Next Generation Security

corero
NETWORK SECURITY plc

Annual Report & Accounts 2011

corero
NETWORK SECURITY plc

Corero Network Security plc ('Corero', the 'Group' or the 'Company'), is a software focused business with a leading position in its two markets: network security and business management solutions.

Corero Network Security

An international network security company and the leading provider of Distributed Denial of Service (DDoS) defence and Intrusion Prevention System (IPS) solutions. Corero's products and services provide comprehensive, integrated, high-performance protection against constantly evolving network-borne cyber threats. Customers include enterprises, service providers and government organisations worldwide. Corero's appliance-based solutions are highly adaptive and pre-emptively respond to modern cyber attacks, known and unknown, protecting critical information and online assets. Corero's products have superior performance, are highly scalable, and feature the lowest latency and best reliability in the industry.

www.corero.com

Corero Business Systems

A leading provider of powerful and dynamic modular accounting, human resources, payroll and learner management information software to the schools (including academies) and further education sectors in the UK and internationally.

www.coreroresource.com

Contents

Highlights

Financial highlights

- Consolidated revenue £11.3 million (2010: £3.0 million)
  - Corero Network Security: £6.9 million
  - Corero Business Systems: £4.4 million
- Consolidated operating profit* £287,000 (2010: £333,000)
- Adjusted consolidated loss before tax** of £260,000 (2010: loss £32,000)
- Loss per share 2.75p (2010: 0.68p)
- Cash of £4.3 million at 31 December 2011 (2010: £7.2 million)
- Raised £4.56 million (before costs) on 6 March 2012 by way of a placing to support the growth of the Corero Network Security business

Operating highlights

- Corero Network Security division
  - Acquired Top Layer Networks, Inc in March 2011, renamed Corero Network Security
  - Repositioned through investments in product development and a new international sales organisation
  - Sales order intake up on the previous year
  - 78 new customers in 2011 with an average order value per customer of £36,000
  - Management team reshaped
  - Launch of DDoS Defence System (DDS), a network-layer and application-layer Distributed Denial of Service (DDoS) defence product
- Corero Business Systems division
  - Revenue up 45% on 2010
  - 36% operating profit margin (2010: 34%)
  - Won contracts from 192 Academies (2010:70)
  - Reseller agreement signed with Serco Learning, part of FTSE 100 Serco plc
  - Management team strengthened

* before depreciation, amortisation, acquisition and restructuring costs and financing

** excluding acquisition and restructuring costs and amortisation of acquired intangible assets

Our performance in 2011 has validated our strategy in the network security market. This market is forecast to continue to grow strongly, and with ongoing growth prospects in Corero Business Systems, we continue to see the opportunities for Corero as compelling.

Jens Montanana Chairman

Business Profile

CORERO NETWORK SECURITY

Robust Platform

Superior Performance

Unmatched Protection

Vision

To be recognised as a leading provider of the industry's most innovative network security technologies, delivering value to customers through solutions and services that provide a "First Line of Defence" to pre-empt and dynamically respond to the threats posed by the constantly evolving landscape of network based cyber attacks.

Technology for Today's Problems, Tomorrow's Challenges

Corero is uniquely positioned to build upon and extend its suite of industry-leading Intrusion Prevention System (IPS) and DDoS Defence System (DDS) security products through development and selective acquisition. Corero's agility and flexibility lies in its primacy as a software company developing solutions which run on its powerful Core Platform.

The Corero Core Platform, which integrates Tilera Corporation's multi-core processors with the proprietary Corero Operating System ("CoreOS"), is the foundation on which Corero developers and engineers create network security products that combat today's cyber security assaults, and rapidly respond to tomorrow's new threats and changing IT business environments. This high performance platform delivers a full suite of fundamental capabilities for network security processing, including packet handling, deep packet inspection and policy management.

The IPS and DDS products built upon the Core Platform leverage Corero's Three Dimensional Protection ("3DP") technology. 3DP combines traffic rate management, stateful firewall filtering and deep inspection traffic analysis, allowing for the strongest possible defence against today's malware penetration attempts and both network and application-layer DDoS (Distributed Denial of Service) attacks.

Corero products are available in a range of high throughput appliances that provide the lowest latency and highest reliability in the industry. The powerful scaling attributes of Corero ProtectionCluster technology, provides high availability, multiples of processing power and performance, and the utmost flexibility for deployment.

This foundation of powerful and flexible hardware, in concert with security centric software development, enables Corero to rapidly create new products in response to customers' network security needs.

Corero also leverages the expertise of its technology partners, which include eIQnetworks, Kaspersky, Netronome, RSA and Tilera.

Corero's Customers

Corero's "First Line of Defence" network security products can protect customers against cyberattacks in any industry. Currently Corero's core vertical markets are: finance and banking, power and energy, education, defence, on-line gaming and e-Commerce.

Customers include some of the world's largest service providers (including BT, BSkyB, Telefonica, Telekom Austria, Telekom Malaysia, SFR and Verizon), and:

- Air Liquide – one of the world's largest industrial gases suppliers
- Laclede Gas Company – leading US-based natural gas distributor
- Applied Innovations – web hosting provider, hosting 35,000 websites worldwide
- Brady Distributing – second largest distributor in the US of amusement games and vending machines
- Bridgepoint Education – on-line and campus based Higher Education provider
- Butler Community College – Kansas-based college with over 13,000 students
- bwin – leading on-line gaming company
- Camelot National Lottery – lottery operator
- City of Baltimore
- Journal Register – one of the largest newspaper publishers in the US
- Pep Boys – multi-billion automotive services and retail chain with more than 700 stores across the US and Puerto Rico
- Yankee Candle Company

The Real Core is Service

Corero believes that the best security technology requires best-in-class services to assure customers' protection and success. These services include Corero's Threat Update Service, an automated protection update service that provides customers with timely pro-active protection from the latest security threats (including malicious software threats), and SecureWatch, a cyber security monitoring service.

Corero is committed to work with like-minded channel partners, who combine security expertise and technical savvy with the same dedication to partnership and customer service.

Trusted partnership is the cornerstone of the Corero-customer relationship. Partnership, through the combination of products and services, enables Corero to create holistic network security solutions which inspire confidence and engender trust.

"Corero's device was the only one that combined the high levels of performance with the deep packet inspection that made us comfortable with putting it in-line in our network that simply cannot afford a minute being offline."

Charles Neely Harper, Director National Supply & Pipeline Operations
for Air Liquide Industrial Gases
Corero Network Security customer

Corero's IPS delivers the most comprehensive network protection compared to other IPS products. The IPS solution comprises (i) an in-line, transparent network appliance, (ii) Network Security Analyzer Software, a powerful real-time security event manager, (iii) IPS Controller software, a centralized management module for multi-device deployments and (iv) Threat Update Service, a comprehensive update service together with (v) hardware and software support & maintenance.

Corero's newest product family, Corero DDS*, is the first solution to offer an integrated approach to DDoS defence, providing network through to application layer protection against evolving DDoS threats.

Aligned with its DDS offering, in 2011 Corero launched SecureWatch® PLUS, a comprehensive suite of DDoS-defence, configuration optimization, monitoring and response services. SecureWatch PLUS is emblematic of Corero services: a continuous, collaborative DDoS defence program engaging the customer and their trusted partner, Corero.

* Corero's DDS Winner of Info Security 8th Annual 2012 'Global Excellence Award' in the category 'Security Products and Solutions for Enterprises (Large)'

CORERO BUSINESS SYSTEMS

Market Leading Finance Software for Schools, Academies and Colleges
Powerful Student Record Management System for Post 16 Education Sector

Vision

To be recognised as one of the leading strategic business software providers in the schools and further education sectors in the UK and internationally, both directly and through partnerships.

Focus

Corero is a provider of business accounting, human resources, payroll and management information software solutions to the schools and academies, further education and commercial markets. Corero's proprietary software solution, Resource, is at the core of the Corero suite of business applications. Resource empowers business and finance departments by providing streamlined processes which offer increased efficiencies, help to control costs and improve an organisation's cash flow management, all of which address the 21st Century challenges for public sector and commercial organisations faced with tighter funding and increased competition.

The two core Corero Resource software solutions are:

- Resource Financials & HR ("Resource Financials"), a financial, human resources and payroll software solution; and
- Resource Education Management System ("Resource EMS"), a learner management information system.

Resource Financials

Resource Financials is a market-leading finance management solution delivering web-enabled, workflow controlled business processes which lower the cost of processing transactions and increase both visibility and control over revenues and expenses. Its functionally rich and flexible modules cater for:

- Core Accounting and Banking
- Web-based Purchase Requisitioning and e-Procurement
- Web-based Sales Requisitioning and Billing
- Project Costing with Web based Timesheets and Expenses entry and approval
- Fixed Asset accounting and tracking
- Human Resources and Payroll
- Document Scanning and management
- Graphical Reporting and Business Intelligence with full drill-down to view source transactions
- Web-based HR Self-Service

Resource EMS

Resource EMS is a modern and powerful Learner Record Management Information System, designed specifically to meet the challenges of the post 16 Education sector in England. Resource EMS manages the complete learner life-cycle, from initial enquiry through to completion. Easy to use, easy to learn, responsive and flexible, Resource EMS is designed to empower both staff and learners with accurate, up to date information in easy reach. Fully integrated modules replace the many disparate and costly add-on systems to become a true establishment-wide management information solution. Resource EMS streamlines and validates all data capture ensuring complete confidence in the quality of data, provides integrated marketing and CRM to increase enrolment and employer engagement opportunities and enables accurate delivery of ILR (Individualised Learner Record) data to improve the efficiency of the funding claim process. Its key application modules cater for:

- Staff & Learner Web Portal
- Web Enquiry, Application & Enrolment
- Graphic Timetabling
- Web Attendance
- Management Reporting & KPI Dashboards
- Course Planning & Management
- Learner Tracking & Reviews
- UCAS References
- Customer/Employee Relationship Management
- Activity Management
- Statutory Returns

Corero's Customers

Resource Financials

Resource Financials customers include over 350 academies and schools and over 100 colleges. Attracted by the breadth of the solutions available and proven track record within education, Corero is recognised as a market leading provider to the education sector.

Schools and Academies including:

- The School Partnership Trust
- Landau Forte Academy Trust
- St. Mary Magdalene Academy
- Walsall Academy
- The Cabot Federation Bristol
- West London Academy
- North Liverpool Academy
- The Kemnal Academies Trust
- The Samworth Enterprise Academy
- Barnby Road Primary

Further Education and Sixth Form colleges including:

- Heythrop College
- Dumfries & Galloway College
- Peterborough Regional College
- Leeds College Of Art & Design
- Loughborough College
- Cirencester College
- Havering Sixth Form College
- Norwich School of Art and Design
- Queen Elizabeth Sixth Form College
- Queen Mary's College
- Royal College of Music
- Stoke On Trent Sixth Form College

In addition, Corero has over 50 commercial customers including architect, consulting engineer, market research and design companies.

Resource EMS

Resource EMS has over 40 Sixth Form and Further Education Colleges including:

- South Staffordshire College
- Oxford & Cherwell College
- North West Kent College
- Mid Kent College
- St John Rigby College
- Joseph Chamberlain Sixth Form College
- Richmond Adult Community College
- Gateway College
- Wyggeston & Queen Elizabeth I College
- Rotherham College of Arts & Technology
- Lewisham College
- Guildford College

Key Features

Resource Financials key features include:

- Workflow automation of key business processes
- Business Intelligence and Dashboard solutions for real-time reporting to Senior Leadership teams
- Key management reports output integrated with Microsoft Excel
- Web-based organisation/departmental/cost centre reporting with full drill-down providing devolved on-line access for budget holders and senior management
- Web-based and intuitive timesheet, expense, purchase and sales requisition entry and approval plus web HR 'Self Service'
- Embedded document and file management and scanning offering efficiencies in the storage and retrieval of key financial documents such as Invoices and Contracts

Resource EMS key features include:

- Management and administration of the complete learner life-cycle from initial enquiry through to achievement and destination following the completion of the course
- Advanced course/programme planning and examination management tools
- Full management of statutory returns such as the new Single Individualised Learner Record (SILR)
- Timetabling, registers, staff and resource planning tools
- Web Portal deployment that delivers real time information to both tutors and learners
- Simple, at-a-glance reporting and analysis
- Full integration with Resource Financials to provide a true college wide 'Enterprise' suite of business solutions for Colleges

"From every point of view, the implementation of the Resource system has significantly improved the efficiency of our financial management. In addition to being able to make much more effective use of the budgets available through tighter control, the web portal has enabled us to achieve considerable savings through more streamlined purchasing."

Auditors, West London Academy
Corero Business Systems customer

Chairman's Statement

"The network security market is forecast to continue to grow strongly fueled by escalating cyber crime and cyber war threats, economic disruption and associated costs as cyber attacks multiply, and growing security compliance and business continuity requirements."

Jens Montanana
Chairman

Introduction and results highlights

2011 was a transformational year for Corero with the acquisition and successful integration of Top Layer Networks, Inc ("Top Layer") coupled with the continuing growth of the Corero Business Systems division ("CBS"). The Top Layer acquisition closed on 2 March 2011 and Top Layer was rebranded Corero Network Security ("CNS") in June 2011.

Corero plc was also renamed as Corero Network Security plc on 29 June 2011.

CNS has made significant progress post acquisition, with the establishment of an international sales team and considerable investment into product development, leading to increased sales momentum and order intake. In addition, CBS has experienced strong growth during the period. In the year ended 31 December 2011 the Group reported revenues of £11.3 million (2010: £3.0 million) and operating profit before depreciation, amortisation, acquisition and restructuring costs and financing of £287,000 (2010: £333,000).

Corero Network Security review

Corero's acquisition of Top Layer marked the first step in the Company's stated strategy to build an international network security business delivering software and hardware solutions to mid-market and enterprise customers, telecommunication service providers and government agencies, through an international network of distributors, integrators and specialised channels partners.

CNS reported revenue of £6.9 million and an operating loss before depreciation, amortisation, acquisition and restructuring costs and financing of £550,000 in the period since the 2 March 2011 acquisition date.

CNS sales order intake (bookings) in the year ended 31 December 2011 was $12.0 million (£7.5 million) with an average value per customer of $47,000 (£29,000). This compared to $11.7 million (£7.6 million) in 2010 with an average value per customer of $32,000 (£21,000). The increase in order intake along with the increase in the average value per customer was encouraging, particularly in the light of the restructuring of the US sales team post the acquisition and establishing the international team in the second half of 2011.

CNS secured 78 new customers in 2011 with an average order value per customer of $57,000 (£36,000). This added new customers in the core vertical markets of finance and banking, education, defence, on-line gaming and e-Retail. New customer wins included significant orders from: bwin (one of the world's largest on-line gaming companies); City of Baltimore; a leading spread betting and CFD provider; an award winning developer and publisher of online games; and Bridgepoint Education (an on-line & campus based Higher Education provider). Particularly pleasing was new business wins with major telecommunications service providers in France and Spain.

In addition, material upgrade orders were secured from existing customers including Party Gaming (which was acquired by bwin in 2011); a Texas based clinical healthcare provider; one of the largest health insurance associations in the United States; one of the largest insurers in the United States;

"We have recently purchased and implemented a finance package from Corero. Corero's support has been invaluable during our conversion to an Academy and their work has been a major factor in our successful transition. I know they are always at the end of the phone and always happy to help, they go the extra mile and the 'Helpdesk' service is second to none."

Humberston Park Special School
Corero Business Systems customer

and an agency of the United States Department of Defense.

In 2011, CNS secured maintenance and Threat Update Service renewals of $2.8 million (£1.75 million) including material renewals from a leading US-based insurer and one of the world's largest energy companies.

In the period since the acquisition closed, a number of important milestones have been achieved:

- Management team reshaped with the appointment of new CEO, VP of Engineering, Chief Marketing Officer, VP Sales North America and VP of Finance.
- Launch of DDoS Defence System (DDS), a network-layer and application-layer Distributed Denial of Service defence product.
- Launch of DDoS defence support services, SecureWatch Plus, a comprehensive suite of DDoS defence, configuration optimisation, monitoring and response services.
- Significant new investment and progress made in growing the product development team.
- Sales teams recruited in France, Italy, Malaysia, Spain and Taiwan.
- The rebranding of Top Layer to Corero Network Security.
- Licensing agreement with Kaspersky Lab, a leading developer of threat management solutions, to augment Corero's Intrusion Prevention solution.
- Appointment of over 30 new channel partners.

The security market dynamics and opportunity for Corero Network Security

The network security market is forecast to continue to grow strongly, fuelled by escalating cyber threats, economic disruption and associated costs as cyber attacks multiply, and growing security compliance and business continuity requirements (Gartner forecast cumulative annual growth of over 8% in the period to 2014).

The nature, frequency and sophistication of cyber attacks continue to increase across all spectrums:

- Cyber-crime driven by financial motivation of cyber criminals.
- Cyber-activism which in 2011 saw hacktivism (the convergence of hacking and activism) activities increase significantly with the exploits of groups such as Anonymous and Lulzsec.
- Cyber-espionage and cyber-warfare impacting both government and commercial organisations targeting national security information, trade secrets and intellectual property assets. Cyberspace is increasingly being regarded as the new frontline of warfare – the fifth domain along with land, sea, air and space.
- Cyber-terrorism which US intelligence agencies consider is likely to overtake terrorism as the number one threat facing the US.

According to independent research recently commissioned by Corero, DDoS attacks are becoming

"Corero's detection capabilities have picked up a lot of things we weren't aware were going through our network. Its protocol analysis [Corero's unique Protocol Validation Modules and file format-specific Data Validation Modules, which evaluate payloads as well the protocols themselves] does an effective job and tips me off when things aren't right."

Gary Kay, Director Infrastructure and Security Services at Laclede Gas Company
Corero Network Security customer

"The education sector in the UK offers Corero an excellent opportunity for growth, particularly in light of the continuing trend for schools in England to convert to Academies."

increasingly prevalent with 31% of organisations having suffered an attack in the past 12 months. The research, conducted by VansonBourne, questioned 300 mid to large-sized enterprises in the UK and US and found US companies were twice as likely to be attacked as those in the UK, with 63% of US and 29% of UK IT directors concerned over future attacks. Political and ideological motivation was cited as the largest source of DDoS attacks among UK companies with the retail sector most concerned. In the US 52% of attacks were caused by competitors seeking unfair business advantages.

