Inspired Innovation

Spirent Communications plc





Annual Report 2006

Spirent Communications plc is a leading communications technology company focused on delivering innovative systems and services to meet the needs of customers worldwide. We are a global provider of performance analysis and service assurance solutions that enable the development and deployment of next-generation networking technologies such as broadband services, Internet telephony, 3G wireless and web applications and security testing. The Systems group develops power control systems for specialist electrical vehicles in the mobility and industrial markets.

Contents

Spirent Communications plc is a public limited company registered in England. Its Ordinary shares are traded on the London Stock Exchange and, in the form of American Depositary Shares, on the New York Stock Exchange.

This report is the Annual Report of Spirent Communications plc for the year ended 31 December 2006 and complies with UK regulations. The Annual Report is available on Spirent's website at www.spirent.com.

Our business at a glance

Performance Analysis

Spirent's Performance Analysis group provides expertise and solutions to accelerate the development and deployment of devices, networks, applications and services. Testing functionality, conformance, interoperability, scalability and Quality of Experience ("QoE") under real-world conditions in the lab shortens the development cycle, improves quality, and reduces the cost and risk associated with service rollout resulting in lower customer churn. Spirent's solutions provide complete coverage of the next-generation wireless and wireline networks, including access, metro, core and application servers, as well as a wide range of architectures and services including IMS, 3G, 4G, voice, data, video, IPTV and push to talk over cellular.

£192.2m
Revenue

Service Assurance

The world's leading telecom service providers use Spirent's service assurance solutions to ensure technologies and revenue generating services such as TDM, Ethernet, ATM, IP as well as residential triple play services including DSL, voice over IP ("VoIP") and IPTV are deployed efficiently and effectively. Our service assurance solutions are used to diagnose, troubleshoot and determine how to solve telecom service problems. Customers benefit from Spirent's service assurance solutions through reduced operating costs, automation to scale their business, and superior performance metrics that allow them to protect their subscriber base through high quality service delivery.

£43.6m
Revenue

Systems

PG Drives Technology is a leading supplier of sophisticated electronic control systems for specialist electrically powered vehicles in the mobility and industrial markets. These include medical vehicles such as powered wheelchairs and mobility scooters as well as small industrial vehicles such as floor cleaning vehicles, golf carts, fork-lift trucks and aerial access platforms. Our systems allow the user to control the direction and speed of the vehicle as well as other vehicle functions, including seating or platform position, lights, turn indicators and vehicle diagnostics.

£35.8m
Revenue

Summary of results

£ million	2006	2005	Change (%)
Reported			
Continuing operations			
Revenue	271.6	259.3	5
Loss before tax	(50.1)	(41.7)	
Basic loss per share (pence)	(5.51)	(3.97)	
Group			
Profit/(loss) for the year	108.8	(24.5)	
Basic earnings/(loss) per share (pence)	11.75	(2.62)	
Adjusted[1]			
Continuing operations			
Operating profit[2]	8.3	6.4	30
Profit/(loss) before tax[3]	14.3	(0.2)	
Adjusted earnings/(loss)[4] per share (pence)	1.41	(0.22)	

Highlights
- Much improved performance for the second half year.
- Markets were highly competitive partly as a result of consolidation amongst our largest customers.
- Restructuring actions taken during the year with total annualised cost savings of £16 million at a total cost of £9.1 million.
- 24 per cent of orders for Communications group in the final quarter of 2006 came from new product platforms.

Performance Analysis
- Overall performance reflects continued product transition:

  – Spirent TestCenter™ sales grew to £20 million (2005 £4 million);

  – Existing older platforms, SmartBits and AX, orders declined by £27 million, 15 per cent of total Performance Analysis activity, to £48 million (2005 £75 million);

  – All other Broadband products and services grew.
- Wireless continued to make good overall progress.

Service Assurance
- Signed our first major contract with TELUS, a leading provider of data, IP and wireless solutions in Canada, to provide triple play service assurance solutions.

Financial
- Four acquisitions made for a total initial consideration of £39.7 million.
- Goodwill impairment of £46.8 million in relation to Service Assurance and SwissQual.
- Net funds at the year end of £106.1 million with £41.9 million returned to shareholders to date at an average price of 46.1 pence per share.

Board and management
- New leadership at both Board level and in key operational positions: in-depth business review underway.

Notes
1 The adjusted profit and earnings per share measures have been restated to include share-based payment of £5.2 million (2005 £5.1 million) and intangible amortisation of £1.6 million (2005 nil).
2 Before material one-time items and goodwill impairment.
3 Before material one-time items, goodwill impairment, profit on the disposal of operations and costs associated with the repayment of loan notes.
4 Adjusted earnings/(loss) per share is based on adjusted earnings as set out in note 13 of Notes to the consolidated financial statements.

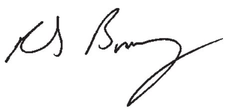
Chairman's statement

At the end of 2006 a number of new directors were appointed to the Board and I was appointed Chairman. Since that time, the Board as a whole has embarked on an in-depth review of each of the Company's operations.

Since I was not at Spirent during most of 2006 my comments are necessarily limited. However, it is already clear that the Company has a strong base of technology and customer relationships, reflecting a very talented group of employees. I would like to express our thanks to them for their contributions during a year of transition and some market uncertainty.

We also find ourselves with a strong balance sheet, largely due to the sale of the HellermannTyton business in February. Overall the Company has a sound foundation on which to build for which thanks are due to a number of Board members who departed during the year.

As you will read below, conditions in some of our markets are somewhat challenging. However, in reality the outlook for Spirent's financial performance in 2007 and beyond will be more affected by the actions resulting from the Board's review than by any foreseeable market developments. The major purpose of the Board's review is to decide where to focus our resources and how to be the most efficient and effective competitor in our chosen areas. We expect to announce the results of the review prior to the Annual General Meeting on 9 May and look forward to communicating with shareholders again at that time.



Edward Bramson
Chairman

Business review
Group overview

Introduction
The year as a whole saw a series of challenges, primarily due to the continuing variable market conditions resulting from the impact of customer consolidation and product transition which both depressed sales and margins and was particularly notable in the first half. As expected at the time of the announcement of the interim results we delivered a much improved second half which benefited from the growth in new product revenues and restructuring actions undertaken. For the full year the adjusted profit before tax was £14.3 million compared with a loss before tax of £0.2 million in 2005.

Our newly developed and recently launched products and solutions for next-generation networks continue to grow sales and gain market share and represented almost 25 per cent of orders for Performance Analysis Broadband in the final quarter of the year, demonstrating the success of our investment in product development and the benefit of newly acquired products.

Four acquisitions were completed expanding our breadth of expertise and solutions into new growth areas such as IP multimedia subsystems (“IMS”), IP telephony and security test, whilst boosting our offering in other areas such as wireless.

With new Board leadership and having made key operational appointments we are now undertaking an in-depth business review, the outcome of which will be reported before the AGM in May.

Market conditions
The many high profile mergers of the last two years among our customers have resulted in customers delaying their investment in next-generation networks and have created highly competitive markets. Indeed, our sales to these latter customers as a group fell by 8 per cent in the year as whole, principally in the first half. As a result overall, many of our markets saw no growth, although we remain positive for long term growth prospects. We expect our markets will remain competitive in the current year.

Product transition
The major feature of the year was significant product transition. The growth in sales of all our new and enhanced products was encouraging, with Spirent TestCenter sales reaching £20 million (2005 £4 million), which was the Group’s highest revenue generating product in the final quarter of 2006. As expected, orders of our older platforms, SmartBits and AX declined sharply by £27 million being 36 per cent year-on-year. Revenues from all of our Performance Analysis Broadband products, apart from SmartBits and AX grew in 2006.

Spending on product development by the Communications businesses, totalled £55.0 million (2005 £56.1 million) of which £5.0 million was incurred by our newly acquired businesses. Product development was primarily focused on the new Spirent TestCenter platform, WCDMA performance test equipment for mobile handsets and triple play IP service assurance monitoring solutions, as well as in our other faster growing product lines.

Spirent TestCenter was developed to take testing to new levels by consolidating a host of solutions on a single platform. To date, our new and upgraded products have been well received by customers, who consistently report enhanced functionality, improved productivity and reliability. Spirent TestCenter’s performance is very encouraging. It has already been purchased by over 200 customers worldwide, compared to just 90 when we reported our interim results in August 2006. These include most of the leading global companies in our industry and all of our largest customers.

We were pleased with strong performances in our Asia Pacific operations, especially in Performance Analysis, and Europe, which was boosted by our recent acquisitions.

Restructuring actions

During the year we continued to manage the balance between the cost base and maintaining the capability to generate long term growth. Accordingly, we undertook two major restructuring actions to realign resources and to reduce operating expenses in our Performance Analysis and Service Assurance divisions, one announced in June and the other in October, as follows:

– in June, a total annualised cost reduction of approximately £9.0 million per year at a one-time cost of £3.9 million;

– in October, a total annualised cost reduction of approximately £7.0 million per year at a one-time cost of £5.2 million.

These actions included completion of the outsourcing of all manufacturing except final assembly and test, continuing investment in our low cost offshore engineering centre, further divisional management changes and restructuring of support functions.

Including these actions, we are targeting a long term improvement in operating margin in Performance Analysis Broadband, with an interim goal to deliver a run rate of 15 per cent by the end of 2007. The success of Spirent TestCenter as a single platform should enable the Group to realise significant operating efficiencies in product development, sales and marketing and other areas within the division.

The significant restructuring actions within Service Assurance is intended to allow the division to target a break-even position through 2007, whilst funding the investment in the future of next-generation triple play IP monitoring solutions.

The Board and staff

Following the Extraordinary General Meeting on 22 December 2006, John Weston, Andrew Given, Fred D'Alessio, Marcus Beresford and Kurt Hellström ceased to be directors of the Company. We would like to thank them for their collective service to Spirent over many years.

At the EGM, Edward Bramson, Ian Brindle, Gerard Eastman and Alex Walker were appointed directors of the Company. Subsequently, Edward Bramson was elected as Chairman of the Board and appointed as Chairman of the Nomination Committee; Ian Brindle was appointed Chairman of the Audit Committee, and as a member of the Remuneration Committee and Nomination Committee; Alex Walker was appointed as the Senior Independent Non-executive Director and Chairman of the Remuneration Committee, and as a member of the Audit Committee and Nomination Committee; and Gerard Eastman was appointed as a member of the Audit, Remuneration and Nomination Committees.

Outlook

Our performance in 2007 is expected to benefit from the investment in new and upgraded products and the acquisitions made last year and further progress beyond that will depend on the outcome of the business review. We are confident that our new products, led by Spirent TestCenter, will grow revenue and continue to gain market share although this will be offset by the decreasing revenue from our older products. With market conditions continuing to be similar to last year, we consequently expect only a modest growth in Performance Analysis revenues. In addition, should sterling continue its recent strength relative to the US dollar, our performance for 2007, particularly in Systems, will be held back.

Summary

2006 has been a busy and challenging year for Spirent with variability and unpredictability in our markets. We have worked hard to stay ahead of the competition and drive the development of our new products and services. We achieved an improved performance in the second half over the first half year.

We made good progress with our new products and saw growth in a number of key product areas during 2006. We have secured the first major contract for a full-scale triple play service assurance solution. We intend to build on this in 2007. In particular the development plans we have for Spirent TestCenter will deliver increased functionality, scale, ease of use and automation for our customers.

The sale of the HellermannTyton Division enabled Spirent to achieve a significantly strengthened balance sheet and to return capital to our shareholders. Over the coming months the newly constituted Board will be working to undertake an in-depth business review and will report the outcome before the AGM in May.

We evaluate the performance of Spirent based on revenue and operating profit/(loss) before the effect of material one-time items and goodwill impairment so that period-on-period comparisons are not distorted. Operating profit/(loss) and return on sales are referred to in the text before material one-time items and goodwill impairment unless otherwise stated.

Business review
Financial review

Description of the business

Spirent Communications plc is a global provider of performance analysis and service assurance solutions that enable the development and deployment of next-generation networking technologies such as broadband services, Internet telephony, 3G wireless and web applications and security testing. The Systems group develops power control systems for specialist electrical vehicles in the mobility and industrial markets.

The Group is organised into two groups Communications and Systems with Communications consisting of two divisions, Performance Analysis and Service Assurance.

Spirent's Performance Analysis group provides expertise and solutions to accelerate the development and deployment of devices, networks, applications and services. Testing functionality, conformance, interoperability, scalability and QoE under real-world conditions in the lab shortens the development cycle, improves quality, and reduces the cost and risk associated with service rollout resulting in lower customer churn. Spirent's solutions provide complete coverage of the next-generation wireless and wireline networks, including access, metro, core and application servers, as well as a wide range of architectures and services including IMS, 3G, 4G, voice, data, video, IPTV and push to talk over cellular.

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Key performance indicators

The key performance indicators ("KPIs") monitored by the Board and which are considered to be the most effective measures to determine how the Group is progressing towards achieving its strategic objectives are set out below. Targets are set during the annual budget process and are for continuing businesses only.

- **Revenue growth.**
- **Growth in adjusted operating profit.**
- **Return on sales.**
- **Adjusted earnings per share.**
- **Adjusted cash generation from operating activities.**

These KPIs were agreed by the Board in 2006 prior to the recent Board changes. The newly constituted Board will be reviewing these KPIs in 2007.

Group financial performance

The Group's financial performance is reported in accordance with International Financial Reporting Standards ("IFRS") under which the Group's discontinued operations, the HellermannTyton Division, are reported as a single line at the foot of the income statement including the profit on sale.

All comments below refer to continuing activities only unless otherwise stated.

Results
Continuing operations

£ million	Restated first half	Second half	2006	Restated 2005	Change (%)
Revenue	138.2	133.4	271.6	259.3	5
Adjusted operating profit[1,2]	2.8	5.5	8.3	6.4	30
Return on sales[1,2] (%)	2.0	4.1	3.1	2.5	
Adjusted profit/(loss) before tax[1,3]	5.1	9.2	14.3	(0.2)	
Adjusted earnings per share[1,4] (pence)	0.50	0.91	1.41	(0.22)	
Adjusted cash generation from operating activities[5]	(0.9)	13.5	12.6	6.4	

Notes
1 Please note that the adjusted profit and earnings per share measures have been restated to include share-based payment of £5.2 million (2005 £5.1 million) and intangible amortisation of £1.6 million (2005 nil).
2 Before material one-time items and goodwill impairment.
3 Before material one-time items, goodwill impairment, profit on the disposal of operations and costs associated with the repayment of loan notes.
4 As [3] and before any related and prior year tax.
5 Before the cash cost of material one-time items and lump sum pension contribution.

The year has been affected by the complexities of implementing major product transitions combined with continued challenging market conditions in our communications markets. These market conditions to a large extent were a consequence of the consolidations of some of our major customers. Revenue increased by 5 per cent over 2005, excluding the contribution from acquisitions revenue was flat year-on-year. There were some significant areas of growth, namely in our voice, security testing, positioning, client services and of course in sales of our pioneering platform Spirent TestCenter. The growth of these products was offset by the rapid decline of our two traditional products, SmartBits and AX, which were down by 36 per cent, as well as the expected drop in revenue in our Service Assurance division during the second half of the year as carriers continued to shift spending away from legacy networks. We focused on the realignment of resources and the reduction in operating expenses across all divisions and took restructuring actions in both Service Assurance and Performance Analysis in June and also in October which improved the profitability in Performance Analysis during the second half year and allowed us to maintain a near break-even position in Service Assurance.

We are presenting an adjusted earnings measure eliminating the effect of material one-time items and goodwill impairment. Previously we had adjusted for intangible amortisation and share-based payment. Comparatives have been restated to reflect this change.

Adjusted operating profit improved by 30 per cent to £8.3 million compared with £6.4 million in 2005 excluding the effect of exchange, growth was 36 per cent. This result includes a significant reduction in the loss for the Service Assurance division to £1.1 million; (after share-based payment of £1.2 million, 2005 £1.2 million) from a loss of £10.8 million reported in 2005. However, this was offset by the decline in profitability of the Performance Analysis division down from £18.4 million in 2005 to £10.5 million in 2006 (after share-based payment of £3.6 million, 2005 £3.6 million and intangible amortisation of £1.6 million, 2005 nil), although the performance improved in this division in the second half of 2006. The decline in profitability in the Performance Analysis business was largely a result of additional spend on product development and sales and marketing costs associated with the launch of new product releases.

Return on sales for the Group improved to 3.1 per cent from 2.5 per cent in 2005.

Revenue grew by market in the Asia Pacific region by 7 per cent and in Europe by 27 per cent, a result of the SwissQual acquisition, but it was reduced in North America year-on-year.

Currency impact
In 2006 the currency effects were minimal in relation to the income statement. The average sterling to US dollar exchange rate increased from 1.82 in 2005 to 1.85 in 2006. Currency translation reduced revenue by £3.4 million and operating profit by £0.4 million compared with 2005. With the US dollar to sterling rate rising to $1.96 : £1 this is likely to have a more material impact in 2007. In particular our Systems group, which is exposed to transactional currency risk, had hedged its exposures and as a result did not experience the full effect of the weakening of the US dollar in 2006. Should the current exchange rate prevail in 2007, this would have a significant impact on its profitability.

Cost of sales and operating expenses
Product development spend is included in cost of sales in the income statement. 2006 was a year of major product transition hence investment in product development remained high, with a total of £57.3 million, being 21 per cent of revenue, expensed during the year (2005 £58.4 million and 23 per cent of revenue). Of this amount £45.5 million (2005 £42.1 million) was incurred in the Performance Analysis division, £9.5 million (2005 £14.0 million) in the Service Assurance division with the remaining £2.3 million (2005 £2.3 million) in the Systems group. The rate of spend increased in Performance Analysis in 2006 compared with 2005 as we undertook additional investment for the development of the TestCenter platform. Our acquired businesses have added £5.0 million to product development spend in 2006. Product development decreased in Service Assurance year-on-year.

Business review continued

Gross profit was higher at 44 per cent of revenue compared with 41 per cent in 2005 as a result of the reduction in product development expense and the reorganisation of our supply chain activities to increase efficiency as well as the move to increase outsourcing.

Operating costs, excluding material one-time items and goodwill impairment are 41 per cent of sales compared with 39 per cent in 2005. This is a result of the additional sales and marketing effort in respect of new product launches, the significant costs of compliance with the Sarbanes-Oxley Act 2002, £2.6 million, incurred as a result of being a US listed company and intangible amortisation of £1.6 million (2005 nil).

Material one-time items

Material one-time items include restructuring costs of £9.1 million, the costs related to the EGM requisition in December 2006 of £2.0 million, a credit of £0.6 million in relation to the release of provisions on prior period disposals and curtailment and settlement gains of £1.7 million in respect of changes to our defined benefit pension plan. Together these total a net £8.8 million cost for the year. The Group incurred a one-time finance charge of £8.8 million as the loan notes were repaid early out of the proceeds from the sale of the HellermannTyton Division, and we incurred fees to break the associated interest rate swaps.

Restructuring actions took place at the end of June 2006 and in October 2006 affecting both our Communications divisions. These actions were in response to reductions in demand for legacy products in Service Assurance, and include the closure of loss making locations and the initiatives identified to help achieve the divisional margin targets in Performance Analysis. The estimated annualised cost savings from these actions are £16 million in total.

In November 2006 the Company received a notice of requisition from certain shareholders requesting that the Company convene an Extraordinary General Meeting to consider the removal of three of its non-executive directors and the appointment of four proposed new ones. The costs incurred in relation to this action amounted to £2.0 million.

During 2006 active and deferred members of the Spirent Staff Pension Plan were offered the opportunity to leave the Plan and take an enhanced transfer value to another pension arrangement. Many members accepted this offer resulting in a benefit to the funding of the Plan under IFRS of £1.7 million.

Goodwill impairment

We wrote down goodwill in our Service Assurance division by £9.5 million at the interim stage and have taken a further impairment charge in the second half of £9.6 million. £19.1 million has been charged in total reflecting the delays in triple play roll out and continued declines in legacy business. Goodwill in the Service Assurance division has now been fully impaired.

In accordance with IFRS we have also assessed the goodwill carrying value of the SwissQual business that we acquired in January 2006 where activity levels have been lower than had been anticipated. This has resulted in a goodwill impairment charge of £27.7 million. Goodwill in SwissQual has been fully impaired. Whilst we have written down the carrying value of SwissQual, we believe that there are excellent prospects for the new products in the medium term. However, we have discounted the projections to reflect the inherent risk in the growth projections.

Goodwill impairment charged in 2005 was £37.0 million and was in respect of the Service Assurance division.

Intangible amortisation

This is the first year that the Group has acquired businesses under IFRS and consequently this is the first time acquired intangible assets have been recognised and the associated amortisation has been charged. We have made four acquisitions in 2006 resulting in £10.0 million of acquired intangible assets being recognised on the balance sheet and we have estimated that the average useful life of these intangibles is five years. These intangible assets represent current technology and customer relationships in the main. Amortisation of £1.6 million has been expensed in the income statement in 2006 and this is expected to be slightly higher in 2007 to reflect the full year effect of the 2006 acquisitions.

Share-based payment

The charge for share-based payment for 2006 is £5.2 million for our continuing businesses (2005 £5.1 million) based on a fair value model.

Net finance income

In February 2006 we repaid our senior loan notes out of the proceeds of the sale of the HellermannTyton Division. After funding the UK final salary pension plan this left us with a significant cash position some of which has been utilised to pay for acquisitions and commence an on-market share repurchase.

Net finance income was £6.0 million (excluding costs associated with the repayment of loan notes) compared with a net charge of £6.6 million in 2005. Of net income £2.0 million is in respect of the expected return on pension scheme assets less interest on the unwinding of the liabilities (2005 £1.1 million charge) a result of the change to the funding position of the UK final salary pension plan in February 2006. Surplus cash is held on deposit or in short dated commercial paper and is earning current market rates of interest.

Loss before tax for continuing operations

Reported loss before tax for continuing operations was £50.1 million compared with a loss before tax in 2005 of £41.7 million.

Adjusted profit/(loss) before tax is set out below:

£ million	2006	2005
Reported loss before tax	(50.1)	(41.7)
Material one-time items	8.8	8.4
Goodwill impairment	46.8	37.0
Profit on the disposal of operations	–	(3.9)
Costs associated with the repayment of loan notes	8.8	–
Adjusted profit/(loss) before tax	14.3	(0.2)

Tax

The tax charge for 2006 was £0.9 million, an effective rate of 6.3 per cent on the adjusted profit before tax (2005 £4.0 million credit). We continue to incur a low effective rate due to the carry forward of tax losses.

Discontinued operations

Discontinued operations relate to the HellermannTyton Division which was sold to Doughty Hanson & Co Limited on 15 February 2006. For the period up until sale the operating result was a profit after share-based payment of £3.0 million.

The profit on sale before tax was £166.1 million and tax of £9.2 million is payable in relation to the sale. The final proceeds from the disposal on a cash free/debt free basis were £296.7 million. The total expenses of the transaction amounted to £10.9 million, of which £6.7 million was incurred and charged in 2005 and net assets (excluding debt and cash) sold were £128.2 million. We realised a curtailment gain on the UK final salary pension fund of £0.5 million. Unrealised exchange gains of £1.3 million have been transferred from the translation reserve to the profit on sale.

Earnings per share

Basic earnings per share for the Group were 11.75 pence, this includes the profit on sale of the HellermannTyton Division compared with a loss in 2005 of 2.62 pence. Adjusted earnings per share, being before material one-time items, goodwill impairment, profit or loss on the disposal of operations and costs associated with the repayment of loan notes, net of any related tax, was 1.41 pence compared with a loss of 0.22 pence in 2005.

Acquisitions

We acquired four businesses during 2006 paying an initial consideration of £39.7 million and deferred consideration of £3.7 million in the year. All acquisitions were in the Performance Analysis division. Further deferred consideration payments amounting to approximately £6.6 million are expected to be paid.

On 23 January 2006 we acquired SwissQual Holding AG ("SwissQual") for an initial consideration of CHF62.5 million (£27.8 million), paid in cash on completion with up to a further CHF28.0 million (£12.4 million) payable depending on future revenue growth and on various technical and financial milestones being achieved. We have paid an additional £3.1 million of deferred consideration in 2006 and have accrued for a further £4.5 million of deferred consideration. The total estimated consideration is £35.4 million, £4.8 million less than the maximum payable. SwissQual's solutions analyse, measure and improve the quality of experience for users of wireless applications and services.

On 13 February 2006 we acquired QuadTex Systems, Inc. ("QuadTex") for an initial consideration of $7.5 million (£4.3 million), paid in cash on completion with up to a further $1.5 million (£0.9 million) payable depending on certain technical milestones and the retention of key employees. We paid £0.3 million of deferred consideration in 2006. QuadTex is a provider of innovative and leading test tools for IMS and VoIP testing.

On 10 July 2006 we acquired Scientific Software Engineering, Inc. ("SSE"), the US based developer of the Landslide™ product, a leading software based system for testing the performance and functionality of 2.5 and 3G wireless network infrastructure for an initial consideration of $10.0 million (£5.5 million), paid in cash on completion with up to a further $6.0 million (£3.3 million) payable depending on the satisfaction of certain technical milestones and the retention of key employees in 2007. We paid £0.3 million of deferred consideration in 2006.

On 10 August 2006 we acquired the business of Imperfect Networks, Inc. ("Imperfect Networks"), a US based developer of security testing solutions. The acquisition enables Spirent to deliver enhanced security testing solutions to its customers across a number of markets. The initial consideration was $4.0 million (£2.1 million), paid in cash on completion, with up to a further $4.0 million (£2.2 million) payable depending on the satisfaction of certain technical milestones and revenues to be achieved in 2007.

Financing and cash flow

At 1 January 2006 cash and cash equivalents were £49.2 million and borrowings, which comprised mainly of £70.9 million of senior loan notes attracting a 9.1 per cent rate of interest, were £84.8 million. The sale of the HellermannTyton Division enabled the Group to realise a significant amount of cash repaying the loan notes, extinguishing all other debt, funding the £47.0 million deficit in the UK final salary pension plan and commencing an on-market share buy back programme. We ended the year with cash and cash equivalents of £97.6 million, a significant strengthening of the balance sheet from the prior year end. In addition, £8.5 million of cash is held on deposit in a blocked trust account as required by the capital restructuring discussed below.

Operating cash flow was representative of the tough market conditions and the additional costs required to undertake such significant product transition. Net cash outflow from continuing operations before tax was £40.8 million (2005 £1.1 million outflow). This outflow includes a £47.0 million contribution to fund the UK final salary pension plan and other one-time costs.

Business review continued

Adjusted operating cash flow before tax is set out below:

£ million	2006	2005
Reported cash flows from continuing operations	(40.8)	(1.1)
Add back:		
UK final salary pension plan lump sum contribution	47.0	3.5
Material one-time items	6.4	4.0
Adjusted cash generation from continuing operations	12.6	6.4

During 2006 the Group absorbed £10.6 million of working capital much of which was in relation to receivables and a consequence of the higher activity levels experienced during the latter part of the year.

Reported operating cash outflow for the continuing Group after tax was £42.4 million (2005 £1.8 million outflow) and discontinued operations used £0.6 million of operating cash in the period up to disposal (2005 £31.2 million inflow). Tax payments in 2006 amounted to £2.3 million compared with £4.6 million in 2005 (including discontinued operations). In the first quarter of 2007 we will settle tax obligations on the sale of the HellermannTyton Division of approximately £6.7 million.

Capital expenditure was £12.6 million compared with £14.8 million in 2005 for the continuing Group. The depreciation charge was £11.8 million (2005 £11.4 million).

We spent £44.4 million on the acquisition of businesses in 2006 and received net cash of £278.2 million from the sale of the HellermannTyton Division. Deferred consideration payments on acquisitions amounting to approximately £6.6 million are expected to be paid.

As previously mentioned the senior loan notes were repaid in February 2006 and this left the Group debt free. On the early repayment of loan notes a make whole amount was due of £7.2 million and we incurred break fees on the early termination of interest rate swaps of £2.3 million. Net finance income received in 2006 was £4.1 million compared with a net finance cost in 2005 of £6.5 million.

Pension fund

The surplus in the UK defined benefit pension plans at 31 December 2006 was £2.4 million (2005 net deficit £50.8 million), having been funded in February 2006 by way of a special contribution of £47.0 million from the proceeds of the disposal of the HellermannTyton Division. During 2006 the plans have benefited from rising equity markets but have also benefited from an offer made to active and deferred members giving them the opportunity to leave the UK final salary pension plan and take an enhanced transfer value to another pension arrangement. Many members accepted this offer resulting in a benefit to the funding of the plan under IFRS of £1.7 million and a reduction in the total liabilities of the plan of £21.8 million. The value of the surplus at 31 December 2006 has been calculated using the latest mortality assumptions, and as such this has adversely affected the position.

The triennial actuarial valuations of the plans at 1 April 2006 are currently being finalised.

A defined benefit pension plan deficit is reported of £1.4 million at 31 December 2006 in respect of the acquired scheme in SwissQual and the unfunded UK plan.

Capital structure, on-market share repurchase programme and dividend

During 2006, and following on from the cancellation of the share premium account and capital redemption reserve (“the Cancellation”) which took place in 2004, the Company was able to release non-distributable special reserves formed as a result of the Cancellation by placing funds in a blocked trust account in accordance with the undertakings made to the Court at the date of the Cancellation. At 31 December 2006 cash held in the blocked trust account was £8.5 million. The Company currently has reserves of £195.7 million which are capable of being distributed to shareholders through dividend or through share repurchase.

We commenced the on-market share repurchase programme in May 2006 which had been announced to shareholders together with the proposed disposal of HellermannTyton in December 2005. To date we have returned £41.9 million, being 90.3 million shares, to shareholders at an average price of 46.1 pence per share. There is a further £8 million to be returned of the originally announced £50 million programme. Purchases are expected to be completed during 2007. It was also announced in October that the Company proposed to seek authority for a further return of £50 million to shareholders. This will be considered further as part of the in-depth business review currently under way.

Dividend policy is kept under review by the Board, however no dividend is being declared in respect of 2006.

Review of US listing and SEC registration

As announced in October 2006 the Company has been carrying out a review to explore a process by which it can de-list its shares and de-register in the United States. The US listing has become significantly more costly and onerous in recent years, not least due to the imposition of the Sarbanes-Oxley regulations, which have cost the Company approximately £2.6 million during 2006.

If the proposed SEC rule change announced in December 2006 is passed without significant amendment it is expected that the Company will be able to seek a de-registration as a result of its extremely low trading volumes in the US.

A further update on progress towards de-listing and de-registration will be made as and when appropriate.

Business group development and performance

Communications

£ million	Restated first half 2006	Second half 2006	2006	Restated 2005	Change (%)
Revenue					
Performance Analysis	94.5	97.7	192.2	178.8	7
Service Assurance	24.9	18.7	43.6	42.8	2
Communications group	119.4	116.4	235.8	221.6	6
Operating profit/(loss)					
Performance Analysis	3.2	7.3	10.5	18.4	(43)
Service Assurance	0.1	(1.2)	(1.1)	(10.8)	
Communications group	3.3	6.1	9.4	7.6	24
Return on sales (%)					
Performance Analysis	3.4	7.5	5.5	10.3	
Service Assurance	–	–	–	–	
Communications group	2.8	5.2	4.0	3.4	

Performance Analysis

Results for Spirent's Performance Analysis division were marked by significant growth for a number of its products and solutions, including the pioneering Spirent TestCenter platform, and an appreciably improved second half due to early intervention efforts to increase profitability. However, the Division's overall performance was dampened by market variability, intense competition, delays in technology upgrades and a significant decline in revenue for two established products.

In 2006, Performance Analysis introduced many new releases and established a solid foundation for future profitable growth within the segments of 3G wireless, IMS and VoIP. Several products had noteworthy results, including:

- Spirent TestCenter, which was the Group's highest revenue generating product in the fourth quarter;
- Spirent Protocol Tester, which received two industry recognition awards – one of the ten "Best In Test" products for 2006 by Test & Measurement World and Product of the Year by Internet Telephony;
- our security test solutions Avalanche™ and ThreatEx™ (the result of the acquisition of Imperfect Networks);
- Abacus™, a leading VoIP testing solution;
- launch of new Diversity™ product (acquired as a result of the SwissQual acquisition), with subsequent key customer wins; and
- the first test demonstration of a Galileo global positioning system.

In 2006, revenue for this division of £192.2 million (2005 £178.8 million) was up 7 per cent whilst operating profit decreased by 43 per cent to £10.5 million (2005 £18.4 million) principally weighted towards the first half. The decline was largely due to additional spend on product development and sales and marketing costs associated with the launch of new product releases. To mitigate the weak first half restructuring actions were taken at the end of the second quarter together with a greater focus on improving profitability. These actions resulted in a significantly improved second half operating profit of £7.3 million and a return on sales of 7.5 per cent versus a first half of £3.2 million and a return on sales of 3.4 per cent.

Spirent's top 20 customers typically represent an estimated 36 per cent of Performance Analysis revenues. No one customer represented more than 10 per cent of the total divisional revenues. On a geographic basis there was growth in Europe driven by Performance Analysis Positioning and SwissQual. Activity in the Asia Pacific region grew, building on strong growth particularly in China and India.

Throughout 2006, market conditions continued to be variable and unpredictable in Performance Analysis Broadband ("Broadband"). While we saw an increase in spending among some customers in the second half, when combined with customers' reduced spending in the first half, Broadband experienced a flat year overall. This was driven by a reduction in the total available market due to consolidation activity among larger customers, lower spending from our largest customer, Cisco, and strong competition in the routing, switching, access, and L4-7 spaces, and in the VoIP and IMS markets. The tougher competitive environment resulted in pressure on pricing, particularly at our larger accounts.

Despite unpredictable market conditions, Broadband gained position with leading customers and strengthened its position in the growing security market with the acquisition of Imperfect Networks (ThreatEx).

The majority of product development investment for Broadband went to launching new products and to positioning Spirent for the long term. Spirent TestCenter continues to make significant gains in the marketplace, including:

- more than half of Spirent TestCenter customers are repeat buyers;
- a significant number of customer wins are at incumbent accounts of the competition;
- our top 20 Broadband customers are using Spirent TestCenter; and
- more than 200 customers are now using the new platform.

Spirent's Broadband customers are interested in driving significant competitive advantage through faster time to market for new services and products, deploying new services to tap into new revenue streams and seeking highly integrated solutions to reduce their footprint. They understand that complex testing cannot be outsourced and that their resources for implementing complex testing are limited. Development plans for Spirent TestCenter will deliver increased functionality, scale, ease

Business review continued

of use and automation so that our customers can continue to improve time to test, reduce the cost of testing and achieve a faster time to revenue for their new products and services. Spirent TestCenter architecture is significantly ahead of the competition and is designed to integrate new technologies moving forward to protect customers' investments.

Results for Performance Analysis Wireless ("Wireless") mirrored that of Broadband – a combination of key market successes countered by market and product challenges. Spirent's overall CDMA business was down due to a lull in the air interface evolution by network operators which led to the lack of a new technology catalyst for testing. In the WCDMA market, our gains in selling into GSM and WCDMA-based A-GPS mobile device test applications were offset by declines in the RF test business.

In the Mobile Device Test segment, where we hold a significant market share, we had a strong year for Location Based Services test in both the CDMA and WCDMA markets. Spirent's Location Test Systems turned in a record-breaking year, driven by additional regulatory requirements for handsets and growth in the deployment of commercial Location Based Services. More than 60 per cent of Wireless R&D is focused on the WCDMA applications market, and Spirent continues to invest in its core network emulator platform to improve feature capability. Wireless also saw some modest continued growth in the simulator market for faders, driven by the evolution of Mobile Input-Mobile Output technology, a key element of WiMax deployment. At the end of the year, Spirent saw activity in testing for Mobile TV begin to ramp. This exciting industry promises to be a key area of focus for Spirent as mobile network operators deploy multi-media services in 2007.

Performance Analysis Positioning ("Positioning") saw its third year of double-digit growth. Of note, Positioning launched the world's first commercial Galileo simulator and secured key contracts for official Galileo programme business. Galileo is expected to be a significant source of revenue in the future.

Spirent entered into the Subscriber Experience Management ("SEM") market segment as a result of its acquisition of SwissQual. Here, Spirent experienced a significant impact from widespread industry consolidation, reducing demand markedly. In addition, there were substantial delays in purchasing decisions compared to previous years. Competition is intense as well and drove increased pressure on pricing; whilst several competitors merged to improve their market position. Despite these conditions, Spirent added an estimated 30 new SEM customers during the year. It launched a new product, Diversity, which was well received by the market and gained traction with leading mobile network operators.

Service Assurance

In 2006, Spirent's Service Assurance division stabilised its performance amid significant market consolidation, secured important contracts for its triple play service assurance and field test solutions and delivered a break-even result before share-based payment of £1.2 million, marking a significant improvement over its performance in 2005.

