

RADWARE LTD.

CONSOLIDATED FINANCIAL STATEMENTS
as of December 31, 1999

RADWARE LTD.

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REPORT OF INDEPENDENT PUBLIC ACCOUNTANTS

To the Shareholders of
RADWARE LTD.

We have audited the accompanying consolidated balance sheets of Radware Ltd. (an Israeli corporation) as of December 31, 1999 and 1998, and the related consolidated statements of operations, changes in shareholders' equity and cash flows for the years ended December 31, 1999 and 1998 and for the period from commencement of operations (April 1, 1997) to December 31, 1997. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provides a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of the Company as of December 31, 1999 and 1998, and the consolidated results of operations, changes in shareholders' equity and cash flows for the years ended December 31, 1999 and 1998 and for the period from commencement of operations (April 1, 1997) to December 31, 1997, in conformity with accounting principles generally accepted in the United States.

Luboshitz Kasierer
Member Firm of Arthur Andersen

Tel Aviv, Israel
February 3, 2000

RADWARE LTD.

CONSOLIDATED BALANCE SHEETS

In thousands of U.S. dollars (except per share data)

		December 31,	
	Note	1998	1999
Current assets			
Cash and cash equivalents	(3)	1,677	68,747
Trade receivables, net	(4)	839	2,915
Other receivables and prepaid expenses	(4)	471	920
Inventories	(5)	565	782
Total current assets		3,552	73,364
Property and equipment, net	(6)	218	1,036
Deposit with insurance companies	(8)	63	254
Security deposit		-	80
Total assets		3,833	74,734
Current liabilities			
Trade payables		336	1,813
Other payables and accrued expenses	(7)	709	3,248
Total current liabilities		1,045	5,061
Accrued severance pay	(8)	83	254
Total liabilities		1,128	5,315
Commitments	(9)		
Shareholders' equity	(10)		
Ordinary shares of NIS 0.1 par value:			
Authorized - 30,000,000 shares			
(1998 - 16,200,000 shares)			
Issued and outstanding - 14,604,209 shares			
(1998 - 9,526,869 shares)		16	360
Additional paid-in capital		4,262	71,817
Deferred compensation		(88)	(1,553)
Accumulated deficit		(1,485)	(1,205)
Total shareholders' equity		2,705	69,419
Total liabilities and shareholders' equity		3,833	74,734

The accompanying notes form an integral part of these consolidated financial statements.

RADWARE LTD.

CONSOLIDATED STATEMENTS OF OPERATIONS

In thousands of U.S. dollars (except per share data)

		For the period (*) ended December 31,	For the year ended December 31,	
	Note	1997	1998	1999
Sales	(12)	1,159	4,900	14,141
Cost of sales		599	899	2,269
Gross profit		560	4,001	11,872
Operating expenses				
Research and development expenses		411	1,081	2,099
Less-participation by the Chief Scientist of the Government of Israel	(9)	-	341	466
Research and development expenses, net		411	740	1,633
Marketing and selling expenses	(13)	248	4,205	9,678
General and administrative expenses		142	298	1,137
Total operating expenses		801	5,243	12,448
Operating loss		(241)	(1,242)	(576)
Financing income (expenses), net		9	(11)	856
Net income (loss)		(232)	(1,253)	280
Net income (loss) per ordinary share				
Basic		(0.04)	(0.16)	0.03
Diluted		(0.04)	(0.16)	0.02
Weighted average number of shares used in computing per share amounts:				
Basic		6,350,400	7,777,635	11,174,639
Diluted		6,350,400	7,777,635	12,472,318

(*) From commencement of operations - April 1, 1997.

The accompanying notes form an integral part of these consolidated financial statements.

RADWARE LTD.

CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

In thousands of U.S. dollars (except per share data)

	Ordinary shares					
	Shares	Amount	Additional paid-in capital	Deferred compensation	Accumulated deficit	Total
Shares issued	6,350,400	-	-	-	-	-
Net loss (*)	-	-	-	-	(232)	(232)
Balance as of December 31, 1997	6,350,400	-	-	-	(232)	(232)
Shares issued	-	7	-	-	-	7
Shares issued on conversion of debentures	3,176,469	9	4,121 (**)	-	-	4,130
Deferred compensation	-	-	141	(141)	-	-
Amortization of deferred compensation	-	-	-	53	-	53
Net loss	-	-	-	-	(1,253)	(1,253)
Balance as of December 31, 1998	9,526,869	16	4,262	(88)	(1,485)	2,705
Shares issued in a private placement	1,577,340	2	8,898 (***)	-	-	8,900
Shares issued in an initial public offering	3,500,000	82	56,749 (****)	-	-	56,831
Stock split in the form of share dividend	-	260	(260)	-	-	-
Deferred compensation	-	-	2,192	(2,192)	-	-
Amortization of deferred compensation	-	-	(24)	727	-	703
Net income	-	-	-	-	280	280
Balance as of December 31, 1999	14,604,209	360	71,817	(1,553)	(1,205)	69,419

(*) For the period from April 1, 1997 to December 31, 1997.

(**) Net of issuance expenses of \$39.

(***) Net of issuance expenses of \$141.

(****) Net of issuance expenses of \$6,169.

The accompanying notes form an integral part of these consolidated financial statements.

RADWARE LTD.

CONSOLIDATED STATEMENTS OF CASH FLOWS

In thousands of U.S. dollars

	For the period (*) ended December 31, <u>1997</u>	For the year ended December 31, <u>1998</u>	<u>1999</u>
CASH FLOWS FROM OPERATING ACTIVITIES			
Net income (loss)	(232)	(1,253)	280
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:			
Income and expenses not affecting operating cash flows:			
Depreciation	10	44	132
Amortization of deferred stock compensation	-	53	703
Interest accrued on convertible debentures	-	168	-
Accrued severance pay and others	5	10	(18)
Changes in operating assets and liabilities:			
Increase in trade receivables	(35)	(804)	(2,076)
Increase in other receivables and prepaid expenses	(12)	(459)	(449)
Increase in inventories	(272)	(293)	(217)
Increase in trade payables	221	121	1,477
Increase in other payables and accrued expenses	105	605	2,539
Net cash provided by (used in) operating activities	<u>(210)</u>	<u>(1,808)</u>	<u>2,371</u>
CASH FLOWS FROM INVESTING ACTIVITIES			
Purchase of property and equipment	(163)	(130)	(980)
Proceeds from sale of property and equipment	20	-	28
Deposit	-	-	(80)
Net cash used in investing activities	<u>(143)</u>	<u>(130)</u>	<u>(1,032)</u>
CASH FLOWS FROM FINANCING ACTIVITIES			
Proceeds from convertible debentures issued	4,000	-	-
Proceeds from shares issued	-	7	72,041
Share issuance expenses	-	(39)	(6,310)
Net cash provided by (used in) financing activities	<u>4,000</u>	<u>(32)</u>	<u>65,731</u>
INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	3,647	(1,970)	67,070
CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD	<u>-</u>	<u>3,647</u>	<u>1,677</u>
CASH AND CASH EQUIVALENTS AT END OF PERIOD	<u><u>3,647</u></u>	<u><u>1,677</u></u>	<u><u>68,747</u></u>
NONCASH ACTIVITIES			
Conversion of convertible debentures	<u>-</u>	<u>4,168</u>	<u>-</u>

(*) From commencement of operations - April 1, 1997.

The accompanying notes form an integral part of these consolidated financial statements.

RADWARE LTD.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

Note 1 - GENERAL

- A. Radware Ltd. ("the Company"), an Israeli corporation, commenced operations in April 1997. The Company is engaged in the development, manufacture and sale of Internet traffic management solutions that enable continuous, high quality access to Web sites and other Internet Protocol (I/P) services, applications and content.

The consolidated financial statements include the financial statements of the Company and its wholly-owned subsidiary in the United States, Radware Inc., which was incorporated on January 1, 1999. The subsidiary is primarily engaged in the sale and marketing of the Company's products within North America.

