

Registered number 04441386

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## SOLARFLARE COMMUNICATIONS LIMITED

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### DIRECTORS' REPORT AND FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2010



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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  
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 & Statutory 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 2010**

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The directors present their report and the financial statements for the year ended

#### **PRINCIPAL ACTIVITIES**

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 a major software driver release
- bringing the first controller product through volume manufacturing in the Far East
- two new controller board-level products
- successful and beneficial deployment of the OpenOnload TCP/IP stack at a number of large financial services companies

The results for the year to 31 December 2010 are set out in the profit and loss account.

#### **Research and Development**

The company incurred research and development costs of £1,832,395 during the year (2009: £1,706,410), all of which has been expensed to the profit and loss account during the year.

#### **RESULTS AND DIVIDENDS**

The profit for the year, after taxation, amounted to £297,601 (2009: £291,855).

The directors do not recommend payment of a dividend (2009: £nil).

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## **SOLARFLARE COMMUNICATIONS LIMITED**

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### **DIRECTORS' REPORT FOR THE YEAR ENDED 31 DECEMBER 2010**

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#### **DIRECTORS**

The directors who served during the year were

C W A Cotton  
D E Roberts  
S T Hughes

#### **STATEMENT OF DIRECTORS' RESPONSIBILITIES**

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 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 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.

#### **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.

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**SOLARFLARE COMMUNICATIONS LIMITED**

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**DIRECTORS' REPORT  
FOR THE YEAR ENDED 31 DECEMBER 2010**

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**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



**D E Roberts**  
Director

26/9/11

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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 2010, set out on pages 6 to 19. The financial reporting framework that has been applied in their preparation is applicable law and United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice).

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 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**

As explained more fully in the statement of directors' responsibilities, 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**

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of whether the accounting policies are appropriate to the company's circumstances and have been consistently applied and adequately disclosed, the reasonableness of significant accounting estimates made by the directors, and the overall presentation of the financial statements.

#### **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 31 December 2010 and of its profit for the year then ended,
- have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice, 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.

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**SOLARFLARE COMMUNICATIONS LIMITED**

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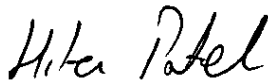
**INDEPENDENT AUDITORS' REPORT TO THE SHAREHOLDERS OF SOLARFLARE COMMUNICATIONS LIMITED**

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**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 remuneration specified by law are not made, or
- we have not received all the information and explanations we require for our audit



HITEN PATEL (Senior statutory auditor)  
for and on behalf of

**Haslers**  
Chartered Accountants  
Statutory Auditor  
Old Station Road  
Loughton  
Essex  
IG10 4PL

28/11



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**SOLARFLARE COMMUNICATIONS LIMITED**

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**PROFIT AND LOSS ACCOUNT  
FOR THE YEAR ENDED 31 DECEMBER 2010**

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	Note	2010 £	2009 £
<b>TURNOVER</b>	1,2	<b>3,021,444</b>	<b>2,758,024</b>
Administrative expenses		<u>(2,753,300)</u>	<u>(2,508,939)</u>
<b>OPERATING PROFIT</b>	3	<b>268,144</b>	<b>249,085</b>
Interest receivable and similar income		<u>1,233</u>	<u>23</u>
<b>PROFIT ON ORDINARY ACTIVITIES BEFORE TAXATION</b>		<b>269,377</b>	<b>249,108</b>
Tax on profit on ordinary activities	7	<u>28,224</u>	<u>42,747</u>
<b>PROFIT FOR THE FINANCIAL YEAR</b>		<u><b>297,601</b></u>	<u><b>291,855</b></u>

All amounts relate to continuing operations

There were no recognised gains and losses for 2010 or 2009 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**  
**REGISTERED NUMBER: 04441386**

