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COMPANY REGISTRATION NUMBER 3533689 (DELAWARE)

PHORM UK, INC.

ANNUAL REPORT AND FINANCIAL STATEMENTS

31 DECEMBER 2009

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PHORM UK, INC.

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YEAR ENDED 31 DECEMBER 2009

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PHORM UK, INC.

OFFICERS AND PROFESSIONAL ADVISERS

YEAR ENDED 31 DECEMBER 2009

THE BOARD OF DIRECTORS

A Croxson
N Richards

REGISTERED OFFICE

2711 Centerville Road
Suite 400
City of Wilmington 19808
County of New Castle
Delaware
USA

BANKERS

HSBC Group plc
70 Pall Mall
St James
London
SW1Y 5EZ

SOLICITORS

Nabarro LLP
Lacon House
Theobald's Road
London
WC1X 8RW

PHORM UK, INC.

DIRECTORS' REPORT

YEAR ENDED 31 DECEMBER 2009

The Directors present their annual report and the unaudited financial statements of the company for the year ended 31 December 2009. The company is a Delaware corporation, however as the company's shares are quoted on the Alternative Investment Market in London, the financial statements have been prepared using United Kingdom Generally Accepted Accounting Principles.

PRINCIPAL ACTIVITIES AND BUSINESS REVIEW

The principal activity of the parent company and of the Group during the year was to develop a platform for the delivery and management of targeted, contextual and behavioural online advertising campaigns on behalf of its clients. The Review of Business is included in the Chairman's and CEO's reports.

PRINCIPAL RISKS AND UNCERTAINTIES

The Directors recognise that within the business there are a number of risks, which may affect the performance of the Group. These risks are subjected to regular review and where appropriate processes are established to minimise the level of exposure.

ISP Risk

The Group's plan to deploy its service using the network of numerous ISPs is wholly dependent on reaching arrangements with such ISPs. There can be no assurance that we will be able to reach satisfactory agreements with said ISPs.

Financial Risks

The Group's financial instruments comprise cash and other items, including trade debtors and trade creditors that arise directly from its operations. The Group seeks to reduce or eliminate financial risk and to invest cash assets safely and profitably. It operates within policies and procedures approved by the Board, which include strict controls on the use of financial instruments in managing the Group's risk. The Group has transactional currency exposure as it deals in multi-currencies however the Directors do seek to limit this risk as much as possible.

People

One of the key assets of the Group is the commitment and skill of its staff. The retention of these people is therefore key to the success of the business. The Group monitors closely the satisfaction of its employees and that their remuneration packages match both contribution and the wider employment market. In addition the Group has a share option scheme which allows employees to participate in the success of the Group as a whole.

Technology and market changes

Phorm UK, Inc. operates at the forefront of the digital advertising technology marketplace. The Directors acknowledge that this is a rapidly evolving environment and the Group monitors closely how changes will impact the Group. During 2006 the Directors made a strategic decision to redirect the focus of the Group towards the ISP marketplace. The Group has needed to expend considerable capital in pursuing its strategy with the global ISP community prior to obtaining any significant revenues from this business.

Competition

The Group continuously monitors new product offerings into the market place and the Directors believe Phorm's technical team have a strong track record in maintaining competitive advantage.

RESEARCH AND DEVELOPMENT

Research and development is undertaken on an ongoing basis in order to further develop and enhance the Group's software products.

PHORM UK, INC.

DIRECTORS' REPORT

YEAR ENDED 31 DECEMBER 2009

THE DIRECTORS AND THEIR INTERESTS

The Directors at the end of the year were as follows

A Croxson

N Richards (resigned on 16 July 2010)

None of the directors who served during the year had any beneficial interests in the share capital of the company

EMPLOYEE CONSULTATION

The policy of informing and consulting with employees is maintained by means of regular team briefs, conference calls and meetings. Employees are encouraged to present their views and suggestions in respect of the Group's performance.

CREDITOR PAYMENT POLICY

The Group's current policy concerning the payment of trade creditors is to

- (i) settle the terms of payment with suppliers when agreeing the terms of each transaction
- (ii) ensure that suppliers are made aware of the terms of payment by inclusion of the relevant terms in contracts
- (iii) pay in accordance with the Group's contractual or other legal obligations

The average trade creditor days for the year were 10 days (2008 10 days)



PHORM UK, INC.

STATEMENT OF DIRECTORS' RESPONSIBILITIES

FOR THE YEAR ENDED 31 DECEMBER 2009

The directors are responsible for preparing the Annual Report and the financial statements in accordance with applicable law and regulations

Company law requires the directors to prepare financial statements for each financial year. Under that law the directors have elected to prepare the financial statements in accordance with United Kingdom Generally Accepted Accounting Practice (United Kingdom Accounting Standards and applicable law). The financial statements are required by law to give a true and fair view of the state of affairs of the company and of the profit or loss of the company for that period. In preparing these financial statements, the directors are required to

- select suitable accounting policies and then apply them consistently,
- make judgments and estimates that are reasonable and prudent,
- state whether applicable UK Accounting Standards have been followed, subject to any material departures disclosed and explained in the financial statements,
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the company will continue in business.