- B. The financial statements of the Company have been prepared in U.S. dollars, as the currency of the primary economic environment in which the operations of the Company are conducted is the U.S. dollar. All of the Company's sales are in U.S. dollars or are dollar-linked. Most purchases of materials and components and most marketing costs are denominated in U.S. dollars. Therefore, the functional currency of the Company is the U.S. dollar.

Transactions and balances originally denominated in dollars are presented at their original amounts. Transactions and balances in other currencies are translated into U.S. dollars in accordance with the principles set forth in Statement No. 52 of the Financial Accounting Standards Board of the United States ("FASB"). Accordingly, items have been translated as follows:

Monetary items - at the exchange rate in effect on balance sheet date.

Nonmonetary items - at historical exchange rates.

Revenue and expense items - at the exchange rates in effect as of date of recognition of those items (excluding depreciation and other items deriving from non-monetary items).

All exchange gains and losses from the translation mentioned above (which are immaterial for all periods presented) are reflected in the statement of operations. The representative rate of exchange at December 31, 1999 was US\$ 1.00 - 4.153 New Israeli Shekels ("NIS") (December 31, 1998 and 1997 - NIS 4.160 and 3.536, respectively).

RADWARE LTD.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Cont.)

Note 2 - SIGNIFICANT ACCOUNTING POLICIES

The financial statements are prepared in accordance with generally accepted accounting principles in the United States. The significant accounting policies followed in the preparation of the financial statements, applied on a consistent basis, are as follows:

A. PRINCIPLES OF CONSOLIDATION

The financial statements include the accounts of the Company and its wholly-owned subsidiary in the United States. Material intercompany balances and transactions have been eliminated.

B. CASH AND CASH EQUIVALENTS

All highly liquid investments with an original maturity of three months or less are considered cash equivalents.

C. ALLOWANCE FOR DOUBTFUL DEBTS

Allowance for doubtful debts is computed for specific debts the collectibility of which is doubtful based upon the Company's experience.

D. INVENTORIES

Inventories are valued at the lower of cost or market. Cost is determined on the "moving average" basis.

E. PROPERTY AND EQUIPMENT

Property and equipment are stated at cost. Depreciation is computed by the straight-line method over the estimated useful life of the assets, ranging from three to fourteen years.

F. PROVISION FOR WARRANTY COSTS

The Company provides warranty for a twelve months period. Provision for warranty costs is based on Company's experience.

RADWARE LTD.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Cont.)

In thousands of U.S. dollars

Note 2 - SIGNIFICANT ACCOUNTING POLICIES (Cont.)

G. REVENUE RECOGNITION

Revenues from product sales are recognized upon shipment in the case of indirect sales, to the distributor, and in the case of direct sales, to the final customers, in each case when no right of return exists and collection is probable. Revenue from sale of Post-Contract Support ("PCS") services is included ratably over the service period. PCS services are generally provided under standard contracts with a one year term at a fixed fee equal to 10% of the purchase price paid for the product.

H. RESEARCH AND DEVELOPMENT COSTS

Research and development costs, net of participation by the Government of Israel through the Ministry of Industry and Trade, Office of the Chief Scientist, are charged to operations as incurred. Software development costs are considered for capitalization when technological feasibility is established in accordance with Statement of Financial Accounting Standards ("SFAS") No. 86, "Accounting for the Costs of Computer Software to be Sold, Leased or Otherwise Marketed." Costs incurred subsequent to achievement of technological feasibility in the process of software production have not been material. Therefore, the Company has not capitalized any of its research and development expenses and does not anticipate that its development process will differ materially in the future.

I. INCOME TAXES

The Company accounts for income taxes under the liability method of accounting. Under the liability method, deferred taxes are determined based on the differences between the financial statement and tax bases of assets and liabilities at enacted tax rates in effect in the year in which the differences are expected to reverse. Valuation allowances are established, when necessary, to reduce deferred tax assets to amounts expected to be realized.

J. FAIR VALUE OF FINANCIAL INSTRUMENTS

Unless otherwise noted, the carrying amount of financial instruments approximates fair value.

RADWARE LTD.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Cont.)

