corero

# Annual Report and Accounts 2017

Corero Network Security plc

A leader in real-time, high performance, DDoS protection.

corero

Corero Network Security is a leader in real-time, high-performance Distributed Denial of Service ("DDoS") defence solutions. Service providers, cloud providers and digital enterprises rely on Corero's award winning SmartWall® Network Threat Defense System ("SmartWall") technology to eliminate the DDoS threat to their environment through automatic attack detection and mitigation, coupled with network visibility, analytics and reporting.

**What is a DDoS attack?**

A Distributed Denial of Service attack is a cyber-threat, in which multiple computer systems attack a target, such as a server, website or other network asset, and cause a denial of service for users of the targeted resource. The flood of incoming messages, connection requests or malformed packets to the target system, forces it to slow down or shut down, thereby denying service to legitimate users or systems. DDoS attacks are a threat to service availability, network security, brand reputation and ultimately lead to lost revenues.

Attackers are continuing to leverage DDoS attacks as part of their cyber-threat arsenal to either disrupt business operations or provide a smokescreen while they access sensitive corporate information, and they are doing it in increasingly creative ways that circumvent traditional security solutions or reduce the previous effectiveness of DDoS scrubbing centres.

## The impact of DDoS attacks

**49%**

**of companies discovered a virus following a DDoS attack**

**$250,000**

**(per hour)**

**revenue at risk in the face of a DDoS attack***

**27%**

**increase in breach incidents experienced in concert with DDoS attacks**

**90%**

**of organisations report some form of breach or associated activity with DDoS attacks**

(Source: Neustar Global DDoS Attacks & Cyber Security Insights Report October 2017)

* As estimated by 49% of over 1,000 respondents in a Neustar survey

## Why is there a need for businesses to address DDoS threats?

- Availability and security of Internet services and applications is essential for digital / online businesses
- Downtime or compromise equates to:
  - Lost revenues and additional operational costs
  - Unhappy customers with increased costs for retention of existing customers and acquisition of new customers
  - Brand and reputation damage
  - Legal liability and fines

# Highlights

Customer wins across the SmartWall target markets – service providers, cloud providers and digital enterprises.

**Revenue**

$8.5m

as contribution from legacy products reduced as expected

(2016: $8.8 million)

**Reduced EBITDA loss***

$5.1m

(2016: $6.4 million)

**Loss per share**

3.1c

(2016: 9.0 cents)

**Net cash**

$1.4m

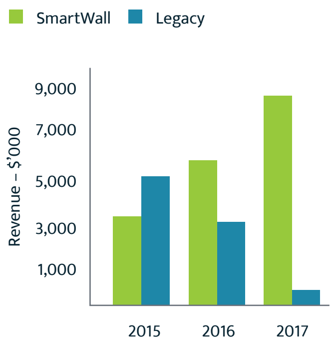
at 31 December 2017

(2016: $2.9 million)

**SmartWall revenue growth**

43%

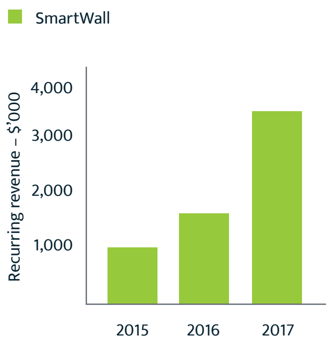
over the prior year




**Recurring** revenue growth**

125%

over the prior year




## Operating highlights

- Strong performance of flagship SmartWall product
- Existing customer add-on orders up 320% over the prior year
- High customer delight with >95% renewal rates for support and services
- First two $1.0 million customers
- Encouraging uptake of DDoS protection as-a-service (launched in late 2016)
- Signed partnerships with global blue-chip technology companies to accelerate revenue growth strategy
  - Juniper Networks, McAfee, Gigamon
- New technology launched following two-year development programme
  - Added 100Gbps capacity product
  - Launched vNTD virtual software appliance

For more information
www.corero.com

* comprises the operating loss less unrealised foreign exchange differences on an intercompany loan, depreciation, amortisation and impairment of goodwill. The Directors consider EBITDA to be a better measure of profitability as it excludes non cash items. The 2016 EBITDA has been adjusted to be on a consistent basis.

** Recurring revenue comprises maintenance, support services and aaS recognised revenue.

## Contents

# Corero at a glance

## Corero is dedicated to improving the security and availability of the Internet through the deployment of innovative DDoS mitigation solutions.

## DDoS attacks continue to rise in size, frequency and complexity, impacting the security and availability of the Internet.

**35%**
**increase in attacks per quarter**

**8**
**attacks per customer per day**

**71%**
**attacks 10 minutes or less**

**96%**
**attacks 5Gbps or less**

(Source: Corero DDoS Trends Report Q2-Q3 2017)

Service providers, cloud providers and Internet connected businesses require real-time protection against this evolving threat landscape. The Corero SmartWall family of products can be deployed in various topologies (in-line or scrubbing).

The SmartWall family of products utilises modern DDoS mitigation architecture to automatically and surgically remove DDoS attack traffic, while allowing good user traffic to flow uninterrupted.

Corero's key operational centres are in Marlborough, Massachusetts in the USA and Edinburgh in the UK, with the Company's registered office in Uxbridge in the UK.

The goal of the Corero real-time DDoS mitigation solution is to protect the customer's service availability and ultimately revenues and brand reputations from harmful DDoS attacks.

The Corero solutions are among the highest performing in the industry, while providing the most automated DDoS protection at unprecedented scale with the lowest total cost of ownership to the customer.

These solutions are designed to provide real-time attack mitigation with continuous threat visibility, enabling the monetisation of DDoS protection as-a-service offering for service providers.

The Corero SmartWall protects against the latest breed of DDoS attacks in seconds not minutes, including volumetric and multi-vector attacks.

# What we do: Automatic Real-time DDoS Protection


**Revenue-protecting real-time DDoS mitigation** product optimised for service providers and cloud providers

Available for **rapid deployment** within the **provider's own infrastructure delivering compelling ROI**

**Revenue and reputation-protecting** real-time DDoS mitigation product for digital enterprises

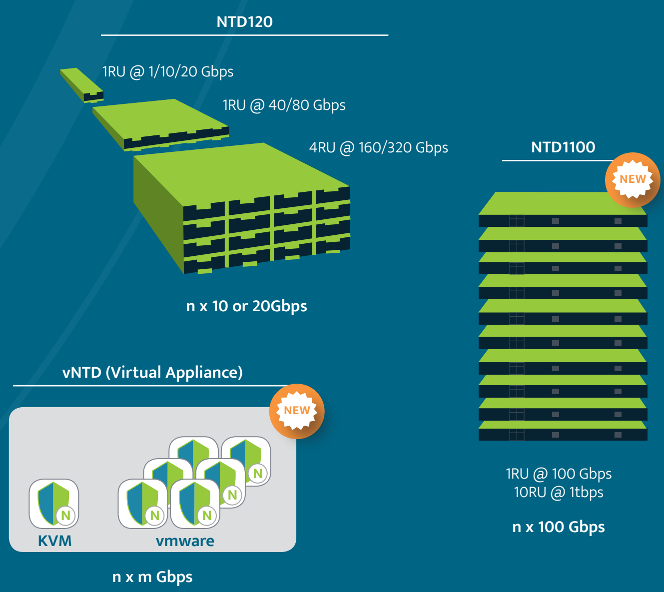
**Solves for the scalability & accuracy demands** of both service cloud providers and digital enterprise businesses

Corero's product **mitigates attacks in less than one second, unlike competing technologies** which mitigate attacks in c.20 minutes

| | |
|---|---|
| **Why** | We believe in a safe Internet protected from cyber-attacks. We strive to eliminate the threat of DDoS attacks. |
| **How** | We do this by combining our patents, algorithms, more than a decade of cyber-security experience and our threat analytics. |
| **What** | Our SmartWall product detects and mitigates DDoS attacks in seconds (or less) allowing our customers to stay open for business (during an attack). |

## Product Overview

Corero has a market leading SmartWall product portfolio endorsed by 90 customers, recommended by NSS Labs (the world's leading independent product testing laboratory) and selected by Juniper Networks as a Juniper Technology Alliance Partner. This product portfolio has been further enhanced for 2018 with the deliverables from a two-year development program.



# Corero is a leader in real-time, high-performance, scalable DDoS defence solutions for Service Providers, Cloud Providers and Digital Enterprises.

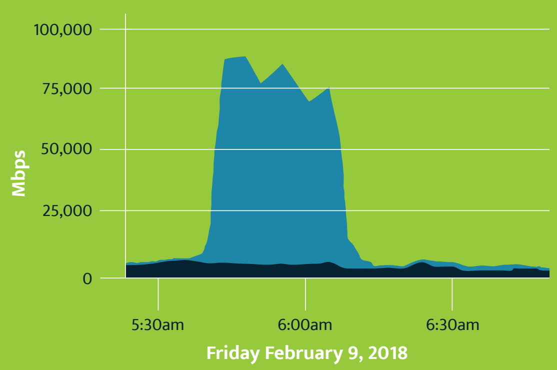
## Automatic Real-time DDoS Protection

Corero protects organisations' online systems, information, data, revenues and brand reputations against the growing cyber-threat of DDoS attacks with dedicated technology for real-time mitigation of DDoS attacks in seconds versus minutes, allowing good user traffic to flow uninterrupted.

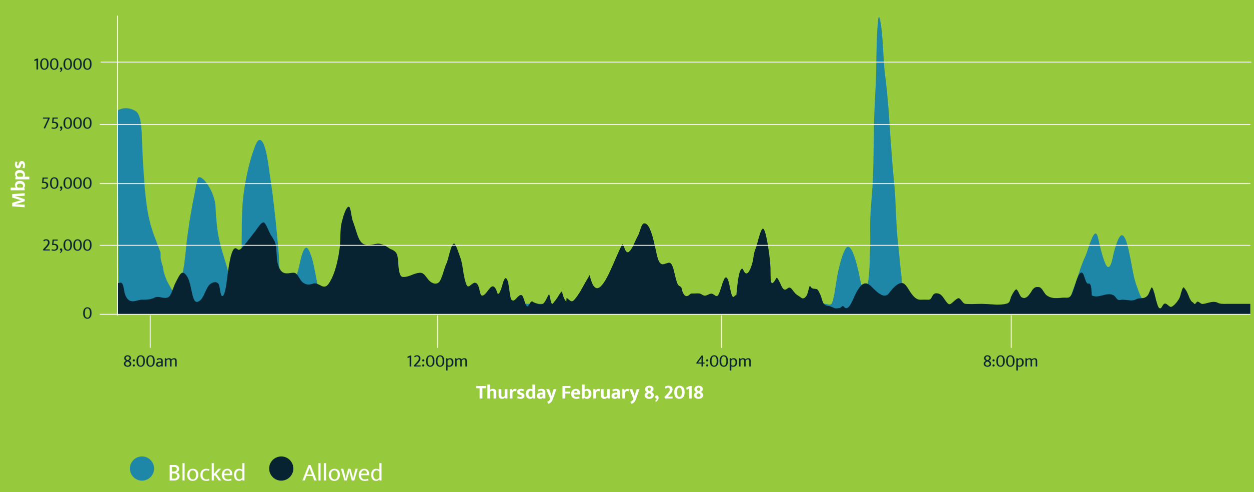
When an organisation selects Corero to protect their assets in the face of DDoS attacks they strengthen their Internet facing security defences and ensure service availability.

Corero customers can utilise this DDoS protection for their own business needs and Service Provider and Cloud Provider customers can monetise a DDoS protection service to their customers enabled through the Corero Service Portal.

### Corero Customer – single large attack




### Corero Customer – multiple attacks over 24 hour period



# Our proposition

## What we do

Corero provides dedicated technology for real-time mitigation of DDoS attacks in seconds versus minutes, allowing good user traffic to flow uninterrupted.

Corero enables revenue protection, customer retention and competitive differentiation in the face of DDoS attacks, for Internet Service Provider, Cloud Provider and Digital Enterprise customers.

The Corero solutions are among the highest performing in the industry, while providing the most automatic security coverage at unprecedented scale with the lowest total cost of ownership to the customer.

Corero enables Service Providers and Cloud Providers to protect their infrastructure from DDoS attacks and to deliver high value DDoS protection services to their customers, allowing for incremental service revenues.

Corero protects Digital Enterprises from DDoS attacks thereby ensuring availability and security of Internet services and applications essential for digital / on-line businesses and in the process:

- Protecting revenues by avoiding downtime and avoiding additional post DDoS attack remediation costs
- Keeping customers happy and avoiding increased costs for retention of existing customers and acquisition of new customers
- Protecting brand and reputation damage
- Avoiding the risk of non-compliance, legal liability and fines.

## How we do it

With varied deployment topologies (in-line or scrubbing) the SmartWall family of solutions utilise modern DDoS mitigation architecture to automatically and surgically remove DDoS attack traffic.

Protection is provided in cost effective scaling increments from 1Gbps to 10Gbps and 100Gbps, to support bandwidth and inspection requirements.

The SmartWall technology provides configurable policies to selectively enable a broad range of specific protection mechanisms to defend critical network assets against DDoS attack traffic.

The Corero SmartProtect program allows for monthly subscription procurement options to acquire SmartWall technology.

The Corero Service Portal allows for provider and tenant visibility for traffic and attack dashboards. Providers can assign subscriber/tenant service levels and distribute reporting and analytics to showcase the value of the protection they are receiving.

Robust reporting and analytics, powered by Splunk, transforms sophisticated DDoS event data into easily consumable dashboards.

The Corero SecureWatch® service is a tiered offering comprised of configuration optimisation, monitoring and mitigation response services. These services, delivered by the Corero Security Operations Centre, are customised to meet the security policy requirements and business goals of each SmartWall customer that engages in a SecureWatch service plan.

# Chief Executive's strategic update

## Corero is well positioned to deliver on its goal of being the leading player in the real-time DDoS mitigation market with SmartWall solution validation from over 90 customers.

### Results

Corero revenue for the year ended 31 December 2017 was $8.5 million (2016: $8.8 million) with SmartWall revenue up 43% over the prior year whilst legacy product revenues declined as expected. Smartwall recurring revenue increased to $3.4 million (2016: $1.5 million). The EBITDA loss reduced to $5.1 million (2016: EBITDA loss $6.4 million).

Revenue and the EBITDA loss for the year ending 31 December 2017 was impacted by delays in world-wide implementation schedules for a large digital enterprise customer win in Q3 2017 and an existing customer's ongoing deployment (with the majority of the revenue from these two customers now expected in the first half of 2018).

### Market dynamics

Cyber-security risks are growing, both in their prevalence and in their disruptive potential. Another growing trend is the use of cyber-attacks to target critical infrastructure and strategic industrial sectors, raising fears that attackers could trigger a breakdown in systems that are essential to modern society. The World Economic Forum Global Risks Landscape for 2018 ranks cyber-attacks as the third most likely risk in its top 10 risk analysis, behind extreme weather events and natural disasters.

The head of the National Cyber Security Centre ("NCSC"), Ciaran Martin, recently commented that while the UK is fortunate to have avoided a so-called category one cyber-attack so far, it is only a matter of time before a catastrophic cyber-attack is launched on its critical infrastructure or election setup.

A recent report from Neustar revealed that many businesses viewed unsecured Internet of Things ("IoT") devices as a major concern. This is hardly surprising, given the recent developments in IoT botnets and the huge potential for unsecured IoT devices to be turned into a botnet army and used by hackers to launch DDoS attacks.

IoT devices still suffer from basic security vulnerabilities and it is precisely this lack of security that makes them so attractive to hackers. But it's not just a password problem anymore. Attackers understand that manufacturers and users are waking up to the problem of passwords on IoT devices, and so are seeking more complex ways to access them. As this trend continues, and hackers become increasingly inventive when searching for new devices and ways to enlist them, there is really no limit to the size and scale of future DDoS attacks driven by IoT botnets. Any device that has an Internet connection and a processor can be exploited. In an ideal world, all devices should be forced to go through some sort of network configuration before being used, rather than being exploitable from a default position.

Businesses and government departments can protect their networks from DDoS attacks fuelled by IoT-driven botnets by deploying a real-time, automated solution at the network edge, which can instantaneously detect and mitigate DDoS activity, thereby eliminating threats from entering a network. As with all DDoS threats, clear visibility is a crucial step in detecting and defending against attacks. The Corero SmartWall solution is this real-time automated solution providing rich actionable analytics.

As organisations develop their businesses to harness the benefits and power of technology, we are seeing companies reassess their security architecture, including DDoS protection, as traditional approaches will not be sufficient to protect enterprises.

### Government regulations

Corero welcomes the investment and attention that governments are committing to the cyber-security of Critical National Infrastructure ("CNI"), particularly recent guidance from the US Government which sets out detailed recommendations on how to boost resilience and ensure suitable protections and mitigation systems are deployed. Corero recently submitted a response to the Joint Committee on the National Security Strategy's inquiry 'Cyber Security: UK National Security in a Digital World' and recommended the following actions are taken:

"We were driven to seek out a DDoS mitigation solution due to the increasing severity and frequency of DDoS attacks against our hosted client base. DDoS attacks can create service interruptions for customers and create unpredictable work efforts for the engineers tasked with resolving them."
**Larry Patterson, Chief Technology Officer and Co-founder, Atomic Data**

- DDoS attacks on CNI, particularly frequent low-volume and short duration attacks, must be a priority area for Government;
- Government must take advantage of opportunities, such as that provided by the implementation of the NIS Directive, to fulfil its ambition of becoming 'the safest place in the world to live and work online';
- The implementation of the Directive on Security of Network and Information Systems ("NIS Directive") should not be treated as a tick box exercise but instead should be grasped as an opportunity for the UK to lead the world in the strength of its cyber-security regulatory framework;
- Government should look at international best practice and adopt a more attack-specific and specialist-led approach towards cyber-security, moving away from generic wide-ranging statements;
- Government must set out and rigorously enforce detailed cyber-security requirements for operators of critical national infrastructure; and
- Government should clarify Departmental cyber-security responsibilities and allocate further resource to the NCSC.

