Registered No 03934955

Alcatel IP Networks Limited

Report and Financial Statements

31 December 2008

Registered No: 03934955

Directors
Ali Sadiq
Mark Smallwood
Rudi Strubbe

Secretary
BLG (Professional Services) Limited
7th Floor Beaufort House
15 St Botolph Street
London
EC3A 7NJ

Auditors
Ernst & Young LLP
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Bankers
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OX4 2RU

Directors' report

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

Results and dividends

The profit for the year amounted to £772,095 (2007: £550,442). The directors do not recommend the payment of any dividends (2007: £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-Lucent 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.

Auditors

A resolution to reappoint Ernst & Young LLP as auditors will be put to the members at the Annual General Meeting.

By order of the Board

Mark Smallwood
Director

22 October 2009

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.

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 2008 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.

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 2008 and of its profit for the year then ended;
- the financial statements have been properly prepared in accordance with the Companies Act 1985; and
- the information given in the directors' report is consistent with the financial statements.

Ernst & Young LLP

Ernst & Young LLP
Registered Auditor
Reading

Date: 23-10-2009

Profit and loss account
for the year ended 31 December 2008

	Notes	*2008* £	*2007* £
Turnover	2	6,812,627	5,142,653
Cost of sales		6,195,148	4,678,215
Gross profit		617,479	464,438
Administrative expenses		193,310	152,016
Operating profit	3	424,169	312,422
Bank interest receivable	6	12,677	11,900
Interest payable and similar charges	7	–	–
		12,677	11,900
Profit on ordinary activities before taxation		436,846	324,322
Tax on profit on ordinary activities	8	335,249	226,120
Profit for the financial year transferred to reserves		772,095	550,442

Statement of total recognised gains and losses

	2008 £	*2007* £
Profit for the financial year	772,095	550,442
Share-based payments credit	21,000	23,938
Total recognised gains relating to the year	793,095	574,380

Balance sheet
at 31 December 2008

	Notes	2008 £	2007 £
Fixed assets			
Tangible assets	9	4,884	35,113
Current assets			
Debtors	10	6,998,095	4,451,051
Cash in hand		112,588	203,286
		7,110,683	4,654,337
Creditors: amounts falling due within one year	11	4,863,494	3,213,816
Net current assets		2,247,189	1,440,521
Total assets less current liabilities		2,252,073	1,475,634
Provisions for liabilities and charges	12	6,759	23,415
Net assets		2,245,314	1,452,219
Capital and Reserves			
Called up share capital	17	1	1
Profit and loss account	18	2,245,313	1,452,218
Equity shareholders' funds	18	2,245,314	1,452,219

Approved by the Board

Mark Smallwood
Director

Date: 22 October 2009

Notes to the financial statements

at 31 December 2008

1. Accounting policies

Basis of preparation

The financial statements are prepared under the historical cost convention and in accordance with applicable accounting standards.

Cash flow statement

A cash flow statement has not been prepared as the company has taken advantage of the exemption granted to 90% or more subsidiaries under FRS 1. This is on the basis that group financial statements including the results of the company are prepared and are publicly available.

Related party transactions

The company is a wholly owned subsidiary of Alcatel-Lucent USA Inc, a company incorporated in America. These financial statements are included in the consolidated financial statements of the ultimate parent company, Alcatel Lucent, a company incorporated in France, which are publicly available. Accordingly, the company has taken advantage of the exemption in FRS 8 from disclosing transactions with members or investees of the Alcatel Lucent group.

Fixed assets

All fixed assets are initially recorded at cost.

Depreciation

Depreciation is provided on all tangible fixed assets at rates calculated to write off the cost, less estimated residual value based on prices prevailing at the date of acquisition of each asset evenly over its expected useful life, as follows:

Furniture and fittings	-	20% - 50% per annum
Computer equipment	-	50% per annum

Deferred taxation

Deferred tax is recognised in respect of all timing differences that have originated but not reversed at the balance sheet date where transactions or events have occurred at that date that will result in an obligation to pay more, or a right to pay less or to receive more, tax, with the following exception:

- deferred tax assets are recognised only to the extent that the directors consider that it is more likely than not that there will be suitable taxable profits from which the future reversal of the underlying timing differences can be deducted.

Deferred tax is measured on an undiscounted basis at the tax rates that are expected to apply in the periods in which timing differences reverse, based on tax rates and laws enacted or substantively enacted at the balance sheet date.

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.

Research and development expenditure

Research and development expenditure is written off as incurred.

Notes to the financial statements
at 31 December 2008

1. Accounting Policies (Continued)

Revenue recognition
Revenue is recognised to the extent that it is probable that the economic benefit will flow to the company and the revenue can be reliably measured. Revenue is measured on a cost plus basis, ie cost plus 7% in accordance with the group transfer pricing policy.

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.