In thousands of U.S. dollars

Note 2 - SIGNIFICANT ACCOUNTING POLICIES (Cont.)

K. NET INCOME (LOSS) PER SHARE

The Company computes net income (loss) per share in accordance with SFAS No. 128, "Earnings per Share".

Under the provisions of SFAS No. 128, basic net income (loss) per share ("Basic EPS") is computed by dividing net income (loss) by the weighted average number of ordinary shares outstanding. Diluted net income (loss) per share ("Diluted EPS") is computed by dividing net income (loss) by the weighted average number of shares and dilutive share equivalents then outstanding. The total number of shares related to the outstanding options excluded from the calculations of diluted net loss per share were 982,692 and 1,541,322 for the period ended December 31, 1997 and the year ended December 31, 1998, respectively. A reconciliation between the numerator and denominator of Basic EPS and Diluted EPS for the year ended December 31, 1999, follows:

	Net income	Weighted average number of shares	Net income per share
	<u>(In thousands)</u>		
Basic EPS:			
Net income attributable to ordinary shares	280	11,174,639	0.03
Effect of dilutive securities:			
Share options	-	1,297,679	(0.01)
Diluted EPS	<u>280</u>	<u>12,472,318</u>	<u>0.02</u>

RADWARE LTD.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Cont.)

In thousands of U.S. dollars

Note 2 - SIGNIFICANT ACCOUNTING POLICIES (Cont.)

L. SHARE-BASED COMPENSATION

The Company has adopted the disclosure provisions of SFAS No. 123, "Accounting for Stock-Based Compensation," and the accounting rules set forth in Accounting Principles Board ("APB") Opinion No. 25, "Accounting for Stock Issued to Employees." The Company has provided the necessary pro forma disclosures as if the fair value method had been applied (See Note 10(C)).

M. USE OF ESTIMATES

The preparation of the financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting periods. Actual results could differ from these estimates.

N. RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS

In June 1998, the Financial Accounting Standards Board issued SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities." The Statement establishes accounting and reporting standards requiring that every derivative instrument be recorded in the balance sheet at its fair value. The Statement requires that changes in the derivative's fair value be recognized currently in earnings unless specific hedge accounting criteria are met. Special accounting for qualifying hedges allows a derivative's gains and losses to offset related results on the hedged item in the income statement. SFAS 133 is effective for fiscal years beginning after June 15, 2000. The Company believes that the adoption of SFAS 133 will not have a material effect on its financial statements.

RADWARE LTD.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Cont.)

In thousands of U.S. dollars

Note 3 - CASH AND CASH EQUIVALENTS

	December 31	
	1998	1999
Cash in banks	151	1,434
Bank deposits		
In U.S. Dollars (bearing annual interest rate of 5.5% to 6.2%)	1,390	67,307
In NIS	136	6
	<u>1,677</u>	<u>68,747</u>

Note 4 - RECEIVABLES

- A. Trade receivables are presented net of allowance for doubtful debts in the amount of \$220 (1998 - none).
- B. Other receivables and prepaid expenses include grants receivable in the amount of \$298 (1998 - \$312).

Note 5 - INVENTORIES

	December 31	
	1998	1999
Materials and components	99	13
Work in progress	72	74
Finished goods	394	695
	<u>565</u>	<u>782</u>

RADWARE LTD.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Cont.)

In thousands of U.S. dollars

Note 6 - PROPERTY AND EQUIPMENT

	December 31	
	1998	1999
COST		
Research and development equipment	44	135
Computer equipment	53	470
Leasehold improvements	2	71
Motor vehicles	163	363
Office furniture and equipment	9	177
	<u>271</u>	<u>1,216</u>
ACCUMULATED DEPRECIATION		
Research and development equipment	11	30
Computer equipment	16	74
Leasehold improvements	-	6
Motor vehicles	25	54
Office furniture and equipment	1	16
	<u>53</u>	<u>180</u>
	<u>218</u>	<u>1,036</u>

The Company's property and equipment are primarily located in Israel.