## Operating performance against strategy

Our performance against our 2017 strategic objectives is summarised below:

- **Establish SmartWall as the leading solution for real-time DDoS mitigation:**
  Continued progress in growing our customer base to 90 customers and the addition of a number of high profile customers including Corero's first US federal government customer, two one million dollar customers, first Australian customer and first potentially significant revenue share contract with a Tier 1 service provider.
- **Improve Smartwall DDoS defence technology:**
  SmartWall software releases in 2017 have added new attack defence and improved forensics and analytics capabilities.
- **New products to address the evolving requirements of the target market:**
  Corero further enhanced its market leading SmartWall product portfolio in 2017 with the deliverables from a two-year development program with a new SmartWall 100Gbps capable product to capture growth in customer demand for 100Gbps connectivity and SmartWall virtual software appliance to capture demand for hybrid on-premises / Cloud DDoS mitigation deployments. Corero announced the first sales of the 100Gbps product (totalling $0.4 million) in early January 2018.
- **Target market focus:**
  Customer wins in 2017 have continued to validate the target market for real-time, automatic DDoS mitigation solutions; namely service providers, cloud providers and digital enterprises.
- **Expand routes to market:**
  Corero's strategy is to work with leading IT and network technology vendors to make DDoS mitigation an integral component of any well-engineered Internet facing network design thereby increasing our go-to-market opportunities. In 2017, Corero signed agreements with major global technology companies including Juniper Networks, Gigamon, and McAfee. The technology alliance partnership with Juniper Networks, a US based multinational corporation that develops and markets networking and security products, has provided benefits in 2017 with the opportunity for Corero to expand its market reach by leveraging Juniper Networks' global footprint.
- **Develop sales models to attract new target customers:**
  The DDoS protection as-a-service model launched in late 2016 has gained traction in 2017 with 16 customers by the year end. In addition, the Service Portal, a turnkey solution for service provider customers to manage the delivery of DDoS mitigation services to their customers, has been an important competitive differentiator.

# Chief Executive's strategic update continued

## Fund raise

On 5 April 2018, Corero will announce a conditional placing and subscription to raise £4.0 million ($5.2 million) ("Equity Fund Raise"). In addition, Corero is in advanced discussions with a UK bank to provide a term loan of £3.0 million ($4.2 million) ("Bank Loan"), contingent on the Equity Fund Raise. The Bank Loan is expected to be finalised and drawn down following the completion of the Equity Fund Raise.

## Outlook

Corero enters 2018 with the foundations in place for continued acceleration of SmartWall revenue growth as a result of:

- strong market demand from the growing awareness of the threat and impact of DDoS attacks, and increased risk associated with the projected growth of IoT deployments;
- pending regulations in the US, UK and Europe, including the NIS Directive which comes into force for all EU member states on the 9th May 2018, are expected to positively impact demand for DDoS mitigation investment in 2018 particularly by Digital Enterprises (including critical national infrastructure providers);
- Corero go-to-market partner recruitment and enablement efforts with partners is expected to contribute to revenue in 2018; and
- investment in channel sales development to grow Corero's routes to market in 2018.

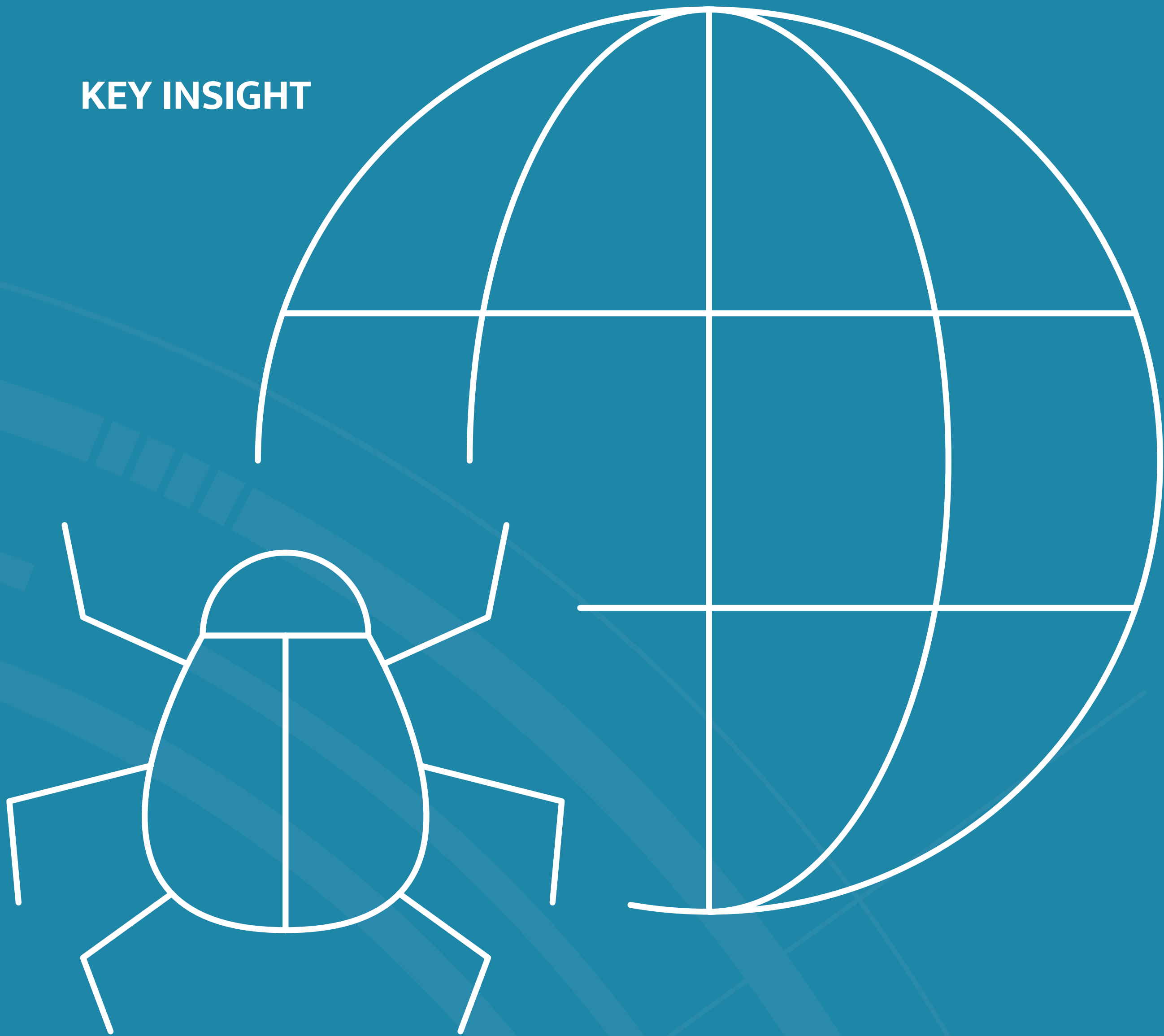
This gives us confidence Corero will deliver revenue growth in 2018.

**Ashley Stephenson**
Chief Executive Officer
4 April 2018

"Corero enters 2018 with confidence following a year of strong growth in SmartWall revenue with proof points of multiple $1.0 million plus customers, a growing catalogue of industry awards and several disruptive contract wins against competitors. In addition, Corero also expanded its ecosystem of world class partners and introduced an enhanced product portfolio. We are excited about the prospects for the future of the business."

**Ashley Stephenson**
Chief Executive Officer

## KEY INSIGHT



## IoT Botnets should be a grave concern

Despite its advantages, the Internet of Things comes with a host of security challenges. IoT devices are usually poorly managed, patched and secured. They are thus prime targets for hacker infiltration and takeover, aside from the personal privacy and security concerns that result from these security gaps.

**The big danger is that these connected devices can be harnessed by hackers for a variety of nefarious purposes; in many cases hackers use them to form a botnet to carry out DDoS attacks.**

# Market overview

## DDoS attacks are accelerating in purpose, sophistication, complexity, scale and frequency.

A wide range of critical cyber-security issues face every Internet connected enterprise or organisation. These threats include denial of service, hacking, breach, phishing, fraud, data theft and exfiltration. These threat vectors present themselves via the essential Internet connections that are required to support the online business.

Today, the vast majority of the leading Internet service providers sell raw Internet transit capacity. This capacity, usually sold via 1Gbps, 10Gbps and increasingly 100Gbps transport connections, carries good customer traffic and malicious bad traffic without discrimination. If an enterprise data centre or hosting facility connects to these raw transit providers they will be exposed to Internet borne cyber-threats and the enterprise's information security posture should be prepared to detect and protect against the associated malicious intent.

Corero has focused on one specific category of these cyber-threats encompassing denial of service and has developed a real time DDoS detection and mitigation solution that can provide automatic detection and protection against DDoS attacks. In contrast to legacy approaches to DDoS mitigation which often require tens of minutes to detect and react, the Corero solution can block DDoS attack traffic in seconds eliminating critical service latency and downtime.

The broad range of motivations for executing a DDoS attack, coupled with the relative ease with which they can be performed, means that they are carried out by a variety of actors, including criminal gangs, activists, terrorist groups and nation state "bad actors". Aside from those who are focused purely on disrupting services, many of those who carry out DDoS attacks do so as a form of extortion or as a smokescreen to steal data, map other vulnerabilities, or plant malware or ransomware.

Both businesses and public-sector organisations are vulnerable to DDoS attacks and recent years have seen some of the world's best-known companies fall victim, with notable UK examples including TalkTalk, the BBC and HSBC. Similarly, the vulnerability of Government services was highlighted in October 2016 when Dyn, a company that provides DNS services to some of the world's largest digital brands, was subject to a DDoS attack resulting in downtime for a range of Government services.

"Attacks are increasing, both in prevalence and disruptive potential. In addition, cybercriminals have an exponentially increasing number of potential targets because the use of cloud services continues to accelerate and the Internet of Things is expected to expand from an estimated 8.4 billion devices in 2017 to a projected 20.4 billion in 2020."
**The Global Risks Report 2018, 13th Edition, World Economic Forum**

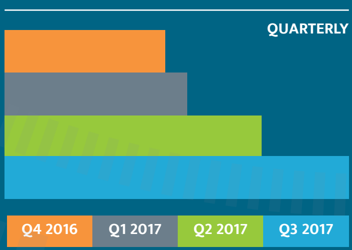
## Average Attack per customer

**8**

Attacks per day

**35%**

Increase in attacks per quarter




## Our Customers

Corero's customers are delighted with our ability to protect their brand and revenues in the face of DDoS attacks. Because of this we have an extremely high renewal rate.

**>95%**

Renewal rate

## Low volume, short duration attacks

While the frequency of attacks is concerning, the size of and duration of attacks are also important to highlight. Approximately 96% of mitigated DDoS attacks were less than 5Gbps in volume, in both Q2 and Q3 2017.

The average duration is also cause for concern. 65% of attacks in Q2 2017 lasted 10 minutes or less, and in Q3, 71% were 10 minutes or less.

**71%**

10 minutes or less

**96%**

Attacks 5Gbps or less

Average Size of DDoS Attacks

| Size | Q4 2016 | Q4 2016 | Q4 2016 | Q4 2016 |
|---|---|---|---|---|
| <1G | 79% | 80% | 82% | 81% |
| 1G – 5G | 18% | 15% | 15% | 15% |
| 5G – 10G | 4% | 4% | 2% | 3% |
| >10G | 1% | 2% | 1% | 1% |

Average Duration of DDoS Attacks

| Minutes | Q4 2016 | Q4 2016 | Q4 2016 | Q4 2016 |
|---|---|---|---|---|
| 0 – 5 | 57% | 56% | 51% | 58% |
| 6 – 10 | 17% | 16% | 14% | 13% |
| 11 – 20 | 7% | 6% | 13% | 11% |
| 21 – 30 | 11% | 12% | 7% | 6% |
| 31 – 60 | 4% | 5% | 8% | 6% |
| >60 | 5% | 5% | 7% | 6% |

Source: Corero DDoS Trends Report Q2-Q3 2017.

## Market opportunity

Corero is targeting a high growth security market; the market for DDoS prevention appliances is forecast by IHS Markit Technology research, a leading analyst, to reach $1.4 billion by 2021 with a CAGR of 15.6% in the period to 2021.

## DDoS market drivers

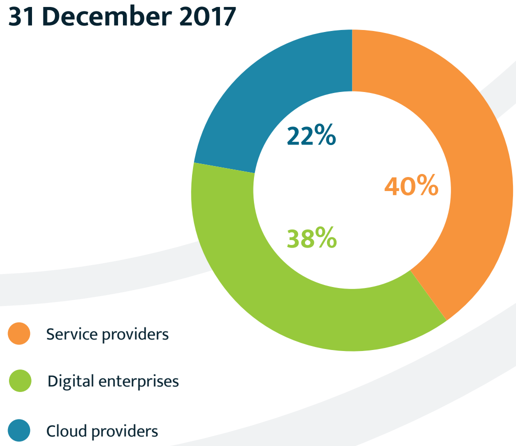
- DDoS attacks represent the dominant threat observed by the vast majority of service providers. (Source: NetScout Arbor's 13th Annual Worldwide Security Report, October 2017)
- Attack sizes have generally risen, but half average less than 10Gbps which reveals determined targeting. (Source: Neustar Global DDoS Attacks & Cyber Security Insights Report, October 2017)
- Service providers deployment of in-line DDoS detection/mitigation systems grew in 2017, an ongoing trend driven by the increased use of best practice hybrid DDoS defence solutions. (Source: NetScout Arbor's 13th Annual Worldwide Security Report, October 2017)
- DDoS attacks ranked as the third most costly form of cyber-attack (behind malware and web-based attacks) with companies spending on average $1.6 million on DDoS attacks (Source: Ponemon Institute 2017 Cost of cyber-crime Study).

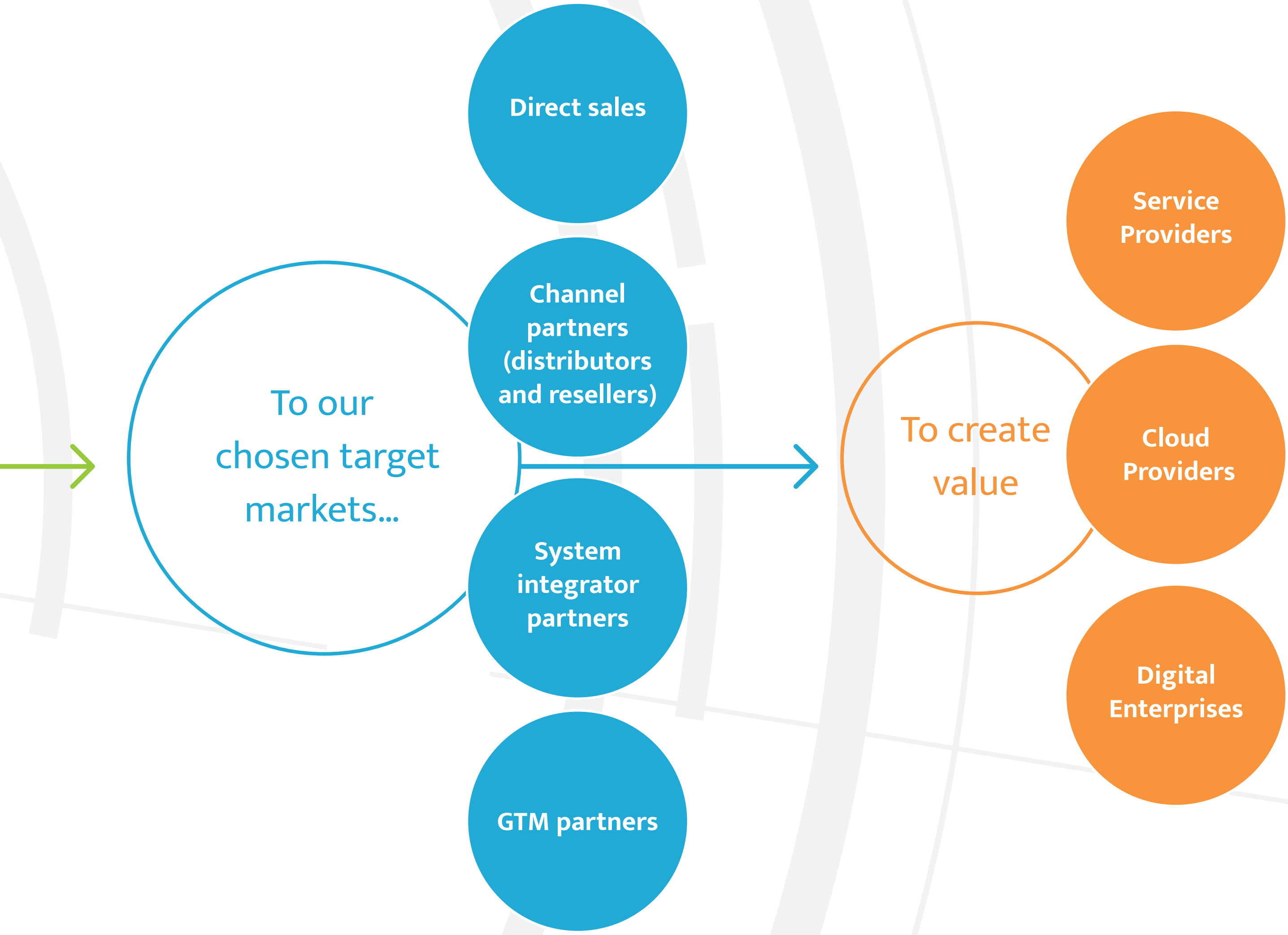
# Our business model

## The Corero business model comprises the development, marketing and sale of network security products and services to provide customers with protection from DDoS attacks.