Share-based payment
The company has applied the requirements of FRS 20 (IFRS 2) 'Share-based Payment'. In accordance with the transitional provisions, FRS 20 has been applied to all grants of equity instruments after 7 November 2002 that were unvested as of 1 January 2005.

The company issues equity-settled share-based payments to certain employees. Equity-settled share-based payments are measured at fair value (excluding the effect of non market-based vesting conditions) at the date of grant. The fair value determined at the grant date of the equity-settled share-based payments is expensed on a straight-line basis over the vesting period, based on the company's estimate of shares that will eventually vest and adjusted for the effect of non market-based vesting conditions.

Stock option fair value is calculated at grant date (i.e. date of approval of the plan by the Alcatel-Lucent Board of Directors) using the Cox-Ross-Rubinstein binomial model. This model permits consideration of the option's characteristics, such as exercise price and expiry date, market data at the time of issuance, the interest rate on risk-free securities, share price, expected volatility at grant date and expected dividends, and behavioural factors of the beneficiary, such as expected early exercise. It is considered that a beneficiary will exercise his/her option once the potential gain becomes higher than 50% of the exercise price.

Notes to the financial statements
at 31 December 2008

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:

	2008	*2007*
	£	*£*
United Kingdom	–	–
Rest of the world	6,812,627	5,142,653
	6,812,627	5,142,653

3, Operating profit
This is stated after charging/(crediting):

		2008	*2007*
		£	*£*
Auditors' remuneration	- audit services	10,000	11,800
	- non-audit services	–	–
Depreciation of owned fixed assets		34,390	41,637
Operating lease rentals	- land and buildings	54,810	50,540
	- plant and machinery	20,183	20,183

4. Staff costs

	2008	*2007*
	£	*£*
Wages and salaries	5,406,468	4,076,352
Social security costs	655,848	423,754
Other pension costs	88,735	84,338
	6,151,051	4,584,444

Included in wages and salaries is a total expense of share-based payments of £21,000 (2007: £23,938) of which £21,000 (2007: £23,938) arises from transactions accounted for as equity-settled share-based payment transactions.

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

	2008	*2007*
	No.	*No.*
Research and development	11	11
	11	11

Notes to the financial statements
at 31 December 2008

5. Directors' emoluments

	2008 *£*	*2007* *£*
Emoluments	587,786	279,846
Company contributions to money purchase pension schemes	8,888	8,888

	2008 *No.*	*2007* *No.*
Members of money purchase pension schemes	1	1

All amounts are in respect of the highest paid director.

The directors' emoluments for other directors have been borne by other Alcatel group companies. The directors' services to the company do not occupy a significant amount of their time. As such the directors do not consider that they have received any remuneration for their incidental services to the company for the years ended 31 December 2008 and 31 December 2007.

6. Interest receivable

	2008 *£*	*2007* *£*
Bank interest receivable	12,677	11,900

7. Interest payable and similar charges

	2008 *£*	*2007* *£*
Bank interest payable	–	–

Notes to the financial statements
at 31 December 2008

8. Taxation on ordinary activities

(a) Tax on profit on ordinary activities

The tax charge is made up as follows:

	2008	*2007*
	£	*£*
Current tax:		
UK corporation tax	(335,249)	(226,120)
Adjustment in respect of previous years	–	–
Total current tax (note 8(b))	(335,249)	(226,120)

(b) Factors affecting current tax charge

The tax assessed on the profit on ordinary activities for the year is lower than the effective rate of corporation tax in the UK of 28.5% (2007: 30%).

The differences are reconciled below:

	2008	*2007*
	£	*£*
Profit on ordinary activities before tax	436,846	324,322
Profit on ordinary activities at the effective rate of corporation tax of 28.5% (2007: 30%)	124,502	97,297
Effects of:		
Research and development tax relief	(476,000)	(344,117)
Expenses not deductible for tax purposes	6,448	8,209
Depreciation in excess of capital allowances	9,801	12,491
Other timing differences	–	–
Adjustment in respect of previous years	–	–
Total current tax (note 8(a))	(335,249)	(226,120)

(c) Deferred tax

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

	2008	*2007*
	£	*£*
Capital allowances in advance of depreciation	60,091	52,937
Tax losses available	65,562	69,013
	125,653	121,950

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

Under the 2007 Finance Act, the rate of UK corporation tax was reduced from 30% to 28% with effect from 1 April 2008.

The effect of this change on the unrecognised deferred tax asset has been taken into account in preparing these financial statements.