For the period ended December 31, 1997 and the years ended December 31, 1998 and 1999, depreciation expense was \$10, \$44 and \$132, respectively.

RADWARE LTD.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Cont.)

In thousands of U.S. dollars

Note 7 - OTHER PAYABLES AND ACCRUED EXPENSES

	December 31	
	1998	1999
Deferred income	164	1,092
Accrued expenses	131	803
Related company	-	692
Employees and employee institutions	181	383
Provision for warranty costs	73	241
Other	160	37
	<u>709</u>	<u>3,248</u>

Note 8 - SEVERANCE PAY

Under Israeli law and labor agreements, the Company is required to make severance payments to its dismissed employees and employees leaving its employment in certain other circumstances. The Company's severance pay liability to its employees, which is calculated on the basis of the salary of each employee for the last month of the reported period multiplied by the years of such employee's employment, is reflected in the Company's balance sheet on the accrual basis, and is partially funded by purchase of insurance policies in the name of the Company. Severance pay expense for the periods ended December 31, 1997, 1998 and 1999 amounted to \$23, \$60 and \$171, respectively.

RADWARE LTD.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Cont.)

In thousands of U.S. dollars

Note 9 - COMMITMENTS

- A. In connection with its research and development, the Company received and accrued participation payments from the Office of the Chief Scientist of the Ministry of Industry and Trade in Israel in the total amount of approximately \$1,950 (including amounts which had been received by an affiliated company). In return for the Government of Israel's participation, the Company is committed to pay royalties at a rate of 3% - 5% of sales of the developed product, up to 100% of the amount of grants received (for grants received under programs approved subsequent to January 1, 1999 - 100% plus interest at Libor). The Company's total commitment for royalties payable with respect to future sales, based on Government participations received or accrued, net of royalties paid or accrued, totaled approximately \$1,070 as of December 31, 1999.
- B. The Company operates from leased premises in Tel-Aviv and Jerusalem, Israel and in New Jersey and California in the United States. Lease agreements expire in the years 2001 to 2004 (some with renewal options). Annual minimum future rental payments due under the above agreements, at exchange rates in effect on December 31, 1999, are approximately as follows:

2000	275
2001	275
2002	260
2003	252
2004	82
	<u>1,144</u>

RADWARE LTD.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Cont.)

In thousands of U.S. dollars

Note 10 - SHAREHOLDERS' EQUITY

- A. In June 1999, the Company issued 1,577,340 Series B preferred shares in a private placement to a group of investors at an aggregate purchase price of \$9,040. On August 30, 1999, the Company increased its authorized share capital to 30,000,000 shares of NIS 0.1 par value per share and all outstanding preferred shares were converted into an identical number of ordinary shares. In October 1999, the Company effected a 27 to 1 stock split in the form of a share dividend. All references to per share amounts and the number of shares in these financial statements have been restated to reflect the above changes.
- B. In October 1999, the Company issued 3,500,000 ordinary shares in an initial public offering on the NASDAQ National Market in consideration for \$56,831 (net of issuance expenses). (See also Note 16).
- C. In 1997, the Company adopted a key employee share incentive plan which provides for the grant by the Company of option awards to purchase up to an aggregate of 1,587,600 ordinary shares to officers and employees of the Company and its subsidiaries. The vesting period for these options ranges from immediate vesting upon grant to ratable vesting over a four year period. The options expire 62 months from the date of issuance. The exercise price of option awards under the plan will be at varying prices ranging from \$0 to the fair market value at the date of the grant. In June 1999, the plan was increased by an additional 226,800 Ordinary shares subject to option grants.

Transactions related to the above discussed options during the period ended December 31, 1997 and the years ended December 31, 1998 and 1999 and the weighted average exercise prices per share and weighted average fair value of the options at the date of grant are summarized as follows:

RADWARE LTD.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Cont.)

