

Registered number: 04441386

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**SOLARFLARE COMMUNICATIONS LIMITED**  
**(formerly Level 5 Networks Limited)**

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**DIRECTORS' REPORT AND FINANCIAL STATEMENTS**  
**FOR THE YEAR ENDED 31 DECEMBER 2007**

TUESDAY



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## **SOLARFLARE COMMUNICATIONS LIMITED**

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### **COMPANY INFORMATION**

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**DIRECTORS**

C W A Cotton  
D E Roberts (appointed 06/06/07)  
S T Hughes (appointed 06/06/07)  
A Hopper (resigned 02/05/07)  
F Golden (resigned 10/05/07)  
H Hauser (resigned 02/05/07)  
B Carano (resigned 27/04/07)

**COMPANY SECRETARY**

D E Roberts

**COMPANY NUMBER**

04441386

**REGISTERED OFFICE**

Block 2, Second Floor,  
Westbrook Centre, Milton Road,  
Cambridge  
CB4 1YG

**AUDITORS**

Haslers  
Chartered Accountants & Registered Auditor  
Old Station Road  
Loughton  
Essex  
IG10 4PL

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**SOLARFLARE COMMUNICATIONS LIMITED**

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## **SOLARFLARE COMMUNICATIONS LIMITED**

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### **DIRECTORS' REPORT FOR THE YEAR ENDED 31 DECEMBER 2007**

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The directors present their report and the financial statements for the year ended 31 December 2007.

#### **PRINCIPAL ACTIVITY**

The principal activity of the company in the year continued to be that of the research and development of ethernet based network technology.

#### **BUSINESS REVIEW**

The company receives commissions from Level 5 Networks Inc equal to its operating costs plus a percentage. The company undertakes research and development exclusively for the parent company. The principal risk and uncertainty for the company therefore relates to the possibility of a discontinuation of that relationship.

The company continues to be dependent on the support of its ultimate parent company, Solarflare Communications Inc, to be able to continue in operation for the foreseeable future. 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 twelve months. Accordingly the directors believe that it is appropriate to prepare the financial statements on a going concern basis.

The company's operations as a Research and Development centre ensure that it has no exposure to price risk. The company also has no exposure to equity securities price risk as it holds no listed or other equity investments. The company is financed solely by the parent company and as such faces no major credit or liquidity risk. The company has interest-bearing assets in the form of cash balances and holds no interest-bearing liabilities.

The Key Performance Indicators for the business include:

Developmental milestones: The Cambridge team successfully completed:

- verification of silicon prior to the production tapeout of its Ethernet Controller
- Windows Hardware Qualification Status for its range of driver software
- Acceptance of driver source code into the standard Linux distributions
- Acceptance of API modifications for the Xen Virtualization environment

Design of new and innovative hardware:

- Started work on a new Ethernet controller for the next generation of integrated Silicon

The results for the year to 31 December 2007 are set out in the profit and loss account.

#### **Research and Development**

The company incurred research and development costs of £1,823,476 during the year (2006: £1,959,079), all of which has been written off to the profit and loss account during the year.

#### **RESULTS AND DIVIDENDS**

The profit for the year, after taxation, amounted to £298,131 (2006 - £148,036).

The directors do not recommend payment of a dividend (2006: £Nil).

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## SOLARFLARE COMMUNICATIONS LIMITED

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### DIRECTORS' REPORT FOR THE YEAR ENDED 31 DECEMBER 2007

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#### DIRECTORS

The directors who served during the year and their interests in the company's issued share capital were:

	Ordinary shares of 0.125p each	
	31/12/07	1/1/07
C W A Cotton	-	-
D E Roberts (appointed 06/06/07)	-	-
S T Hughes (appointed 06/06/07)	-	-
A Hopper (resigned 02/05/07)	-	-
F Golden (resigned 10/05/07)	-	-
H Hauser (resigned 02/05/07)	-	-
B Carano (resigned 27/04/07)	-	-

None of the directors had any interest in the shares of the company at the beginning or end of the year.

