

Registered number: 04441386

SOLARFLARE COMMUNICATIONS LIMITED

DIRECTORS' REPORT AND FINANCIAL STATEMENTS

FOR THE YEAR ENDED 31 DECEMBER 2012

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SOLARFLARE COMMUNICATIONS LIMITED

COMPANY INFORMATION

DIRECTORS

C W A Cotton
D E Roberts
M J Abalos

COMPANY SECRETARY

D E Roberts

REGISTERED NUMBER

04441386

REGISTERED OFFICE

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

INDEPENDENT AUDITORS

Haslers
Chartered Accountants & Statutory 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 2012

The directors present their report and the financial statements for the year ended 31 December 2012

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:

- continued development and verification of another major software driver release
- a major new hardware development to bring an FPGA-based network card, the "AOE", or Application Onload Engine to market
- a new controller board-level product for an OEM custom form-factor
- continued deployment of the OpenOnload TCP/IP stack in collaboration with financial services companies
- support of the verification of a new silicon development

The results for the year to 31 December 2012 are set out in the profit and loss account.

Research and Development

The company incurred research and development costs of £3,473,350 during the year (2011: £2,661,917), 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 £540,914 (2011: £350,568).

The directors do not recommend payment of a dividend (2011: £nil).

SOLARFLARE COMMUNICATIONS LIMITED

DIRECTORS' REPORT FOR THE YEAR ENDED 31 DECEMBER 2012

DIRECTORS

The directors who served during the year were

C W A Cotton
D E Roberts
M J Abalos

DIRECTORS' RESPONSIBILITIES STATEMENT

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

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

- select suitable accounting policies and then apply them consistently,
- make judgments and accounting estimates that are reasonable and prudent,
- 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.

SOLARFLARE COMMUNICATIONS LIMITED

**DIRECTORS' REPORT
FOR THE YEAR ENDED 31 DECEMBER 2012**

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 25 July 2013 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 2012, set out on pages 6 to 21. 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 directors' responsibilities statement, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit and express an opinion on the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

SCOPE OF THE AUDIT OF THE FINANCIAL STATEMENTS

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. In addition, we read all the financial and non-financial information in the directors' report to identify material inconsistencies with the audited financial statements. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report.

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 2012 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.

SOLARFLARE COMMUNICATIONS LIMITED

INDEPENDENT AUDITORS' REPORT TO THE SHAREHOLDERS OF SOLARFLARE COMMUNICATIONS LIMITED

MATTERS ON WHICH WE ARE REQUIRED TO REPORT BY EXCEPTION

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

- adequate accounting records have not been kept, or returns adequate for our audit have not been received from branches not visited by us, or
- the financial statements are not in agreement with the accounting records and returns, or
- certain disclosures of directors' remuneration specified by law are not made, or
- we have not received all the information and explanations we require for our audit



Hiten Patel (senior statutory auditor)
for and on behalf of

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

25 July 2013

SOLARFLARE COMMUNICATIONS LIMITED

**PROFIT AND LOSS ACCOUNT
FOR THE YEAR ENDED 31 DECEMBER 2012**

| | Note | 2012 £ | 2011 £ |
|--|------|-----------------------|-----------------------|
| TURNOVER | 1,2 | 6,254,633 | 4,665,242 |
| Administrative expenses | | <u>(5,726,078)</u> | <u>(4,274,129)</u> |
| OPERATING PROFIT | 3 | 528,555 | 391,113 |
| Interest receivable and similar income | | 18,113 | 36,201 |
| Interest payable and similar charges | 7 | <u>(419)</u> | <u>-</u> |
| PROFIT ON ORDINARY ACTIVITIES BEFORE TAXATION | | 546,249 | 427,314 |
| Tax on profit on ordinary activities | 8 | <u>(5,335)</u> | <u>(76,746)</u> |
| PROFIT FOR THE FINANCIAL YEAR | | <u>540,914</u> | <u>350,568</u> |

All amounts relate to continuing operations

There were no recognised gains and losses for 2012 or 2011 other than those included in the profit and loss account