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

PHORM UK, INC.

PROFIT AND LOSS ACCOUNT

FOR THE YEAR ENDED 31 DECEMBER 2009

| | | 2009 | 2008 |
|--|-------|---------------------|---------------------|
| | Notes | \$ | \$ |
| Cost of Sales | | (1,540,568) | (517,216) |
| Gross Loss | | (1,540,568) | (517,216) |
| Sales and Administrative Expenses | | | |
| - General | | (29,342,782) | (16,441,054) |
| - Share Based Payments | | (3,079,027) | (7,498,243) |
| Operating Loss | 3 | (33,962,377) | (24,456,513) |
| Interest receivable | 6 | 97,563 | 1,806,104 |
| Interest Payable and similar Charges | 7 | (2,089) | (3,749) |
| Loss on Ordinary Activities Before Taxation | | (33,866,903) | (22,654,158) |
| Taxation on Loss on Ordinary Activities | 8 | - | - |
| Loss on Ordinary Activities After Taxation | | (33,866,903) | (22,654,158) |

All activities of the Company are classed as continuing

PHORM UK, INC.

STATEMENT OF TOTAL RECOGNIZED GAINS AND LOSSES FOR THE YEAR ENDED 31 DECEMBER 2009

| | Notes | 2009 \$ | 2008 \$ |
|--|-------|---------------------|---------------------|
| Loss for the financial year | | (33,866,903) | (22,654,158) |
| Share option charge taken to option reserve | | 3,079,027 | 7,498,243 |
| Currency translation difference on overseas divisions | | 743,808 | (13,322,363) |
| Total recognized gains and losses relating to the year | | <u>(30,044,068)</u> | <u>(28,478,278)</u> |
| Total gains and losses recognized since last annual report | | <u>(30,044,068)</u> | <u>(28,478,278)</u> |

PHORM UK, INC.

BALANCE SHEET

AS AT 31 DECEMBER 2009

| | | 2009 | 2008 |
|--|-------|---------------------|---------------------|
| | Notes | \$ | \$ |
| Fixed Assets | | | |
| Tangible assets | 9 | 776,258 | 712,423 |
| | | <u>776,258</u> | <u>712,423</u> |
| Current Assets | | | |
| Debtors | 10 | 9,578,259 | 2,106,417 |
| Cash at bank and in hand | | 13,840,432 | 23,233,797 |
| | | <u>23,418,691</u> | <u>25,340,214</u> |
| Creditors Amounts Falling Due Within One Year | 11 | (97,544,755) | (69,347,141) |
| Net Current Assets | | <u>(74,126,064)</u> | <u>(44,006,927)</u> |
| Total Assets Less Current Liabilities | | <u>(73,349,806)</u> | <u>(43,294,504)</u> |
| Creditors Amounts Falling Due After One Year | 12 | (4,004) | (15,238) |
| Net Assets | | <u>(73,353,810)</u> | <u>(43,309,742)</u> |
| Capital and Reserves | | | |
| Called Up Share Capital | 13 | - | - |
| Share Premium Account | 14 | - | - |
| Foreign Exchange Reserve | 14 | (12,907,761) | (13,651,569) |
| Profit and Loss Account | 14 | (60,446,049) | (29,658,173) |
| Shareholders' Funds | | <u>(73,353,810)</u> | <u>(43,309,742)</u> |

The financial statements of Phorm UK, Inc , registered number 3533689 (Delaware), were approved by the Board of Directors and authorised for issue on 28 January 2011

Signed on behalf of the Board of Directors



A Croxson
Director

PHORM UK, INC.

NOTES TO THE FINANCIAL STATEMENTS

YEAR ENDED 31 DECEMBER 2009

1 ACCOUNTING POLICIES

The financial statements are prepared in accordance with applicable United Kingdom law and accounting standards. The particular accounting policies adopted are described below, and have been applied consistently in the current and preceding year.

Basis of preparation

These financial statements present information about the company as an individual undertaking and not about its group. The accounts have been prepared on an historical cost basis.

The company is exempt from the obligation to prepare and deliver group accounts under Sections 228(2) of the Companies Act 1985 as it is a wholly-owned subsidiary of Phorm Inc (see note 20).

Basis of going concern

These financial statements have been prepared on a going concern basis which assumes that the company will continue to be supported by its parent, Phorm, Inc.

Turnover

Turnover represents amounts receivable for services net of VAT and trade discounts.

Research and development

In accordance with best practice in the software industry, research and development expenditure is expensed to the profit and loss accounts as incurred.

Tangible fixed assets

All tangible fixed assets are initially recorded at cost, and then stated at cost less depreciation.