The company is a wholly owned subsidiary of a company incorporated outside Great Britain and, as permitted by Statutory Instrument 85/802, the register kept in accordance with Section 235 of Companies Act 1985 does not disclose the interest of directors in shares in foreign registered group companies.

#### STATEMENT OF DIRECTORS' RESPONSIBILITIES

The directors are responsible for preparing the annual 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). The financial statements are required by law to 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 these financial statements, the directors are required to:

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

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**SOLARFLARE COMMUNICATIONS LIMITED**

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**DIRECTORS' REPORT  
FOR THE YEAR ENDED 31 DECEMBER 2007**

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**PROVISION OF INFORMATION TO AUDITORS**

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 auditors are 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 information needed by the company's auditors in connection with preparing their report and to establish that the company's auditors are aware of that information.

**AUDITORS**

The auditors, Haslers, will be proposed for reappointment in accordance with section 485 of the Companies Act 2006.

This report was approved by the board on 12 December 2008 and signed on its behalf.



**D E Roberts**  
Director

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## **SOLARFLARE COMMUNICATIONS LIMITED**

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### **INDEPENDENT AUDITORS' REPORT TO THE SHAREHOLDERS OF SOLARFLARE COMMUNICATIONS LIMITED**

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We have audited the financial statements of Solarflare Communications Limited for the year ended 31 December 2007, set out on pages 6 to 18. These financial statements have been prepared under the accounting policies set out therein.

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 auditors' 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' responsibilities for preparing 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).

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 whether in our opinion the information given in the directors' report is consistent with the financial statements.

In addition we 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 directors' report and consider the implications for our report if we become aware of any apparent misstatements within it.

#### **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.

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**SOLARFLARE COMMUNICATIONS LIMITED**

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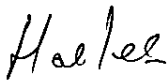
**INDEPENDENT AUDITORS' REPORT TO THE SHAREHOLDERS OF SOLARFLARE COMMUNICATIONS LIMITED**

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**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 31 December 2007 and of its profit for the year then ended;
- 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.



**HASLERS**

Chartered Accountants  
Registered Auditor  
Old Station Road  
Loughton  
Essex  
IG10 4PL

12 December 2008



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**SOLARFLARE COMMUNICATIONS LIMITED**

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**PROFIT AND LOSS ACCOUNT  
FOR THE YEAR ENDED 31 DECEMBER 2007**

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	Note	2007 £	2006 £
<b>TURNOVER</b>	1,2	<b>2,684,800</b>	<b>2,520,474</b>
Operating expenses		<b>(2,457,206)</b>	<b>(2,330,260)</b>
<b>OPERATING PROFIT</b>	3	<b>227,594</b>	<b>190,214</b>
Interest receivable		<b>5,090</b>	<b>7,010</b>
<b>PROFIT ON ORDINARY ACTIVITIES BEFORE TAXATION</b>		<b>232,684</b>	<b>197,224</b>
Tax on profit on ordinary activities	7	<b>65,447</b>	<b>(49,188)</b>
<b>PROFIT FOR THE FINANCIAL YEAR</b>		<b>298,131</b>	<b>148,036</b>

All amounts relate to continuing operations.

There were no recognised gains and losses for 2007 or 2006 other than those included in the profit and loss account.

The notes on pages 8 to 18 form part of these financial statements.