The notes on pages 8 to 21 form part of these financial statements

SOLARFLARE COMMUNICATIONS LIMITED
REGISTERED NUMBER: 04441386

BALANCE SHEET
AS AT 31 DECEMBER 2012

| | Note | £ | 2012 £ | £ | 2011 £ |
|--|------|------------------|-------------------------|------------------|-------------------------|
| FIXED ASSETS | | | | | |
| Tangible assets | 9 | | 600,800 | | 536,854 |
| CURRENT ASSETS | | | | | |
| Debtors | 10 | 2,323,790 | | 1,587,149 | |
| Cash at bank | | 174,798 | | 222,993 | |
| | | <u>2,498,588</u> | | <u>1,810,142</u> | |
| CREDITORS: amounts falling due within one year | 11 | (468,969) | | (334,251) | |
| NET CURRENT ASSETS | | | <u>2,029,619</u> | | <u>1,475,891</u> |
| TOTAL ASSETS LESS CURRENT LIABILITIES | | | <u>2,630,419</u> | | <u>2,012,745</u> |
| CREDITORS: amounts falling due after more than one year | 12 | | (31,044) | | - |
| PROVISIONS FOR LIABILITIES | | | | | |
| Deferred tax | 13 | | (119,221) | | (113,886) |
| NET ASSETS | | | <u><u>2,480,154</u></u> | | <u><u>1,898,859</u></u> |
| CAPITAL AND RESERVES | | | | | |
| Called up share capital | 14 | | 10,500 | | 10,500 |
| Share premium account | 15 | | 147,370 | | 147,370 |
| Profit and loss account | 15 | | <u>2,322,284</u> | | <u>1,740,989</u> |
| SHAREHOLDERS' FUNDS | 16 | | <u><u>2,480,154</u></u> | | <u><u>1,898,859</u></u> |

The financial statements were approved and authorised for issue by the board and were signed on its behalf on 25 July 2013



D E Roberts
Director

The notes on pages 8 to 21 form part of these financial statements

SOLARFLARE COMMUNICATIONS LIMITED

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2012

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

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 LEASING AND HIRE PURCHASE

Assets obtained under hire purchase contracts and finance leases are capitalised as tangible fixed assets. Assets acquired by finance lease are depreciated over the shorter of the lease term and their useful lives. Assets acquired by hire purchase are depreciated over their useful lives. Finance leases are those where substantially all of the benefits and risks of ownership are assumed by the company. Obligations under such agreements are included in creditors net of the finance charge allocated to future periods. The finance element of the rental payment is charged to the profit and loss account so as to produce a constant periodic rate of charge on the net obligation outstanding in each period.

1.5 OPERATING LEASES

Rentals under operating leases are charged to the profit and loss account on a straight line basis over the lease term.

1.6 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 2012

1. ACCOUNTING POLICIES (continued)

1.7 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

1.8 RESEARCH AND DEVELOPMENT

Research and Development costs are expensed in the period in which they are incurred

1.9 PENSION SCHEME ARRANGEMENTS

The company operates a defined contribution pension scheme and the pension charge represents the amounts payable by the company to the fund in respect of the year

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 vested as of 31 December 2012 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

1.12 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

2. TURNOVER

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

SOLARFLARE COMMUNICATIONS LIMITED

**NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2012**

3. OPERATING PROFIT

The operating profit is stated after charging/(crediting)

| | 2012 £ | 2011 £ |
|---|-------------------|-------------------|
| Depreciation of tangible fixed assets | | |
| - owned by the company | 257,421 | 204,908 |
| - held under finance leases | 2,699 | - |
| Operating lease rentals | | |
| - other operating leases | 178,896 | 107,877 |
| Loss on foreign exchange | 33,087 | 100,833 |
| Share based payment expense (see note 19) | 40,381 | 22,881 |
| | <u> </u> | <u> </u> |

4 AUDITORS' REMUNERATION

| | 2012 £ | 2011 £ |
|---|-------------------|-------------------|
| Fees payable to the company's auditor and its associates for the audit of the company's annual accounts | 10,900 | 10,075 |
| Fees payable to the company's auditor and its associates in respect of | | |
| Taxation compliance services | 4,270 | 5,920 |
| | <u> </u> | <u> </u> |