The security market is fragmented, with Gartner estimating that only 44% of the market share belongs to the top five vendors. In this fragmented and ever changing market many established leaders are losing market share to smaller players with new offerings to meet new threats.

CNS's products and services offer an effective first line of defence against cyber attacks. With a strong software centric platform, Corero has the flexibility and performance to address the challenges of customers today and into the future.

Corero Business Systems review

Revenues for the CBS division increased by 45% in 2011 to £4.4 million (2010: £3.0 million). CBS sales order intake in the year to 31 December 2011 was £5.1 million (compared to £3.4 million in 2010).

CBS reported an operating profit before depreciation, amortisation, acquisition and restructuring costs and financing of £1.6 million (2010: £1.0 million).

The CBS division won new contracts from 192 Academies in the 12 months ended 31 December 2011, compared with 70 in 2010, underlying its strong position in this growth market. In addition, despite the tight Public Sector spending environment, CBS won four new contracts with sixth form colleges in 2011. These included three colleges, St John Rigby in Wigan, Joseph Chamberlain in Birmingham and St Dominic's in Harrow for the Resource EMS solution, CBS' Learner Management Information System and one new college, Blackpool Sixth Form College, for its Resource Financials solution.

Key achievements in 2011 include:

- Reseller agreement signed with Serco Learning, part of FTSE 100 Serco plc.
- Strategic partnerships with two schools and academy groups:
  - The School Partnership Trust – a Leeds based educational charity, awarded 'Accredited Schools Group Status' in 2010, with 20 schools and Academies.
  - The Kemnal Academies Trust – a Kent based multi-Academy Trust with 26 secondary and primary Academies, who are establishing one of the first new Teaching Schools.
- Strengthening of the management team by appointment of Sales Director, HR Manager, Product Manager and Service Delivery Manager.

"Having taken the decision to switch our financial package to Corero Resource, I am more than happy to recommend it to other School Business Managers. The support from the start was first class with plenty of advice regarding the setting up our Chart of Accounts. The on-site training can only be described as superb. The system is designed to meet all the demands of Academy status whilst being logical and straight forward to use."

Range High School
Corero Business Systems customer

- Additional sales talent recruited – sales team increased from 6 at 31 December 2010 to 10 at 31 December 2011.
- Launch of Resource Financials v7, CBS' next generation financial software solution.

Business strategy

The strategy for the Corero Network Security division is to drive organic revenue growth through increased marketing and industry visibility of the business' approach and product capabilities. In addition, Corero will continue to develop its international, channel focused sales model to access new markets and customers. The division will also invest in product development, with the emphasis on Cyber defence/attack solutions with its IPS and DDoS protection product offerings and services. The business will continue to explore opportunities that can complement its buy and build strategy.

The strategy for the Corero Business Systems division will be to continue to invest for growth. The focus will remain on the education sector where CBS has a strong market position, particularly in the further education college and academy markets in England. Development will continue on Resource Financials & HR and Resource EMS with additional modules to meet customer requirements. Opportunities in new customer segments and in international markets will also be evaluated.

The Group will continue to manage and operate Corero as two separate divisions with a small central overhead.

Staff

Our employees include highly skilled developers, and experienced management, sales executives and support staff, all focused on delivering market leading solutions to our customers. On behalf of the Board I would like to thank the employees of Corero for their efforts in the last financial year.

Directors

I would like to thank Edward Forwood for his contribution and welcome Stephen Graham to the Board.

Outlook

Significant progress has been made in the Corero Network Security business. The business and management team have been reshaped and the groundwork laid to drive incremental business in many exciting new international markets. This division is well positioned to deliver growth in 2012.

Corero Business Systems performed strongly in 2011 and is expected to continue its robust and profitable development into 2012. The early opportunities identified in this division's core customer segment have enabled the business to build a strong presence and annuity base in the UK education market.

Jens Montanana
Chairman
19 March 2012

"We like the ability of Corero's IPS not only to see things in real time on the unit, but use the reporting features to watch trends over time and do security reviews for our clients. It's important to surgically remove malicious traffic and keep legitimate traffic flowing. We have the blade [Corero IPS], the surgical weapon of choice."

Dan Farrell, Director of Network Operations at Applied Innovations
Corero Network Security customer

Financial Review

for the year ended 31 December 2011

"Corero Network Security and Corero Business Systems are well placed to capitalise on the opportunities in their respective markets and deliver growth with a strong sales pipeline of opportunities going into 2012."

Andrew Miller
COO and Executive Director

Financial performance

For the year ended 31 December 2011, the Group reported an operating profit before depreciation, amortisation, acquisition and restructuring costs and financing of £287,000 (2010: £333,000) and a loss after taxation of £1.2 million (2010: profit £404,000). This included an unrealised exchange gain of £73,000 arising on intercompany balances.

Central costs were £756,000 (2010: £693,000). Central costs relate to the Group finance and administration functions as well as the costs associated with the Company's listing on AIM. Central costs in 2011 include a full year of costs of the management team and directors appointed in August 2010.

Interest costs were £224,000 (2010: £199,00) comprising interest on the Loan Notes issued by Top Layer Networks, Inc (subsequently renamed Corero Network Security, Inc) as part of the purchase consideration for Top Layer and the Corero Network Security working capital facility. The interest in 2010 relates to interest on the Cumulative Unsecured Loan Stock ('CULS') which were redeemed by the Company in the year ended 31 December 2010.

Interest received was £61,000 (2010: £32,000).

The loss per share was 2.75p (2010: 0.68p).

The Group's net assets at the year end were £11.5 million (2010: £6.9 million).

Performance indicators

The directors and managers of the group monitor a number of metrics, both financial and non-financial, on a monthly basis. The most important of these are as follows:

- Revenue: £11.3 million for the year ended 31 December 2011;
- Gross margin: 77% for the year ended 31 December 2011;
- Number of employees: 130 at 31 December 2011; and
- Cash: £4.3 million at 31 December 2011.

The Board is satisfied with the status of the above performance indicators given the current stage of the Group's development. Although not particularly relevant for the period under review, the Board will in future also monitor organic revenue growth, operating margin and cash conversion.

Cash and treasury

The closing cash balance was £4.3 million (2010: £7.2 million). The net reduction in cash and cash equivalents was £931,000 (2010: net increase £768,000).

In 2011 the Company raised £2.3 million (before expenses) of which the directors contributed £0.9 million.

At the end of the year the Group had aggregate banking facilities of £2.1 million which are committed for a period of one year and are repayable on demand. Group companies have complied with the financial covenants relating to these facilities.

Taxation

As a result of losses carried forward in the UK subsidiary and losses in the US acquired through the acquisition of Top Layer, the Group does not expect to pay the full rate of UK or US corporation tax for a number of years.

At 31 December 2011 the Group had unutilised tax losses carried forward of approximately £21.3 million comprising

"We're working with a couple of support companies at the moment, and can we say that Corero has the fastest response times, been the most helpful and fixed the problem the fastest. We realise that different problems take different amounts of time to fix, but we were really impressed by the communication."

St John Rigby College
Corero Business Systems customer

£6.1 million in the UK and £15.2 million in the US. An element of the tax losses carried forward in the US can only be utilised in an equal annual amount of £445,000 over 20 years from the date of the acquisition of Top Layer. Given the varying degrees of uncertainty as to the timescale of utilisation of these losses, the Group has not recognised £5.3 million of potential deferred tax assets associated with these losses.

Dividends

The Board is not recommending the payment of a dividend (2010: nil).

Principal risks and uncertainties

The Directors believe the following risks to be the most significant for the Group. However, the risks listed do not necessarily comprise all those associated with the Group. In particular, the Group's performance may be affected by changes in market or economic conditions and in legal, regulatory and tax requirements. If any of the following risks were to materialise, the Group's business, financial condition, results or future operations could be materially adversely affected. Additional risks and uncertainties not presently known to the Directors, or which the Directors currently deem immaterial, may also have an adverse effect upon the Company.

1. Competition

The Group operates in competitive markets with Corero Network Security and Corero Business Systems main competitors being much larger companies with significant financial resources. The Group has experienced, and expects to continue to experience, competition from a number of companies. This competition may take the form of new products and services to better meet industry needs and to enable competitors to respond more quickly to client requirements. Further, if the market for the Group's products does not develop as it expects or if it fails to respond to market and competitive developments, the Group's business and prospects could be materially adversely affected.

The network security market, in particular, is becoming increasingly competitive and the Group may face significant competition, including from competitors who have greater capital resources than the Group. There is no assurance that the Group will be able to compete successfully in such a market place. The Board are aware of this threat and intend to continue to invest in the enhancement of the Group's products and services and by making strategic acquisitions.

A careful watching brief is maintained on competitors to enable the Group to react quickly to any change in circumstance or technical developments.

2. Technology and market requirements

The markets the Group operates in are fast changing, driven by changing customer requirements and technology trends. As such the Group's solutions require on-going development and enhancement to meet the needs of customers in its target markets. The Group's ability to anticipate changes in technology and customer requirements and to develop successfully and introduce new and enhanced solutions on a timely basis will be significant factors in the Group's ability to grow and remain competitive.

The ability of the Group to invest in such development is dependent on new business generation and future cash flows. There can be no assurance that the Group will have sufficient resources to make such investments, that these investments will bring the

"Corero has absolutely provided the protection that has enabled us to transform our IT organization and our entire enterprise. The peace of mind that the partnership has given us is huge."

Bob Mason, CTO at Journal Register
Corero Network Security customer

"The placing in March 2012 which raised £4.3 million after costs will allow Corero to further penetrate the network security market and ensure that it is well placed to fully exploit opportunities in network security, an area which is becoming ever more relevant to businesses in light of increasing cyber attacks."

full advantages or any advantage as planned or that it will not encounter technical or other difficulties that could delay the introduction of new technologies or enhancements in the future. The Group's failure, for technological or other reasons, to develop in a timely manner, and market, products or services incorporating new technologies could have a material adverse effect on its revenues, results of operations and/or prospects.

3. International expansion

The Group's future success, and particularly the Corero Network Security business, will depend in part on its ability to expand its operations internationally. Such expansion is expected to place significant demands on management, support functions, sales and marketing and other resources and would involve a number of risks. In order to address these risks the Group focuses on developing good relationships with partners, and exploiting these to deliver sales of the Group's products and solutions and recruiting appropriately skilled staff.

4. Technology partners

Corero Network Security's 4th generation IPS and DDoS defence solutions utilise a multi-core processing chip produced by Tilera Corporation. Should the supply of these chips by Tilera Corporation be interrupted or if this relationship was lost, this could result in a material adverse impact on the Group's financial performance. The Group maintains a close relationship with Tilera Corporation to reduce the risk of loss of this relationship.

5. Key management

The Group depends on the recruitment and retention of the services of its key technical, sales, marketing and management personnel. Competition for such personnel can be intense, and the Group cannot give assurances that it will be able to attract or retain such staff. The Group seeks to address this risk by ensuring that suitable and competitive remuneration structures are in place.

6. Foreign business, political and economic risks

The successful penetration of overseas markets by the Group may take longer than the Directors currently expect. The Group contracts and expects to contract with various entities from around the world including distributor and reseller partners. As a result, the Group is exposed to foreign business, including risks associated with political and economic instability, less developed infrastructures, exposure to possible litigation in foreign jurisdictions, competition from foreign-based service providers and the existence of protectionist laws and business practices that favour such providers.

7. Dependence upon key intellectual property

The Group's success depends in part on its ability to protect its rights in its intellectual property. The Group relies upon various intellectual property protections, including patents, copyright, trademarks, trade secrets and contractual provisions to preserve its intellectual property rights. Despite these precautions, it may be possible for third parties to obtain and use the Group's intellectual property without its authorisation and as such the Group may become involved in litigation which could be costly and time consuming.

8. Acquisitions

There can be no guarantee that the Group will successfully identify any further companies or businesses meeting the objectives of its stated

"We were delighted that the implementation was completed so quickly. We were up and running within 4 days and a big plus from our point of view was the ease of data migration from our old system."

Walsall Academy
Corero Business Systems customer

strategy and may be unable to effect an acquisition or investment where there is an identified opportunity and, as a result, resources may be expended on investigative work and due diligence without a transaction being completed.

Further, the Group may encounter other issues arising post-acquisition, including:

- the difficulty of assimilating operations and personnel of acquired companies into the Group's operations;
- the potential disruption of ongoing business and distraction of management;
- additional operating losses and expenses of acquired businesses;
- the difficulty of integrating acquired technology and rights into the Group's products and services and unanticipated expenses related to such integration;
- the impairment of relationships with customers of acquired businesses as a result of the integration; and
- the impairment of relationships with employees of acquired businesses as a result of integration.

Prior to concluding an acquisition, comprehensive technical, legal and financial due diligence is undertaken in order to ensure a full understanding of the business being acquired. Once acquired, a process of integration management is implemented including regular reporting to the Board on progress so that any issues are highlighted at an early stage.

9. System failures and breaches of security

The successful operation of the Group's business depends upon maintaining the integrity of the Group's computer, communication and information technology systems which are vulnerable to damage, breakdown or interruption from events which are beyond the Group's control. All systems are backed up on a regular basis and appropriate investment is made in systems infrastructure within the Group to maintain appropriate standards of integrity and security.

10. Further issues of ordinary shares

It may be desirable for the Company to raise additional capital by way of the further issue of ordinary shares to enable the Group to progress through further stages of development. Any additional equity financing may be dilutive to shareholders. There can be no assurance that such funding, if required, will be available to the Company.

Andrew Miller
Director
19 March 2012

"After the bake-off, it was very easy to pick a winner; in technology, support and overall operational value, Corero's IPS clearly outperformed all of the competitors. It was an easy choice."

Philip Pell, Chief Information Security Officer at Butler Community College
Corero Network Security customer

Directors' Biographies

Jens Montanana

Non-executive Chairman (51)

Jens is the founder and CEO of Datatec Limited, established in 1986. Between 1989 and 1993 Jens served as managing director and vice-president of US Robotics (UK) Limited, a wholly owned subsidiary of US Robotics Inc, which was acquired by 3Com. In 1993, he co-founded US start-up Xedia Corporation in Boston, an early pioneer of network switching and one of the market leaders in IP bandwidth management, which was subsequently sold to Lucent Corporation in 1999 for $246 million. In 1994, Jens became CEO of Datatec Limited which listed on the Johannesburg Stock Exchange in 1994 and on AIM in 2006. He has previously served on the boards and sub-committees of various public companies. Jens is chairman of the Corero Remuneration Committee.

Andrew Miller

COO and Executive Director (47)

Andrew is the Group Chief Operating Officer and is also responsible for the Group's finance function and for acquiring businesses into the Group. Prior to joining the Group, Andrew was with the Datatec Limited group in a number of roles between 2000 and 2009 including the Logicalis Group Limited ("Logicalis") Operations Director and Corporate Finance and Strategy Director. He led the Logicalis acquisition strategy, acquiring and integrating 12 companies in the US, UK, Europe and South America. Prior to this, Andrew gained considerable corporate finance experience in London with Standard Bank, West Deutsche Landesbank and Coopers & Lybrand. He trained and qualified as a chartered accountant and has a bachelor's degree in commerce from the University of Natal, South Africa.

Richard Last

Non-executive Director (54)

Richard is a Fellow of the Institute of Chartered Accountants in England and Wales (FCA). Richard is Chairman of Arcontech Group, a provider of IT solutions for the financial services sector which is listed on AIM and the British Smaller Technology Companies VCT 2 plc, a fully listed Venture Capital Trust. In addition Richard also sits on the Board of Lighthouse Group plc, an AIM listed financial services group as well as a number of private businesses. Richard is also Chairman of CSE Global (UK) Ltd which is a subsidiary of Singapore listed CSE Global Ltd of which he is a Non-executive director. Richard is chairman of the Corero Audit Committee.

"We have found the personal touch, with an open customer/supplier relationship, together with the "can do" attitude of Corero to be a refreshing change. During our implementation of the system we found the Corero team to be extremely professional and we appreciated their consultative approach."

North West Kent College
Corero Business Systems customer

Stephen Graham
Non-executive Director (59)

Stephen is President of CrossHill Financial Group, Inc. ("CrossHill"), a private merchant bank and advisory firm and is General Partner of CrossHill Georgetown Capital, LP and CrossHill Debt II, LP, funds focused on making senior and subordinated debt investments in private entities. Stephen has more than 30 years of investment banking and private equity experience with both public and private companies. Prior to founding CrossHill, he was a Principal of the investment banking firm Kidder, Peabody & Co. Stephen is a Board member and chairs the Audit Committee of TNS, Inc (NYSE:TNS), and is a Board member of Central Park Credit Bank, and the Washington D.C. International Film Festival. He is a graduate of Georgetown University and received an M.B.A. from the University of Chicago.

Duncan Swallow
Company Secretary (47)

Duncan is responsible for the Company secretarial function within the Group and is also the Group Financial Controller. Prior to joining the Company, Duncan was Divisional Financial Controller for CCH, a Wolters Kluwer business, specialising in providing books, online information, software, CPD and fee protection to tax and accounting professionals. He is a fellow of the Association of Chartered Certified Accountants.

"Straight out of the box, Corero's differentiated solution had a lot of capabilities that the other IPS vendors' products just didn't have, such as protection against Distributed Denial of Service (DDoS) attacks, stateful firewall filtering and protection against Botnet attacks. It has made my job a whole lot easier and my network a whole lot safer and the performance is outstanding."

Rick Baird, IT Manager at Brady Distributing
Corero Network Security customer

Directors' Report

for the year ended 31 December 2011

Principal activities

The principal activity of the Group during the year ended 31 December 2011 was the supply of security products and services to international customers and the supply of finance and management information software solutions to the UK education and commercial markets.

A review of the Group's performance is disclosed within the Chairman's Statement and the Financial Review.

Business review

The information satisfying the business review requirements is set out in this report: the Chairman's Statement on pages 6 to 9; the Financial Review on pages 10 to 13; the review of the principal risks and uncertainties on pages 11 to 13; all of which are incorporated into this report by reference. The Corporate Governance report forms part of this Directors' report and is incorporated into it by reference.

Group results

The Group's Statement of Comprehensive Income on page 28 shows a loss for the year of £1.2 million (2010: profit £404,000).

Going concern

The financial position, cash flows and borrowing facilities are described in the Financial Review on pages 10 to 13.

Forecasts and projections, taking into account reasonably possible changes in trading performance, show that the Company and Group will be able to operate within the level of current cash balances and facilities.