**SOLARFLARE COMMUNICATIONS LIMITED**

**BALANCE SHEET  
AS AT 31 DECEMBER 2007**

	Note	£	2007 £	£	2006 £
<b>FIXED ASSETS</b>					
Tangible fixed assets	8		232,022		134,276
<b>CURRENT ASSETS</b>					
Debtors	9	540,035		420,104	
Cash at bank		126,491		110,886	
		<u>666,526</u>		<u>530,990</u>	
<b>CREDITORS:</b> amounts falling due within one year	10	(137,739)		(245,772)	
<b>NET CURRENT ASSETS</b>			<u>528,787</u>		<u>285,218</u>
<b>TOTAL ASSETS LESS CURRENT LIABILITIES</b>			<u>760,809</u>		<u>419,494</u>
<b>PROVISIONS FOR LIABILITIES</b>					
Deferred tax	11		(47,319)		(15,523)
<b>NET ASSETS</b>			<u>713,490</u>		<u>403,971</u>
<b>CAPITAL AND RESERVES</b>					
Called up share capital	12		10,500		10,500
Share premium account	13		147,370		147,370
Profit and loss account	13		555,620		246,101
<b>SHAREHOLDERS' FUNDS</b>	14		<u>713,490</u>		<u>403,971</u>

The financial statements were approved and authorised for issue by the board and were signed on its behalf on 12 December 2008.



**D E Roberts**  
Director

The notes on pages 8 to 18 form part of these financial statements.

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## **SOLARFLARE COMMUNICATIONS LIMITED**

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### **NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2007**

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#### **1. ACCOUNTING POLICIES**

##### **1.1 BASIS OF PREPARATION OF FINANCIAL STATEMENTS**

The 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 TURNOVER**

Turnover represents operating costs recharged to the US parent company.

##### **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:

Leasehold improvements	-	over the period of the lease
Equipment	-	25% straight line
Computer and laboratory equipment	-	33.33% straight line

##### **1.4 OPERATING LEASES**

Costs in respect of operating leases are charged on a straight line basis over the lease term.

##### **1.5 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.

Deferred tax assets are recognised to the extent that they are regarded as recoverable. Deferred tax assets and liabilities are not discounted.

##### **1.6 FOREIGN CURRENCIES**

Monetary assets and liabilities denominated in foreign currencies are translated into sterling at rates of exchange ruling at the balance sheet date.

Transactions in foreign currencies are translated into sterling at the rate ruling on the date of the transaction.

Exchange gains and losses are recognised in the profit and loss account.

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## **SOLARFLARE COMMUNICATIONS LIMITED**

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### **NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2007**

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#### **1. ACCOUNTING POLICIES (continued)**

##### **1.7 RESEARCH AND DEVELOPMENT**

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

##### **1.8 PENSION SCHEME ARRANGEMENTS**

The company operates a defined contribution pension scheme. Contributions are charged to the profit and loss account as incurred. Contributions are based on the pensionable salaries of the scheme members. Contribution to the Solarflare Communications Limited Group Personal Pension Plan is made on a monthly basis.

##### **1.9 GOING CONCERN**

The company receives commissions from Level 5 Networks Inc, its parent company, equal to its operating costs plus a percentage.

The company receives settlement of these commissions from its ultimate parent company, Solarflare Communications Inc. The company will continue to be dependent on the support of Solarflare Communications Inc, to be able to continue in operation for the foreseeable future. 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 twelve months. Accordingly the directors believe that it is appropriate to prepare the financial statements on a going concern basis.

##### **1.10 FINANCIAL INSTRUMENTS**

The financial instruments are held at historical cost.

The financial asset and the financial liability are offset and the net amount presented in the balance sheet, as Solarflare Communications Limited intends either to settle on a net basis, or to realise the asset and settle the liability simultaneously.

##### **1.11 SHARE OPTIONS**

The entity has adopted FRS 20, 'Share-based Payment'. In accordance with this standard the company is required to recognise an expense in respect of options granted after 7 November 2002 that were unvested as of 1 January 2006. This expense, which is calculated by reference to the fair value of the options granted, is recognised on a straight-line basis over the vesting period based on the company's estimate of the number of options that will eventually vest. The charge is credited to retained earnings.

No charge arises if the exercise price of the option is in excess of the fair value of the option.