5. STAFF COSTS

Staff costs, including directors' remuneration, were as follows

| | 2012 £ | 2011 £ |
|-----------------------|-------------------|-------------------|
| Wages and salaries | 2,901,031 | 2,156,432 |
| Social security costs | 343,869 | 258,689 |
| Other pension costs | 88,449 | 73,471 |
| | <u> </u> | <u> </u> |
| | 3,333,349 | 2,488,592 |
| | <u> </u> | <u> </u> |

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

| | 2012 No. | 2011 No |
|--------------------------|-------------------|-------------------|
| Research and Development | 40 | 33 |
| Administration | 7 | 7 |
| Sales | 4 | 1 |
| | <u> </u> | <u> </u> |
| | 51 | 41 |
| | <u> </u> | <u> </u> |

SOLARFLARE COMMUNICATIONS LIMITED

**NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2012**

6. DIRECTORS' REMUNERATION

| | 2012 | 2011 |
|---|----------------|----------------|
| | £ | £ |
| Emoluments | 121,860 | 117,224 |
| Company pension contributions to defined contribution pension schemes | 6,093 | 5,768 |

During the year retirement benefits were accruing to 1 director (2011 - 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 INTEREST PAYABLE

| | 2012 | 2011 |
|---|-------------|-------------|
| | £ | £ |
| On finance leases and hire purchase contracts | 419 | - |

SOLARFLARE COMMUNICATIONS LIMITED

**NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2012**

8. TAXATION

| | 2012 £ | 2011 £ |
|--|--------------|---------------|
| ANALYSIS OF TAX CHARGE IN THE YEAR | | |
| DEFERRED TAX (see note 13) | | |
| Origination and reversal of timing differences | 5,335 | 76,746 |
| TAX ON PROFIT ON ORDINARY ACTIVITIES | <u>5,335</u> | <u>76,746</u> |

FACTORS AFFECTING TAX CHARGE FOR THE YEAR

The tax assessed for the year is lower than (2011 - *lower than*) the standard rate of corporation tax in the UK of 26% (2011 - 26%) The differences are explained below

| | 2012 £ | 2011 £ |
|--|----------------|----------------|
| Profit on ordinary activities before tax | <u>546,249</u> | <u>427,314</u> |
| Profit on ordinary activities multiplied by standard rate of corporation tax in the UK of 26% (2011 - 26%) | 142,025 | 111,102 |
| EFFECTS OF | | |
| Expenses not deductible for tax purposes, other than goodwill amortisation and impairment | 22,519 | 7,428 |
| Depreciation for year in excess of capital allowances | (15,047) | (84,839) |
| Utilisation of research and development tax losses | (149,497) | (33,691) |
| CURRENT TAX CHARGE FOR THE YEAR (see note above) | <u>-</u> | <u>-</u> |

FACTORS THAT MAY AFFECT FUTURE TAX CHARGES

The company has losses carried forward of £3,281,286 (2011 £2,851,682) 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

SOLARFLARE COMMUNICATIONS LIMITED

**NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2012**

9. TANGIBLE FIXED ASSETS

| | Leasehold Improvements £ | Leasehold Equipment £ | Computer and laboratory equipment £ | Other fixed assets £ | Total £ |
|-----------------------|--------------------------------|-----------------------------|---|----------------------------|------------|
| COST | | | | | |
| At 1 January 2012 | 37,739 | 23,565 | 1,478,005 | 690 | 1,539,999 |
| Additions | - | 5,352 | 382,129 | - | 387,481 |
| Transfers intra group | - | - | (64,301) | - | (64,301) |
| Disposals | - | - | - | (690) | (690) |
| At 31 December 2012 | 37,739 | 28,917 | 1,795,833 | - | 1,862,489 |
| DEPRECIATION | | | | | |
| At 1 January 2012 | 37,739 | 20,710 | 944,221 | 475 | 1,003,145 |
| Charge for the year | - | 2,142 | 257,763 | 215 | 260,120 |
| Transfers intra group | - | - | (886) | - | (886) |
| On disposals | - | - | - | (690) | (690) |
| At 31 December 2012 | 37,739 | 22,852 | 1,201,098 | - | 1,261,689 |
| NET BOOK VALUE | | | | | |
| At 31 December 2012 | - | 6,065 | 594,735 | - | 600,800 |
| At 31 December 2011 | - | 2,855 | 533,784 | 215 | 536,854 |

