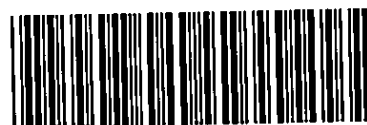


Registered number: 04441386

SOLARFLARE COMMUNICATIONS LIMITED

DIRECTORS' REPORT AND FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2008

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SOLARFLARE COMMUNICATIONS LIMITED

COMPANY INFORMATION

DIRECTORS

C W A Cotton
D E Roberts
S T Hughes

COMPANY SECRETARY

D E Roberts

COMPANY NUMBER

04441386

REGISTERED OFFICE

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

AUDITORS

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

SOLARFLARE COMMUNICATIONS LIMITED

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SOLARFLARE COMMUNICATIONS LIMITED

DIRECTORS' REPORT FOR THE YEAR ENDED 31 DECEMBER 2008

The directors present their report and the financial statements for the year ended 31 December 2008.

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 ultimate parent company, Solarflare Communications Inc. 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 upon 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 these developmental milestones:

The Cambridge team successfully completed:

- development and verification of new software driver release (includes BootROM, Solaris, DOS, and many other customer lead enhancements)
- verification of silicon prior to the production tapeout of its next-gen Ethernet Controller
- support/maintenance of the OpenOnload TCP/IP stack

Design of new and innovative hardware:

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

The results for the year to 31 December 2008 are set out in the profit and loss account.

Research and Development

The company incurred research and development costs of £1,968,219 during the year (2007: £1,823,476), 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 £208,157 (2007 - £298,131).

The directors do not recommend payment of a dividend (2007: £Nil).

SOLARFLARE COMMUNICATIONS LIMITED

DIRECTORS' REPORT FOR THE YEAR ENDED 31 DECEMBER 2008

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	
	31/12/08	1/1/08
C W A Cotton	-	-
D E Roberts	-	-
S T Hughes	-	-

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.

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.

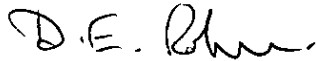
SOLARFLARE COMMUNICATIONS LIMITED

**DIRECTORS' REPORT
FOR THE YEAR ENDED 31 DECEMBER 2008**

AUDITORS

Under section 487 of the Companies Act 2006, Haslers will be deemed to have been reappointed as auditors 28 days after these financial statements were sent to members or 28 days after the latest date prescribed for filing the accounts with the registrar, whichever is earlier.

This report was approved by the board on 11 June 2009 and signed on its behalf.



D E Roberts
Director

SOLARFLARE COMMUNICATIONS LIMITED

INDEPENDENT AUDITORS' REPORT TO THE SHAREHOLDERS OF SOLARFLARE COMMUNICATIONS LIMITED

We have audited the financial statements of Solarflare Communications Limited for the year ended 31 December 2008, set out on pages 6 to 19. 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.

SOLARFLARE COMMUNICATIONS LIMITED

INDEPENDENT AUDITORS' REPORT TO THE SHAREHOLDERS OF SOLARFLARE COMMUNICATIONS LIMITED

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 2008 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

11 June 2009

SOLARFLARE COMMUNICATIONS LIMITED

**PROFIT AND LOSS ACCOUNT
FOR THE YEAR ENDED 31 DECEMBER 2008**

	Note	2008 £	2007 £
TURNOVER	1,2	3,039,633	2,684,800
Operating expenses		<u>(2,773,806)</u>	<u>(2,457,206)</u>
OPERATING PROFIT	3	265,827	227,594
Interest receivable		3,364	5,090
Interest payable	7	<u>(243)</u>	<u>-</u>
PROFIT ON ORDINARY ACTIVITIES BEFORE TAXATION		268,948	232,684
Tax on profit on ordinary activities	8	<u>(60,791)</u>	<u>65,447</u>
PROFIT FOR THE FINANCIAL YEAR		<u>208,157</u>	<u>298,131</u>

All amounts relate to continuing operations.