Delays in customer decisions and spending on new solutions continued throughout the year and competition remains strong as service assurance players vie for fewer customers and retention of incumbent positions due to market consolidation. Carriers continue to shift spending away from legacy networks as they deploy triple play offerings, however the current limited triple play subscriber base is restricting the service assurance market.

Overall revenues were slightly higher for Service Assurance compared to last year, due to the recognition of revenue from one-time projects for remote packet access testing in the first half of 2006. Operating loss was £1.1 million compared with a loss of £10.8 million in 2005. The improvement in profitability is due to increased revenue and margin, coupled with the benefit of restructuring actions that took place in the second quarter. These actions allowed the division to target a break-even position before share-based payment for the year.

The revenue profile has remained comparable with the prior year, with the majority of revenue coming from US service providers. Revenue from DSL equipment (20 per cent of total revenue) was higher in 2006 due to increased customer demand. Leased line revenue for service assurance products (50 per cent of total) was down on 2005 as anticipated as customers continued to move spending away from legacy service assurance solutions.

Service Assurance has begun to see the results of its investment in next-generation services. It secured a strategic contract with TELUS, a leading provider of data, IP and wireless solutions in Canada. The contract represents the first award for a full-scale triple play service assurance solution. It also demonstrates that the triple play market is growing and that carriers understand service assurance solutions are needed before scaling services. In addition, the Service Assurance division's new handheld field test device, Tech-X, was approved and deployed at major North American customers.

Service Assurance is focused on providing the right tools for service providers to scale triple play services and ensure consumers' quality of experience. Its portfolio includes software and hardware based centralised test and diagnostic solutions as well as handheld field test devices. The Tech-X is the first all-in-one field test solution that combines testing of copper, xDSL and triple play services enabling field technicians to access the power of the central test and monitoring systems in the field. Spirent's triple play service assurance solutions allow service providers to get it right the first time, scale the service while managing operating costs, and dispatch to fix not to find problems. From the lab to the live network, Spirent is the only company that offers triple play solutions throughout the entire technology lifecycle.

The Service Assurance division will continue to seek opportunities to realise the potential of its existing baseline business while focusing its investments on expanding its position in the triple play market. However, continuing delays in the roll out of triple play service assurance solutions by our customers is likely to impact the timing of deployment of our new centralised test products. In the short term we expect that revenue from legacy products will decline faster than the ramp up of revenues from our triple play solutions.

Systems

£ million	2006	Restated 2005	Change (%)
Revenue	35.8	37.7	(5)
Operating profit	4.7	4.3	9
Return on sales (%)	13.1	11.4	

The Systems group comprises PG Drives Technology, a leading supplier of control systems for electrically powered medical and industrial vehicles. Revenue was down 5 per cent and operating profit up 9 per cent, respectively. Return on sales increased to 13.1 per cent compared with 11.4 per cent in 2005.

During 2006 we saw continued strong revenues from the VR2, a low cost, mainstream wheelchair control system that we launched in second half of 2005, as well as growing market recognition for the R-net, our highly sophisticated rehab wheelchair system. These new products, together with our established ones, enabled us to increase customer penetration in both the mobility and industrial vehicles markets during the year. This was achieved in spite of continuing constraints in US government healthcare funding for powered wheelchairs. We also moved more of our production to China to reduce the logistical costs of supporting our activities in the Asia Pacific region. At the end of 2006 we launched two new systems, X25/30 and Sigmadrive, targeted at heavier industrial vehicles. These new products will spearhead our entry into new industrial markets.

Non-segmental costs

Non-segmental costs, being those which are not directly attributable to the operating segments, were £5.8 million compared with £5.5 million in 2005. These costs relate to the costs of our Board and costs in relation to our dual listing, including much of the costs of the Sarbanes-Oxley Act of 2002.

Environmental

Good environmental practice and the impact that our operations have on the environment are of great importance to Spirent. The main aim of Spirent's Environmental Policy is to comply with local, state and national environmental legislation in all jurisdictions in which we operate and to adopt responsible environmental practices. The full text of our Environmental Policy is available on our website at www.spirent.com.

Business units are required to comply with Group policy and local statutory regulations and are encouraged to set their own environmental targets. An annual environmental questionnaire is completed by each business unit which highlights their environmental performance.

The vast majority of our products are now manufactured by outside contract manufacturers and we check the environmental policies of these suppliers through audits and surveys. Wherever possible our products are designed and manufactured to take account of the recycling and disposal of the product at the end of its lifecycle. Our businesses comply with both The Waste Electrical and Electronic Equipment Regulations ("the WEEE Regulations") and The Restriction of the Use of Certain Hazardous Substances in Electrical and Electronic Equipment Regulations 2004 ("the RoHS Regulations").

Where possible, business units monitor energy consumption and all business units continue to take positive steps to reduce energy consumptions, such as better space utilisation and more efficient running of equipment and machinery.

Environmental waste management in the Group continues to improve with most business units operating waste minimisation schemes mainly focusing on increased recycling.

The vacant site where historic activity had led to minor land contamination is continuing to be remedied with full cooperation of the local statutory body.

Employees

The Group aims to attract, retain and motivate the highest calibre of employees and encourages their contribution and development.

An environment that fosters innovation and collaboration are critical to Spirent's success. Appropriate career paths and internal recognition programmes are developed for both technical and non-technical staff.

Employees are provided with numerous learning and development opportunities to fulfil their potential. A wide variety of both courses and training materials are available to employees both in the classroom and via the intranet. These development opportunities are structured to align with our organisational objectives and to help employees in furthering their career aspirations.

Spirent demonstrates that it values its employees through several reward and recognition programmes. The Engineering Fellowship Programme honours the top technical talent within the organisation, connecting the best and the brightest of Spirent's technical expertise. The Spirit of Spirent programme tracks outstanding service using Spirent's core values – customer focus, innovation, collaboration, contribution, continuous learning and ethics. This programme is implemented across the Communications group to encourage and reward significant contributions to Spirent by employees. Furthermore, the annual Innovation Awards programme recognises all facets of contributions to Spirent, including outstanding sales, technical innovations and general business innovations.

Similarly, the importance of two-way communication is recognised particularly as it relates to the business and its performance. The leadership team is responsible for providing forums for employees to understand the business objectives and to ask questions. A variety of tools are utilised to foster two-way communications, including management

Business review continued

meetings, "all-hands" employee meetings, the regular distribution of an employee newsletter, and the intranet. In 2006 a revised induction programme was implemented to orient new employees to Spirent and to assure that they have the knowledge and tools to be successful.

Leadership and management development programmes are regularly reviewed and updated as the competition for talented employees increases and the leadership needs of our business grow. Formal performance reviews are conducted and are linked to the values of the organisation.

The Group is committed to providing equality of opportunity to all existing and prospective employees without unlawful or unfair discrimination. Full support is given to the employment and advancement of disabled persons and this is reinforced through the Group's Ethics Policy.

Principal risks and uncertainties

The principal risks and uncertainties facing Spirent Communications plc are discussed below.

Diversification

The Spirent Group now comprises two divisions: Communications and Systems. These divisions operate in different market segments for which, notwithstanding global economic factors, the financial performance and prospects are impacted by different and unrelated factors. The performance and prospects of the Spirent Group since the disposal of the HellermannTyton Division will be largely dependent on the Communications division and any diversification benefit which the Group has historically benefited from will no longer be available.

Communications sector

Unfavourable conditions in the communications industry into which the Spirent Group sells most of its products and services have affected the Spirent businesses from time to time and may continue to do so. Any decline in demand for products and services that has had, and may continue to have, an adverse effect on the results could further harm the business, operating results and financial condition.

Technological change

The Spirent Group sells products and systems in several industries that are characterised by rapid technological changes, frequent product and service introductions and evolving industry standards. It believes that the continued success of the Communications business is dependent on its ability to advance next-generation technologies and services. If the Communications business fails to extend its existing capabilities in the next-generation technology, the business, operating results and financial condition of the Communications group will suffer.

Industry consolidation

The communications industry has recently experienced significant consolidation. If this trend continues, the disruption caused by the process of consolidation for Spirent's communications customers could reduce demand for Spirent's products or could reduce the number of potential customers to whom Spirent's communications testing products and services could be sold. The consolidated entities could also purchase products and services from other sources or use the additional leverage they gain from their consolidated purchasing power to demand more favourable terms, which could harm the business, operating results and financial condition of the Communications group.

Customer base

In some businesses, Spirent relies on a limited number of customers, which makes relationships with these customers, as well as the success of those customers' businesses, critical to the success of Spirent's business. The loss of one or more large customers could harm the business, operating results and financial condition.

Product quality

Whilst Spirent strives to ensure its products are of the highest standards, in the event that products are defective, Spirent may be held responsible for the damages that result and the costs associated with recalling the products themselves. Spirent's reputation with customers may be damaged as a result of any such event. Product liabilities or the costs of implementing a recall could hurt profitability, and the damage to reputation if products prove to be defective could cause Spirent to lose customers.

Operational risks and systems

Operational risks are present in the Spirent Group's businesses. These risks include, but are not limited to, the risk of failed internal and external processes and systems (including information technology systems), human error and external events. Such events could have an impact on the business, operating results and financial condition.

A significant portion of Spirent's communications operations are located in California which has experienced natural disasters, including earthquakes, in the past. A significant natural disaster, such as an earthquake, could disrupt its ability to conduct business in the affected locations and could have a material adverse impact on business, operating results and financial condition.

Competition

The Spirent Group faces competition in all of its businesses. To stay competitive these businesses will need to introduce successful new products and also may have to adjust prices of some products. The business, operating results and financial condition may suffer if the Spirent Group does not compete effectively.

Operational review

The Spirent Communications plc Board is conducting an in-depth review of the Spirent Group operations and the results of that review are not expected before the end of April 2007. The major purpose of the Board's review is to decide where to focus the Company's resources and how to be the most efficient and effective competitor in its chosen area of business. However, there may be costs incurred by Spirent in taking certain measures which may be recommended as part of this review and such measures may also have a short term disruptive effect on the Spirent Group business, which could have a material adverse impact on Spirent's business, operating results and financial condition.

Retention of key staff

Spirent's success is dependent on attracting and retaining highly qualified and skilled employees. There is intense competition for personnel from other organisations and the loss of key employees, or the failure to attract and retain other highly skilled employees, may impair Spirent's ability to run and expand its business effectively.

Intellectual property

While Spirent does not believe that any of its products infringe the valid intellectual property rights of third parties, it may be unaware of intellectual property rights of others that may cover some of its technology, products and services. As a result Spirent could suffer litigation expenses or could be prevented from selling certain products as a result of third-party infringement claims.

The success of Spirent depends in part on proprietary technology. Should Spirent fail to maintain or enforce intellectual property rights, or if competitors design around its technology or develop competing technologies, its competitive position could suffer and its operating results may be harmed.

Business development activity

The Spirent Group is subject to the risks associated with business development activity, including acquisitions and disposals. The Spirent Group has made a number of disposals for which the Spirent Group has retained liabilities either contractually or through representations, warranties or indemnities that have not yet expired. Although Spirent evaluates the financial impact of each transaction and conducts due diligence, should unforeseen circumstances occur, such that previously unknown liabilities arise, or should erroneous assumptions have been used, the business, operating results and financial condition of Spirent could be adversely affected.

Regulation

The businesses are subject to various significant international, federal, state and local regulations currently in effect and scheduled to become effective in the near future, including but not limited to environmental, health and safety and import/export regulations. These regulations are complex, change frequently, can vary from country to country, and have increased over time. Spirent may incur significant expense in order to comply with these regulations or to remedy violations of them.

Any failure by Spirent to comply with applicable government regulations could result in non-compliant portions of our operations being shut down, product recalls or impositions of civil and criminal penalties and, in some cases, prohibition from distributing our products or performing our services until the products and services are brought into compliance, which could significantly affect our operations.

Compliance with section 404 of the Sarbanes-Oxley Act

If Spirent is unable to de-register in the United States as intended, Spirent will be required to comply with section 404 of the US Sarbanes-Oxley Act of 2002 for our Annual Report on Form 20-F for the year ending 31 December 2006. Section 404 requires that the Group evaluate and report on its systems of internal control over financial reporting. In addition, its independent auditors will have to report on management's evaluation of those controls. In the course of such review and evaluation, deficiencies in the systems of internal controls over financial reporting may be identified that may require remediation. Spirent can give no assurances that any such deficiencies identified may not be considered material weaknesses that may have an adverse effect on the financial condition of the business or the ability to raise capital or other forms of finance in the future.

Exchange rate

Since Spirent conducts operations globally, a substantial portion of the assets, liabilities, revenues and expenses are denominated in various currencies, principally the US dollar and the pound sterling. Because the reporting currency of the Group is pounds sterling, fluctuations in exchange rates, especially if the US dollar weakens against the pound, could have a material impact on the reported results.

Forward-looking statements

This document includes forward-looking statements concerning Spirent's business, operations and financial performance and condition. Forward-looking statements are based on current expectations and projections about future events. These forward-looking statements are subject to risks, uncertainties, and assumptions about the Spirent Group. The Spirent Group undertake no obligation to update publicly or revise any forward-looking statements, whether as a result of new information, future events or otherwise. Given these considerations, readers are cautioned not to place undue reliance on such forward-looking statements.

Possible volatility of the price of ordinary shares

The market price of the Spirent Group's Ordinary shares is significantly affected by a variety of factors, including but not limited to, changes in sentiment regarding the Spirent Ordinary share, variations in the Spirent Group's operating results compared with the expectations of market analysts and investors, its business developments or those of its competitors, the operating performance of its competitors or speculation about the Spirent Group's business. Shareholders should therefore be aware that the value of the Spirent Ordinary share can go down as well as up.

Board of directors

Executive directors

1. Anders Gustafsson, Chief Executive (46) ○ #

Anders Gustafsson was appointed Chief Executive in August 2004. Prior to joining the Company he was the Senior Executive Vice President – Global Business Operations of Tellabs, Inc.

2. Eric Hutchinson, Chief Financial Officer (51)

Eric Hutchinson was appointed Finance Director in 2000, having previously been responsible for all financial reporting and control within the Group. He is also a non-executive director and Chairman of the audit committee of Trifast plc.

Non-executive directors

3. Edward Bramson, Chairman (55) ○ #

Edward Bramson was appointed Chairman of the Board and Chairman of the Nomination Committee on 22 December 2006. He is a member of the board of directors of Elementis plc where he served as Chairman from June 2005 to September 2006 and he is currently a non-executive director. Mr Bramson was Chairman of 4imprint Group plc from October 2003 to July 2004 and a non-executive director until his resignation from the board in April 2005. He is currently Chairman of Ampex Corporation and a partner in Sherborne Investors, a turnaround investment firm.

4. Ian Brindle (63) ● ● ○

Ian Brindle was appointed to the Board on 22 December 2006 and is Chairman of the Audit Committee. He was previously UK Chairman of PricewaterhouseCoopers and is currently Deputy Chairman of the Financial Reporting Review Panel. He serves as a non-executive director on the Boards of 4imprint Group plc and Elementis plc.

5. Gerard Eastman (49) ● ● ○

Gerard Eastman was appointed as a non-executive director on 22 December 2006. He is a partner in Sherborne Investors, a turnaround investment firm. He was previously a Managing Director of investment banking at Citigroup and before that held senior positions at Salomon Brothers and S.G.Warburg & Co.

6. Göran Ennerfelt (66) ○

Göran Ennerfelt was appointed to the Board in 2000. He is President and Chief Executive Officer of Axel Johnson AB and either Chairman or a Board director of other entities in the Axel Johnson Group.

7. Alex Walker (60) ● ● ○

Alex Walker was appointed to the Board on 22 December 2006 and is the senior independent director and Chairman of the Remuneration Committee. Mr Walker was Chief Executive of Yule Catto & Co. plc until 17 August 2006 and is currently a member of the audit, remuneration and nomination committees of Rotork plc.

● Audit Committee
● Remuneration Committee
○ Nomination Committee
On 8 March 2007 Mr Gustafsson left the Company and Mr Bramson became Executive Chairman.

Statements on the independence of Board members are given in the Directors' statement on corporate governance on page 23.

Former directors serving in 2006

The following directors served on the Board during 2006:
Marcus Beresford – resigned 22 December 2006;
Frederick D'Alessio – resigned 22 December 2006;
Andrew Given – resigned 22 December 2006;
Kurt Hellström – resigned 22 December 2006;
John Weston – resigned 22 December 2006; and
James Wyness – retired 3 May 2006

Further biographical details of the directors can be found on the Company's website at www.spirent.com. The executive directors are supported by a team of senior management and their biographies can also be found on the Company's website.

Corporate social responsibility statement

We recognise that our social, environmental and ethical conduct has an impact on our reputation. We therefore take our corporate social responsibilities ("CSR") seriously and are committed to advancing our policies and systems across the Group to ensure we address and monitor all aspects of CSR that are relevant to our business. These include good ethical behaviour, concern for employee health and safety, care for the environment and community involvement.

We strive to maintain a productive and open dialogue with all parties who may have an interest in our activities including shareholders, customers, suppliers and employees. We have an established investor relations programme, conduct regular customer satisfaction surveys, monitor supplier performance and actively encourage feedback from our employees using a variety of methods including employee surveys. We maintain our website as one of the main routes for providing information to interested parties and for contacting us.

The Board takes ultimate responsibility for CSR and is committed to developing and implementing appropriate policies while adhering to a fundamental commitment to create and sustain long term value for shareholders. As a Group driven largely by technological innovation, our main assets are the talents and skills of the people we employ. The Board does not believe that, to date, the activities of the Group present any significant environmental risks.

Ethics

Spirent expects that all of its business is conducted in compliance with high ethical standards of business practice. We apply these standards to all dealings with employees, customers, suppliers and other stakeholders.

The Group's Ethics Policy, which has been approved by the Board, is available on our website at www.spirent.com. Our Ethics Policy has been developed to ensure that the Group's business is conducted in adherence with high ethical and legal principles and sets standards of professionalism and integrity for all employees and operations worldwide. The following is a summary of the Ethics Policy:

- all employees have the right and responsibility to ensure that Spirent's business is conducted with high ethical and legal principles;
- our policy is to operate within applicable laws;
- discrimination or harassment of any kind will not be tolerated;
- as a matter of policy, we do not make political donations;
- no bribes shall be given or received;
- conflicts of interest must be avoided;
- we aim to be a responsible partner within our local communities; and
- employees are encouraged and supported to report, in confidence, any suspected wrongdoings ("whistleblowing").

Appropriate ethical behaviour is reviewed as part of the Group's internal control process.

Employees

The Group aims to attract, retain and motivate the highest calibre of employees and encourages their contribution and development.

An environment that fosters innovation and collaboration are critical to Spirent's success. Appropriate career paths and internal recognition programmes are developed for both technical and non-technical staff.

Employees are provided with numerous learning and development opportunities to fulfil their potential. A wide variety of both courses and training materials are available to employees both in the classroom and via the intranet. These development opportunities are structured to align with our organisational objectives and to help employees in furthering their career aspirations.

Spirent demonstrates that it values its employees through several reward and recognition programmes. The Engineering Fellowship Programme honours the top technical talent within the organisation, connecting the best and the brightest of Spirent's technical expertise. The Spirit of Spirent Programme tracks outstanding service using Spirent's core values: customer focus, innovation, collaboration, contribution, continuous learning and ethics. This Programme is implemented across the Communications group to encourage and reward significant contributions to Spirent by employees. Furthermore, the Annual Innovation Awards Programme recognises all facets of contributions to Spirent, including outstanding sales, technical innovations and general business innovations.

Similarly, the importance of two-way communication is recognised particularly as it relates to the business and its performance. The leadership team is responsible for providing forums for employees to understand the business objectives and to ask questions. A variety of tools are utilised to foster two-way communications, including management meetings, "all-hands" employee meetings, the regular distribution of an employee newsletter, and the intranet. In 2006 a revised induction programme was implemented to orient new employees to Spirent and to assure that they have the knowledge and tools to be successful.

Leadership and management development programmes are regularly reviewed and updated as the competition for talented employees increases and the leadership needs of our business grow. Formal performance reviews are conducted and are linked to the values of the organisation.

The Group is committed to providing equality of opportunity to all existing and prospective employees without unlawful or unfair discrimination. Full support is given to the employment and advancement of disabled persons and this is reinforced through the Group's Ethics Policy.

Corporate social responsibility statement continued

Health and safety

The Chief Executive is the director appointed by the Board to have responsibility for the health and safety performance of the Group.

The Health and Safety risk profile of the Group has improved following the divestment, in February 2006, of the HellermannTyton Division which had a number of manufacturing sites. Additionally, certain other business units have moved to an outsourcing model which has again improved the risk profile. The main risks of the Group have now changed to being based more around working environment issues such as ergonomics and RSI.

The Group Health and Safety Policy places responsibility for the management of health and safety on the local business unit management, who are supported by the Group Risk Manager and local external advisers, where necessary.

It is the Group's intention that each business unit should have a senior individual designated as being responsible for ensuring the business unit conforms to local statutory health and safety regulations as well as Group policy. All business units are responsible for providing employees with a written health and safety policy.

Our corporate goal is for continuous improvement in the area of health and safety. An annual internal report on our health and safety performance is collated from a questionnaire completed by all our business units. The highlights of this report in respect of 2006 are:

– we had 135 incidents that required on-site First Aid, a significant decrease from 2005 and 2004;

– we saw a decrease in ill health/long term sickness levels with one case reported compared with three in 2005 and five in 2004;

– we saw a reduction in accident frequency and severity; and

– we had no accidents that required short term hospitalisation compared with three in 2005 and two in 2004.

Independent external reviews of the Company's health and safety performance are conducted annually at selected business units. Regular designated health and safety awareness training programmes are also carried out.

The Group's health and safety performance and significant risk exposures are reviewed regularly by management – twice a year by the Audit Committee and annually by the Board.

Environmental

Good environmental practice and the impact that our operations have on the environment are of great importance to Spirent. The main aim of Spirent's Environmental Policy is to comply with local, state and national environmental legislation in all jurisdictions in which we operate and to adopt responsible environmental practices. The full text of our Environmental Policy is available on our website at www.spirent.com.

Business units are required to comply with Group policy and local statutory regulations and are encouraged to set their own environmental targets. An annual environmental questionnaire is completed by each business unit which highlights their environmental performance.

The vast majority of our products are now manufactured by outside contract manufacturers and we check the environmental policies of these suppliers through audits and surveys. Wherever possible our products are designed and manufactured to take account of the recycling and disposal of the product at the end of its lifecycle. Our businesses comply with both The Waste Electrical and Electronic Equipment Regulations ("the WEEE Regulations") and The Restriction of the Use of Certain Hazardous Substances in Electrical and Electronic Equipment Regulations 2004 ("the RoHS Regulations").

Where possible, business units monitor energy consumption and all business units continue to take positive steps to reduce energy consumption, such as better space utilisation and more efficient running of equipment and machinery.

Environmental waste management in the Group continues to improve with most business units operating waste minimisation schemes mainly focusing on increased recycling.

The vacant site where historic activity had led to minor land contamination is continuing to be remedied with full cooperation of the local statutory body.

Community

Spirent strives to be a responsible partner in the communities in which we operate, and we recognise the significance of local communities through our Charitable Donations Policy. Our businesses are encouraged to support the particular needs of their population by contributing to local charities and participating in community initiatives. Support takes the form of employee time and skills, gifts in kind and cash donations. In 2006, Spirent made charitable cash donations of £32,000 (2005 £35,000).

Our employees help their communities by volunteering their time to various programmes and donating materials and equipment to local causes. In 2006, we continued to support education by offering internships and work experience programmes. We again participated in a programme that introduces local high school students to jobs related to engineering, including participation in exercises in job shadowing and career days. Through Junior Achievement, an organisation which educates young people about business, economics and free enterprise, we help raise funds for children's education. We also were involved in fund raising activities for local concerns and community initiatives, such as "food drives", collections and sponsored events that help organisations provide food, clothing and children's toys to people around the world.

Spirent continues to support all of our employees and businesses in finding new ways of becoming involved to help their communities.

Report of the directors

The directors present their Report, the audited consolidated financial statements and the parent Company financial statements for the year to 31 December 2006.

Change of Company name

At the 2006 Annual General Meeting ("2006 AGM") shareholders voted in favour of changing the company name from Spirent plc to Spirent Communications plc to ensure it reflected the focus of the Group. The new company name was effective from 8 May 2006.

Principal activities, business review and results

The principal activities, business review and results for the year (inclusive of financial performance, likely future developments and prospects) are set out on pages 4 to 15. Principal divisions and subsidiaries are listed on page 111.

Dividends

No interim dividend was paid during the year (2005 nil) and the directors do not recommend the payment of a final dividend (2005 nil).

Research and development

Product development and innovation are considered key strategies to maintain and improve the Group's competitive position and therefore continue to receive high priority. This commitment is highlighted by the £57.3 million research and development spend during the year, equivalent to 21 per cent of sales (2005 £58.4 million and 23 per cent). The Company will continue to commit resources as appropriate to research and development.

Major transactions

On 23 January 2006, the Company announced the acquisition of SwissQual Holding AG (renamed Spirent Communications (Switzerland) AG) for an initial consideration of CHF62.5 million (£27.8 million) which was paid in cash, with up to a further CHF28.0 million (£12.4 million) payable depending on revenue growth and various technical and financial milestones.

On 13 February 2006, the Company announced the acquisition of QuadTex Systems, Inc for an initial consideration of $7.5 million (£4.3 million), paid in cash with further consideration of up to $1.5 million (£0.9 million) payable depending on certain technical milestones and the retention of key employees.

On 15 February 2006, the sale of the HellermannTyton Division to funds controlled by Doughty Hanson & Co Limited for a cash free/debt free equivalent value of £296.7 million was completed.

On 10 July 2006, the Company completed the acquisition of Scientific Software Engineering, Inc with the initial consideration settled by way of a cash payment of $10.0 million (£5.5 million). A further amount is payable of up to $6.0 million (£3.3 million) depending on the satisfaction of certain technical milestones and the retention of key employees.

On 10 August 2006, the Company announced the acquisition of the business of Imperfect Networks, Inc for an initial consideration of $4.0 million (£2.1 million) paid in cash, with up to a further $4.0 million (£2.2 million) payable depending on the satisfaction of certain technical milestones and revenues to be achieved in 2007.

Further details of these transactions are set out in note 36 and 37 to the consolidated financial statements.

Share capital

Changes in the Company's share capital during 2006 are given in note 32 to the consolidated financial statements and note 17 to the parent Company financial statements.

Substantial shareholdings

At the date of this Report, the Company had been notified of the following interests in 3 per cent or more of its issued Ordinary share capital:

	% held
Sherborne Investors GP, LLC	14.69
Lexa BV	13.53
Prudential plc	6.89
Aberforth Partners LLP	4.66
Legal & General Group plc	3.64
Sun Life Assurance Company of Canada (UK) Ltd	3.03

Additional shareholder information, including a profile of shareholdings, appears on page 115.

Share listings

The primary listing for the Company's Ordinary shares is on the London Stock Exchange. The Company's Ordinary shares are also traded on the New York Stock Exchange in the form of American Depositary Shares and these are evidenced by American Depositary Receipts ("ADRs"), each one of which represents four Ordinary shares. The Bank of New York is the authorised Depositary bank for the Company's ADR programme.

Board of directors

The names and brief biographical details of the current directors are shown on page 16. At an Extraordinary General Meeting held on 22 December 2006 ("2006 EGM"), shareholders voted to remove as directors of the Company, John Weston, Frederick D'Alessio and Andrew Given (who had held office throughout the year) and appoint as directors of the Company, Edward Bramson, Ian Brindle, Gerard Eastman and Alex Walker. Following the conclusion of the 2006 EGM, Kurt Hellström and Marcus Beresford resigned as directors of the Company. James Wyness retired from the Board with effect from 3 May 2006.

Report of the directors continued

Re-election of directors

Pursuant to the Company's Articles of Association and the Combined Code on Corporate Governance, Göran Ennerfelt will retire at the Annual General Meeting to be held on 9 May 2007 ("2007 AGM") and, being eligible, offers himself for re-election. On appointment to the Board of directors on 22 December 2006, Edward Bramson and Gerard Eastman stated that they would retire and offer themselves for re-election as directors on an annual basis commencing at the 2007 AGM. None of the above directors have a service contract with the Company or any Group company.

Directors' interests

Göran Ennerfelt has a connected notifiable interest in the Spirent Communications plc Ordinary shares held by Lexa BV (see Substantial shareholdings on page 19) which, for statutory purposes, is also deemed to be an interest of the director.

Edward Bramson and Gerard Eastman have a connected notifiable interest in the Spirent Communications plc Ordinary shares held by Sherborne Investors GP, LLC (see Substantial shareholdings on page 19). This connected notifiable interest, is also deemed, for statutory purposes, to be an interest of each director as they are members of Sherborne Investors GP, LLC, which is the general partner of Sherborne Investors, LP. Sherborne Investors, LP is the managing member of each of the following funds, which are the beneficial owners of Spirent's Ordinary shares: Sherborne Strategic Fund A, LLC; Sherborne Strategic Fund B, LLC; Hayden Investor Partners, LLC; Hayden Investor Partners II, LLC.

The directors' interests (including those of their immediate families and any connected persons) in the share capital of the Company are set out in the Report on directors' remuneration on pages 26 to 32.

Directors' indemnity arrangements

Save as disclosed, at no time during the year did any director hold a material interest in any contract of significance with the Company or any of its subsidiary undertakings other than a third party indemnity provision between each director and the Company and service contracts between each executive director and a Group company.

The Company has purchased and maintained throughout the year, directors' and officers' liability insurance in respect of itself and its directors. The directors also have the benefit of the indemnity provision contained in the Company's Articles of Association.

Following the amendment of the Companies Act 1985 by the Companies (Audit, Investigations and Community Enterprise) Act 2004, the Company has executed a deed of indemnity for the benefit of the directors of the Company and persons who were directors of the Company during 2006 (except Mr Wyness) in respect of costs of defending claims against them and third party liabilities. These provisions are currently in force.

Employees

The Group's and the Company's employment policies regarding disabled persons and further information on employee training, development and involvement is explained in the Corporate social responsibility statement on page 17.

Employee share plans

The Company operates a number of share incentive plans, details of which can be found in note 32 to the consolidated financial statements and note 17 to the parent Company financial statements.

Share repurchase programme

The Company was authorised at the 2006 AGM to repurchase up to 14.99 per cent of its own Ordinary shares, within certain limits and as permitted by the Company's Articles of Association. This share repurchase programme commenced on 15 May 2006 and a total of 90.3 million Ordinary shares, each with a nominal value of 3⅓ pence were repurchased for an aggregate consideration of £41.9 million and placed in Treasury during the year. This represents 9.3 per cent of the Company's issued share capital (at the time the authority was granted by shareholders – see also, note 32 to the consolidated financial statements and note 17 to the parent Company financial statements). No further Ordinary shares were repurchased between 1 January 2007 and the date of this Report.

There is a further £8 million to be returned of the originally announced £50 million programme and purchases are expected to be completed during 2007. It was also announced in October 2006 that the Company proposed to seek authority for a further return of £50 million to shareholders. This will be considered further as part of the in-depth business review currently underway and the Company will seek authority at the 2007 AGM to facilitate this further return of capital if it is concluded that it is in the best interests of shareholders.

Social responsibility and donations

The Group's Corporate social responsibility statement appears on pages 17 and 18. Charitable donations of £32,000 were made in the year (2005 £35,000). This amount excludes operating units' support and participation in local community activities. No political donations were made in the year (2005 nil).

Policy on payment of suppliers

Group operating companies are responsible for agreeing the terms and conditions under which business transactions with their suppliers are conducted and it is Group policy to comply with those terms and to make suppliers aware of them.

At 31 December 2006, the Company had an average of 37 days purchases outstanding in trade creditors (2005 48 days).

Corporate governance

The Directors' statement on corporate governance is set out on pages 23 to 25. The Statement of directors' responsibilities in respect of the financial statements appears on page 22.

Going concern

After making enquiries, the directors confirm that they have a reasonable expectation that the Group and Company has adequate resources to continue in operational existence for the foreseeable future. For this reason, the going concern basis continues to be adopted in preparing the financial statements.

Annual General Meeting

The 2007 AGM will be held at 10.30 am on Wednesday 9 May 2007 at the offices of the Company's PR advisers, Financial Dynamics, Holborn Gate, 26 Southampton Buildings, London WC2A 1PB, United Kingdom.

Auditors

A resolution to re-appoint Ernst & Young LLP as auditors and to authorise the directors to determine their remuneration will be proposed at the 2007 AGM.

Disclosure of information to auditors

The directors who were members of the Board at the time of approving the Report of the directors are listed on page 16. Having made enquiries of fellow directors and of the Company's auditors, each of these directors confirms that:

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

By Order of the Board

Paul Eardley
Company Secretary
1 March 2007

Statement of directors' responsibilities in respect of the financial statements

The Companies Act 1985 requires directors to prepare financial statements for each accounting period which give a true and fair view of the state of affairs of the Company and the Group at the end of the accounting period and of the profit or loss of the Group for that period. In preparing the financial statements the directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and estimates that are both reasonable and prudent;
- state whether applicable accounting standards, International Financial Reporting Standards as adopted by the European Union or UK Generally Accepted Accounting Practice, as appropriate, have been followed, subject to any material departures being disclosed and explained in the notes to the financial statements; and
- provide additional disclosures when compliance with the specific requirements is insufficient to enable users to understand the impact of particular transactions, other events and conditions on the financial position and financial performance of the entity.

The directors are responsible for:

- keeping proper accounting records which disclose with reasonable accuracy at any time the financial position of the Company and the Group and enable them to ensure that the financial statements comply with the Companies Act 1985 and, for the Group, Article 4 of the International Accounting Standards Regulation; and
- taking reasonable steps to safeguard the assets of the Company and the Group and to prevent and detect fraud and other irregularities.

The directors are responsible for the maintenance and integrity of the Company's website. Financial information published on the website is based on legislation in the UK governing the preparation and dissemination of financial statements that may be different from comparable legislation in other jurisdictions.

Directors' statement on corporate governance

This statement describes how the principles and provisions of corporate governance set out in the Combined Code on Corporate Governance ("the Code") have been applied within the Group.

The Board

The Board comprises a Chairman (who is not independent), four further non-executive directors, and two executive directors, details of whom are given on page 16. The Board operates within a framework of controls, including a formal schedule of matters specifically reserved for its decision. The roles of Chairman and Chief Executive are separate with a clear division of responsibility between them which is set out in writing and agreed by the Board.

The Board helps to develop and set the strategic aims and objectives for the Company and regularly reviews its performance in achieving those aims and objectives. The Board regularly reviews management performance and sets values and standards to ensure that its obligations to its shareholders and others are understood and met.

Following the appointment of Edward Bramson, Ian Brindle, Gerard Eastman and Alex Walker to the Board, by virtue of the shareholders vote on 22 December 2006, the Board was no longer in compliance with paragraph A.3.2 of the Code. The Board intends to appoint two further independent non-executive directors during 2007 to bring the composition of the Board back into compliance with the Code. Edward Bramson, the Chairman, has a connected material notifiable interest in the share capital of the Company and accordingly does not meet the independence criteria in paragraph A.2.2 of the Code.

The independence of each director is reviewed at least annually. As Edward Bramson, Gerard Eastman and Göran Ennerfelt have a connected material notifiable interest in the share capital of the Company (see the Report of the directors on pages 19 to 21), the Board has concluded that they are not to be considered as independent of the management of the Company.

Alex Walker currently serves as the senior independent director. The senior independent director is available to meet shareholders upon request if they have concerns which contact through the normal channels of the Chairman or executive directors has failed to resolve, or for which such contact is inappropriate.

It is the policy of the Board to hold at least six Board meetings a year, including a meeting to review and approve long term strategy. There were 17 Board meetings during 2006. The activity at the end of the year meant that there were several meetings scheduled at short notice. Full attendance of the Board is expected at meetings and in 2006 all directors attended except for the following absences: Marcus Beresford (1), Frederick D'Alessio (4), Andrew Given (2), Göran Ennerfelt (8) and Kurt Hellström (5). The reasons for the absences were due to either the fact that a number of meetings were scheduled at short notice, unavoidable changes in the Board meeting calendar at short notice, the director being ill or the director having to be elsewhere for other urgent business. Where the director was absent, full documentation for the meeting was issued and briefings were provided as appropriate.

Certain of the matters specifically reserved for the Board's decision have been delegated to three standing Committees with clearly defined terms of reference which, together with the composition of each Committee, are reviewed annually. Each Committee is provided with sufficient resources so that it may undertake its duties. The terms of reference for the Audit, Remuneration and Nomination Committees are available upon request to the Company Secretary and are also available on the Company's website.

