Alcatel IP Networks Limited

Report and Financial Statements

31 December 2006

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COMPANIES HOUSE

Directors
Ali Sadiq
Mark Smallwood
Rudi Strubbe

Secretary
BLG (Professional Services) Limited
7th Floor Beaufort House
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EC3A 7NJ

Auditors
Ernst & Young LLP
Apex Plaza
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Berkshire
RG1 1YE

Bankers
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Oxford Business Park
Oxford
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OX4 2RU

Statement of directors' responsibilities in respect of the financial statements

The directors present their report and financial statements for the year ended 31 December 2006

Results and dividends

The profit for the year amounted to £246,196 (2005 profit of £71,674) The directors do not recommend the payment of any dividends (2005 £nil)

The directors report has been prepared in accordance with the special provisions relating to small sized companies under section 246 (4) (a) of the Companies Act 1985 and therefore an Enhanced Business Review is not presented

Principal activities and review of the business

The company's principal activity during the year was the development of networking hardware and systems for members of the Alcatel group

Future developments

The directors expect the general level of activity to continue over the next 12 months

Directors

The directors who served the company during the year were as follows

Ali Sadiq
Mark Smallwood
Rudi Strubbe

There are no directors' interests requiring disclosure under the Companies Act 1985

Directors' liabilities

The company has granted an indemnity to one or more of its directors against liability in respect of proceedings brought by third parties, subject to the conditions set out in the Companies Act 1985 Such qualifying third party indemnity provision remains in force as at the date of approving the directors' report

Directors' statement as to disclosure of information to auditors

The directors who were members of the board at the time of approving the directors' report are listed on page 1 Having made enquiries of fellow directors and of the company's auditors, each of these directors confirms that

- to the best of each director's knowledge and belief, there is no information relevant to the preparation of their report of which the company's auditors are unaware, and
- each director has taken all the steps a director might reasonably be expected to have taken to be aware of relevant audit information and to establish that the company's auditors are aware of that information

By order of the Board

Mark Smallwood
Director
Date 31/10/2007

Statement of directors' responsibilities in respect of the financial statements

The directors are responsible for preparing the Annual Report and the financial statements in accordance with applicable United Kingdom law and United Kingdom Generally Accepted Accounting Practice

Company law requires the directors to prepare financial statements for each financial year Under that law the directors have elected to prepare the financial statements in accordance with United Kingdom Generally Accepted Accounting Practice (United Kingdom Accounting Standards and applicable law) The financial statements are required by law to give a true and fair view of the state of affairs of the company and of the profit or loss of the company for that period In preparing those 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, and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the company will continue in business

The directors are responsible for keeping proper accounting records that disclose with reasonable accuracy at any time the financial position of the company and to enable them to ensure that the financial statements comply with the Companies Act 1985 They are also responsible for safeguarding the assets of the company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities

Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions

ERNST & YOUNG

Independent auditors' report
to the members of Alcatel IP Networks Limited

We have audited the company's financial statements for the year ended 31 December 2006 which comprise the Profit and Loss Account, the Statement of Total Recognised Gains and Losses, the Balance Sheet and the related notes 1 to 19 These financial statements have been prepared under the accounting policies set out therein

This report is made solely to the company's members, as a body, in accordance with Section 235 of the Companies Act 1985 Our audit work has been undertaken so that we might state to the company's members those matters we are required to state to them in an auditors' report and for no other purpose To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the company and the company's members as a body, for our audit work, for this report, or for the opinions we have formed

Respective responsibilities of directors and auditors

The directors' responsibilities for preparing the Annual Report and the financial statements in accordance with applicable United Kingdom law and Accounting Standards (United Kingdom Generally Accepted Accounting Practice) are set out in the Statement of Directors' Responsibilities

Our responsibility is to audit the financial statements in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland)

We report to you our opinion as to whether the financial statements give a true and fair view and are properly prepared in accordance with the Companies Act 1985 We also report to you whether in our opinion the information given in the directors' report is consistent with the financial statements