> "Investing in the Corero SmartWall TDS system is the best solution to more effectively monitor and mitigate DDoS threats automatically, in-line and in real-time. We plan to use the new DDoS mitigation capabilities to create new service offerings that would benefit customers with enhanced service level agreements supported by further secured core networks."
>
> **Tim Berelsman, CEO CNI Independents**

**Sales order intake for the year ended 31 December 2017**






## Routes to Market

Corero has, in 2017, focused on developing and expanding its routes to market which include:

- Corero sales team: selling directly and indirectly with value added distributor and reseller partners in its chosen markets of North America, Europe, and Australia;
- Go-to-market ("GTM") partners: "meet-in-the-market" relationships with leading IT and network technology vendors to leverage these partner's customer and geographic market reach; and
- System integrator partners: relationships with leading systems integrators to leverage their customer and geographic market reach.

Corero sells the SmartWall technology to customers in the form of either (a) an appliance sale and perpetual software license plus annual SecureWatch services, (b) as a software subscription for its virtual appliance software, or (c) as-a-service which enables the customer to utilise the technology on a subscription or revenue share basis (without owning the appliance and software).

SecureWatch services include:

- Updates delivered to the Corero appliances and software instances in customer networks to provide proactive on-going protection from the latest DDoS threats; and
- 24x7x365 monitoring and support services including DDoS attack mitigation services delivered by the Corero Security Operations Centre.

# Our strategy

## The Corero strategy is to develop software and provide services to protect against a continuously evolving DDoS threat landscape that threatens any Internet connected business, or the providers that serve them.

### Product

#### Maintain competitive advantage in real-time DDoS mitigation

New DDoS attack defences

Additional forensics and analytics capabilities

#### Grow customer base

Sell the new SmartWall NTD1100 100Gbps and TDS220 virtual appliance software

Develop the digital enterprise market opportunity through targeted system integrator and GTM partner leverage

### Go To Market

#### Expand routes to market

Generate first $ revenues from GTM partners

Leverage the channel to broaden end-user customer reach

Explore licensing opportunities for the SmartWall virtual appliance software

#### Continue to focus on customer delight

Superior customer service and support

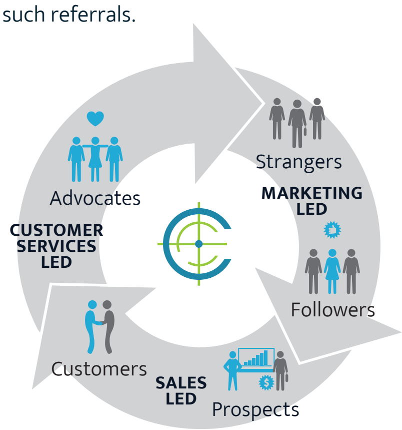
Target world class support and services renewal rates of >90%

At Corero, our most deeply ingrained shared value is "Customer Delight". Far from being a marketing gimmick, delivering on customer delight simply makes good business sense. This becomes ever more true with our increasing levels of recurring business being driven by our support and service renewals in our growing base of SmartWall customers and DDoS Protection as-a-Service business model. Our experience is that delighted customers renew their subscriptions, they buy more products as their businesses grow, and they are happy to share their positive experiences with their industry colleagues.

We measure Customer Delight using our Delight-o-Meter. The science behind this tool is consistent with that promoted by Bain Consulting's Net Promoter Score® ("NPS"). At Corero, we do not explicitly track NPS as each customer relationship is important to us. As such, we frequently take a Delight-o-Meter reading (scaled from 0 to 10). Our readings are consistently high. This delight is reflected in our world-class renewal rates.

Delighted customers are also an important contributor to finding new customers for Corero's products and services.

Our Customer Journey typically begins with "Strangers" being enticed to follow our published content (e.g. research, press releases, blogs) such that they become "Followers". Our marketing automation investments allow us to identify these Followers and to qualify them as "Prospects". In turn, the efforts of our direct and channel sales teams are focussed upon persuading these Prospects to become "Customers". Whilst a new customer order is always a cause for celebration, this event is the starting point for what we hope will become a lasting relationship. Our goal is to deliver a delighted customer who is happy to be an "Advocate" for us in the market. Our Advocates who inform other Strangers close the virtuous circle of our Customer Journey. Many of Corero's sales wins in 2017 came via such referrals.



## KEY INSIGHT

## RDoS

**Ransom Denial of Service ("RDoS") made a significant comeback in Q3 2017. A widespread wave of RDoS threats from the Phantom Squad hacker group kicked off in September. These threats targeted companies throughout the US, Europe and Asia with targets spanning a number of industries – banking, hosting providers, online gaming and SaaS organisations.**

**This extortion campaign launched messages demanding Bitcoin payment, with a threat to execute attacks on September 30 unless the demands were met. Most solutions focus on recovery from such attacks rather than defeating or blocking them.**

## KEY INSIGHT

## Regulations and compliance

- **Freedom of Information data reveals lack of cyber-resilience among Critical National Infrastructure ("CNI") organisations**

Over a third of CNI organisations in the UK (39%) have not completed basic cyber-security standards issued by the UK government, according to data revealed to Corero in August 2017 under the Freedom of Information Act by 163 CNI organisations in the UK, including fire and rescue services, police forces, ambulance trusts, NHS trusts, energy suppliers and transport organisations (out of a total of 338 requests). It suggests that some of these organisations could be liable for fines of up to £17m, or 4% of global turnover, under the UK government's proposals to implement the EU's Network and Information Systems ("NIS") directive.

- **CNI organisations could be ignoring 90% of the DDoS attacks on their networks by not mitigating short duration DDoS attacks, which are frequently used by hackers to distract from data theft attempts**

This research suggests that CNI organisations are not as cyber-resilient as they should be, and must take proactive steps in deploying dedicated, real-time mitigation and visibility solutions to stay ahead of the threat.

DDoS attacks against national infrastructure have the potential to inflict significant, real-life disruption and prevent access to critical services that are vital to the functioning of our economy and society.

Boards and IT professionals of CNI organisations will be worrying about the implications of the NIS Directive, which will come into effect in May 2018. It could mean monetary fines for CNI organisations that experience service outages due to a cyber-attack.

**Over a third of CNI organisations in the UK (39%) have not completed basic cyber-security standards.**

# Principal risks and uncertainties

## Sales growth

Corero's business success depends on growing SmartWall product and Secure Watch Service sales to new customers in its target market of service providers, cloud providers and digital enterprises. If Corero is not successful in identifying customer prospects with a business need Corero can solve, or developing go-to-market partner and channel partner relationships which generate revenue, this will compromise growth plans and success.

To be successful Corero will:

- Focus its lead generation and sales resources, and product development, on its target markets
- Develop relationships with go-to-market partners, channel partners and system integrators to expand its routes to market.

## Market awareness

Corero is an emerging player in the DDoS prevention market and competes with much larger organisations. If Corero is not successful in connecting with the market and raising its profile this will compromise growth plans.

To raise market awareness of Corero and its DDoS mitigation solutions, the Group will invest in targeted public relations and marketing.

## Technology change and innovation

The DDoS mitigation market is competitive and characterised by constant changes in technology, customer requirements and frequent new product introductions and improvements. Cyber-security and DDoS attacks are constantly evolving and changing as attackers develop new methods and tools to evade defences. To be a market leader and to grow, Corero needs to be focused on its chosen market and deliver continuous innovation by adding new DDoS attack defences.

## People

Retaining and recruiting people with the necessary skills and experience. To grow and address the challenges resulting from technology change and innovation in the DDoS mitigation market, the Company needs to retain and recruit the required sales, business development, and technical product development skills. Corero operates in a high growth market with new players emerging. If Corero is unable to recruit and retain the right skills this will compromise growth plans.

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Corero is dependent on revenue growth to deliver on its strategy. Lower sales growth will reduce the Company's cash resources which could impact the investment in product development.

# Financial review

## Corero ended the year strongly, with a record final quarter SmartWall order intake.

SmartWall revenue of $7.9 million grew 43% over the prior year, with the contribution from legacy product revenue only $0.6 million (2016: SmartWall revenue of $5.5 million and legacy product revenue of $3.3 million).

Revenue for the year ending 31 December 2017 was however impacted by delays in world-wide implementation schedules for a large digital enterprise customer win in Q3 2017 and an existing customer's ongoing deployment (with the majority of the revenue from these two customers now expected in the first half of 2018).

SmartWall order intake for the year ending 31 December 2017 was $9.3 million, with 50% representing recurring revenue in the form of support, services, and as-a-service contracts (2016: SmartWall order intake was $6.7 million including recurring revenue order intake of $2.6 million).

The loss for the year after taxation amounted to $8.6 million (2016: $17.2 million including an impairment to goodwill acquired of $9.0 million) and includes:

- Unrealised exchange loss of $0.6 million (2016: gain $1.2 million) arising on an intercompany loan;
- Finance costs of $0.004 million (2016: $0.006 million).

### Review of performance & performance indicators

The Directors monitor a number of metrics, both financial and non-financial, on a monthly basis.

The most important financial metrics are as follows:

- Sales order intake: $9.3 million for the year ended 31 December 2017 (2016: $7.1 million);
- Gross margin: 75% for the year ended 31 December 2017 (2016: 76%). The 2016 revenue included support revenue of $3.3 million from the legacy product (the recognition of support revenue from multi-year contracts). Support revenue gross margins are high, with margins of c.100%. The equivalent revenue in 2017 was $0.6 million;
- Operating expenses (gross of research and development costs capitalised and before unrealised foreign exchange differences on an intercompany loan, depreciation and amortisation): $13.7 million for the year ended 31 December 2017 (2016: $15.6 million gross of research and development costs capitalised and before unrealised foreign exchange differences on an intercompany loan, depreciation, amortisation and impairment of goodwill). Following the mid-year completion of the SmartWall NTD1100 and vNTD virtual software appliance development, Corero optimised its development resources by reducing the size of the development team in the US and increasing the Edinburgh based team with the additional benefit of grant funding for the increased Edinburgh investment. In addition, lower management bonuses were awarded in 2017 versus 2016, and a provision relating to an indemnity provided in relation to the sale of Corero Business Systems in 2013 was released in 2017;
- Research and development $2.2 million (2016: $2.5 million) was spent on the continuing development of the SmartWall product portfolio. These costs relate to (i) the SmartWall NTD120 – 1/10/20 Gbps product, SmartWall NTD1100 – 100Gbps product and the virtual software appliance, and (ii) the Smartwall Service Portal which is sold as an add-on for Service provider and Cloud provider customers; and
- Cash and cash equivalents: $1.4 million at 31 December 2017 (2016: $2.9 million).

The order intake in 2017 comprised $9.3 million of SmartWall orders, an increase of 38% over the prior year (2016: $6.7 million).

The average perpetual license order value in 2017 was $250,000 (2016: $200,000), and the average as-a-service contract value was $40,000 per annum (2016: $40,000 per annum).

The 2017 operating loss of $8.7 million (2016: $17.3 million) includes amortisation of capitalised development expenditure of $2.4 million (2016: $2.3 million). The 2016 operating loss included an impairment to goodwill of $9.0 million.

### Cash and Treasury

The closing cash balance was $1.4 million (2016: $2.9 million). Corero had no debt at 31 December 2017 (2016: $0).

The net reduction in cash from operating activities in the year ended 31 December 2017 was $6.0 million (2016: $5.5 million). In the year ending 31 December 2017, the Company raised $7.0 million (before expenses), of which the Chairman contributed $4.4 million, to fund the further development of the SmartWall product and sales and marketing activities.

On 5 April 2018, Corero will announce a conditional placing and subscription to raise £4.0 million ($5.2 million). In addition, Corero is in advanced discussions with a UK bank to provide a term loan of £3.0 million ($4.2 million), contingent on the Equity Fund Raise. The Bank Loan is expected to be finalised and drawn down following the completion of the Equity Fund Raise.

The Strategic Report on pages 6 to 19 is signed by order of the Board.

**Duncan Swallow**
Company Secretary
4 April 2018

"The drivers and target customers for the DDoS market are an ever-widening and diversifying group as enterprises invest in products for on-premises and hybrid deployments and as service providers upgrade capacity because of massive attacks, network upgrades, and demand from customers for managed DDoS services."
**IHS Markit Technology research, DDoS Prevention Appliances, Biannual Market Tracker, November 2017**

## Financial highlights

Revenue

$8.5m

(2016: $8.8 million)

EBITDA loss before unrealised foreign exchange differences on an intercompany loan, depreciation, amortisation, impairment of goodwill and financing

$5.1m

(2016: $6.4million)

SmartWall revenue

43%

Increase over the prior year, whilst legacy product revenues declined as expected.

Group's net assets at 31 December 2017

$17.5m

(2016: $18.2 million)

Loss per share

3.1c

(2016: 9.0 cents)

"SmartWall revenue increased 43% over the prior year, whilst legacy product revenue reduced as expected."

**Andrew Miller**
Chief Financial Officer

# Board of Directors

## Jens Montanana
Non-Executive Chairman
Age: 57
Appointed: 9 August 2010

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.

## Richard Last
Independent Non-Executive Director
Age: 60
Appointed: 22 May 2008

Richard is Chairman of ITE Group plc and the British Smaller Technology Companies VCT 2 plc both of which are quoted on the London Stock Exchange. He is also Chairman of a number of AIM listed companies including: Gamma Communications plc, a UK telecommunications service provider; Tribal Group plc, a technology group; Arcontech Group plc, a provider of IT solutions for the financial services sector; Lighthouse Group plc, a financial services Group. Richard is also a Director of a number of private companies. Richard is a Fellow of the Institute of Chartered Accountants in England and Wales ("FCA"). Richard is Chairman of the Corero Audit Committee.

## Ashley Stephenson
Chief Executive Officer
Age: 58
Appointed: 6 September 2013

Ashley is an IT industry executive and Internet technology entrepreneur, with operating experience in the United States, Europe and Asia. Previously, he was CEO of Reva Systems, acquired by ODIN, and Xedia Corporation, acquired by Lucent. He has provided strategic advisory services to a number of leading multi-national IT companies including technology vendors, distributors and services companies. Ashley began his career at IBM Research & Development in the UK. He is a graduate of Imperial College, London with a degree in Physics and an Associate of the Royal College of Science.

## Andrew Lloyd

President and Executive Vice President Sales & Marketing
Age: 52
Appointed: 3 January 2017*

Andrew has been involved in the IT software and systems sector for more than 30 years. His career has included roles in early stage companies, high-growth pre-IPO ventures such as Workplace Systems, as well as large corporations such as Computer Associates and Oracle. Andrew has a BSc (Hons), Electronic and Electrical Engineering from Heriot-Watt University, Scotland.

* Andrew Lloyd was appointed an Executive Director on 3 January 2017. He was previously a Non-Executive Director (appointed 19 November 2012).

## Andrew Miller

Chief Financial Officer
Age: 54
Appointed: 9 August 2010

Prior to joining the Company, Andrew was with the Datatec Limited group in a number of roles between 2000 and 2009 including the Logicalis Group 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.

## Duncan Swallow

Company Secretary
Age: 53
Appointed: 1 November 2007

Duncan is responsible for the Company secretarial function 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.

# Chairman's Introduction

## Corero is well placed for continued SmartWall revenue growth.

### Overview

The cyber-security and DDoS market growth fundamentals remain very strong, fuelled by rampant cyber-crime and a growing awareness of the significant threat posed by cyber-attacks, including DDoS, as well as pending regulations.

Corero has a market leading SmartWall product portfolio which has been further enhanced in 2017 with new SmartWall 100Gbps and virtual appliance software products.

### Our employees and values

Successful companies have a strong culture and deeply rooted shared values.
In common with most intellectual property businesses, at Corero, we know that the skills, experiences and passion of our employees are genuinely what make our products and services work. The Corero culture has been shaped by our decade-long experience in the United States and our more recent expansion in Europe. Corero's team in Scotland is especially diverse; we have team members from seven European nations based in Edinburgh.

With a growing business, the level of team diversity and multi-site operations, we have recognised the importance of our culture and values. During the year, we invested in bringing the whole company to Scotland for a meeting that we called "The Gathering". At The Gathering, the team agreed Corero's values and refined the definition of these values. Corero's agreed values are:

- Integrity
- Customer delight
- Innovation
- Open and honest communications
- Empowerment

More recently, Corero invested in an online tool, known as Kudos, which is being used to acknowledge, reinforce and measure the values-supporting behaviours and actions taken by team members.

### Board changes

The notice of AGM will include a resolution to reappoint Jens Montanana and Andrew Miller who retire by rotation in accordance with the Company's Articles of Association.

### Looking ahead

With its market leading SmartWall product and the significant investment made in the SmartWall technology, and the strategy of expanding Corero's routes to market through channels and go to market partners, the business is well placed to deliver on its strategic goals and become a leading player in the DDoS mitigation market.

I would like to give special thanks to our institutional and private investors for their continued support of the Company's strategy and funding requirements.

Finally, thank you to all our employees for their hard work and commitment.

**Jens Montanana**
Chairman
29 March 2018

"I am confident the business will deliver on its strategic goals and become a leading player in the DDoS mitigation market."

