

Registered number 04441386

SOLARFLARE COMMUNICATIONS LIMITED

DIRECTORS' REPORT AND FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2009

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SOLARFLARE COMMUNICATIONS LIMITED

COMPANY INFORMATION

DIRECTORS

Mr C W A Cotton
Dr D E Roberts
Mr S T Hughes

COMPANY SECRETARY

Dr 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 Auditors
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 2009

The directors present their report and the financial statements for the year ended 31 December 2009

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 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 2009 are set out in the profit and loss account.

Research and Development

The company incurred research and development costs of £1,706,410 during the year (2008: £1,950,019), 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 £291,855 (2008: £208,157).

The directors do not recommend payment of a dividend (2008: £Nil).

SOLARFLARE COMMUNICATIONS LIMITED

DIRECTORS' REPORT FOR THE YEAR ENDED 31 DECEMBER 2009

DIRECTORS

The directors who served during the year were

Mr C W A Cotton
Dr D E Roberts
Mr 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.

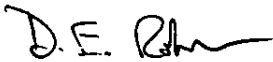
SOLARFLARE COMMUNICATIONS LIMITED

**DIRECTORS' REPORT
FOR THE YEAR ENDED 31 DECEMBER 2009**

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 26 May 2010 and signed on its behalf



Dr 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 2009, set out on pages 6 to 20. 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 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 2009 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.

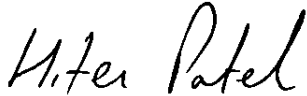
SOLARFLARE COMMUNICATIONS LIMITED

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 Auditors
Old Station Road
Loughton
Essex
IG10 4PL

26 May 2010

SOLARFLARE COMMUNICATIONS LIMITED

**PROFIT AND LOSS ACCOUNT
FOR THE YEAR ENDED 31 DECEMBER 2009**

	Note	2009 £	2008 £
TURNOVER	1,2	2,758,024	3,039,633
Administrative expenses		(2,508,939)	(2,773,806)
OPERATING PROFIT	3	249,085	265,827
Interest receivable		23	3,364
Interest payable	7	-	(243)
PROFIT ON ORDINARY ACTIVITIES BEFORE TAXATION		249,108	268,948
Tax on profit on ordinary activities	8	42,747	(60,791)
PROFIT FOR THE FINANCIAL YEAR		291,855	208,157

All amounts relate to continuing operations

There were no recognised gains and losses for 2009 or 2008 other than those included in the profit and loss account


The notes on pages 8 to 20 form part of these financial statements

SOLARFLARE COMMUNICATIONS LIMITED
REGISTERED NUMBER 04441386

BALANCE SHEET
AS AT 31 DECEMBER 2009

	Note	£	2009 £	£	2008 £
FIXED ASSETS					
Tangible fixed assets	9		286,284		436,770
CURRENT ASSETS					
Debtors	10	815,793		585,078	
Cash at bank		354,397		268,554	
			<u>1,170,190</u>	<u>853,632</u>	
CREDITORS: amounts falling due within one year	11	(168,602)		(253,261)	
NET CURRENT ASSETS			<u>1,001,588</u>		<u>600,371</u>
TOTAL ASSETS LESS CURRENT LIABILITIES			<u>1,287,872</u>		<u>1,037,141</u>
PROVISIONS FOR LIABILITIES					
Deferred tax	12		(65,364)		(108,110)
NET ASSETS			<u>1,222,508</u>		<u>929,031</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		1,064,638		771,161
SHAREHOLDERS' FUNDS	15		<u>1,222,508</u>		<u>929,031</u>

The financial statements were approved and authorised for issue by the board and were signed on its behalf on 26 May 2010



Dr D E Roberts
Director

The notes on pages 8 to 20 form part of these financial statements

SOLARFLARE COMMUNICATIONS LIMITED

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2009

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

SOLARFLARE COMMUNICATIONS LIMITED

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2009

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 2009. 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.

SOLARFLARE COMMUNICATIONS LIMITED

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2009

3. OPERATING PROFIT

The operating profit is stated after charging/(crediting)

	2009 £	2008 £
Depreciation of tangible fixed assets		
- owned by the company	231,325	149,378
Operating lease rentals		
- other operating leases	85,004	70,445
Loss/(gain) on foreign exchange	31,246	(15,065)
Share based payments expense (see note 19)	1,622	7,383
	<u>231,325</u>	<u>149,378</u>

4. AUDITORS' REMUNERATION

	2009 £	2008 £
Fees payable to the company's auditor for the audit of the company's annual accounts	9,650	9,850
Fees payable to the company's auditor and its associates in respect of		
Other services relating to taxation	4,570	7,120
	<u>9,650</u>	<u>9,850</u>

5. STAFF COSTS

Staff costs, including directors' remuneration, were as follows

	2009 £	2008 £
Wages and salaries	1,360,715	1,518,587
Social security costs	155,926	167,071
Other pension costs	62,559	72,312
	<u>1,579,200</u>	<u>1,757,970</u>

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

	2009 No.	2008 No.
Research and Development	26	29
Administration	6	7
	<u>32</u>	<u>36</u>

SOLARFLARE COMMUNICATIONS LIMITED

**NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2009**

6 DIRECTORS' REMUNERATION

	2009 £	2008 £
Emoluments	<u>94,686</u>	<u>91,476</u>
Company pension contributions to money purchase pension schemes	<u>4,633</u>	<u>4,574</u>