Depreciation

Depreciation is calculated so as to write off the cost of an asset, less its estimated residual value, over the useful economic life of that asset as follows:

| | |
|-------------------------------|---------------|
| Computer hardware & machinery | - 50% on cost |
| Fixtures and fittings | - 33% on cost |
| Software development costs | - 50% on cost |

Fixed asset investments

Fixed asset investments are stated at cost less provision for impairment in value.

Leasing and hire purchase commitments

Assets held under finance leases and hire purchase contracts are treated as if they had been purchased outright at the present value of the rentals payable, less finance charges, over the primary period of the agreements. The corresponding obligations under these agreements are included in creditors. The finance element of the rentals payable is charged to the profit and loss account so as to produce a constant rate of charge on the outstanding balance in each period.

Rentals applicable to operating leases where substantially all of the benefits and risks of ownership remain with the lessor are charged against profits on a straight-line basis over the period of the lease.

Contribution to pension funds

The company contributes to individual defined contribution pension plans for the benefit of certain employees and directors. The assets of the scheme are administered by trustees in a fund independent from those of the company.

The pension costs charged against profits represent the amount of the contributions payable to the scheme in respect of the accounting period.

PHORM UK, INC.

NOTES TO THE FINANCIAL STATEMENTS

YEAR ENDED 31 DECEMBER 2009

ACCOUNTING POLICIES *(Continued)*

Share based payments

The Group issues equity-settled share-based payments to certain employees and has applied Financial Reporting Standard No 20 'Share-based payments'

The cost of employee share-based compensation awards is recognised as an expense. The total amount to be expensed rateably over the vesting period is determined by reference to the fair value of the options determined at the grant date, excluding the impact of non-market vesting conditions (for example, profitability and sales targets). Non-market vesting conditions are included in the assumptions about the number of options that will eventually vest. This estimate is revised at each reporting date and an adjustment is made to the profit and loss account. Fair value is measured by using the Black-Scholes pricing model, except for options with market based vesting conditions, where a binomial model is used.

Employer's taxes on share options

Employers' national insurance contributions in the UK, are calculated using the market value of the company's shares at the reporting date, and pro-rated over the vesting period of the options.

Deferred taxation

Current tax, including UK corporation tax and foreign tax, is provided at amounts expected to be paid (or recovered) using the tax rates and laws that have been enacted or substantively enacted by the balance sheet date.

Deferred tax is provided in full on timing differences which result in an obligation at the balance sheet date to pay more tax, or a right to pay less tax, at a future date, at rates expected to apply when they crystallise based on current rates and law. Timing differences arise from the inclusion of items of income and expenditure in taxation computations in periods different from those in which they are included in the accounts. Deferred tax is not provided on timing differences arising from the revaluation of fixed assets where there is no commitment to sell the assets. Deferred tax assets are recognised to the extent that it is regarded as more likely than not that they will be recovered. Deferred tax assets and liabilities are not discounted.

Foreign currencies

Monetary assets and liabilities in foreign currencies are translated into US dollars at the closing rates of exchange ruling at the balance sheet date. Transactions in foreign currencies are translated into US dollar at the rate of exchange ruling at the date of the transaction. All differences are taken to the profit and loss account.

The results of overseas branches are translated into US dollars at the average rates for the year. The net assets/(liabilities) of overseas branches are translated at year-end exchange rates. The exchange differences arising on translation of the opening net assets/(liabilities) and results of overseas operations are taken to reserves.

Functional currency

The financial statements have been prepared in US dollars as the majority of the Company's trade occurs in this currency.

Cash flow statement

The company has taken advantage of the exemption available under Financial Reporting Standard No 1 'Cash flow statements (Revised 1996)' not to prepare a statement of cash flows as it is a wholly-owned subsidiary undertaking. Phorm UK, Inc. cash flows are included in the consolidated accounts of Phorm, Inc, which are publicly available.

Segmental reporting

The company has taken advantage of the exemption available under Statement of Standard Accounting Practice 25 'Segmental reporting', paragraph (41) not to provide additional segmental reporting disclosures as it is a wholly owned subsidiary undertaking. Phorm UK, Inc. segmental reporting disclosures are included in the consolidated accounts of Phorm Inc, which are publicly available.

PHORM UK, INC.