In thousands of U.S. dollars (except per share data)

Note 10 - SHAREHOLDERS' EQUITY

C. (Cont.)

	Outstanding options	Weighted average exercise price per share	Weighted average fair value of options granted
Inception	-	\$ -	\$ -
Options granted	982,692	-	-
Outstanding December 31, 1997	982,692	-	-
Options granted	140,508	-	1.01
Outstanding December 31, 1998	1,123,200	-	-
Options granted	557,540	4.68	8.48
Options forfeited	(50,004)	-	-
Outstanding December 31, 1999	<u>1,630,736</u>	<u>1.6</u>	-

The following table summarizes information about options outstanding and exercisable at December 31, 1999:

Exercise price	Options outstanding			Options exercisable	
	Number outstanding at December, 31 1999	Weighted- average remaining contractual life	Weighted- average exercise price	Number outstanding at December 31, 1999	Weighted- average exercise price
\$ -	1,389,339	3.21	\$ -	894,983	\$ -
4.59	38,583	4.64	4.59	-	-
5.73	113,400	4.91	5.73	113,400	5.73
18.00	79,414	4.92	18.00	-	-
35.00	10,000	5.16	35.00	-	-
	<u>1,630,736</u>			<u>1,008,383</u>	

RADWARE LTD.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Cont.)

In thousands of U.S. dollars (except per share data)

Note 10 - SHAREHOLDERS' EQUITY (Cont.)

C. (Cont.)

The amounts of deferred compensation recognized arising from the difference between the exercise price and the fair market value on the date of grant of \$141 and \$2,192, for options granted in the years ended December 31, 1998 and 1999, respectively, are included in shareholders' equity and are being amortized over the vesting periods of the respective options in accordance with APB 25. The balance of unamortized deferred compensation at December 31, 1999, is \$1,553. Under APB 25 the deferred compensation that has been charged to operations for the year ended December 31, 1999 amounted to \$703 (year ended December 31, 1998 - \$53).

If deferred compensation had been determined under the alternative fair value accounting method provided for under SFAS No. 123, the Company's net income (loss) and net income (loss) per share would have been changed to the following pro forma amounts:

	For the period ended December 31, 1997	For the year ended December 31, 1998	1999
Net income (loss)			
As reported	(232)	(1,253)	280
Pro forma	(232)	(1,253)	(121)
Basic income (loss) per share:			
As reported	(0.04)	(0.16)	0.03
Pro forma	(0.04)	(0.16)	(0.01)
Diluted income (loss) per share:			
As reported	(0.04)	(0.16)	0.02
Pro forma	(0.04)	(0.16)	(0.01)

Under SFAS No. 123, the fair value of each option grant is estimated on the date of grant using the Black-Scholes option-pricing model with the following weighted average assumptions used for grants in 1997, 1998 and 1999: (1) expected life of the options of 2.13, 2.75 and 2.33 for the period ended December 31, 1997 and the years ended December 31, 1998 and 1999, respectively; (2) no dividend yield (1997, 1998 - same); (3) expected volatility of 274% (1997, 1998 - 0%) and (4) risk - free interest rate of 5% (1997, 1998 - same).

RADWARE LTD.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Cont.)

Note 11 - TAXES ON INCOME

- A. The Company submitted an investment program in June 1998 to the Investment Center for approval as an approved enterprise in accordance with the Law for the Encouragement of Capital Investments, 1959 (the "Law") and the Investment Center granted an approval in December 1998 for establishing an approved enterprise in Tel-Aviv. As the Company has elected to apply the alternative benefits method for this program, the Company will be entitled to a tax exemption with respect to the income derived from the approved enterprise program for two years and will be taxed at a 25% rate for five additional years (8 years, if foreign shareholding in the Company exceeds 25%). As the Company's facilities are located in Jerusalem, the Company has submitted a request to the Investment Center to reconsider its investment program to qualify for the benefits afforded to an approved enterprise established in Jerusalem. If the request is accepted, the Company will be entitled to a tax exemption with respect to the income derived from the approved enterprise program for six years and will be taxed at a 25% rate for one additional year. The six-year period of full tax exemption may be extended to a ten years if the Company applies to the Investment Center for recognition as a "High Technology" facility and this status is recognized.