**Jens Montanana**
Chairman

# Corporate Governance Report

Corero has taken note of the UK Corporate Governance Code ("the UK Code") published in April 2016. The UK Code and associated guidance can be found on the Financial Reporting Council website at www.frc.org.uk/corporate/ukcgcode.cfm. The rules of the London Stock Exchange do not require companies that have securities traded on AIM to formally comply with the UK Code and the Company does not seek to formally comply nor give a statement of compliance. However, the Board is accountable to the Company's shareholders for good governance and has sought to apply those principles of corporate governance commensurate with the Company's size. The Company's approach is set out 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 Chief Executive Officer.

The Board of Directors comprises the Non-Executive Chairman, three Executive Directors and one Non-Executive Director whose Board and Committee responsibilities as at 4 April 2018 are set out below:

| | Board | Audit | Remuneration |
|---|---|---|---|
| Jens Montanana | Chairman | Member | Chairman |
| Ashley Stephenson | Member | | |
| Andrew Lloyd | Member | | |
| Andrew Miller | Member | | |
| Richard Last | Member | Chairman | 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.

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. Jens Montanana and Andrew Miller 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 for 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;
- 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 2017, the Board received monthly briefings on the Group's performance (including detailed commentary and analysis), key issues and risks affecting the Group's business.

# Corporate Governance Report continued

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 2017 the Board met on 5 scheduled occasions; further meetings and conference calls were held as and when necessary. Details of Directors' attendance at scheduled meetings in the year to 31 December 2017 is shown in the table below:

| | Meetings attended |
|---|---|
| Jens Montanana | 5/5 |
| Ashley Stephenson | 5/5 |
| Andrew Miller | 4/5* |
| Richard Last | 5/5 |
| Andrew Lloyd | 5/5 |

* Andrew Miller was unable to attend one scheduled Board meeting due to illness.

## 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 Chief Financial Officer and Group Financial Controller, 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 interim financial statements, preliminary results 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 2017. The attendance of individual Committee members at Audit Committee meetings in the year to 31 December 2017 is shown in the table below:

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

## Remuneration Committee

The Remuneration Committee comprises Jens Montanana, who is the Committee Chairman, and Richard Last. The Remuneration Committee 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.

In the year ended 31 December 2017, the Remuneration Committee Board met on four scheduled occasions; further meetings and conference calls were held as and when necessary. The attendance of individual Committee members at Remuneration Committee meetings in the year to 31 December 2017 is shown in the table below:

| | Meetings attended |
|---|---|
| Jens Montanana | 4/4 |
| Richard Last | 4/4 |

## 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. There were no specific reports tabled during the year ended 31 December 2017.

The Group operates a risk management process, which is embedded in normal management and governance processes. As part of the annual and budgeting process, the Group 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 any reports prepared on internal controls by management and any issues identified by external auditors.

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 management 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 2017 are disclosed in note 25 of the financial statements.

Details of Directors' remuneration for the year ended 31 December 2017 is set out in note 22 of the financial statements. Jens Montanana has elected to waive the fees payable to him for the financial year ended 31 December 2017.

Ashley Stephenson, Executive Director, has a service agreement which provides for the payment of six months' base salary if the agreement is terminated by the Company without cause.

Andrew Lloyd, Executive Director, has an employment agreement which can be terminated by either party on not less than three months' written notice increasing by one month at the end of each complete 12 month period of continuous employment provided that the notice period shall not exceed six months in total. The agreement contains provisions for early termination in certain circumstances.

Andrew Miller, Executive Director, has an employment agreement which can be terminated by either party on not less than three months' written notice increasing by one month at the end of each complete 12 month period of continuous employment provided that the notice period shall not exceed six months in total. The agreement contains provisions for early termination in certain circumstances.

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.

"Despite continued discussions about nation state attackers, security professionals believe that criminal extortionists are the most likely group to inflict a DDoS attack against their organisations, with 38% expecting attacks to be financially motivated. By contrast, just 11% believe that hostile nations would be behind a DDoS attack against their organisation."

**Corero survey conducted at InfoSecurity 2017**

# Directors' Report

## Group results

The Group's Statement of Comprehensive Income on page 34 shows a loss for the year of $8.6 million (2016: $17.2 million).

## Going concern

The financial position and cash flows are described in the Financial Review on pages 18 and 19. An indication of likely future developments affecting the Company is included in the Strategic Report on pages 6 to 19.

On 5 April 2018, Corero will announce a conditional placing and subscription to raise £4.0 million ($5.2 million). In addition, Corero is in advanced discussions with a UK bank to provide a term loan of £3.0 million ($4.2 million), contingent on the Equity Fund Raise. The Bank Loan is expected to be finalised and drawn down following the completion of the Equity Fund Raise.

A circular containing a notice of General Meeting will be sent to shareholders on 5 April 2018. At the General Meeting to be convened on 26 April 2018, Corero shareholders will be asked to approve the Equity Fund Raise. Since the participants in the Equity Fund Raise include shareholders which at 4 April 2018 held more than 75% of the Company's issued shares, it is anticipated that the resolutions to approve the Equity Fund Raise will be duly passed.

The Board are confident that the Equity Fund Raise and Bank Loan will be completed successfully.

The Directors believe that on the basis of a successful Equity Fund Raise and draw down of the Bank Loan, that the Company and the Group have, or have access to, the necessary financial resources to continue operating for the foreseeable future.

The Directors are of the opinion that the Group and Company 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.

On this basis, the Directors have therefore concluded that it is appropriate to prepare the financial statements on a going concern basis. However, in the absence of certainty that the Equity Fund Raise and Bank Loan will successfully complete as anticipated, a material uncertainty exists which may cast significant doubt over the Group's and Company's ability to continue as a going concern. The financial statements do not include the adjustments that would result if the Group and Company was unable to continue as a going concern. Further details are included within note 2 to the financial statements on page 40.

## Dividends

The Directors have not recommended a dividend (2016: $nil).

## 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 20 to the financial statements.

As at the date of this report, 315,417,642 ordinary shares of 1p each ("ordinary shares") were in issue and fully paid with an aggregate nominal value of $3.2 million.

The market price of the ordinary shares at 31 December 2017 was 6.75p and the shares traded in the range 5.05p to 12.875p during the year.

## Issue of shares

At the AGM held on 20 June 2017, 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 £678,058.

Also at the AGM held on 20 June 2017, 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 £203,418 without application of the statutory pre-emption rights contained in section 561 (1) of the Act.

## 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 4 April 2018:

| Ordinary shares of 1 pence each | Number | % |
|---|---|---|
| Jens Montanana* | 138,000,000 | 43.8 |
| Miton UK Microcap Trust PLC | 28,185,555 | 8.9 |
| Richard John Koch | 26,370,500 | 8.4 |
| Herald Investment Management | 25,006,406 | 7.9 |
| Sabvest Capital Holdings Limited | 20,500,000 | 6.5 |
| Peter Kennedy Gain** | 17,433,333 | 5.5 |

* of which 25,987,889 are held in the name of JPM International Limited, which is wholly owned by Jens Montanana, and 94,258,302 are held in the name of The New Millennium Technology Trust of which Jens Montanana is a beneficiary.

** of which 4,900,000 shares are held in the name of Draper Gain Investments Ltd.

## Directors' shareholdings

| | 4 April 2018 | | 31 December 2017 | | 31 December 2016 | |
|---|---|---|---|---|---|---|
| | Number | % | Number | % | Number | % |
| Jens Montanana | 138,000,000 | 43.8 | 138,000,000 | 43.8 | 69,303,990 | 34.1 |
| Ashley Stephenson | 35,000 | 0.0 | 38,000 | 0.0 | 38,000 | 0.0 |
| Andrew Miller | 1,091,437 | 0.4 | 1,091,437 | 0.4 | 891,437 | 0.4 |
| Richard Last | 1,316,667 | 0.4 | 1,316,667 | 0.4 | 1,316,667 | 0.7 |
| Andrew Lloyd | 300,000 | 0.1 | 300,000 | 0.1 | – | – |

## Directors' indemnities

The Company has qualifying third party indemnity provisions in place for the benefit of its Directors. These remain in force at the date of this report.

## 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 above.

The biographical details of the current Directors of the Company are given on pages 20 and 21.

Jens Montanana, Ashley Stephenson, Andrew Miller, Richard Last and Andrew Lloyd hold share options, details of which are shown in note 25 to the financial statements.

## Financial risk management objectives and policies

The Group's business activities expose it to a variety of financial risks. The policies for managing these risks are described below:

- Liquidity risk – arises from the Group's management of working capital and finance charges. It is a risk that the Group will encounter difficulty in meeting its financial obligations as they fall due. Liquidity risk is managed by the finance function. Budgets are agreed by the Board annually in advance, enabling the Group's cash flow requirements to be anticipated.
- 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 14).

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

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

- Cash flow interest rate risk – the Group's policy is to minimise interest rate cash flow risk exposure on its financing. The Group's policy is to balance the risk in relation to cash balances held by spreading these across a number of financial institutions as opposed to maximising interest income
- Currency risk – there is no material impact on the Group's profit or loss for the year 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. An exchange rate risk does arise in relation to equity fund raises which are in GBP, given the Company's AIM listing, to the extent these funds are required to support US dollar denominated funding requirements. The Group has not hedged such GBP fund raises in the past but will review this policy based on the expected timing of US dollar and GBP operational funding requirements.

The principal risk which applies to the parent Company's financial statements is the risk that the returns generated by the subsidiaries might not support the carrying value of the cost of the investments in subsidiaries. The carrying value is tested at least annually for impairment and, if necessary, impaired.

## Capital management

The Group monitors its available capital, which it considers to be all components of equity 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 Company may return capital to shareholders, issue new shares, or sell assets. The Group does not review its capital requirements according to any specified targets or ratios.

# Directors' Report continued

## Treasury management

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 Financial Controller who reports to the Board on the implementation of Group treasury policy.

## 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. The Group complies with local WEEE regulations. 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 $2.2 million (2016: $2.5 million) was made during the year. Amortisation of $2.4 million (2016: $2.3 million) and costs not capitalised of $1.5 million (2016: £2.4 million) were 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 Company's progress. 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 plans to provide incentives for achievements which add value to the business.

## Post balance sheet event

On 5 April 2018 Corero will announce a conditional placing and subscription to raise £4.0 million ($5.6 million) before expenses. This Equity Fund Raise is subject to shareholder approval at a general meeting of the Company on 26 April 2018.

## Annual General Meeting

A circular including the notice convening the AGM together with the details of the business to be considered will be sent to shareholders in due course.

## 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.

By order of the Board

**Duncan Swallow**
Company Secretary
4 April 2018

"According to Gartner, the cyber-security industry will break another record in 2017 for spending—analysts predict organizations worldwide will shell out $90 billion. Despite this increased spending, the cost of cyber-crime continues to outpace investments in enterprise security and risk products; in 2016, cyber-crime cost the worldwide economy $450 billion. Cyber-crime is a dark industry, and it is making money hand over fist by probing for weaknesses in enterprise security infrastructure."
**NSS Labs, January 2018**

# 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"). The Directors have chosen to prepare the Company financial statements in accordance with FRS101. 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 they have been prepared in accordance with IFRSs as adopted by the European Union, 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

## Opinion
We have audited the financial statements of Corero Network Security plc (the 'parent company') and its subsidiaries (the 'Group') for the year ended 31 December 2017 which comprise the consolidated statement of comprehensive income, the consolidated statement of financial position, the company statement of financial position, the consolidated statement of cash flows, the consolidated statement of changes in equity, the company statement of changes in equity and notes to the financial statements, including a summary of significant accounting policies.

The financial reporting framework that has been applied in the preparation of the Group financial statements is applicable law and International Financial Reporting Standards ("IFRSs") as adopted by the European Union. The financial reporting framework that has been applied in the preparation of the parent company financial statements is applicable law and United Kingdom Accounting Standards, including Financial Reporting Standard 101 Reduced Disclosure Framework (United Kingdom Generally Accepted Accounting Practice).

In our opinion:

- the financial statements give a true and fair view of the state of the Group's and of the parent company's affairs as at 31 December 2017 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 United Kingdom Generally Accepted Accounting Practice; and
- the financial statements have been prepared in accordance with the requirements of the Companies Act 2006.

## Basis for opinion
We conducted our audit in accordance with International Standards on Auditing (UK) ("ISAs (UK)") and applicable law. Our responsibilities under those standards are further described in the Auditor's responsibilities for the audit of the financial statements section of our report. We are independent of the Group and the parent company in accordance with the ethical requirements that are relevant to our audit of the financial statements in the UK, including the FRC's Ethical Standard as applied to listed entities, and we have fulfilled our other ethical responsibilities in accordance with these requirements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

## Material uncertainty related to going concern
We draw attention to note 2 in the financial statements which states that the Group and the parent company is reliant on securing additional funding, which it has planned to secure by means of an Equity Fund Raise and Bank Loan. The planned Equity Fund Raise is subject to Corero shareholder approval at a General Meeting which will be convened after the date of these financial statements and may or may not be forthcoming. In addition, the Company has received a credit approved Bank Loan offer, which is subject to final agreement of loan documentation and is contingent on the Equity Fund Raise. If finalised it will only be drawn down after the date of these financial statements.

These events or conditions indicate that material uncertainties exist that may cast significant doubt on the Group and the parent company's ability to continue as a going concern. Our opinion is not modified in respect of this matter.

Given the conditions and uncertainties noted above we considered going concern to be a key audit matter. We have performed the following work as part of our audit:

- we reviewed the terms of the Bank Loan and Equity Fund Raise documents to understand the conditions attached to both the Bank Loan and Equity Fund Raise;
- we reviewed the Bank Loan covenant terms and whether these are likely to be met based upon cash flow forecasts;
- we considered whether the terms of the Bank Loan and Equity Fund Raise are in line with the disclosures in the financial statements; and
- we reviewed and challenged the Directors' forecasts used to assess the Group's and Company's ability to meet its financial obligations as they fall due for a period of at least 12 months from the date of approval of the financial statements, taking in to account the additional funding expected to be received.

## Use of our report
This report is made solely to the parent 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 parent 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 parent company and the parent company's members as a body, for our audit work, for this report, or for the opinions we have formed.

## Key audit matters

In addition to the matter described in the material uncertainty related to going concern section, key audit matters are those matters that, in our professional judgment, were of most significance in our audit of the financial statements of the current period and include the most significant assessed risks of material misstatement (whether or not due to fraud) we identified, including those which had the greatest effect on: the overall audit strategy, the allocation of resources in the audit; and directing the efforts of the engagement team. These matters were addressed in the context of our audit of the financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters.

| Key audit matter | How we addressed the Key Audit Matter in the Audit |
|---|---|
| **Revenue recognition** | |
| See accounting policy at note 2.5.<br><br>The Group generates revenue primarily from the sale of hardware and associated software and related maintenance and support contracts. It does this through arrangements with direct end-users, either through the sale of hardware and a software licence or by selling the software as-a-service, as well as to distributors.<br><br>We considered there to be a significant audit risk arising from the allocation of the value of the transaction between the multiple elements or deliverables included in the sale as well as the timing of revenue recognition with regard to proper deferral of support revenues. | Our audit procedures included assessing the appropriateness of the revenue recognition policy in accordance with IAS 18.<br><br>We gained an understanding of the detail of the Group's methodology in determining the fair value of the different deliverables in multiple element arrangements as set out in note 2.5 and interrogated the approach, comparing the quantitative measures by which BESP was determined to actual pricing practices used by the company, to ensure it provided a suitable basis on which to recognise revenues.<br><br>For each type of revenue, we selected a sample of contracts for testing. We assessed whether the revenue recognised was calculated in accordance with the Group's accounting policy.<br><br>We also tested the accuracy of the deferred income balance, which arises most commonly on deferred maintenance and support income, and tested a sample of transactions around the year end to ensure that they were recorded in the correct period.<br><br>Finally, in relation to the Group's SaaS revenues, a sample of contracts was obtained, and the revenue recognition in relation to these contracts was confirmed as appropriate. |
| **Goodwill and intangible asset impairment risk** | |
| See accounting policy at note 2.12 and note 8.<br><br>In accordance with IAS 36, goodwill is tested for impairment annually and other non-current tangible assets with finite lives are tested for impairment whenever an indicator of impairment arises.<br><br>Management performed an impairment review over its sole cash generating unit ("CGU") – Corero Network Security ("CNS") – as at 31 December 2017 using a discounted cash flow model to calculate fair value less costs to sell. The impairment review necessitates significant management judgement over the timing and degree of certainty attaching to future net cash flows and the rate at which those cash flows should be discounted to present value.<br><br>The recoverable amount of the Group's CNS CGU was assessed as being higher than its carrying value at the reporting date.<br><br>Management concluded that the goodwill and intangible assets were not impaired at the reporting date. | Our work on the impairment reviews prepared by management had a dual focus: firstly, to ensure the model was mechanically accurate and prepared in accordance with the detailed requirements of IAS36 and secondly, to ensure that the assumptions regarding future cash flows and the rate at which they had been discounted were appropriate to the Group's circumstances.<br><br>We used specialists in order to assist with our interrogation of the model and to support our assessment of the treatment of future tax savings arising from available losses. This work also included comparison to industry data, historic trading, and macro-economic factors.<br><br>Our audit procedures relating to the review of operating cash flows included verification of the existence of selected future sales opportunities which are expected to drive growth in 2018, as well as a comparison of previous performance to expectations.<br><br>We took into account previous shortfalls against sales targets and discussed key sensitivities with those charges with governance. Fundamental to this evaluation was a comparison of the forecasts in the impairment review to recent financial performance and budgets approved by the Board, verifying that the sensitivities prepared by management were sufficiently challenging.<br><br>We also examined development cost intangible assets and property, plant and equipment to determine that there no additional impairment indicators in respect of specific assets within the CGU. |

# Independent Auditor's Report continued
to the members of Corero Network Security plc

## Our application of materiality

We apply the concept of materiality both in planning and performing our audit, and in evaluating the effect of misstatements. For planning, we consider materiality to be the magnitude by which misstatements, including omissions, could influence the economic decisions of reasonable users that are taken on the basis of the financial statements. In order to reduce to an appropriately low level the probability that any misstatements exceed materiality, we use a lower materiality level, performance materiality, to determine the extent of testing needed. Importantly, misstatements below these levels will not necessarily be evaluated as immaterial as we also take account of the nature of identified misstatements, and the particular circumstances of their occurrence, when evaluating their effect on the financial statements as a whole.