The Directors are satisfied, in view of the cash reserves of £4.3 million (2010: £7.2 million) held on the balance sheet at 31 December 2011 that the Company and the Group have adequate resources to continue operating for the foreseeable future. For this reason they have adopted the going concern basis in preparing the accounts.

Dividends

The Directors have not recommended a dividend (2010: £nil).

Transfers to reserves

The loss for the year amounting to £1.2 million (2010: profit £404,000) will be taken to retained earnings and carried forward to next year.

Post balance sheet events

On 6 March 2012, the Company raised £4.56 million (before costs), of which the directors and senior management contributed £1.4 million, by way of a placing of 10,615,694 new ordinary shares at a price of 43p per share, to support the growth of the Corero Network Security business by investing in the sales and marketing functions of the business to gain end-user customer and channel partner awareness, and investing in its product development capabilities.

"Our more professional, efficient systems give us the ability to improve our performance for our customers, governors, staff, auditors, regulators and the government alike. We made the right choice selecting Resource from Corero and we would recommend it to others. The Corero team has the right skills, the right technology and the right attitude."

Richmond Adult Community College
Corero Business Systems customer

Share capital

The issued share capital of the Company together with details of movements in the Company's issued share capital during the financial period are shown in note 27 to the financial statements. As at the date of this report, 58,329,412 ordinary shares of 1p each ('ordinary shares') were in issue and fully paid with an aggregate nominal value of £583,294.

The market price of the ordinary shares at 31 December 2011 was 44.5p and the shares traded in the range 31p to 49p during the year.

Issue of shares

At the AGM held on 24 May 2011 shareholders granted authority to the Board under the Articles and section 551 of the Companies Act 2006 (the 'Act') to exercise all powers of the Company to allot relevant securities up to an aggregate nominal amount of £158,579.05. It is proposed at the forthcoming AGM to renew the authority to allot relevant securities up to an aggregate nominal amount of £194,431, being one-third of the nominal value of the current issued share capital.

Also at the AGM held on 24 May 2011, shareholders granted authority to the Board under the Articles and section 570(1) of the Act to exercise all powers of the Company to allot equity securities wholly for cash up to an aggregate nominal amount of £71,360.58 without application of the statutory pre-emption rights contained in section 561 (1) of the Act. It is proposed at the forthcoming AGM to renew the authority to allot relevant securities wholly for cash up to an aggregate nominal amount of £87,494 being 15% of the current nominal value of the issued share capital, without application of the statutory pre-emption rights.

Substantial shareholdings

The Company has been notified of the following holdings that are 3% or more of the Group's ordinary share capital as at 19 March 2012:

Ordinary shares of 1 pence each	Number	%
Jens Montanana*	15,793,687	27.08
Andre Stewart**	5,731,023	9.83
Herald Investment Management Limited	3,928,389	6.73
BlackRock, Inc.	3,581,705	6.14
Legal and General Investment Management Limited	2,790,697	4.78
Octopus Investments Limited	2,790,697	4.78
Investec Bank plc	2,460,132	4.22
CrossHill Debt II, L.P.	2,168,346	3.72

* of which 11,936,545 are held in the name of JPM International Limited, which is wholly owned by Jens Montanana.

**of which 5,731,023 are held in the name of BFG Investments Group Limited which is wholly owned by Andre Stewart.

"Corero has allowed us to quickly cut out malicious traffic from our network, maintain high levels of performance and save time and expenses wasted on other inefficient security scans. We chose Corero over our existing HP TippingPoint IPS for improved performance and support, and its devices and support team have each delivered."

Bruce Pruitte, Permanent General Insurance
Corero Network Security customer

Directors' Report continued

Directors and directors' interests

The directors who served in office during the year and up to the date of this report and their interests in the Company's shares were as follows:

Ordinary shares held	19 March 2012 Number	%	31 December 2011 Number	%	31 December 2010 Number	%
Jens Montanana	15,793,687	27.08	12,828,571	26.9	10,400,000	32.5
Andrew Miller	623,255	1.07	600,000	1.3	600,000	1.9
Richard Last	400,000	0.69	221,619	0.5	7,333	–
Stephen Graham (appointed 19 March 2012)	–	–	n/a	–	n/a	–
Edward Forwood (appointed 29 June 2011, resigned 19 March 2012)	–	–	–	–	–	–
Bernard Snowe (resigned 30 June 2011)	n/a	–	n/a	–	1,373	–
Peter Waller (resigned 4 February 2011)	n/a	–	n/a	–	20,600	0.1

The biographical details of the current Directors of the Company are given on pages 14 to 15.

Jens Montanana and Andrew Miller hold share options, details of which are shown in note 33 to the Financial Statements.

Bernard Snowe, managing director of Corero Business Systems, stepped down as a Director of the Company with effect from 30 June 2011 to enable him to focus entirely on the growth of Corero Business Systems and build on the division's strong presence in the UK education sector. He remains a director of Corero Business Systems Limited (the Corero Business Systems trading entity).

Edward Forwood, a director of Loudwater Trust Limited ('Loudwater') was appointed a non-executive director on 29 June 2011. His appointment was a result of Loudwater, which became a significant shareholder in the Company following the acquisition of Top Layer, exercising its right to appoint a non-executive director, as set out in a board representation and observer rights agreement between (1) the Company, (2) CrossHill Debt II, L.P., ('Crosshill') (3) Crosshill Georgetown Capital, L.P. ('Georgetown') and (4) Loudwater dated 7 February 2011 ('Relationship Agreement'). For the purposes of this summary of the Relationship Agreement, 'Shareholders' means Crosshill and Georgetown on the one hand (together being a 'Shareholder') and Loudwater on the other hand. The Relationship Agreement provides that for so long as the Shareholders (or any of them) hold any of the Loan Notes (note 22) and such notes remain outstanding or the Shareholders (or any of them) are, in aggregate, the legal and beneficial owners of more than 10% of the entire issued ordinary shares of the Company, the Larger Shareholder (being the Shareholder that holds the greater number of ordinary shares or, if neither Shareholder holds any ordinary shares, the Shareholder that holds Loan Notes representing the greater principal sum) shall be entitled (but not obliged) to require the

"We selected Corero for our financial system based on research and strong recommendations from our Auditors. We have been delighted with the professionalism of the implementation team and particularly the training that has been provided to our Business Manager and Finance Team and their prompt response to any enquiries made."

Congleton High School
Corero Business Systems customer

appointment of one director to the Board, such appointment to be of a non-executive Director. Loudwater, being the Larger Shareholder exercised its right to appoint a non-executive director on 6 June 2011 and nominated Edward Forwood.

In addition, for as long as either (a) the Shareholders (or any of them) are, in aggregate, the legal and beneficial owners of more than 10% of the entire issued ordinary shares of the Company, or (b) the Shareholders (or any of them) hold Loan Notes with an aggregate principal value of not less than $1 million, the Smaller Shareholder shall have the right, exercisable by notice in writing to the Company, to appoint a representative as an observer ("Observer"), to attend (in person or by conference telephone facility) (but not to speak, vote or to place items on the agenda for discussion) at each and any meeting of the Board and remove any person so appointed. CrossHill being the Smaller Shareholder exercised the right to appoint an Observer on 14 October 2011. On 19 March 2012 following Loudwater's disposal of their in shares in Corero on 6 March 2012, Edward Forwood resigned as a director of the Company.

On 19 March 2012, CrossHill exercised their right to appoint a non-executive director and nominated Stephen Graham whose appointment was confirmed at a Board meeting of that date. On 19 March 2012 Loudwater exercised the right to appoint an Observer.

Payment of suppliers

It is Group policy to agree and clearly communicate the terms of payment as part of the commercial arrangements negotiated with suppliers and then to pay according to those terms based upon the satisfactory completion of contractual obligations and timely receipt of an accurate invoice. The creditor days outstanding (based on the count back method) at 31 December 2011 was 29 days (2010: 24 days).

Environment

The Group's activities are primarily office based and as such the directors believe that there is no significant environmental impact arising from the Group's activities. No environmental performance indicators are therefore included within this report. The Group's environmental policy states: "We endeavour to recycle appropriate materials where possible and to efficiently use natural resources and energy supplies so as to minimise our environmental impact. We will comply with the relevant statutes and legislation. Furthermore employees are encouraged to be environmentally aware. Company cars are not provided."

Research and development

The development of computer software is an integral part of the Group's business and the Group continues to develop its core software in response to user demand, and particularly the changing IT security threat landscape, and changes in software technology. During the year the Group enhanced its existing products and developed new products. A capital investment of £1.1 million (2010: £367,000) was made during the year. Amortisation of £201,000 (2010: £270,000) was charged to the Statement of Comprehensive Income during the year.

Employees

The quality and commitment of the Group's employees has played a major role in the Group's business success. This has been demonstrated in many ways, including strong customer satisfaction, the development of new product offerings and the flexibility employees have shown in adapting to changing business requirements. The Group operates sales commission, incentive bonus plans and share option and incentive plans to provide incentives for achievements which add value to the business.

"Corero Network Security has brought just the right product (DDS) to market at just the right time."

Forbes, June 2011

Directors' Report continued

Charitable or political donations

A donation of £1,000 was made to a charity during the year (2010: £1,000). No political donations were made during the year.

Annual General Meeting

The AGM will be held at the offices of FinnCap Ltd, 60 New Broad Street, London, EC2M 1JJ, on 7 June 2012 at 10 a.m. The notice convening the meeting is on pages 69 to 72 together with details of the business to be considered and explanatory notes relating to each of the resolutions being proposed.

Auditors

In so far as each director is aware:

- there is no relevant audit information of which the Company's auditors are unaware; and
- the directors have taken all the steps that they ought to have taken to make themselves aware of any relevant audit information and to establish that the Company's auditors are aware of that information.

BDO LLP was appointed as auditor during the year and a resolution to re-appoint BDO LLP for the ensuing year will be proposed at the AGM.

By order of the Board

Duncan Swallow
Company Secretary
19 March 2012

Corporate Governance Report

As an AIM listed company, Corero is not required to comply with the Corporate Governance Code prepared by the Committee on Corporate Governance, appended to the Listing Rules of the FSA, however the Company has regard to the requirements of the Code and its activities in these areas are described below.

The Board

Corero recognises its responsibility to provide entrepreneurial and responsible leadership to the Group within a framework of prudent and effective controls (described below) allowing assessment and management of the key issues and risks impacting the business. The Board sets Corero's overall strategic direction, reviews management performance and ensures that the Group has the necessary financial and human resources in place to meet its objectives. The Board is satisfied that the necessary controls and resources exist within the Group to enable these responsibilities to be met.

Operational management of the Group is delegated to the Executive Director and Business unit heads who meet regularly to discuss such matters. These matters include product development and roadmap, sales, customer relationships and employee matters.

The Board of Directors comprises the Non-executive chairman, one executive director and two Non-executive directors whose Board and Committee responsibilities as at 31 December 2011 are set out below:

	Board	Audit	Remuneration
Jens Montanana	Chairman	Member	Chairman
Andrew Miller	Member		
Richard Last	Member	Chairman	Member
Edward Forwood	Member		

The composition of the Board of Directors is reviewed regularly. Appropriate training, briefings, and induction are available to all directors on appointment and subsequently as necessary, taking into account existing qualifications and experience.

Richard Last is considered to be independent. The Company plans in due course to appoint an additional independent Non-executive director.

Executive directors' normal retirement age is 60 and non-executive directors' normal retirement age is 65. One third of all directors are subject to annual reappointment by shareholders as well as any director appointed by the Board in the period since the last AGM. Richard Last and Stephen Graham (appointed 19 March 2012) will be offering themselves for re-election at the forthcoming AGM.

The Board of Directors meets on average once a quarter and additional meetings are held each year to review and approve the Group's strategy and financial plans for the coming year. Each director is provided with sufficient information to enable them to consider matters in good time for meetings and enable them to discharge their duties properly.

All directors have access to the advice and services of the Company Secretary. There is also a procedure in place for any director to take independent professional advice if necessary, at the Company's expense.

The Board also ensures that the principal goal of the Company is to create shareholder value, while having regard to other stakeholder interests and takes responsibility for setting the Company's values and standards.

There is a documented schedule of matters reserved for the Board, the most significant of which are:

- responsibility of the overall strategy and management of the Group;
- approval of strategic plans and budgets and any material changes to them;
- approval of the acquisition or disposal of subsidiaries and major investments, projects and contracts;
- oversight of the Group's operations ensuring competent and prudent management, sound planning and management of adequate accounting and other records;
- changes relating to the Group's capital structure;

Corporate Governance Report continued

- final approval of the annual and interim financial statements and accounting policies;
- approval of the dividend policy;
- ensuring an appropriate system of internal control and risk management is in place;
- approval of changes to the structure, size and composition of the Board;
- review of the management structure and senior management responsibilities;
- with the assistance of the Remuneration Committee, approval of remuneration policies across the Group;
- delegation of the Board's powers and authorities;
- consideration of the independence of the Non-executive Directors; and
- receiving reports on the views of the Company's shareholders.

In the year ended 31 December 2011 the Board received monthly briefings on the Group's performance (including detailed commentary and analysis), key issues and risks affecting the Group's business.

The Company maintains liability insurance for its directors and officers. The Company has also entered into indemnity agreements with the Directors, in terms of which the Company has indemnified its directors, subject to the Companies Act limitations, against any liability arising out of the exercise of the directors' powers, duties and responsibilities as a director or officer.

In the year ended 31 December 2011 the Board met on five scheduled occasions; further meetings and conference calls are held as and when necessary. Details of Directors' attendance at scheduled meetings during the year are set out in the table below:

	Meetings attended
Jens Montanana	5/5
Andrew Miller	5/5
Richard Last	5/5
Edward Forwood (appointed 29 June 2011)	3/3
Peter Waller (resigned 4 February 2011)	1/1
Bernard Snowe (resigned 30 June 2011)	3/3

Board Committees

The Company has an Audit Committee and Remuneration Committee, details of which are set out below.

Audit Committee

The audit committee members comprise Richard Last, who is the committee chairman, and Jens Montanana, and meets twice a year. The Group Financial Controller, Chief Operating Officer and the Company's external auditors attend the meetings. The audit committee considers the adequacy and effectiveness of the risk management and control systems of the Group. It reviews the scope and results of the external audit, its cost effectiveness and the objectivity of the auditors. It also reviews, prior to publication, the interims, preliminary announcement, the annual financial statements and the other information included in the annual report.

The Audit Committee met twice in the year ended 31 December 2011. The attendance of individual Committee members at Audit Committee meetings in the year to 31 December 2011 is shown in the table below:

	Meetings attended
Richard Last	2/2
Jens Montanana	2/2

Remuneration Committee

The Remuneration Committee comprises Jens Montanana, who is the committee chairman, and Richard Last. It meets at least twice a year and reviews and advises upon the remuneration and benefits packages of the executive directors. The remuneration of the chairman and non-executive directors is decided upon by the Board of Directors.

The Remuneration Committee met six times in the year ended 31 December 2011. The attendance of individual Committee members at Remuneration Committee meetings in the year to 31 December 2011 is shown in the table below:

	Meetings attended
Jens Montanana	6/6
Richard Last	6/6

Nominations Committee

Due to the size of the Board of Directors, the directors do not consider there to be any need for a nominations committee. Issues that would normally be dealt with by a nominations committee are handled by the Board of Directors. The Board of Directors will review the need for a nominations committee on a regular basis.

Internal controls

The directors are responsible for the Group's system of internal control and for reviewing its effectiveness whilst the role of management is to implement policies on risk management and control. The Group's system of internal control is designed to manage, rather than eliminate, the risk of failure to achieve the Group's business objectives and can only provide reasonable, and not absolute, assurance against material misstatement or loss.

The Board continually reviews the effectiveness of other internal controls, including financial, operational, compliance controls and risk management.

The Group operates a risk management process, which is embedded in normal management and governance processes. As part of the annual strategic planning and budgeting process, each business unit documents the significant risks identified, the probability of those risks occurring, their potential impact and the plans for managing and mitigating each of those risks.

The Group operates a series of controls to meet its needs. These controls include, but are not limited to, the annual strategic planning and budgeting process, a clearly defined organisational structure with authorisation limits, reviews by senior management of monthly financial and operating information including comparisons with budgets, monthly treasury and cash flow reports and forecasts to the Board.

The Audit Committee receives reports from management and observations from the external auditors concerning the system of internal control and any material control weaknesses. Significant risk issues, if any, are referred to the Board of Directors for consideration.

The Board of Directors makes an annual assessment of the effectiveness of the Group's internal control system, including financial, operational and compliance controls, before making this statement. The Board of Directors also considers issues included in reports received during the year, how the risks have changed during the year and reviews reports on internal controls from management and any issues identified by external auditors.

Corporate Governance Report continued

The Board of Directors does not believe it is currently appropriate to establish a separate, independent internal audit function given the size of the Group.

Remuneration report

The Remuneration Committee's principal function is to set remuneration of the Group's executive directors and business unit heads to ensure they are fairly compensated.

Basic salaries are set to ensure high quality executive directors and management are attracted and retained by the Group. They reflect the knowledge, skill and experience of each individual director. Bonuses are non-pensionable and only payable if the Remuneration Committee assesses the director's achievements as worthy of the award.

The Remuneration Committee is also responsible for ensuring the Group's share option schemes are operated properly. Details of directors' share options at 31 December 2011 are disclosed in note 33 of the Financial Statements.

Details of directors' remuneration for the year ended 31 December 2011 are set out in note 30 of the Financial Statements. Jens Montanana has elected to waive the fees payable to him for the financial years ended 31 December 2010 and 2011.

None of the Non-executive Directors has a service agreement. Letters of appointment for Jens Montanana and Richard Last are for 12 month terms and provide that the appointment may be terminated by either party giving to the other not less than three months notice. Stephen Graham's appointment is governed by the Relationship Agreement.

Statement of Directors Responsibilities

The directors are responsible for preparing the Annual Report and 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 Group and Company financial statements in accordance with International Financial Reporting Standards as adopted by the European Union (IFRSs). Under company law the directors must not approve the financial statements unless they give a true and fair view of the state of affairs of the Group and parent company and of the profit or loss of the Group for that period. The directors' are also required to prepare financial statements in accordance with the rules of the London Stock Exchange for companies trading securities on the AIM. In preparing these financial statements, the directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and estimates that are reasonable and prudent;
- state whether applicable IFRSs 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 Group will continue in business.