In the event of distribution by the Company of a cash dividend out of retained earnings which were tax exempt due to its approved enterprise status, the Company would have to pay a 25% corporate tax on the amount distributed, and a further 15% withholding tax would be deducted from the amounts distributed to the recipients.

Should the Company derive income from sources other than the approved enterprise program, such income will be taxable at regular corporate tax rate, which is 36%.

The Company is entitled to claim accelerated depreciation for a period of five years in respect of property and equipment of its approved enterprise program. The Company has not utilized this benefit to date.

RADWARE LTD.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Cont.)

In thousands of U.S. dollars

Note 11 - TAXES ON INCOME (Cont.)

A. (Cont.)

The benefits from the Company's approved enterprise program are dependent upon the Company fulfilling the conditions stipulated by the Law and the regulations published thereunder, as well as the criteria set forth in the approval for the specific investment in the Company's approved enterprise. If the Company does not comply with these conditions, the tax benefits may be canceled, and the Company may be required to refund the amount of the canceled benefits, with the addition of linkage differences and interest. As of the date of these financial statements, the Company believes it complies with these conditions, although none of such benefits have been utilized by the Company to date.

- B. The Company is subject to the Income Tax Law (Inflationary Adjustments), 1985, measuring income on the basis of changes in the Israeli Consumer Price Index.
- C. As at December 31, 1999, the Company and its U.S. subsidiary have net operating loss carryforwards for tax purposes in immaterial amounts. No provision for taxes on income is required in respect of reported net income, due to utilization of tax losses generated in previous years.

Details of deferred tax assets are as follows:

Deferred tax assets, mainly in respect of reserves and allowances not currently deductible	\$ 1,100
Valuation allowance	<u>1,100</u>
	\$ <u>-</u>

- D. The Company has not received final tax assessments since commencement of operations (1997).

RADWARE LTD.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Cont.)

In thousands of U.S. dollars

Note 12 - SALES

The Company manages its business on the basis of one reportable segment.

	For the period ended December 31 1997	For the year ended December 31	
		1998	1999
The Company's sales by geographic areas are as follows:			
North America (principally United States)	1,124	3,206	7,935
Europe	14	523	2,254
Far East	-	1,015	2,639
Other	21	156	1,313
	<u>1,159</u>	<u>4,900</u>	<u>14,141</u>

Note 13 - MARKETING AND SELLING EXPENSES

	For the period ended December 31 1997	For the year ended December 31	
		1998	1999
Marketing and selling expenses include royalties to the Government of Israel	<u>5</u>	<u>152</u>	<u>515</u>

Note 14 - CONCENTRATION OF CREDIT RISK

For the periods ended December 31, 1997, 1998 and 1999, no single customer accounted for more than 10% of the Company's sales. As of December 31, 1999, one customer represented 12% of trade receivables (December 31, 1997 and 1998 - no customer represented more than 10% of trade receivables). The Company does not require collateral to support credit sales. Allowances are maintained for potential credit losses.

RADWARE LTD.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Cont.)

In thousands of U.S. dollars

Note 15 - RELATED PARTY BALANCES AND TRANSACTIONS

A. BALANCES WITH RELATED PARTIES

	December 31	
	1998	1999
Trade receivables	700	357
Trade payables	78	536
Other payables and accrued expenses	-	694

B. TRANSACTIONS WITH RELATED PARTIES

	For the period ended December 31, 1997	For the year ended December 31,	
		1998	1999
Sales	1,145	807	1,239
Cost of sales (1)	864	689	1,089
Operating expenses	262 (2)	1,392	519
Purchase of property and equipment	-	-	171

(1) Includes amounts held in inventory and expensed in later periods when the corresponding sale is recognized.

(2) Upon commencement of operations, the Company obtained a perpetual, non-exclusive, royalty-free license for technology relating to the Company's products from an affiliated company for \$250, which amount was charged to operations in 1997.

Until December 31, 1998, the Company's products were marketed and sold in North America through an affiliated company.

Note 16 - SUBSEQUENT EVENTS

Subsequent to balance sheet date, the Company issued 1,250,000 ordinary shares in a secondary public offering in consideration for approximately \$60 million (net of issuance expenses).

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