**BALANCE SHEET**  
**AS AT 31 DECEMBER 2010**

	Note	£	2010 £	£	2009 £
<b>FIXED ASSETS</b>					
Tangible assets	8		210,086		286,284
<b>CURRENT ASSETS</b>					
Debtors	9	1,266,010		815,793	
Cash at bank		281,527		354,397	
		<u>1,547,537</u>		<u>1,170,190</u>	
<b>CREDITORS</b> · amounts falling due within one year	10	(195,073)		(168,602)	
<b>NET CURRENT ASSETS</b>			<u>1,352,464</u>		<u>1,001,588</u>
<b>TOTAL ASSETS LESS CURRENT LIABILITIES</b>			<u>1,562,550</u>		<u>1,287,872</u>
<b>PROVISIONS FOR LIABILITIES</b>					
Deferred tax	11		(37,140)		(65,364)
<b>NET ASSETS</b>			<u>1,525,410</u>		<u>1,222,508</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		1,367,540		1,064,638
<b>SHAREHOLDERS' FUNDS</b>	14		<u>1,525,410</u>		<u>1,222,508</u>

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

26/9/11

*D E Roberts*

**D E Roberts**  
Director

The notes on pages 8 to 19 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 2010

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#### 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 applicable accounting standards

##### 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 (net of interest received and excluding share based payments charges) 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
Other fixed assets	-	over a period of 12 months from the month of purchase
Leasehold equipment	-	over the period of the lease
Computer and laboratory equipment	-	33 33% straight line, 25% straight line, 50% straight line and 20% straight line

##### 1.4 OPERATING LEASES

Rentals under operating leases are charged to the profit and loss account 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

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## **SOLARFLARE COMMUNICATIONS LIMITED**

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### **NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2010**

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#### **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 expensed 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 2010. 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.

#### **2 TURNOVER**

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

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**SOLARFLARE COMMUNICATIONS LIMITED**

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**NOTES TO THE FINANCIAL STATEMENTS  
FOR THE YEAR ENDED 31 DECEMBER 2010**

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**3 OPERATING PROFIT**

The operating profit is stated after charging

	2010 £	2009 £
Depreciation of tangible fixed assets		
- owned by the company	198,959	230,557
Operating lease rentals		
- other operating leases	80,046	85,004
Loss on foreign exchange	3,773	31,246
Share based payments expense (see note 18)	5,301	1,622
	<u>          </u>	<u>          </u>

**4 AUDITORS' REMUNERATION**

	2010 £	2009 £
Fees payable to the company's auditor for the audit of the company's annual accounts	9,900	9,650
Fees payable to the company's auditor and its associates in respect of		
Other services relating to taxation	6,657	4,570
	<u>          </u>	<u>          </u>

**5 STAFF COSTS**

Staff costs, including directors' remuneration, were as follows

	2010 £	2009 £
Wages and salaries	1,521,724	1,360,716
Social security costs	172,788	155,927
Other pension costs	64,343	62,559
	<u>          </u>	<u>          </u>
	1,758,855	1,579,202
	<u>          </u>	<u>          </u>

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

	2010 No	2009 No
Research and Development	27	26
Administration	6	6
	<u>          </u>	<u>          </u>
	33	32
	<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 2010**

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**6 DIRECTORS' REMUNERATION**

	2010 £	2009 £
Emoluments	<u>102,332</u>	<u>94,686</u>
Company pension contributions to defined contribution pension schemes	<u>5,117</u>	<u>4,633</u>

During the year retirement benefits were accruing to 1 director (2009 - 1) in respect of defined contribution 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 TAXATION**

	2010 £	2009 £
<b>ANALYSIS OF TAX CHARGE IN THE YEAR</b>		
<b>DEFERRED TAX</b> (see note 11)		
Origination and reversal of timing differences	<u>(28,224)</u>	<u>(42,747)</u>
<b>TAX ON PROFIT ON ORDINARY ACTIVITIES</b>	<u>(28,224)</u>	<u>(42,747)</u>

**FACTORS AFFECTING TAX CHARGE FOR THE YEAR**

The tax assessed for the year is lower than (2009 - lower than) the standard rate of corporation tax in the UK of 28% (2009 - 28%) The differences are explained below