In addition we report to you if, in our opinion, the company has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law regarding directors' remuneration and other transactions is not disclosed

We read the directors' report and consider the implications for our report if we become aware of any apparent misstatements within it

Basis of audit opinion

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements It also includes an assessment of the significant estimates and judgments made by the directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the company's circumstances, consistently applied and adequately disclosed

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or other irregularity or error In forming our opinion we also evaluated the overall adequacy of the presentation of information in the financial statements

ERNST & YOUNG

Independent auditors' report
to the members of Alcatel IP Networks Limited (continued)

Opinion
In our opinion

- the financial statements give a true and fair view, in accordance with United Kingdom Generally Accepted Accounting Practice, of the state of the company's affairs as at 31 December 2006 and of its profit for the year then ended,
- the financial statements have been properly prepared in accordance with the Companies Act 1985, and
- the information given in the directors' report is consistent with the financial statements

Ernst & Young LLP

Ernst & Young LLP
Registered Auditor
Reading

Date 31 October 2007

Profit and loss account

for the year ended 31 December 2006

	Notes	2006 £	(Restated) 2005 £
Turnover	2	4,210,749	3,045,241
Cost of sales		3,721,563	2,744,836
Gross profit		489,186	300,405
Administrative expenses		248,335	233,519
Operating profit	3	240,851	66,886
Bank interest receivable	6	5,345	4,865
Interest payable and similar charges	7	–	(77)
		5,345	4,788
Profit on ordinary activities before taxation		246,196	71,674
Tax on profit on ordinary activities	8	–	–
Profit for the financial year transferred to reserves		246,196	71,674

Statement of total recognised gains and losses

for the year ended 31 December 2006

	2006 £	(Restated) 2005 £
Profit for the financial year	246,196	71,674
Equity credit - share-based payment	76,438	136,651
Total recognised gains and losses related to the year	322,634	208,325
Prior year adjustment to the profit and loss account - FRS 20	(136,651)	
Equity credit - share-based payment	136,551	
Total gains and losses recognised since last annual report	322,634	

Balance sheet
at 31 December 2006

	Notes	2006 £	2005 £
Fixed assets			
Tangible assets	9	63,361	61,833
Current assets			
Debtors	10	1,698,163	1,652,862
Cash in hand		197,090	135,906
		1,895,253	1,788,768
Creditors amounts falling due within one year	11	1,296,152	1,410,613
Net current assets		599,101	378,155
Total assets less current liabilities		662,462	439,988
Provisions for liabilities and charges	12	92,547	192,707
Net assets		569,915	247,281

	Notes	2006 £	2005 £
Capital and Reserves			
Called up share capital	17	1	1
Profit and loss account	18	569,914	247,280
Equity shareholders' funds	18	569,915	247,281

Mark Smallwood
Director

Date 31/10/2007

Notes to the financial statements
at 31 December 2006

1. Accounting policies

Basıs of preparatıon

The financıal statements are prepared under the hıstorıcal cost conventıon and ın accordance wıth applıcable accountıng standards

In preparıng the financıal statements for the current year, the company has adopted FRS 20 'share-based payment' The adoptıon of FRS 20 has resulted ın a change ın accountıng polıcy for share-based payment transactıons FRS 20 requıres the faır value of optıons and share awards whıch ultımately vest to be charged to the profit and loss account over the vestıng or performance perıod For equıty-settled transactıons the faır value ıs determıned at the date of grant usıng the Black-Scholes optıon prıcıng model The company does not have any cash-settled share-based payment transactıons Prevıously, the company dıd not recognıse an expense for employees who were granted awards under the parent company's varıous share schemes Consequently, ın 2006 addıtıonal staff costs of £76,438 (2005 £136,651) have been recognısed ın the profit and loss account The ımpact on retaıned profits ıs nıl as a correspondıng credıt to reserves offsets the ıncrease to wages and salarıes costs ın both years