The directors are responsible for keeping adequate accounting records that are sufficient to show and explain the Group's transactions and disclose with reasonable accuracy at any time the financial position of the Group 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 Group and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

The directors are responsible for ensuring the annual report and the financial statements are made available on a website. Financial statements are published on the Company's website in accordance with legislation in the United Kingdom governing the preparation and dissemination of financial statements, which may vary from legislation in other jurisdictions. The maintenance and integrity of the Company's website is the responsibility of the directors. The directors' responsibility also extends to the ongoing integrity of the financial statements contained therein.

Independent Auditor's Report

to the members of Corero Network Security plc

We have audited the financial statements of Corero Network Security plc for the year ended 31 December 2011 which comprise the consolidated statement of comprehensive income, the consolidated and company statements of financial position, consolidated statement of cash flows, the consolidated statement of changes in equity and the related notes. The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union and, as regards the parent company financial statements, as applied in accordance with the provisions of the Companies Act 2006.

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 auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the company and the company's members as a body, for our audit work, for this report, or for the opinions we have formed.

Respective responsibilities of directors and auditors

As explained more fully in the statement of directors' responsibilities, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit and express an opinion on the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's (APB's) Ethical Standards for Auditors.

Scope of the audit of the financial statements

A description of the scope of an audit of financial statements is provided on the APB's website at www.frc.org.uk/apb/scope/private.cfm.

Opinion on financial statements

In our opinion:

- the financial statements give a true and fair view of the state of the group's and the parent company's affairs as at 31 December 2011 and of the group's loss for the year then ended;
- the group financial statements have been properly prepared in accordance with IFRSs as adopted by the European Union;
- the parent company financial statements have been properly prepared in accordance with IFRSs as adopted by the European Union and as applied in accordance with the provisions of the Companies Act 2006; and
- the financial statements have been prepared in accordance with the requirements of the Companies Act 2006.

Opinion on other matters 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.

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 by the parent company, or returns adequate for our audit have not been received from branches not visited by us; or
- the parent company 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.

Gary Hanson (senior statutory auditor)
For and on behalf of BDO LLP, statutory auditor
Cambridge
19 March 2012

BDO LLP is a limited liability partnership registered in England and Wales (with registered number OC305127).

Consolidated Statement of Comprehensive Income

for the year ended 31 December 2011

	Note	Existing continuing 2011 £'000	Acquired 2011 £'000	Continuing total 2011 £'000	Total 2010(1) £'000
Revenue		4,393	6,872	11,265	3,020
Cost of sales		(857)	(1,699)	(2,556)	(593)
Gross profit		3,536	5,173	8,709	2,427
Operating expenses before highlighted items		(2,699)	(5,723)	(8,422)	(2,094)
– Depreciation and amortisation of intangible assets	15,16,17	(219)	(730)	(949)	(198)
– Acquisition and restructuring costs		(306)	(297)	(603)	(60)
Operating expenses		(3,224)	(6,750)	(9,974)	(2,352)
Operating profit/(loss)		312	(1,577)	(1,265)	75
Finance income	6	61	–	61	32
Finance costs	7	–	(224)	(224)	(199)
Profit/(loss) before taxation		373	(1,801)	(1,428)	(92)
Taxation	9	–	192	192	–
Profit/(loss) for the year from continuing/acquired operations		373	(1,609)	(1,236)	(92)
Profit from discontinued operations	10	–	–	–	4
Profit from sale of discontinued operations	10	–	–	–	492
Profit/(loss) for the year		373	(1,609)	(1,236)	404
Total profit/(loss) for the year attributable to:					
Equity holders of the parent		345	(1,609)	(1,264)	404
Non-controlling interest		28	–	28	–
		373	(1,609)	(1,236)	404
Other comprehensive income					
Difference on translation of foreign subsidiary		–	25	25	–
Total comprehensive income/(expense) for the year		373	(1,584)	(1,211)	404
Total comprehensive income/(expense) for the year attributable to:					
Equity holders of the parent		345	(1,584)	(1,239)	404
Non-controlling interest		28	–	28	–
Total		373	(1,584)	(1,211)	404

(1) restated for change in cost of sales accounting policy as set out in note 13.

There were no acquisitions in 2010.

Basic and diluted (loss)/earnings per share	Note	2011 Pence	2010 Pence
Basic loss per share from continuing and acquired operations		(2.75)	(0.68)
Basic earnings per share from discontinued operations		–	3.67
Basic (loss)/earnings per share	12	(2.75)	2.99
Diluted loss per share from continuing and acquired operations		(2.58)	(0.62)
Diluted earnings from discontinued operations		–	3.35
Diluted (loss)/earnings per share	12	(2.58)	2.73

In the previous year the diluted earnings per share figure was omitted from the approved financial statements in error. As a result this has been calculated and included within the financial statements this year. There was no difference between basic and diluted earnings per share for the year ended 31 December 2009.

The notes on pages 32 to 68 form part of these financial statements.

Consolidated Statement of Financial Position

as at 31 December 2011

	Note	Group 2011 £'000	Group 2010 £'000	Company 2011 £'000	Company 2010 £'000
Assets					
Non-current assets					
Goodwill	14	12,144	509	–	–
Acquired intangible assets	15	3,008	5	–	–
Capitalised development expenditure	16	1,484	591	–	–
Property, plant and equipment	17	655	36	–	–
Investments in subsidiaries	18	–	–	11,787	411
		17,291	1,141	11,787	411
Current assets					
Inventories	19	241	–	–	–
Trade and other receivables – due in less than one year	20	3,266	818	2	64
Trade and other receivables – due in more than one year	20	158	2	3,977	2,844
Cash and cash equivalents		4,312	7,186	3,043	6,345
		7,977	8,006	7,022	9,253
Liabilities					
Current Liabilities					
Trade and other payables	21	(2,824)	(735)	–	(2)
Borrowings	22	(176)	–	–	–
Deferred income	24	(5,416)	(1,485)	–	–
Provisions		–	(4)	–	–
		(8,416)	(2,224)	–	(2)
Net current (liabilities)/assets		(439)	5,782	7,022	9,251
Non-current liabilities					
Borrowings	22	(3,557)	–	–	–
Deferred income	24	(808)	–	–	–
Deferred taxation	25	(1,012)	–	–	–
		(5,377)	–	–	–
Net assets		11,475	6,923	18,809	9,662
Equity					
Ordinary share capital	27	477	319	477	319
Deferred share capital	27	4,542	4,542	4,542	4,542
Shares to be issued	28	80	–	80	–
Share premium	29	19,846	14,341	19,846	14,341
Merger reserve		–	1,023	–	1,023
Share options reserve		166	146	166	146
Non-controlling interest		28	–	–	–
Translation reserve		25	–	–	–
Retained earnings		(13,689)	(13,448)	(6,302)	(10,709)
Total surplus attributable to equity holders of the parent		11,475	6,923	18,809	9,662

These financial statements were approved by the Board of Directors on 19 March 2012 and signed on their behalf.

Andrew Miller

Director

The notes on pages 32 to 68 form part of these financial statements.

Consolidated Statement of Cash Flows

for the year ended 31 December 2011

		Group		Company	
		2011	2010	2011	2010
Cash flows from operating activities	Note	£'000	£'000	£'000	£'000
Continuing operations					
(Loss)/profit before taxation		(1,428)	(92)	3,384	65
Adjustments for:					
Amortisation of acquired intangible assets	15	576	7	–	–
Amortisation of capitalised development expenditure	16	201	168	–	–
Depreciation	17	172	22	–	–
Finance income	6	(61)	(32)	(94)	(26)
Finance expense	7	224	199	–	199
Decrease in provisions		(4)	(8)	–	–
Share based payment charge	33	20	131	20	131
Changes in working capital					
Increase in inventories		(94)	–	–	–
(Increase)/decrease in trade and other receivables		(1,729)	(344)	(216)	323
Increase/(decrease) in payables		1,192	424	(3,596)	(692)
Cash (used)/generated from continuing operations		(931)	475	(502)	–
Net cash from discontinued operations	10	–	293	–	–
Net cash from operating activities		(931)	768	(502)	–
Cash flows from investing activities					
Acquisition of subsidiaries, net of cash acquired	35	(2,283)	–	(2,413)	–
Purchase of intangible assets	15	(38)	–	–	–
Capitalised development expenditure	16	(1,094)	(367)	–	–
Purchase of property, plant and equipment	17	(629)	(24)	–	–
Repayments from subsidiaries		–	–	1,314	–
Payments made to subsidiaries		–	–	(3,851)	(64)
Net cash used in investing activities		(4,044)	(391)	(4,950)	(64)
Cash flows from financing activities					
Net proceeds from issue of ordinary share capital		2,089	6,383	2,089	6,383
Term loan received		162	–	–	–
Finance income	6	61	32	61	26
Finance expense		(10)	(292)	–	–
Capital element of finance lease repayments		(14)	–	–	–
Repayment of credit facility		(187)	–	–	–
Net cash from financing activities		2,101	6,123	2,150	6,409
Net (decrease)/increase in cash and cash equivalents		(2,874)	6,500	(3,302)	6,345
Cash and cash equivalents at 1 January		7,186	686	6,345	–
Cash and cash equivalents at 31 December		4,312	7,186	3,043	6,345

Significant non-cash transactions

a) The conversion of 50% of the convertible unsecured loan stock to equity
b) Disposal proceeds of the sale of the Financial Markets division (note 10)
c) Part of the purchase consideration for the acquisition of Top Layer Networks, Inc (note 35)

The notes on pages 32 to 68 form part of these financial statements.

Consolidated Statement of Changes in Equity

for the year ended 31 December 2011

Group	Ordinary and deferred share capital £'000	Shares to be issued £'000	Share premium account £'000	Merger reserve £'000	Share options reserve £'000	CULS equity reserve £'000	Non-controlling interest £'000	Translation reserve £'000	Profit and loss reserve £'000	Total £'000
1 January 2010	4,557	–	6,369	1,023	14	146	–	–	(13,898)	(1,789)
Share based payments	–	–	–	–	132	–	–	–	–	132
Redemption of CULS	–	–	–	–	–	(146)	–	–	146	–
CULS fair value adjustments	–	–	–	–	–	–	–	–	567	567
Issue of share capital	304	–	7,972	–	–	–	–	–	(667)	7,609
Profit for year ended 31 December 2010	–	–	–	–	–	–	–	–	404	404
31 December 2010	4,861	–	14,341	1,023	146	–	–	–	(13,448)	6,923
Share based payments	–	–	–	–	20	–	–	–	–	20
Issue of share capital	158	–	5,505	–	–	–	–	–	–	5,663
Merger reserve transfer	–	–	–	(1,023)	–	–	–	–	1,023	–
Shares to be issued	–	80	–	–	–	–	–	–	–	80
Other comprehensive income	–	–	–	–	–	–	–	25	–	25
Loss for the year ended 31 December 2011	–	–	–	–	–	–	28	–	(1,264)	(1,236)
31 December 2011	5,019	80	19,846	–	166	–	28	25	(13,689)	11,475

Company	Ordinary and deferred share capital £'000	Shares to be issued £'000	Share premium account £'000	Merger reserve £'000	Share options reserve £'000	CULS equity reserve £'000	Profit and loss reserve £'000	Total £'000
1 January 2010	4,557	–	6,369	1,023	14	146	(10,953)	1,156
Share based payments	–	–	–	–	132	–	–	132
Redemption of CULS	–	–	–	–	–	(146)	146	–
CULS fair value adjustments	–	–	–	–	–	–	567	567
Issue of share capital	304	–	7,972	–	–	–	(667)	7,609
Profit for year ended 31 December 2010	–	–	–	–	–	–	198	198
31 December 2010	4,861	–	14,341	1,023	146	–	(10,709)	9,662
Share based payments	–	–	–	–	20	–	–	20
Issue of share capital	158	–	5,505	–	–	–	–	5,663
Merger reserve transfer	–	–	–	(1,023)	–	–	1,023	–
Shares to be issued	–	80	–	–	–	–	–	80
Profit for the year ended 31 December 2011	–	–	–	–	–	–	3,384	3,384
31 December 2011	5,019	80	19,846	–	166	–	(6,302)	18,809

The notes on pages 32 to 68 form part of these financial statements.

Notes to the Financial Statements

1. General information

These consolidated financial statements are presented in pounds sterling, which represents the functional currency of the parent and each of its UK subsidiaries.

Corero Network Security plc is a public limited company incorporated in the United Kingdom under the Companies Act 2006.

2. Significant accounting policies

2.1 Basis of preparation

The Group and parent Company financial statements have been prepared in accordance with EU endorsed International Financial Reporting Standards (IFRS), International Financial Reporting Interpretations Committee (IFRIC) interpretations and those parts of the Companies Act 2006 applicable to companies reporting under IFRS.

The Group and parent Company financial statements have been prepared under the historical cost convention. A summary of the significant Group accounting policies adopted in the preparation of the financial statements is set out below.

The preparation of financial statements which comply with IFRS requires the use of estimates and assumptions, and for management to exercise its judgement in the process of applying the Group's accounting policies. Critical judgements and key estimates and assumptions are disclosed in note 3.

2.2 Going Concern

The financial statements have been prepared on a going concern basis. The Group was loss making and used cash in operating activities during the year.

The directors have prepared detailed income statement, balance sheet and cash flow projections for the period to 31 December 2013. The cash flow projections have been subjected to sensitivity analysis at the revenue, cost and combined revenue and cost levels. The cash flow projections show that the Group will maintain a positive cash balance until at least 31 December 2013.

As a result, the directors are of the opinion that the Group has adequate working capital to continue as a going concern for the foreseeable future and, in particular, for a period of at least 12 months from the date of approval of these financial statements.

2.3 Basis of consolidation

The consolidated financial statements incorporate the results, assets, liabilities and cash flows of the Company and each of its subsidiaries for the financial year ended 31 December 2011, or for the period from the date on which control of the subsidiary was obtained to 31 December 2011 in the case of the subsidiaries acquired during the year.

Subsidiaries are entities controlled by the Group. Control is deemed to exist when the Group has the power, directly or indirectly, to govern the financial and operating policies of an entity so as to obtain benefits from its activities. The results, assets, liabilities and cash flows of subsidiaries are included in the consolidated financial statements from the date control commences until the date that control ceases.

Where necessary, adjustments are made to the financial statements of subsidiaries to bring the accounting policies used into line with those used by the Group.

Intra-group balances and transactions are eliminated on consolidation.

2.4 Business combinations

The acquisition method is used to account for all acquisitions. The cost of an acquisition is measured at the fair values, on the date of exchange, of assets given, liabilities incurred or assumed, and equity instruments issued.

At the date of acquisition, the identifiable assets and liabilities and contingent liabilities of a subsidiary are measured at their fair values. Any excess of the cost of acquisition over the fair values of the identifiable net assets acquired is recognised as goodwill.

Non-controlling interests are initially recognized at their fair value. The total comprehensive income of non-wholly owned subsidiaries is attributed to owners of the parent and to the non-controlling interests in proportion to their relative ownership interests.

2.5 Revenue

Revenue is measured at the fair value of the consideration received or receivable and represents the amounts receivable for services provided in the normal course of business, net of all related discounts and sales tax.

The Group has adopted the following policy in respect of revenue recognition:

1. Software Products

Revenue results mainly from the sale of licences, which provide customers with the right to use these products. Such revenue is recognised on the following basis:

i. If an arrangement to deliver software or a software system, either alone or together with other products or services, requires significant production, modification, or customisation, the revenue for both services and software is recognised under the percentage of completion method.

ii. If services are essential to the functionality of the software and the payment terms are linked, the revenue for both software and services is recognised when the following conditions are met:

- A signed contract exists;
- Delivery has occurred;
- The sales price is fixed and determinable;
- Collection of the debt is probable; and
- No significant obligations remain.

iii. If services are incidental to the functionality and/or the payment terms are linked to installations, revenue from the grant of perpetual or fixed term licences to use Corero's software is recognised when the above conditions are met and services revenue is recognised separately as the services are provided. Where services are not incidental to the functionality, licence revenues are recorded as agreed project milestones are achieved.

Software rentals or licences invoiced on a periodic basis are recognised at the start of the term of the agreement.

2. Hardware and Software Products
When a sales arrangement contains multiple elements, such as hardware and software products, licenses and/or services, the Group allocates revenue to each element based on a selling price hierarchy, having evaluated each deliverable in an arrangement to determine whether they represent separate units of accounting. A deliverable constitutes a separate unit of accounting when it has standalone value.

The selling price for a deliverable is based on its vendor specific objective evidence ("VSOE") if available, third party evidence ("TPE") if VSOE is not available, or best estimated selling price ("BESP") if neither VSOE nor TPE is available. In multiple element arrangements where more-than-incidental software deliverables are included, revenue is allocated to each separate unit, accounting for each of the non-software deliverables and to the software deliverables as a group using the relative selling prices of each of the deliverables in the arrangement based on the aforementioned selling price hierarchy.

The Group establishes the VSOE of selling price using the price charged for a deliverable when sold separately. The TPE of selling price is established by evaluating similar and interchangeable competitor products or services in standalone sales to similarly situated customers. The best estimate of selling price is established considering both internal and external factors such as pricing practices, customer pricing strategies, margin objectives, market conditions, competitor pricing strategies, and industry technology lifecycles.

3. Consulting and Professional Services
Revenue from the provision of consultancy and professional services is recognised as the work is performed.

4. Support income is recognised on a straight line basis over the life of the agreement.

5. Interest income is accrued on a time basis using the effective interest method.

2.6 Cost of sales

Cost of sales includes all direct costs associated with revenue generation, including services delivery, support costs and amounts charged by external third parties for services and goods directly related to revenue. Examples of such costs would include, but not be limited to, external consultants and third party hardware and software costs (details of the change made to the treatment of certain costs are presented in note 13).

2.7 Foreign currencies

Transactions in foreign currencies are translated at the exchange rate ruling at the date of each transaction. Foreign currency monetary assets and liabilities are retranslated using the exchange rates at the reporting date. Gains and losses arising from changes in exchange rates after the date of the transaction are recognised in profit or loss in the Statement of Comprehensive Income.

Non-monetary assets and liabilities that are measured in terms of historical cost in a foreign currency are translated at the exchange rate at the date of the original transaction.