### Level of materiality applied and rationale

We consider EBITDA to be the most appropriate performance measure for the basis of materiality in respect of the audit of the Group as this measure reflects the Group's profitability excluding the impact of non-operating charges. EBITDA is calculated for this purpose as Operating Loss adjusted for depreciation and amortisation. Using this benchmark, we set materiality at $291,000 (2016: $255,000) being 5% of EBITDA.

Materiality in respect of the audit of the parent company has been set at $145,000, based on 50% of Group materiality.

Performance materiality was set at 75% of materiality for both the Group and parent company audits. In setting the level of performance materiality we considered a number of factors including the expected total value of known and likely misstatements (based on past experience and other factors) and management's attitude towards proposed adjustments.

### Component materiality

We set materiality for the Corero Network Security, Inc. component of the Group based on 90% of Group materiality as it makes up all of the Group's external revenue generating activities. UK components were audited to a lower materiality of between 10% and 50% of Group materiality. In the audit of each component, we further applied a performance materiality level of 75% of the component materiality level to our testing to ensure that the risk of errors exceeding component materiality was appropriately mitigated.

### Agreement with the Audit Committee

We agreed with the Audit Committee that we would report to the Committee all audit differences individually in excess of $14,000 (2016: £13,000). We also agreed to report differences below this threshold that, in our view, warranted reporting on qualitative grounds.

## An overview of the scope of our audit

Our Group audit was scoped by obtaining an understanding of the Group and its environment, including the Group's system of internal control, and assessing the risks of material misstatement in the financial statements at the Group level.

We obtained an understanding of the entity-level controls of the Group as a whole which assisted us in identifying and assessing risks of material misstatement due to fraud or error, as well as assisting us in determining the most appropriate audit strategy.

A full scope audit was performed for each component included in the consolidation. All audit work was undertaken by the Group audit team.

## Other information

The directors are responsible for the other information. The other information comprises the information included in the annual report, other than the financial statements and our auditor's report thereon. Our opinion on the financial statements does not cover the other information and, except to the extent otherwise explicitly stated in our report, we do not express any form of assurance conclusion thereon.

In connection with our audit of the financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit or otherwise appears to be materially misstated. If we identify such material inconsistencies or apparent material misstatements, we are required to determine whether there is a material misstatement in the financial statements or a material misstatement of the other information. If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report in this regard.

## Opinions on other matters prescribed by the Companies Act 2006

In our opinion, based on the work undertaken in the course of the audit:

- the information given in the strategic report and the directors' report for the financial year for which the financial statements are prepared is consistent with the financial statements; and
- the strategic report and the directors' report have been prepared in accordance with applicable legal requirements.

## Matters on which we are required to report by exception

In the light of the knowledge and understanding of the Group and the parent company and its environment obtained in the course of the audit, we have not identified material misstatements in the strategic report or the directors' report.

We have nothing to report in respect of the following matters in relation to which 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.

## Responsibilities of directors

As explained more fully in the directors' responsibilities statement, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view, and for such internal control as the directors determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, the directors are responsible for assessing the Group's and the parent company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless the directors either intend to liquidate the Group or the parent company or to cease operations, or have no realistic alternative but to do so.

## Auditor's responsibilities for the audit of the financial statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs (UK) will always detect a material misstatement when it exists.

Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

A further description of our responsibilities for the audit of the financial statements is located on the Financial Reporting Council's website at: www.frc.org.uk/auditorsresponsibilities. This description forms part of our auditor's report.

**Julian Frost (Senior Statutory Auditor)**
For and on behalf of BDO LLP, Statutory Auditor
London

4 April 2018

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 2017

| | Note | Total 2017 $'000 | Total 2016 $'000 |
|---|---|---|---|
| **Revenue** | 4 | 8,531 | 8,772 |
| Cost of sales | | (2,126) | (2,071) |
| **Gross profit** | | 6,405 | 6,701 |
| Operating expenses before highlighted items | | (12,157) | (11,847) |
| Depreciation* and amortisation of intangible assets | 9,10,11 | (2,938) | (3,128) |
| Impairment of goodwill | 8 | – | (8,992) |
| Operating expenses | | (15,095) | (23,967) |
| **Operating loss** | | (8,690) | (17,266) |
| Finance income | | 5 | 9 |
| Finance costs | | (4) | (6) |
| **Loss before taxation** | | (8,689) | (17,263) |
| Taxation | 6 | 116 | 85 |
| **Loss for the year** | | (8,573) | (17,178) |
| **Other comprehensive expense** | | | |
| Items that will or may be reclassified to profit and loss: | | | |
| Difference on translation of UK functional currency entities | | 805 | (2,355) |
| **Total comprehensive expense for the year** | | (7,768) | (19,533) |
| **Total loss for the year attributable to:** | | | |
| Equity holders of the parent | | (8,573) | (17,178) |
| **Total** | | (8,573) | (17,178) |
| **Total comprehensive expense for the year attributable to:** | | | |
| Equity holders of the parent | | (7,768) | (19,533) |
| **Total** | | (7,768) | (19,533) |

| **Basic and diluted loss per share** | | 2017 Cents | 2016 Cents |
|---|---|---|---|
| Basic and diluted loss per share | 7 | (3.1) | (9.0) |

* DDoS as-a-service depreciation charged to cost of sales

The notes on pages 40 to 63 form part of these financial statements.

# Consolidated Statement of Financial Position

as at 31 December 2017

| | Note | 2017 $'000 | 2016 $'000 |
|---|---|---|---|
| **Assets** | | | |
| **Non-current assets** | | | |
| Goodwill | 8 | 8,991 | 8,991 |
| Acquired intangible assets | 9 | 37 | 82 |
| Capitalised development expenditure | 10 | 7,664 | 7,901 |
| Property, plant and equipment | 11 | 770 | 970 |
| Trade and other receivables | 14 | 76 | 80 |
| | | 17,538 | 18,024 |
| **Current assets** | | | |
| Inventories | 13 | 94 | 65 |
| Trade and other receivables | 14 | 2,955 | 2,227 |
| Cash and cash equivalents | | 1,365 | 2,940 |
| | | 4,414 | 5,232 |
| **Liabilities** | | | |
| **Current Liabilities** | | | |
| Trade and other payables | 15 | (1,305) | (1,728) |
| Deferred income | 18 | (2,896) | (2,457) |
| | | (4,201) | (4,185) |
| **Net current assets** | | 213 | 1,047 |
| **Non-current liabilities** | | | |
| Deferred income | 18 | (287) | (855) |
| | | (287) | (855) |
| **Net assets** | | 17,464 | 18,216 |
| **Total equity attributable to owners of the parent** | | | |
| Ordinary share capital | 20 | 4,556 | 3,119 |
| Capital redemption reserve | | 7,051 | 7,051 |
| Share premium | 21 | 73,239 | 67,681 |
| Share options reserve | | 322 | 301 |
| Translation reserve | | (1,318) | (2,123) |
| Retained earnings | | (66,386) | (57,813) |
| **Total equity** | | 17,464 | 18,216 |

These financial statements were approved by the Board of Directors on 4 April 2018 and signed on their behalf.

**Andrew Miller**

Director

The notes on pages 40 to 63 form part of these financial statements.

# Company Statement of Financial Position (Company number 02662978)
as at 31 December 2017

| | Note | 2017 $'000 | 2016 $'000 |
|---|---|---|---|
| **Assets** | | | |
| **Non-current assets** | | | |
| Investments in subsidiaries | 12 | 21,015 | 21,137 |
| Trade and other receivables | 14 | 7,043 | 5,409 |
| | | 28,058 | 26,546 |
| **Current assets** | | | |
| Cash and cash equivalents | | 680 | 2,504 |
| **Net assets** | | 28,738 | 29,050 |
| **Equity** | | | |
| Ordinary share capital | 20 | 4,556 | 3,119 |
| Capital redemption reserve | | 7,051 | 7,051 |
| Share premium | 21 | 73,239 | 67,681 |
| Share options reserve | | 322 | 301 |
| Translation reserve | | (10,019) | (13,157) |
| Retained earnings | | (46,411) | (35,945) |
| **Total equity** | | 28.,738 | 29,050 |

The Company financial statements were prepared in accordance with Financial Reporting Standard 101 Reduced Disclosure Framework. The Company has taken advantage of the following disclosure exemptions:

The requirements of IAS 7 Statement of Cash Flows, IFRS 7 Financial Instruments: Disclosures and IAS 24 Related Party Disclosures.

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 loss for the year was $10.5 million (2016: loss $20.0 million).

These financial statements were approved by the Board of Directors on 4 April 2018 and signed on their behalf.

**Andrew Miller**
Director

The notes on pages 40 to 63 form part of these financial statements.

# Consolidated Statement of Cash Flows

for the year ended 31 December 2017

| | | Group | |
|---|---|---|---|
| **Cash flows from operating activities** | **Note** | **2017 $'000** | **2016 $'000** |
| Loss for the year | | (8,573) | (17,178) |
| Adjustments for non-cash movements: | | | |
| Amortisation of acquired intangible assets | 9 | 55 | 325 |
| Impairment loss on intangible assets | 8 | – | 8,992 |
| Amortisation and impairment of capitalised development expenditure | 10 | 2,408 | 2,252 |
| Depreciation | 11 | 548 | 551 |
| Loss on sale of property, plant and equipment | | – | 9 |
| Finance income | | (5) | (9) |
| Finance expense | | 4 | 6 |
| Taxation | 6 | (116) | (85) |
| Qualifying research and development expenditure tax credit | | 116 | – |
| Share-based payment charge | 25 | 21 | 19 |
| Decrease in inventories and as-a-service assets | | 127 | 596 |
| (Increase)/decrease in trade and other receivables | | (33) | 1,605 |
| Decrease in payables | | (596) | (2,623) |
| **Net cash used in operating activities** | | (6,044) | (5,540) |
| | | | |
| **Cash flows from investing activities** | | | |
| Purchase of intangible assets | 9 | (10) | (32) |
| Capitalised development expenditure | 10 | (2,171) | (2,533) |
| Purchase of property, plant and equipment | 11 | (497) | (644) |
| **Net cash used in investing activities** | | (2,678) | (3,209) |
| | | | |
| **Cash flows from financing activities** | | | |
| Net proceeds from issue of ordinary share capital | | 6,995 | 11,392 |
| Finance income | | 5 | 9 |
| Finance expense | | (4) | (6) |
| **Net cash from financing activities** | | 6,996 | 11,395 |
| | | | |
| Effects of exchange rates on cash and cash equivalents | | 151 | (2,412) |
| Net (decrease)/increase in cash and cash equivalents | | (1,575) | 234 |
| Cash and cash equivalents at 1 January | | 2,940 | 2,706 |
| **Cash and cash equivalents at 31 December** | | 1,365 | 2,940 |

The notes on pages 40 to 63 form part of these financial statements.

# Consolidated Statement of Changes in Equity
for the year ended 31 December 2017

| | Share capital $'000 | Capital redemption reserve $'000 | Share premium account $'000 | Share options reserve $'000 | Translation reserve $'000 | Retained earnings $'000 | Total attributable to equity holders of the parent $'000 |
|---|---|---|---|---|---|---|---|
| **1 January 2016** | 2,573 | 7,051 | 56,835 | 282 | 232 | (40,635) | 26,338 |
| Loss for the year | – | – | – | – | – | (17,178) | (17,178) |
| Other comprehensive income | – | – | – | – | (2,355) | – | (2,355) |
| **Total comprehensive expense for the year** | – | – | – | – | (2,355) | (17,178) | (19,533) |
| **Contributions by and distributions to owners** | | | | | | | |
| Share-based payments | – | – | – | 19 | – | – | 19 |
| Issue of share capital | 546 | – | 10,846 | – | – | – | 11,392 |
| **Total contributions by and distributions to owners** | 546 | – | 10,846 | – | – | – | 11,392 |
| **31 December 2016 and 1 January 2017** | 3,119 | 7,051 | 67,681 | 301 | (2,123) | (57,813) | 18,216 |
| Loss for the year | – | – | – | – | – | (8,573) | (8,573) |
| Other comprehensive income | – | – | – | – | 805 | – | 805 |
| **Total comprehensive expense for the year** | – | – | – | – | 805 | (8,573) | (7,768) |
| **Contributions by and distributions to owners** | | | | | | | |
| Share-based payments | – | – | – | 21 | – | – | 21 |
| Issue of share capital | 1,437 | – | 5,558 | – | – | – | 6,995 |
| **Total contributions by and distributions to owners** | 1,437 | – | 5,558 | 21 | – | – | 7,016 |
| **31 December 2017** | 4,556 | 7,051 | 73,239 | 322 | (1,318) | (66,386) | 17,464 |

The share capital comprises the nominal values of all shares issued.

The capital redemption reserve comprises the amount transferred from deferred shares on redemption of the deferred shares.

The share premium account comprises the amounts subscribed for share capital in excess of the nominal value.

The share options reserve represents the cost to the Group of share options.

The translation reserve arises on retranslating the net assets of UK operations into US dollars.

The retained earnings are all other net gains and losses and transactions with owners not recognised elsewhere.

The notes on pages 40 to 63 form part of these financial statements.

# Company Statement of Changes in Equity
for the year ended 31 December 2017

| | Share capital $'000 | Capital redemption reserve $'000 | Share premium account $'000 | Share options reserve $'000 | Translation reserve $'000 | Retained earnings $'000 | Total equity $'000 |
|---|---|---|---|---|---|---|---|
| **1 January 2016** | 2,573 | 7,051 | 56,835 | 282 | (3,755) | (15,970) | 47,016 |
| Loss for the year | – | – | – | – | – | (19,975) | (19,975) |
| Other comprehensive income | – | – | – | – | (9,402) | – | (9,402) |
| **Total comprehensive expense for the year** | – | – | – | – | (9,402) | (19,975) | (29,377) |
| **Contributions by and distributions to owners** | | | | | | | |
| Share-based payments | – | – | – | 19 | – | – | 19 |
| Issue of share capital | 546 | – | 10,846 | – | – | – | 11,392 |
| **Total contributions by and distributions to owners** | 546 | – | 10,846 | 19 | – | – | 11,411 |
| **31 December 2016 and 1 January 2017** | 3,119 | 7,051 | 67,681 | 301 | (13,157) | (35,945) | 29,050 |
| Loss for the year | – | – | – | – | – | (10,466) | (10,466) |
| Other comprehensive income | – | – | – | – | 3,138 | – | 3,138 |
| **Total comprehensive expense for the year** | – | – | – | – | 3,138 | (10,466) | (7,328) |
| **Contributions by and distributions to owners** | | | | | | | |
| Share-based payments | – | – | – | 21 | – | – | 21 |
| Issue of share capital | 1,437 | – | 5,558 | – | – | – | 6,995 |
| **Total contributions by and distributions to owners** | 1,437 | – | 5,558 | 21 | – | – | 7,016 |
| **31 December 2017** | 4,556 | 7,051 | 73,239 | 322 | (10,019) | (46,411) | 28,738 |

The notes on pages 40 to 63 form part of these financial statements.

# Notes to the Financial Statements

## 1. General information

### Presentation currency

These consolidated financial statements are presented in US dollars ("$") which represents the presentation currency of the Group.

The average $-GBP sterling ("GBP") exchange rate, used for the conversion of the Statement of Comprehensive Income, for the 12 months ended 31 December 2017 was 1.29 (2016: 1.36). The closing $-GBP exchange rate, used for the conversion of the Group's assets and liabilities, at 31 December 2017 was 1.35 (2016: 1.23).

Corero Network Security plc is a public limited company incorporated in the United Kingdom under the Companies Act 2006 and registered in England and Wales. The functional currency of the Company is GBP.

## 2. Significant accounting policies

### 2.1 Basis of preparation

The Group 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 parent Company financial statements have been prepared in accordance with FRS 101 (Financial Reporting Standard 101) 'Reduced Disclosure Framework'.

### 2.2 Going Concern

The financial statements have been prepared on a going concern basis.

The Directors have prepared detailed income statement, balance sheet and cash flow projections for the period to 31 December 2019. These include cash of £4.0 million ($5.6 million) to be raised by the proposed Equity Fund Raise to be announced by the Company on 5 April 2018 and Bank Loan of £3.0 million ($4.2 million) which is expected to be drawn down following the completion of the Equity Fund Raise. 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 and Company will maintain a positive cash balance until at least December 2019.

A circular containing a notice of General Meeting will be sent to shareholders on 5 April 2018. At the General Meeting to be convened on 16 April 2018, Corero shareholders will be asked to approve the Equity Fund Raise. Since the participants in the Equity Fund Raise include shareholders which at 4 April 2018 held more than 50% of the Company's issued shares, it is anticipated that the resolutions to approve the Equity Fund Raise will be duly passed.

The Board are confident that the Equity Fund Raise will be completed successfully.

On this basis, the Directors have therefore concluded that it is appropriate to prepare the financial statements on a going concern basis. However, in the absence of certainty that the Equity Fund Raise and Bank Loan will successfully complete as anticipated, a material uncertainty exists which may cast significant doubt over the Group's and Company's ability to continue as a going concern. The financial statements do not include the adjustments that would result if the Group and Company was unable to continue as a going concern.