##### **1.12 CASH FLOW STATEMENT**

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

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**SOLARFLARE COMMUNICATIONS LIMITED**

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**NOTES TO THE FINANCIAL STATEMENTS  
FOR THE YEAR ENDED 31 DECEMBER 2007**

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**2. TURNOVER**

The whole of the turnover is attributable to recharges of operating costs to the parent company.

**3. OPERATING PROFIT**

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

	2007 £	2006 £
Depreciation of tangible fixed assets:		
- owned by the company	104,100	74,271
Operating lease rentals:		
- other operating leases	68,504	67,783
Difference on foreign exchange	5,556	(8,080)
	<u>          </u>	<u>          </u>

**4. AUDITORS' REMUNERATION**

	2007 £	2006 £
Fees payable to the company's auditor for the audit of the company's annual accounts	9,850	11,500
Fees payable to the company's auditor and its associates in respect of:		
Other services relating to taxation	3,100	-
	<u>          </u>	<u>          </u>

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**SOLARFLARE COMMUNICATIONS LIMITED**

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**NOTES TO THE FINANCIAL STATEMENTS  
FOR THE YEAR ENDED 31 DECEMBER 2007**

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**5. STAFF COSTS**

Staff costs, including directors' remuneration, were as follows:

	2007 £	2006 £
Wages and salaries	1,471,792	1,411,219
Social security costs	169,032	162,519
Other pension costs	70,568	67,030
	<u>1,711,392</u>	<u>1,640,768</u>

The average monthly number of employees, including the directors, during the year was as follows:

	2007 No.	2006 No.
Research and Development	28	29
Administration	6	7
	<u>34</u>	<u>36</u>

**6. DIRECTORS' REMUNERATION**

	2007 £	2006 £
Emoluments	<u>51,975</u>	<u>73,007</u>
Company pension contributions to money purchase pension schemes	<u>2,599</u>	<u>-</u>

During the year retirement benefits were accruing to 1 director (2006 - NIL) in respect of money purchase pension schemes.

The directors' interests in share options granted over shares in the ultimate parent company, Solarflare Communications Inc, are disclosed in the accounts of the parent company.

**SOLARFLARE COMMUNICATIONS LIMITED**

**NOTES TO THE FINANCIAL STATEMENTS  
FOR THE YEAR ENDED 31 DECEMBER 2007**

**7. TAXATION**

	2007 £	2006 £
<b>ANALYSIS OF TAX (CREDIT)/CHARGE IN THE YEAR</b>		
<b>CURRENT TAX</b> (see note below)		
UK corporation tax charge on profit for the year	-	73,268
Adjustments in respect of prior periods	(97,243)	7,231
<b>TOTAL CURRENT TAX</b>	<u>(97,243)</u>	<u>80,499</u>
<b>DEFERRED TAX</b> (see note 11)		
Origination and reversal of timing differences	31,796	(31,311)
<b>TAX ON PROFIT ON ORDINARY ACTIVITIES</b>	<u>(65,447)</u>	<u>49,188</u>

**FACTORS AFFECTING TAX CHARGE FOR THE YEAR**

The tax assessed for the year is lower than (2006 - *higher than*) the standard rate of corporation tax in the UK (20%). The differences are explained below:

	2007 £	2006 £
Profit on ordinary activities before tax	<u>232,684</u>	<u>197,224</u>
Profit on ordinary activities multiplied by standard rate of corporation tax in the UK of 20% (2006 - 30%)	46,537	59,167
<b>EFFECTS OF:</b>		
Expenses not deductible for tax purposes	2,551	4,801
Capital allowances for year in excess of depreciation	(19,549)	16,381
Expenses deductible for tax purposes (EMI options exercised)	(4,856)	-
Use of losses	(24,683)	(7,081)
Adjustments to tax charge in respect of prior periods	(97,243)	7,231
<b>CURRENT TAX (CREDIT)/CHARGE FOR THE YEAR</b> (see note above)	<u>(97,243)</u>	<u>80,499</u>

**FACTORS THAT MAY AFFECT FUTURE TAX CHARGES**

The company has losses carried forward of £995,419 (2006: £662,966). No deferred tax asset has been recognised in respect of these tax losses as it is not known when such an asset would become recoverable.