Cash flow statement

A cash flow statement has not been prepared as the company has taken advantage of the exemptıon granted to 90% or more subsıdıarıes under FRS 1 Thıs ıs on the basıs that group financıal statements ıncludıng the results of the company are prepared and are publıcly avaılable

Related party transactıons

The company ıs a wholly owned subsıdıary of Alcatel USA Sourcıng Inc, a company ıncorporated ın Amerıca These financıal statements are ıncluded ın the consolıdated financıal statements of the ultımate parent company, Alcatel Lucent, a company ıncorporated ın France, whıch are publıcly avaılable Accordıngly, the company has taken advantage of the exemptıon ın FRS 8 from dısclosıng transactıons wıth members or ınvestees of the Alcatel Lucent group

Fıxed assets

All fixed assets are ınıtıally recorded at cost

Depreciatıon

Depreciatıon ıs provıded on all tangıble fixed assets at rates calculated to wrıte off the cost, less estımated resıdual value based on prıces prevaılıng at the date of acquısıtıon of each asset evenly over ıts expected useful lıfe, as follows

Furnıture and fittıngs	-	20% - 25% per annum
Computer equıpment	-	50% per annum

Deferred taxatıon

Deferred tax ıs recognısed ın respect of all tımıng dıfferences that have orıgınated but not reversed at the balance sheet date where transactıons or events have occurred at that date that wıll result ın an oblıgatıon to pay more, or a rıght to pay less or to receıve more, tax, wıth the followıng exceptıon

- deferred tax assets are recognısed only to the extent that the dırectors consıder that ıt ıs more lıkely than not that there wıll be suıtable taxable profits from whıch the future reversal of the underlyıng tımıng dıfferences can be deducted

Deferred tax ıs measured on an undıscounted basıs at the tax rates that are expected to apply ın the perıods ın whıch tımıng dıfferences reverse, based on tax rates and laws enacted or substantıvely enacted at the balance sheet date

Notes to the financial statements
at 31 December 2006

1. Accounting policies (continued)

Foreign currencies

Transactions in foreign currencies are recorded at the rate ruling at the date of the transaction

Monetary assets and liabilities denominated in foreign currencies are retranslated at the rate of exchange ruling at the balance sheet date All differences are taken to the profit and loss account

Operating lease agreements

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

Pension costs

The company operates a defined contribution pension scheme Contributions are charged to the profit and loss account as they become payable in accordance with the rules of the scheme

2. Turnover

Turnover which is stated net of value added tax, represents amounts recharged to a group company

Turnover is attributable to one continuing activity, the development of networking hardware and systems for members of the Alcatel Lucent group

An analysis of turnover by geographical market is given below

	2006	*2005*
	£	*£*
United Kingdom	–	–
Rest of the world	4,210,749	3,045,241
	4,210,749	3,045,241

3. Operating profit

This is stated after charging/(crediting)

		2006	*2005*
		£	*£*
Auditors' remuneration	- audit services	12,000	10,500
	- non-audit services	–	–
Depreciation of owned fixed assets		35,223	52,120
Operating lease rentals	- land and buildings	50,540	50,540
	- plant and machinery	20,183	20,183

Notes to the financial statements
at 31 December 2006

4. Staff costs

	2006 £	(Restated) 2005 £
Wages and salaries	3,216,779	2,348,715
Social security costs	434,243	327,971
Other pension costs	78,425	78,425
	3,729,447	2,755,111

Included in wages and salaries is a total expense of share-based payments of £76,438 (2005 £136,651) of which £76,438 (2005 £136,651) arises from transactions accounted for as equity-settled share-based payment transactions

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

	2006 No	2005 No
Research and development	11	10
	11	10

5. Directors' emoluments

	2006 £	2005 £
Emoluments	452,508	57,604
Company contributions to money purchase pension schemes	8,888	5,184