### 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 2017.

Subsidiaries are entities controlled by the Group. Control is deemed to exist when the Group has all of the following elements a) power over the subsidiary, b) exposure or rights to variable returns from that subsidiary, c) ability to use its power to affect the amount of the return from the subsidiary. 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.

### 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. Hardware and Software Products**

When a sales arrangement contains multiple elements, such as combined 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. As Corero's hardware product with embedded software is generally not sold on a standalone basis, the Company determined that VSOE cannot be obtained. Management has also determined that third party pricing for similar products sold separately is not obtainable or reliable so TPE cannot be used, therefore BESP is used (note 3).

**2. DDoS Protection as-a-Service contracts**

Revenue is recognised on a straight line basis over the life of the agreement.

**3. Consulting and Professional Services**

Revenue from the provision of consultancy and professional services is recognised as the work is performed.

**4. Maintenance and Support Services**

Revenue is recognised on a straight line basis over the life of the agreement.

### 2.6 Government grants

Government grants are recognised at fair value when there is reasonable assurance that the Group will comply with the conditions attaching to them and the grant will be received. Grants related to purchase of assets are treated as deferred income and allocated to the Statement of Comprehensive Income over the useful lives of the related assets while grants related to expenses are netted off against the related item of expenditure in the Statement of Comprehensive Income – Profit and Loss.

### 2.7 Cost of sales

Cost of sales includes all direct costs associated with revenue generation, including goods directly related to revenue, services delivery, operation costs, DDoS as-a-service depreciation and amounts charged by external third parties for services. Examples of such costs would include, but not be limited to, royalties and third party hardware and software costs.

### 2.8 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 UK operations are translated from GBP into US dollars at the exchange rate at the reporting date. Income and expense items are translated into US dollars at the average exchange rates for the period. The resulting exchange differences are recognised in the translation reserve.

# Notes to the Financial Statements continued

## 2. Significant accounting policies continued

### 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.

Expenditure not meeting these criteria is expensed in the Statement of Comprehensive Income – Profit and Loss.

After initial recognition, internally generated intangible assets are carried at cost less accumulated amortisation and any impairment losses. Amortisation is charged once the asset is capable of generating economic benefits.

**Acquired intangible assets**
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.

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.

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

- Computer software acquired – 3 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 and useful lives are reviewed, and if necessary adjusted, at each reporting date.

### 2.10 Property, plant and equipment

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, evaluation units and DDoS Protection as-a-service units – 3 years straight line
- Fixtures and fittings – 5 years straight line

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. Evaluation units are used by customers during proof of concept trials. Evaluation units are stated at cost less accumulated depreciation. When an evaluation unit is retained by a customer as part of a sale the net book value of the evaluation unit is charged to cost of sales. DDoS as-a-service depreciation is charged to cost of sales.

Subsequent costs are included in an assets 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 – Profit and Loss as incurred.

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 – Profit and Loss.

### 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, the value of which may not be recoverable.

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 recoverable amount is calculated using the present value of the future cash flows expected to be derived from an asset or cash-generating unit. This present value is derived using a cost of capital 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 – Profit and Loss.

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 - Profit and Loss. Impairment losses on goodwill are not subsequently reversed.

### 2.13 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 – Profit and Loss 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 – Profit and Loss on a straight-line basis over the lease term. The aggregate benefit of lease incentives are recognised as a reduction of the rental expense over the lease term on a straight-line basis.

### 2.14 Investments in subsidiaries

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

### 2.15 Taxation

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

# Notes to the Financial Statements continued

## 2. Significant accounting policies continued

**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.

### 2.16 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.

### 2.17 Post-retirement benefits

The Group makes contributions in respect of certain employees to defined contribution pension plans under which it is required to pay fixed contributions to group and personal pension funds.

Contributions to the schemes are based on a proportion of the employees' earnings and are charged to the Statement of Comprehensive Income – Profit and Loss when incurred. The Group has no obligation beyond these contributions.

### 2.18 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 and deposits on call with banks.

**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.

### 2.19 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 costs.

### 2.20 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.

### 2.21 Receivables-backed working capital facility

The Group has use of a receivables-backed working capital facility. 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.

### 2.22 Standards and Interpretations not yet effective

The following standards and interpretations that have been issued but are not yet effective have not been applied by the Group in these financial statements:

IFRS 9 – Financial Instruments. Effective date, periods beginning after 1 January 2018

IFRS 15 – Revenue from Contracts with Customers. Effective date, periods beginning after 1 January 2018

IFRS 16 – Leases. Effective date, periods beginning after 1 January 2019

The effect on the financial statements of the application of the standards and interpretations that are expected to have a significant impact or are relevant to the Group, is:

IFRS 15 – Revenue from Contracts with Customers

The standard requires an analysis of 5 key steps:

1. Identify the contract with the customer;
2. Identify the performance obligations in the contract;
3. Determine the transaction price;
4. Allocate the transaction price to the separate performance obligations; and
5. Recognise revenue when (or as) each performance obligation is satisfied.

The Management have applied the 5 steps to each of the sources of revenue and concluded that no change will be required to the current revenue recognition. The standard also requires consideration of the incremental costs of obtaining a contract including sales commission. Sales commission relating to the deferred element of a sale will be capitalised and amortised over 5 years which has been assessed as the period of a customer relationship. The value of deferred commission at 31 December 2017 not deferred was $0.16 million. The Group will adopt the Retrospective Method of adoption for IFRS 15 in the 2018 Financial Statements and restate the operating expenses for the effect of deferred commissions. No changes will be made to the reported revenues.

Management are in the process of evaluating IFRS 9 and 16 and will report on the impact once known.

## 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 and a project has passed the feasibility phase, 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:

# Notes to the Financial Statements continued

## 3. Critical accounting judgements and key sources of estimation uncertainty continued

**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. Fair value less costs to sell is estimated using discounted future cash flows. Significant assumptions are made in estimating future cash flows about future events including future market conditions, future growth rates and appropriate discount rates. Changes in these assumptions could affect the outcome of impairment reviews. Details of the main assumptions used in the assessment of the carrying value of the Group's cash generating unit is set out in note 8.

**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 investment and intercompany balances between the Company and Corero Network Security, Inc. and Corero Network Security (UK) Limited have been reviewed with reference to a valuation based on a discounted free cash flow which the Directors consider to be an appropriate valuation methodology, 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 contained in the projections is detailed in the note 2.2.

**Best Estimated Selling Price – Revenue Recognition**

On a quarterly basis the Group analyses the selling prices for each deal compared to the current BESP. Analysis includes grouping similar deals based on qualitative factors such as customer profile, size, and region followed by quantitative comparison to the then current BESP. BESP fair value prices are adjusted for future quarters if management identifies a pattern of variances, greater than 10%, between actual selling prices versus the then current BESP.

## 4. Segment reporting

### Business segments

The Group is managed according to one business unit, Corero Network Security, which makes up the Group's reportable operating segment. This business unit forms 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 Group's revenues from external customers and its non-current assets are divided into the following countries:

| | 2017 Revenue $'000 | 2017 Non-current assets $'000 | 2016 Revenue $'000 | 2016 Non-current assets $'000 |
|---|---|---|---|---|
| USA | 5,660 | 17,360 | 5,151 | 17,890 |
| UK | 1,866 | 178 | 2,135 | 134 |
| Belgium | – | – | 507 | – |
| Other European countries | 596 | – | 788 | – |
| Australia | 395 | – | – | – |
| APAC | – | – | 45 | – |
| UAE | 14 | – | 146 | – |
| Total | 8,531 | 17,538 | 8,772 | 18,024 |

Revenues from external customers 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 IFRS.

The revenue is analysed as follows for each revenue category:

| | 2017 $'000 | 2016 $'000 |
|---|---|---|
| Hardware and licence revenue | 4,510 | 4,019 |
| DDoS Protection as-a-service revenue | 323 | – |
| Maintenance and support services revenue | 3,698 | 4,753 |
| Total | 8,531 | 8,772 |

## 5. Loss for the year

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

| | 2017 $'000 | 2016 $'000 |
|---|---|---|
| DDoS as-a-service depreciation | 74 | – |
| Unrealised loss/(gain) on intercompany loan | 627 | (1,217) |
| Development expenditure not capitalised | 1,486 | 2,401 |
| Impairment of goodwill (note 8) | – | 8,992 |
| Amortisation of acquired intangible assets (note 9) | 55 | 325 |
| Amortisation of capitalised development expenditure (note 10) | 2,408 | 2,252 |
| Depreciation of property, plant and equipment (note 11) | 548 | 551 |
| Operating lease rentals payable | 319 | 325 |

### Auditor's remuneration

| | 2017 $'000 | 2016 $'000 |
|---|---|---|
| Remuneration received by the Company's auditor for the audit of these Financial Statements | 84 | 76 |
| The audit of the accounts of other group companies | 23 | 18 |
| Fees payable to the Company's auditor for corporate services | 8 | 9 |
| Fees payable to the Company's auditor for taxation compliance services | 27 | 24 |
| Fees payable to the Company's auditor for taxation advisory services | 3 | – |
| | 145 | 127 |

## 6. Tax on loss on ordinary activities

| | 2017 $'000 | 2016 $'000 |
|---|---|---|
| Current tax credit | 116 | – |
| Deferred tax credit for the year | – | 85 |
| Total | 116 | 85 |

The tax assessed on the loss on ordinary activities for the year differs from the weighted average UK corporate rate of tax of 19.25% (2016: 20.0%). The differences are reconciled below:

| | | |
|---|---|---|
| Total tax reconciliation | | |
| Loss before taxation | (8,689) | (17,263) |
| Theoretical tax credit at UK Corporation tax rate 19.25% (2016: 20.0%) | (1,673) | (3,453) |
| Effect of: | | |
| – expenditure that is not tax deductible | 53 | 1,806 |
| – R&D tax credits | 116 | (35) |
| – accelerated capital allowances | (15) | (11) |
| – other timing differences | 1 | (1) |
| – losses not utilised | 1,634 | 1,694 |
| – deferred tax credit | – | 85 |
| Actual taxation credit | 116 | 85 |

**Factors affecting future tax charges**

As at 31 December 2017, the Group's cumulative fixed asset timing differences were $426,000 (2016: $62,000) and no deferred tax asset has been recognised in respect of these items.

In addition, the tax losses at that date amounted to $82.0 million (2016: $72.8 million). This comprised UK tax losses of $12.5 million and US tax losses of $69.5 million. $9.0 million of the tax losses relate to pre-acquisition US tax losses which can be offset against taxable profits over 15 years (there is a limit on the utilisation of pre-acquisition tax losses of $0.7 million per annum and any unused loss may be carried forward to subsequent periods). All other US tax losses will expire in 20 years from the end of the accounting period in which the loss arose. UK tax losses do not expire.

The deferred tax assets of $2.1 million (2016: $2.1 million) at a rate of 17.0% relating to the UK tax losses and the deferred tax assets of $14.6 million (2016: $21.3 million) at a rate of 21% relating to the US tax losses and taxable temporary fixed asset differences have not been recognised due to uncertainties as to the extent and timing of their future recovery.

# Notes to the Financial Statements continued

## 7. Loss per share

Loss 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. The effects of anti-dilutive ordinary shares resulting from the exercise of share options are excluded from the calculation of the loss per share. Therefore the diluted loss per share is equal to the loss per share.

| | 2017 loss $'000 | 2017 weighted average number of 1p shares Thousand | 2017 loss per share Cents | 2016 loss $'000 | 2016 weighted average number of 1p shares Thousand | 2016 loss per share Cents |
|---|---|---|---|---|---|---|
| Basic and diluted loss per share | (8,573) | 280,130 | (3.1) | (17,178) | 189,959 | (9.0) |

## 8. Goodwill

### Group

| | $'000 |
|---|---|
| **Cost** | |
| At 1 January 2016 | 17,983 |
| At 31 December 2016 | 17,983 |
| **At 31 December 2017** | 17,983 |
| | |
| **Impairment** | |
| At 1 January 2016 | – |
| At 31 December 2016 | (8,992) |
| **At 31 December 2017** | (8,992) |
| **Carrying amount** | |
| **At 31 December 2017** | 8,991 |
| At 31 December 2016 | 8,991 |
| At 1 January 2016 | 17,983 |

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 single cash-generating unit ("CGU") Corero Network Security ("CNS").

The recoverable amount for the CNS CGU was determined based on a discounted cash flow calculation to calculate fair values less costs to sell using cash flow projections over a 10 year period (2016: 10 year period). The discounted cash flow approach is a level 3 fair value calculation in the IFRS 13 fair value hierarchy. The key assumptions for the discounted cash flow calculation are those regarding revenue growth and discount rates as summarised in the table below and commented on below:

| | 2017 | 2016 |
|---|---|---|
| Forecast cash flow period | Years 1–2 | Years 1–2 |
| Extrapolated cash flow period | Years 3–10 | Years 3–10 |
| Cumulative annual growth rate ("CAGR") for revenue used for the forecast/extrapolated periods | 17.8% | 19.6% |
| Average revenue growth rates used for the forecast/extrapolated periods: | | |
| Year 1–2 (forecast period) | 36.1% | 33.1% |
| Years 3–5 (extrapolated period) | 24.9% | 28.2% |
| Years 6–10 (extrapolated period) | 7.4% | 9.9% |
| Revenue growth rate used beyond the extrapolated period | 2.5% | 2.5% |
| Discount rate | 17.7% | 16.5% |

The pre-tax cash flows for the forecast period are derived from the most recent financial budget for the year ending 31 December 2018 and the plan for the year ending 31 December 2019 approved by the Board, with a sensitivity to reflect prior years forecast inaccuracies (35% applied to the 2018 budget and 40% to the 2019 plan). The extrapolation for the period 2020 to 2027 is based on management estimates (with the key assumptions set out below).

The future pre-tax cash flows are discounted by a WACC of 17.7%.

The key assumptions underlying the cash flow projections and which the recoverable amount is most sensitive to are (i) the revenue growth rates forecast and extrapolated for the period 2019 to 2023 and (ii) the discount rate.

The cash flow forecasts assume a CAGR revenue growth of 29.3% in the period 2017 to 2022 (36.1% for the period 2017 to 2019) and 7.4% for the period 2022 to 2027 (a CAGR of 17.8% for 10-year forecast period). These growth rates reflect a sensitivity of 35% applied to the CNS 2018 budget revenues and a sensitivity of 40% applied to the 2019 plan revenues (and a sensitivity of 17.5% to 2018 operating costs and a sensitivity of 20% to 2019 operating costs) to reflect risk associated with historic forecast accuracy.

The management of the Group believe these growth rates are appropriate for the forecasts given the expected impact from the SmartWall sales traction in 2017, the focus on delivering sales growth through channel partners, the expected contribution from go-to-market partners to expand the opportunities Corero can sell into and the 100Gbps and virtual software products introduced in late 2017, all of which are expected to deliver a step change in revenue in the forecast period.

These growth rates are supported by the fact that the IT security market is forecast to grow strongly for the foreseeable future.

According to IDC (one of the leading global IT analyst firms), the global spending on security-related hardware, software and services was forecast to grow $83.5bn in 2017 (an increase of 10.3% over 2016) and to $119.9bn in 2021 (a CAGR of 9.6% over the 2016-2021 forecast period). (Source: IDC Update to Worldwide Semi-annual Security Spending Guide published 19 October 2017).

The DDoS appliance market is expected to reach $1.4bn by 2021 – a CAGR or 15.6% in the period 2016 to 2021. (Source: IHS Market Technology research - DDoS Prevention Appliances Worldwide, Biannual Market Tracker (November 2017)).

These security market growth rates contrast with Gartner's Q4 2017 Worldwide IT Spending Forecast, which shows IT spend will grow from $3.5 trillion in 2017 to $4.0 trillion in 2021, a CAGR 3.3% over the 2017-2021 forecast period.

The above market growth rates used in the future cash flow assumptions reflect that CNS is in the early stages of the commercial exploitation of its intellectual property. In addition, the business' strategy is to continue to develop its product and solution offerings to remain a market leader in its chosen markets thereby providing the opportunity to generate above market average growth rates.

The growth rate assumed in the period beyond the 10-year extrapolation period of 2.5% is considered reasonable as historically IT spend has exceeded GDP growth.

The discount rate is based on a cost of equity using the Capital Asset Pricing Model with the key inputs being a risk-free interest rate estimate of 2.48% (based on 10-year US government bonds) (2016: 2.44%), comparable company betas, an equity risk premium of 7.4% (2016: 7.4%), and small company risk premium of 4.5% (2016: 4.5%). The WACC has been assessed based on that fact that the Company had no gearing at 31 December 2017. The WACC used in the valuation reflects current market assessments of the time value of money and the risks specific to CNS.

As stated above, the valuation to support the value in use of the CNS CGU is highly sensitive to changes in cash flow forecasts and discount rate assumptions, and there is no guarantee that the expected growth will be achieved. If the discount rate is increased by 50%, which in the assessment of management is reasonably possible, from 17.7% to 26.6%, this would result in an impairment of goodwill with the result that the goodwill would be fully impaired. If the sensitivity of 35% applied to the CNS 2018 budget and 40% to the 2019 plan revenues (and a sensitivity of 17.5% to CNS Budget 2018 operating costs and 20% to the 2019 Plan operating costs) was increased to 50% for revenue (and a sensitivity of 25% to operating costs), which in the assessment of management is reasonably possible, this would result in an impairment of goodwill with the result that the goodwill would be fully impaired.