Board appointments

The Company's Articles of Association require that all directors seek election by shareholders at the first Annual General Meeting following their appointment. They also require that all directors seek re-election at least every three years. Notwithstanding the requirements of the Company's Articles of Association, Edward Bramson and Gerard Eastman have agreed to offer themselves for re-election at each Annual General Meeting whilst they serve on the Board.

Board Committees

Audit Committee

Chairman, Ian Brindle

Throughout 2006 until 22 December, the Audit Committee comprised three independent non-executive directors. It currently comprises three non-executive directors. Its membership is not in accordance with paragraph C.3.1 of the Code. However, the Board intends to bring the Audit Committee back into compliance following the appointment to the Board of two further independent non-executive directors during 2007.

Directors' statement on corporate governance continued

The Code requires that the Audit Committee includes a member who has recent, significant and relevant financial experience and the Board believes that Ian Brindle provides such experience. During 2006, the Audit Committee held five meetings at which there was full attendance by Committee members with the exception of Marcus Beresford and James Wyness who were both absent for one meeting. At all meetings the external auditors, the Chairman, the Chief Executive, the Chief Financial Officer, the Head of Internal Control and the Head of Financial Reporting are in attendance.

The Audit Committee reviews all published financial statements and post audit findings before their presentation to the Board, focusing in particular on accounting policies, compliance, management judgement and estimates. It also monitors the Group's internal control and risk management regime (including the effectiveness of the internal audit function) and financial reporting. Any significant findings or identified weaknesses are closely examined so that appropriate action can be taken, monitored and reported to the Board.

The Audit Committee also advises the Board on the appointment of external auditors and on the scope, results and cost effectiveness of both audit and non-audit work. The Board has adopted a policy which prohibits certain types of non-audit work from being performed by the Company's auditors, particularly where auditor objectivity and independence would be at risk. Non-audit work is put to tender where considered appropriate.

Nomination Committee

Chairman, Edward Bramson

The Nomination Committee comprises the Chairman, all the non-executive directors and the Chief Executive and meets at least once a year. During 2006, the Nomination Committee held one meeting at which there was full attendance by Committee members. The Nomination Committee is responsible for reviewing the composition and structure of the Board and for identifying and recommending candidates for executive and non-executive positions, based on the required role and capabilities which have been specified for the appointment. Executive search consultants are used by the Nomination Committee to assist this process as appropriate. The Board intends to appoint two further independent non-executive directors during 2007 in order to bring the composition of the Board back into compliance with paragraph A.3.2 of the Code. The Board has agreed that its members will be selected by the independent non-executive directors, notwithstanding the terms of reference of the Nomination Committee.

Remuneration Committee

Chairman, Alex Walker

Throughout 2006 until 22 December, the Remuneration Committee comprised five independent non-executive directors. It currently comprises three non-executive directors. Its membership is not in accordance with paragraph B.2.1 of the Code. However, the Board intends to bring the Remuneration Committee back into compliance once the two further independent non-executive directors have been appointed to the Board during 2007. During 2006, the Remuneration Committee held four meetings at which there was full attendance by Committee members with the exception of Frederick D'Alessio who was absent for one meeting.

Details about the Remuneration Committee are included in the Report on directors' remuneration on pages 26 to 32.

Relations with shareholders

The Board attaches considerable importance to its relationships and communication with shareholders. Communication is facilitated by full year and interim reports. The Board has taken steps to ensure that the members of the Board, including the non-executive directors develop an understanding of the views of major shareholders about the Company.

Internal control

The Board has overall responsibility for the Group's system of internal control. The Board assisted by the Audit Committee has reviewed the effectiveness of this system and this review did not reveal any significant findings or weaknesses. The Board confirms that this process was in place throughout the year under review and up to the date of approval of these financial statements. The primary aim is to operate a system which is appropriate to the business and which can, over time, increase shareholder value whilst safeguarding the Group's assets. The system is designed to manage, rather than eliminate, the risk of failure to achieve business objectives and can only provide reasonable and not absolute assurance against material misstatement or loss.

Process

Day-to-day responsibility for effective internal control and risk monitoring rests with senior management at operating group and business unit level.

Spirent operates a corporate internal control and risk management function which reports into the Head of Internal Control. The function operates on a global basis and plays a key role in providing an objective view and continuing assessment of the effectiveness of the internal control systems throughout the Group to operating management, the Audit Committee and the Board. The work programme of the functions is focused on the areas perceived to be of greatest risk to the Group and is agreed annually in advance by the Audit Committee. During 2006 the work programme focused mainly on Sarbanes-Oxley compliance relating to the Company's secondary listing on the New York Stock Exchange and associated registration with the US Securities and Exchange Commission.

The Group's system of internal control and risk management comprises an integrated risk management strategy consisting of regular self-assessment encompassing all operating units and preparation of a remedial action plan, as appropriate. This system is coordinated by Spirent's corporate internal control and risk management functions. Significant risks are also regularly reviewed by the Audit Committee and by the Board.

In addition to this process, the following key elements are critical to the overall internal control environment:

– an organisational structure with clear operating procedures, defined lines of responsibility and delegated levels of authority;

– an Ethics Policy (which has been approved by the Board), which sets standards of professionalism and integrity for all employees and operations. The Ethics Policy also includes "whistleblowing" procedures whereby employees may report, in confidence, suspected wrongdoings;

– a comprehensive strategic planning, financial control and budgeting system which is properly documented and regularly reviewed; and

– a disciplined acquisitions and divestments due diligence process and post acquisition integration programme.

US corporate governance compliance

As the Company has a secondary listing on the New York Stock Exchange ("NYSE"), it is subject to certain US legislation. Following the introduction of the Sarbanes-Oxley Act of 2002 in the US, NYSE introduced new corporate governance standards. Companies which do not have their primary listing on NYSE (such as Spirent) are generally permitted to follow home country practice (ie the UK Listing, Disclosure and Prospectus Rules and the Code) in lieu of NYSE's standards. Generally, NYSE's corporate governance standards do not vary significantly from those adopted in the UK, however, NYSE rules require any such significant variances to be disclosed. Following a review of NYSE corporate governance standards, the following are considered significant variances to home country practice:

– NYSE rules provide that nomination committees should consist entirely of independent directors. Spirent's Nomination Committee includes Edward Bramson, Gerard Eastman, Göran Ennerfelt and Anders Gustafsson, none of whom are independent;

– NYSE rules provide that nomination/corporate governance committees are responsible for developing and recommending to the Board a set of corporate governance principles applicable to the Company. Spirent, however, reserves these responsibilities for the whole Board (in accordance with the Code); and

– NYSE rules require audit committees to be directly responsible for the appointment and retention of the Company's external auditor. Spirent's Audit Committee, however, in accordance with the Code, is responsible for making recommendations to the Board on the appointment and retention of the auditor.

In accordance with NYSE requirements, the above summary of significant variances in corporate governance practices can be found on the Company's website at www.spirent.com.

Pensions governance

The Group's principal pension and retirement schemes exist in the UK and the US. Scheme funds are held separately from those of the Group and are administered by Trustees (which include employees and independent bodies). The schemes do not lend money or lease any assets to the Group. Following completion of the disposal of the HellermannTyton Division on 15 February 2006, the Company made a special contribution of £47.0 million into the UK final salary pension scheme, which substantially funds the scheme.

Reporting

The Statement of directors' responsibilities in respect of preparing the financial statements is set out on page 22. A report by the auditors, Ernst & Young LLP, which includes details of their responsibilities in respect of the Group's compliance with the Code, is set out on page 33.

Report on directors' remuneration

1. Introduction and compliance

This Report has been prepared by the Remuneration Committee ("the Committee") and approved by the Board in compliance with statutory requirements and the Combined Code on Corporate Governance ("the Code").

2. Role and remit of the Remuneration Committee

The composition of the Committee during the year was made up wholly of non-executive directors. The Committee members from 1 January to 22 December 2006 were Marcus Beresford (Chairman to 3 May), Frederick D'Alessio (Chairman from 3 May), Andrew Given, Kurt Hellström, John Weston, and James Wyness (retired 3 May). On 22 December 2006 the Board changed the composition of the Committee to Alex Walker (Chairman), Ian Brindle and Gerard Eastman.

Details of the number of Committee meetings and attendance by members during the year are set out in the Directors' statement on corporate governance.

The Committee made recommendations to the Board on the policy, framework and cost of executive remuneration. The Committee also approved the remuneration of each executive director and certain other senior executives. In addition, on behalf of the Board, the Committee was responsible for monitoring and managing shareholder dilution arising from share incentive plans.

3. Remuneration policy

The Company's remuneration policy, which did not change during 2006, was to provide executive pay which was competitive when compared with organisations of similar size, complexity and type and was structured so that remuneration was linked to long term growth and profitability targets.

In order to assist the Committee in carrying out its duties during 2006, the Committee consulted on a regular basis with its independent external remuneration advisers. During the year the Committee retained Watson Wyatt Ltd (who are also consultant actuaries to the Company on pension matters) as advisers. Other advisers during the year were as follows:

– Kepler Associates; and

– Linklaters (who are one of the Company's legal advisers).

The Committee also consulted with the Company's Senior Vice President of Human Resources, Senior Director Global Compensation and the Company Secretary regarding remuneration and related corporate governance issues. In addition, with respect to the remuneration of senior executives (for whom the Company's remuneration policy also applied), the Committee also consulted with the Chief Executive.

There are four elements to the remuneration packages for executive directors: competitive basic salary (annually reviewed); short term incentive bonus; long term share incentive awards and pension benefits. Both short term incentive bonuses and long term share-based incentives are performance related. In normal circumstances, it was the Committee's policy that at least 50 per cent of an executive director's target total annual remuneration package be based on performance related elements.

At the EGM held on 22 December 2006, shareholders voted to remove certain directors of the Company and appoint four new directors. Accordingly, the composition of the Board and the Committee changed on that date and a review of remuneration policy is currently taking place. Revised Terms of Reference for the Committee (which can be found on the Company's website) were approved in February 2007.

4. Executive directors' remuneration

a) Base salary and benefits

The level of base salary was reviewed on 1 January 2006 by reference to both the performance and responsibilities of the individual and prevailing market rates for executives of similar status in comparable companies. Further details can be found in paragraph 6(a).

Pension and other benefits were also reviewed on 1 January 2006 having regard to competitor practice. Benefits include a car allowance, healthcare and life insurance coverage. Pension details are given in paragraphs 4(d), 6(a) and 6(b).

On 1 August 2006 Anders Gustafsson entered into two service agreements which replaced the previous single service agreement entered into on 1 August 2004. The two new agreements provide for him to devote 80 per cent and 20 per cent of his working time to his duties in the USA and UK respectively and base salary is split in the same proportion and paid in the local currency of each jurisdiction.

b) Annual and other incentive bonus schemes

The Committee reviewed annual incentive bonus scheme targets and performance conditions to incentivise the executive to meet the short term strategic objectives of the Company.

In respect of 2006, Anders Gustafsson and Eric Hutchinson participated in an annual cash bonus scheme which, consistent with UK market practice and levels, was structured around a formula providing for an on-target performance bonus of 50 per cent of base salary with a maximum of 100 per cent of base salary for exceptional performance. Performance was measured against targets in the Company's adjusted earnings per share ("EPS") and cash flow, accounting for 80 per cent and 20 per cent of any bonus, respectively. As the threshold targets for 2006 were not achieved, neither executive director earned a bonus under the annual scheme.

c) Medium and long term incentive plans

The Committee approved the grant of all awards under the Employee Incentive Plan ("EIP") in which executive directors participate (see below). All grants are subject to the prior satisfactory performance of the individual and grant amounts vary in accordance with the individual's potential to add value to the business over the medium to long term.

The executive directors are also eligible to participate in the Company's all employee share plans, further details of which are provided in note 32 to the consolidated financial statements and note 17 to the parent Company financial statements.

1995 Executive Share Option Scheme

The 1995 Executive Share Option Scheme expired during 2005 and no grants have been made to directors under this scheme since 2005. Further details in respect of this scheme are provided in note 32 to the consolidated financial statements and note 17 to the parent Company financial statements.

2005 Employee Incentive Plan

The EIP was approved by shareholders in May 2005 and both executive directors participated in this plan during 2006. Under the EIP, the Company is able to grant options and share settled stock appreciation rights ("SARs"), the exercise of which will be subject to challenging EPS criteria. Performance shares may also be granted, the vesting of which will be subject to challenging total shareholder return ("TSR") criteria. This combination reflects UK market trends in the use of long term incentives and creates a more balanced incentive package for executive directors.

In normal circumstances, SARs/options under the EIP will vest three years following grant provided the Company's EPS growth targets (after excluding inflation) have been met over a three year performance period. The growth targets in respect of awards made to executive directors during 2005 and 2006 require that the Company's EPS increases within a range of 6 per cent per annum (for 25 per cent vesting) and 15 per cent per annum (for 100 per cent vesting) over the performance period, with a sliding scale between these points.

In normal circumstances, performance shares under the EIP will vest three years following grant provided the Company's TSR targets have been met over a three year performance period. TSR is the growth in the value of a share or index, assuming dividends and other distributions are reinvested. The performance condition requires that Spirent's TSR rating be between the median of a comparator group (for 30 per cent vesting) and in the upper quartile of a comparator group (for 100 per cent vesting) over the performance period, with a sliding scale between these points. The comparator group consists of the 30 largest companies by market capitalisation in the FTSE TechMARK 100 Index, excluding those TechMARK companies who were also constituents of the FTSE 100 at the commencement of the performance period. The Committee considers the selected comparator group provides a suitable benchmark for Spirent's TSR rating.

All EIP awards will be tested once on or shortly following the third anniversary of grant. Any part of an award which does not vest will lapse and there will be no opportunity for retesting.

The executive directors receive a mix of SARs/options and performance shares, utilising a ratio of two SARs/options being equivalent to one performance share. At least 25 per cent of each grant is delivered in SARs/options and at least 25 per cent in performance shares, with the balance of the grant delivered through a mix of SARs/options and performance shares as determined by the Committee. In normal circumstances, the maximum combined award under the EIP will be limited to 250 per cent of salary face value in SARs/options. As explained above, grants normally consist partly of SARs/options and partly of performance shares, with the proviso that the performance share element may not exceed a face value of 100 per cent of salary (ie using the ratio of two SARs/options being equivalent to one performance share).

Shareholder dilution

The Committee is mindful of the need to manage shareholder dilution in a responsible manner. As explained in the Circular to shareholders dated April 2005 ("the 2005 Circular"), the current shareholder approved mandate includes an aggregated annual allowance of up to 3.1 per cent of the issued share capital under the EIP and the Spirent Stock Incentive Plan ("SSIP"). As part of the Committee's sustainable dilution strategy, SARs are used in lieu of options in the operation of the EIP and SSIP. This "SARs" approach helps the Company manage its actual dilution more efficiently as only the appreciation value and not the entire share value needs to be funded when an award is exercised.

Further information on the "SARs" approach, the operation of other share plans and shareholder dilution is provided in note 32 to the consolidated financial statements and note 17 to the parent Company financial statements.

Shareholder consultation

In the 2005 Circular, the Company stated that the performance conditions and award criteria in respect of the EIP would operate for two annual award cycles (ie 2005 and 2006) and that the Company would revert to shareholders in 2007 if it wished to propose any material changes. The Company also stated in the 2005 Circular that the SSIP would operate for three annual award cycles (ie 2004, 2005 and 2006) and the Company would revert to shareholders in 2007.

As mentioned above, the Remuneration Committee is currently reviewing remuneration policy within the Group and as such has agreed that no material changes to the Company's share plans will be proposed at the 2007 Annual General Meeting and shareholders will be consulted when remuneration policy had been formulated. However, in this transitional stage, shareholder authority is being sought to renew the SSIP in the same form as approved by shareholders in June 2004 and this authority to operate the SSIP will expire at the 2008 Annual General Meeting (see the Notice of 2007 Annual General Meeting for further details).

Report on directors' remuneration continued

d) Directors' pensions

During the year, Eric Hutchinson transferred the value of his accrued benefits from the Spirent Communications plc Staff Pension and Life Assurance Plan ("the Staff Plan") to a personal pension arrangement. The transfer payment of £3,984,844 was made pursuant to an enhanced transfer value offer which was made to all active and deferred members of the Staff Plan. At 31 December 2005 the transfer value of this plan was £2,635,000.

Prior to the transfer, Eric Hutchinson participated in the non-contributory funded senior executive level of the Staff Plan, a defined benefit arrangement which would have provided him at normal retirement age of 60, and dependent on length of service, with a pension of up to two-thirds of salary, subject to HM Revenue & Customs limits and other statutory conditions. It also provided for dependants' pensions and a cash lump sum on death.

Since 1 August 2006, when he ceased membership of the Staff Plan, Eric Hutchinson has received an annual cash allowance in lieu of pension of 20 per cent of base salary, totalling £24,571 in 2006.

Prior to his relocation to the US, Anders Gustafsson's contract provided him with a pension contribution of 30 per cent of basic salary. Subject to statutory limits, and in accordance with his direction, the Company made approved contributions into the executive section of the Spirent Retirement Cash and Life Assurance Plan ("the Cash Plan"). The Executive Section of the Cash Plan is non-contributory and provides benefits on a defined contribution basis. Contributions to the Cash Plan are held in an individual account and invested in accordance with member elections. The Company established an unfunded unapproved retirement benefit ("UURB") on a defined contribution basis to which the balance of contributions in excess of the statutory limits were credited together with interest on the UURB balance.

Following his relocation to the US, the accrued UURB balance of £263,955 was cashed out, £237,232 being paid in cash after deduction of tax to Mr Gustafsson and £26,723 being paid into the Cash Plan. Since 1 August 2006, Mr Gustafsson has received an annual cash allowance in lieu of pension of 30 per cent of total base salary, which is paid in the US and which for 2006 totalled $114,263 (£60,950).

Further details of pension contributions and payments are given in paragraphs 6(a) and 6(b).

e) Service agreements

The Committee's policy is to offer service contracts which provide for no more than 12 months' notice from the Company in normal circumstances.

Anders Gustafsson entered into two service agreements on 1 August 2006 (see 4(a) for further details) which currently have an unexpired term of 160 months and are terminable by the Company on 12 months' notice and by him on six months' notice. Eric Hutchinson entered into a service contract on 13 December 1999 which currently has an unexpired term of 99 months and is terminable at any time by either party on 12 months' notice.

All contracts contain provisions for the Company to make payment in lieu of notice and for removal of the director for poor performance or misconduct without compensation. The Company will seek to apply practical mitigation measures to any payment of compensation on termination, taking into account all relevant circumstances. All service contracts contain appropriate provisions to protect the legitimate interests of the Company with respect to preventing any terminated director from working in a business which competes against the Company. Service contracts do not contain any compensation rights which could be increased on a change of control in the Company.

f) External appointments

Spirent recognises the mutual benefit for executive directors to serve as non-executive directors of companies in other industries outside the Group. Such appointments are subject to prior Board approval and any related fee entitlements are for the account of the executive director concerned. During 2006, Eric Hutchinson served on the Board of Trifast plc as a non-executive director and received fees of £31,250 arising from this appointment.

5. Non-executive directors' remuneration

The remuneration of John Weston (Chairman to 22 December 2006) was determined by the Committee and the remuneration of the other non-executive directors was determined by the Board. The remuneration of all non-executive directors in office at 1 January 2006 was reviewed following a recommendation by the Chief Executive and after consultation with independent external advisers concerning competitive market practice. The Company's Remuneration Policy with regards to non-executive directors is to pay fees which are in line with market practice.

John Weston's remuneration for 2006 remained unchanged as did that of all non-executive directors in office at 1 January 2006. Edward Bramson, who was appointed Chairman on 22 December 2006, and Gerard Eastman, who was appointed as a non-executive director on the same date (both partners of Sherborne Investors GP, LLC ("Sherborne"), the Company's largest shareholder), waived their rights to any fees while they manage an operational turnaround of the Group.

Non-executive directors are not eligible to participate in bonus or share incentive arrangements and their service does not qualify for pensions or other benefits. No element of their fees is performance related. Non-executive directors do not have service contracts and are normally appointed, subject to the Company's Articles of Association, for an initial three year term. Any subsequent extension to the term by the Board is not automatic and is subject to prior recommendation of the Nomination Committee. Edward Bramson and Gerard Eastman have stated that, as partners of Sherborne, they will seek re-election by shareholders on an annual basis commencing at the 2007 Annual General Meeting.

Further information on non-executive directors' fees is provided in paragraph 6(a) below.

6. Directors' remuneration[1]

a) Individual and total remuneration of the directors holding office during 2006

	Salary £000	Fees[2] £000	Taxable benefits[3] £000	Bonus[4] £000	Cash in lieu of pension[5] £000	Total[6] 2006 £000	Total[6] 2005 £000
Executive directors							
A Gustafsson	487.6	–	217.9	–	298.2	1,003.7	679.7
E Hutchinson[7]	294.9	0.5	17.3	–	24.5	337.2	375.6
Non-executive directors							
M Beresford	–	39.1	–	–	–	39.1	40.0
E Bramson	–	–	–	–	–	–	–
I Brindle	–	1.1	–	–	–	1.1	–
F D'Alessio	–	41.6	–	–	–	41.6	38.0
G Eastman	–	–	–	–	–	–	–
G Ennerfelt	–	33.0	–	–	–	33.0	33.0
A Given	–	39.1	–	–	–	39.1	40.0
K Hellström	–	32.3	–	–	–	32.3	33.0
R Moley	–	–	–	–	–	–	13.0
A Walker	–	1.1	–	–	–	1.1	–
J Weston	–	150.0	–	–	–	150.0	150.0
J Wyness	–	13.6	–	–	–	13.6	40.0
Total 2006	782.5	351.4	235.2	–	322.7	1,691.8	–
Total 2005	743.5	387.5	125.4	185.9	–	–	1,442.3

Notes
1 Information relating to directors' remuneration in 6(a) and 6(b) has been audited.
2 Eric Hutchinson earned these fees in respect of his services to the Board and its Committees. The non-executive directors receive a basic annual fee of £33,000 in respect of their services (except Edward Bramson and Gerard Eastman who have waived their fees). John Weston received an annual fee of £150,000 which covered both his basic annual fee and his additional duties as Chairman. Non-executive directors who chair a Board Committee receive an additional £7,000 per annum. The Senior Independent Director receives an additional £7,000 per annum (except where he also chairs a Board Committee). Frederick D'Alessio received an additional £5,000 per annum in recognition of the extensive international travelling commitment required to perform his duties.
3 Taxable benefits include a car allowance, healthcare, personal tax advice, premiums for life assurance and relocation costs incurred to date of £142,000 in respect of Anders Gustafsson relocating from the UK to the US, which have been met in accordance with the Company's normal policy.
4 Further details of the annual bonus scheme are provided in paragraph 4(b) above.
5 Information regarding cash in lieu of pension is provided in 4(d) above.
6 The figures relate to the period of each director's Board membership. Richard Moley and James Wyness ceased to be directors of the Company in May 2005 and May 2006 respectively. At a requisitioned Extraordinary General Meeting held on 22 December 2006, Edward Bramson, Ian Brindle, Gerard Eastman and Alex Walker were all appointed as directors of the Company and Marcus Beresford, Frederick D'Alessio, Andrew Given, Kurt Hellström and John Weston all ceased to be directors of the Company.
7 Remuneration figures above exclude fees received as a result of external appointments (see paragraph 4(f) for further details).

b) Directors' remuneration and payments to former directors – summary

	2006[1] £000	2005[1] £000
Total emoluments of all directors	1,691.8	1,442.3
Gains made on exercise of share options[2]	487.1	–
Company contribution to the Cash Plan in respect of pensions[3]	26.7	22.9
Ex gratia pension to former director[4]	3.8	5.0
	2,209.4	1,470.2

Notes
1 Figures relate to the period of each director's Board membership.
2 This relates to the exercise and sale of 1,128,000 share options by Eric Hutchinson on 18 October 2006 (see 7(b) below for further details).
3 These payments relate to approved contributions made by the Company in respect of Anders Gustafsson's participation in the Cash Plan (see 4(d) for further details).
4 This relates to an annual *ex gratia* pension to Geoff Bastians, who retired from the Board in 1984 and died during 2006.

Report on directors' remuneration continued

7. Directors' interests[1]

a) Summary of interests in Ordinary share capital

The beneficial and non-beneficial interests of the directors (and their immediate families and any connected persons) in the Ordinary share capital of the Company at the beginning and end of the year are set out below. The Company's statutory register of directors' interests contains full details of directors' shareholdings and options over shares and is available for inspection at the registered office during normal business hours on any business day.

		At 31 December 2006[2]			At 1 January 2006[2]	
	Ordinary shares beneficial[3]	Ordinary shares non-beneficial	Options and rights to acquire Ordinary shares[4]	Ordinary shares beneficial[3]	Ordinary shares non-beneficial	Options and rights to acquire Ordinary shares[4]
Executive directors[5]						
A Gustafsson	100,000	180,180[6]	4,925,750	50,000	180,180[6]	3,232,000
E Hutchinson	871,731	–	3,494,742	753,707	–	4,091,733
Non-executive directors						
M Beresford	65,225	–	–	65,225	–	–
E Bramson[7]	130,270,000	–	–	130,270,000	–	–
I Brindle	4,525	–	–	4,525	–	–
F D'Alessio	28,000	–	–	28,000	–	–
G Eastman[7]	130,250,000	–	–	130,250,000	–	–
G Ennerfelt[8]	120,000,000	–	–	120,000,000	–	–
A Given	–	–	–	–	–	–
K Hellström	–	–	–	–	–	–
A Walker	–	–	–	–	–	–
J Weston	1,662,000	–	–	1,662,000	–	–
J Wyness	346,037	–	–	346,037	–	–

Notes
1 Information relating to directors' interests in 7(a) and 7(b) has been audited by the Company's auditors.
2 The figures relate to the period of each director's Board membership. Messrs Bramson, Brindle, Eastman and Walker were appointed to the Board in December 2006. Mr Wyness retired in May 2006. Messrs Beresford, D'Alessio, Given, Hellström and Weston all ceased to be directors in December 2006.
3 Directors' beneficial holdings do not form part of the remuneration provided by the Company.
4 Options and other rights to acquire shares in respect of the executive directors include share options, stock appreciation rights and performance shares.
5 The Company's executive directors, together with other employees of the Group, are potential beneficiaries of certain Ordinary shares held in the Employee Share Ownership Trust ("ESOT"). UK executive directors, together with other employees of the Group, are also potential beneficiaries of the Spirent Sharesave Trust ("SST"). As potential beneficiaries of the ESOT and the SST, the respective directors are deemed by the Companies Act 1985 to be interested in some of the Ordinary shares held by those Trusts. At 31 December 2006, the deemed beneficial interests in the ESOT and the SST were 180,180 Ordinary shares and 1,857,576 Ordinary shares, respectively (31 December 2005 180,180 and 3,231,940, respectively). Further details on the Company's share plans are provided in note 32 to the consolidated financial statements and note 17 to the parent Company financial statements.
6 The non-beneficial interests of Anders Gustafsson arise from a conditional award over shares to a value of £100,000. The award was made in 2004 in recognition of his appointment to the Board and the shares are held in the ESOT. In normal circumstances, the shares will be released beneficially to him on the third anniversary of his appointment, subject to him still being in the Company's employment at that time.
7 Messrs Bramson and Eastman have a connected notifiable interest in the 130,250,000 Ordinary shares held by Sherborne Investors GP, LLC, which for statutory purposes, is also deemed to be an interest of the director. Mr Bramson is also the beneficial owner of 20,000 Ordinary shares.
8 Göran Ennerfelt has a connected notifiable interest in the 120,000,000 Ordinary shares held by Lexa BV, which for statutory purposes, is also deemed to be an interest of the director.

b) Options and rights to acquire Ordinary shares

	Plan type[1]	At 31 December 2006	Exercised/ lapsed during the year	Granted during the year	At 1 January 2006	Date of grant	Exercise price per share pence	Market value on date of grant pence	Date first exercisable	Expiry date
A Gustafsson	ESOS	1,800,000	–	–	1,800,000	05 Aug 04	56	56	05 Aug 07	04 Aug 14
	EIP	1,128,300	–	–	1,128,300	25 Aug 05	53	53	25 Aug 08	24 Aug 15
	EIP	303,700	–	–	303,700	25 Aug 05	nil[2]	53	25 Aug 08	25 Aug 08
	EIP	1,334,450	–	1,334,450	–	05 May 06	48	48	05 May 09	04 May 16
	EIP	359,300	–	359,300	–	05 May 06	nil[2]	48	05 May 09	05 May 09
E Hutchinson	ESOS	–	42,928[3]	–	42,928	29 Apr 96	140	140	29 Apr 99	28 Apr 06
	ESOS	33,786	–	–	33,786	23 Apr 97	118	118	23 Apr 00	22 Apr 07
	ESOS	29,586	–	–	29,586	27 Apr 98	152	152	27 Apr 01	26 Apr 08
	SRSOS	–	12,363[3]	–	12,363	22 Oct 98	83	83	01 Jan 06	30 Jun 06
	ESOS	75,156	–	–	75,156	01 Apr 99	133	133	01 Apr 02	31 Mar 09
	ESOS	–	105,000[3]	–	105,000	09 Apr 01	305	305	09 Apr 04	08 Apr 11
	SRSOS	8,693	–	–	8,693	05 Oct 01	93	93	01 Dec 08	31 May 09
	ESOS	234,000	–	–	234,000	02 Apr 02	134	134	02 Apr 05	01 Apr 12
	ESOS	387,000	–	–	387,000	02 May 02	113	113	02 May 05	01 May 12
	ESOS	–	1,128,000[4]	–	1,128,000	25 Mar 03	16	16	25 Mar 06	24 Mar 13
	SRSOS	24,721	–	–	24,721	26 Sep 03	38	38	01 Dec 10	31 May 11
	ESOS	1,128,000	–	–	1,128,000	05 Aug 04	56	56	05 Aug 07	04 Aug 14
	EIP	695,300	–	–	695,300	25 Aug 05	53	53	25 Aug 08	24 Aug 15
	EIP	187,200	–	–	187,200	25 Aug 05	nil[2]	53	25 Aug 08	25 Aug 08
	EIP	544,650	–	544,650	–	05 May 06	48	48	05 May 09	04 May 16
	EIP	146,650	–	146,650	–	05 May 06	nil[2]	48	05 May 09	05 May 09

Notes
1 Key to plan type:
EIP – 2005 Employee Incentive Plan; ESOS – 1995 Executive Share Option Scheme; SRSOS – UK Savings Related Share Option Scheme. An explanation of each plan and its operation is given in note 32 to the consolidated financial statements and note 17 to the parent Company financial statements.
2 This relates to an award of performance shares under the EIP. There is no exercise price payable for a performance share upon vesting. Further details on performance shares are provided in section 4(c) above.
3 These awards lapsed unexercised during the year.
4 Eric Hutchinson exercised 1,128,000 share options on 18 October 2006 and disposed of all the shares on the same day. The market value of an Ordinary share at the point of disposal was 59.179 pence and the gain before transaction costs, taxes, employer's and employee's national insurance was £487,061.

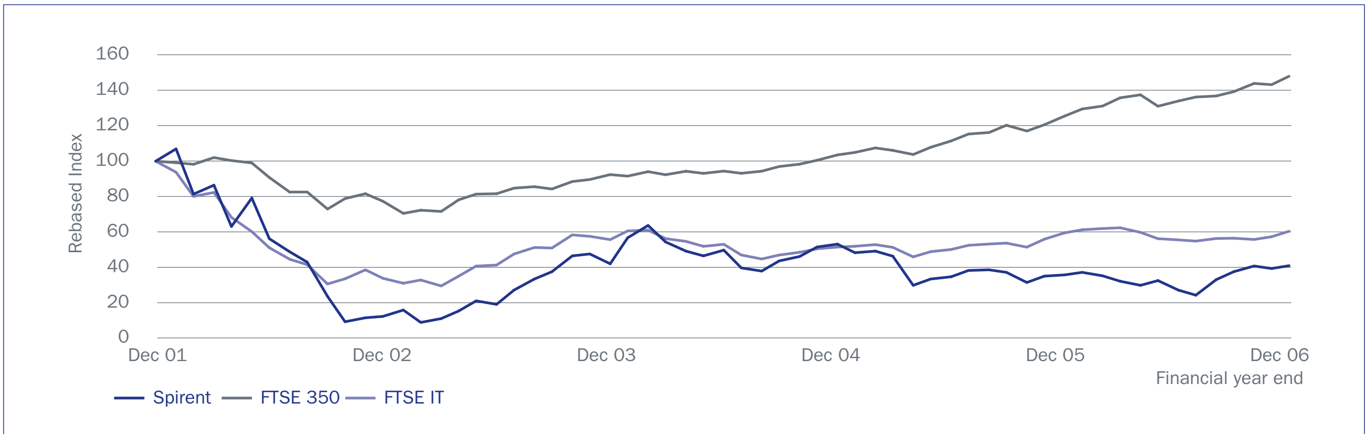
The middle market price of an Ordinary share on 3 January 2006 (being the first day the London Stock Exchange was open for trading in 2006) and 31 December 2006 was 50.0 pence and 56.75 pence, respectively, and during that period ranged between a high of 62.75 pence and a low of 33.0 pence.

Save as disclosed, there have been no changes between the year end and 1 March 2007 (the date on which the financial statements have been signed) in the directors' beneficial or non-beneficial interests in the Ordinary share or loan capital of the Company or any subsidiary.

Report on directors' remuneration continued

8. Total Shareholder Return performance

The graph below shows Total Shareholder Return ("TSR") performance (ie growth in the value of a share or index, assuming dividends and other distributions are reinvested) for the last five financial years of Spirent Communications plc as shown against the FTSE 350 Index ("FTSE 350") and the FTSE Information Technology Index ("FTSE IT"). The Committee believes that both the FTSE 350 and the FTSE IT provide broad equity market indices against which the performance of Spirent can be fairly compared, and that the FTSE IT provides a particularly representative collection of comparator companies.



9. Shareholder advisory resolution in respect of the report on directors' remuneration

In accordance with statutory requirements, an ordinary resolution to approve this Report on directors' remuneration will be proposed at the forthcoming 2007 Annual General Meeting.

Signed on behalf of the Board

Alex Walker
Chairman of the Remuneration Committee
1 March 2007

Independent auditors' report to the members of Spirent Communications plc

We have audited the Group financial statements of Spirent Communications plc for the year ended 31 December 2006 which comprise the Consolidated income statement, the Consolidated balance sheet, the Consolidated cash flow statement, the Consolidated statement of recognised income and expense and the related notes 1 to 38. These Group financial statements have been prepared under the accounting policies set out therein.

We have reported separately on the parent Company financial statements of Spirent Communications plc for the year ended 31 December 2006 and on the information in the directors' remuneration report that is described as having been audited.

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

Respective responsibilities of directors and auditors

The directors' responsibilities for preparing the Annual Report and the Group financial statements in accordance with applicable United Kingdom law and International Financial Reporting Standards (IFRSs) as adopted by the European Union are set out in the Statement of directors' responsibilities.

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

We report to you our opinion as to whether the Group financial statements give a true and fair view and whether the Group financial statements have been properly prepared in accordance with the Companies Act 1985 and Article 4 of the IAS Regulation. We also report to you whether in our opinion the information given in the directors' report is consistent with the financial statements.

In addition we report to you if, in our opinion, we have not received all the information and explanations we require for our audit, or if information specified by law regarding director's remuneration and other transactions is not disclosed.

We review whether the Corporate governance statement reflects the Company's compliance with the nine provisions of the 2003 Combined Code specified for our review by the Listing Rules of the Financial Services Authority, and we report if it does not. We are not required to consider whether the Board's statements on internal control cover all risks and controls, or form an opinion on the effectiveness of the Group's corporate governance procedures or its risk and control procedures.

We read other information contained in the Annual Report and consider whether it is consistent with the audited Group financial statements. The other information comprises only the directors' report, the Chairman's statement, the Business review and the Corporate governance statement. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the Group financial statements. Our responsibilities do not extend to any other information.

Basis of audit opinion

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

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

Opinion

In our opinion:

- the Group financial statements give a true and fair view, in accordance with IFRSs as adopted by the European Union, of the state of the Group's affairs as at 31 December 2006 and of its profit for the year then ended;
- the Group financial statements have been properly prepared in accordance with the Companies Act 1985 and Article 4 of the IAS Regulation; and
- the information given in the directors' report is consistent with the Group financial statements.