The net book value of assets held under finance leases or hire purchase contracts, included above, are as follows

| | 2012 £ | 2011 £ |
|-----------------------------------|-----------|-----------|
| Computer and laboratory equipment | 45,891 | - |

10. DEBTORS

| | 2012 £ | 2011 £ |
|-------------------------------------|-----------|-----------|
| Amounts owed by parent undertakings | 2,089,954 | 1,404,031 |
| Other debtors | 106,626 | 95,850 |
| Prepayments | 127,210 | 87,268 |
| | 2,323,790 | 1,587,149 |

Amounts owed by the parent undertaking are unsecured, and have no fixed repayment date. Interest charged to the parent undertaking was £18,100 (2011 £36,178)

SOLARFLARE COMMUNICATIONS LIMITED

**NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2012**

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

| | 2012 £ | 2011 £ |
|--|----------------|----------------|
| Net obligations under finance leases and hire purchase contracts | 15,114 | - |
| Trade creditors | 185,355 | 172,998 |
| Social security and other taxes | 114,075 | 80,660 |
| Accruals | 154,425 | 80,593 |
| | <u>468,969</u> | <u>334,251</u> |

**12. CREDITORS
AMOUNTS FALLING DUE AFTER MORE THAN ONE YEAR**

| | 2012 £ | 2011 £ |
|--|---------------|-----------|
| Net obligations under finance leases and hire purchase contracts | <u>31,044</u> | <u>-</u> |

Obligations under finance leases and hire purchase contracts, included above, are payable as follows

| | 2012 £ | 2011 £ |
|----------------------------|---------------|-----------|
| Between one and five years | <u>31,044</u> | <u>-</u> |

13. DEFERRED TAXATION

| | 2012 £ | 2011 £ |
|----------------------|----------------|----------------|
| At beginning of year | 113,886 | 37,140 |
| Charge for year | 5,335 | 76,746 |
| At end of year | <u>119,221</u> | <u>113,886</u> |

The provision for deferred taxation is made up as follows

| | 2012 £ | 2011 £ |
|--|----------------|----------------|
| Accelerated capital allowances | 154,441 | 138,607 |
| Share based payments timing difference | (35,220) | (24,721) |
| | <u>119,221</u> | <u>113,886</u> |

SOLARFLARE COMMUNICATIONS LIMITED

**NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2012**

14. SHARE CAPITAL

| | 2012 £ | 2011 £ |
|--|---------------|---------------|
| ALLOTTED, CALLED UP AND FULLY PAID | | |
| 8,400,264 Ordinary shares of £0.00125 each | <u>10,500</u> | <u>10,500</u> |

15. RESERVES

| | Share premium account £ | Profit and loss account £ |
|------------------------|----------------------------------|---------------------------------|
| At 1 January 2012 | 147,370 | 1,740,989 |
| Profit for the year | | 540,914 |
| Share options movement | | 40,381 |
| | <u>147,370</u> | <u>2,322,284</u> |
| At 31 December 2012 | | |

16. RECONCILIATION OF MOVEMENT IN SHAREHOLDERS' FUNDS

| | 2012 £ | 2011 £ |
|-----------------------------|------------------|------------------|
| Opening shareholders' funds | 1,898,859 | 1,525,410 |
| Profit for the year | 540,914 | 350,568 |
| Share option movements | 40,381 | 22,881 |
| | <u>2,480,154</u> | <u>1,898,859</u> |
| Closing shareholders' funds | | |

17. PENSION COMMITMENTS

The company operates a defined contribution pension scheme and contributions are charged to the profit and loss account as incurred. Contributions of £88,449 were made during the year to 31 December 2012 (2011: £73,471). There were no contributions outstanding at the year end (2011: £nil). The company provides no other post retirement benefits to its employees.