The adjustment in respect of prior periods arises because research and development claims were submitted to HM Revenue & Customs during the year in relation to prior periods, and the losses arising therefrom resulted in corporation tax that was previously paid by the company being repayable.

**SOLARFLARE COMMUNICATIONS LIMITED**

**NOTES TO THE FINANCIAL STATEMENTS  
FOR THE YEAR ENDED 31 DECEMBER 2007**

**8. TANGIBLE FIXED ASSETS**

	Leasehold Improvements £	Equipment £	Computer and laboratory equipment £	Total £
<b>COST</b>				
At 1 January 2007	37,739	15,840	227,079	280,658
Additions	-	2,418	199,428	201,846
At 31 December 2007	<u>37,739</u>	<u>18,258</u>	<u>426,507</u>	<u>482,504</u>
<b>DEPRECIATION</b>				
At 1 January 2007	11,907	5,645	128,830	146,382
Charge for the year	9,435	4,977	89,688	104,100
At 31 December 2007	<u>21,342</u>	<u>10,622</u>	<u>218,518</u>	<u>250,482</u>
<b>NET BOOK VALUE</b>				
At 31 December 2007	<u>16,397</u>	<u>7,636</u>	<u>207,989</u>	<u>232,022</u>
At 31 December 2006	<u>25,832</u>	<u>10,195</u>	<u>98,249</u>	<u>134,276</u>

**9. DEBTORS**

**DUE AFTER MORE THAN ONE YEAR**

Other debtors	24,293	24,293
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**DUE WITHIN ONE YEAR**

Amounts owed by group undertakings	363,845	323,439
Other debtors	98,742	40,391
Prepayments	53,155	31,981
	<u>540,035</u>	<u>420,104</u>

Amounts owed by the parent undertaking are unsecured, interest-free and have no fixed repayment date. Other debtors due after more than one year relate to a rent deposit on a lease which expires in March 2009.



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**SOLARFLARE COMMUNICATIONS LIMITED**

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**NOTES TO THE FINANCIAL STATEMENTS  
FOR THE YEAR ENDED 31 DECEMBER 2007**

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**10. CREDITORS:  
AMOUNTS FALLING DUE WITHIN ONE YEAR**

	2007 £	2006 £
Trade creditors	43,285	37,777
Corporation tax	-	73,269
Social security and other taxes	40,058	59,067
Other creditors	-	280
Accruals and deferred income	54,396	75,379
	<u>137,739</u>	<u>245,772</u>

**11. DEFERRED TAXATION**

	2007 £	2006 £
At beginning of year	15,523	46,834
Charge for/(released during) year	31,796	(31,311)
	<u>47,319</u>	<u>15,523</u>

The provision for deferred taxation is made up as follows:

	2007 £	2006 £
Accelerated capital allowances	64,687	29,475
Share based payments timing difference	(17,368)	(13,952)
	<u>47,319</u>	<u>15,523</u>

**12. SHARE CAPITAL**

	2007 £	2006 £
<b>AUTHORISED</b>		
20,000,000 Ordinary shares of 0.125p each	<u>25,000</u>	<u>25,000</u>
<b>ALLOTTED, CALLED UP AND FULLY PAID</b>		
8,400,264 Ordinary shares of 0.125p each	<u>10,500</u>	<u>10,500</u>

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**SOLARFLARE COMMUNICATIONS LIMITED**

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**NOTES TO THE FINANCIAL STATEMENTS  
FOR THE YEAR ENDED 31 DECEMBER 2007**

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**13. RESERVES**

	Share premium account £	Profit and loss account £
At 1 January 2007	147,370	246,101
Profit for the year		298,131
Share options reserve movement		11,388
	<u>147,370</u>	<u>555,620</u>
At 31 December 2007	<u>147,370</u>	<u>555,620</u>