Notes to the financial statements
at 31 December 2008

9. Tangible fixed assets

	Fixtures and fittings £	*Computer equipment* £	*Total* £
Cost:			
At 31 December 2007	95,432	205,525	300,957
Additions	-	4,161	4,161
At 31 December 2008	95,432	209,686	305,118
Depreciation:			
At 31 December 2007	74,631	191,213	265,844
Charge for the year	16,765	17,625	34,390
At 31 December 2008	91,396	208,838	300,234
Net book value:			
At 31 December 2008	4,036	848	4,884
At 31 December 2007	20,801	14,312	35,113

10. Debtors

	2008 £	*2007* £
Amounts due from group undertakings	6,959,133	4,393,562
Other debtors	11,661	17,718
Prepayments and accrued income	27,301	39,771
	6,998,095	4,451,051

11. **Creditors:** amounts falling due within one year

	2008 £	*2007* £
Trade creditors	7,902	26,134
Other taxation and social security	37,712	38,650
Accruals and deferred income	4,817,880	3,148,221
Other creditors	-	811
	4,863,494	3,213,816

Notes to the financial statements
at 31 December 2008

12. Provisions for liabilities and charges

	Employers' National Insurance £
At 31 December 2007	23,415
Credited to the profit and loss account	(16,656)
At 31 December 2008	6,759

A number of the company's employees have been granted stock options over the shares of the company's ultimate parent company, Alcatel Lucent. The company is liable to pay National Insurance, currently 12.8%, on the difference between the option exercise price and the market value of the related shares when the options are exercised.

Accordingly, the company has made a provision of £6,759 in relation to the stock options. The provisions are expected to be utilised over varying periods of up to 4 years, being the periods over which the options vest. The total National Insurance liability on options granted is calculated and then that proportion relating to the period vested is recognised as a provision.

The amount of the National Insurance payable on the stock options will depend on the number of UK employees who remain with the company and when they exercise their options, the market price of the parent company's common shares at the time of exercise and the prevailing National Insurance rates at the time.

13. Pensions

The company operates a defined contribution pension scheme. Contributions are charged to the profit and loss account as they become payable. Outstanding contributions at 31 December 2008 were £nil (2007: £nil).

14. Share-based payments

Share-based payment plan

The employees of the company have been granted share options in the ultimate controlling company Alcatel Lucent, a company incorporated in France.

Vesting is gradual with options vesting in successive portions over four years, for which 25% of the options are vested if the employee remains after twelve months and, for each month after the first year, $1/48^{th}$ of the options are vested if the employee remains employed by the Group. Options can be exercised as soon as they are vested.

The expense recognised for share-based payments in respect of employee services received during the year to 31 December 2008 is £21,000 (2007: £23,938). The portion of that expense arising from equity-settled share-based transactions is £21,000 (2007: £23,938).

Notes to the financial statements

at 31 December 2008

14. Share-based payments (continued)

The following table illustrates the number and weighted average exercise price (WAEP) of, and movements in, share options during the year.

	2008 No.	*2008 WAEP €*	*2007 No.*	*2007 WAEP €*
Outstanding at 1 January	287,277	8.27	279,777	8.27
Granted during the year	11,100	3.80	7,500	9.10
Forfeited during the year	–	–	–	–
Exercised during the year	–	–	–	–
Expired during the year	–	–	–	–
Outstanding at 31 December	298,377	8.08	287,277	8.27
Exercisable at 31 December	279,954	8.23	205,216	8.27

The weighted average contractual life for the share options outstanding at 31 December 2008 is 3.01 years (2007: 3.85 years).

The range of exercise prices for options outstanding at the end of the year was €3.80 - €13.20 (2007: €6.70 - €13.20).

The fair value of the equity settled share options granted is estimated as at the date of grant using the Cox-Ross-Rubinstein binomial pricing model. The following table lists the main inputs to the model used for the years ended 31 December 2008 and 31 December 2007.

For the year ended 31 December	*2008*	*2007*
Risk free interest rate (%)	3.9	4.0
Expected dividends (%)	0.8	0.8
Expected volatility (%)	45.0	33.0
Vesting period (years)	4	4
Exercise period (years)	4	4
Weighted average fair value of the granted options (€ per option)	1.50	3.04

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.

In addition, a behavioural factor is retained. It is considered that a beneficiary will exercise his/her option once the potential gain becomes higher than 50% of the exercise price.

15. Capital commitments

Amounts contracted for but not provided in the financial statements amounted to £nil (2007: £nil).

Notes to the financial statements
at 31 December 2008

16. Commitments under operating leases

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

	2008		2007	
	Land and buildings	*Other*	*Land and buildings*	*Other*
	£	*£*	*£*	*£*
Operating leases which expire:				
Within one year	–	–	53,200	–
In two to five years	55,005	–	–	–
In over five years	–	–	–	–
	55,005	–	53,200	–

17. Share capital

		Authorised
	2008	*2007*
	£	*£*
Ordinary shares of £1 each	100	100

	Allotted, called up and fully paid			
	2008		2007	
	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 2008	1	1,452,218	1,452,219
Share-based payment	–	21,000	21,000
Profit for the year	–	772,095	772,095
At 31 December 2008	1	2,245,313	2,245,314

19. Ultimate parent company and controlling party

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