SOLARFLARE COMMUNICATIONS LIMITED

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2012

18. OPERATING LEASE COMMITMENTS

At 31 December 2012 the company had annual commitments under non-cancellable operating leases as follows

| | Land and buildings | |
|-----------------------|--------------------|----------------|
| | 2012 | 2011 |
| | £ | £ |
| EXPIRY DATE | | |
| Between 2 and 5 years | <u>168,116</u> | <u>133,216</u> |

19. 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, 2010, 2011 and 2012 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, Inc 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 2012**

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 | 12/01/2010 | 23/09/2010 |
| 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 |

SOLARFLARE COMMUNICATIONS LIMITED

**NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2012**

| | 25/10/2011 | 27/07/2011 | 09/03/2011 | 03/02/2012 | 27/04/2012 |
|------------------------|------------|------------|------------|------------|------------|
| Exercise price (£) | 0.038 | 0.037 | 0.049 | 0.038 | 0.037 |
| Number of employees | 7 | 43 | 7 | 6 | 4 |
| Shares under option | 420,000 | 4,664,947 | 400,000 | 475,000 | 295,000 |
| Vesting period (years) | 4 | 4 | 4 | 4 | 4 |
| Volatility | 74.75 % | 74.48 % | 77.56 % | 50.30% | 47.32 |
| Option life (years) | 10 | 10 | 10 | 10 | 10 |
| Expected life (years) | 6.01 | 5.97 | 5.42 | 6.03 | 6.01 |
| Risk free rate | 1.31 % | 1.91 % | 2.26 % | 1.08% | 1.09% |
| Dividend yield | - % | - % | - % | - % | - % |
| Fair value (£) | 0.013 | 0.013 | 0.018 | 0.018 | 0.017 |

| | 04/10/2012 | 27/11/2012 |
|------------------------|------------|------------|
| Exercise price (£) | 0.056 | 0.057 |
| Number of employees | 4 | 4 |
| Shares under option | 392,000 | 282,000 |
| Vesting period (years) | 4 | 4 |
| Volatility | 46.54% | 46.54% |
| Option life (years) | 10 | 10 |
| Expected life (years) | 6.05 | 6.05 |
| Risk free rate | 0.85% | 0.87% |
| Dividend yield | - % | - % |
| Fair value (£) | 0.025 | 0.025 |

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 2012 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 |

SOLARFLARE COMMUNICATIONS LIMITED

**NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2012**

| | 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 |

| | 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 |

SOLARFLARE COMMUNICATIONS LIMITED

**NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2012**

| | 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 |

| | No. of options | Price £ |
|------------------------------|-------------------|------------|
| Outstanding 1 January 2011 | 5,271,544 | 0.053 |
| Granted | 5,484,947 | 0.038 |
| Forfeited | 283,256 | 0.430 |
| Exercised | 69,516 | 0.040 |
| Outstanding 31 December 2011 | 10,403,719 | 0.020 |
| Exercisable 31 December 2011 | 5,226,609 | 0.046 |

| | No. of options | Price £ |
|------------------------------|-------------------|------------|
| Outstanding 1 January 2012 | 10,403,719 | 0.046 |
| Granted | 1,444,000 | 0.046 |
| Forfeited | 248,146 | 0.085 |
| Exercised | 99,660 | 0.027 |
| Outstanding 31 December 2012 | 11,499,913 | 0.020 |
| Exercisable 31 December 2012 | 6,890,332 | 0.044 |

The weighted average fair value of the options exercised in the year was £0 016 (2011 £0 015)

The weighted average exercise price and weighted average expected and contractual lives for 2010, 2011 and 2012 were

| | 2012 | 2011 | 2010 |
|---|-----------|-----------|-----------|
| Weighted Average Exercise Price (£) | 0.046 | 0.038 | 0.026 |
| Number of shares | 1,444,000 | 5,484,947 | 5,334,786 |
| Weighted average contractual life (years) | 10.00 | 10.00 | 10.00 |
| Weighted average expected life (years) | 6.02 | 5.93 | 5.60 |

The weighted average exercise price of the shares exercised in 2012 was £0 027 (2011 £0 040)

The total charge for the year relating to employee share based payment plans was £40,381 (2011 £22,881), all of which related to equity-settled share based payments transactions

SOLARFLARE COMMUNICATIONS LIMITED

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2012

20. 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 £5,108,274 (2011 £3,104,133) from Solarflare Communications, Inc and turnover of £6,254,633 (2011 £4,665,242) 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 £2,089,954 (2011 £1,404,031)

21. 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 X Affiliates Fund, LP, 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.