During the year retirement benefits were accruing to 1 director (2008 - 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

	2009 £	2008 £
Other interest payable	<u>-</u>	<u>243</u>

8 TAXATION

	2009 £	2008 £
ANALYSIS OF TAX CHARGE IN THE YEAR		
DEFERRED TAX (see note 12)		
Origination and reversal of timing differences	<u>(42,747)</u>	<u>60,791</u>
TAX ON PROFIT ON ORDINARY ACTIVITIES	<u>(42,747)</u>	<u>60,791</u>

SOLARFLARE COMMUNICATIONS LIMITED

**NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2009**

8 TAXATION (continued)

FACTORS AFFECTING TAX CHARGE FOR THE YEAR

The tax assessed for the year is lower than *(2008 - lower than)* the standard rate of corporation tax in the UK (28%) The differences are explained below

	2009 £	2008 £
Profit on ordinary activities before tax	<u>249,108</u>	<u>268,948</u>
Profit on ordinary activities multiplied by standard rate of corporation tax in the UK of 28% (2008 - 21%)	69,750	56,479
EFFECTS OF:		
Expenses not deductible for tax purposes	905	1,585
Depreciation for year in excess of capital allowances	42,038	(42,966)
Utilisation of research and development tax losses	(112,693)	(15,069)
Expenses deductible for tax purposes (EMI options exercised)	-	(29)
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 £1,591,513 (2008 £1,482,066) 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 2009**

9. TANGIBLE FIXED ASSETS

	Leasehold Improvements £	Leasehold Equipment £	Computer and laboratory equipment £	Other fixed assets £	Total £
COST					
At 1 January 2009	37,739	18,881	780,010	-	836,630
Additions	-	-	79,170	1,669	80,839
At 31 December 2009	37,739	18,881	859,180	1,669	917,469
DEPRECIATION					
At 1 January 2009	30,777	16,469	352,614	-	399,860
Charge for the year	6,962	2,306	221,289	768	231,325
At 31 December 2009	37,739	18,775	573,903	768	631,185
NET BOOK VALUE					
At 31 December 2009	-	106	285,277	901	286,284
At 31 December 2008	6,962	2,412	427,396	-	436,770

10. DEBTORS

	2009 £	2008 £
Amounts owed by parent undertakings	729,447	439,588
Other debtors	35,712	90,630
Prepayments	50,634	54,860
	815,793	585,078

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

SOLARFLARE COMMUNICATIONS LIMITED

**NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2009**

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

	2009 £	2008 £
Trade creditors	76,873	111,947
Social security and other taxes	43,422	52,291
Accruals and deferred income	48,307	89,023
	<u>168,602</u>	<u>253,261</u>

12. DEFERRED TAXATION

	2009 £	2008 £
At beginning of year	108,111	47,319
(Released during)/charge for year	(42,747)	60,791
	<u>65,364</u>	<u>108,110</u>

The provision for deferred taxation is made up as follows

	2009 £	2008 £
Accelerated capital allowances	85,433	127,693
Share based payments timing difference	(20,069)	(19,583)
	<u>65,364</u>	<u>108,110</u>

13. SHARE CAPITAL

	2009 £	2008 £
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 2009**

14. RESERVES

	Share premium account £	Profit and loss account £
At 1 January 2009	147,370	771,161
Profit for the year		291,855
Share options movement		1,622
At 31 December 2009	<u>147,370</u>	<u>1,064,638</u>

15. RECONCILIATION OF MOVEMENT IN SHAREHOLDERS' FUNDS

	2009 £	2008 £
Opening shareholders' funds	929,031	713,491
Profit for the year	291,855	208,157
Share option movements	1,622	7,383
Closing shareholders' funds	<u>1,222,508</u>	<u>929,031</u>

16. CAPITAL COMMITMENTS

At 31 December 2009 the company had capital commitments as follows

	2009 £	2008 £
Project costs contracted for but not provided in these financial statements	<u>8,500</u>	<u>-</u>

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 £62,559 were made during the year to 31 December 2009 (2008 £72,312). Contributions of £Nil were due to be paid at the year end (2008 £110). 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 2009

18. OPERATING LEASE COMMITMENTS

At 31 December 2009 the company had annual commitments under non-cancellable operating leases as follows

	Land and buildings	
	2009	2008
	£	£
EXPIRY DATE:		
Within 1 year	-	18,261
Between 2 and 5 years	80,282	-

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 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:

SOLARFLARE COMMUNICATIONS LIMITED

**NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2009**

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	07/06/2007
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 2009 is shown below.

SOLARFLARE COMMUNICATIONS LIMITED

**NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2009**

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

SOLARFLARE COMMUNICATIONS LIMITED

**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

The weighted average fair value of the options exercised in the year was £Nil (2008 £221)

The weighted average exercise price and weighted average expected and contractual lives for 2007, 2008 and 2009 are

	2009	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 2009 was £Nil (2008 £0 065)

The total charge for the year relating to employee share based payment plans was £1,622 (2008 £7,383), all of which related to equity-settled share based payments transactions

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 under the EMI scheme as the company met the qualifying criteria at that date.

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 £2,468,165 (2008 £3,160,580) from Solarflare Communications Inc and turnover of £2,758,024 (2008 £3,039,633) 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 £729,447 (2008 £439,588). This balance is unsecured, interest free and has no fixed payment date.

SOLARFLARE COMMUNICATIONS LIMITED

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2009

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 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.