In the consolidated financial statements, the net assets of the Group's foreign operations are translated at the exchange rate at the reporting date. Income and expense items are translated at the average exchange rates for the period. The resulting exchange differences are recognised in translation difference on translation of foreign subsidiary and included in the translation reserve. Such translation differences are recognised in profit or loss on the disposal of the foreign operation.

2.8 Goodwill

Goodwill on acquisition of subsidiaries represents the excess of the cost of an acquisition over the fair value of the Group's share of the identifiable net assets of the acquired subsidiary. Goodwill is not amortised, but tested at least annually for impairment, and carried at cost less accumulated impairment losses. Impairment losses are immediately recognised in the Statement of Comprehensive Income and are not subsequently reversed.

2.9 Intangible assets

Internally generated intangible assets
The Group's internally generated intangible asset relates to its development expenditure.

Development expenditure is capitalised only when it is probable that future economic benefit will result from the project and the following criteria are met:

- The technical feasibility of the product has been ascertained;
- Adequate, technical, financial and other resources are available to complete and sell or use the intangible asset;
- The Group can demonstrate how the intangible asset will generate future economic benefits and the ability to use or sell the intangible asset can be demonstrated;
- It is the intention of management to complete the intangible asset and use it or sell it; and
- The development costs can be measured reliably.

Notes to the Financial Statements continued

2. Significant accounting policies continued

2.9 Intangible assets continued

Expenditure not meeting these criteria is expensed in the Statement of Comprehensive Income.

After initial recognition, internally generated intangible assets are carried at cost less accumulated amortisation and any impairment losses.

Acquired intangible assets

Purchased computer software is carried at cost less accumulated amortisation and any impairment losses.

Customer contracts and the related customer relationships are carried at cost less accumulated amortisation and any impairment losses.

Identifiable intangible assets acquired as part of a business combination are initially recognised separately from goodwill, irrespective of whether the assets have been recognised by the acquiree before the business combination. An intangible asset is considered identifiable only if it is separable or if it arises from contractual or other legal rights, regardless of whether those rights are transferable or separable from the entity or from other rights and obligations.

Intangible assets acquired as part of a business combination and recognised by the Group are computer software, customer contracts and the related customer relationships.

After initial recognition, assets acquired as part of a business combination are carried at cost less accumulated amortisation and any impairment losses.

Amortisation

Intangible assets are amortised on a straight line basis, to reduce their carrying value to their residual value, over their estimated useful lives. The following useful lives were applied during the year:

Computer software acquired –
3 or 5 years straight line

Customer contracts and the related customer relationships –
7 years straight line

Capitalised development expenditure –
5 years straight line

Amortisation costs are included within operating expenses in the Statement of Comprehensive Income.

Methods of amortisation, residual values and useful lives are reviewed, and if necessary adjusted, at each reporting date.

2.10 Property, plant and equipment

Property, plant and equipment is stated at cost less accumulated depreciation and any impairment losses. Cost comprises the purchase cost of property, plant and equipment together with any directly attributable costs.

Subsequent costs are included in an asset's carrying value or are recognised as a separate asset when it is probable that future economic benefits associated with the additional expenditure will flow to the Group and the cost of the item can be measured reliably. All other costs are charged to the Statement of Comprehensive Income as incurred.

Depreciation commences when an asset is available for use. Depreciation is calculated so as to write off the cost or value of an asset, net of anticipated disposal proceeds, over the useful life of that asset as follows:

Leasehold improvements –
Period of the lease straight line

Computer equipment –
2 to 4 years straight line

Fixtures and fittings –
2 to 5 years straight line

Office equipment –
3 to 5 years straight line

Methods of depreciation, residual values and useful lives are reviewed, and if necessary adjusted, at each balance sheet date.

The gain or loss arising from the disposal or retirement of an item of property, plant and equipment is determined as the difference between the net disposal proceeds and the carrying amount of the item, and is included in the Statement of Comprehensive Income.

2.11 Inventory

Inventory is stated at the lower of cost or net realisable value. Cost is computed using standard cost, which approximates actual cost, on a first-in, first-out basis. Rapid technological change and new product introductions and enhancements could result in excess or obsolete inventory. To minimise this risk, the Group evaluates inventory levels and expected usage on a periodic basis and records valuation allowances as required.

2.12 Impairment

At each reporting date, the Group assesses whether there is any indication that its assets have been impaired. If any such indication exists, the recoverable amount of the asset is estimated in order to determine the extent of any impairment. If it is not possible to estimate the recoverable amount of the individual asset, the recoverable amount of the cash-generating unit to which the asset belongs is determined.

The recoverable amount of an asset or a cash-generating unit is the higher of its fair value less costs to sell and its value in use. The value in use is the present value of the future cash flows expected to be derived from an asset or cash-generating unit. This present value is discounted using a pre-tax rate that reflects current market assessments of the time value of money and of the risks specific to the asset for which future cash flow estimates have not been adjusted. If the recoverable amount of an asset is less than its carrying amount, the carrying amount of the asset is reduced to its recoverable amount. That reduction is recognised as an impairment loss.

An impairment loss relating to assets carried at cost less any accumulated depreciation or amortisation is recognised immediately in the Statement of Comprehensive Income.

Goodwill acquired in a business combination is, from the acquisition date, allocated to each of the cash-generating units or groups of cash-generating units that are expected to benefit from the synergies of the combination.

Goodwill is tested for impairment at least annually, and whenever there is an indication that the asset may be impaired.

An impairment loss is recognised for cash-generating units if the recoverable amount of the unit is less than the carrying amount of the unit. The impairment loss is allocated to reduce the carrying amount of the assets of the unit by first reducing the carrying amount of any goodwill allocated to the cash-generating unit, and then reducing the carrying amounts of the other assets of the unit pro rata.

If an impairment loss subsequently reverses, the carrying amount of the asset is increased to the revised estimate of its recoverable amount but limited to the carrying amount that would have been determined had no impairment loss been recognised in prior years. A reversal of an impairment loss is recognised in the Statement of Comprehensive Income. Impairment losses on goodwill are not subsequently reversed.

2.13 Borrowing costs

All borrowing costs directly attributable to a qualifying asset are capitalised as part of the cost of the asset.

2.14 Leases

Where substantially all of the risks and rewards incidental to ownership of a leased asset are transferred to the Company (a “finance lease”), the asset is treated as if it had been purchased outright. The amount initially recognised as an asset is the lower of the fair value of the leased property and the present value of the minimum lease payments payable over the term of the lease. The corresponding lease commitment is shown as a liability. Lease payments are analysed between capital and interest. The interest element is charged to the Statement of Comprehensive Income over the period of the lease and is calculated so that it represents a constant proportion of the lease liability. The capital element reduces the balance owed to the lessor.

Where substantially all of the risks and rewards incidental to ownership are not transferred to the Company (an “operating lease”), the total rentals payable under the lease are charged to the Statement of Comprehensive Income on a straight-line basis over the lease term. The aggregate benefit of lease incentives is recognised as a reduction of the rental expense over the lease term on a straight-line basis.

2.15 Investments in subsidiaries

In the Company’s separate financial statements, investments in subsidiaries are carried at cost less any impairment provisions.

2.16 Taxation

The tax expense represents the sum of current tax and deferred tax.

Current tax

Current tax is based on taxable profit for the year and is calculated using tax rates enacted or substantively enacted at the reporting date. Taxable profit differs from accounting profit either because items are taxable or deductible in periods different to those in which they are recognised in the financial statements, or because they are never taxable or deductible.

Deferred tax

Deferred tax on temporary differences at the reporting date between the tax bases of assets and liabilities and their carrying amounts for financial reporting purposes is accounted for using the balance sheet liability method.

Using the balance sheet liability method, deferred tax liabilities are recognised in full for all taxable temporary differences and deferred tax assets are recognised to the extent that it is probable that taxable profits will be available against which deductible temporary differences can be utilised. However, if the temporary difference arises from the initial recognition of goodwill or the initial recognition of an asset or liability in a transaction other than a business combination, that at the time of the transaction affects neither accounting nor taxable profit, it is not recognised as deferred tax asset or liability.

Deferred taxation is measured at the tax rates that are expected to apply when the asset is realised, or the liability settled, based on tax rates and laws enacted or substantively enacted at the reporting date.

2.17 Provisions

A provision is recognised when, as a result of a past event, the Group has a legal or constructive obligation, it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation and a reliable estimate of the amount of such an obligation can be made.

Provisions are measured at the best estimate of the expenditure required to settle the obligation at the reporting date. When the effect is material, the expected future cash flows required to settle the obligation are discounted at the pre-tax rate that reflects the current market assessments of the time value of money and the risks specific to the obligation.

2.18 Post-retirement benefits

The Group operates defined contribution group personal pension plans under which it is required to pay fixed contributions to separate funds controlled by trustees. Contributions to the schemes are based on a proportion of the employees’ earnings and are charged to the Statement of Comprehensive Income when incurred.

The Group has no obligation to the scheme beyond these contributions.

Notes to the Financial Statements continued

2. Significant accounting policies continued

2.19 Financial instruments

The Group classifies financial instruments, or their component parts, on initial recognition as a financial asset, a financial liability or an equity instrument in accordance with the substance of the contractual arrangement.

Financial assets and financial liabilities are recognised in the Group's statement of financial position when the Group becomes party to the contractual provisions of the instrument.

The particular recognition and measurement methods adopted for the Group's financial instruments are disclosed below:

Trade and other receivables

Trade and other receivables are stated at their fair value at time of initial recognition, reflecting where material the time value of money. A provision for impairment of trade receivables is established when there is evidence that the Group will not be able to collect all amounts due according to the original terms of these receivables. The amount of the provision is the difference between the carrying value and the present value of estimated future cash flows, discounted at the original effective interest rate.

Cash and cash equivalents

Cash and cash equivalents include cash in hand, deposits on call with banks and bank overdrafts. Bank overdrafts are disclosed as current borrowings in the statement of financial position.

Trade and other payables

Trade and other payables are not interest bearing and are stated at their fair value at time of initial recognition. Thereafter they are accounted for at amortised cost.

Fair value determination

Whenever available, the fair value of a financial instrument is derived from quoted prices in an active market. For assets held, fair value is the bid price and for liabilities held it is the asking price. If there is no active market, fair value is established by using a valuation technique. Valuation techniques include the use of information from recent arm's length market transactions between knowledgeable, willing parties, if available, reference to the current fair value of similar instruments and discounted cash flow analysis. The valuation technique used incorporates all factors that market participants would consider in setting a price and is consistent with accepted economic methodologies for pricing financial instruments.

2.20 Equity instruments

An equity instrument is any contract that evidences a residual interest in the assets of the Company after deducting all its liabilities. Equity instruments issued by the Company are recorded at the proceeds received, net of directly attributable issue cost.

2.21 Employee share option schemes

The Group operates an equity-settled share-based compensation plan. The fair value of the employees' services received in exchange for the grant of share options is measured at grant date and recognised as an expense on a straight line basis over the vesting period, based on the Group's estimate of shares that will eventually vest. Fair value is determined by reference to the Black Scholes option pricing model.

At each reporting date, the Group revises its estimate of the number of options that are expected to become exercisable.

When share options are exercised, the proceeds received, net of any transaction costs, are credited to share capital (nominal value) and share premium.

2.22 Discontinued operations

A discontinued operation is a component of the Group that has been disposed of and represents a separate major line of business or geographical area of operations.

The amounts presented in the Statement of Comprehensive Income comprise the post-tax profit of discontinued operations and the post-tax gain resulting from the disposal of the assets of discontinued operations. These amounts are further analysed in note 10.

The disclosures for discontinued operations in the prior year relate to all operations that have been discontinued by the reporting date for the latest period presented.

2.23 Invoice discounting

The group makes use of an invoice discounting facility to fund certain of its operations. Trade receivables are recognised as the Group retains the significant risks and benefits. The related funding is shown as a financial liability and accounted for on an amortised cost basis.

2.24 Standards and Interpretations not yet effective

At the date of authorisation of these financial statements, certain new standards, amendments and interpretations to existing standards have been published but are not yet effective, and have not been adopted early by the Group.

Management anticipates that all of the relevant pronouncements will be adopted in the Group's accounting policies for the first period beginning after the effective date of the pronouncement and EU adoption. Information on new standards, amendments and interpretations that are expected to be relevant to the Group's Financial Statements is provided below. Certain other new standards and interpretations have been issued but are not expected to have a material impact on the Group's financial statements.

Standards, amendments or interpretations issue but not yet effective.

Disclosures – Transfers of Financial Assets (Amendments to IFRS 7)

Deferred Tax – Recovery of Underlying Assets (Amendments to IAS 12)

Presentation of Items of Other Comprehensive Income (Amendments to IAS 1)

IFRS 10 Consolidated Financial Statements

IFRS 11 Joint Arrangements

IFRS 12 Disclosure of Interests in Other Entities

FRS 13 Fair Value Measurement

IAS 27 Separate Financial Statements

IAS 28 Investments in Associates and Joint Ventures

Disclosure – Offsetting Financial Assets and Financial Liabilities (Amendments to IFRS 7)

Offsetting Financial Assets and Financial Liabilities (Amendments to IAS 32)

IFRS 9 Financial Instruments

Standards, amendments or interpretations adopted during the year that do not have a material effect on the Group's financial statements

Classification of Rights Issues (Amendment to IAS 32)

IFRIC 19 Extinguishing Financial Liabilities with Equity Instruments

Revised IAS 24 Related Party Disclosures

Improvements to IFRSs (2010)

3. Critical accounting judgements and key sources of estimation uncertainty

3.1 Critical judgements in applying the Group's accounting policies

In the process of applying the Group accounting policies, the following judgements have had a significant effect on the amounts recognised in the financial statements:

Internally generated research and development costs

Management monitors progress of internal research and development projects. Judgement is required in distinguishing the research phase from the development phase. Development costs are recognised as an asset when all criteria are met, whereas research costs are expensed as incurred. Management monitors whether the recognition requirements for development costs continue to be met. This is necessary as the economic success of any product development is uncertain.

3.2 Key accounting estimates and assumptions

Key assumptions concerning the future and other key sources of estimation uncertainty that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year, are as follows:

Impairment of intangible assets and property, plant and equipment

The Group tests goodwill at least annually for impairment, and whenever there is an indication that the asset may be impaired. All other intangible assets and property, plant and equipment are tested for impairment when indicators of impairment exist. Impairment is determined with reference to the higher of fair value less costs to sell and value in use. Value in use is estimated using adjusted future cash flows. Significant assumptions are made in estimating future cash flows about future events including future market conditions and future growth rates. Changes in these assumptions could affect the outcome of impairment reviews.

Impairment of investments and intercompany balances (applies to the Company Financial Statements only)

The directors have reviewed the carrying value of the intercompany balances and cost of investments in subsidiaries of the Company with reference to current and future trading conditions. The provision recorded at 31 December 2010 in relation to the intercompany balance between the Company and Corero Business Systems Limited is now deemed recoverable based on the estimated market value of Corero Business Systems Limited and as result the provision has been released. The estimated market value has been calculated by reference to a multiple of the 2011 profit which the directors consider to be an appropriate valuation method.

The investment and intercompany balances between the Company and Corero Network Security, Inc and Corero Network Security (UK) Limited have been reviewed with reference to the Equity Value based on the discounted free cash flow used in conjunction with the goodwill impairment review.

Going Concern

The directors have reviewed the future profit and cash flow projections in conjunction with the current economic climate in order to express an opinion on the adequacy of working capital and the ability to continue as a going concern for the foreseeable future. The methodology and uncertainties contained in the projections are detailed in the note 2.2.

4. Financial risk management

Capital management

The Group monitors its available capital, which it considers to be all components of equity other than amounts reflecting non-controlling interests, against its expected requirements.

The Group's objectives when maintaining capital are to safeguard the entity's ability to continue as a going concern, so that it can continue to provide returns for shareholders and benefits for other stakeholders, and to ensure that sufficient funds can be raised for investing activities. In order to maintain or adjust the capital structure, the Group may return capital to shareholders, issue new shares, or sell assets to reduce debt. The Group does not review its capital requirements according to any specified targets or ratios.

Notes to the Financial Statements continued

4. Financial risk management continued

Treasury management

Group treasury policies are reviewed and approved by the Board. The objectives of Group treasury policies are to ensure that adequate financial resources are available for development of the business while at the same time managing financial risks. Financial instruments are used to reduce financial risk exposures arising from the Group's business activities and not for speculative purposes.

The Group's treasury activities are managed by the Group finance function under the direction of the Group Financial Controller. The Group Financial Controller reports to the Board on the implementation of Group treasury policy.

The Group's business activities expose it to a variety of financial risks that include:

- Liquidity risk;
- Credit risk;
- Cash flow interest rate risk;
- Currency risk; and
- Market risk.

The policies for managing these risks are described below:

Liquidity risk

Liquidity risk is the risk that arises from the Group's management of working capital and finance charges. It is the risk that the Group will encounter difficulty in meetings its financial obligations as they fall due. Liquidity risk is managed centrally by the finance function. Budgets are set locally and centrally, and agreed by the Board annually in advance, enabling the Group's cash flow requirements to be anticipated.

Credit risk

Credit risk arises from cash and cash equivalents and from credit exposures to the Group's customers including outstanding receivables and committed transactions. Credit risk is managed with regular reports of exposures reviewed by management. The Group does not set individual credit limits but will seek to ensure that customers enter into legally enforceable contracts that include settlement terms that demonstrate the customers' commitment to the transaction and minimise this risk exposure.

The amounts of trade receivables presented in the Statement of Financial Position are shown net of allowances for doubtful accounts estimated by management based on prior experience and their assessment of the current economic environment (note 20).

The credit risk on liquid funds and financial instruments is limited because the counterparties are banks with high credit ratings assigned by international credit rating agencies.

The Group has no significant concentration of credit risk, with exposure spread over a large number of customers.

Cash flow interest rate risk

The Group's policy is to minimise interest rate cash flow risk exposure on its financing. The majority of the Group's financing is held in fixed rate loans therefore no analysis of interest rate sensitivity is presented.

Currency risk

There is no material impact on the Group's Statement of Comprehensive Income from exchange rate movements, as foreign currency transactions are entered into by Group companies whose functional currency is aligned with the currencies in which it transacts.

Market risk

The fair values of cash and cash equivalents, receivables, payables and borrowings with a maturity of less than one year are assumed to approximate their book values.