	2006 No	2005 No
Members of money purchase pension schemes	1	1

All amounts are in respect of the highest paid director

6. Interest receivable

	2006 £	2005 £
Bank interest receivable	5,345	4,865

7. Interest payable and similar charges

	2006 £	2005 £
Bank interest payable	–	(77)

Notes to the financial statements

at 31 December 2006

8. Taxation on ordinary activities

(a) Tax on profit on ordinary activities

The tax charge is made up as follows

	2006	2005
	£	£
Current tax		
UK corporation tax	–	–
Tax underprovided in previous years	–	–
Total current tax (note 8(b))	–	–

(b) Factors affecting current tax charge

The tax assessed on the profit on ordinary activities for the year is lower than the standard rate of corporation tax in the UK of 30% (2005 30%)

The differences are reconciled below

	2006	(Restated) 2005
	£	£
Profit on ordinary activities before tax	246,196	71,674
Profit on ordinary activities at the standard rate of corporation tax of 30% (2005 30%)	73,859	21,502
Expenses not deductible for tax purposes	(250,777)	(126,112)
Depreciation in excess of capital allowances	10,567	–
Other timing differences	(12,545)	
Group relief not paid for	178,896	104,610
Total current tax (note 8(a))	–	–

(c) Deferred tax

The deferred taxation asset not recognised in the financial statements is as follows

	2006	2005
	£	£
Capital allowances in advance of depreciation	40,446	32,202
Tax losses available	69,012	69,012
	109,458	101,214

The deferred tax asset has not been recognised due to uncertainty over the availability of suitable future taxable profits

From financial year 2008, the UK corporation tax rate will reduce from 30% to 28% It is estimated that as a result the company's unrecognised deferred tax asset will decrease by £7,297 Further changes are anticipated in elation to capital allowances, although the impact on the company's unrecognised deferred tax asset is not yet quantifiable

Notes to the financial statements
at 31 December 2006

9. Tangible fixed assets

	Fixtures and fittings £	*Computer equipment* £	*Total* £
Cost			
At 31 December 2005	92,224	158,593	250,817
Additions	–	36,751	36,751
At 31 December 2006	92,224	195,344	287,568
Depreciation			
At 31 December 2005	42,362	146,622	188,984
Charge for the year	15,784	19,439	35,223
At 31 December 2006	58,146	166,061	224,207
Net book value			
At 31 December 2006	34,078	29,283	63,361
At 31 December 2005	49,862	11,971	61,833

10. Debtors

	2006 £	*2005* £
Amounts due from group undertakings	1,646,530	1,610,757
Other debtors	17,946	7,257
Prepayments and accrued income	33,687	34,848
	1,698,163	1,652,862

11. Creditors: amounts falling due within one year

	2006 £	*2005* £
Trade creditors	8,165	57
Other taxation and social security	41,157	35,580
Accruals and deferred income	1,245,341	1,370,235
Other creditors	1,489	4,741
	1,296,152	1,410,613

Notes to the financial statements
at 31 December 2006

12. Provisions for liabilities and charges

	Employers' Natıonal Insurance £
At 31 December 2005	192,707
Charged to the profit and loss account	(100,160)
At 31 December 2006	92,547

A number of the company's employees have been granted stock optıons over the shares of the company's ultımate parent company, Alcatel Lucent The company ıs lıable to pay Natıonal Insurance, currently 12 8%, on the dıfference between the optıon exercıse prıce and the market value of the related shares when the optıons are exercısed

Accordıngly, the company has made a provısıon of £92,547 ın relatıon to the stock optıons The provısıons are expected to be utılısed over varyıng perıods of up to 4 years, beıng the perıods over whıch the optıons vest The total Natıonal Insurance lıabılıty on optıons granted ıs calculated and then that proportıon relatıng to the perıod vested ıs recognısed as a provısıon

The amount of the Natıonal Insurance payable on the stock optıons wıll depend on the number of UK employees who remaın wıth the company and when they exercıse theır optıons, the market prıce of the parent company's common shares at the tıme of exercıse and the prevaılıng Natıonal Insurance rates at the tıme