There were no recognised gains and losses for 2008 or 2007 other than those included in the profit and loss account.

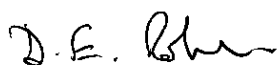
The notes on pages 8 to 19 form part of these financial statements.

SOLARFLARE COMMUNICATIONS LIMITED

**BALANCE SHEET
AS AT 31 DECEMBER 2008**

	Note	£	2008 £	£	2007 £
FIXED ASSETS					
Tangible fixed assets	9		436,770		232,022
CURRENT ASSETS					
Debtors	10	585,078		540,037	
Cash at bank		268,554		126,491	
		<u>853,632</u>		<u>666,528</u>	
CREDITORS: amounts falling due within one year	11	<u>(253,261)</u>		<u>(137,740)</u>	
NET CURRENT ASSETS			<u>600,371</u>		<u>528,788</u>
TOTAL ASSETS LESS CURRENT LIABILITIES			<u>1,037,141</u>		<u>760,810</u>
PROVISIONS FOR LIABILITIES					
Deferred tax	12		<u>(108,110)</u>		<u>(47,319)</u>
NET ASSETS			<u>929,031</u>		<u>713,491</u>
CAPITAL AND RESERVES					
Called up share capital	13		10,500		10,500
Share premium account	14		147,370		147,370
Profit and loss account	14		<u>771,161</u>		<u>555,621</u>
SHAREHOLDERS' FUNDS	15		<u>929,031</u>		<u>713,491</u>

The financial statements were approved and authorised for issue by the board and were signed on its behalf on 11 June 2009.



D E Roberts
Director

The notes on pages 8 to 19 form part of these financial statements.

SOLARFLARE COMMUNICATIONS LIMITED

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2008

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.

GOING CONCERN

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

The company receives settlement of this income 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.

1.2 TURNOVER

Turnover represents operating costs recharged to the US parent company, plus a fixed percentage mark-up.

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	-	25% straight line
Leasehold equipment	-	over the period of the lease
Computer and laboratory equipment	-	33.33% straight line, 25% straight line, and 20% 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.

SOLARFLARE COMMUNICATIONS LIMITED

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2008

1. ACCOUNTING POLICIES (continued)

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.

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 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.

1.10 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 vested as of 31 December 2008. 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 at grant date.

1.11 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.

SOLARFLARE COMMUNICATIONS LIMITED

**NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2008**

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):

	2008 £	2007 £
Depreciation of tangible fixed assets:		
- owned by the company	149,378	104,100
Operating lease rentals:		
- other operating leases	70,445	68,504
Difference on foreign exchange	(15,065)	5,556
	<u> </u>	<u> </u>

4. AUDITORS' REMUNERATION

	2008 £	2007 £
Fees payable to the company's auditor for the audit of the company's annual accounts	9,850	9,850
Fees payable to the company's auditor and its associates in respect of:		
Other services relating to taxation	7,120	3,100
	<u> </u>	<u> </u>

SOLARFLARE COMMUNICATIONS LIMITED

**NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2008**

5. STAFF COSTS

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

	2008 £	2007 £
Wages and salaries	1,518,587	1,471,792
Social security costs	167,071	169,032
Other pension costs	72,312	70,568
	<u>1,757,970</u>	<u>1,711,392</u>

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

	2008 No.	2007 No.
Research and Development	29	28
Administration	7	6
	<u>36</u>	<u>34</u>

6. DIRECTORS' REMUNERATION

	2008 £	2007 £
Emoluments	<u>91,476</u>	<u>51,975</u>
Company pension contributions to money purchase pension schemes	<u>4,574</u>	<u>2,599</u>

During the year retirement benefits were accruing to 1 director (2007 - 1) 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 that company.