SOLARFLARE COMMUNICATIONS LIMITED

**DETAILED TRADING AND PROFIT AND LOSS ACCOUNT
FOR THE YEAR ENDED 31 DECEMBER 2012**

| | Page | 2012 £ | 2011 £ |
|----------------------------|-------------|--------------------|--------------------|
| Turnover | 23 | 6,254,633 | 4,665,242 |
| Less: Overheads | | | |
| Net operating expenses | 23 | (5,726,078) | (4,274,129) |
| Operating profit | | 528,555 | 391,113 |
| Interest receivable | 24 | 18,113 | 36,201 |
| Interest payable | 24 | (419) | - |
| Profit for the year | | 546,249 | 427,314 |

SOLARFLARE COMMUNICATIONS LIMITED

**SCHEDULE TO THE DETAILED ACCOUNTS
FOR THE YEAR ENDED 31 DECEMBER 2012**

| | 2012 £ | 2011 £ |
|---|------------------|------------------|
| Turnover | | |
| Recharge of operating costs to parent company | <u>6,254,633</u> | <u>4,665,242</u> |
| | 2012 £ | 2011 £ |
| Net operating expenses | | |
| Directors salaries | 121,860 | 117,224 |
| Directors national insurance | 15,797 | 14,963 |
| Directors pension costs | 6,093 | 5,768 |
| Staff salaries | 2,779,171 | 2,039,208 |
| Staff national insurance | 328,072 | 243,726 |
| Staff pension costs | 82,356 | 67,703 |
| Staff private health insurance | 35,674 | 27,129 |
| Staff relocation costs | - | 6,000 |
| Share based payments expense | 40,381 | 22,881 |
| Staff training | 5,616 | 87 |
| Staff welfare | 28,646 | 30,153 |
| Recruitment costs | 145,829 | 81,712 |
| Research and development expenditure | 158,176 | 284,483 |
| Entertainment | 60,893 | 15,680 |
| Hotels, travel and subsistence | 98,002 | 61,483 |
| Printing and stationery | 11,238 | 4,815 |
| Postage | 35,520 | 30,398 |
| Telephone and fax | 25,047 | 14,711 |
| Computer costs | 95,453 | 71,053 |
| Advertising and promotion | 59,586 | 40,592 |
| Trade subscriptions | 2,055 | 2,631 |
| Consultancy | 846,065 | 492,826 |
| Legal and professional | 12,847 | 18,998 |
| Auditors' remuneration | 10,900 | 10,075 |
| Auditors' remuneration - non audit services | 4,270 | 5,920 |
| Equipment hire | 2,556 | 976 |
| Bank charges | 889 | 1,090 |
| Sundry expenses | 9,338 | 6,674 |
| Rent | 178,896 | 107,877 |
| Service charges | 143,799 | 73,146 |
| Light and heat | 64,905 | 46,432 |
| Insurances | 9,374 | 7,507 |
| Repairs and maintenance | 13,567 | 14,468 |
| Depreciation - other fixed assets | 215 | 1,326 |
| Depreciation - computer equipment | 257,763 | 202,312 |
| Depreciation - leasehold property and equipment | 2,142 | 1,269 |
| Loss/(gain) on foreign exchange | 33,087 | 100,833 |
| | <u>5,726,078</u> | <u>4,274,129</u> |

SOLARFLARE COMMUNICATIONS LIMITED

**SCHEDULE TO THE DETAILED ACCOUNTS
FOR THE YEAR ENDED 31 DECEMBER 2012**

| | 2012 £ | 2011 £ |
|--------------------------------|------------------|------------------|
| Interest receivable | | |
| Bank interest receivable | 13 | 23 |
| Other interest receivable | 18,100 | 36,178 |
| | <u>18,113</u> | <u>36,201</u> |
| | | |
| | 2012 £ | 2011 £ |
| Interest payable | | |
| Hire purchase interest payable | 419 | - |
| | <u>419</u> | <u>-</u> |