13. Pensions

The company operates a defined contrıbutıon pensıon scheme Contrıbutıons are charged to the profit and loss account as they become payable Outstandıng contrıbutıons at 31 December 2006 were £nıl (2005 £nıl)

14. Share-based payments

Share-based payment plan

The employees of the company have been granted share optıons ın the ultımate controllıng company Alcatel Lucent, a company ıncorporated ın France

The expense recognısed for share-based payments ın respect of employee servıces receıved durıng the year to 31 December 2006 ıs £76,438 (2005 £136,651) The portıon of that expense arısıng from equıty-settled share-based transactıons ıs £76,438 (2005 £136,651)

The followıng table ıllustrates the number and weıghted average exercıse prıce (WAEP) of, and movements ın, share optıons durıng the year

	2006 No	*2006 WAEP* €	*2005 No*	*2005 WAEP* €
Outstandıng at 1 January	283,012	8 14	283,896	8 03
Granted durıng the year	9,500	11 70	15,300	10 00
Forfeıted durıng the year	–	–	–	–
Exercısed durıng the year	(12,735)	7 97	(16,184)	7 97
Expıred durıng the year	–	–	–	–
Outstandıng at 31 December	279,777	8 27	283,012	8.14
Exercısable at 31 December	194,844		147,411	

Notes to the financial statements
at 31 December 2006

14. Share-based payments (continued)
The weighted average contractual life for the share options outstanding at 31 December 2006 is 4 76 years (2005 5 67 years)

The fair value of the equity settled share options granted is estimated as at the date of grant using a Black-Scholes option pricing model The following table lists the inputs to the model used for the years ended 31 December 2006 and 31 December 2005

For the year ended 31 December	*2006*	*2005*
Risk free interest rate (%)	3 5	3 5
Expected dividends (%)	1 0	1 0
Expected volatility (%)	32 0	40 0
Vesting period (years)	4 0	4 0
Exercise period (years)	4 0	4 0
Weighted average fair value of the granted options (€ per option)	3 66	3 59

The dividend yield reflects the assumption that future dividend yields would reflect the current dividend yield at the grant date The expected volatility reflects the assumption that the historical volatility is indicative of future trends, which may also not necessarily be the actual outcome

No other features of the options granted were incorporated into the measurement of fair value

15. Capital commitments
Amounts contracted for but not provided in the financial statements amounted to £nil (2005 £7,742)

16. Commitments under operating leases
At 31 December 2006 the company had annual commitments under non-cancellable operating leases as set out below

		2006		*2005*
	Land and buildings	*Other*	*Land and buildings*	*Other*
	£	*£*	*£*	*£*
Operating leases which expire				
Within one year	–	–	–	–
In two to five years	53,200	–	53,200	–
In over five years	–	–	–	–
	53,200	–	53,200	–

Notes to the financial statements
at 31 December 2006

17. Share capital

				Authorised
			2006	*2005*
			£	*£*
Ordinary shares of £1 each			100	100

	Allotted, called up and fully paid			
		2006		*2005*
	No	*£*	*No*	*£*
Ordinary shares of £1 each	1	1	1	1

18. Reconciliation of shareholders' funds and movement on reserves

	Share capital	*Profit and loss account*	*Total share-holders' funds*
	£	*£*	*£*
At 1 January 2005 as previously reported	1	38,955	38,956
Share-based payment	–	136,651	136,651
Profit for the year as restated	–	71,674	71,674
At 1 January 2006 as restated	1	247,280	247,281
Share-based payment	–	76,438	76,438
Profit for the year	–	246,196	246,196
At 31 December 2006	1	569,914	569,915

19. Ultimate parent company

The company is under the immediate control of Alcatel USA Sourcing Inc which holds 100% of the company's issued share capital Alcatel USA Sourcing Inc is incorporated in the USA and is part of a group headed by a company incorporated in France, Alcatel Lucent