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

# Notes to the Financial Statements continued

## 9. Acquired intangible assets

### Group

| | Computer software $'000 | Customer relationships $'000 | Total $'000 |
|---|---|---|---|
| **Cost** | | | |
| **At 1 January 2016** | 5,961 | 197 | 6,158 |
| Additions | 32 | – | 32 |
| **At 31 December 2016 and at 1 January 2017** | 5,993 | 197 | 6,190 |
| Additions | 10 | – | 10 |
| **At 31 December 2017** | 6,003 | 197 | 6,200 |
| **Amortisation** | | | |
| **At 1 January 2016** | (5,648) | (135) | (5,783) |
| Charge for year | (263) | (62) | (325) |
| **At 31 December 2016 and at 1 January 2017** | (5,911) | (197) | (6,108) |
| Charge for year | (55) | – | (55) |
| **At 31 December 2017** | (5,966) | (197) | (6,163) |
| **Net book value** | | | |
| **At 31 December 2017** | 37 | – | 37 |
| **At 31 December 2016** | 82 | – | 82 |
| At 1 January 2016 | 313 | 62 | 375 |

### Company

The Company has no intangible fixed assets (2016: $nil).

## 10. Capitalised development expenditure

### Group

| | Total $'000 |
|---|---|
| **Cost** | |
| **At 1 January 2016** | 13,135 |
| Additions | 2,533 |
| **At 31 December 2016 and at 1 January 2017** | 15,668 |
| Additions | 2,171 |
| **At 31 December 2017** | 17,839 |
| **Amortisation** | |
| **At 1 January 2016** | (5,515) |
| Charge for year | (2,252) |
| **At 31 December 2016 and at 1 January 2017** | (7,767) |
| Charge for year | (2,408) |
| **At 31 December 2017** | (10,175) |
| **Net book value** | |
| At 31 December 2017 | 7,664 |
| At 31 December 2016 | 7,901 |
| At 1 January 2016 | 7,620 |

### Company

The Company has no capitalised development expenditure (2016: $nil).

## 11. Property, plant and equipment

### Group

| | Computer Equipment $'000 | Evaluation units $'000 | DDoS as-a-service units $'000 | Fixtures and Fittings $'000 | Office Equipment $'000 | Leasehold Improvements $'000 | Total $'000 |
|---|---|---|---|---|---|---|---|
| **Cost** | | | | | | | |
| **At 1 January 2016** | 2,688 | 546 | – | 94 | 131 | 77 | 3,536 |
| Additions | 243 | 273 | 62 | 43 | – | 23 | 644 |
| Disposals | (841) | – | – | (67) | (131) | (77) | (1,116) |
| Foreign currency translation | (6) | – | – | (1) | – | (1) | (8) |
| **At 31 December 2016 and at 1 January 2017** | 2,084 | 819 | 62 | 69 | – | 22 | 3,056 |
| Additions | 213 | 149 | 135 | – | – | – | 497 |
| Transfers | – | (187) | 187 | – | – | – | – |
| Disposals | – | (228) | (4) | – | – | – | (232) |
| Foreign currency translation | 9 | – | | 1 | – | 1 | 11 |
| **At 31 December 2017** | 2,306 | 553 | 380 | 70 | – | 23 | 3,332 |
| | | | | | | | |
| **Depreciation** | | | | | | | |
| **At 1 January 2016** | (2,240) | (115) | – | (84) | (127) | (77) | (2,643) |
| Charge for year | (378) | (161) | – | (8) | (1) | (3) | (551) |
| Disposals | 835 | – | – | 67 | 128 | 77 | 1,107 |
| Foreign currency translation | 1 | – | – | – | – | – | 1 |
| **At 31 December 2016 and at 1 January 2017** | (1,782) | (276) | – | (25) | – | (3) | (2,086) |
| Charge for year | (223) | (230) | (74) | (13) | – | (8) | (548) |
| Transfers | – | 68 | (68) | – | – | – | – |
| Disposals | – | 76 | – | – | – | – | 76 |
| Foreign currency translation | (3) | – | – | – | – | (1) | (4) |
| **At 31 December 2017** | (2,008) | (362) | (142) | (38) | – | (12) | 2,562 |
| | | | | | | | |
| **Net book value** | | | | | | | |
| At 31 December 2017 | 298 | 191 | 238 | 32 | – | 11 | 770 |
| At 31 December 2016 | 302 | 543 | 62 | 44 | – | 19 | 970 |
| At 1 January 2016 | 448 | 431 | – | 10 | 4 | – | 893 |

### Company

The Company has no property, plant and equipment (2016: $nil).

# Notes to the Financial Statements continued

## 12. Investments in subsidiaries

| Company | 2017 $'000 | 2016 $'000 |
|---|---|---|
| Net book value | | |
| **At 1 January** | 21,137 | 28,797 |
| Additional investment in Corero Network Security, Inc. | 4,580 | 5,576 |
| Investment in Corero Network Security (UK) Limited | 4,064 | 12,038 |
| Provision against investment in subsidiaries | (10,789) | (20,565) |
| Foreign currency translation | 2,023 | (4,709) |
| **At 31 December** | 21,015 | 21,137 |

The Directors have reviewed the carrying value of the cost of investments in subsidiaries of the Company with reference to current and future trading conditions and a valuation based on a discounted free cash flow which the Directors consider to be an appropriate valuation methodology, in conjunction with the goodwill impairment review (note 8) and concluded that an impairment of the investment balances was required. As at 31 December 2017 the provision against investment in subsidiaries was $50.2 million (2016: $36.0 million).

Included in the Company's investment in Corero Network Security, Inc. is a loan note instrument. These loan notes bear interest at 5% per annum that at the election of Corero Network Security, Inc. is payable quarterly or added to the principal amount. In November 2016 the loan notes repayment date was amended to 31 October 2021, previously 31 October 2016.

| | 2017 $'000 | 2016 $'000 |
|---|---|---|
| Loan note instrument | 7,341 | 6,378 |

**The Company owns:**

100% of the issued share capital of Corero Network Security, Inc. a company incorporated in Delaware, USA. The company's business address is 225 Cedar Hill Street, Marlborough, MA 01752, 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 company's business address is Regus House, Highbridge, Oxford Road, Uxbridge, Middlesex, UB8 1HR. 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 company's business address is 3rd Floor, 53 Hanover Street, Edinburgh, EH2 2PJ. The principal business of the company consists of providing development and sales and marketing services on behalf of Corero Network Security, Inc.

## 13. Inventories

| | Group 2017 $'000 | Group 2016 $'000 |
|---|---|---|
| Gross inventory | 207 | 232 |
| Less: provision for impairment | (113) | (167) |
| Net inventory | 94 | 65 |

Net inventory comprises finished goods and raw materials.

**Company**

The Company holds no inventory (2016: $nil).

## 14. Trade and other receivables

| | Group 2017 $'000 | Group 2016 $'000 | Company 2017 $'000 | Company 2016 $'000 |
|---|---|---|---|---|
| Trade receivables | 2,181 | 1,495 | – | – |
| Less: provision for impairment | – | – | – | – |
| Net trade receivables | 2,181 | 1,495 | – | – |
| Amounts owed by subsidiaries | – | – | 6,967 | 5,340 |
| Other debtors | 137 | 138 | 76 | 69 |
| Prepayments and accrued income | 713 | 674 | – | – |
| | 3,031 | 2,307 | 7,043 | 5,409 |

The banking facility of the Group, summarised in note 16, is secured by assets of Corero Network Security, Inc. 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.

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

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 2017 $'000 | Group 2016 $'000 |
|---|---|---|
| Not more than 3 months | 181 | 345 |
| | 181 | 345 |

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 2017 $'000 | Group 2016 $'000 | Company 2017 $'000 | Company 2016 $'000 |
|---|---|---|---|---|
| In one year or less, or on demand | 2,955 | 2,227 | – | – |
| In more than one year, but not more than five years | 76 | 80 | 7,043 | 5,409 |
| | 3,031 | 2,307 | 7,043 | 5,409 |

Balances due in more than one year, but not more than five years, are presented as non-current in the Statement of Financial Position.

The analysis of trade and other receivables by foreign currency is set out in the table below:

| | Group 2017 $'000 | Group 2016 $'000 | Company 2017 $'000 | Company 2016 $'000 |
|---|---|---|---|---|
| US dollars | 2,749 | 2,023 | – | – |
| UK pound | 282 | 284 | 7,043 | 5,409 |
| | 3,031 | 2,307 | 7,043 | 5,409 |

The Group's foreign currency receivables are denominated in the functional currency of the subsidiaries in which they arise. There is no impact on the loss for the year from exchange rate movements on such financial instruments.

# Notes to the Financial Statements continued

## 15. Trade and other payables

| | Group 2017 $'000 | Group 2016 $'000 | Company 2017 $'000 | Company 2016 $'000 |
|---|---|---|---|---|
| Trade payables | 720 | 767 | – | – |
| Other payables | 16 | 23 | – | – |
| Accruals | 569 | 938 | – | – |
| | 1,305 | 1,728 | – | – |

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% (2016: 76%) of the trade and other payables are due in less than 3 months.

The analysis of trade and other payables by foreign currency is set out in the table below:

| | Group 2017 $'000 | Group 2016 $'000 |
|---|---|---|
| US dollars | 903 | 1,178 |
| UK pound | 402 | 550 |
| | 1,305 | 1,728 |

The Group's foreign currency payables are denominated in the functional currency of the subsidiaries in which they arise. There is no impact on the loss for the year from exchange rate movements on such financial instruments.

## 16. Borrowings

The Group and Company borrowings were $nil (2016: $nil).

The accounts receivable financing facility was not utilised at the year end. The facility bears interest at c.16.8% of the financed value with a limit of US$1.5 million or 80% of the eligible accounts receivable balance. The funding is secured by a first lien on the corporate assets of Corero Network Security, Inc. and is guaranteed by Corero Network Security plc.

All receipts for financed assets are payable to a lockbox account held with the provider of the financing facility. The accounts receivable assets are exposed to the risk of non or late payment by customers. There are no restrictions on the use of the financed accounts receivable assets.

At 31 December 2017, 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 | |
|---|---|---|
| | 2017 $'000 | 2016 $'000 |
| Trade and other payables | 1,305 | 1,728 |
| Total | 1,305 | 1,728 |

## 17. Financial instruments

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

**Group**

| | Book Value 2017 $'000 | Book Value 2016 $'000 |
|---|---|---|
| **Financial assets** | | |
| Loans and Receivables: | | |
| Trade and other receivables | 2,268 | 1,576 |
| Cash | 1,365 | 2,940 |
| | 3,633 | 4,516 |

**Group**

| | Book Value 2017 $'000 | Book Value 2016 $'000 |
|---|---|---|
| **Financial liabilities** | | |
| Financial liabilities at amortised cost: | | |
| Trade and other payables | 1,305 | 1,728 |
| | 1,305 | 1,728 |

The Group manages liquidity and credit risk in line with the Financial risk management objectives and policies on page 27. At the present time the Group does not have significant exposure to foreign exchange or interest rate risk.

There are no differences between the fair values and book values held by the Group.

## 18. Deferred income

**Group**

| | 2017 $'000 | 2016 $'000 |
|---|---|---|
| Current | 2,896 | 2,457 |
| More than one year but less than five years | 287 | 855 |
| | 3,183 | 3,312 |

The Group's deferred income balance 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 (2016: $nil).

## 19. Pensions

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

**Defined contribution schemes**

| | 2017 $'000 | 2016 $'000 |
|---|---|---|
| Defined contribution pension costs | 125 | 93 |

# Notes to the Financial Statements continued

## 20. Share capital

### Authorised share capital

The authorised share capital comprises 745,821,970 (2016: 745,821,970) ordinary shares of 1p (1.35c) each.

### Issued ordinary share capital

| | $'000 |
|---|---|
| **1 January 2016** | |
| 165,637,416 ordinary shares of 1p each | 2,573 |
| **Issued** | |
| 37,773,560 ordinary shares of 1p each (1.54c) | 546 |
| 6,666 ordinary shares of 1p each (1.32c) | – |
| **31 December 2016 and at 1 January 2017** | |
| 203,417,642 ordinary shares of 1p each | 3,119 |
| **Issued** | |
| 112,000,000 ordinary shares of 1p each (1.28c) | 1,437 |
| **31 December 2017** | |
| 315,417,642 ordinary shares of 1p each | 4,556 |

On 10 May 2016, 37,773,560 ordinary shares with a nominal value of 1p were issued at 22p (34c) per share by way of a subscription, placing and open offer. On 15 September 2016, 6,666 ordinary shares with a nominal value of 1p were issued at 15p (20c) per share as the result of the exercise of an option.

On 25 April 2017, 112,000,000 ordinary shares with a nominal value of 1p were issued at 5p (6c) per share by way of a subscription and placing.

On 5 April 2018 Corero will announce a conditional placing and subscription. This Equity Fund Raise is subject to shareholder approval at a general meeting of the Company.

## 21. Share premium

| | $'000 |
|---|---|
| **1 January 2016** | 56,835 |
| 37,773,560 ordinary shares of 22p each (34c) less issue costs | 10,845 |
| 6,666 ordinary shares of 15p each (20c) | 1 |
| **31 December 2016 and at 1 January 2017** | 67,681 |
| 112,000,000 ordinary shares of 5p each (6c) less issue costs | 5,558 |
| **31 December 2017** | 73,239 |

Consideration received in excess of the nominal value of the 112,00,000 shares issued on 25 April 2017 as a result of the subscription and placing has been included in share premium, less registration, commission and professional fees of $193,000. The amount of such directly attributable costs deducted from share premium in 2016 was $622,000.

## 22. Employees and Directors

### Employee expenses during the period

Group

| | Total 2017 $'000 | Total 2016 $'000 |
|---|---|---|
| Wages and salaries | 7,846 | 9,337 |
| Social security costs | 753 | 840 |
| Other pension costs (note 19) | 125 | 93 |
| | 8,724 | 10,270 |

**Average monthly numbers of employees (including Directors) employed**

| | 2017 Number | 2016 Number |
|---|---|---|
| Sales and marketing | 19 | 19 |
| Technical, support and services | 32 | 38 |
| Management, operations and administration | 10 | 11 |
| | 61 | 68 |

**Company**

The Company has no employees (2016: nil).

**Directors, being the Key Management personnel**

| | Salary & fees $'000 | Bonus $'000 | Benefits $'000 | Pension $'000 | Subtotal $'000 | Options $'000 | Company National Insurance Contributions $'000 | Total 2017 $'000 | Total 2016 $'000 |
|---|---|---|---|---|---|---|---|---|---|
| **Executive Directors** | | | | | | | | | |
| Ashley Stephenson | 270 | 54 | 15 | – | 339 | 5 | 8 | 352 | 351 |
| Andrew Lloyd | 243 | 31 | – | 12 | 286 | 9 | 33 | 328 | 32 |
| Andrew Miller | 205 | 39 | 7 | 21 | 272 | 4 | 34 | 310 | 329 |
| Jens Montanana | 34 | – | – | – | 34 | 2 | – | 36 | 39 |
| Richard Last | 26 | – | – | – | 26 | 1 | 2 | 29 | 32 |
| | 778 | 124 | 22 | 33 | 957 | 21 | 77 | 1,055 | 783 |

Bonus payments of $124,000 were awarded during the period to 31 December 2017 (2016: $63,000).

Andrew Miller has a service contract with a 6 month notice period. A subsidiary company provides for pension contributions (included in the table above) of 10% of basic salary payable to a personal pension plan.

Andrew Lloyd was appointed an Executive Director on 3 January 2017. He has a service contract with a 3 month notice period. A subsidiary company provides for pension contributions (included in the table above) of 5% of basic salary payable to the Group's defined pension plan.

One Director is accruing benefits from the Group's defined contribution pension arrangements (2016: $nil). The Company makes contributions to Andrew Miller's personal pension scheme.

Post the year end, Jens Montanana notified the Company that he wished to waive his Non-Executive Director fees for the year ended 31 December 2017 of $34,000. Jens Montanana waived his Non-Executive Director fees for the year ended 31 December 2016 of $35,000.

# Notes to the Financial Statements continued

## 23. Operating lease commitments

The Group has total future minimum lease payments under non-cancellable operating leases totalling $360,000 (2016: $593,000) analysed by year of expiry as follows:

| | 2017 $'000 | 2016 $'000 |
|---|---|---|
| Land and building agreements expiring: | | |
| Within one year | 83 | 21 |
| Within two to five years | 53 | 215 |
| Other agreements expiring: | | |
| Within one year | 1 | 1 |
| Within two to five years | 223 | 356 |
| | 360 | 593 |

Other operating leases agreements relate to the costs of a co-location provider.

**Company**
The Company has no operating lease commitments (2016: $nil).

## 24. Contingent liabilities

Corero Network Security (UK) Limited was in December 2015 awarded a grant of up to £600,000 for a development project over three years from Scottish Enterprise. Any monies becoming repayable by Corero Network Security (UK) Limited under the terms typical for such a grant, including not complying with the grant conditions which include requirements to hire employees in Scotland, progress on the project is not satisfactory, a change of control, are guaranteed by the Company.

## 25. Share options

The Company has the following share option schemes:

- Enterprise Management Incentive Scheme for its employees, which has been approved by HMRC, 2010 Executive Enterprise Management Incentive Scheme, which has been approved by HMRC, 2010 Unapproved Share Option Scheme, and
- Deferred Payment Share 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 2010–2017 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. Shares acquired on the exercise of an option may not be sold until the expiry of the second anniversary following the date of option grant.

If an option holder ceases to be in employment or hold office within the Group, options granted shall immediately lapse unless such cessation is because of the option holder's death; the option holder's ill health or disability; the company that employs the option holder ceasing to be under the control of the Company or such company ceasing to be within the Group; the transfer of sale of the undertaking or part-undertaking in which the option holder is employed to a person who is neither under the control of the Company nor within the Group; or any other reason that the Board in its absolute discretion shall determine.