NOTES TO THE FINANCIAL STATEMENTS

YEAR ENDED 31 DECEMBER 2009

2 TURNOVER

During 2006 the Directors made a strategic decision to cease the sale and marketing of the desktop software business (Pagesense Desktop), and focus the company's resources on the online behavioural and contextual advertising market through arrangements with global ISPs. The company therefore did not generate any revenue in the current year (2008: none)

3 OPERATING LOSS BEFORE TAX

Operating loss is stated after charging/(crediting)

| | 2009 \$ | 2008 \$ |
|--|------------|--------------|
| Research and development expenditure written off | 6,624,682 | 7,135,861 |
| Operating lease rentals | | |
| - Other assets | 1,193,543 | 1,638,499 |
| Share Based Payments | | |
| - Charge under FRS 20 | 3,079,027 | 7,498,243 |
| - Employer's NIC | 76,846 | (992,894) |
| Depreciation of owned fixed assets | 915,289 | 605,159 |
| Depreciation of tangible fixed assets held under finance lease and hire purchase contracts | 10,445 | 6,964 |
| Auditors' remuneration | | |
| Fees payable to the Company's auditors for the audit of the company's annual accounts | 133,797 | 191,872 |
| Fees payable to the Company's auditors for other services | 16,032 | 223,329 |
| Net loss/(profit) on foreign currency translation | 5,847,787 | (25,203,618) |

Fees payable to the company's auditors for non-audit services to the company are not required to be disclosed because the consolidated financial statements are required to disclose such fees on a consolidated basis

4 STAFF COSTS

The average number of staff employed by the Company during the financial year amounted to

| | 2009 No. | 2008 No. |
|--------------------------|-------------|-------------|
| Research and development | 7 | 4 |
| Sales and administration | 73 | 93 |
| | <u>80</u> | <u>97</u> |

The aggregate payroll costs of the above were

| | 2009 \$ | 2008 \$ |
|---------------------------------|-------------------|-------------------|
| Wages and salaries | 11,935,187 | 23,117,758 |
| Compensation for loss of office | 666,419 | 3,651,503 |
| Social security costs | 1,005,274 | 520,799 |
| Other pension costs | 337,922 | 400,232 |
| | <u>13,944,802</u> | <u>27,690,292</u> |

PHORM UK, INC.

NOTES TO THE FINANCIAL STATEMENTS

YEAR ENDED 31 DECEMBER 2009

5. DIRECTORS' EMOLUMENT

The Directors' aggregate emoluments in respect of qualifying services were

| | 2009 \$ | 2008 \$ |
|--|----------------|------------------|
| Emoluments receivable | 552,639 | 757,121 |
| Compensation for loss of office | - | 507,998 |
| Sums paid to third parties in respect of directors' services | 225,014 | - |
| | <u>777,653</u> | <u>1,265,119</u> |

Emoluments of highest paid director

| | 2009 \$ | 2008 \$ |
|--|----------------|----------------|
| Total emoluments (excluding pension contributions) | <u>344,293</u> | <u>379,510</u> |

The highest paid director did not exercise any share options in the year

The company has made pension contributions of \$26,043 (2008 \$29,199) under defined contribution schemes in respect of the directors

6. INTEREST RECEIVABLE

| | 2009 \$ | 2008 \$ |
|--------------------------|---------------|------------------|
| Bank interest receivable | 97,563 | 1,806,104 |
| | <u>97,563</u> | <u>1,806,104</u> |

7. INTEREST PAYABLE AND SIMILAR CHARGES

| | 2009 \$ | 2008 \$ |
|--|--------------|--------------|
| Interest payable on Finance lease and hire purchase contracts | 2,089 | 3,749 |
| | <u>2,089</u> | <u>3,749</u> |

8. TAXATION ON ORDINARY ACTIVITIES

| | 2009 \$ | 2008 \$ |
|---|--------------|--------------|
| Current tax | | |
| Delaware state tax | - | - |
| Total current tax | <u>-</u> | <u>-</u> |
| Factors affecting the tax charge for the period | | |
| Loss on ordinary activities before taxation | (33,866,903) | (22,654,158) |
| Profit on ordinary activities before taxation multiplied by blended rate of UK corporation tax of 28% (2008 28.5%) | (9,482,733) | (6,456,435) |
| Effects of | | |
| Expenses not deductible for tax purposes | 76,607 | 18,239 |
| Capital allowances for the period in excess of depreciation | 128,913 | 51,644 |
| Other tax adjustments | 833,538 | 1,429,288 |

PHORM UK, INC.

NOTES TO THE FINANCIAL STATEMENTS

YEAR ENDED 31 DECEMBER 2009

| | | |
|---------------------------|-----------|-----------|
| Movement on tax losses | 8,443,675 | 4,957,264 |
| Current Tax charge | <u>-</u> | <u>-</u> |

Deferred tax assets have not been recognised as they may not be utilised until suitable profits arise and it is not yet sufficiently probable that such profits will be available in the future