	2010 £	2009 £
Profit on ordinary activities before tax	<u>269,377</u>	<u>249,108</u>
Profit on ordinary activities multiplied by standard rate of corporation tax in the UK of 28% (2009 - 28%)	75,426	69,750
<b>EFFECTS OF.</b>		
Expenses not deductible for tax purposes, other than goodwill amortisation and impairment	1,478	905
Depreciation for year in excess of capital allowances	21,110	42,038
Utilisation of research and development tax losses	(98,014)	(112,693)
<b>CURRENT TAX CHARGE FOR THE YEAR</b> (see note above)	<u>-</u>	<u>-</u>

**SOLARFLARE COMMUNICATIONS LIMITED**

**NOTES TO THE FINANCIAL STATEMENTS  
FOR THE YEAR ENDED 31 DECEMBER 2010**

**7 TAXATION (continued)**

**FACTORS THAT MAY AFFECT FUTURE TAX CHARGES**

The company has losses carried forward of £2,157,637 (2009 £1,591,513). 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.

**8 TANGIBLE FIXED ASSETS**

	Leasehold Improvements £	Leasehold Equipment £	Computer and laboratory equipment £	Other fixed assets £	Total £
<b>COST</b>					
At 1 January 2010	37,739	18,881	859,180	1,669	917,469
Additions	-	4,684	117,115	1,484	123,283
Disposals	-	-	(522)	(1,669)	(2,191)
At 31 December 2010	37,739	23,565	975,773	1,484	1,038,561
<b>DEPRECIATION</b>					
At 1 January 2010	37,739	18,775	573,903	768	631,185
Charge for the year	-	666	196,759	1,534	198,959
On disposals	-	-	-	(1,669)	(1,669)
At 31 December 2010	37,739	19,441	770,662	633	828,475
<b>NET BOOK VALUE</b>					
At 31 December 2010	-	4,124	205,111	851	210,086
At 31 December 2009	-	106	285,277	901	286,284

**9 DEBTORS**

	2010 £	2009 £
Amounts owed by parent undertakings	1,170,464	729,447
Other debtors	38,058	35,712
Prepayments	57,488	50,634
	<u>1,266,010</u>	<u>815,793</u>

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

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**SOLARFLARE COMMUNICATIONS LIMITED**

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**NOTES TO THE FINANCIAL STATEMENTS  
FOR THE YEAR ENDED 31 DECEMBER 2010**

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

	2010 £	2009 £
Trade creditors	75,203	76,873
Social security and other taxes	61,201	43,422
Accruals and deferred income	58,669	48,307
	<u>195,073</u>	<u>168,602</u>

**11 DEFERRED TAXATION**

	2010 £	2009 £
At beginning of year	65,364	108,111
Released during year	(28,224)	(42,747)
	<u>37,140</u>	<u>65,364</u>

The provision for deferred taxation is made up as follows

	2010 £	2009 £
Accelerated capital allowances	57,356	85,433
Share based payments timing difference	(20,216)	(20,069)
	<u>37,140</u>	<u>65,364</u>

**12 SHARE CAPITAL**

	2010 £	2009 £
<b>ALLOTTED, CALLED UP AND FULLY PAID</b>		
8,400,264 Ordinary shares of £0.00125 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 2010**

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**13. RESERVES**

	Share premium account £	Profit and loss account £
At 1 January 2010	147,370	1,064,638
Profit for the year		297,601
Share options movement		5,301
	<u>147,370</u>	<u>1,367,540</u>
At 31 December 2010	<u>147,370</u>	<u>1,367,540</u>

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

	2010 £	2009 £
Opening shareholders' funds	1,222,508	929,031
Profit for the year	297,601	291,855
Share option movements	5,301	1,622
	<u>1,525,410</u>	<u>1,222,508</u>
Closing shareholders' funds	<u>1,525,410</u>	<u>1,222,508</u>

**15. CAPITAL COMMITMENTS**

At 31 December 2010 the company had capital commitments as follows

	2010 £	2009 £
Project costs contracted for but not provided in these financial statements	<u>-</u>	<u>8,500</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 £64,343 were made during the year to 31 December 2010 (2009 £62,559). The company provides no other post retirement benefits to its employees.