7. INTEREST PAYABLE

	2008 £	2007 £
Other interest payable	<u>243</u>	<u>-</u>

SOLARFLARE COMMUNICATIONS LIMITED

**NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2008**

8. TAXATION

	2008 £	2007 £
ANALYSIS OF TAX CHARGE/(CREDIT) IN THE YEAR		
CURRENT TAX (see note below)		
Adjustments in respect of prior periods	-	(97,243)
DEFERRED TAX (see note 12)		
Origination and reversal of timing differences	60,791	31,796
	<u>60,791</u>	<u>(65,447)</u>
TAX ON PROFIT ON ORDINARY ACTIVITIES		
	<u>60,791</u>	<u>(65,447)</u>

FACTORS AFFECTING TAX CHARGE FOR THE YEAR

The tax assessed for the year is lower than (2007 - *lower than*) the standard rate of corporation tax in the UK (21%). The differences are explained below:

	2008 £	2007 £
Profit on ordinary activities before tax	268,948	232,684
Profit on ordinary activities multiplied by standard rate of corporation tax in the UK of 21% (2007 - 20%)	56,479	46,537
EFFECTS OF:		
Expenses not deductible for tax purposes	1,585	2,551
Capital allowances for year in excess of depreciation	(42,966)	(19,549)
Expenses deductible for tax purposes (EMI options exercised)	(29)	(4,856)
Use of losses	(15,069)	(24,683)
Adjustments to tax charge in respect of prior periods	-	(97,243)
CURRENT TAX CHARGE/(CREDIT) FOR THE YEAR (see note above)	<u>-</u>	<u>(97,243)</u>

FACTORS THAT MAY AFFECT FUTURE TAX CHARGES

The company has losses carried forward of £1,511,901 (2007: £993,193). 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 previous 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 2008**

9. TANGIBLE FIXED ASSETS

	Leasehold Improvements £	Leasehold Equipment £	Computer and laboratory equipment £	Total £
COST				
At 1 January 2008	37,739	18,258	426,507	482,504
Additions	-	623	353,503	354,126
At 31 December 2008	<u>37,739</u>	<u>18,881</u>	<u>780,010</u>	<u>836,630</u>
DEPRECIATION				
At 1 January 2008	21,342	10,622	218,518	250,482
Charge for the year	9,435	5,847	134,096	149,378
At 31 December 2008	<u>30,777</u>	<u>16,469</u>	<u>352,614</u>	<u>399,860</u>
NET BOOK VALUE				
At 31 December 2008	<u>6,962</u>	<u>2,412</u>	<u>427,396</u>	<u>436,770</u>
At 31 December 2007	<u>16,397</u>	<u>7,636</u>	<u>207,989</u>	<u>232,022</u>

10. DEBTORS

	2008 £	2007 £
DUE AFTER MORE THAN ONE YEAR		
Other debtors	-	24,293
DUE WITHIN ONE YEAR		
Amounts owed by parent undertakings	439,588	363,845
Other debtors	90,630	98,744
Prepayments	54,860	53,155
	<u>585,078</u>	<u>540,037</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 related to a rent deposit on a lease which expires in September 2009. This deposit is now included within other debtors due within one year.

SOLARFLARE COMMUNICATIONS LIMITED

**NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2008**

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

	2008 £	2007 £
Trade creditors	111,947	43,285
Social security and other taxes	52,291	40,058
Accruals and deferred income	89,023	54,397
	<u>253,261</u>	<u>137,740</u>

12. DEFERRED TAXATION

	2008 £	2007 £
At beginning of year	47,319	15,523
Charge for year	60,791	31,796
	<u>108,110</u>	<u>47,319</u>

The provision for deferred taxation is made up as follows:

	2008 £	2007 £
Accelerated capital allowances	127,693	64,687
Share based payments timing difference	(19,583)	(17,368)
	<u>108,110</u>	<u>47,319</u>

13. SHARE CAPITAL

	2008 £	2007 £
AUTHORISED		
20,000,000 Ordinary shares of 0.125p each	<u>25,000</u>	<u>25,000</u>
ALLOTTED, CALLED UP AND FULLY PAID		
8,400,264 Ordinary shares of 0.125p each	<u>10,500</u>	<u>10,500</u>