5. Segment reporting

Business segments

The Group is managed according to two business units which make up the Group's two reportable operating segments: Corero Network Security and Corero Business Systems. These divisions are the basis on which the Group reports its primary segment information to the Board, which management consider to be the Chief Operating Decision maker for the purposes of IFRS 8 Operating Segments. The principal activity of Corero Network Security is the design, development and delivery of network security products. The principal activity of Corero Business Systems is the design, development and delivery of finance and management information software to the school, further education and commercial sectors.

In 2011, segment results, assets and liabilities include items directly attributable to a segment. The 2010 segment assets and liabilities include items directly attributable to a segment as well as those that can be allocated on a reasonable basis. Unallocated assets and liabilities comprise items such as cash and cash equivalents, taxation, VAT, PAYE, prepayments and borrowings. Central costs comprise mainly central and parent company overheads relating to the group management, the finance function and regulatory requirements.

None of the Group's customers require disclosure in accordance with IFRS 8 Operating Segments.

Continuing and acquired operations

	Reportable Operating Segments				Unallocated Items			
	Network Security		Business Systems		Central Costs		Total	
	2011 £'000	2010 £'000	2011 £'000	2010 £'000	2011 £'000	2010 £'000	2011 £'000	2010 £'000
Revenue to external customers								
Product and licence	3,042	–	1,233	556	–	–	4,275	556
Professional services	152	–	1,266	699	–	–	1,418	699
Support	3,678	–	1,894	1,765	–	–	5,572	1,765
Total	6,872	–	4,393	3,020	–	–	11,265	3,020
Cost of sales	(1,699)	–	(857)	(593)	–	–	(2,556)	(593)
Gross profit	5,173	–	3,536	2,427	–	–	8,709	2,427
Operating expenses	(5,723)	–	(1,947)	(1,406)	(732)	(557)	(8,402)	(1,963)
Share options charge	–	–	–	–	(20)	(131)	(20)	(131)
Operating (loss)/profit before depreciation, amortisation, acquisition and restructuring costs and financing	(550)	–	1,589	1,021	(752)	(688)	287	333
Depreciation	(146)	–	(22)	(26)	(4)	(5)	(172)	(31)
Amortisation of intangible assets	(584)	–	(193)	(167)	–	–	(777)	(167)
Operating (loss)/profit before acquisition and restructuring costs and financing	(1,280)	–	1,374	828	(756)	(693)	(662)	135
Acquisition and restructuring costs	(297)	–	–	–	(306)	(60)	(603)	(60)
(Loss)/profit before financing	(1,577)	–	1,374	828	(1,062)	(753)	(1,265)	75
Finance income	–	–	–	–	61	32	61	32
Finance costs	(224)	–	–	–	–	(199)	(224)	(199)
(Loss)/profit before taxation	(1,801)	–	1,374	828	(1,001)	(920)	(1,428)	(92)
Taxation	192	–	–	–	–	–	192	–
(Loss)/profit after taxation	(1,609)	–	1,374	828	(1,001)	(920)	(1,236)	(92)

Discontinued Operations

	2011 £'000	2010 £'000
Profit for the year	–	4
Profit on sale	–	492

Discontinued operations relate to the Financial Markets division (note 10).

Notes to the Financial Statements continued

5. Segment reporting continued

	Reportable Operating Segments				Unallocated Items			
	Network Security		Business Systems		Central Costs		Total	
	2011 £'000	2010 £'000	2011 £'000	2010 £'000	2011 £'000	2010 £'000	2011 £'000	2010 £'000
Non-current assets								
Goodwill	11,635	–	509	509	–	–	12,144	509
Acquired intangible assets	3,003	–	5	5	–	–	3,008	5
Capitalised development expenditure	627	–	857	591	–	–	1,484	591
Property, plant & equipment	599	–	56	36	–	–	655	36
	15,864	–	1,427	1,141	–	–	17,291	1,141
Current assets								
Inventories	241	–	–	–	–	–	241	–
Trade and other receivables – due in less than one year	2,278	–	954	532	34	288	3,266	820
Trade and other receivables – due in more than one year	95	–	6	–	57	–	158	–
Cash and cash equivalents	461	–	524	–	3,327	7,186	4,312	7,186
	3,075	–	1,484	532	3,418	7,474	7,977	8,006
Current liabilities								
Trade, other payables and provisions	(1,857)	–	(883)	(252)	(84)	(487)	(2,824)	(739)
Borrowings	(176)	–	–	–	–	–	(176)	–
Deferred income	(3,382)	–	(2,034)	(1,485)	–	–	(5,416)	(1,485)
	(5,415)	–	(2,917)	(1,737)	(84)	(487)	(8,416)	(2,224)
Net current (liabilities)/assets	(2,340)		(1,433)	(1,205)	3,334	6,987	(439)	5,782
Non-current liabilities								
Borrowings	(3,557)	–	–	–	–	–	(3,557)	–
Deferred income	(808)	–	–	–	–	–	(808)	–
Deferred taxation	(1,012)	–	–	–	–	–	(1,012)	–
	(5,377)	–	–	–	–	–	(5,377)	–
Net assets/(liabilities)	8,147	–	(6)	(64)	3,334	6,987	11,475	6,923

The Group's revenues from external customers and its non-current assets are divided into the following geographical areas:

Continuing and acquired operations

Geographical area	2011 Revenue £'000	2011 Non-current assets £'000	2010 Revenue £'000	2010 Non-current assets £'000
North America	3,680	15,864	–	–
EMEA	6,644	1,427	3,020	1,141
APAC	809	–	–	–
Other countries	132	–	–	–
Total	11,265	17,291	3,020	1,141

EMEA revenue analysis

	2011 £'000	2010 £'000
UK	5,561	3,020
Europe	1,083	–
Total	6,644	3,020

Discontinued operations

Geographical area	Revenue 2011 £'000	Non-current assets 2011 £'000	Revenue 2010 £'000	Non-current assets 2010 £'000
North America	–	–	25	–
EMEA	–	–	742	–
Other countries	–	–	219	–
Total	–	–	986	–

Revenues from external customers in the Group's domicile, United Kingdom, as well as its major markets have been identified on the basis of invoicing systems for the Corero Business Systems division. Revenues for external customers for the Corero Network Security division are identified on the basis of invoicing systems and adjusted to take into account the difference between invoiced amounts and deferred revenue adjustments required by IAS.

Notes to the Financial Statements continued

5. Segment reporting continued

The Group's revenue may be analysed as follows for each revenue category:

	Continuing/acquired operations		Discontinued operations	
	2011 £'000	2010 £'000	2011 £'000	2010 £'000
Licence revenue	4,275	556	–	270
Professional services revenue	1,418	699	–	175
Support revenue	5,572	1,765	–	541
Total	11,265	3,020	–	986

6. Finance income

	2011 £'000	2010 £'000
Interest on bank deposits	61	32

7. Finance costs

	2011 £'000	2010 £'000
8% Loan Note interest payable	214	–
Bank interest payable: accounts receivable financing facility and term loan	7	–
Finance interest	3	–
Interest payable on CULS	–	176
Amortisation of notional CULS interest charges	–	23
	224	199

8. Loss for the year

The following items have been included in arriving at the loss for the year before taxation:

	Continuing 2011 £'000	Acquired 2011 £'000	Total 2011 £'000
Amortisation of acquired intangible assets (note 15)	5	571	576
Amortisation of capitalised development (note 16)	188	13	201
Depreciation of property, plant and equipment (note 17)	26	146	172
Operating lease rentals payable	78	136	214
Trade receivables impairment	–	(4)	(4)

	Continuing 2010 £'000	Discontinued 2010 £'000	Total 2010 £'000
Amortisation of acquired intangible assets (note 15)	7	58	65
Amortisation of capitalised development (note 16)	168	102	270
Depreciation of property, plant and equipment (note 17)	22	13	35
Operating lease rentals payable	71	83	154
Trade receivables impairment	(4)	–	(4)

In 2011 there were no discontinued operations nor were there any acquired operations in 2010.

Auditor's remuneration

	2011 £'000	2010 £'000
Services provided to the Company and its subsidiaries		
Fees payable to the Company's auditor for the audit of the annual financial statements	56	33
Fees payable to the Company's auditor for other services	163	–
Fees payable to the Company's auditor for taxation services	15	22
	234	55

Notes to the Financial Statements continued

9. Tax on loss on ordinary activities

	2011 £'000	2010 £'000
Deferred tax credit for the year	192	–

The tax assessed on the loss on ordinary activities for the year differs from the weighted average UK corporate rate of tax of 26.5% (2010: 28%). The differences are reconciled below:

	2011	2010
Total tax reconciliation		
Loss before taxation	(1,428)	(92)
Theoretical tax credit at UK Corporation tax rate 26.5% (2010: 28%)	(378)	(26)
Effect of:		
– expenditure that is not tax deductible	250	102
– accelerated capital allowances	(11)	(3)
– other timing differences	1	(3)
– relief for losses brought forward	(304)	–
– losses not carried forward/(utilised)	442	(70)
– deferred tax credit	192	–
Actual taxation credit	192	–

Factors Affecting Future Tax Charges

As at 31 December 2011, the Group's cumulative movements on accelerated capital allowances claimed was £55,000 (2010: £54,000).

In addition, the tax losses at that date amounted to £21.3 million (2010: £4.8 million). This comprised UK tax losses of £6.1 million and US tax losses of £15.2 million. £5.5 million of the tax losses relates to US capitalised R&D deductions which will be available at an accelerated level for 5 years. £8.9 million of the tax losses relates to pre-acquisition US tax losses which can be offset against taxable profits over 20 years (there is a limit on the pre-acquisition tax losses of £445,000 per annum and any unused loss may be carried forward to subsequent periods). The resultant deferred tax asset at a rate of 25% (2010: 26%) of £5.3 million (2010: £1.3 million) has not been recognised due to uncertainties as to the extent and timing of its future recovery.

10. Discontinued Operations

10.1 Profit from sale of discontinued operations

On 6 August 2010, the business and assets of the Group's Financial Markets division were sold for a total consideration of £2,127,000, settled by the assumption by the purchaser of the Company's liability to CULS holders with a nominal value of £2.0 million and deferred interest of £127,000. The carrying value of the Financial Markets division was considered to approximate to its fair value, having taken into account historical and forecast results for the division. The profit on disposal of the division amounted to £492,000, further details of which are set out in note 10.2.

10.2 Results from discontinued operations up to the date of disposal

(as per the 2010 Statement of Comprehensive Income format and cost of sales accounting policy)

	2010 £'000
Revenue	986
Cost of sales	(49)
Gross profit	937
Trading expenses	(829)
Trading profit	108
Other non trading items	(104)
Profit before taxation	4
Taxation	–
Profit for the year	4

The profit on the sale can be analysed as follows:

	£'000	£'000
Disposal proceeds	–	2,127
Net assets disposed of:	–	–
Goodwill	(1,168)	–
Customer contracts and related customer relationships	(233)	–
Research and development	(322)	–
Fixed assets	(34)	(1,757)
Deferred income release	337	
Legal and professional fees	(101)	
Bonuses and benefits	(24)	
Property related costs	(90)	122
Profit on sale		492

Cash flows generated by the Financial Markets division until the date of disposal are summarised as follows:

	2010 £'000
Profit before taxation	4
Adjustments for:	
Depreciation	13
Amortisation of acquired intangible assets	58
Amortisation of capitalised development	102
Decrease in trade and other receivables	409
Decrease in payables	(293)
Cash generated from discontinued operations	293

Notes to the Financial Statements continued

11. Profit of the parent Company for the financial year

The Company has taken advantage of section 408 of the Companies Act 2006 and has not included an income statement in these financial statements. The parent Company's profit for the year was £3,384,000 (2010: £198,000).

12. (Loss)/earnings per share

Basic (loss)/earnings per share is calculated by dividing the earnings attributable to ordinary shareholders of the Company by the weighted average number of ordinary shares in issue during the year.

Diluted (loss)/earnings per share is calculated by dividing the earnings attributable to ordinary shareholders by the weighted average of ordinary shares in issue during the year plus potentially dilutive ordinary shares attributable to share options issued by the Company, which is the only potential dilutive class of instruments. The total number of share options outstanding at the end of the year was 3,051,716 (2010:1,306,475). Of these, 45,133 were not potentially dilutive in the year to 31 December 2011 (2010: 49,475).

	2011 loss £'000	2011 weighted average number of 1p shares Thousand	2011 loss per share Pence	2010 (loss)/ earnings £'000	2010 weighted average number of 1p shares Thousand	2010 (loss)/ earnings per share Pence
Loss per share from continuing and acquired operations	(1,239)	45,074	(2.75)	(92)	13,530	(0.68)
Earnings per share from discontinued operations	–	–	–	496	13,530	3.67
(Loss)/earnings per share	(1,239)	45,074	(2.75)	404	13,530	2.99
Diluted loss per share from continuing and acquired operations	(1,239)	48,080	(2.58)	(92)	14,787	(0.62)
Diluted earnings per share from discontinued operations	–	–	–	496	14,787	3.35
Diluted (loss)/earnings per share	(1,239)	48,080	(2.58)	404	14,787	2.73

In the previous year the diluted earnings per share figure was omitted from the approved financial statements in error. As a result this has been calculated and included within the financial statements this year. There was no difference between basic and diluted earnings per share for the year ended 31 December 2009.

13. Statement of Comprehensive Income – restatement

The Statement of Comprehensive Income below illustrates the Statement of Comprehensive Income for the year ended 31 December 2011 prepared on the same basis and applying the cost of sale accounting policy adopted in the 31 December 2010 financial statements.

The changes have been made to achieve a fairer presentation of the costs directly related to revenue and to align the gross margin presentation with peer companies.

	2011 £'000	2010 £'000
Revenue	11,265	3,020
Cost of sales	(1,933)	(230)
Gross profit	9,332	2,790
Trading expenses	(10,860)	(2,675)
Trading (loss)/profit	(1,528)	115
Share options charge	(20)	(131)
Other non trading items*	283	91
(Loss)/profit before financing	(1,265)	75
Finance income	61	32
Finance costs	(224)	(199)
(Loss)/profit before taxation	(1,428)	(92)
Taxation	192	–
Loss for the year from continuing operations	(1,236)	(92)
Profit from discontinued operations	–	4
Profit from sale of discontinued operations	–	492
(Loss)/profit for the year	(1,236)	404

* holiday pay accrual, capitalisation and amortisation of development costs and acquisition and restructuring costs

Notes to the Financial Statements continued

13. Statement of Comprehensive Income – restatement continued

The Statement of Comprehensive Income below illustrates the Statement of Comprehensive Income for the year ended 31 December 2011 prepared on the same basis and applying the cost of sale accounting policy adopted in the year ended 31 December 2010 financial statements as shown in the column "Old Basis" and the effect of the new cost of sales accounting policy and reclassification of costs shown in the column "New Basis".

	Year ended 31 December 2011 Old Basis £'000	Change in cost of sales accounting policy and reclassification £'000	Year ended 31 December 2011 New Basis £'000
Revenue	11,265	–	11,265
Cost of sales	(1,933)	(623)	(2,556)
Trading/operating expenses	(10,860)	2,458	(8,402)
Share options charge	(20)	–	(20)
Depreciation and amortisation of intangible assets	–	(949)	(949)
Acquisition and restructuring costs	–	(603)	(603)
Other non trading items	283	(283)	–
Loss before financing	(1,265)	–	(1,265)

The Group has not presented restated Consolidated Statement of Financial Positions for the three years ended 31 December 2011 within the primary statements as a result of the reclassification of the costs noted above. This is because the reclassification affected the Statement of Comprehensive Income only. The reclassification had no impact on the profit or loss for any period and nor were any figures within the Consolidated Statement of Financial Position reclassified.

14. Goodwill

Group

	2011 £'000	2010 £'000
Cost		
At 1 January	509	2,360
Additions (note 35)	11,042	–
Foreign currency translation	593	–
Disposal (note 10)	–	(1,851)
At 31 December	12,144	509
Impairment		
At 1 January	–	683
Disposal (note 10)	–	(683)
At 31 December	–	–
Carrying amount at 31 December	12,144	509

Goodwill is tested at least annually for impairment and whenever there are indications that goodwill might be impaired.

Goodwill is allocated to the Group's cash-generating units (CGUs) which are Corero Network Security and Resource EMS (part of Corero Business Systems). As at 31 December 2011 goodwill relates to Corero Business Systems and Corero Network Security.

The recoverable amounts for the Group's cash-generating units were determined based on value-in-use calculations using cash flow projections over a five year period. The key assumptions for the value-in-use calculations are those regarding growth and discount rates.

The cash flows for the projections are derived from the most recent financial budget approved by management. Future cash flows are discounted in line with the weighted average cost of capital of 10% pre-tax. The average revenue growth rates are based on the management's estimates of growth in those specific markets based on past experience and expected future developments. Management estimated discount rates using pre-tax rates that reflect current market assessments of the time value of money and the risks specific to the CGUs.

	Resource EMS	Corero Network Security
Projected cash flow period	5 years	5 years
Revenue growth rates used in 5 year projection	5%	7.5%
Revenue growth rates used beyond 5 year projection	0%	0%
Discount rate	10%	10%
Discount rate required for recoverable amount to equal carrying amount	*	12%
Percentage reduction in 2013 revenue for recoverable amount to equal carrying amount	*	9%
Amount by which the CGUs recoverable amount exceeds its carrying amount	£1.8 million	£4.9 million

* for the Resource EMS CGU no reasonably possible changes to key assumptions would result in the carrying value of the goodwill allocated to that CGU equalling its recoverable amount.

Apart from the considerations described in determining the value in use of the Corero Network Security CGU described above, the management of the Group is not currently aware of any other probable changes that would necessitate changes in its key estimates.

Notes to the Financial Statements continued

15. Acquired intangible assets

Group

	Computer software £'000	Customer relationships £'000	Total £'000
Cost			
At 1 January 2010	199	668	867
Disposals	(10)	(668)	(678)
At 31 December 2010	189	–	189
Disposals	(83)	–	(83)
Acquisition	3,638	121	3,759
Additions	38	–	38
Foreign currency translation	187	6	193
At 31 December 2011	3,969	127	4,096
Amortisation			
At 1 January 2010	(186)	(377)	(563)
Charge for year	(7)	(58)	(65)
Disposals	9	435	444
At 31 December 2010	(184)	–	(184)
Disposals	83	–	83
Acquisition	(372)	–	(372)
Foreign currency translation	(39)	–	(39)
Charge for year	(561)	(15)	(576)
At 31 December 2011	(1,073)	(15)	(1,088)
Net book value			
At 31 December 2010	5	–	5
At 31 December 2011	2,896	112	3,008

Company

The Company has no acquired intangible assets (2010: £nil).