**14. RECONCILIATION OF MOVEMENT IN SHAREHOLDERS' FUNDS**

	2007 £	2006 £
Opening shareholders' funds	403,971	255,935
Profit for the year	298,131	148,036
Other movements in profit and loss reserve	11,388	-
	<u>713,490</u>	<u>403,971</u>
Closing shareholders' funds	<u>713,490</u>	<u>403,971</u>

**15. PENSION COMMITMENTS**

The company operates a defined contribution pension scheme and contributions are charged to the profit and loss account as incurred. Contributions of £70,568 were made during the year to 31 December 2007 (2006: £67,030). Contributions of £80 were due to be refunded at the year end (2006: refund due of £13,404). The company provides no other post retirement benefits to its employees.

**16. OPERATING LEASE COMMITMENTS**

At 31 December 2007 the company had annual commitments under non-cancellable operating leases as follows:

	Land and buildings 2007 £	2006 £
<b>EXPIRY DATE:</b>		
Between 1 and 2 years	<u>73,035</u>	<u>73,035</u>

# SOLARFLARE COMMUNICATIONS LIMITED

## NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2007

### 17. SHARE BASED PAYMENTS

The Enterprise Management Incentive Share Option Scheme (EMI) was introduced in 2003. Under the EMI the Board of Directors can grant options over shares in the ultimate US parent company to employees of the group. Options are granted with a fixed exercise price equal to the market price of the shares under option at the date of grant. Options are granted in US Dollars and for reporting purposes have been converted to Sterling using the spot rate on the last calendar day of each year. The contractual life of an option is 10 years. All permanent employees are eligible for Awards under the EMI. The company has made regular option grants in 2004, 2005, 2006 and 2007 with the majority of shares granted on each employee's hire date. Most options granted under the EMI scheme will become exercisable 25% after the first year and pro rata monthly thereafter for the next 36 months. Vesting of an option is subject to continued employment, with exercises allowed for up to 90 days after termination of employment. The company merged with Solarflare Communications in April 2006. The share option grants detailed below, up to 31 December 2006, are the original grants. They were subsequently converted into options to purchase shares in Solarflare Communications Inc, and therefore a merger fraction of 0.70699108 applied to the calculations. Options were valued using the Black-Scholes option-pricing model. No performance conditions were included in the fair value calculations. The fair value per option granted and the assumptions used in the calculation are as follows:

	29/04/2004	03/05/2004	15/07/2004	09/09/2004	20/09/2004
Exercise price (£)	0.024	0.024	0.024	0.024	0.024
Number of employees	3	11	1	1	1
Shares under option	192,000	1,575,000	10,000	40,000	175,000
Vesting period (years)	4	4	4	4	4
Volatility	100.30 %	93.40 %	93.70 %	93.60 %	93.50 %
Option life (years)	10	10	10	10	10
Expected life (years)	6.08	6.08	6.08	6.08	6.08
Risk free rate	3.98 %	3.96 %	3.98 %	3.69 %	3.55 %
Dividend yield	- %	- %	- %	- %	- %
Fair value (£)	0.019	0.019	0.019	0.019	0.019

	02/11/2004	02/12/2004	21/02/2005	27/04/2005	27/07/2005
Exercise price (£)	0.024	0.024	0.052	0.052	0.052
Number of employees	1	3	6	23	2
Shares under option	40,000	155,000	260,000	2,062,612	150,000
Vesting period (years)	4	4	4	4	4
Volatility	92.90 %	92.30 %	100.50 %	103.50 %	93.00 %
Option life (years)	10	10	10	10	10
Expected life (years)	6.08	6.08	6.08	6.08	6.08
Risk free rate	3.60 %	3.98 %	3.98 %	3.99 %	4.13 %
Dividend yield	- %	- %	- %	- %	- %
Fair value (£)	0.019	0.019	0.041	0.041	0.041