On a cessation of employment or office as set out above, options shall be exercisable to the extent they have vested according to the terms of the option agreement and the provisions of the relevant share option scheme and must be exercised within 30 days following such cessation unless it is by reason of death whereby the option holder's personal representatives must exercise the option within 12 months following the date of the option holder's death.

On the 18 March 2014, the Enterprise Management Incentive Scheme was extended by 10 years to 20 April 2021.

Share options granted at 31 December 2017 were as follows:

| Option Holders | Date granted | Expiry date | Exercise price | At 1 January 2017 | Granted | Exercised | Forfeit/ cancelled | At 31 December 2017 |
|---|---|---|---|---|---|---|---|---|
| **Enterprise Management Incentive Scheme** | | | | | | | | |
| Other Holders | March 2011 | March 2021 | 40p (65c) | 40,000 | – | – | (40,000) | – |
| | March 2012 | March 2022 | 54.5p (89c) | 25,000 | – | – | (25,000) | – |
| | September 2012 | September 2022 | 43p (70c) | 110,000 | – | – | (110,000) | – |
| | April 2013 | April 2023 | 25p (38c) | 85,000 | – | – | (85,000) | – |
| | May 2014 | May 2024 | 25p (42c) | 40,000 | – | – | (40,000) | – |
| | September 2014 | September 2024 | 25p (41c) | 10,000 | – | – | (10,000) | – |
| | April 2015 | April 2025 | 15p (23c) | 750,000 | – | – | (250,000) | 500,000 |
| | October 2015 | September 2025 | 15p (23c) | 57,000 | – | – | (57,000) | – |
| | January 2016 | January 2026 | 20p (29c) | 1,067,000 | – | – | (1,067,000) | – |
| | May 2016 | May 2026 | 22.5p (33c) | 31,305 | – | – | (31,305) | – |
| | April 2017 | April 2027 | 8p (10c) | – | 1,620,569 | – | (7,000) | 1,613,569 |
| | June 2017 | June 2027 | 13.6 (18c) | – | 1,715,305 | – | – | 1,715,305 |
| | September 2017 | September 2027 | 9.1p (12c) | – | 542,000 | – | – | 542,000 |
| **2010 Executive Enterprise Management Incentive Scheme** | | | | | | | | |
| Andrew Miller | August 2010 | August 2020 | 25p (41c) | 476,000 | – | – | – | 476,000 |
| | September 2012 | March 2022 | 54.5p (89c) | 80,000 | – | – | – | 80,000 |
| | April 2013 | April 2023 | 25p (38c) | 250,000 | – | – | – | 250,000 |
| | May 2014 | May 2024 | 25p (42c) | 362,570 | – | – | – | 362,570 |
| Andrew Lloyd | April 2017 | April 2027 | 8p (10c) | – | 3,124,999 | – | – | 3,124,999 |
| **2010 Unapproved Share Option Scheme** | | | | | | | | |
| Jens Montanana | August 2010 | August 2020 | 25p (41c) | 165,000 | – | – | – | 165,000 |
| | March 2012 | March 2022 | 54.5p (89c) | 30,000 | – | – | – | 30,000 |
| | April 2013 | April 2023 | 25p (38c) | 80,000 | – | – | – | 80,000 |
| | January 2016 | January 2026 | 20p (29c) | 150,000 | – | – | – | 150,000 |
| | April 2017 | April 2027 | 8p (10c) | – | 994,000 | – | – | 994,000 |
| Richard Last | March 2012 | March 2022 | 54.5p (89c) | 20,000 | – | – | (20,000) | – |
| | April 2013 | April 2023 | 25p (38c) | 60,000 | – | – | (60,000) | – |
| | January 2016 | January 2026 | 20p (29c) | 100,000 | – | – | (100,000) | – |
| | April 2017 | April 2027 | 8p (10c) | – | 450,000 | – | – | 450,000 |
| | June 2017 | June 2027 | 13.6 (18c) | – | 180,000 | – | – | 180,000 |
| Andrew Lloyd | April 2013 | April 2023 | 25p (38c) | 60,000 | – | – | (60,000) | – |
| | May 2014 | May 2024 | 25p (42c) | 40,000 | – | – | (40,000) | – |
| | January 2016 | January 2026 | 20p (29c) | 100,000 | – | – | (100,000) | – |
| | April 2017 | April 2027 | 8p (10c) | – | 870,001 | – | – | 870,001 |
| | June 2017 | June 2027 | 13.6 (18c) | – | 200,000 | – | – | 200,000 |
| Ashley Stephenson | March 2012 | March 2022 | 54.5p (89c) | 180,000 | – | – | (180,000) | – |
| | April 2013 | April 2023 | 25p (38c) | 400,000 | – | – | (400,000) | – |

# Notes to the Financial Statements continued

## 25. Share options continued

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | May 2014 | May 2024 | 25p (42c) | 1,720,000 | – | – | (1,720,000) | – |
| | April 2015 | April 2025 | 15p (23c) | 200,000 | – | – | (200,000) | – |
| | January 2016 | January 2026 | 20p (29c) | 700,000 | – | – | (700,000) | – |
| | April 2017 | April 2027 | 8p (10c) | – | 2,319,000 | – | – | 2,319,000 |
| | June 2017 | June 2027 | 13.6 (18c) | – | 3,200,000 | – | – | 3,200,000 |
| Andrew Miller | May 2014 | May 2024 | 25p (42c) | 387,430 | – | – | – | 387,430 |
| | April 2015 | April 2025 | 15p (23c) | 300,000 | – | – | – | 300,000 |
| | January 2016 | January 2026 | 20p (29c) | 500,000 | – | – | – | 500,000 |
| | April 2017 | April 2027 | 8p (10c) | – | 1,919,000 | – | – | 1,919,000 |
| Other holders | August 2010 | August 2020 | 31p (50c) | 308,000 | – | – | – | 308,000 |
| | March 2011 | March 2021 | 36p (59c) | 54,750 | – | – | (54,750) | – |
| | March 2011 | March 2021 | 40p (65c) | 290,000 | – | – | – | 290,000 |
| | September 2011 | September 2021 | 37.5p (61c) | 163,500 | – | – | (123,500) | 40,000 |
| | March 2012 | March 2022 | 54.5p (89c) | 206,250 | – | – | (66,250) | 140,000 |
| | September 2012 | September 2022 | 43p (70c) | 7,000 | – | – | (7,000) | – |
| | April 2013 | April 2023 | 25p (38c) | 287,000 | – | – | (187,000) | 100,000 |
| | September 2013 | September 2023 | 25p (40c) | 40,000 | – | – | (40,000) | – |
| | May 2014 | May 2024 | 25p (42c) | 1,054,416 | – | – | (383,750) | 670,666 |
| | September 2014 | September 2024 | 25p (41c) | 120,000 | – | – | (115,000) | 5,000 |
| | April 2015 | April 2025 | 15p (23c) | 343,000 | – | – | (290,000) | 53,000 |
| | October 2015 | September 2025 | 15p (23c) | 277,000 | – | – | (172,000) | 105,000 |
| | May 2016 | May 2026 | 20p (29c) | 1,073,000 | – | – | (973,000) | 100,000 |
| | September 2016 | September 2026 | 22.5p (33c) | 470,500 | – | – | (8,000) | 462,500 |
| | April 2017 | April 2027 | 8p (10c) | – | 1,239,626 | – | (343,000) | 896,626 |
| | June 2017 | June 2027 | 13.6 (18c) | – | 1,371,750 | – | (275,000) | 1,096,750 |
| | September 2017 | September 2027 | 9.1p (12c) | – | 505,000 | – | – | 505,000 |
| | | | | 13,270,721 | 20,251,250 | – | (8,340,555) | 25,181,416 |

The closing mid-market price for the Company's shares at 31 December 2017 was 6.75p (8c) and the high and low for the year was 12.9p (16c) and 5.1p (6c). There are no performance conditions to be met before share options are exercisable.

No options were exercised and 1,673,500 options were forfeited in the 12 months to 31 December 2017. On 9 June 2017, the Company announced the cancellation and re-granting of options over Ordinary Shares to certain Directors and employees, with an option re-grant price of 13.6p ("New Option Grant Price") being the weighted average price of the Company's historic investment rounds). A total of 6,667,055 options were granted on 8 June 2017 at the New Option Grant price in return for the cancellation of existing option grants. The new options have the same vesting and share sale conditions as the existing share option grants.

The Company also announced that it intended to cancel 2,356,000 options previously granted to Andrew Miller and 425,000 options granted to Jens Montanana and grant an equal number of new options to each of them (the "New Concert Party Options") at the New Option Grant Price. Andrew Miller and Jens Montanana are considered to be a "Concert party" under the City Code on Takeovers and Mergers. Since the terms of the New Concert Party Options are different from existing options currently held by Andrew Miller and Jens Montanana, the Company will require consent from the Panel on Takeovers and Mergers ("Panel") to waive the obligation on them to make a general offer to shareholders under Rule 9 of the Code that could otherwise arise if the New Concert Party Options were exercised. The Panel's waiver (if given) will be subject to the approval of independent shareholders, being shareholders other than Andrew Miller and Jens Montanana, taken on a poll at a general meeting of the Company. The Company can confirm that it intends, subject to the Panel granting a waiver, to seek approval at the 2018 AGM for the grant of the New Concert Party Options and to include the required resolution in the notice of AGM.

Share options granted at 31 December 2016 were as follows:

| Option Holders | Date granted | Expiry date | Exercise price | At 1 January 2016 | Granted | Exercised | Forfeit | At 31 December 2016 |
|---|---|---|---|---|---|---|---|---|
| **Enterprise Management Incentive Scheme** | | | | | | | | |
| Other Holders | March 2011 | March 2021 | 36p (59c) | 7,000 | – | – | (7,000) | – |
| | March 2011 | March 2021 | 40p (65c) | 40,000 | – | – | – | 40,000 |
| | March 2012 | March 2022 | 54.5p (89c) | 30,000 | – | – | (5,000) | 25,000 |
| | September 2012 | September 2022 | 43p (70c) | 110,000 | – | – | – | 110,000 |
| | April 2013 | April 2023 | 25p (38c) | 95,000 | – | – | (10,000) | 85,000 |
| | May 2014 | May 2024 | 25p (42c) | 48,000 | – | – | (8,000) | 40,000 |
| | September 2014 | September 2024 | 25p (41c) | 10,000 | – | – | – | 10,000 |
| | April 2015 | April 2025 | 15p (23c) | 750,000 | – | – | – | 750,000 |
| | October 2015 | September 2025 | 15p (23c) | 57,000 | – | – | – | 57,000 |
| | January 2016 | January 2026 | 20p (29c) | – | 500,000 | – | (500,000) | – |
| | May 2016 | May 2026 | 22.5p (33c) | – | 1,072,000 | – | (5,000) | 1,067,000 |
| | September 2016 | September 2026 | 15p (20c) | – | 31,305 | – | – | 31,305 |
| **2010 Executive Enterprise Management Incentive Scheme** | | | | | | | | |
| Andrew Miller | August 2010 | August 2020 | 25p (41c) | 476,000 | – | – | – | 476,000 |
| | September 2012 | March 2022 | 54.5p (89c) | 80,000 | – | – | – | 80,000 |
| | April 2013 | April 2023 | 25p (38c) | 250,000 | – | – | – | 250,000 |
| | May 2014 | May 2024 | 25p (42c) | 362,570 | – | – | – | 362,570 |
| **2010 Unapproved Share Option Scheme** | | | | | | | | |
| Jens Montanana | August 2010 | August 2020 | 25p (41c) | 165,000 | – | – | – | 165,000 |
| | March 2012 | March 2022 | 54.5p (89c) | 30,000 | – | – | – | 30,000 |
| | April 2013 | April 2023 | 25p (38c) | 80,000 | – | – | – | 80,000 |
| | January 2016 | January 2026 | 20p (29c) | – | 150,000 | – | – | 150,000 |
| Richard Last | March 2012 | March 2022 | 54.5p (89c) | 20,000 | – | – | – | 20,000 |
| | April 2013 | April 2023 | 25p (38c) | 60,000 | – | – | – | 60,000 |
| | January 2016 | January 2026 | 20p (29c) | – | 100,000 | – | – | 100,000 |
| Andrew Lloyd | April 2013 | April 2023 | 25p (38c) | 60,000 | – | – | – | 60,000 |
| | May 2014 | May 2024 | 25p (42c) | 40,000 | – | – | – | 40,000 |
| | January 2016 | January 2026 | 20p (29c) | – | 100,000 | – | – | 100,000 |
| Ashley Stephenson | March 2012 | March 2022 | 54.5p (89c) | 180,000 | – | – | – | 180,000 |
| | April 2013 | April 2023 | 25p (38c) | 400,000 | – | – | – | 400,000 |
| | May 2014 | May 2024 | 25p (42c) | 1,720,000 | – | – | – | 1,720,000 |
| | April 2015 | April 2025 | 15p (23c) | 200,000 | – | – | – | 200,000 |
| | January 2016 | January 2026 | 20p (29c) | – | 700,000 | – | – | 700,000 |
| Andrew Miller | May 2014 | May 2024 | 25p (42c) | 387,430 | – | – | – | 387,430 |
| | April 2015 | April 2025 | 15p (23c) | 300,000 | – | – | – | 300,000 |
| | January 2016 | January 2026 | 20p (29c) | – | 500,000 | – | – | 500,000 |

# Notes to the Financial Statements continued

## 25. Share options continued

| Option Holders | Date granted | Expiry date | Exercise price | At 1 January 2016 | Granted | Exercised | Forfeit | At 31 December 2016 |
|---|---|---|---|---|---|---|---|---|
| Other holders | August 2010 | August 2020 | 31p (50c) | 308,000 | – | – | – | 308,000 |
| | March 2011 | March 2021 | 36p (59c) | 54,750 | – | – | – | 54,750 |
| | March 2011 | March 2021 | 40p (65c) | 290,000 | – | – | – | 290,000 |
| | September 2011 | September 2021 | 37.5p (61c) | 163,500 | – | – | – | 163,500 |
| | March 2012 | March 2022 | 54.5p (89c) | 216,250 | – | – | (10,000) | 206,250 |
| | September 2012 | September 2022 | 43p (70c) | 14,500 | – | – | (7,500) | 7,000 |
| | April 2013 | April 2023 | 25p (38c) | 307,000 | – | – | (20,000) | 287,000 |
| | September 2013 | September 2023 | 25p (40c) | 40,000 | – | – | – | 40,000 |
| | May 2014 | May 2024 | 25p (42c) | 1,432,750 | – | – | (378,334) | 1,054,416 |
| | September 2014 | September 2024 | 25p (41c) | 440,000 | – | – | (320,000) | 120,000 |
| | April 2015 | April 2025 | 15p (23c) | 1,803,000 | – | (6,666) | (1,453,334) | 343,000 |
| | October 2015 | September 2025 | 15p (23c) | 352,000 | – | | (75,000) | 277,000 |
| | January 2016 | January 2026 | 20p (29c) | – | 700,000 | – | (700,000) | – |
| | May 2016 | May 2026 | 22.5p (33c) | – | 1,073,000 | – | – | 1,073,000 |
| | September 2016 | September 2026 | 15p (20c) | – | 470,500 | – | – | 470,500 |
| | | | | 11,379,750 | 5,396,805 | (6,666) | (3,499,168) | 13,270,721 |

Andrew Miller has a contractual right (granted in March 2011) to purchase 140,000 ordinary shares in the Company from the Employee Share Ownership Trust at 40p per share pursuant to a grant made to him under the Deferred Payment Share Plan.

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 10 years from the date of grant.

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

### Options granted

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

| | 2017 | 2016 |
|---|---|---|
| Share price at date of grants | 8p–9p (10c–12c) | 13p–21.5p (17c–31c) |
| Exercise price | 8p–13.6p (10c–18c) | 15p–22.5p (20c–33c) |
| Expected volatility | 0.26% | 0.2–0.26% |
| Years to maturity | 9.3–9.7 | 9.0–9.7 |
| Risk free interest rate | 0.39–0.74% | 0.35–1.18% |

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

| | |
|---|---|
| Weighted average remaining contractual life | 6.8 years |
| Average remaining contractual life | 6.4 years |
| Options exercisable | 4,427,499 |
| Exercise price range | 8p–55p (10c–68c) |
| Weighted average share price | 11p (15c) |
| Weighted average exercise price | 13p (18c) |
| Expected volatility | 0.2%–6.4% |
| Risk free rate – 5 year gilt rate | 0.35%–2.6% |
| Expected dividend yield | Nil |

Volatility is calculated as the standard deviation of the closing daily share price over a period of 24 months prior to the grant date.

Operating expenses in the Statement of Comprehensive Income included a charge of $21,000 (2016: $19,000) relating to employee share-based payments.

## 26. Related parties and transactions

As part of the subscription and placing on 25 April 2017, Jens Montanana contributed $4.4 million, Andrew Miller contributed $13,000 and Andrew Lloyd contributed $19,000 (note 21).

As part of the subscription and placing on 10 May 2016, Jens Montanana contributed $1.2 million and Andrew Miller contributed $22,000 (note 21).

The Directors consider the Group's key management personnel to be the Board of Directors of the Company whose compensation is detailed in note 23.

Company key management compensation was $nil (2016: $nil) as the key management are employed by subsidiaries.

# Corporate Directory

## Directors
Jens Montanana (Non-Executive Chairman)
Richard Last (Non-Executive Director)
Ashley Stephenson (CEO)
Andrew Lloyd (President and EVP Sales & Marketing)
Andrew Miller (CFO)

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## Solicitors
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