9 TANGIBLE FIXED ASSETS

| | Computer Hardware & Machinery \$ | Fixtures & Fittings \$ | Total \$ |
|----------------------------|---|---|---------------------|
| COST | | | |
| At 1 January 2009 | 1,313,736 | 173,944 | 1,487,680 |
| Additions | 1,072,340 | - | 1,072,340 |
| Disposals | (225,856) | - | (225,856) |
| Exchange differences | 119,717 | 656 | 120,373 |
| At 31 December 2009 | <u>2,279,937</u> | <u>174,600</u> | <u>2,454,537</u> |
| DEPRECIATION | | | |
| At 1 January 2009 | 687,151 | 88,106 | 775,257 |
| Charge for the year | 872,385 | 42,904 | 915,289 |
| Disposals | (57,381) | - | (57,381) |
| Exchange differences | 44,849 | 265 | 45,114 |
| At 31 December 2009 | <u>1,547,004</u> | <u>131,275</u> | <u>1,678,279</u> |
| NET BOOK VALUE | | | |
| At 31 December 2009 | <u>732,933</u> | <u>43,325</u> | <u>776,258</u> |
| At 31 December 2008 | <u>626,585</u> | <u>85,838</u> | <u>712,423</u> |

Finance Leases and Hire Purchase Contracts

The net book value of tangible fixed assets includes an amount of \$13,927 (2008 \$24,372) in respect of assets held under finance lease or hire purchase contracts. The depreciation charge for the year was \$10,445 (2008 \$6,964).

10. DEBTORS

| | 2009 \$ | 2008 \$ |
|------------------------------------|--------------------|--------------------|
| Amounts owed by Group undertakings | 7,814,741 | 380,030 |
| Rent deposit | 315,920 | 348,806 |
| VAT recoverable | 103,854 | 212,650 |
| Other debtors | 387,831 | 124,928 |
| Prepayments and accrued income | 955,913 | 1,040,003 |
| | <u>9,578,259</u> | <u>2,106,417</u> |

PHORM UK, INC.

NOTES TO THE FINANCIAL STATEMENTS

YEAR ENDED 31 DECEMBER 2009

11. CREDITORS Amounts falling due within one year

| | 2009 \$ | 2008 \$ |
|--|-------------------|-------------------|
| Net obligations under finance leases and hire purchase contracts | 11,234 | 10,068 |
| Amounts owed to Group undertakings | 95,482,136 | 65,981,873 |
| Trade creditors | 457,294 | 734,693 |
| Other taxation and social security | 417,680 | 531,792 |
| Other creditors | 35,828 | 25,470 |
| Accruals and deferred income | 1,140,583 | 2,063,245 |
| | <u>97,544,754</u> | <u>69,347,141</u> |

The intercompany balance due to the parent company represents the sterling fund raising on the UK equity market. The parent company has confirmed that this loan is of any equity nature and it is not envisaged that this loan will be repaid.

12. CREDITORS Amounts falling due after one year

| | 2009 \$ | 2008 \$ |
|---|---------------|---------------|
| Provisions for social taxes on share based payments | - | - |
| Net obligations under finance leases and hire purchase contracts | 4,004 | 15,238 |
| | <u>4,004</u> | <u>15,238</u> |
| Net obligations under finance leases and hire purchase contracts | | |
| Repayable within one year | 11,234 | 10,068 |
| Repayable between one and five years | 4,004 | 15,238 |
| | <u>15,238</u> | <u>25,306</u> |
| Included in liabilities falling due within one year | (11,234) | (10,068) |
| | <u>4,004</u> | <u>15,238</u> |

13. SHARE CAPITAL

Authorised share capital

| | 2009 \$ | 2008 \$ |
|-----------------------------------|------------|------------|
| 100 Common shares of \$0.001 each | <u>0.1</u> | <u>0.1</u> |

Allotted, called up and fully paid

| | 2009 No | \$ | 2008 No | \$ |
|-------------------------------|------------|------------|------------|------------|
| Common shares of \$0.001 each | <u>100</u> | <u>0.1</u> | <u>100</u> | <u>0.1</u> |

PHORM UK, INC.

NOTES TO THE FINANCIAL STATEMENTS

YEAR ENDED 31 DECEMBER 2009

14 RESERVES

| | Share capital \$ | Additional paid in capital \$ | Warrants \$ | Translation reserve \$ | Accumulated Deficit \$ | Total \$ |
|--|------------------------|--|----------------|------------------------------|------------------------------|--------------|
| At 1 January 2008 | - | - | - | (329,206) | (14,502,258) | (14,831,464) |
| Loss for the year | - | - | - | - | (22,654,158) | (22,654,158) |
| Share-based payment charge | - | - | - | - | 7,498,243 | 7,498,243 |
| Issue of new stock | - | - | - | - | - | - |
| Transfer of stock | - | - | - | - | - | - |
| Exchange differences on translation of overseas operations | - | - | - | (13,322,363) | - | (13,322,363) |
| Transfer on exercise of warrants | - | - | - | - | - | - |
| At 1 January 2009 | - | - | - | (13,651,569) | (29,658,173) | (43,309,742) |
| Loss for the year | - | - | - | - | (33,866,903) | (33,866,903) |
| Share-based payment charge | - | - | - | - | 3,079,027 | 3,079,027 |
| Issue of new stock | - | - | - | - | - | - |
| Transfer of stock | - | - | - | - | - | - |
| Exchange differences on translation of overseas operations | - | - | - | 743,808 | - | 743,808 |
| Transfer on exercise of warrants | - | - | - | - | - | - |
| At 31 December 2009 | - | - | - | (12,907,761) | (60,446,049) | (73,353,810) |

PHORM UK, INC.