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## SOLARFLARE COMMUNICATIONS LIMITED

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### NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2010

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#### 17 OPERATING LEASE COMMITMENTS

At 31 December 2010 the company had annual commitments under non-cancellable operating leases as follows

	Land and buildings	
	2010	2009
	£	£
<b>EXPIRY DATE.</b>		
Between 2 and 5 years	<b>80,282</b>	<b>80,282</b>

#### 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 option grants in 2004, 2005, 2006, 2007 and 2010 with the majority of shares granted on each employee's hire date. The 2007 options granted were under consideration as to whether they qualified under the EMI scheme criteria. Having found that they do not, in January 2010 the directors cancelled those options and issued new options with accelerated vesting periods under the EMI scheme as the company met the qualifying criteria at that date.

Most original options granted under the EMI scheme will become exercisable 25% after the first year and pro rata monthly thereafter for the next 36 months, options after the initial grant typically vest monthly after a 48 month period. 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:

**SOLARFLARE COMMUNICATIONS LIMITED**

**NOTES TO THE FINANCIAL STATEMENTS  
FOR THE YEAR ENDED 31 DECEMBER 2010**

**SHARE BASED PAYMENTS (continued)**

	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
	09/09/2005	02/11/2005	13/01/2006	12/01/10	23/09/10
Exercise price (£)	0.052	0.052	0.046	0.025	0.051
Number of employees	2	3	3	28	5
Shares under option	150,000	150,000	417,500	5,129,786	205,000
Vesting period (years)	4	4	4	4	4
Volatility	102.30 %	102.10 %	101.40 %	59.86 %	74.79 %
Option life (years)	10	10	10	10	10
Expected life (years)	6.08	6.08	6.08	5.59	6.02
Risk free rate	4.17 %	4.56 %	4.31 %	2.06 %	1.65 %
Dividend yield	- %	- %	- %	- %	- %
Fair value (£)	0.041	0.041	0.036	0.030	0.017

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 2010 is shown below.

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**SOLARFLARE COMMUNICATIONS LIMITED**

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**NOTES TO THE FINANCIAL STATEMENTS  
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**SHARE BASED PAYMENTS (continued)**

	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
	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	27,056	1.788
Exercisable 31 December 2008	23,895	5.364

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**SOLARFLARE COMMUNICATIONS LIMITED**

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**NOTES TO THE FINANCIAL STATEMENTS  
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**SHARE BASED PAYMENTS (continued)**

	No of options	Price £
Outstanding 1 January 2009	27,056	1 788
Granted	-	-
Forfeited	2,786	3 120
Exercised	-	-
Outstanding 31 December 2009	24,270	1.357
Exercisable 31 December 2009	24,270	6 533

	No of options	Price £
Outstanding 1 January 2010	24,270	1.357
Granted	5,334,786	0 024
Forfeited	84,561	0 045
Canceled	2,951	0 105
Exercised	-	-
Outstanding 31 December 2010	5,271,544	0.020
Exercisable 31 December 2010	4,443,908	0 053

The weighted average fair value of the options exercised in the year was £nil (2009 £nil)

The weighted average exercise price and weighted average expected and contractual lives for 2008, 2009 and 2010 were

	2010	2009	2008
Weighted Average Exercise Price (£)	0.026	-	-
Number of shares	5,334,786	-	-
Weighted average contractual life (years)	10.00	-	-
Weighted average expected life (years)	5.60	-	-

The weighted average exercise price of the shares exercised in 2010 was £nil (2009 £nil)

The total charge for the year relating to employee share based payment plans was £5,301 (2009 £1,622), all of which related to equity-settled share based payments transactions

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## **SOLARFLARE COMMUNICATIONS LIMITED**

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### **NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2010**

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#### **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 £2,616,506 (2009 £2,468,165) from Solarflare Communications Inc and turnover of £3,021,444 (2009 £2,758,024) was receivable for the year from 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 £1,171,464 (2009 £729,447) 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 parties of Solarflare Communications, Inc is Oak Investments Partners L P (being Oak Investment Partners X, L P and Oak Investment Partners XI, L P ), limited partnerships formed in the United States of America As far as the directors are aware, there is no one ultimate controlling party of Oak Investments Partners L P