SOLARFLARE COMMUNICATIONS LIMITED

**NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2008**

14. RESERVES

	Share premium account £	Profit and loss account £
At 1 January 2008	147,370	555,621
Profit for the year		208,157
Share options reserve movement		7,383
At 31 December 2008	<u>147,370</u>	<u>771,161</u>

15. RECONCILIATION OF MOVEMENT IN SHAREHOLDERS' FUNDS

	2008 £	2007 £
Opening shareholders' funds	713,491	403,971
Profit for the year	208,157	298,131
Share option movements	7,383	11,389
Closing shareholders' funds	<u>929,031</u>	<u>713,491</u>

16. PENSION COMMITMENTS

The company operates a defined contribution pension scheme and contributions are charged to the profit and loss account as incurred. Contributions of £72,312 were made during the year to 31 December 2008 (2007: £70,568). Contributions of £110 were due to be paid at the year end (2007: £80 was due to be refunded). The company provides no other post retirement benefits to its employees.

17. OPERATING LEASE COMMITMENTS

At 31 December 2008 the company had annual commitments under non-cancellable operating leases as follows:

	Land and buildings 2008 £	2007 £
EXPIRY DATE:		
Within 1 year	18,261	-
Between 1 and 2 years	<u>-</u>	<u>73,035</u>

SOLARFLARE COMMUNICATIONS LIMITED

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2008

18. 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. On 19 December 2008, Solarflare Communications Inc had a 100:1 reverse stock split and each share of the company's issued and outstanding Common Stock was converted into 0.01 shares of Common Stock. Following the reverse stock split, the exercise price and number of shares of all outstanding share options were adjusted proportionately such that:

- a) the number of shares issuable upon exercise of each option was multiplied by 0.01; and
- b) the per share exercise price payable upon exercise of each option was divided by 0.01.

It was decided that the share options shall not be exercisable for fractional shares of the company's common stock so, in the event that the reverse stock split adjustments results in an optionee holding an option exercisable for a fraction of a share, such fractional share shall be disregarded for all purposes of the EMI scheme until the optionee shall hold an entire share. 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

SOLARFLARE COMMUNICATIONS LIMITED

**NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2008**

	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

	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 2008 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

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	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
	No of options	Price £
Outstanding 1 January 2008	2,779,884	0.035
Granted	-	-
Forfeited	44,187	0.094
Exercised	30,636	0.065
Outstanding 31 December 2008	2,705,061	0.018
Exercisable 31 December 2008	2,393,230	0.054
after 100:1 reverse stock split:		
Outstanding 31 December 2008	27,004	1.788
Exercisable 31 December 2008	23,895	5.364

The weighted average fair value of the options exercised in the year was £221 (2007: £12,652).

The weighted average exercise price and weighted average expected and contractual lives for 2008 and 2007 are:

	2008	2007
Weighted Average Exercise Price (£)	-	0.105
Number of shares	-	359,853
Weighted average contractual life (years)	-	10.00
Weighted average expected life (years)	-	6.07

The weighted average exercise price of the shares exercised in 2008 was £0.065 (2007: £0.060).

The total charge for the year relating to employee share based payments plans was £7,383 (2007: £11,388) 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.

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NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2008

19. 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 obtained funds of £3,160,580 (2007: £3,169,922) from Solarflare Communications Inc and was owed turnover for the year of £3,039,633 (2007: £2,684,800) by Level 5 Networks Inc.

The company has the right to net these payable and receivable amounts and, as such, the net balance owed to the company, following revaluation at the exchange rate ruling at the year-end, was £439,588 (2007: £363,845). This balance is unsecured, interest free and has no fixed payment date.

20. 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.

The ultimate controlling party of Solarflare Communications Inc. is Oak Investments Partners X, L.P., a limited partnership formed in the United States of America. The directors are not aware that there is one ultimate controlling party of Oak Investments Partners X, L.P.