**SOLARFLARE COMMUNICATIONS LIMITED**

**NOTES TO THE FINANCIAL STATEMENTS  
FOR THE YEAR ENDED 31 DECEMBER 2007**

	09/09/2005	02/11/2005	13/01/2006	07/06/07
Exercise price (£)	0.052	0.052	0.046	0.105
Number of employees	2	3	3	28
Shares under option	150,000	150,000	417,500	359,853
Vesting period (years)	4	4	4	4
Volatility	102.30 %	102.10 %	101.40 %	70.99
Option life (years)	10	10	10	10
Expected life (years)	6.08	6.08	6.08	6.07
Risk free rate	4.17 %	4.56 %	4.31 %	5.06
Dividend yield	- %	- %	- %	- %
Fair value (£)	0.041	0.041	0.036	0.035

As Solarflare Communications Inc is not a publicly traded company, the expected volatility is based on companies that are directly deemed comparable to Solarflare Communications Inc. The expected life is the average expected period to exercise. The risk-free rate is based on the spot rates for US Treasury Strips with maturities similar to the options. A reconciliation of options movements over the year to 31 December 2007 is shown below:

	No of options	Price £
Outstanding 1 January 2005	1,523,000	0.027
Granted	2,772,612	0.052
Forfeited	-	-
Exercised	-	-
Outstanding 31 December 2005	4,295,612	0.043
Exercisable 31 December 2005	738,211	0.028
	No of options	Price £
Outstanding 1 January 2006	4,295,612	0.038
Granted	417,500	0.046
Forfeited	76,146	0.033
Exercised	38,854	0.025
Outstanding 31 December 2006	4,598,112	0.036
Exercisable 31 December 2006	2,484,646	0.031
	No of options	Price £
Outstanding 1 January 2007	4,598,112	0.036
Convert options into options to purchase shares in Solarflare Communications Inc (using merger fraction of 0.70699108)	(1,347,288)	-
	3,250,824	0.036
Granted	359,853	0.105
Forfeited	-	-
Exercised	830,793	0.063
Outstanding 31 December 2007	2,779,884	0.035
Exercisable 31 December 2007	1,953,836	0.051

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## SOLARFLARE COMMUNICATIONS LIMITED

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### NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2007

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The weighted average fair value of the options exercised in the year was £12,652 (2006: £14,925)

The weighted average exercise price and weighted average expected and contractual lives for 2006 and 2007 are:

	2007	2006
Weighted Average Exercise Price (£)	0.105	0.046
Number of shares	359,853	417,500
Weighted average contractual life (years)	10.00	9.04
Weighted average expected life (years)	6.07	5.12

The weighted average exercise price of the shares exercised in 2007 was £0.060 (2006: £0.023).

The total charge for the year relating to employee share based payments plans was £11,388 (2006: £31,910) all of which related to equity-settled share based payments transactions.

The 2007 options granted are under consideration as to whether they do in fact qualify under the EMI scheme criteria. If it is found that they do not, it is the directors intention to cancel those options and reissue new options under the EMI scheme as and when the company does meet the qualifying criteria. This will have no implication for the financial statements.

#### 18. RELATED PARTY TRANSACTIONS

During the period the company entered into a number of transactions with Level 5 Networks Inc, the immediate parent company and Solarflare Communications Inc, the ultimate parent company.

During the period, the company lent funds to Level 5 Networks Inc for working capital purposes whilst it obtained funds from Solarflare Communications Inc of £Nil (2006: £535,976). The company has the right to net the payable and receivable amounts and as such the net balance owed to the company was £363,845 (2006: £276,933). This balance is unsecured, interest free and has no fixed payment date.

The company's turnover is derived principally from recharges to its immediate parent company. The company's turnover for the year amounted to £2,684,800 (2006: £2,520,474).

#### 19. ULTIMATE PARENT UNDERTAKING AND CONTROLLING PARTY

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

There is no one ultimate controlling party of Solarflare Communications Inc.