Ernst & Young LLP
Registered auditor
London

1 March 2007

Consolidated income statement

Year to 31 December	Notes	2006 £ million			2005 £ million		
		Before material one-time items and goodwill impairment	Material one-time items and goodwill impairment	Total	Before material one-time items and goodwill impairment	Material one-time items and goodwill impairment	Total
Continuing operations							
Revenue	3, 4	271.6	–	271.6	259.3	–	259.3
Cost of sales		(151.2)	–	(151.2)	(151.7)	(1.4)	(153.1)
Gross profit		120.4	–	120.4	107.6	(1.4)	106.2
Selling and distribution		(71.2)	–	(71.2)	(70.9)	–	(70.9)
Administration		(40.9)	(55.6)	(96.5)	(30.3)	(44.0)	(74.3)
Operating profit/(loss)	4	8.3	(55.6)	(47.3)	6.4	(45.4)	(39.0)
Profit on the disposal of operations	37	–	–	–	–	3.9	3.9
Profit/(loss) before interest		8.3	(55.6)	(47.3)	6.4	(41.5)	(35.1)
Finance income	8	7.6	–	7.6	1.5	–	1.5
Finance costs	9	(1.6)	–	(1.6)	(8.1)	–	(8.1)
Costs associated with the repayment of loan notes	9	–	(8.8)	(8.8)	–	–	–
Profit/(loss) before tax	4, 5	14.3	(64.4)	(50.1)	(0.2)	(41.5)	(41.7)
Tax	12	(0.9)	–	(0.9)	4.0	–	4.0
Profit/(loss) for the year from continuing operations after tax		13.4	(64.4)	(51.0)	3.8	(41.5)	(37.7)
Discontinued operations							–
Profit for the year from discontinued operations	6	2.9	156.9	159.8	19.9	(6.7)	13.2
Profit/(loss) for the year		16.3	92.5	108.8	23.7	(48.2)	(24.5)
Attributable to:							
Equity holders of parent		16.3	92.5	108.8	23.3	(48.2)	(24.9)
Minority shareholders' interests – discontinued operations		–	–	–	0.4	–	0.4
Profit/(loss) for the year		16.3	92.5	108.8	23.7	(48.2)	(24.5)
Earnings/(loss) per share (pence)	13						
Basic and diluted earnings/(loss)				11.75			(2.62)
Basic and diluted loss from continuing operations				(5.51)			(3.97)

The notes on pages 38 to 92 and page 111 form part of these financial statements.

Consolidated statement of recognised income and expense

Year to 31 December	Notes	2006 £ million	2005 £ million
Income and expense recognised directly in equity			
Gains on cash flow hedges taken to equity		–	1.9
Exchange differences on retranslation of foreign operations		(10.3)	4.1
Actuarial gains/(losses) on defined benefit pension plans	11	1.6	(16.1)
		(8.7)	(10.1)
Transfers to income statement			
Exchange gain transferred to profit on sale	37	(1.3)	–
Gains on cash flow hedges		(1.9)	(0.5)
Transfers to balance sheet			
Write off of deferred tax asset on pension liability	12	–	(11.1)
Net (expense)/income recognised directly in equity		(11.9)	(21.7)
Profit/(loss) for the year		108.8	(24.5)
Total recognised income and expense for the year	34	96.9	(46.2)
Attributable to:			
Equity holders of parent		96.9	(46.8)
Minority shareholders' interests – discontinued operations	34	–	0.6
		96.9	(46.2)

The notes on pages 38 to 92 and page 111 form part of these financial statements.

Consolidated balance sheet

At 31 December	Notes	2006 £ million	2005 £ million
Assets			
Non-current assets			
Intangible assets	14	63.3	71.5
Property, plant and equipment	15	25.3	30.1
Trade and other receivables	20	1.4	1.7
Cash on deposit	21	8.5	–
Defined benefit pension fund surplus	11	2.4	–
Deferred tax	24	1.2	1.0
		102.1	104.3
Current assets			
Inventories	19	25.4	27.0
Trade and other receivables	20	63.8	56.3
Derivative financial instruments	30	0.1	2.6
Cash and cash equivalents	21	97.6	49.2
		186.9	135.1
Assets held in disposal group held for sale	6	–	164.1
Total assets		289.0	403.5
Liabilities			
Current liabilities			
Trade and other payables	22	(61.8)	(62.9)
Current tax		(30.5)	(24.7)
Derivative financial instruments	30	–	(0.7)
Short term borrowings and overdrafts	23	–	(3.9)
Provisions and other liabilities	26	(5.9)	(4.1)
		(98.2)	(96.3)
Non-current liabilities			
Trade and other payables	25	(0.5)	(0.7)
Derivative financial instruments	30	–	(2.0)
Long term borrowings	27	–	(71.2)
Defined benefit pension fund deficit	11	(1.4)	(51.5)
Deferred tax	24	–	(0.8)
Provisions and other liabilities	26	(6.1)	(10.1)
		(8.0)	(136.3)
Liabilities included in disposal group held for sale	6	–	(48.7)
Total liabilities		(106.2)	(281.3)
Net assets		182.8	122.2
Capital and reserves			
Share capital	32, 34	32.5	32.2
Share premium account	34	10.6	4.4
Capital reserve	34	5.5	10.2
Translation reserve	34	(6.1)	5.5
Net unrealised gains and losses	34	–	1.9
Retained earnings	34	140.3	66.1
Equity holders of parent		182.8	120.3
Minority interests	34	–	1.9
Total equity		182.8	122.2

The notes on pages 38 to 92 and page 111 form part of these financial statements.

Signed on behalf of the Board

Anders Gustafsson
Director
1 March 2007

Consolidated cash flow statement

Year to 31 December	Notes	2006 £ million	2005 £ million
Cash flows from operating activities			
Cash flow from operations	35	(40.7)	34.0
Tax paid		(2.3)	(4.6)
Net cash (outflow)/inflow from operating activities		(43.0)	29.4
Cash flows from investing activities			
Dividends received from associates	18	–	0.2
Interest received		5.5	1.4
Cash on deposit		(8.5)	–
Disposal of operations	37	278.2	2.4
Purchase of intangible assets		(0.8)	–
Purchase of property, plant and equipment		(14.1)	(30.5)
Proceeds from the sale of property, plant and equipment		0.4	0.6
Acquisition of subsidiaries	36	(44.4)	–
Net cash from/(used in) investing activities		216.3	(25.9)
Cash flows from financing activities			
Interest paid		(1.4)	(7.4)
Interest element of finance lease rental payments		–	(0.5)
Costs associated with the repayment of loan notes and swap break fees		(9.5)	–
Proceeds from the issue of share capital and employee share ownership trust		2.4	2.7
On-market share repurchase	34	(41.9)	–
New borrowings		23.0	–
Repayments of borrowings		(95.7)	(0.2)
Repayments of capital element of finance lease rentals		–	(1.4)
Net cash used in financing activities		(123.1)	(6.8)
Net increase/(decrease) in cash and cash equivalents		50.2	(3.3)
Cash and cash equivalents at the beginning of year		48.8	51.0
Effect of foreign exchange rate changes		(1.4)	1.1
Cash and cash equivalents at the end of the year		97.6	48.8
Cash and cash equivalents comprise:			
Cash and cash equivalents	21	97.6	49.2
Overdrafts	23	–	(0.4)
		97.6	48.8

The notes on pages 38 to 92 and page 111 form part of these financial statements.

Notes to the consolidated financial statements

1. Corporate information

The Group's consolidated financial statements for the year ended 31 December 2006 were authorised for issue by the Board of directors on 1 March 2007. Spirent Communications plc is a public limited company incorporated and domiciled in England and Wales. The Company's Ordinary shares are traded on the London Stock Exchange and, in the form of American Depositary Shares, on the New York Stock Exchange.

As required by the European Union's IAS Regulation and the Companies Act 1985, the Group has prepared its consolidated financial statements in accordance with International Financial Reporting Standards ("IFRS") as adopted by the European Union ("EU").

2. Summary of significant accounting policies

Basis of preparation

The consolidated financial statements have been prepared under the historical cost convention modified to include revaluation to fair value of certain instruments as described below.

The Group has prepared its financial statements under IFRS. The significant accounting policies applied in the preparation of these consolidated financial statements are set out below.

Basis of consolidation

The consolidated financial statements incorporate the financial statements of the Company and its subsidiaries made up to 31 December each year. The financial statements of subsidiaries are prepared for the same reporting year as the parent Company, using consistent accounting policies.

Results of subsidiaries are consolidated from the date on which control is transferred to the Group and cease to be consolidated from the date on which control is transferred out of the Group. All intra Group transactions, balances, income and expenses are eliminated on consolidation.

Interests in associates and joint venture

The consolidated financial statements include the Group's share of profits or losses of associates and joint ventures.

Associates are those in which the Group is in a position to exercise significant influence, but not control or joint control, through participation in the operating policy decisions of the investee. Results are based on management accounts to 31 December each year. The investment in associates is accounted for using the equity method and carried in the balance sheet at cost plus post acquisition changes in the Group's share of net assets of the associate, less any impairment in value.

Jointly controlled entities in which the Group enters into a contractual arrangement to undertake an economic activity with another party or parties that is subject to joint control are treated as joint ventures. The investment in joint ventures is accounted for using the equity method. Results are based on management accounts to 31 December each year.

Goodwill

Goodwill arising on the acquisition of subsidiaries, representing the excess of cost over the net fair value of the identifiable assets, liabilities and contingent liabilities acquired, is capitalised as an intangible asset. Goodwill is carried at cost less any accumulated impairment losses.

For the purpose of impairment testing, goodwill is allocated to the related cash-generating units monitored by management, usually at business segment level or statutory company level as the case may be. Where the recoverable amount of the cash-generating unit is less than its carrying amount, including goodwill, an impairment loss is recognised in the income statement.

The carrying amount of goodwill allocated to a cash-generating unit, an operation within a cash-generating unit, an associate or jointly controlled entity is included in the profit or loss on its disposal.

Intangible assets

Intangible assets are carried at cost less accumulated amortisation and accumulated impairment losses. Separately identifiable intangible assets such as patent fees, licence fees, trademarks and customer lists and relationships are capitalised on the balance sheet only when the value can be measured reliably or the intangible asset is purchased as part of the acquisition of a business. Such intangible assets are amortised over their useful economic lives on a straight line basis. The carrying value of intangible assets is reviewed for impairment if events or changes in circumstances indicate the carrying value may not be recoverable.

Intangible assets arising on the Group's various product development projects are recognised only if all of the following conditions are met:
i) an asset is created that can be separately identified (such as software or a new process);
ii) it is probable that the asset created will generate future economic benefits;
iii) the development cost can be measured reliably;
iv) it is intended that the asset is completed and used; and
v) there is adequate financial, technical and other resources to complete, use or sell the asset.

Product development costs are expensed as incurred until the technological feasibility of the product under development has been established. Technological feasibility in Spirent's circumstances occurs when a working model is completed. For software development technological feasibility is not established until the process of developing the software is complete. After technological feasibility is established, additional costs are capitalised and amortised on a straight line basis over the estimated useful life.

Property, plant and equipment

Property, plant and equipment are stated at cost less accumulated depreciation and accumulated impairment. Depreciation is not provided on freehold land. Depreciation is provided to write off the cost, less estimated residual value, of all other assets over their estimated useful lives on a straight line basis at rates which take into account commercial conditions at their location. Usual asset lives are as follows:

Freehold buildings	50 years
Properties held under finance leases	Over the lease period
Plant and machinery	3 to 8 years
Fixtures, fittings and equipment	
Building installations	20 years or lease period if less
Fittings and equipment	3 to 8 years
Motor vehicles	3 to 5 years
Business systems software	4 years

The carrying values of property, plant and equipment are reviewed for impairment if events or changes in circumstances indicate the carrying value may not be recoverable.

Impairment of assets

The Group assesses at each reporting date whether there is an indication that an asset may be impaired. If any such indication exists, or when annual impairment testing for an asset is required, the Group makes an estimate of the asset's recoverable amount. An asset's recoverable amount is the higher of an asset's or cash-generating unit's fair value less costs to sell and its value in use and is determined for an individual asset, unless the asset does not generate cash inflows that are largely independent of those from other assets or groups of assets. Where the carrying amount of an asset exceeds its recoverable amount, the asset is considered impaired and is written down to its recoverable amount. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. Impairment losses of continuing operations are recognised in the income statement of those expense categories consistent with the function of the impaired asset.

An assessment is made at each reporting date as to whether there is any indication that previously recognised impairment losses may no longer exist or may have decreased. If such indication exists, the recoverable amount is estimated. A previously recognised impairment loss is reversed only if there has been a change in the estimates used to determine the asset's recoverable amount since the last impairment loss was recognised. If that is the case the carrying amount of the asset is increased to its recoverable amount. The increased amount cannot exceed the carrying amount that would have been determined, net of depreciation, had no impairment loss been recognised for the asset in prior years. Such reversal is recognised in the income statement. After such a reversal the depreciation charge is adjusted in future periods to allocate the asset's revised carrying amount, less any residual value, on a systematic basis over its remaining useful life.

Notes to the consolidated financial statements continued

2. Summary of significant accounting policies continued

Leases

Finance leases, which transfer substantially all the risks and rewards of ownership of the assets concerned, are capitalised on the balance sheet at the lower of fair value of the leased property and net present value of the minimum lease payments at the inception of the lease. The corresponding liabilities are recorded as long term or current liabilities depending on the period when they are due. The interest elements of the rental obligations are charged to the income statement over the periods of the leases as a finance cost. Lease payments are apportioned between the finance cost and the reduction in the lease liability so as to achieve a constant rate of interest on the remaining balance of the liability. Capitalised leased assets are depreciated over their useful life as above.

Operating leases are leases where the lessor retains substantially all the risks and rewards of ownership of the asset and are not finance leases. Operating lease rentals are charged to the income statement on a straight line basis over the period of the lease.

Inventories

Inventories are stated at the lower of cost and estimated net realisable value. Cost includes all costs in bringing each product to its present location and condition, being the full manufacturing cost on a first-in-first-out basis, including all attributable overheads based on a normal level of activity and excluding borrowing costs. Net realisable value represents selling price less further costs to be incurred to completion and on sale.

Trade and other receivables

Trade receivables, which generally have 30 to 90 day terms, are recognised and carried at original invoice amount less an allowance for any uncollectable amounts. An estimate for doubtful debts is made when collection of the full amount is no longer probable. Bad debts are written off when identified.

Cash and cash equivalents

Cash and cash equivalents in the balance sheet comprise cash at bank and in hand and short term deposits with an original maturity of three months or less.

For the purposes of the consolidated cash flow statement, cash and cash equivalents consist of cash and cash equivalents as defined above, net of outstanding bank overdrafts.

Provisions

Provisions are recorded when the Group has a present, legal or constructive obligation as a result of a past event which it is probable that the Group will be required to settle by an outflow of resources and for which a reliable estimate of the amount of the obligation can be made. Provisions are reviewed at each balance sheet date and adjusted to reflect the current best estimate.

Where the effect of the time value of money is material, the amount of the provision shall be the present value of the expenditures expected to be required to settle the obligation.

Foreign currencies

The consolidated financial statements are presented in pounds sterling, which is the Company's functional and presentation currency.

Transactions in foreign currencies are recorded at the rates of exchange prevailing on the dates of the transactions. Monetary assets and liabilities denominated in foreign currencies are translated at the rates ruling at the balance sheet date. Non-monetary assets and liabilities denominated in foreign currencies are measured in terms of historical costs using the exchange rate at the date of the initial transactions.

The functional currencies of the Group's operations are principally US dollar, sterling or euro.

On consolidation the assets and liabilities of the Group's foreign operations are translated into the Group's presentation currency at exchange rates prevailing at the balance sheet date. The results of foreign operations are translated into sterling using average rates.

Equity investments in foreign operations include long term intra group loans, the settlement of which is neither planned nor likely to occur in the foreseeable future. Exchange differences arising from the retranslation of opening net assets of foreign investments and exchange adjustments arising from the translation of the results of foreign operations, are classified as equity and transferred to the Group's translation reserve. Such translation differences are recognised as part of the profit or loss on disposal should an operation be disposed of. The Group has elected to apply the exemption in IFRS 1 'First Time Adoption of International Financial Reporting Standards' which allows the cumulative translation differences for all foreign operations to be deemed to be zero at the date of transition to IFRS, being 1 January 2003. The gain or loss on the subsequent disposal of any foreign operation therefore excludes translation differences that arose before the date of transition.

Goodwill and fair value adjustments arising on the acquisition of a foreign entity are treated as assets and liabilities of the foreign entity and translated at closing rates of exchange. As permitted by IFRS 1 the Group has elected to treat goodwill and fair value adjustments arising on acquisitions prior to the date of transition to IFRS as an asset of the parent, and as such these are sterling denominated.

All other exchange profits and losses are taken to the income statement, with the exception of differences on foreign currency borrowings that provide an effective hedge against the Group's equity investments in foreign operations, which are taken to equity together with the exchange differences on assets and liabilities of foreign operations.

Financial instruments

Financial assets and liabilities are recognised on the Group's balance sheet when it becomes a party to the contractual provisions of the instrument.

Interest-bearing loans and borrowings

Loans and overdrafts are initially recognised at fair value of the consideration received, net of issue costs.

After initial recognition, interest-bearing loans and borrowings are subsequently measured at amortised cost using the effective interest method. Amortised cost is calculated by taking into account any issue costs and any discount or premium on settlement.

Hedge accounting is adopted where derivatives such as "fixed to floating" interest rate swaps are held as fair value hedges against fixed interest rate borrowings. Under fair value hedge accounting, fixed interest rate borrowings are revalued at each balance sheet date by the change in the fair value attributable to the interest rate risk being hedged.

Equity instruments

Equity instruments are recorded at the proceeds received, net of direct issue costs.

Derivative financial instruments

The Group uses derivative financial instruments to hedge its exposures to fluctuations in interest and foreign exchange rates. The Group's policy is not to undertake any trading activity in financial instruments. Such derivative financial instruments are stated at fair value.

Such derivative financial instruments are initially recognised at fair value on the date on which a derivative contract is entered into and are subsequently remeasured at fair value. Derivatives are carried as assets when the fair value is positive and as liabilities when the fair value is negative.

For those derivatives designated as hedges and for which hedge accounting is desired, the hedging relationship is documented at its inception. This documentation identifies the hedging instrument, the hedged item or transaction, the nature of the risk being hedged and how effectiveness will be measured throughout its duration. Such hedges are expected at inception to be highly effective.

Forward exchange contracts are used to hedge foreign exchange exposures arising on forecast receipts and payments in foreign currencies. The fair value of forward exchange contracts is calculated by reference to current forward exchange rates for contracts with similar maturity profiles. Interest rate swaps are used to hedge the Group's exposure to movements in interest rates. The fair value of interest rate swaps is determined by reference to market rates for similar instruments.

For the purpose of hedge accounting, hedges are classified as fair value hedges when they hedge the exposure to changes in the fair value of a recognised asset or liability, or cash flow hedges where they hedge exposure to the variability in cash flows that is due to the risk associated with a recognised asset or liability or a forecast transaction. The Group discontinues hedge accounting if the hedging instrument expires or is sold, terminated or exercised, the hedge no longer meets the criteria for hedge accounting or the Group revokes the designation.

Notes to the consolidated financial statements continued

2. Summary of significant accounting policies continued

In relation to these fair value hedges (interest rate swaps) which meet the conditions for hedge accounting, any gain or loss from remeasuring the hedging instrument is recognised in the income statement and any gain or loss on the item that is being hedged is adjusted against its carrying amount and recognised in the income statement.

In relation to cash flow hedges (forward foreign exchange contracts) to hedge firm commitments or highly probable forecast transactions and which meet the conditions for hedge accounting, the proportion of the gain or loss on the remeasurement of the fair value of the hedging instrument that is deemed to be effective is recognised in equity and the ineffective portion is recognised in the income statement.

When the firm commitment or highly probable forecast transaction results in the recognition of a non-financial asset or a non-financial liability, the associated gains and losses that have previously been recognised in equity are included in the initial measurement of the carrying amount of the asset or liability at the time the asset or liability is recognised.

For derivatives that do not qualify for hedge accounting, any gains or losses arising from changes in fair value are taken to the income statement.

Gains or losses arising on hedging instruments, which are cancelled due to termination of the underlying exposure, are taken to the income statement immediately.

Derivatives embedded in other financial instruments or other host contracts are treated as separate derivatives when their risks and characteristics are not closely related to those of the host contracts.

Pensions

In the UK, the Group operates two defined benefit pension schemes for the benefit of employees. These schemes require contributions to be made to separately administered funds, based on triennial actuarial valuations. There is also a defined benefit scheme in Switzerland. Other schemes are defined contribution in nature.

The cost of providing benefits under the defined benefit pension schemes is determined separately for each scheme using the projected unit credit method, which attributes entitlement to benefits to the current period (to determine current service cost) and to the current and prior periods (to determine the present value of defined benefit obligations) and is based on actuarial advice. Past service costs are recognised in the income statement on a straight line basis over the vesting period or immediately if the benefits have vested. When a settlement (eliminating all obligations for benefits already accrued) or a curtailment (reducing future obligations as a result of a material reduction in the scheme membership or a reduction in future entitlement) occurs the obligation and related scheme assets are remeasured using current actuarial assumptions and the resultant gain or loss recognised in the income statement during the period in which the settlement or curtailment occurs.

The interest element of the defined benefit cost represents the change in present value of scheme obligations resulting from the passage of time and is determined by applying the discount rate to the opening present value of the benefit obligation, taking into account material changes in the obligation during the year. The expected return on scheme assets is based on an assessment made at the beginning of the year of long term market returns on scheme assets, adjusted for the effect on the fair value of scheme assets of contributions received and benefits paid during the year. The difference between the expected return on scheme assets and the interest cost is recognised in the income statement.

Actuarial gains and losses are recognised in full in the statement of recognised income and expense in the period in which they occur.

The defined benefit pension asset or liability in the balance sheet comprises the total for each scheme of the present value of the defined benefit obligation (using a discount rate based on high quality corporate bonds), less any past service cost not yet recognised and less the fair value of scheme assets out of which the obligations are to be settled directly. Fair value is based on market price information and, in the case of quoted securities, is the published bid price. The value of a net pension benefit asset is restricted to the sum of any unrecognised past service costs and the present value of any amount the Group expects to recover by way of refunds from the scheme or reductions in the future contributions.

Contributions payable to the defined contribution schemes are charged to the income statement in the year for which they are due.

Treasury shares

Spirent Communications plc shares held by the Group are classified in shareholders equity as treasury shares and are recognised at cost and shown as a deduction from retained earnings. Consideration received for the sale of such shares is also recognised in equity, with any difference between the proceeds from sale and the original cost being taken to retained earnings.

Revenue recognition

Revenue is recognised when it is probable that economic benefits will flow to the Group, the revenue can be reliably measured and when the Group has transferred to the buyer the significant risks and rewards of ownership. In addition, revenue is only recognised when collectability is probable.

For the sale of services, revenue is recognised in accounting periods in which the service is rendered. Revenue from maintenance contracts is recognised over the period of performance on a straight line basis.

Revenue from product sales of hardware and software is recognised at the time of delivery and acceptance and when there are no significant vendor obligations remaining. It is not until acceptance has occurred that the risks and rewards of ownership are transferred to the buyer. Terms of acceptance are dependent upon the specific contractual arrangement agreed with the customer.

Contractual arrangements are accounted for as two or more separate transactions only where the commercial substance is that the individual components operate independently of each other because they are capable of being provided separately from one another and it is possible to attribute reliable fair values to every component. To the extent that a separate component comprises a product sale of hardware or software, revenue is recognised as described above. Revenue is recognised on other components as the Group fulfils its contractual obligations and to the extent that it has earned the right to consideration.

Employee benefits

When an employee has rendered services to the Group during an accounting period, short term benefits expected to be paid in exchange for those services are recognised in the same accounting period.

Share-based payment

Employees (including directors) of the Group receive remuneration in the form of share-based payment transactions, whereby employees render services in exchange for shares or rights over shares (equity-settled transactions).

The cost of equity-settled transactions with employees is measured by reference to the fair value at the date at which they are granted. The fair value is determined using a binomial model.

The cost of equity-settled transactions is recognised, together with a corresponding increase in equity, over the period in which the performance conditions are fulfilled, ending on the date on which the relevant employees become fully entitled to the award (vesting date). The cumulative expense recognised for equity-settled transactions at each reporting date, until the vesting date, reflects the extent to which the vesting period has expired and the number of awards that will ultimately vest, in the opinion of the directors of the Company at that date and based on the best available estimates.

No expense is recognised for awards that do not ultimately vest, except for awards where vesting is conditional upon a market condition, which are treated as vesting irrespective of whether or not the market condition is satisfied, provided that all other performance conditions are satisfied.

Where the terms of an equity-settled award are modified, as a minimum an expense is recognised as if the terms had not been modified. In addition, an expense is recognised for any increase in the value of the transaction as a result of the modification, as measured at the date of modification.

Where an equity-settled award is cancelled, it is treated as if it had vested on the date of cancellation and any expense not yet recognised for the award is recognised immediately. However, if a new award is substituted for the cancelled award and designated as a replacement award on the date that it is granted, the cancelled and new awards are treated as if they were a modification of the original award, as described in the previous paragraph.

The dilutive effect of outstanding options is reflected in the computation of diluted earnings per share.

The Group has an employee share trust for the granting of certain options to employees. Shares in the Group held by the employee share trust are treated as treasury shares and presented in the balance sheet as a deduction from equity.

The Group took advantage of the transitional provisions of IFRS 1 in respect of equity-settled awards and has applied IFRS 2 ‘Share-based Payment’ only to equity-settled awards granted after 7 November 2002 which were unvested at 1 January 2005.

Notes to the consolidated financial statements continued

2. Summary of significant accounting policies continued

Tax

Current tax assets and liabilities are measured at the amount expected to be recovered from or paid to the taxation authorities, based on tax rates and laws that are enacted or substantively enacted by the balance sheet date.

Deferred income tax is recognised on all temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the financial statements, with the following exceptions:

– where the temporary difference arises from the initial recognition of goodwill or of an asset or liability in a transaction that is not a business combination that at the time of the transaction affects neither accounting nor taxable profit or loss;

– in respect of taxable temporary differences associated with investments in subsidiaries, associates and joint ventures, where the timing of the reversal of the temporary differences can be controlled and it is probable that the temporary differences will not reverse in the foreseeable future; and

– deferred income tax assets are recognised only to the extent that it is probable that taxable profit will be available against which the deductible temporary differences, carried forward tax credits or tax losses can be utilised.

Deferred income tax assets and liabilities are measured on an undiscounted basis at the tax rates that are expected to apply when the related asset is realised or liability is settled, based on tax rates and laws enacted or substantively enacted at the balance sheet date.

Income tax is charged or credited directly to equity if it relates to items that are credited or charged to equity. Otherwise income tax is recognised in the income statement.

Critical accounting assumptions and judgements

The preparation of financial statements requires the Group to make estimates and assumptions that affect items reported. Such estimates and assumptions are based on management's best knowledge of current facts, circumstances and future events, actual results may differ, possibly significantly, from those estimates. The areas requiring a high degree of judgement or where assumptions and estimates are significant to the consolidated financial statements are discussed below.

Goodwill impairment

The Group tests annually by cash-generating unit whether goodwill has suffered impairment and more frequently when events or circumstances indicate that the current carrying value may not be recoverable. The recoverable amounts of cash-generating units have been determined based on value in use calculations which require the use of estimates and assumptions. These are described in note 14.

Defined benefit pension schemes

The pension cost and the defined benefit obligation of the Group's defined benefit pension schemes is based on a number of selected assumptions, these include the discount rate, inflation rate, salary growth, longevity and expected return on the schemes' assets. Differences arising from actual experience or future changes in assumptions will be reflected in future periods.

Income taxes

The Group is subject to income taxes in a number of tax jurisdictions and judgement is applied in determining the worldwide provision for income taxes. There are many transactions for which the final tax determinability is uncertain. For example liabilities are recognised for anticipated tax audit issues based on whether additional taxes are likely to be due based on the facts and circumstances known at the time the financial statements are prepared. Where the final outcome differs from the amounts that were initially recorded the differences will be recorded in the future period in which the determination is made.

Deferred taxes

The extent to which deferred tax assets can be recognised is based on current forecasts and estimates prepared by management. A change to these forecasts and estimates could result in a different recognition outcome.

Provisions

The Group records a provision for vacant property based on future rentals and reduced by its expected ability to sublease the vacant space to a third party and discounted where the effect is significant. Changes in the actual outcome compared with expected outcome on subleasing or changes to expectations will be recorded in future periods.

New standards and interpretations not applied

During the year, the IASB and IFRIC have issued the following standards and interpretations with an effective date for the Group after the date of these financial statements:

International Accounting Standards ("IAS/IFRS")		Effective date
IFRS 7	Financial Instruments: Disclosures	1 January 2007
IAS 1	Amendment – Presentation of Financial Statements: Capital Disclosures	1 January 2007
IFRS 8	Operating Segments	1 January 2009
IFRIC 8	Scope of IFRS 2	1 January 2007
IFRIC 9	Reassessment of embedded derivatives	1 January 2007
IFRIC 10	Interim Financial Reporting and Impairment	1 January 2007
IFRIC 11	IFRS 2 Group and Treasury Share Transactions	1 January 2008
IFRIC 12	Service Concession Arrangements	1 January 2008

The directors do not anticipate that the adoption of these standards and interpretations will have a material impact on the Group's financial statements in the period of initial application.

Upon adoption of IFRS 7, the Group will have to disclose additional information about its financial instruments, their significance and the nature and extent of risks that they give rise to. More specifically, the Group will need to disclose the fair value of its financial instruments and its risk exposure in greater detail. There will be no effect on reported income or net assets.

Upon adoption of IFRIC 8, the Group will be required under IFRS 2 to disclose any arrangements where equity instruments are issued for consideration which appears to be less than fair value.

3. Revenue

	2006 £ million	2005 £ million
Sales of goods	235.5	228.8
Maintenance and support services	36.1	30.5
Total revenue from continuing operations	271.6	259.3

Revenues for discontinued operations principally relate to sales of goods.

4. Segmental analysis

The Group's primary reporting format is business segments and its secondary format is geographical segments.

Business segments

For management purposes, the Group is currently organised on a worldwide basis into two operating groups, Communications and Systems. Communications is further subdivided into two divisions Performance Analysis and Service Assurance. The Network Products group was disposed of during the current reporting period and, as described in note 6, this group together with the investment in associated companies ("HellermannTyton Division") has been classified as a discontinued operation. The remaining three operating segments are the basis on which the Group reports its primary segment information.

The principal activities of each segment are as follows:

– Performance Analysis division of the Communications group develops testing solutions for a broad range of Communications technologies critical to the development of next-generation network equipment and devices;

– Service Assurance division of the Communications group provides network monitoring and management systems for service providers to assure the quality of their high bandwidth data services. Sales include hardware and software products as well as maintenance and support services; and

– Systems group comprises PG Drives Technology, which develops power control systems for specialist electrical vehicles in the mobility and industrial markets.

Notes to the consolidated financial statements continued

4. Segmental analysis continued

Non-segmental costs represent corporate expenses, non-segmental assets comprise cash and cash equivalents held for central treasury purposes and other corporate assets and non-segmental liabilities represent senior unsecured loan notes, defined benefit pension fund deficit, tax payable and other corporate liabilities.

2006
£ million

	Performance Analysis	Service Assurance	Communications total	Systems	Non-segmental	Continuing operations Total	Discontinued operations Network Products	Total operations
Revenue								
External sales	192.2	43.6	235.8	35.8	–	271.6	28.0	299.6

There were no inter-segment sales.

	Performance Analysis	Service Assurance	Communications total	Systems	Non-segmental	Continuing operations Total	Discontinued operations Network Products	Total operations
Profit/(loss)								
Operating profit/(loss) before material one-time items and goodwill impairment	10.5	(1.1)	9.4	4.7	(5.8)	8.3	3.0	11.3
Material one-time items *note 7*	(3.8)	(5.3)	(9.1)	–	0.3	(8.8)	–	(8.8)
Goodwill impairment *note 14*	(27.7)	(19.1)	(46.8)	–	–	(46.8)	–	(46.8)
Operating profit/(loss)	(21.0)	(25.5)	(46.5)	4.7	(5.5)	(47.3)	3.0	(44.3)
Share of profit of associates	–	–	–	–	–	–	0.1	0.1
Operating profit/(loss) of the Group and associates	(21.0)	(25.5)	(46.5)	4.7	(5.5)	(47.3)	3.1	(44.2)
Profit on the disposal of operations						–	166.1	166.1
Finance income						7.6	–	7.6
Finance costs						(1.6)	(0.1)	(1.7)
Costs associated with the repayment of loan notes						(8.8)	–	(8.8)
Profit/(loss) before tax						(50.1)	169.1	119.0
Tax						(0.9)	(9.3)	(10.2)
Profit/(loss) after tax for the year						(51.0)	159.8	108.8
Other information								
Product development	45.5	9.5	55.0	2.3	–	57.3	0.7	58.0
Share-based payment *note 33*	3.6	1.2	4.8	0.1	0.3	5.2	0.4	5.6
Intangible amortisation *note 14*	1.6	–	1.6	–	–	1.6	–	1.6
Capital expenditure *note 15*	11.4	0.9	12.3	0.3	–	12.6	1.5	14.1
Depreciation *note 15*	9.8	1.4	11.2	0.5	0.1	11.8	1.6	13.4
Assets								
Segment assets	159.7	8.6	168.3	12.5	108.2	289.0	–	289.0
Liabilities								
Segment liabilities	(46.5)	(7.8)	(54.3)	(3.7)	(48.2)	(106.2)	–	(106.2)
Net assets	113.2	0.8	114.0	8.8	60.0	182.8	–	182.8

2005
£ million

	Performance Analysis	Service Assurance	Communications total	Systems	Non-segmental	Continuing operations Total	Discontinued operations Network Products	Total operations
Revenue								
External sales	178.8	42.8	221.6	37.7	–	259.3	205.5	464.8
Inter-segment sales	–	0.1	0.1	–	–	0.1	–	0.1
Segment revenue	178.8	42.9	221.7	37.7	–	259.4	205.5	464.9
Inter-segment sales are charged at prevailing market rates.								
Profit/(loss)								
Operating profit/(loss) before material one-time items and goodwill impairment	18.4	(10.8)	7.6	4.3	(5.5)	6.4	24.8	31.2
Material one-time items *note 7*	(2.5)	(5.4)	(7.9)	–	(0.5)	(8.4)	(0.4)	(8.8)
Goodwill impairment *note 14*	–	(37.0)	(37.0)	–	–	(37.0)	–	(37.0)
Operating profit/(loss)	15.9	(53.2)	(37.3)	4.3	(6.0)	(39.0)	24.4	(14.6)
Share of profit of associates	–	–	–	–	–	–	2.7	2.7
Operating profit/(loss) of the Group and associates	15.9	(53.2)	(37.3)	4.3	(6.0)	(39.0)	27.1	(11.9)
Profit/(loss) on the disposal of operations						3.9	(6.7)	(2.8)
Finance income						1.5	0.1	1.6
Finance costs						(8.1)	(1.2)	(9.3)
Profit/(loss) before tax						(41.7)	19.3	(22.4)
Tax						4.0	(6.1)	(2.1)
Profit/(loss) after tax for the year						(37.7)	13.2	(24.5)
Other information								
Product development	42.1	14.0	56.1	2.3	–	58.4	4.4	62.8
Share-based payment *note 33*	3.6	1.2	4.8	0.1	0.2	5.1	0.5	5.6
Capital expenditure *note 15*	12.1	1.9	14.0	0.7	0.1	14.8	18.2	33.0
Depreciation *note 15*	9.0	1.6	10.6	0.5	0.3	11.4	11.2	22.6
Assets								
Segment assets	139.0	32.4	171.4	13.7	54.3	239.4	148.0	387.4
Investment in associates	–	–	–	–	–	–	16.1	16.1
Total assets	139.0	32.4	171.4	13.7	54.3	239.4	164.1	403.5
Liabilities								
Segment liabilities	(41.0)	(12.9)	(53.9)	(4.9)	(177.6)	(236.4)	(44.9)	(281.3)
Net assets	98.0	19.5	117.5	8.8	(123.3)	3.0	119.2	122.2

Notes to the consolidated financial statements continued

4. Segmental analysis continued

Geographical segments

The Group manages its business segments on a global basis and the operations are based in three main geographical areas. The following table presents external revenue and other information regarding the Group's geographical segments and is based on the location of the customer and the geographical area in which the assets are located.