16. Capitalised development expenditure

Group

	Total £'000
Cost	
At 1 January 2010	1,585
Additions	367
Disposals	(885)
At 31 December 2010	1,067
Additions	1,094
At 31 December 2011	2,161
Amortisation	
At 1 January 2010	(769)
Charge for year	(270)
Disposals	563
At 31 December 2010	(476)
Charge for year	(201)
At 31 December 2011	(677)
Net book value	
At 31 December 2010	591
At 31 December 2011	1,484

Company

The Company has no capitalised development expenditure (2010: £nil).

Notes to the Financial Statements continued

17. Property, plant and equipment

Group

	Computer Equipment £'000	Fixtures and Fittings £'000	Office Equipment £'000	Leasehold Improvements £'000	Total £'000
Cost					
At 1 January 2010	263	59	57	122	501
Additions	20	2	2	–	24
Disposals	(126)	(22)	(16)	(60)	(224)
At 31 December 2010	157	39	43	62	301
Acquisition	837	287	108	124	1,356
Additions	615	3	3	8	629
Foreign currency translation	42	14	5	6	67
At 31 December 2011	1,651	343	159	200	2,353
Depreciation					
At 1 January 2010	(238)	(38)	(57)	(90)	(423)
Charge for year	(15)	(8)	–	(12)	(35)
Disposals	122	17	14	40	193
At 31 December 2010	(131)	(29)	(43)	(62)	(265)
Acquisition	(744)	(257)	(92)	(104)	(1,197)
Foreign currency translation	(41)	(13)	(5)	(5)	(64)
Charge for year	(151)	(12)	(4)	(5)	(172)
At 31 December 2011	(1,067)	(311)	(144)	(176)	(1,698)
Net book value					
At 31 December 2010	26	10	–	–	36
At 31 December 2011	584	32	15	24	655

Company

The Company has no property, plant and equipment (2010: £nil).

18. Investments in subsidiaries

	Company 2011 £'000	Company 2010 £'000
Net book value		
At 1 January	411	3,493
Additional investment in Corero Business Systems Limited	3,098	–
Investment in Corero Network Security, Inc	8,278	–
Disposal of subsidiaries	–	(3,082)
At 31 December	11,787	411

An amount of £4.0 million of the Company's investment in Corero Network Security, Inc is held as a Loan Note instrument. These Loan Notes bear interest at 5% that at the election of Corero Network Security, Inc is payable quarterly or added to the principal amount. The Loan Notes are repayable on 31 October 2016.

The Company owns:

100% of the issued share capital of Corero Network Security, Inc, a company incorporated in Delaware, USA. The principal business of the company consists of the development and sale of hardware and software security products.

100% of the issued share capital of Corero Group Services Limited, a company incorporated and registered in England and Wales. The principal business of the company consists of providing administration services to the Group.

100% of the issued share capital of Corero Network Security (UK) Limited, a company incorporated and registered in England and Wales. The principal business of the company consists of providing sales and marketing services on behalf of Corero Network Security, Inc.

93% of the issued share capital of Corero Business Systems Limited, a company incorporated and registered in England and Wales. The principal business of the company consists of the development and sale of computer software, comprising finance and management information software, and services, primarily to the education and commercial sectors.

On 18 July 2011, the Board of Directors approved the establishment of a Corero Business Systems Limited Deferred Payment Share Plan ("Plan") in terms of which Corero Business Systems Limited can issue, at fair market value, (or the Company can sell) up to 10% of Corero Business Systems issued ordinary shares to employees. The purpose of the Plan is to incentivise the employees to profitably grow the business.

On 1 August 2011, Corero Business Systems Limited issued, at a market value of £4,000, 2,062 ordinary shares (comprising 7.0% of Corero Business Systems Limited issued ordinary shares) under the terms of the Plan to members of the Corero Business Systems management team. No directors of the Company can participate in the Plan.

Notes to the Financial Statements continued

19. Inventories

Group

	2011 £'000	2010 £'000
Gross inventory	730	–
Less: provision for impairment	(489)	–
Net inventory	241	–

Net inventory comprises only finished goods.

Company

The Company holds no inventory (2011: £nil).

20. Trade and other receivables

	Group 2011 £'000	Group 2010 £'000	Company 2011 £'000	Company 2010 £'000
Trade receivables	2,853	540	–	–
Less: provision for impairment	(32)	(10)	–	–
Net trade receivables	2,821	530	–	–
Amounts owed by subsidiaries	–	–	3,921	2,844
Other debtors	165	66	56	64
Prepayments and accrued income	438	224	2	–
	3,424	820	3,979	2,908

None of the Company's trade and other receivables are secured by collateral or credit enhancements.

Up to 80% of the trade receivables of Corero Network Security, Inc, included under 'Group', can be financed and are therefore secured for credit enhancements.

The Corero Business Systems overdraft facility covenant requires 150% trade receivables cover.

Amounts due from Group undertakings are recoverable after more than one year from the reporting date.

The age of trade receivables not impaired but past due are as follows:

	Group 2011 £'000	Group 2010 £'000
Not more than 3 months	791	248
More than 3 months but not more than 6 months	64	59
More than 6 months but not more than 1 year	80	5
More than one year	12	–
	947	312

The directors consider that the carrying amount of trade and other receivables approximates their fair value.

The maturity profile of trade and other receivables is set out in the table below:

	Group 2011 £'000	Group 2010 £'000	Company 2011 £'000	Company 2010 £'000
In one year or less, or on demand	3,266	818	2	64
In more than one year, but not more than five years	158	2	3,977	2,844
	3,424	820	3,979	2,908

The functional currency of trade and other receivables is set out in the table below:

	Group		Company	
	2011 £'000	2010 £'000	2011 £'000	2010 £'000
UK pound	1,070	820	3,977	2,908
US dollars	2,354	–	–	–
	3,424	820	3,977	2,908

The foreign currency denominated receivables are the reporting currency of the subsidiary in which they report. There is no impact on the Statement of Comprehensive Income from exchange rate movements as the Statement of Comprehensive Income of the subsidiary is denominated in the currency of the subsidiary.

Notes to the Financial Statements continued

21. Trade and other payables

	Group 2011 £'000	Group 2010 £'000	Company 2011 £'000	Company 2010 £'000
Trade payables	880	164	–	–
Other taxation and social security	427	203	–	–
Other payables	223	3	–	–
Accruals	1,294	365	–	2
	2,824	735	–	2

None of the Group or Company's trade and other payables are secured by collateral or credit enhancements.

The directors consider that the carrying amount of trade and other payables approximates its fair value.

90% of the trade and other payables are due in less than 3 months.

The functional currency of trade and other payables is set out in the table below:

	Group 2011 £'000	Group 2010 £'000
UK pound	1,228	735
US dollars	1,596	–
	2,824	735

The foreign currency denominated payables are the reporting currency of the subsidiary in which they report. There is no impact on the Statement of Comprehensive Income from exchange rate movements as the Statement of Comprehensive Income of the subsidiary is denominated in the currency of the subsidiary.

22. Borrowings

	Group 2011 £'000	Group 2010 £'000	Company 2011 £'000	Company 2010 £'000
Current				
Accounts receivable financing facility	122	–	–	–
Fixed term loan	54	–	–	–
	176	–	–	–
Non-current				
Fixed term loan	108	–	–	–
8% Loan Notes	3,449	–	–	–
	3,557	–	–	–

The accounts receivable financing facility bears interest at c.8% of the financed value. The facility limit is US$2.0 million (£1.3 million). 80% of the eligible accounts receivable balance can be financed. The covenant requires a minimum quick asset ratio of 1.25:1.

The term loan of $250,000 (£162,000) bears interest at 8.5% and is repayable over 33 months commencing February 2012.

Interest on the 8% Loan Notes is at the election of Corero Network Security, Inc payable bi-annually or added to the principal amount. The Loan Notes are repayable on 2 March 2014. The outstanding principal and accrued interest at 31 December 2011 amount to $5.3 million (£3.4 million).

Undrawn facilities at 31 December 2011 amounted to £500,000 comprising the Corero Business Systems overdraft facility. The covenant requires 150% trade receivables cover and a Company guarantee.

At 31 December 2011, the Group's liabilities have contractual maturities which are summarised below. These contractual maturities reflect the payment obligations which may differ from the carrying values of the liabilities at the balance sheet date.

Group

	In one year or less, or on demand		More than one but less than five years	
	2011 £'000	2010 £'000	2011 £'000	2010 £'000
Trade and other payables	2,707	739	117	–
Borrowings	176	–	3,557	–
Total	2,883	739	3,674	–

Company

	In one year or less, or on demand	
	2011 £'000	2010 £'000
Trade and other payables	–	2
Total	–	2

Highlights
Business Profile
Chairman's Statement
Financial Review
Governance
Financial Statements
Notice of AGM
Corporate Directory

Notes to the Financial Statements continued

23. Financial instruments

The Group's financial instruments are categorised as shown below:

Group

	Book Value 2011 £'000	Fair Value 2011 £'000	Book Value 2010 £'000	Fair Value 2010 £'000
Financial assets				
Trade and other receivables	2,986	2,986	596	596
Cash	4,312	4,312	7,186	7,186
	7,298	7,298	7,782	7,782

Group

	Book Value 2011 £'000	Fair Value 2011 £'000	Book Value 2010 £'000	Fair Value 2010 £'000
Financial liabilities				
Financial liabilities at amortised cost:				
Trade and other payables	2,824	2,824	735	735
Accounts receivable financing	122	122	–	–
Fixed term loan	162	162	–	–
8% Loan Notes	3,449	3,449	–	–
	6,557	6,557	735	735

24. Deferred income

Group

	2011 £'000	2010 £'000
Current	5,416	1,485
More than one year but less than five years	808	–
	6,224	1,485

The deferred income balance that is presented as falling due in less than one year will be recognised as revenue evenly over the remaining term of the support agreements in place. Support agreements expire at various times throughout the year with no particular seasonality.

Company

The Company has no deferred income (2010: £nil).

25. Deferred tax liability

Group

	£'000
1 January 2011	–
Addition	1,152
Foreign currency translation	59
31 December 2011	1,211
Credit to income statement	(192)
Foreign currency translation	(7)
31 December 2011	1,012

The deferred tax liability relates to the software and customer relationships acquired as part of the Top Layer Networks, Inc acquisition (note 35). The deferred tax liability has been calculated using a US Federal tax rate of 34%. The liability will be released to the Statement of Comprehensive Income as the intangible software and customer relationship assets are amortised.

Company

The Company has no deferred tax liability (2010: £nil).

26. Pensions

The Group's pension arrangements are operated through defined contribution schemes.

	Continuing 2011 £'000	Acquired 2011 £'000	Total 2011 £'000
Defined contribution pension costs	68	8	76

	Continuing 2010 £'000	Discontinued 2010 £'000	Total 2010 £'000
Defined contribution pension costs	54	23	77

Notes to the Financial Statements continued

27. Share capital

	2011 £'000	2010 £'000
Authorised		
745,821,970 ordinary shares of 1p each	7,458	7,458
1,518,990 deferred shares of £2.99 each	4,542	4,542
	12,000	12,000

Issued and fully paid

Ordinary share capital	2011 £'000
1 January 2011	
31,963,434 ordinary shares of 1p each	319
Issued	
9,038,855 ordinary shares of 1p each	90
6,571,429 ordinary shares of 1p each	66
140,000 ordinary shares of 1p each	2
31 December 2011	
47,713,718 ordinary shares of 1p each	477

On 2 March 2011, 9,038,855 ordinary shares with a nominal value of 1p were issued at 39p per share as part of the acquisition consideration of Top Layer.

On 2 March 2011, 6,571,429 ordinary shares with a nominal value of 1p were issued at 35p per share by way of a placing.

On 22 March 2011, 140,000 ordinary shares with a nominal value of 1p were issued at 40p per share.

Deferred share capital	2011 £'000
1 January 2011	
1,518,990 deferred shares of £2.99 each	4,542
31 December 2011	4,542

The deferred shares arose as a result of a capital reorganisation that took place in June 2009. The deferred shares have no voting or dividend rights and, on a return of capital, will have the right to receive the amount paid up thereon after the holders of the ordinary shares have received, in aggregate, the amount paid up thereon plus £10,000,000 per ordinary share. The deferred shares are not transferable (save with the consent of the Directors). The Company may, at any time, transfer the deferred shares to any other person or buy back the deferred shares, for an aggregate payment of 1p.

28. Shares to be issued

Shares to be issued relate to the deferred consideration of Top Layer Networks, Inc, comprising 177,145 new ordinary shares due to be issued on 2 September 2012 subject to adjustment for set off against any warranty claims brought by the Company in accordance with the terms of the acquisition agreement (note 35). These shares have been treated as a component of equity, with a sterling equivalent of £80,000.

29. Share premium

	2011 £'000
1 January 2011	14,341
9,038,855 ordinary shares at 38p each less issue costs	3,328
6,571,429 ordinary shares at 34p each less issue costs	2,122
140,000 ordinary shares at 39p each	55
31 December 2011	19,846

Consideration received in excess of the nominal value of the 15,610,284 shares issued on 2 March 2011, as a result of the subscription and placing has been included in the share premium, less registration, placing commission and professional fees of £267,000 associated with the simultaneous share issue.

30. Employees and directors

Group

Employee expenses during the period

	Total 2011 Number	Total 2010 Number
Wages and salaries	7,294	2,353
Social security costs	652	282
Other pension costs (note 26)	76	77
Cost of employee share scheme (note 33)	20	131
	8,042	2,843

Group

Average monthly numbers of employees (including directors) employed

	Total 2011 Number	Total 2010 Number
Sales and Marketing	38	9
Consulting and Professional Services	11	6
Technical and Support	46	21
Administration	11	5
	106	41

Company

The Company has no employees (2010: nil).

Notes to the Financial Statements continued

30. Employees and directors continued

Directors

	Salary & fees £'000	Bonus £'000	Benefits £'000	Pension £'000	Share based payments £'000	2011 £'000	2010 £'000
Executive directors							
Andrew Miller	134	68	4	12	–	218	112
Bernard Snowe (resigned 30 June 2011)	68	48	1	–	11	128	220
Peter Waller (resigned 4 February 2011)	4	–	–	–	–	4	41
Non-executive directors							
Richard Last	15	–	–	–	–	15	13
Jens Montanana	15	–	–	–	–	15	21
Edward Forwood	–	–	–	–	–	–	–
	236	116	5	12	11	380	407

Bonus payments of £116,000 were awarded to the executive directors during the period to 31 December 2011 (2010: £118,000).

Andrew Miller has a service contract with a 4 month notice period. A subsidiary company provides for pension contributions of 10% of basic salary.

No directors were accruing benefits from the Group's defined contribution pension arrangements (2010: nil).

Post the year end, Jens Montanana notified the Company that he wished to waive his non-executive director fees for the years ended 31 December 2010 and 2011.

31. Operating lease commitments

Group

The Group has total future minimum lease payments under non-cancellable operating leases totalling £1.0 million (2010: £300,000) analysed by year of expiry as follows:

	2011 £'000	2010 £'000
Land and building agreements expiring:		
Within one year	24	–
Within two to five years	977	300
	1,001	300

Company

The Company has no operating lease commitments (2010: £nil).

32. Contingent liabilities

The Group and Company do not have any contingent liabilities (2010: £nil).

On 17 March 2011, the Corero Remuneration Committee approved the establishment of the Corero Early Exit Incentive Plan ("EEIP"). The EEIP is a cash settled change of control incentive plan for the senior executives of the Group that provides for a cash payment in the event of (i) a sale of substantially all of the assets of Corero Network Security business, or (ii) an offer for all of the shares of Corero Network Security plc, in the period up to 30 April 2014 (thereafter it will lapse).

The cash incentive payment is determined based on the difference between (i) the value of the transaction (consideration for the sale of all or substantially all of the assets of Corero Network Security, Inc or offer for all of Corero Network Security plc's shares) and (ii) Corero Network Security plc's accumulated cost of capital comprising the cash investment by Corero Network Security plc shareholders and shares issued for acquisitions or other purposes, defined as the "Total Gain". The EEIP will pay those executives granted the incentive a percentage of the Total Gain. Under the terms of the EEIP, awards up to a maximum of 3.0% of the Total Gain can be issued with a maximum of 0.5% per individual. At 31 December 2011, EEIP awards comprising 2.4% of the Total Gain had been awarded (including an award of 0.5% to Andrew Miller, a director).

As at the date of this report no discussions are in progress or contemplated which would result in the incentive payment being payable. As a result no provision has been recorded in the financial statements relating to the EEIP.

33. Share options

The Company has the following share option schemes:

- Enterprise Management Incentive Scheme for its employees, which has been approved by HMR&C
- 2010 Executive Enterprise Management Incentive Scheme, which has been approved by HMR&C
- 2010 Unapproved Share Option Scheme
- Deferred Payment Plan

In August 2010, 1,257,000 options were granted to certain directors and employees under the 2010 Executive Enterprise Management Incentive Scheme and 2010 Unapproved Share Option Scheme. The options granted vested immediately upon grant.

All other options granted in 2010 and 2011 have a three year vesting period, vesting one third on the first anniversary of grant, one third on the second anniversary of grant and one third on the third anniversary of grant. There are no vesting conditions.

