The company has adopted the presentation requirements of FRS 25 "Financial Instruments: Disclosure and Presentation" for the first time this year. All financial instruments are carried at fair value. The company has taken advantage of the exemption from restatement in respect of comparative figures on first implementing FRS 25. Financial instruments in comparative periods were valued at costs. There are no significant adjustments required to make the comparative information comply with FRS25.

2 Net operating expenses

	2005 £	2004 £
Research and development expenses	1,741,787	941,801
Sales and marketing expenses	109,822	166,964
Administrative expenses	380,321	155,294
	<u>2,231,930</u>	<u>1,264,059</u>

3 Directors' emoluments

	2005 £	2004 £
Aggregate emoluments	<u>107,850</u>	<u>36,000</u>

4 Employees

The average monthly number of persons (including executive directors) employed by the company during the year was:

	2005	2004
By activity		
Research and Development	24	10
Sales and Marketing	1	1
Administration	8	6
	<u>33</u>	<u>17</u>

LEVEL 5 NETWORKS LIMITED

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED) FOR THE YEAR ENDED 31 DECEMBER 2005

	Staff costs (for the above persons)	2005	2004
		£	£
	Wages and salaries	1,216,370	618,248
	Social security costs	144,607	68,685
	Other pension costs	43,384	22,575
	Other costs	28,070	7,599
		<u>1,432,431</u>	<u>717,107</u>
5	Operating profit/(loss)	2005	2004
		£	£
	Operating profit/(loss) is stated after charging:		
	Impairment of intangible assets	-	-
	Depreciation of tangible fixed assets	48,476	18,674
	Accelerated depreciation of tangible fixed assets		3,887
	Auditors' remuneration		
	- Audit services	8,000	11,500
	Operating lease charges:		
	Land and building	61,899	24,714
	Staff costs	1,432,431	717,107
6	Taxation	2005	2004
		£	£
	Current tax:		
	UK Corporation Tax on profits of the period	16,728	-
	Adjustment in respect of previous period	16	(8)
	Total current tax	<u>16,744</u>	<u>(8)</u>
	Deferred tax:		
	Origination and reversal of timing differences (ACA)	46,835	0
	Tax on profit on ordinary activities	<u>63,578</u>	<u>(8)</u>

No corporation tax liability arises on the results for the period due to the accumulated losses carried forward from previous period. A tax credit has arisen as a result of tax losses being surrendered in respect of research and development expenditure.

LEVEL 5 NETWORKS LIMITED

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED) FOR THE YEAR ENDED 31 DECEMBER 2005

At 31 December 2005 there were no tax losses available to carry forward (2004: tax losses carried forward amounted to £76,376).

Factors affecting the tax credit for the year	2005	2004
	£	£
Profit on ordinary activities before taxation	212,464	113,497
Tax on profit on ordinary activities multiplied by the research and development tax credit rate of 19% (2004: 19%)	40,368	21,564
Tax effect of reconciling items:		
Expenses not deductible for tax purposes	2,956	(26,766)
Carried forward losses		20,379
Differences between capital allowances and depreciation	(26,596)	(15,177)
Adjustments to tax charge in respect of previous period	16	(8)
Current tax (credit)	16,744	(8)

Deferred taxation

The potential deferred tax asset in respect of cumulative losses has not been recognised in these financial statements as there is no immediate prospect of these being utilised. The losses are available to be carried forward indefinitely under current law.

Deferred tax (assets) are comprised as follows:

	Provided 2005 £	Unprovided 2004 £
Accelerated capital allowances	46,834	27,753
Losses	0	(65,579)
	46,834	(37,826)

LEVEL 5 NETWORKS LIMITED

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED) FOR THE YEAR ENDED 31 DECEMBER 2005