	2006 £ million	2005 £ million
Revenue by market		
Continuing operations		
Europe	54.6	43.0
North America	153.0	158.2
Asia Pacific, Rest of Americas, Africa	64.0	58.1
	271.6	259.3
Discontinued operations		
Europe	16.4	122.8
North America	5.8	42.0
Asia Pacific, Rest of Americas, Africa	5.8	40.7
	28.0	205.5
	299.6	464.8
Revenue by source		
Continuing operations		
Europe	76.5	61.2
North America	175.9	180.9
Asia Pacific, Rest of Americas, Africa	19.2	17.2
	271.6	259.3
Discontinued operations		
Europe	17.5	131.0
North America	5.7	40.3
Asia Pacific, Rest of Americas, Africa	4.8	34.2
	28.0	205.5
	299.6	464.8

	2006 £ million	2005 £ million
Geographical assets		
Continuing operations		
Europe	144.1	76.6
North America	136.6	156.5
Asia Pacific, Rest of Americas, Africa	8.3	6.3
	289.0	239.4
Discontinued operations		
Europe	–	92.3
North America	–	32.1
Asia Pacific, Rest of Americas, Africa	–	39.7
	–	164.1
	289.0	403.5
Capital expenditure		
Continuing operations		
Europe	1.2	1.9
North America	10.2	12.6
Asia Pacific, Rest of Americas, Africa	1.2	0.3
	12.6	14.8
Discontinued operations		
Europe	0.7	11.1
North America	0.7	3.2
Asia Pacific, Rest of Americas, Africa	0.1	3.9
	1.5	18.2
	14.1	33.0

Notes to the consolidated financial statements continued

5. Profit/(loss) before tax

The following items have been included in arriving at profit/(loss) before tax and are disclosed for continuing and discontinued operations:

	2006 £ million	2005 £ million
Employee benefit costs *note 10*	129.6	176.7
Costs of inventories recognised as an expense	81.2	133.9
Write-down of inventories to net realisable value	1.2	2.8
Goodwill impairment *note 14*	46.8	37.0
Amortisation of intangible assets *note 14*	1.6	–
Depreciation of property, plant and equipment		
Owned assets	13.4	22.3
Under finance leases	–	0.3
Loss on disposal of property, plant and equipment	0.5	–
Operating leases		
Minimum lease payments	8.7	8.5
Sublease income	(1.4)	(1.4)
Product development costs	58.0	62.8
Net foreign exchange charge/(credit)	0.5	(0.1)

Services provided to all of the operations of the Group by the auditor, Ernst & Young LLP, and its associates

	2006 £ million	2005 £ million
Audit services		
Statutory audit	0.6	0.9
Other fees to auditors		
Local statutory audits for subsidiaries	0.1	0.1
Other services pursuant to legislation	1.1	0.5
Other services relating to tax	0.2	0.2
Other fees relating to corporate finance transactions	0.1	0.1
	1.5	0.9
	2.1	1.8

A description of the work of the Audit Committee is set out in the directors' statement on corporate governance and includes an explanation of how auditor objectivity and independence is safeguarded when non-audit services are provided by the auditors.

6. Discontinued operations

On 15 December 2005 the Board accepted a formal offer from funds controlled by Doughty Hanson & Co Limited for the HellermannTyton Division. This transaction was approved by shareholders at an Extraordinary General Meeting held on 24 January 2006. The disposal was completed on 15 February 2006. At 31 December 2005 the HellermannTyton Division was classified as a disposal group held for sale.

The results for discontinued operations are presented below:

	2006 £ million	2005 £ million
Revenue	28.0	205.5
Cost of sales	(16.6)	(120.7)
Gross profit	11.4	84.8
Expenses	(8.4)	(60.4)
Operating profit	3.0	24.4
Share of profit of associates	0.1	2.7
Profit on the disposal of operations *note 37*	166.1	(6.7)
Finance income *note 8*	–	0.1
Finance costs *note 9*	(0.1)	(1.2)
Profit before tax from discontinued operations	169.1	19.3
Tax *note 12*	(0.1)	(6.1)
Tax on the disposal of operations *note 12*	(9.2)	–
Profit for the year from discontinued operations	159.8	13.2

Expenses in 2005 include £0.4 million in respect of material one-time items for restructuring.

The major classes of assets and liabilities of the discontinued operations measured at the lower of carrying amount and fair value less costs to sell at 31 December 2005 were as follows:

	2005 £ million
Assets	
Goodwill *note 14*	5.5
Property, plant and equipment *note 15*	70.9
Investment in associates *note 18*	16.1
Inventories	33.7
Trade and other receivables	37.9
Assets held in disposal group held for sale	164.1
Liabilities	
Trade and other payables	(35.2)
Current tax	(1.9)
Short term borrowings – finance lease obligations	(0.9)
Long term borrowings – finance lease obligations £8.1 million, other loans £0.7 million	(8.8)
Deferred tax	(1.9)
Liabilities included in disposal group held for sale	(48.7)
Net assets attributable to discontinued operations	115.4

Notes to the consolidated financial statements continued

6. Discontinued operations continued

The net cash flows after tax of the Network Products group are as follows:

	2006 £ million	2005 £ million
Operating	(0.6)	31.2
Investing	(1.4)	(15.1)
Financing	(0.1)	(2.4)
Net cash inflow	(2.1)	13.7

7. Material one-time items

	2006 £ million	2005 £ million
Inventory provisions	–	1.4
Restructuring costs	9.1	6.9
EGM costs	2.0	–
Curtailment and settlement gains on defined benefit pension scheme *note 11*	(1.7)	–
Release of provisions for previous years disposals	(0.6)	–
Exit from joint venture	–	0.1
	8.8	8.4

The Group defines material one-time items as those items which, by virtue of their size or nature, would distort the comparability of the Group's results from year to year.

Material one-time items relating to discontinued operations for 2005 are shown in note 6.

Restructuring costs

Major restructuring actions were taken in June and in October 2006 in both the Performance Analysis and Service Assurance divisions. Restructuring costs include severance costs of £5.9 million (2005 £4.0 million), impairment of property, plant and equipment of £0.8 million, inventory write down of £0.4 million and onerous lease provisions in respect of the separable vacant space of £2.0 million (2005 £2.9 million).

EGM costs

In November 2006 the Company received a notice of requisition from certain shareholders requesting that the Company convene an Extraordinary General Meeting to consider the removal of three of its non-executive directors and the appointment of four proposed new ones. The costs incurred in relation to this action were £2.0 million.

Curtailment and settlement gains

During 2006 an offer was made to active and deferred members of the Spirent Staff Plan giving them the opportunity to leave the Staff Plan and take an enhanced transfer value. A significant number of members accepted this offer giving rise to a settlement gain of £0.5 million and a curtailment gain of £1.2 million.

Release of provisions for previous years disposals

Provisions were released that related to disposals of operations in prior years which were no longer required.

8. Finance income

	2006 £ million	2005 £ million
Continuing operations		
Bank interest receivable	5.6	1.5
Defined benefit pension schemes *note 11*	2.0	–
	7.6	1.5
Discontinued operations *note 6*		
Bank interest receivable	–	0.1
	7.6	1.6

9. Finance costs

	2006 £ million	2005 £ million
Continuing operations		
Bank loans and overdrafts	0.6	0.1
Senior unsecured loan notes	0.7	6.6
	1.3	6.7
Defined benefit pension schemes *note 11*	–	1.1
Leasehold provisions discount adjustment *note 26*	0.3	0.3
Finance cost before costs associated with the repayment of loan notes and swap break fees	1.6	8.1
Material one-time items		
Swap break fees net of fair value adjustment	1.6	–
Costs associated with the repayment of loan notes	7.2	–
Costs associated with the repayment of loan notes and swap break fees	8.8	–
Continuing operations	10.4	8.1
Discontinued operations *note 6*		
Bank loans and overdrafts	0.1	0.4
Finance leases	–	0.5
Other	–	0.3
	10.5	9.3

Interest charged using the effective rate interest method was £1.4 million (2005 £7.9 million).

In February 2006 the Company repaid the senior loan notes out of the proceeds of the sale of the HellermannTyton Division. A make-whole amount of $13.9 million (£7.2 million) was paid due to the loan notes being repaid prior to their maturity date. In addition interest rate swaps, which hedged the interest rate exposure on the loan notes, were broken incurring a break fee of £2.3 million. The above material one-time finance charge of £8.8 million is net of fair value adjustments.

Notes to the consolidated financial statements continued

10. Employees

The average number of people employed by the Group during the year was:

	2006 Number	2005 Number
Manufacturing	1,348	2,504
Selling and distribution	801	1,436
Administration	286	438
	2,435	4,378

Employee benefit costs were:

	£ million	£ million
Remuneration	110.9	148.1
Social security costs	9.2	16.9
Pension and other related costs	3.9	6.1
Expense of share-based payment *note 33*	5.6	5.6
	129.6	176.7

Employee numbers and costs include discontinued operations up to the date of disposal.

Please refer to the Report on directors' remuneration on pages 26 to 32 for disclosures relating to the emoluments, share option and long term incentive interests and pensions of the directors.

11. Pensions

Defined benefit schemes

The significant defined benefit pension schemes are in the United Kingdom and comprise the Staff Pension Plan and the Retirement Cash Plan. These schemes have been combined for the purposes of the following disclosures. There is a less significant scheme in Switzerland which is disclosed separately.

The assets and liabilities on the balance sheet are as follows:

	2006 £ million	2005 £ million
Assets		
UK defined benefit pension plan surplus	2.4	–
Liabilities		
UK defined benefit plan deficit	–	(50.8)
UK unfunded plan	(0.7)	(0.7)
Overseas defined benefit plan deficit	(0.7)	–
Defined benefit pension plan deficit	(1.4)	(51.5)

UK defined benefit pension schemes

The most recent actuarial valuation of schemes' assets and the present value of the defined benefit schemes' obligations using the projected unit credit method at 1 April 2003 have been used and updated by our independent actuaries.

The triennial actuarial valuations of the schemes at 1 April 2006 are currently in progress.

i) The key financial assumptions

	2006 %	2005 %
Inflation	3.1	2.9
Rate of increase in pensionable salaries	3.8	3.6
Rate of increase for pensions in payment pre 2001 service	3.5	3.5
Rate of increase for pensions in payment post 2001 pre April 2005 service	3.1	2.8
Rate of increase for pensions post April 2005 service	2.3	2.1
Rate of increase in deferred pensions	3.1	2.9
Rate used to discount scheme liabilities	5.2	4.7
Expected rate of return on scheme assets	6.1	6.4

The expected long term rate of return on assets has been set reflecting the price inflation expectation, the expected real return on each major asset class and the long term asset allocation strategy adopted for the schemes.

The mortality assumptions are based on standard mortality tables which allow for future mortality improvements. The assumptions used imply that a member who retires in 2026 at age 65 will live on average for a further 22 years after retirement if they are male and for a further 24 years after retirement if they are female.

ii) The assets and the liabilities in the schemes

	Long term rate of return expected %	2006 £ million	Long term rate of return expected %	2005 £ million
Equities	8.0	65.9	7.6	77.2
Government bonds	4.5	67.7	4.1	22.1
Corporate bonds	5.0	11.3	4.5	13.4
Cash	5.2	1.7	4.8	2.1
Property	7.0	6.3	6.6	5.5
Other	5.7	7.7	5.2	8.5
Fair value of schemes' assets	6.1	160.6	6.4	128.8
Present value of defined benefit pension schemes' obligations		(158.2)		(179.6)
Net surplus/(deficit) in the schemes		2.4		(50.8)

The schemes are prohibited from investing in Spirent's own financial instruments.

Notes to the consolidated financial statements continued

11. Pensions continued

iii) Analysis of the amounts charged to the income statement

	2006 £ million	2005 £ million
Analysis of amount charged to operating costs		
Current service cost	1.0	2.0
Curtailment gains on disposal of operations	(0.5)	–
Other curtailment gains	(1.2)	–
Settlement gains	(0.5)	–
Total operating (credit)/charge	(1.2)	2.0
Analysis of amount (credited)/charged to finance (income)/costs		
Expected return on pension schemes' assets	(10.0)	(6.5)
Interest on pension schemes' liabilities	8.0	7.6
Finance (income)/expense	(2.0)	1.1
Net (credit)/charge	(3.2)	3.1

iv) Analysis of amount recognised directly in the statement of recognised income and expense

	2006 £ million	2005 £ million
Actual return on pension schemes' assets	10.5	21.1
Expected return on pension schemes' assets	(10.0)	(6.5)
Experience gains on the schemes' assets	0.5	14.6
Experience gains/(losses) arising on the schemes' liabilities	(10.0)	4.8
Changes in assumptions underlying the present value of the schemes' liabilities	11.6	(35.5)
Actuarial gain/(loss) recognised directly in equity	2.1	(16.1)

The cumulative amount of actuarial gains and losses recognised since 1 January 2003 in the Group's statement of recognised income and expense is £10.7 million loss (2005 £12.8 million loss). The directors are unable to determine how much of the pension scheme deficit recognised on 1 January 2003 and taken directly to equity of £41.9 million in the Group is attributable to actuarial gains and losses since inception of those pension schemes. Consequently, the directors are unable to determine the amount of actuarial gains and losses that would have been recognised in the Group's statement of recognised income and expense before 1 January 2003.

v) Movements in the present value of defined benefit obligations

	2006 £ million	2005 £ million
At 1 January	179.6	144.2
Current service cost	1.0	2.0
Interest cost	8.0	7.6
Employee contributions	0.3	0.6
Benefit payments	(6.8)	(5.5)
Transfer values paid	(20.1)	–
Curtailment gains	(1.7)	–
Settlement gains	(0.5)	–
Actuarial (gain)/loss	(1.6)	30.7
Present value of defined benefit pension schemes' obligations	158.2	179.6

vi) Movements in the fair value of schemes' assets

	2006 £ million	2005 £ million
At 1 January	128.8	106.9
Expected return on schemes' assets	10.0	6.5
Employer contributions	47.9	5.7
Employee contributions	0.3	0.6
Benefit payments	(6.8)	(5.5)
Transfer values paid	(20.1)	–
Actuarial gain/(loss)	0.5	14.6
Fair value of schemes' assets	160.6	128.8

vii) History of experience gains and losses

	2006 £ million	2005 £ million	2004 £ million	2003 £ million	2002 £ million
Present value of defined benefit pension schemes' obligations	(158.2)	(179.6)	(144.2)	(142.2)	(130.9)
Fair value of schemes' assets	160.6	128.8	106.9	98.8	89.0
Net surplus/(deficit) in schemes	2.4	(50.8)	(37.3)	(43.4)	(41.9)
Experience gains and losses on schemes' liabilities					
Amount (£ million)	(10.0)	4.8	2.4	6.8	(0.9)
Percentage of schemes' liabilities (%)	(6.3)	2.7	1.7	4.8	(0.7)
Experience gains and losses on schemes' assets					
Amount (£ million)	0.5	14.6	3.6	6.6	(20.3)
Percentage of schemes' assets (%)	0.3	11.3	3.4	6.7	(22.8)

The above schemes are funded and have full UK HM Revenue & Customs tax-exempt approval. Certain members, whose salaries were in excess of the statutory earnings cap, had their benefits increased through unapproved, unfunded arrangements, to the level that would otherwise have applied in respect of the basic salary only. The Group has contractually agreed to pay the additional retirement benefits itself and a provision is made in respect of this obligation in the balance sheet at 31 December 2006 of £0.7 million (2005 £0.7 million). This represents the actuarial value as confirmed by the Group's pension advisers, of the unapproved benefit entitlements accrued at that date. The value is assessed and reviewed on a Market Value basis in line with the Main Plan Valuation and adjusted each year by the charge for the year (equivalent to a contribution to a funded scheme) of nil (2005 £0.1 million) and interest of nil on the unfunded liability (2005 nil).

Expected contributions for these schemes for 2007 are £0.3 million.

The Group contributed £47.0 million to the Spirent Staff Pension Plan in February 2006 from the proceeds of the sale of the HellermannTyton Division.

Curtailment and settlement gains arose during 2006 on:

- the disposal of the HellermannTyton Division; and
- an offer made to active and deferred members of the Spirent Staff Pension Plan to leave the Plan and take an enhanced transfer value to another pension arrangement. A significant number of members accepted the offer. The gains have been calculated based on those members who had committed to the transfer by 31 December 2006.

Notes to the consolidated financial statements continued

11. Pensions continued

Overseas defined benefit schemes

The Group has a defined benefit scheme in Switzerland as a consequence of its acquisition in SwissQual in 2006.

i) The key financial assumptions

	2006 %
Inflation	1.0
Rate of increase in pensionable salaries	4.0
Rate used to discount scheme's liabilities	3.3
Expected rate of return on scheme's assets	3.0

ii) The assets and the liabilities in the scheme

	Long term rate of return expected %	2006 £ million
Qualifying insurance policies	3.0	1.7
Fair value of scheme's assets	3.0	1.7
Present value of defined benefit pension scheme's obligations		(2.4)
Net deficit in the scheme		(0.7)

iii) Analysis of the amounts charged to the income statement

	2006 £ million
Analysis of amount charged to operating costs:	
Current service cost	0.1
Total operating charge	0.1
Analysis of amount charged to finance costs:	
Expected return on pension scheme's assets	(0.1)
Interest on pension scheme's liabilities	0.1
Finance (income)/expense	–
Net charge	0.1

iv) Analysis of amount recognised directly in the statement of recognised income and expense

	2006 £ million
Actual return on pension scheme's assets	(0.4)
Expected return on pension scheme's assets	0.1
Experience losses on the scheme's assets	(0.3)
Experience losses arising on the scheme's liabilities	(0.2)
Actuarial loss recognised directly in equity	(0.5)

v) Movements in the present value of defined benefit obligations

	2006 £ million
Scheme acquired	1.4
Current service cost	0.1
Interest cost	0.1
Employee contributions	0.2
Transfers in	0.4
Actuarial loss	0.2
Present value of defined benefit pension scheme's obligations	2.4

vi) Movements in the fair value of scheme's assets

	2006 £ million
Scheme acquired	1.1
Expected return on scheme's assets	0.1
Employer contributions	0.2
Employee contributions	0.2
Transfers in	0.4
Actuarial loss	(0.3)
Fair value of scheme's assets	1.7

vii) History of experience gains and losses

	2006 £ million
Present value of defined benefit pension scheme's obligations	(2.4)
Fair value of scheme's assets	1.7
Net deficit in scheme	(0.7)
Experience gains and losses on scheme's liabilities	
Amount (£ million)	(0.2)
Percentage of scheme's liabilities (%)	(8.3)
Experience gains and losses on scheme's assets	
Amount (£ million)	(0.3)
Percentage of scheme's assets (%)	(17.6)

Defined contribution schemes

United Kingdom

The Group maintains defined contribution pension schemes for employees in the UK. Employer contributions into these schemes for 2006 were £0.4 million (2005 £0.3 million).

United States

The Group maintains a defined contribution pension benefit scheme for employees of its US subsidiaries. This scheme, also known as a 401(k) Plan, allows employees to defer a percentage of their salary for retirement. The investment choices offered by the scheme are a selection of diversified mutual funds offering a broad mix of investment return potential with varying levels of risk.

Notes to the consolidated financial statements continued

11. Pensions continued

In aggregate, the Group contributions to the various US schemes totalled $3.4 million for 2006 (2005 $4.6 million). Total assets in the defined contribution schemes at the end of 2006 were $123.1 million (2005 $129.2 million). There were no defined benefit schemes in the US in 2006 or 2005.

Other jurisdictions

Outside the United Kingdom and the United States employees are provided with pension arrangements determined in accordance with approved local practice and regulations and apart from a small defined benefit scheme in Switzerland these arrangements are defined contribution schemes. Total contributions for 2006, in respect of these schemes amounted to nil (2005 £0.3 million).

Total contributions to defined contribution schemes were £2.2 million (2005 £3.1 million).

Directors' pension arrangements

The pension arrangements of the executive directors, Anders Gustafsson and Eric Hutchinson are described in detail in the Report on directors' remuneration on pages 26 to 32.

12. Tax

	2006 £ million	2005 £ million
Tax charge in the income statement		
Current income tax		
Foreign tax		
Continuing operations	1.2	1.9
Discontinued operations	10.1	6.5
Current income tax charge	11.3	8.4
Amounts overprovided in previous years		
UK tax	–	(1.6)
Foreign tax	(0.3)	(4.3)
Total current income tax	11.0	2.5
Deferred tax		
Origination and reversal of temporary differences	(0.8)	(0.4)
Total deferred tax	(0.8)	(0.4)
Tax charge in the income statement	10.2	2.1
The tax charge in the income statement is disclosed as follows:		
Income tax expense/(credit) on continuing operations	0.9	(4.0)
Income tax expense on discontinued operations *note 6*	0.9	6.1
Deferred tax relating to the disposal of operations *note 6*	(0.8)	–
Tax on the disposal of operations *note 6*	9.2	–
	10.2	2.1

	2006 £ million	2005 £ million
Tax relating to items charged or credited to equity		
Deferred tax		
Write off of deferred tax asset on pension liability	–	11.1
Tax charge in the statement of recognised income and expense	–	11.1

There was no tax effect in respect of material one-time items (2005 nil).

In 2005 a deferred tax asset was not recognised in relation to the defined benefit pension fund deficit. In 2005 £11.1 million was written off to the statement of recognised income and expense in relation to the asset that had previously been recognised as the future recovery was uncertain.

Reconciliation of the total tax charge

The tax expense in the income statement for the year is lower than the standard rate of corporation tax in the UK of 30 per cent (2005 higher, and 30 per cent).

The differences are reconciled below:

	2006 £ million	2005 £ million
Loss before tax from continuing operations	(50.1)	(41.7)
Profit before tax from discontinued operations *note 6*	169.1	19.3
Accounting profit/(loss) before tax	119.0	(22.4)
Accounting profit/(loss) multiplied by the UK standard rate of corporation tax of 30 per cent (2005 30 per cent)	35.7	(6.7)
Material one-time items not given credit	2.0	2.6
Intangible assets	14.5	10.6
Share-based payment	1.7	1.2
Disposals (non taxable gains)	(40.6)	0.8
Differences in overseas rates and other adjustments	(2.0)	0.2
Tax overprovided in previous years	(0.3)	(5.9)
Other	(0.8)	(0.7)
Total tax expense reported in the income statement	10.2	2.1

13. Earnings/(loss) per share

	2006 pence	2005 pence
Basic and diluted earnings/(loss) per share	11.75	(2.62)
Basic and diluted loss per share from continuing operations	(5.51)	(3.97)
Basic and diluted earnings per share from discontinued operations	17.26	1.35
Adjusted earnings per share	1.73	1.72
Adjusted earnings/(loss) per share from continuing operations	1.41	(0.22)
Adjusted earnings per share from discontinued operations	0.32	1.94

The Group discloses adjusted earnings per share attributable to equity shareholders in order to provide a measure to enable period-on-period comparisons to be made of its performance.

Notes to the consolidated financial statements continued

13. Earnings/(loss) per share continued

Earnings/(loss) per share is calculated by reference to the profit/(loss) for the year and the number of Ordinary shares in issue during the year as follows:

2006 £ million	Continuing operations	Discontinued operations	Total operations
Profit/(loss) for the year	(51.0)	159.8	108.8
Material one-time items	8.8	–	8.8
Goodwill impairment	46.8	–	46.8
Profit on the disposal of operations	–	(156.9)	(156.9)
Costs associated with the repayment of loan notes	8.8	–	8.8
Prior year tax credit	(0.3)	–	(0.3)
Adjusted earnings attributable to equity holders of parent	13.1	2.9	16.0

2005 £ million	Continuing operations	Discontinued operations	Total operations
Profit/(loss) for the year	(37.7)	13.2	(24.5)
Less: minority shareholders' interests	–	(0.4)	(0.4)
Profit/(loss) for the year attributable to equity holders of parent	(37.7)	12.8	(24.9)
Material one-time items	8.4	0.4	8.8
Goodwill impairment	37.0	–	37.0
(Profit)/loss on the disposal of operations	(3.9)	6.7	2.8
Prior year tax credit	(5.9)	–	(5.9)
Prior year tax credit on associate	–	(1.5)	(1.5)
Adjusted earnings/(loss) attributable to equity holders of parent	(2.1)	18.4	16.3

	2006 Number million	2005 Number million
Weighted average number of shares in issue – basic and adjusted	925.9	950.4
Dilutive potential of employee share options	3.8	10.2
Weighted average number of shares in issue – diluted	929.7	960.6

The shares in issue used to calculate basic and adjusted earnings/(loss) per share exclude the shares held by Spirent Sharesave Trust, the Employee Share Ownership Trust and shares held in treasury in accordance with IAS 33 'Earnings per Share'.

14. Intangible assets

£ million

	Goodwill	Intangible assets	Total
Cost net of accumulated amortisation and impairment losses			
At 1 January 2005	106.5	–	106.5
Attributable to discontinued operations *note 6*	(5.5)	–	(5.5)
Impairment	(37.0)	–	(37.0)
Exchange adjustment	7.5	–	7.5
At 1 January 2006	71.5	–	71.5
Increase during the year – acquisitions *note 36*	39.2	10.0	49.2
– other	–	0.8	0.8
Amortisation for the year	–	(1.6)	(1.6)
Impairment charge	(46.8)	–	(46.8)
Exchange adjustment	(9.1)	(0.7)	(9.8)
At 31 December 2006	54.8	8.5	63.3
At 31 December 2005			
Cost (gross carrying amount)	1,777.3	–	1,777.3
Amortisation and accumulated impairment losses	(1,705.8)	–	(1,705.8)
Net carrying amount	71.5	–	71.5
At 31 December 2006			
Cost (gross carrying amount)	1,744.6	10.1	1,754.7
Amortisation and accumulated impairment losses	(1,689.8)	(1.6)	(1,691.4)
Net carrying amount	54.8	8.5	63.3

Material assets

The carrying amounts of goodwill at 31 December 2006 by cash-generating unit are as follows:

£ million

	Performance Analysis Total
Europe	5.5
North America	49.3
	54.8

Notes to the consolidated financial statements continued

14. Intangible assets continued

The carrying amounts of intangible assets at 31 December 2006 by class is as follows:

£ million

	Customer list	Current technology	Other	Total
Europe	2.4	2.2	–	4.6
North America	0.5	2.6	0.8	3.9
	2.9	4.8	0.8	8.5

Amortisation and impairment charges

Goodwill acquired through business combinations has been allocated for impairment testing purposes to three cash-generating units, Performance Analysis excluding SwissQual Holding AG ("SwissQual"), SwissQual, acquired in January 2006 and the Service Assurance Broadband business unit. Performance Analysis is a reportable segment and SwissQual is a business unit which is included within Performance Analysis. Service Assurance Broadband is a business unit within the Service Assurance reportable segment.

Intangible assets are amortised on a straight line basis over the estimated useful lives which are on average five years and the charge is included within administration expenses in the income statement.

The remaining amortisation period of the intangible asset balances arising in relation to customer list and current technology are 4.1 years and 4.2 years, respectively.

Impairment of Service Assurance Broadband in the first half of 2006

IAS 36 'Impairment of Assets' requires that a cash-generating unit to which goodwill has been allocated should be tested whenever there is an indication that the unit may be impaired. As a result of a decline in revenues from some of the unit's existing products experienced in the first half of 2006 and the delay to expectations in securing orders for the new IP products and services, this unit was tested for impairment in June 2006. The recoverable amount of this unit was determined based on a value in use calculation using a pre-tax discount rate of 21.2 per cent. Following the impairment test, a goodwill impairment charge of £9.5 million was recognised through administration expenses in the first half of 2006.

Annual impairment test

The recoverable amounts of these cash-generating units at 30 November 2006, the annual impairment testing date, have been calculated based on a value in use calculation using cash flow projections over a three year period. These were based on financial budgets approved by the Board for the next year and on approved strategic plans for the following two years. Cash flows in subsequent years have been extrapolated using a 2.5 per cent growth rate which approximates to the average long term growth rate for the industries in which these units operate.

Further impairment of Service Assurance Broadband

Increased uncertainty in the second half of 2006 in relation to expectations in securing orders for the new IP products and services and revisions to three year cash flow projections arising from organisational changes and a re-evaluation of the cost structure have resulted in a further impairment charge of £9.6 million in the second half year, giving a total charge of £19.1 million recognised through administration expenses in the full year. As a result the goodwill in the Service Assurance Broadband unit is fully impaired at 31 December 2006. For the annual impairment test the recoverable amount of this unit was determined based on a value in use calculation using a pre-tax discount rate of 22.2 per cent (2005 17.2 per cent).

Impairment of SwissQual

SwissQual was acquired by the Group on 23 January 2006. Activity levels experienced in SwissQual were much lower in 2006 compared with expectations at the time the business was acquired, in part due to delays in the launch of new products. The recoverable amount of this unit at 30 November 2006 was determined based on a value in use calculation using a pre-tax discount rate of 22.0 per cent. Following the impairment test, a goodwill impairment charge of £27.7 million was recognised through administration expenses. As a result the goodwill arising on acquisition is fully impaired at 31 December 2006.

Performance Analysis excluding SwissQual

For the Performance Analysis (excluding SwissQual) unit the cash flows were discounted using a pre-tax discount rate of 21.8 per cent (2005 15.9 per cent). The recoverable amount of this unit, calculated on a value in use basis, was in excess of its carrying value and consequently no impairment has been recognised.

Key assumptions for the annual impairment test

The key assumptions in these value in use calculations were:

- Revenue growth rates used in the budget and strategic plans.
- Gross margin.
- Operating expenses.
- Discount rate.
- Growth rate used to extrapolate cash flows beyond the strategic plan period.

Revenue growth rates used in the budget and strategic plans are based on management's estimate of growth in the markets served, taking into account products yet to be launched and which are in the development pipeline. They are consistent with external sources of information including comparable companies operating in the same markets and analysts' forecasts.

Gross margins are based on historical values achieved by the respective cash-generating units.

Operating expenses are based upon historical levels suitably adjusted for changes in activity levels and organisational structure over the term of the cash flow projections.

The discount rates are based on the Group's weighted average cost of capital adjusted to reflect management's estimate of the specific risk profile associated with the cash flow projections for each cash-generating unit.

Long term growth rates are based upon industry analysis and are consistent with analysts' forecasts.

Sensitivity to changes in key assumptions

With regard to the assessment of value in use for the Performance Analysis excluding SwissQual cash-generating unit outlined above, management believes that no reasonable possible change in any of the above key assumptions would cause the carrying value of a unit to exceed its recoverable amount.

For both the Service Assurance Broadband unit and SwissQual the goodwill has been fully impaired as a result of the impairments taken in 2006. Any adverse change in the key assumptions would, however, cause a further impairment loss to be recognised.

Notes to the consolidated financial statements continued

15. Property, plant and equipment

£ million

	Land and buildings	Plant and machinery	Fixtures, fittings and equipment	Total
Cost, net of accumulated depreciation and accumulated impairment				
At 1 January 2005	33.8	32.7	19.8	86.3
Additions				
Owned assets	1.7	16.3	12.5	30.5
Leased assets	2.2	–	0.3	2.5
Inter-class transfers	0.2	(0.8)	0.6	–
Disposals	–	–	(0.6)	(0.6)
Attributable to discontinued operation *note 6*	(31.0)	(27.3)	(12.6)	(70.9)
Depreciation charge for the year	(2.1)	(12.3)	(8.2)	(22.6)
Exchange adjustment	1.4	2.4	1.1	4.9
At 1 January 2006	6.2	11.0	12.9	30.1
Additions				
Acquired *note 36*	–	–	0.5	0.5
Owned assets	0.7	7.4	4.5	12.6
Inter-class transfers	0.5	0.6	(1.1)	–
Disposals	(1.4)	(0.3)	(0.6)	(2.3)
Depreciation charge for the year	(1.4)	(4.9)	(5.5)	(11.8)
Impairment	–	–	(0.8)	(0.8)
Exchange adjustment	(0.2)	(1.5)	(1.3)	(3.0)
At 31 December 2006	4.4	12.3	8.6	25.3
At 31 December 2005				
Cost	16.7	41.0	50.0	107.7
Accumulated depreciation and accumulated impairment	(10.5)	(30.0)	(37.1)	(77.6)
Net carrying amount	6.2	11.0	12.9	30.1
At 31 December 2006				
Cost	11.5	46.8	40.8	99.1
Accumulated depreciation and accumulated impairment	(7.1)	(34.5)	(32.2)	(73.8)
Net carrying amount	4.4	12.3	8.6	25.3

Property, plant and equipment include assets held under finance leases as follows:

£ million

	Plant and machinery	Fixtures, fittings and equipment	Total
Net book value at 31 December 2005	0.3	–	0.3
Net book value at 31 December 2006	–	–	–

16. Capital commitments and contingent liabilities

	2006 £ million	2005 £ million
Capital expenditure commitments		
Contracted but not provided	–	0.4

For 2005 capital expenditure commitments are for continuing Group operations.

The Group has provided indemnities of £0.6 million (2005 £1.0 million) for certain ongoing business obligations under letters of credit for subsidiary companies.

During 2006 Spirent discovered potential violations of the United States Export Administration Regulations surrounding the valuation and classification of exports together with record keeping requirements. The Company has notified the Office of Export Enforcement of the US Department of Commerce and is currently undertaking a review of its records. Until the review is completed and the Office of Export Enforcement has concluded on this matter, the Company is unable to determine what liability, if any, might be due in respect of this.

17. Subsidiaries

A list of the significant investments in subsidiaries, including the name, country of incorporation and proportion of ownership interest is given on page 111 of these financial statements.

18. Investments in associates

	2005 £ million
At 1 January 2005	14.3
Exchange adjustment	(0.7)
Share of associates' net profit – discontinued operations *note 6*	2.7
Dividend	(0.2)
Attributable to discontinued operations *note 6*	(16.1)
At 31 December 2005	–

The share of associates net profit in 2005 includes a prior year tax credit of £1.5 million in respect of tax on the unremitted earnings.

The associated companies at 31 December 2005 were as follows:

	% holding	Nature of business
Tyton Company of Japan	49	Cable management products
3M/ECC	20	Cable management products

Tyton Company of Japan has a reporting date of 31 March being the date of preparation of statutory financial statements.

At 31 December 2005, the investment in associates has been included in assets held in disposal group held for sale, as these investments form part of the HellermannTyton Division (note 6). The associated companies were disposed of on 15 February 2006.

Notes to the consolidated financial statements continued

19. Inventories

	2006 £ million	2005 £ million
Raw materials	5.7	5.8
Work in progress	4.1	2.2
Finished goods	15.6	19.0
	25.4	27.0

An expense of £1.2 million (2005 £2.8 million) has been recognised in the period for inventory write-downs.

20. Trade and other receivables

	2006 £ million	2005 £ million
Non-current assets		
Prepayments	1.4	1.7
Current assets		
Trade receivables	50.9	45.8
Other receivables	4.6	2.3
Prepayments, accrued income and deferred costs	8.3	8.2
	63.8	56.3
	65.2	58.0

Trade and other receivables relating to discontinued operations are disclosed in note 6 for 2005.

The trade receivables are stated net of provisions for doubtful debts, and the movement in the provision was as follows:

	2006 £ million	2005 £ million
At 1 January	0.5	1.3
Charge for the year	0.9	0.4
Other movements	(0.1)	(1.2)
At 31 December	1.3	0.5

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

The Group has no significant concentration of credit risk attributable to its trade receivables as the exposure is spread over a large number of customers.

21. Cash and cash equivalents

	2006 £ million	2005 £ million
Cash at bank and in hand	5.3	22.3
Short term bank deposits	87.2	26.9
Short dated commercial paper	5.1	–
	97.6	49.2

Short term bank deposits are made for varying periods of between one day and three months depending on the cash requirements of the Group and earn interest at the short term deposit rates appropriate for the term of the deposit and currency. Short dated commercial paper has a maturity of between one day and three months and is rated Standard & Poor's A or Moodys A-2 or better.

	2006 £ million	2005 £ million
Non-current		
Cash on deposit	8.5	–

At 31 December 2006 £8.5 million is held in a blocked trust account and is only available for use by the Company once all creditors who were outstanding at the date of the cancellation of the share premium and capital redemption reserve fund, being 24 November 2004, are settled. See note 34.

22. Trade and other payables – current

	2006 £ million	2005 £ million
Trade payables	11.4	11.1
Payments received on account	1.1	6.9
Other taxes and social security costs	2.0	2.7
Other payables	2.7	4.4
Accruals and deferred income	44.6	37.8
	61.8	62.9

Trade and other payables relating to discontinued operations are disclosed in note 6 for 2005.

Trade payables are non-interest bearing and are normally settled on 60 day terms. Other payables are non-interest bearing.

The directors consider that the carrying amount of trade payables approximates to their fair value.

23. Short term borrowings and overdrafts

	2006 £ million	2005 £ million
Senior unsecured loan notes *note 28*	–	3.2
Bank overdrafts (secured)	–	0.4
Bank loans due within one year	–	0.2
Finance lease obligations due within one year *note 27*	–	0.1
	–	3.9

Bank overdrafts are repayable on demand. Overdrafts are secured either by mortgages on the freehold properties or by floating charges on the assets of the borrowing subsidiaries.