NOTES TO THE FINANCIAL STATEMENTS

YEAR ENDED 31 DECEMBER 2009

15. SHARE BASED PAYMENTS

The group has a share scheme whereby options over the common shares of the company are granted to employees, consultants and directors. Options are granted at the mid market price on close of the day of grant and must be exercised within 10 years of grant unless the employment is terminated in which case options generally must be exercised within 90 days of termination.

The reconciliation of option movements during the year ended 31 December 2009 is shown below

| | Number | 2009 Weighted average exercise price £ | Number | 2008 Weighted average exercise price £ |
|------------------------------------|-------------|--|-----------|--|
| Outstanding at beginning of period | 3,162,002 | 8.65 | 3,028,553 | 8.32 |
| Granted during the year | 2,011,597 | 3.35 | 331,567 | 13.40 |
| Lapsed | (1,813,290) | 8.06 | 129,479 | 16.82 |
| Exercised | (145,667) | 1.00 | 68,639 | 1.93 |
| Outstanding at end of period | 3,214,642 | 5.96 | 3,162,002 | 8.65 |
| Exercisable at end of period | 1,185,231 | 8.16 | 1,178,797 | 9.96 |

The following options over ordinary shares were in existence at 31 December 2009

| Range of exercise Price £ | Number | Weighted average exercise price £ | 2009 Weighted average remaining life (years) | Number | Weighted average exercise price £ | 2008 Weighted average remaining life (years) |
|------------------------------------|-----------|--|--|-----------|--|--|
| £0.01 - £2.49 | 1,017,664 | 1.58 | 7.19 | 1,277,038 | 1.72 | 6.83 |
| £2.50 - £4.99 | 1,508,613 | 3.75 | 9.19 | 106,500 | 4.70 | 7.49 |
| £5.00 - £9.99 | 124,650 | 9.59 | 7.12 | 765,750 | 6.96 | 7.68 |
| £10.00-£15.00 | 86,000 | 12.16 | 7.14 | 188,250 | 11.84 | 7.86 |
| £15.00-£20.00 | 300,500 | 17.97 | 8.04 | 425,250 | 17.94 | 9.05 |
| £20.00-£25.00 | 100,300 | 21.53 | 7.92 | 262,300 | 21.81 | 8.96 |
| £25.00-£30.00 | 76,915 | 27.30 | 7.58 | 136,914 | 27.30 | 8.58 |
| Total | 3,214,642 | 5.96 | 8.24 | 3,162,002 | 8.65 | 7.67 |

The fair value of the options granted during the year was calculated using the following assumptions

PHORM UK, INC.

NOTES TO THE FINANCIAL STATEMENTS

YEAR ENDED 31 DECEMBER 2009

2009 grants:

| Grant date | 5 Feb 2009 | 5 Feb 2009 | 5 Feb 2009 | 5 Feb 2009 | 24 Mar 2009 |
|--|---------------|---------------|---------------|---------------|---------------|
| Pricing model | Black Scholes | RSU | RSU | RSU | Black Scholes |
| Share price at grant | £2 43 | £2 43 | £2 43 | £2 43 | £3 75 |
| Exercise price | £2 43 | N/A | N/A | N/A | £3 75 |
| Vesting criteria | (1) | (2) | (5) | (6) | (7) |
| Expected volatility | 57 7% | N/A | N/A | N/A | 57 3% |
| Expected life (years) | 7 0 | N/A | N/A | N/A | 5 3 |
| Risk free rate | 3 2% | N/A | N/A | N/A | 2 4% |
| Dividend yield | 0% | 0% | 0% | 0% | 0% |
| Estimated forfeiture rate p a | 5%/12% | 0% | 0% | 0% | 5%/12% |
| Probability non-market based performance criteria is met | N/A | N/A | N/A | N/A | N/A |
| Fair value per option | £1 46 | £2 43 | £2 43 | £2 43 | £1 96 |
| Grant date | 24 Mar 2009 | 24 Mar 2009 | 24 Mar 2009 | 24 March 2009 | 24 March 2009 |
| Pricing model | RSU | Black Scholes | Black Scholes | Black Scholes | Black Scholes |
| Share price at grant | £3 75 | £3 75 | £3 75 | £3 75 | £3 75 |
| Exercise price | N/A | £3 75 | £3 75 | £3 75 | £3 75 |
| Vesting criteria | (2) | (8) | (9) | (10) | (11) |
| Expected volatility | N/A | 57 3% | 57 3% | 57 3% | 57 3% |
| Expected life (years) | N/A | 10 0 | 5 7 | 6 5 | 7 5 |
| Risk free rate | N/A | 3 3% | 2 5% | 2 7% | 2 7% |
| Dividend yield | 0% | 0% | 0% | 0% | 0% |
| Estimated forfeiture rate p a | 0% | 0% | 0% | 0% | 0% |
| Probability non-market based performance criteria is met | N/A | 100% | N/A | N/A | N/A |
| Fair value per option | £3 75 | £2 60 | £2 04 | £2 15 | £1 48 |
| Grant date | 24 Mar 2009 | 24 Mar 2009 | 16 Jun 2009 | 16 Jun 2009 | 3 Sep 2009 |
| Pricing model | Black Scholes | Black Scholes | Black Scholes | RSU | Black Scholes |
| Share price at grant | £3 75 | £3 75 | £5 49 | £5 49 | £1 75 |
| Exercise price | £3 75 | £3 75 | £5 49 | N/A | £1 75 |
| Vesting criteria | (12) | (1) | (1) | (2) | (1) |
| Expected volatility | 57 3% | 57 3% | 56 5% | N/A | 82 7% |
| Expected life (years) | 5 9 | 7 0 | 7 0 | N/A | 7 0 |
| Risk free rate | 2 5% | 2 5% | 3 6% | N/A | 2 3% |
| Dividend yield | 0% | 0% | 0% | 0% | 0% |
| Estimated forfeiture rate p a | 5%/12% | 5%/12% | 12% | 0% | 5%/12% |
| Probability non-market based performance criteria is met | 0% | N/A | N/A | N/A | N/A |
| Fair value per option | £2 0616 | £2 60 | £3 25 | £5 49 | £1 31 |
| Grant date | 28 Sep 2009 | 2 Nov 2009 | 3 Dec 2009 | | |
| Pricing model | Black Scholes | Black Scholes | Black Scholes | | |
| Share price at grant | £1 35 | £1 85 | £2 93 | | |
| Exercise price | £1 35 | £1 85 | £2 93 | | |
| Vesting criteria | (1) | (1) | (1) | | |
| Expected volatility | 83 0% | 83 9% | 85 0% | | |
| Expected life (years) | 7 0 | 7 0 | 7 0 | | |
| Risk free rate | 2 2% | 2 3% | 2 0% | | |
| Dividend yield | 0% | 0% | 0% | | |
| Estimated forfeiture rate p a | 5% | 12% | 5% | | |
| Probability non-market based performance criteria is met | N/A | N/A | N/A | | |
| Fair value per option | £1 01 | £1 39 | £2 21 | | |

PHORM UK, INC.

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YEAR ENDED 31 DECEMBER 2009

18 Share-based payment expense (continued)

2008 grants:

| Grant date | 4 Jan 2008 | 10 Jan 2008 | 24 Jan 2008 | 31 Jan 2008 | 12 May 2008 |
|--|---------------|---------------|---------------|---------------|---------------|
| Pricing model | Black Scholes | Black Scholes | Black Scholes | Black Scholes | Black Scholes |
| Share price at grant | £20 00 | £20 20 | £24 75 | £23 95 | £17 13 |
| Exercise price | £20 00 | £20 20 | £24 75 | £23 95 | £17 13 |
| Vesting criteria | (1) | (1) | (1) | (1) | (1) |
| Expected volatility | 50 1% | 50% | 50% | 49 9% | 59 6% |
| Expected life (years) | 4 1 | 4 1 | 4 1 | 4 1 | 4 1 |
| Risk free rate | 4 23% | 4 2% | 4 29% | 4 22% | 4 28% |
| Dividend yield | 0% | 0% | 0% | 0% | 0% |
| Estimated forfeiture rate p a | 12% | 12% | 12% | 5%/12% | 5%/12% |
| Probability non-market based performance criteria is met | N/A | N/A | N/A | N/A | N/A |
| Fair value per option | £8 87 | £8 94 | £10 98 | £10 59 | £8 63 |

| Grant date | 30 May 2008 | 30 May 2008 | 21 Oct 2008 | 21 Oct 2008 | 3 Nov 2008 |
|--|---------------|---------------|---------------|---------------|---------------|
| Pricing model | Black Scholes | Black Scholes | Black Scholes | Black Scholes | Black Scholes |
| Share price at grant | £11 50 | £11 50 | £2 375 | £2 375 | £1 875 |
| Exercise price | £11 50 | £11 50 | £2 375 | £2 375 | £1 875 |
| Vesting criteria | (1) | (3) | (1) | (4) | (1) |
| Expected volatility | 60 1% | 60 1% | 56% | 56% | 56% |
| Expected life (years) | 4 1 | 10 | 5-7 | 5-7 | 5-7 |
| Risk free rate | 4 92% | 4 92% | 4 24% | 4 61% | 3 95% |
| Dividend yield | 0% | 0% | 0% | 0% | 0% |
| Estimated forfeiture rate p a | 12% | 0% | 5%/12% | 0% | 12% |
| Probability non-market based performance criteria is met | N/A | N/A | N/A | 100% | N/A |
| Fair value per option | £5 91 | £8 48 | £1 35 | £1 68 | £1 06 |