Notes to the Financial Statements continued

33. Share options continued

Share options granted at 31 December 2011 were as follows:

Option Holders	Date granted	Expiry date	Exercise price	At 1 January 2011	Granted	Lapsed	At 31 December 2011
Enterprise Management Incentive Scheme							
Peter Waller	April 2006	April 2016	555p	2,509	–	(2,509)	–
Bernard Snowe	April 2001	April 2011	975p	1,333	–	(1,333)	–
	October 2001	October 2011	525p	250	–	(250)	–
	December 2001	December 2011	765p	250	–	(250)	–
	January 2002	January 2012	825p	500	–	–	500
	February 2005	February 2015	495p	1,667	–	–	1,667
	April 2006	April 2016	555p	4,861	–	–	4,861
	March 2011	March 2021	40p	–	125,000	–	125,000
Other Holders	January 2003	January 2013	735p	633	–	–	633
	October 2003	October 2013	1,095p	333	–	–	333
	February 2005	February 2015	495p	533	–	–	533
	April 2006	April 2016	555p	500	–	–	500
	September 2008	September 2018	300p	27,334	–	–	27,334
	March 2011	March 2021	36p	–	40,750	–	40,750
	March 2011	March 2021	40p	–	40,000	–	40,000
	May 2011	May 2021	35p	–	24,000	(24,000)	–
2010 Executive Enterprise Management Incentive Scheme							
Andrew Miller	August 2010	August 2020	25p	476,000		–	476,000
2010 Unapproved Share Option Scheme							
Jens Montanana	August 2010	August 2020	25p	165,000	–	–	165,000
Other holders	August 2010	August 2020	25p	308,000	–	–	308,000
	August 2010	August 2020	31p	308,000	–	–	308,000
	March 2011	March 2021	36p	–	634,250	(206,917)	427,333
	March 2011	March 2021	40p	–	500,000	(60,000)	440,000
	May 2011	May 2021	35p	–	190,000	–	190,000
	September 2011	September 2021	37.5p	–	546,500	(60,000)	486,500
Unapproved Share Option Scheme							
Bernard Snowe	April 2008	April 2017	555p	8,772	–	–	8,772
				1,306,475	2,100,500	(355,259)	3,051,716

The closing mid market price for the Company's shares at 31 December 2011 was 44.5p and the high and low for the year was 49p and 31p. There are no performance conditions to be met before share options are exercisable.

Changes in directors options held between 1 January 2011 and the 31 December 2011 are detailed in the following table.

	At 1 January 2011	Granted during year	Lapsed during year	At 31 December 2011	Exercise price	Date from which partially exercisable	Expiry date
Peter Waller	2,509	–	(2,509)	–	555p	April 2009	
Bernard Snowe	1,333	–	(1,333)	–	975p	April 2002	April 2011
	250	–	(250)	–	525p	October 2002	October 2011
	250	–	(250)	–	765p	December 2002	December 2011
	500	–	–	500	825p	January 2003	January 2012
	1,667	–	–	1,667	495p	February 2006	February 2015
	4,861	–	–	4,861	555p	April 2009	April 2016
	8,772	–	–	8,772	555p	April 2010	April 2017
	–	125,000	–	125,000	40p	September 2011	March 2021
Andrew Miller	476,000	–	–	476,000	25p	August 2010	August 2020
Jens Montanana	165,000	–	–	165,000	25p	August 2010	August 2020

None of the directors holding office at the balance sheet date exercised options during the year.

Share based payments

The Remuneration Committee can grant options to employees of the Group under the Group's share option schemes.

Options are granted with a fixed exercise price which is equal to the market price at the date of the grant or higher price determined by the Remuneration Committee. The contracted life is ten years from the date of grant.

Options are valued using the Black-Scholes option-pricing model.

Options granted during 2011

The value of options granted during the year was calculated using the Black-Scholes option pricing model. The following variables and ranges were used:

Share price at date of grants	35p-40p
Exercise price	35p-40p
Expected volatility	0.4%-6.4%
Years to maturity	9.7-9.95
Risk free interest rate	1.39%-2.58%

Notes to the Financial Statements continued

33. Share options continued

The following table provides information on all options outstanding at the end of the year:

Weighted average remaining contractual life	9.0 years
Exercise price range	25p-1,095p
Weighted average share price	38p
Weighted average exercise price	38p
Expected volatility	0.4%-10.7%
Risk free rate – 5 year gilt rate	1.39%-5.3%
Expected dividend yield	Nil

The total charge in the year relating to employee share based payments was £20,000 (2010: £131,000).

34. Related parties and transactions

Related party transactions subsist between Group companies and relate to costs paid on behalf of the parent Company. The 2011 costs paid by other Group companies on behalf of the parent Company were £192,000 (2010: £501,000).

The directors consider that the Group's key management personnel are the Board of directors, whose compensation is detailed in note 30.

Company key management compensation was £nil (2010: £nil) as the key management are employed by subsidiaries.

35. Acquisition

On 2 March 2011, the Company acquired the entire issued share capital of Top Layer Networks, Inc which has since been renamed Corero Network Security, Inc.

The aggregate consideration for the acquisition was $15,288,160 satisfied as follows:

- $6,304,602 by the issue, credited as fully paid, of 9,038,855 new ordinary shares of Corero Network Security plc;
- $5,000,000 by the issue of Loan Notes by Top Layer. These Loan Notes bear interest at 8% per annum and are repayable on 2 March 2014;
- $3,860,000 in cash; and
- Deferred consideration of $123,558, to be satisfied by the issue of 177,145 new ordinary shares in the Company to be issued on 2 September 2012 subject to adjustment for set off against any warranty claims brought by the Company in accordance with the terms of the acquisition agreement. These shares have been treated as a component of equity, with a sterling equivalent of £80,000.

The assets and liabilities of Top Layer at the date of acquisition were:

	Book value £'000	Fair value £'000
Property, plant and equipment	159	159
Other non-current assets	84	84
Inventory	136	136
Trade and other receivables	820	820
Cash and cash equivalents	130	130
Trade and other payables	(1,292)	(1,292)
Other short term financial liabilities	(362)	(362)
Deferred income	(3,874)	(3,874)
Other non-current liabilities	(185)	(185)
Net liabilities	(4,384)	(4,384)
Deferred taxation	(1,152)	(1,152)
Goodwill		11,042
Customer contracts and related customer relationships		121
Software		3,266
Satisfied by consideration		8,893
Consideration comprises:		
Completion consideration shares		3,344
Loan Notes		3,071
Cash		2,413
Deferred consideration shares		65
Total consideration		8,893

The Company's strategy as set out in the Circular to shareholders dated 14 July 2010 is to build a network security technology focused business. The acquisition of Top Layer was the first step in executing the Company's acquisition strategy and provided a core platform on which to build a leading network security business. The goodwill arising from the acquisition includes Top Layer's 12 years of deep domain expertise in security and networking and its proprietary technology offering with a multi-core processing platform to support high performance security applications and scalable architecture. The Company plans to add functionality to the Top Layer platform to broaden its network security offering to deliver revenue growth.

The costs relating to the acquisition of Top Layer and associated placing were £564,000, of which £297,000 has been recognised as an expense in the Statement of Comprehensive Income and included under acquisition and restructuring costs, and £267,000 has been charged to the share premium account arising from the issue of the consideration and placing shares.

The revenue and loss of Top Layer since the acquisition date included in the Statement of Comprehensive Income for the year ended 31 December 2011 is shown in note 5 under the heading Corero Network Security. The consolidated revenue and loss before taxation for the year ended 31 December 2011 as though the acquisition date had been effective as of the beginning of the annual reporting period would have been £7,771,000 and £2,121,000 respectively.

Notes to the Financial Statements continued

36. Post balance sheet event

On 6 March 2012, the Company raised £4.56 million (before issue costs), of which the directors and senior management contributed £1.4 million, by way of a placing of 10,615,694 new ordinary shares at a price of 43p per share. The funds were raised to support the growth of the Corero Network Security business by investing in the sales and marketing functions of the business to gain end-user customer and channel partner awareness, and investing in its product development capabilities.

Notice of Annual General Meeting

Notice is hereby given that the Annual General Meeting (the "AGM") of Corero Network Security plc (the "Company") will be held at the offices of FinnCap Ltd, 60 New Broad Street, London, EC2M 1JJ, on 7 June 2012 at 10.00 a.m. for the following purposes:

Ordinary Business

To consider and, if thought fit, pass the following resolutions which will be proposed as ordinary resolutions:

1. Report and accounts

To receive the audited annual accounts of the Company for the year ended 31 December 2011, together with the directors' report and the auditor's report on those annual accounts.

2. Re-election of director

To re-elect Mr Richard Last, who retires by rotation in accordance with the Company's articles of association, as a director of the Company.

3. Re-election of director

To re-elect Mr Stephen Graham, who retires in accordance with the Company's articles of association, as a director of the Company.

4. Re-appointment of auditors

To re-appoint BDO LLP as auditors of the Company to hold office from the conclusion of this AGM until the conclusion of the next annual general meeting at which accounts are laid before the Company.

5. Auditors' remuneration

To authorise the directors to determine the remuneration of the auditors.

Special Business

To consider and, if thought fit, pass the following resolutions of which resolution 6 will be proposed as an ordinary resolution and resolutions 7 and 8 will be proposed as special resolutions:

6. Directors' authority to allot shares

THAT, in substitution for all existing and unexercised authorities and powers granted to the Directors prior to the date of this resolution in accordance with section 551 of the Companies Act 2006 ("Act"), the Directors be generally and unconditionally authorised for the purposes of section 551 of the Act to exercise all the powers of the Company to allot shares in the Company and grant rights to subscribe for or to convert any security into shares of the Company (such shares and rights to subscribe for or to convert any security into shares of the Company being "relevant securities") up to a maximum nominal amount of £194,431.37 on such terms and conditions as the Directors may determine provided that, unless previously revoked, varied or extended, this authority shall expire on the earlier of the date falling 15 months after the date of the passing of this resolution and the conclusion of the next annual general meeting of the Company except that the Company may at any time before such expiry make an offer or agreement which would or might require relevant securities to be allotted after such expiry and the Directors may allot relevant securities in pursuance of such an offer or agreement as if this authority had not expired.

7. Disapplication of pre-emption rights

THAT, in substitution for all existing and unexercised authorities and powers granted to the Directors prior to the date of this resolution in accordance with section 570(1) of the Act and subject to and conditional on the passing of resolution 7, the Directors be and are hereby empowered to allot equity securities (as defined in section 560(1) of the Act) of the Company for cash, pursuant to the authority of the Directors under section 551 of the Act conferred by resolution 7 above, and/or by way of a sale of treasury shares for cash (by virtue of section 573 of the Act), in each case as if section 561(1) of the Act did not apply to such allotment, provided that this power shall be limited to:

(a) the allotment of equity securities in connection with an offer by way of a rights issue (i) to the holders of ordinary shares in proportion (as nearly as may be practicable) to their respective holdings and (ii) to holders of other equity securities as required by the rights of those securities or as the Directors otherwise consider necessary, but subject to such exclusions or other arrangements as the Directors may deem necessary or expedient in relation to treasury shares, fractional entitlements, record dates, legal or practical problems in or under the laws of any territory or the requirements of any regulatory body or stock exchange; and

Notice of Annual General Meeting continued

7. Disapplication of pre-emption rights continued

(b) the allotment and/or sale of treasury shares for cash (otherwise than pursuant to resolution 8(a) above) of equity securities up to a maximum nominal amount of £87,494.12,

and that, unless previously revoked, varied or extended, this power shall expire on the earlier of the date falling 15 months after the date of the passing of this resolution and the conclusion of the next annual general meeting of the Company except that the Company may before the expiry of this power make an offer or agreement which would or might require equity securities to be allotted (and treasury shares to be sold) after such expiry and the Directors may allot equity securities (and sell treasury shares) in pursuance of such an offer or agreement as if this power had not expired.

8. Authority to purchase Company's own shares

THAT the Company be generally and unconditionally authorised for the purposes of section 701 of the Act to make market purchases (as defined in section 693(4) of the Act) on a recognised investment exchange (as defined in section 693(5) of the Act) of ordinary shares of £0.01 each in the capital of the Company ("Ordinary Shares") and to hold such shares as treasury shares (as defined in section 724(3) of the Act) provided that:

(a) this authority shall be limited to the purchase of Ordinary Shares up to a maximum aggregate nominal value equal to £58,329.41 representing approximately 10 per cent. of the nominal value of the current issued ordinary share capital of the Company;

(b) the minimum price which may be paid for such Ordinary Shares is £0.01 (exclusive of expenses);

(c) the maximum price (exclusive of expenses) which may be paid for an Ordinary Share shall not be more than 5 per cent. above the average middle market quotations for an Ordinary Share on the relevant recognised investment exchange on which Ordinary Shares are traded for the five business days immediately preceding the date on which the Ordinary Share is purchased;

(d) unless previously revoked, varied or extended, the authority hereby conferred shall expire at the earlier of the date which is 15 months from the date of the passing of this resolution and the conclusion of the next annual general meeting of the Company; and

(e) the Company may make a contract or contracts to purchase Ordinary Shares under the authority hereby conferred prior to the expiry of such authority which will or may be executed wholly or partly after the expiry of such authority and may make a purchase of Ordinary Shares in pursuance of any such contract or contracts.

By order of the Board

Duncan Swallow
Company Secretary
19 March 2012

Registered Office:

169 High Street
Rickmansworth
Hertfordshire
United Kingdom
WD3 1AY

Notes

1. Pursuant to Regulation 41 of the Uncertificated Securities Regulations 2001 (as amended), only those members registered in the register of members of the Company at 6.00 p.m. on 1 June 2012 (or if the AGM is adjourned, on the day which is two business days before the time fixed for the adjourned General Meeting) shall be entitled to attend and vote at the AGM in respect of the number of shares registered in their name at that time. Any changes to the register of members after such time shall be disregarded in determining the rights of any person to attend or vote at the General Meeting.

2. CREST members who wish to appoint a proxy or proxies through the CREST electronic proxy appointment service may do so for the AGM to be held at 10.00 a.m. on 7 June 2012 and any adjournment(s) thereof by using the procedures described in the CREST Manual. CREST personal members or other CREST sponsored members, and those CREST members who have appointed a voting service provider should refer to their CREST sponsors or voting service provider(s), who will be able to take the appropriate action on their behalf.

   In order for a proxy appointment or instruction made by means of CREST to be valid, the appropriate CREST message (a "CREST Proxy Instruction") must be properly authenticated in accordance with Euroclear UK & Ireland Limited's specifications and must contain the information required for such instructions, as described in the CREST Manual. The message must be transmitted so as to be received by the Company's agent, Capita Registrars Limited (CREST Participant ID: RA10), no later than 10.00 a.m. on 1 June 2012. For this purpose, the time of receipt will be taken to be the time (as determined by the time stamp applied to the message by the CREST Application Host) from which the Company's agent is able to retrieve the message by enquiry to CREST in the manner prescribed by CREST.

   CREST members and, where applicable, their CREST sponsor or voting service provider should note that Euroclear UK & Ireland Limited does not make available special procedures in CREST for any particular messages. Normal system timings and limitations will therefore apply in relation to the input of CREST Proxy Instructions. It is the responsibility of the CREST member concerned to take (or, if the CREST member is a CREST personal member or sponsored member or has appointed a voting service provider, to procure that his CREST sponsor or voting service provider takes) such action as shall be necessary to ensure that a message is transmitted by means of the CREST system by any particular time. In this connection, CREST members and, where applicable, their CREST sponsor or voting service provider are referred in particular to those sections of the CREST Manual concerning practical limitations of the CREST system and timings.

   The Company may treat as invalid a CREST Proxy Instruction in the circumstances set out in Regulation 35(5)(a) of the Uncertificated Securities Regulations 2001.

3. If you wish to attend the AGM in person, you should make sure that you arrive at the venue for the AGM in good time before the commencement of the meeting. You may be asked to prove your identity in order to gain admission.

4. A member who is entitled to attend, speak and vote at the AGM may appoint a proxy to attend, speak and vote instead of him. A member may appoint more than one proxy provided each proxy is appointed to exercise rights attached to different shares (so a member must have more than one share to be able to appoint more than one proxy). A proxy need not be a member of the Company but must attend the AGM in order to represent you. A proxy must vote in accordance with any instructions given by the member by whom the proxy is appointed. Appointing a proxy will not prevent a member from attending in person and voting at the AGM (although voting in person at the AGM will terminate the proxy appointment). A proxy form is enclosed. The notes to the proxy form include instructions on how to appoint the Chairman of the AGM or another person as a proxy. You can only appoint a proxy using the procedures set out in these Notes and in the notes to the proxy form.

5. To be valid, a proxy form, and the original or duly certified copy of the power of attorney or other authority (if any) under which it is signed or authenticated, should reach the Company's registrar, Capita Registrars, PXS, 34 Beckenham Road, Beckenham BR3 4TU, by no later than 10.00 a.m. on 1 June 2012.

6. In the case of joint holders of shares, the vote of the first named in the register of members who tenders a vote, whether in person or by proxy, shall be accepted to the exclusion of the votes of other joint holders.

Notice of Annual General Meeting continued

7. A member that is a company or other organisation not having a physical presence cannot attend in person but can appoint someone to represent it. This can be done in one of two ways: either by the appointment of a proxy (described in Notes 2 and 4 to 6 above) or of a corporate representative. Members considering the appointment of a corporate representative should check their own legal position, the Company's articles of association and the relevant provision of the Companies Act 2006.

8. The following documents are available for inspection at the registered office of the Company during the usual business hours on any weekday (Saturday, Sunday or public holidays excluded) from the date of this notice until the conclusion of the AGM and will also be available for inspection at the place of the AGM from 9.00 a.m. on the day of the AGM until its conclusion:

    (a) copies of the executive directors' service contracts with the Company and any of its subsidiary undertakings; and

    (b) letters of appointment of the non-executive directors.

Corporate Directory

Directors
Jens Montanana (Non-executive Chairman)
Andrew Miller (Executive Director)
Richard Last (Non-executive Director)
Stephen Graham (Non-executive Director)

Secretary and Registered Office
Duncan Swallow
169 High Street
Rickmansworth
Hertfordshire
WD3 1AY

Nominated Adviser and Broker
FinnCap
60 New Broad Street
London
EC2M 1JJ

Auditor
BDO LLP
Clarendon House
Clarendon Road
Cambridge
CB2 8FH

Solicitors
Dorsey and Whitney LLP
21 Wilson Street
London
EC2M 2TD

Bankers
Santander
2 The Forbury
Reading
RG1 3EU

Silicon Valley Bank
3003 Tasman Drive
Santa Clara
California
95054
USA

Registrars
Capita Registrars Limited
The Registry
34 Beckenham Road
Beckenham
Kent
BR3 4TU

Website address
www.coreroplc.com

designed and produced by
FULTON.
UNCOVERING CORPORATE CHARISMA
Brand | Literature | On-line | Reporting

Corero Network Security plc

169 High Street
Rickmansworth
Hertfordshire WD3 1AY

T +44 (0)1923 897333

www.coreroplc.com

Corero Business Systems Limited

169 High Street
Rickmansworth
Hertfordshire WD3 1AY

T +44 (0)1923 897333

www.coreroresource.com

Corero Network Security, Inc

1 Cabot Road
Hudson
MA 01749

www.corero.com