Notes to the consolidated financial statements continued

24. Deferred tax

The movements in the deferred tax liabilities are as follows:

	Accelerated tax depreciation £ million	Other short term temporary differences £ million	Total £ million
At 1 January 2005	1.4	1.1	2.5
Attributed to discontinued operations *note 6*	(1.3)	(0.6)	(1.9)
Exchange adjustment	–	(0.4)	(0.4)
Charge during the year *note 12*	0.7	(0.1)	0.6
At 1 January 2006	0.8	–	0.8
Attributed to discontinued operations *note 12*	(0.8)	–	(0.8)
At 31 December 2006	–	–	–

The movements in the deferred tax assets are as follows:

	Other £ million	Retirement benefit obligations £ million	Total £ million
At 1 January 2005	–	11.1	11.1
Write off of deferred tax asset *note 12*	–	(11.1)	(11.1)
Recognised during the year *note 12*	1.0	–	1.0
At 1 January 2006	1.0	–	1.0
Acquired	0.2	–	0.2
At 31 December 2006	1.2	–	1.2

Deferred tax assets on temporary differences of £78.8 million (2005 £46.4 million) arising principally in the US, Canada and the UK have not been recognised. These assets can only be realised when they reverse against suitable taxable profits. Although the directors ultimately expect to realise these assets, there is currently insufficient evidence under IAS 12 'Income Taxes' to recognise a deferred tax asset in respect of these temporary differences.

In addition, the Group has tax losses arising in the US of £42.2 million (2005 £79.6 million) and in the UK of £72.7 million (2005 £42.2 million) that are available for offset against future taxable profits. A deferred tax asset has not been recognised in respect of these losses as their future recovery is uncertain. US tax losses can be carried forward for 20 years and UK losses can be carried forward indefinitely.

In total deferred tax assets amounting to £67.1 million (2005 £76.0 million) have not been recognised on unutilised losses and temporary differences.

In 2005 £0.1 million of deferred tax was recognised on the unremitted earnings of overseas subsidiaries and associates.

No deferred tax asset has been recognised in respect of the tax deduction which may be available on the future exercise of stock options.

25. Trade and other payables – non-current

	2006 £ million	2005 £ million
Other payables	0.3	0.2
Deferred income	0.2	0.4
Pension	–	0.1
	0.5	0.7

26. Provisions and other liabilities

£ million

	Restructuring provisions	Lease provisions	Total
At 1 January 2006	0.5	13.7	14.2
Charged during the year	5.9	2.0	7.9
Movement in discount rate	–	(0.3)	(0.3)
Utilised in the year	(4.4)	(4.0)	(8.4)
Exchange adjustment	(0.1)	(1.3)	(1.4)
At 31 December 2006	1.9	10.1	12.0

Provisions have been analysed as follows:

	2006 £ million	2005 £ million
Current	5.9	4.1
Non-current	6.1	10.1
	12.0	14.2

The lease provisions are for the continuing obligations under leases in respect of properties which have been vacated by the Group. Where material, lease obligations are discounted. The Group expects these provisions to be utilised over the next ten years.

The restructuring provisions relate to the exit from the Spirent DM joint venture, the closure of certain Service Assurance facilities and redundancy costs in the Communications businesses.

Notes to the consolidated financial statements continued

27. Long term borrowings

	2006 £ million	2005 £ million
Senior unsecured loan notes *note 28*	–	67.7
Bank loans	–	2.2
Finance lease obligations	–	1.3
	–	71.2

Finance lease obligations

	2006 £ million	2005 £ million	2006 £ million	2005 £ million
	Minimum lease payments		Present value of minimum lease payments	
Amounts payable under finance leases				
Within one year	–	0.2	–	0.1
Between one and five years	–	0.7	–	0.4
After five years	–	1.0	–	0.9
	–	1.9	–	1.4
Less: amounts representing future finance charges	–	(0.5)		
Present value of lease obligations	–	1.4		

For 2005 all leases are on a fixed repayment basis and no arrangements have been entered into for contingent rental payments. The Group's obligations under finance leases are secured by the lessors' charges over the leased assets.

During 2006 the finance lease obligation was transferred to the sub-lessee, who is an unaffiliated company. In return the Company has guaranteed the obligation.

28. Senior unsecured loan notes

	2006 £ million	2005 £ million
Due within one year *note 23*		
Senior unsecured loan notes 2006	–	3.2
Due after more than one year *note 27*		
Senior unsecured loan notes 2009	–	67.7
	–	70.9

On 15 February 2006 the loan notes were repaid out of the proceeds of sale of the HellermannTyton Division. A make-whole amount of $13.9 million (£7.2 million) was also paid.

29. Financial risk management

The Group's principal financial instruments, other than derivatives, comprise trade receivables, trade payables, cash, short term deposits and short dated commercial paper. The main purpose of these financial instruments, other than trade receivables and trade payables, is to fund the Group's liquidity requirements.

The Group enters into derivative transactions, principally forward foreign exchange contracts, for the management of the Group's currency risks and other exposures when deemed appropriate.

The key objective of the Group Treasury department is to manage the financial risks of the business and to ensure that sufficient liquidity is available to the Group. All treasury activity operates within a formal control framework. The Board has approved treasury policies and guidelines and periodically reviews treasury activities. Additionally, it is the Group's policy that speculative treasury transactions are expressly forbidden.

Interest rate risk

The Group has limited exposure to market risk for changes in interest rates following repayment of its long term debt obligations in February 2006. The Group's excess funds are held in the United Kingdom and United States and invested in short term deposits or short dated commercial paper.

Foreign currency risk

Currency exposures arise from trading transactions undertaken by the Group in foreign currencies and on the translation of the operating results and net assets of overseas subsidiaries. As a result of the Group having significant operations in the United States, its results can be affected significantly by movements in the US dollar exchange rate. During the year, sterling strengthened against the US dollar.

Group Treasury, by means of forward foreign exchange contracts, carries out the majority of the transaction hedging activity in relation to normal trading activity. The Group does not enter into instruments to hedge the translation exposure of the operating results or net assets of its overseas subsidiaries since these are accounting and not cash exposures.

Credit risk

The Group has no significant concentrations of credit risk at 31 December 2006. The Group has implemented policies that require appropriate credit checks on potential customers before sales commence and no one customer accounts for more than 10 per cent of total Group revenues. All financial instruments are transacted with commercial banks. Financial instrument counterparties are subject to pre-approval by the Group Audit Committee and such approval is limited to financial institutions with a rating of Standard & Poor's A or Moodys A-2 or better. The amount of exposure to any individual counterparty is subject to a limit.

Liquidity risk

The Group's objective is to ensure that there are sufficient sources of funding to meet projected requirements. Its operations are financed through cash and cash equivalents held centrally and cash generated from operations. The Group had cash and cash equivalents of £97.6 million at 31 December 2006. The Group currently has no borrowing facilities in place.

Notes to the consolidated financial statements continued

30. Financial instruments

a) Interest rate risk

The financial assets of the Group comprise:

	2006 £ million	2005 £ million
Cash and cash equivalents *note 21*	97.6	49.2
Cash on deposit non-current *note 21*	8.5	–
Derivative financial instruments *see below*	0.1	2.6
	106.2	51.8

Floating rate financial assets comprise cash deposits at call, seven day and monthly rates.

Fixed rate financial assets comprise short dated commercial paper and fixed rate short term cash deposits.

Trade receivables for the continuing and discontinued operations have been excluded from the above tables as they are all due in less than one year and are non-interest bearing.

The financial liabilities of the Group comprise:

	2006 £ million	2005 £ million
Short term borrowings and overdrafts *note 23*	–	3.9
Long term senior unsecured loan notes *note 27*	–	67.7
Long term bank loans *note 27*	–	2.2
Long term other loans and finance lease obligations *note 27*	–	1.3
Non-current other payables *note 25*	0.3	0.2
Provisions *note 26*	12.0	14.2
Derivative financial instruments *see below*	–	2.7
	12.3	92.2

The floating rate liabilities at 31 December 2005 comprise primarily $72.1 million of the senior unsecured loan notes for which interest rate swaps were in place. Other floating rate liabilities bear interest at various rates set with reference to the prevailing LIBOR or equivalent for the time period and country.

Finance lease obligations of the discontinued operations of £9.0 million and other loans of £0.7 million have not been included in the tables for 2005, see note 6.

Trade payables for the continuing and discontinued operations have been excluded from the above tables as they are all due in less than one year and are non-interest bearing.

The interest rate risk profile of financial assets and liabilities is as follows:

2006
£ million

	Effective interest rate	Within 1 year	1-2 years	2-3 years	3-4 years	4-5 years	More than 5 years	Total
Fixed rate								
Fixed deposits	5.15%	87.2	–	–	–	–	–	87.2
Short dated commercial paper	5.11%	5.1	–	–	–	–	–	5.1
		92.3	–	–	–	–	–	92.3
Floating rate								
Foreign currency contracts		0.1	–	–	–	–	–	0.1
		0.1	–	–	–	–	–	0.1

In addition £8.5 million is held in a blocked trust account and is currently earning interest of 5.15 per cent. The maturity of the deposit is less than one year, at maturity the interest rate will be reset.

The cash must be retained in the blocked trust account in accordance with the terms of the undertakings made at the time of the cancellation of the share premium account and capital redemption reserve fund (“the Cancellation”). The funds must remain in this account until all the creditors who existed at the date of the Cancellation have been repaid and therefore the maturity of this account is uncertain.

2005
£ million

	Effective interest rate	Within 1 year	1-2 years	2-3 years	3-4 years	4-5 years	More than 5 years	Total
Fixed rate								
Senior unsecured loan notes	9.1%	(3.2)	–	–	(25.8)	–	–	(29.0)
Obligations under finance leases and hire purchase contracts		(0.1)	(0.1)	(0.1)	(0.1)	(0.1)	(0.9)	(1.4)
US dollar bank loan $4.2 million	7%	(0.2)	(0.2)	(2.0)	–	–	–	(2.4)
		(3.5)	(0.3)	(2.1)	(25.9)	(0.1)	(0.9)	(32.8)
Floating rate								
Bank deposits		39.3	–	–	–	–	–	39.3
Bank overdrafts		(0.4)	–	–	–	–	–	(0.4)
Senior unsecured loan notes		–	–	–	(41.9)	–	–	(41.9)
Interest rate swaps (see 30(d) below)		–	–	–	(2.0)	–	–	(2.0)
Foreign currency contracts		1.9	–	–	–	–	–	1.9
		40.8	–	–	(43.9)	–	–	(3.1)

Interest rates on financial instruments classified as fixed rate are fixed until the maturity of the instrument. All fixed rate deposits mature within three months after which date they will be exposed to floating rates of interest.

The other financial instruments of the Group that are not included in the above table are non-interest bearing and are therefore not subject to interest rate risk.

Notes to the consolidated financial statements continued

30. Financial instruments continued

b) Credit risk

The Group has no significant concentrations of credit risk at 31 December 2006.

The maximum credit exposure at the balance sheet date in the event that other parties fail to perform obligations under financial instruments is £20.0 million in relation to bank deposits. Financial instrument counterparties are subject to pre-approval by the Group Audit Committee and such approval is limited to financial institutions with a rating of Standard & Poor's A or Moodys A-2 or better.

The amount of exposure to any individual counterparty is subject to a limit.

c) Fair value of financial instruments

Set out below is a comparison by category of the carrying amounts and fair values of all of the Group's financial assets and liabilities (other than current trade and other receivables and current trade and other payables that approximate to fair value) that are carried in the financial statements.

	2006 £ million		2005 £ million	
	Book value	Fair value	Book value	Fair value
Financial assets				
Cash and cash equivalents *note 21*	97.6	97.6	49.2	49.2
Blocked trust account	8.5	8.5	–	–
Financial liabilities				
Short term borrowings and overdrafts *note 23*	–	–	(3.9)	(3.9)
Other financial liabilities *note 25*	(0.3)	(0.3)	(0.2)	(0.2)
Long term senior unsecured loan notes *note 27*	–	–	(67.7)	(76.1)
Other long term borrowings *note 27*	–	–	(3.5)	(3.4)
Provisions and other liabilities *note 26*	(12.0)	(12.0)	(14.2)	(14.2)
	93.8	93.8	(40.3)	(48.6)
Interest rate swaps	–	–	(2.0)	(2.0)
Currency derivatives	0.1	0.1	1.9	1.9
	93.9	93.9	(40.4)	(48.7)

Market values have been used to determine the fair value of the long term senior unsecured loan notes. The fair value of derivatives and borrowings has been calculated by discounting the expected future cash flows at prevailing interest rates.

d) Derivative financial instruments

The fair value of the derivative financial instruments at 31 December is as follows:

	2006 £ million		2005 £ million	
	Assets	Liabilities	Assets	Liabilities
Interest rate swaps – expected to be realised in more than one year	–	–	–	(2.0)
Currency derivatives – expected to be realised in less than one year	0.1	–	2.6	(0.7)
	0.1	–	2.6	(2.7)

The derivative financial instruments are as follows:

Interest rate swaps

Fixed to floating interest rate swaps were in place at 31 December 2005 to hedge $72.1 million of the senior unsecured loan notes outstanding at that time. The interest rate swaps were designated as hedges and were included in the balance sheet as derivative financial instruments non-current liabilities at their fair value with movements in fair value being reflected through the income statement. These swaps were terminated on 15 February 2006 at which point all gains and losses were recognised in the income statement together with a break fee due on early termination of £2.3 million.

Currency derivatives

The Group uses forward foreign exchange contracts in the management of transactional exchange rate exposures. These contracts are designated where possible as hedging instruments.

At 31 December 2006 the Group held various foreign exchange contracts in respect of the forward sale of US dollars and euro on trading transactions. These contracts total £8.8 million, are for various maturity dates over the period to December 2007 and are at exchange rates in the range 1.86 to 1.95 for US dollar contracts and 1.47 for euro contracts. These contracts have not been designated as hedges.

Hedge of net investment in foreign entities

As at 31 December 2005 senior unsecured loan notes of $124.8 million were designated as a hedge of the net investments in the United States and were used to reduce the exposure of the foreign exchange risk. Gains or losses on the retranslation of this borrowing were transferred to equity to offset any gains or losses on translation of the net investments in subsidiaries.

As previously stated the loan notes were repaid in February 2006 and as such the Group does not have at 31 December 2006 hedges of this nature in place.

31. Operating lease commitments

At 31 December, the Group had outstanding commitments for future minimum lease payments under non-cancellable operating leases, which fall due as follows:

	2006 £ million	2005 £ million
Continuing operations		
Within one year	7.7	7.6
In the second to fifth years	17.4	17.1
Over five years	5.2	5.4
	30.3	30.1
Discontinued operations		
Within one year	–	1.6
In the second to fifth years	–	4.2
Over five years	–	9.0
	–	14.8
	30.3	44.9

The Group leases certain land and buildings under non-cancellable operating lease agreements with a variety of terms. The Group also leases certain plant and equipment under non-cancellable operating lease agreements. Total future sublease payments receivable relating to the above leases amounted to £1.5 million (2005 £5.4 million).

Notes to the consolidated financial statements continued

32. Authorised and issued share capital

Authorised

	2006 £ million	2005 £ million
1,250 million (2005 1,250 million) Ordinary shares of 3⅓ pence each	41.7	41.7

Issued and fully paid

	Number of Ordinary shares million	£ million
At 1 January 2005	956.2	31.9
Allotted pursuant to share-based incentives exercised	9.6	0.3
At 1 January 2006	965.8	32.2
Allotted pursuant to share-based incentives exercised	10.1	0.3
At 31 December 2006[1]	975.9	32.5

Note
1 During 2006, the Company repurchased and placed in treasury 90.3 million of its own Ordinary shares as part of the Share Repurchase Programme approved by shareholders on 3 May 2006. When treasury shares are taken into account and excluded from the calculation, the issued share capital of the Company, as at 31 December 2006 was 885.6 million Ordinary shares.

At the Annual General Meeting held on 3 May 2006, shareholders gave authority for the Company to repurchase up to 145 million of its own Ordinary shares in the market subject to certain specified conditions. At 1 March 2007, 90.3 million shares had been repurchased under this authority.

In accordance with the rules of the following share schemes, share-based incentives were exercised during the year which resulted in new Ordinary shares being allotted by the Company or existing shares being transferred from Spirent Sharesave Trust ("SST") as follows:

	Number of Ordinary shares million	Consideration received £000
1995 Executive Share Option Scheme	3.9	622.9
Spirent Stock Incentive Plan	2.5	448.3
Acquisition Plans[1]	3.7	783.3
All Employee Share Schemes	1.4	539.5
	11.5	2,394.0

Note
1 The Acquisition Plans are the Netcom Amended and Restated Stock Option Plan, the Zarak Amended and Restated Stock Option Plan and the Caw Amended and Restated Stock Plan (see notes (d), (e) and (f) on page 83).

During the year 1.4 million shares were transferred from the SST to satisfy options exercised under the UK All Employee Share Schemes. No shares were transferred from the Employee Share Ownership Trust ("ESOT") to satisfy options exercised under the Spirent Stock Incentive Plan during 2006.

There has been no material increase in the issued share capital, whether by exercise of options, purchase rights or otherwise, between the end of the year and 1 March 2007, the date on which these financial statements have been signed.

Movements in share incentives over a two year period ending on 31 December 2006 are shown below:

	Executive Share Option Schemes[1]		2005 Employee Incentive Plan[2]		Spirent Stock Incentive Plan[3]		Acquisition Plans[4]		UK Sharesave Schemes[5]		Employee Stock Purchase Plans[6]	
	Number of shares million	Weighted average exercise price pence	Number of shares million	Weighted average exercise price pence	Number of shares million	Weighted average exercise price pence	Number of shares million	Weighted average exercise price pence	Number of shares million	Weighted average exercise price pence	Number of shares million	Weighted average exercise price pence
Incentives outstanding at 31 December 2004	27.1	107	–	–	76.7	94	9.7	60	5.9	45	2.7	50
Granted	–	–	3.2	40	24.3	54	–	–	–	–	–	–
Exercised	(2.1)	16	–	–	(4.2)	20	(0.6)	18	(0.4)	41	(2.7)	50
Forfeited	(0.5)	141	–	–	(7.9)	67	(0.2)	10	(0.3)	41	–	–
Expired	(3.3)	175	–	–	(7.3)	177	(0.2)	123	(0.6)	68	–	–
Incentives outstanding at 31 December 2005	21.2	105	3.2	40	81.6	81	8.7	62	4.6	43	–	–
Granted	–	–	3.6	33	22.2	47	–	–	–	–	–	–
Exercised	(3.9)	16	–	–	(2.7)	21	(3.7)	21	(1.4)	39	–	–
Forfeited	(0.4)	168	(0.2)	24	(9.3)	56	–	–	(0.9)	41	–	–
Expired	(1.5)	178	–	–	(8.0)	114	(0.5)	86	(0.8)	56	–	–
Incentives outstanding at 31 December 2006	15.4	119	6.6	37	83.8	74	4.5	93	1.5	40	–	–
Incentives exercisable:												
At 31 December 2005	4.0	152	–	–	39.5	103	8.7	62	0.8	48	–	–
At 31 December 2006	11.4	131	–	–	43.5	93	4.5	93	0.3	41	–	–

Notes

1 Includes options granted under the 1995, 1985 and International Executive Share Option Schemes. As at 31 December 2005, the 1985 and International Executive Share Option Schemes were closed and no options remained outstanding.

2 Figures for the 2005 Employee Incentive Plan include share options, stock appreciation rights and performance shares in aggregate.

3 Shows both traditional share options and share settled stock appreciation rights in aggregate. A grant of 12.1 million options with an exercise price of 60.75 pence per share awarded in December 2003 under the Spirent Stock Incentive Plan was partially hedged by 6.1 million Ordinary shares held in the ESOT. As at 31 December 2006, the balance of shares held in the ESOT in respect of the December 2003 grant was 5.9 million Ordinary shares.

4 The Acquisition Plans are share plans which originally granted options over other companies' equity which have been rolled-over into Spirent shares when the said companies were acquired by Spirent Communications plc. A description of the Acquisition Plans can be found in notes (d) to (f) on page 83 of these financial statements.

5 1.4 million Spirent Ordinary shares were transferred from the SST to settle the exercise of UK Sharesave options in 2006. As at 31 December 2006, 1.9 million Ordinary shares remained in the SST hedging share option grants made under the UK Sharesave Schemes.

6 The Employee Stock Purchase Plans includes the US Employee Stock Purchase Plan, the Global All Employee Share Purchase Plan and the UK Employee Share Purchase Plan. No purchase rights were outstanding under these plans as at 31 December 2006.

7 The weighted average share price at exercise date was 50.5 pence (2005 63.2 pence).

Notes to the consolidated financial statements continued

32. Authorised and issued share capital continued

The following information relates to outstanding share incentives:

				2006			2005		
Share scheme	Notes	Exercise period (as at 31 December 2006)	Range of exercise prices pence	Weighted average exercise price pence	Number million	Weighted average remaining contractual life	Weighted average exercise price pence	Number million	Weighted average remaining contractual life
Executive Share Option Schemes[1]	a	25.03.06-24.03.13	16	16	1.2	6.2	16	5.2	7.2
		03.10.04-04.08.14	56-72	62	6.5	7.3	62	6.8	8.2
		11.04.98-01.05.12	91-163	133	5.7	3.7	125	6.6	4.6
		11.05.03-08.04.11	305-598	317	2.0	3.9	318	2.6	4.9
2005 Employee Incentive Plan	b	25.08.08-04.05.16	0-53[2]	37	6.6	7.2	40	3.2	8.0
Spirent Stock Incentive Plan	c	10.10.03-09.10.09	6	6	0.1	2.8	6	0.2	3.8
		14.11.03-09.04.10	13-18	17	4.2	3.0	17	6.5	4.0
		08.05.04-07.05.10	22	22	0.1	3.4	22	0.1	4.3
		12.09.03-06.12.13	37-57	50	37.9	6.0	52	22.6	6.5
		03.10.02-08.11.13	59-87	67	31.2	4.0	67	39.4	4.9
		30.08.02-12.06.09	94-140	116	1.2	2.1	115	1.5	3.1
		21.06.02-13.03.09	141-190	143	6.8	2.2	143	8.3	3.2
		11.05.01-06.06.08	270-400	320	1.4	1.0	319	1.7	2.0
		07.09.01-14.02.08	488-617	583	0.9	1.0	583	1.3	2.0
Acquisition Plans	d, e, f	15.08.02-25.06.12	8-11[3]	9	0.1	5.2	9	0.1	6.0
		23.07.99-12.11.07	15-18	18	1.2	0.6	18	2.9	1.4
		23.07.99-18.01.08	24-36	24	0.2	1.0	24	2.2	1.9
		23.07.99-22.03.08	54-79	54	0.1	1.3	54	0.1	2.2
		23.07.99-12.10.10	90-127	104	2.4	2.2	103	2.9	3.2
		17.05.00-19.07.09	151	151	0.4	2.5	151	0.4	3.5
		14.11.00-12.11.10	350-572	523	0.1	3.8	523	0.1	4.8
UK Sharesave Schemes	g	01.12.06-31.05.11	38-41	39	1.5	1.8	39	4.4	2.2
		01.01.06-31.05.09	83-103	93	0.0	1.3	89	0.1	1.4
		01.12.06-30.11.08	142-518	166	0.0	0.5	314	0.1	1.0
Employee Stock Purchase Plans	h, i, j	–	–	–	–	–	–	–	–
					111.8			119.3	

Notes
1 Includes options granted under the 1995, 1985 and International Executive Share Option Schemes. As at 31 December 2005, the 1985 and International Executive Share Option Schemes were closed and no options remained outstanding.
2 Figures for the 2005 Employee Incentive Plan include share options, stock appreciation rights and performance shares in aggregate. No exercise price is payable on the vesting of a performance share.
3 These exercise prices relate to the Caw Amended and Restated Stock Plan and are expressed in this table in sterling using the average exchange rate between pounds sterling and US dollars for the year. The actual exercise prices of these options are priced in US dollars at either 15.03 US cents or 20.03 US cents per share.

Potential dilution of issued share capital arising from employee share schemes

In accordance with guidelines issued by the Association of British Insurers ("ABI"), the following information is provided in respect of possible future dilution of the Company's issued share capital arising from the exercise of awards under the Group's employee share schemes. The issued share capital at 31 December 2006 was 885.6 million Ordinary shares (this figure excludes the 90.3 million Ordinary shares held in treasury). The closing price of a Spirent Ordinary share on 31 December 2006 was 56.75 pence per share.

At 31 December 2006

	Total number exercisable million	Total[1] exercisable below 56.75 pence million	Weighted average exercise price of all exercisable awards pence	Shares held[2] in trust million	Maximum[3] number of new issue shares required to satisfy exercisable awards million	Total[4] outstanding below 56.75 pence million	Weighted average exercise price of all outstanding awards pence	Maximum[5] number of new issue shares required to satisfy all outstanding awards million
Discretionary share options	40.7	6.7	114	5.9	6.7	11.4	107	11.4
Options arising from Acquisition Plans[6]	4.5	1.5	93	–	1.5	1.5	93	1.5
Stock appreciation rights[7]	16.2	5.5	100	2.0	0.4	40.2	66	5.1
Conditional share awards[8]	–	–	–	0.2	–	1.9	–	1.7
Stock purchase rights	–	–	–	–	–	–	–	–
Sharesave options	0.3	0.3	41	1.9	–	1.4	40	–
	61.7	14.0		10.0	8.6	56.4		19.7

Notes
1 This is the number of exercisable awards which have an exercise price less than 56.75 pence per share, being the Spirent Communications plc closing share price on 31 December 2006.
2 "Shares held in trust" relates to shares held by the ESOT and the SST. These shares are held to satisfy exercises under various employee share schemes. In addition, there are currently 1.3 million unallocated shares in the ESOT.
3 This is the number of shares which would need to be issued to satisfy the exercise of all exercisable awards with an exercise price of less than 56.75 pence, being the Spirent Communications plc closing share price on 31 December 2006.
4 Total number outstanding relates to outstanding awards (whether exercisable or not) which have an exercise price less than 56.75 pence per share, being the Spirent Communications plc closing share price on 31 December 2006.
5 This is the number of shares which would need to be issued to satisfy the exercise of outstanding awards (whether exercisable or not) with an exercise price of less than 56.75 pence, being the Spirent Communications plc closing share price on 31 December 2006.
6 The Ordinary shares subject to rolled-over options from the acquisition of Netcom, Zarak and Caw, or granted under the SSIP, do not count towards ABI scheme limits.
7 This includes stock appreciation rights awarded under the Spirent Stock Incentive Plan, the 2005 Employee Incentive Plan and the Netcom Stock Appreciation Rights Plan, which is fully hedged by market purchased shares in the ESOT (see note (k) below for further details on this plan).
8 Performance shares awarded under the EIP (see note (b) below for further details on the EIP) have been made in the form of conditional share awards.

Description of employee share schemes

a) 1995 Executive Share Option Scheme ("ESOS")

The ESOS is now closed (however outstanding options may still be exercised) and has been replaced by the 2005 Employee Incentive Plan referred to in (b) below.

Awards under the ESOS, normally determined annually, were at the sole discretion of the Remuneration Committee after considering recommendations made to it by the Chief Executive. No price was payable on the grant of an option and no options were granted at a discount to the market price.

The normal exercise period for options granted under the ESOS is between the third and tenth anniversary of the date of grant. Options awarded under the ESOS are subject to the achievement of an earnings per share ("EPS") performance condition before they can be exercised. The condition is that over a period of three consecutive financial years, there has been an increase in the Company's adjusted EPS which is at least 6 per cent more than the increase in the Retail Price Index over the same period. The performance condition is tested on the third anniversary of grant and, if it has not been met at that time, at each subsequent anniversary of grant until the option expires (ie on the tenth anniversary of grant in normal circumstances).

Notes to the consolidated financial statements continued

32. Authorised and issued share capital continued

All ESOS grants made after 11 May 2000 to executive directors are subject to enhanced performance conditions. The performance condition requires the Company's adjusted EPS to increase over a period of three consecutive financial years within a range of 9 per cent (minimum performance for 25 per cent option vesting) and 15 per cent (for 100 per cent option vesting), with a sliding scale between these points. In addition, performance testing over the ten year option term is measured from a base point fixed at the date of grant. Performance will be tested on the third anniversary of grant and, if the target conditions at that time have not yet been met in full, performance will be tested again on the fourth and fifth anniversaries of grant only, with the performance hurdle being increased in proportion to the extended period.

b) 2005 Employee Incentive Plan ("EIP")

On 4 May 2005, Spirent shareholders approved the EIP to replace the now closed ESOS. The EIP is currently available for selected employees (including executive directors) on a similar discretionary basis as the ESOS. No price is payable on the grant of an award and no award has been granted at a discount to the market price. The Company is able to grant share options, including HMRC approved options, share settled stock appreciation rights ("SARs") and performance shares under the EIP.

In normal circumstances, options or SARs under the EIP will vest three years following grant provided the Company's EPS growth targets (after excluding inflation) have been met over a three year performance period. The growth targets in respect of the initial award require that the Company's EPS increases within a range of 6 per cent per annum (for 25 per cent vesting) and 15 per cent per annum (for 100 per cent vesting) over the performance period, with a sliding scale between these points.

In normal circumstances, performance shares under the EIP will vest three years following grant provided the Company's total shareholder return ("TSR") targets have been met over a three year performance period. The performance condition requires Spirent's TSR to be between the median of a comparator group (for 30 per cent vesting) and the upper quartile of a comparator group (for 100 per cent vesting) over the performance period, with a sliding scale between these points. The comparator group consists of the 30 largest companies by market capitalisation in the FTSE TechMARK 100 Index, excluding those TechMARK companies who are also constituents of the FTSE100 Index at the commencement of the performance period.

All EIP awards will be tested once on or shortly following the third anniversary of grant. Any part of an award which does not vest shall lapse and there is no opportunity for retesting.

SARs granted under the EIP will deliver the appreciation value (ie the aggregated increase in market value of an Ordinary share over the base price of the SAR) in the form of new issue Ordinary shares. This "SARs" approach, which is also being utilised for the Spirent Stock Incentive Plan (see note (c) below), will help the Company manage its dilution headroom more efficiently as only the SAR gain and not the entire share value needs to be funded. Using a SARs based approach, it is not possible to determine the precise level of dilution until the SARs are exercised. 4.6 million EIP SARs with an average base price of 50 pence were outstanding as at 31 December 2006. No EIP SARs have been exercised to date.

Options and SARs granted under the EIP expire on the tenth anniversary of their grant unless they have previously lapsed or been exercised.

c) Spirent Stock Incentive Plan ("SSIP")

The SSIP was introduced in 2000. This discretionary plan is primarily targeted at selected employees in the Communications group with grants normally determined annually by reference to the seniority and contribution of the individual, together with the performance of the relevant business and prevailing local market practice. Under the SSIP, grants are also permitted to selected newly hired and promoted employees on a monthly basis.

At an Extraordinary General Meeting held in June 2004, shareholders approved the renewal of the SSIP until the Company's 2007 Annual General Meeting along with several amendments including the ability to award SARs as well as stock options. The current shareholder approved mandate regarding annual dilution rates includes an annual allowance of 2.5 per cent of shares outstanding for the SSIP and 0.6 per cent of shares outstanding for the EIP (see (b) above).

27.8 million SSIP SARs with an average base price of 55 pence were outstanding as at 31 December 2006. During 2006, 22,928 Ordinary shares were issued as a consequence of the exercise of 216,315 SSIP SARs.

Awards made pursuant to the SSIP normally vest over four years, provided that the employee remains in employment. Awards normally become 25 per cent exercisable on the first anniversary of the date of grant and thereafter in equal proportions on a monthly basis over a further 36 months. Any award not exercised by the seventh anniversary of grant will lapse.

No price is payable on the grant of options or SARs and no options or SARs have been, or can be, granted at a discount to the market price.

d) Netcom Amended and Restated Stock Option Plan ("NARSOP")

Spirent completed the acquisition of Netcom Systems, Inc. ("Netcom") in 1999. $44.5 million of the total consideration was satisfied through the roll-over of outstanding options over Netcom shares, into options over approximately 23.8 million Ordinary shares (as adjusted) on substantially similar terms as previously existed. All remaining outstanding options are fully vested and exercisable until they expire.

e) Zarak Amended and Restated Stock Option Plan ("ZARSOP")

Out of a total consideration of approximately 44.9 million Ordinary shares issued for the acquisition of Zarak Systems Corporation ("Zarak") in 2000, approximately 3.8 million shares arose in connection with the roll-over of outstanding options over Zarak shares into options over Spirent Ordinary shares on substantially similar terms as previously existed. These options have either a five or ten year life from the original date of grant.

Unvested rolled-over options were capable of immediate exercise (ie prior to their respective vesting date) and any shares arising from such an event were held in the ESOT until the relevant vesting date. The option holder was entitled to the beneficial (but not legal) interest in the shares whilst they were held in trust but they remained subject to forfeiture (with the original option exercise prices being refunded to the participant) if the participant's employment was terminated prior to the vesting date. All ZARSOP options and resulting shares held in the ESOT have now fully vested.

f) Caw Amended and Restated Stock Plan ("CARSP")

Out of a total initial consideration for the acquisition of Caw Networks, Inc. ("Caw") in 2002 of $49 million, approximately $4 million was in respect of Spirent Ordinary shares and options which arose on the roll-over of outstanding options and shares under the previous Caw employee stock plan. The options and shares would vest over a period ending in 2006 on substantially similar terms as previously existed. The options have a ten year life from the original date of grant. Pursuant to the terms of the Merger Agreement for Caw, an additional cash payment of 78.8 US cents was payable as each share vested or upon the exercise of a vested option.

Unvested rolled-over options were capable of immediate exercise (ie prior to their respective vesting date) and any shares arising from such an event were held in the ESOT until the relevant vesting date. The option holder was entitled to the beneficial (but not legal) interest in the shares whilst they were held in the ESOT but they remained subject to forfeiture (with the original option exercise prices being refunded to the participant) if the participant's employment was terminated prior to the vesting date. All CARSP options and resulting shares held in the ESOT have now fully vested.

In accordance with the original terms for acquiring Caw, in March 2004, Spirent allotted 4.3 million Ordinary shares and issued 75,000 options following the achievement by Caw of certain technical and financial earn out targets. Participation in the CARSP entitled the participants to a share in the earn out. Any earn out payment for an outstanding CARSP option was made by increasing the number of shares subject to the option and decreasing the per share exercise price so as to preserve the existing aggregate total exercise price. Of the 4.3 million shares, 54,000 shares were issued to the ESOT in respect of unvested restricted shares, which remained subject to forfeiture prior to vesting. As a result of the earn out, the additional cash payment referred to above was adjusted to 66.9 US cents as each share vested or upon the exercise of a vested option.

The Ordinary shares subject to rolled-over options from the acquisition of Netcom, Zarak and Caw, or granted under the SSIP, do not count towards ABI scheme limits. The plans mentioned in (a) and (d) to (f) above are closed to new entrants and no further awards of options can be made under them.

Notes to the consolidated financial statements continued

32. Authorised and issued share capital continued

g) UK Savings Related Share Option Scheme ("SRSOS") and the 2005 Sharesave Scheme

The SRSOS closed in 2005 and was replaced by the 2005 Sharesave Scheme. SRSOS options which remain outstanding may still be exercised prior to expiry, however no further grants can be made. Both schemes operate as HMRC approved Save-As-You-Earn schemes and are open to all UK employees, subject to a qualifying service period. Any future sharesave invitations will be made under the 2005 Sharesave Scheme, which is broadly similar to the SRSOS.

The employee enters into a Save-As-You-Earn contract with the Company's savings carrier to save a regular sum of between £5 and £250 per month for a fixed period of either three or five years.

No price is payable on the grant of an option. The option exercise price is calculated by reference to the middle market price of an Ordinary share on the business day prior to the beginning of the invitation period, discounted by up to 20 per cent, at the Board's discretion. Options are normally exercisable within six months of the third, fifth or seventh anniversary of the contract commencement date, as elected by the option holder at the start of the contract.

The Company operates the SST to honour the commitment to deliver Ordinary shares against the exercise of outstanding options under the SRSOS. Spirent Sharesave Trust Ltd, a wholly-owned subsidiary of Spirent Communications plc, acts as sole trustee of the SST. During the year, 1.4 million Ordinary shares were transferred to participants.

No invitations have been made under either UK Sharesave Schemes since 2003.

h) US Employee Stock Purchase Plan ("ESPP")

The ESPP enables the Company to grant eligible US employees the right to acquire Spirent American Depositary Shares using proceeds of a savings contract. When joining the ESPP, participants enter into a contract to save up to 15 per cent of basic salary (gross), subject to an individual maximum of $1,000 (net) per month, over a contract period of 12 months by way of regular payroll deductions.

No offer has been made under this plan since 2003.

i) Global All Employee Share Purchase Plan ("GAESPP")

The GAESPP was approved by shareholders in 2001 and offers employees in countries other than the UK or US an opportunity to share in the Company's performance through share ownership. The GAESPP was implemented in Canada in January 2002 and operates on similar terms to the ESPP above, with participants entering into a 12 month contract to save up to 15 per cent of basic salary (gross), subject to an individual maximum of Cdn $1,000 (net) per month.