7	Tangible fixed assets	Computer and laboratory equipment	Equipment	Leasehold improvements	Total
					£
	Cost				
	At 1 January 2005	116,144	-	-	116,144
	Additions	58,502	15,840	37,739	112,080
		-----	-----	-----	-----
	At 31 December 2005	174,646	15,840	37,739	228,224
		-----	-----	-----	-----
	Accumulated depreciation				
	At 1 January 2005	23,635	-	-	23,635
	Charge for the year	44,665	1,114	2,697	48,476
		-----	-----	-----	-----
	At 31 December 2005	68,300	1,114	2,697	72,111
		-----	-----	-----	-----
	Net book value				
	At 31 December 2005	106,345	14,726	35,042	156,113
		-----	-----	-----	-----
	At 31 December 2004	92,509	-	-	92,509
		-----	-----	-----	-----
8	Debtors		2005	2004	
			£	£	
	Prepayments		32,385	20,474	
	Corporation tax recoverable		0	27,106	
	Other Debtors		55,608	43,021	
	Amounts owed by parent undertaking		106,172	0	
			-----	-----	
			194,165	90,601	
			-----	-----	

Amounts owed by the parent undertaking are unsecured, interest-free and have no fixed repayment date.

LEVEL 5 NETWORKS LIMITED

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED) FOR THE YEAR ENDED 31 DECEMBER 2005

9	Creditors: amounts falling due within one year	2005 £	2004 £
	Trade Creditors	66,831	50,786
	Other taxation and social security	73,072	28,953
	Amounts owed to parent undertaking		113,210
	Bank overdraft	0	4
	Accruals	72,578	57,191
	Other Creditors	6,578	4,441
	Corporation tax payable	16,744	0
		<u>235,803</u>	<u>254,585</u>

Amounts owed to the parent undertaking are unsecured, interest-free and have no fixed repayment date.

10	Provisions for liabilities and charges	Deferred tax provision excluding deferred tax on pension assets £	Total £
	1 January 2005	0	0
	Charged to the profit and loss account	46,834	46,834
	31 December 2005	46,834	46,834

11	Share Capital	2005 £	2004 £
	Authorised		
	20,000,000 (2003: 20,000,000) ordinary shares of 0.125p each	25,000	25,000
	Allotted, called up and fully paid		
	8,400,264 (2003: 8,400,264) ordinary shares of 0.125p each	10,500	10,500

LEVEL 5 NETWORKS LIMITED

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED) FOR THE YEAR ENDED 31 DECEMBER 2005

12	Statement of movement on reserves	Share premium account £	Profit and loss account £
	At 1 January 2005	147,370	(82,730)
	Profit for the year	-	148,885
		-----	-----
	At 31 December 2005	147,370	66,155
		-----	-----
13	Reconciliation of movement in shareholders' deficit	2005 £	2004 £
	Opening shareholders' funds/(deficit)	75,140	(38,365)
	Profit for the financial year	148,885	113,505
		-----	-----
	Closing shareholders' funds	224,025	75,140
		-----	-----
14	Financial commitments		
	At 31 December 2005, the company had annual commitments under non-cancellable operating leases as follows:		
		2005	2004
	Land and buildings		
	Expiring within 1 year	73,035	39,542
	Expiring within 2-5 years	180,079	176,524
		-----	-----
		253,114	81,077
		-----	-----
15	Related party disclosures		
	During the period the company entered into a number of transactions with Level 5 Networks Inc., the immediate and ultimate parent company:		
	During the period, the company lent funds to Level 5 Networks Inc. for working capital purposes £123,554 (2004: the company obtained funds of £113,636).		

LEVEL 5 NETWORKS LIMITED

NOTES TO THE FINANCIAL STATEMENTS (CONTINUED) FOR THE YEAR ENDED 31 DECEMBER 2005

The amount outstanding at the balance sheet date was (£123,554) (2004: £113,120). This balance is unsecured, interest free and has no fixed repayment date.

The company's turnover is derived principally from sales to its parent company. The company's turnover for the year amounted to £2,451,445 (2004: £1,248,460)

There were no companies other than Level 5 Networks Inc. and Level 5 Networks Limited within the group at 31 December 2005.

16 Ultimate parent undertaking

The directors regard Solarflare Communications Inc, a company incorporated in the USA to be the ultimate parent company. Solarflare Communications Inc has a 100% interest in the issued share capital of Level 5 Networks Inc, Level 5 Networks Inc holds a 100% interest in Level 5 Networks Ltd.

17 Patents and trademarks

An error in classification of patent & trademark and consulting costs occurred during the year to 31 December 2004 resulting in revenue and R&D costs being understated by £125,428. The misclassification resulted in no change to the net profit declared for the year.