Vesting criteria

- 1 At the rate of 1/8th after 6 months, and 1/48th subsequently, for a total vesting period of 48 months
- 2 100% vested immediately
- 3 The options vest based on the achievement of certain performance conditions relating to the signing of agreements with Internet service providers (ISPs) and deployment of the OIX platform to a specified number of such ISP's Internet users. Certain conditions have to be achieved within one to three years from date of grant
- 4 The Restricted Stock Units ("RSUs") vest based on the achievement of certain performance conditions relating to the signing of agreements with Internet service providers (ISPs) and revenue generated following deployment of the OIX platform. Certain conditions have to be achieved within one to two years from date of grant
- 5 RSUs 50% vest immediately, 50% vest on 31-Mar-09
- 6 RSUs vesting 5,000 at the end of the calendar month for the 6 months following grant date
- 7 1/12th per month over 12 months

PHORM UK, INC.

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YEAR ENDED 31 DECEMBER 2009

18. Share-based payment expense (continued)

- 8 1/3 vest upon signing of definitive agreements with Korea Telecom, SK Broadband and LG Communications within one year of the grant 1/3 vest upon deployment of the Company's service to 50% of Korea Telecom's users, SK Broadband users and LG Communications users within two years of grant 1/3 vest upon the Company generating \$1m in revenue derived from the Korean business within three years of grant
- 9 The options vest equally over three years
- 10 These options vest in full if within 3 years of the date of grant, being 24 March 2009, Phorm achieves 3 consecutive months of £0 30 revenue per opted in UK subscriber and revenues are of an amount sufficient to cover 50% of the UK attributable annualised overhead
- 11 This grant comprises six separate grants of 75000 options each, vesting of which is dependent on market specific performance Each tranche vests if within five (5) years from the grant date, being 24 March 2009, Phorm owns at least 25% of the operations within each of Japan, South Korea, USA, France, Canada and Australia and such operations, after netting out the annualised costs associated with such operation, is cash positive for a period of six months
- 12 Will vest upon 6 consecutive months of \$3m in monthly net revenue, if the beginning of such a period is within 3 years

The expected volatility was based upon historical volatility of the company's share price from IPO to date of grant The expected life is the expected period to exercise

At the year end the company has accrued \$100,038 (2008 \$23,192) in respect of potential employers' National Insurance Contribution arising on exercise of the options by United Kingdom employees, calculated in line with the FRS 20 charge This is included in accruals in creditors falling due within less than one year

PHORM UK, INC.

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YEAR ENDED 31 DECEMBER 2009

16. RECONCILIATION OF MOVEMENTS IN SHAREHOLDERS' FUNDS

| | 2009 | 2008 |
|---|--------------|--------------|
| | \$ | \$ |
| Loss for the financial year | (33 866 903) | (22,654,158) |
| New share capital subscribed | - | - |
| Other recognized gains and losses | 3,822,835 | (5,824,120) |
| Net addition/(reduction) to shareholders' funds | (30,044,068) | (28,478,278) |
| Opening shareholders' funds | (43,309,742) | (14,831,464) |
| Closing shareholders' funds | (73,353,810) | (43,309,742) |

17. PENSIONS

Defined Contribution

The Company operates a defined contribution pension scheme. The assets of the scheme are held separately from those of the Company in an independently administered fund. The pension cost charge represents contributions payable by the Company to the fund and amounted to \$337,922 (2008 \$400,232). At the year end a creditor of \$92,886 (2008 \$34,820) was owed in respect of unpaid contributions.

18. FINANCIAL COMMITMENTS

Capital commitments

At 31 December 2009, no capital commitments (2008 none) had been authorised or contracted for by the directors.

Operating lease commitments

At 31 December 2009, the Company had annual commitments under non-cancellable operating leases as set out below -

| | Land and buildings | |
|-------------------------------|--------------------|------------------|
| | 2009 | 2008 |
| | \$ | \$ |
| Operating leases which expire | | |
| Within one year | 886,556 | 1,556,940 |
| Within 2 to 5 years | 686,895 | 188,977 |
| More than 5 years | - | - |
| | <u>1,573,451</u> | <u>1,745,917</u> |

19. RELATED PARTY TRANSACTIONS

Transactions with the directors of the company are disclosed in note 5.

The company has taken advantage (where applicable) of the exemptions in paragraph 3(c) of Financial Reporting Standard 8 'Related party disclosures' and has not disclosed details of transactions with fellow group companies.

There are no other related party transactions during the year.

20. ULTIMATE CONTROLLING PARTY

Phorm Inc is the immediate and ultimate parent company and controlling party of the smallest and largest group that prepares group accounts, which are publicly available. The Group's annual report and accounts are available from www.phorm.com.