No offer has been made under this plan since 2003.

j) UK Employee Share Purchase Plan ("UK ESPP")

On 4 May 2005, shareholders approved the UK ESPP, which is based on an HMRC approved share incentive plan, available to all UK employees (subject to a qualifying service period). The UK ESPP offers three ways to provide Ordinary shares to employees: free shares, partnership shares and matching shares. The UK ESPP will operate in conjunction with a trust, which will hold the shares on the behalf of participants.

Each year awards of free shares may be made to eligible employees up to a value of £3,000. Awards may be made subject to performance targets determined by the directors. In normal circumstances, free shares must be held in trust for between three and five years and normally become free of income tax and national insurance if held for five years.

Employees may be offered the opportunity to purchase partnership shares out of monthly contributions taken from pre-tax salary (up to £1,500 or 10 per cent of salary, if less). The directors determine an accumulation period of between one and 12 months following which the shares are purchased. Where the savings period is longer than one month, the purchase price will be the lesser of the price at the beginning of the accumulation period or the price at the end. Participants can withdraw partnership shares from the trust at anytime, however, doing so before five years may trigger a tax liability.

If partnership shares have been offered to employees, the Company may also offer matching shares up to a maximum of two matching shares for each partnership share. In normal circumstances, matching shares must be held in trust for a period of at least three years and may be subject to forfeiture if the participant leaves employment prior to the end of this period.

No awards have been made so far under this plan.

k) Stock Appreciation Rights Plan ("SARP")

The SARP was introduced in September 1999 as an interim incentive arrangement for the employees of Netcom following the closure of the NARSOP described in (d) above and subsequently for certain other employees in the Communications group. Under the SARP, recruitment, promotion and recognition awards over Ordinary shares have been made in line with historic and local market practice. The operation of the SARP reflected as far as practicable the NARSOP. Accordingly, rights under the SARP vested over four years, 25 per cent vesting one year after the date of grant and the remainder vesting on a monthly basis over a further 36 months. Rights granted were not subject to the fulfilment of any performance conditions.

The SARP will deliver the appreciation value (ie the aggregated increase in the market value of an Ordinary share over the rights price) in the form of existing Ordinary shares which have been purchased in the market by the Company's ESOT. The SARP is closed and no further grants can be made under it.

At 31 December 2006, the following rights were outstanding under the SARP:

Rights exercise dates	Rights price pence	Number of rights outstanding million
10.09.00-29.06.10	182-400	2.0

33. Share-based payment

The total charge for the year relating to employee share-based payment plans is as follows:

	2006 £ million	2005 £ million
Continuing operations		
1995 Executive Share Option Scheme	0.1	0.4
2005 Employee Incentive Plan	0.4	0.1
Spirent Stock Incentive Plan	4.6	4.4
Acquisition Plans	–	0.2
Employee Sharesave Schemes	0.1	–
	5.2	5.1
Discontinued operations		
1995 Executive Share Option Scheme	0.4	0.4
Employee Sharesave Schemes	–	0.1
	0.4	0.5
	5.6	5.6

Notes to the consolidated financial statements continued

33. Share-based payment continued

The fair value of the options and purchase rights over Ordinary shares is estimated as at the date of grant using a binomial model. The following table gives the assumptions made in arriving at the share-based payments charge:

	2006	2005
Weighted average share price (pence)	45	53
Weighted average fair value (pence)	23	24
Expected volatility (%)	40-50	50-55
Expected life (years)	4.5	4.5
Risk free rate (%)	4.7-5.1	4.2
Dividend yield (%)	nil	nil-1.0

The expected volatility was determined by calculating the historical volatility of the Company's share price over the previous two years which management considers to be the period which is likely to be most representative of future volatility. The expected life used in the model has been adjusted, based on management's best estimate for the effects of non-transferability, exercise restrictions and behavioural considerations. For performance shares granted under the 2005 Employee Incentive Plan, which have a market based performance condition, it has been assumed that there will be 50 per cent vesting for valuation purposes.

34. Reconciliation of movements in equity

£ million

	Share capital	Share premium account	Capital reserve	Translation reserve	Net unrealised gains and (losses)	Retained earnings/ (loss)	Minority interests	Total equity
At 1 January 2005	31.9	1.3	10.9	1.6	0.5	112.8	1.3	160.3
Total recognised income and expense for the year	–	–	–	3.9	1.4	(52.1)	0.6	(46.2)
Share-based payment	–	–	–	–	–	5.4	–	5.4
New shares issued	0.3	3.1	(0.7)	–	–	–	–	2.7
At 1 January 2006	32.2	4.4	10.2	5.5	1.9	66.1	1.9	122.2
Total recognised income and expense for the year	–	–	–	(11.6)	(1.9)	110.4	–	96.9
Minority interests sold	–	–	–	–	–	–	(1.9)	(1.9)
Share-based payment	–	–	–	–	–	5.2	–	5.2
New shares issued	0.3	6.2	(4.7)	–	–	–	–	1.8
Employee share ownership trust	–	–	–	–	–	0.5	–	0.5
On-market share repurchase	–	–	–	–	–	(41.9)	–	(41.9)
At 31 December 2006	32.5	10.6	5.5	(6.1)	–	140.3	–	182.8

Nature and purpose of reserves

A reconciliation of the opening and closing balance on each reserve is shown in the Reconciliation of movements in equity. The nature and purpose of each reserve within equity is as follows:

i) Share premium account: this reserve records the consideration premium for shares issued at a value that exceeds their nominal value;
ii) Capital reserve: this reserve arises in relation to share option plans in acquired companies;
iii) Translation reserve: this reserve is used to record exchange differences arising from the translation of the financial statements of foreign subsidiaries. It is also used to record foreign exchange arising on the net investments hedged in these subsidiaries; and
iv) Net unrealised gains and losses: this reserve records movements in fair value of effective forward currency contracts accounted for using hedge accounting.

Investment in own shares

At 31 December 2006, an amount of £43.9 million (2005 £2.6 million) is deducted from retained earnings in relation to the cost of investment in own shares. These shares include shares held in trust and treasury shares.

Shares held in trust relates to 1.9 million Ordinary shares (2005 3.2 million) held by the Spirent Sharesave Trust ("SST") and 9.7 million Ordinary shares (2005 9.4 million) held by the Spirent Employee Share Ownership Trust ("ESOT"). Shares held by the SST will be used to satisfy options under the Company's Savings Related Share Option Schemes. Shares held in the ESOT are primarily held to hedge awards under various discretionary employee share schemes. The market value of own shares held in trust at 31 December 2006 was £6.6 million (2005 £6.2 million).

At 31 December 2006 the Company held 90.3 million Ordinary shares in treasury (2005 nil). The market value of own shares held in treasury at 31 December 2006 was £51.2 million (2005 nil).

Cancellation of share premium and capital redemption reserves

On 24 November 2004, Spirent Communications plc was granted an order of the High Court for the approval of the cancellation of the share premium account and capital redemption reserve ("the Cancellation") which stood at that date at £702.7 million and £0.7 million, respectively.

The Cancellation created a reserve in the financial statements of the Company which was applied to eliminate the deficit in distributable reserves. The balance of this reserve, created after the deficit in distributable reserves had been eliminated, was transferred to a special non-distributable reserve. The special non-distributable reserve at 31 December 2005 was £11.1 million. During 2006 the Company transferred funds equal to the aggregate amount due to any creditors of Spirent Communications plc, who were creditors on 24 November 2004, and who still remained creditors, to a blocked trust account. Placing these funds in a blocked trust account in accordance with the undertakings made at the time of the Cancellation allowed the special reserve to be released to distributable reserves.

Notes to the consolidated financial statements continued

35. Reconciliation of profit/(loss) before tax to cash generated from operations

	2006 £ million	2005 £ million
Continuing operations		
Loss before tax	(50.1)	(41.7)
Adjustments for:		
Profit on the disposal of operations	–	(3.9)
Finance income	(7.6)	(1.5)
Finance costs	1.6	8.1
Costs associated with the repayment of loan notes	8.8	–
Goodwill impairment	46.8	37.0
Depreciation of property, plant and equipment	11.8	11.4
Loss on the disposal of property, plant and equipment	0.6	0.1
Impairment of property, plant and equipment	0.8	–
Intangible asset amortisation	1.6	–
Share-based payment	5.2	5.1
Settlement and curtailment gains on pension plan	(1.7)	–
Changes in working capital		
Deferred income (released)/received	(1.3)	5.8
(Increase)/decrease in receivables	(6.1)	0.4
Increase in inventories	(0.4)	(0.4)
Decrease in payables	(2.8)	(16.8)
Decrease in provisions	(1.0)	(0.9)
Defined benefit pension fund	(47.0)	(3.8)
Cash flows from continuing operations	(40.8)	(1.1)
Discontinued operations		
Profit before tax	169.1	19.3
Adjustments for:		
Share of profit of associates	(0.1)	(2.7)
Profit/(loss) on sale of discontinued operations	(166.1)	6.7
Finance income	–	(0.1)
Finance costs	0.1	1.2
Depreciation of property, plant and equipment	1.6	11.2
Profit on the disposal of property, plant and equipment	(0.1)	(0.1)
Share-based payment	0.4	0.5
Changes in working capital		
Increase in receivables	(2.9)	(1.7)
Decrease/(increase) in inventories	0.5	(3.0)
(Decrease)/increase in payables	(2.4)	3.8
Cash flows from discontinued operations	0.1	35.1
Cash flows from operations	(40.7)	34.0

36. Acquisition of businesses

During the year the Group acquired the following businesses:

	% acquired	Date
SwissQual Holding AG ("SwissQual")	100	23 January 2006
QuadTex Systems, Inc ("QuadTex")	100	13 February 2006
Scientific Software Engineering, Inc ("SSE")	100	10 July 2006
The assets of Imperfect Networks, Inc ("IN")		10 August 2006

The book value and fair value of assets acquired and liabilities assumed were as follows:

			2006 £ million			2006 £ million
	SwissQual	Others	Book value Total	SwissQual	Others	Fair value Total
Intangible assets	0.5	–	0.5	6.0	4.0	10.0
Property, plant and equipment	0.5	–	0.5	0.5	–	0.5
Inventories	0.6	–	0.6	0.6	–	0.6
Trade and other receivables	6.0	0.5	6.5	6.5	0.5	7.0
Cash and cash equivalents	–	0.1	0.1	–	0.1	0.1
Trade and other payables	(3.7)	(0.2)	(3.9)	(5.6)	(0.2)	(5.8)
Defined benefit pension plan deficit	(0.3)	–	(0.3)	(0.3)	–	(0.3)
Overdraft	(0.2)	–	(0.2)	(0.2)	–	(0.2)
Deferred tax	(0.2)	–	(0.2)	(0.2)	–	(0.2)
Net assets acquired	3.2	0.4	3.6	7.3	4.4	11.7
Goodwill				28.4	10.8	39.2
				35.7	15.2	50.9
Consideration						
Cash (including expenses)				31.2	13.1	44.3
Deferred consideration accrued				4.5	2.1	6.6
				35.7	15.2	50.9
The cash flows in respect of the acquisition of businesses are as follows:						
Initial cash consideration paid				27.8	11.9	39.7
Deferred consideration paid				3.1	0.6	3.7
Expenses				0.3	0.6	0.9
Cash consideration paid				31.2	13.1	44.3
Less cash and cash equivalents acquired				0.2	(0.1)	0.1
Net cash outflow on acquisitions				31.4	13.0	44.4

There were no acquisitions in 2005.

Goodwill arising on the acquisitions results from assets that cannot be recognised separately and cannot be measured reliably.

Deferred consideration accrued is the Company's best estimate and may change as a result of the actual future performance and achievement of milestones of the businesses acquired.

Notes to the consolidated financial statements continued

36. Acquisition of businesses continued

The amount of revenue and profit since the date of acquisition included in the consolidated income statement for the Group in respect of SwissQual is £12.7 million and £1.0 million, respectively. For the full year SwissQual reported revenue of £12.8 million and profit of £0.7 million. The other acquisitions in 2006 have been fully integrated into Performance Analysis and it is not therefore possible to derive separate revenue and profit figures for them post acquisition or for the full year.

Changes in the carrying value of goodwill during the period since acquisition are as follows:

			2006 £ million
	SwissQual	Others	Total
Goodwill arising on acquisition	28.4	10.8	39.2
Impairment losses recognised during the period since acquisition	(27.7)	–	(27.7)
Exchange adjustments	(0.7)	(0.7)	(1.4)
Goodwill at 31 December	–	10.1	10.1

SwissQual

SwissQual is a Swiss based provider of voice and video solutions that analyse, measure and improve the quality of experience for users of wireless applications and services. The initial consideration was CHF 62.5 million (£27.8 million), paid in cash on completion with up to a further CHF28.0 million (£12.4 million) payable depending on revenue growth and various technical and financial milestones. Of the deferred consideration CHF7.0 million (£3.1 million) was earned and paid by the Group in 2006.

QuadTex

QuadTex is a US based provider of test tools for internet protocol multimedia subsystem (“IMS”) and voice over IP (“VoIP”) testing. The initial consideration was $7.5 million (£4.3 million), paid in cash on completion with up to a further $1.5 million (£0.9 million) payable depending on certain technical milestones. Of this deferred consideration $0.8 million (£0.4 million) is related to the continued employment of certain employees and will be treated as a compensation cost over the relevant period. Deferred consideration of $0.6 million (£0.3 million) was paid by the Group in 2006.

SSE

SSE is a US based developer of the Landslide product, a leading software based system for testing the performance and functionality of 2.5 and 3G wireless network infrastructure. The initial consideration was $10.0 million (£5.5 million), paid in cash on completion with up to a further $6.0 million (£3.3 million) payable depending on the satisfaction of certain technical milestones. Of this deferred consideration $3.6 million (£2.0 million) is related to the continued employment of certain employees and will be treated as a compensation cost over the relevant period. Deferred consideration accounted for as an acquisition cost of $0.5 million (£0.3 million) was paid by the Group in 2006.

IN

IN is a US based developer of security testing solutions. The acquisition will enable Spirent to deliver enhanced security testing solutions to its customers across a number of markets. The initial consideration was $4.0 million (£2.1 million), paid in cash on completion, with up to a further $4.0 million (£2.2 million) payable depending on the satisfaction of certain technical milestones and revenues to be achieved in 2007.

37. Disposal of operations

	2006 £ million	2005 £ million
Net assets disposed of		
Goodwill	5.5	–
Investment in associates	16.1	–
Property, plant and equipment	70.9	–
Inventories	33.1	–
Trade and other receivables	56.9	–
Cash and cash equivalents	7.3	–
Current tax	(1.7)	–
Trade and other payables	(48.7)	–
Loans and finance leases	(9.4)	–
Deferred tax	(2.0)	–
Minority interests	(1.9)	–
Net assets	126.1	–
Consideration net of expenses	290.4	(2.8)
Consideration less net assets	164.3	(2.8)
Exchange gain transferred to profit on sale	1.3	–
Curtailment gain on pension fund	0.5	–
Profit/(loss) on disposal of operations	166.1	(2.8)
Profit on disposal of operations	–	3.9
Profit on disposal of discontinued operations – HellermannTyton Division *note 6*	166.1	(6.7)
	166.1	(2.8)

During 2005, the Group disposed of certain non-trading companies for £3.9 million and incurred costs amounting to £6.7 million in relation to the announced disposal of the HellermannTyton Division. The sale of the HellermannTyton Division to funds controlled by Doughty Hanson & Co Limited was completed on 15 February 2006.

Cash flows in respect of the disposal of operations are as follows:

	2006 £ million	2005 £ million
Consideration received on disposal of operations	320.4	3.9
Less cash consideration paid for the associated companies	(25.8)	–
Cash expenses paid on the disposal of the HellermannTyton Division	(4.2)	(6.7)
Consideration net of expenses	290.4	(2.8)
Less cash and cash equivalents sold	(7.3)	–
	283.1	(2.8)
Expenses accrued on the disposal of the HellermannTyton Division	0.3	5.2
Expenses paid accrued in the prior year	(5.2)	–
Net cash flow	278.2	2.4

Notes to the consolidated financial statements continued

38. Related party transactions

Transactions between the Company and its subsidiaries, which are related parties, have been eliminated on consolidation and are not disclosed in this note. Transactions between the Group and its associates are disclosed below.

Trading transactions

During the year, Group companies entered into the following transactions with related parties who are not members of the Group:

£ million

	Sales of goods		Purchases of goods		Amounts owed by related parties		Amounts owed to related parties	
	2006	2005	2006	2005	2006	2005	2006	2005
Associates	0.4	1.2	0.3	3.0	–	0.5	–	1.3

Sales to and purchases from related parties are made at normal market prices.

The amounts outstanding are unsecured and will be settled in cash. No guarantees have been given or received. No provisions have been made in respect of the amounts owed by related parties. The amounts owed by and to related parties for 2005 are included in discontinued operations.

Remuneration of key management personnel

The remuneration of the directors, who are the key management personnel of the Group, is set out below in aggregate for each of the categories specified in IAS 24 'Related Party Disclosures'.

	2006 £000	2005 £000
Short term employee benefits	1,692	1,442
Share-based payment	440	504
Post-retirement benefits	27	32
	2,159	1,978

In addition Eric Hutchinson made gains on the exercise of Share options of £487,000 before transaction costs, taxes and employers and employees national insurance. Employers national insurance was £47,000.

During the year, Eric Hutchinson transferred the value of his accrued benefits from the Staff Plan to a personal pension arrangement. The transfer payment of £3,984,844 was made pursuant to an enhanced transfer value offer which was made to all active and deferred members of the Staff Plan.

Independent auditors' report to the members of Spirent Communications plc

We have audited the parent Company financial statements of Spirent Communications plc for the year ended 31 December 2006 which comprise the Company balance sheet and the related notes 1 to 22. These parent Company financial statements have been prepared under the accounting policies set out therein. We have also audited the information in the directors' remuneration report that is described as having been audited.

We have reported separately on the Group financial statements of Spirent Communications plc for the year ended 31 December 2006.

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

Respective responsibilities of directors and auditors

The directors' responsibilities for preparing the Annual Report, the directors' remuneration report and the parent Company financial statements in accordance with applicable United Kingdom law and Accounting Standards (United Kingdom Generally Accepted Accounting Practice) are set out in the Statement of directors' responsibilities.

Our responsibility is to audit the parent Company financial statements and the part of the directors' remuneration report to be audited in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland).

We report to you our opinion as to whether the parent Company financial statements give a true and fair view and whether the parent Company financial statements and the part of the directors' remuneration report to be audited have been properly prepared in accordance with the Companies Act 1985. We also report to you whether in our opinion the information given in the parent Company directors' report is consistent with the financial statements.

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

We read other information contained in the Annual Report and consider whether it is consistent with the audited parent Company financial statements. The other information comprises only the directors' report, the Chairman's statement and the Business review. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the parent Company financial statements. Our responsibilities do not extend to any other information.

Basis of audit opinion

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

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

Opinion

In our opinion:

– the parent Company financial statements give a true and fair view, in accordance with United Kingdom Generally Accepted Accounting Practice, of the state of the Company's affairs as at 31 December 2006;

– the parent Company financial statements and the part of the directors' remuneration report to be audited have been properly prepared in accordance with the Companies Act 1985; and

– the information given in the directors' report is consistent with the parent Company financial statements.

Ernst & Young LLP
Registered auditor
London

1 March 2007

Company balance sheet

At 31 December	Notes		2006 £ million		2005 £ million
Fixed assets					
Tangible assets	4		1.8		15.9
Fixed asset investments					
Shares in subsidiaries	5		143.4		233.2
Loans to subsidiaries	6		109.4		119.1
Investment in associate	7		–		0.1
Total fixed assets			254.6		368.3
Current assets					
Stocks	8	3.7		9.3	
Trade and other debtors	9	8.8		21.9	
Derivative financial instruments	16	0.1		2.6	
Cash and bank deposits		89.1		26.4	
		101.7		60.2	
Current liabilities					
Creditors due within one year	10	(12.7)		(23.4)	
Derivative financial instruments	16	–		(0.6)	
Loans due within one year	14	–		(3.2)	
		(12.7)		(27.2)	
Net current assets			89.0		33.0
Assets less current liabilities			343.6		401.3
Long term liabilities					
Creditors due after more than one year	11		(91.4)		(234.3)
Derivative financial instruments	16		–		(2.0)
Provisions for liabilities and charges					
Deferred tax	12		–		(0.8)
Provisions	13		(2.7)		(1.7)
Assets less liabilities (excluding pension fund surplus/(deficit))			249.5		162.5
Pension fund surplus/(deficit)	3		1.7		(51.5)
Assets less liabilities (including pension fund surplus/(deficit))			251.2		111.0
Capital and reserves	17				
Called up share capital			32.5		32.2
Share premium account			10.6		4.4
Capital reserve			5.5		10.2
Net unrealised gains and losses			–		2.0
Profit and loss account			202.6		62.2
Shareholders' funds – equity			251.2		111.0

The notes on pages 95 to 111 form part of these financial statements.

Signed on behalf of the Board

Anders Gustafsson
Director
1 March 2007

Notes to the parent Company financial statements

1. Significant accounting policies

Basis of accounting

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

As the Company is included in the consolidated financial statements, made up to 31 December each year, it is not required to present a separate profit and loss account as provided by Section 230 of the Companies Act 1985.

Tangible assets

Depreciation is not provided on freehold land. Depreciation is provided to write off all other assets over their estimated useful lives at rates which take into account commercial conditions at their location. Usual asset lives are as follows:

Freehold buildings	50 years
Leasehold properties	Over the lease period
Plant and machinery	3 to 8 years
Fixtures, fittings and equipment	
Building installations	20 years or lease period if less
Fittings and equipment	3 to 8 years
Motor vehicles	3 to 5 years
Business systems software	4 years

The carrying values of tangible fixed assets are reviewed for impairment in periods if events or changes in circumstances indicate the carrying value may not be recoverable.

Investments

Fixed asset investments, including investment in subsidiaries, are stated at cost and reviewed for impairment if there are indications that the carrying value may not be recoverable.

Leases

Finance leases, which transfer substantially all the risks and rewards of ownership of the assets concerned, are capitalised on the balance sheet at net present value. The corresponding liabilities are recorded as long term or current liabilities depending on the period when they are due. The interest elements of the rental obligations are charged to the profit and loss account over the periods of the leases as a finance cost. Capitalised leased assets are depreciated over their useful life.

Operating lease rentals are charged to the profit and loss account over the period of the lease on a straight line basis.

Inventories

Inventories are valued at the lower of cost and estimated net realisable value. Cost includes all costs in bringing each product to its present location and condition, being the full manufacturing cost on a first-in-first-out basis, including all attributable overheads based on a normal level of activity. Net realisable value represents the selling price less further costs to be incurred to completion and on sale.

Trade and other debtors

Trade debtors, which generally have 30 to 90 day terms, are recognised and carried at original invoice amount less an allowance for any uncollectable amounts. An estimate for doubtful debts is made when collection of the full amount is no longer probable. Bad debts are written off when identified.

Provisions

Provisions are recorded when the Company has a present, legal or constructive obligation as a result of a past event which it is probable that it will be required to settle by an outflow of resources and for which a reliable estimate of the amount of the obligation can be made. Provisions are reviewed at each balance sheet date and adjusted to reflect the current best estimate.

Where the effect of the time value of money is material, the amount of the provision shall be the present value of the expenditures expected to be required to settle the obligation.

Notes to the parent Company financial statements continued

1. Significant accounting policies continued

Revenue recognition

Revenue is recognised when it is probable that the economic benefits will flow to the Company, the revenue can be reliably measured and when the Company has transferred to the buyer the significant risks and rewards of ownership. In addition, revenue is only recognised when collectability is probable.

For the sale of services, revenue is recognised in accounting periods in which the service is rendered.

Foreign currencies

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

Monetary assets and liabilities denominated in foreign currencies are translated at the rates ruling at the balance sheet date. All exchange profits and losses are taken to the profit and loss account.

Product development

Expenditure is charged to the profit and loss account in the year in which it is incurred.

Financial instruments

Financial assets and liabilities are recognised on the Company's balance sheet when it becomes a party to the contractual provisions of the instrument.

Interest-bearing loans and borrowings

Loans and overdrafts are initially recognised at fair value of the consideration received, net of issue costs. Issue costs are amortised over the expected life of the instrument.

After initial recognition, interest-bearing loans and borrowings are subsequently measured at amortised cost using the effective interest method. Amortised cost is calculated by taking into account any issue costs and any discount or premium on settlement.

From 1 January 2005, hedge accounting is adopted where derivatives such as "fixed to floating" interest rate swaps are held as fair value hedges against fixed interest rate borrowings. Under fair value hedge accounting, fixed interest rate borrowings are revalued at each balance sheet date by the change in the fair value attributable to the interest rate risk being hedged.

Equity instruments

Equity instruments are recorded at the proceeds received, net of direct issue costs.

Derivative financial instruments

The Company uses derivative financial instruments to hedge its exposures to fluctuations in interest and foreign exchange rates. The Company's policy is not to undertake any trading activity in financial instruments. Such derivative financial instruments are stated at fair value with effect from 1 January 2005.

Derivative financial instruments are initially recognised at fair value on the date on which a derivative contract is entered into and are subsequently remeasured at fair value. Derivatives are carried as assets when the fair value is positive and as liabilities when the fair value is negative.

For those derivatives designated as hedges and for which hedge accounting is desired, the hedging relationship is documented at its inception. This documentation identifies the hedging instrument, the hedged item or transaction, the nature of the risk being hedged and how effectiveness will be measured throughout its duration. Such hedges are expected at inception to be highly effective.

Forward exchange contracts are used to hedge foreign exchange exposures arising on forecast receipts and payments in foreign currencies. The fair value of forward exchange contracts is calculated by reference to current forward exchange rates for contracts with similar maturity profiles. Interest rate swaps are used to hedge the Company's exposure to movements in interest rates. The fair value of interest rate swaps is determined by reference to market rates for similar instruments.

For the purpose of hedge accounting, hedges are classified as fair value hedges when they hedge the exposure to changes in the fair value of a recognised asset or liability; or cash flow hedges where they hedge exposure to the variability in cash flows that is due to the risk associated with a recognised asset or liability or a forecast transaction.

In relation to these fair value hedges (interest rate swaps) which meet the conditions for hedge accounting, any gain or loss from remeasuring the hedging instrument is recognised in the profit and loss account and any gain or loss on the item that is being hedged is adjusted against its carrying amount and recognised in the profit and loss account.

In relation to cash flow hedges (forward foreign exchange contracts) to hedge firm commitments or highly probable forecast transactions and which meet the conditions for hedge accounting, the proportion of the gain or loss on the remeasurement of the fair value of the hedging instrument that is deemed to be effective is recognised in equity and the ineffective portion is recognised in the profit and loss account.

When the firm commitment or highly probable forecast transaction results in the recognition of an asset or liability, the associated gains and losses that have previously been recognised in equity are included in the initial measurement of the carrying amount of the asset or liability at the time the asset or liability is recognised.

For derivatives that do not qualify for hedge accounting, any gains or losses arising from changes in fair value are taken to the profit and loss account.

Gains or losses arising on hedging instruments, which are cancelled due to termination of the underlying exposure, are taken to the profit and loss account immediately.

Derivatives embedded in other financial instruments or other host contracts are treated as separate derivatives when their risks and characteristics are not closely related to those of the host contracts.

Pensions

The Company operates two defined benefit pension schemes for the benefit of employees. These schemes require contributions to be made to separately administered funds, based on triennial actuarial valuations. Other schemes are defined contribution in nature.

The assets of the defined benefit schemes are measured at their market value at the balance sheet date and the liabilities of the schemes are measured using the projected unit credit method. The discount rate used to measure the schemes' liabilities is the current rate of return on an AA corporate bond of equivalent term and currency to the liabilities. The extent to which the schemes' assets exceed or fall short of the schemes' liabilities is shown as a surplus or deficit in the balance sheet net of deferred tax.

The regular service cost of providing retirement benefits to employees in defined benefit schemes is charged to operating profit in the year together with the cost of providing benefit improvements in respect of past service and gains or losses arising on settlements and curtailments.

A credit for the expected return on the schemes' assets and a charge for the increase during the period in the present value of the schemes' liabilities because the benefits are one year closer to settlement, are included in other finance income or expense in the profit and loss account. Differences arising between the actual and expected returns on the schemes' assets together with changes in the actuarial assumptions are included in the statement of recognised gains and losses.

Contributions payable to the other defined contribution schemes are charged to the profit and loss account in the year for which they are due.

Treasury shares

Spirent Communications plc shares held by the Company are classified in shareholders equity as treasury shares and are recognised at cost and shown as a deduction from retained earnings. Consideration received for the sale of such shares is also recognised in equity, with any difference between the proceeds from sale and the original cost being taken to retained earnings.

Notes to the parent Company financial statements continued

1. Significant accounting policies continued

Employee benefits

When an employee has rendered service to the Company during an accounting period, short term benefits expected to be paid in exchange for that service are recognised in the same accounting period.

Share-based payment

The cost of equity-settled transactions with employees is measured by reference to the fair value at the date at which they are granted. The fair value is determined using a binomial model.

The cost of equity-settled transactions is recognised, together with a corresponding increase in equity, over the period in which the performance conditions are fulfilled, ending on the date on which the relevant employees become fully entitled to the award (vesting date). The cumulative expense recognised for equity-settled transactions at each reporting date, until the vesting date, reflects the extent to which the vesting period has expired and the number of awards that will ultimately vest, in the opinion of the directors of the Company at that date and based on the best available estimates.

No expense is recognised for awards that do not ultimately vest, except for awards where vesting is conditional upon a market condition, which are treated as vesting irrespective of whether or not the market condition is satisfied, provided that all other performance conditions are satisfied.

Where the terms of an equity-settled award are modified, as a minimum an expense is recognised as if the terms had not been modified. In addition, an expense is recognised for any increase in the value of the transaction as a result of the modification, as measured at the date of modification.

Where an equity-settled award is cancelled, it is treated as if it had vested on the date of cancellation and any expense not yet recognised for the award is recognised immediately. However, if a new award is substituted for the cancelled award and designated as a replacement award on the date that it is granted, the cancelled and new awards are treated as if they were a modification of the original award, as described in the previous paragraph.

The Company has an employee share trust for the granting of certain options to employees. Shares are held by the employee share trust, treated as treasury shares and presented in the balance sheet as a deduction from equity.

Tax

The tax expense represents the sum of the tax currently payable and deferred tax.

The tax currently payable represents the amount expected to be paid or recovered in respect of taxable profit for the year and is calculated using tax rates that have been enacted or substantially enacted at the balance sheet date.

Deferred tax is provided on an undiscounted basis on all timing differences that have originated but not reversed at the balance sheet date except as referred to below. Amounts provided are calculated with reference to tax rates that are expected to apply in the periods in which the timing differences are expected to reverse, based on tax rates and laws that have been enacted or substantively enacted by the balance sheet date.

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

Deferred tax is not provided on gains on the disposal of fixed assets that have been rolled over into replacement assets, unless there is a binding agreement to dispose of the assets concerned. Provision will not be made where it is considered more likely than not that the taxable gain will be rolled over into replacement assets and charged to tax only when the replacement assets are sold.

2. Employees

Please refer to the Report on directors' remuneration on pages 26 to 32 for disclosures relating to the emoluments, share options and long term incentive interests and pensions of the directors.

3. Pensions

Defined benefit schemes

The defined benefit schemes are in the United Kingdom and comprise the Staff Pension Plan and the Retirement Cash Plan. These schemes have been combined for the purposes of the following disclosures.

The most recent actuarial valuation of the schemes' assets and the present value of the defined benefit schemes' obligations using the project unit credit method at 1 April 2003 have been used and updated by our independent actuaries.

The triennial actuarial valuations of the schemes at 1 April 2006 are currently in progress.

i) The key financial assumptions used were:

	2006 %	2005 %	2004 %
Inflation	3.1	2.9	2.9
Rate of increase in pensionable salaries	3.8	3.6	3.6
Rate of increase for pensions in payment pre 2001 service	3.5	3.5	3.0
Rate of increase for pensions in payment post 2001 pre April 2005 service	3.1	2.8	2.7
Rate of increase for pensions post April 2005 service	2.3	2.1	–
Rate of increase in deferred pensions	3.1	2.9	2.9
Rate used to discount scheme liabilities	5.2	4.7	5.3

The expected long term rate of return on assets has been set reflecting the price inflation expectation, the expected real return on each major asset class and the long term asset allocation strategy adopted for the plans.

The mortality assumptions are based on standard mortality tables which allow for future mortality improvements. The assumptions used imply that a member who retires in 2026 aged 65 will live on average for a further 22 years after retirement if they are male and a further 24 years after retirement if they are female.

ii) The assets and the liabilities in the scheme were as follows:

	Long term rate of return expected %	2006 £ million	Long term rate of return expected %	2005 £ million	Long term rate of return expected %	2004 £ million
Equities	8.0	65.9	7.6	77.2	7.5	62.2
Government bonds	4.5	67.7	4.1	22.1	4.5	11.9
Corporate bonds	5.0	11.3	4.5	13.4	5.0	18.8
Cash	5.2	1.7	4.8	2.1	5.0	2.6
Property	7.0	6.3	6.6	5.5	6.5	4.6
Other	5.7	7.7	5.2	8.5	5.6	6.8
Fair value of scheme assets	6.1	160.6	6.4	128.8	6.5	106.9
Present value of funded obligations		(158.2)		(179.6)		(144.2)
Net surplus/(deficit) in the schemes		2.4		(50.8)		(37.3)
Related deferred tax asset		–		–		11.1
Surplus/(deficit) in schemes net of tax		2.4		(50.8)		(26.2)
Present value of unfunded obligations		(0.7)		(0.7)		(0.8)
Net pension asset/(liability)		1.7		(51.5)		(27.0)

In 2005 a deferred tax asset was not recognised as its future recovery was uncertain. The schemes are prohibited from investing in Spirent's own financial instruments.

Notes to the parent Company financial statements continued

3. Pensions continued

iii) Analysis of the amounts charged to the profit and loss account

	2006 £ million	2005 £ million
Analysis of amount charged to operating costs		
Current service cost	1.0	2.4
Curtailment gains on disposal of operations	(0.5)	–
Other curtailment gains	(1.2)	–
Settlement gains	(0.5)	–
Total operating (credit)/charge	(1.2)	2.4
Analysis of amount charged to finance costs		
Expected return on pension schemes' assets	(10.0)	(6.9)
Interest on pension schemes' liabilities	8.0	7.6
Finance costs	(2.0)	0.7
Net profit and loss (credit)/charge	(3.2)	3.1

iv) Analysis of amount recognised directly in equity

	2006	2005
Actual return less expected return on pension schemes' assets	0.5	14.6
Experience gains arising on the schemes' liabilities	(10.0)	4.8
Changes in assumptions underlying the present value of the schemes' liabilities	11.6	(35.5)
Actuarial gain/(loss) recognised directly in equity	2.1	(16.1)

v) Movements in the surplus/(deficit) in the year

	2006 £ million	2005 £ million
At 1 January	(50.8)	(37.3)
Current service cost	(1.0)	(2.4)
Interest income/(expense)	2.0	(0.7)
Employer contributions	47.9	5.7
Curtailment gains	1.7	–
Settlement gains	0.5	–
Actuarial gain/(loss)	2.1	(16.1)
Net surplus/(deficit) in the schemes at 31 December	2.4	(50.8)

vi) History of experience gains and losses

	2006 £ million	2005 £ million	2004 £ million	2003 £ million	2002 £ million
Present value of schemes' liabilities	(158.2)	(179.6)	(144.2)	(142.2)	(130.9)
Fair value of schemes' assets	160.6	128.8	106.9	98.8	89.0
Net surplus/(deficit) in schemes	2.4	(50.8)	(37.3)	(43.4)	(41.9)
Experience gains and losses on the schemes' assets					
Amount (£ million)	0.5	14.6	3.6	6.6	(20.3)
Percentage of the schemes' assets (%)	0.3	11.3	3.4	6.7	(22.8)
Experience gains and losses on the schemes' liabilities					
Amount (£ million)	(10.0)	4.8	2.4	6.8	(0.9)
Percentage of the present value of the schemes' liabilities (%)	(6.3)	2.7	1.7	4.8	(0.7)
Total amount recognised in the statement of recognised gains and losses					
Amount (£ million)	2.1	(16.1)	3.0	0.3	(23.6)
Percentage of the present value of the schemes' liabilities (%)	1.3	(9.0)	2.1	0.2	(18.0)

The cumulative amount of actuarial gains and losses recognised since 1 January 2003 in the Company's statement of recognised gains and losses is £10.7 million loss (2005 £12.8 million loss). The directors are unable to determine how much of the pension scheme deficit recognised on 1 January 2003 and taken directly to equity of £41.9 million in the Company is attributable to actuarial gains and losses since inception of those pension schemes. Consequently, the directors are unable to determine the amount of actuarial gains and losses that would have been recognised in the Company's statement of recognised gains and losses before 1 January 2003.

Expected cash contributions for 2007 for these schemes are £0.3 million.

The above schemes are funded and have full UK HM Revenue & Customs tax-exempt approval. Certain members, whose salaries were in excess of the HM Revenue & Customs statutory earnings cap, have had their benefits increased through unapproved, unfunded arrangements, to the level that would otherwise have applied in respect of the basic salary only. The Company has contractually agreed to pay the additional retirement benefits itself and a provision is made in respect of this obligation in the balance sheet at 31 December 2006 of £0.7 million (2005 £0.7 million). This represents the actuarial value as confirmed by the Company's pension advisers, of the unapproved benefit entitlements accrued at that date. The value is assessed and reviewed on a Market Value basis in line with the Main Plan Valuation and adjusted each year by the charge for the year (equivalent to a contribution to a funded plan) of nil (2005 £0.1 million).

Defined contribution schemes

United Kingdom

The Company maintains defined contribution pension schemes for employees in the UK. Employer contributions into these schemes for 2006 were £0.4 million (2005 £0.3 million).

Notes to the parent Company financial statements continued

4. Tangible assets

£ million

	Land and buildings Freehold	Land and buildings Long lease	Land and buildings Short lease	Plant and machinery	Fixtures, fittings and equipment	Total
Cost						
At 1 January 2006	1.2	9.1	0.4	34.6	9.1	54.4
Additions						
Owned assets	–	–	–	0.4	0.2	0.6
Disposal of businesses	(1.2)	(7.5)	–	(32.2)	(4.7)	(45.6)
Disposals	–	–	–	(0.1)	(0.2)	(0.3)
At 31 December 2006	–	1.6	0.4	2.7	4.4	9.1
Depreciation and impairment						
At 1 January 2006	0.5	2.4	0.2	27.7	7.7	38.5
Provided during the year	–	0.1	–	0.7	0.3	1.1
Disposal of businesses	(0.5)	(1.5)	(0.1)	(26.2)	(3.8)	(32.1)
Disposals	–	–	–	–	(0.2)	(0.2)
At 31 December 2006	–	1.0	0.1	2.2	4.0	7.3
Net book value at 31 December 2005	0.7	6.7	0.2	6.9	1.4	15.9
Net book value at 31 December 2006	–	0.6	0.3	0.5	0.4	1.8

5. Shares in subsidiaries

£ million

Cost	
At 1 January 2006	820.1
Additions	35.1
Transfers to subsidiaries	1.0
Disposals	(30.9)
At 31 December 2006	825.3
Provisions	
At 1 January 2006	586.9
Increases in provisions	116.4
Disposals	(21.4)
At 31 December 2006	681.9
Net book value at 31 December 2005	233.2
Net book value at 31 December 2006	143.4

6. Loans to subsidiaries

	£ million
At 1 January 2006	119.1
Advances	8.2
Repayments	(7.4)
Exchange adjustment	(10.5)
At 31 December 2006	109.4

7. Investments in Associates

	2006 £ million	2005 £ million
Cost		
At 31 December	–	0.1

The associated company as at 31 December 2005 was:

	Location	% holding	Nature of business
Tyton Company of Japan	Japan	49%	Cable management products

8. Stocks

	2006 £ million	2005 £ million
Raw materials	2.7	3.1
Work in progress	0.3	0.7
Finished goods	0.7	5.5
	3.7	9.3

9. Trade and other debtors

	2006 £ million	2005 £ million
Due within one year		
Trade debtors	4.2	8.7
Owed by subsidiaries	2.8	8.5
Owed by associates	–	0.1
Other debtors	1.0	1.9
Tax recoverable	–	1.3
Prepayments and accrued income	0.8	1.4
	8.8	21.9

Notes to the parent Company financial statements continued

10. Creditors due within one year

	2006 £ million	2005 £ million
Trade creditors	3.8	9.0
Owed to subsidiaries	0.3	1.5
Other creditors	0.4	3.9
Accruals and deferred income	2.7	7.8
Tax payable	4.9	–
Other taxes and social security costs	0.6	1.2
	12.7	23.4

11. Creditors due after more than one year

	2006 £ million	2005 £ million
Senior unsecured loan notes *note 14*	–	67.7
Owed to subsidiaries	91.4	166.4
Pension	–	0.2
	91.4	234.3

12. Deferred tax

	£ million
At 1 January 2006	0.8
Credit for the year	(0.8)
At 31 December 2006	–

	2006 £ million	2005 £ million
Deferred tax provided		
Capital allowances in advance of the corresponding charges for depreciation	–	0.8

13. Provisions

	£ million
Lease provisions	
At 1 January 2006	1.7
Charged during the year	1.4
Utilised in the year	(0.7)
Movement in discount rate	0.3
At 31 December 2006	2.7

Provisions are analysed as follows:

	2006 £ million	2005 £ million
Current	0.4	0.3
Non-current	2.3	1.4
	2.7	1.7

These provisions are in respect of obligations for properties which have been vacated under operating leases.

14. Senior unsecured loan notes

	2006 £ million	2005 £ million
Due within one year		
Senior unsecured loan notes 2006	–	3.2
Due after more than one year *note 11*		
Senior unsecured loan notes 2009	–	67.7
	–	70.9

On 15 February 2006 the loan notes were repaid out of the proceeds of sale of the HellermannTyton Division. A make whole amount of $13.9 million (£7.2 million) was also paid.

15. Operating lease commitments

At the balance sheet date, the Company had annual commitments which expire as follows:

	2006 £ million	2005 £ million
In the second to fifth years	–	0.2
Over five years	0.5	1.1
	0.5	1.3

16. Derivative financial instruments

The Company has taken advantage of the exemption under FRS 25 'Financial Instruments: Disclosure and Presentation' for parent company financial statements. The disclosures in respect of the Company are included in the consolidated financial statements.

The fair value of derivative financial instruments is as follows:

	2006 £ million		2005 £ million	
	Assets	Liabilities	Assets	Liabilities
Interest rate swaps	–	–	–	(2.0)
Currency derivatives	0.1	–	2.6	(0.6)
	0.1	–	2.6	(2.6)

Currency derivatives, which are cash flow hedges, are expected to be recognised within one year.

Interest rate swaps

Fixed to floating interest rate swaps were in place at 31 December 2005 to hedge $72.1 million of the senior unsecured loan notes outstanding at that time. The interest rate swaps were designated as hedges and were included in the balance sheet as derivative financial instruments non-current liabilities at their fair value with movements in fair value being reflected through the profit and loss account. These swaps were terminated on 15 February 2006 at which point all gains and losses were recognised in the income statement together with a break fee due on early termination of £2.3 million.

Currency derivatives

The Company uses forward foreign exchange contracts in the management of transactional exchange rate exposures. These contracts are designated where possible as hedging instruments.

At 31 December 2006 the Company held various foreign exchange contracts for various transactional exchange exposures, which have not been designated as hedges.

Notes to the parent Company financial statements continued

17. Capital and reserves

£ million

	Called up share capital	Share premium account	Capital reserve	Net unrealised gains and losses	Profit and loss account[2]
At 1 January 2006	32.2	4.4	10.2	2.0	62.2
New shares issued	0.3	6.2	(4.7)	–	–
Profit for the year[3]	–	–	–	–	178.9
Share-based payment	–	–	–	–	0.8
Actuarial gain recognised on the pension schemes	–	–	–	–	2.1
Unrealised gains and losses	–	–	–	(2.0)	–
Employee Share Ownership Trust	–	–	–	–	0.5
On-market share repurchase	–	–	–	–	(41.9)
At 31 December 2006	32.5	10.6	5.5	–	202.6

Notes
1 The Company has taken advantage of the exemption given in section 230 of the Companies Act 1985 not to publish its profit and loss account.
2 The Company's profit and loss account of £202.6 million (2005 £62.2 million) includes non-distributable reserves of £6.9 million (2005 £51.1 million) and a special non-distributable reserve of nil (2005 £11.1 million).
3 The profit for the year dealt with in the financial statements of the Company was £178.9 million (2005 loss £25.9 million).

Defined benefit pension schemes

Amounts included within reserves in respect of the defined benefit pension schemes are as follows:

	2006 £ million	2005 £ million
Profit and loss account excluding pension fund surplus	200.2	113.0
Pension fund surplus/(deficit) *note 3*	2.4	(50.8)
Profit and loss account including pension fund surplus/(deficit)	202.6	62.2

	Authorised		Issued and fully paid	
	2006 £ million	2005 £ million	2006 £ million	2005 £ million
Called up share capital – Ordinary shares of 3⅓ pence each	41.7	41.7	32.5	32.2

Changes during the year in the Ordinary share capital were as follows:

	Number of Ordinary shares million
Issued and fully paid at 1 January 2006	965.8
Allotted pursuant to share-based incentives exercised	10.1
Issued and fully paid at 31 December 2006[1]	975.9

Note
1 During 2006, the Company repurchased and placed in treasury 90.3 million of its own Ordinary shares as part of the Share Repurchase Programme approved by shareholders on 3 May 2006. When treasury shares are taken into account and excluded from the calculation, the issued share capital of the Company, as at 31 December 2006 was 885.6 million Ordinary shares.

At the Annual General Meeting held on 3 May 2006, shareholders gave authority for the Company to repurchase up to 145 million of its own Ordinary shares in the market subject to certain specified conditions. At 1 March 2007, 90.3 million shares had been repurchased under this authority.

In accordance with the rules of the following share schemes, options and purchase rights were exercised during the year which resulted in new Ordinary shares being allotted by the Company or existing shares being transferred from Spirent Sharesave Trust ("SST") as follows:

	Number of Ordinary shares million	Consideration received £000
1995 Executive Share Option Scheme	3.9	622.9
Spirent Stock Incentive Plan	2.5	448.3
Acquisition Plans	3.7	783.3
All Employee Share Schemes	1.4	539.5
	11.5	2,394.0

During the year 1.4 million Ordinary shares were transferred from the SST to satisfy options exercised under the UK all employee share schemes. No shares were transferred from the Employee Share Ownership Trust ("ESOT") to satisfy options exercised under the Spirent Stock Incentive Plan during 2006.

There has been no material increase in the issued share capital, whether by exercise of options, purchase rights or otherwise, between the end of the year and 1 March 2007, the date on which these financial statements have been signed.

Investment in own shares

At 31 December 2006, the ESOT held 9.7 million Ordinary shares (2005 9.5 million Ordinary shares) to satisfy awards under various share-based incentive schemes. Of this number, 0.3 million Ordinary shares were unconditionally vested at 31 December 2006 (2005 0.4 million Ordinary shares). At 31 December 2006, the SST held 1.9 million Ordinary shares (2005 3.2 million Ordinary shares) to satisfy awards made to UK based employees under an all employee share scheme. The market value of own shares held in trust at 31 December 2006 was £6.6 million (2005 £6.2 million).

At 31 December 2006, the Company held 90.3 million Ordinary shares in treasury (2005 nil). The market value of own shares held in treasury at 31 December 2006 was £51.2 million (2005 nil).

Employee share schemes

The Company operates a number of employee incentive schemes as described below. The following share incentives over Ordinary shares under these schemes have been granted and remain outstanding.

Movements in share incentives during the year to 31 December 2006 are shown below:

	1995 Executive Share Option Scheme		2005 Employee Incentive Plan		UK Sharesave Schemes	
	Number of shares million	Weighted average exercise price pence	Number of shares million	Weighted average exercise price pence	Number of shares million	Weighted average exercise price pence
Options outstanding at 31 December 2005	12.2	88	3.1	41	3.5	42
Granted	–	–	3.1	37	–	–
Exercised	(2.6)	16	–	–	(1.1)	39
Forfeited	(0.2)	161	(0.1)	48	(0.8)	41
Expired	(0.6)	151	–	–	(0.8)	53
Options outstanding at 31 December 2006	8.8	102	6.1	39	0.8	39
Options exercisable at 31 December 2006	5.0	124	–	–	0.2	38

The weighted average share price at exercise date was 58.0 pence (2005 63.2 pence).

Notes to the parent Company financial statements continued

17. Capital and reserves continued

The following information relates to outstanding share incentives at 31 December 2006:

Share scheme	Notes	Exercise period (as at 31 December 2006)	Range of exercise prices pence	Weighted average exercise price pence	Number million	2006 Weighted average remaining contractual life
1995 Executive Share Option Scheme	a	25.03.06-24.03.13	16	16	0.6	6.2
		03.10.04-04.08.14	56-72	59	4.6	7.4
		29.04.99-01.05.12	113-152	131	2.8	4.2
		11.05.03-08.04.11	305-334	318	0.8	3.9
2005 Employee Incentive Plan	b	25.08.08-04.05.16	0-53[1]	39	6.1	7.4
UK Sharesave Schemes	c	01.12.06-31.05.11	38-41	38	0.7	1.7
		01.12.08-31.05.09	93	93	0.1	2.4
Total					15.7	

Note
1 Figures for the 2005 Employee Incentive Plan include share options, stock appreciation rights and performance shares in aggregate. No exercise price is payable on the vesting of a performance share.

a) 1995 Executive Share Option Scheme (“ESOS”)

The ESOS is now closed (however outstanding options may still be exercised) and has been replaced by the 2005 Employee Incentive Plan referred to in (b) below.

Awards under the ESOS, normally determined annually, were at the sole discretion of the Remuneration Committee after considering recommendations made to it by the Chief Executive. No price was payable on the grant of an option and no options were granted at a discount to the market price.

The normal exercise period for options granted under the ESOS is between the third and tenth anniversary of the date of grant. Options awarded under the ESOS are subject to the achievement of an earnings per share (“EPS”) performance condition before they can be exercised. The condition is that over a period of three consecutive financial years, there has been an increase in the Company’s adjusted EPS which is at least 6 per cent more than the increase in the Retail Price Index over the same period. The performance condition is tested on the third anniversary of grant and, if it has not been met at that time, at each subsequent anniversary of grant until the option expires (ie on the tenth anniversary of grant in normal circumstances).

All ESOS grants made after 11 May 2000 to executive directors are subject to an enhanced performance condition. The performance condition requires the Company’s adjusted EPS to increase over a period of three consecutive financial years within a range of 9 per cent (minimum performance for 25 per cent option vesting) and 15 per cent (for 100 per cent option vesting), with a sliding scale between these points. In addition, performance testing over the ten year option term is measured from a base point fixed at the date of grant. Performance will be tested on the third anniversary of grant and, if the target conditions at that time have not yet been met in full, performance will be tested again on the fourth and fifth anniversaries of grant only, with the performance hurdle being increased in proportion to the extended period.

b) 2005 Employee Incentive Plan (“EIP”)

On 4 May 2005, Spirent shareholders approved the EIP to replace the now closed ESOS scheme. The EIP is currently available for selected employees (including executive directors) on a similar discretionary basis as the ESOS and any awards will be subject to prior satisfactory individual performance. No price is payable on the grant of an award and no award has been granted at a discount to the market price. The Company is able to grant share options, including HMRC approved options, share settled stock appreciation rights (“SARs”) and performance shares under the EIP.

In normal circumstances, options or SARs under the EIP will vest three years following grant provided the Company's EPS growth targets (after excluding inflation) have been met over a three year performance period. The growth targets in respect of the initial award require that the Company's EPS increases within a range of 6 per cent per annum (for 25 per cent vesting) and 15 per cent per annum (for 100 per cent vesting) over the performance period, with a sliding scale between these points.

In normal circumstances, performance shares under the EIP will vest three years following grant provided the Company's total shareholder return ("TSR") targets have been met over a three year performance period. The performance conditions require Spirent's TSR to be between the median of a comparator group (for 30 per cent vesting) and the upper quartile of a comparator group (for 100 per cent vesting) over the performance period, with a sliding scale between these points. The comparator group consists of the 30 largest companies by market capitalisation in the FTSE TechMARK 100 Index, excluding those TechMARK companies who are also constituents of the FTSE100 Index at the commencement of the performance period.

All EIP awards will be tested once on or shortly following the third anniversary of grant. Any part of an award which does not vest shall lapse (ie there is no opportunity for retesting).

SARs granted under the EIP will deliver the appreciation value (ie the aggregated increase in market value of an Ordinary share over the base price of the SAR) in the form of new issue Ordinary shares. This "SARs" approach will help the Company manage its dilution headroom more efficiently as only the SAR gain and not the entire share value needs to be funded. Using a SARs based approach, it is not possible to determine the precise level of dilution until the SARs are exercised.

Options and SARs granted under the EIP expire on the tenth anniversary of their grant unless they have previously lapsed.

c) UK Savings Related Share Option Scheme ("SRSOS") and 2005 Sharesave Scheme

The SRSOS closed in 2005 and was replaced by the 2005 Sharesave Scheme. SRSOS options which remain outstanding may still be exercised prior to expiry, however no further grants can be made. Both schemes operate as HMRC approved Save-As-You-Earn schemes and are open to all UK employees, subject to a qualifying service period. Any future sharesave invitations will be made under the 2005 Sharesave Scheme, which is broadly similar to the SRSOS.

The employee enters into a Save-As-You-Earn contract with the Company's savings carrier to save a regular sum of between £5 and £250 per month for a fixed period of either three or five years.

No price is payable on the grant of an option. The option exercise price is calculated by reference to the middle market price of an Ordinary share on the business day prior to the beginning of the invitation period, discounted by up to 20 per cent at the Board's discretion. Options are normally exercisable within six months of the third, fifth or seventh anniversary of the contract commencement date, as elected by the option holder at the start of the contract.

The Company operates the SST to honour the contractual commitment to deliver Ordinary shares against the exercise of outstanding options under the SRSOS and Spirent Sharesave Trust Ltd, a wholly-owned subsidiary of Spirent Communications plc, acts as sole trustee of the SST. During the year, 1.4 million shares were transferred to participants.

No invitations have been made under either UK Sharesave Scheme since 2003.

Notes to the parent Company financial statements continued

18. Share-based payment

The total charge for the year relating to employee share-based payment plans is as follows:

	2006 £ million	2005 £ million
1995 Executive Share Option Scheme	0.3	0.4
2005 Employee Incentive Plan	0.4	0.2
All Employee Share Plans	0.1	0.1
	0.8	0.7

The fair value of the options and purchase rights over Ordinary shares is estimated as at the date of grant using a binomial model. The following table gives the assumptions made in arriving at the share-based payments charge:

	2006	2005
Weighted average share price (pence)	37	53
Weighted average fair value (pence)	28	24
Expected volatility (%)	40-50	50
Expected life (years)	4.5	4.5
Risk free rate (%)	4.7-5.1	4.2
Dividend yield (%)	nil	nil

The expected volatility was determined by calculating the historical volatility of the Company's share price over the previous two years which management considers to be the period which is likely to be most representative of future volatility. The expected life used in the model has been adjusted, based on management's best estimate, for the effects of non transferability, exercise restrictions and behavioural considerations. For performance shares granted under the 2005 Employee Incentive Plan, which have a market based performance condition, it has been assumed that there will be 50 per cent vesting for valuation purposes.

19. Related party transactions

The Company has taken advantage of the exemption under FRS 8 'Related Party Disclosures' and as such disclosures are provided in the consolidated financial statements.

20. Subsidiaries

A list of the significant investments in subsidiaries, including the name, country of incorporation and proportion of ownership interest is given on page 111 of this Annual Report.

21. Capital commitments and contingent liabilities

	2006 £ million	2005 £ million
Capital expenditure commitments		
Contracted but not provided	–	0.1
Contingent liabilities		
Bank guarantees	–	1.5

Spirent Communications plc has provided indemnities of £0.6 million (2005 £1.0 million) for certain ongoing business obligations under letters of credit for subsidiary companies.

22. Directors emoluments and transactions with directors

Please refer to the Report on directors' remuneration on pages 26 to 32 for disclosures relating to the remuneration, share options and long term incentives and pensions of the directors.

Principal divisions and subsidiaries

	% held at 31 December 2006
Communications	
Communications performance analysis and service assurance solutions	
Spirent Communications Inc	100
Calabasas, California, USA	
Eatontown, New Jersey, USA	
Honolulu, Hawaii, USA	
Sunnyvale, California, USA	
Spirent Communications of Ottawa Ltd	100
Nepean, Ontario, Canada	
Spirent Communications (SW) Ltd*	100
Paignton, Devon, UK	
Spirent Communications (Switzerland) AG (formerly SwissQual Holding AG)	100
Solothurn, Switzerland	
Spirent Communications of Rockville, Inc	100
Rockville, Maryland, USA	
Spirent Communications (Scotland) Ltd*	100
Hamilton, Glasgow, UK	
Spirent Communications International Ltd*	100
Crawley, West Sussex, UK	
Spirent Communications (India) Pvt Limited	100
Bangalore, India	
Spirent Communications (Asia) Limited	100
Hong Kong	
Spirent Communications Technology (Beijing) Limited*	100
Beijing, PRC	
Systems	
Control systems for the mobility and industrial markets	
PG Drives Technology Ltd	100
Christchurch, Dorset, UK	
PG Drives Technology Inc	100
Delaware, USA	

The above companies operate and are incorporated in the countries listed. All shareholdings in the companies are held indirectly by Spirent Communications plc, except where indicated by an asterisk (*) where the shareholding is held directly by Spirent Communications plc. The activity mentioned is indicative and not comprehensive.

The percentage held reflects the proportion of shares controlled and not the beneficial interest.

Financial history

£ million

	2006	2005	2004	2003	2002
	IFRS	IFRS	IFRS	IFRS	UK GAAP
Consolidated income statement					
Continuing operations					
Revenue	271.6	259.3	287.2	291.8	394.2
Operating profit/(loss)	(47.3)	(39.0)	15.2	11.3	(959.1)
Add back:					
Material one-time items	8.8	8.4	2.9	7.5	38.3
Goodwill impairment	46.8	37.0	–	–	901.6
Goodwill amortisation	–	–	–	–	54.6
Operating profit before material one-time items, goodwill impairment and amortisation	8.3	6.4	18.1	18.8	35.4
Joint venture's profit/(loss)	–	–	(0.7)	1.4	7.4
Share of loss of associate	–	–	–	–	(1.0)
Profit/(loss) on disposal of operations	–	3.9	4.0	8.6	(48.4)
Profit/(loss) before interest	(47.3)	(35.1)	18.5	21.3	(1,001.1)
Net finance expense	6.0	(6.6)	(6.8)	(9.8)	(11.8)
Costs associated with the part prepayment of loan notes	(8.8)	–	(0.5)	(16.1)	–
Profit/(loss) before tax	(50.1)	(41.7)	11.2	(4.6)	(1,012.9)
Tax	(0.9)	4.0	(2.0)	4.2	(24.0)
Profit/(loss) from continuing operations after tax	(51.0)	(37.7)	9.2	(0.4)	(1,036.9)
Discontinued operations	159.8	13.2	17.3	14.2	(13.4)
Profit/(loss) for the year	108.8	(24.5)	26.5	13.8	(1,050.3)
Minority interest	–	(0.4)	(0.3)	(0.2)	(0.4)
Profit/(loss) attributable to equity holders of parent	108.8	(24.9)	26.2	13.6	(1,050.7)
Consolidated balance sheet					
Intangible assets	63.3	71.5	106.5	110.9	113.6
Property, plant and equipment	25.3	30.1	86.3	90.2	110.0
Investments	–	–	14.3	13.4	63.4
Working capital (excluding cash, overdrafts and deferred tax)	(2.2)	(3.3)	23.0	27.3	46.6
Operating assets	86.4	98.3	230.1	241.8	333.6
Net assets classified as held for sale	–	115.4	–	–	–
Derivative financial instruments (net)	0.1	(0.1)	–	–	–
Net funds/(borrowings)	106.1	(25.9)	(26.4)	(57.5)	(161.8)
Provisions and other liabilities	(12.0)	(14.2)	(13.8)	(17.9)	(28.4)
Deferred tax	1.2	0.2	8.6	10.1	–
Defined benefit pension plan surplus/(deficit)	1.0	(51.5)	(38.1)	(48.2)	(46.2)
Net assets	182.8	122.2	160.4	128.3	97.2
Equity holders of parent	182.8	120.3	159.1	126.1	95.1
Minority interests	–	1.9	1.3	2.2	2.1
Total equity	182.8	122.2	160.4	128.3	97.2

£ million

	2006	2005	2004	2003	2002
	IFRS	IFRS	IFRS	IFRS	UK GAAP
Other information					
Capital expenditure – owned assets	14.1	30.5	25.3	16.7	27.6
– leased assets	–	2.5	0.3	0.3	0.2
Depreciation	13.4	22.6	25.4	29.3	33.6
Product development	58.0	62.8	67.3	66.0	77.7
Intangibles amortisation	1.6	–	–	–	–
Share-based payment	5.6	5.6	5.2	1.0	0.5
Share information					
Basic earnings/(loss) per share (pence)	11.75	(2.62)	2.79	1.46	(113.90)
Basic earnings/(loss) per share from continuing operations (pence)	(5.51)	(3.97)	0.98	(0.04)	(112.40)
Adjusted earnings per share (pence)	1.73	1.72	2.59	2.25	3.36
Adjusted earnings/(loss) per share from continuing operations (pence)	1.41	(0.22)	0.78	0.74	2.02
Diluted earnings/(loss) per share (pence)	11.75	(2.62)	2.74	1.46	(113.90)
Diluted earnings/(loss) per share from continuing operations (pence)	(5.51)	(3.97)	0.96	(0.04)	(112.40)
Fully paid Ordinary shares in issue at year end (million)[3]	975.9	965.8	956.2	944.0	939.4
Segmental analysis					
Business segments					
Revenue					
Performance Analysis	192.2	178.8	176.8	148.7	184.0
Service Assurance	43.6	42.8	74.7	91.7	131.4
Communications	235.8	221.6	251.5	240.4	315.4
Systems	35.8	37.7	31.3	37.9	34.3
On going operations	271.6	259.3	282.8	278.3	349.7
Other disposals[2]	–	–	4.4	13.5	44.5
Continuing operations	271.6	259.3	287.2	291.8	394.2
Network Products	28.0	205.5	187.8	174.4	164.7
	299.6	464.8	475.0	466.2	558.9
Operating profit[1]					
Performance Analysis	10.5	18.4	18.5	4.4	10.0
Service Assurance	(1.1)	(10.8)	1.1	13.3	20.8
Communications	9.4	7.6	19.6	17.7	30.8
Systems	4.7	4.3	3.3	6.8	3.8
Non-segmental	(5.8)	(5.5)	(5.4)	(5.1)	–
On going operations	8.3	6.4	17.5	19.4	34.6
Other disposals[2]	–	–	0.6	(0.6)	0.8
Continuing operations	8.3	6.4	18.1	18.8	35.4
Network Products	3.0	24.8	20.9	16.8	15.0
	11.3	31.2	39.0	35.6	50.4

Financial history continued

£ million

	2006	2005	2004	2003	2002
	IFRS	IFRS	IFRS	IFRS	UK GAAP
Geographical segments					
Revenue					
Europe	76.5	61.2	59.0	49.4	39.8
North America	175.9	180.9	206.2	219.1	300.4
Asia Pacific, Rest of Americas, Africa	19.2	17.2	17.6	9.8	9.5
On going operations	271.6	259.3	282.8	278.3	349.7
Other disposals[2]	–	–	4.4	13.5	44.5
Continuing operations	271.6	259.3	287.2	291.8	394.2
Network Products	28.0	205.5	187.8	174.4	164.7
	299.6	464.8	475.0	466.2	558.9

Rates against sterling

Average exchange rates for major currencies					
US dollar	1.85	1.82	1.83	1.64	1.51
Euro	1.47	1.46	1.47	1.45	1.59

Number

Average employment by geographical area					
Europe	818	1,771	1,742	1,722	1,909
North America	1,380	1,813	1,988	2,071	2,622
Asia Pacific, Rest of Americas, Africa	237	794	791	705	648
	2,435	4,378	4,521	4,498	5,179

Notes
1 Before goodwill amortisation and impairment and material one-time items.
2 Other disposals includes other less significant disposals and closures which do not qualify as discontinued operations.
3 The issued share capital of the Company, as at 31 December 2006, excluding treasury shares is 885.6 million Ordinary shares.

Shareholder information

Shareholder analysis

At 1 March 2007, the number of registered shareholders was 5,601 and the number of Ordinary shares in issue was 886.6 million (excluding treasury shares).

	Number of holdings	Percentage of total shareholders	Number of shares million	Percentage of share capital
Range of holdings:				
1-5,000	3,961	70.72	6.0	0.68
5,001-10,000	626	11.18	4.7	0.53
10,001-50,000	654	11.68	13.9	1.57
50,001-100,000	83	1.48	5.8	0.66
100,001-250,000	75	1.34	12.9	1.45
250,001-500,000	49	0.87	18.0	2.00
500,001-1,000,000	47	0.84	33.5	3.80
1,000,001-Highest	106	1.89	791.8	89.31
Total	5,601	100.00	886.6	100.00
Held by:				
Individuals	4,492	80.20	24.8	2.54
Institutions	1,109	19.80	861.8	97.46
Total	5,601	100.00	886.6	100.00

Lloyds TSB Registrars

Enquiries concerning shareholdings, change of address or other particulars should be directed in the first instance to the Company's Registrar, Lloyds TSB Registrars on 0870 600 3964. They also provide a range of online shareholder information services at www.shareview.co.uk, where shareholders can check their holdings and find practical help on transferring shares or updating their details.

Spirent Single Company ISA

Lloyds TSB Registrars (a division of Lloyds TSB Bank plc, which is authorised and regulated by the Financial Services Authority) operate a Single Company Individual Savings Account in which Spirent Ordinary shares can be held in a tax efficient manner. Full details and an application form can be obtained from Lloyds TSB Registrars on 0870 242 4244.

Internet, telephone and postal share dealing services

Lloyds TSB Registrars Shareview Dealing is a telephone and Internet service that provides a simple and convenient way of buying and selling Spirent Ordinary shares. For telephone services call 0870 850 0852 between 8.30am and 4.30pm, Monday to Friday and for Internet services visit www.shareview.co.uk/dealing.

A postal dealing service for buying and selling Ordinary shares is also available and a dealing form can be obtained by calling 0870 606 0302.

Share price information

The Spirent share price is available via the Company's website (www.spirent.com) and also in various newspapers published in the UK.

UK capital gains tax

For the purposes of capital gains tax, the market value of an Ordinary share on 31 March 1982, as adjusted for subsequent capitalisation issues, was 97.233 pence per share.

American Depositary Receipts – The Bank of New York

The Company's shares are traded on the New York Stock Exchange (ticker: SPM) in the form of American Depositary Shares ("ADS") and these are evidenced by American Depositary Receipts ("ADRs"), each one of which represents four Ordinary shares. The Bank of New York is the authorised Depositary bank for the Company's ADR programme. The Company's ADS price is quoted daily in the Wall Street Journal and can be obtained from either the Spirent website or via the New York Stock Exchange website at www.nyse.com.

Spirent website at www.spirent.com

The Spirent website provides further information about Spirent and its operating groups and also provides access to annual and interim reports, company news and share price information.

Unsolicited mail

The Company is obliged by law to make its share register available upon request to the public and to other organisations, which may use it as a mailing list, resulting in shareholders receiving unsolicited mail. Shareholders wishing to limit the receipt of such mail should write to the Mailing Preference Service, DMA House, 70 Margaret Street, London W1W 8SS, United Kingdom or call +44 (0)20 7291 3310 for an application form or visit www.mpsonline.org.uk.

ShareGIFT

Shareholders who hold only a small number of shares, where dealing costs may make it uneconomical to sell them, may wish to consider donating them to charity through ShareGIFT, a registered charity administered by The Orr Mackintosh Foundation. The relevant share transfer form can be obtained from Lloyds TSB Registrars. Further information is available at www.sharegift.org or telephone +44 (0)20 7337 0501.

Annual General Meeting

The Company's 2007 Annual General Meeting ("2007 AGM") will be held at 10.30am on Wednesday 9 May 2007 at the offices of the Company's PR advisers, Financial Dynamics, Holborn Gate, 26 Southampton Buildings, London WC2A 1PB, United Kingdom. Shareholders who are not attending the 2007 AGM may appoint a proxy and vote their shares electronically by using www.sharevote.co.uk or CREST and following the instructions on the enclosed Form of Proxy.

Glossary

3G (Third Generation)	Future generation of mobile communications following first generation (analogue) and second (digital).
4G (Fourth Generation)	Future generation of mobile communications following 3G.
10 Gig E (10-gigabit Ethernet)	Networking technology enabling Ethernet data to be transported at 10 gigabits per second.
A-GPS (Assisted GPS)	A system utilising GPS, assisted by the cellular signal to a mobile device, to more quickly pinpoint its location.
Access	The connection between the local exchange and the home/office, etc (also referred to as the Access Network or the Local Loop).
ATM (Asynchronous Transfer Mode)	High-speed transmission technology used for transporting multiple simultaneous services (voice, data and multimedia applications) with high quality of service levels.
Broadband	Generic term for devices with a bandwidth greater than one megabit per second.
CDMA (Code Division Multiple Access)	Technology allowing communications circuits to carry multiple conversations simultaneously, thus increasing its capacity.
DSL (Digital Subscriber Line)	Technology that uses existing telephone/copper lines to transport high-bandwidth data such as multimedia and video to service subscribers.
Ethernet	A family of networking technologies developed for local area networks and now migrating to metro area networks.
Galileo	The informal name for the European Global Navigation Satellite System, a system that will offer users anywhere in the world "near pinpoint" geographic positioning when it becomes fully operational.
Gig E (Gigabit Ethernet)	Transmission protocol over a local area network that operates at a speed of 10 billion bits (gigabit) per second.
GPS (Global Positioning System)	A system for determining location and height at any point on the earth's surface. A receiver uses minute differences in measured time signals from clocks on satellites to calculate these positions and altitudes.
GSM (Global System for Mobile communication)	A digital mobile telephony system that is widely used in Europe and other parts of the world.
HSDPA (High-speed Downlink Packet Access)	An evolution of W-CDMA.
IMS (Internet protocol multimedia subsystem)	A standardised next-generation architecture for telecoms operators who want to provide mobile and fixed multimedia services.
Internet telephony	Generic term used to describe various approaches to running voice telephony over IP (Internet Protocol).
IP (Internet Protocol)	Data protocol used by many networking devices to facilitate and control the flow of data.
IPTV (Internet Protocol television)	The delivery of programming by video stream encoded as a series of IP packets.
Leased line	A long-distance dedicated channel sold to enterprises to carry their voice and data traffic.
Metro	A metropolitan (city) area. Generally excludes suburban zones but can include university campuses.
Push to talk over Cellular	A means of instantaneous communication that uses a button to switch a device from voice transmission mode to voice reception mode employed in a wireless network.
RF (Radio Frequency)	A technology used for wireless broadcasting and/or communications.
Routing	The process of determining the path packets take when moving through a network.
Security Testing	Testing the security of communications networks, equipment and applications.
Switching	The process of forwarding data packets on within a network.
TDM	Time Division Multiplexing – a digital transmission method that combines signals from multiple sources on a common path increasing capacity.
Triple play	Voice, video and data transmitted over a single transport medium.
VoIP (voice over IP)	The technology that makes it possible to have a telephone conversation where the signal is carried over the Internet or a dedicated network in Internet Protocol (IP) packets, instead of over dedicated voice transmission lines.
WCDMA (Wideband CDMA)	A global standard for mobile 3G.
Web Applications	Applications accessed or delivered over a network.
WiMax (Worldwide Interoperability for Microwave Access)	A wireless transmission technology.
xDSL	Variants of DSL eg ADSL, ADSL2, ADSL2+, VDSL.

Contact details

Head office and registered office
Spirent Communications plc
Spirent House
Crawley Business Quarter
Fleming Way
Crawley
West Sussex RH10 9QL
United Kingdom
Tel: +44 (0)1293 767676
Fax: +44 (0)1293 767677
Email: plc@spirent.com
Website: www.spirent.com

Spirent Communications plc
Registered in England No: 470893

Auditor
Ernst & Young LLP
1 More London Place
London SE1 2AF
United Kingdom
Tel: +44 (0)20 7951 2000
Website: www.ey.com

Registrar
Lloyds TSB Registrars
The Causeway
Worthing
West Sussex BN99 6DA
United Kingdom
Service Helplines:
Tel: 0870 600 3964 (UK)
Tel: +44 121 415 7047 (overseas)
Website: www.shareview.co.uk

ADR depositary
The Bank of New York
Investor Relations
PO Box 11258
Church Street Station
New York
NY 10286-1258
USA
Tel: 1 888 BNY ADRS (toll free – US)
Tel: +1 (212) 815 3700 (outside US)
Email: shareowners@bankofny.com
Website: www.adrbny.com

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